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Camdessus Commends Indonesia's "Impressive" Economic Policy Program

On October 31, IMF Managing Director Michel Camdessus warmly welcomed Indonesia's "impressive program of macroeconomic adjustment and structural reform," which had been introduced that day. Camdessus said, "I strongly commend the actions taken by the authorities and the strength of the commitments they have made in this program, which have made the decision to lend support to their efforts an easy one. These measures should restore confidence in the Indonesian economy and contribute to the stabilization of regional financial markets.

"The program is based, in the first instance, on strong monetary and fiscal policies, designed to bring about an orderly adjustment in the economy and to restore confidence to financial markets. The second leg of the program consists of a major restructuring of the financial sector, along with measures to ensure its future soundness. The third leg involves significant deregulation measures and trade reforms that should have an immediate and long-lasting effect in improving economic efficiency. Simultaneous efforts to promote transparency and openness will significantly improve the governance framework and the business climate.

"On November 5, under the emergency financing mechanism, and in view of the major improvements that this program is designed to bring about in the longer-term prospects of the Indonesian economy, I will be asking the Executive Board to approve Indonesia's request for a three-year Stand-By Arrangement in the amount of about $10 billion (SDR 7.3 billion). In addition to the IMF funding, the reform program will be (Please turn to the following page)

> *These measures should restore confidence in the Indonesian economy.*
> –Camdessus

Seminar Highlights IMF Role in Asia's Development

Fresh perspectives on Asia's economic record and the IMF's role were presented at a public seminar in Hong Kong, China, sponsored by the IMF. Leading academic economists from throughout Asia joined senior IMF and national officials for the one-day event.

Tanzi, Director of the IMF's Fiscal Affairs Department (left), and Hashbat Hulan, ; Parliamentary Standing Committee on Social Policy, Mongolia, at the seminar.

Chen Yuan, Deputy Governor of the People's Bank of China, opened the seminar on September 19 by assuring participants that continued modernization of the Chinese economy—including reform of the state-owned sector—would sustain China's strong economic growth, which he projected at an annual rate of 8–9 percent for the next few years, with inflation remaining below 6 percent. Chen concluded that China's solid performance, plus its close trade and investment links with Asian partners, could make a significant contribution to regional prosperity.

Michael Mussa, IMF Economic Counsellor and Director of the Research Department, led off a discussion of IMF policy in Asia by likening the IMF to a "macroeconomics doctor." IMF surveillance proffers sound analysis and advice to assist member countries in maintaining good macroeconomic health and financial stability and avoiding the (Continued on page 345)

(Continued from front page) supported by substantial financing from the World Bank and the Asian Development Bank, which have made notable contributions to the design of the program, particularly in the field of financial sector rehabilitation and structural reform. These institutions intend to contribute to the program through technical assistance and loans, with financing amounting to $4 1/2 billion and $3 1/2 billion, respectively. In addition, taking account of other expected contributions to the financing package, including the use of part of Indonesia's own substantial external assets, we arrive at a first line of financing of the order of $23 billion. At the same time, a number of important economies (including at this stage Australia, China, Hong Kong Special Administrative Region, Japan, Malaysia, Singapore, and the United States) have indicated that in the event that unanticipated adverse external circumstances create the need for additional resources to supplement Indonesia's reserves and the resources made available by the IMF, they would be prepared to consider making available supplemental financing in support of Indonesia's program with the IMF.

"After 30 years of sustained rapid growth and remarkable poverty reduction in Indonesia, this program ushers in ambitious reforms designed to equip Indonesia's economy for the challenges and opportunities of globalization in the coming decades.

"I am confident that this program and the strong support for Indonesian reforms provided by the international community will be of great benefit for the people of Indonesia, particularly the poorest," Camdessus said.

Strengthening the Framework For Financial Stability

Weak banking systems—whether in industrial, developing, or transition economies—can threaten financial stability and severely disrupt macroeconomic performance. As countries increasingly move toward removing remaining restrictions on their capital account transactions, and as banking assumes a more regional and international dimension, the cross-border impact of banking system problems is likely to increase. These considerations have prompted calls for concerted international action to promote banking sector stability and soundness. In response, several official bodies, including the Basle Committee on Banking Supervision, the Bank for International Settlements, the World Bank, and the IMF, have intensified their examination of ways to strengthen financial stability. The Basle Committee has been at the forefront of this effort with the recent release of its Core Principles for Effective Banking Supervision. These principles constitute a blueprint for enhanced banking supervision and have become the focal point for the effort to strengthen financial sectors around the world. They also provide the foundation for a proposed framework for financial stability developed by a staff team of the IMF, which is to be published in the IMF's World Economic and Financial Surveys series early in 1998. The objective of this framework, summarized below, is to enhance IMF surveillance over banking sector issues of macroeconomic significance.

Efforts to strengthen the financial sector must originate with the national authorities.

While the thrust of policy efforts to strengthen financial sector performance must originate with national authorities, the IMF—with its near-universal membership and responsibility to engage in surveillance of member countries' economic policies—has an important role to play in this area. The increase in IMF surveillance of financial sector issues will focus on identifying those weaknesses in financial systems—particularly in banking systems—that have major macroeconomic implications. As such, a framework for financial stability centers on maintaining the soundness of relatively large and complex banking organizations—those that have the potential to create systemic problems domestically or internationally.

The IMF can make a major contribution to an effective framework for financial stability by:

- enhancing its surveillance to cover developments in member countries' banking systems, particularly where they exhibit problems with the potential for generating serious macroeconomic disturbances;
- applying conditionality to the use of IMF resources to ensure that weaknesses in members' banking systems are dealt with in a timely and effective fashion; and
- providing technical assistance, together with the World Bank, so that member countries in the process of liberalizing their banking systems learn from the experience of others.

Key Aspects of the Framework

An unstable macroeconomic environment is a principal source of vulnerability in the financial system. Significant swings in the performance of the real economy and volatile interest rates, exchange rates, asset prices, and inflation rates make it difficult for banks to assess accurately the credit and market risks they incur. Moreover, banks in many developing and transition economies are less able than those in industrial economies to diversify these risks. Large and volatile international capital flows often add to the

challenges faced by banks in these countries. While IMF surveillance will seek to improve the macroeconomic framework, a structural framework for sound banking should also be supported by prudential and structural policies.

Improving Management. The first line of defense against unsound banking is competent management. Most bank failures stem from inadequate management that allows the bank to acquire low-quality assets and take inappropriate risk positions and fails to detect and resolve deterioration in existing assets and risk positions. Quantitative regulations, although important, cannot ensure that a bank is well run. As such, bank managers need a high degree of integrity, as well as adequate training and experience. A sound bank management appropriately delegates authority and applies prudent, well-documented credit approval and risk limitation and administrative procedures.

Increasing Transparency. Most bank assets are illiquid and lack an objectively determined market value, hindering a reliable assessment of a bank's financial condition. Bank managers are also often unable or unwilling to derive a realistic measure of a bank's impaired loan portfolio, and incentives for underreporting or concealing data on bad loans grow as a bank's financial situation deteriorates. Opaque financial data not only inhibit effective corporate governance, market discipline, and official oversight, but distort prudential, monetary, and macroeconomic analysis. Furthermore, the lack of hard data tends to encourage supervisory forbearance and makes the supervisory and judicial processes more vulnerable to political influences.

Sound banking therefore calls for timely and reliable information for use by management, supervisors, and market participants. Best practices include realistic valuation of bank assets as well as increased public disclosure and prudential reporting. To this end, the application of internationally recognized accounting standards—with particular attention to loan classification, provisioning, and income recognition rules and practices for their effective implementation—are desirable. Best practices in many countries typically go beyond disclosing traditional financial statements and provide other quantitative and qualitative information, such as the structure of the bank's ownership, risk concentration, and details of policies and practices of risk-management systems. Supervisors should have the right to request such data from banks upon reasonable notice.

Limiting Public Sector Distortions. If markets are to play an important role in disciplining bank managers and owners, there must be a presumption that financial assistance will not be provided automatically to troubled banks and that owners and large creditors will not be fully protected. The broad goal for public sector policy should be to leave enough room for markets to work well enough to allow a bank's funding cost to appropriately reflect the quality of its balance sheet. The proper role of central bank lender-of-last-resort facilities is to provide support promptly to illiquid but solvent institutions—typically at a penalty rate and against collateral—and to deny support to insolvent banks.

While the danger of precipitating a general loss of confidence makes it difficult to close large banks without fully compensating most depositors, it is almost always possible to make the owners and large creditors bear a substantial part of the financial burden of losses. Deposit insurance arrangements are designed to compensate some classes of depositors in case of individual bank failure. They are, however, prone to problems of moral hazard and need to be designed to contain such problems. Effective deposit insurance and lender-of-last-resort arrangements require a credible exit policy for problem banks. For exit to occur smoothly, the financial system must be sufficiently robust to limit the spillovers from the failing institutions to the rest of the system. Problem banks should therefore be closed before they become deeply insolvent and cause major losses for their creditors.

Controlling Risk Through Oversight. Bank regulation and supervision seek to limit the adverse impact of the official safety net on risk taking and to force banks to internalize the externalities of failures. The objective of such oversight should not be to guarantee the survival of every bank but to make sure that the banking system as a whole remains sound. Banking laws and regulations seek to establish policies that allow only financially viable banks to operate; limit excessive risk taking by owners and managers of banks; establish appropriate accounting, valuation, and reporting rules; and provide for corrective measures and restrictions on activities of weak institutions. As part of their general duty to promote financial stability, banking supervisors monitor the soundness of the banking system and the adequacy of banks, as well as risk management practices and financial data and their compliance with prudential regulations. To be effective, a supervisory authority must have sufficient autonomy, authority, and capacity. The supervision of individual banks is the responsibility of the national supervisory authority and is not an area that IMF surveillance would normally cover. Nonetheless, there are cases when inadequacy in the supervisory approach can be a cause of system weakness with macroeconomic consequences, thus making it a legitimate cause of inquiry.

The first line of defense against unsound banking is competent management.

Strengthening the Structural Framework. The structure and concentration of bank ownership may adversely affect the performance and stability of the system. The recent trend toward larger banks and financial conglomerates, for example, increases the potential for systemic risk, which in turn increases the need for official oversight. Market perception that institutions are too big to fail also undermines market discipline and, therefore, requires increased official supervision.

One of the issues relating to ownership concerns the desirability of state, private, or foreign ownership of banks. The track record of state-owned banks has frequently been poor. Nevertheless, these banks can operate efficiently if they conform to the same prudential rules as private banks and if they transfer their quasi-fiscal undertakings to the government budget. Since state banks in emerging markets rarely meet these conditions, privatization may be the best path to a sounder banking system—although private ownership in itself is no guarantee for good governance. Foreign-owned banks can introduce competition, professional skills, and new technology; but perhaps most important, they can reduce systemic risk because they tend not to be affected as readily by confidence problems as domestic institutions and are less likely to make claims on the official safety net.

Fostering Supervisory Coordination. The various sectors of the financial system are prone to interact with the banking system in a number of ways, and disturbances in one sector can easily spill over into the banking system. In many countries, banks and other parts of the financial system are typically regulated and supervised by different national authorities. Regulatory and supervisory policies and practices must therefore be harmonized as far as possible, to reduce the scope for contagion and regulatory arbitrage. In an environment of increasing internationalization of banking that tends to undermine the effectiveness of nationally focused prudential supervision through the use of complex corporate structures and offshore derivatives, additional efforts at international harmonization of regulatory standards and supervisory practices are also essential.

Much Work Remains

Neither external market discipline nor supervisors alone can assure a safe and sound banking system. It is the appropriate combination of the two elements that encourages the competent and effective management that leads to a sounder banking system. In many countries, however, supervisors are unable to guide management, owing to political interference or insufficient resources. Moreover, embryonic markets may fail to provide the needed market disciplining forces. Thus, improvements are required in all relevant areas. ■

How Effective Is Structural Adjustment?

Ten years after the IMF's Enhanced Structural Adjustment Facility (ESAF) was set up, the question is being asked: how effective has it been? To provide some answers, an IMF staff team recently completed a wide-ranging study of the experience of 36 countries under ESAF-supported programs (see IMF Survey*, August 5). In addition, the IMF's Executive Board commissioned a panel of external experts to evaluate the ESAF. The internal study was published in September 1997, and the external evaluation is expected to be completed later this year.*

An IMF Economic Forum, on September 9, addressed the question, "Structural Adjustment: What Does the Record Show?" The discussion was chaired by Jack Boorman, Director of the IMF's Policy Development and Review Department (PDR). Participants included two authors of the internal review—Susan Schadler and Hugh Bredenkamp, both of PDR—and Professor Mark Gersovitz of The Johns Hopkins University and David Beckman, President of Bread for the World.

The benefits of structural adjustment—although hotly disputed over the years—have been confirmed by an increasing body of evidence. Jack Boorman explained that the purpose of the internal review was to take stock of where ESAF countries are in the process of reform and what effects the reforms have had so far. He pointed out that the results of the internal study on ESAF-supported programs are encouraging, with improvements in economic performance and reductions in inflation and fiscal imbalances. Social indicators also improved in most countries: infant mortality rates have declined, life expectancy has increased, and most of the countries reviewed in the study have shifted toward a market orientation.

But these economies clearly needed to deliver faster and more sustainable growth if they were to bring living standards up to the level in other developing countries and make significant inroads into poverty. To achieve this, the review spelled out several key areas where policies need to be strengthened.

Catching Up with the Rest of the Developing World

ESAF countries share several distinct characteristics: they are among the poorest in the world; their economies are chronically weak; and they were buffeted by serious shocks during the late 1970s and early 1980s. According to Susan Schadler, the IMF's strategy to assist these countries is intended to establish a well-functioning economy and growth rates that will support their populations with improved living standards and without unsustainable reliance on external support. This strategy calls for policies that essentially level the

playing field for domestic residents and create a transparent environment in which people can make rational decisions about savings and investment, she said.

The record shows that economic growth did improve measurably in the countries with ESAF-supported adjustment programs, particularly in recent years, Schadler said. In fact, the gap between per capita growth in the ESAF countries and that in other developing countries shifted from about 2 percentage points in the early 1980s to a little less than 1 percentage point—"quite a noticeable shift," she observed. The investment and savings gap between the ESAF countries and other developing countries also narrowed noticeably, though saving, in particular, remains lower than in other developing countries, and the gains were not uniformly distributed through all the ESAF countries included in the sample.

It was true, Schadler acknowledged, that good luck and timing played a role in narrowing the gap in growth rates: the terms of trade improved and civil unrest eased, with favorable effects. But about half the narrowing occurred because of strong government action: "Macroeconomic and structural policies were stronger, and macroeconomic conditions were more stable," she said.

Given these encouraging signs, what else is needed, Schadler asked. ESAF countries are still less open to foreign competition than other developing countries and are less attractive to foreign investors. Also, policy needs to be more transparent. In the overall design of adjustment programs, Schadler emphasized, countries need to put more resources into human capital development—an area where ESAF countries still lag considerably behind other developing countries.

The goal of external viability—one of the ultimate objectives of ESAF-supported programs—is achieved through declining debt burdens, relative to national income or export earnings, and reduced dependence on "exceptional" financing such as debt relief. According to Hugh Bredenkamp, although about three-quarters of the ESAF countries surveyed have moved in the direction of external viability, progress has been disappointingly modest. Debt-service burdens have fallen in relation to exports—to about 26 percent in 1991–95 from about 28 percent in 1981–85—but much less so, if at all, in relation to national income. The burden on government budgets of servicing the debt remains severe in many countries. In fact, despite several years of adjustment and reform efforts, two-thirds of countries with ESAF-supported programs are now defined as highly indebted poor countries. Many of them may require extraordinary debt relief under the joint IMF and World Bank initiative to help highly indebted poor countries attain sustainable external positions.

The debt problem that continues to plague some ESAF countries raises the question of why these countries were not more successful in moving toward external viability under ESAF-supported programs. Part of the answer, Bredenkamp said, stems from differences in output growth and the growth of exports between strong and weak performers. "GDP growth in countries making clear progress toward external viability under the ESAF was a full 6 percentage points higher than those whose debt burdens were unchanged or worsened." This suggests that for the weak performers growth-oriented policies may not have been strong enough or implemented in a sustained fashion. One part of the solution, Bredenkamp said, is to boost saving by reducing budget deficits, but to do so in a "growth friendly" way. This means cutting spending in areas where durable savings could be realized, such as in the civil service and public enterprises, while protecting—or in some cases increasing—spending on health, education, and basic infrastructure.

Mark Gersovitz (left), Susan Schadler, Jack Boorman, Hugh Bredenkamp, and David Beckman respond to questions at the Economic Forum on structural adjustment.

Broadening the IMF's Agenda?

An important theme that emerged from the Economic Forum was whether the IMF's traditional mandate was too narrow to address the needs of countries requiring assistance under the ESAF and whether the IMF was equipped to deal with issues that went beyond sustained growth and external viability. The IMF certainly considered it of "enormous importance" that the benefits of growth be shared among the entire population, Boorman said. In its advice to member countries, the IMF emphasizes reorienting budget resources to critical expenditures and helping countries design social safety nets to protect those segments of the population that may suffer initially from the effects of the reform process.

In Mark Gersovitz's view, ESAF-supported programs represent a changing—or at least a broadening—of the IMF's mandate. But he expressed concern about the IMF's ability to act effectively within this broadened

mandate. The goal of achieving strong economic performance in countries with ESAF-supported programs is subject to constraints, the most important of which is the budget constraint. Since external support is not a permanent resource, countries cannot live beyond their means and governments cannot, therefore, run deficits indefinitely. Government financial balance is thus a major, overriding objective. Inflation is another concern, since it also reflects "living beyond one's means." The same holds true for liberalized trade and exchange policies, which imply uncontrolled domestic interest rate policy and prices and further threats to the government's financial balance.

To illustrate how an issue could lead the IMF into areas beyond its mandate, Gersovitz cited public enterprises. Inefficient enterprises are certainly a constraint on the budget that would be directly affected by the need for spending cuts. An appropriate policy prescription would therefore be to move toward privatization. But the move to privatization raises many additional issues. For instance, it is important that assets not be sold at a discount to individuals with political connections or to other insiders. Privatizing monopolies without making provision for competition can also cause problems. As the IMF moves away from the external constraints with which it has traditionally been concerned and into areas that are removed from its original mandate, it will have to worry about a whole new set of problems. "I do worry that this has been a less articulated agenda than is perhaps desirable," Gersovitz concluded.

Social concerns, such as health and education, have been getting increased attention in IMF-supported programs, Boorman acknowledged. The IMF can certainly appreciate the need to protect health and education spending in budgets and, in fact, tries to press countries to do that. "But we are not experts in health and education spending," he stressed, and these issues require considerable coordination among all the interested parties. There is also concern that the IMF would have to go way beyond its mandate if it were to involve itself in what were perceived as strictly sovereign national issues.

David Beckman argued, however, that the IMF's mandate was too narrow. He said the IMF was "like a Cyclops," who has one eye and sees very clearly out of that one eye. But other things are happening in ESAF countries that the IMF does not see. Even the internal report did not, according to Beckman, "tell the whole story." In his view, it was important for the IMF to engage with nongovernmental organizations (NGOs) around the world, "since their main concern is with unmet human and moral issues." The IMF did not have to be an expert on the whole range of human concerns, but discussions with grassroots organizations would bring an array of issues to the surface. ■

Gita Bhatt
IMF External Relations Department

IMF Institute Expands Its Services At Home and Abroad

Mohsin Khan, Director of the IMF Institute since December 1996, recently spoke with the IMF Survey *about the Institute's expanding activities. The Institute offers training in economic management to government officials from all IMF member countries as well as in-house training for IMF economists. Khan, a Pakistani national, was Deputy Director in the IMF's Research Department before assuming his present position.*

In the Asia-Pacific region, the demand for training is growing rapidly.

IMF SURVEY: *The IMF has recently joined with the government of Singapore to establish a training center in Singapore for Asian government officials, similar to the Joint Vienna Institute (JVI), which was set up to train officials from transition economies in the Baltics, Russia, and the other countries of the former Soviet Union. Why is a second regional training center necessary and what training priorities do you have for Asian government officials?*

KHAN: The practicalities of being able to meet the growing demand for training of government officials dictated that we develop ways to provide more training opportunities than we currently have room for at headquarters. For example, for each place in a course we generally have three to four applications. Setting up regional training centers is one solution. The motivating idea behind the JVI was essentially to meet the huge demand for training government officials from the transition countries. As demand continues to grow, the idea of setting up external training centers has extended into other regions. In the Asia-Pacific region, the demand for training is growing rapidly. The IMF-Singapore Regional Training Institute (STI), which will begin operations in May 1998, should help meet some of that demand.

The idea of a regional center in Singapore first came up late last year—actually before I came to the Institute—during a meeting between IMF Managing Director Michel Camdessus and Richard Hu, Singapore's Minister for Finance. This suggestion led to extensive discussions during the spring and summer, which came to fruition at the 1997 Annual Meetings

when the Managing Director and Singapore's Minister for Finance signed the memorandum of understanding creating the STI. The IMF Institute is responsible for administering the Singapore Training Institute, which will cover the Asia-Pacific region. Its main function is to train government officials in the same areas that the IMF Institute trains government officials at headquarters and overseas.

IMF SURVEY: *What sort of cooperation do you envisage between the Singapore Training Institute and the IMF's newly established Regional Office for Asia and the Pacific in Tokyo?*

KHAN: They will collaborate closely. Indeed, Kunio Saito, Director of the Regional Office for Asia and the Pacific, has been involved at all stages in the creation of the STI. The regional office will identify issues, countries, and even participants that it feels ought to come to the courses offered by the Institute. In particular, I intend to rely on the IMF's Asia regional office to identify topics and areas that the courses should focus on. After all, the Asia office is well placed to know the training needs in Asia.

IMF SURVEY: *The JVI is tentatively scheduled to cease operations at the end of 1998. How successful has it been and what are the chances for extending its life beyond the five years originally envisaged?*

KHAN: The JVI— a joint effort, sponsored by the IMF with the World Bank, the Bank for International Settlements, the Organization for Economic Cooperation and Development, and the European Bank for Reconstruction and Development—has been a great success. Earlier this year, I attended a "brainstorming" meeting in Vienna, which brought together representatives from the JVI sponsoring institutions and the host country, as well as former participants and government officials from the region, to talk about the future of the JVI. There was unanimous support for what the JVI had done and for its continuation.

The next step is for the sponsoring organizations to agree formally whether to support the JVI's continuation beyond 1998. The JVI Board recently commissioned an independent evaluation, and the results strongly confirm the value of the JVI for the training needs of the transition countries. Basically, people are very pleased with what the JVI has done so far. More important, as I mentioned earlier, the demand for the type of training the JVI provides continues to grow. There is also support for a change, or broadening, of the curriculum—for example, to offer more advanced training for officials from countries in Eastern Europe whose requirements have moved beyond the basic training currently available. At the same time, respondents in many countries have indicated that they still need basic training.

The curriculum of the JVI will probably change, but there is no question in my mind that it will continue to fill a need not being met elsewhere. Many government officials have received training from JVI, but more and more—especially young people—are entering government service, and they need training. I do not think anyone would like to see the JVI stop operations at the end of its first five years.

Khan: There is no question in my mind that the JVI will continue to fill a need not being met elsewhere.

IMF SURVEY: *What efficiencies and training enhancements have technology and the Internet made possible?*

KHAN: Technology has been a major help, even though we have not yet exploited it fully. A principal innovation has been interactive videoconferencing, which we often use between headquarters and the JVI. It is now quite easy to have somebody like IMF First Deputy Managing Director Stanley Fischer give a lecture in Washington for a course going on in Vienna. It would be difficult for us to get him to Vienna to give a lecture, but it takes only about an hour and a half of his time here. We plan to use videoconferencing extensively in conjunction with the courses at the STI.

We are not using the Internet as yet, but the Institute has a major project under way to examine the issue of distance learning through the Internet. Eventually, I think the Internet will be an integral part of the way we communicate with our participants. I say "eventually," because despite the major advances in technology, not everyone has access to the Internet, or, for that matter, to computers, or, sometimes, even to reliable telephone lines. This is true for many of our member countries where we have training operations. So, one has to proceed carefully and cautiously. We may have the technology available to us, but in many cases we need to wait for the development of the necessary technology at the receiving end.

IMF SURVEY: *The Institute has begun to recruit outside instructors for some of its courses for government officials How are these instructors selected and has this practice helped to broaden the IMF staff's analytical perspective?*

KHAN: In the past, Institute courses for member country officials were taught almost exclusively by IMF staff—usually Institute staff. I thought it might be a good idea to invite some of the people who have taught our internal training courses to lecture on specific issues to participants in the Institute's courses. I believe this will have an important beneficial effect on the quality of the training that we offer, because these people are at the forefront of their particular area of interest. So far, the feedback from participants has been overwhelmingly positive.

IMF Managing Director Michel Camdessus (left) and Singapore's Minister for Finance Richard Hu in Hong Kong, China, after signing the memorandum of understanding creating the STI.

We pick topics for which we think an outside speaker would be appropriate. In selecting outside lecturers, we tend to favor academics who are former IMF staff members. The advantage is twofold. First, in addition to being current with the latest in research in their particular field, they are also in the teaching business. Second, as former IMF staff members, they have firsthand, inside knowledge of how the IMF works, what its mission is, and what information participants need and want. They can understand the questions and concerns that participants raise, either in terms of specific country experience or more generally. Fortunately for us, there are several former IMF staff at first-rate universities around the world, so we have a reasonable pool to choose from.

We are facing many new issues, including capital account liberalization.

IMF SURVEY: *Do you sense any change in or broadening of the Institute's mission within the next few years in line with new issues facing the IMF and its member countries? Are there any particular directions in which you would like to see the Institute move?*

KHAN: Certainly we are facing a number of new issues, including the ramifications of capital account liberalization and financial market developments. Another big issue is what the Managing Director has called "second-generation reforms." Training both IMF staff and government officials in the area of second-generation reforms has become a very high priority. We need to identify specific topics for training that fall under the general umbrella of second-generation reforms. This is not easy because although people in the IMF are very familiar with mainstream macro topics—and I would have no problem finding someone to teach a course in, for example, exchange rate policy—it is more difficult to organize a course on poverty alleviation or institutions and development, simply because we do not know the field or the people working in it. One of the main challenges for the Institute, in fact, is how to deliver training in these new areas both to IMF staff and to participants and to find the right teachers.

Another direction I would like to see the Institute move in is in broadening our audience. When I came to the Institute, we had a pretty good handle on the mainstream courses we were offering junior and mid-level government officials. We also offer high-level seminars for central bank governors, ministers, and deputy ministers. What was missing were courses directed to a core group of senior officials in central banks and in ministries. I felt we should offer this group short-term mini-courses on certain specialized topics of interest to them. We are in the process of organizing week-long courses in exchange rate policy, inflation targeting, and second-generation reforms for next year.

In addition to broadening our audience and our curriculum, the Institute is also expanding physically through the creation of other institutes around the world, along the lines of the JVI and the new STI. We are looking at several possibilities, including more collaborative efforts with partner institutes.

I would like to see the Institute continue to move simultaneously in two directions: improving the quality of our product and increasing the number of officials we train. The principal means we are employing to achieve these goals, as we have focused on here, are recruiting high-quality economists to teach in a variety of areas and developing mechanisms, such as the new institute in Singapore and distance learning, to help deliver the product to a wider group of people. ■

Seminar Focuses on Fresh Perspectives on Asia

(Continued from front page) accidents or bad habits that may contribute to poor health. IMF financial support to members experiencing macroeconomic difficulty complements their adjustment programs aimed at restoring good macroeconomic health. Typically, however, the period of recuperation can be uncomfortable.

Mussa pointed out two limitations. First, although the international community agrees on the broad policies that promote rapid and steady economic growth—low inflation, financial stability, and social progress—the economics profession, like the medical profession, has no magic formula for achieving the desired goals. Both must continuously strive to extend, revise, and apply the body of relevant professional knowledge. Second, the IMF "does not, cannot, and should not determine or dictate the economic policies of its members." Even for countries negotiating the terms of an adjustment program meriting IMF financial support, economic policies depend largely on the authorities' judgment of what is desirable and feasible and on the willingness and capacity of the political system to pursue appropriate policies.

Montek Singh Ahluwalia, India's Finance Secretary, emphasized the increasing complexity of the IMF's work. The IMF now considers a multiplicity of national policy objectives that compel it to go beyond its traditional "grandmotherly" advice to contain the fiscal deficit and money supply. The world economy has also changed. The shift from a par value system to one with a variety of flexibly managed exchange rate regimes has tended to reduce discipline and postpone adjustment. More recently, the emergence of large capital flows not only increases the size of a possible shock, should a country fail to adjust, but poses the risk of a large shock unrelated to conditions in the country itself. Ahluwalia advised the IMF to assess rigorously the financial fragility of members' economies.

Andrew Sheng, Deputy Chief Executive of the Hong Kong Monetary Authority, urged more consideration of the quality of financial assets. Sound microeconomic policies—including for the payments system and the financial supervisory and regulatory system—and transparency of information were as essential as sound macroeconomic policies.

Vito Tanzi, Director of the IMF's Fiscal Affairs Department, and Jack Boorman, Director of the IMF's Policy Development and Review Department, summarized recent changes in IMF policies. Tanzi reminded participants that IMF fiscal policy recommendations extend well beyond a deficit target. Since the early 1980s, he said, the IMF has recognized that the composition of expenditure and revenue policies affects not only the sustainability of deficit reduction but the social sustainability of adjustment programs and their impact on inequality and growth. Accordingly, the IMF recommends adopting more growth-oriented tax policies and better targeted social outlays as well as cutting unproductive spending and improving fiscal transparency.

Boorman reported that the IMF was adapting to a fast-changing international environment in which the role of national governments and the benefits and risks of globalized markets were being reassessed. The adaptations include:

- strengthening country surveillance to help ensure stability;
- helping to strengthen the operation of global financial markets;
- providing policy advice and financial assistance quickly when crises emerge; and
- helping to ensure that no member country is marginalized.

> *The IMF does not determine or dictate the economic policies of its members.* –Mussa

Commenting on the points raised by Mussa and Tanzi and Boorman, Hashbat Hulan, Chair of the Mongolian Parliament's Social Policy Committee, noted that Mongolia was striving to achieve massive economic restructuring while addressing social needs and building democratic institutions. She urged the IMF to increase the flexibility and political sensitivity of its policy recommendations to Mongolia and other transition economies.

Jesus Estanislao, President of the University of Asia and the Pacific and formerly Secretary of Finance of the Philippines, said he wished the IMF had adopted its "more holistic" view sooner. He advised protecting crucial social and infrastructure expenditures during adjustment but also saw a need to undertake major structural reforms, even in periods of economic instability, to achieve long-term economic growth.

Angela Wood of the Bretton Woods Project asked how the IMF's changing role would mesh with the World Bank's expertise and responsibilities. Boorman responded that the IMF must reach out not only to the Bank but also to other institutions with relevant expertise and make certain IMF economists can draw upon that knowledge. The IMF cannot develop expertise itself in all areas, but it must develop closer cooperation with other institutions and carry out collaborative efforts in ways less burdensome on national authorities.

Stanley Fischer, First Deputy Managing Director of the IMF, discussed the IMF's role in promoting capital market liberalization at a luncheon co-hosted by the Hong

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

Kong Monetary Authority (see *IMF Survey*, October 20, page 321). Fischer pointed out that liberalization can bring major benefits to countries, but acknowledged that it increases an economy's vulnerability to swings in market sentiment. Fischer said that countries can reduce their vulnerability by pursuing sound macroeconomic policies, strengthening the domestic financial system, and phasing capital account liberalization appropriately. The

Recent IMF Publications

Working Papers ($7.00)

97/125: *Globalization and Growth Prospects in Arab Countries*, Patricia Alonso-Gamo and others. An analysis of the empirical relationship between integration and growth in Arab countries, concluding that integration is necessary if high growth rates are to be attained and the region is not to become marginalized.

97/126: *Exchange Rate Volatility, Pricing to Market, and Trade Smoothing*, Peter B. Clark and Hamid Faruqee. An investigation of the consequences of exchange rate volatility on the variability of export prices and quantities in the presence of market segmentation and pricing to market.

97/128: *Cyclical Fluctuations in Brazil's Real Exchange Rate: The Role of Domestic and External Factors*, Pierre-Richard Agénor and others. An examination of the effects of capital inflows and domestic factors on Brazil's real exchange rate.

97/129: *Intergovernmental Fiscal Relations: The Chinese System in Perspective*, Vivek B. Arora and John Norregaard. An overview of recent Chinese reforms to introduce a modern system of fiscal federalism that balances the need for central macroeconomic control with the economic advantages of decentralized government.

97/130: *The Scope for Inflation Targeting in Developing Countries*, Paul R. Masson and others. A consideration of the wider applicability of inflation targeting to developing countries.

97/131: *Can Switching Between Inflationary Regimes Explain Fluctuations in Real Interest Rates?*, Michael Bleaney. An assessment of the merits of the regime-switching theory as an explanation for the apparent fluctuations in real interest rates in Australia, Canada, Germany, the United Kingdom, and the United States.

97/132: *Time-Series of Structural Import Demand Equations: A Cross-Country Analysis*, Abdelhak Senhadji. Derives a structural import demand equation and estimates it for a large number of countries, using recent time-series techniques that address the problem of nonstationarity.

97/133: *Fiscal Policy and the Predictability of Exchange Rate Collapse*, Betty C. Daniel. A study of the predictability of exchange rate collapse finds that when a policy change violates the fiscal constraint imposed by short-term viability, collapse is instantaneous.

97/134: *External Finance and Foreign Debt in Central and Eastern European Countries*, Stefano Manzocchi. Analyzes the determinants of net external borrowing in ten transition economies during 1990–95 and assesses the impact of the outstanding stock of foreign liabilities on net financial inflows.

97/135: *Macroeconomic Cycles in China*, S. Erik Oppers. An investigation of the macroeconomic cycles China has experienced since the onset of reform in the late 1970s.

97/136: *Implications for Savings of Aging in the Asian Tigers*, Peter S. Heller and Steve Symansky. A study suggesting that initially the Asian tigers could become increasingly important for world savings; after 2025, aging populations in the Tigers may reinforce the tendency toward a declining world saving rate.

97/137: *Labor Market Institutions and Unemployment Dynamics in Transition Economies*, Pietro Garibaldi and Zuzana Brixiova. A study of the interactions between labor market institutions and unemployment dynamics in transition economies.

97/138: *Transparency and Ambiguity in Central Bank Safety Net Operations*, Charles Enoch and others. A study of the relative roles of transparency and ambiguity within the scope of the financial safety net.

97/139: *Corruption, Public Investment, and Growth*, Vito Tanzi and Hamid Davoodi. An analysis using cross-country data and regression analysis that examines the impact of corruption on economic growth.

97/140: *Banking Crises in Latin America in the 1990s: Lessons from Argentina, Paraguay, and Venezuela*, by Alicia García-Herrero. Finds that the Latin American countries that responded to banking crises with rapid, consistent, and comprehensive policies reduced the negative macroeconomic consequences of such crises.

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IMF has been helping by improving the quality and dissemination of information to markets, providing timely surveillance of market developments and national policies, and lending in crises.

Asian Challenges

Turning to Asia's economic record and challenges for sustaining growth, Professor Kazuo Ueda of the University of Tokyo hypothesized that East Asia's recent difficulties were caused in part by earlier successes. A large share of the investment boom had consisted of direct investment from Japan—a shift of manufacturing capacity encouraged by sharp yen appreciation lasting until 1994. When the yen subsequently depreciated, East Asia (with the notable exception of China) faced deteriorating competitiveness. Gradual recovery should be feasible, Ueda said, if structural adjustment accompanies continuation of already strong economic fundamentals, high savings rates, and openness of East Asian economies.

Commenting on Ueda's presentation, Ross Garnaut of the Australian National University suggested that the 1997 crisis originated in short-term economic policy mismanagement—mainly exchange rate misalignment—not long-term structural factors. Garnaut believed that strong growth and structural change in China could continue to sustain strong growth in East Asia's developing economies.

Noordin Sopiee, Chairman of the Institute of Strategic Studies in Kuala Lumpur, emphasized East Asia's lengthy record of successfully overcoming major economic obstacles and achieving rapid growth. He agreed with an earlier comment by Mussa that "complacency is the mother of crises." The Thai crisis had been a timely wake-up call to East Asian countries to refocus on improving productivity and competitiveness.

Young-Ki Lee, Vice-President of the Korea Development Institute, also saw future growth as dependent upon increasing manufacturing productivity. Labor force skills should be improved and investment in science and technology increased. Governments should remove outdated regulations, allowing the private sector to lead in boosting productivity.

Peter Sutherland, Chairman of Goldman Sachs International and former Director-General of the World Trade Organization, said the key challenges for sustaining Asian growth were further development of domestic capital markets and deregulation of financial services. Current financial difficulties in Asia were exacerbated by existing financial structures and regulatory regimes. Liberalization of financial services should produce strong financial systems, reduce risks, and make currency volatility manageable. According to Sutherland, studies showed that opening domestic financial services markets to foreign providers leads to more efficiency, better access to foreign capital, better domestic financial services, and better financial infrastructure, regulation, and supervision. Liberalization can dramatically improve developing countries' access to equity and debt financing. More efficient capital distribution, greater market liquidity and depth, plus positive spillover effects on savings and investment and allocation of resources can stimulate economic growth, Sutherland argued.

Pisit Leeahtham, Executive Vice President of Bangkok Bank, agreed that weaknesses in Thailand's financial sector had contributed to the crisis. Sound banking and closer domestic regulation and supervision should accompany financial market liberalization.

Teh Kok Peng, Deputy Managing Director of the Monetary Authority of Singapore, shared the consensus view that the basic factors supportive of Asian economic growth remained and were buttressed by a consensus on sound macroeconomic policies. With the addition of better managed exchange rates, strengthened financial systems, and greater attention to improving labor force skills, the remarkable growth record could be extended into the future.

The seminar concluded with personal recollections on the evolution of Asian economies and the IMF's role by P. R. Narvekar, a former IMF Deputy Managing Director, currently Special Advisor to the President of Nikko Securities. Narvekar thought the IMF's interaction with Asian countries would continue to be substantive and weighty. With a billion people still living in poverty and income inequality appearing to rise in several Asian countries, the IMF's increasing attention to such issues in its policy advice should only be welcomed by their authorities. ■

Robert W. Russell
IMF External Relations Department

The text of Narvekar's remarks and those of most other speakers are available on the IMF's external web site (www.imf.org/external/am/focus.htm).

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
October 20	4.14	4.14	4.54
October 27	4.19	4.19	4.59

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

IMF Evaluation Is Broad and Continuous

The IMF Survey *spoke with Eduard Brau, Director of the IMF's Office of Internal Audit and Inspection, about how the IMF learns from its experience and evaluates its policies and procedures.*

IMF SURVEY: *How does the IMF evaluate its effectiveness?*

BRAU: Evaluation is about learning, improving results relative to objectives, and translating feedback and error correction into more effective performance. It can be done well in different ways. The IMF has long had a culture of vigorous debate and continuous learning. Close scrutiny, review, and debate precede the submission of policy recommendations to member governments or to the IMF's management or Executive Board. This is intrinsic to the organization, and one of the pillars of its strength. The IMF's internal review process seeks to mobilize the best available advice and serves as a system of checks and balances.

Brau: The IMF has long had a culture of vigorous debate and continuous learning.

When the IMF commits financial resources to a member or draws a conclusion from its surveillance of a member's economic policies, these decisions are approved by its 24-member Executive Board, which represents all 181 member countries. Board proposals are scrutinized by a representative of the country's government, representatives of other governments, and the authorities and independent resources behind them.

Periodically, the Board steps back and takes stock of what has been learned from country experiences. All basic policies, ranging from the use of IMF financial resources to policy surveillance, are periodically reviewed by Executive Directors. Reviews are sometimes preceded by, or conducted in parallel with, conferences with academic advisors.

The review process also relies on input from outside experts. On specific countries, IMF departments may invite country specialists outside the organization to contribute their views. Some observers see the IMF as a doctrinaire or monolithic institution. But the IMF prides itself on speaking with one voice when it advises a country or assists in the design of an adjustment program. This single voice is the product of robust debate and a careful, and extensive, review process.

IMF SURVEY: *Who is responsible for evaluating various aspects of the IMF's work?*

BRAU: The IMF's evaluation process has five principal actors: the staff, an Audit Office, an External Audit Committee, external evaluators, and ad hoc evaluators. The first two—the staff and the Office of Internal Audit and Inspection—are mechanisms that are built into the internal functioning of the IMF.

For 30 years, staff of the IMF's Policy Development and Review Department (PDR)—a department responsible for ensuring the consistency of IMF policy advice—has reviewed the organization's experience and provided the Board with reports on IMF-supported adjustment programs. Recently, for example, PDR's staff examined the IMF's experience with programs under the Enhanced Structural Adjustment Facility (ESAF) [see page 340]. This solid, candid review will be available in the IMF's Occasional Paper series. These ESAF reviews take place every four years and provide the Board, management, staff, and the public with an assessment of the ESAF's effectiveness in promoting structural reform and growth in developing countries.

In 1995, PDR evaluated programs supported by the IMF's Extended Fund Facility (EFF) and Stand-By Arrangements to determine their impact on growth. A year earlier the IMF carried out a periodic evaluation of its technical assistance program, which consumes substantial staff resources. The findings of the EFF and Stand-By study were published; the results of the technical assistance review were not.

Every two years, PDR and Research Department staff also prepare a review for the Board on the quality and effectiveness of IMF surveillance. The highlights appear in the IMF's *Annual Report*. A theme that emerged during the Board's 1997 surveillance review was a concern for greater transparency. The Board discussion paved the way for the introduction of Press Information Notices (PINs). PINs contain the conclusions of the Board's discussion of the IMF's Article IV (surveillance) consultations with individual countries; they are issued voluntarily at the behest of the country concerned.

The IMF's Office of Internal Audit and Inspection, which is staffed with auditors, economists, and business process experts, is charged with a broad range of responsibilities. These include:

- Financial audits, which review the accuracy of the IMF's financial statements.
- Internal organizational reviews, carried out at the request of management, which examine whether the IMF is organized and carrying out its responsibilities in the most efficient manner possible. The audit office is currently assessing the efficiency of all the IMF's administrative and support services and is assisting departments with work practice reviews.
- Effectiveness reviews are carried out at the request of management and the Board. The first such report, in 1997, provided a candid evaluation of the function and

work of the IMF's resident representatives in some 65 member countries. The next study will review all IMF-supplied technical assistance.

IMF Survey: *In what instances does the IMF use external auditors and evaluators?*

Brau: In the audit area, it is standard practice to use external auditors to give added credibility to the audit process. The IMF employs external auditors—a committee of three professional auditors nominated annually by the Executive Board and assisted by a well-known public accounting firm—who annually certify the accuracy of its financial statements. Traditionally, this process goes beyond a review of financial statements and entails substantial disclosure of information, including in the notes to the financial statements.

From time to time, the IMF has also gone outside the organization to seek an expert and independent evaluation of its effectiveness. In 1995, for example, the Monetary and Exchange Affairs (MAE) Department employed external experts, with no ties to the IMF, to evaluate its technical assistance. The report made a range of recommendations reviewed by the Executive Board and subsequently adopted by MAE.

IMF Survey: *Are any major external evaluations currently under way?*

Brau: The IMF is engaged in a wide-ranging pilot project using external evaluators. Over the course of this two-year experiment (1997–98), the Executive Board will choose the topics, set the terms of reference, and select the outside experts who will conduct studies on the basis of unrestricted access to IMF information and report their findings to the Board. During this pilot phase, up to two to three evaluations will be carried out each year. The first study, evaluating several aspects of ESAF, is in full swing. Jan Willem Gunning of the University of Amsterdam and Paul Collier of Oxford University are examining social expenditure policies under ESAF; Koichi Hamada of Yale University is evaluating external payments viability; and Kwesi Botchwey, now of Harvard University and formerly Minister of Finance of Ghana, is looking at national ownership of IMF-supported programs. By design, this study parallels the internal evaluation of ESAF, and the evaluators are encouraged to tap a wide circle of views on ESAF, including those of nongovernmental organizations. Their conclusions will be available at the end of the year, and the Board may well decide to publish their report.

Executive Directors have begun considering further topics for external evaluation. One possible topic is the impact of IMF surveillance advice on the policies of countries not using the IMF's financial assistance. Other possible topics for evaluation might include the IMF's involvement in financial sector reform and the status of reform in transition economies.

IMF Survey: *Are there any other circumstances in which an external evaluation is done?*

Brau: Infrequently, the IMF has used external evaluation on an ad hoc basis. In the aftermath of the Mexico crisis, the Managing Director asked Alan Whittome, a former director of the IMF's European and PDR Departments, to conduct a review to determine why the IMF had failed to see the strains in the Mexican economy earlier and better, and what lessons could be learned. This influential report led to substantial reforms, including the IMF's initiatives on better dissemination of country data.

IMF Survey: *Should the IMF have an evaluation department?*

Brau: The Executive Board has spent years debating how best to evaluate the organization's work. A 1992 task force recommended the creation of an evaluation office. The recommendation came at a time when the IMF's staff and operating budget were under substantial strain from the intensive demands of the transition economies, and the proposal was not implemented.

IMF Survey: *What are the relative merits of internal and external evaluation?*

Brau: Ultimately, evaluation is about learning. Staff do the bulk of the learning, and they need incentives to learn. Is an external evaluation, while independent, as likely to have its findings as thoroughly or as deeply absorbed as an internal study whose staff have gone through the "learning process" and the discipline of publishing their findings? Well-focused external evaluation can, of course, be very helpful. The organizational efficiency reviews currently being carried out by the audit office bring in recognized outside experts to compare our processes to first-rate standards; this establishes benchmarks and counteracts complacency.

IMF Survey: *Is there a consensus view within the IMF on how the work of the IMF should be evaluated?*

Brau: The Executive Board appears reluctant to grant a monopoly on evaluation. Would, for example, an evaluation department monopolize the evaluation process? Would external evaluators still be welcome? Would it replace staff reviews? Management and staff believe internal reviews are essential for policy development. With a number of questions and few clear answers, the Board thought it prudent to set up this experiment with external evaluation. It will review the results before further steps are taken.

There seems to be a consensus in the Board, though, that there should continue to be a strong process of internal evaluation. The Board can then, where it seeks another view on a well-defined topic, look to independent outsiders for a "second opinion." Independent external evaluators, with unrestricted access to IMF information, may be able to provide just such an analysis. ■

From the Executive Board

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

Algeria: Article VIII

The government of Algeria has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, with effect from September 15. 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 141 countries have now assumed Article VIII status.

Algeria joined the IMF on September 26, 1963. Its quota is SDR 914.4 million (about $1.3 billion).

Press Release No. 97/47, October 16

Pakistan: ESAF/EFF

The IMF approved a three-year financing package for Pakistan equivalent to SDR 1.1 billion (about $1.6 billion) in support of its medium-term adjustment and reform program. Of this amount, SDR 682.4 million (about $935 million) is available under the Enhanced Structural Adjustment Facility (ESAF), and SDR 454.9 million (about $623 million) under the Extended Fund Facility (EFF). Of the total, SDR 151.6 million (about $208 million) is available immediately.

Pakistan: Selected Economic Indicators

	1995/96	1996/97[1]	1997/98[2]	1998/99[2]	1999/2000[2]
			(percent change)		
Real GDP growth	4.6	3.1	5.5	5.8	6.0
Consumer price index (annual average)	10.8	11.8	10.5	9.0	7.0
			(percent of GDP)		
Overall fiscal balance	–6.9	–6.1	–5.0	–4.5	–4.0
External current account balance (excluding official transfers)	–6.8	–6.4	–5.1	–4.8	–4.2
			(weeks of imports)		
Gross international reserves	8.2	5.2	7.0	10.0	13.0

[1]Preliminary.
[2]Program.

Data: Pakistan authorities and IMF staff estimates

Medium-Term Strategy and the 1997/98 Program

The macroeconomic objectives for the three-year program period (1997/1998–1999/2000) are to raise the average annual growth rate of real GDP growth to the 5–6 percent range (from 3.1 percent in 1996/97); to progressively reduce annual inflation to about 7 percent (from 11.8 percent in 1996/97); and to reduce the external current account deficit (excluding official transfers) to the range of 4.0–4.5 percent of GDP (from 6.4 percent in 1996/97), with a view to substantially strengthening the external reserve position. The policy actions in the key fiscal area are designed to cut the overall budget deficit to 4.0 percent of GDP by the third year of the program (from 6.1 percent in 1996/97).

In line with the medium-term strategy, the program for 1997/98 seeks to raise the growth rate of real GDP to 5.5 percent; reduce the year-on-year inflation to 10.5 percent; and bring down the external current account deficit to 5.1 percent of GDP. To achieve these objectives, the budget deficit will be contained to 5.0 percent of GDP.

Structural Policies

The government's strategy is to rationalize the public sector further, shifting more of the primary productive role to the private sector, and to strengthen local institutional capacity. In the public sector, the domestic tax base will be broadened, tax administration strengthened, government expenditure shifted toward the social services and human capital formation, and key public enterprises restructured.

Social and Environmental Policies

Public expenditure on the social sectors is projected to rise significantly during the program period. The program emphasizes improvements in the areas of education, health care, population welfare, and family planning. To address environmental concerns, the following steps will be taken over the program period: enactment of the Environmental Protection Law; development of provincial capabilities for enforcement, including development of systems for enforcing pollution controls and assessing pollution's environmental impact; and implementation of popular environmental awareness programs.

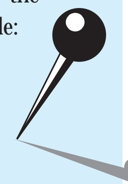
Pakistan joined the IMF on July 11, 1950. Its quota is SDR 758.2 million (about $1.0 billion). Pakistan's outstanding use of IMF financing currently totals SDR 871 million (about $1.2 billion).

Press Release No. 97/48, October 20

Press Information Notices

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

Paraguay, No. 97/29, October 22
Grenada, No. 97/30, October 22
Madagascar, No. 97/31, October 28



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

A Formula for Asian Monetary Cooperation

In this year's Per Jacobsson Lecture, Joseph C. K. Yam, Chief Executive of the Hong Kong Monetary Authority, argued for greater monetary cooperation in Asia and suggested a strategy and agenda for such cooperation. Edited excerpts follow below.

Let me spell out how I think monetary cooperation in Asia should proceed. First, we must have clearly defined and realistic common goals. Notwithstanding increasing economic integration, the Asian economies are a diverse group in many respects. Reflecting this diversity, there are also dramatic differences in policies in terms of the objectives pursued and approaches used to achieve these objectives. With monetary policy, although there seems to be a clear consensus on the desirability of maintaining currency stability, there is great diversity on the degree of clarity with which this is defined. Given the differences in the economic and financial structure, on the one hand, and differences in policy objectives and approaches, on the other, the monetary transmission mechanism of Asian economies and their monetary reactions to internal and external shocks are also quite different.

How then should Asian economies pursue regional monetary cooperation? The extent of the diversity in Asia's economies clearly points to the inappropriateness of monetary integration, at least for the time being. Realistically, Asian monetary cooperation will have to be pursued in a multicurrency environment. Asian monetary cooperation is not about monetary integration. There has been no attempt to identify the pros and cons of monetary policy coordination. The contagious turmoil in the currencies and financial markets of Asia, however, will stimulate some interest in it. I expect some initiative in putting the matter on the agenda for future discussions among monetary authorities in the region.

By contrast, there is much enthusiasm among monetary authorities of the region for promoting Asian monetary cooperation when it does not inhibit the freedom to determine domestic policies. I am sure, for example, that we would be keen to discuss how to strengthen our monetary defensive mechanisms against attacks on our currencies, and how to enhance the pain tolerance level of our financial systems so that we can absorb financial shocks more effectively. There is also considerable interest in building more robust financial infrastructures—on the one hand, to facilitate effective financial intermediation, and, on the other hand, to limit the contagion effect of financial crises domestically and on a regional basis. I believe this is a sensible way forward, at least for now.

At the EMEAP [Executives' Meeting of East Asia Pacific Central Banks] forum, monetary authorities have examined the whole spectrum of central banking functions quite comprehensively and have identified issues where monetary cooperation would be beneficial. Before going into these issues, let me make two points about the approach that should be adopted in Asian monetary cooperation. First, Asian monetary cooperation must be considered within the context of global monetary cooperation—that is, we should not—and I believe we are not trying to—build "Fortress Asia." Second, given the great diversity of the economies in the region, at different stages of financial development, Asian monetary cooperation should proceed with flexibility and at a pace comfortable for those wishing to take part in it.

Issues for Asian Monetary Cooperation

There are five areas for Asian monetary cooperation: information exchange, resource provision, market infrastructure development, banking supervision and financial regulation, and policy consultations.

• *Information exchange is the easiest area of monetary cooperation.* The use of the EMEAP Virtual Secretariat, using Internet technology, has greatly facilitated the exchange of information, helping the sharing of market intelligence, techniques, and experience in all areas of central banking.

• *Resource provision entails the provision of liquidity and the provision of credit.* On the provision of liquidity, we have the network of bilateral repurchase agreements of U.S. Treasury securities among EMEAP central banks. But the contagious nature of Asian monetary problems is such that when one of us is short of liquid foreign reserves, others may be in the same boat. It may thus be beneficial if the network could be cast wider, involving possibly non-Asian economies also holding substantial foreign reserves in U.S. Treasuries.

> *We should not—and I believe we are not trying to—build "Fortress Asia."*

Asian monetary cooperation took a significant step forward when the financial package for Thailand organized by the IMF was met with ready willingness by a number of Asian economies, including our own. This I believe is the first significant arrangement involving Asian monetary cooperation through the provision of credit. Asian monetary cooperation through the provision of credit should be on a multilateral basis and conditional upon the implementation of credible structural adjustment programs.

Are the current multilateral arrangements to handle international financial crises totally satisfactory? It has been argued that economies in need should go earlier to the IMF for assistance. However, given the tough medicine the IMF is known to prescribe, there may

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have been a reluctance to approach the IMF, given also the limited resources available for a cure, thus delaying the process of crisis prevention and damage control. While the Thai package showed how neighbors are willing to help supplement IMF resources, this has the tendency to reinforce regional arrangements rather than deal with the issue on a global basis.

We hope a precedent has not been set that, if the Mexican crisis was an American problem, the Thai crisis an Asian one, the next case will be for whichever region to resolve. Such regionalism does not auger well for international monetary cooperation. The resources of the IMF should be strengthened considerably and access levels reviewed in the light of recent developments. This also applies to IMF monitoring and enforcement efforts. It would not be efficient for regional groupings to duplicate the role of the existing international organizations such as the IMF and the BIS [Bank for International Settlements] with recognized expertise and the machinery to deal with these issues. In any case, a regional crisis is quite often not limited geographically, but has global ramifications. In dealing with a crisis, the IMF should also have the mechanisms and authority to negotiate with private sector lenders to ensure that equitable burden sharing remains and that the burden of adjustment does not fall only on official creditors.

• *Market infrastructure development.* While billions are spent to build highways and airports as part of the physical infrastructure to move people around efficiently and safely, very little is spent to build the financial highways and airports to move money around efficiently and safely. As a result, the money does not move, at least not as much as one would like to see. Another common complaint about Asian financial markets is the inefficiency of settlement and clearing processes for money and financial products.

• *Banking supervision and financial regulation.* As financial markets are further liberalized and integrated, the growth of cross-border banking activities and other financial transactions is accelerating, increasing the risk of contagion. As ultimately monetary problems surface in the banking system, regulators in different economies must cooperate to safeguard the integrity of the banking and financial systems in the region. Part of the work will involve harmonizing supervisory practices, including the adoption of the Core Principles for effective supervision advocated by the Basle Committee [see page 337].

Through working closer together, such as the collaboration of the EMEAP Study Group on Banking Supervision, supervisory authorities in the region would be able to improve their understanding of each others' banking systems and supervision framework and approach. We will also review practices in the region against the existing Basle Committee benchmarks, identify reasons for any differences, and thus help to raise the quality of supervision in the region.

Yam: Often, a regional crisis is not limited geographically, but has global ramifications.

• *Policy consultation.* Clearly, there is scope to improve mutual understanding of each other's policy framework and priorities. This may or may not be a prelude to policy coordination, but a regular channel of communication on policy issues is needed. The EMEAP forum is a good start, but it needs to be strengthened. The IMF and the BIS have demonstrated how closer relations and deeper appreciation of the issues can only be fostered through a system of formal and informal communications and regular discussions. Such discussions promote not only appreciation of the issues facing individual economies but also regional and international matters. We look forward to their playing a more significant role in this region.

Conclusion

The road to international monetary cooperation has never been straight and smooth. The European experience suggests that there are many bumps along the way. With much more diverse needs and perspectives in Asia, we must allow Asian monetary cooperation to take shape gradually and in a flexible way. I believe the approach of building an Asian monetary network capable of further linkages to form a global monetary network is the correct one. It is based on voluntary participation and accommodates each participant's unique circumstances. I am confident that in the end, we will be able to build a robust and efficient Asian monetary network that would contribute to monetary and financial stability, and economic prosperity in Asia, and in turn contribute to global financial stability and prosperity.