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Departing Deputy Managing Director

Ouattara assesses challenges for global economy, poverty reduction issues, and role of IMF

Alassane D. Ouattara, a Côte d'Ivoire national, is resigning as Deputy Managing Director of the IMF, a position he has held since July 1994. He was Director of the IMF's African Department from 1984 to 1988 (and was appointed a Counsellor of the IMF in 1987), Governor of the Banque Central des Etats de l'Afrique de l'Ouest from 1988 to 1990, and Prime Minister of Côte d'Ivoire from 1990 to 1993. Ouattara spoke with Laura Wallace of the IMF's External Relations Department about the world economy, debt relief, conflict prevention, social issues, and the IMF's changing role.

Ouattara: All countries need to adopt good policies and have open economies to fully benefit from globalization.

IMF SURVEY: *With only a few months left in 1999, what do you see as the greatest challenges facing the world economy in the next millennium?*

OUATTARA: Given the globalization of the world economy, it is essential for all countries to be fully engaged in the process. This means that, whether they be small or large, all countries need to adopt good policies and have open economies to fully benefit from globalization. The past two years have shown that even if there is a crisis, taking steps to open the economy; to have transparency, accountability, and good governance in the management of public resources; and to demand good economic policies does yield results. We have seen examples in Korea, Thailand, the Philippines, and other countries.

For the poorer countries, particularly in Africa, the task is much more difficult. They have not been able so far to attract foreign capital as easily, and armed conflicts too often damage their image. But good policies in the end do give the assurance of best results. So in the next few years, I think the key task of the world community, particularly of the IMF, will be to continue to sustain a framework of good policies globally.

IMF SURVEY: *Drawing on your perspective both as a politician and as an IMF official, what can the IMF do to encourage a politician to follow good advice on economic policy?*

OUATTARA: The IMF is not a political institution. That has to be clear. Moreover, as an international organization, it is very difficult for us to become involved in domestic affairs. The choice of leaders and the choice of economic programs should be in the hands of the population, of the citizens of that country.

But on the economic front, the IMF can certainly have an important input. For example, by supporting the policy elements that lead to the liberalization of the domestic economy, we are helping to create a level playing field for all economic players in the country. This support also ensures that public or private monopolies, usually owned by political interest groups, can be dismantled and replaced by a competitive system of access to the assets of the country.

IMF SURVEY: *Democracy is generally seen as the answer to holding countries with diverse ethnic groups together. Yet, as the world has become more democratic, countries have been increasingly splitting apart in response to ethnic tensions. Has your conception of the nation-state changed?*

OUATTARA: There are conflicts in many places in the world, and some of these are ethnic conflicts. But I do not think the cause of the conflicts is the diversity of the population. Rather, it has more to do with the lack of fair treatment of segments of a population by certain groups of the population—for example, the oppression by a majority or the holding on to power by a minority. So the fairness and transparency of elections and the fair treatment of citizens are special requirements for building a successful nation-state. A clear case is South Africa,

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where the transition from apartheid to democracy was carried out very smoothly, certainly thanks to President Mandela as a person, but also thanks to the process, which was viewed by both white and black populations as having been fair.

In a 1998 meeting, Ouattara and senior IMF African Department staff confer with a delegation from Eritrea that included President Isaias Afewerki (foreground, third from left) and Ambassador Semere Russon (foreground, second from left).

At the same time, you have to make sure that there is enough decentralization—that all the power and decision making is not concentrated in the hands of the central government or a core group of people. This is important because, at some stage, if certain regions receive the bulk of public resources, including public investment, those in the other regions might feel that they are being shortchanged by the system.

The IMF should continue to encourage governments to devote as much of their resources as possible to the social sectors.
–Ouattara

IMF SURVEY: *How do the increasing globalization of world markets and the call for greater regionalization in Africa fit in?*
OUATTARA: Of course, you cannot speak of nation building without looking at it in the context of globalization. In Africa, there are more than 20 countries with fewer than 10 million people, and 15 that are landlocked. These countries need to come together in large enough economic—and probably even political—units, so that they can achieve economies of scale and have more of a say at the international level.

IMF SURVEY: *In light of the ongoing conflicts, can the IMF play a role in conflict prevention and resolution, on top of the postconflict assistance we now offer?*
OUATTARA: Again, the IMF is not a political institution; questions of prevention and resolution should be dealt with at the bilateral level (by individual countries), the regional level (by the Organization of African Unity, among others), and the international level (by the United Nations). But from an economic angle, the IMF can play a role by looking at the financial impact of aid flows, whether they be financial or humanitarian. It can also play a role by looking at the composition of spending. Is the government putting money into productive areas, such as health and education, or into nonproductive areas, such as military expenditures? Here I would like to add that the role of the major industrial countries is critical, but their efforts must be better coordinated. Ultimately, however, peace begins with the fair treatment of people as individuals or as a group in a country. The stories of Kosovo and Rwanda are the stories of one group trying to suppress the other.

IMF SURVEY: *What impact has the IMF had on the developing world over the past 10 years, especially since the inception of the Enhanced Structural Adjustment Facility (ESAF)? In what direction do you see the IMF's role in these developing regions evolving?*
OUATTARA: The IMF has an important role in the developing world, and this was reinforced in 1987 when the Managing Director Michel Camdessus proposed setting up the ESAF. I believe that this facility has been helpful, first, by reassuring the poor countries that they have a place in the institution and, second, by helping them achieve economic progress. Indeed, the data show that countries that have implemented policies in the framework of ESAF programs have achieved better results, not only on growth but on inflation and on social indicators. This process must be reinforced. The IMF should continue to encourage governments to devote as much of their resources as possible to the social sectors—including monitoring social policies to find out how many classrooms have been built, how many dispensaries have been provided with medication, how many teachers are going to teach, and so forth.

IMF SURVEY: *There is a lot of talk right now about debt relief and, since the Group of Eight summit in Cologne in June, of enhanced debt relief. How do you judge the potential impact of an enhanced debt-relief initiative? And what do you feel about its greater focus on poverty reduction?*
OUATTARA: The focus of debt relief should be on poverty alleviation. In Africa, poverty indicators for most countries are higher than 50 percent of the population, which is simply not acceptable. Remember that in East Asia, about a quarter of a century ago, these indicators were also at between 50 and 70 percent, and now in many countries they are well below 10 percent.

How can we link debt reduction to poverty alleviation? We need to ensure that programs are coherent on the macro level, and that the resources freed up by debt relief benefit well-monitored social programs. And I believe that IMF-supported programs also need to be linked to governance issues. When you look at the composition of expenditures, you will see that in many countries, the problem of lack of growth, or slow growth, stems from the fact that countries have devoted resources to nonproductive ends. So trying to make sure that expenditures are more oriented to human development will yield better results.

IMF SURVEY: *Is there a case for outright debt cancellation?*
OUATTARA: Clearly this is a matter of how many resources you can devote to relief. You can imagine that this could be done, but the danger is that creditor countries might stop giving additional resources to the country involved and the debtor country might abandon good economic policies. Just look at the former Soviet Union (FSU) countries. Russia took up the debt of all the other FSU countries—many of them ESAF countries—and yet many have continued to build up debt, with debt now becoming a problem for some. Completely canceling that debt did not lead to faster economic growth or good economic policies. Thus, it is critical that any debt relief be linked to conditionality, accountability, good social policies, good governance, and sound economic policies.

IMF SURVEY: *What do you see as the IMF's role in governance issues? Has the IMF been able to make any progress in this area with member countries?*
OUATTARA: In terms of governance and issues of corruption, for example, the IMF can play an important role by helping governments pinpoint the areas where there is corruption or misallocation of resources. This has happened in many countries, not only in Africa but in Asia and Latin America, and several programs have been suspended while waiting for the government to try to correct these abuses or misallocations of resources. It must also be said that liberalization of the financial and trade sectors, or the labor markets, contributes to better governance by creating more opportunities—and equal opportunities—for citizens' access to goods and services and jobs.

Ouattara and senior IMF officials greet visiting French President Jacques Chirac.

IMF SURVEY: *One of your contributions inside the IMF has been to bring the wisdom of a practitioner to the internal debate. What do you now take with you from your experience as Deputy Managing Director?*
OUATTARA: When I was offered the job of Deputy Managing Director, I accepted because I felt that given my experience as a central bank governor, and thereafter as a politician—since I was prime minister and acting president in my country before coming here—my contribution could be twofold: bringing in the viewpoint of the recipient countries, namely, the poor countries; and

IMF Executive Board bids farewell to Ouattara

In Press Release 99/30, dated July 14, the IMF Executive Board adopted the following Resolution of Appreciation for outgoing Deputy Managing Director Alassane D. Ouattara. The text of the press release is also available on the IMF's website (www.imf.org).

"WHEREAS on July 31, 1999, Mr. Alassane D. Ouattara will relinquish the post of Deputy Managing Director which he has held since July 1, 1994, after having served as a staff member from 1968 to 1973 and from 1984 to 1988, thus completing a record of distinguished service in the IMF; and

"WHEREAS Mr. Ouattara, with his vast experience inside and outside the IMF, brought an invaluable dimension to our work here; and

"WHEREAS Mr. Ouattara, throughout his career at the IMF, has devoted himself wholeheartedly to the service of the institution and made a lasting contribution to the IMF's efforts to help members address challenges and benefit from opportunities in an era of globalizing financial markets; and

"WHEREAS Mr. Ouattara has brought with him the highest qualities of public service, marked by absolute rectitude and public spiritedness, and unequaled courtesy and generosity, which he extended to all of us; and

"WHEREAS Mr. Ouattara has been valued as friend and counselor by Executive Directors and staff members alike;

"NOW THEREFORE IT IS RESOLVED: That the members of the Executive Board express unanimously to Mr. Ouattara their tribute to his committed service to the IMF; their appreciation for his outstanding achievements during his period of service; their hope that they may continue to count on his friendship; and their best wishes for satisfaction and fulfillment in his future activities."

IMF Managing Director Michel Camdessus pays tribute to Ouattara at a staff reception in honor of the outgoing Deputy Managing Director.

underscoring that the political process is quite complex. It is not easy for a government to decide to reduce subsidies, for example, on bread or on bus tickets. It is not easy for a government to reduce the size of the civil service without adequate compensation or to freeze salaries over a long period of time. So the IMF has to take social circumstances into account when proposing policy measures, and I feel that this has become an important element in our decisions. I have also been convinced by my experience as a politician that we need to look at key social indicators, not just economic indicators, as the latter by themselves do not necessarily translate into happiness or even economic development.

What am I taking back with me? Three elements. First, a deep sense of humility. Over the past 30 years, I have worked with staff members who are extremely competent and devoted to their jobs and the objectives of the institution. The high quality of the staff is something that has to be noted and praised, and I think the evolution of the IMF over the past 50 years reflects that.

Second, I take with me the experience of a broader sample of decision making, because the IMF has 182 member countries. During the past five years, I have dealt with about 110 countries. To see the political system evolving from one country to another—or even within the same country—to see how governments have addressed policy issues and emergency cases, as was the case in East Asia recently, and to see how some of the poorer countries are struggling to get out of poverty—all these are experiences that I value.

Third, an appreciation of the efficiency of the institution, especially in its decision-making process.

IMF SURVEY: *What are you looking forward to doing after you leave the IMF?*

OUATTARA: I am looking forward to going back to my country, Côte d'Ivoire, to put to good use what I have learned in this great institution. I have come to the conclusion, after nearly three decades of national, regional, and international service, that true and lasting progress must mostly come from within a country, with the continued support of the international community. At some point in your lifetime, you need to contribute directly to the well-being of your people: this is what I hope to achieve. ■

Ouattara outlines key policy areas as Africa prepares for the twenty-first century

Ouattara and President Teodoro Obiang Nguema Mbasogo of Equatorial Guinea.

On June 4, outgoing IMF Deputy Managing Director Alassane D. Ouattara addressed the National Summit on Africa in San Francisco. He concluded by recommending several policy actions essential to sustained growth and global integration. The full text of the address is available on the IMF's website (www.imf.org).

The image of an Africa ready to take off economically is being undercut by the image of an Africa increasingly mired, once again, in political turmoil, civil unrest, and armed conflict. Now is the time for the international community and regional groupings to intensify their efforts to secure lasting peace across the continent. And now is the time for Africa itself to say "enough." For only with peace can Africa attract the trade and capital flows it so desperately needs. And only with peace can Africa's citizens enjoy the benefits of sustained high-quality growth and join the global economy of the new millennium.

Ultimately, Africa holds its destiny in its own hands. What should it be doing? Besides maintaining macroeconomic stability, it can help strengthen the virtuous circle of better policies and higher growth by the intensified pursuit of good governance and by focusing, above all, on five key policy areas:

- *ensuring a predictable environment for investment* by promoting good governance, transparency, and accountability and by shunning all forms of corruption and cronyism. This is vital to remove the sense of uncertainty that still too often plagues investor decision-making.
- *strengthening human capital* by giving priority to education and health in public expenditure. This is vital to help spur more broad-based sustainable growth and greater poverty reduction.
- *strengthening the financial sector.* This is needed to better mobilize savings and enhance financial intermediation.
- *speeding up trade liberalization.* This will boost the efficiency and competitiveness of domestic producers, along with enabling African countries to benefit more from the liberalization of other countries' trade barriers and the growth of world trade.
- *deepening regional integration*. This would allow African countries to better overcome the disadvantages of their relatively small economies, permit them to realize economies of scale, and enhance their ability to trade on a global basis. ■

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

Camdessus stresses fight against poverty, sees peace as crucial for development

Following are edited extracts of an address by IMF Managing Director Michel Camdessus at the 1999 substantive session of the United Nations Economic and Social Council (ECOSOC) in Geneva on July 5. The full text is available on the IMF's website (www.imf.org).

What we have witnessed during the last few years—the most severe economic crisis of the last 50 years, unconvincing progress in fighting poverty in the world, and war undermining the prospects for development in Africa and elsewhere—has reminded us of the fragility of the progress accomplished and the magnitude of the challenges we face as we approach the millennium.

Overcoming and avoiding crisis

The global economy has just passed through a perilous period. Less than a year ago, a worldwide recession was a distinct possibility, and many observers had jumped to the conclusion that our forms of cooperation were ineffective and that the process of globalization, which had brought such clear benefits to many economies, was fundamentally flawed and should be reversed. None of these predictions has come to pass. Although growth rates are still below the long-term averages, and performance has not been evenly distributed, the global economy has quickly overcome the risk of recession. And despite the still difficult external situation faced by many countries, almost universally the governments of the world have resisted the temptations of retreating behind protectionist barriers, restricting capital movements, and drifting into financial isolation.

This outcome owes a lot to the courageous policy action of many countries. A major contribution to the cause of long-term global stability and progress has come from the efforts of the emerging markets in Asia and Latin America to adopt reforms right away. They have shown that resolute policy implementation, with appropriate international support, does prevail. Their experience offers hope to other countries that remain in difficult circumstances or may face challenges in the future. We in the IMF have been proud to be with these countries in their search for solutions for these unprecedented crises, and we are most encouraged by the bright prospects they have helped to create.

But the cost of this crisis remains enormous, giving us a terrifying illustration of the risks that accompany the opportunities of the new century. What lessons should we draw from it for all countries?

• Excellence in macroeconomic policy is a must in international markets where complacency is an invitation to speculation; firmness goes hand in hand with flexibility.

• The health of the corporate and financial sectors must be kept under much stronger surveillance once crisis has struck, and a comprehensive strategy of strengthening and/or restructuring must be put in place without delay.

• Exchange rate regimes and the conduct of exchange rate policy have to be adapted to the economic fundamentals.

• Transparency and governance must be seen as essential components of sustainability of policies.

• Countries must act—before crisis strikes—to set up social safety nets adapted to the needs of vulnerable groups and to implement social policies consistent with a country's values and culture.

• Only participatory decision-making systems can guarantee durable popular support for in-depth reform. A program of economic stabilization or reform will not work unless it is effectively "owned" by the authorities of the country.

These six lessons tell us why the countries in Asia are beginning to emerge from crisis, with strong prospects for the future. But it must also be recognized that the crisis was not entirely of their own making. Significant, too, were poor investment decisions by external creditors and the deficiencies in international monitoring and supervision that allowed exposure to risk to accumulate to the extent that it threatened global financial stability. That is why the international community has been intensively debating how to strengthen the architecture of the international monetary and financial system. Avoidance of crises, or at least the reduction of their frequency or intensity, hinges on the success of those efforts.

Struggle against poverty

The fight against poverty has two dimensions—the national and the international. Ultimately, the key to generating employment, alleviating poverty, and narrowing gender differences is high-quality growth. And the most indispensable ingredient in promoting growth is investment: investment in countries' human resources, especially education, health, infrastructure, and investment—especially private investment—to promote productive activity. How can the level of private investment be raised? Here, the six lessons of the recent crisis are applicable, with particular emphasis on a stable macroeconomic foundation. Practical, institutional policies can also be adopted to improve access to opportunity for households—especially women—to promote their investment. A leading example is micro credit and financing.

Another essential foundation of the environment for investment is respect for the rule of law and a judicial system that enforces property rights and honors contracts.

Trade liberalization offers another far-reaching contribution. Individual countries can take a leaf from the book of many countries in Asia and Latin America that have achieved accelerated growth through outwardly oriented economic policies, including progressive trade liberalization. The international community can also make a major contribution. The industrial countries could open their economies to all exports of the poorest countries, not only encouraging existing primary commodity exports, but—more important for long-term growth—creating the potential for new, more diversified, export production.

This brings us to the international dimension of the fight against poverty. It starts with an effort to optimize the macroeconomic policies of industrial countries so as to bring their growth to full potential and to generate the external demand indispensable for developing countries. Beyond that, the recent renewed emphasis on social issues in international forums provides a golden opportunity to press forward with a major offensive on poverty alleviation.

Three tangible elements comprise an enabling international environment for poverty alleviation and investment in human resources. The first is debt relief. The poorest countries cannot face a globalized world unless the millstone of unsustainable debt is removed from around their necks. We in the IMF see with immense satisfaction that a broader part of the Heavily Indebted Poor Countries (HIPC) Initiative we launched in 1996, with the World Bank, is now endorsed by the Group of Eight. The Cologne Initiative [see *IMF Survey*, July 5, page 214] is a major step forward, and I hope that the necessary actions can be taken well before the end of this year to bring the proposal to fruition, including the financing.

The significance of the revised HIPC Initiative is reflected in its estimated cost, now projected to more than double. To meet this cost, we will make the best use of the resources at our disposal, and we are ready, if agreement is reached among our membership, to play our part, including through use of our gold, as we first proposed three years ago.

The second element is also part of the Cologne Initiative—namely, the establishment of a tighter link between debt relief and social spending, especially for education and health. This link can help make structural adjustment programs much more effective in setting the priority of human investment and development.

The third element should be the most straightforward. To accelerate the alleviation of poverty, a supplement of official development assistance (ODA) is necessary. But here let us stop lamenting our failure to reach our pledge of devoting 0.7 percent of industrial GNP to ODA by the year 2000. Of course, we must reverse this deplorable trend, but we should also remember the pledges that both industrial and developing countries have adopted at past ECOSOC conferences in the 1990s. They include a commitment not only to reduce extreme poverty by half but also to achieve universal primary education, reduce infant and child mortality by two-thirds and maternal mortality by three-fourths, achieve universal access to reproductive health service, and ensure that current trends in the loss of environmental resources are reversed—all by the year 2015. And they include this essential precondition for the durable empowerment of women: elimination of gender disparity in primary and secondary education by 2005. Taken together, and steadily implemented, they could lead to a formidable change for the better for all the poorest people of the world.

Serving peace

As human beings and as heads of institutions striving for improving economic conditions around the world, we cannot accept the fact that time and again the efforts of so many countries and the world community for economic progress are annihilated by new armed conflicts with all their consequences of human suffering, and destruction of property, jobs, and opportunities. I believe the global community has a sacred duty to address this issue.

I dare to raise this sensitive matter, which is much more your business as diplomats than mine as the head of a financial institution, because it is not purely a political issue but an economic and social one too: excessive military expenditure diverts resources from human development. It is tragic that military conflicts in many of the poorest corners of the world are creating new pressures for increased military spending. Accordingly, as you certainly recognize that the sale of military equipment, beyond what can reasonably be justified, severely undermines peace and development, I propose we revisit four suggestions:

- We should adopt agreements that would restrain sales of military equipment in sensitive regions well in advance of any open belligerence.
- We should pledge to banish any export credit for military purposes, as a means to reduce debt accumulated for unproductive purposes.
- African nations—indeed, poor nations everywhere—should accept the recommendations made by the Secretary General one year ago to reduce military expenditure to 1.5 percent of GDP and to maintain zero growth of defense budgets for the next decade.
- We should interdict the smuggling of raw materials and natural resources used to finance armed insurgency in many African countries.

Speaking from my own limited experience, for high-quality growth, for employment and work, for poverty eradication, for empowerment and advancement of women, and for education and opportunities for a better life for the children of the world, remember: peace is a must.

$4.1 billion package

IMF approves Stand-By credit for Mexico, commends authorities for sound policies

In a press release dated July 7, the IMF approved a 17-month Stand-By credit for Mexico equivalent to SDR 3.1 billion (about $4.1 billion) to support the government's 1999–2000 economic program. There will be seven disbursements under the Stand-By credit. The first three will be for SDR 517.2 million (about $687 million) each. The first is available immediately; the second, when the end-June 1999 performance criteria are met; and the third, based on the first program review scheduled to be completed by December 1999 and subject to the end-September 1999 performance criteria having been met. The next four disbursements of SDR 387.9 million each (about $515 million) will become available based on the performance criteria being met for end-December 1999, end-March 2000, end-June 2000, and end-September 2000, and subject to reviews scheduled to be completed by March and June 2000, respectively.

In commenting on the Executive Board's discussion of the request by Mexico, IMF First Deputy Managing Director Stanley Fischer made the following statement:

"Directors commended the authorities for their pursuit of sound economic policies and structural reforms, which have restored confidence and set the stage for sustainable growth. As a result of these policies and the authorities' prompt response to external shocks, the resilience of the Mexican economy has increased. Directors noted in particular the role that the floating exchange rate had played in absorbing shocks and ensuring that major external imbalances did not develop. Directors supported the program's access to IMF resources, considering this an appropriate preventive strategy to maintain market confidence. The view was expressed that, should the international environment improve, the authorities should treat this arrangement as precautionary.

"Directors cautioned that the Mexican economy remains vulnerable to shocks. The continued fragility of the banking system was a major weakness, and Directors urged the authorities to accord this area top priority and to accelerate the pace of banking reform. They underscored the importance of enforcing strict adherence to existing financial regulations and upgrading the financial system's legal, regulatory, and supervisory framework consistent with the Basle core principles.

"Directors considered that the fiscal stance was appropriately tight, and based on a conservative oil price assumption, as well as on measures that will increase nonoil revenues by about 2 percentage points of GDP. Directors praised the authorities for protecting social expenditures, while lowering noninterest expenditures to their lowest level relative to GDP in this decade. In this regard and pointing to the still high incidence of poverty, Directors considered it important to strengthen the social safety net and the delivery of social services, with due regard to budgetary constraints. They particularly urged the authorities to follow through on their own plans to restrain public expenditures through the presidential elections and to build a consensus for a tax reform package that could be submitted for congressional consideration. Directors also encouraged greater fiscal transparency, particularly related to banking restructuring costs.

"Directors also broadly supported the stance of monetary policy, within the context of the existing floating exchange rate regime. They recognized that the demonstrated commitment to inflation reduction was engendering confidence, as evidenced by the steady decline in inflation expectations, and encouraged continuation of policies aimed at further reducing inflation.

Mexico: selected economic indicators

	1995	1996	1997	1998[1]	1999[2]	2000[2]
	(annual percent change)					
Real GDP	–6.2	5.1	6.8	4.8	3.0	5.0
Consumer prices (end of year)	52.0	27.7	15.7	18.6	13.0	10.0
	(percent of GDP)					
External current account	–0.6	–0.5	–1.8	–3.8	–2.2	–3.1

[1]Preliminary.
[2]Projections.

Data: Mexican National Institute of Statistics and Geography; Bank of Mexico; Mexican Secretariat of Finance and Public Credit; and IMF staff estimates

"Directors agreed that, as capital market access improved, the external current account deficit could well widen and be financed mostly by foreign direct investment. In this regard, they stressed the importance of monitoring private sector access to international capital markets, and making full use of the early warning debt monitoring system that has been established. They noted that the authorities' prudent debt management strategy should provide a manageable medium-term external debt profile," Fischer said.

Program summary

Mexico's economy expanded strongly from mid-1995 as a result of a pursuit of sound economic policies and structural reforms, which have reestablished credibility and set the stage for sustainable growth over the medium term. These policies have also increased the resilience of the

Mexican economy to external shocks, as reflected in the limited impact of recent international financial market turbulence. The government's reaction to the shocks through prompt adjustments in fiscal and monetary policies, in the context of a flexible exchange rate regime, gave market participants confidence that major external imbalances would not develop. To further reduce vulnerability to adverse shocks, the Mexican authorities are continuing their efforts to restructure the banking system, which needs to play a key role in supporting economic growth.

The medium-term strategy seeks to consolidate the gains made in 1995–98 and set the economy on a sustainable growth path that would expand employment opportunities and reduce poverty in the context of low inflation. The economic program aims to reduce inflation to 13 percent during 1999 from 19 percent during 1998, and to 10 percent during 2000. Real GDP growth is expected to decline to 3 percent in 1999, reflecting, in part, reduced access to international capital markets, but is set to recover to 5 percent in 2000 as conditions improve. Correspondingly, the external current account deficit is projected to decline to 2.2 percent of GDP in 1999 and then to increase to 3.1 percent of GDP in 2000 as the pace of investment picks up. The overall public sector deficit is programmed, based on a conservative oil price assumption, at 1 ¼ percent of GDP in 1999. Fiscal measures already in place are expected to raise non-oil revenue by ½ of 1 percent of GDP, while noninterest expenditure is budgeted to fall to its lowest level relative to GDP this decade without affecting social expenditure.

The authorities also intend to continue carrying out structural reforms aimed at bolstering market confidence in the Mexican economy and consolidating access to international capital markets on increasingly favorable terms.

Despite a decline in public sector noninterest expenditures of 2 percent of GDP in 1998, social sector expenditure as a percent of GDP increased to 9 percent in 1998 from 8.6 percent in 1997. The authorities have also undertaken to improve the efficiency of social expenditure through better targeting, such as the linkage of family income transfers to compliance with preventive health care guidelines, vaccination schedules, and primary school attendance.

Mexico is an original member of the IMF; its current quota is SDR 2.6 billion (about $3.4 billion). Its outstanding use of IMF financing currently totals SDR 4.3 billion (about $5.7 billion). ■

The text of Press Release No. 99/28 is available on the IMF's website (www.imf.org).

UNCTAD press release

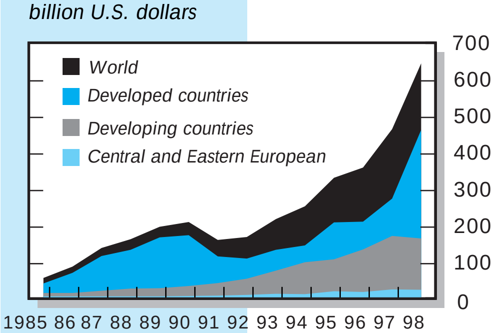
Global foreign direct investment surged in 1998

Cross-border mergers and acquisitions in developed countries fueled a 39 percent leap in global foreign investment in 1998 from 1997, according to a press release of the United Nations Conference on Trade and Development (UNCTAD). World foreign direct investment inflows increased to $644 billion in 1998 from $464 billion in 1997, despite a slowdown in world economic growth to 2 percent in 1998 from 3.4 percent the previous year.

Global foreign direct investment rose in 1998 despite the financial crises that hit many developing countries and Russia, the decline in the value of world trade, instability in Russia and Latin America, commodity price declines, and a slowdown of privatization programs, as well as excess capacity in the automobile, steel, and petroleum-related products industries, according to UNCTAD.

Foreign direct investment inflows

billion U.S. dollars



Data: UNCTAD.

Mega deals

Cross-border mega deals with transaction values of more than $3 billion were the order of the day in 1998, when 32 such deals took place, compared with 15 in 1997 and 8 in 1996, UNCTAD reports. In 1998, nearly 90 percent of large cross-border mergers and acquisitions—which do not necessarily require cash or new funds but can be based on a mutual exchange of stock—took place in developed countries, where this mode of entry is more important than in developing countries.

The total value of majority-owned, international mergers and acquisitions amounted to $411 billion in 1998, almost twice that of 1997 and three times the 1995 level. The surge in merger and acquisition activity is partly due to increased competition brought about by liberalization and international business consolidation. The value of cross-border mergers and acquisitions cannot be calculated as a percentage of foreign direct investment, because they are financed by foreign direct investment as well as by borrowing from capital markets, and the financial transactions related to mergers and acquisitions can be phased over several years, UNCTAD notes.

Regional activity

The European Union was the largest investor and recipient of foreign direct investment; the United States was the single largest host and home country for foreign direct investment; and in Japan, mergers and acquisitions increased inflows, while outflows declined substantially, primarily because of corporate restructuring.

Inflows into Latin America and the Caribbean were more than $71 billion in 1998, marking a 5 percent increase over 1997, according to another UNCTAD press release. South American countries received 75 percent of total foreign direct investment in the region, and, among those, Brazil recorded an increase of 53 percent in inflows, to $29 billion, according to UNCTAD. (For information on foreign direct investment in Central and Eastern Europe and Russia, see *IMF Survey*, July 5, page 223, and for developing Asia, see *IMF Survey*, May 24, page 175.) ■

The full texts of both press releases are available on UNCTAD's website (www.unctad.org).

Y2K problem

Developing countries could be vulnerable to disruption caused by "millennium bug"

***A**s the twentieth century draws to a close, concerns have arisen about the year 2000 (Y2K) problem. The May 1999 edition of the* World Economic Outlook *(see* IMF Survey, *May 10, page 158) includes a brief description of the potential macroeconomic implications of the "millennium bug." (See also* IMF Survey, *April 26, page 119.)*

The Y2K problem is a legacy of a computer programming shortcut used in the 1960s and 1970s to save computer memory. Software programmers used two digits instead of four (for example, 99 instead of 1999) to identify the year in the date field in software code. As a result, many computer programs and systems may fail or generate errors as they misinterpret 00 as 1900 instead of 2000.

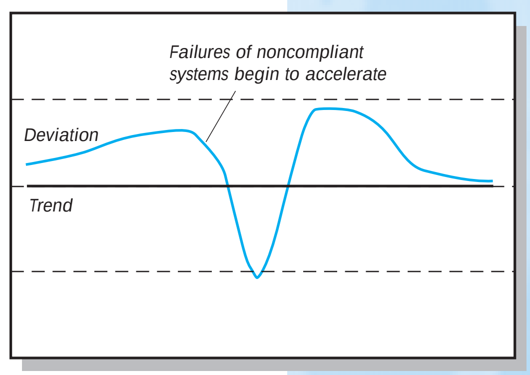
Government agencies and businesses around the world have spent considerable resources to assess the extent of the problem in their systems and to fix and test vulnerable systems. Despite these efforts, the *World Economic Outlook* notes, considerable uncertainty remains about the extent of the remaining problem. Many governments, public sector entities, and private companies, particularly small and medium-sized enterprises, have not finished—or in some cases, even begun—the remediation process. In addition, it is almost impossible to ensure that systems are fully protected from the bug in an era when computer and information systems are extensively interconnected. Because of these uncertainties and others regarding anticipatory behavior—such as the hoarding of goods and currency and the avoidance of travel—estimates of the Y2K problem vary widely and are subject to wide margins of effort. Thus, the IMF staff study notes, the projections in the *World Economic Outlook* do not attempt to incorporate any estimate of these effects. However, it is possible to speculate in qualitative, rather than quantitative, terms about the potential macroeconomic consequences.

Negative supply shock

The impact of the millennium bug, the *World Economic Outlook* suggests, may best be compared to that of a negative supply shock, such as a natural disaster, since a portion of the existing capital stock in the form of hardware and software will become temporarily unusable and, in some cases, obsolete. Because the problem has been foreseen, there has been some time to attempt to reduce its potential impact. But because it is a global shock, resources and expertise to repair problems could become severely constrained early in 2000.

Some businesses, the IMF staff study notes, particularly insurance companies and other financial services firms that make projections about the future, began efforts to make their systems Y2K compliant more than 10 years ago, partly because systems failures had already begun to occur. In recent years, repair efforts have intensified and expanded to include other sectors. Because measured GDP does not take into account the depreciation of systems caused by the Y2K problem, these repairs have actually boosted measured output to the extent that they have increased spending—for example, as firms have advanced plans to modernize their information technology infrastructure without reducing other expenditures. For the U.S. economy, for example, the impact on real GDP has been estimated to have been several tenths of a percentage point in each of the past few years. In other economies, where the repair effort is not as advanced and reliance on computers is less, the impact on GDP has been correspondingly smaller. Toward the end of 1999, GDP may also be stimulated by stock building of goods by consumers and businesses as a precaution against potential economic disruptions in early 2000.

Impact of Y2K: stylized depiction of deviation of GDP from trend



Data: IMF, *World Economic Outlook*, May 1999

Some disruptions in economic activity are expected in early 2000, according to the *World Economic Outlook*, to the extent that some firms and government agencies will not have addressed the problem in time. In addition, destocking as the threat of disruption fades and lower Y2K-related spending in organizations that have already completed their remediation efforts may tend to reduce aggregate demand and output early in 2000. However, as unprepared firms and government agencies repair their computer systems and make up for lost output, GDP may be boosted, perhaps starting later in 2000, possibly followed by a small negative impact as the extra spending is unwound. The figure on page 233 is a stylized (that is, no actual measurements on the *x* or *y* axes) depiction of the time profile of the net outcome of those effects in terms of aggregate output: an initial boost to activity resulting from anticipatory expenditures, followed by a drop in output as Y2K takes its main toll, and then a renewed upswing resulting from repair spending.

As with other types of supply shocks, the macroeconomic effects could include higher prices or lower profits and lower productivity. Already, the IMF staff study notes, wages among COBOL programmers—those most involved with the compliance effort—have risen significantly, and prices may rise to cover these higher wage costs as well as other costs of the remediation effort. Firms that face relatively high costs will realize a reduction in profits.

Perhaps the greatest uncertainties are attached to the possible impact of the Y2K problem in developing and transition economies.

Developing and transition economies

Perhaps the greatest uncertainties are attached to the possible impact of the Y2K problem in the developing and transition countries, according to the *World Economic Outlook*. On the one hand, these economies are generally less dependent than the advanced economies on computer-based technology, which suggests that the potential disruptions would be less serious than in the advanced economies. Moreover, in the rapidly growing economies at least, a larger share of the capital stock is recently installed and therefore relatively likely to be Y2K compliant. On the other hand, because some countries are less likely to have invested sufficiently in fixing the Y2K problem, they may be more vulnerable, particularly to infrastructure failures in such areas as electricity, water, communications, transportation, and health services, which tend to be dependent on older computer systems. Government tax collection and statistical systems may also be vulnerable. In addition, to the extent these countries have problems, it may take them longer to fix their computer and information systems because of financial and human resource constraints. Also, failures in payment and other financial systems that are not Y2K compliant could lead to disruptions in international trade, while perceived or actual compliance problems might increase capital flight and affect the cost and availability of external financing, especially in those cases where potential problems might affect production for exports and, therefore, the balance of payments.

Conclusion

The macroeconomic effects of the Y2K problem are potentially significant but extremely difficult to quantify, the *World Economic Outlook* concludes. They should not be exaggerated, since experience suggests that economies can quickly recover from temporary shocks. In industries and sectors where compliance problems have been identified, there may still be time to alleviate the problem. But it is unlikely that all problems can be addressed in time. ■

Copies of the May 1999 *World Economic Outlook* are available for $36.00 (academic rate: $25.00) each from IMF Publication Services. See ordering information on page 237. The full text is also available on the IMF's website (www.imf.org).

Members' use of IMF credit
(million SDRs)

	During June 1999	January–June 1999	January–June 1998
General Resources Account	899.91	6,105.39	7,223.54
Stand-By Arrangements	114.50	4,309.07	5,666.68
SRF	0.00	3,636.09	4,400.00
EFF arrangements	561.91	1,129.70	1,556.86
CCFF	223.50	666.62	0.00
ESAF arrangements	32.34	413.20	460.70
Total	932.25	6,518.59	7,684.24

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

Data: IMF Treasurer's Department

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
July 5	3.34	3.34	3.80
July 12	3.35	3.35	3.81

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 (as of January 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 113.7 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer's Department

Press release

Following is an extract of a recent IMF press release. The full text is available on the IMF's website (www.imf.org) under "news" or on request from the IMF's Public Affairs Division (202) 623-6278.

Senegal: ESAF

The IMF approved the second annual loan under the Enhanced Structural Adjustment Facility (ESAF) to support Senegal's economic and financial program. The three-year ESAF loan was approved on April 20, 1998 (see Press Release No. 98/14, *IMF Survey*, May 27, 1998, page 137) in an original amount of SDR 107.0 million (about $141.9 million), of which SDR 35.7 million (about $47.3 million) has been disbursed. Today's decision provides Senegal with another SDR 35.7 million to be disbursed during the second annual economic and financial program supported by the ESAF, with SDR 14.3 million (about $18.9 million) available immediately.

In commenting on the Executive Board's discussion of the request by Senegal, IMF Deputy Managing Director Alassane D. Ouattara made the following statement:

"Directors welcomed Senegal's continued macroeconomic stability under the ESAF-supported program. Economic performance in 1998 had been strong, with relatively high growth, low inflation, and a decline in the external current account deficit. A broadly similar performance was expected in 1999.

"Directors also welcomed the orientation of fiscal policy to raising revenues and curtailing nonessential expenditures so as to create room for social expenditures to rise without threatening financial stability. They welcomed the planned reduction in domestic debt. Directors looked forward to full implementation of the Common External Tariff of the West African Economic and Monetary Union (WAEMU) on January 1, 2000, which would include reduction in the maximum tariff rate and the elimination of distortionary features of the trade system. Directors attached importance to proceeding as rapidly as possible with the planned reform of the value-added tax, so as to offset revenue losses from tariff reductions.

"Directors emphasized the need for effective government expenditure to promote human resource development, alleviate poverty, and improve Senegal's social indicators. Directors stressed, in particular, the importance of improvements in education, provision of basic health services, and investment in rural infrastructure. A merit-based system for government salaries was seen as important in improving the efficiency of spending.

Senegal: selected economic and financial indicators

	1996	1997[1]	1998 Revised program	1998 Estimates	1999[2,3]	2000[3]	2001[3]
	(annual percent change)						
Real GDP	5.2	5.0	5.7	5.7	6.4	6.0	6.0
Consumer prices (annual average)	2.8	1.8	...	1.1	2.0	2.0	2.0
	(percent of GDP)						
Overall fiscal balance (commitment basis, excluding grants)	–4.6	–2.0	–2.0	–3.3	–4.4	–3.4	–2.6
External current account (excluding official transfers)	–8.0	–7.8	–7.7	–6.8	–7.0	–6.3	–5.8

[1]Estimates.
[2]The fiscal projections for 1999 and 2000 are shown including the supplementary budget.
[3]Projections.

Data: Senegalese authorities and IMF staff estimates and projections

"Acceleration and deepening of structural reforms remain central in removing impediments to private enterprise and sustaining economic growth. Directors welcomed the authorities' program to complete the privatization and restructuring of publicly owned enterprises by end-2000, and emphasized

IMF launches pilot project for voluntary release of Article IV staff reports

On April 5, the IMF Executive board agreed to a pilot project for the voluntary release of Article IV staff reports. Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with its members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The views expressed in an Article IV staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities. The views of the Executive Board are summarized in a Public Information Notice (PIN), which is attached to the Article IV report. Comments by the authorities on the staff report are also attached, if any were submitted at the time of the Executive Board discussion. Additional documentation prepared by IMF staff for the Article IV consultation may be posted on the IMF's website separately as part of the Staff Country Report series and subsequent to the posting of the Article IV staff report.

The IMF will review the experience with the publication of Article IV staff reports under the pilot project after a year. Comments on the reports and the project are invited (details available on the IMF's website: www.imf.org).

Following are recently published Article IV staff reports in the Staff Country Report series:

99/47: Kingdom of the Netherlands—Aruba

99/48: Trinidad and Tobago

99/50: Albania (also includes request for second annual arrangement under the Enhanced Structural Adjustment Facility and request for augmentation)

99/59: Republic of Estonia

99/60: Malta

IMF Staff Country Reports are available for $15.00 a copy from IMF Publication Services. See page 237 for ordering information.

the need for liberalization of the energy and transport sectors. Directors encouraged the authorities to press ahead with their ongoing efforts to strengthen the judicial and legal systems, and improve governance."

Program summary

The medium-term strategy under the program is to achieve higher growth by raising investment rates and productivity. The program for 1999–2001 seeks to raise real GDP growth to 6.4 percent in 1999 and 6 percent in 2001 from 5.7 percent in 1998. Annual inflation is to be held at around 2 percent, and the external current account deficit (excluding official transfers) is expected to narrow to less than 6 percent of GDP in 2001.

To meet these objectives, the government policies aim at strengthening financial viability while reducing the structural rigidities that have constrained growth in the past. Monetary policy will continue to be conducted at the regional level by

Extended Fund Facility (EFF) arrangements are designed to rectify balance of payments problems that stem from structural problems.

Stand-By, EFF, and ESAF arrangements as of June 30

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By Arrangements			32,633.28	8,239.55
Bosnia and Herzegovina	May 29, 1998	April 28, 2000	77.51	38.77
Brazil[1]	December 2, 1998	December 1, 2001	13,024.80	5,969.70
Cape Verde	February 20, 1998	December 31, 1999	2.50	2.50
El Salvador	September 23, 1998	February 22, 2000	37.68	37.68
Korea[1]	December 4, 1997	December 3, 2000	15,500.00	1,087.50
Philippines	April 1, 1998	March 31, 2000	1,020.79	633.40
Thailand	August 20, 1997	June 19, 2000	2,900.00	400.00
Uruguay	March 28, 1999	March 28, 2000	70.00	70.00
EFF			12,058.43	7,415.10
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	15.80
Bulgaria	September 25, 1998	September 24, 2001	627.62	418.42
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Indonesia	August 25, 1998	November 5, 2000	5,383.10	1,922.40
Jordan	April 15, 1999	April 14, 2002	127.88	117.22
Kazakhstan	July 17, 1996	July 16, 1999	309.40	154.70
Moldova	May 20, 1996	May 19, 2000	135.00	72.50
Pakistan	October 20, 1997	October 19, 2000	454.92	341.18
Panama	December 10, 1997	December 9, 2000	120.00	80.00
Peru	Jun 24, 1999	May 31, 2002	383.00	383.00
Ukraine	September 4, 1998	September 3, 2001	1,919.95	1,428.60
Yemen	October 29, 1997	October 28, 2000	105.90	76.90
ESAF			4,090.20	2,204.26
Albania	May 13, 1998	May 12, 2001	35.30	13.95
Armenia	February 14, 1996	December 20, 1999	109.35	20.93
Azerbaijan	December 20, 1996	January 24, 2000	93.60	17.55
Benin	August 28, 1996	January 7, 2000	27.18	14.50
Bolivia	September 18, 1998	September 17, 2001	100.96	67.31
Burkina Faso	June 14, 1996	September 13, 1999	39.78	0.00
Cameroon	August 20, 1997	August 19, 2000	162.12	54.04
Central African Republic	July 20, 1998	July 19, 2001	49.44	41.20
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	161.98
Ethiopia	October 11, 1996	October 22, 1999	88.47	58.98
The Gambia	June 29, 1998	June 28, 2001	20.61	17.18
Georgia	February 28, 1996	July 26, 1999	166.50	27.75
Ghana	May 3, 1999	May 2, 2002	155.00	132.84
Guinea	January 13, 1997	January 12, 2000	70.80	23.60
Guyana	July 15, 1998	July 14, 2001	53.76	35.84
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Honduras	March 26, 1999	March 25, 2002	156.75	96.90
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	43.00
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	27.28
Madagascar	November 27, 1996	November 26, 1999	81.36	54.24
Malawi	October 18, 1995	December 16, 1999	50.96	7.64
Mali	April 10, 1996	August 5, 1999	62.01	0.00
Mongolia	July 30, 1997	July 29, 2000	33.39	21.89
Mozambique	June 28, 1999	June 27, 2002	58.80	58.80
Nicaragua	March 18, 1998	March 17, 2001	148.96	67.27
Niger	June 12, 1996	August 30, 1999	57.96	9.66
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	47.60
Senegal	April 20, 1998	April 19, 2001	107.01	71.34
Tajikistan	June 24, 1998	June 23, 2001	100.30	60.00
Tanzania	November 8, 1996	February 7, 2000	181.59	29.38
Uganda	November 10, 1997	November 9, 2000	100.43	43.52
Yemen	October 29, 1997	October 28, 2000	264.75	140.75
Zambia	March 25, 1999	March 24, 2002	254.45	244.45
Total			48,781.91	17,858.91

[1]Includes amounts under Supplemental Reserve Facility.
EFF = Extended Fund Facility
ESAF = Enhanced Structural Adjustment Facility
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

the Central Bank of the West African States (BCEAO) through the use of direct, market-based instruments.

In 1999, the government will continue to contain the growth of current expenditures to ensure adequate funding for priority social sectors, maintenance of public infrastructure, and investment.

Structural reforms will focus on sustaining the overall strategy to accelerate private-sector-led growth and to achieve a lasting reduction in poverty. Some of the key measures center on finalizing the privatization and restructuring of public enterprises, developing a favorable environment for the private sector, deepening sectoral reforms, improving human resource management, and promoting economic integration among the WAEMU countries.

Senegal joined the IMF on August 31, 1962, and its quota is SDR 161.8 million (about $214.6 million). Its outstanding use of IMF financing currently totals SDR 192.42 million (about $255.2 million).

Press Release No. 99/29, July 12

Recent publications

Working Papers ($7.00)

99/75: *Simple Monetary Policy Rules Under Model Uncertainty*, Peter Isard, Douglas Laxton, and Ann-Charlotte Eliasson

IMF Staff Country Reports ($15.00)

99//46: Cameroon: Selected Issues and Statistical Appendix
99/47: Kingdom of the Netherlands—Aruba: Staff Report for the 1999 Article IV Consultation
99/48: Trinidad and Tobago: Staff Report for the 1999 Article IV Consultation
99/49: Zimbabwe: Statistical Appendix
99/50: Albania: Staff Report for the 1999 Article IV Consultation, Request for the Second Annual Arrangement Under the Enhanced Structural Adjustment Facility, and Request for Augmentation
99/51: Kingdom of the Netherlands—Aruba: Recent Economic Developments
99/59: Republic of Estonia: Staff Report for the 1999 Article IV Consultation
99/60: Malta: Staff Report for the 1999 Article IV Consultation

Other Publications

Guidelines for Public Expenditure Management, Barry H. Potter and Jack Diamond ($15.00)

Publications are available from IMF Publication Services, Box XS900, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; e-mail: publications@imf.org.

For information on the IMF on the Internet—including the full 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). The full texts of all Working Papers and Policy Discussion Papers are also available on the IMF's website.

Available on the web

News Briefs

99/39, July 2. IMF Executive Board Completes Central African Republic Midterm Review

99/40, July 2. IMF Management Recommends Approval of Brazil's Next Review

Public Information Notices (PINs) are IMF Executive Board assessments of members' economic prospects and policies issued following Article IV consultations—with the consent of the member—with background on the members' economies; and following policy discussions in the Executive Board at the decision of the Board. Recently issued PINs include

99/55: Estonia, July 1
99/56: Peru, July 6
99/57: Togo, July 7
99/58: The Gambia, July 12
99/59: Malta, July 13
99/60: Netherlands Antilles, July 13

Letters of Intent and Memorandums of Economic and Financial Policies are prepared by a member country and describe the policies that the country intends to implement in the context of its request for financial support from the IMF. Recent releases include

Central African Republic, Letter of Intent, June 7
Bosnia and Herzegovina, Letter of Intent, June 14
Mexico, Memorandum of Economic Policies, July 2
Mexico, Letter of Intent, June 15

Policy Framework Papers are prepared by the member country in collaboration with the staffs of the IMF and the World Bank. These documents, which are updated annually, describe the authorities' economic objectives and macroeconomic and structural policies for three-year adjustment programs supported by Enhanced Structural Adjustment Facility resources. Recent releases include

Albania, May 28
Mozambique, June 10

http://
www.imf.org

Concluding Remarks for Article IV Consultations. At the conclusion of annual Article IV discussions with the authorities, and prior to the preparation of the staff's report to the Executive Board, the IMF mission often provides the authorities with a statement of its preliminary findings. Recent releases include

Tunisia, June 16
United States, June 17
Greece, June 28

IMFSURVEY

Economic Forum

Participants debate benefits and challenges of dollarization for Latin American economies

Economic Forum participants

Jeffrey Frankel
New Century Chair, The Brookings Institution, and Harpal Chair, Kennedy School of Government, Harvard University

Guillermo Ortiz
Governor, Bank of Mexico

Miguel Kiguel
Chief, Cabinet of Advisors, and Under Secretary of Finance, Argentina,

Eduardo Borensztein
Chief, Developing Country Studies Division, Research Department, IMF

Moderator
David Goldsbrough
Deputy Director, Western Hemisphere Department, IMF

A report early this year from Argentina's central bank on the feasibility of full official dollarization and how it might be achieved has jump-started discussion on dollarization as a possible alternative exchange rate arrangement. The interest of a country as large and independent as Argentina has swiftly moved the topic from the realm of the theoretical to the realm of the possible, sparking a wide debate on its relative merits and feasibility. To gauge the practicality of dollarization in a large economy and to weigh possible costs and benefits, the IMF assembled a panel of academics and policymakers for an Economic Forum entitled "Dollarization: Fad or Future for Latin America."

Participants in the July 1 discussion, moderated by David Goldsbrough, offered a range of perspectives on the pros and cons of dollarization. In addition, Jeffrey Frankel contributed a broad review of exchange rate regime options; Guillermo Ortiz examined why floating rates have worked for Mexico; Miguel Kiguel explained why Argentina, despite the effectiveness of its currency board arrangement, is seriously considering full dollarization; and Eduardo Borensztein advised proceeding with some caution, given the scarcity of experience with dollarization in a large economy.

Exchange rate options

From the recent succession of exchange rate crises in emerging markets, some have concluded that only fixed or floating regimes can be effective in a globalized financial environment. But Jeffrey Frankel demurred. Fixed and floating regimes do offer certain benefits: a reduction in transaction costs and risks as well as the provision of a credible nominal anchor for monetary policy in the case of fixed rates, and the ability to pursue independent monetary policy under floating rates. But there is a danger, he warned, in overstating the need to choose one or the other.

Frankel: Neither a currency board nor dollarization will serve up "credibility in a bottle" without the necessary underlying institutions and political will.

According to Frankel, the optimal regime for a country still depends a great deal on individual circumstances, such as size, openness, correlation of shocks, labor mobility, fiscal cushions, desire to integrate with major partners, and the political will to sacrifice monetary sovereignty for stability. Also key are the availability of reserves, the strength of the banking system, and the existence of the rule of law (particularly crucial if a currency board is being considered). The regime itself is not the cure, he argued; neither a currency board nor dollarization will serve up "credibility in a bottle" without the necessary underlying institutions and political will.

Taking up the question of the advisability of dollarization for Argentina, Frankel pointed to the extensive dollarization that already exists in the country and asked whether anything would be lost by going further. Not opting for full dollarization, he suggested, would preserve a modicum of independence, allowing the country to abandon the currency board, peg to a different currency, or keep its limited scope to sterilize and cushion in the event of a reserves outflow. But the theoretical advantages of retaining some residual monetary independence are in practice illusory, Frankel observed.

Under its present currency board arrangement, Argentina is highly sensitive to U.S. interest rates. Under full dollarization, a U.S. decision on interest rates might run contrary to Argentina's domestic needs, but it is likely to be more advantageous, Frankel's data indicated, than the current situation. At present, Argentine interest rates rise, on average, 2.7 basis points for every 1 basis point increase in U.S. rates. By contrast, Panama, which is fully dollarized, sees its interest rates rise less, and rates in Mexico and Brazil rise "a lot more." This suggests, Frankel said, that full dollarization might provide a relative interest rate advantage and ensure, at worst, a one-to-one ratio.

The Argentine dollarization proposal suggested it would seek seigniorage, access to the U.S. Federal Reserve Board's discount window, and cooperation regarding bank supervision. Frankel suspected, however, that the United States would be wary of incurring contingent liabilities and unwilling to give up the seigniorage. The possible benefits for the United States—seigniorage, ease of business and travel transactions, increased trade (from greater stability and prosperity), and possible foreign policy gains—seemed to outweigh the potential costs, however, and he believed the dollarization proposal merited tacit, if not official, U.S. support.

Ultimately, Frankel observed, full official dollarization is probably a good idea for some Latin American countries, particularly several of the small open economies of Central America. It might even be a good idea for Argentina, he said, if the political willingness to give up all monetary sovereignty truly exists.

A Mexican perspective

As if to bolster Frankel's argument that the choice of exchange rate regimes is fundamentally driven by individual circumstances, both Guillermo Ortiz and Miguel Kiguel debated the pros and cons of dollarization from their countries' recent experiences with two very different regimes. Argentina, Mexico, and now Brazil, Ortiz noted, have adopted their current exchange rate regimes amid crises. When Mexico adopted a floating regime in 1994, it had run out of reserves and options.

Ortiz admitted that he was no fan of floating rates at the time. He feared a floating rate regime would be volatile in a country such as Mexico, that lacked futures and forward markets. At best, he hoped, Mexico might use the floating rates as an interim solution while it built up its reserves again. But four and a half years later, Ortiz was a convert. Floating rates had not impeded efforts to significantly lower inflation rates (down to an anticipated 13 percent in 1999 from 52 percent in 1995), and volatility has not been the problem he feared. Foreign investment flows have also held reasonably steady, and the floating regime has allowed Mexico to weather the Asian, Russian, and Brazilian shocks "in a very satisfactory fashion."

Ortiz contrasted Mexico's experience with those of Canada, Australia, and New Zealand, which also have floating regimes and have been hit by terms of trade shocks. In all four countries, the real exchange rate depreciated by 8–12 percent, but growth was preserved in all but New Zealand. This track record compares favorably with two economies with currency boards in place—Hong Kong SAR and Argentina, which both suffered recessions. "But of course," Ortiz added, "the fact that we are next to the United States, and Argentina is next to Brazil may have something to do with it, no?" On the flip side, Ortiz acknowledged, inflation has been higher in Mexico—and much higher for Mexico than for Canada, Australia, or New Zealand. Ortiz pointed to the credibility of monetary policies as one of Mexico's biggest remaining challenges.

On dollarization, Ortiz toted up the possible costs and benefits and found little to tempt Mexico. Latin America was not yet sufficiently integrated with the U.S. economy to accrue the types of benefits that a common currency (under the optimal currency area literature) might afford. And he was skeptical of credibility achieved essentially by burning one's bridges. Dollarization would reduce inflation and provide a great incentive to fiscal and financial discipline, but a dollarized economy would need a very strong financial system with ample liquidity and credit lines from abroad to function without a lender of last resort. He also underscored that, with monetary policy independence and floating rates, Mexico has been able to cope with external shocks and preserve growth.

At this juncture, Ortiz argued, greater integration with North America makes more sense for Mexico than dollarization. If Mexico were able to move toward the fiscal surpluses, very low inflation, and strong financial systems of its North American Free Trade Agreement (NAFTA) partners, any exchange rate regime would function better.

Why Argentina may be different

Ortiz: Monetary policy independence and floating rates have allowed Mexico to cope with external shocks and preserve growth.

Acknowledging that Canada, Mexico, and now perhaps Brazil are satisfied with floating rate regimes, Miguel Kiguel nonetheless insisted that Argentina is "somewhat special." A currency board arrangement has allowed the country to record possibly the best performance it has had in the century, despite recessions in 1995 and 1999. Running down a list of achievements, he cited the lack of interest that currently greets the release of inflation figures as perhaps the best indication of the profound change that has taken place in Argentina. Foreign investment has reached record levels, and foreign direct investment has been at its highest levels since the 1920s.

It is also important to understand, he said, that Argentina is already a highly dollarized economy. "People think in dollars," he observed; whenever a big figure is mentioned, it is a dollar figure. The capital market functions fully in dollars. While the peso is used for current transactions, Argentines by and large save in dollars: 92 percent of public debt is in dollars or other foreign currencies, and 58 percent of bank deposits—and 74 percent of savings—is in dollars. Argentines borrow in dollars also, with 66 percent of current bank loans denominated in dollars.

Kiguel: Dollarization could provide Argentina with less volatile interest rates and less uncertainty.

The obvious question then is, if the currency board has been a success, why raise the issue of full dollarization? Because, in times of crises, Kiguel said, the peso-dollar spread still rises sharply when there is an external crisis. The hope is that full dollarization will provide added stability.

This step, given Argentina's currency board and degree of dollarization, would not be as drastic a change for Argentina as it would be for other countries. Loss of monetary policy is cited as a distinct disadvantage of dollarization, but Argentina already has an essentially passive monetary policy, Kiguel pointed out. The quantity of money is determined entirely endogenously in the sys-

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tem, and the interest rate is fully market determined. The central bank still controls liquidity requirements, which affect credit; this, he suggested, is perhaps the key issue today.

One of the chief benefits of dollarization, the central bank analysis indicated, would be reduced country risk. If the fear of devaluation could be removed, country risk would be diminished. The Argentine report estimated that removing the devaluation risk could produce a significant (150–200 basis point) reduction in country risk.

Argentina also holds substantial reserves. Argentina could dollarize tomorrow if it wants, Kiguel said, but unilateral dollarization is not nearly as attractive a proposition as negotiated dollarization. If it dollarized unilaterally, Argentina stood to lose $700–750 million a year (about 2 percent of government revenues) when it exchanged its present holdings of U.S. treasury bills for dollars. Argentina was searching for ways to continue to earn the same interest. Dollarization would also effectively halve reserves, so that Argentina is seeking, he said, some combination of private sector and multilateral or U.S. government arrangements to enable the central bank to act as lender of last resort.

Dollarization, Kiguel stressed, is no panacea, but it does offer a means of strengthening convertibility and could thus afford Argentina less volatile interest rates and less uncertainty. Of course, he added, with either convertibility or dollarization, Argentina must continue to pursue strict fiscal policy, sound debt management, and an even stronger banking sector.

Issues to be considered

The present currency board arrangement and the substantial amount of dollars already in the economy do make dollarization a much less drastic step for Argentina than it would be for Mexico or other floating regimes, Eduardo Borensztein observed. But the decision, once made, would be very hard to reverse, and the potential costs and benefits could be difficult to measure, he advised.

Traditional optimal currency area literature has little relevance, he said, for countries considering dollarization, since they are in search of more immediate gains—namely, market credibility and shelter in the event of crises. The more pertinent issues, Borensztein argued, are seigniorage, country risk, and lender of last resort. The first two are relatively easy to quantify. The dollarized economy will lose seigniorage, and the country risk premium should be lower with dollarization. He cautioned, however, that the extent to which country risk could be reduced could be difficult to predict with accuracy. While there is a close correlation between currency risk and sovereign risk, it is less clear that currency risk causes sovereign risk. Panamanian bond spreads, for example, have not been fully protected from contagion or international market sentiment and tend to follow emerging market trends.

Borensztein: With few country experiences to draw from, the gains that large economies might expect from dollarization remain difficult to measure.

Argentina's experience with a currency board arrangement would facilitate its adaptation, under a dollarization scheme, to the absence of a formal lender of last resort. Floating regimes do provide the authorities with greater flexibility, but Borensztein noted that if there is a large problem in the banking sector, the ability to solve it by printing money has its limits. As a rule, he said, the more open an economy becomes and the higher the level of its capital mobility, the less margin there is for monetary policy.

Argentina's participation in the MERCOSUR regional trade arrangement and Mexico's in NAFTA also raise the issue of whether dissimilar exchange rate regimes complicate regional trade arrangements. At present, Argentina has a currency board, while Brazil, the largest member of MERCOSUR, has adopted a floating rate. Dollarization would not worsen the situation that already exists, Borensztein argued. There has not been significant exchange rate volatility other than the wide fluctuations that have been correlated with periods of high inflation and stabilization and the recent currency crisis in Brazil. With regard to Mexico and NAFTA, he believed exchange rate fluctuations would become problematic only if the regional arrangement were to deepen. The creation of a single market would, however, provide the impetus for a common currency. (A deepening of the MERCOSUR relationship would likely also raise the question of whether Argentina's trading partners would be willing to adopt the dollar.)

Ultimately, Borensztein noted, the biggest potential benefits from dollarization are likely to be the hardest to assess. Will adoption of the U.S. dollar increase trade and foreign direct investment and enhance credibility? And if it does, will this significantly accelerate convergence with the U.S. economy? With few country experiences to draw from, the gains that large economies might expect from dollarization remain difficult to measure with any certainty, he concluded.

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The full transcript of "Dollarization: Fad or Future for Latin America" is available on the IMF's website (www.imf.org).