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Japan and IMF Discuss Strategy for Growth

Do IMF-supported adjustment programs pay enough attention to growth? Does the IMF favor a big-bang approach over gradual adjustment? And, why does the institution shy away from recommending the kind of interventionist industrial policies that appear to have worked well in East Asia? These questions and others were put to IMF staff by leading Japanese academics and policymakers at a seminar on Macroeconomic Adjustment and Growth held in Tokyo on May 21–22. The seminar—jointly sponsored by the IMF and the Institute of Fiscal and Monetary Policy of Japan's Ministry of Finance—sought to shed light on differences of view between influential Japanese and IMF staff on the advice the IMF gives to countries.

A semiconductor plant in Malaysia. The strategy of some fast-growing East Asian countries raises some issues regarding IMF policy advice for its member countries.

"Growth is the ultimate goal of economic policy, and IMF-supported adjustment programs, of necessity, must focus on growth," said Stanley Fischer, the IMF's (Please turn to the following page)

IMF Gives More Attention to Social Spending of Member Countries

In recent years, the IMF has paid increasing attention in its policy advice to governments to the composition of public expenditure, in recognition of its importance for member countries' efficient use of domestic and external resources. To this end, in June 1995, IMF Managing Director Michel Camdessus and World Bank President James Wolfensohn agreed to enhance IMF-Bank collaboration on public expenditure work, and guidance was given to the staffs of both institutions (*IMF Survey*, September 25, 1995). Since then, Bank and IMF staffs have intensified their collaboration in this area, including through a regular monitoring of public expenditure practices of member countries.

As part of this effort, IMF staff have also focused on social sector spending of member countries—in particular, on health and education—in its surveillance and program activities. This focus reflects a recognition of the crucial links between the level and efficiency of health and education spending and economic growth. The new emphasis was also prompted by the IMF Executive Board's request that the staff pay particular attention to social spending and social indicators in the context of adjustment programs supported by the IMF's enhanced structural adjustment facility (ESAF) and in the context of the initiative to help heavily indebted poor countries (HIPCs) achieve sustainable external debt positions. In this work, IMF staff rely mainly on the expertise of other institutions—in particular, the World (Continued on page 196)

The IMF's attention to members' social spending emphasizes health and education.

First Deputy Managing Director, who chaired a session of the seminar with Haruhiko Kuroda, President of the Institute of Fiscal and Monetary Policy. Fischer noted that IMF staff draw on a broad body of analytical research and on the experiences of member countries in designing adjustment strategies that are tailored to the individual needs of the countries that come to the IMF for assistance. The experience of the world's fast-growing economies—including those in East Asia—indicates that a number of ingredients are essential for rapid growth. These are macroeconomic stability; a competitive exchange rate; an outward-oriented development strategy; an effective institutional framework, including an efficient public sector and attention to property rights and the rule of law; policies to promote high savings and investment; an emphasis on building human capital through investment in education and health; and the provision of basic infrastructure.

While agreeing with many aspects of this general framework, a number of Japanese participants wondered why, if the IMF placed such emphasis on promoting growth, that growth in countries that had undertaken IMF-supported adjustment programs had generally been disappointingly low. Masaki Shiratori, Vice President of Japan's Overseas Economic Co-operation Fund, and Masaru Yoshitomi, Vice Chairman of the Research Institute of the Long-Term Credit Bank of Japan, felt that a market-based development strategy would not best serve many developing and transition economies whose markets were not well developed. Nascent markets needed help to develop and, following the Japanese example, governments should intervene to correct market failures and guide market development. Given the success of the East Asian model in which government intervention had figured prominently in a number of countries, Shiratori and Yoshitomi asked why the IMF did not embrace such policies more enthusiastically.

The role of industrial policy and the pace of reforms were key themes of the seminar.

Speaking on his country's experience, Yung Chul Park, President of the Korean Institute of Finance, observed that, in fact, the debate over government intervention versus free market policies was fast becoming passé because of the pressures of globalization. The highly regulated economic framework prevalent in such countries as Japan and Korea, he said, was proving unworkable in the new global environment and was being dismantled.

Zeti Akhtar Aziz, Assistant Governor of the Central Bank of Malaysia, said that in the 1970s many East Asian countries had addressed problems of large macroeconomic imbalances and below-potential growth and had turned their economies around within a few years. They did so by following the sound policy framework outlined by Stanley Fischer but with more emphasis on state-led industrial policies and a gradualist approach to deregulating and liberalizing markets.

Susan Schadler of the IMF's Policy Development and Review Department underscored the extremely weak starting positions—in terms of the size of fiscal and external imbalances, external debt burdens, and distortive government intervention—of countries receiving IMF assistance. The size and depth of these countries' problems suggested that the debate was not about optimal development strategies beginning from a stable initial condition. Rather, it was how to achieve sweeping changes in public finances, the external position, and the structure of the economy.

The view that the IMF pushes for rapid adjustment on all fronts in all countries was a convenient but inaccurate characterization, Fischer said. The rapid price liberalization and privatization of state-owned industry that the European transition countries pursued under IMF-supported adjustment programs were at the behest of these governments, he noted, and in most instances inevitable in light of the accompanying political changes taking place. These countries wanted to break the power of entrenched bureaucracies and to make the reforms irreversible. In other countries, the pace of reform was also adapted to the conditions and needs of the country concerned.

The IMF did not disapprove of a more interventionist approach to development on ideological grounds, observed Jack Boorman, Director of the IMF's Policy Development and Review Department. Rather, the IMF's approach was grounded in its practical experience. In many developing countries, government involvement in the economy had not led to the positive results seen in much of East Asia. Quite the contrary, in many cases such involvement had created opportunities for rent-seeking and inefficiency.

The pace of structural reform was an important issue for many participants, particularly in the context of the continuing radical economic transformation in Eastern Europe, the Baltics, and the countries of the former Soviet Union. A number of Japanese participants felt that the sharp output collapse experienced by these countries at the beginning of the economic transition might have been avoided if a more gradual approach to structural reform had been taken. Responding to this issue, Boorman emphasized that the policy issues arising from this transformation should not be cast in terms of "shock therapy versus gradualism"; the reality was more complex.

Conclusions

The discussion over the two days revealed substantial areas of agreement, but differences of opinion remained between many of the IMF and non-IMF participants over the pace and extent of trade and financial sector liberalization, the political role of the state in industrial policy, the usefulness of directing credit, and the speed of privatization.

In his closing remarks, Boorman noted that the debate needed to continue and advised that it be defined away from "shock therapy versus gradualism" toward a more nuanced discussion focusing on several elements, including:

- the sufficiency of markets to support private sector institutions and activity;
- the capacity of governments to provide quickly the social, legal, and other infrastructure needed for successful private sector operations and ways in which capacity could be increased; and
- the residual role for government, including if necessary, market intervention.

If the debate were reframed in this way, said Boorman, it could be much more productive in terms of identifying specific actions that would place a country on the track to rapid growth. ■

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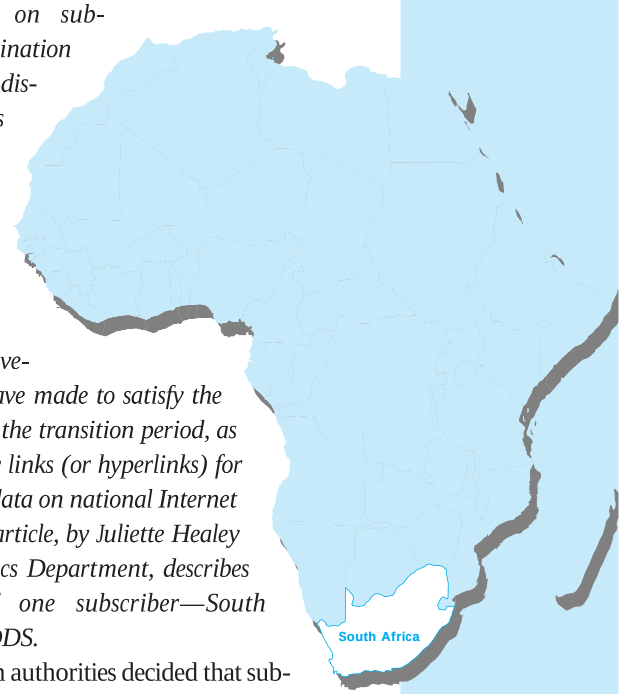
IMF External Relations Department

South Africa's Experience With the SDDS

In April 1996, the IMF established the Special Data Dissemination Standard (SDDS) for members having, or seeking, access to world capital markets. In September 1996, the IMF set up a Dissemination Standards Bulletin Board (DSBB) on the Internet, which provides information on subscribers' data dissemination practices. At present, dissemination practices of most of the 42 subscribers to the SDDS are carried on the DSBB—which is updated frequently. This includes any improvements subscribers have made to satisfy the SDDS by the end of the transition period, as well as the electronic links (or hyperlinks) for eight subscribers to data on national Internet sites. The following article, by Juliette Healey of the IMF's Statistics Department, describes the experience of one subscriber—South Africa—with the SDDS.



The South African authorities decided that subscribing to the SDDS would be of substantial benefit to the country, despite the concerted effort that adherence to the standard would require of several government agencies. Subscription was consistent with the authorities' desire to provide accurate, timely, and comprehensive information to potential international investors, underscoring South Africa's reintegration into the international financial community. Subscription to the standard would also ensure the availability of timely and comprehensive statistics in the short run and thereby contribute to the pursuit of sound macroeconomic policies.

The Minister of Finance signed South Africa's letter of subscription to the SDDS in August 1996. To ensure that the country meets the standard by the end of the transition period—December 31, 1998—and that transition plans conform with the national statistical system, the relevant agencies have assigned a high priority to all SDDS-related work. Other important competing priorities, however, such as the implementation of the *System of National Accounts, 1993*, and other major projects, will necessitate a comprehensive review of the national statistical system and the resources allocated for this purpose during the transition period.

Progress to Date

South Africa's Department of Finance, the South African Reserve Bank (SARB), and the Central

DSBB

Statistical Service (CSS) have taken steps to ensure the country's observance of the SDDS by the end of the transition period.

• With respect to real sector data, a new table has been added to the *Quarterly Bulletin* of the SARB, thereby fully meeting the SDDS for national accounts data. Also, the CSS has improved the timeliness of the production price index and is currently introducing measures to improve the timeliness of the manufacturing production index and the employment and earnings data.

South Africa's hyperlink to the DSBB allows it to disseminate its data to a far wider audience.

• For fiscal data, the Exchequer Account has been amended to provide information on interest costs incurred by the Department of Finance, which is encouraged by the SDDS. In addition, steps have been taken to ensure that the separation of domestic financing between the bank and nonbank sectors is available before the end of 1998.

• With respect to financial and external sector data, the *Monthly Release of Selected Data* of the SARB has been supplemented by the release of daily current market rates on the Bank's Internet website, enabling interest and exchange rates and equity price indices to be disseminated daily.

• Public access to the data will soon be improved by the introduction, by each of the above institutions, of quarter-ahead advance release calendars.

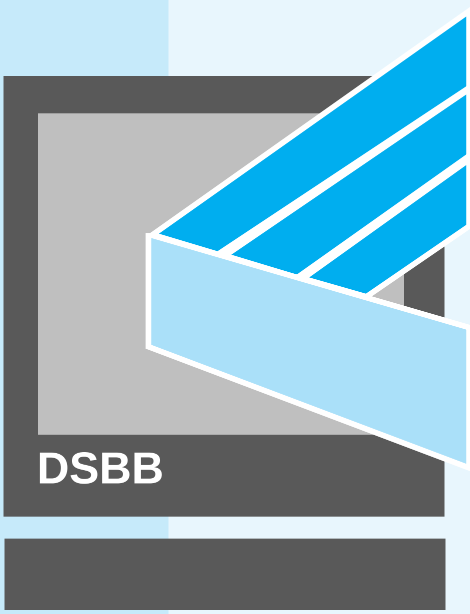
Under the SDDS, subscribers may take two flexibility options and still be considered in full observance. South Africa has taken two flexibility options—one for labor market statistics, and one for central government debt. Remaining plans to be implemented during the transition period aim to ensure that South Africa meets the SDDS by the end of 1998.

Both domestic and overseas users of South African economic and financial data have responded favorably to the country's subscription to the SDDS. Improvements in data timeliness, coverage, and periodicity—and, more recently, the hyperlinking between the DSBB and South Africa's Internet data site—together with the prospect of further improvements, have been enthusiastically welcomed.

South Africa's official data dissemination agencies firmly supported the IMF's hyperlinking initiative because it provides the opportunity to disseminate in summary form key economic and financial data to a far broader audience. At the same time, it provides links to more comprehensive data sites already developed. Since the hyperlinks to South Africa's national site were officially opened by the IMF on April 25, the number of "hits" recorded on both the SARB and CSS websites has increased sharply. Electronic mail enquiries regarding data related to that disseminated on the summary page in particular have grown exponentially in recent weeks, and comments by local and overseas users have been overwhelmingly positive. ■

Work Advances on the General Data Dissemination System

At a meeting in March, the IMF's Executive Board endorsed staff proposals for a framework for the General Data Dissemination System (GDDS). While the Special Data Dissemination Standard (SDDS) is aimed at member countries having, or seeking, access to capital markets, the GDDS will focus on improving data quality and systems for the production and dissemination of statistics for *all* IMF members.



The GDDS framework takes into account the wide diversity of economies and the still-developing state of many countries' statistical systems. It will consist of a "good-practices" standard for data production and dissemination while serving as a useful guide for countries developing their statistical systems. As with the SDDS, participation in the GDDS will be voluntary and will help data users assess participating countries' statistical practices. In the coming months, IMF staff will consult a wide variety of data producers and users and subsequently formulate specific proposals for consideration by the Executive Board. The IMF hopes to establish the GDDS by late 1997.

The address of the IMF's Dissemination Standards Bulletin Board on the Internet is http://dsbb.imf.org.

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Globalization Calls for EU Collaboration on Competition Policy

As Europe increasingly integrates, the European Union's (EU) policy on competition will play a key role in reshaping the EU's industrial landscape. Previously protected sectors are being liberalized, national markets integrated, monopolies being broken up, and state subsidies being rethought—with considerable implications for world trade. For this reason, the Organization for Economic Cooperation and Development (OECD) is formulating a more internationalized and concerted approach to trade and competition, and some countries have been pushing for the World Trade Organization (WTO) to enter the competition policy arena, too.

The harmonious workings of the EU and of transatlantic trade are crucial to the smooth functioning of the world economy. To address EU competition policy from several perspectives, the IMF sponsored an Economic Forum on June 5 at IMF headquarters. Moderated by Massimo Russo, Special Advisor to the Managing Director, participants included Alexander Schaub, Director General, Directorate General (DG) for Competition, European Commission; Alberto Pera, Secretary General of the Italian Antitrust Authority; and Ambassador Hugo Paemen, Head of the EU's Washington delegation.

The ultimate objective of competition policy is to create an environment in which business can flourish and contribute to economic growth and employment. EU governments long ago adopted competition policies as a means of ensuring an efficient allocation of resources. Within the EU, the central competition authority—the Directorate General for Competition—is responsible for enforcing competition law, empowered by its mandate to intervene against monopolization, punish abuses of a dominant position, restrict anticompetitive mergers, and monitor and control state aid. One of its greatest achievements has been to promote liberalization in sectors previously dominated by state monopolies, which, according to Schaub, is of utmost importance to the EU's goal of establishing a competitive market.

Liberalization has led to the need for industries to restructure, which has, in turn, given rise to a range of anticompetitive practices, such as predatory pricing, cross-subsidization, and state aid. It is the latter, according to Schaub, that represents one of the last remaining barriers to the completion of the single market. State aid, it is commonly agreed, distorts markets through inefficient resource allocation, resulting in unfair competition among firms. This is not to say that the Commission cannot, under certain conditions, approve aid schemes designed to correct or remedy market imperfections. For example, small firms are an important and dynamic part of the European economy, as well as a key source of job creation. Yet, their access to capital markets is limited. The EU's competition authority therefore allows for various aid programs to small- and medium-scale enterprises to "level the playing field and help them compete." Similarly, regional aid and support for research and development and environmental programs can be useful in remedying market imperfections and achieving other policy objectives. Nevertheless, even in those areas where aid may have potential benefits, the competition authority continues to play a monitoring role.

EU Shapes National Initiatives

EU institutions have helped shape the attitudes of national authorities. The process of liberalization and privatization in most European countries has been guided by directives and decisions taken at a central level by the European Commission, the Council, and the Court of Justice, Pera explained.

EU policies of liberalization taken at the central level, particularly in telecommunications and transportation—but more recently in energy, electricity, gas, and

Hugo Paemen (left), Massimo Russo, Alberto Pera, and Alexander Schaub at the Economic Forum on competition policy. The objective is to create an environment in which business can contribute to growth and employment.

railways—have forced governments to introduce measures to change the structure of these sectors.

Citing the case of Italy, Pera noted that the introduction of national antitrust legislation in 1990 and the establishment of an antitrust authority responsible for applying the act have advanced the country's privatization process. This authority has played a high-profile role in pressing for domestic liberalization and privatization through advisory powers granted to it by parliament. Direct intervention by the authority takes the form of sanctions on uncompetitive practices. In many cases, the Italian authority has been helped by EU legislation not only because the Italian system is modeled on that of the EU, but because it has the power to bring EU decisions to the national level. Schaub explained that competition cases, being primarily national in scope, are best dealt with by the national authorities who are closer to the relevant market. As such, while insisting on a consistent application of competition rules across the EU, the central competition authority encourages a decentralized approach to applying these rules. Decentralization, noted Pera, is greatly helped by recent efforts at harmonization of legislation across EU member states.

Competition cases are best dealt with by national authorities, who are closer to the relevant market.

Pera added that, at the enforcement level, national competition authorities are increasingly confronting cases with international ramifications, while businesses are increasingly finding their practices spanning several different jurisdictions. In the absence of agreement on principles and practices of enforcement, different decisions are likely to ensue about similar practices. Therefore, collaboration between national and EU competition authorities is vital: many new national competition laws are modeled on that of the EU, ensuring that the various authorities act in the same way and that enterprises face the same laws.

In reviewing the relationship between competition and trade policies within the EU, Paemen said that the regulation of trade in the EU has undergone profound change. With the introduction of the European market, trade policy at the national level was replaced by provisions set out by competition policy—a trading regime that had at one time been regulated by national trade policy measures is now almost exclusively managed by the central competition authority.

International Convergence Sought

A concern shared by trade and competition policymakers alike is that the benefits of the globalization of trade could be lost unless market access through competition is preserved and enhanced. With more economies pursuing liberalization and deregulation, and with the number and size of transnational companies increasing, competition policy becomes increasingly important as a means to protect economies from the potential distortionary effects of anticompetitive behavior, stated Paemen. Schaub agreed, adding that the growing globalization of markets calls for antitrust authorities around the world to collaborate, not only to facilitate the investigation of cross-border restrictive trade practices, but also to take remedial action against such practices. Furthermore, over the longer term, full international competition rules will need to be developed, a process already under way through discussion in the WTO, OECD, and other multilateral forums.

Indeed, convergence of national competition policies has been an ongoing process driven by trade liberalization, economic integration, and globalization. In various international forums, the exchanges on views on principles of competition law and their enforcement have led to substantial similarities in the emerging new legislation, as countries learn from one another. There is overall agreement, for instance, about the general direction of competition policy, the importance of transparency and nondiscrimination in enforcement, the need for competition laws to be applied uniformly and universally, and the importance of identifying barriers to entry into markets (although there remain marked differences in the identification and treatment of such barriers).

While countries generally agree on the usefulness of international cooperation to investigate anticompetitive behavior, as well as the procedures for enforcing the laws, substantial issues relating to sovereignty and jurisdiction, as well as differing views on the procedures for enforcing the laws, remain to be dealt with. One suggestion for facilitating the application of national competition laws internationally has been to establish, within the WTO, the rules and machinery to investigate and resolve disputes in the competition policy area. A WTO working party is scheduled to meet soon to focus on these issues, with the hope that as many countries as possible commit to adopting domestic competition rules and devising the means to enforce them.

A starting point would be agreement on a hard core of common competition rules covering "horizontal restrictions," such as price fixing, market sharing, and bid rigging, as well as "vertical restrictions," such as mergers and dominant positions, Paemen said.

Success of EMU Hinges on Euro's Stability

European economic and monetary union (EMU), set to begin on January 1, 1999, will have a major impact on the international monetary system, in large part through the creation of the euro. Unlike the European currency unit (ECU), the euro will not represent a basket of currencies, but will be a currency in its own right. As measured by the combined GDP of the currency area, the euro's economic base will rival that of the U.S. dollar, and its stability will determine the success of EMU. Will the euro facilitate economic stability? How will the composition of reserve currency holdings change under EMU? What impact will EMU have on international policy coordination? These are among several issues considered by Paul Masson and Bart Turtelboom of the IMF's Research Department in a new IMF Working Paper, *Characteristics of the Euro, the Demand for Reserves, and Policy Coordination Under EMU*.

At the outset, EMU will face a number of uncertainties, explain Masson and Turtelboom. It has yet to be determined which European Union (EU) countries will join the EMU. And even after the start of monetary union, EMU's ultimate composition will remain uncertain since the EU may admit additional members, particularly from Eastern Europe. The way the European central bank (ECB) will operate is also unclear. Regardless of whether it chooses a monetary or inflation target as a policy objective, the ECB will have to establish a track record to win credibility. While ECB statutes guarantee that the euro will be backed by monetary policies oriented to price stability—and procedures established by the Maastricht treaty will help ensure that fiscal policies do not interfere with this monetary objective—traditional indicators of the monetary stance will no longer give off the same signals, or be interpretable in the same ways. This issue will complicate the ECB's task of implementing monetary policy and the markets' assessment of its success.

EMU Likely to Promote Stability

From the perspective of the past behavior of European economies, Masson and Turtelboom attempt to determine whether European monetary policy under EMU will be associated with greater or lesser variability of macroeconomic indicators. Using simulations, they examine the effect of substituting European currencies with the euro and replacing an asymmetric monetary policy (influenced mainly by events in Germany) with a symmetric policy that reflects Europe-wide developments—that is, for members of EMU. These simulations assume that all 15 EU countries will join in EMU. Along with other elements, the simulations also take into account the impact of two intermediate targets—a broad monetary aggregate (M3) and an inflation target, plus a variant of inflation targeting that includes a weight on output.

Institutional Preparations Needed for EMU to Promote Cooperation

While broad interests coincide, the completion of European economic and monetary union (EMU) will impair international cooperation on exchange rates and other matters unless the European Union (EU) adopts further changes in its policymaking institutions. The European central bank (ECB) is reasonably well defined and will be intimately involved in the making of most international monetary policies. The political authority, which would correspond to the U.S. Secretary of the Treasury, for example, is almost completely missing and its working relationship to the ECB unspecified, according to C. Randall Henning in *Cooperating with Europe's Monetary Union*, published by the Institute for International Economics (IIE). Changes must be introduced quickly, says Henning, so that robust institutions are put in place before, rather than after, the next international monetary crisis. Most important, the EU must decide who will represent the monetary union in international negotiations and organizations and who will manage currency crises.

Henning calls for immediate consultations between U.S. and European officials on EMU's external monetary policy, along with the creation of a monetary Group of Three—from the present Group of Seven—to discuss exchange rate and monetary matters among the United States, Japan, and EMU members. He also advocates direct EMU representation in the IMF. More immediately, Henning suggests that the EU and the IMF must resolve a number of practical issues, including:

- the roles of the ECB versus national central banks in EMU's dealings with the IMF;
- the reconfiguration of the constituencies within the IMF's Executive Board;
- the reconstitution of the SDR;
- introduction of the euro into the IMF's operational budget;
- the conduct of multilateral surveillance; and
- procedures for activating the recently agreed New Arrangements to Borrow.

For copies of Henning's study, at $12.95 each, contact the IIE by telephone (202) 328-9000, or at 11 Dupont Circle, NW, Washington, DC 20036.

Overall, the experiments suggest that moving to a more symmetric European monetary policy is likely to promote stability of major macroeconomic variables, including output, inflation, interest rates, and the exchange rate. The results of a comparison of the two major alternative intermediate targets also suggest that inflation targeting would further improve European macroeconomic stability relative to money targeting. In particular, a contemporaneous inflation targeting procedure (aimed at the current year's outcome) would lower the variability of inflation, short-term interest rates, and the exchange rate of the euro against the dollar, without increasing output variability.

Euro May Rival the Dollar

With the introduction of EMU, the euro has the potential to become an attractive international currency that may challenge the U.S. dollar for both official and private uses—as an official foreign currency reserve asset, as the currency of denomination for trade and cross-border claims, or as a vehicle currency in foreign exchange markets. Limiting their analysis to the official sector, the authors attempt to estimate the potential demand for euro in foreign exchange reserves. They note that the extent to which monetary union will change demand for, and holdings of, reserves will depend on the number of countries that actually join EMU. Assuming that all 15 EU members do so, current reserve holdings of EU currencies by EU central banks will cease to be reserves, and their holdings of reserves will decline—to about $205 billion. However, demand for reserves will also decline, since much of what was foreign trade will be trade between members of the monetary union.

Intra-EU imports constitute about 60 percent of total imports of EU countries, and if the demand for reserves is proportional to imports, as is often assumed, the demand for reserves after EMU would fall by about 60 percent, to about $100 billion. As such, some $105 billion—mostly held in U.S. dollars—would be excess and might lead to a tendency for the U.S. dollar to depreciate over time, as EU countries decrease their reserve holdings. Nevertheless, such calculations entail a number of uncertainties, and the pressures of reduced dollar reserve holdings by EU countries—whatever their magnitude may be—are not likely to be the dominant influence on exchange rates post-EMU. Other factors, such as the monetary stance and credibility of the ECB and the cyclical position of the EU relative to the United States and Japan, will have greater influence.

The authors also consider the attractiveness of euro reserves as a store of value by central banks from the perspective of optimal diversification. Although central banks are not guided primarily by such considerations in their choice of reserve holdings, they cannot be indifferent to them over the longer run. A currency that either does not hold its value in real terms, or fluctuates wildly in real value, will not be as attractive as a reserve currency. Therefore, the risk and return properties of the euro will significantly affect its attractiveness relative to the dollar as a reserve currency. Leaving aside other factors affecting reserve use—such as the extent trade will be denominated in euro—the authors' simulation results suggest that, absent credibility problems and changes in structure, holdings of euro reserves should be more attractive than the deutsche mark for portfolio reasons.

Uncertain Demand for Euro Complicates Targeting

After considering the international impact of EMU using historical relationships, Masson and Turtelboom highlight how uncertain a guide such relationships may be in the face of a major regime change. Among other effects, this may have important implications for what the ECB chooses to do in the initial years of monetary union.

Uncertainties relating to the potential size of the monetary union and the use of the euro currency outside the EMU area will make imprecise the estimation of the demand for any euro money aggregate. Given that effective monetary targeting requires a stable and predictable demand for money, this would clearly complicate the monetary policy of the ECB if it were to use money as its intermediate target. That uncertainty will make both monetary and inflation targeting frameworks problematic, because the transmission mechanism and the demand for money will not conform to historical relationships, with little quantitative evidence available for updating them.

As a result of these uncertainties, the ECB will likely be forced, at least initially, to practice a reasonably discretionary policy, whether or not it announces an intermediate target. Such discretionary policy would no doubt rely on various indicators of current and future developments with respect to economic activity and inflation. One indicator that might be given prime attention is the exchange value of the euro. The exchange rate is a particularly visible and publicly recognized indicator, and the exchange rate against the dollar or yen will have a clear interpretation for the general public. Indeed, there is considerable discussion in Europe of whether the euro will be as strong as the deutsche mark. To judge the euro's strength, the public is unlikely to be guided, at least initially, by European inflation, which, say Masson and Turtelboom, is a relatively unfamiliar aggregate. EMU-wide money growth will also be subject to major problems of measurement and interpretation, and it is not a variable familiar to, or monitored by, the general public. These considerations may induce the ECB initially to give more weight to such indicators as the exchange rate, whose interpretation is less questionable and on which monetary policy may have a more predicable effect.

Given the increased uncertainty about the effects of monetary policy under EMU, considerable discussion has centered on the effect of EMU on international policy coordination. The authors argue that the EMU will not necessarily impede international policy coordination, because coordination may help to contain the overall uncertainty facing Europe. ■

Copies of IMF Working Paper 97/58, *Characteristics of the Euro, the Demand for Reserves, and Policy Coordination Under EMU*, by Paul Masson and Bart G. Turtelboom, are available for $7.00 from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org. The full text is also available on the IMF's web site (http://www.imf.org).

Stand-By, EFF, and ESAF Arrangements as of May 31

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
Stand-by arrangements			3,766.48	2,481.97
Argentina	April 12, 1996	January 11, 1998	720.00	321.00
Bulgaria	April 11, 1997	June 10, 1998	371.90	348.70
Djibouti	April 15, 1996	March 31, 1998	6.60	2.63
Egypt	October 11, 1996	September 30, 1998	271.40	271.40
El Salvador	February 28, 1997	April 27, 1998	37.68	37.68
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
Pakistan	December 13, 1995	September 30, 1997	562.59	267.90
Papua New Guinea	July 14, 1995	December 15, 1997	71.48	36.14
Romania	April 22, 1997	May 21, 1998	301.50	241.20
Venezuela	July 12, 1996	July 11, 1997	975.65	625.65
Yemen	March 20, 1996	June 19, 1997	132.38	14.38
EFF arrangements			10,183.93	6,058.01
Algeria	May 22, 1995	May 21, 1998	1,169.28	422.08
Azerbaijan	December 20, 1996	December 19, 1999	58.50	49.14
Croatia	February 12, 1997	March 11, 2000	353.16	324.38
Gabon	November 8, 1995	November 7, 1998	110.30	49.63
Jordan	February 9, 1996	February 8, 1999	238.04	127.74
Kazakstan	July 17, 1996	July 16, 1999	309.40	309.40
Lithuania	October 24, 1994	October 23, 1997	134.55	20.70
Moldova	May 20, 1996	May 19, 1999	135.00	112.50
Peru	July 1, 1996	March 31, 1999	300.20	139.70
Philippines	June 24, 1994	June 23, 1997	474.50	438.00
Russia	March 26, 1996	March 25, 1999	6,901.00	4,064.74
ESAF arrangements			4,013.09	1,611.21
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	26.52
Cambodia	May 6, 1994	August 31, 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	83.25
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	3.68
Guyana	July 20, 1994	April 17, 1998	53.76	8.96
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	March 31, 1998	88.15	16.13
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	45.47
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	31.01
Mauritania	January 25, 1995	January 24, 1998	42.75	14.25
Mozambique	June 21, 1996	June 20, 1999	75.60	50.40
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	January 12, 1998	130.79	17.84
Sierra Leone	March 28, 1994	December 31, 1997	101.90	5.06
Tanzania	November 8, 1996	November 7, 1999	161.59	110.18
Togo	September 16, 1994	September 15, 1997	65.16	32.58
Uganda	September 6, 1994	November 17, 1997	120.51	—
Vietnam	November 11, 1994	November 10, 1997	362.40	120.80
Zambia	December 6, 1995	December 5, 1998	701.68	40.00
Total			17,963.50	10,151.19

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

Data: IMF Treasurer's Department

Members drawing on the IMF "purchase" other members' currencies, or SDRs, with an equivalent amount of their own currency.

IMF Conducts Seminar for Bulgarian Parliamentarians

In late May, the IMF's External Relations Department and IMF Institute organized a seminar on Economic Policies for Controlling Inflation and Restoring Economic Growth for deputies of the Bulgarian National Assembly in Bulgaria. The 36 parliamentarians who took part included heads and their deputies of the Budget and Economic Committees and members of all five political parties represented in the newly elected National Assembly. On April 11, the IMF had approved an SDR 372 million stand-by credit to support the government's economic program for 1997–98, a program that entails rapid stabilization underpinned by structural reforms.

Deputies shared the staff's concern about the banking system and generally supported reform.

Bulgarian parliamentarians at the seminar were most interested in their country's impending currency board arrangement and its implications for financial reform and fiscal policy. Support for a currency board was unanimous, but many deputies expressed concern about Bulgaria's ability to implement it successfully, owing to banking problems and the weak fiscal situation.

Regarding the financial system, IMF staff stressed the importance of Bulgarian commercial banks learning to make sound loans on an arm's-length basis and with appropriate collateral and loan documentation, while avoiding lending to insolvent enterprises. Staff also emphasized the importance of full implementation of regulatory and supervisory standards for the banking system. They noted that the currency board arrangement would likely prompt private capital inflows, which would need to be invested soundly to boost Bulgaria's economic recovery. This put additional urgency on financial system reform—as well as on privatization, closure of insolvent banks and enterprises, strict contract enforcement, and clarification of property rights in certain areas. Deputies shared the staff's concern about the banking system and generally supported reform.

Regarding the fiscal situation, IMF staff pointed out that although the budget would be tight and tax reform was urgent, privatization receipts and external financing would provide adequate support for the currency board arrangement and the budget. Many deputies expressed interest in various tax exemptions and multirate tax structures, as well as concern about limits on social expenditures and subsidies for industry and depressed regions. Reform-minded deputies, however, appreciated the IMF staff's emphasis on the costs and ineffectiveness of tax exemptions—and the merits of confronting subsidy issues transparently on the expenditure side of the budget.

Toward the end of the seminar, IMF staff underscored the need for structural reform to ensure lasting macroeconomic stabilization and durable growth in Bulgaria, citing evidence of real wage stagnation—and even decline—in Bulgaria, in contrast to the growing real wages in other East European economies. Staff stressed that the hardships of reform should be seen in the context of the high social costs Bulgaria had already been paying by not undertaking consistent and comprehensive reform earlier. The seminar closed with comments by IMF staff on the encouraging prospects for an economic turnaround in Bulgaria if the IMF- and World Bank-supported program is carried out promptly and thoroughly. ■

Robert Russell
IMF External Relations Department

Members' Use of IMF Credit
(million SDRs)

	May 1997	Jan.–May 1997	Jan.–May 1996
General Resources Account	517.7	1,876.5	2,135 8
Stand-by arrangements	1.1	373.5	1,207.3
EFF arrangements	516.6	1,395.4	928.5
CCFF	0.0	107.6	0.0
SAF and ESAF arrangements	64.5	223.4	222.0
Total	582.2	2,099.9	2,357.8

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

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
June 9	3.98	3.98	4.36
June 16	3.92	3.92	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 109.6 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171.
Data: IMF Treasurer's Department

Is the IMF Needed in an Era of Massive Private Capital Flows?

Following are edited excerpts of remarks given by IMF Managing Director Michel Camdessus at the Economic Club of New York in New York on June 6.

The IMF and the World Bank were founded to help restore economic stability and growth in the aftermath of World War II. Half a century later, they are still working to promote these goals, but in a world that has changed. In particular, the international economy is now dominated by massive private capital flows that are opening new opportunities for investment, trade, and growth to an ever-larger number of countries. Last year was another record year. Net private capital flows to emerging market economies reached $235 billion—five times the level in 1990. So, one may well ask: do we still need the IMF?

In my view, the answer is a clear "yes." It is true that global economic opportunities are increasing, but many countries are not yet able to take advantage of them. Moreover, for countries that do tap private capital markets, the risks have increased. The market rewards what it sees as sound economic policy and punishes—sometimes resoundingly—what it perceives as policy weakness. Hence, the upside potential for good economic performers is substantial, but the latitude for policy mistakes remains, and the cost of mistakes can be much greater. This is why our 181 member countries are increasingly looking to the IMF to help enhance the stability of the global economic and financial system and increase the prospects for high-quality growth in ways that individual countries are not as well equipped to do. The IMF is called upon to:

• encourage countries—through its policy advice, technical assistance, and, when appropriate, financial support—to pursue the sound economic and financial policies required to attract private capital and thereby expand opportunities for investment, trade, and growth;

• through this emphasis on appropriate policies, reduce the risk of a sudden reversal of capital flows and their potentially destabilizing spillover effects;

• when crises do occur, ensure they are dealt with in ways not detrimental to international prosperity; and

• provide a forum in which members can discuss and learn from each other's policy successes and failures, assess global economic developments, and, to the extent possible, diffuse emerging problems before they become major crises.

The IMF can hardly expect to forestall every crisis, but we do believe that prevention is better than cure. We have thus taken a number of steps both to strengthen the IMF's traditional surveillance over member country policies and to broaden its scope.

• *capital account liberalization.* The benefits of an open and liberal system of capital movements are widely recognized. But in order to have full access to private capital, countries have to open their capital accounts. Up to now, the IMF's mandate was practically limited to the current transactions. Now, the membership agrees that the IMF's charter should be amended to call specifically on the IMF to promote capital account liberalization and to give the IMF appropriate oversight over restrictions on capital movements.

• *financial sector soundness.* In many countries, poor bank management, weak supervision, and unfavorable macroeconomic conditions have left the banking system in a perilous state. Moreover, when the banking system is weak, countries are often reluctant to tighten macroeconomic policies when they should, for fear of provoking a banking sector crisis. In these circumstances, a banking crisis is an accident waiting to happen.

From the IMF's perspective, the main emphasis should be on strengthening internal bank management and reinforcing market discipline over banking practices. There is also a clear need to improve bank regulation and supervision. The IMF has pointed to the need for a set of "best practices" that are internationally recognized and applicable in countries at varying stages of development. We have indicated our readiness to help disseminate these "best practices" through our policy discussions with member countries. Important steps are now being taken in this direction—such as the Basle Committee's "Core Principles for Effective Banking Supervision."

The IMF can hardly expect to forestall every crisis, but we do believe that prevention is better than cure.

• *transparency.* Since market perceptions determine where capital will flow, there is now a much higher premium on accurate information about country economic policies and performance. The IMF is actively encouraging all countries—especially those tapping, or hoping to tap international capital markets—to improve the economic and financial data they provide to the public [see page 187 for story on South Africa's experience with the Special Data Dissemination Standard].

• *marginalization.* In this era of global markets, countries face a stark choice: either integrate into the international economy or become marginalized from it. This marginalization is not only the source of much human misery, but also a drag on world growth, and increasingly, a threat to peace. Traditionally, IMF assistance has focused on helping countries correct macroeconomic imbalances, reduce inflation, and undertake the key structural reforms needed to improve efficiency and expand production. But increasingly, we find that a much broader range of institutional reforms is needed if countries are to establish and maintain private sector confidence, and thereby lay the basis for sustained growth. These reforms—the "second generation" of structural reform—include a simple, transparent regulatory system, an independent and professional judicial system, and a government that makes cost-effective use of public resources. The IMF's approach is to focus on those aspects of "good governance" most closely related to our surveillance over macroeconomic policies, such as increasing the transparency of government accounts and encouraging countries to reduce unproductive public expenditure in favor of investments in health, education, and basic infrastructure.

Subscribing to an IMF quota increase does not reduce net worth or increase the budget deficit.

Financing the IMF's Operations

This is where the IMF is heading. Now, I turn to what it takes to get there: the financial support of the IMF's shareholders, especially its largest shareholder, the United States.

The IMF is a financial cooperative. On joining, each member country subscribes a sum of money called its "quota." When a member encounters a need for temporary balance of payments financing and "borrows" from the IMF, it exchanges a certain amount of its own national currency for an equivalent amount of currency of another member in a strong balance of payments position. The borrowing country pays interest at a floating market rate on the amount of currency it is using, while the country whose currency is being used receives interest. When it comes time to "repay," the country exchanges the hard currency it is using for its own national currency.

For a country—rich or poor—subscribing to a quota increase is like putting money in the bank: it does not reduce net worth or increase the budget deficit. The United States, for example, considers its quota subscription an exchange of assets with the IMF, not a budgetary outlay. In fact, in many years, the United States has actually made money on its position in the IMF through the interest it receives on other countries' use of dollars and the exchange rate gains it has realized on its SDR-denominated position.

The economic history of the world over the last fifty years is marked by many occasions when the United States exercised its leadership to help strengthen the world economy: in successful trade liberalization rounds, in the reduction of the debt crisis, and in the economic transformation of Eastern Europe and the former Soviet Union. It has been able to accomplish all of this, and at relatively little cost to the U.S. Treasury, in large part because it could work through the IMF and because the IMF itself has maintained its financial strength. Our membership is now considering an increase in IMF quotas, to ensure that the IMF continues to have the strength and the credibility to fulfill its functions. Americans are well known for their pragmatism. Thus, I am confident that America will continue to recognize the benefits of a strong IMF, see what a miraculously good business it is, and give the IMF its wholehearted support. ■

IMF Monitors Members' Public Spending

(Continued from front page) Bank—although staff help member countries compile fiscal data. IMF staff analyses of social expenditure have been constrained by several elements, including the lack of data in some countries, the poor quality and incomplete coverage of data when available, and the lack of expertise of IMF staff. Nonetheless, available data point to a promising trend in health and education expenditure in some of the poorer countries engaged in IMF-supported adjustment programs.

In recognition of these elements and to strengthen the staff's work in the area of health and education expenditure in developing and transition economies, the Managing Director has recently called on the IMF staff to, among other things:

• improve the collection of timely and comprehensive data on government spending on health and education, disaggregated by function, that are consistent with the overall fiscal accounts;

• provide technical assistance from IMF or other sources to improve the quality of data when weaknesses are severe;

• report on available fiscal data on health and education spending in Executive Board papers and attempt to draw conclusions regarding the level and efficiency of such spending;

• strengthen collaboration with the World Bank to help governments incorporate and monitor realistic targets for social expenditure, including in the context of IMF-supported programs; and

• monitor developments in basic social indicators—such as poverty rates, infant mortality, life expectancy, illiteracy, school enrollment, and access to basic social services—that are compiled by the World Bank. In countries where such indicators are worsening or failing to improve, IMF staff would seek World Bank advice and may, if necessary, raise the issue with the relevant national authorities. ■

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

Romania: Stand-By

The IMF has approved a 13-month stand-by credit for Romania, equivalent to SDR 301.5 million (about $414 million), to support the government's 1997–98 economic program. Of the total, SDR 60.3 million (about $83 million) is available immediately.

1997–98 Program

The economic program for 1997–98, supported by the new stand-by credit, seeks a decline in the external current account deficit to 4.5 percent of GDP in 1997 from 6.6 percent in 1996, and a sharp cut in the monthly rate of inflation to about 2 percent by the end of 1997 from a monthly rate of 10 percent at end-1996. Real GDP, however, is expected to decline by 1.5 percent in 1997, in part due to a drop in output at a large number of state enterprises as subsidies are withdrawn and input prices are increased.

To these ends, the authorities are undertaking a major fiscal adjustment, reducing the combined total of the general government deficit and quasi-fiscal subsidies from 8.3 percent of GDP in 1996 to 3.7 percent of GDP in 1997.

Structural Reforms

An ambitious program of structural reforms under the program will focus, in the enterprise sector, on restructuring—involving liquidation or privatization—of many state-owned farms, and of industrial and commercial enterprises. Reform of the financial sector will center on improving prudential supervision, strengthening the legal framework governing banks and other financial intermediaries, and privatizing the banks.

Romania: Selected Economic Indicators

	1994	1995	1996	1997[1]
		(percent change)		
Real GDP	3.9	7.1	4.1	–1.5
Consumer prices (end of period)	61.7	27.8	56.9	88.8
		(percent of GDP)		
Consolidated general government balance (plus quasi-fiscal subsidies from the NBR)	—	—	–8.3	–3.7
External current account balance	–1.7	–4.7	–6.6	–4.5
		(months of imports)		
Gross reserves	3.8	2.0	2.4	3.3

[1]Program.

Data: Romanian authorities and IMF staff estimates

Addressing Social Costs

The government will rely on the extension and improved targeting of existing social programs to guarantee timely assistance to the most vulnerable groups. Child allowances, which have been eroded in recent years, have recently been increased substantially. To soften the impact of enterprise restructuring, severance pay packages will be used selectively to support workers affected by layoffs in economically depressed regions.

Romania joined the IMF on December 15, 1972; its quota is SDR 754.1 million (about $1.0 billion); and its outstanding use of IMF credit currently totals SDR 424 million (about $581 million).

Press Release No. 97/20, April 22

Sierra Leone: Selected Economic Indicators

	1995[1]	1996[1]	1997[2]	1998[3]	1999[3]	2000[3]
			(percent change)			
Real GDP	–10.0	5.0	10.1	14.8	8.7	5.7
Consumer prices (end of period)	34.5	6.4	8.0	5.0	5.0	5.0
			(percent of GDP)			
Current account balance (excluding official transfers)	–21.1	–20.9	–25.7	–20.3	–13.7	–10.9
Overall fiscal balance (commitment basis, excluding grants and foreign-financed election and reconstruction expenses)	–9.8	–6.3	–4.9	–3.6	–2.5	–2.0
			(months of imports)			
Gross international reserves	3.1	1.5	1.8	2.5	4.0	5.1

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

Data: Sierra Leonean authorities and IMF staff estimates and projections

Sierra Leone: ESAF

The IMF approved the third annual loan under the enhanced structural adjustment facility (ESAF), in an amount equivalent to SDR 10.1 million (about $14 million), for Sierra Leone to support its 1997 economic program. The loan is available in two semiannual installments, the first of

which will be available immediately. In December 1995, the IMF approved an augmented second annual loan for Sierra Leone under the ESAF, raising the total three-year ESAF loan to SDR 101.9 million (about $139 million) from the original SDR 88.8 million (about $121 million). (See Press Release No. 95/68, *IMF Survey*, January 8, 1996.)

Medium-Term Strategy and 1997 Program

The government's medium-term macroeconomic program has been formulated against the backdrop of a large donor-supported resettlement, rehabilitation, and reconstruction program that will be implemented over the next five years. As an initial step, Sierra Leone is undertaking a two-year Quick Action Program designed to resettle people displaced by the war, reconstruct the basic social and economic infrastructure, and demobilize ex-combatants. Under the 1997 program, real GDP is targeted to grow about 10 percent, the rate of inflation to be contained at 8 percent, and gross international reserves to increase to the equivalent of 1.8 months of imports.

Structural Reforms

The key structural reforms to be undertaken during 1997 include rationalizing the government workforce, streamlining public enterprise reform, and rationalizing legal requirements for foreign and domestic investment.

Addressing Social Needs

Poverty reduction remains the greatest economic and social challenge facing Sierra Leone. Sustained economic growth in a low-inflation environment remains the most effective solution by creating jobs for the estimated 80 percent of the labor force that remains out of work or underemployed. Sectoral policies will focus on private sector development and job creation in agriculture, fisheries, tourism, and mining.

Sierra Leone joined the IMF on September 10, 1962, and its quota is SDR 77.2 million (about $105 million). Its outstanding use of IMF financing currently totals SDR 119 million (about $163 million).

Press Release No. 97/23, May 5

Djibouti: Selected Economic Indicators

	1993	1994	1995	1996[1]	1997[2]
			(percent change)		
Real GDP	–3.9	–2.9	–4.0	–1.2	1.0
Consumer prices (average)	4.4	6.5	4.9	4.2	4.0
			(percent of GDP)		
External current account balance (excluding foreign budgetary transfers)	–15.1	–13.2	–5.9	–6.1	–6.9
Overall government primary balance (excluding grants)	–21.3	–13.0	–9.3	–5.1	–3.2
			(months of imports)		
Gross official reserves	3.3	3.7	3.5	3.8	3.9

[1]Preliminary.
[2]Program.

Data: Djibouti authorities and IMF staff estimates

Djibouti: Augmented Stand-By

The IMF approved a request by the government of Djibouti to extend the current stand-by credit through end-March 1998 and to augment the amount available under it by SDR 2 million (about $2.8 million), to support the government's economic and financial program for 1997. The Executive Board had approved a stand-by credit for an amount equivalent to SDR 4.6 million (about $6.4 million) on April 15, 1996 (see Press Release No. 96/16, *IMF Survey*, May 6, 1996).

Djibouti joined the IMF on December 29, 1978. Its quota is SDR 11.5 million (about $16 million).

Press Release No. 97/25, May 22

Guinea-Bissau: Article VIII

The government of Guinea-Bissau 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 January 1, 1997. 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 139 countries have now assumed Article VIII status.

Guinea-Bissau joined the IMF on March 24, 1977. Its quota is SDR 10.5 million (about $15 million).

Press Release No. 97/26, May 29

Export Credit Agencies Assume Expanded Development Financing Role

Officially supported export credit agencies are playing an increasingly important role in financing the development of developing and transition economies. In a new IMF working paper, *Recent Export Credit Market Developments*, Paulo F. N. Drummond reviews recent developments in the export credit markets—notably an increase in new commitments and a concentration of activity in relatively large middle- and low-income countries and the high-performing Asian economies. He also examines three key developments that have shaped the performance of these markets: broader involvement of export credit agencies in project financing, their stronger participation in investment insurance, and a deepening of the forfaiting market.

Export Credit Market

By the end of 1995, total exposure of official export credit agencies—located mostly in member countries of the Organization for Economic Cooperation and Development (OECD) countries—to developing and transition economies approached one-half trillion dollars, with total exposure growing at 12 percent annually, in contrast to the 10 percent during 1990–94.

In 1995, as in previous years, exposure was heavily concentrated in a handful of countries. Ten middle- and low-income countries accounted for more than half of the exposure. Export credit exposure in Russia (12 percent of the total) largely reflected claims on the former Soviet Union. For China (9 percent) and Indonesia (6 percent), exposure reflected strong export credit activity (see box, page 200).

New Commitments. New commitments increased by $20 billion, to $107 billion in 1995. Roughly 1 percent of this increase was indicative of broader country coverage, with the Berne Union—the International Union of Credit and Investment Insurers—expanding its coverage of debtor countries by 20. New commitments were nevertheless concentrated in countries characterized by large export activity and favorable risk assessment. The already high exposure of agencies in China and Indonesia (jointly, 30 percent) and Hong Kong, Malaysia, and Thailand (20 percent combined) did not dampen enthusiasm for increased activity in these countries.

By the end of 1995, export credits represented about one-third of the total external debt of the 20 largest countries. Export credits represented up to 70 percent of external debt in countries such as Algeria, Iran, and Nigeria, and as little as 10–15 percent in countries with a more diversified base of foreign financing, such as Brazil, India, and Mexico.

Financial Performance. As measured by net cash flow, the financial performance of most export credit agencies improved during 1995. Of the 39 export credit agencies surveyed, 36 recorded improvements in cash flow balances. For the first time since 1981, premium income and recoveries almost offset new claims payments and administrative costs. The combined cash-flow deficit dropped to $0.5 billion in 1995 from $6.4 billion in 1994. New claims payments declined to $12 billion in 1995, and recoveries increased by 30 percent, while premium income rose 13 percent. This recovery, notes Drummond, reflects three recent developments:

- The payments position for a number of major debtor countries has improved and several countries concluded Paris Club reschedulings.
- Recoveries on rescheduled debts have become a significant source of income, particularly for the large export credit agencies.
- Many agencies have adjusted premium schedules to better reflect transaction risks.

Market and Institutional Developments

The export credit market has for 19 years operated within a framework guided by the OECD "Consensus"—the Arrangement on Guidelines for Officially Supported Export Credits. These working guidelines are updated periodically, most recently in August 1994. Within this framework, there have been market changes in the export credit business in three main areas: project financing, investment insurance, and forfaiting market.

Export credits extended for project financing rely primarily on the cash flow generated by the project rather than on the borrower's general creditworthiness. No sovereign guarantees are involved, but additional security—such as project completion guarantees, charges on project assets—may be required. Increased privatization and deregulation have expanded opportunities for project financing without sovereign guarantees, but they have also increased the degree to which creditor risk is now being shared between export credit agencies and commercial banks. A related, and sensitive, issue is the constraints under which official export credit agencies operate, since they are required to adjust financing terms to the project's cash flow—a constraint private sector banks do not face.

By the end of 1995, export credit exposure was growing by 12 percent annually.

Demand for investment insurance from export credit agencies has remained strong in recent years—at $8–9 billion a year—despite growing private sources of external finance and increased privatization in developing countries. Export credit agencies traditionally furnish insurance against political risk—that is, risk asso-

IMF SURVEY

ciated with currency transfer, expropriation, war and civil unrest, and breach of contract. Less traditional is the coverage provided by these agencies for cancellations of export or import licenses, nonpayment by a public buyer, and changes in the regulatory environment that may negatively affect a project. Since political, legal, and regulatory uncertainties can readily dampen investor enthusiasm, the availability of investment insurance from official bilateral and multilateral agencies has helped developing countries catalyze private finance for projects in recent years.

Forfaiting entails the purchase—at a discount—of trade finance paper such as bills of exchange, promissory notes, and other freely negotiable instruments. The forfaiteur eliminates the risk of nonpayment to an exporter, operating not unlike a traditional official export credit agency or private insurance company. The deepening of the forfaiting market has improved the flexibility of export terms and conditions, and provided additional liquidity where export credit agencies have reached their credit limit. The forfaiting market also reaches a broader range of countries and applies less strict cover. However, the increased liquidity may come at a cost—in terms of increased riskiness in export credit markets. ■

Copies of IMF Working Paper 97/27, *Recent Export Credit Market Developments*, by Paulo F. N. Drummond, are available for $7.00 from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org. The full text is also available on the IMF's web site (http://www.imf.org).

Export Credit Agency Activity in Selected Countries

Export credit agencies reinforced their exposure to certain large middle- and low-income countries whose export activity was already large and whose risk assessment remained favorable. In the two largest low-income recipients—China and Indonesia—all of the export credit agencies remained open and operated generally without restriction. New commitments to China rose to $18 billion in 1995—a 5 percent increase over 1994—while new commitments to Indonesia climbed to $12 billion—a nearly 60 percent jump. In both instances, the new commitments reflected strong import demand and strong external positions.

Elsewhere in Asia, new commitments to Hong Kong rose slightly to $8 billion, and Malaysia and Thailand garnered new commitments of $9 billion and $5 billion, respectively, reflecting high growth rates and good payment records, notwithstanding concerns regarding overheating and current account deficits. New commitments to the Philippines more than doubled in 1995—mirroring strong activity in the economy and large capital inflows. In India, new commitments declined slightly to $3.6 billion, with agencies generally remaining open without restriction for short-term transactions, and with limited restrictions on medium- and long-term transactions.

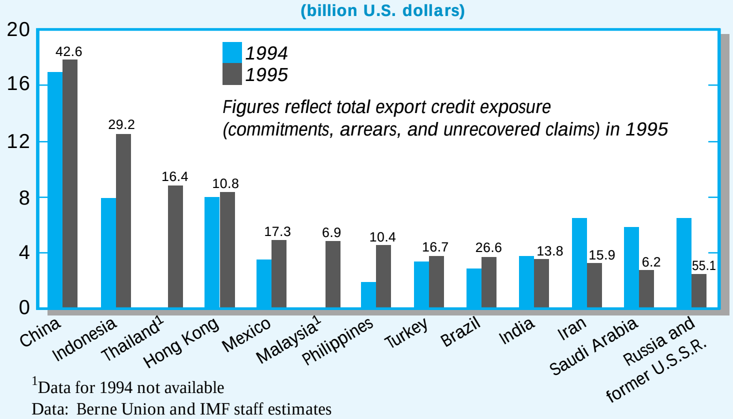
In Latin America, Mexico recorded an almost 40 percent increase in new commitments in 1995, with most export credit agencies open for cover without restrictions. Earlier concerns about Mexico were alleviated by the country's strong adjustment program and a good record of repayments. In Brazil, new commitments by the export credit agencies increased 30 percent to $3.5 billion, despite a mixed payment record.

In Russia, most agencies were open for business in 1995 with restrictions for short-term transactions. Some agencies did not cover medium- and long-term transactions, while others did so only with sovereign guarantees. In the Baltic countries and other countries of the former Soviet Union, the cover policy remained restrictive and the volume of new commitments, low. In resource-rich Kazakstan, Turkmenistan, and Uzbekistan, most agencies were open for business only with sovereign guarantees, and only Turkmenistan and Uzbekistan attracted relatively large new commitments.

Finally, several countries experienced substantial declines in new commitments in 1995—notably Venezuela, whose 50 percent decline resulted from a deteriorating policy environment and accumulating payments arrears; Algeria, whose 40 percent decline was largely linked to concerns over political developments; Iran, whose new commitments dropped 50 percent after a spike in 1994; and Saudi Arabia, whose new commitments fell 50 percent. Most agencies remained open for business for medium- and long-term transactions with the public sector in Saudi Arabia, but most agencies insisted on—and did not receive—sovereign guarantees.

New Export Credit Commitments in Selected Major Markets

(billion U.S. dollars)



[1]Data for 1994 not available

Data: Berne Union and IMF staff estimates

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