

# IMFSURVEY

International  
Monetary Fund  
VOLUME 31  
NUMBER 12

June 24, 2002

In this issue

193  
**Global Financial  
Stability Report**

193  
**Krueger details  
debt restructuring  
mechanism**

197  
**Rogoff and  
Zettelmeyer on roots  
of SDRM idea**

200  
**Bretton Woods  
Committee meeting**

200  
**Brazil eligible to  
draw \$10 billion**

201  
**Singh will head  
Western Hemisphere  
Department**

202  
**Yergin on  
globalization**

207  
**Getting corporate  
restructuring right**

and...

201  
**Use of IMF credit**

204  
**Recent publications**

205  
**Selected IMF rates**

205  
**New on the web**

206  
**IMF arrangements**

193

Global Financial Stability Report

## Weak corporate profits pose risk for improving financial market conditions

[www.imf.org/imfsurvey](http://www.imf.org/imfsurvey)

Corporate profitability is a source of uncertainty in a generally positive global market outlook, IMF International Capital Markets Department Head and Counsellor Gerd Häusler said at a June 12 press conference. Summarizing the findings (see charts, pages 194–95) of the IMF's second Global Financial Stability Report, he noted that "the near-term outlook in mature markets is largely free of imminent threats, mainly because the world economy has recovered and has helped build support also for financial markets." However, emerging markets in South America have come under recent pressure. This report is designed to "detect fault lines in global financial markets," and a theme running through this issue is the uncertainty posed by the level and quality of corporate profits.

Robust corporate earnings are the springboard for capital spending, but, to date, the *Global Financial Stability Report* noted, capital investment is the miss-



Gerd Häusler (right), with Donald Mathieson (center), and Garry Schinasi at the June 12 press conference.

ing component in the current economic recovery, and corporate profitability has been disappointing in many sectors. The quality of corporate earnings is also of concern. Once the fallout from corporate excesses in the financial (Please turn to the following page)

## Krueger offers fresh details on proposed sovereign debt restructuring mechanism

In a speech to the Bretton Woods Committee annual meeting in Washington, D.C., on June 6, IMF First Deputy Managing Director Anne Krueger said that the IMF has no intention of acting as judge and jury in its efforts to help develop a better international system to resolve sovereign debt crises. Edited excerpts follow.



I would like to bring you up to speed on progress on the two-track approach to improving sovereign debt restructuring—an approach that the United States and the rest of the interna-

tional community endorsed at our recent spring meetings [see also *IMF Survey*, April 29]. The first track involves more ambitious use of collective-action clauses in sovereign bond contracts. The second—and complementary—track involves creating a statutory mechanism that we believe can help secure more orderly and timely restructuring of unsustainable sovereign debts by empowering a supermajority of creditors to make key decisions in the restructuring process in negotiation with the debtor.

A key challenge confronting both approaches is the coordination of a diffuse and diverse creditor base to enable different creditors to seek enforcement of their rights in different legal jurisdictions. Dealing with this issue when relying entirely on collective-action clauses is very difficult. But within the statutory approach, we believe it is possible to resolve (Please turn to page 196)

## Changes under way on corporate governance

**A healthy development has been that the markets have punished corporations whose reported earnings appeared unsustainable or were derived through questionable accounting.**

(Continued from front page) system is resolved, however, a fresh start can be made, where shareholder value is respected, but short-term share price increases are not held up as an ultimate goal at the expense of proper accounting practices.

Gearing all incentives toward short-term movements in share prices tempts potential misdoers, Häusler observed. Share prices operate not only as a yardstick for investors but also as a compensation mechanism for senior executives and an acquisition currency for the company, thereby enticing executives to broach ethical boundaries in the quest for the holy grail of improved share prices.

A healthy development has been that the markets have punished corporations whose reported earnings appeared unsustainable or were derived through questionable accounting. As the report points out, this in turn provides powerful incentives for corporations to make their financial accounts more transparent and puts pressure on countries to enact the regulatory changes needed to rebuild and safeguard the integrity of financial markets. Changes, supported by the IMF, are under way in the United States and Europe to strengthen corporate governance and oversight of capital markets.

the IMF would look more closely into the Japanese domestic financial system in the context of its upcoming country (Article IV) consultation and the ongoing Financial Sector Assessment Program. The *Global Financial Stability Report* focused its attention on the potential transmission of Japan's financial difficulties to the international financial system, but it concluded that none of the three main transmission mechanisms is now of serious concern. The report finds little likelihood of any substantial repatriation of Japanese overseas assets back to Japan, given the very poor returns such assets can now earn in Japan; slim risk of a sharp fall in emerging market finance to Asian countries, because Asian countries are in much better shape and more resilient than a few years ago; and little concern about potential contagion through the interbank market, given that Japanese banks are less closely integrated into the international banking system than a few years ago.

### Risky insurance?

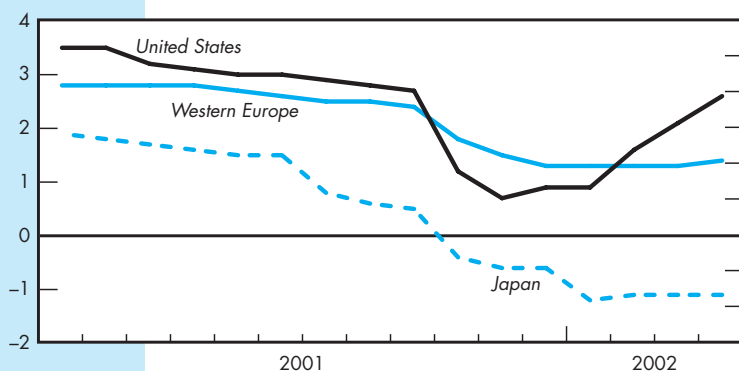
A lack of profitability in insurance companies' core business has induced them to get more involved in capital markets. What this means for insurance companies, and for the stability of the financial sector, is the subject of the report's third chapter. In general, the report finds that international systemic risks associated with the financial market activities of insurance companies are relatively limited compared with those of the major internationally active banks and commercial banks. But uncertainties remain about the adequacy of their capital, the quality of their risk management, and the potential for financial risks to migrate from the banking to the insurance sector. Given the possibility that a collapse of insurance or reinsurance companies could threaten financial stability, the report recommends gathering better information on the financial activities of insurers and reinsurers. It points, in particular, to the need to know more about "the size, extent, and nature of reinsurance cover and the potential for a critical mass of major reinsurers to simultaneously experience financial difficulties." It is encouraging, however, as Häusler noted, that insurers have liquid assets and illiquid liabilities—the reverse of banks.

### Underperforming emerging market equities

Can local securities markets provide insurance against the vagaries of international markets? The report looks at this question and concludes that the underperformance of emerging market equities is not primarily due to overvaluation. The main factors contributing to the underperformance of emerging market equities are

### Evolution of consensus 2002 GDP growth forecasts

percent, year on year



Data: Consensus Economics

Weak corporate profitability has also had a negative impact on banks, with much strategic downsizing both in the cost base of some banks and in balance sheets, reducing the lending of some banks, not least to emerging markets. This trend will probably continue, Häusler added.

### Japan and the rest of the world

What of Japan, whose financial and corporate sectors have been hit particularly hard in recent years by the lack of corporate profitability? Häusler indicated that

- a string of financial crises, starting with Mexico in 1994, which drastically pruned U.S. dollar returns on emerging market equities;
- concerns about corporate transparency and governance; and
- the growing importance of American Depository Receipts and the trend away from local to international market listings, which have reduced the universe of liquid stocks in emerging markets and cut both the domestic and the global investor base.

### Recent market performance

Since the report was finalized, Häusler pointed out, developments in mature equity markets have confirmed the report's concerns about the pace of the recovery and the quality of earnings. That will probably continue until there are clearer signs of a turnaround in corporate profitability. The U.S. dollar has declined against the euro (about 3 percent) and the yen (about 2.5 percent) since May, but European equity prices did not benefit from that development, and there is also a lack of confidence in the profitability of European companies. The market is not convinced that if the U.S. equity market fell, Europe would necessarily benefit, which suggests that any exchange rate movement would not be violent.

Are U.S. equities still overvalued? The answer to that question, Häusler noted, depends on future earnings as well as on expectations. The March *Global Financial Stability Report* said that U.S. equities were richly valued, and they have fallen since then. If corporate earnings were to recover, Häusler said, there is no reason why U.S. equities should still be regarded as overvalued.

In the emerging bond markets, Häusler noted, there has for some time been a "rotation" away from Latin America and particularly from Brazil. This has led to significant investor risk aversion to emerging market debt, particularly with regard to South America, and other regions have not necessarily benefited as a result. Cash holdings of emerging market investors have risen, so the benefits for the rest of the world are limited. The investor base for such emerging market investments is critical and has to be monitored carefully.

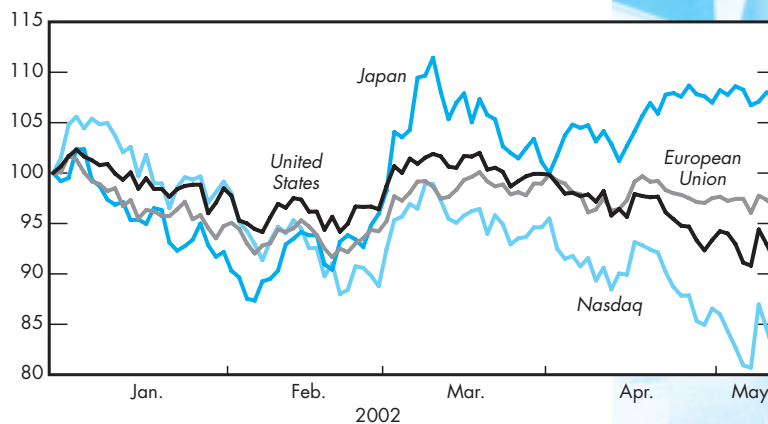
With the decline of bank credit (especially from European and Japanese banks) as a source of capital flows to emerging markets and with the crossover investor less reliable than a dedicated investor as a source of funding, the role of foreign direct investment (FDI) has become increasingly crucial. Therefore, the investment climate under which FDI takes place, particularly in Latin America, has become extremely important. Any policies that hinder such

investment or create contagion in that direction must be guarded against, Häusler cautioned.

What is the IMF's forecast for capital flows for the emerging markets? Donald Mathieson, Chief of the IMF's Emerging Market Surveillance Division, observed that while investment-grade borrowers continue to have reasonable access to both the bond and syndicated loan markets, bond markets are effectively closed for unsecured non-investment-grade borrowers. "They really cannot enter the market at any price they're willing to pay, and we see that as a condition that's likely to continue in the near term." With regard to regional discrimination, Asian, Eastern European, and Russian borrowers have been able to access bond markets quite successfully, at both the corporate and sovereign levels, but corporate borrowers in Latin America have found access to markets much more difficult recently.

Should the emerging markets be concerned about the ramifications of an abrupt fall in the U.S. dollar? Garry Schinasi, Chief of the IMF's Financial Market Stability Division, based his response on historical experience with the U.S. dollar-yen rate. While there

### Mature equity market indices broadly flat



Data: IMF, *Global Financial Stability Report*, June 2002

might be increases in volatility and some adjustments in other asset markets, he said it was hard to recall any real difficulty with adjustment in mature markets. But he added that the next *Global Financial Stability Report* would look into the implications of abrupt exchange rate movements for capital flows, particularly in emerging market economies. ■

Marina Primorac  
IMF External Relations Department

Copies of the June 2002 issue of the *Global Financial Stability Report* are available for \$42.00 (\$35.00 for academics) each from IMF Publication Services. For ordering details, see page 204. The full transcript of the June 12 press briefing on the report is available on the IMF's website ([www.imf.org](http://www.imf.org)).

The dispute resolution forum should operate—and be seen to operate—independent not only of the Executive Board but also of the governors, management, and staff of the IMF.

—Anne Krueger

## Krueger updates two-track approach

(Continued from front page) this coordination problem by creating a framework that would aggregate claims across instruments for voting purposes while paying due regard to the seniority of certain creditors and, more generally, to creditors' varying economic interests.

A framework that provides for such aggregation would require the establishment of a dispute resolution forum that would enjoy limited but exclusive powers for the orderly conduct of the restructuring process, including the resolution of disputes between a sovereign debtor and its creditors, on the one hand, and among creditors, on the other hand. Some commentators have expressed fears that the creation of such a forum might be a back-door way for the IMF to exert a malign influence over the restructuring process. That is not the case.

### Two-track approach

The key to improving the current system is to allow a supermajority of creditors—across a broad range of instruments—to make the terms of a restructuring binding on the rest. This should help secure restructuring prior to default. But in case this proves impossible, the new approach would also need to do the following: First, give the debtor legal protection from creditors while negotiating; second, give the creditor assurances that the debtor will negotiate in good faith and pursue policies that protect asset values and restore growth; and, third, guarantee that fresh private lending would not be restructured. Finally, you also need a way to verify claims, oversee voting, and adjudicate disputes.

Use of the mechanism would be for the debtor to request, and not for the IMF or anyone else to impose. The existence of a predictable framework should, in most cases, be sufficient to encourage voluntary agreement “in the shadow of the law,” without formal activation.

Collective-action clauses—typical of bonds issued under English law—are one way to provide the key features of the new approach. But they have important drawbacks. To begin with, they only bind holders of a single bond issue. If these are to facilitate comprehensive restructuring, then they need to be adapted to aggregate across all claims, including banks. But such “super collective-action clauses” are problematic for three reasons:

- First, how do you persuade creditors and debtors to issue new debt and exchange existing debt for bonds that include these clauses when they are already reluctant to include ordinary collective-

action clauses? One suggestion has been to make this a condition of access to IMF lending. But this would be the time at which the private sector is most reluctant to lend and when the debtor may be most reluctant to signal a greater chance of default by adopting them.

- A second problem is that emerging market sovereigns typically borrow in several legal jurisdictions. Not even identical restructuring language in collective-action clauses would necessarily guarantee uniform interpretation or application.

- Third, the current domestic laws of some of our members do not provide a clear statutory basis that allows the rights of minority creditors to be modified without their consent.

We are working on ways to tackle these drawbacks, but in the end I am sure that we will need a statutory underpinning too.

The statutory approach would use a treaty obligation—probably achieved through an amendment of the IMF's Articles of Agreement—to empower a supermajority of creditors to reach agreement with the debtor and bind in the rest. This would resolve the problem posed by different legal jurisdictions, as the treaty obligation would provide for legal uniformity in all jurisdictions. But an amendment of the Articles would be used only as a tool to empower the creditors and debtor, not as a way to extend the IMF's legal authority. The IMF would influence the process only as it does now, through its normal lending decisions.

For the new approach to sovereign debt restructuring to enjoy credibility and legitimacy, it will need to have the capacity to resolve disputes among creditors—and between creditors and the debtor—in a way that is demonstrably fair to all parties.

This role could not therefore be played by the Executive Board of the IMF. Not only do Executive Directors lack the necessary expertise, but their decisions could be thought to be influenced by the IMF's role as a creditor and by the representation of the debtor and bilateral creditors on the Executive Board. Indeed, the dispute resolution forum should operate—and be seen to operate—independent not only of the Executive Board but also of the governors, management, and staff of the IMF. The flip side of this independence is that the role of the dispute resolution forum should be strictly limited. ■

The full text of the speech is available on the IMF's website ([www.imf.org](http://www.imf.org)).



Interview with Rogoff and Zettelmeyer

## Success of SDRM idea has many fathers

*“When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonorable to the debtor, and least hurtful to the creditor.”*

This quote comes from Adam Smith in 1776— one of the many surprises that an IMF study turned up on the history of proposals to apply bankruptcy procedures to resolving sovereign debt crises. The *IMF Survey* talked with the authors of the study, Kenneth Rogoff, IMF Economic Counsellor and Director of the Research Department, and Jeromin Zettelmeyer, Senior Economist in the Research Department.

**IMF SURVEY:** Why did you do the study? How can history help us?

ROGOFF: There were two motivations. First, we noticed in the press that many people were rushing forward to take credit for First Deputy Managing Director Anne Krueger’s proposal as soon as it started to receive acclaim. Note that success has many fathers: for example, a *New York Times* article attributed the idea largely to Jeffrey Sachs. Second, we were aware that there was an earlier literature, but we had no idea how extensive it was. We were interested in tracing out who had said what and when. In the process, we really learned a lot. At some level, the fact that the SDRM [sovereign debt restructuring mechanism] proposal represents an evolution in thinking, rather than something out of thin air, is reassuring.

**IMF SURVEY:** Who have been the stars in this history?

ROGOFF: The dark horse celebrity is a lawyer named Christopher Oechsli, who wrote an article in the *Virginia Journal of International Law* in 1981 that can only be described as prescient. It explored how bankruptcy laws could be applied in the sovereign context. He wasn’t as worried about the free-rider problem as some of the later proposals were, but he was very worried about the slow nature of negotiations between private creditors, official creditors, and the debtor countries. He definitely stands in the limelight as the unknown star of this literature.

ZETTELMEYER: However, he stands in the limelight only if we shine it on him now. There were no stars until 1995, when Jeffrey Sachs gave his Princeton University lecture. There were also three lawyers fresh out of Harvard Law School—Barry Barnett, Sergio

Galvis, and Ghislain Gouraige—who wrote a path-breaking article in the *Harvard Journal of International Law* in 1984. So there were people who came up with these ideas in the 1980s, but their names didn’t really stick in the public debate—not even in the academic debate—and they aren’t cited very often in the papers that come later. As for the recent stars, one has to point out Barry Eichengreen and Richard Portes. Their 1995 book really kicked off the idea of collective-action clauses as the main vehicle for orderly workouts—an idea that is very hot in the current debate. U.S. Treasury Undersecretary John Taylor’s recent proposal is all about applying such clauses.

**IMF SURVEY:** Why do you quote Adam Smith? Was he an early star?

ZETTELMEYER: It’s a great quote, because he says there are certain situations where the best a country can do is face up to bankruptcy and proceed in an orderly way. The context is one where he tries to argue against high inflation as a way of “solving” public debt problems. But he doesn’t go into any details about how one would go about organizing an orderly bankruptcy.

**IMF SURVEY:** Were there any IMF stars in this history?

ROGOFF: There was an Executive Board discussion of these issues and a Board paper in 1995, written by the Legal Department. It was far more detailed than Sachs’s lecture on how a sovereign bankruptcy mechanism would work in practice. Even in the late 1980s, there was significant discussion of this issue within the IMF. The IMF was not behind the curve. But in November 2001, the First Deputy Managing Director brought it to the fore in the policy debate.

**IMF SURVEY:** What did you learn about the assumed inefficiencies motivating the various proposals?

ROGOFF: In the early 1980s, Oechsli was worried about the ex post inefficiencies following deep debt



Kenneth Rogoff



Jeromin Zettelmeyer

crises—cleaning up after the problem occurred. Sachs's 1995 lecture was the first to argue that a bankruptcy mechanism could deal with liquidity crises as well. This question appears in the academic literature in the 1980s, including in IMF work, but it wasn't in the public consciousness. However, with a modern eye, we don't view that distinction as sharply as they did some years ago; it's not easy to distinguish between solvency and liquidity crises. Then, after the Mexican crisis, moral hazard caused by international crisis lending surfaced as a major worry. Most of the modern proposals try to deal with this problem.

**ZETTELMEYER:** Another way to look at it is that the counterfactual has changed. Initially, the alternative to an orderly bankruptcy procedure was only disruptive defaults. Now, the alternative also includes moral hazard caused by large-scale international crisis lending.

**IMF SURVEY:** How have the proposed solutions changed over time?

**ZETTELMEYER:** There are two phases. The first is from the early 1980s until 1995, during which the spectrum of suggested remedies was staked out. At one end was the voluntary, public policy-based approach, where no institution would be changed, no new laws would be passed, and no treaties would be amended. However, the official sector would behave differently, thereby hopefully imparting different incentives. This is the Oechsli, minimalistic approach. At the other end of the spectrum—as proposed in 1984 by Barnett, Galvis, and Gouraige and a few years later by Benjamin Cohen—were very ambitious proposals for creating a new international institution. In the middle, a number of proposals popped up in 1995 after the Mexican crisis, basically pushing the contractual approach that plays such a big role in the current debate. The idea of using collective-action clauses in private bond contracts wasn't new, but it was new to suggest that they be used as a universal tool for crisis management.

**IMF SURVEY:** How about post-1995? Has there been a convergence?

**ZETTELMEYER:** Since then, we've seen a little bit of a narrowing, at least in the official community. On one side, we now recognize that in order to have an effective statutory solution we might not need a broad range of functions concentrated at the international level. Instead, we could have a statutory system that is largely self-enforcing and requires international arbitration only to a very limited extent—the so-called less heavy-handed approach. This idea was put forward both by Krueger in her modified proposal

[see page 193] and by Steven Schwarcz, a Duke law professor, in 2000. On the other side, the proponents of collective-action clauses have realized that they really need to be clear about how to create the incentives for private actors to adopt such clauses.

**IMF SURVEY:** How political is all this?

**ROGOFF:** There's clearly an interplay. Fundamental to the whole problem of sovereign debt is that you don't have an international legal system that is the same as national legal systems. There's also a transition issue. You can say, this is where I want to be in 25 years. But what do you do about the existing stock of bonds and those issued while a new proposal is being formulated? This may raise distributional issues, even though, in principle, the large potential efficiency gains to be had from a better debt resolution mechanism can still make everyone better off, even in a transition.

**IMF SURVEY:** Isn't the whole issue of sovereignty quite political?

**ROGOFF:** Yes it is. If you subject yourself to an independent forum to resolve disputes between creditors and debtors, as envisaged by Krueger's proposal, it's a small subordination of sovereignty. The same is true if you sign an international treaty that commits you to incorporate collective-action clauses and workout rules into your bonds—as in the newer variants of the Eichengreen and Portes proposal. But it's very much in line with other ideas aimed at achieving a better, smoother globalization.

In terms of solutions, the debate has been remarkably frank and nonpolitical. In fact, I would argue that the debate has become less political in the sense that the desirability of an orderly debt-workout regime for countries is now widely recognized. The very first institutional proposal in the late 1970s occurred in a very political context. The proposal, put forward by the Group of 77 developing countries at the UN Conference on Trade and Development, was to create an international debt commission. Its focus was distribution, debtor interests versus creditor interests. That's why it didn't fly—the creditor countries didn't support it. Now, we have a large part of the official community, including the main creditor countries, supporting some form of international bankruptcy.

**IMF SURVEY:** What are the policy implications of your study?

**ROGOFF:** Many of these ideas have a long legacy and a long history and have been thought through quite carefully, and we are really reaching a stage where it's

In terms of solutions, the debate has been remarkably frank and nonpolitical.

—Kenneth Rogoff

possible to move from an academic idea to something concrete—which is what the IMF is trying to do.

**IMF SURVEY: Any final thoughts?**

**ROGOFF:** Just one other thing: I view the moral hazard problem as actually having existed significantly in the 1980s. The World Bank and the IMF did substantially step in as private creditors pulled out of many countries, but it all happened in slow motion. It took place over five years instead of over a few weeks or months. I think there's a feeling that the way the IMF intervened

in the Asian crisis was much more efficient in that we didn't have five years of stagnation over the bargaining process between the debtor- and creditor-country governments. But it may have exacerbated the moral hazard problem—and raised the world's awareness of it—by lowering the deadweight cost of default. ■

This interview is based on a forthcoming expanded study by the authors. For an initial version of the study, see *Early Ideas on Sovereign Bankruptcy: A Survey*, IMF Working Paper 02/57, available on the IMF's website ([www.imf.org](http://www.imf.org)).

**How do the main proposals for improved sovereign bankruptcy procedures differ?**

MOTIVATION	APPROACHES				
	Change mainly official policies	Change debt contracts	National law	Change statutes	
				Narrow role for international institutions	Broad role for international institutions
Inefficient workouts	Oechsli (1981)		Miller (1991)	Debevoise (1984)	Barnett and others (1984) Cohen (1989) Raffer (1990) Reinisch (1994)
Inefficient workouts + debt runs		Eichengreen and Portes (1995)	Hurlock (1995)		Sachs (1995) IMF Legal Department (1995)
Inefficient workouts and/or debt runs + moral hazard	G-10 Deputies Working Group (1996)  Haldane and M. Kruger (2001)	Macmillan (1995) Eichengreen (2000) Taylor (2002)		Schwarzc (2000)  Krueger (2002)	Chun (1996)  Krueger (2001)

Barnett, Barry C., Sergio J. Galvis, and Ghislain Gouraige, Jr., 1984, "On Third World Debt," in *Harvard International Law Journal*, Vol. 25 (Winter), pp. 83–151.

Chun, John H., 1996, "Post-Modern Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?" *Fordham Law Review*, Vol. 64 (May), p. 2647.

Cohen, Benjamin, 1989, "A Global Chapter 11," *Foreign Policy*, Vol. 75, pp. 109–11.

———, 1989, "Developing Country Debt: A Middle Way," *Princeton Essays in International Finance 173* (Princeton: Princeton University Press).

Debevoise, Whitney, 1984, "Exchange Controls and External Indebtedness: A Modest Proposal for a Deferral Mechanism Employing the Bretton Woods Concepts," *Houston Journal of International Law*, Vol. 7 (Autumn), pp. 157–68.

Eichengreen, Barry, 2000, "Can the Moral Hazard Caused by IMF Bailouts Be Reduced?" *Geneva Reports on the World Economy Special Report 1*, August.

———, and Richard Portes, 1995, *Crisis? What Crisis? Orderly Workouts for Sovereign Debtors* (London: Center for Economic Policy Research).

Group of 10, 1996, *The Resolution of Sovereign Liquidity Crises. A Report to the Ministers and Governors Prepared Under the Auspices of the Deputies*, May 1996 (available on the BIS Website, <http://www.bis.org/publ/other.htm#Gten>).

Haldane, Andy, and Mark Kruger, 2001, "The Resolution of International Financial Crises: Private Finance and Public Funds," *Bank of Canada Working Paper 2001-20*, November 2001.

Hurlock, James, 1995, "The Way Ahead for Sovereign Debt," *Eurromoney* (August), pp. 78–9.

IMF, Legal Department, 1995, "Note on an International Debt Adjustment Facility for Sovereign Debtors," EBS/95/90, May 26, 1995 (unpublished internal report to the IMF Executive Board).

Krueger, Anne, 2001, "International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring," address given at the National Economists' Club Annual Members' Dinner, American Enterprise Institute, Washington D.C., November 26 (available at <http://www.imf.org/external/np/speeches/2001/sp01ind.htm>)

———, 2002, "New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking," address given at the Conference on Sovereign Debt Workouts: Hopes and Hazards, Institute for International Economics, Washington D.C., April 1, 2002 (available at <http://www.imf.org/external/np/speeches/2002/040102.htm>).

Macmillan, Rory, 1995, "Towards a Sovereign Debt Work-Out System," *Northwestern Journal of International Law and Business*, Vol. 16, pp. 57–75.

Miller, Brett H., 1991, "Sovereign Bankruptcy: Examining the United States Bankruptcy System as a Forum for Sovereign Debtors," *Law and Policy in International Business*, Vol. 22, pp. 107–32.

Oechsli, Christopher G. 1981, "Procedural Guidelines for Renegotiating LDC Debts: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act," *Virginia Journal of International Law*, Vol. 21, pp. 305–41.

Raffer, Kunibert (1990), "Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face," *World Development*, 18 (2): pp. 301–11.

Reinisch, August, 1994, "The Need for an International Insolvency Procedure," *Österreichisches Bank-Archiv*, Vol. 42, pp. 115–28.

Sachs, Jeffrey D., 1995, "Do We Need an International Lender of Last Resort?" Frank D. Graham Lecture at Princeton University 8, April 20, 1995 (unpublished manuscript available at <http://www.ksg.harvard.edu/cid/ciddirector/publicat.html#Working>).

Schwarzc, Steven L., 2000, "Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach," *Cornell Law Review*, Vol. 85, pp. 101–87.

Taylor, John, 2002, "Sovereign Debt Restructuring: A U.S. Perspective," address given at Conference on Sovereign Debt Workouts: Hopes and Hazards, Institute for International Economics, Washington, D.C., April 1, 2002 (available at <http://www.treas.gov/press/releases/po2056.htm>).



*Bretton Woods Committee***Debt restructuring, trade, and aid spark proposals and debate**

Grant Aldonas

*New ideas and hot topics filled the agenda for the June 6 annual meeting of the Bretton Woods Committee. This U.S.-based nonprofit group, established in 1983 to promote awareness of international finance and development issues, heard from senior officials at the IMF and the World Bank, as well as from national and European Union authorities and think tanks. The daylong program highlighted a new proposal on international debt restructuring and offered a lively range of views on key trade, aid, and development issues.*

**Debt restructuring and dispute resolution**

In a major address, IMF First Deputy Managing Director Anne Krueger unveiled the newest element of her proposed sovereign debt restructuring mechanism—namely, a dispute resolution forum (see excerpts from speech, page 193). If accepted by the IMF's membership, this forum would provide a framework within which sovereign debtors and their creditors could restructure debts in an orderly way. Creditors with disputes among themselves could also avail themselves of this forum.

The proposed forum would have no authority to challenge decisions by the IMF's membership as to the adequacy of policies or the sustainability of debt. The forum's credibility and legitimacy would be based on its capacity to resolve disputes among creditors—and between creditors and the debtor—in a way that is demonstrably fair to all parties, Krueger explained. “In a world in which sovereign borrowers

have diffuse and diverse creditor bases,” she said, “we need a way to overcome the coordination and collective-action problems that stand in the way of timely and efficient restructuring. . . . We believe that a dispute resolution forum—small in size, limited in role, and demonstrably independent in its membership and operation—is the best way to achieve this.”

**Trans-Atlantic trade friction**

Do current disagreements between the United States and the European Union threaten to disrupt their key economic partnership? What potentially can be done to calm things down? Representatives from the two sides did their best to come up with some answers. Grant Aldonas, Undersecretary for International Trade at the U.S. Department of Commerce, indicated that the upcoming Doha trade round would be the appropriate venue for resolving such disputes. Gerard Depayre, Deputy Head of the European Union (EU) delegation in Washington, D.C., emphasized that trans-Atlantic trade disputes over agriculture and steel should not distort the larger, more cooperative commercial partnership between the United States and the European Union. What particularly concerned EU members of late, however, was that recent U.S. actions to subsidize domestic agriculture threaten to undercut nascent efforts to reform Europe's Common Agricultural Policy. Echoing Aldonas, Depayre urged both parties to use the Doha negotiation framework to resolve the current impasse.



Gerard Depayre

**Brazil eligible to draw up to \$10 billion from IMF**

The IMF's Executive Board announced on June 18 that Brazil is now eligible to draw up to the equivalent of about \$10 billion (SDR 7.7 billion) immediately under its \$15.7 billion loan (SDR 12.14 billion) with the IMF. The Board's decision, following a third review of the country's performance under a Stand-By Arrangement, adds about \$4.8 billion (SDR 3.7 billion) to the \$5.2 billion (SDR 4 billion) already available, but unused, under previous reviews.

Anne Krueger, First Deputy Managing Director and Acting Chair, noted that despite Brazil's solid policy performance, “financial market developments in recent weeks indicate that the authorities' commitment to maintain their cautious approach to macroeconomic policy is fully warranted.” Measures announced on June 13, she said, should enhance the country's already-strong macroeconomic fundamentals and contribute to a stabilization in financial markets. In par-

ticular, “the increase in the primary surplus target for the consolidated public sector should contribute to improved public debt dynamics, while the recent tightening of liquidity should provide support to the real. The planned buyback of external debt should provide an improved benchmark for Brazilian corporations seeking to access international capital markets and help to strengthen the real. The lowering of the floor on net international reserves under the program will allow this operation to occur without reducing the central bank's room for maneuver.”

Over the medium term, Krueger observed, additional progress in reducing the country's large external borrowing requirement, the borrowing requirements of the public sector, and the large share of the public debt contracted at floating rates or linked to the exchange rate would—along with attention to the remaining elements of the structural reform agenda—should help further strengthen Brazil's position.

For the full text of IMF News Brief 02/50 on Brazil, see the IMF's website ([www.imf.org](http://www.imf.org)).



## New aid consensus?

Turning to an area where views seem more clearly to be converging, World Bank President James Wolfensohn declared that the development community had reached an important turning point. Developing countries are now persuaded of the value of open markets, privatization, entrepreneurship, and self-help, he said. And the March 2002 Financing for Development Conference in Monterrey, Mexico, helped developing countries fully recognize that they themselves bear the ultimate responsibility for the success or failure of their economic strategies and for the extent of their participation in the global economy. For their part, industrial countries have begun to recognize that meeting the Millennium Development Goals will require greater effort and generosity. Now the key requirement for both sides is “implementation.” Common action is increasingly necessary, as the world has recognized that “the imaginary wall that divided the rich world from the poor world came crashing down” on September 11. “There are not two worlds. There is only one,” Wolfensohn said.

U.S. Treasury Undersecretary John Taylor also addressed the global development agenda, citing the large productivity gap between rich and poor countries as the key challenge facing developing countries. This gap, he said, is a product of poor governance, insufficient education, and restrictions on business activity. Bridging this gap will require better targeted, results-oriented foreign assistance from the donor community.

## Social and political obstacles to growth

But while aid can facilitate growth, economic progress is crucially dependent on social and political stability. This fundamental message emerged from separate statements delivered by Richard Murphy, from the Council on Foreign Relations, and José Angel Gurría, former Mexican Finance and Foreign

Minister. Focusing on the Middle East, Murphy suggested that the “misery and hopelessness” that lie at the heart of so much recent terrorism in the region will not be rooted out without greater economic development and an “increased stake in the political life of their countries for relatively well educated but disenfranchised and angry youth.”

In remarks titled “Emerging Markets’ Love-Hate Relations with the International Financial Institutions,” Gurría praised the Bretton Woods institutions for their ability to remain “relevant” to the needs of Latin America. He cautioned, however, that recent political trends in the region bear watching, notably popular dissatisfaction with “politics as usual” and the growing influence of unelected nongovernmental organizations (NGOs) in the policy process. Things have reached the point, according to Gurría, where democratically elected leaders are afraid to take action for fear of offending such groups. ■

John Starrels  
IMF External Affairs Department



James Wolfensohn



John Taylor

## Anoop Singh will head Western Hemisphere Department

IMF Managing Director Horst Köhler announced on June 10 that Anoop Singh, currently Director for Special Operations, would succeed Claudio Loser as Director of the IMF’s Western Hemisphere Department. Singh will serve as Director-designate of the Western Hemisphere Department until Loser’s retirement later in the year. For the time being, he will remain in his current position in Special Operations—a unit that, by the end of the summer, management intends to integrate into the IMF’s organizational structure and enhance the IMF’s capacity to manage and prevent financial crises.

Singh, an Indian national, has more than 25 years of experience at the IMF. Before being appointed Director for Special Operations in February 2002, he was Deputy Director of the Asia and Pacific Department and has held a range of senior positions within the IMF. In the early 1980s, Singh served as Special Advisor to the Governor of the Reserve Bank of India. In the late 1980s, on secondment from the IMF, he was Senior Advisor to the World Bank’s Vice President for Asia. Köhler noted that Singh “has demonstrated strong operational and intellectual leadership in a variety of assignments. This background will serve Anoop well as he takes on the challenges of his new position in this critically important region.”

Köhler also praised Loser’s contribution, noting that he has given “excellent service to the IMF during his distinguished career.” Loser has served as Director of the Western Hemisphere Department since 1994.

For the full text of News Brief No 02/46, see the IMF’s website ([www.imf.org](http://www.imf.org)).



## Members’ use of IMF credit

(million SDRs)

	During May 2002	January– May 2002	January– May 2001
General Resources Account	436.13	9,383.88	7,668.73
Stand-By	50.00	8,722.51	7,609.93
SRF	0.00	0.00	4,007.28
EFF	386.13	661.37	58.80
CFF	0.00	0.00	0.00
PRGF	0.00	323.03	283.89
Total	436.13	9,706.91	7,952.62

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

Interview with Daniel Yergin

## Confidence in markets rose after the 1970s, but the pendulum may be swinging back



Yergin: “Unfortunately, countries that do well as a result of trade get shunted off the board of the debate and, strangely enough, don’t seem to count in the argument.”

On June 4, at the invitation of the IMF’s External Relations Department, Pulitzer Prize–winning author Daniel Yergin came to the IMF for a discussion with staff of *The Commanding Heights: The Battle for the World Economy*. This six-hour series, which ran recently on U.S. public television, is based on a book of the same title, written by Yergin and Joseph Stanislaw. It tells the story of the battle of economic ideas, especially concerning the role of government in the marketplace, that was such an important part of the history of the twentieth century. Following the discussion, Yergin spoke to Prakash Loungani of the External Relations Department.

**LOUNGANI:** What is the grand theme of *The Commanding Heights*?

**YERGIN:** There are two: how governments and markets have tussled for control of the commanding heights—Lenin’s term for strategic sectors—of the economy and the big, bruising debate on the effects of globalization, particularly the new wave of globalization that started with the fall of the Berlin Wall. World trade has doubled since that time.

**LOUNGANI:** Not exactly escapist fare. How has it been received? Will it be shown outside the United States?

**YERGIN:** The reviews have been excellent, and the response positive—from the policy communities, the private sector, and academia. It’s also very gratifying to hear from people that their teenagers sat engaged through it all. It was surprising to find, at one point, that the video was outselling the *Star Wars* trilogy on Amazon. We expect that the series will be appearing on television networks in dozens of other countries. There’s also a very good website [[www.pbs.org/wgbh/commandingheights](http://www.pbs.org/wgbh/commandingheights)] that goes with the series.

**LOUNGANI:** The difficulties of defining what globalization is and when it began don’t seem to hamper the debate over its effects.

**YERGIN:** Yes, I agree. My son insists that globalization began in 1964 when the Beatles made their first worldwide tour. Others might say it has been going

on for 500 years since the invention of movable type and the “age of discovery.” So there’s arbitrariness about the choice of date. I think modern globalization started after World War II, when wise people sat down and reflected on the lessons of the two World Wars and the Depression and took steps to keep these from happening again. Eight rounds of trade negotiations, leading to an enormous expansion of trade, occurred in the period that followed. I would date the second age of globalization to the end of communism, which was followed by an enormous increase in trade during the 1990s.

**LOUNGANI:** You champion free trade, but others take a more guarded view of its effects.

**YERGIN:** Trade has been the way out of poverty for many countries. Unfortunately, countries that do well as a result of trade get shunted off the board of the debate and, strangely enough, don’t seem to count in the argument. Forty years ago, Singapore was so poor that some people doubted it would make it as a country. Today, its per capita income is higher than the United Kingdom’s. Korea and India had similar levels of per capita income in the 1960s, but today Korea is 20 times richer. Why? One big reason is that it engaged with the world economy, and India did not. There were a lot of other differences between the countries, but that has to be a key one. India has clearly done better since it opened up. The most dynamic players in today’s economy are the new globalizers. One of the basic lessons of history for me is the power and importance of trade as an engine for reducing poverty. The concept of “the gains from trade” is so obvious to economists that they take it for granted that other people get it, but many don’t.

**LOUNGANI:** What about the effects of trade on income inequality? Some argue that trade—globalization and markets more generally—leads to an unequal division of the spoils.

**YERGIN:** Deng Xiaoping wrestled with this question in China during his years of house arrest, following which he came up with his famous statement, “I have a choice—I can distribute wealth or I can distribute poverty.” You can have a system in which everyone is equal and very poor. Or you can have a market system, which works through incentives and unequal distribution of the gains in income. And there’s always a risk with market systems that things go to excess. Greed

runs away; values decline; and corruption increases. But you have that same risk in controlled systems, as the experience of the communist countries showed.

**LOUNGANI:** Many point to Africa as an example of the perils of globalization—how it helps some countries but leaves others behind. And they often blame the IMF and the World Bank for Africa’s plight.

**YERGIN:** These are examples of what Jagdish Bhagwati calls the “fallacy of misassigned blame.” I was on a television show recently where the other guest said the IMF and the World Bank were responsible for AIDS in Africa. Pardon me? Is it because of health crises, corruption, lack of law, barriers to entrepreneurship, wars, and ethnic conflict that so many African countries are suffering, or is it because of globalization? I also find it difficult to accept that trade and globalization increase the potential for conflicts or other problems. India may be on the verge of a conflict at the moment, but would it make sense to say that it’s a result of the enormous increase in India’s exports of software products?

**LOUNGANI:** Let’s talk about the tussle between markets and central planning. Cato Institute’s Brink Lindsey says in a new book that the dead hand of statist thought still pervades much of the world.

**YERGIN:** You have to recognize a shift toward greater confidence in markets since the 1970s, even if, as Lindsey says, implementation is lagging in many countries. In the United States in the 1970s, you had wage and price controls; in India, an emphasis on a mixed economy; throughout the developing world, with the exception of East Asia, a profound distrust of foreign capital. Theories of international relations talk about the balance of power. In discussions about markets versus the state, it’s useful to think of the balance of confidence. I think the balance of confidence has clearly shifted toward the markets. Very recently, the pendulum may have swung back some the other way.

**LOUNGANI:** Why?

**YERGIN:** A number of reasons. The increased emphasis on security since September 11 obviously gives the state a bigger role. Argentina’s experience raises questions in some minds about whether markets deliver. And then Enron and other companies raise issues of corporate governance, whether markets can be self-governing or will need a heavier dose of government regulation, or at least some reworking of regulation. Right now, the focus is on corporate governance. Of course, at least right now, there’s less economic optimism and more anxiety.

**LOUNGANI:** Of those three developments, Argentina is obviously of great interest to us at the IMF. What do you make of its experience?

**YERGIN:** For many years, Argentina was the poster child for reform, and Russia was the bad boy. Now there’s been a reversal of fortunes. Argentina is facing an economic nightmare. Some will want to blame reform, the movement to markets, and—as you well know—the IMF. But it certainly seems that the real problem was the failure to reform enough. Argentina’s reforms really stopped in the mid-1990s. A political culture that built up a \$142 billion debt that could not be serviced, the nature of federal and provincial relations, corruption—these seem to be some of the problems.

**LOUNGANI:** Whatever the sources of the problems, does the Argentine experience risk derailing market reforms in the region as a whole?

**YERGIN:** People should look at the individual countries more closely and compare, for instance, the experiences of Argentina and Chile. In his interview for the program, President Ricardo Lagos Escobar of Chile says that reforms prepared his country for a more open world. Remember, this endorsement comes from someone who was a great opponent of Augusto Pinochet; he was slated to be Salvador Allende’s ambassador to Moscow. Chile has now had 14 years of democracy and has done quite well. Mexico continues to show the benefits of integration with the world economy. Venezuela is in a difficult situation. In Brazil, a lot will depend on the outcome of the presidential election. Overall, there are question marks now and much less optimism.

**LOUNGANI:** Your book *The Prize* said that “oil is 10 percent business and 90 percent politics.” Is that still true?

**YERGIN:** That statement is about the oil business in the 1930s, but it underlines the peculiar nature of oil. Politics is still very much a part of the business. Most of the time, oil is just another commodity. But it hasn’t lost its ability to quickly become a unique strategic commodity, because it’s tangled with geopolitics in a way no other commodity is. For the most part, we have a big, complex, and resilient oil supply system—it’s really quite amazing how large it is and how well it works. And it’s increasingly driven by the market. We’ve moved from national champions to international brands even in the power business. We have global electric utilities. We have Russian private oil companies, still

**Enron and other companies raise issues of corporate governance, whether markets can be self-governing or will need a heavier dose of government regulation, or at least some reworking of regulation.**

—Daniel Yergin



**Photo credits:** Denio Zara, Padraic Hughes, Pedro Márquez, and Michael Spilotro for the IMF; Bretton Woods Committee, pages 200–201.

with a state tinge, but quite different from what was there before.

But it's a business that is still susceptible to politics. There are battles in Venezuela. There's uncertainty about how things will evolve in the Middle East. A lot of forces are at work in that region, from demographic pressures to the influence of satellite TV, whose impact is becoming clearer. When I interviewed Margaret Thatcher for *The Commanding Heights*, she reminded

me of Thatcher's Law: "The unexpected happens." That's a fundamental maxim of energy security. That's why there has been a "fear premium" as high as \$5–\$6 in the oil price in recent months, although it's now down to \$2 or \$3 a barrel.

**LOUNGANI:** One segment of the series deals with the Asian financial crisis and the ones that followed. In your view, what caused the Asian crisis?



Yergin: "We need to get the right rules in place so the global system is more resilient, more beneficial, and more legitimate. International institutions have a tough but indispensable role in this. And you all have to do your jobs while coping with uninformed animosity."

**YERGIN:** It erupted partly as a result of weak capital markets, the buildup of short-term debt, corporate governance issues, and the emergence of China as a competitive trading force after 1994. As an economic historian, I also see it as the bursting of a classic bubble. People forget the ebullience of the period just before the crisis, around 1995–96. After a decade of solid growth, Asia represented the future. "Asian values" were to be paramount. In the series, we cite an interview with a chief executive officer who says, "If we are not in Asia tomorrow, we're too late." This bubble replicated the Japanese bubble of the 1980s. In fact, I had wanted to dramatize this in the series through a bullet train starting out in Tokyo, going into a tunnel, and ending up, visually, in Southeast Asia.

**LOUNGANI:** Many IMF staff, including me, found your treatment of the IMF's role in the crisis very balanced.

**YERGIN:** Thank you. Our main purpose was to tell the story clearly and cogently rather than deal in clichés and assign blame. It was a difficult and constantly

## Recent publications

### IMF Staff Country Reports (\$15.00)

- 02/106: Switzerland: 2002 Article IV Consultation
- 02/107: Switzerland: Selected Issues
- 02/108: Switzerland: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes
- 02/109: Hungary: Selected Issues and Statistical Appendix
- 02/110: Hungary: Report on the Observance of Standards and Codes
- 02/111: Hungary: 2002 Article IV Consultation
- 02/112: Hungary: Financial System Stability Assessment Follow-up, including Reports on the Observance of Standards and Codes
- 02/113: Bangladesh: 2001 Article IV Consultation
- 02/114: Bangladesh: Selected Issues and Statistical Appendix

### Working Papers (\$10.00)

- 02/85: *When Is Economic Growth Pro-Poor? Experiences in Malaysia and Pakistan*, Mahmood H. Khan
- 02/86: *Determinants and Repercussions of the Composition of Capital Inflows*, Mark Carlson and Leonardo F. Hernandez

- 02/92: *Macroeconomic Adjustment in a Highly Dollarized Economy: The Case of Cambodia*, Mario de Zamaroczy and Sopenha Sa
- 02/93: *Escaping the Curse of Oil? The Case of Gabon*, Ludvig Soderling
- 02/94: *The Role of Internal Audit in Government Financial Management: An International Perspective*, Jack Diamond
- 02/95: *Why Is It So Hard to Finance Budget Deficits? Problems of a Developing Country*, Andrew Feltenstein and Shigeru Iwata
- 02/96: *The Estonian Currency Board: Its Introduction and Role in the Early Success of Estonia's Transition to a Market Economy*, Adalbert Knöbl, Andres Sutt, and Basil B. Zavoico

### Other

- Manual on Fiscal Transparency* (\$19.50)



Publications are available from IMF Publication Services, Box X2002, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: [publications@imf.org](mailto:publications@imf.org).

For information on the IMF on the Internet—including the full texts of the English edition of the *IMF Survey*, the *IMF Survey's* annual *Supplement on the IMF, Finance & Development*, an updated *IMF Publications Catalog*, and daily SDR exchange rates of 45 currencies—please visit the IMF's website ([www.imf.org](http://www.imf.org)). The full texts of all Working Papers and Policy Discussion Papers are also available on the IMF's website.

evolving situation, and people at every stage were caught by surprise. It just went on and on—Thailand, Korea, Indonesia, Russia, the Long-Term Capital Management hedge fund, Brazil. However, people need to go back and see what lessons they can learn about the right policies for the future. Are high interest rates necessary to stabilize the currency and the economy, or do they kill the economy? How high should interest rates be? We need a dispassionate analysis of this question. What kind of money flowed out first from the Asian countries? The evidence suggests that a lot of this “hot money” was short-term bank lending by Japanese and European banks and money belonging to local nationals.

**LOUNGANI:** Yet if it was the bursting of a classic bubble, as you suggest, even if we had an answer to such questions, it would be difficult to prevent crises completely.

**YERGIN:** Of course. Coming away from the whole span of history covered by the series, you realize how deadly debt can be, whether it’s 1929–31 in the United States, the Asian crisis, or the telecom bust still unfolding today. People build up debt on the assumption that things will remain on the track they have been on for the past few years, without an awareness of how much debt is in the system as a whole—and without much thought that economic circumstances can change radically. When things are booming, no one wants to be left out. That seems the bigger risk. There’s a kind of competitive frenzy. There’s always a lot more debt and many more vulnerable institutions than people are aware of. All this is not to disparage the steps that have been taken—the initiatives to improve transparency, better monitor private debt, and caution about liberalizing the capital account too quickly.

### Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
June 10	2.32	2.32	2.97
June 17	2.31	2.31	2.96

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?2002](http://www.imf.org/cgi-shl/bur.pl?2002)).

General information on IMF finances, including rates, may be accessed at [www.imf.org/external/fin.htm](http://www.imf.org/external/fin.htm).

Data: IMF Treasurer’s Department

**LOUNGANI:** Our Managing Director, in an impromptu remark recently, said that he was concerned that, “despite all the rhetoric, the world is in a difficult situation and is threatened by fragmentation.” Reactions?

**YERGIN:** I find that very striking. It resonates with our own research. We work with three scenarios of the future: “globalism,” “leviathan,” and “fragmentation.” To me, the eeriest quote in the series was [Friedrich von] Hayek’s remark: “We didn’t realize how fragile our civilization was.” He was referring to the assassin’s bullet in 1914 that unleashed 30 years of untold misery. The IMF and the World Bank emerged from Bretton Woods in 1944 because wise, farsighted people sat down to learn the lessons of those 30 years and how things could be prevented from going wrong again. What were those lessons?

### Available on the web ([www.imf.org](http://www.imf.org))

#### News Briefs

- 02/46: IMF Names Anoop Singh to Head Western Hemisphere Department, June 10 (see page 201)
- 02/47: IMF Completes Fifth Review Under Mauritania’s PRGF Arrangement, Approves in Principle \$8 Million Disbursement, June 10
- 02/48: IMF completes Fourth Review Under Mozambique’s PRGF Arrangement and Approves \$11 Million Disbursement, June 17
- 02/49: IMF Management Recommends Augmentation of Uruguay Stand-By, June 18
- 02/50: IMF Completes Third Review of Stand-By Arrangement with Brazil, June 18

#### Press Releases

- 02/26: Zambia Accepts Article VIII Obligations, May 20
- 02/27: IMF Approves \$750 Million PRGF Arrangement for the Democratic Republic of the Congo, June 13
- 02/28: IMF Adopts Declaration of Noncooperation for Zimbabwe and Suspends Technical Assistance, June 14

#### Public Information Notices

- 02/58: IMF Concludes 2002 Article IV Consultation with Hungary, June 5
- 02/59: IMF Executive Board Discusses Quota Formulas, June 14
- 02/60: IMF Concludes 2002 Article IV Consultation with St. Kitts and Nevis, June 14

#### Speeches

- “Sovereign Debt Restructuring and Dispute Resolution,” Anne Krueger, IMF First Deputy Managing Director, Bretton Woods Committee Annual Meeting, Washington, D.C., June 6 (see page 193)

#### Transcripts

- Press Briefing, Thomas C. Dawson, Director, IMF External Relations Department, June 6
- Press Briefing on the *Global Financial Stability Report*, June 12 (see page 193)

They were about avoiding fragmentation and the breakdown of cooperation among nations.

We still live in a world of nation-states and a global marketplace. We need to get the right rules in place so the global system is more resilient, more beneficial, and more legitimate. International institutions have a tough but indispensable role in this. And you all have to do your jobs while coping with uninformed animosity. At times of stress, I hope you can draw inspi-

ration from the founding fathers at Bretton Woods and remind yourselves of their vision for the future and of the resolve and farsightedness with which they set about their historic work. ■

The series, *The Commanding Heights: The Battle for the World Economy*, is on video and available from Amazon.com or WGBH-TV Boston at (800) 949-8670).

### Stand-By, EFF, and PRGF arrangements as of May 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
<b>Stand-By</b>				
Argentina <sup>1</sup>	March 10, 2000	March 9, 2003	16,936.80	7,180.49
Brazil <sup>1</sup>	September 14, 2001	December 13, 2002	12,144.40	8,468.82
Bulgaria	February 27, 2002	February 26, 2004	240.00	208.00
Guatemala	April 1, 2002	March 31, 2003	84.00	84.00
Latvia	April 20, 2001	December 19, 2002	33.00	33.00
Lithuania	August 30, 2001	March 29, 2003	86.52	86.52
Peru	February 1, 2002	February 29, 2004	255.00	255.00
Romania	October 31, 2001	April 29, 2003	300.00	248.00
Sri Lanka	April 20, 2001	August 19, 2002	200.00	48.32
Turkey <sup>1</sup>	February 4, 2002	December 31, 2004	12,821.20	4,627.20
Uruguay	April 1, 2002	March 31, 2004	594.10	471.50
<b>Total</b>			<b>43,695.02</b>	<b>21,710.85</b>
<b>EFF</b>				
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2003	3,638.00	1,926.72
Serbia/Montenegro	May 14, 2002	May 13, 2005	650.00	600.00
Ukraine	September 4, 1998	September 3, 2002	1,919.95	726.95
<b>Total</b>			<b>8,164.95</b>	<b>5,210.67</b>
<b>PRGF</b>				
Armenia	May 23, 2001	May 22, 2004	69.00	59.00
Azerbaijan	July 6, 2001	July 5, 2004	80.45	64.35
Benin	July 17, 2000	July 16, 2003	27.00	12.12
Bolivia	September 18, 1998	June 7, 2002	100.96	37.10
Burkina Faso	September 10, 1999	December 9, 2002	39.12	5.58
Cambodia	October 22, 1999	February 28, 2003	58.50	16.72
Cameroon	December 21, 2000	December 20, 2003	111.42	63.66
Cape Verde	April 10, 2002	April 9, 2005	8.64	7.41
Chad	January 7, 2000	January 6, 2003	47.60	15.80
Côte d'Ivoire	March 29, 2002	March 27, 2005	292.68	234.14
Djibouti	October 18, 1999	October 17, 2002	19.08	10.00
Ethiopia	March 22, 2001	March 21, 2004	100.28	41.72
Georgia	January 12, 2001	January 11, 2004	108.00	81.00
Ghana	May 3, 1999	November 30, 2002	228.80	52.58
Guinea	May 2, 2001	May 1, 2004	64.26	51.41
Guinea-Bissau	December 15, 2000	December 14, 2003	14.20	9.12
Honduras	March 26, 1999	December 31, 2002	156.75	48.45
Kenya	August 4, 2000	August 3, 2003	190.00	156.40
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	61.68
Lao People's Dem. Rep.	April 25, 2001	April 24, 2004	31.70	22.64
Lesotho	March 9, 2001	March 8, 2004	24.50	14.00
Madagascar	March 1, 2001	February 29, 2004	79.43	56.74
Malawi	December 21, 2000	December 20, 2003	45.11	38.67
Mali	August 6, 1999	August 5, 2003	51.32	19.65
Mauritania	July 21, 1999	December 20, 2002	42.49	12.14
Moldova	December 21, 2000	December 20, 2003	110.88	92.40
Mongolia	September 28, 2001	September 27, 2004	28.49	24.42
Mozambique	June 28, 1999	June 27, 2002	87.20	25.20
Niger	December 22, 2000	December 21, 2003	59.20	33.82
Pakistan	December 6, 2001	December 5, 2004	1,033.70	861.40
São Tomé & Príncipe	April 28, 2000	April 27, 2003	6.66	4.76
Sierra Leone	September 26, 2001	September 25, 2004	130.84	74.67
Tanzania	April 4, 2000	April 3, 2003	135.00	35.00
Vietnam	April 13, 2001	April 12, 2004	290.00	207.20
Zambia	March 25, 1999	March 28, 2003	278.90	174.08
<b>Total</b>			<b>4,225.56</b>	<b>2,725.03</b>
<b>Grand total</b>			<b>56,085.53</b>	<b>29,646.55</b>

<sup>1</sup>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.

## Corporate restructuring seen as key to reviving postcrisis economies

**C**orporate restructuring on a large scale is potentially one of the most challenging tasks facing economic policymakers. The need arises in the aftermath of a financial crisis when corporate distress is pervasive. Mark R. Stone, a Senior Economist in the IMF's Monetary and Exchange Affairs Department, argues in an *Economic Issues* pamphlet to be published shortly that successful restructuring requires a government to take the lead in establishing restructuring priorities, addressing market failures, reforming legal and tax systems, and, perhaps most important, dealing with obstructions posed by powerful interest groups.

After a decade of sluggish economic performance in Japan, it is now widely recognized that its economy will not improve and crisis vulnerability will not be reduced without major restructuring of the corporate sector. Corporate leverage is quite high in Japan, reflecting investment and governance problems. The low profitability of the corporate sector is linked to the weak balance sheets and operating income of the banks. While important progress has been made in reducing corporate leverage in recent years, this has been attained not only by an increase in equity but also by a relatively sharp decline in corporate borrowing, which may limit the scope for economic expansion.

The authorities in 2002 began accelerating the introduction of measures aimed at jump-starting corporate restructuring. Banks and firms are being encouraged to agree to out-of-court restructuring in exchange for debt forgiveness or debt-equity conversion, subject to guidelines to be established by relevant ministries and the business and bankers' associations.

As the case of Japan illustrates, large-scale corporate restructuring made necessary by increased financial vulnerability or, as in other countries, by a full-blown financial crisis, is one of the more daunting policy challenges a country can face. The government is forced to take a leading role, even if indirectly, because of the need to prioritize policy goals, address market failures, reform legal and tax systems, and deal with the resistance of powerful interest groups.

Stone, the author of papers and articles on the corporate sector, financial crises, and monetary policy, says that successful government-led corporate restructuring policies usually follow a sequence. First, the government should formulate macroeconomic and legal policies that lay the basis for successful restructuring. After that, financial restructuring must start to establish the proper incentives to get banks involved

and get credit flowing again. Only then can corporate restructuring begin in earnest with the separating out of the viable from nonviable corporations, with the former being restructured and the latter liquidated.

### Laying the foundation

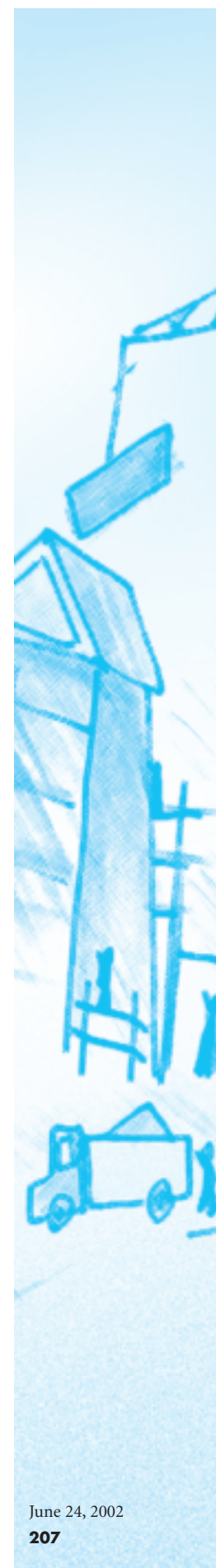
Corporate restructuring on a large scale is usually made necessary by a systemic financial crisis—defined as a severe disruption of financial markets that, by impairing their ability to function, has large and adverse effects on the economy. The intertwining of the corporate and financial sectors that defines a systemic crisis requires that the restructuring address both sectors together. Stone argues that successful restructuring must have a strong foundation established by government action across the spectrum of economic policies:

- Overall economic stability must be entrenched to provide the confidence needed for debt restructuring. Stable prices, interest rates, and exchange rates are needed for debtors, creditors, and potential investors to have enough certainty to do business.
- The scale and nature of corporate distress must be quickly assessed to determine if the problems are systemic and thus whether the government should take a leading role.
- A comprehensive strategy for restructuring, encompassing both the corporate and financial sectors, should be drawn up as soon as the crisis is judged to be systemic and should involve all interested parties.
- A supportive legal, regulatory, and accounting environment needs to be in place. Important legal aspects of restructuring include foreclosure standards, foreign investment rules, and merger and acquisition policies.

- Corporate governance must be brought up to international standards to provide incentives for viable firms to restructure their balance sheets and maximize their value.

- Closing nonviable corporations will incur social costs that may require offsetting government actions to help the poor and to maintain political support for restructuring. Social measures should be formulated with the cooperation of corporations and unions.

**Financial sector.** Even after the foundation has been laid, corporate restructuring cannot begin to make headway without substantial progress in restructuring the financial sector. The draining of bank capital as part of the crisis will usually lead to a sharp cutback in lending to viable and nonviable corporations alike, worsening the overall contraction. Moreover, banks





Laura Wallace  
Editor-in-Chief

Sheila Meehan  
Senior Editor

Elisa Diehl  
Assistant Editor

Natalie Hairfield  
Assistant Editor

Jacqueline Irving  
Assistant Editor

Lijun Li  
Editorial Assistant

Maureen Burke  
Editorial Assistant

Philip Torsani  
Art Editor

Julio R. Prego  
Graphic Artist

Prakash Loungani  
Contributing Editor

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 23 times a year, plus an annual *Supplement on the IMF* and an annual index. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on National Geographic's *Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Text from the *IMF Survey* may be reprinted, with due credit given, but photographs and illustrations cannot be reproduced in any form. Address editorial correspondence to Current Publications Division, Room IS7-1100, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to [imfsurvey@imf.org](mailto:imfsurvey@imf.org). The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged \$79.00 annually. Apply for subscriptions to Publication Services, Box X2002, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430; fax: (202) 623-7201; e-mail: [publications@imf.org](mailto:publications@imf.org).

June 24, 2002

208

must have the capital and incentives to play a role in restructuring.

The first task of financial restructuring is to separate out the viable from the nonviable financial institutions to the extent possible. To do this work, financing and technical assistance from international financial institutions can be helpful. Nonviable banks should be taken over and their assets eventually sold or shifted to an asset management corporation, while viable banks should be recapitalized.

**Corporate sector.** Corporate restructuring can begin only when banks and market players are willing and able to participate. As with the financial sector, the first task is distinguishing viable from nonviable corporations. Nonviable corporations are those whose liquidation value is greater than their value as a going concern, taking into account potential restructuring costs, the "equilibrium" exchange rate, and interest rates. The closure of nonviable firms ensures that they do not absorb credit or worsen bank losses. However, the identification of nonviable corporations is complicated by the poor overall performance of the corporate sector during and just after the crisis. Liquidation can be speeded up by special courts or new bankruptcy laws.

### What are the government's choices?

Stone finds that the government's role in corporate restructuring is highly country-specific because of the complexity, social consequences, and involvement of different elements of society. Thus, there are relatively few overarching operational principles or obvious ways to organize the policy choices, especially in comparison to other structural policy areas, such as capital account liberalization and labor market reform.

Stone identifies five government-led corporate restructuring methods, and includes case studies from Chile, Hungary, Mexico, Poland, and Thailand to illustrate his points. The five approaches, in ascending order of government involvement, are government mediation, government-financed incentive schemes, bank recapitalization, the creation of a government-financed asset management corporation, and the appointment of a restructuring director to accelerate the pace of reform.

Financial incentives through a preset government-financed scheme can help if corporate distress is systemic, market or regulatory failures inhibit restructuring, and the government has adequate fiscal



resources at hand. A government-financed asset management corporation can buy bad loans, provide equity to banks and corporations, negotiate with debtors, and take an active financial and operational role in restructuring. Stone argues that this type of approach is called for if

the number of troubled corporations is large and there are microeconomic elements that severely inhibit restructuring.

### Lessons from country experiences

What general lessons can be drawn from these countries' experiences? Stone suggests the following:

- Governments should be prepared to take on a large role as soon as a crisis is judged to be systemic.
- A sound supporting macroeconomic and legal environment is essential.
- Measures should be taken quickly to offset the social costs of crisis and restructuring.
- Restructuring should be based on a holistic and transparent strategy encompassing the corporate and financial sectors.
- Restructuring goals should be stated at the outset, and sunset provisions embedded within the enabling legislation for new restructuring institutions based on these goals.
- A determined effort to establish effective bankruptcy procedures in the face of pressures from vested interest groups is essential.
- The government should pare back its role in the economy after achieving its restructuring goals to set the stage for higher growth in the long run.
- Large-scale postcrisis corporate restructuring takes five years to complete, on average.
- Finally, crisis can ultimately boost long-term growth prospects both by weakening special interests that had previously blocked change and by encouraging the successful completion of corporate restructuring. ■

Jeremy Clift  
IMF External Relations Department

Copies of the Economic Issues pamphlet, *Corporate Sector Restructuring: The Role of Government in Times of Crisis*, by Mark R. Stone, will be available free from IMF Publication Services in July. See page 204 for ordering information.