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Review of IMF Financial Policies Is Ongoing

On December 20, 1996, David Williams, Treasurer of the IMF since 1991, was interviewed by the Editor of the IMF Survey. *The Treasurer's Department is responsible for the formulation of the IMF's financial policies and practices, the conduct and control of financial operations and transactions, and control over accounts and financial records.*

IMF SURVEY: *The IMF is described as a monetary institution with a catalytic financial role. Can you explain the significance of these aspects of the IMF's character?*

WILLIAMS: The IMF is a monetary institution in two senses: it is financed with members' liquid external financial assets, which members can use at short notice to satisfy a balance of payments need, and it lends its resources to help members correct balance of payments deficits over the short to medium term. In contrast to the World Bank and other multilateral development institutions, the IMF provides only balance of payments financing, rather than project finance or financing for developmental purposes.

The catalytic role of the IMF enhances its monetary character. IMF financing is provided in support of a member's adjustment policies; it is structured to generate additional financial support for that member from other sources—either financial markets or governments—so as to provide financing sufficient to help the member correct its balance of payments maladjustment.

David Williams, Treasurer of the IMF.

IMF SURVEY: *The IMF liquidity position has weakened and appears set to weaken further. How serious is this weakening, given projected financing requirements?*

WILLIAMS: The liquidity of the IMF refers to the volume of usable resources—currencies and SDRs—available to help it finance members' balance of payments deficits in the context of its support for their adjustment programs, and also to meet the IMF's short-term liabilities. Usable currencies refers to currencies of members in sufficiently strong balance of payments and reserve positions; the strength of members' positions is determined quarterly by the Executive Board in accordance with the IMF's Articles of Agreement. *(Please turn to following page)*

Making the Most of Debt Relief, External Finance

The debt and financing problems that confront the heavily indebted poor countries have raised concerns about their prospects for achieving sustainable growth. On December 10–11, 1996, the IMF and the World Bank hosted a Conference on External Financing for Low-Income Countries to address this challenge within the context of the new multilateral debt initiative for heavily indebted poor countries. Organized by the IMF Institute and the IMF's Policy Development and Review Department, the conference focused on the impact of the debt burden and overhang on economic performance within the context of both traditional debt-relief mechanisms and the IMF-World Bank debt initiative and the contribution of official financing for indebted poor countries.

Opening the conference, Alassane D. Ouattara, Deputy Managing Director of the IMF, highlighted the marked economic recovery of a number of low-income countries in 1995—including more than 20 countries in Africa *(Please turn to page 10)*

We pay considerable attention to the so-called liquidity ratio, which is a ratio of the IMF's usable resources to its short-term liabilities. Each sale of currency by the IMF creates a matching liability, which represents an asset for the member whose currency has been sold by the IMF and is held in the form of a reserve position with the IMF. The IMF's usable resources have fallen considerably since the ninth quota increase came into effect at the end of 1992, owing to very heavy demand, including by such countries as Argentina, Mexico, Russia, and Ukraine.

The strong demand on IMF financial resources is expected to continue over the next few years, although at present the staff is not projecting large-scale or exceptional demand by any country. The liquidity ratio is now close to 100 percent, following the recent addition of two major currencies to the list of usable currencies. The long-run average for the liquidity ratio is about 70 percent. When the ratio falls below 70 percent—as it appears likely to do—it signals that IMF liquidity may be entering a period of potential strain, which raises concerns about the possible need to increase IMF quotas. Assuming the number of usable currencies does not increase—which may be somewhat pessimistic—and that there is no exceptional demand for IMF resources, staff project the liquidity ratio to fall to about 75 percent by the end of 1997, and to less than 60 percent by the end of 1998. These are uncomfortably low ratios, and they explain in part why the Interim Committee has asked the Executive Board to give the utmost priority to concluding the Eleventh Review of Quotas as soon as possible.

IMF SURVEY: *Why are quotas so important to the IMF?*

WILLIAMS: Quotas have many functions. They purport to reflect members' relative economic size and also constitute members' subscriptions, which are the IMF's fully paid-in capital and provide its usable resources. Quota resources are readily available to finance IMF operations; they are less expensive than borrowing; and they are a good measure of a member's rights in, and obligations to, the IMF. A member's access to IMF resources is determined by its quota; a member's voting rights are directly related to the size of its quota; and SDR allocations are proportional to members' quotas. These functions directly affect the operations of the IMF and underscore the need for the IMF to remain a quota-based institution.

IMF SURVEY: *What is the budgetary impact on members of quota subscriptions?*

WILLIAMS: Quota payments—either a member's initial subscription or subsequent increase—are not budgetary items; they are off budget. Quota subscriptions are financed in two parts: 25 percent of a quota increase (or roughly 25 percent of the initial quota) is paid for out of the member's reserves, either in SDRs or in hard currencies, in return for which a member receives a reserve position in the IMF—which represents an exchange of assets. The remainder of the quota subscription is paid in the member's local currency, either in cash or usually in non-interest-bearing, nonnegotiable promissory notes, issued either by the member's central bank or by its treasury. These payments are also not budgetary items. Nevertheless, a quota increase usually requires parliamentary approval and, in some cases, parliamentary appropriation, despite the fact that the IMF's financial operations are essentially exchanges of assets.

IMF SURVEY: *Can you comment on the size of the expected quota increase and when it may come into effect?*

WILLIAMS: The Managing Director has made a powerful case for a doubling of quotas from their current level of SDR 145.3 billion, or about $200 billion, and most Executive Directors believe that a substantial increase is now called for. The main points being considered are the need to maintain a credible IMF in terms of its size relative to the world economy; to accommodate the prospective demand for IMF resources over the medium term; to take into account the time needed to legislate a quota increase, which will have to take the IMF into the early years of the next century; and to recognize that globalization is increasingly associated with potentially large-scale changes in capital flows, which could well affect both the demand for IMF financing and the supply of its usable resources. Moreover, the IMF does not normally rely on borrowing to finance its operations, except in emergencies.

Discussions on the Eleventh Review of Quotas are under way in the Executive Board, which is focusing on the appropriate size and distribution of the increase. It is a difficult exercise, in part because of the many functions that quotas perform in the IMF. The Eleventh Review technically ends in March 1998, but it is hoped that discussions will be concluded before then, especially as members will need to complete time-consuming legislative procedures.

IMF SURVEY: *What about progress on expanding the General Arrangements to Borrow (GAB)?*

WILLIAMS: In March 1995, the Managing Director initiated a review in the Executive Board of the adequacy of the GAB. At its meeting in April 1995, the Interim Committee also examined issues related to borrowing by the IMF from members and, in particular, the role of the GAB. At the 1995 Group of Seven Summit in Halifax, the Group of Ten and other countries with the capacity to support the international monetary system were asked to develop financing arrangements with the objective of doubling—to SDR 34 billion—as soon as possible the amount currently available under the GAB to respond to financial emergencies. After many discussions among potential participants, it has been agreed to establish a new set of lending arrangements. Under these arrangements, a number of countries would make available to the IMF loans up to specified amounts when the IMF needs supplementary resources to forestall or cope with an impairment of the international monetary system, or to deal with an exceptional situation that poses a threat to the stability of the system; these will be the New Arrangements to Borrow (NAB).

The new arrangements signal an important extension of international monetary cooperation and financial support for the IMF in special circumstances. The GAB will continue in force, but the combined amount borrowed by the IMF under the GAB and NAB will at no time exceed SDR 34 billion. The Board will consider the proposed decision on the NAB in the near future.

Williams: A quota increase usually requires parliamentary approval, even though IMF financial operations are essentially exchanges of assets.

IMF Survey: *The IMF is mobilizing funds to finance the enhanced structural adjustment facility (ESAF) during the interim period of 2000/01–2004 and, in that context, to finance the IMF's participation in the debt initiative for heavily indebted poor countries. How is this proceeding and what impact will these financing demands have on the IMF's liquidity?*

Williams: At the September 1996 Interim Committee meeting, Governors unanimously agreed to the continuation of the ESAF and for the IMF's participation through it in the debt initiative for the highly indebted poor countries (HIPCs). The details of the financing of the interim ESAF require further consideration in the Executive Board.

As regards the capital needed to enable the ESAF to finance loans for the interim period of 2000/01–2004—about SDR 4 billion—the Board must decide whether to use the general resources of the IMF or continue the policy of the last nine years of further borrowing by the ESAF Trust. If the IMF's resources are used, its liquidity will be adversely affected, but only to a relatively small extent. Since the capital resources would generally be available only at market-related interest rates, a subsidy must also be provided to enable ESAF financing to continue to carry a concessional interest rate of 0.5 percent a year. It has generally been agreed that the IMF would seek to maximize members' bilateral contributions to subsidize interim ESAF loans (and for HIPC operations) toward a target of SDR 2.5 billion. In this connection, the Executive Board will consider use of resources now held in the IMF in a "special contingent account"—the so-called SCA-2—and, if needed, through the optimization of the management of the IMF's reserves. To the extent that resources are insufficient to finance HIPC operations, funding is expected to be provided from an early transfer of resources from the Reserve Account of the existing ESAF Trust.

IMF Survey: *The ESAF's interim financing raises the issue of gold in the IMF. Can you elaborate?*

Williams: The IMF is the second largest official holder of gold in the world after the United States, with holdings of 103.4 million ounces. Gold is a fundamental part of the financial strength of the IMF. It is an asset valued in the IMF's balance sheet considerably below its market price. The Executive Board has recently discussed gold in the IMF and the conclusions of that discussion are in the IMF's 1996 *Annual Report*. One important conclusion is that the use of gold should be restricted for purposes widely supported by the membership. Moreover, the IMF should capitalize the profits of the sale of the gold and retain them in the IMF, with only the investment income from those profits used for the IMF's purposes. Any use of the IMF's gold would also have to take into account gold's role in the international monetary system and not unduly affect the gold market, other gold holders, or gold producers. A sale of gold by the IMF requires an 85 percent majority of the total voting power.

IMF Survey: *What is the status of the "equity" SDR allocation?*

Williams: The Interim Committee endorsed the Managing Director's proposal for a special onetime allocation of SDRs; this would be achieved through an amendment of the Articles so as to give all members a stake in the SDR system, including those that have not previously received an SDR allocation. Such an allocation would promote equity among members. The Executive Board is discussing the modalities of such an allocation, in particular a method to equalize the ratio of cumulative allocations to quota for all members at a particular level, and the size of the allocation. The Managing Director has proposed equalizing the ratio of accumulated allocations to quota at 33 percent. If agreed by the membership, this would yield a special onetime allocation of SDR 26.6 billion, or $38 billion.

IMF Survey: *Arrears to the IMF have declined recently. To what do you attribute this progress, and do you expect it to continue?*

Williams: Arrears now amount to SDR 2.2 billion, well below their peak of SDR 3.6 billion in 1991. They are concentrated among four countries: Sudan, Liberia, Somalia and, increasingly, Zaïre. Countries with smaller arrears outstanding include Iraq, Afghanistan, and the Federal Republic of Yugoslavia (Serbia/Montenegro). No new countries have fallen into protracted arrears to the IMF for some years. I attribute this largely to the strength of the cooperative strategy on arrears implemented by the IMF since 1990.

IMF Survey: *What impact will European economic and monetary union have on the IMF's operations?*

Williams: A number of operational issues are expected to arise. One important one will be to assess the relative balance of payments positions of members of the monetary union for purposes of the IMF's operational budget. The introduction of the euro will also have important implications for the IMF in terms of its effects on the valuation of the SDR and the determination of the interest rate on the SDR. The conversion of the euro into freely usable currencies will affect the IMF's operational requirements, and the coming into effect of the European central bank will need to be examined as regards the depository for the IMF's assets and the "ownership" of reserve positions in the IMF by members of the EU.

The principle of a single currency serving as the currency of a number of members is, per se, not a problem; for example, the same situation arises for the CFA franc zone members in Africa. However, the EU encompasses creditor member countries that are important in supporting IMF financial operations; this raises a number of unique issues that we are examining with great care.

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WTO Ministerial Conference Seeks to Strengthen the Multilateral Trading System

The World Trade Organization (WTO), established in 1995 to succeed the General Agreement on Tariffs and Trade, meets at the ministerial level every two years to review progress in implementing multilateral trade agreements and to establish its work program. The first Ministerial Conference was held in Singapore on December 9–13, 1996. In addition to the 128 WTO members, attendees included representatives from many observer governments and international organizations, including the IMF and the United Nations Conference on Trade and Development, as well as a large number of selected nongovernment organizations. (See page 6 for excerpts from IMF Managing Director Michel Camdessus's address to the plenary session and page 8 for a review of the IMF-WTO Cooperation Agreement.) Following is a summary of the conference by Alan Tait and Piritta Sorsa, Director and Senior Economist, respectively, of the IMF's Office in Geneva.

WTO Director-General Renato Ruggiero (left) and IMF Managing Director Michel Camdessus confer at the WTO's first Ministerial Conference in Singapore.

The WTO's first Ministerial Conference exceeded the expectations of many participants, although apart from a sweeping agreement on information technology, the results were modest. The conference agreed that implementation of the WTO's multilateral trade agreements, which were signed in Marrakesh in April 1994, had in general proceeded well. The declaration issued at the end of the conference endorsed an agenda for talks on further trade liberalization in selected areas and spelled out a work program for the WTO on several new trade-related issues such as investment, corruption, and competition.

The conference took several actions, including:

• adoption of an information technology agreement (ITA) to liberalize the $500 billion of global trade in information technology products;

• recognition of the International Labor Organization's (ILO) competence to deal with core labor standards, rejection of their use for protectionist purposes, and endorsement of WTO-ILO cooperation; and

• adoption of a draft comprehensive and integrated WTO plan of action for the least-developed countries.

Although many issues had already been settled in Geneva before the conference, several controversial new issues needed to be resolved. The final declaration reflects a compromise between deep differences of view among the participants about the WTO's work program for the coming years. Most developing countries—weary of the recent eight-year WTO negotiations—wanted to limit the discussions to a stocktaking of the implementation of Uruguay Round agreements, especially in textiles and clothing. They preferred to leave discussion of any future trade issues to the built-in agenda (a list of deadlines on implementation or negotiations defined in the Uruguay Round agreements). Most industrial countries, however, wanted to begin work on new trade issues, including those related to labor, investment, competition, and corruption.

The main accomplishment of the conference was clearly the ITA, which will liberalize international trade in computer-related products, which now account for about one-tenth of world trade. The agreement was characterized as equivalent to a global tax cut for consumers with spillovers into important sectors, such as education. Countries accounting for more than 90 percent of trade in information technology products agreed to sign on. The ITA will be finalized early in 1997, and tariffs will decline to zero and be bound at that level over a three-year period. Success in reaching agreement on this important issue helped bridge differences in other contentious areas.

The decision to include new items on the agenda gives the WTO a mandate to tackle such emerging trade issues as investment and competition policies. Even though the WTO's authority in this area will be limited, the mandate could strengthen the organization's multilateral leadership role by enabling it to confront old and new protectionist challenges in the international trading system. Working parties will examine these issues, but without deadlines or any reference to potential negotiations on new rules.

As stated in the declaration, the conference also agreed to work toward an agreement on tackling corruption in international trade, although no deadline was set. A working party will examine transparency in procurement practices. Although the absence of a deadline may make it difficult to reach early agreement, including this issue in the declaration may send a signal to many countries about the increased concerns over corruption and the willingness of the international community to take action.

The agreements reached during the conference also clarified the path to be taken toward future liberalization by endorsing the built-in agenda in general—and services and agriculture especially. However, some participants were disappointed by the failure to agree on future negotiations on industrial tariffs. The declaration also notes the disappointing results to date of the sectoral negotiations in services (telecommunications, financial services, and maritime transport) and commits members to completing them within set deadlines. To prepare for the negotiations on agriculture and services expected to take place at the turn of the century, analytical studies and information exchange on existing regulations will be undertaken in 1997–98.

Ministerial participants held widely divergent views on the WTO's position with regard to labor and the environment. On labor standards, it was important for developing countries that protectionism should be avoided and that their comparative advantage not be undermined. For some industrial countries, it was important that at least some notice be taken of core labor standards. The final text of the declaration reflects a balanced compromise between these two views. It recognizes the competence of the ILO in dealing with core labor standards and notes that labor standards should not be used for protectionist purposes or to undermine the comparative advantage of low-wage countries. It also states that the existing collaboration between the WTO and ILO secretariats will continue. Conference participants decided that the WTO's Trade and Environment Committee should continue to work on all items on its agenda.

Promoting Freer Trade: The IMF's Perspective

Following are excerpts from a statement given by IMF Managing Director Michel Camdessus at the first Ministerial Conference of the World Trade Organization (WTO) in Singapore on December 9, 1996.

The roles of the IMF and the WTO are complementary. As stated in the IMF Articles of Agreement, one of the primary purposes of the IMF is "to facilitate the expansion and balanced growth of international trade." We do this in several ways.

First, through our surveillance over members' economic policies and our assistance in the design of IMF-supported programs, we promote the sound macroeconomic policies, appropriate and stable exchange rates, and structural reforms that must underpin trade liberalization.

Second, in keeping with our mandate "to assist in the establishment of a multilateral system of payments in respect of current transactions," we have encouraged our members to eliminate restrictions on all current account transactions.

And third, we encourage countries to adopt outward-oriented policies—that is, policies that do not discriminate between production for the domestic market and for export, or between purchases of domestic and foreign goods. Moreover, programs we support frequently include measures to increase the outward orientation of the economy, in keeping with members' obligations to the WTO.

But as we all know, reforming economies and dismantling protection is a painful process with, at times—at least in the short and medium term—harsh social consequences. This is why the enhanced and sound competition we want to promote through trade liberalization can only be beneficial if accompanied by appropriate social policies at home and credible instruments of multilateral solidarity. The IMF has adapted its financing instruments to support members' adjustment and reform needs. In particular, the extended Fund facility and the enhanced structural adjustment facility for low-income members have allowed the IMF to support medium-term programs with greater emphasis on structural adjustment, including trade liberalization.

What has been the IMF's experience with trade liberalization? In our work with 181 member countries, we repeatedly see that opening economies to external trade

Further integration of the least-developed countries into the world trading system and the importance of continued liberalization of their economies have been important issues for the WTO. Conference participants approved a plan of action for least-developed countries. The plan calls on WTO members to implement the proposal of the WTO Director-General to accord duty-free access to exports of the least-developed countries and to organize a high-level meeting to facilitate aid coordination and technical assistance, particularly to meet the requirements of the Uruguay Round. The position of a preconference report on net-food-importing countries—that these countries should approach the relevant institutions directly (for example, the IMF and the World Bank)—was also reaffirmed.

In the area of textile and clothing exports, conference participants could not agree to the request of exporting countries to accelerate implementation of the Uruguay Round liberalization program—phased removal of import restrictions during a ten-year period. The declaration acknowledges, however, the main concerns of the exporters about the back-loaded liberalization of restricted items and affirms the commitment to "full and faithful" implementation of the Textiles and Clothing Agreement.

The declaration focuses on the interests of the industrial countries—the ITA, investment, competition, and transparency in government procurement. Liberalization of trade in high-technology products will provide solid proof of the potential benefits for business from multilateral negotiations. Visible results from the ITA may therefore increase the interest of the business community in the WTO system. This interest might support governments as they introduce WTO rules into their domestic legal systems. The discussion about corruption may increase interest in multilateral trade rules.

Developing countries did not achieve all their goals with respect to textile exports and the problems of the least-developed countries. Review of implementation received considerably less attention than they had hoped for. The developing countries' main achievement was to block the start of new work on labor standards from being added to the WTO agenda. Interest groups advancing labor and environment issues suffered the most disappointments, which may affect their commitment to freer global trade.

helps get domestic prices "right," so that market signals improve domestic resource allocation, increase efficiency, and create conditions under which domestic firms can compete successfully in foreign markets. We also see that countries that open their markets tend to attract additional resources and grow more rapidly. This creates a virtuous circle of trade, investment, and growth that greatly facilitates achieving other development policy objectives, such as the reduction of poverty and the development of human resources.

But there is the other side of the coin. Just as developing countries and countries in transition must adopt outward-oriented policies—both for the sake of their own economic development and integration into the global economy and for the greater prosperity of the global economy—so must industrial countries. And not just to provide greater market access to developing and transition countries but also to increase their own efficiency so that they, too, can take advantage of new trade opportunities in the global economy. In many cases, this process could be greatly facilitated if industrial countries accelerated their own structural reforms, especially in labor markets.

Of course, it is never easy to make such adjustments in any country. All countries face temptations to try to preserve the status quo by maintaining existing barriers or creating new ones—always said to be just temporary. Yet we all know that protectionism is self-defeating. And while it is important to provide a social safety net for the most vulnerable segments of the population, attempts to preserve an uncompetitive sector or enterprise are in the long run doomed to failure—and in the meantime, impose unjustified costs on the taxpayer and the consumer.

Considerable progress has been made on trade liberalization, but much more remains to be done in such areas as agriculture, textiles, and services. In fact, with the globalization of the world economy, trade has become more complex, and trade liberalization, more challenging. We are fortunate to have the forum and machinery established under the WTO to help move the process forward. The IMF, for its part, will join in this task through its surveillance and support of members' adjustment and reform efforts.

IMF and WTO Sign Cooperation Agreement

On December 9, 1996, IMF Managing Director Michel Camdessus and World Trade Organization (WTO) Director-General Renato Ruggiero signed a Cooperation Agreement between the two institutions.

The Agreement, which was signed during the WTO's first Ministerial Conference in Singapore (see page 5), seeks to formalize and build on the close, collaborative relationship that had evolved between the IMF and the contracting parties to the General Agreement on Tariffs and Trade (GATT). The new agreement seeks to broaden this collaboration, taking into account the new mandate and operating modalities of the WTO.

Both the IMF and the WTO are committed to promoting policies and an environment conducive to achieving and sustaining economic growth. In particular, both organizations operate within mandates and areas of expertise that advance an international trade and payments system free of restrictions. The IMF does this by fostering international monetary cooperation and, through its surveillance over its members' exchange rates, by providing advice and balance of payments support to achieve macroeconomic stability and structural adjustment. The WTO promotes this common objective by providing a forum to enforce the legal rights and obligations of its members in the multilateral trading system and by furnishing a forum for the conduct of multilateral trade negotiations. WTO surveillance over its members' trade regimes also allows members to exercise peer pressure.

Mutual Obligations

In noting the globalization of markets, the preamble of the Cooperation Agreement points to the linkages in economic policymaking that fall within the mandates of the two organizations and sets out the relevant provisions on cooperation and/or consultation in the IMF's Articles of Agreement and the Marrakesh Agreement establishing the WTO. The ensuing paragraphs detail the operative obligations of the IMF and the WTO; these include institutional consultations, staff attendance at each other's meetings, exchange of documents and information, staff consultations, and standard clauses on confidentiality and on implementation, review, and approval and termination.

Institutional consultations between the IMF and the WTO relate to:

• carrying out their respective mandates in accordance with the Agreement, thus providing the basis for institutional cooperation;

• achieving greater coherence in global economic policymaking;

• informing the WTO of IMF decisions (concerning an IMF member's restrictions on the making of payments or transfers for current international transactions, discriminatory currency arrangements or multiple currency practices, and capital outflows). This is important for the WTO in implementing GATT 1994—that is, the original GATT and various specified protocols, decisions, and understandings—and the General Agreement on Trade in Services (GATS). These Agreements recognize the right of a WTO member that is an IMF member to maintain exchange controls and restrictions, as well as restrictions on current international transactions, that are in accordance with the IMF's Articles. Also under the GATS, WTO members are allowed to impose controls on capital transactions under certain circumstances, including if such controls are imposed at the request of the IMF;

• IMF participation in consultations carried out by the WTO Committee on Balance of Payments Restrictions, which reviews measures taken by a WTO member to safeguard its balance of payments position. This provision confirms existing procedures that require the WTO to consult fully with the IMF on all questions relating to monetary reserves, balance of payments, or foreign exchange arrangements. In the course of this formal consultation, the IMF provides the Committee with background documentation, and, in most cases, with a statement approved by the IMF's Executive Board; and

• communicating respective views to each institution, or any of their respective organs or bodies, excluding dispute settlement panels, in writing on matters of mutual interest. This final provision provides a means for the IMF and the WTO to communicate their views on matters of mutual interest. These views will be incorporated in the official record of each body but will not be binding on that party. In practice these communications are expected to involve only important matters of policy and/or jurisdiction. The Agreement also requires the IMF to inform the relevant WTO body, including dispute settlement panels, considering exchange measures within the IMF's jurisdiction whether these measures are consistent with the IMF's Articles of Agreement. IMF communications on jurisdictional matters will have official status in the WTO proceedings and will fulfill the WTO's requirement under Article XV of the GATT to consult with the IMF on consistency of exchange rate matters within the IMF's jurisdiction.

Attendance at Meetings

In addition to outlining institutional consultations, the Cooperation Agreement also provides for staff attendance (as observers) at certain meetings of the other institution (see box). The WTO Secretariat will be invited to meetings of the IMF's Executive Board when general and regional trade policy issues are discussed—including the formulation of IMF policies on trade matters—and to discussions of the World Economic Outlook, when there is a significant trade content.

When consultations between the IMF's staff and the WTO Secretariat conclude that matters of particular common interest to both organizations will be discussed at other meetings of the Executive Board—including country-specific matters—or at the meetings of the Committee on Liaison with the WTO, the IMF Managing Director will recommend invitations be extended to the WTO Secretariat. Although not part of the Cooperation Agreement, the IMF's Executive Board has also recommended to its Board of Governors that the WTO Secretariat be granted permanent observer status at the IMF-World Bank Annual Meetings. Moreover, the Managing Director has recommended that the Director-General of the WTO be invited regularly as an observer to Interim and Development Committees' plenary sessions and to those restricted sessions where matters of common interest are to be addressed.

In turn, in addition to the meetings cited in the box, the WTO will invite IMF staff as observers to meetings of the WTO Dispute Settlement Body when matters of jurisdictional relevance to the IMF are to be considered. The WTO will also invite the IMF to other meetings of the Dispute Settlement Body—as well as to other WTO bodies for which attendance is not provided—when the WTO, after consultation between the WTO Secretariat and IMF staff, finds that such a presence would be of particular common interest to both organizations.

Provisions of Cooperation Agreement

Meetings

WTO Secretariat will have observer status in:

- IMF Executive Board meetings (depending on type)
- Committee on Liaison with WTO (selected meetings)

IMF staff will have observer status in:

- Ministerial Conference
- General Council
- Trade Policy Review Body
- Three sectoral councils
- Committee on Trade and Development
- Committee on Regional Trade Agreements
- Committee on Trade-Related Investment Measures
- Committee on Trade and the Environment
- Subsidiary bodies of the above (with the exception of Committee on Budget, Finance and Administration, and dispute settlement panels)
- Dispute Settlement Body (selected meetings)

Document Exchange

WTO Secretariat will provide the IMF staff with:

- Trade Policy Review reports
- Summary records and reports of Councils, Bodies, and Committees
- Reports of WTO members to above cited bodies
- Agendas of the Dispute Settlement Body

IMF will provide the WTO Secretariat with:

- Staff reports and related background staff papers on Article IV consultations and on use of IMF resources
- Agendas of Executive Board meetings

Exchange of Information

Regarding the exchange of documents and information under the Cooperation Agreement, the IMF will, shortly after circulation to its Executive Board, provide the WTO Secretariat for its confidential use, and subject to the consent of the member, the reports cited in the box on common members and on IMF members seeking accession to the WTO. Similarly, the WTO will provide the IMF, for the confidential use of its management and staff, with the documents listed in the box.

Each organization must ensure that information shared under the Agreement is used only within the limits specified by the other organization. Each is also committed to making available to the other in advance the agendas and relevant documents for the meetings to which they are invited. In addition, the IMF Managing Director and the WTO Director-General are committed to ensure cooperation between the staffs of the two institutions and to agree on appropriate procedures for collaboration, including access to databases and exchange of views on jurisdictional and policy issues.

Joint Consultation

The final operative obligation of the Cooperation Agreement requires IMF staff and the WTO Secretariat to consult at the staff level about matters that one organization is discussing with a common member that could raise issues of possible inconsistencies regarding the member's obligations under WTO Agreements or the IMF's Articles of Agreement.

The two institutions will now focus on implementing the Cooperation Agreement and working toward coherence in global economic policymaking. To this end, a working group on coherence, comprising senior staff from the IMF, the World Bank, and the WTO, will prepare a joint report on an approach to achieve such coherence.

The IMF-WTO Cooperation Agreement should strengthen the long relationship and informal contacts the IMF had with the GATT. By building on past practices and incorporating the new mandate of the WTO, it provides a firm basis for enhanced, effective, and broad collaboration between the two institutions.

Robert Sharer and Nur Calika
IMF Policy Development and Review Department

Best Strategy Is Outward Oriented

(Continued from front page) that grew at an annual rate of 4 percent. For a number of countries, however, heavy debt burdens dampened future growth prospects. In response, he said, the IMF and World Bank are seeking to help resolve the external debt problems of those heavily indebted poor countries that follow sound policies but for which traditional debt-relief mechanisms are inadequate to secure a sustainable debt position over the medium term.

Ouattara made the following additional points:

• Globalization provides new opportunities through a spectacular expansion in the international capital and goods markets. But it can also magnify the adverse effects of policy weaknesses, pose new risks, and confront the international community with difficult policy dilemmas. Reaping gains from globalization requires a firm commitment to further market opening in both developed and developing countries.

• Internal budgetary pressures in most donor countries have constrained their ability to expand official concessional finance. Developing countries will need to fill this gap through expanded domestic savings.

• Governments cannot be expected to play the dominant role in fostering growth. The most effective economic strategies are private sector led and outward oriented.

• Market perceptions are crucial in gauging the appropriateness and consistency of national economic policies; likewise, the transparent and responsible conduct of public affairs is key in determining the success or failure of debtor country efforts.

Highlighting the "extraordinary promise" of globalization for developing countries, Sven Sandström, a Managing Director of the World Bank, strongly endorsed the new debt initiative as critical for helping ensure the full participation of the poorer countries in the expanding system of global trade and investment. At the same time, Sandström expressed concern about the potential marginalization of the poorer developing countries in the absence of concessional aid flows.

Tackling the Debt Problem

While most middle-income debtor countries have improved their external debt positions over the past decade, the heavily indebted poor countries continue to experience difficulty in meeting their external debt-service obligations on a timely basis.

Scope and Impact. The debt problems of the poor countries differ in important respects from those facing middle-income developing countries a decade ago, according to Ravi Kanbur of the World Bank and Peter Wickham of the IMF. Many of the former are characterized not only by high debt, but also by relatively poor economic performance and slow economic policy reform. Also, in comparison with middle-income countries, the heavily indebted poor countries have continued to receive a positive net transfer of resources from official creditors and donors. These transfers notwithstanding, most countries in this group have continued to accumulate arrears on at least a portion of their external obligations, said Kanbur and Wickham. Adverse terms of trade, along with drought and civil war, are partly responsible for these countries' debt problems. But their current predicament can often be traced to severe deficiencies in macroeconomic management and the persistence of microeconomic distortions and structural weaknesses.

To bolster the economic performance of the heavily indebted poor countries, Kanbur and Wickham emphasized that increased debt relief be conditioned on strong programs of domestic economic stabilization and reform. Ibrahim A. Elbadawi, of the African Economic Research Consortium in Nairobi, maintained that the reform efforts of many sub-Saharan African countries had been undermined at the outset by their onerous debt burdens. While commending the scope of the new debt initiative, Elbadawi questioned whether it would permit more ambitious growth rates.

Traditional Approaches Revisited. Conference participants also debated the role of traditional debt-relief mechanisms. Reviewing the debt crisis of the 1980s, William R. Cline of the Institute of International Finance in Washington, cited the paramount importance of domestic economic reform in strengthening external viability. Tony Killick of the London-based Overseas Development Institute called for a number of reforms in the operation of existing debt-relief mechanisms, including the establishment of a new creditor-debtor relationship based on the principles of ownership, selectivity, support, and dialogue; and more precise criteria for determining eligibility and debt sustainability.

Traditional mechanisms for addressing the debt problems of low-income countries—including IMF and World Bank loans and Paris Club reschedulings—are considered to be

Photo Credits: Denio Zara for the IMF, pages 1 and 3; IMF Office in Geneva, page 5; Tel Aviv University, page 16.

sufficient for many of the highly indebted low-income countries to achieve debt sustainability, concluded Anthony R. Boote of the IMF and Axel van Trotsenburg of the World Bank. However, for some of these countries, even the full use of traditional debt-relief mechanisms—together with sound economic policies—would prove insufficient in helping them achieve sustainable debt levels within reasonable time horizons, Boote and van Trotsenburg said. The joint IMF-World Bank debt initiative represents a vital new instrument to help ensure that all countries adopting appropriate policies will achieve debt sustainability.

The debt initiative helps ensure that countries adopting the right policies will achieve debt sustainability.

Increasing Private Capital Flows

Sub-Saharan Africa accounted for only 1.6 percent of private capital flows during 1990–95. This contrasted with the earlier lending boom of 1977–82, when flows to the region were 8.9 percent of total flows going to developing countries. Conference participants discussed both the causes of this disparity and the steps that could be jointly taken by the donor community and the heavily indebted poor countries—largely African—to attract more private capital flows.

Challenges and Incentives. Robert H. Bates of Harvard University stressed the importance of political institutions to economic reform. The economic upheavals of the 1980s throughout Latin America, he noted, were predominantly a crisis of governance in financially bankrupt states. To regain fiscal health, the state itself had to be transformed through the erection of appropriate legal and political institutions.

The surge in private capital flows to developing countries, noted Amar Bhattacharya of the World Bank and Sunil Sharma of the IMF, has not been shared by the heavily indebted poor countries of Africa—mainly because of political instability, weak financial systems, and poor macroeconomic fundamentals. To attract foreign private capital, these countries needed to boost output growth, achieve relative stability in real effective exchange rates, lower external indebtedness, and raise investment rates by shifting to more outward-oriented and market-based investment regimes.

S. Ibi Ajayi of the University of Ibadan, Nigeria, argued that debt forgiveness—not rescheduling—constituted the best approach to help raise sub-Saharan Africa's low rate of foreign investment. Solving the capital flight problem, according to Ajayi, would likewise require a combination of strong macroeconomic policies and longer-term attitudinal changes in favor of greater accountability and transparency. According to Guy Pfeffermann of the International Finance Corporation, the most effective means for increasing private capital inflows resides in policies that address concerns of private investors more directly, particularly macroeconomic stabilization, broad-based market liberalization, and enhanced transparency in governmental operations. David Dollar of the World Bank maintained that sound fiscal, monetary, and trade policies are a vital prerequisite for growth in poorer developing countries. The key issue, he said, was how official flows could best catalyze private flows.

Debt in Perspective. In a luncheon address, Lord Meghnad Desai of the London School of Economics expressed support for the new debt initiative. Flexible implementation of the initiative, he said, was important in light of the data limitations of many debtor countries. The Bretton Woods institutions should also be encouraged to incorporate human development concerns into traditional investment and growth discussions that will form the background to the new debt initiative, said Desai.

Summing Up

Summarizing the two-day discussion, Jack Boorman, Director of the IMF's Policy Development and Review Department, said that consensus had been largely achieved on four major points:

- Strong macroeconomic policy and structural reform are essential preconditions for debt relief to be effective in low-income developing countries.
- The IMF-World Bank debt initiative provides a crucial new instrument to address the debt problems of the low-income countries. Some of its key features, however, will require additional refinement within the context of individual country cases.
- Major responsibility for implementing the initiative rests with the IMF and the World Bank. To move the initiative forward, a spirit of cooperation will continue to be required.
- The chief long-term value of the new debt initiative lies in its potential to foster more rapid growth in debtor countries by providing the poorer developing countries with the necessary incentives to adopt appropriate policies.

John Starrels
Senior Editor, *IMF Survey*

Morocco: Paving the Way for Higher Growth

In 1993, Morocco completed a decade-long implementation of IMF-supported structural adjustment programs and "graduated" from the use of IMF resources and external debt rescheduling. The following article, based on the Executive Board's 1996 Article IV consultation with Morocco, reviews economic developments since 1993 and assesses upcoming challenges and opportunities.

Despite difficult circumstances during 1993–95, the Moroccan authorities managed to preserve broad macroeconomic stability and accelerate structural reforms in important areas. During this period, the Moroccan economy suffered serious setbacks—mainly weather related. Severe drought in 1993 and 1995 crippled the agricultural sector, which accounts for about 17 percent of GDP, and real GDP fell in both years. The exodus from rural to urban areas accelerated during 1993–95, increasing pressures on infrastructure, provision of basic social services, and job markets. With annual nonagricultural GDP growth averaging barely 2 percent during 1993–95 and nongovernment investment stagnating at about 18 percent of GDP, the number of jobs created was insufficient to absorb all new entrants into the labor market. At the end of 1995, urban unemployment reached 23 percent, with higher rates among the young.

The fiscal deficit, excluding privatization receipts, was held at about 4 percent of GDP during 1993–94, although it widened to 5.7 percent in 1995. A restrained credit policy helped contain inflation rates at or below 6 percent, despite temporary surges in food prices. The external current account deficit moved broadly in parallel with the fiscal balance and also widened markedly in 1995, partly reflecting drought-related food imports as well as weakening tourism receipts. The larger external account deficit was financed through a drawdown of gross official reserves—which had reached record levels at the end of 1994—and through increased borrowing, mainly from bilateral sources, often on highly concessional terms.

Structural Reforms Emphasize Liberalization

Recent structural reforms include implementation of an ambitious program to privatize public enterprises and allow more scope for private sector involvement in the operation of utilities and infrastructure. In the financial sector, the authorities' adoption of a new banking law in 1993 laid the basis for enhanced banking supervision to enforce prudential regulations based on international standards. The move to a market-based credit policy has also continued. Since mid-1995, the central bank has used weekly repurchase auctions as the principal instrument in refinancing banks; and in early 1996, bank lending rates were fully liberalized. In addition, the legal basis was laid for the development of markets for short-term bills and other instruments outside the banking system. The privatization process has also given a boost to the Casablanca stock exchange, with market capitalization and stock market turnover growing strongly in recent years.

The government continued to make further progress in liberalizing its exchange and trade system:

• In 1993, the authorities moved to full current account convertibility, adopting the obligations under Article VIII of the IMF's Articles of Agreement, which include agreeing not to impose restrictions on payments for current international transactions.

• In 1994, Morocco bound all tariffs under the World Trade Organization and unilaterally reduced certain tariffs;

• In 1995, the government concluded an Association Agreement with the European Union, which provides for the establishment of free trade in industrial products within 12 years and a far-reaching harmonization of trade-related policies and regulations.

• In mid-1996, the authorities eliminated the remaining quantitative restrictions on imports.

What Remains to Be Done

To reduce high unemployment and improve living standards, especially in

Morocco: Main Economic Indicators

	1993	1994	1995	1996[1]
		(percent)		
Real GDP	–1.0	11.6	–7.6	10.3
Inflation (consumer prices)	5.2	5.1	6.1	3.0[2]
Broad money (end of year, percent change)	7.9	10.2	7.0	7.0
		(percent of GDP)		
Urban unemployment (percent of labor force)	15.9	20.3	22.9	19.0
External current account balance	–2.1	–2.5	–4.9	–2.0
External debt	80.1	71.0	72.2	62.0
Government budget balance (excluding privatization receipts)	–3.9	–3.9	–5.7	–4.7[3]

[1]IMF staff projections.
[2]November 1996 actual.
[3]Fiscal year 1996/97.

Data: Moroccan authorities and IMF staff estimates many rural areas, Morocco needs to move to a higher economic growth trajectory. At the same time, public expenditure needs to focus more on basic education and health services to allow the poorer segments of the population to participate fully in the country's development. To boost private investment and facilitate the industry's adjustment to the removal of tariff protection under the EU Agreement, administrative inefficiencies and regulatory rigidities in labor and land markets must be addressed. To underpin an export-led growth strategy, competitiveness needs to be improved through structural measures that enhance productivity.

To free resources for private investment and reduce public debt, the authorities plan to reach virtual budget balance by the year 2000, including through reforms of the transfer and subsidy system and the civil service. The domestic tax system is being strengthened with IMF technical assistance in anticipation of the loss of tariff revenue.

The social consensus required for bold and comprehensive policy action has recently been strengthened, and developments in 1996 have provided a favorable start. Excellent rains have ensured a record harvest, and real GDP is estimated to have grown by at least 10 percent. By November 1996, inflation had fallen to 3 percent and gross official reserves had partly recovered the losses suffered in 1995. Recent initiatives to grant innovative build-operate-transfer concessions to private investors, together with the continuation of the privatization program, have contributed to Morocco's growing attractiveness to foreign investors.

The Moroccan government's continuing pursuit of fiscal consolidation and structural reform should boost prospects for a marked acceleration of growth over the longer term.

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IMF Middle Eastern Department

From the Executive Board

Beginning with this issue, the IMF Survey *will publish excerpts of recent IMF press releases. The full texts are available on the IMF's web site (http://www.imf.org) under the heading NEWS or on request (fax only, please) from the IMF's Public Affairs Division (fax: (202) 623-6278).*

Madagascar: ESAF

The IMF approved a three-year loan for Madagascar under the enhanced structural adjustment facility (ESAF), for an amount equivalent to SDR 81.4 million (about $118 million), to support the government's economic reform program for 1996–99. The first annual loan, equivalent to SDR 27.1 million (about $39 million), is available in two equal semiannual installments.

Medium-Term Strategy and the 1996–97 Program

The government's medium-term objectives are to restore confidence to create the conditions for a sustained recovery of private investment and to seek a reduction in poverty. Economic growth is programmed to reach 4.5 percent by 1999 from 2 percent in 1996, while year-on-year inflation is expected to fall to 3 percent in 1999 from 10 percent in 1996.

Consistent with the medium-term framework, the program for 1996–97, which is supported by the first annual ESAF loan, aims to increase real GDP growth to 3 percent in 1997; reduce inflation to 7 percent by the end of 1997; and contain the external current account deficit (excluding official transfers) at 7.2 percent of GDP in 1997. To these ends, the government intends to reduce the overall fiscal balance (excluding grants) to 6.9 percent of GDP in 1997 from 8.5 percent in 1996.

Structural Reforms

Structural reforms under the program will seek to improve the business environment, divest public enterprises, strengthen tax and customs administration and reform the value-added tax, improve government operations, combat poverty by improving basic health and primary education facilities as well as public security, raise agricultural productivity, and complete the liberalization of the foreign exchange market. The government will also initiate a civil service reform aimed at attracting, training, and motivating skilled personnel.

Addressing Social Issues

The government's strategy to alleviate the pervasive poverty in Madagascar lies in improving the provision of essential services. Accordingly, it will restructure expenditures with a view to promoting growth and enabling the least privileged social groups to participate in the country's development.

The Challenge Ahead

The two main risks to the program are that a continuation of political instability may prevent a return of confidence and that the authorities may not succeed in reforming tax and customs administration, so that fraud would continue to be pervasive and investor confidence would remain low.

Madagascar joined the IMF on September 25, 1963, and its quota is SDR 90.4 million (about $131 million). Its outstanding use of IMF financing currently totals SDR 39.8 million (about $58 million).

Press Release No. 96/57, November 27, 1996

Madagascar: Selected Economic Indicators

	1995[1]	1996[2]	1997[2]	1998[2]	1999[2]
			(percent change)		
Real GNP growth	1.8	2.0	3.0	3.6	4.5
Consumer price index (end of period)	37.3	10.0	7.0	5.0	3.0
			(percent of GDP)		
Overall fiscal balance (excluding grants)	–9.0	–8.5	–6.9	–6.6	–5.5
External current account balance (excluding grants)	–10.4	–7.7	–7.2	–7.4	–6.5

[1]Preliminary.
[2]Program.

Data: Malagasy authorities and IMF staff estimates

Namibia: Article VIII

The government of Namibia has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, with effect from September 20, 1996. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval.

Namibia joined the IMF on September 25, 1990. Its quota is SDR 99.6 million (about $143 million).

Press Release No. 96/62, December 12, 1996

Republic of Yemen: Article VIII

The government of the Republic of Yemen has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, with effect from December 10, 1996. IMF members accepting the obligations of Article VIII undertake to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. A total of 136 countries have now assumed Article VIII status.

Yemen's membership in the IMF dates from May 22, 1990. Its quota is SDR 176.5 million (about $254 million).

Press Release 96/65, December 26, 1996

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
December 16	3.82	3.82	4.18
December 23	3.87	3.87	4.23
December 30	3.91	3.91	4.28
January 6, 1997	3.93	3.93	4.30

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 109.4 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

Optimum Currency Areas: The Challenge for Policy

IMF officials, central bankers, and academics gathered in Tel Aviv in early December 1996 to discuss issues of international monetary and fiscal integration relevant for European Union (EU) members on the threshold of monetary union. The conference was dedicated to Robert Mundell, who pioneered the theory of optimum currency areas (OCA) back in 1961 while on the research staff of the IMF. It was organized by Mario I. Blejer of the IMF's Monetary and Exchange Affairs Department and Assaf Razin of Tel Aviv University and hosted by the IMF, the Bank of Israel, and Tel Aviv and Hebrew Universities.

In his trailblazing paper, Mundell said that "if the world could be divided into regions, within each of which there is factor mobility and between which there is factor immobility, then each of these regions should have a separate currency which fluctuates relative to all other currencies." A region adopting a common currency would do so where costs are minimized and benefits maximized. The costs entail the loss of an independent monetary policy and exchange rate to cushion shocks, while the benefits include reduced transactions costs, greater efficiency associated with integration of markets, and anchoring of prices in a larger monetary area. Mundell said that whether or not Europe could be considered a single region—and hence a candidate for an OCA—was essentially an empirical question. His theory was extended by Ronald McKinnon (in 1964) and Peter Kenen (in 1969), but these pioneering analyses offered little empirical evidence. Given the prospective European economic and monetary union (EMU), the pace of empirical work on OCAs has stepped up considerably to shed more light on EMU's potential costs and benefits.

The Tel Aviv conference thus focused on various empirical aspects of OCAs, assessing prospects for EMU by 1999. At a luncheon address, Robert Mundell, noting that developments in the past year and a half had boosted the chances of monetary union, speculated that by 1999, all 15 countries of the EU might participate. Several participants took a different view. They agreed that political momentum and economic developments had recently improved prospects for monetary union, but debated the costs and benefits—and its implications for fiscal policy. Martin Wolf of the *Financial Times*, for example, thought that a 15-member EMU would fail and leave in its wake an inner core of 7–8 members, about the situation now prevailing.

Who Should Join in EMU?

A number of economic criteria determine whether a country should join a monetary union, according to Andrew Rose of the University of California at Berkeley: two such criteria are the intensity of trade with potential partners and the correlation of domestic business cycles. Both, however, said Rose, are endogenous. He said that research on 20 industrial countries he had conducted with Jeffrey Frankel of the U.S. Council of Economic Advisers showed that sharing a common currency tended to boost trade intensity, which in turn increased business cycle correlation—hence, a country was more likely to satisfy the criteria for entry into a currency union ex post than ex ante.

In his luncheon address, Mundell elaborated on the reasons for a country to join an OCA:

• to reduce transactions and currency printing and maintenance costs;

• to participate in a purchasing power parity area;

• to establish an exchange rate anchor for policy;

• to remove discretion from monetary and fiscal policymaking;

• to prevent the exchange rate from being used as a political football;

• to have a multinational cushion against shocks;

• to participate more fully in the capital market of the union;

• to share in international seigniorage from the union's currency;

• to enforce monetary and fiscal discipline;

• to provide a catalyst for political integration;

• to share in the political decision of determining the OCA's inflation rate; and

• to establish a monetary bloc as a countervailing power against a superpower, and to enhance and expand the power of the bloc.

Research by Daniel Gros of the Centre for European Policy Studies and Alfred Steinherr of the European Investment Bank led them to conclude that a small open economy is generally expected to gain from joining an OCA. One had to look not only at the degree of openness but also at the product of the openness and the importance of external shocks. For example, if an open economy's export structure differed from the union average, it would lose much more from not having the exchange rate as an adjustment instrument than an economy with a different export structure that was less open.

Implications for Fiscal Policy

A key theme underlying the conference was the importance of fiscal stabilization in an OCA, since a currency union precludes the use of the exchange rate to cope with shocks and given the unavailability of other shock absorbers—such as labor mobility and fiscal federalism.

Lans Bovenberg of the Netherlands Bureau for Economic Policy Analysis, presenting a paper coauthored with Roel Beetsma of Maastricht University, advanced the notion that monetary union would reduce inflationary pressure on the European central bank (as compared with a national central bank with a single fiscal authority) and thus strengthen fiscal discipline—and the larger the number of participants, the larger the reduction in inflation bias. This conclusion rested on the thesis that subsidiarity in fiscal policymaking may be a good thing. In this context, fiscal coordination would have the potential to weaken fiscal discipline by making the European central bank more vulnerable to inflationary bailouts.

Maastricht criteria are macro-focused, but the current debate on unemployment underscores structural reforms.

–Guitián

The level at which fiscal policy is conducted is important, argued Paul Masson and Tamim Bayoumi of the IMF. Fiscal stabilization is likely to achieve "more bang for the buck" at the federal (or EU), rather than the national, level. This is because the deficits incurred at the federal level are partly non-debt-creating since deficits in some countries would be offset by surpluses in some others. The advisability of going to a federal system in Europe had to be qualified, however, by the distortions of higher overall taxation and the lack of political support by EU members for a federal fiscal authority.

Bent Sorensen of Brown University and Oved Yosha of Tel Aviv University assessed the implications of monetary union for risk sharing. They maintained that the European Union would need to provide massive interregional insurance to smooth income shocks in an EMU until capital markets are sufficiently integrated to perform the task.

Roundtable on Fixed Versus Floating Rates

Updating the perennial debate on fixed versus floating exchange rates at the Tel Aviv conference were Jacob Frenkel, head of the Bank of Israel; Manuel Guitián, Director of the IMF's Monetary and Exchange Affairs Department; Richard Portes, Director of the Centre for Economic Policy Research; Assaf Razin; and William White of the Bank for International Settlements. Roundtable participants generally agreed that the huge increase in capital flows since Mundell wrote his paper in 1961 had severely restricted the options available to monetary authorities and that market discipline had become a major constraint on policy.

White saw nothing new in the debate on fixed versus floating. There was still no right choice; rather, opinion seemed to shift from one to the other and back again as soon as the warts apparent in each became clear. White was nonetheless encouraged by the considerable empirical work being done on the analytical framework for an OCA. He stressed the importance of credibility—won and kept by sound medium-term macroeconomic and structural policy—to preserve parity. Similarly, Jacob Frenkel said that the debate was not about fixed versus flexible policy, but about good versus bad policy. No exchange rate system would protect against bad policy and no country possessed reserves suffi-

Assaf Razin (left), William White, Richard C. Portes, and Manuel Guitián listen as Jacob Frenkel responds to a question at the policy forum.

cient to support a bad exchange rate. The new reality, Frenkel said, was that monetary policy had to be conducted with a medium-term perspective by an independent central bank; that fiscal policy required a medium-term perspective with no fine-tuning; and that trade policy was ruled out owing to trade liberalization. Thus, all that remained was to establish a consistent set of "global rules of the game."

Manuel Guitián agreed with Frenkel that the focus should be on sound policy rather than on the exchange rate regime. He contrasted the emphasis in Mundell's 1961 article on the structural characteristics of economies (including price flexibility and labor mobility) with the Maastricht criteria's focus on nominal convergence (of inflation, interest rates, and fiscal positions). The current debate on unemployment, however, highlights the continuing importance of structural reforms, Guitián said.

The transition economies of Eastern and Central Europe provided a useful laboratory of experiments with exchange rates, according to Richard Portes. These countries' experiences, he said, had shown that exchange rate-based stabilization was not very successful.

Drawing on work undertaken with Thomas Krueger and Douglas Laxton of the IMF, Assaf Razin cited the EMU's serious potential for deflation bias, since the European central bank would likely conduct tight monetary policy, aimed exclusively at price stability. This, he said, was because European central bank governors would not be accountable to any national authority and the new central bank would try to establish its inflation-fighting credentials.

Money as Unit of Account

In discussing the concept of an OCA, it is important not to lose sight of the role of money as a unit of account, cautioned Mundell in his luncheon remarks. Charles Goodhart of the London School of Economics elaborated on this theme. He maintained that money is accepted because of the power of the state issuing it, rather than any intrinsic value. Thus, he questioned whether the euro would be accepted and whether monetary union, which separated the issuance of money from the individual state, could succeed. Goodhart argued further that removal of national central banks under EMU might avoid exchange rate risk but was likely to shift that risk to bond markets. This, he said, supported arguments for a stability pact. Daniel Gros, in contrast, argued that EMU was a unique event and could not be evaluated by historical precedent.

David Cheney
Editor, *IMF Survey*

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1997 marks the *IMF Survey's* 25th Anniversary Year

The *IMF Survey* (ISSN 0047-083X) is published by the International Monetary Fund 23 times a year, plus an annual *Supplement on the IMF,* an annual Index, and occasional supplements. Editions are also published in French and Spanish. Opinions and materials in the *IMF Survey*, including any legal aspects, do not necessarily reflect the official views of the IMF. Material from the *IMF Survey* may be reprinted, provided due credit is given. Address editorial correspondence to Current Publications Division, Room IS9-1300, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-8585; or e-mail 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 an annual rate of $79.00. Apply for subscriptions to Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430. Cable: Interfund. Fax: (202) 623-7201. Internet: publications@imf.org