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In this issue

Summit meetings

Leaders call for cooperative effort to reduce debt and poverty, promote growth, liberalize trade

The leaders of the Group of Seven and Group of Eight countries held summit meetings in Okinawa, Japan, on July 21–23. Two statements were issued at the meetings: the first, on July 21, by the leaders of the Group of Seven countries, comprising Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States; and the second, on July 23, by the leaders of the Group of Eight countries (Group of Seven plus Russia). Excerpts from the statement of the Group of Seven follow (see page 245 for an excerpt from the Group of Eight statement).

Picture not available

Meeting in Okinawa were (left to right) U.K. Prime Minister Tony Blair, U.S. President Bill Clinton, Canadian Prime Minister Jean Chrétien, German Chancellor Gerhard Schröder, Japanese Prime Minister Yoshiro Mori, Russian President Vladimir Putin, Italian Prime Minister Giuliano Amato, and French President Jacques Chirac.

World economy

Since we last met in Cologne, prospects for world economic growth have further improved, as *(Please turn to the following page)*

Fischer address

Private sector involvement is important element in reform of international monetary system

Following are edited extracts of an address given by IMF First Deputy Managing Director Stanley Fischer to the International Law Association Biennial Conference in London on July 26. The sections of the address reproduced here focus on the role of the private sector in helping to strengthen the international monetary system. The full text of the address is available on the IMF's website (www.imf.org).

In joining the IMF, and accepting its Articles of Agreement, our 29 founder members signed up to a treaty laying out clear rules for the operation of the international monetary system. These rules included a commitment to work toward currency convertibility and formal procedures to ensure the orderly adjustment of pegged but adjustable exchange rates.

The Bretton Woods system came under mounting pressure as the postwar growth of international trade was complemented by an even more dramatic expansion of cross-border capital flows. These starkly revealed the "impossible trinity" of a fixed exchange rate, an open capital account, and a monetary policy dedicated to domestic economic goals. With the leading countries unwilling to subordinate domestic policies to maintenance of the exchange rate, the fixed exchange rate regime among the major economies gave way. The Articles of Agreement of the IMF were amended in 1978 to reflect this new reality.

The growth of international capital flows has continued apace in the *(Continued on page 246)*

(Continued from front page) the underlying fundamentals of the industrial countries and the world economy more generally have strengthened, and as our economies move toward a more balanced and therefore more sustainable pattern of growth. Emerging market economies, including the crisis-affected economies in Asia and elsewhere, continue to strengthen.

At the same time, continued vigilance and further action are needed to ensure that sustained, strong, and balanced growth is achieved. We agree on the importance of directing macroeconomic and structural policies in all our countries at achieving this objective, with emphasis on taking full advantage of the investment opportunities created by new technologies to raise potential growth rates.

Strengthening financial architecture

Following a series of crises since 1997, the international community has endeavored to promote greater stability of the global economy through strengthening the international financial architecture, in view of the drastic changes to the global financial landscape, particularly in light of the increasing size and importance of private capital markets.

We welcome the progress made thus far and support the further steps set out by our finance ministers [at their pre-economic summit meeting in Fukuoka, Japan, on July 8. See *IMF Survey*, July 17, page 225]. We will continue to work together with other members of the international community to further strengthen the international financial architecture.

Reform of the IMF. The IMF should continue to play a central role in advancing macroeconomic and financial stability as an important precondition for sustainable global growth and should continue to evolve to meet the challenges of the future. As a universal institution, the IMF must work in partnership with all its members, including the poorest, based on shared interests. In this regard, we attach particular importance to the following measures:

• *Strengthening IMF surveillance to prevent crises.* A substantial qualitative shift in the nature and scope of the surveillance is needed in light of globalization and large-scale private capital flows.

• *Implementation of international codes and standards.* We are determined to strengthen our efforts to this end, including through their incorporation in IMF surveillance.

• *Reform of IMF facilities.* To adapt to the globalization of capital markets, we attach priority to early progress in achieving a streamlined, incentive-based structure for IMF lending as set out by our finance ministers.

• *Safeguarding IMF resources and post-program monitoring.* It is imperative to implement the strengthened safeguard measures and to enhance the IMF's capacity for post-program monitoring.

• *Strengthening governance and accountability.* It is important that the IMF's decision-making structure and its operation remain accountable, taking into account changes in the world economy.

• *Promotion of private sector involvement in crisis prevention and resolution.* We welcome that private external creditors have contributed to the financing of recent IMF programs, confirming the importance of making operational the approach agreed by our finance ministers last April based on the framework we laid out in Cologne.

Reform of the multilateral development banks (MDBs). The core role of the MDBs should be accelerating poverty reduction in developing countries while improving the efficiency of assistance and avoiding competition with private financial flows. The MDBs should increase their resources devoted to core social investments, such as basic health and education, clean water, and sanitation. The Comprehensive Development Framework and the poverty reduction strategy papers should become the basis for programs that have strong ownership by the recipient countries.

All the MDBs should allocate their support increasingly on the basis of borrower performance. Country assistance strategies should take full account of borrowers' policy environments, including governance issues. The MDBs' own governance and accountability should also be strengthened.

We look to the MDBs to play a leadership role in increasing the provision of global public goods, particularly for urgently needed measures against infectious and parasitic diseases including HIV/AIDS; and environmental degradation.

Highly leveraged institutions, capital flows, and offshore financial centers. We stress the importance of implementing measures recommended by the Financial Stability Forum (FSF) last March. With regard to the concerns about the potential consequences of the activities of highly leveraged institutions, we agree that the recommended measures should be fully implemented and that they will be reviewed to determine whether additional steps are necessary.

We urge the IMF to conduct quickly assessments of offshore financial centers identified by the FSF as a priority.

We agree that it remains essential for each country to strengthen the financial system, choose an appropriate foreign exchange rate regime, and liberalize the capital account in a well-sequenced manner.

Regional cooperation. We agree that regional cooperation through intensified surveillance can help contribute to financial stability by strengthening the policy framework at the national level. Cooperative financing arrangements at the regional level designed to supplement resources provided by the international financial institutions in support of IMF programs can be effective in crisis prevention and resolution. In this context, we welcome the recent developments in Asia and North America. In a different institutional context, economic and financial integration mechanisms and monetary unification in Europe are also contributing to the economic and financial stability of the global economy.

Debt initiative

The international development goal of cutting in half by 2015 the proportion of the world's population living in extreme poverty is an ambitious one. It demands a strategy of economic growth accompanied by the right social sector policies, which can contribute to a virtuous circle of poverty reduction and economic development. Debt relief for HIPCs is only one part of such a strategy, but it is a crucial part.

Last year in Cologne, we agreed to launch the enhanced HIPC Initiative to deliver faster, broader, and deeper debt relief, releasing funds for poverty reduction [see *IMF Survey*, July 5, 1999, page 214]. We welcome endorsement of this initiative by the international community last autumn.

Since then, while further efforts are required, progress has been made in implementing the enhanced HIPC Initiative. As reported in the Group of Seven finance ministers' report, *Poverty Reduction and Economic Development*, nine countries (Benin, Bolivia, Burkina Faso, Honduras, Mauritania, Mozambique, Senegal, Tanzania and Uganda) have already reached their decision points and are seeing the benefits of the initiative. Total debt relief under the HIPC Initiative for these countries should amount to more than $15 billion in nominal terms ($8.6 billion in net present value terms.)

We welcome the efforts being made by HIPCs to develop comprehensive and country-owned poverty reduction strategies through a participatory process involving civil society. We encourage those HIPCs that have not yet done so to embark quickly on the process and thus fully benefit from the debt reduction. We are concerned by the fact that a number of HIPCs are currently affected by military conflicts that prevent poverty reduction and delay debt relief. We call upon these countries to end their involvement in conflicts and to embark quickly upon the HIPC process. We agree to strengthen our efforts to help them prepare and come forward for debt relief, by asking our ministers to make early contact with the countries in conflict to encourage them to create the right conditions to participate in the HIPC Initiative. We will work together to ensure that as many countries as possible reach their decision points, in line with the targets sets in Cologne, giving due consideration to the progress of economic reforms and the need to ensure that the benefits of debt relief are targeted to assist the poor and most vulnerable.

In this regard, we welcome the establishment of the Joint Implementation Committee by the World Bank and the IMF and strongly urge both HIPCs and international financial institutions to accelerate their work toward the implementation of the initiative. International financial institutions should, along with other donors, help HIPCs prepare poverty reduction strategy papers and assist their financial resource management by providing technical assistance.

Picture not available

Bankokshinryokan (Bridge to the World) provided the venue for the summit meeting in Nago, Okinawa.

We reaffirmed our commitment to provide 100 percent debt reduction of official development assistance claims and newly commit to 100 percent debt reduction of eligible commercial claims. We welcome the announcement made by some non–Group of Seven countries that they, too, will provide 100 percent debt relief, and we urge other donors to follow suit.

We note the progress made in securing the required financing of the international financial institutions for effective implementation of the Enhanced HIPC Initiative and welcome pledges and the initial contributions, including those to the HIPC Trust Fund. We reaffirm our commitment to make available as quickly as possible the resources we have pledged. In this context, we recognize the importance of fair burden sharing among creditors.

Given the enormous destructive effect of war and crisis, we call upon the OECD [Organization for Economic Cooperation and Development] to review strengthened measures, including a review of national rules and regulations, toward ensuring that export credits to HIPCs and other low-income developing countries are not used for nonproductive purposes. We encourage the OECD to complete this work and publish the results as soon as possible.

Actions against financial abuse

To secure the benefits of the globalized financial system, we need to ensure that its credibility and integrity are not undermined by money laundering, harmful tax competition, and poor regulatory standards.

We welcome and strongly endorse our Group of Seven finance ministers' report, "Actions Against Abuse of The Global Financial System," and attach particular importance to the following developments:

• *Money laundering*. We welcome the initial work of the Financial Action Task Force on Money Laundering, which has published its review of the rules and practices of 29 countries and territories and its identification of 15 noncooperative countries and territories. We note with satisfaction the issuance of advisories to our domestic financial institutions that they should take cognizance and enhance their scrutiny of the risks associated with business and transactions with individuals or entities from the 15 noncooperative countries and territories. We are ready to give our advice and provide, where appropriate, our technical assistance to jurisdictions that commit to making improvements to their regimes. We are prepared to act together, when required and appropriate, to implement coordinated countermeasures against those noncooperative countries and territories that do not take steps to reform their systems appropriately, including the possibility of conditioning or restricting financial transactions with those jurisdictions and conditioning or restricting support from international financial institutions to them.

• *Tax havens and other harmful tax practices*. We welcome the OECD, *Report on Progress on Identifying and Eliminating Harmful Tax Practices*, which includes two lists: certain jurisdictions meeting tax haven criteria and potentially harmful regimes within the OECD member countries. We also welcome public commitments already made by jurisdictions to eliminate harmful tax practices, and we urge all jurisdictions to make such commitments. We encourage the OECD to continue its efforts to counter harmful tax practices and to extend its dialogue with nonmember countries.

We also reaffirm our support for the OECD's report on improving access to bank information for tax purposes and call on all countries to work rapidly toward a position where they can permit access to, and exchange, bank information for all tax purposes.

• *Offshore financial centers*. Regarding offshore financial centers that do not meet international financial standards, we welcome the identification by the FSF of priority jurisdictions for assessment. We consider it essential for offshore financial centers to implement all measures recommended by the FSF, with a view to improving weak regulatory and supervisory systems, as well as to eliminate harmful tax competition and to adopt anti–money laundering measures.

• *Role of international financial institutions*. We urge international financial institutions, including the IMF and the World Bank, to help countries implement relevant international standards in the context of financial sector assessments as well as program design and assistance.

We stress the urgent need for concrete actions against abuse of the global financial system at both the national and international levels. We also strongly urge better coordination, further impetus to efforts under way in various international forums, and expeditious follow-up actions.

Recent publications

Working Papers ($10.00)

00/103: *Do Asset Prices in Transition Countries Contain Information About Future Economic Activity?* Peter Christoffersen and Torsten Sløk

00/104: *The Impact of Intersectoral Labor Reallocation on Economic Growth*, Helene Poirson

Economic Issues (free)

Improving Governance and Fighting Corruption in the Baltic and CIS Countries: The Role of the IMF, Thomas Wolf and Emine Gürgen

IMF Staff Country Reports ($15.00)

00/72: Former Yugoslav Republic of Macedonia: Recent Economic Developments

00/75: Belize: Statistical Appendix

00/77: Bosnia and Herzegovina: Selected Issues and Statistical Appendix

00/78: Republic of Latvia: Staff Report for the 2000 Article IV Consultation and First Review Under the Stand-By Arrangement

00/79: Republic of Estonia: Staff Report for the 2000 Article IV Consultation and First Review Under the Stand-By Arrangement

00/80: Sudan: Statistical Appendix

00/81: Cameroon: Statistical Appendix

00/82: Italy: Selected Issues

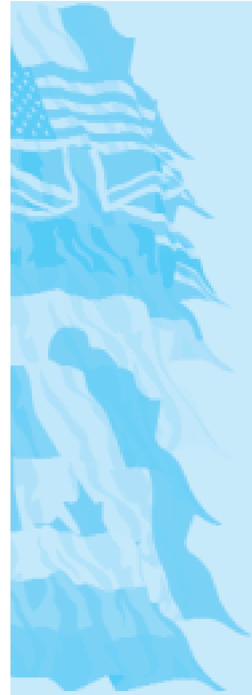
00/83: Singapore: Selected Issues

00/84: Singapore: Statistical Appendix

00/85: Grenada: Staff Report for the 2000 Article IV Consultation

Publications are available from IMF Publication Services, Box X2000, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

For information on the IMF on the Internet—including the full texts of the English edition of the *IMF Survey*, the *IMF Survey*'s annual *Supplement on the IMF*, *Finance & Development*, an updated *IMF Publications Catalog*, and daily SDR exchange rates of 45 currencies—please visit the IMF's website (www.imf.org). The full texts of all Working Papers and Policy Discussion Papers are also available on the IMF's website.



Following are excerpts of the preamble of the Group of Eight statement following its summit meeting in Okinawa, Japan, on July 23.

During the last quarter of the twentieth century, the world economy has achieved unprecedented levels of prosperity, the Cold War has come to an end, and globalization has led to an emerging common sense of community. Driving these developments has been the global propagation of those basic principles and values consistently advocated by the summiteers—democracy, the market economy, social progress, sustainable development, and respect for human rights. Yet we are keenly aware that even now in many parts of the world, poverty and injustice undermine human dignity, and conflict brings human suffering.

As we make the transition into the new century, we will continue to exercise leadership and responsibility in addressing these persistent problems and squarely face new challenges as they arise. We must tackle the root causes of conflict and poverty. We must bravely seize the opportunities created by new technologies in such areas as information and communications technology and life sciences. We must acknowledge the concerns associated with globalization, while continuing to be innovative in order to maximize the benefits of globalization for all. In all our endeavors, we must build on our basic principles and values as the foundations for a brighter world in the twenty-first century.

We hope that our discussions in Okinawa provide a positive contribution to the United Nations (UN) Millennium Summit, which we expect to articulate—in the spirit of the Secretary-General's report *We the Peoples*—a vision that will guide the UN as it rises to the challenges of the new century. To that end, we will continue to work for a strengthened, effective and efficient UN and remain convinced that reforms of the UN, including the Security Council, are indispensable. ■

See http://www.g7.utoronto.ca/ for links to the full text of these statements, as well as related information about the Okinawa summit.

Available on the web (www.imf.org)

Press Releases

00/43: IMF Approves Three-Year, $35.7 Million PRGF Loan for Benin, July 18

00/44: Benin to Receive Around $460 Million in Debt-Service Relief, July 18

News Briefs

00/56: IMF Begins Publishing *Quarterly Progress Reports on Special Data Dissemination Standard*, July 19

00/57: IMF Completes First Review of The Gambia Under PRGF-Supported Program and Approves $4.51 Million Disbursement, July 21

00/58: IMF Completes First Review of Djibouti Under PRGF-Supported Program and Approves $3.6 Million Disbursement, July 25

00/59: IMF Approves $28 Million Disbursement to Jordan, July 25

00/60: IMF Executive Board Discusses Recent Economic Developments in Thailand, July 25

00/61: IMF Completes First Review of Chad Under PRGF-Supported Program and Approves $13.7 Million Disbursement, July 25

00/62: IMF Board Reviews Issues Surrounding Work on Offshore Financial Centers, July 26

Public Information Notices (PINs)

00/50: Grenada, July 20

00/51: West African Economic and Monetary Union, July 24

Letters of Intent and Memorandums of Economic and Financial Policies (date posted)

Panama, July 11

Benin, July 18

Burkina Faso, July 19

The Gambia, July 21

Jordan, July 25

Heavily Indebted Poor Countries (HIPC) Initiative

Honduras: Decision Point Document Under the Enhanced HIPC Initiative, July 17

Senegal: Decision Point Document Under the Enhanced HIPC Initiative, July 17

Cameroon: Preliminary Document on the Enhanced HIPC Initiative, July 19

Report on the Observance of Standards and Codes

Estonia, July 18

Turkey, July 24

Concluding Remarks for Article IV Consultations (date posted)

France (Preliminary Conclusions), July 19

Other

IMF Has Helped Russia to Move Ahead—A Letter to the Editor by John Odling-Smee, July 11

IMF's Financial Resources and Liquidity Position, 1998 to June 2000, July 12

IMF Research Bulletin, July 12

Statement of IMF Mission After Article IV Consultation with the United States of America, July 13

Financial Activities Update, July 14

Brief Guide to Committees and Groups—a fact sheet, July 18

Concluding Statement of the IMF Mission on the Economic Policies of the Euro Area, July 19

Schedule of Public Engagements of IMF Management, July 21

IMF Financial Activities, July 21

Private sector contribution to economic stability

(Continued from front page) quarter-century since then. But as their volume grew, the potential effects of reversals became larger, and countries dependent on such flows—particularly short-term flows—became increasingly vulnerable to crises of confidence, akin to runs on banks. And contagion—the spreading of crises from one country to another—has also become more powerful and complex.

Nonetheless, we are bound to live in an international financial system in which private capital flows play an increasing role. How can the official sector contribute to economic stability and growth in such a system, one in which we can envisage more and more countries reaching emerging market status?

We have to help strengthen both individual economies and the international system in which they interact.

Engagement with private sector

What about the role of the private sector—in particular, investors and financial institutions? How should they contribute to ensuring the smooth running of the international monetary system, preventing financial crises where possible, and helping to resolve them where necessary?

In normal times, countries with market access can rely on the continuation of that access, provided their policies remain strong. The more successful of the emerging market countries devote a great deal of effort to keeping their investors informed of their intentions and economic developments, both through direct contacts and through the regular provision of comprehensive data. Countries that maintain constructive relationships with their creditors in good times will be better able to draw on those relationships to help resolve difficulties should they occur.

The same principle of constructive engagement applies to relationships between the international institutions and the private sector, particularly between the IMF and the private financial sector. By strengthening its relationships with the private financial sector, the IMF should not only be able to carry out its normal tasks of surveillance more effectively but also be able to make the process of crisis resolution more efficient and somewhat less painful for all concerned.

In the domestic context, the central bank can act as a crisis lender and manager when banks get into trouble by acting as a lender of last resort. In the international context, the IMF cannot act as a textbook lender of last resort because its resources are limited by its inability to print money. And if the IMF or another institution were to be able to act as an international lender of last resort, it would have to operate with rules that limit moral hazard. Otherwise, institutions would be tempted to lend with an irresponsible lack of regard for the underlying risk, secure in the knowledge that they would be bailed out if things went wrong.

On most occasions when a country runs into balance of payments problems, a combination of strong reform efforts and limited financial support from the IMF will be sufficient to catalyze a restoration of access to private capital. But if a country faces a severe liquidity problem (a large short-term financing requirement and little hope of an early return to the capital market) or a solvency problem (an unsustainable medium-term debt burden), then the resolution of the crisis may require a concerted contribution from the private sector.

While contributing to crisis resolution is in creditors' collective interest, individual creditors have an incentive to block the settlement for their own gain.

Concerted private sector involvement has been necessary in a number of countries in recent years, with the precise mechanics differing from case to case. In examples where bank debt has predominated, the coordination of lenders has varied from a light touch in Brazil to a more heavy-handed approach in Korea. Dealing with bond debt is inherently more difficult as the holders are more numerous, more diverse, and more difficult to identify. Fears of disruptive litigation proved unduly pessimistic in Ukraine and Pakistan, in part because of the presence of collective-action clauses in some bond contracts that limit the power of rogue creditors.

Investors are understandably frustrated that the rules of the game are unclear. To some extent, this is inevitable, given the many factors that determine the appropriate approach in a given case. Clarifying the situation is made no easier by differences of opinion among our leading shareholders—some favoring clear rules determining when the private sector is to be "bailed in" and others arguing for constructive ambiguity.

Progress *has* been made on the topic of private sector involvement in financial crises. We have not dealt with the recent cases in Romania, Ukraine, Pakistan, and Ecuador in the same way that we would have done five years ago. But nonetheless, greater clarity about the rules of the game would be desirable. Whatever set of rules is developed, an element of discretion is bound to remain as the profile of the external debt and the macroeconomic situation differs between countries.

In the meantime, we need to do what we can ex ante to prevent crises and put in place the conditions that will make them easier to resolve. This includes, importantly, encouraging constructive engagement in normal times among countries, their creditors, and the international institutions. ■

Outreach

IMF-World Bank team visits Asia to discuss international standards and codes

Standards and codes play a central role in the new international financial architecture being developed to promote greater financial stability following crises in Asia and elsewhere. The emphasis on standards and codes reflects a view that vulnerabilities are reduced if transparency in the institutional and regulatory structures of the economic and financial sectors, and in the information that these sectors provide to the public, reflects the good practices that many countries follow. The IMF and the World Bank have been involved, together with other international financial institutions and professional bodies, in setting relevant standards and codes (see box, page 248). In addition, procedures to assess observance of standards and codes have been developed. Specifically, Reports on the Observance of Standards and Codes (ROSCs) are being prepared on a pilot basis. Currently, ROSCs covering either the full range of standards or just one or two standards have been published on the IMF's external website.

As part of an outreach program, the IMF and the World Bank have begun a series of regional visits to explain the role of standards and codes in the new international financial architecture, describe progress in developing standards and codes, provide information on ROSCs, and seek preliminary feedback on this work. During July 10–14, a joint IMF-World Bank staff team embarked on the first of these visits, holding seminars in Tokyo, Hong Kong SAR, Bangkok, and Singapore. IMF staff members included Charles Enoch (Statistics Department), Udaibir Das (Monetary and Exchange Affairs Department), Richard Hemming (Fiscal Affairs Department), and Martin Parkinson (Policy Development and Review Department). Axel Peuker represented the World Bank.

Seminars spark interest

Attendees at the seminars included representatives of the financial and nonfinancial sectors, media, academics, and government officials. Attendance ranged from around 35 in Bangkok to 65 in Singapore. In Hong Kong SAR, the IMF–World Bank seminar was combined with one being conducted under the outreach program of the Financial Stability Forum (FSF). Andrew Sheng (Hong Kong Securities and Futures Commission and Chairman of the FSF's Task Force on Implementation of Standards) opened the seminar by outlining the importance of standards and codes and linked the work of the IMF and the Bank in this area to that of the FSF. There was press coverage of the seminars in Hong Kong SAR and Singapore, and television coverage in Singapore.

There was a great deal of interest in IMF and Bank work on standards and codes and in other work related to the new international financial architecture and considerable support for outreach activities of this type. The statement of the Group of Seven finance ministers, who met on July 8 in Fukuoka, Japan, and discussed a number of initiatives relating to standards and codes, made the visit particularly timely (see *IMF Survey*, July 17, page 225). Similarly, the announcement of Hong Kong SAR's observance of its Special Data Dissemination Standard obligations the day before the seminar, together with the publication on July 19 of the first quarterly report on compliance with the Special Data Dissemination Standard, provided a timely illustration of progress being made in implementing standards and codes.

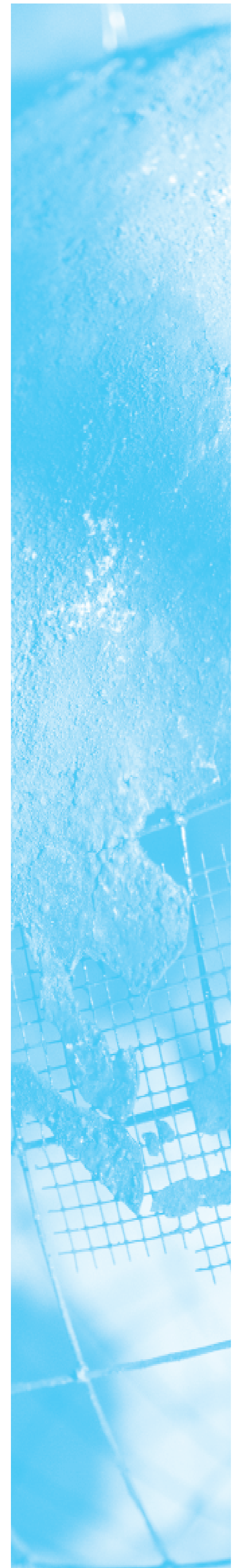
Most participants in the Tokyo, Hong Kong SAR, and Singapore seminars had considerable knowledge of, and interest in, the Special Data Dissemination Standard. Several participants commented that it was very useful and had already led to a marked improvement in data standards. Participants also raised some issues regarding the Special Data Dissemination Standard, including the timeliness and credibility of the data and the IMF's role in ensuring quality. The Hong Kong SAR representative of one U.S. investment house, who had sought a briefing from his New York headquarters, reported that the standards they regard as most critical were those relating to corporate governance, data dissemination, monetary and fiscal transparency, and accounting. In Bangkok, attention focused almost exclusively on fiscal transparency.

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
July 17	4.55	4.55	5.27
July 24	4.57	4.57	5.30

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 (as of May 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (115.9 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 or check the IMF website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer's Department



Reports on standards and codes

There seemed to be only limited awareness of the ROSC process. Few participants had heard of ROSCs before the seminar, and the IMF and the Bank were urged to make greater efforts to publicize them. Some participants who were more familiar with the ROSCs said they thought that the reports should be shorter and more focused, with brief summaries and conclusions, while others wanted specific details on where and why countries failed to meet standards and codes. A few representatives indicated that compliance with standards and codes is now explicitly reflected in their organizations' risk-assessment practices. One investment house representative indicated that ROSCs were currently being evaluated to see if they could assist the firm's own country assessments. While the IMF and the World Bank were keen to make ROSCs as user-friendly as possible, the IMF-Bank team pointed out that the two institutions did not intend to act as rating agencies.

Macroprudential indicators

In the seminars and bilateral meetings, there was some discussion of the work being done by the Monetary and Exchange Affairs and Statistics Departments to develop macroprudential indicators, with particular mention being made of the recently issued Occasional Paper on the subject (see *IMF Survey*, July 3, page 213) and the survey currently being undertaken to investigate national authorities' use of such indicators. While most commentators considered this work useful, some found the results so far to be pretty crude and highlighted the unclear links between the microprudential standards on which macroprudential indicators were based and the macroeconomic vulnerabilities they were intended to foreshadow.

Overall, the visit to Asia proved useful in determining the level of awareness of IMF and World Bank work on standards and codes and in obtaining feedback. Further visits are therefore likely over the coming months to Latin America, Africa, the Middle East, and possibly Europe. ■

Charles Enoch
IMF Statistics Department

The first quarterly report on compliance with the Special Data Dissemination Standard is available on the IMF's website at www.imf.org/external/np/rosc/index.htm.

Copies of IMF Occasional Paper 192, *Macroprudential Indicators of Financial System Soundness,* by a staff team led by Owen Evans, Alfredo M. Leone, Mahinder Gill, and Paul Hilbers, are available for $20.00 each (academic rate: $17.50) from IMF Publication Services. See page 244 for ordering information.

Codes and standards

Area	Standard	Issuing body
Macroeconomic policy and data transparency		
Monetary and financial policy transparency	Code of Good Practices on Transparency in Monetary and Financial Policies	IMF
Fiscal policy transparency	Code of Good Practices on Fiscal Transparency	IMF
Data dissemination	Special Data Dissemination Standard	IMF
	General Data Dissemination System	IMF
Institutional and market infrastructure		
Insolvency	Principles and Guidelines on Insolvency Regimes for Developing Countries	World Bank
Corporate governance	Principles of Corporate Governance	OECD
Accounting	International Accounting Standards (IAS)	IASC
Auditing	International Standards on Auditing (ISA)	IFAC
Payment and settlement	Core Principles for Systemically Important Payment Systems	CPSS
Financial regulation and supervision		
Banking supervision	Core Principles for Effective Banking Supervision	BCBS
Securities regulation	Objectives and Principles of Securities Regulation	IOSCO
Insurance supervision	Insurance Supervisory Principles	IAIS

Note:
BCBS: Basel Committee on Banking Supervision
CPSS: Committee on Payment and Settlement Systems
IAIS: International Association of Insurance Supervisors
IASC: International Accounting Standards Committee
IFAC: International Federation of Accountants
IMF: International Monetary Fund
IOSCO: International Organization of Securities Commissions
OECD: Organization for Economic Cooperation and Development

Dornbusch offers advice on role of countries' exchange rate policies

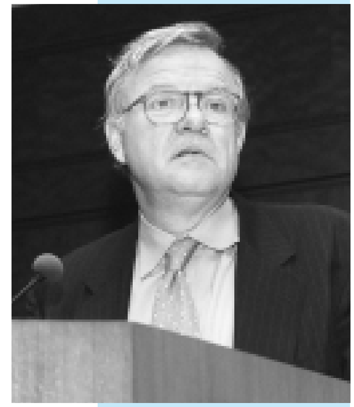
Rudi Dornbusch is never boring—particularly not when offering advice on exchange rate policies ("Mexico should adopt a currency board") or providing his take on recent developments in exchange markets. At an IMF Institute seminar on July 15, the irrepressible MIT professor opened his presentation with a conundrum—economists do not have good models to explain exchange rate movements, particularly short-run movements, but exchange rate movements do have an important impact on other economic variables, such as GDP, inflation, and the current account. Policymakers and their economic advisors are thus in a bind. On the one hand, exchange rate arrangements and policies are too important to be neglected; on the other, the value of any advice on these matters is hampered by the lack of a good understanding of what moves exchange rates.

Of course, this did not prevent Dornbusch from offering very clear advice on exchange rate policies ("To be dogmatic is the only way to be useful," he explained). He was against oft-floated proposals to constrain the world's major currencies—the U.S. dollar, the euro, and the yen—within target zones. But for many emerging markets on the periphery of the major countries, including—as noted—for Mexico, he did favor an extreme kind of bondage, namely, currency boards.

Why do exchange rates fluctuate so much?

Dornbusch noted that the law of one price—the proposition that identical goods should sell for the same price in different markets—holds a powerful intellectual appeal for economists. In international economics, the law goes by the name "purchasing power parity" (PPP) and posits that the exchange rates should move to eliminate price differentials between countries. For example, the franc-dollar exchange rate should be such that the price of a McDonald's Big Mac in Millau (France), when expressed in dollars, equals the price of a Big Mac in Washington, D.C. Of course, there are many reasons to expect that the price would not be equated exactly. Transport costs and differences in the relative costs of doing business in Millau and Washington enter into the price of a Big Mac. Consequently, a weaker version of PPP posits merely that the exchange rate should change so as to equalize the rate of change of prices in the two countries.

However, exchange rates often take large and persistent swings away from the values suggested by even this weaker version of PPP. What causes these deviations from PPP values? Dornbusch argued that productivity differentials between two countries can explain long-run movements in their exchange rates but have limited success at explaining short-to-medium-run movements. Other so-called fundamentals, such as money growth and interest rates, fare no better.



Indeed, faced with the poor performance of macroeconomic fundamentals, economists have turned to market microstructure as a possible explanation of exchange rate movements. This new line of research looks at the behavior of participants in the foreign exchange market, their risk preferences, their "inventories" of different currencies, and other such features to explain exchange rate movements, particularly their volatility. Poor forecasting habits may also play a role. Dornbusch presented evidence that exchange rate forecasters show a strong tendency to extrapolate recent trends in the data, which tends to impart momentum to any swing away from PPP values.

Dornbusch presented evidence that exchange rate fluctuations have significant impacts on macroeconomic variables, such as real GDP, the price level, and the current account.

Dornbusch cautioned that in the case of emerging markets, the preceding discussion has to be qualified for a couple of reasons. First, in many countries, movements in fundamentals, such as money growth, have often been so extreme that the impact on exchange rates is much easier to discern than in industrial countries. Second, in many emerging markets, political economy considerations play a large role in determining exchange rates. In many Latin American countries, in particular, governments have in the past, he said, tried to deliver prosperity—the real wage necessary to ensure social peace in their countries—through increased spending. This spending is funded through overvalued currencies, and so governments have resorted to the printing press or to borrowing from foreign sources. These methods fail to deliver real prosperity, forcing a contraction in spending and a consequent rise in unemployment or a devaluation and consequent fall in real wages. Neither option is socially palatable, Dornbusch observed, and so results in the fall of the political regime caught at the end of the process.

Macroeconomic effects

Drawing on OECD and U.S. Federal Reserve estimates, Dornbusch presented evidence that exchange rate fluctuations have significant impacts on macroeconomic variables, such as real GDP, the price level, and the current account. For instance, the OECD estimates that a 10 percent appreciation of the dollar low-

Dornbusch dismissed proposals for target zones on the grounds that they may, at times, inappropriately make the domestic objectives of monetary policy—namely, price stability and elimination of output gaps—subservient to the exchange rate objective.

ers U.S. real GDP by about 1 percent below its baseline over a four-year period, lowers the price level by about 2 percent, and raises the current account deficit, albeit with a lag. In Japan and the European Union, the appreciation of the dollar raises output and the price level and lowers current account deficits. Results of an analogous nature hold if one considers instead an appreciation of the yen or the euro.

Dornbusch did not present evidence on the macroeconomic effects of exchange rate movements in emerging markets. That these effects are substantial is evident, however, from the economic (and political) turmoil in the aftermath of currency crises; moreover, other studies have shown that these effects are substantial even in the cases of less dramatic movements in exchange rates.

Major currencies: set them free?

What can be done if exchange rates among the world's major currencies—the U.S. dollar, the euro, and the yen—appear to be misaligned; that is, they exhibit substantial, persistent deviations from PPP values? Dornbusch did not advocate the benign neglect he said was reflected in former U.S. Treasury Secretary John Connally's statement that "the dollar is our money but their problem." But he did not seem very favorably inclined toward any method that would attempt to correct misalignments or keep them from emerging in the first place. Interventions by central banks tend to have, at best, limited short-run success, though they should be retained as a tool to use at some moments, for example, when markets are thin or when markets are turning toward the desired direction but need a little push.

Dornbusch dismissed proposals for target zones on the grounds that they may, at times, inappropriately make the domestic objectives of monetary policy—namely, price stability and elimination of output gaps—subservient to the exchange rate objective. For instance, he suggested that if the United States were currently under a target zone, it may have had to cut interest rates to bring down the dollar—a move that appears at odds with what is needed to achieve domestic objectives. Far better for the United States to pursue price stability and financial stability and let the burden of adjustment to the value of the dollar fall on others.

By the same token, Dornbusch was against active measures to correct the decline in the value of the euro from the "hyped-up" level at which it was launched. The main reason for the euro's decline is the stronger performance of the U.S. economy relative to Europe. Raising interest rates would be too costly, and intervention too ineffective. Better to let the euro recover as the U.S. economy starts to slow, he counseled.

Bondage along the periphery?

While the major currencies should largely be free to float, Dornbusch argued that the Mexican, Asian, Russian, and Brazilian crises provide a clear lesson for quite different exchange rate strategies along the periphery. Many countries along Europe's periphery should adopt currency boards backed by the euro, he said, while countries in Latin America could dollarize their economies, as Ecuador has done, or follow the Argentine example of a currency board backed by the U.S. dollar.

With respect to Mexico, Dornbusch acknowledged that for the moment the presumption has to be that "this time is different" and that the currency collapse around election years that happened on two previous occasions can be avoided. There has been a successful transition to a new party, there is modest economic growth, inflation is down to 10 percent, debt is tilted toward long maturities, and the budget appears sound. Moreover, the exchange rate this time around is flexible and not extremely appreciated in real terms.

Nevertheless, Dornbusch argued that Mexico cannot attain the 7 percent growth promised by President-elect Vicente Fox without a fundamental move on exchange rate policy. The lingering possibility of a peso devaluation forces Mexico to pay a high premium for borrowing in foreign capital markets. In emerging markets, capital costs account for far more of total production costs than in industrial countries; hence, that premium translates into a significant increase in the cost of capital to Mexican businesses.

IMF staff, and many others, suggest that certain preconditions have to be met to ensure a successful move to a currency board. First, with the hands of the monetary authority completely tied, fiscal conditions have to remain suitably tight. Second, the country needs a strong and well-supervised banking system. Third, the country needs enough foreign exchange reserves to back the domestic currency. In addition, the loss of exchange rate flexibility can prove costly in some circumstances. In fact, Mexico's ability to weather the 1998 Brazilian crisis is attributed by many, including the country's central bank governor, to its flexible exchange rate policy.

Dornbusch's response to these concerns was, in essence, to state the mantra "just do it." Some of what others consider preconditions can be accomplished, in his view, after the adoption of the currency board. And the costs of the loss of exchange rate flexibility are outweighed by the gain achieved from lowering the currency risk premium and, hence, interest costs. ■

Prakash Loungani
IMF External Relations Department

IMF SURVEY

Participants discuss emerging market role of multilateral development banks

Recent efforts to review the functions and effectiveness of the multilateral financial institutions have given rise to a debate about the most appropriate role for multilateral development banks in emerging markets, particularly given the increased reliance on private capital by the big, middle-income emerging markets. On July 13, the U.S.-based Bretton Woods Committee—a bipartisan, nonprofit group organized to build public understanding of international financial and development issues—hosted a symposium on reassessing the role of multilateral banks in emerging markets. Participants were drawn from the private and public sectors, government agencies, and nongovernmental organizations.

Division of labor

A panel made up of Matthew Hennesey, formerly of the U.S. Treasury; Adam Lerrick, head of a private investment company; and Richard Frank of Darby Overseas Investment, Ltd. considered the appropriate division of labor between multilateral development banks and the private sector. Hennesey argued for a pragmatic approach, noting that policy responses must be flexible and policy formulation realistic, based on a recognition of what international consensus will allow and what resources can be mustered.

Noting that 70 percent of World Bank lending goes to a handful of middle-income countries that have access to private capital, thus diminishing the share that goes to countries lacking market access, Lerrick said that the multilateral development banks should redirect their resources toward providing global public goods—such as disease control and promotion of good governance. World Bank money does not, he contended, help influence policies in countries that have access to much larger private flows but merely helps to subsidize financing of fiscal and monetary imbalances.

For many developing countries, poverty reduction is a major preoccupation. According to Frank, a market economy offers the best approach to poverty alleviation. Domestic sources, or if necessary, external sources, should be tapped to finance private sector activities. Multilateral development banks should devote more resources to private sector activities, he said. With the right policies, private capital will flow in.

In the roundtable discussion that followed, several participants commented on the useful role the multilaterals play in maintaining a dialogue with the middle-income countries, which can be critical in building political support for action on health, education, the environment, and human rights.

Improving graduation policies

John Williamson of the Institute for International Economics objected to the recommendation of the so-called Meltzer Commission that the World Bank phase out its concessional lending to countries that enjoy access to capital markets. The criterion for "graduation," he said, should be based solely on per capita income. Williamson was not suggesting that countries with access to capital markets should be discouraged from seeking private financing, but noted that countries may want to continue a dialogue with the World Bank, especially if they still have a poverty problem and lack institutional and development capacity.

Amar Bhattacharya of the World Bank said that since 1947, 26 countries have graduated, including 6 in the 1980s. Although the Bank's graduation policy was formally instituted in 1982, the criteria for graduation have always been flexibly applied, serving as a trigger point for discussion in the Bank's Executive Board.

Development financing

In discussing whether the World Bank or the regional development banks should finance emerging market economies, Nancy Birdsall, Senior Associate at the Carnegie Endowment for International Peace, argued that World Bank participation created competition between the banks, which is beneficial. The benefits of competition, she said, offset any costs of duplication between the banks. Also, competition puts borrowers "in the driver's seat" and makes the banks more accountable.

In the roundtable that followed, discussants generally agreed that the competition created by different development agencies was advantageous to both developing countries and the private sector. The differences between the World Bank and the regional banks make it possible for each to offer a variety of lending instruments in their programs.

Crisis lending

There was a consensus among the participants that multilateral development banks—which are institutions of public policy—play an important role in helping to resolve crises. One participant noted, however, that if the international financial system functioned as it should, the IMF would be able to handle crisis lending and there would be no need for the multilateral development banks to serve this purpose. Crisis lending is useful, according to one participant, for helping countries sustain viable social expenditures, improve targeting, and develop monitoring and evaluation systems. ■

Competition puts borrowers "in the driver's seat" and makes the banks more accountable.
— Birdsall

Geneva meeting

UN Social Summit adopts declaration on social development and action program

A Special Session of the United Nations General Assembly met in Geneva on June 26–30 to assess the progress that had been made in the five years since the March 1995 Copenhagen Summit adopted a Declaration on Social Development and Program of Action. In the Copenhagen declaration the heads of state or government of 117 countries had committed themselves to fighting poverty, unemployment, and social disintegration. In the intervening five years, there has been heightened concern over the economic and social consequences of international financial crises, growing insecurity over globalization, and, in some regions, a deepening of poverty and unemployment.

At the Special Session in Geneva—entitled The World Summit for Social Development and Beyond: Achieving Social Development for All in a Globalizing World—delegates assessed the progress made since the Copenhagen meeting and explored new initiatives that might move the social development agenda forward, including through current forms of international cooperation and the role of international institutions. They found that the record indicated that improvements in some areas had gone hand in hand with setbacks in others. In some countries, resource constraints, natural disasters, HIV/AIDs, and internecine conflict undermined the potential for improvement. The global financial crisis, too, had reversed considerable social gains in a number of countries. As the conclusion of their meeting, the participants issued a joint declaration (see box, this page). As at Copenhagen, a parallel summit—Geneva 2000—was held for more than two thousand representatives of civil society, including representatives of nongovernmental organizations (NGOs), who had gathered to participate in various workshops and seminars and to follow the official discussions.

From Copenhagen to Geneva

The ambitious agenda in Copenhagen outlined 10 commitments to social development (see box, page 253) and a program of action to give greater prominence to social issues in public policy. The summit also highlighted the links between social and economic problems and the need to generate and sustain economic growth—in the context of macroeconomic stability and structural change—and thereby address social problems effectively.

Five years down the road, have words been translated into action? This was the fundamental question delegates asked themselves in Geneva. Certainly, progress has been made in some areas, they stressed. Poverty reduction, which was spearheaded in Copenhagen, has become the main development objective of national and international policy. Delegates agreed that the IMF and the World Bank are strengthening their focus and collaboration on the social dimension in their adjustment and reform programs.

Geneva Declaration: a summary

The Special Session of the General Assembly on social development had three objectives: reaffirm the commitment and strategies adopted in Copenhagen; review and assess progress; and decide on further concrete actions and initiatives. These three objectives were set out in the Geneva declaration.

In general, the political declaration reaffirms the commitment to implement the Copenhagen Social Summit Declaration and Program of Action of 1995, including the strategies and agreed targets. It notes the growing awareness of the positive impact of effective social policies on economic and social development, and the continued efforts to improve human well-being and eradicate poverty, but it also recognizes the need for further action to fully implement the Copenhagen commitments. Recognizing the opportunities and challenges of globalization and the need to extend the benefits of social and economic development to all countries, the declaration reiterates the determination to eradicate poverty, promote full and productive employment, foster social integration, and create an enabling environment for social development. While social development is described as a national responsibility, the United Nations and other relevant international organizations (within their respective mandates) are called upon to strengthen the quality and consistency of their support for sustainable development. Additional resources are required, and governments will strive to fulfill the yet-to-be-attained internationally agreed target of 0.7 percent of GNP of developed countries for overall official development assistance as soon as possible. They also reaffirm their pledge to find effective, equitable, development-oriented, and durable solutions to the external debt and debt-servicing burdens of developing countries. Governments also recognize the need to continue work on a wide range of reforms for a strengthened and more stable international financial system, enabling it to deal more effectively and in a timely manner with the new challenges of development. They also call for a coordinated follow-up to all major conferences and summits, including by all of the bodies and organizations of the UN system, within their respective mandates.

But progress has been unsatisfactory in a number of areas, delegates observed. In many countries, the number of people living in poverty has increased since 1995. Many social indicator targets set for 2000, especially in Africa, have still not been met. Many least developed countries have also seen their share of official development assistance shrink. In Geneva, delegates noted in their declaration that achieving the goals would require "much stronger and more comprehensive action, and new, innovative approaches by all actors, national and international, governmental and nongovernmental, taking into account the relevant United Nations conferences and summits."

The "other" Geneva forum

The UN summit was not the only forum in Geneva. The Swiss government organized "Geneva 2000: The Next Step to Social Development," which comprised several high-quality panel discussions, exhibitions, and workshops organized by civil society groups to permit participants to share experiences and exchange information. The IMF held seminars on poverty concerns in macroeconomic policy and on social policy issues in IMF-supported programs. IMF staff also served as panelists on a session on the Heavily Indebted Poor Countries (HIPC) Initiative. IMF participants included Reinhard Munzberg, Special Representative of the IMF to the United Nations; Sanjeev Gupta, Division Chief, Fiscal Affairs Department; and Louis Dicks-Mireaux, Deputy Division Chief, Policy Development and Review Department.

Participants asked a range of questions, such as whether IMF-supported programs squeeze public spending; the impact of the Asian financial crises; the extent of consultation with civil society groups; how participatory processes could be strengthened in countries with IMF-supported programs; how poverty reduction would be factored into the macroeconomic framework; the impact of adjustment programs on the poor; and the rationale for various privatization programs.

NGOs, in particular, expressed concern that the emphasis on growth in adjustment programs ignored the interests of the poor. IMF staff representatives explained that growth is an important source of poverty reduction but also noted there is now greater acceptance that investing in primary education and basic health, for example, can boost the potential of the poor to contribute to output and thus help to speed up economic growth itself. NGOs criticized the enhanced HIPC Initiative, arguing that it provided too little debt relief and much too slowly. IMF staff pointed out that the IMF is working to provide early debt relief under the initiative. It is essential to ensure that debt relief is put to effective use, they stressed.

A Better World for All

On the opening day of the summit, UN Secretary-General Kofi Annan released the report *A Better World for All*, prepared jointly by the IMF, the Organization for Economic Cooperation and Development, the United Nations, and the World Bank (see *IMF Survey*, July 3, page 209). He congratulated the four organizations for their collaboration, noting that the report reviews progress toward the internationally agreed goals for reducing extreme poverty and establishing a common vision for the future.

At the same time, the report met with unexpected criticism from representatives of some seventy NGOs and a few trade unions. They complained they were not consulted on the report. In their view, it represented the views of the Group of Seven and of the IMF and the World Bank. They argued that the report failed to question the effectiveness of structural adjustment programs. The biggest criticism was that the report supported globalization unreservedly, calling for open markets in trade, technology, and ideas. Some NGOs and labor unions asked Annan to dissociate himself from the report but Annan came out in strong support of the report, stressing that it reflected the support of partner organizations for UN targets and objectives. In a letter to the head of the World Council of Churches, he said "it would be truly ironic if, after years of trying to get them [partner organizations] to do so, we were now not to accept their 'yes' as an answer." ■

Gita Bhatt
IMF External Relations Department

Picture not available

UN Secretary-General Kofi Annan during the World Summit for Social Development, a special session of the United Nations General Assembly in Geneva.

Copenhagen Commitments

- Create an economic, political, social, cultural, and legal environment that will enable people to achieve social development.
- Eradicate absolute poverty by a target date to be set by each country.
- Support full employment as a basic policy goal.
- Promote social integration based on the enhancement and protection of all human rights.
- Achieve equality and equity between women and men.
- Attain universal and equitable access to education and primary health care.
- Accelerate the development of Africa and the least developed countries.
- Ensure that structural adjustment programs include social development goals.
- Increase resources allocated to social development.
- Strengthen cooperation for social development through the United Nations.

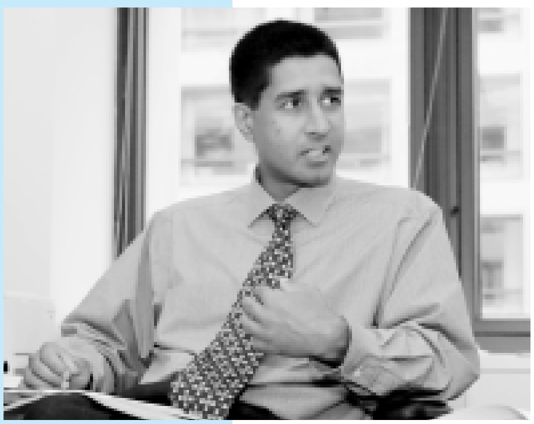
IMF Working Paper

Interventions have had small, but persistent, effects on yen-dollar rate

In recent years, there has been growing skepticism about the ability of central bank interventions to move exchange rates in the desired direction. A new IMF Working Paper argues, however, that interventions in the yen-dollar rate have had small, but persistent, effects. Authors Ramana Ramaswamy, a Senior Economist in the IMF's Asia and Pacific Department, and Hossein Samiei, a Senior Economist in the IMF's European I Department, spoke with the IMF Survey *about their findings.*

IMF Survey: What prompted you to examine the effectiveness of yen-dollar interventions?

Ramaswamy: The yen-dollar rate is more than just the exchange value of one currency against another. Changes in this exchange rate tend to have systemic implications for the global economy. In the 1980s, for instance, fluctuations in the yen-dollar rate exacerbated trade frictions between the United States and Japan. Swings in the yen-dollar rate in the 1990s also proved to be of systemic importance. The yen appreciated sharply in the first half of the 1990s and then depreciated very sharply from mid-1995 until late 1998, before appreciating yet again after that. Because other Asian currencies were closely tied to the dollar, when the yen depreciated against the dollar, it also depreciated against the other Asian currencies. Countries like Korea, Malaysia, Thailand, and Singapore lost competitiveness, which was one of the reasons for the outbreak of the Asian crisis in 1997. Also, swings in the yen-dollar rate obviously have direct implications for the Japanese economy, which was stagnant through much of the 1990s.



Ramaswamy: Changes in the yen-dollar rate tend to have systemic implications for the global economy.

The Japanese authorities intervened actively in the latter half of the 1990s to influence the yen-dollar rate. And they intervened at different times both to strengthen their currency and to weaken it. We wanted to see how effective these interventions had been in influencing this important exchange rate. Also, we were surprised to find that, while there were a number of academic studies that examined the effectiveness of interventions in the post–Plaza Accord period, there were literally none that examined interventions in the yen-dollar market in the latter half of the 1990s—during part of which the global economy was in the grips of a serious financial crisis. For all these reasons, interventions in the yen-dollar market seemed like an interesting topic to work on.

IMF Survey: For much of the 1990s, the popular view seemed to be that interventions were no longer an effective means of moving the exchange rate. Why this skepticism, given the success of the 1985 Plaza Accord in addressing the overvalued dollar?

Samiei: This is an interesting question. Perhaps to put it in the right context we should emphasize that interventions cannot be the centerpiece of an exchange rate policy or the principal means of trying to control the exchange rate. In particular, it is unreasonable to expect interventions to maintain an exchange rate that is unsustainable relative to fundamentals or, at times, relative even to market perceptions that might be false. At best, interventions can only smooth the dynamics of exchange rate movements and, at times, change the long-run path moderately.

In this context, look at the experience of the 1990s. In the United Kingdom, Sweden, and some Asian countries, central banks attempted to defend exchange rate levels that were essentially not sustainable. All these countries intervened heavily, based perhaps on the view that interventions could fundamentally change an exchange rate or maintain an unsustainable rate. In all these cases, the interventions failed to hold the peg. I think that this experience has colored perceptions about the effectiveness of interventions. But in the context of our paper, it is useful to remember that we are dealing with foreign exchange interventions in a floating exchange rate regime, which is an altogether different issue from central bank actions to defend exchange rate pegs. Here, the issue is not how successful interventions are in holding a peg, but rather one of finding out how much, if at all, they succeed in changing the exchange rate, and whether interventions have a short-run impact or a long-term one. It is also useful to remember that the interventions connected with the Plaza Accord—interventions that a number of academic studies have found to be effective—were attempts to influence floating exchange rates.

IMF Survey: How do the Bank of Japan and the U.S. Federal Reserve intervene in the exchange rate market? And what pattern and frequency did these interventions have in the latter half of the 1990s, the period you looked at in detail?

Ramaswamy: In Japan, the authority to intervene is vested with the ministry of finance. It gives the orders to intervene, and the Bank of Japan carries out the actual intervention by either buying or selling foreign currency, as the case may be. The timing of the interventions is usually decided by mutual consultation between the ministry of finance and the Bank of Japan. In the United States, both the Federal Reserve Board and the treasury have independent legal authority to intervene. In practice, however, it has largely been the treasury that has decided on interventions, and the Federal Reserve Board carries out the intervention through the operations of the New York Federal Reserve Bank. The financing of the interventions is generally split between the treasury and the Federal Reserve Board.

Prior to the Plaza Accord, interventions tended to be secretive affairs. The authorities seemed to believe that the best chance of success for interventions was if they surprised the markets. But in the post-Plaza Accord period, interventions have mainly been carried out openly. When either the Bank of Japan or the U.S. Fed intervenes, the entire market usually knows about it within 30 minutes of the act, since these central banks buy and sell currencies openly through the big commercial banks. The data on the Fed's intervention operations are available to the public with a time lag, although the Bank of Japan does not provide official data on when it intervenes or by how much. But because the Bank of Japan's interventions are, nevertheless, in practice public knowledge and are reported extensively in the financial press, we could get the information on the dates on which they intervened by looking at press reports of the past five years.

The period 1995–99 was rich in data as far as interventions are concerned. There were interventions to both strengthen and weaken the yen, and there were both unilateral and coordinated interventions. However, most interventions in this period were unilateral actions by the Bank of Japan to weaken the yen. We identified 32 instances in which the Japanese authorities intervened unilaterally to weaken the yen and 6 coordinated interventions. Efforts to strengthen the yen included 9 unilateral Japanese interventions and 2 instances of coordinated interventions.

IMF Survey: Why was the Bank of Japan so much more active than the United States during this period?

Samiei: Normally, one looks at the openness of the economy to see whether a country should care more about the exchange rate. But Japan and the United States have a roughly identical share of trade in their GNP—about 12–14 percent—so the effect of the exchange rate on inflation and activity should be broadly similar. What differs is that while the yen-dollar rate is one among many exchange rates for the United States, the overall effective exchange rate for Japan very much reflects movements of the yen-dollar rate. This is because Japan trades with a number of countries whose currencies are fixed to the dollar. So every time the yen strengthens against the dollar, it also strengthens against the currencies fixed to the dollar. Consequently, the yen-dollar rate matters more to Japan than it does to the United States.

Samiei: The overall effective exchange rate for Japan very much reflects movements of the yen-dollar rate.

One should also remember that the relative performance of the two economies was very different in the 1990s. Because the U.S. economy has been doing very well, a strengthening of the dollar is not worrisome—in fact, it can be a positive thing because it helps to contain inflation pressures. The Japanese economy has been so weak, however, that every strengthening of the yen has had an adverse impact. Negative shocks to demand in a country in crisis are more problematic than negative shocks to a strong economy.

IMF Survey: The yen-dollar interventions were typically sterilized and, contrary to conventional wisdom, did have an impact on yen-dollar rates. Why was this so?

Ramaswamy: In practice, most central banks in industrial countries sterilize their foreign exchange interventions. The act of buying and selling foreign currencies by a central bank can affect domestic liquidity and interest rates if there are no offsetting operations. As a result, central banks generally tend to offset the impact of their selling and buying of foreign currencies on domestic liquidity through counteracting operations in the bill and bond markets, and this is essentially what sterilization is all about.

When sterilized, foreign exchange interventions don't affect domestic interest rates. And in countries like Japan and the United States, central banks routinely sterilize foreign exchange interventions because they want to separate the decision to intervene from the decision to change monetary policy. The objective of monetary policy in these countries is broadly to achieve a low and stable rate of inflation, not to influence the exchange rate. In the case of the Bank of Japan, there is an added political economy consideration: the decision to intervene is the exclusive preserve of the ministry of finance, while monetary policy is the Bank of Japan's exclusive preserve. So the Bank of Japan does not want the decision of the ministry of finance to intervene in the foreign exchange markets to influence interest rates and monetary policy.

Now, conventional wisdom has it that sterilized interventions do not have an impact on the exchange rate because of a simplistic view that exchange rate

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changes should be determined mainly by interest rate differentials between the relevant countries. Thus, it is perceived that if the Bank of Japan sterilizes its interventions, nothing happens to either the Japanese or the U.S. interest rates, and hence, the exchange rate ought not to change.

Samiei (left) and Ramaswamy: Sterilized interventions can also provide signals to the market about what the central bank thinks about the future fundamentals of the economy.

But the important thing to note is that the exchange rate is an asset price determined not only by current interest rate differentials but also by expectations of future interest rate differentials. In this regard, decisions by the central bank to intervene, even when sterilized, can provide signals about the future direction of interest rates, which matters for the exchange rate. For example, the decisions by the Bank of Japan to intervene to weaken the yen in early 1995 portended the decision later that year to ease monetary policy and proved successful in weakening the yen.

Sterilized interventions can also provide signals to the market about what the central bank thinks about the future fundamentals of the economy. Such signals can be effective—in particular, when currencies are misaligned for a long period of time. In such circumstances, most market participants are probably in agreement that the currency is misaligned, but no one wants to make the first move. By intervening in this context, the central bank acts as a first mover to break the collective action logjam, which can prove successful in moving the exchange rate. So we believe the conventional wisdom in this regard provides only a rather limited perspective on assessing the effectiveness of sterilized interventions.

IMF SURVEY: How effective are coordinated versus unilateral interventions? And what conditions tend to trigger interventions?

SAMIEI: Coordinated interventions in the yen-dollar market have generally proved more successful than unilateral interventions. Our study indicates that in 75 percent of the cases, coordinated interventions in the yen-dollar market were effective in affecting the rate. This contrasts with a 50 percent success rate for unilateral interventions. Moreover, we found that when they were successful, coordinated interventions moved the exchange rate by a larger amount—about 3 percent on average. Unilateral ones, in contrast, tended to move the exchange rate in the range of 1 percent. In our framework, the signaling effect of coordinated interventions is much stronger because market participants see that both authorities are in agreement and are likely to treat this signaling as a more definite indication of future monetary policy.

You also asked what triggers interventions. We tried to estimate the probability of an intervention as depending on the extent of the cumulative change in the exchange rate over limited intervals. We tested this proposition, because the authorities in Japan officially state that their decision to intervene is based on whether the exchange rate has appreciated or depreciated excessively over time, and not on the level of the exchange rate. We have shown that the extent of the change in the exchange rate does matter, although it is not a complete explanation of the event of intervention. This is not surprising, given that the Japanese authorities are likely to be more comfortable with exchange rate fluctuations around certain levels of the yen-dollar rate than over others, even though there are no official pronouncements about what these zones of comfort are. Consequently, movements in the yen-dollar rate over some ranges are unlikely to provoke interventions in practice. ■

Copies of IMF Working Paper No. 00/95, *The Yen-Dollar Rate: Have Interventions Mattered?* by Ramana Ramaswamy and Hossein Samiei, are available for $10.00 each from IMF Publication Services. See page 244 for ordering information.

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Correction

The report on IMF Managing Director Horst Köhler's visit to Africa in the last issue of the *IMF Survey*, dated July 17, page 225, omitted to mention that he also traveled to Cameroon following his meetings in Senegal. In Cameroon, the Managing Director met with President Paul Biya and other senior officials and had discussions with representatives of civil society.