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Libreville meeting

At economic summit, African leaders sign joint declaration pledging to fight poverty

The heads of state and government leaders from more than twenty African countries gathered in Libreville, Gabon, on January 18–19, for an economic summit on the challenges of accelerating growth and eliminating poverty on the continent. IMF Managing Director Michel Camdessus, First Deputy Managing Director Stanley Fischer, Deputy Managing Director Eduardo Aninat, and other IMF staff participated in the meeting. Also participating were the President of the African Development Bank Omar Kabbaj and Vice President of the World Bank's Africa Regional Office Jean-Louis Sarbib.

In his opening remarks, Camdessus said the IMF, in cooperation with the World Bank and other sister organizations, stands ready to be associated with the poverty reduction strategies developed in individual countries. "Your strategies," Camdessus said, "will serve as the basis for all the concessional lending granted by each of our organizations." For this purpose, the IMF will use the new Poverty Reduction and Growth Facility (PRGF), which replaces the Enhanced Structural Adjustment Facility (ESAF) as the IMF's concessional lending facility, particularly for assisting the heavily indebted poor countries. The central objectives of the PRGF, Camdessus said, will be poverty reduction, debt reduction, and stability, marking a "profound shift" in the IMF's way of doing business.

Camdessus closed by urging leaders to address a matter of the greatest importance—"the quest for peace and an end to the *(Please turn to the following page)*

Boston meeting

AEA sessions discuss emerging markets, the euro, and transition economies

The recent financial crises and ways to prevent them or reduce their effects, the future of the euro, challenges facing transition and emerging market economies, and the effectiveness of IMF programs were among the topics discussed in Boston on January 6–9 at the annual meeting of the Allied Social Science Associations, which includes, among others, the American Economic Association (AEA) and the American Finance Association (AFA).

Financial markets and public policy

A panel on financial markets and public policy, moderated by James L. Bicksler of Rutgers University, considered the failure of current economic theory to provide a foundation for economic policymaking and private sector involvement in crisis prevention and resolution.

Toward a new economic theory. The ability to enact good policy is limited by inadequate theory, according to Douglas North of Washington University, St. Louis. North, an economic historian and Nobel laureate, said that neoclassical economic theory is obsolete. The world we are living in is changing so quickly that it is almost impossible to predict or build policy on the existing body of theory, he said. Current theory is static, designed to solve a problem that exists at a single moment in time. But all the problems we have are dynamic. We need to develop tools that let us be conscious of what may lie down the road. Such theory may, of necessity, be less precise or consistent than current static theory, North said, but even in a rough form, it may provide a more solid base on which to fashion policy.

Private sector and financial crises. In the aftermath of recent financial crises, the need to involve the private sector in both crisis prevention and crisis resolution has become a major focus of attention, IMF First Deputy Managing Director Stanley Fischer *(Continued on page 20)*

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(Continued from front page) conflicts that plague so many countries on this continent." These conflicts, Camdessus said, have economic causes and economic consequences.

In his remarks, which served to sum up the conference, Fischer commended the conference delegates for their "frank and valuable dialogue" and their demonstrated determination to attack the problem of poverty in Africa—in a spirit of partnership and on new terms—with the international community.

In the past 13 years, Fischer noted, the IMF has become progressively better equipped to respond to the specific needs of Africa, and the new PRGF is a further major step in that direction.

Fischer noted several concerns expressed by delegates during the conference about the new approach to poverty reduction embodied in the PRGF:

- how best to involve civil society in the preparation of a national poverty reduction strategy;
- heavy demands for financial assistance on already overstretched institutions and organizations;
- better coordination and avoidance of multiple and overlapping conditionalities among donors;
- need for speed to ensure that debt relief is provided as quickly as possible; and

Joint declaration of Libreville economic summit

Following are edited excerpts from the text of the joint declaration, issued on January 19 in Libreville.

At the invitation of the President of the Gabonese Republic, His Excellency El Hadj Omar Bongo, the heads of state and government of the countries of sub-Saharan Africa met in Libreville on January 18–19 for an economic summit, with a view to deliberating on an agenda for Africa at the dawn of the new millennium and on the challenges of accelerating economic growth and eliminating poverty. On this occasion, they discussed Africa's economic and social progress over the past few years, as well as their vision of Africa's future, and underscored their determination to address resolutely the impediments to social and economic progress and bring about a visible reduction of poverty. They also conferred on ways of strengthening sub-Saharan Africa's partnership with its multilateral and bilateral development partners.

Growth and poverty reduction

The heads of state and government noted the fact that the region is lagging behind the rest of the world in improving living standards. They were also concerned by Africa's negative image, linked to conflict, pandemics, and poor economic and social performance. Moreover, Africa's integration into the world economy has been slow.

The heads of state and government underscored that, despite the recent economic recovery in many countries, much more needed to be done to reduce poverty. Unemployment remains at a distressingly high level, particularly among Africa's youth; illiteracy continues to be high; and progress in combating many endemic diseases has been slow. In particular, the summit participants deeply regretted the spread of AIDS and malaria and their devastating impact on the continent.

The heads of state and government recognized the strong synergy between sound macroeconomic policies and market-friendly structural reforms, on the one hand, and policies that benefit the poor directly, on the other hand. They agreed that the reduction of poverty is not possible in the absence of economic growth.

The heads of state and government pledged to redouble their efforts to promote strong and lasting growth and poverty reduction through, in particular, the elimination of unproductive expenditures and improvements in education, health, social services, and basic infrastructure. They reaffirmed their resolve to reduce poverty by half by 2015. They pledged to establish a committee to monitor the implementation of the recommendations made by this conference.

The heads of state and government stressed the need to use available resources as effectively and efficiently as possible, in order to promote and accelerate social development. Moreover, they affirmed their determination to fight corruption and pledged to continue the reform of the judiciary, strengthen the effectiveness of public institutions, and promote administrative and territorial decentralization. They also recognized the importance of reforming civil services in order to increase efficiency.

In recognition of the crucial role that trade plays in economic development, the heads of state and government called on industrial countries to gradually eliminate agricultural subsidies and open their markets to African products, particularly agricultural goods and textiles. The leaders also reiterated their resolve to accelerate the subregional and regional integration process already under way.

The heads of state and government underscored the importance of deep structural reforms in transforming the private sector into the engine of growth. They firmly hoped that the sustained implementation of reforms would help create the conditions that would attract the necessary concessional foreign assistance, as well as inflows of foreign direct investment.

Regarding the devastating impact that the AIDS epidemic has had on the social and economic fabric of many countries in Africa, the heads of state and government undertook to take all necessary steps to raise public awareness of the problem and to slow the spread of disease, drawing on the successful experiences of their countries. To this end, they appealed to the international community to provide more assistance in supporting these efforts actively.

The heads of state and government underscored the importance of stepping up efforts to build peace and establish regional conflict-resolution and crisis-

• need to ensure that the debt relief from the Heavily Indebted Poor Countries (HIPC) Initiative is truly additional and not a replacement for other forms of financial assistance.

The IMF and the World Bank are working together and with individual countries to address these concerns, Fischer said. He acknowledged that uncertainties remain, and resolving them will take goodwill and cooperation. This conference, he concluded, "proves that the goodwill and the desire to cooperate are there."

In a joint declaration released at the end of their meeting, the leaders declared that "despite the recent economic recovery in many countries, much more needs to be done to reduce poverty." They pledged to redouble their efforts to promote lasting growth and poverty reduction, fight the "devastating impact" of the AIDS epidemic, and build a new partnership with donors based on improved aid coordination, harmonized donor procedures, and firm, longer-term commitments of financing. They also strongly endorsed the new framework for IMF and World Bank concessional lending policies, particularly the introduction of country-owned poverty reduction strategy papers (PRSPs) and the PRGF. Camdessus welcomed the joint declaration, saying that it was a historic document that would serve as "the bible for action for the IMF and the World Bank in the years to come." ■

prevention mechanisms, which would need, however, the firm support of the international community.

The heads of state and government welcomed the interest accorded by the international community to poverty reduction and its full integration into macroeconomic and structural reform programs. They endorsed the new framework for IMF and World Bank concessional lending policies, particularly the introduction of country-owned poverty reduction strategy papers (PRSPs) and the transformation of the Enhanced Structural Adjustment Facility into the Poverty Reduction and Growth Facility. The new framework should signal a new approach for cooperation among the recipient countries, multilateral institutions, and other donors. This should also include assistance in building up the necessary administrative and institutional capacity to formulate and implement poverty reduction policies. However, the heads of state and government requested that this new approach should not result in additional conditionality. They further underscored that the planned timing of structural reforms would have to take into account the requirements of the consultative process and the impact of external and internal shocks, so as to avoid the interruption of programs.

The heads of state and government agreed on the need for consultation between government and civil society in order to increase the public's understanding and ownership of its country's strategy. However, this consultative process should take cultural factors and customs in the countries concerned into account and should not constitute a political conditionality.

The heads of state and government reaffirmed the need to devote particular attention to the role of women in the development process.

External assistance

In discussing the role of external assistance, the heads of state and government called for a new partnership with donors based on improved aid coordination, harmonized donor procedures, and firm, longer-term commitments. To this end, they called for the elimination of multiplicity of donor conditionalities, as well as cross-conditionality, and urged that external assistance be based on the PRSP to support efficient public expenditure programs geared to achieving poverty reduction within a sustainable medium-term fiscal framework.

The heads of state and government renewed their solemn appeal to the international community for the cancellation of Africa's debt. They appreciated the impetus given by the Cologne Summit [June 18–19, 1999; see *IMF Survey*, July 5, 1999, page 209] and saluted the recent strengthening of the Joint Initiative for Heavily Indebted Poor Countries (HIPC Initiative).

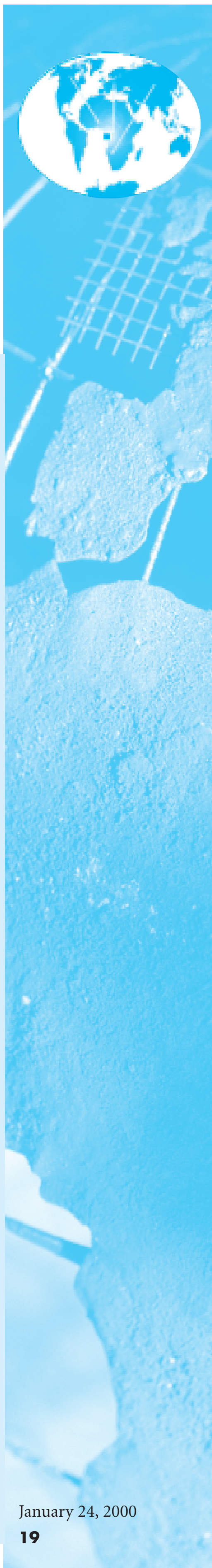
HIPC Initiative

They called on their development partners to reduce substantially the time required for access to debt relief and to fully finance the HIPC Initiative. The heads of state and government also stressed the importance of finding innovative solutions for the heavily indebted middle-income countries where social indicators are weak, as well as small island or landlocked economies whose potential is handicapped by their debt burden.

The heads of state and government stressed the importance of the link between the HIPC Initiative and poverty reduction strategies; they pledged to apply the resources made available by debt relief to poverty reduction programs. They urged donors to provide additional resources, so as to contribute to the success of these strategies. They also asked the international community to provide sufficient financial assistance to conflict or postconflict countries, particularly those in a situation of arrears to multilateral institutions. Special assistance should also be provided to neighboring countries affected by such conflicts.

In conclusion, the heads of state and government recognized that poverty reduction is a challenge that they must address themselves. They therefore expressed their determination to move ahead in confronting this challenge head-on, with the support of their development partners. They noted that Africa is a continent of untapped potential, and their aim at the dawn of the new millennium was to realize fully this potential and to translate it into sustained and broad-based development.

The heads of state and government paid high homage to Michel Camdessus, a great friend of Africa who has never yielded to Afro-pessimism, for his unwavering fight for African debt relief and poverty reduction.



Transition and development in the global economy

(Continued from front page) said. The need to ensure private sector involvement arises, Fischer explained, for two main reasons: moral hazard and the fact that the public sector will not—nor should it—be able to provide very large financing packages in the future.

Stanley Fischer

Moral hazard is almost inevitable whenever insurance is provided, Fischer said. At the same time, public financing in the event of a serious external financial crisis may be needed to help restore financial stability and reduce the effects of the crisis on economic activity. Therefore, in the event of an external financial crisis in which official financing is provided to the country, private sector involvement will typically be needed, both to ensure that the needed balance of payments adjustment by the country is not excessive and to reduce moral hazard.

The first step in trying to resolve the issue of private sector involvement, Fischer said, is to find ways to prevent crises. For countries, this will involve good macroeconomic policies, including choosing an exchange rate regime that effectively resolves the "incompatible trinity" of mobile capital, fixed exchange rates, and domestic monetary policy. However, crises cannot be prevented altogether, whatever the exchange rate regime, so there is still a need to reduce the moral hazard inherent in any workout scheme, Fischer said. Bankruptcy procedures are needed to handle private sector claims, while workout procedures for public sector claims will need to be developed. Fischer acknowledged that problems persist in both private and public sector debt-resolution procedures. Many countries have weak bankruptcy laws and legal systems. In the case of sovereign debt, the international community and creditors do not want to make debt restructuring easy. But the harder creditors make it to default, the more severe the default when it happens. Various proposals for changing the structure of debt contracts are under consideration, he said, but consensus among debtors, creditors, and advanced and emerging markets on the way ahead remains to be developed.

Mervyn King

Monetary policy in the United Kingdom

At a luncheon, Mervyn King, Deputy Governor of the Bank of England, spoke about the pursuit of monetary policy with an independent central bank. The granting of independence to the Bank of England in 1997, King said, represented a convergence of theory and practice. Although it has long been recognized that institutional arrangements matter for monetary policy, much has changed over the past several years. What was once perceived as a "dark art practiced in secret by magicians" has given way to transparency and openness. The hallmarks of U.K. monetary policy now include the adoption of more explicit inflation targets as a framework for monetary policy, communication to the public of expectations and targets, and a new interest in monetary policy in an environment of low inflation.

Decade of transition

In the past decade, many countries in Asia and Eastern and Central Europe have been in the process of transforming their economies from centrally planned to market based. As discussed in this session, moderated by Fischer, the speed and success of transition have varied markedly across countries.

"Good" and "bad" federalism. Why has the Chinese experience been so much more successful than the Russian? Olivier Blanchard (Massachusetts Institute of Technology) and Andrei Shleifer (Harvard University) attempted to answer this question by analyzing the relation of the central government to local governments. The central government in China provides incentives to the private sector, while the Russian government, which has consistently protected state firms, has stood in the way of private sector growth. The difference, Blanchard said, lies in the amount of control the central government can exert over local governments. In China, local governors are appointed by the central government. If they misbehave—say, by withholding from the central government locally collected taxes—they are removed from office. Officials who play by the rules are allowed to retain a higher proportion of the revenue from locally collected taxes. In Russia, local governments are elected. Although the Russian central government is perennially revenue-hungry, its hold on the local governments is so tentative that misbehaving local politicians are unlikely to be punished.

The implications for Russia, Blanchard and Shleifer suggested, are that the development of an effective democratic electoral process should involve the emergence of strong, unified parties that, when voted into office, can assert unified and consistent political pressure on local governments.

Escaping the "underreform trap." Countries lacking a strong democratic process that enables voters to throw corrupt, rent-seeking officials out of office tend to get stuck in the "underreform trap," according to Simon Johnson (Massachusetts Institute of Technology). Looking at a range of transition economies, Johnson said, he and his coauthors, Anders Äslund (Carnegie Endowment for International Peace) and Peter Boone (Brunswick University), found that countries with a history of social democracy, such as Poland and Hungary, or that had radically transformed their economy and rooted out entrenched interests, such as the Czech Republic and Slovakia, were most successful in beating back "bureaucratic predation." In contrast, transformation is incomplete in countries, such as Ukraine and

Russia, where the Communist Party retains a stronghold and electoral backlash is weak.

Some solutions to the underreform problem, Johnson said, include adopting a system of fiscal federalism, narrowing opportunities for corruption, passing effective laws, and firing bureaucrats and managers unwilling to adapt to the new environment.

Performance in transition economies. In a survey of the experience of transition economies over the past decade, Fischer and Ratna Sahay (IMF) analyzed output performance and transition strategy. Although all countries experienced a fall in output at the beginning of the transition process, their study found considerable differences in the recovery process. Some—especially in Central and Eastern Europe and the Baltic states—recovered more rapidly than others, such as Russia, Ukraine, and some other states of the former Soviet Union. Sahay said that slower structural reforms contributed more to the initial decline than adverse initial conditions. In most countries, recovery started after two years of macroeconomic stabilization. The driving force behind the high growth observed in some countries was the speed with which structural reforms were implemented. Transition economies seemed to have received substantial technical assistance but relatively little external financial assistance, Sahay said. But while external assistance was important, its effectiveness depended on policy commitment by domestic policymakers.

Is transition complete? After 10 years, are transition economies still a unique phenomenon, to be treated differently from other countries at a similar stage of development? Or have they successfully thrown off the legacy of central planning and should they now be regarded as fully functioning emerging markets? In his presentation, Daniel Gros of the Center for European Policy Studies attempted to answer this question by measuring the performance of a sample of transition economies against a control group of countries in Southeast Asia. Using indicators such as share of industry and services in employment, levels of corruption, importance of the financial sector in the economy, and financial liberalization, Gros found that the legacy of central planning was still strong in the countries of the former Soviet Union. By contrast, the countries of Central and Eastern Europe can be said to have "graduated" from the transition process, and their future development efforts should be based on the same principles as other comparable emerging market economies.

Euro developments

A roundtable on the euro, the dollar, and the international monetary system was held on the first anniversary of the launch of the euro. Opinions among the participants varied about the value of a single currency for Europe and its chances for survival in the long run.

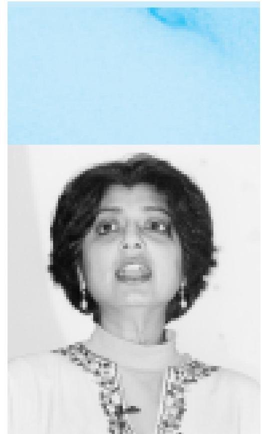
The European Central Bank (ECB), the sole monetary policy authority for all European Economic and Monetary Union (EMU) members, has a single mandate—maintaining internal stability within the EMU. According to Otmar Issing, a member of the ECB Executive Board, after only a year, the bank has apparently gone far toward fulfilling that mandate. But, he continued, because the transition to a single monetary policy was relatively smooth, people tend to forget the daunting challenges the ECB faced last year. In particular, the ECB was obliged to adopt a monetary policy strategy for a newly launched and untested monetary system, without benefit of real time series or data that could provide indications of possible outcomes. Further, the Maastricht Treaty, which gave the ECB its mandate, did not provide an operational definition for price stability. Issing said it would take a few years to determine if the strategy the ECB adopted has been successful, but after only one year, the bank already appears to enjoy a high degree of credibility, as measured by long-term interest rates. This is remarkable, Issing said, because an institution usually needs several years to build up a track record of keeping its word. He attributed this success to a belief by financial markets that the ECB's adopted strategy is capable of fulfilling the provisions of the Maastricht Treaty. Another important contributor is the ECB's transparent communications policy.

Sounding a dissenting note, Martin Feldstein (Harvard University and National Bureau of Economic Research) said EMU was an "expensive device for the political unification of Europe." In his view, the single currency will have negative effects on employment and could lead to trade conflicts between Europe and the United States. In the single year of its existence, the value of the euro vis-à-vis the U.S. dollar has declined by about 15 percent, the European economy has been weak, and unemployment in Europe has been more than twice that in the United States.

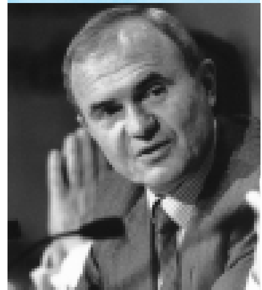
The ECB's ability to maintain stability in the long run, Feldstein said, will depend on the ability of member countries to contain excessive demand. Differences in demand conditions among countries will be a problem, particularly with low labor mobility and no central fiscal authority that can offset fiscal differences through transfers.

Most of the unemployment in Europe is structural, not cyclical, Feldstein noted, but, in his opinion, EMU will reduce the likelihood of countries introducing structural reform. They will tend, rather, to blame unemployment on the high interest rates mandated by the ECB. This resistance is not likely to break down over time and could reduce European competitiveness, leading to the erection of protectionist barriers, especially against the United States, he said.

Although initially skeptical about EMU, Rudiger Dornbusch of the Massachusetts Institute of



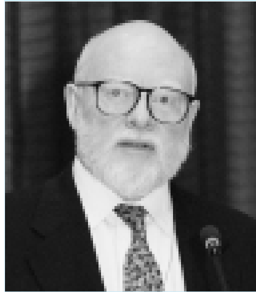
Ratna Sahay



Otmar Issing

Technology said the ability of planners "to pull it off" had converted him. The introduction of the euro has already had beneficial effects both on inflation and in European capital markets, he said. In the face of a falling euro, the ECB "learned to stop talking about the exchange rate" and concentrated instead on internal stability. The collapse of European interest rates led to a cleanup of financial sectors.

The single currency does face considerable challenges, Dornbusch acknowledged—in particular, how to cope with an upturn. What happens, he asked, if labor markets stay unreformed and growth goes up? The ECB and the euro have not changed the reality of a "totally unreconstructed supply side," he said, but that is not the fault or the responsibility of the ECB. The ECB should not give in to inflationary pressures, Dornbusch warned; it will have to control growth by sticking to stability and leave structural concerns to national governments.


Ronald I. McKinnon

Economists have used the arguments in Robert Mundell's seminal essay on optimal currency areas to rail against EMU ever since the paper was published in 1961, according to Ronald I. McKinnon of Stanford University. But whereas economists have tended to oppose EMU, politicians have pushed it. Where, asked McKinnon, did the economics profession go wrong? The "1961 Mundell" posited stationary expectations in capital markets, labor mobility, and the use of a flexible exchange rate outside the currency union area. But in 1970, Mundell published two further papers on optimum currency areas that have gone largely unregarded, McKinnon said. A closer look at the 1970 papers reveals "a second Mundell," who had, according to McKinnon, changed his mind. In the 1970 papers, Mundell introduced the idea that the exchange rate was forward looking and therefore subject to volatility in the short run. But an uncertain exchange rate made it difficult to organize capital markets to deal with asymmetric shocks unless there was a single currency to share the risks. McKinnon said Mundell's conclusion—that the exchange rate should be removed from international consideration—presaged EMU.

Guillermo Calvo

The promise of EMU has been realized, McKinnon said. European countries signing Maastricht accepted the stick of fiscal control in exchange for the carrot of shared risk and narrowing premiums. The euro will not replace the U.S. dollar, McKinnon said, but as EMU continues to expand, fluctuations in the euro will matter less and less.

Carmen Reinhart

Macroeconomics of emerging markets

The fallout from financial crises—both in the country of origin and in other countries to which the contagion spreads—has focused attention on exchange rate issues in emerging market economies, according to Guillermo Calvo of the University of Maryland.

Presenting a paper coauthored with Calvo, Enrique Mendoza (Duke University) said that incomplete or asymmetric information was instrumental in creating the problems—namely, financial vulnerability, economic collapse, and contagion—emerging markets encountered in the capital market crises in the 1990s. When an investor is perceived to have inside information, other traders blindly follow, regardless of whether the so-called informed investor is following fundamentals or responding to an unrelated signal (like a margin call). This herd behavior could precipitate a major disruption in capital flows, with far-reaching consequences for vulnerable emerging markets.

Policy lessons that have emerged from analyses of recent crises, Mendoza said, include the need to improve information channels and develop "information-efficient" systems. Dollarization, the internationalization of financial systems, and lengthening of debt-maturity profiles are other measures that could help increase the resilience of emerging markets.

"Mirage" of floating. Recent turbulence in emerging markets has suggested to many observers that countries trying to peg in a world of mobile capital are "fighting against the wind," Carmen Reinhart of the University of Maryland said; therefore, these observers argue, emerging markets should let their currencies float. Most emerging markets do, in fact, claim that they are floating, suggesting that the fixed exchange rate is no longer a preferred option. But after looking at the experience of the past forty years, Reinhart said she discovered that the apparent demise of fixed exchange rates was "a myth."

With a freely floating exchange rate, Reinhart said, the exchange rate varies as the interest rate responds to money demand shocks; reserves do not vary. With a fully credible peg, the exchange rate does not vary, as the central bank intervenes in the foreign exchange market to maintain the nominal interest rate at the level of the international interest rate. Noncredible pegs, Reinhart said, which carry with them the likelihood of default, also feature a fixed exchange rate, but it is stabilized through open market operations and not through purchases and sales of foreign exchange. This operation of fixed exchange rates masquerading as managed floats is, according to Reinhart, currently "very fashionable."

Observing the behavior of 146 countries, Reinhart concluded that the systems of most countries that claim to float more closely resemble noncredible pegs. The reason, she said, is widespread "fear of floating." This fear is fueled by liability dollarization (most liabilities of emerging markets are denominated in U.S. dollars), contractionary devaluations (income does not go up when the current account increases), and credibility problems.

Despite the evidence presented in Reinhart's paper, Roberto Chang (Federal Reserve Bank of Atlanta) and

Andres Velasco (New York University) asserted that since the 1970s, emerging markets have moved toward floating or are opting for more flexibility. In their paper, Chang said, they considered the economic consequences of exchange rate policy. Although they leaned toward floating as the most appropriate regime for most emerging markets, they acknowledged that decisions were likely to be country specific, and there was a need to develop theoretical models that were applicable to actual cases.

The fear of floating mentioned by Reinhart has considerable validity, Chang and Velasco acknowledged. The case for flexibility is weaker the greater the extent of dollarization. Also, a devaluation hurts those who borrow in dollars but whose earnings are denominated in local currency. A devaluation could be contractionary because of the effect of the dollar value of collateral, leading possibly to a credit crunch caused by market imperfections.

As the effects of the financial crises have subsided, Chang and Velasco concluded, exchange rate policy needs to be analyzed as an aspect of monetary policy. The development of appropriate microfoundations is a priority.

Assessing the IMF

As panel moderator Joseph Joyce of Wellesley College noted, an assessment of the IMF is particularly timely, given IMF Managing Director Michel Camdessus's impending resignation and emerging developments on the international monetary scene. Some panelists expressed reservations about the IMF's effectiveness, but all agreed that commitment and reform efforts at the domestic level are as important as international financial assistance.

IMF as catalyst. How effective has the IMF been in mobilizing international finance? Graham Bird (University of Surrey) and Dane Rowlands (Carleton University) challenged what they called the commonly held belief that IMF financial support was guaranteed to generate additional financing from other sources.

The empirical evidence Bird and Rowlands examined did not, in their view, reveal any clear-cut evidence of a positive catalytic effect from IMF support. They found, rather, among countries with IMF-supported programs a high rate of recidivism (that is, countries returning to the IMF for additional assistance to support new or revised programs), low rates of completion, and no measurable improvement. What matters, they concluded, is credibility—markets respond to a government's strong commitment to reform, with or without the IMF.

Recidivism. One of the consequences of the apparent failure of IMF support to mobilize capital flows is that some countries have become frequent users of these resources. In a related paper, Bird and coauthor Joseph Joyce asked whether recidivism was a case of "many happy returns," or whether the IMF should be concerned about the recidivism rate.

Countries turn to the IMF, Bird said, because of balance of payments problems, macroeconomic mismanagement, external shocks, and failure to attract other external financial resources. If they keep coming back to the IMF, he argued, the reason may be that the programs the IMF supports either are not well designed or are not completed, or that some countries are "slower learners" than others.

According to Bird and Joyce, the IMF appears to regard recidivism as relatively benign—part of an "ongoing relationship." A less positive interpretation, they said, might be that the programs are not working. Bird and Joyce suggested that a way to reduce recidivism is to examine its causes and consider these factors in the design of reform programs. Increasing structural efficiencies, providing incentives for program completion, and encouraging good governance should play a role in programs designed to help countries "graduate" permanently from IMF support.

Responding to the Bird and Joyce paper, Stanley Black (University of North Carolina) suggested that the authors should have distinguished more clearly between "slow" and "effective" learners, particularly with regard to their access to private capital markets. Countries with low access to private markets had far fewer options than those with high access and were, thus, more likely to keep coming back to the IMF, regardless of how effective their programs had been.

Another view. Some critics of the IMF's advice to Asian countries hit by the financial crises of 1997 and 1998 have asserted that the IMF's standard prescription—fiscal and monetary tightening—was inappropriate and dangerous, because the crises were structural, rather than macroeconomic in origin, according to James Boughton of the IMF. It was unreasonable, these critics say, to ask countries whose domestic economy was in balance before the crisis to tighten fiscal and monetary policy anyway. But, Boughton noted, tightening can be avoided only if investor confidence can somehow be restored quickly. How to do that is a question of psychology, not economics.

James Boughton

The appropriate policy response, Boughton said, does not depend on whether fiscal and monetary policy was appropriate before the crisis; what matters is what is appropriate after the crisis. The IMF advised tightening to countries suddenly in the position of having to attract capital flows. The choice was between tighter policy and a stable exchange rate or easier policy and a sharply devalued exchange rate. You cannot argue with the arithmetic, Boughton said: Maintaining external stability with limited financial resources calls for a tightening of macropolicy. ■

Sara Kane
Deputy Editor, *IMF Survey*

World Bank-IMF Seminar

Review focuses on dynamics of banking crises, lessons that have been learned

Few industrial and emerging market countries over the past two decades have been immune to banking sector turbulence. Full-blown crises, in particular, have exacted a tremendous toll. The frequency and high cost of these episodes prompted the World Bank and the IMF to set up a Bank-Fund Financial Sector Liaison Committee to strengthen the exchange of information on financial sector issues and better coordinate their advice to member countries.

On January 11, the committee sponsored a seminar on managing banking crises to share their accumulated experience. The seminar, held at the World Bank, focused on the dynamics of banking crises and the lessons learned from efforts to resolve major episodes in Indonesia, Korea, Mexico, and Russia, and others. Among the recommendations of the seminar were the creation of a single agency to deal with a crisis, having authorities assume a private sector approach to the management of banking crises, and ensuring adequate resources are assigned to the resolution process.

Stijn Claessens

The seminar, chaired by Stefan Ingves, Director of the IMF's Monetary and Exchange Affairs Department, included presentations by Stijn Claessens, Lead Economist of the World Bank's Financial Sector Strategy and Policy Department; Charles Enoch, Assistant Director, and David Hoelscher, Advisor, of the IMF's Monetary and Exchange Affairs Department; Fernando Montes-Negret, Sector Leader for the World Bank's Latin American Finance Group; and David Scott, Advisor in the Bank's Financial Sector Department. Following is a summary of the seminar presentations. The slide projections that accompanied these presentations are available on the World Bank's website (www.worldbank.org/finance).

Charles Enoch

Dynamics of banking crises

In an opening presentation, Claessens outlined the scope and structure of banking crises, and detailed their global reach and the significant costs involved in recapitalizing and restructuring banking systems and, often, in coping with major output losses. After surveying the macroeconomic and microeconomic missteps that can lead to a banking crisis, he discussed the "phases of distress" of a crisis. These he segmented into a containment phase (a critical period when appropriate steps can halt the spread of a banking crisis); a restructuring phase (when various institutional, rehabilitation, and recapitalization measures are called for); and a reform phase (when the deeper causes should be addressed through fundamental and necessarily longer-term reforms).

Claessens further divided the containment and restructuring phases into discrete stages. The containment phase, he noted, has an onset stage when bad financial conditions are accelerating; a period of open crisis, which sometimes features bank runs and often includes large liquidity support, currency crises, and interest rate spikes; an effort to limit losses, which frequently entails suspending weak banks, imposing conservatorships, and issuing government guarantees of depositor holdings; and a stabilization program.

The restructuring phase, he said, typically has five stages: diagnosis, in which both the scope and the source of the problems are determined; development of appropriate institutional tools and adaptation of the legal framework as needed; creation of a strategy that outlines the authorities' vision of a reformed banking sector; loss allocation and government support (including such steps as write-offs, closures, and the use of public funds); and reprivatization and normalization of the financial system.

Indonesia

Indonesia's banking crisis, Enoch noted, was characterized by particularly deep insolvency, a large number of banks in the system, limited management capacity, and little scope for resolution through outside acquisitions. In November 1997, in the face of widespread runs on the banking system, the authorities closed 16 banks (3 percent of the banking system). The closures themselves were handled efficiently, but there was a lack of clarity as to why the banks had been selected. The authorities failed to demonstrate commitment to the concomitant economic program, and the limited deposit insurance scheme prompted concerns about losses among large depositors. Over the following weeks runs on the banks resumed and became pervasive, leading to a generalized run on the currency.

At the end of January 1998, and facing imminent financial meltdown, the authorities announced a blanket guarantee for all depositors and creditors and established the Indonesian Bank Restructuring Agency (IBRA). In mid-February, IBRA intervened in 55 banks that had borrowed more than twice their capital from the central bank. But this very "soft" open bank resolution, which did not replace owners and managers or announce these steps to the public, did little to stem the crisis. The next month, IBRA took over seven large banks that had borrowed heavily (over $240 million), changed management and suspended owners' rights. IBRA also closed seven small banks that had borrowed over 500 percent of their capital, subsequently closing

three and identifying the largest remaining bank as a "platform bank" into which the remaining banks of this group would be folded. Finally, in March 1999, the authorities were able to take a comprehensive approach to resolving the remaining private banks. They categorized 74 small banks as sufficiently strong to survive unaided; jointly recapitalized, with the owners, 9 middle-performing banks, and closed 38 very weak banks.

Enoch observed that banking system resolution typically involves both bank closures (where the doors are closed and assets and liabilities transferred) and open bank resolution (where ownership and management generally change but the bank stays open). In either case, he said, intervention is only the first stage, and the final cost of intervention will be determined as much by the efficiency of follow-up activities. The authorities' approach will evolve as information becomes available, but initial interventions are likely to be on banks with protracted runs or deep insolvency, or where there is evidence of fraud.

For the succeeding period, Enoch suggested, the authorities may have to rely on indicators of liquidity, which is a good proxy for insolvency in conditions of limited information. They may also need to contain central bank liquidity support to avoid losing monetary control. Outside auditors can help provide a fuller picture of banks' underlying condition and provide the basis for identifying banks strong enough to survive without official support, banks who should be given official support under stringent conditions, and banks with no viable future that should be closed. Overall a banking crisis will lead to fewer banks and—at least temporarily—an increase in the share of state ownership, he noted.

According to Enoch, Indonesia's experience underscores the importance of uniform and well-explained criteria for invention. It also suggests that when there is fear of systemic problems, the introduction of blanket guarantees, despite their potential cost and moral hazard implications, is likely to be a part of any resolution strategy. The choice between closure and open bank resolution is likely to have to be determined case-by-case and will vary across countries, but where there is pervasive insolvency, many banks, and evidence of fraud, Enoch concluded, bank closures are likely to be part of the program.

Mexico

According to Montes-Negret, the roots of Mexico's 1994 banking crisis lay in the government's emphasis on maximizing revenue from the privatization of banks that already had portfolio problems. Banks that were nationalized in 1982 had long ago lost private sector initiative and their best staff. When Mexico reprivatized these banks in 1991–92, excluding foreign banks, it awarded licenses without proper tests of new and unproven bankers and permitted a number of banks to be set up with little capital and highly leveraged assets. A 1991–94 credit boom, a large number of foreign-currency-denominated loans, inadequate accounting standards, weak supervision, and distorted incentives set the stage for a banking crisis even before political and economic shocks led to a run on the currency in late 1994.

Prolonged denial and very poor accounting standards characterized the first phase of Mexico's banking crisis. Montes-Negret cited serious conflicts of interest in which supervisors also directly involved themselves in bank restructuring deals. Efforts to attract foreign investment led to great deals for foreign banks. Also, he said, some insolvent banks continued to operate far too long and at great fiscal cost. Bank managers were replaced too slowly, even when there had been looting of bank assets. Lax legal arrangements induced nonpayment, and little information about the depth of the crisis was available to other government agencies. One positive feature, however, was that Mexico experienced no runs on its banks.

A second phase in 1997 saw the introduction of a new accounting framework, but the resolution process became overpoliticized in 1998, with political discussion continuing while costs continued to rise. A more decisive phase began in 1999 with the formation of a new resolution and deposit insurance agency.

Among the chief lessons are, Montes-Negret said, that hiding a problem does not solve it, and as Mexico has become more democratic, there has been more disclosure. Further, supervisors entered into complex ad hoc deals without a global framework, resulting in far too much discretion and excessive secrecy. Clearly also, he emphasized, a least-cash solution is not always the least-cost solution. Mexico's accounting solution merely postponed the financial solution, and its overly complex "engineering," which provided government paper to banks in lieu of cash, actually worsened the banks' cash-flow situation in some cases. Finally, he said, beware of early declarations of victory and of tailoring a solution to fit the cash on hand.

Russia

The Russian banking system grew with astonishing rapidity, Hoelscher noted, burgeoning from 10 banks to 1,600 between 1992 and 1997. With most banks meeting Russia's prudential regulations, the authorities assumed that all was well in the banking system, but existing statistics did not reflect actual conditions, he said. The banking system was highly concentrated (10 banks held 80 percent of the system's assets), and the portfolios of these large banks were heavily concentrated (almost 60 percent were concentrated in GKOs, the Russian government bonds) and had significant exposure to foreign exchange risk.

While a forced restructuring of the GKOs and exchange rate depreciation provided the immediate impetus for the 1998 banking crisis, its roots, Hoelscher

Fernando Montes-Negret

David Hoelscher

suggested, lay in the banks' significant level of nonperforming loan portfolios, as well as their vulnerability to exchange rate volatility and the heavy concentration in GKOs. The crisis immediately left large banks illiquid. As a result, deposits were frozen, the payment system ground to a halt, and banks defaulted on forward exchange contracts and foreign debt-service obligations.

But the Russian authorities, who remained unconvinced that this was an insolvency problem, called for a moratorium on foreign debt payments and permitted households to shift deposits to Sherbank, the state-owned savings bank. In the absence of reliable data and in the face of severe budget and institutional constraints, a joint IMF-World Bank team of advisors identified the need to collect more accurate data on the major banks, strengthen the legal framework for bank restructuring and liquidation, and establish an institutional framework for restructuring. A World Bank–financed due diligence review subsequently found 15 of the 18 major banks deeply insolvent, with a net negative worth of 173 percent of assets (in individual cases, net negative worth was the equivalent of 400 percent of assets). The review also found that the default on the GKOs was not the principal culprit—provisions for nonperforming loans and foreign exchange losses figured much more prominently.

As a result of this review and a series of technical assistance missions and activities related to the use of IMF and World Bank resources, the Central Bank of Russia removed the licenses of 6 of the 18 banks and put 3 others under management of a newly established bank restructuring agency, Hoelscher explained. Both bank bankruptcy and bank restructuring legislation were signed into law in 1999. In addition, the central bank began modernizing supervisory regulations and consolidating and improving the management of these supervisory functions.

David Scott

A joint World Bank-IMF mission has developed an action plan for the coming year that calls for continued consolidation of the banking system, development of a core banking system, and improvement of the operating environment, including continued modification of prudential regulations and a revision of bank disclosure requirements.

The Russian crisis, Hoelscher indicated, taught the IMF and the Bank that authorities' perceptions can critically influence the sequencing of reform measures and that close Bank-IMF cooperation can produce a more coherent and more successful program.

Minimizing the cost of crises

Scott described the approach taken in advising Korea on how to reduce the costs of crises. These costs, he explained, grow with time and are to a large extent determined by the behavior of debtors, creditors, and the authorities. Often unnecessary bailouts and theft also contribute to the costs. While governments can do much to control costs, he argued, they are normally not well equipped to do so and frequently get it wrong. He recommended the use of a specialized team focusing exclusively on resolving the crisis. The team should view its job as akin to investment management, with the goal of minimizing the amount of government outlays needed to get the job done and maximizing the value of that investment over time. Ultimately, he said, the team can get the best results by acting like private investors.

Scott asserted that acting like private investors would entail, among other things, moving fast to minimize the negative carry associated with nonperforming assets, avoiding bailing out those who can service their debt, avoiding moral hazard (which, he said, arises when the authorities allow support to be squandered and then provide additional rounds of support), and stopping the looting of banks by getting inside the banks, both before and after support is given. Governments can maximize their investment (that is, their support) by promoting a corporate debt restructuring that is sensitive to growth and does not leave banks hobbled, ensuring that banks carry out operational restructuring, and leveraging the crisis to achieve structural change that will make the market more attractive for new investment by the private sector.

Scott reiterated the well-understood policy that government support should be provided to banks only after existing shareholders have absorbed existing losses. These recapitalized and perhaps nationalized banks should then be sold as rapidly as possible. Pursuing rapid sales, he emphasized, gives focus to all restructuring actions, makes transparent the true financial situation of the bank, and forcefully demonstrates the intentions and resolve of the authorities.

Finally, Scott stressed that having access to adequate resources for investing in banks and assets was essential to doing the job right the first time. Failure to provide adequate support will force the government to intervene again, he said, triggering moral hazard and raising long-run costs. ■

Members' use of IMF credit
(million SDRs)

	During December 1999	January–December 1999	January–December 1998
General Resources Account	**1,103.63**	**10,010.09**	**20,586.19**
Stand-By Arrangements	1,051.33	7,480.40	12,098.01
SRF	0.00	3,636.09	8,726.31
EFF	52.30	1,849.30	6,331.63
SRF	0.00	0.00	675.02
CCFF	0.00	680.40	2,156.55
PRGF[1]	**32.95**	**736.78**	**895.96**
Total	**1,136.58**	**10,746.87**	**21,482.15**

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CCFF = Compensatory and Contingency Financing Facility
PRGF = Poverty Reduction and Growth Facility

Figures may not add to totals shown owing to rounding.
[1]Formerly ESAF—the Enhanced Structural Adjustment Facility.

Participants discuss ways to enhance effectiveness of IMF-supported adjustment programs

The credibility and effectiveness of IMF-backed programs came under the spotlight at a January 10 workshop convened in Washington by Georgetown University and Claremont College as participants examined the success rate of IMF-supported economic policies.

The workshop brought together IMF staff members, academics, and others to consider whether IMF programs meet their objectives, how they might be improved, and the need for greater and more systematic political input. The final point was particularly topical in view of the need to develop poverty reduction strategy papers (PRSPs) as the central means of coordinating concessional lending to low-income developing member countries. (For a description of the PRSP process, please see *IMF Survey*, January 10, page 3.)

Do adjustment programs work?

Mohsin Khan, Director of the IMF Institute, initiated the discussion with his paper "Do IMF-Supported Programs Work?" It is now generally accepted, he said, that IMF-supported adjustment programs are effective in improving a country's current account balance and overall balance of payments. The results on inflation and growth are less clear, he acknowledged, although IMF programs have been more effective in achieving their objectives than earlier analyses have suggested.

Graham Bird of the Center for International Economic Studies at the University of Surrey agreed that IMF programs were effective in improving the balance of payments. However, he added that the number of countries returning to the IMF for additional, or continuing, support showed that in many cases the initial IMF program had not achieved its objectives. He also had severe doubts about the role of conditionality in determining the outcome of IMF programs and said that the completion rate of IMF programs was often poor.

In response, Khan agreed that implementation of IMF-supported programs was crucial. He stressed that evaluating programs was a complex procedure and that better empirical analysis was often needed.

Bird presented two other papers examining whether IMF programs had a catalytic effect in mobilizing international capital and whether the IMF imposed too many conditions on member countries. As a discussion point, he suggested there may be a "conditionality Laffer curve," under which conditionality becomes excessive beyond a certain point. In its response to the Asian crisis, he said, the IMF appeared to impose much more detailed conditionality, which he termed "conditionality creep." Bird added, "there are indicators to suggest that the move toward greater conditionality may have gone too far, with negative effects on both the incentive for countries to implement IMF programs and, ultimately, economic outturns." He expressed his concern that excessive conditionality might have adverse systemic consequences.

Jack Boorman, Director of the IMF's Policy Development and Review Department, countered by saying that what was often termed "mission creep," or in this case "conditionality creep," was in fact a reflection of the end of ideological tensions in the world and a common view of best practices in organizing an open market economy and of global economic standards. These changes enabled the IMF to be more specific in its programs. Overall, he said, the more ambitious programs have been the more successful ones. Also, governments that took "ownership" of programs implemented them better.

On the supposed catalytic effect of IMF programs in mobilizing capital flows, Bird said that it was generally weak and could not be relied upon, a consideration that had implications for designing future programs. But Andrew Berg of the IMF's Research Department challenged this assumption, arguing that Bird had not taken into account what would have happened to capital flows without IMF involvement.

Program ownership

Boorman stressed that government ownership of programs was important and that a frequent cause of initial failure in IMF programs was the failure of governments to acknowledge the cause and depth of the problem. In the Asian crisis, this "denial syndrome" partially explained the need for repeated renegotiation of programs after initial failure.

For the future, Boorman said, the new emphasis by the IMF and the World Bank on developing PRSPs with governments and civil society would create many new problems. The IMF would have to engage in public debate in ways it had never done before, he observed.

Need for political analysis

A second session focused on the need to pay greater attention to the political impact of IMF programs and to

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Mohsin Khan

Jack Boorman

the political trade-offs involved in negotiating conditionality. A paper by Tom Willett, Director of the Claremont Institute of Economic Policy Studies, highlighted the need for greater political acumen by the IMF and argued that in Russia, for example, the IMF had been pushed into helping its principal shareholders pursue geopolitical objectives "on the cheap." This, he argued, had helped to devalue the IMF's credibility and "seal of approval." Because the IMF was staffed mostly by economists, it was not used to making systematic political judgments. But in the future, he said, the IMF would increasingly need to decide whether to support a particular stabilization effort or to opt out to preserve its own credibility.

Jacek Kugler, Professor of International Relations at Claremont's Center for Politics and Economics, suggested that while IMF programs had generally been more successful than many critics had claimed, their effectiveness could be improved substantially by taking political factors into account. In his paper, he explained how a model designed to assess political risk under crisis conditions could yield better results and also lessen the need to renegotiate IMF programs. Supporting Kugler's view, Hilton Root, Senior Fellow of the Milken Institute, said that political models could be a valuable tool during the crisis management phase of IMF negotiations and that it was important to assess what was politically feasible and what was not.

Ratna Sahay, Advisor in the IMF Research Department and a discussant of Kugler's paper, said that political considerations were, indeed, an important factor in designing IMF programs. Although in some cases, she added, programs might do even better if they took *less* account of political constraints.

Boorman, quoting from the IMF's conditionality guidelines, said that it was the Managing Director's responsibility to assure the Executive Board that a program was politically feasible and would be implemented. Since the political model was not explained in the paper, participants were somewhat skeptical about the results presented. Despite the skepticism expressed by many IMF participants on applying formal political models to IMF programs as a general rule, some were impressed by the claimed performance of the model in forecasting outcomes in political crisis situations.

Although there were no formal conclusions from the workshop, it proved valuable in highlighting the need for increased research and follow-up on the issue of program effectiveness. As Khan observed, "as long as IMF-supported programs are to be an integral part of the adjustment strategies of developing countries, the search for the most appropriate way to evaluate the effects of past programs must continue." ■

Jeremy Clift
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Recent publications

Books

Africa: Adjusting to the Challenges of Globalization, edited by Laura Wallace ($23.50)

Occasional Papers ($18.00; academic rate: $15.00)

191: *Social Issues in IMF-Supported Program*, Sanjeev Gupta, Louis Dicks-Mireaux, Ritha Khemani, Calvin McDonald, and Marijn Verhoeven

Working Papers ($7.00)

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99/176: *Fiscal Federalism and Government Size in Transition Economies: The Case of Moldova*, Luiz de Mello

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00/3: *Does Deposit Insurance Increase Banking System Stability*? Aslı Demirgüç-Kunt and Enrica Detragiache

00/4: *Identifying Domestic and Imported Core Inflation*, Hilde C. Bjørnland

Policy Discussion Papers ($7.00)

99/8: *Inflation Targeting: What Is the Meaning of the Bottom of the Band?* Eric V. Clifton

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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.

Institute of International Finance assesses data release practices

Among 27 emerging market economies surveyed by the Institute of International Finance (IIF), many have made progress in providing capital markets with data on their economies, according to an IIF report released on January 6. None of the economies fully satisfies all the standards, but the report, *Data Release Practices of Emerging Market Economies: 1999 Assessment,* gives high marks to nine economies—Argentina, Colombia, the Czech Republic, Israel, Mexico, Peru, Poland, Thailand, and Turkey—for their overall performance against the IIF's benchmark standards. The standards focus on the comprehensiveness, timeliness, and frequency of data reported in 25 areas, including the external debt, gross reserves, and balance of payments. Although the IIF does not evaluate the quality of the data, it encourages the authorities of emerging market economies to supplement their data with explanations of methodology and sources.

A number of other countries have made considerable progress in meeting the standards since 1997, when the IIF first assessed the data release practices of emerging market economies, the report states. Included in this group are Argentina, Hong Kong SAR, Malaysia, the Philippines, Poland, and Thailand. The report notes that data provision in the Asian region, in particular, improved as a result of the renewed focus on transparency that grew out of the Asian financial crisis. China, Egypt, Kuwait, Morocco, Saudi Arabia, and Tunisia have also made progress in providing more complete and timely information in a number of categories, but continue to lag behind in meeting the overall data dissemination standards.

Despite significant and continuing progress among these economies, the report states that "serious shortcomings remain in certain areas that should be a particular focus of authorities' efforts to improve data provision." All the economies need to provide more regular and timely information about external debt amortization schedules, which is crucial for allowing lenders and investors to judge the sustainability of an economy's external financing position. There is also scope for improvement in the reporting of data on gross reserves, including drains on reserves, and on fiscal accounts, especially for the public sector as a whole.

The 27 economies covered in the report are among the most important emerging markets in terms of global trade and production and the most active in international capital markets. The assessments are intended to improve transparency, thereby minimiz-

Periodicity and timeliness of country data (performance against IIF data standards)

Economy	Standards satisfied in 1999 (percent)
Argentina	23 (92)
Brazil	18 (72)
Chile	19 (76)
China	6 (24)
Colombia	21 (84)
Czech Republic	21 (84)
Egypt	4 (16)
Hong Kong SAR	12 (48)
Hungary	19 (76)
India	13 (52)
Indonesia	20 (80)
Israel	23 (92)
Korea	15 (60)
Kuwait	7 (28)
Malaysia	19 (76)
Mexico	23 (92)
Morocco	3 (12)
Peru	23 (92)
Philippines	14 (56)
Poland	21 (84)
Russian Federation	16 (64)
Saudi Arabia	4 (16)
South Africa	15 (60)
Thailand	23 (92)
Tunisia	8 (32)
Turkey	21 (84)
Venezuela	11 (44)

Data: IIF, *Data Release Practices of Emerging Market Economies: 1999 Assessment*

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
January 10	3.86	3.86	4.39
January 17	3.89	3.89	4.42

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 (currently 113.7 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

ing surprises, maximizing stability, and enhancing flows in emerging market finance. In discussing the report during the press conference announcing its release, IIF Deputy Managing Director and chief economist William Cline noted that, although no correlation had been established between greater transparency and increased market access, improvements could be expected in the future. ■

For more information about the IIF, including publication details about the report, see its website: www.iif.com.

Stand-By, EFF, and PRGF arrangements as of December 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By			**39,897.68**	**12,711.81**
Bosnia and Herzegovina	May 29, 1998	April 28, 2000	77.51	24.24
Brazil[1]	December 2, 1998	December 1, 2001	10,419.84	2,550.69
Cape Verde	February 20, 1998	March 15, 2000	2.50	2.50
El Salvador	September 23, 1998	February 22, 2000	37.68	37.68
Korea[1]	December 4, 1997	December 3, 2000	15,500.00	1,087.50
Latvia	December 10, 1999	April 9, 2001	33.00	33.00
Mexico	July 7, 1999	November 30, 2000	3,103.00	2,068.60
Philippines	April 1, 1998	March 31, 2000	1,020.79	475.13
Romania	August 5, 1999	March 31, 2000	400.00	347.00
Russia	July 28, 1999	December 27, 2000	3,300.00	2,828.57
Thailand	August 20, 1997	June 19, 2000	2,900.00	400.00
Turkey	December 22, 1999	December 21, 2002	2,892.00	2,670.28
Uruguay	March 29, 1999	March 28, 2000	70.00	70.00
Zimbabwe	August 2, 1999	October 1, 2000	141.36	116.62
EFF			**14,035.13**	**8,826.90**
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	March 19, 2000	58.50	5.26
Bulgaria	September 25, 1998	September 24, 2001	627.62	313.82
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Indonesia	August 25, 1998	November 5, 2000	5,383.10	1,585.40
Jordan	April 15, 1999	April 14, 2002	127.88	106.56
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Moldova	May 20, 1996	May 19, 2000	135.00	47.50
Pakistan	October 20, 1997	October 19, 2000	454.92	341.18
Panama	December 10, 1997	December 9, 2000	120.00	80.00
Peru	June 24, 1999	May 31, 2002	383.00	383.00
Ukraine	September 4, 1998	September 3, 2001	1,919.95	1,207.80
Yemen	October 29, 1997	March 1, 2001	105.90	65.90
PRGF			**3,639.70**	**1,957.27**
Albania	May 13, 1998	May 12, 2001	45.04	23.69
Azerbaijan	December 20, 1996	January 24, 2000	93.60	11.70
Benin	August 28, 1996	January 7, 2000	27.18	10.87
Bolivia	September 18, 1998	September 17, 2001	100.96	67.31
Burkina Faso	September 10, 1999	September 9, 2002	39.12	33.53
Cambodia	October 22, 1999	October 21, 2002	58.50	50.14
Cameroon	August 20, 1997	August 19, 2000	162.12	36.03
Central African Republic	July 20, 1998	July 19, 2001	49.44	32.96
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	161.98
Djibouti	October 18, 1999	October 17, 2002	19.08	16.36
The Gambia	June 29, 1998	June 28, 2001	20.61	13.74
Ghana	May 3, 1999	May 2, 2002	155.00	110.70
Guinea	January 13, 1997	January 12, 2000	70.80	15.73
Guyana	July 15, 1998	July 14, 2001	53.76	35.84
Honduras	March 26, 1999	March 25, 2002	156.75	80.75
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	43.00
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	27.28
Madagascar	November 27, 1996	July 27, 2000	81.36	40.68
Mali	August 6, 1999	August 5, 2002	46.65	39.90
Mauritania	July 21, 1999	July 20, 2002	42.49	36.42
Mongolia	July 30, 1997	July 29, 2000	33.39	21.89
Mozambique	June 28, 1999	June 27, 2002	58.80	50.40
Nicaragua	March 18, 1998	March 17, 2001	148.96	53.82
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	38.08
Senegal	April 20, 1998	April 19, 2001	107.01	57.07
Tajikistan	June 24, 1998	June 23, 2001	100.30	53.34
Tanzania	November 8, 1996	February 7, 2000	181.59	0.00
Uganda	November 10, 1997	November 9, 2000	100.43	17.85
Yemen	October 29, 1997	October 28, 2000	264.75	114.75
Zambia	March 25, 1999	March 24, 2002	254.45	244.45
Total			**57,572.51**	**23,495.98**

[1]Includes amounts under Supplemental Reserve Facility.
EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility (formerly ESAF—Enhanced Structural Adjustment Facility).
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

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

While short-term controls may be useful, free capital flows provide long-term benefits

Capital controls can be useful in dealing with volatile movements of capital, but they are difficult to administer and must be used in conjunction with proper macroeconomic policies, according to a new IMF staff report. At a press briefing held on January 11, to announce the release of the report, Stefan Ingves, Director of the IMF's Monetary and Exchange Affairs Department, emphasized that this conclusion in no way negates the IMF's position that "free capital flows are good for everyone in the long run."

Akira Ariyoshi, Assistant Director in the department's Exchange Regime and Market Operations Division, described the objectives of the report, *Country Experiences with the Use and Liberalization of Capital Controls.* These, he said, include examining why some countries have imposed capital controls and why others have liberalized, the form the controls have taken, the effectiveness of controls, and the costs of adopting them. The 14 countries covered in the report are grouped by similarity of purpose to permit the authors to draw more generally applicable conclusions. In addition, Ariyoshi noted, the report studies the link between prudential policies and capital controls to show how better prudential policies and accelerated financial sector reforms could address the risks in cross-border capital flows.

Stefan Ingves

Discussing motivations for adopting capital controls, the report explains that countries have imposed such restrictions for a variety of reasons: to improve economic welfare by compensating for financial market imperfections; to allow monetary policy to pursue domestic objectives; to reduce pressures on the exchange rate; to protect monetary and financial stability in the face of persistent capital flows; and to support policies of financial repression to provide cheap financing for government budgets and priority sectors.

The design of controls has varied among the countries. Some have taken the form of administrative controls, which usually prohibit cross-border capital transactions outright or stipulate an approval procedure for such transactions. Others have been market-based or indirect controls, which attempt to discourage particular capital movements through taxes or taxlike measures. These affect the price or volume of a given transaction, or both. Although the effectiveness of controls has been mixed, according to the report, the country

Akira Ariyoshi

Available on the web (www.imf.org)

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- **00/1: IMF Approves Poverty Reduction and Growth Facility Loan for Chad, January 7**
- **00/2: IMF Approves Emergency Post-Conflict Assistance for Guinea-Bissau, January 7**

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Letters of Intent and Memorandums of Economic and Financial Policies
- **Chad, November 12, 1999 (posted January 7)**
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- **Update on Costing the Enhanced HIPC Initiative, January 12**
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- **Poland, December 14 (Preliminary)**

Notes

Letters of Intent and Memorandums of Economic and Financial Policies are prepared by a member country and describe the policies that the country intends to implement in the context of its request for financial support from the IMF.
Concluding Remarks for Article IV Consultations. At the conclusion of annual Article IV discussions with the authorities, and prior to the preparation of the staff's report to the Executive Board, the IMF mission often provides the authorities with a statement of its preliminary findings.
Preliminary Documents on the HIPC Initiative present a preliminary assessment of a country's eligibility for assistance under the HIPC Initiative. Documents summarize the debt sustainability analysis agreed by the staffs of the IMF and the World Bank with country authorities and are available after they have been discussed by the Boards of the institutions—with the approval of the respective country.

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experiences invariably showed that capital controls provided no benefits when underlying policies, especially macroeconomic policies, were inconsistent or ill conceived. Countries that used controls effectively on outflows, Ariyoshi said at the press briefing, gained "some temporary breathing space in which to adopt and implement sound economic policies and reforms." Even when controls seem to be effective, he cautioned, it is difficult to disentangle their contribution from those of the other policies a country is implementing.

When countries adopt capital controls or reimpose controls after having liberalized transactions, the report states, they can incur a number of costs whether or not the controls are effective. First, restrictions on capital flows may interfere with desirable capital and current transactions along with the undesirable ones. Implementing controls may also involve administrative costs, particularly when the measures must be broadened to prevent market participants from finding ways to circumvent the controls. A third cost is that imposing controls may delay a country's implementation of necessary reforms. Finally, controls may cause market participants to view the country in a negative light, making it more difficult and expensive for the country to access foreign funds.

The report draws a number of tentative conclusions from the 14 case studies that the authors believe may prove useful in formulating policy:

• No single capital control measure is effective across all countries at all times.

• Controls on specific transactions may effectively limit those transactions, but market participants will find ways, especially in sophisticated markets, of circumventing the controls through unrestricted channels. Thus, to be effective in the longer run, controls generally need to be comprehensive and strictly enforced.

• The need for controls to be comprehensive implies that more effective controls are also more distortionary and hence more costly.

• Administrative capacity to implement the controls and the level of financial market development will influence the choice of controls and their effectiveness.

• The evidence is mixed on whether capital controls can correct financial market imperfections and serve a prudential purpose.

• Strong prudential policies were found to play an important role in orderly and successful capital account liberalization and in reducing a country's vulnerability to external shocks. ■

Use and liberalization of capital controls

Capital controls to limit short-term inflows	Controls imposed
Brazil	1993–97
Chile	1991–98
Colombia	1993–98
Malaysia	1994
Thailand	1995–97
Capital outflow controls during financial crises	
Malaysia	1998–99
Spain	1992
Thailand	1997–98
Extensive exchange controls during financial crises	
Romania	1996–97
Russia	1998–present
Venezuela	1994–96
Long-standing, extensive controls and gradual liberalization	
China	
India	
Rapid liberalization of capital controls	**Liberalization undertaken**
Argentina	1991
Kenya	1991–95
Peru	1990–91

Data: IMF, *Country Experiences with the Use and Liberalization of Capital Controls*

An advance copy of *Country Experiences with the Use and Liberalization of Capital Controls,* by Akira Ariyoshi, Karl Habermeier, Bernard Laurens, Inci Otker-Robe, Jorge Iván Canales-Kriljenko, and Andrei Kirilenko, is available on the IMF's website (www.imf.org). The final version of the report, which will be part of the IMF Occasional Papers series, is scheduled for publication in March 2000.

IMF mission to review Ecuador's dollarization plan

IMF Managing Director Michel Camdessus made the following statement on January 10:

"In light of the announcement yesterday by the government of Ecuador of its intention to move the economy to full dollarization, the IMF is prepared to send a fact-finding mission to Quito to provide technical assistance in adapting [the country's] fiscal and banking strategies to dollarization. Once suitable measures are identified, IMF management looks forward to working with the authorities to support their economic program."

The text of News Brief 00/1 is also available on the IMF's website (www.imf.org).