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IMF Management to Recommend Release of Funds After Russia Announces New Fiscal Measures

John Odling-Smee, Director of the IMF's European II Department, told a press conference in Moscow on May 29 that IMF management and staff welcome the Russian government's statement on the measures that it is taking to bring Russia's fiscal situation under control. "In view of these adjustments in fiscal policy, together with continued firm monetary policy and progress on structural reforms," Odling-Smee said, "the IMF management intends to recommend that the IMF's Executive Board complete the seventh quarterly review under the Extended Fund Facility for Russia. This would release a tranche of $670 million." [The total credit, approved in March 1996, was $10.1 billion. See Press Release No. 96/13, *IMF Survey*, April 1, 1996, page 119.]

"We are particularly reassured by the emphasis placed on the practical implementation of policies and the understanding by the new Russian government of the need for clarity, coherence, and continuity of government policy. When fully implemented, these measures would allow the reduction of the federal government budget deficit to 5 percent of GDP in 1998 and the achievement of primary balance. They also represent an attack on the two major problems that have frustrated attempts at fiscal consolidation in the past: weaknesses in tax collection and government spending commitments in excess of what can be afforded. This bodes well for the pursuit of fiscal adjustment in 1999 and beyond.

"The clarification and strengthening of fiscal policy implied by the government's statement should reassure financial markets that economic and financial policies are consistent with the *(Please turn to the following page)*

Neiss Press Conference

As Indonesian Economy Continues to Weaken, IMF to Consider Easing Program Deadlines

At the conclusion of a five-day visit to Indonesia, Hubert Neiss, Director of the IMF's Asia and Pacific Department, said in a news conference in Jakarta on May 30 that the Indonesian economy could contract by 10 percent—possibly even more—in 1998, twice the IMF's estimate earlier this year. Inflation would be higher than previously forecast, he said, and it was not clear how the currency would behave in coming months, as this depended on a return of confidence. Neiss was in Indonesia to assess the economic situation and to compile a report for consideration by the IMF's Executive Board on how to proceed with the next program review that would lead to the next $1 billion disbursement of the country's $10 billion stand-by loan.

Because of the worsening economic situation, Neiss said during the press conference, which was held jointly with Indonesian Coordinating *(Continued on page 175)*

Photo unavailable due to copyright protection.

Ginandjar Kartasasmita (left) and Hubert Neiss at press briefing in Jakarta.

(Continued from front page) government's objectives of creating conditions for stronger growth and a continued reduction in inflation. The IMF management and staff believe that the central bank's exchange rate policy is a key part of these policies, and that a devaluation of the ruble can and should be avoided. With the reestablishment of confidence in the currency, we hope to see stability return to financial markets. We intend to continue to work closely with the Russian government to help ensure the achievement of these goals," Odling-Smee said.

United States Welcomes Russia's Reforms

U.S. President Bill Clinton said on May 29 that the United States welcomes Russia's reform efforts, supported by the IMF.

"I strongly welcome Russia's announcement today [May 29] of its new economic program for 1998," Clinton said in his statement. "This program, developed in consultation with the IMF, signals Russia's commitment to a bold economic reform agenda to strengthen financial stability and encourage investment and growth. The United States intends to support this program when it is reviewed by the IMF Board.

"Russia's new economic plan puts in place a solid strategy for fiscal reform. It gives Russian officials the authority they need to collect taxes, crack down on companies that ignore their obligations to the government, and control spending in line with revenues. What is now important is to carry out these reforms decisively and resolutely. The United States will continue to encourage strong IMF and World Bank engagement in support of reform."

In a further statement, on May 31, Clinton stressed that implementation of the Russian program would "strengthen the fundamentals of the Russian economy and foster maintenance of a stable ruble." He added, "The United States endorses additional concessional financial support from the international financial institutions, as necessary to promote stability, structural reforms, and growth in Russia." A senior U.S. official emphasized that the focus of discussions was on additional support being provided by the IMF and the World Bank and on Russia's efforts to raise resources from the private sector, rather than on bilateral support from the United States.

Elements of Russian Fiscal Package

In its May 29 statement, the Russian government said that the current situation required "a substantive adjustment" of fiscal and monetary policy. "All these actions are taken," the statement continued, "with one goal in mind—to safeguard the stability of the Russian domestic currency and the stability of the entire economy."

The government's three-year budget plan envisages a reduction of 3.5 percent of GDP in the federal budget deficit in 1999 and a 1 percent of GDP excess of revenues over noninterest expenditures.

Increasing Budget Revenues. Overall revenue is to be lower because of revised tax expectations, the statement said, but an extra 10 billion rubles ($1.6 billion) in income from new initiatives has been added. Also, about twenty corporate tax debtors will be asked to pay at least 5 billion rubles ($800 million) in back taxes by the end of June. Other measures to increase revenues include the following:

- The government will recover unpaid taxes from the export proceeds of delinquent oil companies.
- Effective August 1, payment of value-added taxes and gas excises will be on an accrual basis.

IMF Seeks Comments on Proposals to Modify SDDS International Reserves Data Category

A consultation paper has recently been posted on the Dissemination Standards Bulletin Board (DSBB) inviting comments on a proposed modification of the Special Data Dissemination Standard (SDDS) data category for international reserves.

In March 1996, the IMF, in consultation with member countries, established the SDDS to encourage the timely publication of economic data used by market participants in evaluating a country's policies and prospects (see *IMF Survey*, May 20, 1996, page 165). The SDDS is aimed at member countries that have, or seek, access to international capital markets. It identifies several data categories and associated requirements of coverage, periodicity, and timeliness that are important in ensuring comprehensive coverage of macroeconomic statistics. For the external sector, the SDDS includes gross official reserves, denominated in U.S. dollars, as a prescribed component to be provided by SDDS subscribers on a monthly basis with a one-week lag, with reserve-related liabilities as an encouraged component.

In concluding its first review of the SDDS in December 1997, the IMF's Executive Board agreed that consideration should be given to modifying the data category for international reserves to include reserve-related liabilities and net commitments under financial derivative positions. At its April 1998 meeting, the IMF's Interim Committee echoed this view and called on the IMF to expedite its efforts to broaden and strengthen the SDDS by, among other changes, modifying the international reserves category to incorporate these additional data. In light of these developments, the IMF's Statistics Department is seeking input from SDDS subscribers and other interested national authorities and data users on modifying the SDDS data category for international reserves. The staff hope to complete this process by the end of June 1998 and would appreciate responses by mid-June. Responses may be e-mailed to sdddsreserves@imf.org. More information is available on the IMF's web site (http://www.imf.org, or http://dsbb.imf.org), and copies of the consultation paper are available on request in Arabic, French, Russian, and Spanish (e-mail address: ddsd@imf.org).

• The government will take the necessary steps to enable the special inspectorate for large taxpayers set up in January 1998 to operate efficiently.

Expenditure Controls. The program envisages a reduction in federal spending in 1998 of 40.4 billion rubles ($6.5 billion). Measures include:

• reduction by 29 percent in the number of direct recipients of budgetary financing;

• reduction in the number of public sector employees;

• consolidation of extrabudgetary accounts financed by the federal government;

• reorganization of budget organizations, including through mergers or divestiture, or by closing them down;

• suspension of work and supplies for state needs that are not supported by financial resources;

• reduction in and better targeting of subsidies; and

• strict limits on the overall volume of transfers to regions, including budgetary loans to clear wage arrears.

Structural Measures. The government has taken a number of measures over the past few months to accelerate the process of structural transformation, the statement noted. These include measures to:

• increase transparency in the operation of national monopolies and ensure full transfer of dividends from government holdings in these and other companies to the federal budget;

• reform fiscal federal relations; and

• improve monetary policy management and the payment system.

The government is also committed to accelerating privatization in a transparent manner as financial markets stabilize, the statement concluded. ■

Indonesian Review

(Continued from front page) Minister for Economy, Finance, and Industry Ginandjar Kartasasmita, the IMF would consider easing some of the deadlines Indonesia had earlier agreed to in implementing its economic program. "Since the economy is now much weaker than it was when the program was discussed with the government, we will have to revise the macroeconomic barometers," Neiss said. "We want to build the program on realistic assumptions, and when it does not make sense to stick with certain deadlines, we have to be pragmatic and relax the deadlines," he added. Neiss said he was confident the IMF Executive Board would reach a decision soon on proceeding with the next program review and resuming loan disbursements.

Asked how long he thought it would take the economy to get back on track, Neiss said it would depend on a return of confidence. "I would hope the downward slide in the economy can be stopped quickly, and a recovery—probably gradual—can be initiated in the latter part of this year," he said. He added that it was essential for the reestablishment of confidence in the country that progress in political reforms and in economic reforms went hand in hand.

During his visit, Neiss conferred with a wide spectrum of Indonesian opinion as background for his report to the IMF Executive Board. He was the first IMF official to meet with newly designated Indonesian President Jusuf Habibie. He also spoke with government ministers, experts, members of the opposition—including Megawati Soekarnoputri and Amien Rais—labor leaders, university professors, and student leaders. ■

Camdessus Welcomes Debt Agreements

IMF Managing Director Michel Camdessus strongly welcomed the agreements reached in Frankfurt on June 4 between Indonesia and the Bank Steering Committee representing creditor banks on interbank debt, trade credit, and corporate debt. "These agreements," Camdessus said, "which have the immediate effect of relieving the pressure on the foreign exchange market and will help to revive international trade and economic activity, are of major importance for the Indonesian economy."

IMF Publications Cover Asian Crisis and Reviews of Member Country Prospects

The Asian crisis and its implications for the global economy are the special focus of the June issue of *Finance & Development.*

• Stanley Fischer, First Managing Director of the IMF, discusses the Asian crisis and the IMF's response.

• Guillermo Ortiz Martinez, Governor of the Bank of Mexico, describes the parallels between the Mexican crisis of 1994–95 and the Asian crisis.

• John Lipsky, Chief Economist and Director of Research at Chase Manhattan Bank, New York, analyzes the weaknesses that the crisis has exposed in the current international financial system and ways to restore private capital flows.

• Manuel Guitián, Director of the IMF's Monetary and Exchange Affairs Department, reviews the challenges of managing global capital flows in the light of the Asian crisis.

Other articles discuss the problems of aging societies in the Asian economies, infrastructure development in East Asia, private investment in the West Bank and Gaza Strip, the destructive impact of bribery in international commerce, and the prospective role of the euro as an international currency.

The IMF is now the sole publisher of *Finance & Development* following a decision by the World Bank to withdraw its participation in the publication.

Economic Reviews

The Executive Board's comprehensive reviews of member countries' economic prospects and policies are now being released in a triannual new series of *IMF Economic Reviews.* These assessments will also continue to be released individually as Press Information Notices, posted on the IMF's web site (http://www.imf.org), and announced in the *IMF Survey.*

The first *IMF Economic Reviews*, covering January–April 1998, is now available. The second and third reviews, covering May–August and September–December 1998, will be released later this year and in early 1999, respectively.

Both *Finance & Development* and the *IMF Economic Reviews* series are available free of charge. For subscription information, please contact IMF Publication Services (see page 186).

Structural Reform and Market-Based Policies Heighten Need for Policy Coordination

In many countries, policymakers have subordinated monetary policy to fiscal needs, requiring their central banks to finance public sector deficits. This has often introduced inflationary biases. In recent years, however, monetary authorities worldwide have increasingly implemented policies to ensure price stability and strengthen central bank independence. Simultaneously, in the fiscal area, financial market development has allowed public debt managers to focus more on minimizing costs. This separation of the two functions in no way lessens the need for effective coordination of monetary and fiscal policy, if overall economic performance is to be optimized and maintained in the long term. In a new study, Coordination of Monetary and Fiscal Policies, *Bernard Laurens and Enrique G. de la Piedra, both of the IMF's Monetary and Exchange Affairs Department, discuss the importance of such policy coordination and examine the institutional and operational aspects of coordination arrangements. Laurens and de la Piedra spoke with the* IMF Survey *about their study.*

IMF Survey: *What is the rationale for monetary and fiscal policy coordination, and what is required to achieve it? Why has this become an important issue?*

de la Piedra: Close coordination between monetary and fiscal policy is essential for sustainable economic growth in a context of price stability and viable external accounts. Effective policy coordination makes it easier for policymakers to achieve their objectives efficiently, in part by ensuring their commitment to mutually agreed objectives. Without efficient policy coordination, financial instability could ensue, leading to high interest rates, pressures on exchange rates, rapid inflation, and an adverse impact on economic growth.

Enrique G. de la Piedra

To be efficient, coordination must be based on sustainable and credible monetary and fiscal policies. Even if decision makers attempt to coordinate their policies, efforts will ultimately fail if one or both policies are unsustainable. The less credible one policy is, the larger will be the burden on the other policy. Coordination also needs to account for the different time frames in which monetary and fiscal policies operate. Whereas monetary policy can be adjusted on short notice, it usually takes longer to alter the fiscal stance. The joint determination of objectives and policies by the monetary and fiscal authorities is also required for efficient policy coordination. If policy consistency comes about simply by the passive reaction in one policy area to the commanding position of the other area, the intended policy effects will not be achieved.

There is always a need for policy coordination, irrespective of an economy's stage of development. However, with the increased emphasis in many countries on structural reform and market-based policies, it has become more important to ensure that actions in one policy area do not undermine those in a different area, but rather that they support each other.

IMF Survey: *What is the main impact of monetary policy on public debt management and of public debt management on monetary policy?*

de la Piedra: Monetary policy affects public debt management through several channels. It can, for example, improve or hinder the government's ability to place debt at reasonable cost. An expansionary monetary policy may initially permit placement of public debt at low interest rates; however, inflationary pressures will likely ensue, interest rates will tend to increase, and available financing will fall unless real interest rates increase. If this happens, the fiscal authority would end up being forced to lower other expenditures to meet the higher interest costs and to match available financing.

On the other hand, a restrictive monetary policy could initially increase debt-service costs for the government. Nevertheless—if coordinated with a responsible fiscal policy—it will help to build credibility, which will eventually lead to lower interest rates and a more sustained development of the domestic financial markets. The choice and design of monetary policy instruments also have an impact on the fiscal authority's capacity to place debt in the financial market. The monetary authority can help lower the cost of public debt service by enhancing the liquidity of government securities through open market operations and through the design of the central bank's rediscount and reserve requirement regulations.

The government's financing strategy also affects the conduct of monetary policy and places constraints on central bank autonomy. Public debt management modalities will affect interest rates, while financial operations between the government and the banks will complicate the central bank's task of maintaining an orderly behavior of the monetary aggregates. In particular, if market participants view debt growth as unsustainable, the credibility of the overall policy mix is weakened, and interest rates will rise. In countries where the capital account has been liberalized, high interest rates will, in turn, attract capital from abroad, which will require

monetary sterilization operations by the central bank. This will further complicate monetary management.

IMF SURVEY: *How do the roles of monetary and fiscal policy differ under different exchange rate regimes?*

DE LA PIEDRA: Under a fixed exchange rate regime, the higher the degree of capital mobility, the less likely are policy actions to affect domestic interest rates. So, fiscal policy will tend to be particularly effective in influencing the level of aggregate demand, because it will not provoke a rise in interest rates that would tend to simultaneously reduce private sector activity. Monetary policy, in turn, will remain relatively ineffective in this regard; thus, an expansionary monetary policy will only tend to change the sources of money supply but will achieve little, if any, modification in the level of monetary aggregates or interest rates. Under a flexible exchange rate regime, the opposite will tend to be true: the authorities will be able to use monetary policy to a greater extent to change the level of aggregate demand, since the monetary stock is now under their control, and fiscal policy would be less effective than before. In either case, however, there will be limits to the effectiveness of a given policy. Under a fixed exchange rate regime, for example, an excessively expansionary fiscal policy would weaken market confidence in the exchange rate peg. At the same time, under a flexible exchange rate regime, continued monetary expansion could lead to an unsustainable process of exchange rate depreciation and domestic inflation.

IMF SURVEY: *What mechanisms do countries currently have in place to ensure effective monetary and fiscal policy coordination? In this context, what is the function of a country's central bank or its ministry of finance?*

LAURENS: Current trends point to an increasing institutional separation of monetary and fiscal policy responsibilities. This "divorce" is characterized by a large degree of central bank independence. Central banks are typically assigned the primary objective of maintaining price stability, sometimes supported by institutional arrangements to promote fiscal discipline—such as balanced budget clauses or the Growth and Stability Pact agreed upon by European Monetary Union participants. An issue closely related to central bank independence is the extent to which a government can receive direct credit from the central bank. Traditionally, statutory ceilings have limited a central bank's ability to provide such credit. These controls are not perfect, however, since there are ways to circumvent them. Countries with developed financial markets tend to prohibit direct central bank lending to the government and to authorize voluntary purchases of government securities in the secondary market, provided this is motivated by monetary policy considerations. The experience of some countries—in particular, Argentina, Estonia, and Lithuania—shows that currency board arrangements have also been effective in promoting and maintaining fiscal discipline.

Institutional arrangements alone cannot, however, be expected to prevent policy inconsistencies, but when they occur, the process to resolve them seems reasonably clear. In the case of a tight monetary policy to counteract an expansionary fiscal policy, for instance, the government would have two options: either adjust fiscal policy or change the price-stability target assigned to the central bank with the risk of eroding the central bank's credibility. The "divorce" of monetary and debt management functions in no way lessens the need for effective coordination of monetary and fiscal policy if overall economic performance is to be optimized and maintained in the long term.

Bernard Laurens

IMF SURVEY: *In day-to-day coordination, what must policymakers pay attention to?*

LAURENS: Policymakers need to focus daily on the effects of changes in government balances on monetary conditions. The central bank must monitor the impact of changes in government deposits on the level of bank reserves, while the treasury focuses on maintaining effective control over cash management and public expenditure. A particularly important element in policy coordination is an appropriate framework for projecting government cash flow. Both the central bank and the public debt manager need this information: the former, so as to decide on the timing and size of its open market operations; the latter, so as to rationalize debt issuance and minimize the debt-service costs. Short-term government cash flow forecasts will need to be shared by the central bank and the public debt manager—both when the management of government balances is centralized at the central bank and when the government is allowed to place funds with commercial banks, as is the case in Canada, France, Germany, Malaysia, the United Kingdom, and the United States. The treasury and the central bank should also discuss whether forecast errors are the result of temporary shortfalls or surpluses, which will be self-correcting, or result from more fundamental and permanent events that could prompt a change in macroeconomic policies. Preparing such projections facilitates regular public disclosure of the size of the government's financing requirements and its plans for meeting them. ■

Copies of Working Paper 98/25, *Coordination of Monetary and Fiscal Policies*, by Bernard Laurens and Enrique G. de la Piedra, are available for $7.00 each from IMF Publication Services. See page 186 for ordering information.

Study Analyzes Role of External Borrowing Among Countries of Former Soviet Union

The stock of external debt of many transition economies in the Baltics, Russia, and the other countries of the former Soviet Union has been growing rapidly in recent years and has played an important part in the transition process. Although not especially high by the standards of most developing countries, the current level of debt—above 100 percent of exports in some countries—is nevertheless remarkable, given that it was zero, or close to zero, less than seven years ago. In a new study, External Borrowing in the Baltics, Russia, and Other States of the Former Soviet Union—The Transition to a Market Economy, *John Odling-Smee and Basil Zavoico, both of the IMF's European II Department, discuss the role that external borrowing has played in the transition process and some of the risks it poses.*

An important concern is that the option to borrow abroad may weaken efforts to transform the region's economies and their institutions, including governments. A balance must therefore be struck between taking advantage of growing external borrowing opportunities and not allowing such borrowing to finance wasteful expenditures or delay the transition process. This is especially important, since the rising stock of external debt makes the borrowing countries increasingly vulnerable to changes in perceived creditworthiness. Accordingly, countries must adopt policies and press ahead with structural reforms, to ensure that the borrowing is used to promote sound growth.

Character of Region's Debt

Since the breakup of the Soviet Union in late 1991, virtually all of the new independent countries in the region have resorted to external borrowing from multilateral, official bilateral, and private creditors to meet their financing needs. For the region as a whole, total external finance is estimated at about $200 billion for 1993–97. Each country's stage of transition, success in achieving macroeconomic stabilization, medium-term growth prospects, endowments of natural resources, and perceived creditworthiness determined the character and amounts of such financing. In general, countries more advanced in the transition process were more successful in mobilizing private capital flows, while countries less advanced relied more on official disbursements.

By the end of 1993, the study finds, the median external debt/export ratio had reached 36 percent (see table, page 179), continued to rise to 59 percent at the end of 1996, and reached an estimated 70 percent at the end of 1997. The public sector or publicly guaranteed debtors undertook the overwhelming proportion of this borrowing, primarily to finance current, rather than capital, spending, including the settlement of wage and pension arrears. A number of countries also resorted to instruments that are not formally included in the definition of external debt but nevertheless create potential servicing liabilities, especially for the public sector. These include government guarantees of debt to government agencies, municipalities, and enterprises, and long-term lease agreements.

While most borrowers contracted funds on market terms, a number of low-income countries in the region—including Armenia, Georgia, Kyrgyz Republic, and Tajikistan—also had access to concessional financing—primarily from the IMF. This helped mitigate their external debt-service burdens. As overall debt levels increased, the sovereign direct external borrowing of a number of countries in the region shifted toward private market financing, particularly through Eurobond issues. However, toward the end of 1997, access to external finance tightened as markets reassessed emerging markets in the wake of the Asian crisis.

Motivation for Borrowing Abroad

Several elements explain the external debt buildup and concentration in the region's public sectors, the authors note. Key was the emergence of large government budget deficits as substantial and prolonged contraction of output during the early years of transition sharply reduced government revenues. This was combined with substantial pressures for maintaining spending levels, not least because industrial restructuring strained social safety net expenditures. Initially, governments financed this spending with central bank credit, but the experience of hyperinflation soon persuaded the authorities to reduce deficits and to look for noninflationary external and domestic nonbank financing.

Another reason for the external debt buildup was the availability abroad of loans at lower interest rates and longer maturities than borrowing from domestic financial markets. Domestically, monetary stringency and uncertainty caused residents to hold savings in foreign currency rather than in banks or in domestic securities and tended to keep domestic interest rates high. Moreover, the trend toward greater stability in exchange rates that accompanied the decline in inflation as transition progressed implied that the advantage of lower interest rates abroad was not fully offset by exchange rate depreciation.

Another cause for much of the debt was the need to finance imports. This was especially true in the case of financing energy imports from Russia and Turkmenistan by other countries in the region. Sometimes, the Russian government or energy producers extended loans to partner countries to enable them to import energy. More often, imports took place without full payment being

made, and the resulting arrears were in many cases subsequently converted into intergovernmental loans.

In addition, the study continues, enthusiasm on the part of the international financial community to lend to the countries in the region over the past few years was a consequence of a perception that these countries had lower external indebtedness than most developing and transition economies and were therefore worthwhile risks, especially as substantial margins could be picked up relative to traditional sovereign borrowers. Since the Asian crisis of late 1997, however, markets have become more discriminating.

Prognosis for Region's Debt

Although external borrowing in countries of the region will continue, its growth rate may be tempered by a reassessment of the attractiveness of emerging market debt following the turbulence in Asian capital markets in late 1997, the study observes. The expectation is also that governments and governmental entities will remain the principal borrowers. This is mainly because—despite considerable progress in macroeconomic stabilization—the fiscal position of many governments in the region is likely to remain under significant pressure over the medium term. For the countries that are seen as good risks, a greater proportion of external borrowing over the next few years will come from private sources, especially international bond issues and commercial banks credits, and a smaller share from the international financial institutions.

The case for continuing to contract external debt is clear. It expands a country's opportunities, thereby enabling it to finance in a noninflationary manner—assuming appropriate macroeconomic policies are implemented—more consumption or more investment, or both. In particular, the resumption of growth requires an adequate amount of investment.

With greater macroeconomic stability becoming widespread in countries in the region, the authors note that the emphasis now must be on speeding up the structural reform program to create an environment that encourages private economic activity and investment. This will permit an early resumption of rapid and sustainable growth, which in turn will enhance the ability to service external debt. Yet the temptation will often be in the opposite direction: that of borrowing abroad to avoid making the difficult structural and fiscal reforms. This temptation must be resisted at all cost, the study cautions.

Since much of the external borrowing has been undertaken by governments, special emphasis must be given to the reform of the public sector, the study emphasizes. Tax structures and tax administration in most countries in the region need to be strengthened so as to improve tax compliance, including by encouraging the shadow economy to come out into the open and reduce the tax burden on compliant taxpayers. On the expenditure side, there remains much room for rationalizing the structure so as to streamline the tax administration, reform health and education services, target the social safety net to the most needy, and eliminate subsidies for economic activity. Budget deficits must be reduced and turned into surpluses as growth accelerates, so that the government does not preempt domestic savings and external borrowing that would be better employed financing private investment. In some cases, external borrowing will be directly linked to the implementation of structural reforms, as with the conditional lending of the IMF and the World Bank. However, the Asian experience shows that markets can be unforgiving, and many countries in the region may have correctly drawn the conclusion that reforms need to be pursued energetically whatever the source of financing. ■

Ratios of External Debt to Exports[1,2]

(percent)

	1993	1994	1995	1996
Advanced Reformers				
Estonia	12.3	9.2	8.8	9.4
Latvia	15.3	23.5	19.6	18.5
Lithuania	18.9	26.9	29.3	34.7
Intermediate Reformers				
Armenia	76.3	77.9	121.6	168.0
Georgia	4.4	204.4	258.8	255.5
Kazakhstan	38.7	73.2	59.8	55.8
Kyrgyz Republic	86.6	105.1	135.0	128.0
Moldova	56.7	82.3	90.8	102.5
Russia	181.6	152.6	122.6	126.4
Late Reformers				
Azerbaijan	6.0	51.9	69.8	67.1
Ukraine	32.9	59.2	59.6	58.6
Uzbekistan	36.1	37.7	44.1	56.7
Others				
Belarus	36.1	47.4	32.7	16.3
Tajikistan	111.6	136.1	124.4	186.0
Turkmenistan	6.2	12.7	26.4	39.5
Other Developing Countries				
Brazil	308.1	286.8	245.9	194.9
Czech Republic	54.2	64.6	61.0	60.3
Hungary	267.2	319.8	206.1	201.4
Poland	276.1	183.8	122.7	111.5

[1]Exports of goods and services, except for Belarus, Latvia, Lithuania, the Kyrgyz Republic, Tajikistan, and Turkmenistan, which are exports of goods only.
[2]External debt includes public and private sector borrowing from multilateral and bilateral lenders as well as private sources (mainly commercial banks), except for Estonia and Russia, which is only public and publicly guaranteed debt. Debt also includes rescheduled debt service and arrears accumulation.

Data: IMF staff estimates

Copies of IMF Paper on Policy Analysis and Assessment, *External Borrowing in the Baltics, Russia, and Other States of the Former Soviet Union—The Transition to a Market Economy*, by John Odling-Smee and Basil Zavoico are available for $7.00 each from IMF Publication Services. See page 186 for ordering information.

Experience of Ten Countries

Low-Income Countries' External Debt Histories Yield Lessons for Future

Since the 1970s, the external debt burden of many low-income developing countries has increased considerably. In a new study, External Debt Histories of Ten Low-Income Developing Countries: Lessons from Their Experience, *an IMF staff team assesses the main elements behind the external debt buildup for a sample of ten countries—Bolivia, Cameroon, the Democratic Republic of the Congo, Côte d'Ivoire, Ghana, Kenya, Nicaragua, Niger, Uganda, and Zambia—and draws some lessons from their experiences. This varied sample of countries — a cross section of heavily indebted poor countries—includes countries with high external debt burdens (Congo, Nicaragua) and those with more sound debt management (Ghana, Kenya); countries with a high fiscal burden of debt (Niger, Cameroon) and those with relatively low ones (Bolivia, Kenya); countries with a highly concentrated export base and vulnerability to commodity price shocks (Uganda, Niger, Zambia) and those with less export concentration (Bolivia, Côte d'Ivoire, Kenya); and countries with considerable debt to private creditors (Cameroon, Côte d'Ivoire).*

Evolution of External Debt Burden

The debt burden increased markedly between the late 1970s and the early 1990s in all ten countries (see table, page 181). In the late 1970s, their external debt-to-exports ratios stood at relatively moderate levels, at about 200 percent or below (Bolivia was the highest at 260 percent). For Cameroon, Ghana, Niger, and Uganda, the ratio was somewhat lower, at about 100 percent. However, by the early 1990s, most sample countries' debt-to-exports ratio had increased by at least three or four times.

In Nicaragua and Uganda—the countries with the largest increase in the debt-to-exports ratio between 1976–80 and 1991–95—the ratios rose as a result of a large increase in the nominal debt stock—some 600 percent in U.S. dollar terms. Clearly, the study observes, external borrowing was not used to enhance effective export capacity. Indeed, weak export performance was partly responsible for the need to borrow and reschedule to support adjustment efforts. In contrast, Kenya kept its debt at manageable levels and experienced one of the smallest increases in the debt-to-exports ratio between 1976–80 and 1991–95. This reflected its success in achieving high export growth (about 55 percent in U.S. dollar terms) in tandem with substantive borrowing—its debt stock increased by 215 percent over this period. Bolivia's debt-to-exports ratio peaked earlier—it increased more than fourfold between 1976 and 1987 as the country's debt grew by 450 percent, while exports, after increasing rapidly through 1980, declined to close to their initial level.

In the early 1990s, for most countries, the net present value (NPV) of debt-to-export ratios was lower than the nominal ratios because a significant share of debt was concessional. The study notes that, given that the share of concessional debt increased over time, the NPV ratios would not have increased as quickly as the nominal ratios. A lack of NPV data for the earlier period makes it difficult to judge the extent of this change. Nonetheless, the present value ratios were still above 220 percent in 1991–95 for five sample countries despite the sizable share of concessional debt (see table, page 181).

Variables Behind the Increase

A combination of elements, rather than a single factor, was responsible for the increase in the sample countries' external debt burden, the study finds. These include:

- *Exogenous factors*, such as adverse terms-of-trade shocks and—to a lesser extent—adverse weather conditions. All countries under review suffered adverse terms-of-trade shocks to varying degrees during 1975–95. Those countries with the least diversified export bases were hardest hit, particularly Niger, Uganda, and Zambia, which, in the early 1980s, obtained more than 80 percent of their exports from a single commodity—uranium, coffee, and copper, respectively.
- *A lack of sustained adjustment policies*, particularly in the face of exogenous shocks, which gave rise to sizable financing needs and failed to strengthen the debt-servicing capacity. In most cases, inadequate progress was made with structural reforms that would promote sustainable growth of output and exports. The lack of appropriate policies was a particular problem in Cameroon, Congo, Côte d'Ivoire, Nicaragua, and Zambia, and to a lesser extent in Kenya and Niger.
- *Largely nonconcessional lending and refinancing terms* through the mid-1980s, and *capitalization of interest* that contributed to the debt buildup. Recognizing these countries' limited debt-servicing capacity, creditors and donors have—since the late 1980s—moved increasingly to provide financing through concessional reschedulings involving debt reduction and grants.
- *A lack of prudent debt management*, driven in part by excessive optimism by creditors and debtors about the prospects for increasing export earnings and building debt-servicing capacity.

• *A lack of careful management of the currency composition of debt*. Exchange rate changes among major currencies also contributed to the increase in the debt burden. Most countries did not appear to consider the currency composition of debt important in the management of their external debt and placed little emphasis on matching the currency composition of debt with that of export earnings.

• *Political factors*, including civil war and strife. Civil strife was a major factor affecting the debt burden in Nicaragua and Uganda, and to a lesser extent, in Congo and Niger. In Nicaragua, the armed conflict throughout the 1980s eroded the export base and led to a very large buildup of external debt to finance both military and nonmilitary imports. In Uganda, civil strife in the 1970s and early 1980s destroyed the country's infrastructure and left large areas of fertile land uncultivated. As a result, by the mid-1980s, non-coffee exports were virtually nonexistent.

Lessons Learned

The study identifies several important lessons for the sample countries' future adjustment and external debt strategies, and for poor countries and creditors more generally.

Strong and sustained implementation of sound macroeconomic and structural adjustment policies, particularly in response to exogenous shocks, is crucial in limiting the need for financing, especially of the public sector, and in creating an environment conducive to export growth. Bolivia's export earnings doubled between 1987 and 1995, notwithstanding a sharp deterioration in the export price of gas in the early 1990s, owing to a successful diversification of the export base. Ghana and Uganda were more successful than other countries in adjusting to sizable terms-of-trade shocks by achieving some export growth as a result of sound policy implementation over an extended period. Exchange and trade liberalization, supported by tight financial policies, appeared to be key ingredients for export growth in these countries. Countries that failed to put in place a sustained record of strong policies—Cameroon, Congo, Côte d'Ivoire, Nicaragua, Niger, and Zambia—also failed to encourage the broad-based export growth that would have strengthened their debt-servicing capacity and reduced their financing needs.

A diversified export base, with limited reliance on commodities that are subject to large price swings, is important in reducing the vulnerability of export receipts to commodity price shocks. Kenya, for example, was able to offset large terms-of-trade shocks through its reasonably well-diversified export base and export growth, particularly following fundamental exchange and trade regime reform. Bolivia, Ghana, Nicaragua, and Uganda were also successful in reducing their vulnerability to shocks by diversifying their export base.

The lack of prudent debt management and risk assessment created difficulties in Bolivia, Cameroon, Congo, Côte d'Ivoire, Nicaragua, Niger, and Zambia. In the late 1970s and early 1980s, the countries undertook sizable borrowing on nonconcessional terms with relatively short maturities—often from private sources. While it is difficult to define prudent debt management, it should be geared to keeping external obligations at sustainable levels, the study advises. This would call for debtors and creditors alike to focus on contracting highly concessional loans and to place more emphasis on the use to which resources are put. A more prudent strategy would also include taking greater care to assess the most appropriate currency composition of debt, so as to avoid large cross-currency fluctuations adversely affecting debt-servicing capacity.

More cautious assumptions about debt-servicing capacity can help limit loan financing and encourage more adjustment. In many of the sample countries, sizable borrowing was based in part on the erroneous assumption of a recovery in export earnings. Also, large increases in commodity prices may have given rise to an inappropriate assessment of a country's permanent capacity to generate income and thus to excessive borrowing. Overall, there is a need for more in-depth risk analysis, based on a country's historical vulnerability to shocks. ■

External Debt and Export Data for Ten Low-Income Countries

	Total External Debt[1] (million U.S. dollars)		Debt-to-Exports Ratio[1] (percent)		Grant Element of Debt (percent of total debt)	Net Present Value of Debt (percent of exports)
	1976–80	1991–95	1976–80	1991–95	1991–95	1991–95
Bolivia	2,089	4,548	261	450	50	221
Cameroon	1,608	7,860	117	322	45	177
Côte d'Ivoire	4,094	18,428	132	513	46	275
Congo, Dem. Rep. of	4,072	11,704	237	798	49	400
Ghana	1,147	5,018	107	389	55	174
Kenya	2,285	7,204	141	296	56	129
Nicaragua	1,466	10,468	205	2,512	50	1,147
Niger	4,802	1,592	113	522	67	173
Uganda	460	3,133	123	1,126	72	274
Zambia	2,626	6,924	243	581	75	146

[1]Annual averages.

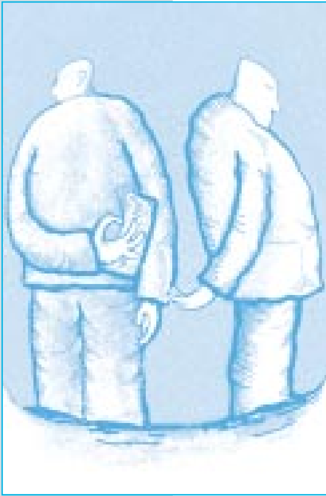
Data: World Bank, *Global Development Finance*, 1997; and IMF, *World Economic Outlook*, 1997

Copies of Working Paper 98/72, *External Debt Histories of Ten Low-Income Developing Countries: Lessons from Their Experience*, by Ray Brooks, Mariano Cortes, Francesca Fornessari, Benoit Ketchekmen, Ydahlia Metzgen, Robert Powell, Saqib Rizavi, Doris Ross, and Kevin Ross, are available for $7.00 each from IMF Publication Services. See page 186 for ordering information.

Role of Government

Comprehensive Strategy Is Needed To Fight Global Corruption

Corruption has lately attracted a considerable—if not, unprecedented—amount of attention. In *Corruption Around the World: Causes, Consequences, Scope, and Cures*, Vito Tanzi, Director of the IMF's Fiscal Affairs Department, finds that this growing interest in corruption reflects not only a greater awareness of an age-old phenomenon but also an increase in its scope, as political and economic developments brought corruption to a peak in the 1990s. Tanzi suggests that the increasing role of government in the economy since 1960 and other economic changes that have taken place in many countries—especially the transition economies—have contributed to the rise and spread of corruption in the past decade. In many cases, he contends, the government has become so integrally involved in the economy that the fight against corruption cannot proceed independently from a reform of the state.



What Promotes Corruption?

Corruption, according to Tanzi, is generally connected with the activities of the state—in particular, its monopoly and discretionary power—which provide a fertile ground for corruption.

Regulations and Authorizations. In many countries—especially developing countries— licenses, permits, and authorizations are required to engage in such activities as opening a shop, borrowing money, investing, or engaging in foreign trade. These regulations and authorizations give the officials who authorize or inspect these activities a monopoly power and require frequent and protracted contact between citizens and bureaucrats. Surveys from developing and transition countries in particular indicate that managers of enterprises spend an enormous amount of time dealing with bureaucracies. This time can be reduced through the payment of bribes.

Taxation. Clear tax laws that do not require contacts between taxpayers and tax inspectors are less likely to lead to corruption. However, when the state's controls on its agents are weak, corruption is likely to be a major problem in tax and customs administrations. Among the specific situations inviting corruption are:

- frequent contacts required between taxpayers and administrators, such as when the laws are difficult to understand and taxpayers need assistance in complying with them;
- low wages of tax administrators;
- nontransparent or ineffectively monitored administrative procedures; and
- tax administrators with broad discretionary power over important decisions, such as provision of tax incentives and determination of tax liabilities.

Spending Decisions. Lack of transparency and effective institutional controls can invite corruption in public spending through several channels, including investment projects, procurement spending—that is, government's purchase of goods and services—and extrabudgetary accounts set up to reduce the political and administrative controls more likely to accompany spending that goes through the budget.

Goods and Services. Provision for goods and services at below market prices—for example, foreign exchange, credit, electricity and water, public housing, access to educational and health facilities, and access to public land—is another government activity that can breed corruption. In some cases, limited supply makes rationing or queuing unavoidable. Public employees often have to decide how to apportion this limited supply, while those who want such goods might be willing to pay a bribe to gain access.

Other Discretionary Decisions. In many countries, some public officials may have discretion over important decisions. In these situations, corruption, including high-level political corruption, can play a major role. It is natural that some individuals and enterprises to whom these decisions mean a lot will attempt to get favorable decisions either by paying bribes or exploiting close personal relations with a public official. Important areas include decisions regarding:

- the use of private land (zoning laws) and government-owned land—for example, for logging;
- authorizing major foreign investments, the sale of public sector assets, and the privatization of state-owned enterprises; and
- providing monopoly power to certain export, import, or domestic activities.

Bureaucracy. The quality of the bureaucracy varies greatly among countries and bears on the degree of corruption. Politically motivated hiring, patronage, nepotism, and the absence of clear rules on promotions and hiring all undermine the quality of a bureaucracy.

Photo Credits: Supri for Reuters, page 173; Pedro Marquez for the IMF, pages 176 and 177; artwork by Massoud Etemadi, page 182.

Among the factors that help determine the degree of corruption are the level of public sector wages, institutional controls, transparency of rules, laws, and processes, and examples by the leadership.

Corruption and Growth

It is widely acknowledged that corruption has a negative effect on growth—both qualitatively and quantitatively. Corruption reduces public revenue and increases public spending, thus contributing to larger fiscal deficits and making it more difficult for a government to run a sound fiscal policy. Further, corruption tends to increase income inequality by allowing those in influential positions to take advantage of government activities at the expense of the rest of the population.

In most countries, small enterprises are the main engine of growth, Tanzi notes. When they do not grow, economies languish and unemployment rises. This is particularly true in developing countries and, even more so, in economies in transition. Yet, small enterprises—especially new, emerging enterprises—are particularly vulnerable to cost-increasing corruption. Pressures on them often come from local government officials who impose high fees—both legal and illegitimate payments—to obtain licenses and authorizations. These pressures also entail high costs in terms of the time that managers must spend to comply with the many regulations imposed on them. The burden of these costs is likely to fall more heavily on small enterprises because they operate in a far more competitive market than large ones and have greater difficulty passing the costs on to their customers.

Corruption also reduces economic growth by distorting markets and the allocation of resources. Corruption interferes with the government's ability to impose necessary regulatory controls and inspections to correct for market failures and reduces or distorts the fundamental role of government—for example, in the areas of enforcing contracts and protecting property rights. Finally, corruption undermines the legitimacy of the market economy and perhaps of democracy.

Corruption can have a quantitative effect on growth through its negative influence on economic variables. Tanzi cites several recent analytical studies whose results provide evidence that corruption can retard growth by:

• reducing investment and the productivity of public investment and infrastructure;

• reducing expenditure for education and health and for operating and maintaining existing public works, because such spending does not lend itself easily to corrupt practices by those who make budgetary decisions;

• reducing tax revenue mainly through its impact on the administration and customs; and

• reducing foreign direct investment, because corruption has the effect of a tax.

The State and the Fight Against Corruption

Corruption is complex and cannot be explained by a single cause, Tanzi observes. Because of its complexity, the fight against corruption must be pursued on many fronts. The greatest mistake that can be made, Tanzi cautions, is to rely on a strategy that depends excessively on actions in a single area.

Any realistic strategy must start with the explicit recognition that there are those who demand corrupt actions from public sector employees and there are public employees who are willing to perform these actions for a price. To a large extent, the state, through its many policies and actions, creates the environment and the incentives that influence those who pay bribes and those who accept or demand them. Thus, the fight against corruption is not distinct and independent from the reform of the state.

The growth of corruption is closely linked with the growth of many government activities. It is therefore unlikely that corruption can be substantially reduced without modifying the way governments operate. Any serious strategy to attempt to reduce corruption, Tanzi concludes, will need action on several fronts:

• honest and visible commitment by the leadership to the fight against corruption;

• policy changes that reduce the demand for corruption by scaling down regulations and other policies, such as tax incentives, and by making those that remain as transparent and nondiscretionary as possible; and

• reducing the supply of corruption by increasing public sector wages, increasing incentives for honest behavior, and instituting effective controls and penalties on public servants. ■

Copies of IMF Working Paper 98/63, *Corruption Around the World: Causes, Consequences, Scope, and Cures*, by Vito Tanzi, are available for $7.00 from IMF Publication Services. See page 186 for ordering information.

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
May 26	4.30	4.30	4.60
June 1	4.22	4.22	4.52

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 107 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 web site (http://www.imf.org/external/np/tre/sdr.htm).

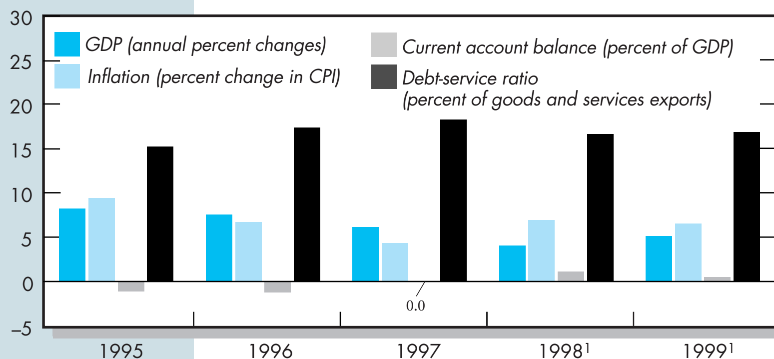
Data: IMF Treasurer's Department

ADB Surveys Asian Developing Country Prospects

The substantial decline in export growth in East and Southeast Asia served as the prelude to "the worst year the region has seen since its development began accelerating three decades ago," according to the *Asian Development Outlook, 1998*. The report, which focuses on the economic progress and prospects of the Asian Development Bank's (ADB) developing country members, notes that currency and financial crises followed quickly on the heels of this export slowdown.

In 1997, the growth rate dropped to 6.1 percent; inflation declined to 5.6 percent, and the current account situation improved to a deficit of less than 1 percent of GDP in 1997. But these average figures in 1997 mask widely divergent experiences within the region and do not reflect the full impact of the Asian crisis on these economies (see chart for overall trends and projections). Given the significance of the financial turmoil for many of these economies, the study provides an analysis of the evolution, causes, and impact of the crisis and offers policy options and lessons.

Selected Economic Indicators: Developing Asia



[1]Projections.

Data: Asian Development Bank, *Asian Development Outlook 1998*

In a section on population and development, the report asks whether the crisis is not at least partially attributable to declining competitiveness. While adjustment to changing international conditions has always been necessary, in the present context, Mitsuo Sato, President of the ADB, stresses, "such adjustment is imperative." To underscore this point, the study gives greater weight to policy and development issues in its country profiles.

Risks and Uncertainties

For Indonesia, Korea, and Thailand, failure to address the crisis that has left their economies in disarray would not only exacerbate their problems, the report warns, but also undermine the growth momentum in the rest of the world. "A full commitment to economic and policy reform is a prerequisite for early recovery and sustained future growth," it adds, noting that in 1998 government actions, particularly in Indonesia and Korea, to "deal with the private sector's maturing large external debt will inevitably determine these countries' performance."

There is important work to be done elsewhere as well. The report casts a wary eye on the level of commitment, the degree of implementation, and the speed with which the reform process is proceeding in South Asia and the Central Asian republics. The study also notes the likelihood of continued pressure on the Hong Kong dollar and the Chinese renminbi. The success of the authorities in defending these exchange rates, it says, will have important implications for the recovery of the Asian economies.

The study also cautions that the severe drought associated with El Niño is likely to produce a 1 percent decline in output in Indonesia, Malaysia, and the Philippines in 1998.

Human Capital and Development

One of the key elements in the Asian miracle—and one, the report stresses, that less developed Asian countries ignore at their peril—is human capital development. But all investments in human capital are not equal—or equally appropriate—the *Asian Development Outlook* argues. For the poorest countries eager to equip a low-skilled workforce, investments in nutrition and health are key. As the complexity of the work increases, investments first in primary and lower secondary education, and eventually in higher education, become critical. There is also an important role for government to play in ensuring that sufficient resources are directed to the most appropriate areas.

Particularly in a period of intensifying globalization and a much compressed cycle of industrialization, competitiveness requires constant adaptation. The more developed Asian economies now face stiff competition in the production of low-cost, low-value-added goods from Bangladesh, China, India, and Vietnam. Ideally, the more developed Southeast Asian economies would move up to high-technology production, but they have been hampered by a shortage of scientific and engineering expertise. What had served as the foundation for Southeast Asia's high export volumes and rapid economic growth may now, the report argues, "prevent these countries from effecting a timely transition to a more diversified and high value-added export structure in the future." A highly flexible, highly skilled labor force is needed to continue to adapt to a more competitive global economy.

The hope is that the lessons learned from the current crisis will not be limited to financial sector reforms, the study concludes, but will extend to a fuller understanding of the importance of appropriate investments in human capital development to ensure long-term growth and prosperity. ■

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

Bosnia and Herzegovina: Stand-By Arrangement

The IMF on May 29 approved a 12-month stand-by credit for Bosnia and Herzegovina in an amount equivalent to SDR 60.6 million (about $81 million), in support of the government's 1998–99 economic program. Of the total, an amount equivalent to SDR 24.2 million (about $32 million) is available immediately.

1998–99 Program

The economic strategy under the 1998–99 program is based on four elements: a fixed exchange rate under a currency board arrangement; budgets that are as supportive as possible of reconstruction and social needs, while avoiding any domestic borrowing; external financial assistance to help supplement the still-limited domestic resources and promote economic recovery; and acceleration of the transition to a market economy through structural reforms. Under the program, economic growth in 1998 is projected at 30 percent, inflation at 10 percent, and gross international reserves to reach the equivalent of 3½ months of merchandise imports.

The fiscal strategy is tied closely to the currency board arrangement, under which the monetary authorities are precluded from extending credit to the public sector. In addition, the banking system has little capacity for financial intermediation and domestic capital markets are nonexistent. Therefore, budget plans are based on avoiding domestic borrowing at all levels of government, and cash-basis expenditures will not be able to exceed the total of revenues and external financing. Reflecting this cautious approach, total fiscal expenditures are expected to rise from an estimated 33 percent of GDP in 1997 to about 35 percent in 1998.

Structural Reform

The key structural elements of the program for 1998–99 include banking reform, the initiation of enterprise privatization, pension and health system reform, implementation of a simplified customs tariff system, exchange and trade liberalization, and steps to improve economic statistics.

Addressing Social Needs

During the coming year the authorities will continue their efforts to design a more efficient social safety net, targeted on the most vulnerable groups, and to complete a poverty assessment with the assistance of the World Bank. Special programs are being devised with the assistance of international donors to provide housing, infrastructure, and employment opportunities in conjunction with the return of refugees.

On December 20, 1995, Bosnia and Herzegovina succeeded to the membership in the IMF of the former Socialist Federal Republic of Yugoslavia, effective December 14, 1992; its quota is SDR 121.2 million (about $162 million). Its outstanding use of IMF credit currently totals SDR 30 million (about $40 million).

Press Release No. 98/19, May 29

Bosnia and Herzegovina: Selected Economic Indicators

	1994	1995	1996	1997[1]	1998[2]
		(percent change)			
Real GDP	—	32.0	50.0	30.0	30.0
Consumer prices (end of period)					
Federation (DM)	—	–4.0	–25.0	14.0	10.0
Republika Srpska (DM–based index)	—	13.0	45.0	–7.0	10.0
		(percent of GDP)			
Consolidated fiscal balance[3]	–11.0	0.0	–4.0	–1.0	–2.0
External current account balance (excluding official transfers)	–25.0	–26.0	–39.0	–33.0	–34.0
		(months of imports)			
Gross international reserves	1.2	2.4	2.9	3.7	3.4

[1]Estimate.
[2]Projection.
[3]Since 1995, the deficit has been financed entirely by external grants and loans.

Data: Bosnia and Herzegovina authorities and IMF staff estimates and projections

Zimbabwe: Stand-By Arrangement

The IMF approved a stand-by credit for Zimbabwe, authorizing drawings of up to SDR 130.8 million (about $175 million) over the next 13 months in support of Zimbabwe's 1998 economic reform program. Of the total, SDR 39.2 million (about $52 million) is available immediately. Subsequent disbursements, on a quarterly basis, will be made available subject to Zimbabwe's meeting performance targets and program reviews.

Program for 1998

The fundamental goal of the economic program is to ensure that the recent depreciation of the exchange rate is translated into a substantial improvement in competitiveness. The primary instruments for achieving this goal are fiscal consolidation and monetary restraint. The 1998 program therefore targets a reduction in the budget deficit, excluding grants and privatization proceeds, to 5.5 percent of GDP. Fueled by the recent exchange rate depreciation, the 12-month rate of inflation rose markedly to 26 percent during the first four months of 1998 on an end-of-period basis, but is projected to decline to about 19 percent by the end of the year.

Structural Reforms

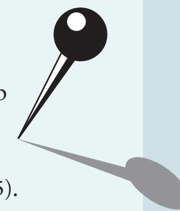
Privatization of public enterprises began in earnest in 1997 when several of the larger parastatals were sold. The divestiture program is being accelerated by advancing the sale of

Press Information Notices

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

Moldova, No. 35, May 27

Luxembourg, No. 36, June 1



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

PINs will also be published thrice yearly in the new series of *IMF Economic Reviews* (see page 175).

government shares in public and private companies; proceeds are expected to total the equivalent of nearly 2 percent of GDP in 1998. While the land reform program is still in the early design stages, the redistribution of land will proceed within the confines of the law and the pace of land acquisition will be governed by the availability of budgeting resources.

Social Safety Net

The social impact of the fall in real incomes and employment since the early 1990s has been exacerbated by the recent sharp depreciation of the Zimbabwe dollar and the large price increases for basic food items. Broad-based economic growth and price stability are, of course, the key to effective poverty alleviation in the medium term. In the meantime, the government is taking a number of steps to protect the most vulnerable groups and has released additional maize from the strategic grain reserve to help alleviate immediate price pressures. Allocations for social spending were raised in the current budget and have been protected from the recent round of budgetary cuts.

Zimbabwe joined the IMF on September 29, 1980, and its quota is SDR 261 million (about $349 million). Its outstanding use of IMF financing currently totals SDR 270 million (about $361 million).

Press Release No. 98/20, June 1

Zimbabwe: Selected Economic Indicators

	1997[1]	1998[2]	1999[3]	2000[3]	2001[3]
	(percent change)				
Real GDP	3.7	3.0	5.3	5.5	5.7
Consumer prices (end of period)	20.1	18.6	8.1	4.5	4.5
	(percent of GDP)				
Overall fiscal balance (excluding grants)	–8.3	–5.5	–4.2	–3.9	–2.8
External current account balance	–9.0	–4.9	–4.3	–2.4	–1.8
	(months of imports)				
Gross official reserves	0.8	1.5	1.8	2.6	2.9

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

Data: Zimbabwean authorities and IMF staff estimates

Recent IMF Publications

World Economic and Financial Surveys Series

World Economic Outlook, May 1998 ($36.00; academic price $25.00) (see *IMF Survey*, April 27, page 138)

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

No. 166: *Hedge Funds and Financial Market Dynamics*, by a staff team led by Barry Eichengreen and Donald Mathieson. (see *IMF Survey*, May 11, page 155.)

Working Papers ($7.00)

98/49: *Trade Liberalization and Tax Reform in the Southern Mediterranean Region*, George T. Abed. Proposes reforms to help generate compensatory revenue and reduce the distortionary effects of the tax and tariff systems.

98/50: *EMU, Adjustment, and Exchange Rate Variability*, Luca Antonio Ricci and Peter Isard. Investigates how European Monetary Union is likely to affect exchange rate variability.

98/51: *The Canadian Agreement on Internal Trade: Developments and Prospects*, Michael P. Leidy. Takes stock of the achievements and shortcomings of Canada's Agreement on Internal Trade.

98/52: *From Transition to Market—Evidence and Growth Prospects*, Stanley Fischer, Ratna Sahay, and Carlos A. Végh. Presents evidence on the behavior of output and inflation in the transition economies during 1992–95.

98/53: *How Far Is Eastern Europe from Brussels?* Stanley Fischer, Ratna Sahay, and Carlos A. Végh. Compares income gaps between Central and Eastern European and European Union (EU) countries.

98/54: *The Design of Instruments for a Government Finance in an Islamic Economy*, Nadeem Ul Haque and Abbas Mirakhor. Offers a viable approach for the design of a government finance instrument in Islamic economies.

98/55: *Fiscal Discipline and the Cost of Public Debt Service: Some Estimates for OECD Countries*, Francesco Caselli and others. Examines the influence of fiscal variables on borrowing costs in a panel of OECD countries.

98/56: *Public Sector Efficiency and Fiscal Austerity*, Nadeem Ul Haque and others. Uses a simple model to analyze the forces that determine the size of the public sector and the quality of workers employed in that sector.

98/57: *Money Demand and Regional Monetary Policy in the West African Economic and Monetary Union*, Philipp C. Rother. Presents empirical money demand estimations for regional monetary aggregates and analyzes their stability and forecast performance.

98/58: *Competitiveness and the Evolution of the Real Exchange Rate in Chile*, Martine Guerguil and Martin Kaufman. Reviews the evolution of selected price and nonprice competitiveness indicators in Chile.

98/59: *Interest Rate Spreads in the Eastern Caribbean*, Ruby Randall. Examines interest rate spreads in the Eastern Caribbean and seeks to explain why they are persistently high compared with other low-inflation countries.

Economic Issues (free)

No. 14: *Lessons from Systemic Bank Restructuring*, Claudia Dziobek and Ceyla Pazarbaşıoğlu. Analyzes the experiences of 24 countries that initiated reforms in the 1980s and early 1990s.

Publications are available from Publication Services, Box XS800, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

For information on the IMF on the Internet—including the full text 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 web site (http://www.imf.org). The full texts of all Working Papers, Papers on Policy Analysis and Assessment, and Press Information Notices (PINs) are also available on the IMF's web site.

WAEMU to Extend Integration Efforts To Build Macroeconomic Stability

In January 1994, seven sub-Saharan countries signed a treaty establishing the West African Economic and Monetary Union (WAEMU). These countries, which were joined by Guinea-Bissau in May 1997, form part of the CFA Franc Zone and share a common currency issued by the Central Bank of the West African States (BCEAO)—the CFA franc. During the late 1980s and the early 1990s, declining terms of trade, rising labor costs, and nominal appreciation of the French franc against the U.S. dollar, resulted in a real effective appreciation of the CFA franc. This led to a serious deterioration in the region's competitive position. As part of a wider strategy to address this downturn, countries in the CFA Franc Zone devalued their common currency by 50 percent in January 1994. Since then, most of the region's economies—particularly in the WAEMU—have recovered. Moreover, after a brief surge following the devaluation, inflation has returned to low levels.

Nevertheless, challenges remain. The WAEMU treaty aims to build on the achievements of the West African Monetary Union (WAMU), created in 1962 to provide the macroeconomic stability and the credibility required for sustaining the fixed exchange rate for the common currency. The WAEMU will extend integration efforts already at work in the monetary area to the whole economic sphere.

Recent Economic Developments

During the 1990s, the WAEM faced negative per capita GDP growth and very low saving and investment rates. As income declined and corporate taxpayers faced financial difficulties, the tax base shrunk. The region suffered from a decline in government revenue relative to GDP and a deterioration in the overall fiscal balance, despite severe constraints on government investment. A deterioration in the terms of trade aggravated weak export growth, and the external current account deficit widened to an average of 11 percent of GDP in 1990–93. Sizable domestic and external payments arrears accumulated, the level of public debt increased, and net foreign assets declined. A comprehensive strategy aimed at addressing these problems—including the 1994 devaluation—succeeded in turning the WAEMU economies around (see table, page 188). Export volumes increased sharply in response to the region's improved competitive position. Import volumes fell sharply in 1994, reflecting some demand compression and strong import substitution in favor of agricultural and locally manufactured goods, which also contributed to a narrowing of the regional current account deficit. Imports picked up strongly thereafter, however, owing to rapid growth in aggregate demand. Improved profitability in the tradable goods sector—including nontraditional exports and import substitutes—led to stronger growth performance after 1994. This, together with an improvement in the aggregate financial position of governments in the region, resulted in a large increase in domestic savings rates. Investment also rose substantially in relation to GDP, mainly in the form of private investment.

Following the initial surge in domestic prices associated with the devaluation, inflation declined rapidly to an average of just under 4 percent in 1996–97, reflecting the prudent fiscal and monetary policies and wage restraint. A large buildup in the region's gross foreign assets reflects a return of confidence in price stability and the improvement in the region's external current account. The region's external debt has also dropped substantially since 1994. Data for 1997 confirm a continued favorable economic performance in the WAEMU. Growth is estimated at 5.6 percent and inflation has subsided to less than 4 percent, savings and investment ratios have continued to rise and the overall fiscal position has remained stable. In spite of a deterioration in the terms of trade in 1996–97, the region's external current account deficit declined further as export volumes continued to expand rapidly.

Main Policy Issues

Monetary Policy. Monetary policy in the WAEMU is conducted at the regional level by the BCEAO. With a common currency and a common central bank, there is no scope for a national monetary policy in WAEMU member countries. Fiscal policy, however, remains within the purview of each member. The BCEAO has made an important contribution to macroeconomic stability in the WAEMU. Since 1994, it has been successful in bringing down inflation while raising its foreign exchange reserves to a comfortable level. In addition, except for the single aforementioned change in the exchange rate peg in January 1994, the region's fixed exchange rate regime has been operating without interruption since 1948. This degree of stability testifies to the prudence of the regional authorities' monetary policy and to the supportive nature of WAEMU member governments' fiscal policies. A source of concern in recent years, however, has been the vast pool of unused liquid resources in the banking system, which appears to be related to various structural problems, including insufficient competition among banks, the limited role of the interbank market, administrative obstacles to cross-country banking activities, and the high risks associated with the reimbursements of bank loans. Improving monetary control will require the authorities to address these shortcomings.

Members of CFA Franc Zone

West African Economic and Monetary Union

- Benin
- Burkina Faso
- Côte d'Ivoire
- Guinea-Bissau
- Mali
- Niger
- Senegal
- Togo

Central African Economic and Monetary Community

- Cameroon
- Central African Republic
- Chad
- Republic of Congo
- Equatorial Guinea
- Gabon

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Banking Systems and Supervision. To improve financial sector efficiency, the functioning of the regional interbank market should be improved to allow banks to channel their excess reserves to less liquid banks elsewhere in the WAEMU. The monetary authorities should also enhance competition between financial institutions. Currently, banks need licenses and separate capital bases for each country in which they wish to operate, discouraging them from operating across borders. Allowing banks to open branches throughout the union and encouraging them to compete for deposits and loans would improve the banking system's efficiency and help raise private saving and investment. Additional bank restructuring efforts and an increase in capital adequacy ratios to international standards would also contribute to financial sector soundness.

WAEMU: Selected Economic Indicators[1]

	1990–93	1994	1995	1996	1997
	(annual percentage change)				
Real GDP growth	0.2	3.2	5.7	6.0	5.6
Real per capita GDP growth	–3.0	–0.2	2.5	2.6	2.3
Export volume	3.6	8.8	8.6	13.0	8.8
Import volume	–1.1	–12.0	28.2	5.0	4.8
Terms of trade	–1.9	2.0	4.3	–3.1	–3.9
Inflation	0.6	29.2	12.2	3.9	3.8
	(percent of GDP)				
Overall fiscal balance[2]	–9.1	–8.7	–6.0	–4.3	–4.3
Primary fiscal balance[3]	–3.9	–3.4	–1.2	–0.2	–0.7
Government revenue	16.4	15.2	17.0	17.4	17.4
External current account balance[2]	–11.2	–7.2	–9.1	–8.2	–7.6
Gross domestic savings	7.3	13.6	13.5	14.6	15.7
Gross domestic investment	12.1	14.8	16.2	16.9	18.1
Public external debt (end of period)	85.0	132.0	113.0	109.0	103.0
Gross foreign assets, BCEAO[4]	1.1	2.7	3.7	3.7	3.9

[1]Excluding Guinea-Bissau.
[2]Excluding grants.
[3]Overall balance, excluding interest payments.
[4]In billions of U.S. dollars.

Data: Country authorities and IMF staff estimates

Trade Policy. The WAEMU treaty calls for the elimination of all tariff and nontariff barriers between member countries and for the rationalization and harmonization of trade policies vis-à-vis third countries through the elimination of nontariff barriers and the implementation of a common external tariff. Despite efforts to liberalize trade in recent years, import duties are generally still high in the WAEMU, especially in Burkina Faso, Côte d'Ivoire, and Senegal. The planned move to a common external tariff during 1998–2000 provides an opportunity for member countries to harmonize and rationalize their individual tariff structures, further liberalize external trade, and deepen their integration into the world economy. Some producers will incur losses in response to resource reallocation and greater competition brought on by the common external tariff. In the long run, however, the economic benefits should more than compensate for these unavoidable losses. In some countries, the reduction in average duties will have an adverse effect on government revenue in the near term. While this should be compensated for by the reduction or elimination of exemptions on import duties and by other taxes, a transitional net revenue loss may well remain in a few countries. Any temporary and residual adverse effect of the trade liberalization reforms on a country's external position would be relevant in assessing the need for balance of payments assistance in the context of an adjustment program supported by the IMF and the World Bank.

Macroeconomic Policy Coordination. The WAEMU treaty aims at convergence of member countries' economic policies and improved performance. The common objectives set by convergence criteria are a civil service wage bill not to exceed 40 percent of tax revenue; public investment financed by domestic resources equal to at least 20 percent of tax revenue; a primary fiscal surplus equivalent to at least 15 percent of tax revenue; and a declining or unchanged level of domestic and external arrears. Performance indicators for 1997 suggest that the convergence criterion on the basic primary balance was observed by all member countries, except Burkina Faso, Niger, and Togo. The criterion on domestically financed investment was observed in only two countries (Burkina Faso and Côte d'Ivoire), while a third one (Mali) was within reach of the 20 percent threshold. All countries have satisfied the criterion on the wage bill except Niger and Togo, which are close to the target. All member countries, except Niger, have eliminated external payments arrears; Benin, Burkina Faso, and Senegal have eliminated domestic payments arrears as well.

Other Regional Issues. Despite some improvement in recent years, investment-to-GDP ratios remain low in the WAEMU, raising questions about the sustainability of strong growth. A major challenge for the authorities will be to attract more domestic and foreign private investment. This will require the elimination of discriminatory practices and distortions associated with exemptions from customs duties and other taxes. In this respect, the recent harmonization of business laws represents a major achievement, but it will need to be completed by an overhaul of the functioning of the judiciary system, which in many instances is an important source of delays and unreliable rulings. The planned adoption of a regional investment code should also help attract additional private investment. ■

This article draws on material contained in a forthcoming IMF Occasional Paper, *West African Economic and Monetary Union—Recent Developments and Regional Policy Issues.*