

An "Irreversible Trend"

Seminar Discusses the Orderly Path to Capital Account Liberalization

Is capital liberalization a good idea? What lessons can be gleaned in this area from the financial crisis in Asia? Is amendment of the IMF's Articles—granting it jurisdiction over capital movements—necessary, or should the IMF continue in its present role, supporting the process of capital account liberalization under its present Articles? These and other related issues were discussed in a seminar hosted by the IMF on March 9–10. The seminar was held at

the behest of the IMF Executive Board to elicit views from a wide range of private and official opinions outside the IMF. Participants included high-level government officials, banking and investment officials from



Jack Boorman, Director of the IMF's Policy Development and Review Department (left), and IMF First Deputy Managing Director Stanley Fischer respond to questions during a press briefing held on March 10 after the seminar.

industrial and developing countries, academicians, and representatives from international organizations. IMF senior staff, management, and Executive Board members also participated. *(Please turn to the following page)*

Study by Outside Experts

IMF Releases Report of External Evaluation of ESAF Following Executive Board Review

Following a review by its Executive Board, the IMF released a report of a panel of independent experts that evaluated selected aspects of the IMF's Enhanced Structural Adjustment Facility (ESAF) during a press conference at IMF headquarters on March 13. A group of Executive Directors coordinated the work of the experts on behalf of the Executive Board. The report complements the IMF's latest internal ESAF Review, which the IMF's Executive Board discussed in July 1997 and subsequently published as an IMF Occasional Paper (see *IMF Survey*, August 5, 1997, page 233). In response to the evaluation, IMF staff prepared a note to address some broad questions concerning important implications from the report. This response, along with full texts of related materials—including the evaluators' report, the transcript of the press conference, the Chairman's Summing Up of the Executive Board Meeting on the evaluators' report, and a statement

by Bernd Esdar, Executive Director for Germany and Chairman of the Evaluation Group of Executive Directors—can be accessed on the IMF's web site (www.imf.org/external/np/esaf/indesaf.htm). A published version of the material released to the press will be made available shortly. The full text of the Managing Director's summing up as Chairman of the Executive Board discussion appears on page 86.

New Approach to Evaluation

With the objective of obtaining an independent and fresh outside perspective on crucial IMF policies, the IMF's Executive Board, in October 1996, adopted a newly developed external evaluation instrument to build upon and complement the IMF's in-house evaluations. Executive Directors felt that it would be helpful to seek a view that was not *(Continued on page 85)*

(Continued from the front page)

Is Capital Account Liberalization a Good Idea?

The trend toward capital account convertibility is “irreversible,” IMF Managing Director Michel Camdessus said in a luncheon address on March 9, and “all countries have an important stake in seeing that the process takes place in an orderly way,” no matter where they stand on the opening of their own capital accounts. The benefits of open capital markets, Camdessus said, are well known: free capital movements help channel resources into their most productive uses and thereby increase economic growth and welfare—nationally and internationally. Countries at all levels of development can share in these benefits.

As David Peretz of the U.K. Treasury said, “This is not a subject on which industrial countries and developing countries should divide. There is a common interest in getting it right.” For developing countries, as the traditional sources for financing have dried up, access to international capital markets to finance their current account deficits has become essential to their continued growth and development, according to Muhammad Yaqub, Governor of the State Bank of Pakistan. Without open capital accounts, these deficits may simply not be “financeable at desirable levels of investment and growth.”

Despite its acknowledged widespread benefits, however, free-flowing capital can exacerbate financial crises that threaten the stability of the international monetary system. As Lawrence Summers of the U.S. Treasury noted, “Global financial markets let us go where we want more quickly and, most of the time, more safely than was possible before. But the crashes, when they occur, are that much more spectacular.”

Certainly, massive capital flows played a role in the financial crisis in Asia. Yet, the imposition of capital controls on foreign borrowing—except in certain specific cases—does not appear to be a workable solution and, in fact, would be a step backward, according to Summers. Charles Dallara of the Institute of International Finance agreed, citing the “significant risks” to capital controls.

If the trend toward open capital movements is irreversible, and if the benefits to be realized from free access to capital markets are undeniable, how, then, can the costs and risks be minimized? Three themes emerged from the discussions: preconditions, orderly

and steady progress toward full capital account liberalization, and the IMF’s assumption of jurisdiction over capital movements.

Preconditions

Although no one was willing to say with any certainty how long a country should hold off opening its capital accounts, there was consensus, according to IMF First Deputy Managing Director Stanley Fischer, that “liberalization without a necessary set of preconditions in place may be extremely risky.” The absence of such preconditions could promote a crisis or reveal weaknesses in the financial system that could have been overcome if the authorities had been allowed more time to strengthen the system before the capital markets were opened.

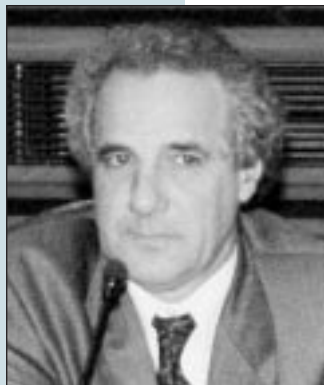
An unresolved issue is how to determine when an economy is sufficiently prepared in terms of preconditions to risk opening the capital account. Some participants expressed the fear that too much talking about preconditions might discourage countries; they would then end up waiting forever for preconditions to be in place. Some participants suggested that change does not happen until it is forced.

Much of the source of the financial crisis in Asia could be traced to lack of attention to structural issues, according to John Lipsky of Chase Manhattan Bank. Conventional wisdom has tended to place the blame on freely flowing capital—often in the form of short-term debt—that washed over the shores of unprotected countries with weak domestic institutions. In fact, the real culprit was the unwillingness of governments to expose their institutions to market discipline by raising interest rates to stem capital flight and refusing to unpeg their exchange rates. As a result, the crisis spread from country to country in the region.

The importance of sound and consistent economic policy cannot be overstressed, according to John Heimann of Merrill Lynch. But helping to prevent—or lessen the impact of—future financial crises requires strong measures on the domestic regulatory side: prudential standards, disclosure requirements, and transparency.

Important conditions for capital account liberalization mentioned by several participants included:

- a sound macroeconomic policy framework; in particular, monetary and fiscal policies that are consistent with the choice of exchange rate regime;
- a strong domestic financial system, including improved supervision and prudential regulations covering capital adequacy, lending standards, asset valuation, effective loan recovery mechanisms, transparency, disclosure, and accountability standards, and provisions ensuring that insolvent institutions are dealt with promptly;
- a strong and autonomous central bank; and



David Peretz



Muhammad Yaqub

- timely, accurate, and comprehensive data disclosure, including information on central bank reserves and forward operations.

Orderly Progression to Liberalization

Capital movements certainly played a major part in the financial crisis sweeping through much of south-east Asia, according to Jack Boorman, Director of the IMF's Policy Development and Review Department. But it was not open capital accounts per se that led to problems. In fact, the economies in the region with the most open capital accounts—Hong Kong SAR and Singapore—have been the most successful in contending with the crisis. Rather, the difficulties in the hardest-hit countries—Indonesia, Korea, and Thailand—arose from the prevailing macroeconomic environment and institutional setting and the way in which capital liberalization was brought about.

The most relevant lesson from the Asian crisis, Boorman said, was that capital account liberalization must proceed in an orderly manner. Yung Chul Park of Korea University and the Korea Institute of Finance concurred, citing the Korean experience. The “gradual and piecemeal approach to liberalization” the authorities pursued so as not to disrupt the economy, he said, proved a failure; during 1994–97, Korea still experienced a surge in foreign inflows—much of it short term and speculative. For emerging market economies, the improper management of the opening of financial markets could, he said, “easily lead to a boom and bust cycle during the transition period.”

The capital account should be opened gradually, according to Carlos Massad, President of the Central Bank of Chile, to protect the economy from unregulated inflows—particularly of short-term capital—that, because they are quickly reversible, can seriously dislocate the economy. In Chile's case, the authorities have imposed controls on inflows with apparent success, bringing about a steady drop in short-term indebtedness. At the same time, as Yung Chul Park noted, a piecemeal, ad hoc approach can also be disruptive. With the gradual approach undertaken by Korea, for example, it was difficult to determine the sequencing for the deregulation of the different types of capital account transactions, which markets should be opened, and the speed with which the liberalization should move. Roque Fernandez, Minister of Economy, Argentina, also noted that in Argentina's case, prudential controls over the banking system, rather than controls on capital inflows, had proved effective in handling the risks of short-term capital inflows.

Institutionalizing Capital Account Liberalization

Since capital flows are now a fact of life, the chief concern is how best to achieve an orderly process of

liberalization. This process, David Peretz said, should be overseen by the IMF—and the Articles should be amended to make this jurisdiction explicit. Although the IMF has encouraged countries with IMF-supported reform programs to free up their capital accounts, legal jurisdiction would allow the IMF to apply the principles of capital liberalization to all member countries through its surveillance activities. The IMF is the ideal agency to undertake this function, he said, because it could deal with each country on a case-by-case basis, adapting the liberalization process to the country's individual capacity and complementary structural reforms.

Jacques Polak, former Director of the IMF's Research Department, emphasized the advocacy role of the IMF. He argued that amending the Articles, although not necessary, would be useful. But, he said, giving the IMF formal jurisdiction over capital flows would be neither necessary nor helpful. In the past, he said, the IMF has moved into areas not specifically covered in its charter, such as governance. Because the IMF has wholeheartedly embraced capital liberalization in its surveillance, financing, and technical assistance activities—despite the lack of mandate and the provisions of Article VI condoning capital controls—it is not necessary to give the IMF jurisdiction in order to liberalize capital movements. Amending the Articles to give the IMF such jurisdiction might take the IMF beyond its area of competence and might also bring it into conflict with other institutions, such as the World Trade Organization, he argued. On the other hand, David Peretz noted, one of the reasons for defining the IMF's jurisdiction would be to reduce conflict with other organizations.

Addressing the legal ramifications of the IMF's jurisdiction over capital movements, François Gianviti, General Counsel of the IMF's Legal Department, said that the IMF could not effectively assume such jurisdiction under its present charter. The other tools provided by the Articles (technical assistance, surveillance, and conditionality) could not achieve a comprehensive, uniform, and permanent liberalization of capital movements. Only an extension of the IMF's jurisdiction to capital movements through an amendment of the Articles would enable the IMF to achieve this objective.

Manuel Guitián, Director of the IMF's Monetary and Exchange Affairs Department, said that the IMF should assume explicit jurisdiction over capital movements, to emphasize commitment to the orderly liberalization of capital accounts. Without commitment, he said, advocacy carries little conviction. A



Lawrence Summers

country's resolution to open its capital account and its agreement not to impose restrictions at a later date would not be credible without the commitment, transparency, and conviction imparted by its obligations as a member of the IMF to proceed toward an open capital account.

The IMF needs to participate in the formulation of universally applicable principles and a code of conduct to guide the liberalization process, Guitián said, thus ensuring that the process of liberalization is orderly. This code of conduct must reflect current events; if it is too far behind reality, it will lose credibility. But the actual speed with which countries move toward full liberalization would depend on individual cases. During the process, they would have recourse to transitional arrangements analogous to those available for progression to current account convertibility. What is important, Guitián said, is that a country commit to general principles; individual commitments could then be determined by all member countries, as they are for current account convertibility. Quoting Managing Director Camdessus, Guitián said capital account liberalization must be "bold in its vision, cautious in its implementation."

Other international organizations and associations are closely associated with both the regulation and the liberalization of capital movements, including the Organization for Economic Cooperation and Development (OECD), the World Trade Organization, and the European Union. It is clear, Stanley Fischer said, that if the IMF's Articles are amended to include jurisdiction over capital movements, the existing close cooperation between the IMF and these organizations will need to be strengthened further.

Issues for Future Consideration

In his summation of the discussions, Fischer cited several issues that require further consideration. Despite considerable enthusiasm for an amendment of the IMF's Articles—from both official sources and the private sector—Fischer noted that there were also "severe doubts"—either on whether capital account liberalization per se was a good idea, or whether advocacy was not sufficient and legalized jurisdiction too painful, complicated, and unnecessary.

A pressing unresolved issue is how the international system can ensure that banking supervisory standards and the quality of banking systems are improved,

Fischer noted. This issue, he said, which was raised by John Heimann, is critical for the efficient operation of the international economy—regardless of whether the Articles are amended. Finding a solution cannot be left entirely to the private markets, Fischer said, although they play an important role.

The consequences of short-term flows pose another set of problems. Aside from their potential dislocating effect on the economy, large short-term flows can also do serious damage to a vulnerable banking system when financial institutions are not strong enough to withstand reversals in these flows. There is no established body of analysis on capital controls, he said—what works and what does not—and a "host of questions" needs to be examined. A capital account amendment of the IMF's Articles, Fischer said, would provide an appropriate context in which such an analysis could be conducted.

How important is capital account liberalization? Responding to this question raised by Stefan Schoenberg of the Deutsche Bundesbank, Fischer noted that as countries become more advanced, they open their capital accounts; when they have the choice, they have done it, suggesting that there are clear benefits. Ninety-five percent of capital movements are already conducted under a liberalized regime, but OECD countries account for a disproportionately large percentage of this amount. If we count in countries, rather than transactions, Fischer said, it is clear that many countries still have some way to go. That an "orderly process of liberalization of the capital account done in a way that makes sense and helps avoid future crises would be very useful for the growth and economic development" of many countries, is, he concluded, a relevant issue for the IMF's membership. ■

Sara Kane
Senior Editor, *IMF Survey*



John Lipsky



Yung Chul Park

Press Information Notices

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

Czech Republic, No. 98/12, February 13

Switzerland, No. 98/13, March 6

Norway, No. 98/14, March 9

Cape Verde, No. 98/15, March 10

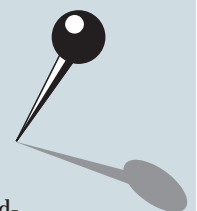
Israel, No. 98/16, March 10

Armenia, No. 98/17, March 12

Brazil, No. 98/18, March 12

Singapore, No. 98/19, March 16

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



(Continued from front page) limited by institutional constraints and agreed that the ESAF should be the first item subject to external evaluation. The panel, comprising Dr. Kwesi Botchwey, Harvard Institute for International Development; Professor Paul Collier, Oxford University; Professor Jan Willem Gunning, Free University, Amsterdam; and Professor Koichi Hamada, Yale University, completed its study in January 1998.

On the basis of terms of reference adopted by the Executive Board, the experts concentrated on three specific areas: social policies and the composition of government spending, developments in countries' external position, and the determinants and influences of differing degrees of national ownership of ESAF-supported programs. In line with the terms of reference, the evaluators also selected a sampling of geographically diverse countries for each of the three topics, choosing to evaluate all three issues for Côte d'Ivoire, Malawi, Uganda, and Zimbabwe; the external viability and ownership issues for Bangladesh and Vietnam; the ownership issues only for Bolivia; and the social issues only for Zambia. Their work involved field work, discussions with IMF staff, and participation in the IMF's Executive Board meeting devoted to a discussion of the internal ESAF review. From August to early October 1997, they undertook a series of country visits, which they interrupted in September to attend the World Bank/IMF Annual Meetings in Hong Kong SAR. During these meetings, they interviewed governors and senior officials from a number of countries. They also met with several IMF Executive Directors and senior World Bank officials. In its report the panel recommended that:

- At a sufficiently high management level, the IMF should engage in intensive and informal policy dialogue with the country's political leadership to understand a country's political constraints and possibilities.
- The timing and duration of IMF staff missions should be arranged to allow adequate time for country preparation in advance of negotiation and consensus-building during the negotiation process itself.
- Steps should be taken to relieve any concerns about the IMF's perceived inflexibility in negotiations through the introduction of an element of choice in the negotiation of program design.
- The IMF should develop a more systematic mechanism for providing ex post support for country-initiated

programs, enabling the IMF to play an important role in countries with balance of payments need but where agreement is impossible or delayed, although the areas of convergence between the IMF and government are substantial, or where a government feels unable to accede to



Professor Jan Willem Gunning (left), Free University, Amsterdam; Professor Paul Collier, Oxford University; Dr. Kwesi Botchwey, Harvard Institute for International Development; Bernd Esdar, Executive Director for Germany and Chairman of the Evaluation Group of Executive Directors; and Shailendra Anjaria, Director of the IMF's External Relations Department at the March 13 press conference.

formal agreement with the IMF for mainly political reasons.

- Ways should be found to both humanize and demystify the IMF's image, so as to assuage the political hazard that countries perceive to be associated with dealing with the IMF.
- IMF/World Bank relations should be better coordinated.
- Resident missions should be strengthened or established in all ESAF countries to reinforce strategies to foster country ownership, particularly with a view to assessing the social impact of reform programs. ■

ESAF Facts

Date Established: December 18, 1987.

Purpose: For low-income developing countries, to promote balance of payments viability and growth in a balanced manner, through the mobilization of domestic and external resources, improvements in resource allocation, and the removal of structural impediments.

Financing Terms: Interest rate of 0.5 percent a year; repayments in ten equal installments, beginning 5½ years and ending 10 years after the date of each disbursement. Amounts committed (as of February 28, 1998): SDR 8.03 billion (\$10.8 billion).

Eligibility Criteria: Upon establishment, low-income countries eligible for the World Bank's International Development Association (IDA) loans. Subsequent changes to the list of IDA countries affect eligibility subject to a decision of the IMF Executive Board. Currently, 79 countries are eligible for ESAF loans.

Executive Board Considers Report of External Evaluators

Following is the text of the Chairman's summing up following the conclusion of the Board's discussion of the external evaluation of the Enhanced Structural Adjustment Facility (ESAF) on March 12, 1998.

Executive Directors expressed their appreciation to Dr. Kwesi Botchwey and to Professors Paul Collier, Jan Willem Gunning, and Koichi Hamada for the very stimulating work they had done in evaluating aspects of the ESAF. Their evaluation complements the internal evaluation of the ESAF discussed by the Executive Board on July 18, 1997. Similarly, Directors saw a high degree of complementarity between the report of the evaluation group and the response formulated by the staff. All Directors endorsed the fundamental view underlying the evaluators' findings that the ESAF is a valuable instrument to assist low-income countries, and that the work of the IMF with this instrument could be improved.

While Directors did not endorse all of the views expressed by the external evaluators, they found that the report provided an opportunity to broaden the debate by offering a fresh and different perspective, and to promote a better understanding of the IMF's work.

Social Policies

Regarding social developments under ESAF-supported programs, Directors agreed with the evaluators' view that economic reforms, while "generally having positive effects on growth and income distribution," do entail temporary costs for certain segments of the population this calls for appropriate compensatory measures to be built into program design. Everything possible should be done in program design to protect such groups, including the provision of well-targeted assistance to the more vulnerable groups and the allocation of adequate resources for social sectors. Also, the sequencing of fiscal and other structural reforms should be further analyzed to minimize any adverse social impact. As the evaluators point out, these actions would help policymakers to build a domestic consensus in favor of important but difficult reform measures.

Directors did consider that important efforts were already being made by the IMF to advise countries to protect poor groups from the impact of adjustment measures and to safeguard social expenditures during fiscal consolidation. They welcomed the proposals by the evaluators to draw more extensively on the expertise and data of the World Bank for a more refined ex ante assessment of the likely impact of adjustment measures on poor groups. They also agreed that it would be desirable to review the effects of the adjustment measures on poor groups as part of the regular ESAF program reviews. Directors asked

management and staff to explore the feasibility of these suggestions, including the availability of the necessary data, with the World Bank, to assess also the ability of the World Bank to provide the envisaged services, and to come back to the Board with operational proposals.

External Positions

Directors agreed that an assessment of progress toward external viability required a broad range of indicators, and they continued to see considerable merit in the traditional export-based indicators of external viability.

On other external aspects, Directors did not share the view of the evaluators that the ESAF constituted an inadvertent tax on exports by virtue of most ESAF funds being disbursed to central banks. They endorsed the staff view that the macroeconomic effects of ESAF disbursements do not depend on the initial recipient of ESAF resources, and noted that the evaluators were not suggesting that the currencies of ESAF-supported countries were generally overvalued.

On fiscal issues, Directors agreed that short-term revenue objectives should be pursued with sensitivity to the important longer-term implications of the tax system for economic efficiency. Directors were not persuaded by the evaluators' view that the IMF systematically exaggerates the size of fiscal deficits. They noted that where the line was drawn in presenting the fiscal balance does not materially affect the setting of fiscal targets, which always is based on considerations of the availability of noninflationary financing and the evolution of the debt and debt-servicing burden. What was essential was transparency and clarity of the breakdown, and Directors were generally satisfied with staff presentations on fiscal positions.

National Ownership

On national ownership of IMF-supported programs, Directors noted with concern the evaluators' assessment—which they saw as a key contribution of the evaluators' report—that a common perception at the country level was "a feeling of loss of control over the policy content and the pace of implementation of reform programs." Directors therefore welcomed the proposals by the evaluators as to the steps that should be taken by national authorities to build a greater policy consensus within society. They agreed that it was, first and foremost, the obligation of national governments to ensure transparency in policymaking and to promote wide public debate of policy issues. They therefore recommended for serious consideration by governments the suggestions of the evaluators concerning national conferences and regular meet-

ings with academics, business, and labor groups. It was important that policy alternatives and trade-offs be openly debated and that economic management teams made up of the economic and social sector ministries and political leaders—already a practice in some countries—be established in all countries to oversee the reform process.

Directors agreed with the evaluators that the IMF staff should take into consideration the political constraints faced by the authorities when making recommendations on the policy mix—although this should not lead to an overall weakening of the programs. Indeed, IMF staff should not be put in a position of having to judge what is and is not politically feasible. Directors supported the recent trend toward a greater variety of contacts between staff and representatives of civil society and noted that the IMF could thereby play a role in easing political constraints.

Directors noted that some of the recommended measures to ensure ownership may prolong the initial stages of negotiations, but considered that that investment would be compensated for over the period of implementation. Some Directors emphasized that ownership is a dynamic concept: even when ownership is not as strong as the ideal initially, early success with reforms can feed stronger commitment. Directors also recognized the importance of striking the right balance between ownership and securing a strong program. Directors observed that unless a government is committed to pursuing the program objectives, the program would have little chance of success and therefore would not merit ESAF support. Directors agreed with the evaluators' recommendation that the IMF should be more cautious in providing ESAF support where the authorities' commitment was in question. They believed that this view may call for greater selectivity in the use of IMF resources.

On the point of the perceived inflexibility by IMF staff, many Directors felt that the evaluators may have inadvertently conveyed an inconsistent message. While criticizing perceived inflexibility, the evaluators were also very clear that “the failure to front load structural reforms with long gestational lags may well be the most serious defect of structural adjustment as currently designed.” Often this failure reflected the willingness of the IMF to accommodate government resistance to specific reforms. Some Directors embraced the suggestion that, wherever feasible, the IMF staff should seek to identify, with the national economic authorities, alternative options for economic programs, each capable of achieving the needed economic results. These alternative options could be presented to national decision makers for their consideration.

Sequencing of Reform

Directors also considered that finding the proper balance between negotiating flexibility and supporting only programs that adequately address economic problems is indeed a delicate matter. These trade-offs and the sequenc-

ing of reform issues will continue to be at the center of future discussions of ESAF programs by the Executive Board. On the sequencing of reform measures, Directors agreed with the staff that member countries often needed to take advantage of windows of opportunity, without being overly constrained by strict sequencing considerations. Directors also felt that, in several cases, what appear to be sequencing problems were in reality problems of lack of implementation of agreed policy measures.

Directors agreed that further efforts were needed to improve public understanding of the IMF in countries receiving ESAF support, including through public explanations of the purpose and benefits of economic reform programs by the governments. As one Director observed, it was important that having a program with the IMF should be seen by members not as a stigma, but as an enviable badge of excellence. Directors agreed with the observations of evaluators concerning the very helpful role of IMF resident representatives in ESAF countries in this regard. They felt that the steps now being taken, to strengthen the role of resident representatives in external relations and to enhance collaboration with national authorities and civil society, were very much in line with the evaluators' views.

Directors agreed that there were many cases in which the IMF must stay engaged in ESAF-eligible countries after the initial macroeconomic stabilization has been achieved. They stressed that this was indeed the essence of the intent of the ESAF, which was to address, in a medium-term context, the structural weaknesses that may threaten the maintenance of financial stability and the achievement of sustained growth and external viability. As the evaluators had suggested, Directors saw a window of opportunity in several African economies that had stabilized and were now approaching high rates of growth as a result of policy reform. However, investment rates in these economies remained far too low for these growth rates to continue over the longer term and significant external capital needed to be attracted to supplement only slowly rising domestic savings rates. To attract external savings from public and private sources in an environment perceived by markets to be risky, a IMF signal of policy adequacy was often essential to help reduce uncertainty.

Ex Post Support

Commenting on the scope for ESAF financing in the post-stabilization phase, several Directors emphasized that the ESAF provides exceptional—and temporary—balance of payments support on concessional terms to low-income members, but that the ESAF is not a long-term aid transfer mechanism, as the evaluators seemed to imply. Therefore, disbursements of ESAF support could not be provided over the long term through a “tapering-in” mechanism coupled with ex post ESAF support for programs that aimed at little, if any, further reform. Directors expressed interest in more extensive

use of precautionary arrangements with the IMF. This could have the advantage of conferring the IMF's stamp of approval for a country's reform efforts, in order to catalyze financial support from other sources. For this purpose, the IMF should also take a close look at the effectiveness of its Article IV consultation process. Directors also saw the need for a greater role for the World Bank and other donors in supporting the reform efforts of ESAF countries in the post-stabilization period.

Directors noted the evaluators' recommendation that the IMF develop more systematic mechanisms for providing ex post support in situations in which stabilization has been achieved but in which agreement between the government and the IMF is delayed or the government feels unable to agree on a conventional IMF arrangement for mainly political reasons. The evaluators sought a move from negotiation to certification. While a few Directors considered that this suggestion deserves attentive consideration, many other Directors were concerned that IMF support for such programs might not be workable. In particular, the absence of ex ante agreement on a framework for policies might mean that any ex post judgment and disbursement of ESAF resources would pose difficulties, as the IMF must avoid arbitrary judgments and unequal treatment of member countries.

Directors noted the indications by the evaluators that World Bank and IMF cooperation could be

improved in some country cases and noted the importance of seeking ways to strengthen this collaboration. These issues had also surfaced in the internal evaluation of the ESAF and on other recent occasions. A few Directors called for early Board review of specific proposals by management to address these issues. Some other Directors, however, considered that it may not be useful to establish further formal rules on coordination. They recommended that priority be given to promoting an open and free flow of information between the IMF and the Bank. For this reason, it has been particularly valuable to have the participation of a World Bank representative in this discussion.

Next Steps

This has been a rich and useful discussion, bringing out worthwhile suggestions for follow-up. We have here started a constructive process and dialogue, and Directors invited the external evaluators and the staff to make themselves available to discuss the findings of the internal and external evaluations with interested parties. This, together with the earlier Board consideration of the internal review of the ESAF, will lead to the formulation of specific proposals for the Executive Board to consider, on operational lessons from these evaluations for the future work of the IMF in assisting low-income countries. ■



Speech to Economic Club Participation in the IMF Is an Investment in World Stability and Prosperity

Following are edited excerpts of an address given by IMF Managing Director Michel Camdessus to the Economic Club of Washington, in Washington, D.C., on March 12.

Throughout its history, the IMF has urged countries to pursue sound economic policies that promote growth through low inflation, sound money, prudent fiscal policies, and a sustainable current account position. Yet, as the economic landscape has changed and we have learned more about how economies work in a globalized world, we have broadened the scope of our advice to include other elements that are also vital for economic growth and financial stability. These include:

- the creation of a more level playing field for the private sector by dismantling monopolies and setting up simpler, more transparent regulatory systems;
- stronger banking systems that protect the savings of small depositors and channel savings not just to a favored few but to those who will use it productively;
- reductions in unproductive government spending, such as costly military buildups and prestige projects;
- higher spending on primary health care and education; adequate social protection for the poor, the

unemployed, and other vulnerable groups; and environmental protection;

- greater transparency and accountability in government and corporate affairs; and
- a more effective dialogue with labor and the rest of civil society.

Questions from the Asian Crisis

The recent financial crisis in Asia has underscored the importance of many of these elements. But it has also generated a lot of debate about the IMF and its policies. Let me address questions that have been at the heart of the discussion.

Are We Giving the Right Advice in Asia? Some people say that the IMF-supported programs in Thailand, Korea, and Indonesia are too tough. There is no question that economic activity in the affected countries is slowing down. But this is mainly the result of the sudden reversal of capital inflows. Without these programs, the international support behind them, and their confidence-building effects, Asia's suffering would be even more acute—with more bankruptcies, larger layoffs, and even deeper currency depreciations. The point of the IMF-supported programs

is to address the problems that precipitated the crisis. Thus, their main emphasis is on strengthening financial systems, improving governance systems, increasing transparency, opening markets, and restoring market confidence.

Are We Creating a Moral Hazard for Borrowers and Investors? As for borrowers, no country would deliberately pursue reckless policies because it thought the IMF would bail it out in the event of a crisis. The economic, financial, social, and political pain would simply be too great.

As for investors, these programs are hardly bailouts. Many private investors are taking heavy losses. With stock markets and exchange rates plunging, foreign equity investors have lost nearly three-quarters of the value of their equity holdings in some markets. Many firms and financial institutions will go bankrupt, and their lenders will not be repaid. Moreover, fourth-quarter earnings reports indicate that, overall, the Asian crisis has been very costly for U.S. and other foreign commercial banks.

That being said, it is true that some short-term private creditors are being at least partly protected. And looking ahead, the international community needs to find better ways of including the private sector in efforts to resolve sovereign debt problems.

Is the IMF Using Taxpayers' Money to Bail Out Asian Economies? The IMF is not a charitable institution. It is not an aid agency. And its operations are not carried out at taxpayer expense. Rather, it operates something like a credit union, or a revolving fund. A country subscribes resources to the IMF, and it can draw a multiple of this subscription—or quota—when the need arises to finance a balance of payments deficit. This arrangement enables the resources of members that are in strong balance of payments positions to be loaned temporarily to other member countries that need them.

What has this arrangement cost U.S. taxpayers? As Treasury Secretary Robert Rubin recently said, since the start of the IMF, America's participation "has not cost the taxpayer one dime."

What does the world, and the United States in particular, get for its money? First, it gets the most effective vehicle yet created for improving economic performance in countries around the world. Second, the IMF provides a highly effective mechanism for burden sharing. While U.S. participation is substantial, U.S. resources still constitute only 18 percent of the IMF's capital base; the rest of the world provides the other 82 percent. Consider how much more costly it would have been for the United States to address any of the major international financial problems of the past few decades if it had not been able to work through the IMF.

Is the IMF Too Secretive? Let me answer this by raising a few questions. What have Thailand, Korea, and Indonesia promised to do in their Letters of Intent to the IMF in return for financial support? What does the IMF's Executive Board think about the economic situation in the Czech Republic, Argentina, and Canada—all countries

taken up by our Board in the past few weeks. And how have we revised our world economic outlook in light of the Asian crisis? You can find the answers to these and probably just about any other question you have on the IMF at our web site on the Internet. There, we have posted a wealth of data and other information—part of our effort in recent years to reduce the mystery surrounding the IMF.

Should the IMF warn markets when it thinks a crisis is brewing? The danger is that our predictions, however well founded, may sometimes be wrong. Moreover, our warnings could provoke the very crises that we are trying to prevent. It is far better that the market come to its own conclusions. That is why we have set up data standards to guide members in releasing reliable data to the public, along with a bulletin board on the Internet so that the public can track the data practices of individual countries. Also, member governments continue to have full access to information on IMF opinions and operations through their representatives on our Executive Board.

Looking Ahead

What could be done to prevent future crises?

- We must continue to encourage countries to *improve the quality of information* that they make available to the IMF and to the public.
- We must find ways to *strengthen domestic financial systems* by improving domestic regulation and supervision and increasing financial sector transparency.
- As countries open their economies to foreign capital, we must encourage them to *liberalize capital flows in a prudent and properly sequenced way* that will maximize the benefits and minimize the risks of freer capital movements. To this end, work is under way on an amendment to the IMF's charter that would make the liberalization of capital movements one of the purposes of the IMF and extend its jurisdiction to capital movements.
- We must continue to *pursue good governance and intensify the fight against corruption*.

But realistically, the international community cannot expect to avert every potential crisis. So what else can be done to ensure that future crises can be handled effectively?

Certainly, better ways need to be found to involve the private sector in official efforts to resolve debt crises and avoid the problem of moral hazard. And we need to enhance the effectiveness of multilateral institutions.

Clearly, the IMF cannot continue to do its job—in Asia or elsewhere—unless it has adequate resources. There are major risks in the world economy. Only a few months ago, many observers thought the Asian crisis might spill across the Pacific. In fact, it did not, but I cannot guarantee you that it will not. Thus, it is a matter of some concern that the IMF's usable resources have dropped to a level that leaves us little room for maneuver—either to protect the liquid reserves that members hold in the IMF or to meet the more normal, but at times very large, financing needs of our member countries—much less to respond to a new crisis.

We must earn our members' support by doing our job well and continuously reforming ourselves. But I hope it will be recognized that participation in the IMF is not fundamentally an expense to the taxpayer; rather, it is an investment. It is an investment in the narrow sense that member countries earn interest on the IMF's use of their currencies. Far more important,

it is also an investment in the broader sense—an investment in the stability and prosperity of the world economy. ■

The full text of this speech is available on the IMF's web site (<http://www.imf.org/external/news.htm>).

ESAF resources are intended to support strong medium-term structural adjustment programs.

Stand-By, EFF, and ESAF Arrangements as of February 28

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
Stand-By Arrangements			27,302.44	11,547.47
Bulgaria	April 11, 1997	June 10, 1998	371.90	124.30
Cape Verde	February 20, 1998	April 19, 1999	2.10	2.10
Djibouti	April 15, 1996	March 31, 1998	6.60	2.63
Egypt	October 11, 1996	September 30, 1998	271.40	271.40
El Salvador	February 28, 1997	May 30, 1998	37.68	37.68
Estonia	December 17, 1997	March 16, 1999	16.10	16.10
Indonesia	November 5, 1997	November 4, 2000	7,338.24	5,136.77
Korea ¹	December 4, 1997	December 3, 2000	15,500.00	4,300.00
Latvia	October 10, 1997	April 9, 1999	33.00	33.00
Romania	April 22, 1997	May 21, 1998	301.50	180.90
Thailand	August 20, 1997	June 19, 2000	2,900.00	1,100.00
Ukraine	August 25, 1997	August 24, 1998	398.92	217.59
Uruguay	June 20, 1997	March 19, 1999	125.00	125.00
EFF Arrangements			13,126.90	7,196.62
Algeria	May 22, 1995	May 21, 1998	1,169.28	168.88
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	33.35
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Gabon	November 8, 1995	November 7, 1998	110.30	49.63
Jordan	February 9, 1996	February 8, 1999	238.04	59.18
Kazakhstan	July 17, 1996	July 16, 1999	309.40	309.40
Moldova	May 20, 1996	May 19, 1999	135.00	97.50
Pakistan	October 20, 1997	October 19, 2000	454.92	417.01
Panama	December 10, 1997	December 9, 2000	120.00	110.00
Peru	July 1, 1996	March 31, 1999	300.20	139.70
Philippines	June 24, 1994	March 31, 1998	791.20	245.95
Russian Federation	March 26, 1996	March 25, 1999	6,901.00	3,064.74
Yemen	October 29, 1997	October 28, 2000	105.90	96.90
ESAF Arrangements			4,058.44	2,043.97
Armenia	February 14, 1996	February 13, 1999	101.25	33.75
Azerbaijan	December 20, 1996	December 19, 1999	93.60	38.02
Benin	August 28, 1996	August 27, 1999	27.18	18.12
Bolivia	December 19, 1994	September 9, 1998	100.96	16.82
Burkina Faso	June 14, 1996	June 13, 1999	39.78	19.89
Cameroon	August 20, 1997	August 19, 2000	162.12	135.10
Chad	September 1, 1995	August 31, 1998	49.56	16.52
Congo, Republic of	June 28, 1996	June 27, 1999	69.48	55.58
Ethiopia	October 11, 1996	October 10, 1999	88.47	73.73
Georgia	February 28, 1996	February 27, 1999	166.50	55.50
Ghana	June 30, 1995	June 29, 1998	164.40	109.60
Guinea	January 13, 1997	January 12, 2000	70.80	47.20
Guinea-Bissau	January 18, 1995	July 24, 1998	10.50	2.36
Guyana	July 20, 1994	April 17, 1998	53.76	0.00
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Kyrgyz Republic	July 20, 1994	March 31, 1998	88.15	0.00
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	36.37
Madagascar	November 27, 1996	November 26, 1999	81.36	54.24
Malawi	October 18, 1995	October 17, 1998	45.81	15.27
Mali	April 10, 1996	April 9, 1999	62.01	20.67
Mauritania	January 25, 1995	July 13, 1998	42.75	0.00
Mongolia	July 30, 1997	July 29, 2000	33.39	27.83
Mozambique	June 21, 1996	June 20, 1999	75.60	37.80
Niger	June 12, 1996	June 11, 1999	57.96	28.98
Pakistan	October 20, 1997	October 19, 2000	682.38	568.65
Sierra Leone	March 28, 1994	May 4, 1998	101.90	5.06
Tanzania	November 8, 1996	November 7, 1999	161.59	74.47
Togo	September 16, 1994	June 29, 1998	65.16	10.86
Uganda	November 10, 1997	November 9, 2000	100.43	80.34
Yemen	October 29, 1997	October 28, 2000	264.75	220.75
Zambia	December 6, 1995	December 5, 1998	701.68	40.00
Total			44,487.78	20,788.05

¹Includes amounts under Supplemental Reserve Facility.

EFF = Extended Fund Facility

ESAF = Enhanced Structural Adjustment Facility

Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

Should Privatization Proceeds Be Viewed in Terms of Revenue or Financing?

The purpose of privatization programs, launched by industrial and developing country governments alike, is to redeploy assets from the public sector to the private sector—where they are expected to be used more efficiently. If this is the case, privatization can enhance welfare and lead to a permanent increase in the aggregate level of output. While privatization programs are not meant to fill holes in the budget, they have been profitable for some governments. Privatization programs in Chile and Mexico, for example, generated proceeds that averaged about 1 percent of GDP in their peak years. Thus, apart from their impact on the productivity of a nation's capital stock and on the long-term growth rate or output level of the economy privatization programs can have important short-run macroeconomic and financial consequences. In a new study, *The Macroeconomic Impact of Privatization*, G. A. Mackenzie addresses some of these consequences. In particular, he examines whether privatization proceeds are best viewed as revenue that can alter the stance of fiscal policy (like taxes) or as financing (like a bond issue).

“Valuation Differential”

A number of elements determine the macroeconomic effects of privatization. One that is particularly important is the “valuation differential”—that is, the difference between the present value of the net income generated by public sector enterprises to be privatized and the value that their shares would command with private sector investors. For example, with a negative valuation differential, the value of a concern is worth less—or deemed to be worth less—in the public sector than in the private sector. When the government privatizes the enterprise, it receives more for it than it is worth as a public sector enterprise. Assuming that the government uses the privatization proceeds to reduce its debt—rather than to finance additional public expenditure—privatization could permanently reduce a deficit, just as a tax increase could. At the same time, private sector wealth—and hence consumption—may increase. The fact that the private sector is willing to acquire the assets implies that the return on them must be no less than the return on alternative investments. In turn, existing resources are used

more efficiently and, although it may take some time for extra productive capacity to come on stream, productive capacity increases. Nevertheless, privatization may displace private sector investment that would otherwise have been undertaken—a result that policymakers need to bear in mind in setting fiscal and monetary policy.

When there is a positive valuation differential, the private sector may be more risk-averse than the government, so that it discounts the assets at a higher rate than the government does and pays less for them than they are worth. Under these circumstances, privatization would actually worsen the government's finances, since the stream of income the government gives up is worth more to it than the proceeds of the privatization. In this case, the private sector would benefit from a wealth effect, implying an increase in aggregate consumption. Privatization would have an expansionary impact on the economy in the short run unless the government offset its effects with a contractionary fiscal policy.

Mode of Implementation

The impact of privatization also depends on the way governments implement privatization programs. Mackenzie looks at the impact of privatizations financed via share offerings as well as through voucher issues.

Share Offerings. Portfolio theory suggests that the private sector will not acquire shares unless the rate of return on financial assets increases. In a closed economy, interest rates could rise following privatization, since the private sector becomes less liquid. This increase in interest rates, by reducing the market value of financial assets, would reduce private sector wealth and aggregate consumption. This effect can, however, be offset if the government uses the proceeds to repurchase public debt held by the private sector or if the central bank conducts an open-market operation. A repurchase operation reduces the stock of

Letters of Intent

In recent months, the IMF has encouraged member country authorities to release to the public the letters of intent for their IMF-supported economic programs, together with the associated memorandums of economic policies. This approach is useful in making the commitments undertaken by country authorities clear and transparent. The actual decision whether to release a letter of intent is, however, made by the authorities of the country concerned.

The letters of intent for Indonesia, Korea, and Thailand have now been made available on the IMF's external web site (www.imf.org). Additional letters of intent will be posted upon the web site as they are released by the authorities.

Clarification

The *IMF Survey* dated February 23, 1998, page 49, reported on the Moscow communiqué announcing that Russia and the IMF had agreed to extend and augment financial support under the existing Extended Fund Facility. It should be clarified that these understandings would come into effect following action by the IMF Executive Board.

bonds in the private sector's hands and increases the money supply by the same amount. The supply of money and the combined value of stocks and bonds will be the same as they were before privatization. Consequently, as long as the shares of the privatized concern are close substitutes for public debt instruments, privatization should not reduce private sector wealth.

In countries where financial markets are not very developed and, in particular, where there is no substantial outstanding stock of government paper that can be used to offset the impact on the liquidity of the privatization operation, privatization may require that shares trade at values that are well below the privatized enterprises' net worth. A

share offering in these circumstances may create a substantial wealth effect for investors who are relatively unconcerned about the marketability of their holdings. However, the

prices of other securities held by the private sector may be depressed by the privatization offering, especially if the outstanding stock of these securities is not large. The low value obtained for the privatized shares also reduces the impact on the government's budget constraint, conceivably resulting in a tightening of its constraint.

Voucher Privatizations. The comparative thinness of financial markets in some countries, and the large scale of some privatization programs, have led some countries to adopt privatization by voucher. Under a voucher program, participants receive, for free, vouchers that make them owners of a part of an enterprise or group of enterprises. Privatization by voucher is akin to a capital transfer by the government to the private sector financed by a sale of assets. The government's property holdings

decline, but its liquid assets do not increase. Unless the privatized concerns had zero or negative net worth, the government's budget constraint is tightened. The private sector, however, enjoys an increase in its wealth. If it can trade or borrow against this wealth, consumption will increase. Hence, voucher privatization has, if anything, a positive impact on domestic consumption and investment. In setting fiscal policy, policymakers must keep this impact in mind.

Implications for Policymakers

Governments may be tempted to treat privatization proceeds as revenue. However, privatization—unlike a tax increase—entails an exchange of assets that does not reduce the net worth of the private sector. The receipt of privatization proceeds therefore does not normally warrant a loosening of the fiscal stance. In exceptional cases, the acquisition by the private sector of assets formerly in the public sector could displace private investment and consumption, so that the government would have to spend more—or tax less—just to maintain aggregate demand. Because it is very difficult for policymakers to predict whether this will be the case, they should view privatization proceeds as a kind of financing, rather than revenue to be spent.

These conclusions do not, however, imply that privatization proceeds should always be used simply to retire debt. Just as there can be very good reasons for an increase in a government's reliance on nonbank or external borrowing during a period of, say, exceptional needs for infrastructure investment, there can be a good reason for using the proceeds of privatization to the same end. The arguments for tax smoothing can be applied to justify reliance on the proceeds of privatization, although the desire to avoid tax hikes is not an argument in favor of "fire sales" of public enterprises.

Privatization also affects an economy's potential supply. If the privatized assets are much more productive in the private sector than they were in the public sector, privatization increases potential output, although probably not at the moment of transfer of ownership. This increase may have implications for macroeconomic policy, since the size of the gap between actual and potential output has a bearing on any assessment of the appropriate settings for fiscal and monetary policy. Given the uncertain impact of privatization on aggregate supply, however, prudence would dictate that policymakers discount somewhat privatization's beneficial supply-side effects. ■

Voucher privatization has a positive impact on domestic consumption and investment.

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
March 9	4.22	4.22	4.63
March 16	4.20	4.20	4.49

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (the U.S. dollar, weighted 39 percent; deutsche mark, 21 percent; Japanese yen, 18 percent; French franc, 11 percent; and U.K. pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 109.6 percent*) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171.

*Effective March 12, the proportion of the rate of charge was reduced to 107 percent.

Data: IMF Treasurer's Department

Copies of IMF Paper on Policy Analysis and Assessment No. 97/9, *The Macroeconomic Impact of Privatization*, by G. A. Mackenzie, are available for \$7.00 each from IMF Publication Services. See page 95 for ordering information.

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

Lesotho: Article VIII

The government of Lesotho has notified the IMF that it has accepted the obligations of Article VIII, Sections 2, 3, and 4, of the IMF Articles of Agreement, with effect from March 5, 1997. Through this action, Lesotho undertakes to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval. A total of 142 countries have now assumed Article VIII status.

Lesotho has been a member of the IMF since July 25, 1968, and its quota in the IMF is SDR 23.9 million (about \$32 million).

Press Release No. 98/4, March 11

Côte d'Ivoire: ESAF

The IMF approved a three-year arrangement under the Enhanced Structural Adjustment Facility (ESAF), in an amount equivalent to SDR 285.8 million (about \$384 million), to support Côte d'Ivoire's economic program for 1998–2000. The first annual arrangement, equivalent to SDR 123.9 million (about \$167 million), is available in two semiannual installments, the first of which, in an amount of SDR 83.4 million (about \$112 million), will be available on March 25, 1998. The IMF also considered the eligibility of Côte d'Ivoire under the Initiative for the Highly Indebted Poor Countries.

Medium-Term Strategy and

1998 Program

The medium-term adjustment strategy for 1998–2000 focuses on three key policy components: prudent fiscal policy to bring the budget close to balance by 2000 and achieve a surplus thereafter; structural reforms to promote private sector development and investment, including foreign direct and portfolio investment; and an ambitious social development agenda designed to reduce poverty, especially through well-targeted and

efficient public spending on education and health. The basic macroeconomic objectives for 1998–2000 are to achieve real GDP growth of about 6 percent a year, allowing per capita income to rise by more than 2 percent annually; maintain an inflation rate of about 3 percent a year, consistent with the exchange rate peg (of the CFA franc vis-à-vis the French franc); and lower the external current account deficit to 2 percent of GDP by 2000.

Within this medium-term strategy, the 1998 program being supported by the first annual ESAF loan aims at achieving a real GDP growth rate of 6 percent; limiting inflation to 3 percent; and narrowing the external current account deficit to 4.1 percent of GDP. To achieve these objectives, fiscal policy is designed to reduce the overall deficit further to 1.5 percent of GDP in 1998, from 2 percent in 1997.

The authorities have already moved to speed up the implementation of their unfinished structural reform agenda, particularly in the areas of trade and price liberalization, cocoa

Côte d'Ivoire: Selected Economic Indicators

	1996	1997 ¹	1998 ²	1999 ²	2000 ²
	(percent change)				
Real GDP	6.8	6.0	6.0	6.0	5.8
Real per capita GDP	3.1	2.3	2.3	2.3	2.1
Consumer prices (end of period)	3.5	5.2	3.0	2.5	2.5
	(percent of GDP)				
Overall fiscal balance	-2.1	-2.0	-1.5	-0.8	-0.3
External current account balance (excluding official transfers)	-4.8	-4.5	-4.1	-3.2	-2.0

¹Estimates.

²Program.

Data: Côte d'Ivoire authorities and IMF staff estimates and projections

and coffee marketing, and privatization. Trade liberalization is being pursued in the context of regional arrangements. Coffee marketing will be fully liberalized in October 1998, and cocoa marketing in October 1999. At the same time, privatization of state-owned enterprises will be accelerated with the sale of 15 enterprises in 1998.

Addressing Social Needs

The authorities' strategy to improve living conditions and to reduce poverty is based on achieving sustained high economic growth, coupled with the implementation of social policies and measures targeted to the most vulnerable groups of the population. The comprehensive poverty reduction action plan adopted by the government in June 1997 includes specific measures and actions targeting the poor.

Côte d'Ivoire joined the IMF on March 11, 1963, and its quota is SDR 238.2 million (about \$320 million). Its outstanding use of IMF financing currently totals SDR 333 million (about \$448 million).

Press Release No. 98/5, March 17

Members' Use of IMF Credit

(million SDRs)

	February 1998	Jan.–Feb. 1998	Jan.–Feb. 1997
General Resources Account	1,536.27	3,620.67	856.03
Stand-By Arrangements	1,536.27	3,036.27	115.78
Of which: Supplemental			
Reserve Facility	1,500.00	3,000.00	n.a.
EFF Arrangements	0.00	584.40	740.25
CCFF	0.00	0.00	0.00
SAF and ESAF Arrangements	16.88	27.74	84.87
Total	1,553.15	3,648.41	940.90

Note: EFF = Extended Fund Facility
CCFF = Compensatory and Contingency Financing Facility
SAF = Structural Adjustment Facility
ESAF = Enhanced Structural Adjustment Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

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

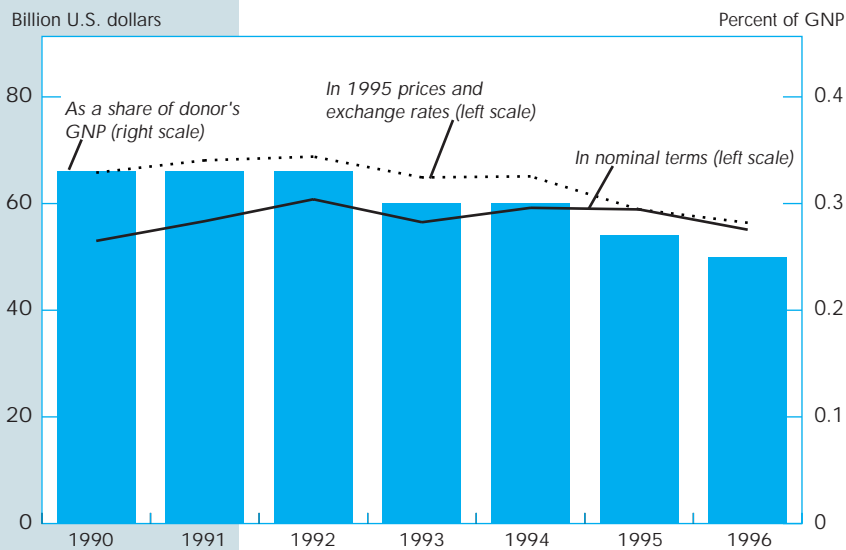
March 23, 1998

Despite Decline in 1996, Official Financing Is Increasingly Vital for Low-Income Countries

Total resource flows to developing countries burgeoned between the early and mid-1990s, but that overall performance masked widely divergent trends in private and official capital flows. Between 1990 and 1996, gross resource flows to developing countries more than doubled, due almost entirely to a vigorous growth in private flows to emerging markets in Asia and Latin America and the transition economies in Eastern Europe. Over

tion for resources (principally from transition economies), and greater needs for emergency assistance—have reshaped the volume and structure of official development assistance. Donors have grown more selective, often directly linking the extension of financial aid with a country's policy performance. Official development assistance is now frequently targeted to efforts to promote long-term economic development, develop infrastructure, reduce poverty, and improve governance.

Net Official Development Assistance Disbursements



Data: IMF, *Official Financing for Developing Countries*

this same period, net flows of official development assistance changed little in nominal terms and dropped in real terms, declining nearly 17 percent since the second half of the 1980s.

This pattern of resource flows, observes the IMF's recently released *Official Financing for Developing Countries*, reflects broader trends that have favored dynamic middle-income economies with strong macroeconomic policy environments and ready access to capital markets. By contrast, many poorer economies remain burdened by debt and stymied by slow or inconsistent implementation of policy reforms. In the absence of private financing, these countries have increasingly relied on official financing sources, including, in particular, grants (which are not shown in the chart above) and on debt restructuring on concessional terms for needed external finance.

Aid and Debt

Developments in the past decade—notably the end of the Cold War, reduced aid budgets, increased compe-

tion for resources (principally from transition economies), and greater needs for emergency assistance—have reshaped the volume and structure of official development assistance. Donors have grown more selective, often directly linking the extension of financial aid with a country's policy performance. Official development assistance is now frequently targeted to efforts to promote long-term economic development, develop infrastructure, reduce poverty, and improve governance.

Debt remains a problem for many low-income countries, and the international creditor community—both official and commercial—has recognized, the study notes, that this is a solvency rather than a liquidity problem. Since 1988, bilateral creditors have rescheduled debt on increasingly concessional terms—reaching a 67 percent reduction in net percent value terms in 1994—and commercial creditors have restructured their claims, often through debt buybacks at high discounts. These provisions will permit many low-income developing countries to reach workable debt levels and graduate from the rescheduling process. Where these traditional mechanisms will not suffice, the IMF and the World Bank have undertaken an initiative to help heavily indebted poor countries (the HIPC Initiative) lower their debt to sustainable levels through concerted action by all creditors, including multilaterals. (To date, assistance has been committed to four countries under the Initiative.)

New Official Flows

In nominal terms, new official development flows have remained constant, averaging \$70 billion annually through the 1990s. In real terms, however, fiscal consolidation by donors, as well as aid fatigue, has fed a 17 percent decline in official flows over this period. Bilateral official development assistance—which represents two-thirds of all official flows—dropped sharply in 1996 in both real (7 percent) and nominal (10 percent) terms. A 16 percent increase in multilateral assistance in real terms only partially offset the decline in bilateral assistance.

Development assistance by members of the Development Assistance Committee (DAC) of OECD averaged 0.25 percent of GNP in 1996—the lowest in 30 years. In 1996, DAC members—acknowledging the changing policy environment in which aid was both extended and received—set quantitative targets for poverty alleviation, social development, and environmental sustainability. In 1997, additional guidelines gave new emphasis to efforts to conflict prevention and participatory and accountable governance.

Export Credits

For the first time since 1992, new commitments of export credits to developing countries and transition economies dipped 3 percent to roughly \$105 billion in 1996, reflecting a substantial decline in several large markets—notably China and Indonesia—where exposure was already high. Export credit flows remained highly concentrated in countries with relatively large export activity, favorable risk assessments, and existing high export credit agency exposure. Russia, China, Indonesia, Nigeria, Brazil, Algeria, Poland, Turkey, Argentina, and Mexico accounted for two-thirds of new commitments in 1996; the top 20 countries drew 90 percent of all new commitments.

The slowdown in new export credit commitments reflects, according to the IMF study, “some slowing down in project financing and growing concerns about macroeconomic imbalances in some Asian countries and the ability of the debtor countries to assimilate previous amounts of export finance.” Export credits made up, on average, 27 percent of the total external debt of the 20 largest export credit recipients, though reliance on export credits varied from one-fifth to two-thirds or more of total external debt, depending upon the country’s access to other sources of foreign financing. The strong flow of new commitments of export credits to Asia continued in 1996, though at a slower pace than the record amounts recorded in 1994–95. Total export

Recent IMF Publications

Books

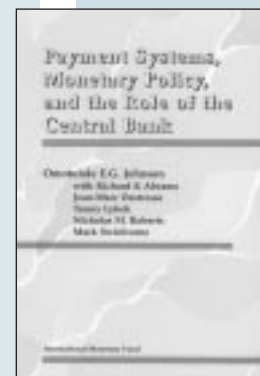
Payment Systems, Monetary Policy, and the Role of the Central Bank, Omotunde E.G. Johnson (\$25.00).

Working Papers (\$7.00)

- 98/15: *The Macroeconomic Consequences of Wage Indexation Revisited*, Esteban Jadresic. Examines the implications of contracts that index wages to lagged inflation.
- 98/16: *Brady Bonds and Default Probabilities*, Ivalio Izvorski. Computes the default probabilities implicit in the prices of Brady bonds of seven developing countries and examines the factors that determine the high cross-correlation of the probability paths.
- 98/17: *Why Do Different Countries Use Different Currencies?* Narayana Kocherlakota and Thomas Krueger. Presents a model where agents have heterogeneous preferences, which are private information, over goods of different national origin.
- 98/18: *Public Debt Indexation and Denomination—The Case of Brazil*, Ilan Goldfajn. Models the optimal debt management strategy of the public sector when issuing nominal, price-level-indexed and foreign-denominated debt securities.
- 98/19: *Financial Sector Reform and Monetary Policy in the Netherlands*, Paul Hilbers. Analyzes the different steps in financial sector liberalization, discusses the main arguments behind the gradual approach, and draws lessons for other countries involved in this process.
- 98/20: *Poverty, Income Distribution, and Economic Policy in the Philippines*, Philip Gerson. Examines the impact of fiscal and other macroeconomic policies on income distribution and poverty in the Philippines.
- 98/21: *Monetary Policy with a Convex Phillips Curve and Asymmetric Loss*, Demosthenes N. Tambakis. Analyzes the Barro-Gordon optimal monetary policy problem under alternative loss functions.
- 98/22: *Opening Up and Geographic Diversification of Trade in Transition Economies*, Oleh Havrylyshyn and Hassan Al-Atrash. Looks at the progress in transition and the geographic diversification of trade, focusing on the degree of trade openness and trade integration.
- 98/23: *The Nonmonetary Determinants of Inflation: A Panel Data Study*, Carlo Cottarelli and others. Explains inflation performance in a sample of industrial and transition economies by looking at policymakers’ incentives to inflate the economy and the perceived costs of disinflation.
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credit exposure to Asia doubled between 1992 and 1996.

Multilateral Financing

After reaching record levels the previous year—reflecting exceptionally large IMF loans in support of Mexican and Russian adjustment programs—multilateral lending declined significantly in 1996. Gross lending dropped off to \$42 billion in 1996 from \$60 billion in 1995; net lending also declined sharply, from \$28 billion to \$15 billion. Multilateral lending to developing countries, which has grown steadily over the past ten years, is now nearly double official bilateral lending in gross terms. Total net multilateral lending to all developing countries increased from an annual average of \$10 billion in 1985–89 to \$15 billion in the 1990s. The share of concessional loans in net multilateral disbursements increased steadily over the last decade to 60 percent in 1996. As a result, developing countries' multilateral debt-service ratio fell from 4½ percent of exports in 1990–95 to 3 percent in 1996; for the heavily indebted poor countries, the decline was from 8½ percent to 7 percent.

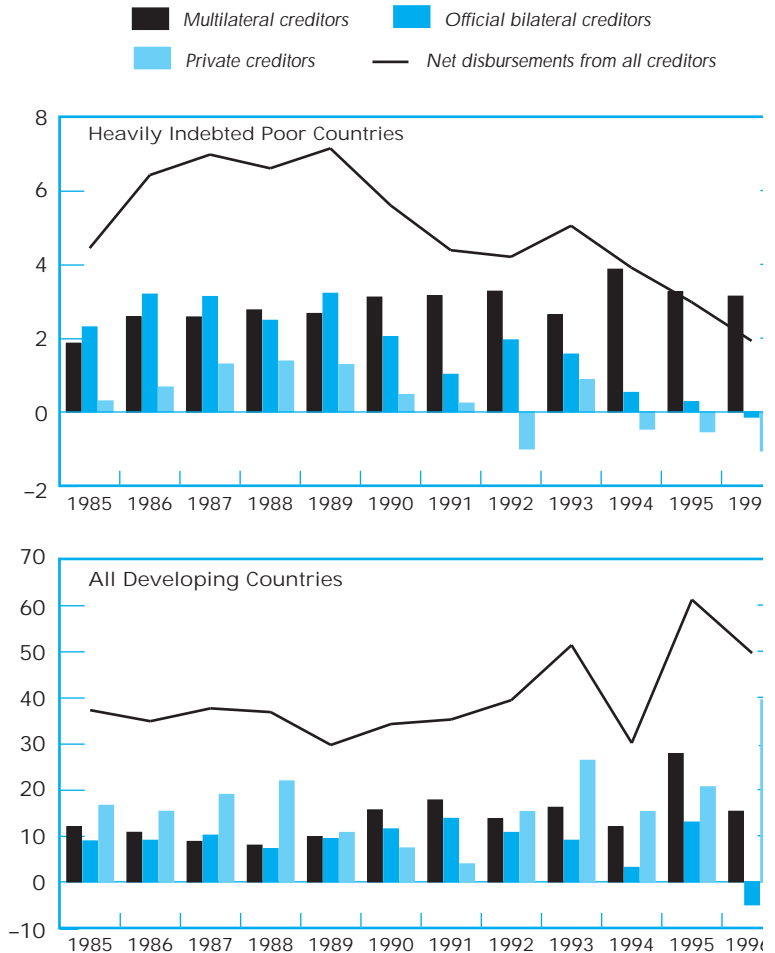
The regional allocation of multilateral lending reflected broader economic and geopolitical trends, with flows to the transition economies of Eastern Europe swelling over the last decade. Lending to Latin America and South Asia declined markedly, reflecting the growing access of many Latin American countries to private capital markets and India's net repayments to the IMF since 1993.

Debt Restructuring

The contrast between middle-income and low-income developing countries in terms of their market access is also evident in their debt-restructuring status. Of the 30 middle-income countries that have rescheduled debt with the Paris Club over the past 20 years, 23 have graduated from reschedulings and 4 (Algeria, Jordan, Peru, and Russia) are expected to do so at the conclusion of their current consolidation periods. Their exit, the IMF study observes, reflects "significant progress in macroeconomic stabilization and structural reform in these countries."

By contrast, less than one-fourth of the 37 low-income developing countries exited the rescheduling process, reflecting both the severity of their debt burden and the "uneven pace of macroeconomic stabilization and structural reform." All of the low-income countries that have recently rescheduled have done so under "Naples terms," with the debt relief varying between 50 percent and

Developing Countries: Net Disbursements on Public External Debt
(billion U.S. dollars)



Note: Net disbursements are on medium- and long-term public and publicly guaranteed debt, including to the IMF.
The estimates for 1996 are provisional.

Data: IMF, *Official Financing for Developing Countries*

67 percent in net present value terms, depending on per capita income and overall indebtedness.

There have also been debt restructurings with non-Paris Club bilateral creditors. Russia was the largest of these creditors and reached an understanding with Paris Club creditors in September 1997 to participate in Paris Club reschedulings as a creditor. This agreement provides for a large up-front discount on Russian claims—with a bigger discount for low-income countries—valued at the official Russian Gosbank ruble exchange rate. The agreement is expected to help regularize the relations of many developing countries with Russia.

Copies of *Official Financing for Developing Countries*, a study in the IMF's World Economic and Financial Surveys series prepared by a staff team in the Policy Development and Review Department led by Anthony R. Boote and Doris C. Ross, are available for \$25 (academic rate: \$20) from IMF Publication Services. See page 95 for ordering information.