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IMF's Role Evolves in Financial and Exchange Rate Arenas

On May 22, Manuel Guitián, Director of the IMF's Monetary and Exchange Affairs Department (MAE), discussed his department's work on capital account convertibility, financial sector soundness, and exchange rate regimes. Guitián, a national of Spain with a law degree from the University of Santiago, Spain, and a Ph.D. in economics from the University of Chicago, has been Director of MAE since 1995.

IMF SURVEY: *The Interim Committee has endorsed amending the IMF's Articles of Agreement to extend IMF jurisdiction over current account issues to include capital account movements. What is the significance of this for the IMF and the implications for MAE's work?*

GUITIÁN: This endorsement is most significant for the IMF. At present, the IMF's jurisdiction is limited to payments and transfers of current transactions. The amendment will not only enlarge the IMF's role, it will also provide for broadly uniform treatment for current and capital transactions. In fact, it will bring the institution's mandate up to date with the evolution of the world economy. Capital flows have become one of the major forces for economic integration of the last two decades, and they represent an important dimension of the phenomenon of globalization. In this respect, events in the international economy have overtaken the Articles of Agreement—the "code of conduct" that has guided international financial relations so far. Granting the IMF a mandate for encouraging capital account liberalization acknowledges that free capital flows are

(Please turn to the following page)

Can Harmonized Labor Standards Boost Trade and Income?

In recent decades, the emergence of developing countries ("the South") as exporters of manufactures, as well as the accompanying liberalization of their trade regimes, has been greeted with considerable ambivalence in the developed countries ("the North"), according to a recent IMF Working Paper, *International Labor Standards and International Trade*, by Stephen S. Golub, a Visiting Scholar from Swarthmore College. Although many in the North view such trade as a source of global growth, others are alarmed by competition with countries whose wage rates are a fraction of those in many Northern countries. High unemployment in Western Europe and stagnant wages for unskilled workers in the United States have magnified these fears, renewed the controversy about linkages between international labor standards and international trade, and fueled calls for protection.

Pressure to harmonize international labor standards reflects these concerns, but views are mixed on the efficacy and implications of such standards. Labor unions, human-rights activists, and some Northern governments argue that access to Northern markets should be conditional on improved labor standards in the South and that trade sanctions be imposed for violations of standards (the so-called social clause). Other Northern governments and nearly everyone in the South see the social clause as protectionism.

Trade Between North and South

Despite concern expressed in some Northern markets, North-South trade in

(Continued on page 179)

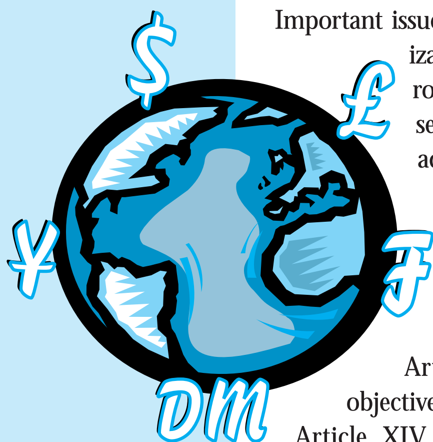
beneficial to member countries and help promote an orderly process of liberalization, thereby helping ensure systemic stability—a major IMF responsibility.

Even though the IMF's Articles are yet to be amended, institutional work has been under way on capital account issues for some time. The IMF's Research Department has generated a wealth of research and analysis on international capital markets. And in MAE, apart from our reports on capital account convertibility, we have begun expanding our country information base on the regulatory framework for capital transactions—in collaboration with other departments. We have just issued a Special Supplement to our 1996 *Annual Report on Exchange Arrangements and Exchange Restrictions* [see *IMF Survey*, May 12, page 147], the coverage of which includes capital transactions. Institutionally, important efforts are under way to ensure proper coordination with other agencies with an interest in the capital account area, such as the Organization for Economic Cooperation and Development, the World Trade Organization, and the Multilateral Agreement on Investment currently under negotiation.

A primary source of potential banking difficulties continues to be credit risk.

IMF Survey: *Will the amendment provide for transitional arrangements?*

Guitián: Certainly. We need to take into account that not every country will be in the same position to liberalize or at the same stage of liberalization. Important issues of the pace and sequence of liberalization, as well as the need to ensure a robust framework for appropriate policy setting and implementation, need to be addressed to ensure a durable capital account opening. All these call for well-designed transitional arrangements. In principle, the approach need not be different from that used to handle current account transactions; Article VIII essentially establishes the objective of current account convertibility, and Article XIV provides the necessary transitional arrangements. An analogous framework can be envisaged for capital account transactions.



IMF Survey: *When will the amendment take effect?*

Guitián: The sooner the better. But an amendment requires a large measure of consensus among our members. We have been working intensely to help build this consensus and will continue to do so, but a time frame is hard to predict. Given the increasing recognition of the importance for the IMF of obtaining this mandate and the momentum that has gathered in that direction, I expect it will not take long.

IMF Survey: *Financial sector soundness is an increasing concern within the global economy. Why is this so, and where are the greatest risks?*

Guitián: Banking and financial sector soundness has become increasingly important as these sectors have become progressively deregulated and, more generally, as economic borders have fallen among countries. In turn, the scale and speed of technological change in the financial area have enhanced the potential for increased economic efficiency and welfare. But they also have widened the scope for risks to be shifted and transmitted among economies and sectors. We have clearly seen an opening of economic frontiers, but also a blurring of the distinction between the activities of different financial intermediaries, between banks and other financial intermediaries, and even between financial and nonfinancial activities. These developments have made supervision and official oversight increasingly complex and demanding.

The potential for banking and financial sector risks exists in all countries. But, clearly, countries that possess well-developed legal and institutional frameworks and flexible and resilient economies are best equipped to deal with those risks. Potential vulnerability is greater in those economies where legal and institutional infrastructures are still being built and markets still developing.

Despite the increasing complexity and sophistication of financial transactions, a primary source of potential banking difficulties continues to be credit risk, a traditional subject of concern to banks—which underscores the critical importance of high-quality bank management. This is an important message in the context of IMF advice on the proper balance between internal bank governance, official oversight, and market discipline.

IMF Survey: *In cooperation with other international organizations and groups, the IMF is developing a set of "best practices" to guide the development of sound banking. What role will the IMF have in promulgating and promoting these standards and how will it coordinate with other groups or organizations?*

Guitián: It was never contemplated that the IMF would play a role in setting rules and standards in the prudential regulation or supervisory areas. This is a task that concerns such groups as the Basle Committee on Banking Supervision and national supervisory authorities. But the IMF can make a contribution through the exercise of its surveillance function. The IMF is responsible for helping members address vulnerabilities not only in policymaking but also in the institutional policy layout, which includes the prudential regulation and supervisory framework. In this connection, the Basle Committee has recently issued a paper presenting the "core principles" for effective

banking supervision, which the IMF will help disseminate among its members through its surveillance and technical assistance. The IMF can also discuss with its members how to adapt such principles to their specific circumstances, and can monitor their implementation.

The objective of bank soundness, however, extends beyond the supervisory realm. It encompasses such issues as the quality and disclosure of information and the adoption of sound macroeconomic and structural policies—which are essential for banks and financial intermediaries to operate efficiently. In the bank soundness area, the IMF coordinates intensively with the Basle Committee, the World Bank, and, as appropriate, with national supervisory authorities. Aspects of this collaboration have been addressed by a working party of the Group of Ten industrial countries and several emerging market economies, which recently issued a report outlining a strategy to foster financial stability in rapidly growing countries [see *IMF Survey*, May 26, page 158]. And the IMF's Managing Director and the President of the World Bank have recently clarified the nature of their institutions' collaboration in strengthening financial sectors in their member countries.

IMF Survey: *Turning to central banking issues, under what circumstances does the IMF recommend inflation versus monetary targeting?*

Guitián: There is a clear consensus among central bankers that domestic price stability is the primary objective of monetary policy. In general, the idea that the value of the currency should be stable has prevailed for a long time. This was an aim of the gold standard as well as of the Bretton Woods par value system, which focused on exchange rate stability—that is, on safeguarding the external value of the currency. With the abandonment of the par value system and the generalized introduction of flexible exchange rate arrangements, the focus moved from exchange rate to price level stability—that is, to protecting the internal value of the currency. Consequently, the framework for monetary policy had to shift from conforming to a fixed exchange rate rule to pursuing a monetary target and, more recently, an inflation target.

Monetary targeting became necessary once exchange rates became flexible, if only because when one anchor is given up, another one is needed. The choice of a monetary target as an anchor was based on a large body of conceptual and empirical work establishing the existence of a stable and predictable relationship between monetary expansion and price level developments. It is a framework that postulates that control over monetary growth—the achievement of an intermediate monetary target—will yield price level stability. This framework was adopted by many countries in the 1970s; but its appropriateness was soon challenged, as questions arose about the stability and predictability of the relationship between money growth and prices. Evidence of a looser and less predictable relationship between these two variables led to the abandonment of monetary targeting.

Countries then began experimenting with other approaches, including the monitoring of a variety of indicators, the adoption of a monetary conditions index, or the direct pursuit of an explicit inflation target. This latter approach sets the anchor on the policy objective rather than on an intermediate policy target or a policy instrument. Monetary and inflation targeting differ, in that while, analytically, the relationship between money growth and price developments is well established, the conceptual framework relating policy instruments to the inflation target—in particular, the transmission mechanism linking them—is still being developed. Empirically, though, monetary policy conducted in the context of this framework has been relatively successful.

As for the choice between monetary or inflation targeting, the specific characteristics of the economy and, in particular, the relationship between money and prices are critical. In both approaches the ultimate aim of policy is the same.

IMF Survey: *An important ingredient for sound monetary policy is central bank independence. Where do you see the greatest need for more independence?*

Guitián: The concept of central bank independence has become increasingly accepted as an important institutional component for formulating and implementing monetary policy. There is a consensus, as I have mentioned, on the importance of price stability as the primary objective for monetary policy. Clarity of purpose will help eliminate inflation bias, increase the credibility of policy, and yet permit flexible monetary management. This is important because, to be effective, central bank independence requires a well-defined objective (such as an inflation target) that helps establish the accountability of monetary management. From this standpoint, important though it is, a central bank law that provides autonomy to the institution may not be enough; autonomy also requires effective implementation of the law.

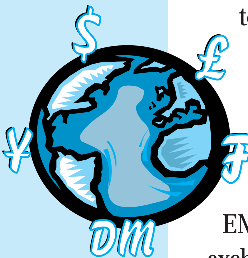
It has been argued that a precise quantitative rule represents a better alternative than central bank independence as a guide for monetary policy. About 35 years ago, for example, Milton Friedman wrote an article asking whether monetary authorities should be independent, and his answer was no. He felt it was too discretionary an institutional arrangement for conducting monetary policy. In his view, a given precise

rule to keep monetary expansion moderate was far more appropriate to obtain price stability. But there is growing evidence that central bank independence, accompanied by a well-defined policy objective and appropriately established accountability, does constitute a proper institutional framework for pursuing price stability. Many countries, including emerging and transition economies, have advanced in this direction, although the degree of progress has varied across countries. Many countries have accepted the notion that central bank independence is an important institutional component for achieving price level stability.

IMF Survey: *How would you assess current trends in exchange rate systems, particularly in developing and transition economies?*

Guitián: The trend in many developing and transition economies has generally been toward exchange rate flexibility, with the type of regime varying depending on the country's characteristics and tradition. But some countries have also used the exchange rate as an anchor to attain price level stability and have therefore adopted a fixed exchange rate. A currency board is essentially a strict form of a fixed rate, which has been used effectively by some members. Other countries have sought the benefits of both systems through the use of bands—the width of the band providing sufficient flexibility, and the band itself offering a certainty of the evolution of the exchange rate.

Under the IMF's current Articles, countries may adopt the exchange arrangement of their choice. In this setting, an important responsibility of the IMF is to encourage consistency between countries' economic policies and their exchange rate regime. Particularly important in this regard is the significant liberalization that has taken place in members' exchange arrangements. Countries that now adhere to Article VIII—or that have established current account convertibility—total 139, compared with 68 in 1990. Multiple exchange rates are far less prevalent today than seven or eight years ago. These are essential objectives that the IMF sought to promote, while taking a pragmatic attitude toward countries' choices of exchange rate regimes. The obvious progress made toward economic liberalization to date underscores the effectiveness of the approach.



IMF Survey: *Do you think the EU's prospective experience with monetary unification will have an impact elsewhere in the exchange rate sphere?*

Guitián: The prospective participants in EMU, among themselves, are abandoning the exchange rate as an adjustment variable and are preparing to adopt a common monetary standard. But vis-à-vis the rest of the world, the exchange rate arrangement will be flexible. The impact of events in Europe for the world economy at large will hinge, I think, on the concrete illustration that EMU will provide of the operation of the internal adjustment mechanism in an environment of diverse economies for which the exchange rate is unavailable as an adjustment variable. Efficiency in adjustment among EMU participants will call for flexibility in these economies' markets for factors of production and for goods and services. Evidence from EMU that the internal adjustment mechanism functions well cannot but lead economies outside the EU to draw inferences. The issue goes to the heart of what constitutes an optimum currency area.

IMF Survey: *MAE is a major provider of technical assistance in the areas of central banking, exchange rate systems, and the design of monetary policy instruments. How does your department deliver, and assess the effectiveness of, its technical assistance?*

Guitián: We deliver technical assistance to member countries in many forms: staff missions, short-term expert assignments, and long-term resident advisors, as well as through seminars and workshops. We assess the effectiveness of our technical assistance both internally and externally. We recently had an external evaluation of our technical assistance that provided useful insights on how to enhance its effectiveness by keeping it well focused and monitoring its results. Internally, we have also established a range of methods to follow up on the quality and use of our advice. In addition to the traditional review of technical assistance reports by other departments, these include an in-house peer review of our reports, close supervision by senior staff, and periodic inspection visits by senior staff to recipient countries. These internal MAE reviews also provide a good basis for integrating technical assistance activities with other areas of IMF work and policy advice. Finally, review of our technical assistance is conducted by senior staff in the context of general examinations of the overall technical assistance activities of the IMF at large. ■

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
May 26	3.95	3.95	4.33
June 2	3.90	3.90	4.27

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

FYR of Macedonia Stabilizes Economy and Seeks to Deepen Structural Reforms

The following article is based on staff reports prepared in conjunction with the IMF's annual consultation with the former Yugoslav Republic (FYR) of Macedonia and the country's request for resources under the IMF's enhanced structural adjustment facility (ESAF). It examines the country's progress to date and its objectives for continued reform.

Amid sometimes turbulent regional developments, the FYR of Macedonia has taken strong steps to stabilize its economy. Its inflation rate—the lowest of all the transition economies—is now at the level of advanced countries. Yet the process of creating a vibrant market economy is far from complete. Over the medium term, it will be crucial for the FYR of Macedonia to reduce its large current account deficit, tackle high and rising unemployment, and address weaknesses in its financial system. To this end, the authorities are committed to maintaining the sound financial policies that have characterized the country's transition efforts and to deepening structural reforms.

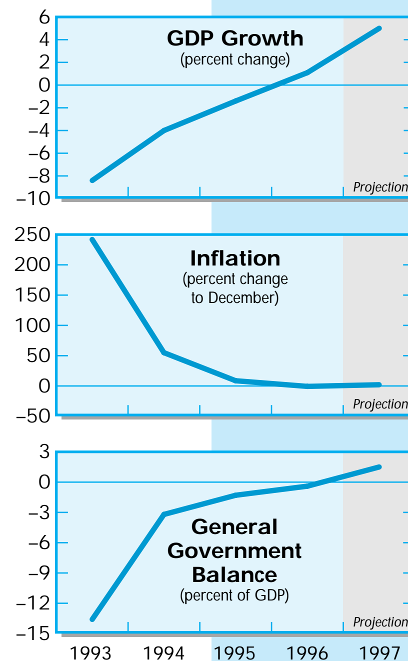
Background

In many respects, the FYR of Macedonia had a tough birth. When it became independent in 1991, the country's traditional trading markets were disrupted—a result of ongoing conflicts in the region—and it lost substantial transfers from the Yugoslav federation that had helped to underwrite the cost of infrastructure and subsidize agriculture and industry. The scale of the adjustment was enormous and created numerous attendant problems.

As a result of a refocusing of monetary policy that was supported by an impressive fiscal consolidation, the FYR of Macedonia was, by mid-1995, able to arrest the decline in output and stabilize prices. Only two years earlier, inflation had topped 240 percent. Price and exchange rate stability provided the authorities with an environment in which to introduce needed structural reforms. In particular, the FYR of Macedonia slashed the fiscal deficit to just 1 percent of GDP in 1995 from 13 percent in 1993, but still found budget resources for a comprehensive rehabilitation package and for a restructuring program for many of the largest public enterprises. The authorities also began privatization in earnest.

New challenges emerged in 1996, as exceptional foreign exchange inflows—related to the regional situation—evaporated and increased consumer confidence stimulated domestic demand and led to sharply higher imports. Exports—despite improved competitiveness resulting from subdued wage growth and higher productivity—did not keep pace, and the external current account deficit swelled considerably. Monetary and fiscal policies remained tight, but for the first time since independence, real GDP growth was positive—increasing an estimated 1 percent in 1996. With improvements in the regional situation, transportation costs declined sharply, helping to keep overall costs stable. The cost of living index actually dipped 0.7 percent in 1996.

The public enterprise sector has continued to adjust, but its overall performance remains weak. Privatization, while proceeding, has been dependent upon employee or management buyouts that have yet to translate into better corporate governance. In the banking sector, low loan collection rates and wide interest rate spreads reflect persistent weaknesses.



Data: The FYRM authorities; and staff estimates

More Reforms Needed

Despite remarkable financial stabilization, the economy of the FYR of Macedonia has yet to achieve a decisive turnaround. Unemployment, for example, is high (an estimated 25 percent in 1996) and has been rising, and the deterioration in the current account deficit has caused concern. To lay the groundwork for sustained growth, the FYR of Macedonia must maintain tight financial discipline and deepen and expand its structural reforms.

The authorities expect external adjustment to be achieved through suitably restrictive financial policies that curb excess demand and structural reforms that enhance productivity and restrain wage growth. They are projecting an overall reduction in the external current deficit of over 3 percent of GDP in 1997 and a 5 percent recovery of output growth. Exports are expected to provide the impetus for higher growth, in the context of subdued domestic demand and import growth. Increased efficiency and flexibility in the economy generated by the structural reforms are expected to spur productivity and boost domestic savings and investment. By 1998 and 1999, improved corporate sector governance, a more efficient financial sector, and key agricultural and other reforms are expected to underwrite a 5 percent growth rate, with continued low inflation (2–3 percent annually). Job creation will be stimulated, but unemployment rates—as enterprises restructure—are expected to remain high.

Fiscal Policy. The key objective will be to reduce the high tax burden within the framework of a balanced budget. This will require overall expenditure restraint and the elimination of unproductive government expenditures. The FYR of Macedonia is committed to virtually eliminating agricultural and export subsidies, reducing contributions to agricultural price supports, scaling back funding for economically questionable projects, and containing or reducing elements of the government's wage bill. In this stringent fiscal environment, the government will nonetheless boost development investment and education expenditures in real terms and maintain the comprehensive social safety net.

Over the medium term, rationalization of social benefits—whose cost is currently the equivalent of 20 percent of GDP—will be a crucial element in containing expenditure growth. Pension expenditures are particularly high, given the relative youthfulness of the population. Recent reform measures have reduced minimum pensions for new retirees and brought benefits more in line with contributions—substantially improving the sustainability of the pension program over the medium term.

Monetary Policy and Financial Reforms. The FYR of Macedonia's exchange rate anchor has played a crucial role in reducing inflation expectations. For 1997, the authorities hope fiscal tightening will provide room for more rapid private sector credit expansion and some easing of interest rates.

Stabilization efforts have not yet translated into a stronger, deeper financial sector that could play a more robust role in promoting growth and development. Intermediation costs remain high, and bank loan collection rates, low. To bolster the financial sector, the authorities have decided to liberalize financial markets, strengthen open market operations of the National Bank, and improve the legal enforcement of lending contracts. Steps will also be taken to stimulate competition in the banking sector and reduce the National Bank's reliance on direct instruments of monetary policy. A new deposit insurance scheme and initiatives to improve banking sector supervision are expected to boost public confidence in the banking system. The largest commercial bank is expected to be sold to a consortium of foreign buyers.

Over time, rationalization of social benefits will be crucial in containing expenditure growth.

Public Sector and Labor Market Reforms. The authorities recognize that while privatization has proceeded, poor management and financial performance still hobble enterprise operations. To encourage more effective ownership, the authorities intend to eliminate restrictions on secondary share transactions and sell remaining government shares to outside investors. Tax and other incentives to convert wage arrears to equity will be offered to accelerate restructuring of enterprises. The FYR of Macedonia is committed to privatizing virtually all eligible enterprises by the end of 1997. Accelerated enterprise restructuring will be complemented by labor market reforms and initiatives to reduce hiring and firing costs. The authorities are undertaking a comprehensive reform of unemployment benefits to enhance labor market mobility and increase work incentives.

Trade. The authorities recognize that for a small economy like the FYR of Macedonia, it is vital to maintain an open trading regime and pursue integration with Europe. The government quickly established a liberal trade regime with an average effective import tax rate of 11 percent. Over the medium term, the government intends to reduce this. The country has reached agreement on trade and financial protocols with the European Union—pending settlement of arrears with the European Investment Bank—and has concluded free-trade agreements with several countries in the region.

Current Account Deficit and External Financing. Increased productivity and competitiveness, as well as new trade agreements and improved transportation, are expected to boost exports 10 percent—they already underpin a substantial reduction in the current account deficit. But even with this reduction, the external financing situation may be tight. Private short-term inflows and net disbursements from official creditors are expected to dip sharply in 1997, with borrowing from the IMF and the World Bank and bilateral assistance expected to cover the financing gap.

Progress and Challenges

FYR of Macedonia's accomplishments—particularly in reducing inflation to advanced country levels and in maintaining a stable exchange rate—have been striking. But low incomes and high unemployment remain problems. The authorities appreciate that there will be no "quick fixes" on the path to sustained recovery and growth. It will be critical for the FYR of Macedonia to maintain tight financial discipline and deepen structural reforms—notably in reducing public sector expenditures and rationalizing public sector employment, accelerating financial liberalization, and aggressively pursuing privatization and attracting foreign participation. The country's strong commitment to sound policies and willingness to sustain difficult reforms bode well for its efforts to foster long-term growth. ■

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

Camdessus Calls for "Second Generation" Of Reforms in Argentina

Following are edited excerpts of an address by IMF Managing Director Michel Camdessus at the 1997 National Banks Convention in Buenos Aires on May 21.

Since the late 1980s, most countries in the region have undertaken programs of macroeconomic stabilization and structural reform. The problems in the region have been similar and the programs have had points in common, especially an emphasis on paring back state intervention to allow the market to allocate a majority of the resources and to give freer rein to the private sector to fulfill its role as the main engine of growth.

The process has not been easy, but there has been a dramatic turnaround in economic performance throughout the region. Average growth in Latin America and the Caribbean rose from less than 1½ percent in 1988–89 to 5 percent in 1994—the highest rate since 1980. Although this growth was not immune to the "tequila effect," it is now once again around 5 percent for the region as a whole. Meanwhile, average annual inflation in the region has fallen from a breathtaking 1,100 percent at the end of 1989 to 19 percent at the end of last year. Gross international reserves have increased fivefold, and private capital inflows have increased from close to zero in 1989 to over $70 billion last year. In Argentina, growth may reach 6 percent this year, and inflation remains close to zero.

Despite these achievements, few observers inside or outside the region would be fully satisfied with the region's overall economic or social progress over the last several decades. Most countries have been unable to narrow the income gap with advanced economies significantly or achieve a decisive reduction in poverty.

I do understand why many in the region are dissatisfied with progress so far. In 1965, average real per capita income in Latin America and the Caribbean was almost twice as high in terms of purchasing power as it was in the Asian countries—now referred to as "newly industrialized economies." Today the situation is just the reverse: real per capita income in these Asian tigers is now about two and a half times higher than in Latin America.

Education levels are lagging as well. In the 1960s, the average level of education in Latin America was in line with or slightly better than that in other countries at a comparable stage of development. Today, the average level of education in the region is two years less than the average for comparable countries elsewhere in the world and four years less than in comparable East Asian countries. Meanwhile, income inequality remains pronounced, and large numbers of people in the region continue to live in poverty, though poverty is less prevalent in Argentina and Uruguay, and Chile is succeeding in progressively reducing poverty. Levels of education, too, are higher in Argentina than the regional average.

It would be a great mistake to lay the blame for these shortcomings on the reform programs of recent years. The deterioration in income distribution and rise in poverty occurred during the period of high inflation and low growth that followed the debt crisis in the 1980s. This is hardly surprising, since the poor and the unskilled are most likely to lose their livelihoods during economic downturns and least able to protect the real value of their income during periods of high inflation.

The record during recent periods of stabilization and reform has been markedly better. Countries that have embarked on reform have seen average GDP growth rise to 3 percent a year in the three years following the start of reform and to nearly 4 percent thereafter, compared to less than 1 percent in the three years preceding reform. Investment as a share of GDP and productivity have followed similar patterns. There is also evidence that poverty has declined. In Brazil, the introduction of the Real Plan was associated with a sharp increase in the real income of the poor and a decline in the poverty rate. In Argentina, the percentage of the population below the poverty line fell by almost 50 percent between 1989 and 1996.

All of this is very encouraging, but progress has been fragile and slow in coming. Poverty, according to some estimates, still affects well over a third of all households in the region, or upward of 200 million people. There is still a tremendous amount of work to do to achieve a decisive improvement in economic opportunities and social conditions throughout Latin America. We know that the only solution is to achieve high, sustainable, and more equitably distributed rates of growth. The wisest course of action is to continue with the stabilization policies, strengthen the reforms that have contributed most to stronger growth, and identify what more needs to be done to ensure that the benefits of strong growth are more widely and equitably shared.

Argentina has been successful largely because sound macroeconomic policies have remained firmly in place for a number of years, and considerable progress has been made on what might be described as the "first generation" of structural reform. Indeed, the fact that Argentina was able to withstand the Mexican crisis—and restore growth and market confidence so quickly thereafter—is a great tribute to these policies. But

clearly, the situation here—where unemployment is high and not all are sharing fully in the benefits of stronger growth—calls for further action. And the same may be said of other countries in the region. More can be done in Argentina and the rest of Latin America to achieve higher growth, greater equality of economic opportunity, and more rapid social progress. This is what I would call the "second generation" of reform.

There is no artificial or rhetorical distinction between these two generations of reforms. This second generation is geared more toward achieving high-quality growth that will be genuinely sustainable, while the first generation of reform focused on restoring basic equilibria and kick-starting the engines of growth. The crux of the second generation of reform concerns completing the transformation of the state's role in the economy. Obviously reducing state intervention in the economy and increasing the transparency of government operations are absolutely essential in limiting the opportunities for corruption and in enhancing public accountability. Beyond these reforms, I see at least three key tasks remaining for the state to perform:

• *establish a simple, transparent regulatory system that is equitably enforced.* This system would ensure equal access to markets—thus promoting equality of economic opportunity—and encourage competition and eliminate unnecessary business costs.

• *uphold the professionalism and independence of the judicial system.* This ensures prompt and equal justice for all, and gives confidence to savers and investors that contracts will be enforced, rights will be protected, and property will be secure. In the past two years, in two vastly different countries, two presidents speaking of the challenges of development very surprisingly said almost the same thing to me: in the task of development and all that it entails, the most important ministry is the Ministry of Justice.

• *improve the quality of public expenditure.* This means reducing unproductive expenditure to make more room for investment in human capital and basic infrastructure. It also means ensuring that essential public services are provided at reasonable cost, intended beneficiaries are reached, and access to these services is equitable. Latin America's countries must make an exceptional effort to improve the level and quality of expenditure on education—an effort that will lead to improved equality of educational opportunity. This would have a substantial positive impact on Latin America's long-term growth potential and prospects for more equitable income distribution, but it cannot be achieved with inflation and higher taxes. It must be done by continuing to eliminate unproductive expenditure.

The second generation of reform requires "good governance" in all its dimensions—particularly, effective and reliable public institutions. Good governance in the public domain can help promote a greater sense of accountability in private affairs—including sound and responsible credit policies, and a culture of tax compliance, which needs to be strengthened or, some would say, properly established. Neglecting these essential aspects only invites a creeping delegitimization of public institutions that sabotages economic efficiency, erodes confidence, and undermines growth and equity.

What implications does this second generation of reform hold for Argentina specifically?

• *financial sector.* Argentina has benefited substantially from having made a relatively early start on financial sector reform and from having followed a basically market-oriented strategy. The second generation should focus on improving transparency. Increasing the flow of timely, comprehensive, and accurate information between banks and supervisory authorities, between borrowers and lenders, and between financial institutions and their shareholders and depositors would encourage better internal governance in banks, permit more effective supervision, and promote better credit analysis.

• *fiscal reform.* The public sector is now leaner, and public expenditure is under better control at the central government level, but there is still room to broaden the tax base and improve tax administration and taxpayer compliance. Likewise, there is ample scope to improve the quality of public expenditure.

• *labor market reform.* Many people associate structural reform with higher unemployment and fear that labor market reform will only make the problem worse. I believe they are mistaken. The key to preserving and expanding employment, particularly among the less skilled, is a flexible labor market that encourages mobility and keeps labor costs in line with labor productivity. Much more needs to be done to decentralize and reform the collective bargaining process, to increase the efficiency and contain the cost of the labor-run health care system, and to reduce the high cost of severance payments.

I have one lingering concern. Argentina's bright prospects could turn to failure unless more concerted efforts are made, at this new stage of the reform process, to reduce the inequality in income distribution and, more important, to create more opportunities for the most disadvantaged, particularly with regard to education and occupational training for young people. These problems are the sovereign responsibility of the Argentine people and should be at the center of democratic debate in this country. We live, however, in an era in which rapid technological change is widening the gaps between the very rich and the very poor, between those who have the most knowledge and those to whom the State has failed to provide the education they need if they are to take full advantage of the world's opportunities. ■

Globalization's Challenges for Africa

Following are excerpts of a May 21 address by IMF Deputy Managing Director Alassane D. Ouattara, at the Southern Africa Economic Summit in Harare, Zimbabwe.

The trend toward more integrated world markets offers a wide potential for greater growth and presents an unparalleled opportunity for developing countries to raise their living standards. At the same time, the Mexican crisis has focused attention on the downside risks of this trend, and concerns have arisen about the risks of marginalization of countries.

The globalization of the world economy amounts to the integration of economies throughout the world through trade, financial flows, the exchange of technology and information, and the movement of people. The extent of the trend toward integration is clearly reflected in the rising importance of global trade and capital flows. Economic success in today's world is less a question of relative resource endowments or geography and more a question of the market's perception of the orientation and predictability of economic policy.

Challenges of Globalization for Africa

Globalization will continue to reinforce interdependencies between different countries and regions. It can also deepen the partnership between the advanced countries and the rest of the world. And to support this partnership in a mutually beneficial way, the advanced countries could help to further open their markets to the products and services in which the developing world has a comparative advantage. In addition, the reform efforts of the African countries will need to continue to be supported by adequate financing on concessional terms. In this regard, the IMF has put the enhanced structural adjustment facility [ESAF], our concessional lending facility, on a permanent footing. Moreover, the IMF and the World Bank have recently begun implementing the initiative to resolve the external debt problems of heavily indebted low-income countries (HIPCs). Three African countries—Burkina Faso, Côte d'Ivoire, and Uganda—are among the first to be considered under the initiative.

The challenge facing the developing world—and Africa in particular—is to design public policies that maximize the potential benefits from globalization and minimize the downside risks of destabilization and/or marginalization. Most African countries have been implementing these policies for some time. In particular, sub-Saharan Africa has made substantial progress toward macroeconomic stability:

- Average real growth has increased from less than 1 percent in 1992 to more than 5½ percent in 1996, and this positive trend is expected to continue.
- Many countries have achieved single-digit inflation rates, and average inflation for the region is expected to fall from the peak of 60 percent in 1994 to 17 percent in 1997.
- The external current account deficit has fallen from an average of 15½ percent of GDP in 1992 to a projected 9 percent this year, while the overall fiscal deficit has been cut from almost 12 percent of GDP to 6 percent over the same period.

African governments have also made considerable strides in opening their economies to world trade. Indeed, 31 sub-Saharan African countries have accepted the obligations of Article VIII of the IMF's Articles of Agreement, almost all since 1993. Most countries have moved ahead with trade and exchange liberalization, eliminating multiple exchange rates and nontariff barriers and also lowering the degree of tariff protection.

Finally, the restructuring of many African economies is gaining momentum. Throughout the continent, government intervention in economic activity is on the wane. Administrative price controls are being reduced, and agricultural marketing has been widely liberalized. The restructuring and privatizing of state enterprises has been under way for some time in most countries, though with varying speed and degrees of success. And fiscal reform is gaining ground—African countries are taking firm steps to rationalize their tax systems, reduce exemptions, and enhance administrative efficiency. At the same time, they are reorienting expenditures away from wasteful outlays toward improved public investment and spending on key social services, particularly health and basic education.

While Africa is on the right track, there is some way to go. I see five areas where African countries need to achieve greater progress to speed up their participation in globalization:

- *maintaining macroeconomic stability and accelerating structural reform.* As the continent enters the "second phase of adjustment," the emphasis must be on maintaining economic stability and reinforcing the implementation of structural policies that will make the economies more flexible, encourage diversification, and reduce their vulnerability to external shocks. These include further reforms in the areas of public enterprise activity, labor markets, and the trade regime. Governments must also ensure that public services are provided reliably and cost efficiently.
- *ensuring economic security.* Policy must remove the sense of uncertainty that still plagues economic decision making in most of Africa. This requires creating a strong national capacity for policy formulation, implementation, and monitoring. It also requires a guarantee of the transparency, predictability, and

impartiality of the regulatory and legal systems. This goes beyond respecting private property rights and enforcing commercial contracts to eliminating arbitrariness, special privileges, and ad hoc exemptions.

• *reforming financial sectors.* Rising capital flows place added burdens on banking regulation and supervision and require more flexible financial structures. This aspect of globalization confronts developing countries with a new challenge—to accelerate the development and liberalization of their financial markets, and enhance the ability of financial institutions to respond to the changing environment.

• *achieving good governance.* National authorities should spare no efforts to tackle corruption and inefficiency and enhance accountability in government. This means reducing the scope of distortionary rent-seeking activities, eliminating wasteful or unproductive uses of public funds, and providing the necessary domestic security. Many African countries will also have to undertake a comprehensive reform of the civil service, aimed at reducing its size while enhancing its efficiency.

• *a partnership with civil society.* African governments need to actively encourage participation of civil society in the debate on economic policy and seek the broad support of the population for adjustment efforts. To this end, governments need to pursue a more active information policy, explaining the objectives of policies and soliciting the input of those whom the policies are intended to benefit.

Globalization and Regional Integration

Throughout the continent, African governments are coming together to coordinate components of their policies, and virtually all countries are now members of regional organizations. Efficient regional cooperation allows the economies of Africa to overcome the disadvantages of their relatively small size and, by opening access to larger markets, to realize economies of scale. The obligations of membership in some of these organizations also make it easier for each individual country to achieve further progress in regulatory and judicial reform (as in the CFA franc zone); to rationalize payments facilities and to relax restrictions on capital transactions and investment flows (as in the Cross-Border Initiative); and to develop the mutual economic infrastructure (as in the Southern African Development Community). Enhancing trade links among themselves also strengthens their ability to participate in trade on a global scale, and could lead to further progress in the direction of nondiscriminatory multilateral trade liberalization.

The challenge for the future is to ensure that these regional organizations are perceived as effective vehicles for integrating African countries into the world economy, providing mutual support to their members in their reform efforts. Common regional objectives should be set in terms of international best practices. And the regional organizations should seek to push through reforms in the areas of legal and regulatory frameworks, financial sector restructuring, labor and investment code reform, and exchange and trade liberalization that seek to reach international standards as quickly as possible. The pace of progress should be what is feasible, not what is comfortable for the slowest member.

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Labor Standards and North-South Trade

(Continued from front page) manufactures is much more important for the South than for the North, Golub notes. Most of the major industrial countries continue to have manufacturing trade surpluses with the developing world. The share of employment in manufacturing in the developed countries has declined; but contrary to popular fears about deindustrialization, this decline mostly reflects the increasing importance of the service sector and the tendency for productivity in manufacturing to increase more rapidly than in services.

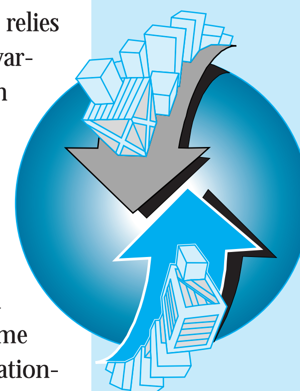
Workers in the North fear that their wages are undercut by their lower-paid counterparts in the South. Many in the North also view low Southern wages as inhumane and unfair. These concerns, says Golub, are exaggerated. The fear that high-wage countries cannot compete with low-wage countries is based on a misconception about the connection between wages and labor productivity and confusion about the difference between absolute and comparative advantage. Overall differences in productivity (absolute advantage) determine wages; sector-specific variations in productivity and costs determine trade patterns (comparative advantage). To the extent that low wages reflect low productivity, any advantage to employing low-wage labor is offset.

A related concern is that the growing ability of developing countries to import capital and foreign technology will equalize productivity in low- and high-wage countries. But in practice, capital flows seem to play a limited role in equalizing productivity. Even with the increasing ease of technology transfer and capital mobility, productivity in poor countries can be held down by low levels of human capital and poor public infrastructure and transportation services.

North-South trade is often blamed for the deteriorating position of unskilled labor in the North. It is true, as the IMF study acknowledges, that even though the North as a whole gains from trading with low-wage countries, imports of labor-intensive products are likely to be harmful to unskilled workers in the North. But, in the United States, for example, trade accounts for, at most, one-fourth of the decline in unskilled workers' real wages. Why, then, does North-South trade receive so much attention? Perhaps, Golub suggests, because it is politically appealing and convenient—and on the surface plausible—to blame imports from low-wage countries for the deteriorating position of unskilled workers, so such trade becomes a lightning rod for workers' frustrations. It is in the context of this controversy, as well as the prospect of an expansion of North-South trade as China and India become major exporters, that the debate about international labor standards is best understood.

Labor Standards: Ethical or Economic?

International labor standards are attempts to move toward harmonization of standards formulated by individual countries to regulate their own labor markets. Efforts to link labor rights with international trade were first crystallized in 1919 with the creation of the International Labor Organization (ILO). The ILO relies on voluntary compliance through ratification of various conventions on labor standards (more than 170 are in force) and works closely with individual member countries to arrive at mutually satisfactory outcomes. The ILO has never attempted to mandate trade sanctions for violations of its standards.



So far, the developing countries have resisted pressures from the United States and some European countries to adopt and abide by international labor standards. It is clear, according to the IMF study, that international agreement on the use of trade sanctions for enforcing adherence to labor standards is out of the question at present.

Arguments for and against harmonization of labor standards often mix the economic and moral aspects. For instance, some proposed core standards conflate fundamental labor "rights," such as freedom of association, with regulations governing working conditions and wages, which are economic in nature. According to the IMF study, the economic arguments for harmonizing labor standards are weak; in fact, well-intentioned attempts to impose higher labor standards on the South may actually be detrimental to Southern workers, especially if they are enforced through trade sanctions. Low labor standards are not the primary source of developing countries' comparative advantage, while most developed country labor standards—such as minimum wages—are not attainable in many poor countries.

The basic reality is that the developing countries' comparative advantage is in unskilled-labor-intensive goods, and their low labor standards are manifestations of both their level of economic development and their large supplies of unskilled labor. Higher labor standards, Golub suggests, are primarily a consequence, rather than a cause, of economic growth, and the surest way to improve labor standards in the South is economic growth, which international trade facilitates. Accordingly, pursuing trade and labor market policies conducive to high growth rates will be far more effective in raising labor incomes than mandating levels of wages and benefits or imposing trade sanctions on perceived violations of standards.

In some cases, there are genuine moral concerns, which has led the ILO to focus on core labor standards that uphold basic labor rights. But only a handful of

labor practices—most obviously, slavery—are universally regarded as unacceptable. Other core labor rights are less universal than sometimes claimed; disparities in income levels as well as cultural factors give rise to wide differences in acceptable behavior in labor markets—for example, child labor and discrimination between men and women. Without a clear basis for international agreement, Golub argues, labor standards would degenerate into protectionism.

Policy Options

Although the economic arguments raised in support of harmonizing labor standards are weak, the IMF study suggests that perceived violation of such standards in the South undermines support for free trade in the North at a time when unskilled labor is faring poorly and import penetration of Southern manufactures is rising rapidly. The South has a high stake in maintaining access to markets in the North and, hence, in forestalling protectionist pressures. Increased international compliance with some core labor standards can therefore be defended as a way to increase the legitimacy of a liberal international trading system, as well as being desirable in itself. A few core labor rights are arguably universal—including freedom of association, bans on forced labor and discrimination, and, possibly, limitations on the use of child labor—and efforts by both developing countries and private firms to adhere to some of them are not likely to impinge heavily on trade patterns.

The use of mutually agreed trade sanctions to enforce labor rights is likely to be problematic, however, owing to the lack of agreement on what constitutes a violation and the high risk of protectionist abuse of sanctions. Reliance on voluntary adherence to labor standards through continued—and enhanced—efforts by the ILO is preferable to coercion, says Golub. Other promising voluntary initiatives include adherence by multinational corporations to the same labor standards abroad that they follow at home, and increased consumer awareness of the conditions under which goods are produced.

On a more fundamental level, the IMF study concludes, Europe and North America must seek to implement polices that improve labor market performance for the poor and the unskilled. Western societies need to find ways both to improve labor-market flexibility and to ensure that the gains from structural change are shared across the board; otherwise, calls for protection are likely to increase. ■

Copies of IMF Working Paper 97/37, *International Labor Standards and International Trade*, by Stephen S. Golub, are available for $7.00 from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org. The full text is also available on the IMF's web site (http://www.imf.org).

Consultations with Three Countries Launch New IMF Series

On May 27, the IMF iss[ued its] first Press Information N[otice] (PIN), for Kingdom of th[e] Netherlands: Aruba. Tw[o] additional PINs, for Bel[ize and] Tunisia, were released [on] June 5. PINs are a new [category] of IMF press notices (se[e Press] Release 97/21; *IMF Sur[vey]*, May 12, page 148). Th[ey will] be issued, on a volunta[ry] basis, following the con[clusion] of the Article IV consulta[tions] for member countries s[eeking] to make known the vie[ws of] the IMF to the public. Th[is] action is intended to str[engthen] IMF surveillance ove[r the] economic policies of me[mber] countries by increasing [the] transparency of the IMF['s] assessment of these po[licies].

Under Article IV of th[e] IMF's Articles of Agreem[ent,] the IMF holds bilateral [discus]sions with members, us[ually] every year. A staff team [visits] the country, collects eco[nomic] and financial informatio[n, and] discusses with officials [the] country's economic dev[elop]ments and policies. On [return] to headquarters, the sta[ff pre]pare a report, which fo[rms] the basis for discussion [by the] Executive Board. At the [con]clusion of the discussion[, the] Managing Director, as Chairman of the Board, [sum]marizes the views of Di[rectors,] and this summary is tra[nsmit]ted to the country's auth[ori]ties. In these PINs, the m[ain] features of the Board's [discus]sion on Aruba, Belize, a[nd] Tunisia are described.

Aruba

The IMF Executive Board on May 19, 1997, concluded the 1997 Article IV consultation with Aruba.

Background

For 1996, Aruba's economic growth is estimated at 4 percent, with inflation just over 3 percent, and negligible unemployment. The moderation of growth from average annual rates of about 5 percent during the 1990s reflects both the moderate appreciation of the real exchange rate over the preceding years and a government decision to limit new construction, given nearly full employment and the island's limited physical resources. Earlier growth rates, based primarily on rapid expansions of the tourism sector, had given rise to a significant population increase, surging housing demand, and incipient inflationary pressures.

While Aruba's public finances moved into deficit over the past two years, with a borrowing requirement of 0.5 percent of GDP in 1995 and 1.5 percent of GDP in 1996, government indebtedness excluding loan guarantees is comparatively modest at just over 30 percent of GDP. The government is aiming to hold its borrowing requirement to 2 percent of GDP in 1997 and to achieve a balanced budget in 1998 and beyond.

The consolidation of Aruba's public health insurance funds into a single-payer system providing universal coverage is scheduled for completion in 1997. The system, financed by wage-based contributions and targeted to improve administrative efficiency and cost controls, will allow individuals to purchase supplementary insurance in the private market. At this time, the benefits level under the plan has not been set.

The net foreign reserves of the banking system, underpinning the peg of the Aruban florin to the U.S. dollar, decreased by Af. 62 million to Af. 427 million (equivalent to four months of imports) during 1996, in large part as a consequence of the government's purchase of a hotel from foreign investors.

There was strong credit growth in 1996 reflecting both government and household borrowing. Nonetheless, given the decline in net foreign assets, broad money increased by just 3 percent in 1996.

The monetary authorities suspended credit ceilings on individual banks at the beginning of 1997 in support of improved efficiency in the allocation of credit. The authorities have also taken important initiatives in recent years to modernize prudential supervision and banking regulation. Further steps in these areas are planned for 1997.

Restrictions on external current transactions were eliminated and capital controls were eased further in January 1997, as part of the continuing liberalization of Aruba's exchange and trade policies. The deficit on Aruba's non-oil external current account narrowed markedly in recent years, falling to 1 percent of GDP in 1996. The improvement stemmed from a strengthening of service and income receipts, reflecting the performance of the tourism sector, along with higher interest earnings on foreign investments.

For 1997 and beyond, with commercial investment strongly limited by the moratorium on the construction of new tourist facilities, economic growth in Aruba will depend on increased capacity utilization, moves to further upgrade the quality of tourism, and the diversification of the economy. Real GDP growth is projected by the IMF staff at 4 percent in 1997, with inflation at 3 to 3½ percent and a deficit in the non-oil (onshore) external current account equivalent to 0.9 percent of GDP.

Executive Board Assessment

Executive Directors commended Aruba on the strong economic growth and moderate inflation that had been achieved over the past decade and on the sound macroeconomic policy that had underpinned that performance. Directors noted that the key challenge facing Aruba now was to ensure continued growth in per capita GDP, while avoiding overheating. Directors, therefore, welcomed the government's intention to foster productivity growth by emphasizing quality in the tourist sector and by diversifying the economy.

Directors observed that the continuation of stability-oriented fiscal and monetary policies would also be essential to facilitate economic growth. Directors accordingly commended the prudent fiscal policy followed in Aruba. They welcomed that the supplementary budget for 1997 aimed at containing the government's borrowing requirement to 2 percent of GDP. They also encouraged the authorities to pursue their objective of returning to near budgetary balance in the next two years. To that end, further measures to restrain public expenditure would be needed in 1997 and the medium term. They should include an enduring reduction in public sector employment and wage restraint. In that connection, some Directors stressed that due regard would need to be paid to retaining quality personnel. Directors thought it advisable to review some large investment projects. Directors also encouraged the Aruban authorities to improve tax administration with a view to increasing the buoyancy of public revenue, and to undertake a study of the structure of the tax system.

Directors agreed that the peg of the florin to the U.S. dollar had served Aruba well. They noted that the central bank had skillfully managed the monetary and banking system in a very open environment. The suspension of direct credit controls as of January 1997 was a welcome step toward allowing greater play for market forces in determining the allocation of credit. It will be crucial to monitor developments under the new system closely to forestall an excessive expansion of monetary and credit aggregates. Directors also said that they understood the authorities' wish to move cautiously to a more fully market-oriented system of monetary control.

Directors noted that important steps had already been taken to modernize the prudential supervision and regulation of the banking system. They observed that the central bank appeared to have the information and regulatory instruments it needed to detect and correct emerging financial problems in individual institutions before they adversely affected the system as a whole. The priority now was to enact the laws and regulations to provide a comprehensive legal framework for supervision that would formalize the methods already used in practice.

Directors commended Aruba on its generally liberal trade policy. On other structural issues, Directors welcomed the government's intention to resell a major hotel without a loan guarantee and to use the proceeds to replenish Aruba's foreign exchange reserves. With respect to the national airline, Directors urged the authorities to eschew any further financial commitments and allow market forces to fill the demand for air transport.

Directors welcomed the efforts at data improvement and called for further improvement in the statistical base, espe-

Aruba: Selected Economic Indicators

	1993	1994	1995	1996[1]
		(percent)		
Domestic Economy				
Change in real GDP	1.8	5.7	5.5	4.0
Unemployment rate	0.5	0.5	0.7	0.6
Change in consumer prices (end of period)	6.4	4.7	3.1	3.2
		(million U.S. dollars)[2]		
External Economy				
Exports, f.o.b.	1,209.0	1,357.0	1,347.0	1,736.0
Imports, f.o.b.	1,396.0	1,439.0	1,597.0	2,043.0
Current account balance	22.0	60.0	–15.0	–74.0
Direct investment	–9.0	–60.0	–1.0	84.0
Portfolio investment	–4.0	–10.0	–17.0	–6.0
Capital account balance	7.0	7.0	15.0	28.0
Gross official reserves	200.0	196.0	242.0	215.0
Current account balance (percent of GDP)	1.8	4.5	–1.1	–4.8
Non-oil sector	–1.5	–4.1	–1.7	–1.0
Change in real effective exchange rate (percent)[3]	2.2	3.6	0.5	0.3
		(percent of GDP)[2]		
Financial Variables				
General government balance	0.9	0.2	–0.5	–1.5
Change in broad money (percent)	6.4	12.6	5.6	2.9
Interest rate (percent)[4]	6.5	6.1	6.2	6.4

[1]IMF staff estimates.
[2]Unless otherwise noted.
[3](+) = appreciation.
[4]12-month time deposits.

cially trade data, in order to facilitate the formulation, implementation, and surveillance of macroeconomic policies.

Belize

The IMF Executive Board on May 12, 1997 concluded the 1997 Article IV consultation with Belize.

Background

Belize's economic performance weakened in 1991–94 as public sector savings fell sharply. Real gross domestic product (GDP) slowed to an average of 4.5 percent in 1991–94 (10 percent a year in 1987–90). Despite a cut in capital outlays and in the deficit during this period the central government relied heavily on domestic financing, particularly from the central bank, to minimize reliance on external financing. The authorities tightened credit policies and the resulting high real domestic interest rates crowded out private sector credit. In addition the slower growth in the agricultural sector was compounded by the effect of the recall in 1994 of most of the UK military contingent that had been posted in Belize, and minimal expansion in construction. Inflation remained in line with international trends, reflecting the peg of the Belize dollar to the U.S. dollar and the openness of the economy. Gross reserves fell from the equivalent of three months of imports in the late 1980s to one month at end-1994.

Belize: Selected Economic Indicators
(Annual percent change unless otherwise noted)

	1991	1992	1993	1994	Prel. 1995	Est. 1996
Domestic Economy						
Domestic demand	10.4	10.1	10.9	–0.4	5.5	8.1
Real GDP (at market prices)	3.1	9.3	3.3	1.8	3.3	3.0
Consumer price index (average)	3.2	2.4	1.4	2.5	2.9	6.3
External Economy						
Export volume	–4.9	19.1	–1.5	4.8	0.5	6.0
Import volume	19.6	6.6	3.6	–10.4	–8.6	–2.9
Current account balance (percent of GDP)	–6.9	–6.0	–8.9	–4.1	–1.7	–2.6
Overall balance (percent of GDP)	–5.0	0.1	–3.7	–0.8	0.6	3.3
External debt (percent of GDP)	34.9	30.9	31.8	32.7	30.3	33.1
Debt-service ratio (percent of exports of goods and services)	6.7	5.0	6.2	8.5	10.0	10.6
Gross reserves (months of imports of goods and nonfactor services)	2.1	2.0	1.1	1.0	1.2	2.0
Real effective exchange rate (depreciation -)	1.7	–2.1	2.4	–4.5	–2.4	5.0
Financial Variables						
Nonfinancial public sector balance (percent of GDP)[1]	–4.1	–7.6	–6.9	–5.6	–2.6	–2.7
Gross national saving (percent of GDP)	22.8	23.9	23.1	20.3	18.3	16.8
Broad money[2]	10.9	17.0	4.8	8.4	17.2	4.3
Interest rate (90-day time deposits)[3]	8.4	8.1	8.2	8.7	9.9	8.5

[1]Refers to fiscal years (April through March).
[2]Money and quasi-money.
[3]Average last quarter of year.

Some corrective measures were adopted during FY 1995/96 (April-March) including a reduction of 9 percent in the civil service in December 1995. However, the effect of these measures was offset by a weak revenue performance associated with tax incentives, and a wage increase granted to civil servants in late 1996. As a result, in FY 1995/96–1996/97 public sector savings remained at an average of about 4 percent of GDP. Nonetheless, capital outlays were reduced, and the public sector deficit narrowed from 5.5 percent of GDP in FY 1994/95 to an average of 2.5 percent of GDP in FY 1995/96–1996/97. In 1996, a loan from bilateral sources together with a tight credit policy, permitted a recovery of gross international reserves to the equivalent of two months of imports. The external current account deficit increased to 2½ percent of GDP in 1996 (1¾ percent in 1995) as a decline in the service account's surplus, associated with a fall in tourism and the withdrawal of the remaining contingent of UK troops stationed in Belize, more than offset an improvement in the trade balance reflecting a recovery of agricultural exports. Real GDP growth was 3 percent on the strength of agricultural production, while the rise in consumer prices peaked at 6.3 percent mainly reflecting the introduction of the value added tax at a 15 percent rate. Inflation has decelerated to 4¾ percent as of February 1997.

Executive Board Assessment

Executive Directors observed that the fiscal measures adopted by the authorities in 1995/96, particularly the retrenchment of a significant part of the civil service, had been important steps toward correcting Belize's fiscal imbalance. However, fiscal imbalances and domestic financing requirements remained large. Directors emphasized that exceptional external financing, such as the country received last year, could only provide temporary relief and could not be a substitute for fiscal measures to redress Belize's macroeconomic imbalances on a sustainable basis.

Accordingly, Directors viewed a further strengthening of fiscal consolidation as the priority in the period ahead. They urged the authorities to implement additional fiscal measures, in particular broadening the tax base, curtailing exemptions, and improving procedures for customs valuation. They also welcomed the steps taken to strengthen tax enforcement. On the expenditure side, Directors urged a more prudent public sector wage policy and, in that context, noted the contribution that the new Public Service Regulations could make in regard to merit awards. They also encouraged the authorities to finalize the Financial

Management Reform Project to strengthen public management. It was also noted that the composition of fiscal consolidation should be improved, in particular by according a higher priority in future to public investment in basic social services and infrastructure.

Directors commended the authorities for reducing customs tariffs by implementing the first two stages of the Caribbean Common Market (CARICOM) agreement. They urged the authorities to eliminate promptly existing quantitative import restrictions. Directors welcomed the introduction of measures to strengthen banking supervision and prudential regulations.

Directors were of the view that the sustainability of the exchange rate peg depended crucially on the strengthening of the fiscal position, and on wage restraint. In addition, Directors observed that, while credit tightening could help in protecting Belize's international reserves position, it could not substitute for the needed fiscal adjustment.

A few Directors urged the authorities to develop an adjustment program that could be supported by the IMF.

Tunisia

The IMF Executive Board on May 23, 1997, concluded the 1997 Article IV consultation with Tunisia.

Background

During the period of the Eighth Development Plan (1992–96), Tunisia achieved annual economic growth of 4.5 percent on average, supported by steady implementation of comprehensive structural reforms and generally prudent macroeconomic policies. Financial imbalances narrowed and social indicators continued to improve, consistent with Tunisia's emphasis within public expenditure on health and education. Inflation decelerated to less than 5 percent per year on average, and external debt declined from 55 to 52 percent of GDP between 1991 and 1996. Exports of goods and nonfactor services grew on average by 6.2 percent a year, and Tunisia maintained a broadly constant share of world merchandise exports.

However, the unemployment rate remained high at about 15 percent, as economic growth fell short of the objective (6 percent). Investment, in particular by the private sector and in manufacturing, was lower than expected. Total factor productivity also improved by less than had been programmed, partly owing to the impact of drought on agriculture but also reflecting the gradual pace of structural reforms aimed at improving the functioning of domestic markets, opening the economy, and enhancing the role of the private sector.

In 1996, economic growth reached 6.9 percent reflecting the recovery in agriculture from two years of drought. Inflation fell and the external accounts improved significantly. However, fiscal performance was weaker than programmed and monetary and credit policies were more expansionary than envisaged. Notwithstanding the strong economic rebound, the government deficit (including social security operations) rose to 4.7 percent of GDP, from 4.4 percent of GDP in 1995. Revenue declined slightly, despite an increase in social security contributions by half a percent of GDP. Expenditure and net lending as a share of GDP remained unchanged from the previous year, although it exceeded the budgeted amount. Broad money expanded by 13.7 percent, notwithstanding continued repayments by the government of its outstanding bank credit; commercial banks continued strong provisioning for nonperforming loans.

Structural reforms proceeded, with solid progress in trade liberalization and the financial sector. Tariffs were lowered, including the first round of tariff reductions envisaged under the Association Agreement with the European Union, and quantitative import restrictions were reduced. The liberalization of bank lending interest rates was completed with the elimination of mandatory lending to priority sectors and associated preferential interest and refinancing rates. Privatization accelerated, mainly focusing on small enterprises. Further steps were made toward involving the private sector in activities previously reserved for public enterprises, through contracting out and the granting of concessions. To facilitate the implementation of structural reforms, social safety net provisions were also strengthened.

Executive Board Assessment

Executive Directors commended the authorities for maintaining macroeconomic stability while pursuing structural reforms aimed at establishing an open, market-based, and private sector driven economy. Directors welcomed the authorities' intention to build on their achievements and to direct their medium-term strategy, as laid out in the draft Ninth Economic Development Plan, toward accelerating integration into the world economy, increasing the role of market forces, and widening the scope for private sector activity, while pursuing prudent macroeconomic policies. At the same time, Directors considered that further fiscal consolidation and a broadening and acceleration of structural reforms were needed to realize the authorities' medium-term growth and employment objectives.

Directors stressed the need for further fiscal consolidation to preserve macroeconomic stability, free additional resources for private sector investment, and strengthen growth prospects. Some Directors expressed concern about the slippages in fiscal performance in 1996 with expenditure overruns and revenue shortfalls, especially against the background of robust growth. Directors welcomed the mini-budget being prepared by the authorities as a step in the right direction, but some thought that a more ambitious and front-loaded package might be needed. Directors stressed the need to reduce and better control spending, particularly with regard to wages, subsidies, and nonproductive spending. In that context, they highlighted the importance of a comprehensive reform of the civil service and a better targeted and rational-

Correction: In the May 26 issue of the *IMF Survey*, page 160, the article describing a proposal for an international banking standard was contributed by Gita Bhatt, External Relations Department.

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ized system for food subsidies. On the revenue side, Directors suggested the early implementation of measures, including raising prices of fuel and basic foodstuffs, eliminating exemptions and broadening the coverage of the value-added tax, raising excises or value-added tax rates, and improving tax administration. In addition, some Directors also pointed to the need to identify and implement in a timely manner contingency measures to offset anticipated losses in tariff revenues.

Noting that the authorities had taken measures to correct the excessive growth of monetary aggregates in 1996, Directors emphasized the need for a tight monetary policy to contain inflationary pressures. They supported the authorities' exchange rate policy and observed that competitiveness should be maintained through firm monetary and wage policies and improvements in productivity. They encouraged the authorities to widen the role of market forces in the interbank market for foreign exchange.

Directors welcomed the Association Agreement with the European Union and observed that it provided opportunities and challenges for the Tunisian economy. Reaping the full benefits of globalization and minimizing the transitional costs would require comprehensive structural reforms. Directors recommended labor market reforms, including greater flexibility in layoff procedures to ease the movement of labor toward sectors of comparative advantage. Directors were encouraged by the authorities' intention to further reduce public sector involvement in the economy and disincentives to private investment. Further relaxation of regulations on foreign investment would help attract foreign direct investment, facilitate technology transfers, and improve access to markets abroad. Directors noted that already agreed wage increases for the next three years underscored the importance of improving productivity. Directors called for an acceleration and deepening of the privatization program, in particular through a broader sectoral coverage, a more effective implementation mechanism, and extending privatization to larger enterprises. They also stressed the need to lift remaining price controls.

To help avoid possible trade diversion effects and transitional increases in effective protection, some Directors recommended that import liberalization be extended on a broader geographical basis, and that tariff reduction for finished goods imports be advanced with respect to the existing schedule. More generally, noting that the level of effective protection remained relatively high, some Directors urged a faster pace of trade liberalization. Directors also urged that remaining quantitative import restrictions be abolished rapidly. It was observed that experience had shown that regional trade integration was most beneficial in the context of an open trading system vis-à-vis the rest of the world.

Directors commended the authorities' progress in reforming the financial sector, but stressed the need for strong banking supervision and strict enforcement of prudential regulations, which were of utmost importance in setting the ground for the development of a competitive and sound financial system. Directors noted that the removal of remaining controls on deposit interest rates and the establishment of a well-functioning and clearly regulated settlement system in the secondary market for treasury paper would enhance the financial system's ability to mobilize savings, intermediate resources efficiently, and prepare the move to full capital account convertibility.

Directors encouraged the authorities to continue their efforts to strengthen data dissemination and eventually subscribe to SDDS, and to improve data provision to the Fund. ■

Tunisia: Selected Economic Indicators

	1993	1994	1995	1996[1]
		(percent)		
Domestic Economy				
Real GDP	2.2	3.3	2.4	6.9
GDP deflator	4.7	4.4	5.1	4.4
Consumer price index (CPI), average	4.0	4.7	6.3	3.7
		(million U.S. dollars)[2]		
External Economy				
Exports, f.o.b.	3,745.0	4,644.0	5,469.0	5,519.0
Imports, f.o.b.	5,756.0	6,211.0	7,458.0	7,324.0
Current account, excluding capital grants (percent)	–8.8	–4.2	–4.6	–3.0
Foreign direct investment[3]	390.0	308.0	194.0	163.0
Capital account balance	1,270.0	1,171.0	963.0	961.0
External debt	7,694.0	8,839.0	9,848.0	9,900.0
Gross official reserves	888.0	1,480.0	1,633.0	1,858.0
Debt service ratio, (percent of current external receipts)	20.4	18.6	18.4	18.9
Real effective exchange rate (depreciation –)	–3.7	0.7	2.1	0.5
		(percent of GDP)[2]		
Financial Variables				
Gross saving	19.8	20.1	19.9	21.7
Gross domestic investment	29.2	24.5	24.6	24.6
Change in money and quasi-money (M2)	7.0	7.8	6.0	13.7
Interest rate (money market, in percent)	10.5	8.8	8.8	7.8

[1]IMF staff estimates.
[2]Unless otherwise noted.
[3]In 1993 and 1994, include large inflows related to the building of a transmediterranean pipeline (Gazoduc) and development of an offshore gasfield (Miskar).

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