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IMF Executive Board submits resolution to Governors proposing 45 percent quota increase (see page 7).

Continuing Response to Asian Crisis

IMF Accelerates Disbursement to Korea; Schedules High-Level Visit to Indonesia

To support the Korean government's intensification and acceleration of its policy adjustments and structural reforms, which it was undertaking in the face of continuing severe liquidity pressures, the IMF Executive Board on December 30, 1997 approved a $2 billion disbursement.

This disbursement, made in advance of the next scheduled disbursement on January 8, 1998, represented an acceleration of the original phasing under the arrangement.

The IMF's decision to accelerate the disbursement of stand-by credits to Korea was taken in the context of broader and related actions by the international community to support Korea's stabilization and reform measures. These include:

• On December 23, the World Bank and the Asian Development Bank announced their approval of loans of $3 billion and $2 billion, respectively, in support of the Korean authorities' financial sector restructuring and other structural reforms.

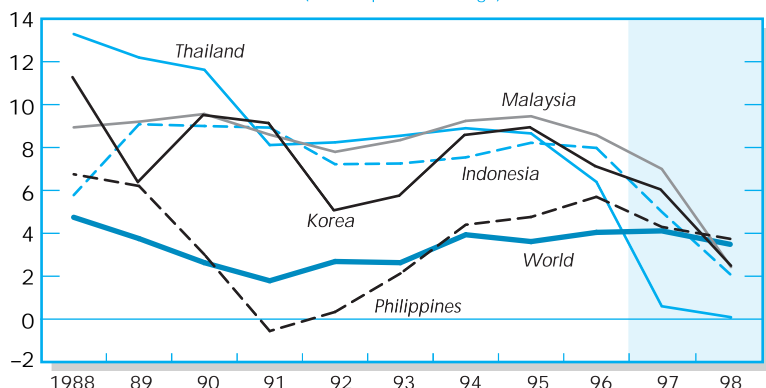
• On December 24, the group of potential participants in a supplemental financial support package for Korea announced that they would be prepared to support the disbursement of a substantial portion of that package—about $8 billion—contingent on a voluntary program by bank creditors to extend the maturities of existing claims on Korea. The countries in the group are Australia, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, New Zealand, Sweden, Switzerland, the United Kingdom, and the United States. *(Please turn to the following page)*

World Economic Outlook

Interim Assessment Revises Global Growth Projections Downward

Amid severe financial turmoil in Asia, the IMF has issued revised global economic projections. The interim *World Economic Outlook*, released on December 21, revised downward the IMF staff's projections for world economic growth by 0.1 percentage point in 1997 and 0.8 percentage point in 1998, with particularly sharp reductions in growth for the most affected Asian economies. The study also examines the roots of the crisis, the expected impact on current account balances, and the implications for policies in Asia and elsewhere.

Selected Asian Economies: Real GDP[1]
(annual percent change)



[1]Shaded areas indicate IMF staff projections.

Data: IMF, *World Economic Outlook*, December 1997

In the wake of a dramatic shift in market sentiment, the region has experienced sharp currency depreciations, growing financial sector weaknesses, and severely reduced capital inflows. The repercussions in regional and global financial markets, the *World Economic Outlook* observes, "have proven much deeper and more extensive than seemed likely only a few months ago." The economic implications are likewise much greater than earlier anticipated, with domestic demand, capital inflows, and economic activity likely to slow markedly in many emerging market economies—particularly in *(Please turn to the following page)*

IMF Accelerates Disbursement to Korea

(Continued from front page) • On December 29, a group of major commercial and investment banks from the leading industrial economies announced their willingness to roll over up to $15 billion in maturing loans and other financial contracts until the end of January 1998 to alleviate Korea's short-term liquidity concerns.

Korean President-Elect Kim Dae-jung (left) and Hubert Neiss during a break in the discussions in Seoul.

The Board's decision to speed up the disbursement was prompted by the Korean government's agreement—following several days of intense discussion between Korean authorities and IMF senior staff, led by IMF Asia and Pacific Department Director Hubert Neiss—to strengthen its economic reform program and accelerate its implementation. This agreement was announced in the government's letter of intent, released on December 24, 1997, spelling out key elements of the strengthened stabilization and reform program that the government pledged to enact. (Excerpts from the letter of intent may be found on the Korea Institute for International Economic Policy web site: http://kiep.go.kr/IMF/ hot-4-2.html.)

On December 29, Korea's National Assembly passed key financial reform bills, clearly indicating that the newly elected government in Seoul was firmly committed to the sweeping reforms in the program.

As a result of these efforts by the Korean authorities and in the context of the significant voluntary increase in rollovers announced on December 29 by international bank creditors on Korean financial institutions, IMF Managing Director Michel Camdessus recommended to the IMF Executive Board that the resources available to Korea under the existing stand-by credit be significantly accelerated. The additional disbursement was made from that portion of the IMF's financial resources available to Korea under the newly established Supplemental Reserve Facility (SRF) (see page 7). Korea is the first IMF member to draw on the SRF.

Subsequently, on January 8, 1998, following renewed turbulence in Indonesia's financial markets, the IMF announced that a staff team was leaving for Indonesia to assess recent economic and market developments and to negotiate an acceleration of the much-needed reforms agreed under the country's IMF-supported program (*IMF Survey*, November 17, 1997, page 353). The mission was to be joined in Jakarta by First Deputy Managing Director Stanley Fischer. The announcement added that, beginning January 12, Managing Director Camdessus would visit a number of countries in the region, including Indonesia, and would continue the discussions begun by Fischer. ■

Global Economic Growth Projections Revised

(Continued from front page) 1998—with rippling effects on growth and current account deficits expected in the industrial countries as well. The *World Economic Outlook* projections assume investor sentiment will begin to turn favorable in emerging market economies in the course of 1998. This outcome, it warns, is dependent upon containment of the current crisis and bold pursuit in the affected countries of macroeconomic discipline, financial sector restructuring, and other reforms.

What Happened in Asia?

The crises that erupted in mid-1997 in Thailand and in the following months in other Asian economies can be tied to four elements.

Price of Success. East Asia's developing economies grew at an exceptional pace in the early 1990s. Moderate inflation, modest fiscal imbalances, and outward-oriented growth strategies attracted investor interest. But the sheer strength of these economies also obscured potential problems. Huge capital inflows taxed countries' ability to use them productively and to ensure their prudent intermediation through still developing financial systems. Short-term flows presented the greatest challenge, particularly in Thailand, Indonesia, Korea, Malaysia, and the Philippines.

External Developments. In the early to mid-1990s, unusually low interest rates in the industrial countries spurred capital inflows into the region, and the depreciation of the U.S. dollar improved the competitiveness of those currencies of the region formally or informally tied to it. Subsequent reversals in these trends—notably a strengthening dollar—began to undercut competitiveness. A dramatic drop in export revenues in 1996 served to further erode the region's trade position.

Macroeconomic and Exchange Rate Policy Management. Declining competitiveness, growing current account deficits, asset price inflation, and sharply increased private sector credit (much of it from foreign sources) suggested the need for macroeconomic policy adjustments, but, with the exception of Korea, inflexible exchange rates greatly limited the available options.

Financial Sector Weaknesses and Other Structural Problems. The resilience of economies with strong financial sectors—such as Hong Kong SAR and Singapore—

underscores the constructive role that strong financial sectors can play in avoiding poor quality or excessive investment and in containing contagion. In many countries in the region, inadequate regulation and supervision of financial institutions—as well as limited experience among financial institutions in the pricing and managing of risk, lack of commercial orientation, poor corporate governance, and lax internal controls—had contributed to imprudent lending. When the region's fortunes changed, the scale of nonperforming loans helped turn unfavorable domestic and external developments into full-fledged liquidity and solvency crises. A number of other structural weaknesses also came to the fore, including those associated with excessive government involvement in the allocation of credit and other resources and limited disclosure of economic and financial information.

Revised Projections

A key element in the interim *World Economic Outlook* assessment is the estimated decline in net private capital flows to developing and newly industrialized economies in 1997 and 1998. Decreased private external financing for emerging market economies is likely to reduce current account deficits sharply in these countries in 1997 and 1998 (approximately $22 billion and $51 billion less, respectively, for all developing countries in 1997 and 1998 than had been projected in the October 1997 *World Economic Outlook*).

The revised *World Economic Outlook* cautions that while its projections indicate a $14 billion adjustment in the external current account balances of all developing countries and the newly industrialized Asian economies taken together in 1998, they point to a $57 billion deterioration in the current account positions of the industrial countries and transition economies. This discrepancy in the projections indicates that a larger adjustment in the developing countries and newly industrialized Asian economies could be needed, and that the *World Economic Outlook*'s 1998 growth projections may be susceptible to more downward revision.

Global. For 1997, the interim *World Economic Outlook* has revised its estimate of global growth downward by 0.1 of 1 percentage point. In 1998, however, world growth is projected to be 0.8 of 1 percentage point lower than forecast in October (see table).

Asia. Growth in 1997 in Thailand, Indonesia, Malaysia, and the Philippines is now estimated to have been markedly weaker than was projected before the crises. For Korea, the impact on growth will be evident in 1998, where growth projections have been substantially reduced. Perhaps the clearest measure of the crises' impact is the comparison of May and December projections for 1997 and 1998. For Thailand, the cumulative decline in output relative to the May 1997 projections will exceed 13 percent. For Indonesia, the corresponding reduction in GDP is 8.5 percent; for Malaysia, 6.4 percent; and for the Philippines, 3.6 percent. For Korea, projected growth in 1998 has been revised downward by almost 4 percentage points.

Industrial Countries. The most significant change has occurred in Japan, where the recovery has effectively stalled. A deteriorating economic performance, the spreading Asian crisis, and lingering concerns about Japan's financial sector have fed a marked decline in equity prices and produced exceptionally low government

Selected Countries: GDP Growth Forecasts
(percent a year)

	May[1]	October[2]	December	Revision (May–December)
1997				
World	4.4	4.2	4.1	–0.3
United States	3.0	3.7	3.8	0.8
Japan	2.2	1.1	1.0	–1.2
Industrial Europe	2.4	2.5	2.6	0.2
Indonesia	8.2	7.0	5.0	–3.2
Malaysia	7.9	7.5	7.0	–0.9
Philippines	6.3	5.3	4.3	–2.0
Thailand	6.8	2.5	0.6	–6.2
Korea	5.6	6.0	6.0	0.4
1998				
World	4.4	4.3	3.5	–0.9
United States	2.2	2.6	2.4	0.2
Japan	2.9	2.1	1.1	–1.8
Industrial Europe	2.9	2.8	2.7	–0.2
Indonesia	7.4	6.2	2.0	–5.4
Malaysia	7.9	6.5	2.5	–5.4
Philippines	6.4	5.0	3.8	–2.6
Thailand	7.0	3.5	—[3]	–7.0
Korea	6.3	6.0	2.5	–3.8

[1]IMF, *World Economic Outlook,* May 1997.
[2]IMF, *World Economic Outlook,* October 1997.
[3]Zero or negligible.
Data: IMF, *World Economic Outlook,* December 1997

bond yields. A sharp drop in real GDP in the second quarter of 1997 prompted a downward revision of the October *World Economic Outlook*'s estimate for 1997 growth from 2 1/4 percent to 1 percent. The interim *World Economic Outlook* also projects lower growth prospects for 1998.

It is imperative that Japan restore the health of its financial sector, including by ensuring that strong banks are not saddled with the costs of bailing out insolvent or very weak banks. Decisive action will be needed to write off problem loans and restructure and consolidate the banking sector. Especially if equity prices do not rebound, public funds will need to play an important role in underwriting restructuring efforts.

Among the other industrial countries, the United States, Canada, Italy, and the United Kingdom are estimated to have experienced slightly stronger growth in 1997 than previously projected. In the United States, the timing of any needed tightening of monetary policy remains the key issue. A surge in domestic demand has been tempered by a strong dollar and the likely impact of slower growth in Asia. If, as expected, growth slows,

the need to tighten monetary policy may be obviated, at least in the near term. In continental Europe, the recovery has been gathering momentum, and 1998 growth projections would likely have been revised upward had the Asian crisis not intervened. The study cautions, however, that the German and French recoveries "remain overly dependent on exports, and a self-reinforcing recovery of domestic demand is not yet in place."

Policy Considerations

The breadth and depth of the Asian crisis were not foretold in its earlier projections, the *World Economic Outlook* acknowledges, but related risks—namely, the dangers of overheating, the problems arising in some circumstances from exchange rate inflexibility, and the grave consequences of failing to strengthen prudential and financial oversight—had been stressed, not only in the *World Economic Outlook* but also through other channels of the IMF's surveillance. In the region, the extended period of strong growth appeared to have contributed to the delay in recognition of, and adaptation to, changing circumstances. Subsequently, political uncertainties and a reluctance to take bold steps to tighten monetary policy and address financial sector problems effectively exacerbated the unfolding crisis.

The extent and severity of the crisis have now slowed private capital flows to emerging market countries, particularly in Asia, and necessitated adjustment measures that will tighten monetary policies, compress domestic investment and consumption, reduce imports, and sharply lower growth rates. These steps, which will be needed to stabilize the most severely affected economies, are expected to have global reverberations, diminishing export demand and temporarily eroding confidence in foreign investments. Given the fragile banking systems in some affected countries and the powerful financial linkages with other countries, the potential remains for even more serious spillovers in the advanced economies.

Decisive action in the most directly affected countries is the key to containing the crises and restoring confidence. Crucial steps will include:

• *Fiscal adjustment*—in varying degrees—to reduce reliance on external saving and meet banking sector restructuring costs. The fiscal adjustment will need to contribute to adjustment of the current account, redress earlier public sector excesses, and ensure the correction of private sector excesses without unduly compressing domestic demand.

• *Monetary policy* must be firm enough—with interest rates being allowed to rise sufficiently—to resist excessive exchange rate depreciation. Where short-term external liabilities are large, it will also be important to roll over rather than repay short-term debt to avoid intensifying downward pressure on the currency. Once confidence has been solidly restored, interest rates can return to more normal levels.

• *Weak financial sectors* require urgent attention. Insolvent institutions need to be closed; weak but viable ones should be restructured. Regulation and supervision need to be strengthened. Blanket public guarantees to domestic or foreign creditors do more harm than good, unnecessarily raising taxpayer costs and exacerbating the problems of moral hazard.

• In addition, *improved public and corporate governance and increased transparency and accountability* can strengthen financial and other institutions. Such actions have been emphasized in the Thai, Indonesian, and Korean adjustment efforts supported by the IMF.

Many countries, particularly in the current environment, are vulnerable to reversals in market sentiment. More flexible exchange rate arrangements may help countries avoid currency misalignments and possible speculative attacks, but they will need to be bolstered by appropriate macroeconomic policies and robust financial sectors.

The major advanced economies, particularly those with strong expansions or strengthening recoveries, must keep a watchful eye on both their own economies and the dimensions of the crisis. They may need to tighten monetary policy if the pace of their expansions is unsustainable or ease monetary policy if the crisis deepens further. A key risk, the *World Economic Outlook* reiterates, is a possible intensification of the slowdown in Japan. The fragilities of Japan's financial sector are significant, but manageable, given the size of the Japanese economy. Of continuing concern, however, is the possibility that the persistence of financial sector problems and "the failure to face up forthrightly to the magnitude of these difficulties and to implement the measures required for their resolution" may amplify the perception of the problem and undermine confidence to a degree unwarranted by the actual situation.

The difficulties in the emerging market economies of Asia and in Japan are occurring amid periods of sustained expansion in North America and western Europe. If the growth of domestic demand in these countries remains sufficiently robust and some deterioration in their current accounts is accepted, this should help sustain global growth. For the Asian economies most affected by the recent turmoil, a strong history of growth and a commitment to outward-oriented policies suggest the capacity, and the will, to regain investor confidence.

The importance of strengthening the capacity to allocate financial resources efficiently on the basis of market principles and the ability to withstand shifts in market sentiments are key lessons, the interim *World Economic Outlook* concludes, to be drawn from the current crisis. ■

Copies of the *World Economic Outlook's* December 1997 Interim Assessment will be available on January 23 for $36.00 (academic rate: $25.00) from IMF Publication Services. The full text of the press version of the *World Economic Outlook* is available on the IMF's web site (http://ww.imf.org/external/pubs/FT/WEO/WEO12997/index.htm).

Press Conference on Economic Outlook

Further Downside Risks Possible from Asia Crisis

On December 19, 1997, IMF Economic Counsellor and Research Department Head Michael Mussa, with Flemming Larsen and Graham Hacche of the IMF's World Economic Outlook *team, briefed the press on the staff's interim assessment of global economic prospects. The interim* World Economic Outlook, *which revises projections in the October* World Economic Outlook, *now forecasts slower growth, particularly in Asia.*

As Mussa stressed in his opening remarks, the IMF is revising its growth projections sharply downward for 1997–98 for Indonesia, Malaysia, the Philippines, Thailand, and Korea. In general, the industrial countries continue to perform well or show signs of recovery steadily gaining momentum. The exception is Japan, whose 1997 growth prospects were revised downward in October and whose 1998 projections were marked down in December. Larsen, commenting on the expected significant decline in capital flows to emerging market economies over the near term, noted that reduced capital inflows will necessitate a substantial correction in current account imbalances. Current account deficits are expected to drop markedly in the most directly affected economies and increase substantially in industrial countries—especially, in the United States.

Following are edited excerpts from the press conference.

QUESTION: *What is the biggest downside risk to this forecast?*

MUSSA: For Asia, one of the key concerns is how long this turbulence will last and whether additional emerging market countries will get pulled into the turmoil to a greater extent. There is considerable uncertainty about the extent of private capital flows to emerging market countries generally and how countries adjust to what will apparently be a significant slowdown in such flows. There are obviously other risks in the industrial countries. In addition to normal business cycle risk in North America and in Europe and uncertainties for the Japanese economy, stock markets could move sharply downward.

QUESTION: *Your 1998 projections for southeast Asia and Korea do not have a single country in what by U.S. standards would be a recession. Isn't that overly optimistic?*

MUSSA: A proper way to think about a recession is how much growth slows relative to the normal trend rate of growth. U.S. growth has averaged a little over 2 percent over the past decade and a half. If growth suddenly slows by 3 percentage points, that is a recession.

With the exception of the Philippines, the southeast Asian economies have had average growth of a little over 7 percent over the past 15 or 20 years. For Thailand to slow down to zero is a drop of 14 percent over two years from its normal trend growth path. That would be—and feel like—a very deep recession in the United States.

Moreover, projections for growth of domestic demand are significantly weaker than for GDP—another 5–7 percentage points over the two years' combined growth of domestic demand below the normal trend rate and substantially below the very rapid growth experienced in 1994 and 1995. That is an 18 or 20 percent slowdown of the growth of domestic demand over two years relative to trend—and that is a pretty severe recession by any standards.

Graham Hacche (left), Flemming Larsen, and Michael Mussa field questions during the press conference.

QUESTION: *How strong is the pressure for the Chinese currency to depreciate?*

MUSSA: The interim *World Economic Outlook* forecasts through 1998, and I am not anticipating any problems that would induce strong pressures on the renminbi, looking a year ahead or a little longer. China will clearly suffer some loss of competitiveness vis-à-vis other east Asian economies. We can anticipate that export growth will slow somewhat, but the Chinese economy is in a relatively good position to absorb that effect. It has huge reserves and is running a current account surplus.

QUESTION: *When will the Asian tigers return to 8–10 percent growth? And what will the crisis mean in terms of jobs?*

MUSSA: The type of growth slowdown we will see in southeast Asia will have a decidedly negative short-term impact. How long might that go on? If we look back at the "tequila crisis" in Mexico and Argentina, which were hard hit, that crisis produced very sharp downturns in the growth rates of GDP and domestic demand for about a year. Then, as the basis for recovery and confidence was established, the upturn came, led by exports, then investment, and, more recently, recovery of consumption. The performance of both Mexico and Argentina this year has been quite spectacular in terms of their economic growth, and we are expecting both economies to continue to do quite well in 1999.

With respect to the longer-term growth prospects of the southeast and east Asian economies, there is every

reason to believe they can return—after a period of adjustment of a year or so—to the type of longer-run average performance that has characterized the past two decades. Korea, which is a more mature economy, is more likely to be growing in the 5–6 percent range over the next decade or so.

There are, of course, no guarantees. It requires continued high levels of saving, high investment directed toward productive activities, improved education of the labor force, and other factors that contribute to sustained growth over the longer term.

QUESTION: *What are the risks of Japan growing at less than the 1 percent now projected for 1998?*
MUSSA: Since early December, when our data were collected, a number of things have changed, and some of them are clearly negative. But the Japanese government has announced significant new measures. While it is not an enormously stimulative fiscal package, I am reasonably confident that it at least outweighs the negative factors that we have seen in the last few days.

Korea is experiencing a severe liquidity and confidence crisis. —Mussa

With respect to the current account, we anticipate Japanese exports to the rest of Asia to slow down and imports from the rest of Asia, which are going to become cheaper, perhaps picking up some. That will tend to worsen the Japanese trade and current account position. But the Japanese current account and trade position will improve vis-à-vis the industrial countries of North America and western Europe, and that will offset the weakness in relation to Asia.

Are there risks to the Japanese forecasts? Obviously. There are clearly risks internally within Japan. Should the downward spiral of confidence continue and consumers decide to save even more and spend even less, that would be a problem. Difficulties in the financial sector would also affect the economy. On the other side, Japanese industry is quite competitive in relation to most other industrial countries.

QUESTION: *Did the recent election affect the outlook for Korea?*
MUSSA: Korea is experiencing a severe liquidity crisis and crisis of confidence with an enormous depreciation of the won. Depreciation makes you more competitive, but there are also severe problems in terms of consumer—and probably also business—confidence, as well as a lot of disruption in the financial sector. It is difficult to believe that in this environment the economy is not going to suffer a large slowdown.

What will matter is the policies that are put in place and the confidence—particularly at home but also abroad—people have in the consistency and determination of those policies to face up to the very real structural difficulties that exist in the Korean economy.

To an important extent, a panic is creating the current difficulties in Korea, but there is substance to the problems that need to be addressed. These are difficult adjustments to make in any economy, and they will be difficult in Korea. It will require the determination of the government to face up to those problems, some of which are going to be quite painful to resolve.

QUESTION: *What is your view of the banking portion of Japan's stimulus package? Also, does your baseline forecast assume the U.S. Federal Reserve will raise rates at some point in 1998? And how plausible is it that the United States will assume the overwhelming bulk of the adjustment in the current account being projected?*
MUSSA: Japan's financial sector package is an important step. No one knows how much support from the public sector may ultimately be needed. The quality and viability of many loans will depend on how well the Japanese economy performs. But it is positive that the politicians are now prepared to step forward and say, yes, we will need a significant amount of public money to deal with these problems.

With respect to the United States, we did assume a small increase—about 40 basis points—in the federal funds rate between 1997 and 1998. What significance to attach to that? Not much. The Federal Reserve is quite sensibly watching developments. The world's dominant central bank has plenty of leverage to slow the economy down if needed or to give it a boost if called for. Similarly in Europe, monetary policy has the capacity to move in either direction as circumstances warrant.

It is a fair and reasonable expectation that the U.S. current account deficit is going to grow significantly between 1997 and 1998, largely reflecting developments in Asia, including Japan. What will happen for Europe, I am a little less confident about, but I think they will also feel some significant impact from Asian developments.

But while growth in the current account deficit may be—and very likely is—a favorable prospect for the near term, a U.S. current account deficit pushing up to, say, $250 billion is not so salutary for the medium and longer term. It is probably more likely that at some point the currently strong dollar will become somewhat less strong. We hope that will occur on a schedule such that a slowing of domestic demand growth in the United States will correspond to improvements in the U.S. competitive position. This would enable the current account position to shift away from deficit and toward surplus in a way that can be accommodated within the growth capacity of the United States without generating inflationary pressures in the economy. ■

The full text of the *World Economic Outlook* is available on the IMF's web site (http://www.imf.org/external/NP/tr/1997/tr971219.htm).

IMF Approves Supplemental Reserve Facility

The IMF Executive Board approved the Supplemental Reserve Facility (SRF) on December 17, 1997. The text of Press Release No. 97/59, issued on December 17, 1997, is as follows.

The IMF has approved the SRF. This facility has been put in place to provide financial assistance to a member country experiencing exceptional balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence reflected in pressure on the capital account and the member's reserves. Assistance under the facility will be available when there is a reasonable expectation that the implementation of strong adjustment policies and adequate financing will result, within a short period, in an early correction of the balance of payments difficulties. This facility should be seen in the context of the IMF's ongoing efforts to strengthen its surveillance and encourage members to implement appropriate policies in order to prevent crises from occurring.

When approving a request for the use of IMF resources under this decision, the IMF will take into account the financing provided by other creditors. In order to minimize moral hazard, a member using resources under this decision would be encouraged to seek to maintain participation of creditors, both official and private, until the pressure on the balance of payments ceases. In this connection, the IMF intends to bring to completion at an early date ongoing studies of mechanisms that could effectively limit the need for official financing in cases of crises of market confidence.

Financing under the SRF, which will be available in the form of additional resources under a Stand-By or Extended Arrangement, will be committed for up to one year and be generally available in two or more tranches. The first tranche will be available at the time of approval of the financing, which will normally coincide with the approval of the corresponding arrangement.

The IMF will determine the amount of financing available under the SRF by taking into account the financing needs of the member; its capacity to repay, including in particular the strength of its economic program; its outstanding use of IMF credit; and its record in using IMF resources in the past and cooperation with the IMF in surveillance, as well as the IMF's liquidity.

Countries borrowing under the SRF will be expected to repay within one to one and a half years of the date of each disbursement, although the Board has the authority to extend this period for repayment by up to one year, at which point the borrower will be obligated to repay. During the first year from the date of approval of financing to a country under the SRF, borrowers will pay a surcharge of 300 basis points above the rate of charge on IMF loans, which has averaged approximately 4.7 percent in 1997. This rate will be increased by 50 basis points at the end of that period and every six months thereafter until the surcharge reaches 500 basis points. ■

IMF Board Submits Resolution to Governors for Quota Increase

The IMF Executive Board has submitted a resolution to the Board of Governors proposing that IMF quotas be increased by 45 percent. The text of Press Release No. 97/63, issued December 23, 1997, is as follows.

The Executive Board of the IMF has submitted a Report and Draft Resolution to the Board of Governors proposing an increase of 45 percent in IMF quotas to approximately SDR 212 billion (about $287 billion) from SDR 146 billion (about $197 billion). The Governors are asked to vote on the proposed Resolution, without meeting, by January 30, 1998. The adoption of the Resolution requires a majority of 85 percent of the total voting power of the IMF's membership.

The quotas proposed for each member were arrived at in the following manner: 75 percent of the overall increase will be distributed among all members in proportion to their existing quotas; 15 percent of the overall increase will be distributed in proportion to members' shares in calculated quotas (based on 1994 data), so as to better reflect the relative economic positions of members; and the remaining 10 percent of the overall increase will be distributed among those members whose present quotas are out of line with their positions in the world economy (as measured by the excess of their share in calculated quotas over their share in actual quotas), of which 1 percent of the overall increase will be distributed among five members whose current quotas are far out of line with their relative economic positions and which are in a position to contribute to the IMF's liquidity over the medium term.

Twenty-five percent of the increase in each member's quota will be paid in SDRs, or in currencies of other members specified, with their concurrence, by the IMF. ■

Experience of 24 Countries

Lessons from Systemic Bank Restructuring

In recent decades, many industrial, transition, and developing countries have experienced systemic banking problems. These problems, often linked to macroeconomic crises, are expensive to resolve and usually involve a heavy fiscal burden (see table, page 9). Their solution lies in carefully designed bank restructuring strategies. In a new study, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries*, Claudia Dziobek and Ceyla Pazarbaşıoğlu of the IMF's Monetary and Exchange Affairs Department analyze the experience of a representative sample of countries where failing banks held at least 20 percent of the total deposits of the banking system. The study draws lessons about of the effectiveness of institutional and regulatory measures, the impact of accompanying macroeconomic policies, and the extent to which particular restructuring instruments contributed to success. It places special emphasis on the role of the central banks.

Prompt corrective action and a comprehensive approach are key.

The study finds that the resumption of bank lending and a return to profitability require prompt corrective action and a comprehensive approach. Policymakers must address the immediate problems of weak and insolvent banks; shortcomings in accounting, legal, and regulatory frameworks; and lax supervision and compliance. During restructuring, the central bank must also stand ready to provide liquidity support to viable banks. The central bank should not, however, provide long-term financing to banks, nor should it be involved in commercial banking activities, as this leads to increased costs and creates conflicts with the central bank's monetary policy objectives.

Objectives of Bank Restructuring

Bank restructuring programs comprise various measures aimed at improving bank performance—that is, restoring solvency and profitability and improving the banking system's capacity to provide financial intermediation. The results of an assessment of the relative progress in improving bank performance indicate that all countries included in the study were much more successful in addressing solvency problems than profitability problems. One explanation is that improvements in bank solvency emanate chiefly from shorter-term financial restructuring, while a return to profitability requires more difficult, longer-term operational restructuring. Swapping bonds for nonperforming loans, for example, instantly improves solvency indicators, but does not necessarily affect costs, earnings, or profits. In practice, the design of bank restructuring packages has often been somewhat unbalanced, focusing more on financial restructuring measures at the expense of operational restructuring measures. Operational restructuring includes improved cost-effectiveness, better internal governance, and effective risk management. Turning to improvements in financial intermediation, results indicate substantial variation across country groups: while countries were usually able to increase the scale of financial intermediation and reduce systemic risk following bank restructuring, they typically made less progress in improving the efficiency of financial intermediation. The latter result, in particular, underlines the need for greater attention to operational restructuring.

Based on these indicators of improvement, the study classifies the sample countries into three main groups: those that made substantial progress in restructuring their banking systems (Côte d'Ivoire, Peru, the Philippines, Spain, and Sweden); those with moderate progress (Chile, Egypt, Finland, Ghana, Hungary, and Korea); and those with slow progress (Kuwait, Mauritania, and Tanzania). Since the remaining countries initiated bank restructuring measures in 1994 or later, they were categorized as recent and were not included in the ranking exercise.

Bank Restructuring Instruments

In addition to originating from exogenous, macroeconomic shocks, banking problems often stem from deficient bank management and poor operational control, shortcomings in regulatory and accounting frameworks related to inadequate management control, and distorted incentive schemes. To overcome these problems, authorities employ a set of instruments, most of which are modified versions of normal bank management tools and strategies. Examples are the formation of specialized units to handle loan collection, reconfigurations of core business, and use of advisory and consulting services to improve specific aspects of bank operations. Where banking problems involve state banks, privatization is also a standard approach to improving the efficiency of banking. Bond instruments—such as an exchange of bonds for nonperforming loans—and issuance of new equity are widely used by all countries. However, such expenditures do not always seem to be disclosed in the budget.

Photo Credits: Paul Barker for Reuters, page 2; Padraic Hughes for the IMF, page 5.

The study indicates that there are differences among performance groups regarding the choice and frequency of use of bank restructuring instruments. Successful countries emphasized a firm exit policy. In contrast, countries exhibiting slow progress consistently avoided these policies, which may imply that insolvent banks were allowed to operate, leading to a further deterioration of these banks. Similarly, the provision of appropriate incentives for managers and owners is a key element of successful restructuring. The use of incentive corrective schemes further strengthened the market-based approach taken by successful countries. In particular, banks receiving support were almost always downsized. Authorities most frequently used central bank liquidity loans, bond swaps, and instruments to shift part of the costs to managers and owners, placing less of the burden on depositors. Deposit insurance was in place for some of the countries, and several introduced a blanket deposit insurance scheme in the aftermath of the banking problems. With the exception of Côte d'Ivoire, Latvia, Peru, and Spain, authorities fully compensated depositors in all of the sample countries.

Role of Central Bank

Countries making extensive use of central bank instruments typically made less progress in bank restructuring. This may partly reflect the fact that where there was a broad political consensus for comprehensive restructuring, it was carried out by specialized agencies to allow the central bank to continue to focus on its main function of implementing monetary policy. In particular, authorities in countries achieving the best results determined at an early stage that the problem was bank insolvency, not lack of liquidity, and they therefore precluded use of lender-of-last-resort facilities. In contrast, all of the slow-progress countries used central bank instruments extensively, with the central bank acting as the sole agency for bank restructuring, often assuming bank and asset management duties. This type of central bank involvement can result in difficulties—liquidity support to insolvent banks provides perverse incentives and fails to address underlying problems, and direct ownership and medium-term lending by the central bank create conflicts of interest.

Lessons from Experience

Emphasis on diagnosis and comprehensiveness at an early stage is rewarded by good results. The speed with which authorities undertake restructuring measures also explains differences in countries' degree of success in dealing with systemic banking problems. Weak performers have addressed their difficulties with a substantially lower frequency than have the moderate or substantial progress countries. In particular, the less successful performers have shown a failure or unwillingness to deal with problems in state-owned banks and, in some cases, nonfinancial public enterprises, or to tackle taxation problems that distort the incentive structure in the banking sector.

Based on a statistical analysis of various bank restructuring strategies employed across the sample countries, the study draws the following lessons:

- Diagnosis of the nature and extent of systemic banking problems enables policymakers to systematically address each of the underlying causes.

Countries Facing Systemic Banking Problems

Country (by region)	Onset of Restructuring Action	Cost Estimates[1] (percent of GDP)
Africa		
Côte d'Ivoire	1991	13.0
Ghana	1989	6.0
Tanzania	1992	14.0
Zambia	1995	3.0
Asia		
Indonesia	1994	2.0
Japan	1995	...
Korea	1993	...
Philippines	1984	4.0
Western and Central Europe		
Finland	1991	9.9
Hungary	1993	12.2
Poland	1993	5.7
Spain	1980	15.0
Sweden	1991	4.3
Baltics and Former Soviet Union		
Kazakhstan	1995	...
Latvia	1995	...
Moldova	1995	...
Middle East		
Egypt	1991	...
Kuwait	1992	45.0
Mauritania	1993	15.0
Western Hemisphere		
Argentina	1994	0.3
Chile	1983	33.0
Mexico	1994	12.0–17.0
Peru	1991	0.4
Venezuela	1994	17.0

[1]Calculated by expressing fiscal or quasi-fiscal outlays in each year as a percentage of that year's GDP. The percentages are then added (for example, if the costs amounted to 11 percent of GDP in 1981, in 1982, and in 1983, the total cost would be noted as 33 percent in this table). These estimates do not take into account cost recoveries achieved by governments.

Data: IMF Working Paper 97/161, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries*

- Successful bank restructuring implies a prompt, comprehensive approach to addressing the immediate solvency and profitability problems of weak and insolvent banks, as well as correcting shortcomings in the accounting, legal, and regulatory framework while improving supervision and compliance.
- Operational restructuring is a necessary condition for banks to return to profitability and sustained solvency. Progress in bank restructuring is highly correlated with whether or not authorities address management deficiencies.

• Systemic bank restructuring should be coordinated and implemented by a designated lead agency.

• Successful bank restructuring is a multiyear process, requiring continuous monitoring of restructuring policies and bank restructuring operations.

• During restructuring, the central bank must stand ready to provide liquidity support to viable banks. The central bank should not provide long-term financing to banks, nor should it be involved in commercial banking activities, since this may conflict with its monetary policy objectives.

• Firm exit policies are an integral part of best practices.

• Government financial support of insolvent banks is unavoidable in most instances.

• Loss sharing between the state, the banks, and the public is an integral part of successful bank restructuring.

• Removing nonperforming loans from a bank's balance sheet immediately improves the balance sheet and helps focus attention on the bank's core business. It does not, however, solve profitability problems.

• Loan workouts, including foreclosures or asset sales, contribute to the recovery of bank restructuring costs and send signals to delinquent borrowers. The institutional setting of these workouts does not appear to have an effect on their success.

• Restructuring programs typically occur in an environment of low or moderate inflation; the fiscal balance often deteriorates immediately following the onset of bank restructuring.

• The design of privatization is important in determining the future profitability and viability of the banking sector. Ill-designed bank privatization policies, which include preferential access to credit, overpricing of bank assets, and weak legislation against concentration of ownership can contain the seeds of subsequent banking crises. ■

Copies of IMF Working Paper 97/161, *Lessons from Systemic Bank Restructuring: A Survey of 24 Countries,* by Claudia Dziobek and Ceyla Pazarbaşıoğlu, are available for $7.00 each from IMF Publication Services.

From the Executive Board

Following are excerpts from recent IMF press releases. The full texts are available on the IMF's web site (http://www.imf.org/external/news.htm) or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

Panama: EFF

The IMF approved a three-year credit for Panama equivalent to SDR 120 million (about $162 million) under the Extended Fund Facility (EFF) to support the government's medium-term economic reform program for 1998–2000.

Panama: Selected Economic Indicators

	1996	1997[1]	1998[1]	1999[1]	2000[1]
			(percent change)		
Real GDP	2.6	3.4	4.1	4.5	4.8
Consumer prices (end of period)	2.3	1.4	1.7	1.6	1.6
			(percent of GDP)		
Overall fiscal balance	0.4	–0.7	–0.7	–0.5	0.6
External current account balance	–1.6	–2.9	–3.5	–3.6	–2.4

[1]Projection.

Data: Panamanian authorities and IMF staff estimates and projections

Medium-Term Strategy

The authorities' economic program through 2000 will deepen and broaden structural reforms within the context of continued prudent fiscal policy and low inflation, with the objective of promoting sustainable output and employment growth and reducing poverty. The program aims at raising GDP growth to about 5 percent by the year 2000 from $2\frac{1}{2}$ percent in 1996, while holding inflation at about $1\frac{1}{2}$ percent a year.

Reflecting the temporary cost of certain structural measures, such as privatization and pension reform, the overall balance of the public sector will show small deficits in 1998–99 before shifting to growing surpluses beginning in 2000. The overall deficit of the public sector is projected to narrow to 0.5 percent of GDP in 1999 and shift to a surplus of 0.6 percent in the year 2000 through current expenditure restraint and implementation of a comprehensive tax reform in the latter part of 1999. The small overall public sector deficit during 1998–99 will be more than covered by external project and policy loans. The external current account deficit will widen temporarily during the program period, mainly because of a rise in investment-related imports, and is expected to be virtually covered by net capital inflows.

Structural Reforms

Structural measures will focus on further privatization, import tariff reduction, and financial sector reform during the first half of the program period. Reforms relating to taxation, civil service, and social security will be implemented during the second half of the program period.

Addressing Social Needs

The authorities intend to strengthen the social safety net for the most vulnerable groups in society. With the assistance of the World Bank, a living stan-

dard survey is being conducted to help identify poverty groups and assess the effectiveness of government policies in reducing the incidence of poverty, which affects 40 percent of the country's population, mostly in rural areas. Efforts are also being made to improve efficiency in the provision of basic health and education service, through investment income from privatization proceeds.

Panama joined the IMF on March 14, 1946. Its quota is SDR 149.6 million (about $202 million). Panama's outstanding use of IMF financing currently totals SDR 98 million (about $132 million).

Press Release No. 97/56, December 10, 1997

Rwanda: Post-Conflict Assistance

The IMF approved a credit for Rwanda equivalent to SDR 5.95 million (about $8 million), under the IMF's policy of emergency post-conflict assistance. A credit under the same policy of SDR 8.9 million (about $12 million) was approved by the IMF on April 22, 1997 (see Press Release No 97/19, *IMF Survey*, May 12, 1997), to support the government's economic program for 1997.

Implementation of 1997 Program

The principal quantitative objectives of the program were to attain a real GDP growth rate of 12.7 percent, an inflation rate of 7 percent, and a level of gross official international reserves equivalent to 4.4 months of imports. According to available information, real GDP growth for 1997 will be in line with the program target; the increase in consumer prices, which is estimated at about 11 percent during the 12-month period ended in July, may exceed the target of 7 percent; but the level of gross official international reserves for the end of 1997 is expected to be reached. Budgetary performance has been broadly in line with the program, with receipts exceeding slightly the program target, and expenditure remaining below the programmed level. The monetary policy aims were met, and commendable progress has been made in rebuilding the National Bank of Rwanda and implementing reforms in the monetary area.

Structural Reforms

Under the ongoing program, the authorities are aiming at fiscal consolidation, including a reduction in the primary budgetary deficit, and considerable progress has been made in strengthening tax administration as well as budgetary and treasury management.

Addressing Social Needs

The National Assembly has approved support for genocide survivors, and the government—assisted by nongovernmental organizations and other members of the international community—is implementing various programs for helping other vulnerable groups.

Rwanda joined the IMF on September 30, 1963, and its quota is SDR 59.5 million (about $80 million). Its outstanding use of IMF financing currently totals SDR 25 million (about $34 million).

Press Release No. 97/57, December 12, 1997

Rwanda: Selected Economic Indicators

	1993	1994	1995	1996	1997[1]
	(percent change)				
Real GDP	–6.8	–49.0	24.6	13.3	13.0
Consumer prices (average)	8.6	64.0	22.0	8.9	11.0
	(percent of GDP)				
Overall fiscal deficit (excluding grants)	–14.5	–12.4	–14.1	–13.7	–13.6
External current account balance (excluding official transfers)	–15.0	–53.3	–23.5	–16.1	–21.8
	(months of imports)				
Gross official reserves	1.6	1.3	5.0	5.1	4.4

[1]Revised projections.
Data: Rwandese authorities and IMF staff estimates and projections

Palau: Membership

The Republic of Palau has become a member of the IMF. The IMF's Articles of Agreement were signed in Washington, D.C., by Vice President and Minister of Administration Tommy E. Remengesau, Jr.

The Republic of Palau's initial quota in the IMF is SDR 2.25 million (about $3.0 million). With the admission of the Republic of Palau, membership in the IMF totals 182 countries, and the total of members' quotas is SDR 145.3 billion (about $196 billion).

Press Release No. 97/58, December 17, 1997

Estonia: Stand-By

The IMF approved a 15-month stand-by credit for Estonia equivalent to SDR 16.1 million (about $22 million) to support the government's 1998 economic pro-

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
December 15	4.32	4.32	4.73
December 22	4.37	4.37	4.79
December 29	4.38	4.38	4.80
January 5	4.37	4.37	4.79

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

gram. The authorities have indicated their intention not to draw on the credit, as was the case under the stand-by that expired in August 1997.

Estonia: Selected Economic Indicators

	1994	1995	1996	1997[1]	1998[2]
			(percent change)		
Real GDP	–1.8	4.3	4.0	7.0	5.4
Consumer prices (end of period)	41.6	28.8	15.0	11.7	8.2
			(percent of GDP)		
Fiscal balance (including net lending)	1.3	–1.2	–1.5	0.4	1.8
External current account balance[3]	–7.4	–5.1	–10.2	–12.2	–9.6
			(months of imports)		
Gross international reserves	3.2	2.7	2.5	2.0	2.1

[1]Estimate.
[2]Program.
[3]The Bank of Estonia has recently revised the balance of payments statistics so that the 1996 current account deficit is now 9.6 percent of GDP. Data for 1997 are also being revised, but such revisions are not reflected in the staff estimates for 1997 and 1998.

Data: Estonian authorities and IMF staff estimates and projections

1997/98 Program

The macroeconomic program for 1998 seeks to ensure that the gains made so far are not reversed, and envisages an annual growth rate of real GDP of over 5 percent, with inflation declining further to about 8 percent. To reduce demand pressures on the economy, the general government surplus is expected to increase to 1.8 percent of GDP, and the current account deficit is projected to decline by more than 2 percentage points.

Structural Reforms

Important financial sector reforms will supplement fiscal and financial policy actions. In particular, there will be a more aggressive approach to financial sector surveillance to reduce systemic risks and improve supervision of bank and nonbank financial institutions. Measures to strengthen securities and capital markets will also be implemented under the program.

Addressing Social Costs

Estonia's social safety net includes a state pension scheme, medical insurance coverage, unemployment compensation, and a targeted income maintenance scheme. A thorough reform of the pension scheme aims to establish a more direct link between contributions and benefits, moving in stages from the current pay-as-you-go system to a three-tier, partially funded system, beginning in early 1998 and becoming fully operational in 2001.

Estonia joined the IMF on May 26, 1992, and its quota is SDR 46.5 million (about $63 million). Its outstanding use of IMF financing currently totals SDR 40 million (about $54 million).

Press Release No. 97/60, December 17, 1997

Tajikistan: Post-Conflict Assistance

The IMF approved a loan for the Republic of Tajikistan equivalent to SDR 7.5 million (about $10 million), under the IMF's emergency post-conflict assistance, to support the government's economic program for 1997–98.

1997–98 Program

The 1997–98 program aims to establish financial stability through further fiscal adjustment, tight monetary policy, and enhanced financial discipline in the enterprise sector. Under the program, real GDP growth is expected to reach 4–5 percent in 1998, compared with preliminary rates of about 2 percent in 1997, and about –28 percent in 1996; inflation is targeted to fall to about 21 percent during 1998, from about 190 percent during 1997; and gross international reserves are programmed to rise to the equivalent of 1.5 months of imports at end-1998, from 1.0 month at end-1997 and 0.3 month at the end of 1996.

To achieve these objectives, fiscal policy is designed to reduce the government deficit to below 3.0 percent of GDP in 1998 from 3.5 percent in 1997, and 5.8 percent in 1996.

Structural Reforms

The program places considerable emphasis on structural policy measures and institution-building to sustain economic recovery and enhance policy implementation capacity. Four areas are particularly important for structural reform: privatization, land reform, bank restructuring, and enterprise reform.

The authorities intend to ensure a continued open trade and exchange regime by refraining from introducing restrictions or requirements on exports or imports during the program.

Tajikistan: Selected Economic Indicators

	1996	1997[1]	1998[1]
		(percent change)	
Real GDP	–28.3	2.2	4.4
Consumer prices (end of period)	40.5	190.6	21.2
		(percent of GDP)	
Fiscal balance (cash)	–5.8	–3.5	–2.8
External current account balance (excluding official transfers)	–10.1	–2.8	–6.8
		(months of imports)	
Gross international reserves	0.3	1.0	1.5

[1]Projections.

Data: Tajik authorities and IMF staff estimates and projections

Addressing Social Needs

In view of the social cost of the war, outlays on the social safety net need to be increased in the 1998 budget. Further increases will be needed later. The main protection against an erosion of the social safety net, however, will be lower inflation.

Tajikistan joined the IMF on April 27, 1993, and its quota is SDR 60.0 million (about $81 million). Its outstanding use of IMF financing currently totals SDR 15 million (about $20 million).

Press Release No. 97/61, December 19, 1997

Azerbaijan: ESAF/ EFF

The IMF has approved loans and credits totaling SDR 46.8 million (about $64 million) for Azerbaijan to support the second annual economic and financial program under the Enhanced Structural Adjustment Facility (ESAF) and the Extended Fund Facility (EFF). Of this total, SDR 29.4 million (about $40 million) is available in two equal semiannual installments of SDR 14.6 million (about $20 million) under the ESAF, and SDR 17.5 million (about $24 million) under the EFF.

Medium-Term Strategy and 1998 Program

Azerbaijan's medium-term economic policy strategy aims at speeding up the transition to a market economy and developing the country's oil resources without adverse impact on the rest of the economy.

Real GDP in expected to grow by 7–9 percent a year in 1998–2000, mainly led by the development and export of oil, while annual inflation should be contained to about 5 percent. The investment ratio should grow to 44 percent of GDP in 2000 from an estimated 27 percent, largely financed by capital inflows. The current account deficit, including imports related to the development of the oil sector, is projected to increase to about 35 percent of GDP in 2000 before declining rapidly in subsequent years because of the rapid growth in oil exports. Fiscal policies will aim to reduce the deficit of the general government to less than 1 percent of GDP during the next three years. Monetary policy will aim at maintaining low levels of inflation.

For 1998, the authorities' program aims at accelerating growth to 7 percent, while maintaining inflation below 5 percent and limiting the external current account deficit to some 27 percent of GDP, including imports related to the development of the oil sector.

Structural Reforms

The medium-term program objectives require strong progress in structural reforms, and the highest priority has been placed on public sector management reform, bank restructuring and privatization, and an equitable process of enterprise and land privatization.

Addressing Social Needs

The government is committed to substantial reforms in the health sector, in response to deteriorating quality and access problems. A comprehensive reform of the education sector is also being planned with a view to a more efficient use of budgetary funds. Expenditures of the Social Protection Fund will be increased to 6.1 percent of GDP in 1998 from 5 percent, while efforts will be made to achieve better targeting the social safety net.

Azerbaijan joined the IMF on September 18, 1992; its quota is SDR 117.0 million (about $159 million); its outstanding use of IMF credit currently totals SDR 181 million (about $246 million).

Press Release No. 97/62, December 23, 1997

Azerbaijan: Selected Economic Indicators

	1995	1996	1997[1]	1998[2]	1999[2]	2000[3]
			(percent change)			
Real GDP	–11.0	1.3	5.0	7.0	8.5	9.6
Consumer prices (end of period)	84.5	6.7	3.9	4.5	5.0	5.0
			(percent of GDP)			
Overall fiscal balance (accrual basis from 1997)	–4.3	–2.6	–2.8	–3.0	–1.1	–0.9
External current account balance	–11.4	–23.6	–21.7	–27.4	–32.1	–34.8
			(months of imports)			
Gross international reserves	1.2	2.0	3.5	4.0	4.0	4.2

[1]Estimate.
[2]Program.
[3]Projection.

Data: Azerbaijan authorities and IMF staff estimates and projections

Guyana: Debt-Reduction Package

The IMF and the World Bank have agreed to support a debt-reduction package for Guyana under the Initiative for Heavily Indebted Poor Countries (HIPC). The total assistance to be provided to Guyana by all of its external creditors will reduce the country's external debt burden by one fourth—$253 million in net present value terms. This is estimated to translate into debt-service relief over time of close to $500 million. The IMF and the World Bank will provide assistance with a net present value of $35 million and $27 million, respectively. In recognition of Guyana's exceptional achievements in implementing reform, it was agreed that the completion point for the delivery of the debt-reduction package will be one year from now in December 1998. This is an acceleration of the normal three-year waiting period under the HIPC Initiative.

Delivery of the debt-reduction package from the IMF and World Bank is subject to confirmation from Guyana's other creditors that they will provide their share and satisfactory implementation of reforms agreed by the Government.

Press Information Notices

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

Panama, No. 97/39, December 22
Tanzania, No. 97/40, December 23
Estonia, No. 97/41, December 24

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

Guyana is the fourth country to benefit under the HIPC Debt Initiative, raising the total debt relief committed under this Initiative in 1997 to about $1.2 billion in net present value terms, or about $2 billion in debt-service reduction over time. Guyana is also the first country to qualify under the fiscal/openness criteria, which were established under this Initiative in April 1997 for highly open economies with a heavy fiscal burden of external debt despite strong efforts in mobilizing revenue. Consistent with these fiscal/openness criteria, Guyana's target for the present value of its external debt was set at 107 percent of exports, compared to a projected ratio of 143 percent before assistance.

Press Release No. 97/64, December 23, 1997

Recent IMF Publications

Occasional Papers ($15.00; academic rate: $12.00)

No. 154: *Credibility Without Rules? Monetary Frameworks in the Post-Bretton Woods Era,* Carlo Cottarelli and Curzio Giannini. Argues that during the last 25 years, monetary practice in most countries has increasingly been characterized by the attempt to achieve credibility of purpose while expanding the freedom of monetary authorities in controlling policy instruments.

Working Papers ($7.00)

97/161: *Lessons from Systemic Bank Restructuring—A Survey of 24 Countries,* Claudia Dziobek and Ceyla Pazarbaşıoğlu. Analyzes a representative sample of 24 countries and provides a summary of policies judged to be successful.

97/162: *Payments Arrears in the Gas and Electric Power Sectors of the Russian Federation and Ukraine,* Hrang Bagratian and Emine Gurgen. Discusses payments arrears in the Russian Federation and Ukraine, with emphasis on the gas and electric power sectors.

97/163: *Policy Reform as Collective Action,* Omotunde E.G. Johnson. Argues that a rational government, to reduce implementation costs and make insignificant the risk of policy reversal, prefers to have the support of citizens for its policy reform program.

97/164: *Speculative Attacks, Forward Market Intervention, and the Classic Bear Squeeze,* Subir Lall. Addresses the question of how an attack is launched on the forward market and what is the optimal policy response to such speculation.

97/165: *Private Investment and Endogenous Growth—Evidence From Cameroon,* Dhaneshwar Ghura. Investigates empirically the factors that have influenced economic growth in Cameroon during 1963–96.

97/166: *Risk Management of Sovereign Assets and Liabilities,* Marcel Cassard and David Folkerts-Landau. Discusses essential reforms in reducing emerging market vulnerability to external shocks.

97/167: *Regional Integration and Baltic Trade and Investment Performance,* Robert Sharer. Analyzes the role of regional arrangements in trade and foreign direct investment performance in the Baltics.

97/168: *Sharp Reductions in Current Account Deficits—An Empirical Analysis,* Gian Milesi-Ferretti and Assaf Razin. Studies determinants and consequences of sharp reductions in current account imbalances (reversals) in low- and middle-income countries.

97/169: *Investment, Uncertainty, and Irreversibility in Ghana,* Catherine Pattillo. Analyzes the impact of uncertainty on the investment behavior of Ghanian manufacturing firms using a panel data set for the years 1994–95.

97/170: *An Econometric Analysis of the Determinants of Inflation in Turkey,* Cheng Hoon Lim and Laura Papi. Seeks to shed some light on the determinants of inflation in Turkey.

97/171: *The Bank of Canada's Monetary Policy Framework: Have Recent Changes Enhanced Central Bank Credibility?,* Brenda Gonzaléz-Hermosillo and Takatoshi Ito. Examines the key issues associated with the recent changes in the Bank of Canada's monetary policy framework.

97/172: *International Evidence on the Determinants of Trade Dynamics,* Eswar S. Prasad and Jeffery A. Gable. Provides some new empirical perspectives on the relationship between international trade and macroeconomic fluctuations in industrial economies.

97/173: *Vertical Tax Externalities in the Theory of Fiscal Federalism,* Michael Keen. Examines vertical tax externalities by considering their implications for a range of issues in fiscal federalism.

97/174: *Money, Wages, and Inflation in Middle-Income Developing Countries,* Pierre-Richard Agénor and Alexander W. Hoffmaister. Examines the short-run links between money growth, exchange rate depreciation, nominal wage growth, the output gap, and inflation in Chile, Korea, Mexico, and Turkey.

Papers on Policy Analysis and Assessment ($7.00)

97/11: *Bank Soundness and Currency Board Arrangements—Issues and Experience,* Veerathai Santiprabhob. Discusses the designs of existing currency board arrangements that may help maintain bank soundness.

IMF Staff Country Reports ($15.00)

97/112: Angola—Recent Economic Developments
97/113: Brunei Darussalam—Statistical Appendix
97/114: Burundi—Recent Economic Developments
97/115: Comoros—Statistical Annex
97/116: The Gambia—Statistical Annex
97/117: Grenada—Recent Economic Developments
97/118: Zambia—Selected Issues and Statistical Appendix

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

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

Prospective Link with EMU Poses Challenge for CFA Franc Zone

The CFA franc zone, which comprises 14 sub-Saharan African countries, is a monetary union with a fixed exchange rate. Since 1948, France—the anchor currency country—has guaranteed the convertibility of the CFA franc into French francs. France is also a member of the European Union. The process of economic and monetary integration in the European Union is scheduled to reach a critical milestone on January 1, 1999, with the introduction of a single currency—the euro—and the creation of the European economic and monetary union (EMU). It is expected that France will meet the necessary entrance requirements and will be among the initial countries joining the euro area and, thereafter, that the peg of the CFA franc will shift from the French franc to the euro.

This prospective shift of the peg of the CFA franc will be a significant political and psychological change for policymakers in the CFA franc zone. Although this shift is likely to leave the arrangements and operating features of the zone essentially unchanged, it raises a number of other questions, according to Michael T. Hadjimichael and Michel Galy, authors of a new IMF Working Paper, *The CFA Franc Zone and the EMU*. Will the change simply require a decision by the CFA franc countries and France, or will it involve the other members of EMU? What is the potential economic impact of EMU on the CFA franc zone? And what are the likely implications on the economic and monetary integration of the CFA franc countries?

CFA Franc Zone: Economic Performance

The CFA franc zone functions under several key operating principles, the most important of which is the French Treasury's guarantee of convertibility of the CFA franc into French francs. This is effected through the establishment by each regional central bank of an operations account with the French Treasury with market-related yields or charges.

Following some thirty years of strong growth and low inflation compared with other sub-Saharan African countries, the growth performance of the CFA franc zone countries began to weaken during 1986–93, in the face of sharp deterioration in the terms of trade. Moreover, fiscal imbalances and the external public debt increased substantially in relation to GDP. The fiscal imbalances contributed to the emergence of sizable domestic and external payments arrears and a major weakening of the soundness and financial position of the banking systems in the CFA franc zone.

Against this background, the CFA franc zone countries decided to devalue their currency by 50 percent in January 1994 and to implement broadly restrictive incomes and credit policies and a range of structural and institutional reforms, including efforts to restore the financial health of banking systems. This policy package—with the devaluation as the critical element—has contributed to a resumption of growth in real per capita incomes and a reduction in inflation and fiscal imbalances. The overall balance of payments deficit has also been contained, while the external public debt burden has been eased substantially through concessional debt relief. Notwithstanding the considerable progress made since 1994, the CFA franc zone countries still bear a heavy external debt burden, continue to be subject to structural rigidities, and remain vulnerable to exogenous shocks.

Until 1994, the degree of economic and financial integration and regional cooperation among the member countries of the CFA franc zone was fairly limited. In addition to a host of administrative restrictions, tax distortions, and protectionist trade policies, political considerations and a perceived need to preserve the special economic and political links to France appear to have dominated the decisions of policymakers, at the expense of regional economic considerations. However, the 1994 devaluation gave impetus to efforts to enhance regional economic and monetary integration, with the objective of establishing a common market based on a customs union and the harmonization of indirect tax legislation, and the coordination of economic policies between member countries through regional surveillance.

CFA Franc Zone, France, and EMU

The third and final stage for the creation of the EMU is slated to begin on January 1, 1999. Stage 3 entails the introduction of a single currency, the euro, and the implementation of a single monetary policy under the European central bank for those countries of the European Union that have satisfied the convergence criteria laid out in the Maastricht Treaty.

Once France enters the EMU, the French franc will be replaced by the euro. The CFA franc countries and France have already indicated their intention to preserve

CFA Franc Zone

The 14 countries of the CFA franc zone belong to two separate monetary areas (or subregions) and share their respective single currencies, which are issued by two regional central banks. The West African Monetary Union (WAMU) includes Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo and is serviced by the Banque Centrale des Etats de l'Afrique d'Ouest (BCEAO). The Central African Monetary Area (CAMA) includes Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon and is serviced by the Banque des Etats de l'Afrique Centrale (BEAC).

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the existing CFA franc zone arrangements, including the French Treasury's guaranteed convertibility of the CFA franc. The CFA franc countries have traditionally regarded this convertibility as crucial for maintaining confidence in, and preserving the stability of, their currency. This feature of the arrangement is also considered the justification for preserving the close political and economic links between the CFA franc countries and France.

The provisions of the Maastricht Treaty on the framework for establishing or modifying exchange rate arrangements with non-EU countries leave room for interpretation, according to the authors. On the one hand, the free convertibility of the CFA franc into euros guaranteed by France could be interpreted as an exchange rate arrangement that affects all EMU countries. On the other hand, it can be argued that the guarantee of free convertibility is a budgetary arrangement between the French Treasury and the two regional central banks of the CFA franc zone. The guaranteed convertibility is not a monetary arrangement; it does not involve the French central bank and will not involve the European central bank.

The arrangement between France and the CFA franc zone is consistent with the EMU's intention to develop and strengthen monetary cooperation with the African, Caribbean, and Pacific countries—and other developing countries as well—that maintain important trade and financial relations with its membership. The European Union has stressed that a stable monetary and financial environment is a prerequisite for the effective implementation of cooperation and aid policy and that the credibility and effectiveness of monetary policy in these countries would be enhanced if they pegged their currencies to a stable currency like the euro, while preserving their competitiveness.

Potential Economic Impact: Benefits and Risks

The linking of the CFA franc to the euro would not fundamentally change the external environment or policy priorities of the CFA franc countries, according to the authors. But it would offer some prospective advantages and pose some likely risks. The zone stands to gain from the link to the euro through three main channels:

• *Output effects.* Because EU countries account for about half of the external trade of the CFA franc countries, a potential strengthening of output growth is bound to stimulate the demand for their exports.

• *Price effects.* Linking the CFA franc to the euro would add to the benefits derived from exchange rate stability, contribute to the stabilization of the nominal effective exchange rate of CFA countries, stimulate trade with EMU countries, and encourage higher inflows of EU foreign direct investment in the CFA franc zone.

• *Market access.* The positive price effects would be reinforced and supported by improved access to the EU money market and the prospect of liberalized capital movements between the CFA franc zone and the EMU.

The main risks of the link to the euro include a potential appreciation of the real effective exchange rate of CFA franc countries and a heightened volatility of the euro in terms of other major currencies—in particular, the U.S. dollar—during the transition to EMU and in the early years, as well as over the long run. In the short term, complications in the EMU process might have adverse implications for economic activity and financial markets in EU countries—and, hence, on the economies of the CFA franc zone, which would be hurt by weakening activity in their main export markets, while an unduly strong and volatile euro might weaken their competitiveness.

Given its high dependence on the production and export of a limited number of primary commodities, whose world prices are expressed in U.S. dollars, and the modest size of intrazone trade, the CFA franc zone would remain substantially more vulnerable to exogenous shocks than the EMU countries. But the linking of the CFA franc to the euro offers the CFA franc countries the opportunity to intensify their adjustment efforts, as well as to step up their initiatives to enhance regional economic integration. The potential exposure of CFA franc countries to asymmetric shocks relative to EMU countries and the risk of a strong euro reinforce the need for these countries to accelerate their structural reforms so as to encourage diversification of their production and export bases. ■

Copies of IMF Working Paper 97/156, *The CFA Franc Zone and the EMU*, by Michael T. Hadjimichael and Michel Galy, are available for $7.00 each and may be purchased from IMF Publication Services.