IMFSURVEY

www.imf.org

International Monetary Fund
VOLUME 30
NUMBER 12

June 18, 2001

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New appointments

Köhler names new First Deputy Managing Director, announces selection of three department heads

On June 7, IMF Managing Director Horst Köhler announced the appointments of the new First Deputy Managing Director and three department heads. The full text of IMF Press Release No. 01/27 is available on the IMF's website (www.imf.org).

IMF Managing Director Horst Köhler has proposed the appointment of Anne O. Krueger, a distinguished international economist at Stanford University and former Vice President of the World Bank, to the position of First Deputy Managing Director to succeed Stanley Fischer, who previously announced his decision to leave the IMF later this year (see *IMF Survey*, May 21, page 167). The Managing Director has also notified the Executive Board that he intends to appoint Directors for the Research Department, the Policy Development and Review Department, and the newly created International Capital Markets (ICM) Department.

Gerd Häusler, former chair of Dresdner Bank AG's investment banking arm and a member of the banking group's managing board, would be Counsellor and Director of the ICM Department, which was created earlier this year to consolidate a range of functions previously spread among three IMF departments (see *IMF Survey*, March 19, page 85). Harvard University economist Kenneth S. Rogoff, an authority on international economics, would become Economic Counsellor and Director of the IMF's Research Department, succeeding Michael Mussa. Timothy Geithner, former U.S. Treasury Undersecretary for International Affairs and currently a Senior Fellow for International Economics at the Council of Foreign Relations, would become Director of the Policy Development and Review Department, succeeding Jack Boorman.

"I look forward to working with these four outstanding individuals," Köhler stated. "With their extensive expertise in economics, international capital markets, and high-level policymaking, Anne Krueger, Gerd Häusler, Kenneth Rogoff, and Timothy Geithner will join current management and senior staff in leading the IMF as we serve our membership and confront the challenges of the global economy. Together, they will build on the contributions of their distinguished predecessors, Stanley Fischer, Michael Mussa, and Jack Boorman. At a time of important change for the IMF, we are confident we have the right team in place."

The appointments are expected to take effect over the course of the summer. The appointment of Anne Krueger, which is to a five-year term, requires Executive Board approval.

Anne O. Krueger: a U.S. national, is the Herald L. and Caroline L. Ritch Professor in Humanities and Sciences in the Department of Economics, and the Director of the Center for Research on Economic Development and Policy Reform, and a Senior Fellow of the Hoover Institution at Stanford.

She is a Distinguished Fellow and past President of the American

(Please turn to the following page)

(Continued from front page) Economic Association, a member of the National Academy of Sciences, and a Research Associate of the National Bureau of Economic Research. Krueger, who has received a number of economic prizes and awards, has published extensively on issues related to financial institutions, economic development, international trade, and the role of multilateral institutions in the international economy. She is also a former chief economist of the World Bank and has held positions at Duke University and the University of Minnesota. She received her Ph.D. at the University of Wisconsin.

As First Deputy Managing Director, Krueger will have wide-ranging responsibilities at the IMF, including chairing Executive Board meetings in the absence of the Managing Director and country-specific and operational functions. She will be a leading member of the IMF's management team headed by Köhler and including Deputy Managing Directors Eduardo Aninat and Shigemitsu Sugisaki.

Gerd Häusler, a German national, is currently a Senior Advisor on strategic issues to Deutsche Börse AG in Frankfurt. He has a range of public and private sector experience, including serving as a member of the Directorate and member of the Central Bank Council of the Deutsche Bundesbank. He also held various positions with the Bundesbank, which included an active responsibility for work on international capital markets issues and reforms. He also served at the Bank for International Settlements. At Dresdner Bank AG, Häusler oversaw its global markets activities worldwide and had overall responsibilities for operations in North America, the Asia-Pacific region, Australia, and the United Kingdom. He served as chair of Dresdner Kleinwort Benson in London from December 1997 until his resignation from the Dresdner Group in May 2000.

Häusler has been a member of the Supervisory Boards of ARBED S.A. in Luxembourg and ESSO Deutschland GmbH, and has served on the boards of directors of a number of German companies. He also has been a member of the German Stock Exchange Advisory Panel, the German Takeover Panel, the International Advisory Committee of the Federal Reserve Bank of New York, and the Group of Thirty. In addition, he was a director of the Institute of International Finance in Washington, D.C. Häusler studied law and economics and holds a law degree from the University of Frankfurt.

Kenneth S. Rogoff, a U.S. national, has published extensively on international economic issues, including, with Maurice Obstfeld, *Foundations of International Macroeconomics*, which is a leading graduate text in the field. He has been a Professor of Economics at Harvard University since September 1999. Prior to that, he held positions at Princeton University, the University of California at Berkeley, and the University of Wisconsin-Madison. Rogoff also served in the International Finance Division of the Board of Governors of the U.S. Federal Reserve System and as an Economist in the Research Department of the IMF, and has held consulting positions with the IMF and the World Bank. He is currently a Research Associate at the National Bureau of Economic Research, coeditor of *NBER Macroeconomics Annual*, and is a former Guggenheim Fellow. Rogoff holds a Ph.D. from the Massachusetts Institute of Technology.

Timothy Geithner, a U.S. national, served in senior U.S. treasury positions from 1997 to 2001. From 1998 to 2001, he was the principal subcabinet-level official on international economic issues, responding, among other things, to international economic and financial crises. He joined the U.S. Treasury as a career civil servant in 1988 and held a variety of positions, including Assistant Financial Attaché at the U.S. Embassy in Tokyo, before appointments to a number of senior positions. Before joining the U.S. Treasury, Geithner was employed by Kissinger Associates. He holds an M.A. degree in international economics and East Asian studies from the Johns Hopkins School for Advanced International Studies, and a B.A. in government and Asian studies from Dartmouth College. ■

IMF releases Managing Director's statement on Board's work program

For the first time, the IMF has released the statement by the Managing Director on the work program of the Executive Board, according to a press release dated June 8. The semiannual document outlines the agenda of policy discussions of the Executive Board during the period leading up to the Annual Meetings of the Boards of Governors of the World Bank Group and the IMF in October 2001. Köhler's statement is available on the IMF website at www.imf.org, as is the text of Press Release No. 01/28.

The Executive Board, with the Managing Director as Chairman, consists of the 24 officials appointed or elected by the IMF's 183 member countries. The Board meets regularly to assess developments at the national, regional, and global levels; to discuss policy issues concerning the international economic and financial system; and to decide on the IMF's loans to member countries.

Summaries of the work program have been released to the public semiannually since July 1999, most recently as News Brief No. 00/102.

Fischer asks if new IMF reforms could have eased Asian crisis, stresses region's future role

On June 1, IMF First Deputy Managing Director Stanley Fischer addressed the Institute of Policy Studies on Asia and the IMF. Following are edited excerpts of his remarks. The full text is available on the IMF's website (www.imf.org).

Following the Mexican crisis, and more intensively after the Asian and Russian crises, the IMF entered a period of far-reaching reform, which is still continuing. The reforms aim to help us prevent crises where we can and mitigate their effects where we cannot.

Crisis prevention

In its crisis prevention efforts, the IMF has responded to the enhanced role of the capital account in financial crises by taking steps in three areas:

Surveillance and the financial sector. The IMF has sharpened its scrutiny of national policies and international markets, focusing in particular on developments that can leave countries vulnerable to crisis. Of all the changes that have taken place in the IMF in recent years, the increase in two-way transparency between the IMF and the outside world is the most significant. Transparency not only helps ensure better-informed citizens and investors, but also encourages policymakers to strengthen their policies and institutions.

The structure of external debt and financial sector weaknesses played key roles in exacerbating capital account crises. We have significantly stepped up our surveillance of external vulnerabilities, including through scrutiny of the national balance sheet, particularly external debt and reserves, and the strength of financial systems, most notably through the Financial Sector Assessment Program. IMF surveillance is also being given greater focus and structure by the development of international standards and codes of conduct, monitored by the IMF or other relevant bodies.

The new International Capital Markets (ICM) Department is evidence of the increased attention the IMF is paying to surveillance over international capital flows. Our interactions with the capital markets have also been enhanced through the creation of the Capital Markets Consultative Group.

Exchange rate and capital account regimes. Every major financial crisis since Mexico's in 1994 has in some way involved a fixed or a pegged exchange rate regime. Having said this, floating exchange rates are not sufficient to prevent crises, and I do not imply that policymakers can or should be indifferent to the exchange rate or necessarily refrain totally from intervention in the foreign exchange markets. If a country decides to float, it must decide on the monetary policy it will follow. Inflation targeting, which many recent converts have chosen, seems to be working well and has much to commend it.

On capital account regimes, it is surely no coincidence that the most advanced economies all have open capital accounts. The IMF has cautiously supported the use of market-based controls on inflows in some emerging markets. The controls seem to have been successful for a time in allowing some monetary policy independence and in shifting the composition of capital inflows away from short-term debt. But empirical evidence suggests that they lose their effectiveness over time.

Capital controls may at times appear attractive, especially during a crisis, but it is telling that even among the countries worst affected by the crises, almost all have resisted the temptation to close themselves off. When push comes to shove, policymakers have abandoned fixed exchange rates before capital mobility—and they have been wise to do so.

Foreign reserves and Contingent Credit Lines. The growth of international capital flows has prompted a rethinking of the way we assess the adequacy of a country's reserves. In an era when crises are more likely to arise from the capital account than the current account, it makes more sense to argue that countries with open capital accounts need reserves sufficient to cover their short-term debt rather than three or four months of imports. In the Asian crisis, countries with very large reserves generally did better in avoiding the worst of the crisis than those with smaller reserves.

A potential source of supplementary reserves is the IMF's recently enhanced Contingent Credit Line Facility, which offers precautionary credit lines to countries with demonstrably sound policies that nonetheless feel threatened by contagion.

Crisis response

I will describe three recent changes in the IMF's response to crises:

The SRF. The SRF was introduced at the end of 1997 to enable the IMF to respond better to capital account–driven crises. Reflecting the potentially large need for financing, there are no formal limits on access to SRF resources. Reflecting the lender of last resort doctrine, SRF loans carry a significantly higher charge than normal Stand-By Arrangements (with the interest charged rising the longer the loan is outstanding). And, reflecting the likelihood that confidence can be restored relatively quickly, SRF loans also have a shorter repayment period than the normal Stand-By Arrangement.

Narrowing the scope of conditionality. Notwithstanding the importance of structural policies in the

countries to which we lend, there is general agreement that our conditionality in this area has sometimes been too extensive and restrictive. Broader programs are more difficult for the IMF to monitor and for the member country to implement. Excessive conditionality may also undermine a country's ownership of the program. We are seeking to focus our conditionality on the IMF's key areas of responsibility: monetary, fiscal, and exchange rate policies, and the financial sector, and on those structural measures that are critical to achieving the macroeconomic objectives of the program.

Private sector involvement. This issue remains one of the thorniest on the IMF's agenda. The goal is to ensure that the private sector contributes to the resolution of financial crises by providing financing, rather than exacerbating the crisis by seeking to withdraw funds at the same time as the public sector is injecting them. More graphically, the argument is that the public sector should not bail out the private sector. The IMF framework seeks to rely on the catalytic approach and voluntary private sector involvement in cases of normal access to IMF resources and in cases of exceptional access where the crisis is likely to be quickly reversed because it is fundamentally one of liquidity. Where the balance of payments outlook over the medium term is not viable without debt restructuring, a coordinated approach will have to be made to ensure private sector involvement. In certain extreme cases, a temporary payments suspension or standstill may be unavoidable.

Revisiting the Asian crisis

What difference might all these changes have made to the course of the Asian financial crisis if they had been in place in 1996? We cannot know, but let me speculate.

First, the exchange rate regime. If exchange rates had been flexible, Asian currencies would have appreciated less in late 1996 than they did as the dollar appreciated. The balance of payments difficulties faced in early 1997 by the countries that later went into crisis would therefore have been mitigated. Further, with more flexible exchange rates, short-term capital inflows—and the subsequent outflows—would probably have been smaller. And neither Thailand nor Korea would have used up essentially all their foreign exchange reserves to defend the exchange rate.

Second, if there had been more transparency, with reserves data meeting the standards of the Special Data Dissemination Standard, far more would have been known about the state of the foreign reserves in the crisis countries. This, too, could have prevented countries using up all their reserves and would have forced earlier action on the exchange rate. Further, more would have been known about the composition of external debts. That should have cut off capital inflows earlier and therefore reduced the disruption caused by subsequent outflows.

Third, if more attention had been focused on the health of the financial system, action could have been taken earlier to begin strengthening weak institutions, avoiding or reducing the extent of liquidity support that was extended in all the crisis countries. For instance, it would have been possible in Indonesia to begin dealing with weak banks before the crisis began and to have been better prepared with bank resolution mechanisms. It would also have been possible to spot the deterioration of corporate finances, and it might have been possible to begin dealing earlier with the disastrous interaction of corporate financial and banking sector weaknesses.

Fourth, if IMF surveillance had been more vigilant, and more attuned to market developments, it is possible that the financial attack on Korea would have rung the alarm bells a month or two earlier than November 1997, and perhaps the Korean government could have been persuaded to let the exchange rate float earlier. In Thailand, we would probably have struck a different balance in informing markets about our increasingly urgent dialogue with the authorities there in the run-up to the crisis.

Perhaps all this means that it would have been possible to advance adjustment, thereby mitigating if not preventing the crisis, if the crisis prevention measures taken since the crisis had been in place in 1996. I do believe that the crisis would have been far less virulent if exchange rates had been floating for some years before 1997. But *the changes would only have made a difference if it had been possible to persuade governments to act in time*. It is not clear that would have happened. After all, many of the warning signs were around before the crisis: some of them were brought to the attention of governments, and others must have been known to governments (including central banks) even though they were not made public.

Why did governments not act? That is hard to know. Some may have been lulled into a false sense of security by many years of success. They had surely heard many earlier warnings of disasters, which had failed to materialize. Some of the governments were politically weak. Some of them were caught up in the familiar syndrome in which an exchange rate peg takes on a political significance that transcends its economic importance. And some of them must have thought that any action they might take would only precipitate the crisis they were trying to avoid.

The interactions between politics and economics in any economic crisis are illustrated by the striking fact that in all three IMF-supported programs in Asia in 1997–98, the economy began to turn only when new governments came into power: first in Thailand, then in Korea, and last, and with the most disruption, in Indonesia in May 1998.

Next, what would have happened had the crises played out exactly as they did to the point where coun-

The crisis would have been far less virulent if exchange rates had been floating for some years before 1997. But *the changes would only have made a difference if it had been possible to persuade governments to act in time.*

—Stanley Fischer

tries turned to the IMF for assistance, but the subsequent changes in methods of crisis response had then been in place. First, conditionality would have been more focused—on macroeconomics, on the exchange rate, and on financial sector restructuring. On the macroeconomic side, we would probably not have asked for as much fiscal tightening as we did initially—though that request was soon reversed in the Thai and other cases.

On the structural side, we would certainly still have urged rapid progress on financial sector restructuring. And we would have worked with greater urgency with the World Bank to try to ensure rapid progress on corporate restructuring. That is to say that the core of structural conditionality in IMF-supported programs would not have been very different; but some other desirable, but not critical, policy changes would probably have been omitted from the programs.

Quite likely, we would have sought to involve the private sector more rapidly in all cases—that would have saved a few weeks in Korea and a few months and some distress in Indonesia and Thailand—and we would have had debt-monitoring systems ready. Possibly, had the SRF then existed, we would have suggested making it available to Thailand. All this means that capital outflows might have been better contained than they were, and exchange rates would likely have stabilized even more quickly than they did.

In brief, with today's methods of crisis response, the crisis would have been better handled. But there is again a "but." *The core structural measures in the Asian crisis countries involved financial and corporate sector restructuring. Those are still the main items on the policy agenda, and it is proving very difficult for the affected governments to implement those reforms thoroughly.* Thus, it is unlikely that conditionality would have been better implemented even had it been focused on these key measures. Nor are the governments of the crisis countries unique in their reluctance to move speedily on financial sector reforms, for governments all over the world are slow to undertake such politically difficult structural changes, be they in Japan at present, or Russia over the past few years, or the United States during the savings and loan crisis of the 1980s. Nonetheless, it remains urgent to move determinedly ahead on these fronts.

Asia and the IMF: looking ahead

In the wake of the crisis, Asian countries are moving to put in place new regional arrangements, including various swaps, and are considering alternative currency arrangements. The management of the IMF welcomes this enhanced regional cooperation, which should be complementary to more global arrangements, such as the IMF. We see potential advantages in regional currency cooperation, even though it will likely take many years—perhaps as many as it took in Europe—for such arrangements to come to fruition.

The IMF stands ready to cooperate fully in helping make these regional arrangements more effective—for instance, by assisting in the surveillance process and by cooperating in the financing arrangements envisaged under ASEAN [Association of South East Asian Nations] + 3 [China, Japan, Korea], where the activation of loans beyond 10 percent of the agreed lines will take place in the context of IMF-supported programs. And, to be sure, the lessons learned from recent crises will be applied when these programs are negotiated.

More also needs to be done to enhance the role of Asian countries in the working of the IMF. The underrepresentation of Asia in the IMF's quotas is indeed a serious problem—recently somewhat mitigated by increasing China's quota to reflect the return of Hong Kong SAR. But votes are rarely taken in the Executive Board of the IMF, and the effectiveness of Executive Directors is more related to their persuasiveness than to the size of their vote. Asia has 5 out of the 24 seats in the Board (Japan, China, and constituencies headed respectively by India, Indonesia, and Australia/Korea). It is important, if Asia's voice is to be heard, that these positions be occupied consistently by the highest quality candidates, and that the countries they represent take a lively interest in the matters discussed in the Board and seek to develop independent policy positions on the key issues. Japan, our second largest member, always plays an important role in guiding the institution.

Since the Executive Board far prefers making decisions by consensus than by voting power, those directors who have coherent positions and the ability to advance them will usually see their views reflected in IMF positions on the issues.

It is also important that the IMF appoint more staff members from currently underrepresented Asian countries. This appears to be a matter more of supply than of demand, for the IMF is always on the lookout for qualified candidates for its staff. Many countries in other regions, and some in Asia, see an appointment to the staff of the IMF for some years as an important way to build up needed human capital about the international financial system inside their governments.

The IMF as a global institution is incomplete if Asia is not playing a full role. I believe Asia needs the IMF if it is to continue to benefit, as it has so spectacularly over the years from its integration into the global economy. For one thing, there is much unfinished business left over from the crisis, including how best to reduce the volatility of international capital flows—an issue on which we have to make further progress. Moreover, while we have implicitly been concentrating on emerging market countries, we also need to ensure that countries in Asia and elsewhere that have not so far been able to enjoy the benefits of integration into the global economy can do so.

To sum up: there is much for the IMF to do in Asia, and much for Asian countries to do inside the IMF. ■

National economy

Hong Kong SAR's strong fundamentals, policies generate quick recovery from Asian crisis

The Asian financial crisis hit the Hong Kong Special Administrative Region (SAR) with full force, despite the economy's strong fundamentals. Its open economy underwent a painful economic and financial adjustment, with periods of intense pressure on its currency board (or "linked") exchange rate system. In accordance with the currency board arrangement, the adjustment took the form of deep asset price deflation, recession, and record unemployment.

But Hong Kong SAR's economy demonstrated remarkable resilience and recovered from the crisis relatively quickly, aided by the authorities' skillful stewardship of the economy. To mitigate the impact of the external shock, the authorities implemented a number of policy measures, including structural reforms to enhance the economy's competitiveness and long-term prospects. Hong Kong SAR's strong fundamentals—sound bank and corporate balance sheets, strong fiscal position and regulatory and supervisory framework, impressive policy track record, and flexible markets—served the economy well. Strong fundamentals and timely policy measures ultimately proved the key to minimizing the adjustment costs associated with the linked exchange rate system.

Contagion and financial crisis

Hong Kong's exceptional openness—including its capital accounts and sizable cross-border financial flows, and its leading role as financial, business, and trade center for the region—exposed the economy to the financial turmoil that began in Thailand in mid-1997 and quickly swept through the region. The Hong Kong dollar, which was linked to the value of the U.S. dollar, came under speculative attack repeatedly between 1997 and 1998. In each case, liquidity conditions tightened and interest rates increased, which led to a quick reversal of capital outflows, as would be expected under a linked exchange rate system. But the "on-and-off" attacks left their marks—the risk premium stayed at higher levels, financial market volatility rose, and asset prices deflated—and had knock-on effects on the real economy, including the banking and corporate sectors.

The first major attack on the Hong Kong financial markets occurred in October 1997. Speculators launched a massive short-selling of the Hong Kong dollar following the floating of the New Taiwan dollar. In response, short-term interest rates rose sharply with a substantial impact on the asset market. Hong Kong SAR's stock market plummeted by more than 10 percent on a single day. But the decision to allow short-term interest rates to rise sharply helped arrest the speculative capital outflow, and pressure on the Hong Kong dollar subsequently abated.

In the aftermath of the October 1997 attack, however, financial market conditions remained volatile. The Hong Kong dollar came under renewed pressure several times as market sentiment toward the region deteriorated sharply (with Indonesia and Korea calling for rescue packages and mainland China's economic outlook weakening) and market concerns of a potential renminbi devaluation rose. As a result, the differential between one-month Hong Kong dollar and U.S. dollar interest rates widened to 230 basis points on average in the first half of 1998, compared with 20 basis points over the same period in 1997. Asset prices also continued to drift downward, and the rapidly deteriorating external conditions spilled over to the real economy.

In August 1998, the linked exchange rate system again came under pressure—the heaviest since October 1997—as market turbulence intensified internationally. Stock and futures prices plummeted, with the stock market falling off almost 25 percent from its mid-July level. With speculators taking short positions on the stock and futures markets as well as on the Hong Kong dollar, interest rates rose and remained high for several weeks.

Market conditions subsequently stabilized, aided by favorable developments in international markets and an improved economic outlook for the region. The risk premium virtually disappeared by the end of the year and the foreign reserves of the Hong Kong Monetary Authority rose.

Economic adjustment and recovery

The rapidly deteriorating external conditions, the rise in interest rates, and the real appreciation of the Hong Kong dollar spilled over to the real economy, causing economic activity to slow sharply and triggering a deflation of the asset price bubble that had emerged in 1997. Real GDP growth turned negative by the fourth quarter, and one quarter later the economy was in a recession that would last five full quarters. In 1998, the economy experienced its first annual contraction in over three decades, and unemployment rose to unprecedented levels.

With the value of the Hong Kong dollar fixed against the U.S dollar, adjustment and a restoration of external competitiveness had to take place through price and cost deflation and productivity gains. Indeed, the adjustment proceeded rapidly, reflecting the underlying flexibility of the economy. Asset prices adjusted immediately, as higher interest rates and the uncertain outlook burst the

asset price bubble. By mid-1998, property prices were down about 40 percent from their peak a year earlier.

The asset price deflation and the weaker economy spread to consumer and factor prices, causing inflation to turn negative around mid-1998. Rentals adjusted with a lag to the correction in property prices, owing to the prevalence of two- to three-year lease contracts, but nonetheless have fallen sharply since their peak in mid-1998. Although labor costs adjusted more slowly, they did moderate—largely through higher layoffs, slower wage growth, and sharp cutbacks in bonuses. Layoffs affected primarily unskilled workers, reflecting companies' efforts to streamline their operations to achieve higher productivity growth. By late 1999, the Hong Kong dollar in real terms had reversed all of the overvaluation resulting from the Asian crisis, aided by declining domestic prices and the appreciation of the yen and other regional currencies, and the real effective exchange rate returned to precrisis levels.

Signs of a recovery began to emerge in the first half of 1999. Initially, these were visible in the asset markets, with a sharp rise in equity prices, driven in part by foreign capital inflows; a marked decline in the risk premium; and a stabilizing of property prices. The market firming then set the stage for a recovery in the real sector. At first, the recovery was led by exports aided by the pickup in the regional economy, but private consumption and eventually investment rebounded strongly as well. Although the unemployment rate fell gradually from its mid-1999 peak, it still remains above its precrisis levels. As the economy turned the corner, the government also prudently moved away from an expansionary fiscal stance to achieve a balanced budget over the medium term.

Domestic prices have continued to adjust downward, however. Although deflation began to ease from mid-2000 onward in line with the strong recovery, the continued decline in consumer prices largely reflected the lagged response of housing rentals to the correction in real estate prices and imported deflation from the mainland. Prices have declined now for 30 consecutive months and prices have slipped to 1996 levels.

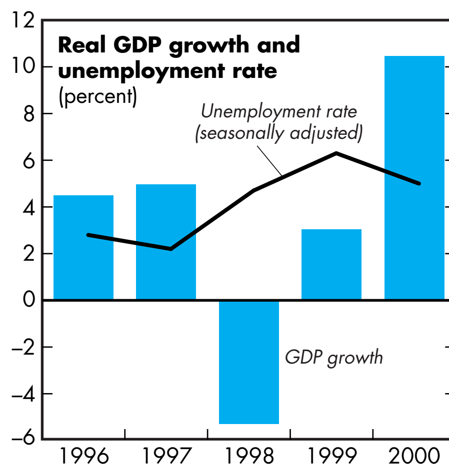
Policy response

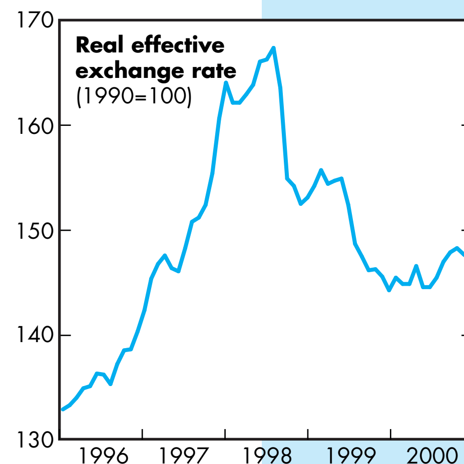
Because a currency board arrangement precludes the use of exchange rate or interest rate policy to buffer the economy against an external shock, Hong Kong SAR's fiscal policy bore the adjustment burden. In mid-1998, the authorities announced a major package of measures designed to strengthen confidence and mitigate the impact of the crisis on the economy and the property market.

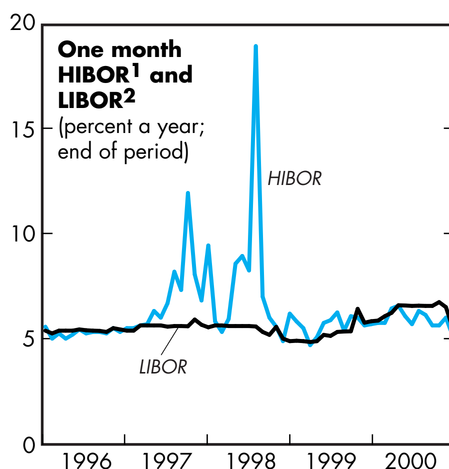
The 1998 budget adopted a temporary fiscal expansion of tax concessions and spending increases, including additional job creation and retraining programs. The authorities also took measures to stem the decline in property prices, suspending government land sales, scaling back production of public housing units, and removing or suspending several measures aimed at curbing real estate speculation. To improve credit and liquidity conditions, the authorities moved to exempt interest income on onshore deposits from corporate taxes to encourage repatriation of offshore funds. These steps, along with weaker revenue projections, led to a sharp budget deterioration.

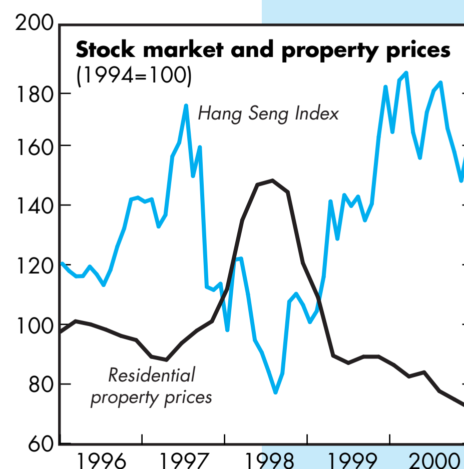
The speculative attack in August 1998 prompted the authorities to take a more proactive, albeit unorthodox, set of actions. Suspecting market manipulation by a few large investors and fearing an erosion of con-

Hong Kong SAR: selected economic indicators, 1996–2000









[1]HIBOR is Hong Kong interbank offered rate.
[2]LIBOR is London interbank offered rate.

Data: Hong Kong SAR authorities and IMF staff estimates

fidence in financial markets, the authorities intervened directly in the stock and futures markets, purchasing HK$118 billion (US$15 billion) in stock—the equivalent of over 130 percent of July's stock market turnover, part of which was financed with the sales of the government's foreign currency assets.

Hong Kong SAR's unorthodox stock market intervention stirred concern that this might signal a departure from the government's traditional noninterventionist approach to the economy and thus undermine the functioning of the securities market and Hong Kong SAR's position as a leading international center. The authorities quickly addressed these concerns, announcing that the government would divest, in an orderly and transparent manner, the equity holdings it had acquired in the intervention. The government immediately sought professional outside guidance and established an independent company to manage and work out a transparent liquidation strategy for the government's shareholdings. The authorities also announced that they would reduce their equity holdings to 5 percent of the government's total asset holdings, including the international reserves. In November 1999, the authorities successfully launched the Tracker Fund, a listed investment vehicle linked to the Hang Seng Index (that is, the broad market index), under which 18 percent of the government's equity holdings (US$4 billion) were sold in the initial public offering. The divestment of stocks has progressed smoothly. So far, about a third of the government's holdings have been sold at a substantial profit.

Immediately following the August 1998 intervention, the authorities also implemented a number of reforms to strengthen the transparency and operations of the exchange rate system. These reforms included a formal announcement that the Hong Kong Monetary Authority would convert all banks' clearing balances into U.S dollars at the fixed rate of HK$7.8 and establish a discount facility. These measures were aimed at redressing operational features that had fueled interest rate volatility in the interbank market.

Moreover, the authorities introduced several securities market reforms designed to enhance transparency and improve the functioning of the markets, as well as increase the cost of speculative activity. These measures included tighter enforcement rules on short-selling and settlement of trades and an increase in margin requirements for investors holding large open positions in futures markets; enhanced disclosure requirements; increased penalties for illegal trading or reporting; and enhanced cross-market supervision through increased coordination among the regulatory agencies.

As part of the new international financial architecture, the authorities have also been pushing for greater disclosure requirements for highly leveraged institutions. Their concern is based on the potential destabilizing impact such investors can have on medium-sized markets (the "elephant in the pond" problem), such as Hong Kong SAR's. Although some progress has been achieved (for instance, the Financial Stability Forum's report on highly leveraged institutions recommends better risk management and disclosure practices for these investors), the Hong Kong SAR authorities view these measures as less than sufficient in addressing their concerns and would like to see even greater transparency.

Looking ahead

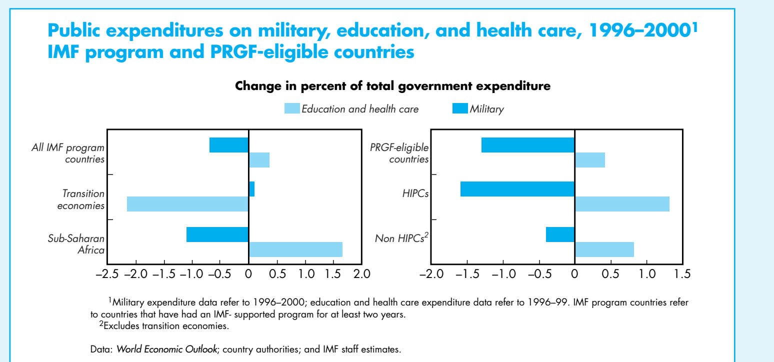
Although financial market stability returned and the economy achieved an impressive recovery, the government has continued to press forward with reforms—notably in the financial markets—to enhance Hong Kong SAR's standing as a world-class financial center in an increasingly competitive global environment.

While the short-term economic outlook is clouded by the global slowdown, the economy's medium-term prospects are bright. Although the economy will face major structural challenges, largely because of China's prospective accession to the World Trade Organization, the swift and smooth return of Hong Kong SAR to Chinese sovereignty (July 1, 1997) and the economy's rapid recovery from the Asian financial crisis once again demonstrate Hong Kong SAR's remarkable strength and resilience in the face of change and adverse external shocks. The economy is continuing to adapt quickly and flexibly, aided by its reputation as one of the most transparent, efficiently managed, and open economies. ■

Jeanne Gobat
IMF Asia and Pacific Department

Correction

The bottom two panels of the chart accompanying the story on military spending in the June 4 *IMF Survey* (pages 194–96) contained an error. The correct version of these two panels is shown below.



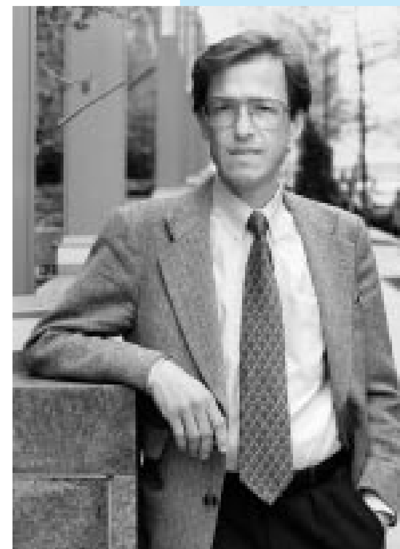
Good governance now widely seen as essential; IMF places emphasis on prevention of corruption

On February 14, the IMF's Executive Board reviewed the experience the organization had had with governance since it issued a Guidance Note on the topic in 1997. The Board discussion was based on a background paper prepared by a team of Development Issues Division staff in the IMF's Policy Development and Review Department. Louis Dicks-Mireaux, Deputy Chief of the Development Issues Division, coordinated the study and speaks here about the growing awareness of the importance of good governance for macroeconomic stability and growth and the IMF's experience with governance in the context of its work with member countries.

IMF Survey: What prompted the IMF to issue the Guidance Note on governance in 1997, and what did the recent review of IMF experience with governance hope to achieve?

Dicks-Mireaux: The 1997 Guidance Note, which was preceded by a series of Executive Board discussions during 1996, stemmed from a growing recognition—both in our dialogue with countries and in empirical research—that good governance is important for macroeconomic stability and growth. We were bumping up against governance issues increasingly in our work and felt we needed a framework in which to operate.

In the early stages, we—and the rest of the international community—were feeling our way. Reflecting this, the 1997 Guidance Note was cast in fairly general terms. It called for a more comprehensive and more proactive approach to governance, but it also called for periodic reviews to evaluate our experience. The review that was completed earlier this year and discussed by the IMF's Executive Board in February was the first such review. The Executive Board endorsed what we had been doing and indicated how we should move forward. The Board also supported the IMF's approach through initiatives that promote good governance across the membership and specific measures to address particular instances of poor governance and corruption. In moving ahead, prevention should be at the center of the IMF's governance strategy.



Dicks-Mireaux: "At the national level, country leaders have increasingly and explicitly acknowledged the need to give attention to good governance."

In preparing the background paper for the review, staff in the IMF's Policy Development and Review Department examined governance in the context of the IMF's surveillance and program activities. In surveillance cases, we looked at the extent to which governance issues were reflected in the Board's summing-up of country economic discussions. On the program side, we looked more specifically at the use of conditionality. Overall, we found a widespread emphasis on governance issues. It had increased somewhat in the IMF's surveillance—particularly in the areas of IMF expertise, such as public sector resource management and the financial sector. In programs, we saw a greater number of governance-related performance criteria and benchmarks. These were used both more often and across a larger number of countries. The IMF's involvement in governance had indeed become both more proactive and more comprehensive.

But we also found that the whole environment in which governance issues are being looked at and addressed had changed radically since 1997. At an international level, virtually all multilateral institutions have guidelines on governance; promoting good governance has become a central element of their work. At the national level, country leaders have increasingly and explicitly acknowledged the need to give attention to good governance. And at the grassroots level, there was also a focus on governance. All of this has created an environment that encourages attention to governance and is more accepting of it. Governance issues are no longer seen as imposed from the outside; nor are they greeted with "you just don't understand." Everyone recognizes that good governance is essential. Of course, notwithstanding this common concern, tackling poor governance can involve difficult issues.

A number of developments have also thrust governance to the forefront, notably the Asian financial crisis, which spurred several reforms, and the HIPC [Heavily Indebted Poor Countries] Initiative, which

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
June 4	3.56	3.56	4.19
June 11	3.53	3.53	4.15

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 rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/cgi-shl/bur.pl?2001).

General information on IMF finances, including rates, may be accessed at www.imf.org/external/fin.htm.

Data: IMF Treasurer's Department

highlighted the need to strengthen the link between delivering debt-service relief and reducing poverty. A lot of IMF technical assistance has been geared toward financial markets and public sector resource management. There is a new willingness to address governance issues explicitly, to see them as a priority, and to understand them, as the IMF does, as a means to achieve macroeconomic stability.

IMF SURVEY: The IMF has a mandate to promote macroeconomic stability and encourage noninflationary growth. How does it determine when a governance issue has implications for macroeconomic stability?

DICKS-MIREAUX: The 1997 Guidance Note indicated, in fairly general terms, that governance issues could be raised when they had significant relevance for the macroeconomy in either the short or the medium term. But it can be difficult to draw clear-cut lines. Market reforms in the transition countries are a good example. You won't necessarily see—certainly in the early years—a big macroeconomic return on those reforms, but they are very important for achieving sustainable growth.

The Board review this year spent a lot of time discussing what might trigger IMF involvement in a governance issue, but no one tried to pin this down to a precise benchmark of macroeconomic significance—for example, "x" percent of GDP. The Board did say that when these issues are the focus of IMF policy advice, the rationale for our involvement should be clear. The Board then has an opportunity to say, "yes, we think that's right" or "well, maybe we should not be so involved."

One useful and important outcome of the recent review is the Board saying that, while it is not possible at this point to put down precise guidelines, the IMF should make it clear to everyone—the public, critics, skeptics, and those who feel we are straying too far from our mandate—why we are involved. The Board also asked staff to continue to look into the links between governance and growth.

IMF SURVEY: In what ways does the governance review dovetail with the IMF's review of its conditionality?

DICKS-MIREAUX: In very important ways. The conditionality review calls for more effective, more focused, and more streamlined IMF conditionality. That means that governance must be a key concern for it to be included in our conditionality. It also means that we will turn to other organizations with the required specialized expertise when that is needed. If, for example, a country has a bloated civil service and limited financial resources, this can translate into poorly paid civil servants with a greater incentive to take bribes. It's important to correct that, and we would turn to the World Bank. In this context, in low-income countries, the Poverty Reduction and Growth Facility (PRGF) and poverty reduction strategy paper (PRSP) processes should greatly enhance IMF–World Bank coordination. Similarly, when the Bank is called upon to provide background work or diagnostics for middle-income countries, its discussion of its work with these countries will likely lead to better preparedness. Finally, in terms of procedure, the Board agreed that future reviews of governance will be folded into its periodic reviews of conditionality, surveillance, and technical assistance.

Recent publications

Working Papers ($10.00)

01/57: *Intrahousehold Allocation of Resources—The Bolivian Family*, Gabriela Inchauste

01/63: *Domestic Bank Regulation and Financial Crises—Theory and Empirical Evidence from East Asia*, Robert Dekle and Kenneth M. Kletzer

01/65: *Intergovernmental Relations and Fiscal Discipline—Between Commons and Soft Budget Constraints*, Giuseppe Pisauro

01/66: *Sanctions and Civil Conflict*, Dmitry Gershenson

01/67: *Bank Debit Taxes in Latin America—An Analysis of Recent Trends*, Isaias Coelho, Liam P. Ebrill and Victoria P. Summers

01/68: *The Long-Run Behavior of Commodity Prices—Small Trends and Big Variability*, Paul Cashin and C. John McDermott

01/69: *An Exploration of the Private Sector Response to Changes in Government Saving Across OECD Countries,* Alun H. Thomas

IMF Staff Country Reports ($15.00)

01/79: Lesotho: 2000 Article IV Consultation and Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility

01/80: Lesotho: Statistical Annex

01/81: Iceland: 2001 Article IV Consultation

01/82: Iceland: Selected Issues and Statistical Appendix

01/83: Jamaica: 2001 Article IV consultation

01/84: Jamaica: Statistical Appendix

01/85: Iceland: Financial System Stability Assessment

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IMF SURVEY: In response to recent crises, the IMF has promoted broad initiatives to improve or put in place standards, codes, and best practices in statistical, monetary, and financial areas. What has been the IMF's experience in this regard?

DICKS-MIREAUX: Very positive. The Board very clearly stated in this review that the centerpiece of our governance strategy should be broad based and preventive, with individual country cases dealt with as needed through our surveillance effort and programs. With particular impetus from the Asian crisis, we have developed, enhanced, and made much more systematic our instruments to strengthen the functioning and integrity of institutions and markets, and thereby promote good governance. The work on standards, codes of conduct, transparency, best practices in monetary and fiscal policy, and other initiatives has generally been welcomed throughout the world and has been seen as a very positive force. It's a voluntary exercise, but there's been a very strong response. Within the IMF, we've also taken steps to make our instruments for safeguarding IMF resources more systematic, which is very important if we are to maintain our credibility in the eyes of the international community and strengthen the IMF's internal governance.

IMF SURVEY: Has the staff review of individual country experiences yielded broader lessons?

DICKS-MIREAUX: Yes. The paper highlighted two overarching issues: accountability and transparency. For me, transparency is the key. If you have transparency, you force accountability. Transparency gives the authorities and supervisors a means to create accountability and allows countries to be accountable to civil society and to donors.

But transparency can only get you so far. It is also important for good governance that there be effective enforcement and corrective mechanisms, as well as assurances that accountability is systematic and on a level playing field rather than ad hoc. High-level commitment is crucial, too, because if corruption exists at the top, it's likely to pervade the entire system. People will say "if he can get away with $10 billion, what's so wrong with $10,000 for me?" That logic spreads quickly.

IMF SURVEY: The 1996–97 discussion of governance also noted the importance of developed countries taking steps to curb bribery at their end. Some Organization for Economic Cooperation and Development (OECD) countries, for example, had permitted their companies to write off as business expenses bribes to public officials in developing countries. What progress has been made?

DICKS-MIREAUX: The OECD picked up this issue and pursued it through a number of conventions, which member countries have signed and which are open for other countries to sign as well. The OECD website provides a chronological history of where countries stand in terms of preparing and approving appropriate legislation and conforming to conventions. The Board asked IMF staff to follow up with country authorities on this issue in our Article IV consultations. Since the Board's discussion of governance in February, the issue has indeed come up in a number of cases.

IMF SURVEY: To what extent does the IMF interact with nongovernmental organizations (NGOs) on governance issues?

DICKS-MIREAUX: The IMF engages in a dialogue with NGOs at several levels. The IMF talks with the larger and more international NGOs at a central level. Now with the PRGF process, in-country NGOs may be involved in the PRSP process, and governance is an issue there. The PRSP process is to listen, learn, and enter into a dialogue, intermediated through the authorities, on these and other poverty-related issues. When the PRGF was proposed, it was expected to place a greater emphasis on governance in public sector resource management.

In a number of cases, NGOs have served as whistleblowers—not necessarily coming directly to the IMF, but revealing problems. Sometimes donors do the same. The IMF staff can then make a judgment on whether to raise the issue with the authorities. In one case (Cambodia's forestry policy reform program, which largely comes under the purview of the World Bank), the authorities agreed that an NGO would be directly involved as one of the monitors—in a sense an auditor—of the effectiveness of the forestry program. ■

Copies of *Review of the Fund's Experience in Governance Issues* (staff background paper), the Public Information Notice summarizing the Executive Board discussion, and the 1997 Guidance Note are available on the IMF's website (http://www.imf.org/external/np/gov/2001/eng/report.htm).

Members' use of IMF credit

(million SDRs)

	During May 2001	January–May 2001	January–May 2000
General Resources Account	**4,028.03**	**7,668.73**	**1,546.54**
Stand-By	4,028.03	7,609.93	1,234.24
SRF	1,657.71	4,007.28	0.00
EFF	0.00	58.80	312.30
CFF	0.00	0.00	0.00
PRGF	**39.72**	**283.89**	**107.77**
Total	**4,067.75**	**7,952.62**	**1,654.31**

SRF = Supplemental Reserve Facility
EFF = Extended Fund Facility
CFF = Compensatory Financing Facility
PRGF = Poverty Reduction and Growth Facility
Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer's Department

What is a debt swap?

Exchange operations play increasing role in managing liability and dealing with crises

A record number of debt exchange operations or swaps occurred in emerging debt markets in 2000. In 2001, the pace has accelerated—most recently with Argentina's $30 billion "mega" debt swap. What are debt swaps? What purposes do they serve? How do they affect emerging debt markets?

What are debt swaps?

A debt swap is an operation in which bondholders agree to sell their bonds to the issuer in exchange for a package of new bonds and, possibly, some cash. Sometimes, the value of the new bonds and cash received exceeds the value of the old bonds, thereby inducing the bondholder to voluntarily exchange bonds and receive the up-front "sweetener." In other instances, however, an issuer close (or perceived to be close) to default may approach bondholders with an offer that would imply an up-front loss, if accepted. Clearly, if bondholders are better off refusing rather than accepting, they will do so. Then, the exchange proceeds only if the issuer has some form of mechanism to "force" bondholders to accept.

Some debt swaps involve both a government's domestic and its external debt (such as Argentina's swaps in February and early June), while others focus only on domestic debt (Turkey is currently considering this), and others include only external debt (the common Brady bond-to-eurobond swaps).

What purposes do debt swaps serve?

Debt swaps are not cost free; the issuer that enters into them replaces bonds issued at one interest rate with new bonds issued at the prevailing market interest rate. If the new interest rate is higher than the original interest rate, clearly the operation entails a cost.

However, there are also benefits, depending on what the main purpose of the operation is:

• ***Liability management***. These swaps capture inefficiencies in the market's pricing of sovereign debt (realize net present value gains for the issuer), and/or release the collateral of some types of bonds, and/or extend the maturity of government bonds to enhance the debt profile. The most frequent type of exchange, the Brady bond–eurobond swap, falls into this category.

• ***Up-front debt-service relief***. These transactions alleviate a temporary bunching of maturities in the near term. They often entail actual net present value costs for the issuer, because debt maturing in the near term is replaced by often more expensive debt maturing in the medium to long term. Argentina's mega debt swap probably falls in this category.

• ***Resolution of sovereign defaults***. For countries that have stopped paying their bondholders but would like to restructure their bonds, these swaps provide a means to reduce the debt-servicing burden. Recent defaults and debt-exchange operations by Russia, Ukraine, and Ecuador are examples of this type.

Impact on emerging debt markets

Recent debt swaps are of such significance that they may lead to the extinction of certain types of bond or the reprofiling of a country's debt service. During 2000, $12 billion in Brady bonds was exchanged for $10.5 billion in eurobonds; during the first quarter of 2001, $5.5 billion in Brady bonds was swapped. To date, Brady-to-eurobond swaps have retired nearly 25 percent of the total stock of Brady bonds outstanding in 1996. One salient impact of this has been that trading volumes and liquidity in emerging debt markets have fallen. Why? Brady bonds used to be among the most frequently traded bonds because of their large issue size. Eurobonds have recently surpassed Brady bonds in total share of outstanding emerging market sovereign bonds, but eurobonds are frequently issued at various maturities and in generally smaller sizes than the Brady bonds. Hence, the liquidity of individual smaller bond issues is less than that for a much larger issue. This trend is likely to continue as some market participants believe that, de facto, Brady bonds will become extinct by 2010 if the current pace of retirement continues.

But the Brady bond–to-eurobond operations have all been small compared with Argentina's recent $30 billion mega debt swap. The Argentine swap, which was designed to give the country enough breathing space to recover from a three-year recession, is estimated by the authorities to have reduced nominal debt-service payments by up to

Bonds: a brief primer

• **Bond:** A form of securitized debt that is tradable in the secondary market. A bond can be issued either domestically or internationally.

• **Eurobond:** The most common form of international bond, issued by both sovereigns and corporate entities.

• **Brady bond:** An international sovereign issued in exchange for defaulted bank claims in the context of a debt restructuring operation. These instruments were part of the Brady plan, named after former U.S. Treasury Secretary Nicholas Brady and developed as a solution to the emerging market debt crisis of the 1980s.

$16 billion over the next five years. This has eliminated the country's need to tap international capital markets for the remainder of this year and reduced its financing needs for 2002. Given Argentina's prominence as a large issuer in the market, the swap may have larger short-term effects on emerging debt markets. The operation's perceived success has already increased interest among other sovereigns in swaps. Turkey, Peru, and Colombia are planning or considering swaps of their own.

During 2000, three swaps succeeded in restructuring bonds that had already been defaulted upon (see *Emerging Market Financing*, Third Quarter 2000, on the IMF's website (www.imf.org)). Ukraine exchanged about $1.6 billion of defaulted debt; Ecuador exchanged $6.4 billion; and Russia carried out a massive $32 billion exchange. The speed and ease with which these distressed exchanges took place surprised observers. The transactions also demonstrated that eurobonds—once thought impossible to restructure—could be defaulted upon and exchanged at a lower than expected cost.

Whether these and other swaps bode well for the future of emerging market financing remains to be seen. Market participants have voiced concerns that the rapid rehabilitation of defaulted sovereigns may increase the probability of future defaults as the stigma or cost of default is reduced. Future bondholders may also demand bonds that are harder to restructure. Debt exchanges or swaps are still at an early stage of evolution. What does seem clear is that whether swaps are used for liability management or crisis prevention or resolution, they are very likely to play an increasingly important role over the next few years. ■

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National economy

Jamaica introduces a wide range of measures to strengthen economy and promote growth

Beginning with a financial crisis in 1995/96, the Jamaican economy faced daunting challenges in the mid-1990s. The crisis resulted from the liberalization of the financial sector undertaken without a sufficiently robust prudential and supervisory framework in place—even across subsectors—against a background of a period of high inflation, high real interest rates, and macroeconomic stability. The ensuing bailout of the financial sector, through government guarantees of deposits—like insurance policies and pension funds—at failed institutions, has been very costly, estimated at more than 40 percent of GDP by end-2000/01. Contagion effects, however, were limited by a fairly large share of bank deposits held in foreign-owned institutions unaffected by the crisis.

In the wake of the crisis, the government adopted a tight monetary and exchange rate policy stance to contain inflation, which declined from about 31 percent at end-1995/96 to about 6 percent by end-1998/99. However, the tight monetary policy, coupled with a widening of fiscal deficits associated with servicing the costs of the financial sector bailout, led to high real interest rates, an erosion in external competitiveness, and unfavorable debt dynamics in subsequent years. The stock of debt, mostly domestic, escalated sharply as interest was capitalized on much of the debt issued to finance the bailout. As a result of these events, the formal economy contracted in real terms by nearly 4 percent in 1996–99. The government's social safety net programs, emigration, and remittances from abroad, as well as the sizable informal sector, have all helped to maintain living standards, including of the poorest. Although unemployment has declined somewhat, it remains high at around 15½ percent.

Economic program

To strengthen the financial sector, as well as provide the foundation for sustained growth and a reduction in the overall debt burden, the Jamaican authorities embarked on an economic program covering the period from April 2000 through March 2002, which the IMF staff is monitoring. The staff-monitored program (SMP) (see box below) envisages a significant reduction in the public sector deficit, a strengthening of the financial sector, and structural reforms that

Staff-monitored programs

A staff-monitored program (SMP) is an informal arrangement between IMF staff and country authorities in which the staff monitors the economic program of the authorities at their request. This monitoring does not, however, represent IMF endorsement of the program. The SMP should

- be guided by the summing-up from the most recent Article IV consultation;
- resemble closely or build toward a program that could be supported by the IMF, including policies that strengthen the member's medium-term outlook and external viability; and
- contain a memorandum of economic and financial policies that spells out the authorities' objectives and policies, including quantitative and structural benchmarks.

Within the Caribbean region, one other country—Trinidad and Tobago—has had an SMP. It expired in late 2000.

The positive achievements under the SMP have been reflected in the international community's perception of Jamaica as a borrower and in greater investor confidence in Jamaica.

would enhance efficiency and external competitiveness. The authorities see the SMPs as a vehicle for maintaining close contact with the IMF, as well as a signal to official creditors, donors, and financial markets of their commitment to implementing a strong adjustment program. The Caribbean Development Bank, the Inter-American Development Bank, and the World Bank have approved assistance totaling $250 million in support of the reforms in the financial sector. (The support includes a loan from the World Bank of $75 million. The Bank will likely consider an additional loan for $75 million later this year, which, if approved, would bring total support to Jamaica to $325 million.)

Since the inception of the authorities' program, economic performance has improved, and the program is broadly on track. After a decline in 1999/2000, real GDP is estimated to have grown by 1 percent in 2000/01, based on recoveries in agriculture and mining, as well as strong growth in tourism. Inflation fell to 6½ percent at end-2000/01, despite some depreciation of the Jamaican dollar early in the year and increases in oil prices. The overall public sector deficit declined by 6 percentage points of GDP over 1999/2000 and 2000/01, mainly as a result of the narrower deficit of the central government stemming from onetime revenue increases and stringent restraint in noninterest expenditures. The public sector primary surplus reached 12½ percent of GDP in 2000/01, and interest rates on six-month treasury bills declined to 16½ percent by the end of April.

The real effective exchange rate depreciated by about 3 percent in 1999/2000 and was broadly unchanged in 2000/01, following a large cumulative real appreciation (40 percent) between 1995/96 and 1998/99. The external current account deficit widened by about 1 percentage point of GDP in 1999/2000 to 4½ percent, mainly as a result of a decline in bauxite exports, and is expected to remain broadly unchanged in 2000/01. Net international reserves increased by over $700 million in 1999/2000–2000/01, on the basis of direct investment inflows, multilateral support, and official borrowing. In mid-May 2001, net international reserves stood at $1.5 billion, equivalent to over four months of the next year's imports of goods and services and more than twice the amount of short-term external debt of the public sector.

The authorities have made progress on structural reforms in recent years, especially in the financial sector. The merger of four intervened banks and some financial institutions into the new Union Bank was completed in April 1999; the bank was subsequently privatized in March 2001. Restructuring of the National Commercial Bank has progressed, and all five intervened insurance companies have been sold. In addition, the parliament approved the Financial Services Commission Act in March 2001, which is designed to strengthen financial sector supervision. Finally, the authorities sold a major public enterprise (the electric company) to a U.S. company.

The positive achievements under the SMP have been reflected in the international community's perception of Jamaica as a borrower and in greater investor confidence in Jamaica. Jamaican sovereign bond spreads have declined by about 150 basis points so far in 2001 to around 650 basis points over comparable U.S. treasury bonds for last year's seven-year issue, and spreads on euro-denominated debt have also declined. In May 2001, Standard and Poor's upgraded Jamaica's long-term sovereign rating to B+ for foreign currency bonds in the context of a U.S. dollar issue of $275 million with a 10-year maturity yielding 12 percent (a spread of 671 basis points over U.S. comparable bonds); a further $125 million was raised later in May, yielding 11½ percent at a spread of 650 basis points. Also, there are some indications that confidence in the Jamaican economy has turned more positive, as private investment rose by about 1¼ percentage points of GDP in 2000, following a number of years of decline or stagnation.

Remaining challenges

Despite these advances, the ratio of public sector debt to GDP stabilized at 137 percent of GDP at end-2000/01, rather than declining substantially as projected earlier. There are a number of reasons for the larger than anticipated stock of debt, including the guarantee of new debt by the central government and higher domestic interest rates than earlier projected. In light of these developments, the authorities have adopted a revised program for 2001/02 that envisages a fall in interest rates and the debt stock, a further decline in inflation, and more progress on raising growth and improving living standards. On fiscal policy, the revised program calls for a central government deficit of 3 percent of GDP—about 1 percentage point of GDP higher than earlier envisaged—reflecting higher interest payments and the larger current and capital expenditures needed to lay the foundation for faster growth over the medium term. Still, the fiscal effort in 2001/02 remains very large, with the public sector primary surplus projected to reach about 11 percent of GDP, reflecting the introduction of revenue-enhancing measures and continued expenditure restraint by the central government. As a consequence, the stock of public sector debt is projected to decline by about 10 percentage points of GDP in 2001/02.

The authorities' revised program for 2001/02 also targets an accumulation in net international reserves of $100 million, which would place them in a comfortable position to meet the large redemptions of international

bonds due in 2002/03. Monetary policy will be geared to achieve a reduction in inflation to 5 percent.

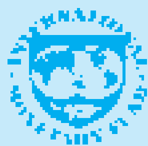
Further action on structural reforms to improve efficiency and competitiveness remains a key element of the authorities' program. In the financial sector, the authorities plan to implement the legislation establishing the Financial Services Commission to regulate insurance companies, securities houses, and trusts and pension funds more effectively and to adopt regulations in line with international best practices. These steps will strengthen prudential supervision and reduce the risk of another financial sector crisis. The program also envisages continued sales of intervened financial institutions and other public entities, with the proceeds used to retire debt. In 2001/02, the authorities plan to complete reforms to improve the

Stand-By, EFF, and PRGF Arrangements as of May 31

Member	Date of arrangement	Expiration date	Amount approved (million SDRs)	Undrawn balance (million SDRs)
Stand-By Arrangements				
Argentina[1]	March 10, 2000	March 9, 2003	10,585.50	5,774.97
Brazil[1]	December 2, 1998	December 1, 2001	13,024.80	5,155.65
Croatia	March 19, 2001	May 18, 2002	200.00	200.00
Ecuador	April 19, 2000	December 31, 2001	226.73	75.58
Estonia	March 1, 2000	August 31, 2001	29.34	29.34
Gabon	October 23, 2000	April 22, 2002	92.58	79.36
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	March 8, 2000	June 7, 2001	61.80	61.80
Nigeria	August 4, 2000	August 3, 2001	788.94	788.94
Pakistan	November 29, 2000	September 30, 2001	465.00	210.00
Panama	June 30, 2000	March 29, 2002	64.00	64.00
Papua New Guinea	March 29, 2000	September 28, 2001	85.54	18.89
Peru	March 12, 2001	March 11, 2002	128.00	128.00
Sri Lanka	April 20, 2001	June 19, 2002	200.00	96.65
Turkey[1]	December 22, 1999	December 21, 2002	15,038.40	8,105.28
Uruguay	May 31, 2000	March 31, 2002	150.00	150.00
Total			**41,173.63**	**20,971.46**
EFF Arrangements				
Bulgaria	September 25, 1998	September 24, 2001	627.62	52.32
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
FYR Macedonia	November 29, 2000	November 28, 2003	24.12	22.97
Indonesia	February 4, 2000	December 31, 2002	3,638.00	2,786.85
Jordan	April 15, 1999	April 14, 2002	127.88	91.34
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Ukraine	September 4, 1998	August 15, 2002	1,919.95	1,017.73
Yemen	October 29, 1997	October 28, 2001	72.90	26.40
Total			**8,696.57**	**6,283.71**
PRGF Arrangements				
Albania	May 13, 1998	July 31, 2001	45.04	4.71
Armenia	May 23, 2001	May 22, 2004	69.00	59.00
Benin	July 17, 2000	July 16, 2003	27.00	16.16
Bolivia	September 18, 1998	September 17, 2001	100.96	56.10
Burkina Faso	September 10, 1999	September 9, 2002	39.12	22.35
Cambodia	October 22, 1999	October 21, 2002	58.50	33.43
Cameroon	December 21, 2000	December 20, 2003	111.42	95.50
Central African Rep.	July 20, 1998	January 19, 2002	49.44	24.96
Chad	January 7, 2000	January 6, 2003	36.40	15.20
Djibouti	October 18, 1999	October 17, 2002	19.08	13.63
Ethiopia	March 22, 2001	March 21, 2004	86.90	69.52
FYR Macedonia	November 29, 2000	December 17, 2003	10.34	8.61
Gambia, The	June 29, 1998	December 31, 2001	20.61	6.87
Georgia	January 12, 2001	January 11, 2004	108.00	90.00
Ghana	May 3, 1999	May 2, 2002	191.90	120.85
Guinea	May 2, 2001	May 1, 2004	64.26	51.41
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Guyana	July 15, 1998	July 14, 2001	53.76	28.88
Honduras	March 26, 1999	March 25, 2002	156.75	64.60
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	28.69
Lao People's Dem.Rep.	April 25, 2001	April 24, 2004	31.70	27.17
Lesotho	March 9, 2001	March 8, 2004	24.50	21.00
Madagascar	March 1, 2001	March 1, 2004	79.43	68.08
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2002	46.65	33.15
Mauritania	July 21, 1999	July 20, 2002	42.49	18.21
Moldova	December 15, 2000	December 20, 2003	110.88	92.40
Mozambique	June 28, 1999	June 27, 2002	87.20	33.60
Nicaragua	March 18, 1998	March 17, 2002	148.96	33.64
Niger	December 14, 2000	December 21, 2003	59.20	50.74
Rwanda	June 24, 1998	January 31, 2002	71.40	19.04
São Tomé & Príncipe	April 28, 2000	April 28, 2003	6.66	4.76
Senegal	April 20, 1998	April 19, 2002	107.01	28.54
Tajikistan	June 24, 1998	December 24, 2001	100.30	28.02
Tanzania	March 31, 2000	April 3, 2003	135.00	75.00
Vietnam	April 13, 2001	April 12, 2004	290.00	248.60
Yemen	October 29, 1997	October 28, 2001	264.75	94.75
Zambia	March 25, 1999	March 28, 2003	254.45	199.51
Total			**3,431.75**	**2,090.87**
Grand total			**53,301.95**	**29,346.04**

[1]Includes amounts under Supplemental Reserve Facility
EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Treasurer's Department

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



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management and accountability of public enterprises and to encourage more flexible labor practices.

While progress on alleviating poverty and other social ills has been slow, reflecting the lack of growth, the Jamaican authorities have taken steps to strengthen their social assistance programs. They are improving their social safety net by consolidating the three existing transfer programs into one that contains increased benefits and is better targeted to those in need. Under the revised program for 2001/02, the authorities will continue to maintain social safety net expenditures in real terms, with a special emphasis on young children and youth. In particular, the authorities plan to continue "Lift Up Jamaica," which helps the young develop marketable skills.

Building on the achievements so far, as well as on the policies outlined for 2001/02, the authorities' program aims to lay the foundation for an acceleration in economic growth to about 3 percent a year, which will help reduce unemployment. Continued fiscal consolidation will help reduce domestic interest rates, which in turn will strengthen the fiscal position. The external position should remain strong, given the comfortable reserve position—in relation to both short-term debt and base money—and projected capital inflows.

The main risks to the medium-term outlook are a less rapid decline in interest rates, delays in privatization receipts, pressures for higher spending, and additional public guarantees on debt, which could slow the pace of reducing Jamaica's debt burden. In addition, Jamaica could be adversely affected—particularly through tourism receipts—by a possible U.S. recession or by higher oil prices. The Jamaican authorities are aware of these potential risks to their strategy and remain determined to achieve their fiscal targets. They have made great strides in dealing with the difficult situation they faced in the mid-1990s. The challenge they face now is to build on those achievements, so as to make lasting improvements in the standard of living of the people of Jamaica. ■

Stephen Tokarick
IMF Western Hemisphere Department

Further information about Jamaica is available on the IMF's website (www.imf.org), including the recently published Public Information Notice No. 01/57: "IMF Concludes Article IV Consultation with Jamaica," and the Letter of Intent of the government of Jamaica, which describes the policies that Jamaica is implementing in the framework of a staff-monitored program. In addition, the IMF has just published two Staff Country reports on Jamaica: 01/84: Jamaica: Statistical Appendix; and 01/83: Jamaica: 2001 Article IV Consultation and Review of Staff-Monitored Program. Country Staff Reports are $15.00 each and may be ordered from IMF Publication Services. See page 206 for ordering information.

Available on the web (www.imf.org)

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IMF First Deputy Director Stanley Fischer, "Asia and the IMF," at the Institute of Policy Studies, Singapore, June 1 (see page 199)

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