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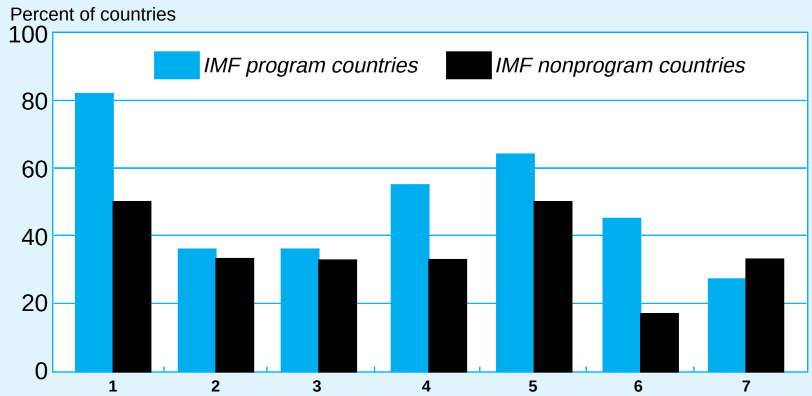
Reducing Unproductive Expenditures Is Important for Fiscal Adjustment

In recent years, IMF policy advice to its member countries has placed greater emphasis on the need for fiscal discipline through reductions in unproductive public expenditures. To shed light on this subject, a recent internal study was undertaken by the IMF Fiscal Affairs Department to assess the nature and depth of this advice for a sample of 17 member countries—11 of which had adjustment programs supported by the IMF—for various periods during 1990–95.

Elements of Unproductive Spending



1. Overstaffed civil service
2. Generalized consumer subsidies or inefficient producer subsidies
3. Possibly excessive military spending
4. Inefficient public enterprises
5. Excessively generous and/or untargeted social security and social assistance programs
6. Underallocation of spending for primary health and education
7. Low-quality investment projects

Data: IMF staff

Rationale for IMF Advice

Unproductive public expenditures are those public outlays that can be reduced without affecting government outputs, such as the provision of law and order and basic education and health services. Such expenditures stem from a number of political and economic influences, including the pursuit of multiple objectives in public expenditure programs (for example, using the public sector as an employer of last resort), the absence of a well-trained and motivated civil service, inadequate budgetary institutions and processes, and corruption. Unproductive spending can trigger large fiscal deficits, a correspondingly lower level of public sector output, and a tax burden that is heavier than necessary.

Reducing unproductive public expenditures is particularly important in countries burdened with low revenue and high spending. But even in countries without major fiscal imbalances or large public sectors, reducing wasteful spending can save scarce financial resources for vital public programs or private investment while strengthening a country's fiscal position. On a broader front, substantial cuts in unproductive expenditures worldwide would yield a large increase in global financial resources.

The main elements of the IMF's policy advice to the 11 countries with IMF-supported programs—Albania, Bangladesh, Bolivia, Costa Rica, Jordan, the Kyrgyz Republic, Mali, Poland, Sri Lanka, Uganda, and Zimbabwe—and the 6 countries without IMF-supported programs—Belgium, Canada, Chile, Germany, Mauritius, and Thailand—were as follows:

• IMF policy advice on reducing unproductive expenditures in IMF program countries covered all key spending components—wages and salaries, *(Please turn to following page)*

social expenditures, military outlays, and transfers to inefficient public enterprises. On average, IMF policy advice covered a significantly broader range of areas in countries with IMF-supported programs than in nonprogram countries. Other areas where the IMF frequently provided advice on reducing unproductive spending included unprioritized public investment programs and extrabudgetary spending.

• For the six nonprogram countries under review, IMF advice was restricted largely to wages and salaries, subsidies, and transfers—with an eye to curtailing unproductive spending levels. For those countries in this group with large public sectors, IMF advice emphasized the importance of cutting unproductive spending in the context of broader expenditure reduction efforts.

IMF policy advice in four key areas to the 17 member countries was as follows:

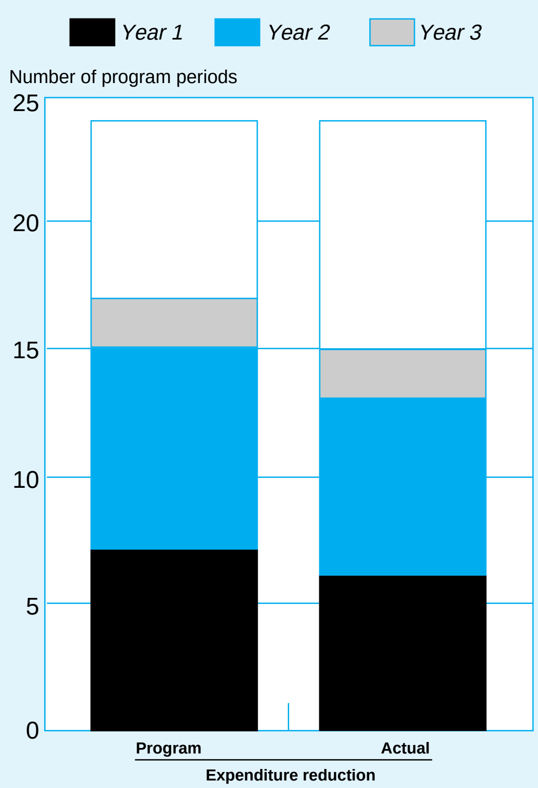
Wages and Salaries. Outlays on wages and salaries have been a major source of excessive public spending—a reflection of both inappropriate wage policy and overstaffing. The IMF recommended a lower wage bill in all 11 countries with IMF-supported adjustment programs—in most cases, this could be achieved through civil service downsizing—and in 3 countries that did not have IMF-supported adjustment programs. IMF staff specifically identified an excessive number of ministries, duplications of functions, or the existence of ghost workers as major instances of unproductive spending (see chart, page 49).

Subsidies and Transfers. In many countries, subsidy and transfer policies were riddled with inefficiencies. Unproductive spending in the form of generalized consumer subsidies, inefficient producer subsidies, untargeted welfare programs, and subsidized credit to inefficient public enterprises were a particular fiscal concern. IMF advice to the six nonprogram countries emphasized that an effectively functioning labor market depended on a viable social security system. For the 11 countries with IMF-supported adjustment programs, the IMF recommended establishing more cost-effective social safety nets.

Military Expenditures. Excessive military expenditure imposes a heavy fiscal burden on developed and developing countries alike. The IMF's advice on such spending often called for reviewing military expenditures to identify potential fiscal savings. For instance, noting the improved security situation in two African countries, the IMF cited the potential for substantial savings. A review of military spending was indicated as a possible means of generating expenditure savings in nonprogram countries as well.

Health and Education. In many countries with IMF-supported adjustment programs, the IMF recommended a shift in the pattern of expenditure to accommodate increased spending for the previously neglected sectors of primary health care and basic education. IMF policy advice in these areas also focused on the powerful links between social spending and education and health indicators.

Implementation Record Under IMF-Supported Programs



Data: IMF staff

Reducing Unproductive Expenditures

The record of the 11 program countries in implementing IMF advice on reducing unproductive expenditures was mixed—with a wide dispersion in individual country performance. In almost all of them, IMF advice was partially implemented during the period examined. Slippages occurred in civil service reform, public investment programs, and public enterprise restructuring. The implementation record was also mixed for nonprogram countries, with deviations from IMF policy advice most notable in the areas of subsidies and social security reform.

Substantial improvements in expenditure productivity were achieved in some cases, however. For example, in countries in transition to market-oriented economies, generalized consumer subsidies and producer subsidies fell significantly.

Another way to appraise the implementation of expenditure measures in program countries is to compare the programmed direction of change in expenditures with their actual direction. Of the 24 program periods examined, 17 envisaged expenditure reductions. Expenditure was actually reduced in 15 periods (see chart, page 50). As noted earlier, these results should not be taken to imply that there were no slippages. In fact, quantitative program targets—which incorporated, on average, annual changes in expenditure equivalent to 1 percent of GDP—were achieved in only about half of the program periods. The implementation record was somewhat weaker during the second and third program periods. The achievement of expenditure targets, however, does not necessarily indicate the implementation of advice on unproductive expenditures, as reduced spending, for example, can be the result of cash rationing or unprioritized expenditure cuts.

Conclusions

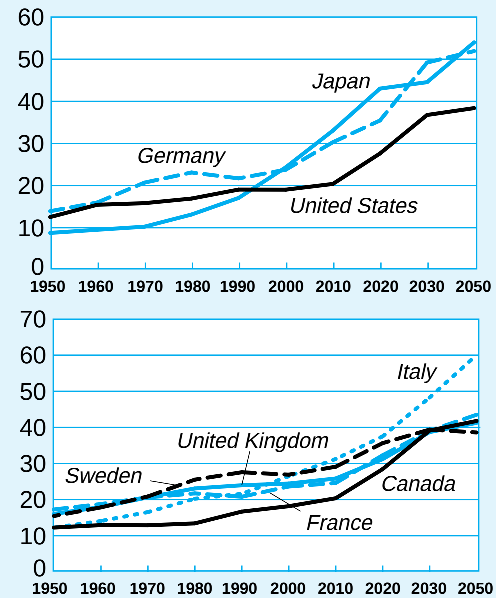
Unproductive public spending was identified in a number of expenditure categories in both program and nonprogram countries, including wages and salaries, subsidies and transfers, military expenditures, and social sector outlays. In response, IMF policy advice has underscored the potential benefits of reducing unproductive expenditure for achieving equitable and efficient fiscal adjustment. Progress recorded by member countries in reducing unproductive public outlays has been mixed, although substantial headway has been made in some areas. Greater efforts by member countries to compile accurate expenditure data in accordance with international standards could facilitate IMF and member countries' analysis of unproductive expenditures.

Fiscal Costs of Aging Populations

Aging of populations affects virtually all societies today, but more so the industrial countries, which have generally experienced it over a longer period and for which further pronounced aging is projected until it peaks in about four decades. Under existing public pension arrangements, which rely heavily on pay-as-you-go schemes, population aging has begun contributing to serious fiscal stresses in most major industrial countries. These stresses are likely to get much worse in coming decades without appropriate reforms. *Aging Populations and Public Pension Schemes*, IMF Occasional Paper No. 147, addresses these issues and suggests solutions.

Elderly Dependency Ratios

(In percent)



Data: IMF, *Aging Populations and Public Pension Schemes*, Occasional Paper 147

In principle, individuals should be responsible for making adequate provision for their own retirement. In practice, this is almost never the case, thereby necessitating publicly supported pension schemes. In the industrial countries, the predominantly pay-as-you-go public schemes for providing for the retired—usually with comprehensive coverage—are most often supplemented by funded schemes operated by the private sector. In the early stages of a pay-as-you-go system, low contributions are sufficient to cover the benefits of a relatively small number of beneficiaries, but as the system matures, benefits paid out tend to exceed contributions, requiring increases in payroll taxes or budget transfers. As the proportion of the elderly rises (see chart), considerable fiscal stress is likely, and it is worsened by the various redistributive elements typically contained in the system.

The issue of how to distribute the burden of supporting the aged has become contentious as the proportion of the working population diminishes while the political strength of the elderly increases. Four ways have been suggested to ameliorate fiscal stress arising from public pension arrangements:

• adjustment of the contribution rate, retirement age, or pension indexation formulas;

• development of a defined-contribution, fully funded scheme outside existing public pension arrangements;

• raising taxes and cutting expenditures not related to public pensions; and

• modifying the size of the labor force by encouraging greater labor force participation or increasing immigration.

The IMF study emphasizes the adjustment of rates and the development of a defined-contribution scheme as a reasonable solution to the problem of providing adequate pensions to the elderly but also considers aspects of the third and fourth approaches. The authors' analysis shows that a combination of reductions in benefits—such as extending the retirement age and modifying indexation arrangements—would in most countries suffice to contain potentially adverse fiscal developments. An important implication is that if such reforms are combined with the implementation of a sustainable contribution rate, the reformed public pension system would be able to cope with the aging population. In effect, such a system anticipates the demands associated with aging by making funding provisions in advance, thereby reproducing an essential aspect of the fully funded approach. By levying a constant projected contribution rate through time, the sustainable contribution rate in this system preserves the compact between the generations at the core of a pay-as-you-go system, as it distributes equally the burden of meeting pensions across the generations. Advance funding has the further advantage of strengthening fiscal discipline if the publication of regular reports on the actuarial status of the pension system heightens awareness of the future cost implications of current pension benefits promises.

The authors caution that the full impact of the aging problem will not likely be felt for 15 years or so but that reform actions are needed soon since the lead time for changing pension arrangements is long and because the earlier the adjustment, the more substantial the savings.

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Copies of IMF Occasional Paper 147, *Aging Populations and Public Pension Schemes*, by Sheetal K. Chand and Albert Jaeger, are available for $15.00 (academic rate: $12.00) from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org

Mobilizing Resources for Sustainable Development

The concept of sustainable development is defined as meeting the economic objectives of growth and efficiency, while at the same time meeting the social objectives of equity and poverty reduction, and the ecological objective of sound natural resource management. Achieving these broad goals requires substantial financial resources, estimated in Agenda 21 (the action plan for protecting the environment and meeting the economic and social goals of developing countries agreed at the 1992 UN Conference on Environment and Development in Rio de Janeiro) at $600 billion for developing countries alone. An internal study by Ved Gandhi, Dale Gray, and Ronald McMorran of the IMF's Fiscal Affairs Department, presented at a recent UN conference in Santiago, seeks to identify the scope for mobilizing domestic financial resources to be applied toward achieving the goal of sustainable development.

Waterfront industry in Shanghai. China's pollution levy system generates about 15 percent of capital spending for pollution control.

Although tax policy is the most important instrument of domestic resource mobilization, any approach that focuses only on taxation is far too limited, according to the authors. A comprehensive approach would entail raising revenues not only from existing general taxes but also from user charges and fees for natural and environmental resources, pollution and other environmental taxes, and savings from reducing environmentally damaging subsidies and containing unproductive expenditures (including excessive military spending). In addition, such a comprehensive approach should take into account any potential effects of macroeconomic and structural reforms on domestic resource mobilization.

Ways to Mobilize Resources

Based on a review of the literature and country examples of successful domestic resource mobilization efforts, the IMF authors cite the wide scope existing for mobilizing domestic resources. Potential sources include the following:

• Reform of current tax systems—including broadening the base of personal income tax and corporate income tax; eliminating widespread exemptions from customs duties; levying payroll, social security, and income and consumption taxes (wherever they do not exist); and strengthening tax and customs administration—can help mobilize additional fiscal revenue. The ratio of tax-to-GDP in OECD industrial countries is much higher than in developing countries, primarily because of industrial countries' heavy reliance on broad-based income taxes (individual and enterprise), consumption taxes (value-added and sales), and other taxes (payroll and social security). Developing countries—particularly low-income African countries—rely heavily on narrowly based international trade taxes, their tax-to-GDP ratios are low, and their tax systems show little buoyancy. Although taxable capacity in most developing countries is limited, and tax-to-GDP ratios are likely to remain lower than those of industrial countries, there is certainly some scope for increasing tax ratios. This is borne out by the recent experience of some African countries, such as Uganda (see box).

• Eliminating underpricing of resources by increasing user fees and charges—especially for energy, water, forests, fisheries, and other mineral resources—is a second major source of additional revenue. Higher fees and charges will also provide further incentive to conserve natural resources.

• Imposing adequate environmental taxes—especially on petroleum products, carbon emissions, and other pollutants—can mobilize additional resources. This will also protect the environment by ensuring that economic agents face both private and social costs associated with environmental degradation.

• Reducing unproductive expenditures and excessively large government bureaucracies, especially in developing and transition economies, is another potential source of resources. Civil servants are often paid salaries and benefits far in excess of their productivity levels; they would be better used if redirected to essential economic, social, and environmental needs.

• Large distortions in production and consumption patterns are created

Mobilizing Resources: Country Cases

Uganda: Tax Reform

With the sharp decline in export duties from the coffee sector in fiscal 1988/89, when Uganda's tax-to-GDP ratio was only 4.5 percent, the authorities embarked upon a major tax reform and revenue mobilization effort. In 1989/90, the authorities introduced measures to broaden the tax base, including increasing import duties, sales taxes, and excise duties; and to streamline the tax system, including by raising the income tax threshold and reducing maximum marginal rates for personal and corporate income taxes.

During 1990/91–1992/93, the government sought to build a stronger revenue foundation. The 1990/91 budget included measures to reduce the number of customs duty rates to five standard rates and impose a surtax on imported goods similar to domestic excisable goods; cut the number of sales tax rates to four; and raise specific duty rates on petroleum, with the stipulation that the rates had to be reviewed periodically to ensure a full pass-through of costs.

Following up, the government adopted a number of important revenue measures in 1992/93 and in 1993/94, all of which sought to rationalize and expand the revenue base even further. It also made major efforts during this period to improve tax administration and collection, including setting up a tax authority. As a result of these reforms, Uganda's tax-to-GDP ratio rose to 10.6 percent in 1994/95.

Indonesia: Fiscal Regime for Petroleum and Minerals

Indonesia is rich in natural resources, including oil, gas, and hard rock minerals. The government has been innovative in developing fiscal regimes for petroleum and minerals that offer incentives for foreign investors while capturing a large portion of the natural resource rent for the government and discouraging excessive rates of depletion.

In 1967, Indonesia pioneered the production-sharing contract ("PSC"), which has now been adopted in many parts of the world. In addition to royalties, under a PSC, petroleum production is shared between the investor and the government—on a progressive basis in favor of the government—with ceilings on the amount of oil received by the company for cost recovery purposes. One of the system's benefits is its sensitivity to cost variations, with investors sharing the price risk. In 1995, revenues from oil and gas accounted for 3 percent of GDP and more than 23 percent of tax revenues.

China: Pollution Levy System

In 1979, China began experimenting with a levy on industrial pollution in urban areas that exceeded established emissions standards. In the early 1980s, the pollution levy system was officially incorporated into law and gradually expanded to cover the entire country. Government revenues from the pollution levy have since increased rapidly—to 2.7 billion yuan in 1993 from 1.2 billion yuan in 1986. The pollution levy now provides about 15 percent of all capital expenditures for pollution control and is the main source of funding for regulatory enforcement activities by local environmental protection bureaus.

through budgetary subsidies that take many explicit and implicit forms. Targeting subsidies that are socially desirable—for example, those targeted at poverty alleviation and basic food—and curtailing or eliminating subsidies that are economically and environmentally undesirable can generate additional resources while reducing social inequities and mitigating environmental damage.

• Although military expenditures have been curtailed in recent years—amounting to 2.4 percent of global GDP in 1995, compared with 3.7 percent in 1990—they are still excessive when compared with demands on social and economic spending.

• Reforms of macroeconomic policies can help foster growth and help mobilize the availability of domestic resources. Moreover, reforms that promote macroeconomic stability can also help preserve the environment by curbing excessive consumption, including of natural and environmental resources.

• Structural reforms relating to financial sectors, capital markets, privatization of parastatal enterprises, and pricing policies can greatly increase domestic financial resources (and help attract foreign capital), particularly if accompanied by macroeconomic policy reforms. In addition, they result in efficiency gains that benefit the environment and the economy.

The authors conclude that if all these opportunities were fully exploited, an estimated $1.2 trillion in global financial resources could be mobilized—more than double the amount estimated to be needed to finance the programs set forth in Agenda 21. The availability of financial resources is therefore not the main constraint for achieving sustainable development. The larger constraints, conclude the authors, are the lack of political will, well-designed and feasible action plans, and effective institutional frameworks for achieving sustainable development.

Currency Board Arrangements More Widely Used

A number of countries have established currency board arrangements in recent years. Four IMF member countries—Argentina, Djibouti, Estonia, and Lithuania—currently maintain such monetary arrangements, and Bosnia and Herzegovina is about to establish one. IMF staff have also discussed the feasibility of introducing currency board arrangements with the post-conflict countries of Somalia and Liberia. In some cases, a currency board arrangement has been a major element of a stabilization program for which a member requests IMF support. Questions arise, therefore, as to what defines a currency board arrangement, what its relative strengths and weaknesses are, and what the IMF's role should be in providing support to those members considering such an arrangement. Following is a summary of an IMF internal study that addresses these questions and the underlying policy issues surrounding the operation of currency board arrangements.

A currency board is a monetary arrangement that commits the authorities to issue domestic currency only in exchange for a specified foreign currency at a fixed rate, and which sharply limits, or eliminates, the authorities' discretion to create money by extending credits. Thus, an essential characteristic of a currency board arrangement is a well-publicized legal barrier to changing the exchange rate and attendant legal restrictions on the ability of the authorities to create money.

The chief advantages of currency board arrangements include their simplicity of operation, the strengthened capability they provide in the conduct of monetary and fiscal policy, and the usefulness of this rule-based arrangement in enhancing transparency and encouraging financial discipline.

The IMF study reaches three main conclusions about currency board arrangements:

• Strong macroeconomic policies are crucial for the establishment and sustainability of a currency board arrangement. Appropriate fiscal policies, a sufficient level of reserves, and a sound banking system should be in place—or be part of the policy package adopted—when a currency board arrangement is established.

• Currency board arrangements promote fiscal discipline, but they do not guarantee it. Fiscal consolidation and reforms are as much a precondition for the establishment of such arrangements as they are an operational constraint.

• IMF support can enhance a currency board arrangement's chances of success.

Under a currency board arrangement, reserve money issuance follows rules similar to those of the gold standard. With only a limited margin for central bank policy discretion, changes in money demand are accommodated

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
February 10	3.92	3.92	4.29
February 17	3.91	3.91	4.28

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

by domestically induced changes in international reserves, rather than by changes in the central bank's net domestic assets. Thus, reserve money varies in close relation to how the level of official international reserves and interest rates are determined—mostly or totally—by local market adjustments to monetary conditions prevailing in the reserve currency country. Even so, under a currency board arrangement, it is always remotely possible for the arrangement to be changed, which builds a risk premium into domestic interest rates. The currency board arrangement may also come under attack, with interest rates needing to be raised sharply, as occurred in Argentina in early 1995.

Interest rates play a major role in facilitating adjustment. In economies with open capital accounts, capital flows tend to reduce monetary disequilibria and facilitate the approximation of local interest rates to those in the reserve currency country. Also, allowing banks to borrow abroad when necessary reduces the need for a domestic lender of last resort. While this mechanism applies to all fixed pegs, in currency board arrangements it is stimulated further by containing exchange rate risk. In addition, free capital mobility heightens the efficiency of a currency board arrangement's monetary adjustment mechanism and enhances the potential for rapid trade and financial integration.

When capital controls or limited financial development restrict capital mobility, the adjustment accordingly takes place more gradually through changes in absorption and adjustments of the trade account. As is also the case in any fixed exchange rate regime, however, capital mobility can on occasion add to the problems of operating a currency board arrangement—for instance, witness the persistent capital inflows into Estonia after its initial stabilization or the capital outflows from Argentina in 1995.

Weighing the Merits

Before establishing a currency board arrangement, the authorities must decide on which outside currency the exchange rate should be pegged to and at what level; how much backing to provide to the currency board arrangement before it begins to operate, and who should have access to it; and whether

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the government can accept the constraints on borrowing that a currency board arrangement imposes. For a government that can satisfactorily address the above issues, a currency board arrangement may offer an effective means to manage its currency in the face of limited central banking expertise or low policy credibility.

When to Say Yes. Currency board arrangements are especially attractive to three groups of countries: small open economies with limited central banking expertise and incipient financial markets; countries that wish to belong to a broader trade or currency area; and countries that wish to enhance the credibility of exchange-rate-based disinflation policies. In the first two instances, the incentives for establishing such arrangements include simplicity of operation and the strengthened credibility of sound monetary and fiscal policies. For countries in the third group—such as Argentina, Estonia, and Lithuania—the chief attraction of currency board arrangements has been transparency and the strict limits they place on the monetization of government deficits or the provision of credits to the banking sector. Such stringencies help provide the essential precondition for a subsequent rapid return of domestic interest rates to international levels in these countries.

When to Say No. Currency board arrangements are not for every country. Their inflexible commitment to a fixed exchange rate parity, for example, might deprive a government of a major tool in addressing real exchange rate misalignments. Similar concerns may likewise arise about the restrictions these arrangements routinely impose on monetary operations—which could seriously limit the authorities' freedom of action in managing a financial crisis or in addressing the effect of destabilizing capital flows. Moreover, operational simplicity may exert a severe cost on a country if it also rules out the exercise of what would be viewed in other countries as important central bank functions. Finally, by removing any possibility of monetary financing of the fiscal deficit, currency board arrangements frequently require a level of fiscal consolidation that is difficult to attain or sustain.

Exiting. The timing of an exit from a currency board arrangement depends on the motivations that a country had for introducing the arrangement in the first place. If, for example, a currency board arrangement was introduced as a transitional step—pending the devel-

GFS Yearbook Features More Current Data

The *1996 Government Finance Statistics Yearbook* has been streamlined and revised to permit greater focus on the main world tables and country statistical pages. Introductory material has been shortened and the number of world tables has been reduced. The *Yearbook* includes data on government operations for 115 reporting countries, with most providing data through 1994. These data are reported on as timely a basis as is feasible, given IMF reporting standards and national budgetary constraints concerning statistical compilations. Through IMF technical assistance and the ongoing adoption of more advanced computer systems, the authorities are reporting more current data. For example, the *GFS Yearbook* includes fiscal year 1996 data for six countries.

The *GFS Yearbook* provides data that, within a common framework, permit analytically useful international comparisons of government operations. It is based on an internationally approved methodology, with common definitions and common institutional and analytical concepts. Data compiled according to this methodology normally differ from data published by national governments, which conform to differing legal and other country-specific requirements.

The *GFS Yearbook* displays data in a number of tables, consistent with the main analytical concepts comprising government operations. Five world tables are featured on the central government for all reporting countries. These tables show data for expenditure categories classified by function and by economic type and for revenue components. The world tables provide data on deficits as a percent of total expenditure and lending minus repayments. The *GFS Yearbook* also includes country pages with detailed transaction data used in compiling the world tables. Tables with central government data on financing and debt are also provided, with these transaction and stock data classified by type of debt holder and type of instrument. Also included in a number of country pages are data on operations of state (or provincial or regional) governments and on local governments.

The *1996 Government Finance Statistics Yearbook* was prepared by the Government Finance Division of the IMF's Statistics Department and is available for $58.00. Computer tape subscriptions are also available. For copies, write to Publication Services, Box XS700, IMF, Washington, DC 20431, U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org opment of a full range of functions typical of a central bank, for example—then the degree of development of such functions would provide a way to gauge the appropriate exit point. In this case, exiting from a currency board arrangement can be regarded as the end of one successful adjustment phase and the beginning of another, as it was for Ireland in the 1970s and for Luxembourg in the 1980s.

A more problematic case might occur for countries that have introduced currency board arrangements to gain credibility. A decision to leave the arrangement would accordingly need to be based primarily on the belief that market credibility is strong enough to be maintained solely by holding to strong policies even after the demise of the currency board arrangement. Whether a currency is under pressure to appreciate or depreciate can likewise facilitate or complicate a country's exit from a currency board arrangement. The experiences of Malaysia and Singapore suggest that a tendency for the domestic currency to appreciate helps minimize, or even eliminate, the market disruption that can ensue when countries abandon currency board arrangements.

IMF Support

The fundamental rationale for IMF financial support of members' adjustment programs—allowing them the opportunity to correct disequilibria in their balance of payments without resorting to trade and payments restrictions—is just as valid in the context of a currency board arrangement as in a conventional fixed exchange rate case.

Moreover, IMF support—in the context of a member's right of access to the IMF's regular financial facilities or to technical assistance—can help bolster credibility in a currency board arrangement and in the viability of a country's underlying policies.

Stand-By, EFF, and ESAF Arrangements As of January 31

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
Stand-by arrangements			**16,803.29**	**6,149.55**
Argentina	April 12, 1996	January 11, 1998	720.00	428.00
Bulgaria	July 19, 1996	March 18, 1998	400.00	320.00
Costa Rica	November 29, 1995	February 28, 1997	52.00	52.00
Djibouti	April 15, 1996	June 14, 1997	4.60	1.73
Egypt	October 11, 1996	September 30, 1998	271.40	271.40
Estonia	July 29, 1996	August 28, 1997	13.95	13.95
Hungary	March 15, 1996	February 14, 1998	264.18	264.18
Latvia	May 24, 1996	August 23, 1997	30.00	30.00
Lesotho	September 23, 1996	September 22, 1997	7.17	7.17
Mexico	February 1, 1995	February 15, 1997	12,070.20	3,312.18
Pakistan	December 13, 1995	September 30,1997	562.59	267.90
Panama	November 29, 1995	March 31, 1997	84.30	23.20
Papua New Guinea	July 14, 1995	December 15, 1997	71.48	36.14
Romania	May 11, 1994	April 24, 1997	320.50	226.23
Ukraine	May 10, 1996	February 9, 1997	598.20	62.20
Uruguay	March 1, 1996	March 31, 1997	100.00	100.00
Uzbekistan	December 18, 1995	March 17, 1997	124.70	59.25
Venezuela	July 12, 1996	July 11, 1997	975.65	625.65
Yemen	March 20, 1996	June 19, 1997	132.38	48.38
EFF arrangements			**9,741.63**	**6,926.67**
Algeria	May 22, 1995	May 21, 1998	1,169.28	506.48
Azerbaijan	December 20, 1996	December 19, 1999	58.50	53.82
Gabon	November 8, 1995	November 7, 1998	110.30	66.18
Jordan	February 9, 1996	February 8, 1999	200.80	118.60
Kazakstan	July 17, 1996	July 16, 1999	309.40	309.40
Lithuania	October 24, 1994	October 23, 1997	134.55	41.40
Moldova	May 20, 1996	May 19, 1999	135.00	112.50
Peru	July 1, 1996	March 31, 1999	248.30	248.30
Philippines	June 24, 1994	June 23, 1997	474.50	438.00
Russia	March 26, 1996	March 25, 1999	6,901.00	5,031.99
ESAF arrangements			**3,993.72**	**1,720.36**
Armenia	February 14, 1996	February 13, 1999	101.25	67.50
Azerbaijan	December 20, 1996	December 19, 1999	93.60	73.12
Benin	August 28, 1996	August 27, 1999	27.18	22.65
Bolivia	December 19, 1994	December 18, 1997	100.96	33.65
Burkina Faso	June 14, 1996	June 13, 1999	39.78	33.15
Cambodia	May 6, 1994	May 5, 1997	84.00	42.00
Chad	September 1, 1995	August 31, 1998	49.56	24.78
Congo	June 28, 1996	June 27, 1999	69.48	55.58
Côte d'Ivoire	March 11, 1994	June 13, 1997	333.48	—
Ethiopia	October 11, 1996	October 10, 1999	88.47	73.73
Georgia	February 28, 1996	February 27, 1999	166.50	111.00
Ghana	June 30, 1995	June 29, 1998	164.40	109.60
Guinea	January 13, 1997	January 12, 2000	70.80	59.00
Guinea-Bissau	January 18, 1995	January 17, 1998	9.45	5.78
Guyana	July 20, 1994	July 19, 1997	53.76	17.92
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Honduras	July 24, 1992	July 24, 1997	47.46	13.56
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Kyrgyz Republic	July 20, 1994	July 19, 1997	88.15	32.25
Lao P.D.R.	June 4, 1993	May 7, 1997	35.19	5.87
Madagascar	November 27, 1996	November 26, 1999	81.36	67.80
Malawi	October 18, 1995	October 17, 1998	45.81	22.91
Mali	April 10, 1996	April 9, 1999	62.01	41.34
Mauritania	January 25, 1995	January 24, 1998	42.75	14.25
Mozambique	June 21, 1996	June 20, 1999	75.60	63.00
Nicaragua	June 24, 1994	June 23, 1997	120.12	100.10
Niger	June 12, 1996	June 11, 1999	57.96	38.64
Senegal	August 29, 1994	August 28, 1997	130.79	17.84
Sierra Leone	March 28, 1994	March 27, 1997	101.90	10.11
Tanzania	November 8, 1996	November 7, 1999	161.59	135.88
Togo	September 16, 1994	September 15, 1997	65.16	32.58
Uganda	September 6, 1994	November 17, 1997	120.51	23.43
Vietnam	November 11, 1994	November 10, 1997	362.40	120.80
Zambia	December 6, 1995	December 5, 1998	701.68	50.00
Total			**30,538.64**	**14,796.53**

EFF = extended Fund facility.
ESAF= enhanced structural adjustment facility.
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

From the Executive Board

IMF Announces Senior Staff Appointments

Michel Camdessus, Managing Director of the IMF, announced, effective February 6, the appointment of Massimo Russo as Special Advisor to the Managing Director, and Michael C. Deppler as Director of the European I Department.

Massimo Russo, 58, a national of Italy, was previously Director of the European I Department. He received a Doctorate in Law from the University of Rome in 1962 and an M.A. in Economics from Yale University in 1963. Mr. Russo joined the IMF as an economist in 1964, occupying a number of positions in the African and Administration Departments, until his appointment as Director of the former European Department in 1987. During this period, he twice resigned from the IMF to take up appointments at the Organization for Economic Cooperation and Development (1972–74) and as Director General of the Commission of the European Communities (1983–87).

Massimo Russo

Michael C. Deppler, 53, a U.S. national, was previously a Deputy Director of the European I Department. Educated at Brown University and Georgetown University, where he received his Ph.D. in Economics in 1976, Mr. Deppler joined the IMF as an economist in 1971. He worked in the Research and European Departments until his appointment as Deputy Director of the European I Department in 1991.

Michael C. Deppler

Mr. Russo succeeds Shigemitsu Sugisaki as Special Advisor to the Managing Director, following Mr. Sugisaki's appointment as Deputy Managing Director (see Press Release No. 97/6, *IMF Survey*, February 10).

Press Release No. 97/7, February 6

JORDAN: EFF Augmentation

The IMF has approved an augmentation in the amount available to Jordan under its extended Fund facility (EFF) credit by the equivalent of SDR 37.2 million (about $51.8 million). As a result, the EFF credit that was approved on February 9, 1996, in support of Jordan's medium-term economic and structural reform program (see Press Release No. 96/4, *IMF Survey*, March 4, 1996) now amounts to SDR 238 million (about $331 million).

Jordan has made commendable progress toward economic reform in the 1990s, and the outcome in terms of macroeconomic indicators has been impressive: growth has averaged around 6 percent annually; the underlying inflation rate has declined to around 3–4 percent; the external current account deficit has been reduced to 3 percent of GDP from almost 20 percent; and the external debt has been halved in terms of GDP.

On the basis of steadfast implementation of adjustment and structural reforms by the authorities and the strength of Jordan's economic program for 1997, the IMF's Executive Board, in the course of its second review of Jordan's economic program supported by the EFF, decided to approve Jordan's request for an augmentation of the EFF credit.

Press Release No. 97/8, February 11

Decision on Sudan

The Executive Board of the IMF unanimously adopted the following decision on Sudan:

"1. In accordance with Decision No. 11319-(96/75), adopted August 2, 1996, the Executive Board has considered further the Managing Director's complaint under Article XXVI, Section 2(c) dated April 8, 1994, which was communicated to the authorities of Sudan on May 17, 1994, setting out the facts on the basis of which it appeared to him that Sudan had persisted in its failure to fulfill its obligations under the Articles of Agreement after the expiration of a reasonable period following the decision on the suspension of Sudan's voting rights under Article XXVI, Section 2(b) on August 6, 1993.

2. The Executive Board, unanimously committed to the Third Amendment of the Articles, finds that Sudan has persisted in not fulfilling its obligations under the Articles of Agreement after the expiration of a reasonable period following the decision on suspension of Sudan's voting rights under Article XXVI, Section 2(b), and, therefore, it has been determined that there is a basis to recommend that, pursuant to Article XXVI, Section 2 of the Articles of Agreement, the Board of Governors require Sudan to withdraw from membership.

3. Nevertheless, given the recent payments made by Sudan, and the strong assurances given by the Sudanese authorities at Executive Board Meeting 97/8 on payments to the Fund and policy reinforcement, the Executive Board will not recommend compulsory withdrawal of Sudan if (1) Sudan makes all the [scheduled] payments...; (2) by March 3, 1997, Sudan has agreed on a letter of intent embodying a program of economic and financial adjustment which the Executive Board decides by March 31, 1997, is of a quality that warrants monthly monitoring by the staff, and (3) after adopting a program in accordance with (2) above, Sudan implements the program satisfactorily in the judgment of the Executive Board.

4. If Sudan fails to meet any of these conditions, the Board will meet promptly to review the situation and recommend compulsory withdrawal to the Board of Governors.

5. The decision will be reviewed not later than August 31, 1997, it being understood that the Board will review performance by Sudan on a monthly basis."

Press Release No. 97/9, February 13

Use of IMF Credit and Loans In January, by Country

(million SDRs)

Member	Stand-By[1]	ESAF
Algeria	84.4	
Azerbaijan		20.5
Guinea		11.8
Niger		9.7
Pakistan	53.6	
Senegal		17.8
Total	**138.0**	**59.8**

Note: ESAF = enhanced structural adjustment facility

[1]Does not include drawings in the first credit tranche.
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

Recent Use of IMF Credit

(million SDRs)

	January 1997	January 1996
General Resources Account	138.0	130.8
Stand-by arrangements	53.6	46.4
EFF arrangements	84.4	84.4
CCFF	0.0	0.0
SAF and ESAF arrangements	59.8	0.0
Total	**197.8**	**130.8**

Note: EFF = extended Fund facility.
CCFF = compensatory and contingency financing facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

Peru: Credits for Commercial Debt Reduction

The IMF approved a disbursement totaling SDR 160.5 million (about $223 million) to support Peru's debt and debt-service-reduction operation with its external commercial creditors. The disbursement consists of an augmentation of the amount of Peru's current extended Fund facility (EFF) credit approved July 1, 1996 (see Press Release No. 96/37, *IMF Survey*, July 29, 1996), by SDR 51.9 million (about $72 million) and the release of the equivalent of SDR 108.6 million (about $151 million), corresponding to the total accumulated amount set aside under the EFF credit.

Following the completion of the debt and debt-service-reduction operation, the ratio of scheduled debt-service obligations to commercial banks will be reduced to 3.1 percent of exports of goods and nonfactor services in 1997 from 7.4 percent in 1995. The operation is cost effective and is expected to provide the basis for a return to voluntary financing by foreign commercial creditors. A debt rescheduling was also granted last July by Paris Club creditors, providing further debt relief over the medium term and substantially improving the prospects of Peru's external viability by the end of the current EFF credit.

Peru joined the IMF on December 31, 1945. Its quota is SDR 466.1 million (about $648 million). Its outstanding use of IMF credit currently totals the equivalent of SDR 642.7 million (about $894 million).

Press Release No. 97/10, February 13

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Keeping Banking Systems Sound Calls for Modern Approaches to Supervision

Banking soundness and monetary policy in a world of global capital markets was the theme of the Seventh Central Banking Seminar organized by the IMF's Monetary and Exchange Affairs Department and the IMF Institute, held at IMF headquarters on January 27–31. Participants included senior officials from central banks and supervisory agencies, representing some forty countries. Following is a summary of remarks made by Manuel Guitián, Director of the IMF's Monetary and Exchange Affairs Department, at the conclusion of the seminar.

Four basic themes emerged at the seminar discussions:

• the interaction of banking soundness with monetary policy;

• the boundary between the public and the private sectors and the risk of moral hazard;

• harmonization of banking supervisor practices and prudential standards and practices; and

• the consequences of technological innovation and advances.

Bank Soundness and Monetary Policy

Bank soundness was once the "neglected dimension" of monetary management, but this no longer applies. Besides the high incidence of banking sector problems, perhaps another reason why bank soundness is now receiving more attention is the growing consensus on the importance of the price stability objective of monetary policy together with the considerable progress that has been made toward achieving it. Thus, when one problem appears to be under control, more time can be devoted to other issues—in this case, bank soundness.

The growing emphasis on bank soundness also represents a return to the origins of central banking: central banks were first organized to provide for an efficient system of payments, and then to ensure the safety of the banking sector. Only in this century did they become the guardians of price stability. The number of inflationary episodes in the twentieth century may explain the emphasis that has been given to inflation control and the pursuit of price stability.

There is a definite relationship between monetary management and bank soundness. As is covered in depth in the recently published IMF volume, *Bank Soundness and Macroeconomic Policy*, an unbalanced monetary environment can fuel banking instability. In addition, price stability contributes to banking soundness, because banking activity in inflationary environments is not conducive to efficiency. Thus, banking activity in a stable macroeconomic environment is actually an instrument for efficient economic behavior.

Boundaries Between the Public and Private Sectors

Delineating the boundaries between the public and private sectors in policy formation may be one of the most critical questions facing economic policymakers in the years ahead. During the seminar, a consensus emerged that market forces have a key role to play in underpinning bank soundness. It was clear, however, that three ingredients are needed to bolster bank soundness: internal bank governance, official oversight, and market discipline. But it was not clear where the proper balance among the three should be drawn. Some participants favored giving the largest weight to market forces; others, although willing to rely heavily on market discipline, still believed that the central bank should retain an important share of responsibility for banking system soundness through the exercise of official oversight.

Essential to all three components of enhanced bank soundness are good data and information. These are essential for the market and official supervisors to make proper judgments and for banks to make the right decisions in managing their portfolios. In the context of data and information, participants discussed at length quantitative versus qualitative standards. It was felt that balance sheet analysis, typically quantitative in nature, would need to be supplemented by assessments of a bank management's ability to manage risk—clearly a qualitative exercise involving a large measure of judgment.

Quantitative factors have a certain appeal: they are specific and transparent. But quantitative factors are not forward looking and not easily adapted to new situations. They are not, therefore, sufficient in and of themselves. Quantitative standards that focus on what happened yesterday are becoming increasingly obsolete in the current fast-changing world, where what matters most is what will happen tomorrow. In addition, quantitative benchmarks—such as the capital adequacy ratio—whether measured to include one or several types of risk, must be underpinned by many elements of supporting infrastructure—for example, accounting, loan valuation, specification, provisioning, and legal standards. These are not always in place in many countries.

Qualitative assessments are therefore vital not only for the supervision of banks but for related economic policy decisions. Supervisors and regulators will need to judge not only whether an individual bank is vulnerable, but also whether an ongoing problem is systemic. Judgment perhaps at a higher level will then be necessary to determine how much of the problem is the responsibility of the public sector and how much lies with private agents. This will entail, among other things, assessing how the resulting costs are to be shared by the government and the private sector.

Harmonization

Two dimensions of harmonization were identified at the seminar: harmonization of national standards across borders, and harmonization of the rules applied to banks and other financial institutions increasingly engaged in banking activities, such as insurance companies and security firms.

The liberalization and globalization of financial activities have made inevitable the need to coordinate the supervisory efforts of individual countries at the international level. Indeed, it was in the aftermath of serious banking crises that placed cross-border financial stability at risk that the Basle Committee on Banking Supervision was established in 1974 by the Governors of the Group of Ten (G-10) industrial countries. The Basle Committee is a clear example of an attempt to handle the international dimension of bank supervision.

Harmonization of rules and standards across financial institutions is particularly important in an environment where these institutions are branching out into each other's business. Commercial banks are becoming increasingly involved in activities that were once the province of nonbanks, such as investment banking, securities trading, and life insurance. And nonbank financial institutions are now taking on activities previously done only by banks. Many of the principles that provided a clear distinction between banks and other financial intermediaries are becoming increasingly blurred. The question arises of whether banks are still special, whether they still merit the continuing concern of central banks for the stability of the banking system and, thus, special safety nets. The consensus at the seminar was that banks remain special and therefore warrant special treatment. But there were open questions in this regard: For how long will banks remain special? And, if the trend toward further erosion of their specialness continues, how can the authorities adapt the safety nets that currently protect the banking sector?

A critical IMF role is to ensure that the macroeconomic environment is conducive to sound banking.

New Technologies

The issue of technological advance and its implications for the financial sector was relevant to the discussions about prudential supervision and official oversight—in particular, the critical need for supervisors to keep up with the new market technologies. The proliferation of new and sophisticated financial products, such as derivatives, and the growing complexity—geographically, technically, and institutionally—of business relationships in the financial industry mean that supervisors face an ongoing effort to update their knowledge and expertise. In this connection, U.S. Federal Reserve Chairman Alan Greenspan said recently in a speech given in Belgium, “If it is technology that has imparted occasional stress to markets, technology can be employed to contain it.” This is clearly true, but tensions between market innovation and supervisors' efforts to keep up with it will remain.

The Role of the IMF

In the area of banking system soundness, the IMF's focus falls more on prevention than on the correction of problems. Thus, from the IMF's perspective, a critical element of its work is to ensure that the macroeconomic environment is conducive to sound banking—that is, that the macroeconomy does not contribute to bank problems. A second area of interest for the IMF is the existence of an appropriate incentive structure, not only in the banking sector but in the economy at large. These are issues that have been discussed with member countries ever since the IMF's creation.

To these must be added another element—the supervisory framework prevailing in the economy. Although the role of the IMF is not that of a bank supervisor or an auditor, there is a clear interaction between the banking sector and the effectiveness of monetary and macroeconomic policy. Therefore, it makes sense for the IMF to include these sectoral and microeconomic issues as part of its regular surveillance activities and consultations with member countries. In this context, it also makes sense for the IMF to contribute to the efforts the international community is making to improve prudential supervision and banking practices by regularly disseminating to IMF members the practices that have been proven useful by experiences in advanced systems. Important work in this area is being done by the Basle Committee and in the European Union. Of particular rele-

Camdessus Outlines Recipe for Bank Soundness

Following are excerpts of an address given by IMF Managing Director Michel Camdessus at the central banking seminar in Washington, on January 31.

Everyone here is well aware of the importance of bank soundness and, more broadly, of financial sector soundness for general economic performance. One of the challenges ahead, then, is to ensure that banking and financial systems, domestic and international, are and remain sound. Given the macroeconomic fallout and other negative externalities of banking system problems, efforts to keep national and international financial systems sound are very much a part of the IMF's mandate. I now want to focus on what needs to be done to promote bank soundness around the world and how the IMF can be involved in, and assist in, that process.

But in order to assess what needs to be done, we must first understand the causes of the problem. One fundamental cause of banking problems is poor management and, more broadly, weak internal governance by owners and managers. These weaknesses are frequently brought to light by adverse macroeconomic developments, which have a negative impact on all banks but tend to affect poorly managed ones most heavily. Normally, we would expect the market to help discipline poorly managed banks. But the market is often not in a position to do so, in part because it lacks information. Sometimes this is because of a lack of data disclosure, but often it also has to do with the difficulties that surround the valuation of bank assets for which there are no objective values, particularly when loans become nonperforming. Moreover, the problem is compounded by the development of new types of financial instruments and the organization of banks into financial conglomerates, whose scope is often hard to grasp and whose operations may be impossible for outside observers, even banking supervisors, to monitor.

What is the role of the authorities in the face of such problems? Many governments are concerned about protecting the central role of the banking system and guarding against the negative externalities associated with bank failures, especially when such failures are widespread. Accordingly, they have introduced safeguards to foster proper internal governance, compensate for failures in market discipline, and help protect the banking system in the event of adverse macroeconomic shocks. These safeguards include not only financial safety nets, such as deposit guarantee schemes and lender-of-last-resort facilities, but also the entire framework of prudential regulation and supervisory practices.

But if official safety nets are to bolster incentives for prudent banking and proper internal governance, as well as market discipline, they have to be properly designed. In particular, they must not create moral hazard. Indeed, even the existence of official supervision can lead to this, if market participants expect supervisors to guarantee the safety and soundness of every bank. Thus, the authorities must make clear what official action can and cannot do.

In particular, they need to clarify what prudential regulation and supervision can and should be expected to do. Supervisors should be expected to maintain a sound and efficient banking system. They should make sure that banks are operated in a prudent manner by fit and proper owners and managers, that risks are managed professionally, that deviations from sound banking practices are promptly corrected, and that failing banks exit the market before their capital has been exhausted. Indeed, the objective of supervisors should not be to keep every problem bank alive but rather to initiate an early, orderly, and efficient exit when banks become severely undercapitalized. Only in such a manner can supervisors make sure that bank creditors will lose as little as possible, that the confidence of savers will be maintained, that claims on the financial safety nets will be minimized, and that the banking system as a whole will remain sound.

But supervisors cannot do all of this singlehanded. The authorities need to put in place proper banking and other financial legislation, as well as an adequate set of prudential regulations. The authorities must also ensure that supervisors have the capacity to assess bank owners and management, their internal risk management systems, the adequacy of their loan provisioning and accounting practices, and the reliability of the data they report.

To make these complicated assessments, there must be a highly skilled professional staff of banking supervisors vance are the Basle Committee's efforts in conjunction with banking supervisors from emerging economies to broaden guidelines for sound banking practices originally devised for the G-10 industrial countries and making them applicable to developing and transition economies. The IMF seeks to underpin the efforts of the Basle

who have thorough training and adequate equipment to perform their demanding tasks. None of this will be sufficient, however, if the supervisors lack the institutional and professional authority to carry out their duties free from political interference. When supervisors identify a problem, they must be able to require remedial measures and to enforce penalties if these measures are not taken.

One important challenge for supervisors in many countries is the increasing complexity of the organizational structures that they are expected to supervise; that is, conglomerates that deal with all types of financial and nonfinancial operations, often not just within one country, but around the globe. Meeting this challenge will require enormous efforts to harmonize regulations and practices among supervisors of different categories of financial institutions, both nationally and internationally.

In this connection, I would like to return to the issue of data quality. A lack of accurate data undermines not only internal governance in banks but also market discipline and official oversight. Increasing the availability of reliable information and data will require a truly massive international effort to improve accounting and auditing standards and especially to get common rules and practices on loan classification and provisioning.

The IMF's Contribution

Clearly, the major role in ensuring banking system soundness belongs to the national authorities. But the IMF can continue to make an important contribution also. We can help maintain sound and stable financial systems through our traditional work of encouraging appropriate and sound macroeconomic policies. To this end, we will continue to adapt our surveillance work in the context of Article IV consultations; we will also continue to expand our technical assistance in key areas.

In particular, we shall be paying closer attention to the linkages between banking system soundness and macroeconomic policy, both in terms of the policy mix and the instruments used. We will also press for transparent fiscal treatment of losses and of contingent costs that may be building up in the banking sector, and for fiscal and monetary policy to take these costs fully into account. And whenever macroeconomic or market signals of likely future trouble in the banking system loom ahead, the IMF will seek to focus the authorities' attention on those signals and encourage them to undertake policies to address them before the situation deteriorates. We will also be incorporating these factors into our program design and technical assistance.

In addition, the IMF will pay increased attention to the overall institutional and regulatory framework of national financial sectors. This will include assessing whether incentive structures conducive for sound banking are in place; to what extent official safety nets are properly designed; whether the proper legal and regulatory framework is in place; whether the supervisory capacity and integrity exist to maintain a prudent system; and, finally, whether market forces and prudential oversight are mutually reinforcing.

To make judgments in all these areas, we need to gain a better understanding of the issues involved and become familiar with the best principles and practices in banking and financial activities. To this end, we are preparing a paper for discussion in our Executive Board toward the end of March that will lay out a broad framework for sound banking, and include a supplement with a list of existing best principles and practices. To compile this list, we will use standards, guidelines, principles, and practices developed by other institutions, such as the Basle Committee on Banking Supervision, the Commission of the European Union, and the World Bank. We will also draw on practices that have proven successful in various of our member countries. We envisage that these best practices will be subject to continued revision and adaptation to ensure that they remain abreast of, and consistent with, market developments.

In concluding, let me return once again to what I see as the central issue: namely, the problem of reliable information and data upon which the success of our endeavors ultimately depends. I hope that a serious international effort will be undertaken to improve the quality and timeliness of data. To be sure, improvements in data and the strengthening of prudential frameworks worldwide will require efforts on many fronts. To bear fruit, these efforts will have to involve international cooperation on a large scale and on an ambitious timetable. The IMF looks forward to cooperating with all other institutions involved.

Some of the central bank and supervisory officials and IMF staff who participated in the IMF-sponsored seminar on bank soundness.

Committee, as well as the efforts by national supervisors in their regional forums.

Concluding Remarks

What lessons were drawn from this seminar? The first is the interaction between price stability and banking soundness. These objectives, however, should not be seen as creating a sustained conflict of policy goals. Durable price stability cannot be pursued at the cost of a weak banking sector, nor can the banking sector be strengthened by relaxing the objective of price stability. The two objectives are mutually supporting and must be pursued together. Policymakers have to think not only of what actions are needed to attain price stability now, but also of what it takes to maintain price stability in the future. And, clearly, for monetary policy instruments to be effective and efficient, a sound and competitive banking sector is required.

The second lesson is that the trend toward market-friendly supervision must be recognized and strengthened. By market-friendly supervision, I mean supervision that takes both account and advantage of market forces. This is not friendly supervision in the sense of forbearance with shortcomings in internal bank governance or in official oversight. Rather, a market-based approach ensures that bank soundness is fully supported by the three essential pillars—internal governance, supervision, and market forces—so that market discipline is not undermined by ineffectual oversight or lax banking management.

A volume containing the papers and proceedings of the central bank seminar will be published in September 1997. Copies of *Bank Soundness and Macroeconomic Policy*, by Carl-Johan Lindgren and others, are available for $23.50, and may be ordered from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org

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