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Managing Director's Announcement

IMF Board Approves Extended Arrangement To Support Indonesia's Economic Program

In a statement issued on August 25, IMF Managing Director Michel Camdessus said: "I am pleased to announce that the IMF's Executive Board today approved the next SDR 734 million (about \$1 billion) credit tranche for Indonesia. At the same time, the Executive Board approved an Extended Fund Facility (EFF) for Indonesia totaling SDR 4.7 billion (about \$6.2 billion) in support of the government's broad-based program to achieve economic recovery. The EFF replaces the three-year stand-by credit approved by the IMF

The longer repayment period will allow time for the reform program to take affect.

—Camdessus

on November 5, 1997, under which disbursements have already amounted to SDR 3.7 billion (about \$4.9 billion), and covers its remaining 26-month period through November 2000 [see Press Release No. 97/50, *IMF Survey*, November 17, 1997, page 354]. The amount of the credit available under the EFF and its duration are identical to those remaining under the stand-by credit that it replaces. However, the repayment period for financing under the EFF, which is intended to support economic programs dealing with deep-seated structural problems, is substantially longer than under a stand-by credit.

"The replacement of the stand-by by the EFF is in response to the broadening (Please turn to the following page)

HIPC Initiative

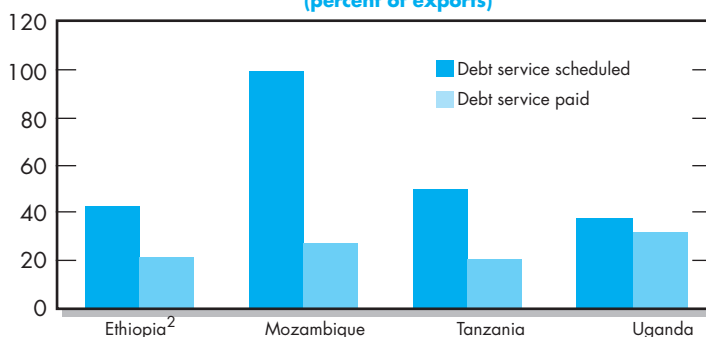
Relief Measures Help Lighten Debt Burden, Pave Way for Growth in Poorest Countries

Integration into the global economy has become the chief passport to economic growth and prosperity, but many of the world's poorest developing countries—in particular, those with unsustainable debt burdens—face the real threat of economic marginalization. For these heavily indebted poor countries (HIPCs), the burden of external debt can be an impediment to economic development and growth. At the same time, official financial assistance has been shown to be effective only in a policy environment conducive to growth. Traditional mechanisms for dealing with the debt problems of low-income countries are sufficiently robust to reduce the external debts of many HIPCs to sustainable levels (see box, page 271). However, even with sound economic policies and full use of traditional mechanisms for rescheduling and debt reduction and the continued provision of concessional financing, a number of coun-

tries are not expected to reach sustainable levels of debt within a reasonable period without further assistance.

To help indebted poor countries break out of this vicious circle, the IMF and the (Continued on page 271)

External Debt Service Scheduled and Paid, 1993–97¹ (percent of exports)



¹Calendar year for Mozambique, and fiscal years 1992/93–1996/97 for the other countries.

²Debt service paid excluding prepayment of Ethiopian airline debt in 1997/96.

Data: IMF staff estimates

Camdessus calls for implementation of Russian measures. See page 275.

(Continued from front page) of Indonesia's economic strategy in recent months under the stand-by credit to include a wide-ranging program of structural reforms. These

Schedule of Purchases Under the Extended Fund Facility

Date	Amount of Purchase (million SDRs)	Percent of Quota ¹
August 25, 1998	733.8	49.0
September 25, 1998	684.3	45.7
October 25, 1998	684.3	45.7
November 25, 1998	684.3	45.7
February 15, 1999	684.3	45.7
May 15, 1999	171.2	11.4
August 15, 1999	171.2	11.4
November 15, 1999	171.2	11.4
February 15, 2000	171.2	11.4
May 15, 2000	171.2	11.4
August 15, 2000	171.2	11.4
October 15, 2000	171.2	11.4
Total	4,669.1	311.8

Note: As of August 20, 1998, 1 SDR=US\$ 1.32542

¹Purchase amounts in percent of quota may not sum to the total access of 311.8 percent of quota due to rounding.

include programs for the restructuring of the banking and corporate sectors, as well as the deregulation of monopolies, the privatization of state-owned industries, and trade liberalization. This comprehensive reform strategy supports macroeconomic policies—a tight monetary stance combined with a fiscal deficit that, while accommodating increased social spending, is fully foreign financed—designed to strengthen the rupiah and reduce inflation. The longer repayment period under the EFF will allow time for the reform program to take full effect and will further strengthen the outlook for the balance of payments, which is already benefiting from substantial bilateral and multilateral external financing and programs for the restructuring of banking system and corporate debt to private creditors.”

Camdessus noted the good policy implementation in recent months and was encouraged by the recent appreciation of the rupiah. Looking forward, he emphasized the importance of maintaining an adequately tight monetary policy to reduce inflation and further strengthen the rupiah. He also stressed the importance of rapid progress with banking system and corporate restructuring to lay the foundation for a resumption of growth. ■

Financial Package

Sugisaki Welcomes Thailand's Resolve to Pursue Economic Restructuring Policies

On August 14, the Thai government announced a package of financial measures. In a news brief issued on August 14, Shigemitsu Sugisaki, Acting Managing Director of the IMF, welcomed these measures. Following is the text of the news brief.



Shigemitsu Sugisaki

“The actions announced by Finance Minister Tarrin Nimmanhaeminda and Central Bank Governor Chatu Mongol aim at decisively restructuring Thailand's financial system and facilitating economic recovery. The announcement recognizes that the recession and the regional economic environment warrant forceful and comprehensive measures.

“The authorities are seeking to address all the main areas of weaknesses in the financial system.

Today's announcement was preceded by forceful action involving intervention by the Bank of Thailand in additional banks and finance companies. Resolution strategies for these as well as previously intervened institutions have been announced, involving the exit,

merger, or sale of the unviable institutions. The hallmark of the announcement is the availability of public funds to catalyze the entry of new private capital, as well as strong incentives for banks to restructure corporate debt. A number of burden-sharing safeguards have been developed, including the write-down of the value of the assets of existing shareholders. Other aspects of the announcement encourage the adoption of international best practice prudential standards, commit the authorities to the operational restructuring of state banks to prepare them for privatization, and arrange for efficient recovery mechanisms for nonperforming assets.

“Today's announcement demonstrates the resolve of Thailand's authorities to pursue economic restructuring in the face of very difficult domestic and regional conditions, ensure the solvency and credibility of the core banking system, and strengthen the basis for the recovery of the economy. The measures constitute the core of ongoing discussions toward completion of the fourth review of the stand-by credit.” ■

Photo Credits: Padraic Hughes for the IMF, page 270; Robert Russell, page 279.

HIPC Provides Coordinated Debt Approach

(Continued from front page) World Bank jointly devised and put in place in September 1996 the HIPC Initiative—a program of action aimed at reducing the debt burdens of all eligible HIPCs to sustainable levels, provided they adopt and pursue strong programs of adjustment and reform. The Initiative builds on instruments available to the international community to deal decisively with the debt problems of low-income countries and allows them to exit—once and for all—from the rescheduling process.

The Initiative is a comprehensive, integrated, and coordinated approach to external debt that requires the participation of all creditors—bilateral, multilateral, and commercial. Central to the Initiative is the country's continued efforts toward macroeconomic adjustment and its implementation of structural reforms. In addition, the Initiative focuses on social sector reform programs—primarily in basic health and education.

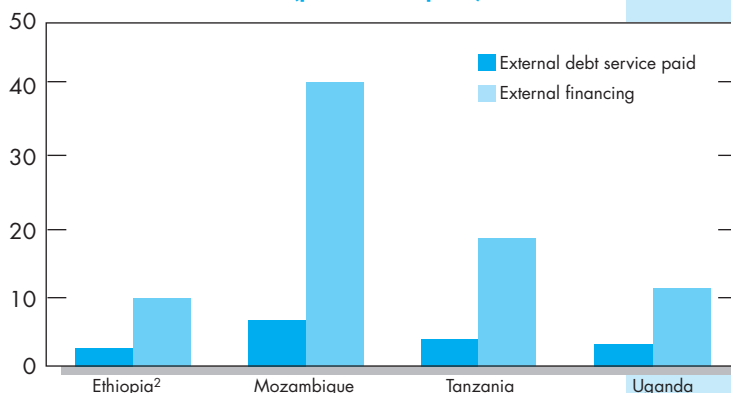
To obtain assistance under the HIPC Initiative, a country must be eligible for concessional assistance from the IMF and the World Bank, face an unsustainable debt burden even after the full application of traditional debt-relief mechanisms, and establish a track record of reform and sound policies through IMF- and World Bank-supported programs.

The Initiative is set up in two stages. In the first stage, the debtor country pursues a strong adjustment and reform program, supported by the IMF and the World Bank, and receives flow reschedulings on concessional terms from bilateral creditors. The *decision point* is reached after the country has established a three-year policy track record. At this point, the international community, including the IMF and the World Bank, makes a commitment to provide sufficient debt relief to reduce the debt burden of an eligible country to sustainable levels at the *completion point*, which is reached

after a further period of strong policy performance (the second stage).

In April 1998, Uganda became the first country to reach the completion point under the HIPC Initiative. During 1997/98, five additional countries reached the decision point—Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, and Mozambique; they are scheduled to reach their completion points under the Initiative at various dates between September 1998 and March 2001. The commitments made by the international financial community to these five countries total about \$2.3 billion in net present value terms (see box, this page), which is estimated to reduce debt service in nominal terms by some \$5.0 billion. Several other countries, including Ethiopia, Mali, and Tanzania, could reach their decision points over the next year or two, depending on their progress in policy implementation.

Debt Service Paid and External Financing, 1993–97¹
(percent of exports)



¹ Calendar year for Mozambique, and fiscal years 1992/93–1996/97 for the other countries.

² Debt service paid excluding prepayment of Ethiopian airline debt in 1997/96.

Data: IMF staff estimates

HIPC Definitions

Debt sustainability. A country may be considered to achieve external debt sustainability when it is able to meet its current and future external debt-service obligations in full, without recourse to debt relief, rescheduling, or the accumulation of arrears. Key indicators of external debt sustainability include the net present value of debt-to-exports ratio and the debt-service ratio. Sustainable debt levels under the Initiative are defined on a case-by-case basis as:

- the net present value of public and publicly guaranteed external debt in percent of exports within the range of 200–250 percent;
- the ratio of external debt service to exports within the range of 20–25 percent; or
- for very open economies with a heavy fiscal debt burden, despite strong efforts to generate fiscal revenue, a net present value

of the debt-to-export ratio below 200 percent and a net present value of the debt-to-fiscal revenue ratio no higher than 280 percent.

The **net present value** of debt is a measure that takes into account the degree of concessionality, in contrast to the face value of the external debt stock, which is not a good measure of a country's debt burden if a significant part of the debt is contracted on concessional terms; for example, with an interest rate below the prevailing market rate. The net present value is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the market interest rate. Whenever the interest rate on a loan is lower than the market rate, the resulting net present value is smaller than the face value, with the difference reflecting the grant element.

Naples terms involve debt reduction in the form of flow restructurings or stock-of-debt operations in net present value terms of 50 percent, or generally, 67 percent from bilateral creditors on eligible debt.

Four Case Studies

Ethiopia, Mozambique, Tanzania, and Uganda—which are in various stages of the HIPC Initiative process—are among the world’s poorest developing countries. In 1996, per capita income ranged from \$95 for Mozambique to

\$300 for Uganda. All four countries have pursued adjustment programs in recent years, with support from the IMF and the World Bank, and all four have benefited from debt relief. Social indicators have shown some improvements in recent years, although much more remains to be achieved.

As noted above, Uganda is the first country to reach the completion point under the HIPC Initiative—only one year after reaching the decision point, reflecting its exceptionally strong policy track record. Since the end of the civil war in 1986, the country has restored macroeconomic stability, and the economy has grown at an annual rate of 8½ percent over the last five years. Uganda has also made good progress in implementing structural reforms. HIPC assistance reduced Uganda’s debt by 20 percent in net present value terms; the debt-service relief that all creditors, including multilaterals, will provide over time is estimated at \$650 million. Some \$175 million of this is expected to be provided over the next five years, releasing resources to meet high priority development needs.

Mozambique, which reached its decision point in April 1998, began wide-ranging reforms in 1987, even before a devastating 15-year civil war ended in 1992. Despite the restoration of macroeconomic growth and stability, however, its reconstruction needs remain large and pressing, both in terms of social services and economic infrastructure. Mozambique is expected to reach its completion point in June 1999, con-

tingent on the continuation of strong economic and social policies. The HIPC assistance of almost \$3 billion in nominal debt-service relief that has been committed to Mozambique is the largest of the assistance packages that have been agreed to, amounting to over half of all relief committed under the HIPC Initiative so far and reducing the stock of Mozambique’s debt by 57 percent in net present value terms. The savings that will result from both past and ongoing traditional debt-relief mechanisms and from HIPC assistance will support a medium-term economic program of macroeconomic, structural, and social policies. This program includes the government’s objective to improve social and poverty indicators to at least the level of other sub-Saharan African countries.

Ethiopia and Tanzania are at a much earlier stage in the debt-relief process. Both countries have obtained IMF and World Bank support for their adjustment efforts in the past, although their track records are shorter and less consistent than those of Uganda and Mozambique. Depending on their progress in policy implementation, they could reach their decision points over the next year or two; both countries are currently expected to require assistance under the HIPC Initiative. Ethiopia made good progress in stabilization and deregulation in the first half of the 1990s, but the three-year ESAF arrangement of 1996/97 veered off track early on. Tanzania undertook adjustment efforts in the late 1980s and early 1990s and made substantial progress with structural reforms. Macroeconomic stabilization remained elusive, however, and growth has averaged only 2½ percent over the past five years. Since late 1996, Tanzania has been implementing a three-year program under the ESAF.

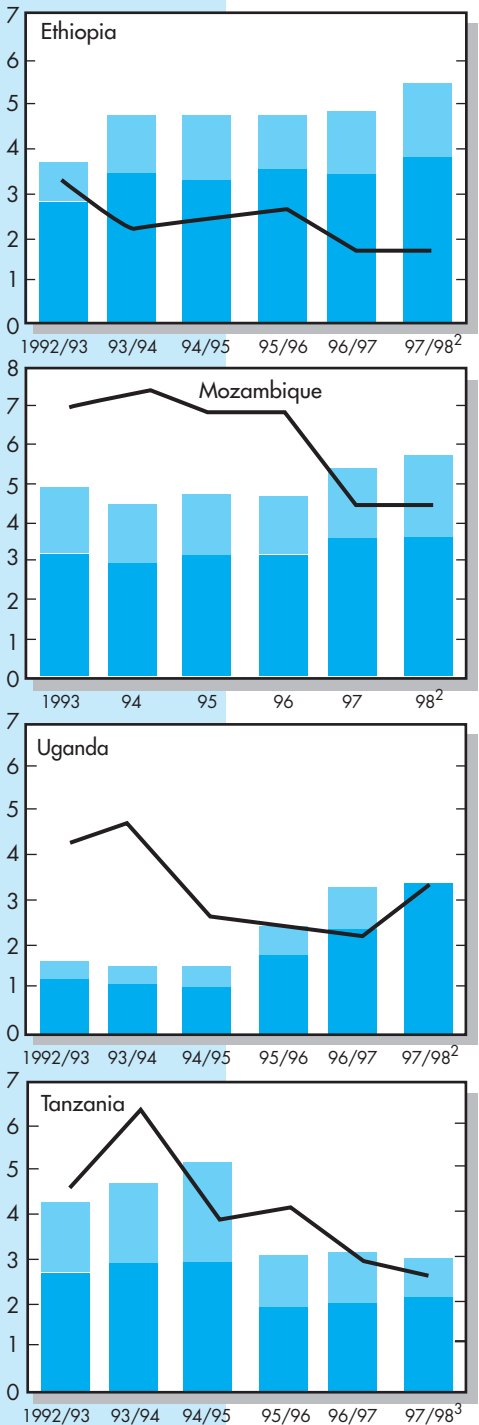
The debt burdens of these four countries share three characteristics:

- All four countries paid less—and, except for Uganda, much less—in debt service than what was scheduled during 1993–97, largely reflecting debt relief under traditional mechanisms (see chart, page 269).
- Foreign financing exceeded debt service paid by three- to fivefold during 1993–97 (see chart, page 271). Furthermore, over half of this assistance was in the form of grants rather than repayable loans, and even the latter contained a high grant element.
- External debt-service payments were lower than budgetary social expenditure in the last two years (see chart, this page). These observations are broadly consistent with a review of 36 countries that pursued SAF/ESAF-supported programs during 1986–95, including 20 countries in Africa (see *IMF Survey*, August 5, 1997, page 233). The review concluded that both education and health spending increased in real terms during such programs, although less so in Africa than in other regions. In line with these findings, as well as donor priorities, assistance under the HIPC Initiative

Social Spending and External Debt Service Paid

(percent of GDP)

— External debt service paid¹
 ■ Education Expenditure ■ Health Expenditure



¹For Ethiopia, data exclude the prepayment of Ethiopian airline debt in 1996/97.

²Projected.

³Projected: breakdown is not available.

is provided not only in support of macroeconomic adjustment and structural reforms but also of enhanced social policies.

Debt Relief Alone Is Not Sufficient

The six-year track record requirement in the HIPC process is part of a general trend in aid policies that puts more emphasis on conditionality. At the same time, aid resources have become increasingly limited in recent years, reflecting budget constraints of creditors and donors. This new emphasis reflects a recognition in the aid community—backed up by recent empirical studies—that aid without adjustment efforts is wasted and, furthermore, poses a moral hazard by discouraging countries from engaging in or continuing to pursue difficult adjustment and reforms.

Many of the HIPCs are in sub-Saharan Africa. The buildup of debt in Africa in the past was typically the result of a combination of factors, rather than a single cause. These included external developments, such as adverse terms of trade shocks or weather; civil strife; a lack of sustained macroeconomic adjustment and structural reforms; the lending policies of many creditors, especially the provision of loans at commercial interest rates with short repayment periods; and lack of prudent debt management policies by debtor countries.

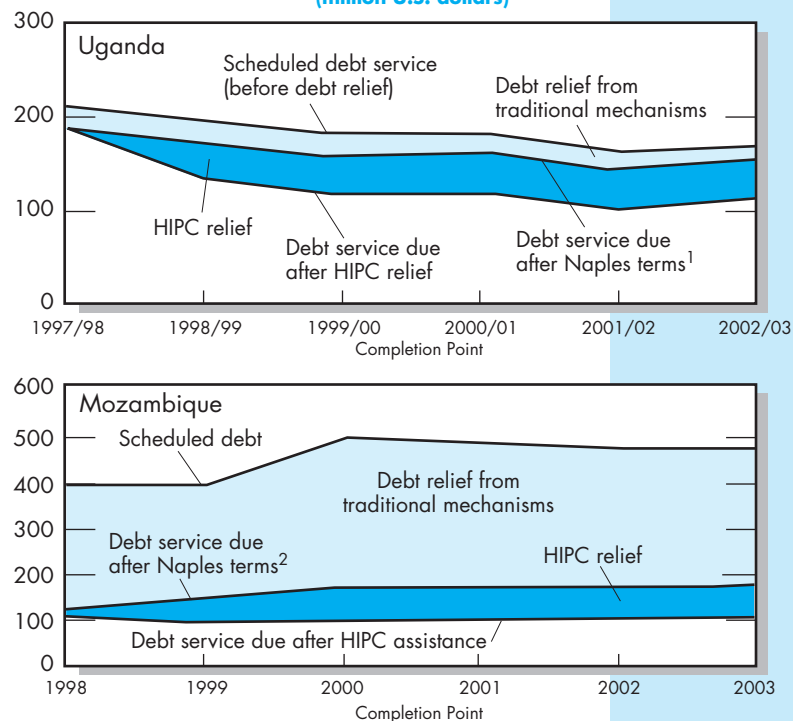
In recent years, economic performance in sub-Saharan Africa has shown a distinct improvement. Real GDP growth averaged just over 4 percent in 1995–97 compared to 1½ percent in 1990–94, and per capita income growth turned from an annual 2 percent decline in the first half of the 1990s to an annual increase of 1½ percent; inflation has dropped sharply from a peak of over 40 percent after the CFA franc devaluation in 1994 to some 13 percent in 1997; also, fiscal imbalances have been reduced, and the region’s external current account deficit has fallen from 6 percent of GDP to 4 percent in 1997. These developments reflect mainly improved policies in many countries in the region and demonstrate the importance of countries’ taking economic and social development into their own hands to lay the basis for a gradual exit from their dependence on debt relief.

Various commentators have called for the unconditional cancellation of all HIPC or developing country external debts by the year 2000. Calls for such a cancellation—given total HIPC external debts of over \$200 billion—are frankly unrealistic and raise false expectations. Debt relief is not a panacea, since debt is clearly only one of many problems these countries face. Unconditional cancellation risks debt relief being squandered on corruption, military expenditure, or grandiose projects with little if any benefit in terms of sustainable growth or poverty reduction. This could further erode support for aid flows in developed coun-

tries. Such widespread debt cancellation would also be difficult to justify—particularly to countries that are poor but not heavily indebted.

Poverty predates debt, and debt is only one of the complex of factors that hinder poverty reduction. Debt cancellation would not be the best way of promoting the twin goals of sustainable development and poverty reduction. These goals are best attained by providing

Debt Service Before and After HIPC Assistance (million U.S. dollars)



¹Reflecting the February 1995 stock-of-debt operation on Naples terms, involving a 67 percent reduction in net present value terms.

²Flow rescheduling on Naples terms from November 1996 onward, and assuming a stock-of-debt operation on Naples terms in mid-1999, involving a 67 percent reduction in net present value terms.

Data: IMF staff estimates

debt relief in a process, such as under the HIPC Initiative, that encourages the adoption of appropriate policies by the recipient country designed to stimulate private sector-led growth. This process also ensures the effective use of the debt relief provided through promoting health and education expenditures. It encourages the continued provision of aid flows to the countries concerned, which is particularly important given the dependence of HIPCs on such aid inflows—a dependence that would continue even if all debt were forgiven.

The HIPC Initiative process also allows countries to focus on tackling other factors that limit their growth—such as developing effective policymaking institutions and addressing governance issues—particularly as they influence investor confidence. These efforts should include commercial codes of conduct, functioning judicial systems, and the effective application of the rule of law.

Such difficult issues will not be resolved overnight. Seen in this light, the claim often made by critics of the HIPC Initiative, that the six-year adjustment record required under the Initiative is unduly long, is not consistent with either the reality of the problems these countries face or the experience of successful reformers. Also, it needs to be

recognized that aid dependency is a condition that these countries can grow out of only slowly; thus, international support beyond debt relief will continue to be essential. ■

Doris Ross and Anthony R. Boote
IMF Policy Development and
Review Department

Recent IMF Publications

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

No. 166: *Hedge Funds and Financial Market Dynamics*, Staff Team led by Barry Eichengreen and Donald Mathieson.

Considers the role of hedge funds in financial market dynamics, with particular reference to the Asian crisis.

No. 167: *Exchange Rate Assessment: Extensions of the Macroeconomic Balance Approach*, edited by Peter Isard and Hamid Faruquee. Examines the IMF's analytic framework for assessing exchange rates and considers extensions to the framework.

No. 168: *Exit Strategies: Policy Options for Countries Seeking Greater Exchange Rate Flexibility*, Staff Team led by Barry Eichengreen and Paul Masson. Studies reasons for and methods of moving to greater exchange rate flexibility.

Working Papers (\$7.00)

98/98: *The Impact of Economic Security on Bank Deposits and Investment*, Michael Fabricius. Presents an index of economic security to analyze the influence of institutional quality on economic activity.

98/99: *Explaining Investment in the WAEMU*, Athanasios Vamvakidis. Finds that differences in domestic investment within the WAEMU region during 1970–95 are related to economic freedom.

98/100: *From Inflation to Growth: Eight Years of Transition*, Peter Christoffersen and Peter Doyle. Reexamines growth in transition economies using panel data to 1997.

98/101: *Inflation and Money Demand in Albania*, Sanjay Kalra. Estimates relationships between prices, money, the exchange rate, and interest rates in Albania during 1993–97.

98/102: *How Big Is the Brain Drain?*, William J. Carrington and Enrica Detragiache. Estimates of emigration for 61 developing countries reveal substantial brain drain from the Caribbean, Central America, and some African and Asian countries.

98/103: *Policy Responses to External Imbalances in Emerging Market Economies: Further Empirical Results*, Chorng-Huey Wong and Luis Carranza. Finds that macroeconomic policy must deal directly with capital inflows to counter current account instability caused by high capital mobility.

98/104: *Determinants of Growth in an Error-Correction Model for El Salvador*, R. Armando Morales. An error-correction model identifies determinants of growth consistent with results from panel regressions for El Salvador for 1970–95.

98/105: *Developing Countries and the Globalization of Financial Markets*, Malcolm Knight. Analyzes the impact of the globalization of financial markets on developing and transition economies.

98/106: *Disinflation in Spain: The Recent Experience*, Nicolas Sobczak. Finds that a fall in inflation expectations, related to Spain's commitment to participate in EMU from the start, is the main element underlying the recent disinflation.

98/107: *Exchange Rate Fluctuations and Trade Flows: Evidence from the European Union*, Giovanni Dell'Ariccia. Analyzes the effects of exchange rate volatility on bilateral trade flows.

98/108: *Structural Reforms in Government Bond Markets*, Mark De Broeck, Dominique Guillaume, and Emmanuel Van der Stichele. Documents reforms in the government debt markets of industrial countries since the early 1980s.

Papers on Policy Analysis and Assessment (\$7.00)

PPAA/98/8: *Sequencing Capital Account Liberalizations and Financial Sector Reform*, R. Barry Johnston. Discusses financial, institutional, and regulatory considerations in connection with capital account liberalization.

IMF Staff Country Reports (\$15.00)

98/54: Cambodia—Recent Economic Developments

98/55: Canada—Selected Issues

98/56: Guinea—Statistical Annex

98/57: Italy—Selected Issues

98/58: Republic of Moldova—Recent Economic Developments

98/59: Republic of Mozambique—Selected Issues

98/60: Slovak Republic—Recent Economic Developments

Other Publications

The IMF and the Environment, Ved P. Gandhi (free). Describes the IMF's approach to environmental issues.

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

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Following Russian Measures, Camdessus Calls For Full Implementation of Economic Program

On August 17, the Russian government announced a set of measures designed to bolster confidence in the areas of financial and budget policy. These included a widening of the exchange rate band for the ruble, under which the currency will be set at the level of 6.0–9.5 rubles to the dollar; a restructuring of government debt; and temporary restrictions on capital payments abroad (see text of announcement below). Following these actions, IMF Managing Director Michel Camdessus made the following statement, which was released in Moscow.

“On July 20 the IMF’s Executive Board approved additional financial assistance to Russia of \$11.2 billion in support of a strengthening of Russia’s economic program. Implementation of this program has been satisfactory. Despite this, confidence in financial markets has not been reestablished and as a result Russia has continued to lose reserves, and asset prices have fallen sharply. In view of the risks implied by the persistence of these trends, the Russian government has announced a set of measures designed to bolster confidence, including a change in exchange rate policy, restructur-

ing of government debt, and a temporary restriction on capital payments abroad.

“These measures and their potential impact will immediately be analyzed by the staff and management of the IMF, and submitted to the Executive Board. As a preliminary reaction, I am of the view that, in the new context created by these measures, it will be especially important for the Russian authorities to take all necessary steps to strengthen the fiscal position; prompt passage of fiscal measures in the forthcoming session of the Duma will be essential to this end. The authorities should also spare no effort to find a cooperative solution to their debt problems, in a close dialogue with Russia’s creditors. I hope that the government’s economic program will continue to be implemented in full, so that the economic and financial situation will improve and the IMF can be in a position to disburse the second tranche under the IMF-supported program in September as scheduled.

“More generally, it is important that the international community as a whole, both public and private sectors, show solidarity for Russia at this difficult time.” ■



Text of Official Statement

Russia Announces Exchange Rate Measures Plus Restructuring of Government Debt

The following is the joint text released on August 17 by the Russian government and central bank announcing exchange rate measures and debt restructuring.

A crisis broke out on world financial markets when the Russian economy was at the start of a recovery. From October 1997, the government and the central bank have been protecting the main achievements of the economic policy of the recent years—stable prices and a fixed ruble and, hence, the living standards of the people.

The problem of servicing the national debt aggravated sharply with the worsening of the foreign economic situation and because of the unsatisfactory state of affairs with revenues of the budget. Expenditures for the redemption of the earlier-issued state securities and the payment of interest on them have become a heavy burden on the state budget with tax collection being low. The Russian government has to reduce the domestic state debt, cutting expenditures under the federal budget and making external borrowings. The government’s economic program was backed in July by international financial organizations and leading countries [see *IMF Survey*, July 20, page 221].

However, the crisis in Asia and a new fall of world prices of oil have not permitted the restoration of the confidence in Russian securities and, hence, the improvement of the situation with the budget. The country’s foreign currency reserves continue to shrink, and the banking system is experiencing difficulties.

In this situation the government and the Bank of Russia deem it necessary to take a set of measures aimed at the normalization of the financial and budget policy.

1. As of August 17, 1998, the Bank of Russia is moving to a new policy of setting the ruble according to a new “currency corridor” fixed at the level of from 6 to 9.5 rubles to the U.S. dollar. Interventions by the Bank of Russia will be made to lessen sharp fluctuations in the ruble rate. The Bank of Russia will be using the interest policy for the same purpose.

2. State securities (treasury bills and federal loans bonds) that are to be canceled up to December 31, 1999, inclusively, will be exchanged for new securities. The technical parameters of the exchange will be announced on Wednesday, August 19, 1998. Biddings in the market of treasury bills—federal loan bonds are suspended until the securities’ exchange is completed.

3. Under the provisions of the regulations of the IMF, the government and the Bank of Russia are introducing temporary restrictions for Russian residents on large-scale foreign currency operations. A 90-day moratorium is imposed as of August 17, 1998, on the repayment of credits received from nonresidents in the Russian Federation, on the payment of insurance on credits insured by the mortgage of securities, on the payments under fixed-term contracts in foreign currency. Nonresidents in the Russian Federation are prohibited to invest funds into ruble assets with the time for repayment of up to one year.

4. The government and the Bank of Russia regard a stable functioning of the banking system and the system of settlements and payments in the Russian Federation as one of important priorities. In this connection, the government and the Bank of Russia favor the setting up of a payments' pool by the biggest Russian banks to maintain stability of interbank settlements. At the same time, the Bank of Russia will make

efforts to consolidate the Russian banking system, and draw into this stable Russian banks and leading foreign banks.

5. To restore the financial market, the Russian government will shortly begin placing short-term treasury bills (for a term of one or two weeks). A broader range of securities will be issued for the population.

6. The government and the Bank of Russia address to the Federal Assembly a legislative initiative to tighten control over the flow of currency abroad. At the same time the government and the Bank of Russia are going to take urgent actions in the area within the bounds of their powers.

7. The Russian government repeatedly suggests to the state Duma to hold an extraordinary session before the end of August to pass key draft laws to help to insure the timely payment of pensions and wages to workers in the state sector, to create legislative procedures for banks' stabilization, and to strengthen the system of currency regulation and currency control. ■

Progress in Structural Reform

Algeria's Reform Program Promotes Economic Growth and Transition to the Market

Over the past decade, Algeria has undergone far-reaching economic changes as it has undertaken major macroeconomic stabilization measures and moved from a centrally planned to a market economy. Since 1994, the country has embarked on a comprehensive reform program with support from the IMF, the World Bank, and other foreign creditors and donors. It made good progress in the fundamental structural reforms that are essential for future economic growth and in May 1998 completed four years under IMF-supported programs. The Algerian authorities now face the renewed challenge of maintaining economic stability and the reform program in the face of a recent sharp fall in hydrocarbon prices.

Economic Reform

Upon independence in 1962, Algeria was predominantly an agrarian society with a limited industrial base. For the next 25 years, Algeria followed a typical socialist growth model, consisting of centralized economic planning, reliance on public enterprises in most services and import-substituting industries, and creation of large state farms through land nationalization. This strategy was financed by export receipts from the nationalized hydrocarbon sector—which benefited from the oil booms of 1973 and 1979–81 and generated sufficient domestic savings to enable it to avoid accumulating a large external debt until the early 1980s. By then, the drawbacks of centralized planning

were apparent. Production yields stagnated in both public enterprises and state farms, which together accounted for most of Algeria's output, and dependence on food imports increased. Large public housing projects lagged considerably behind schedule and most new industrial plants ran below capacity.

By 1986, owing to the reverse oil shock created by falling petroleum prices, Algeria's terms of trade and hydrocarbon budgetary revenues dropped by about 50 percent and the weaknesses of the centrally planned system became more apparent. The authorities responded with a series of macroeconomic stabilization and structural reforms. At first, the pace of adjustment was slow and imbalances worsened. The overall budget deficit reached 13.7 percent of GDP in 1988, as cuts in government expenditure failed to compensate for revenue declines (see chart, page 277). In the absence of a financial market, fiscal deficits were monetized or financed through the buildup of external debt. Consequently, the ratio of external debt to GDP rose to 41 percent in 1988 from 30 percent in 1985, and the ratio of debt service to exports more than doubled. In addition, negative real interest rates and an overvalued currency reinforced the bias toward capital-intensive techniques and imports.

During 1989–91, the authorities embarked on two IMF-supported programs that entailed strict demand management policies and substantial exchange rate depreciation, which strengthened macroeconomic adjustment efforts.

Government expenditure restraint along with higher hydrocarbon revenues led to fiscal surpluses. Tight fiscal policy resulted in a marked slowdown in money growth, permitting excess liquidity to be partially absorbed.

Unfortunately, the lack of a comprehensive framework and of the key measures needed to create an efficient market economy obstructed the benefits of this liberalization and reform process. In 1992–93, the authorities chose to support economic activity with an expansionary fiscal policy, while remaining committed to fully meeting external debt service, which had reached 80 percent of export proceeds. Government consumption increased by 2 percentage points of GDP over the two-year period, while the ratio of government investment to GDP increased to 8.4 percent in 1993 from 6 percent in 1991. As a result, the government's savings-investment balance deteriorated by more than 10 percentage points of GDP.

Reforms Since 1994

Conditions deteriorated further at the beginning of 1994, when a renewed fall in oil prices, growing civil strife, and the drying up of external financing brought the economy to the brink of a balance of payments crisis. In response, the authorities formulated a comprehensive structural adjustment program that received the support of the IMF in May 1994 through a one-year Stand-By Arrangement totaling SDR 731.5 million and, from May 1995, through a three-year arrangement under the Extended Fund Facility totaling SDR 1.1 billion. The programs' chief elements were the following:

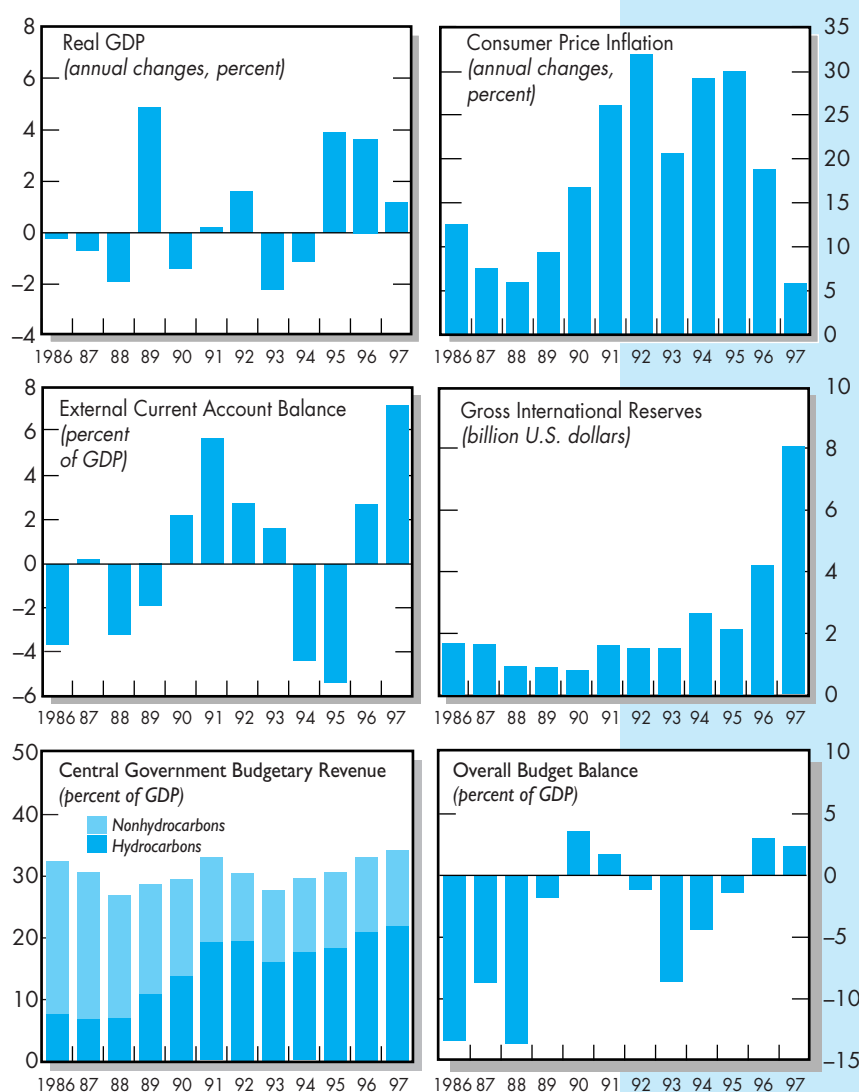
- *Fiscal reform.* Under a major reorientation of fiscal policy, the government aimed to limit its role to the provision of public goods and services. On the structural side, the budget was strengthened by recasting the tax system to reduce gradually the dependence on hydrocarbon revenue and by reorienting expenditures to growth-promoting areas.

- *Financial sector reform.* The government took major steps to establish a sound and market-based system of bank intermediation, moved toward the use of indirect and market-based instruments for the conduct of monetary policy, and ensured the use of market-based mechanisms to mobilize domestic financing for the budget.

- *Social aspects of adjustment.* Prior to the reform, the government sought to provide a social safety net via generalized subsidies, extensive and sheltered employment in the public sector, and income transfers. This system was inadequate and inefficient, and became financially unsustainable. To gain the population's support for the reform program, the authorities adopted measures to mitigate the transitional costs of structural adjustment for the most vulnerable sectors of the population, mainly by overhauling the social safety net and establishing an unemployment insurance scheme.

- *External sector developments.* External developments have always played a key role in Algeria's economy, owing to the dominance of the hydrocarbon sector. Persistent domestic financial imbalances in the late 1980s hindered attempts to liberalize external transactions and gave rise to an overvalued exchange rate and mounting external debt. The reform package included a realignment of relative prices and price liberalization accompanied by a large up-front devaluation, as well as broad trade and exchange rate liberalization measures.

Algeria: Overall Macroeconomic Performance



Data: Algerian authorities and IMF staff estimates

Progress to Date

Despite the fact that the reform program was launched in April 1994 in a difficult social and political environment, it has been remarkably successful in restoring financial stability and establishing the building blocks for a market economy:

- Inflation declined to 6 percent. After a decade of declining per capita income, there were three consecutive years of positive growth in 1995–97.

- The authorities established a market-oriented price system that eliminated price restrictions and generalized subsidies.

- The fiscal and external accounts achieved a substantial surplus. External reserves were built up to nine months of imports by the end of 1997, and the external debt-service ratio was reduced to 30 percent in 1997 from 83 percent in 1993.

- The government accompanied its disengagement from production and trading activities with the establishment of a more market-oriented banking system that enforced budget restraints on its clients, including public enterprises.

Remaining Challenges

Recently, the Algerian economy has come under fresh strains owing to the sharp fall in hydrocarbon prices on the international markets (from \$19.50 a barrel on average in 1997 to under \$14.00 a barrel so far in 1998). With hydrocarbon receipts accounting for more than 95 percent of Algeria's exports and two-thirds of its budgetary revenue, the authorities face a renewed challenge to maintain economic stability.

Despite the setback of declining hydrocarbon receipts, there has already been strong progress in a number of important macroeconomic areas. The exchange rate is now more realistic, real interest rates have become positive, and the government has begun to withdraw from production activities.

While Algeria has made strong progress in its economic stabilization program and achieved substantial surpluses in its fiscal and external current account balances in both 1996 and 1997, growth outside the hydrocarbon sector has been lower than programmed. In particular, the difficult security situation in the country has contributed to an economic response that was below expectations.

While this lower growth has resulted in political pressures in 1998 for additional budget expenditures, it also underlines the need to accelerate key structural reforms measures to achieve the sustained level of growth that will reduce unemployment, maintain a high quality of public expenditure, and ensure a more diversified production base. In particular, for there to be a significant reduction in the current 28 percent unemployment rate, a yearly growth rate of 6–7 percent in the nonhydrocarbon sector is needed, coupled with a concentration of growth in labor-intensive activities.

The following actions will be called for in the area of structural reform:

- A higher degree of public support is needed for the privatization program, since at present the private sector is too small to absorb the large state-owned industries. In addition to the broadening and streamlining of privatization mechanisms, the recently established

stock market should help to mobilize domestic savings and attract foreign partnerships and direct investment.

- Modernization of the banking system with the help of foreign partnerships or privatization will be required to support a growing private sector and deepened financial intermediation.

- Clear property rights in agriculture, housing, and urban real estate must be established. As a first step in the agricultural sector, a law was presented to parliament in early 1998 to clarify land ownership.

- The redirection of housing delivery from the state to the private sector needs to be completed, and the necessary financing and market incentives provided.

- Comprehensive judicial reform is needed to speed the settlement of contractual disputes and bankruptcy proceedings.

- A concentrated effort is needed to reduce unemployment, which is a major cause of social instability. Labor market reforms, public investment in labor-intensive infrastructure, and in particular the promotion of a competitive environment for private investment are required.

- The education system will have to be restructured to meet the labor profile required by the private sector and by Algeria's integration within the Mediterranean basin.

- The further liberalization of trade, services, and capital flows is required to promote Algeria's integration into the world economy and foster the absorption of new technologies. This will be essential if the country is to face the challenges presented by globalization.

While the obstacles to growth are considerable, particularly if security problems continue to deter foreign investment, Algeria also holds great potential. Its dynamic hydrocarbon sector and considerable oil revenues provide both a large internal market and the resources needed to pursue reform. At the same time, the country enjoys both the comparative advantage of low labor costs with a capable human resource base and proximity to the European market and other North African countries. The broadening of political participation following the June and October 1997 elections offers the promise of progress in restoring peace. This, coupled with the structural reforms outlined above, should help create the environment that will enable Algeria to realize its potential. ■

Martha Bonilla

IMF External Relations Department

This article is based on IMF Occasional Paper No. 165, *Algeria: Stabilization and Transition to the Market*, by Karim Nashashibi, Patricia Alonso-Gamo, Stefania Bazzoni, Alain Féler, Nicole Laframboise, and Sebastian Paris Horvitz. Some of the material has been updated. Copies of the Occasional Paper are available for \$18.00 each (academic rate: \$15.00) from IMF Publication Services (see page 274 for ordering information).

Structural and Institutional Reform Are Stressed At Seminar on Economic Transition

Parliamentarians from 11 countries engaged in the economic transition process gathered at the Joint Vienna Institute in mid-July for a one week seminar on economic reform organized by the IMF. The main theme was that pressing on with structural and institutional reform is essential for sustained growth, although the political and organizational obstacles to doing so are daunting.

Major Gains Achieved

The considerable progress achieved by most transition economies in stemming inflation, liberalizing prices, and opening trade and currency markets represents a substantial down payment on what is needed to achieve high, sustained economic growth. Stronger macroeconomic policies have brought yearly inflation rates in most transition economies down, either to single digits or very nearly so. IMF staff presented data and projections of annual GDP growth in transition economies: 1997 marked the first year in which positive economic growth was attained in all three regional groupings of transition economies—Central and Eastern Europe, the three Baltic states, and the countries of the former Soviet Union. Notably, Russian growth turned positive, albeit at a low level.

Seminar participants observed that results over the past year had not been uniformly favorable. Inflation had been especially high and GDP growth negative in Albania, Belarus, Bulgaria, Romania, Tajikistan, and Uzbekistan. Parliamentarians agreed that differences in macroeconomic policies accounted in large part for the variance in outturns and that all countries need to keep budget deficits down to levels that can be financed without recourse to the central bank or to other inflationary devices.

Next Steps

The seminar focused on structural and institutional reforms that could consolidate macroeconomic gains and provide a basis for longer-term economic growth as well as addressing pressing social needs. Liam Ebrill of the IMF's Fiscal Affairs Department presented options for reforming tax policy. He noted that a number of transition economies still have not rewritten their tax codes to increase tax fairness, broaden the tax base, and reduce exceptionally high tax rates in some cases. More effective tax collection ought to be given higher priority in all transition economies. Revenue measures alone will not solve the looming fiscal problems for transition economies, however, Ebrill noted.

Social expenditures in many transition economies are high and rising. Christian Schiller also of the IMF

Fiscal Affairs Department, noted that some types of expenditures should be expected to increase—for example, unemployment compensation. Greater efficiency in social outlays for other purposes is therefore needed. Participants considered possible measures to cope with the special difficulty facing countries with rapidly growing numbers of pensioners.

Paul Hilbers of the IMF's Monetary and Exchange Affairs Department led a discussion on reform issues for central banks both as regulators and supervisors and as lenders of last resort, in some cases, to the financial sector. The focus was on principles and standards for a sound financial system, but several parliamentarians, observing that enterprises and agriculture already have difficulty obtaining commercial credit, stressed that financial sector reform should yield more extensive and efficient financial intermediation.

Case Studies

Many parliamentarians found the three half-day country case studies the most valuable and interesting part of the seminar. IMF resident representatives John King (Albania), Jonathan Dunn (Azerbaijan), and Patrick Lenain (Ukraine) began by summarizing recent economic programs in their respective countries and adding perspectives on significant policy successes and shortcomings. Parliamentarians then presented their own reflections on past and future economic policy challenges in their own countries. Other parliamentarians rounded out the case studies with comments and questions drawn from their own national experiences.

Seminars for Parliamentarians

Over the past two years, the IMF has held four one-week seminars for parliamentarians from transition economies at the Joint Vienna Institute. The series was initiated in August 1996 for Russian parliamentarians, followed by a March 1997 seminar with Ukrainian parliamentarians. Parliamentarians from 12 transition economies attended the third seminar, held in January 1998. The next seminar, the fifth in this series, will be offered the week of January 25 to 29, 1999. Topics will include fiscal policy (both tax and expenditure issues), monetary and financial system policies, and exchange rate policy, as well as a review of progress and prospects for economies in transition. The seminar format consists primarily of discussions between parliamentarians and senior IMF staff. Two or three country case studies are featured, with discussions led by IMF resident representatives and parliamentarians from the countries. Some sessions include live video conferencing between IMF headquarters and the Joint Vienna Institute. Participation is by invitation.

A key conclusion from the case study sessions was that policy solutions often differ from country to country, despite many similarities in the problems transition economies must confront. Parliamentarians and IMF

staff agreed that there is room for alternative approaches in many areas. They also agreed that the approach most likely to fail is procrastination. ■

Robert Russell, IMF External Relations Department

IMF Support Has Been Integral Element in Helping Countries Weather Impact of Asian Crisis

The financial crisis that erupted in Asia in mid-1997 led to sharp declines in the currencies, stock markets, and other asset prices of a number of Asian countries; threatened their financial systems; and disrupted their real economies. The crisis also put pressure on exchange rates in emerging markets outside Asia and is expected to reduce the world growth rate in 1998 by more than 1 percent.

- helping the three countries most affected by the crisis—Indonesia, Korea, and Thailand—arrange economic reform programs that could restore confidence and be supported by the IMF;

- approving some \$35 billion of IMF financial support during 1997 for reform programs in Indonesia, Korea, and Thailand, and spearheading the mobilization of some \$77 billion of additional financing from multilateral and bilateral sources in support of these reform programs. On July 15, 1998, the assistance committed for Indonesia was augmented by an additional \$1.3 billion from the IMF and an estimated \$5 billion from multilateral and bilateral sources (see *IMF Survey*, July 20, page 229), while international donors pledged additional financing of about \$8 billion later in the month; and

- intensifying its consultations with other members, both within and outside the region, that needed to take policy actions to ward off the contagion effects of the crisis, even though they did not necessarily require IMF financial support.

The IMF's immediate effort to reestablish confidence in the affected countries entailed:

- the introduction of flexibility to exchange rates, where it did not already exist;
- a temporary tightening of monetary policy to stem pressures on the balance of payments;
- concerted action to correct obvious weaknesses in the financial system;
- structural reforms to remove features of the economy that had become impediments to growth, such as monopolies, trade barriers, and nontransparent corporate practices;
- efforts to assist in reopening or maintaining lines of external financing; and
- the maintenance of a sound fiscal policy.

Because financial sector problems were a major cause of the crisis, the centerpiece of the Asian programs has been the comprehensive reform of financial systems. These reforms have included closing unviable financial institutions, recapitalizing undercapitalized institutions, closely supervising weak institutions, and increasing the potential for foreign participation in domestic financial systems.

Financial system reform is buttressed by measures designed to address governance issues by improving the efficiency of markets, breaking the close links between business and governments, and prudently liberalizing

IMF Commitments in Response to the Asian Crisis¹ (billion U.S. dollars)

Country	Commitments				IMF Disbursements As of 8/28/98
	IMF	Multilateral ²	Bilateral	Total	
Indonesia	11.2	10.0	21.1 ³	42.3	6.0
Korea	20.9	14.0	23.3	58.2	18.0
Thailand	4.0	2.7	10.5	17.2	2.8
Total	36.1	26.7	54.9	117.7	26.8

¹IMF commitments to the Philippines are not included.

²World Bank and Asian Development Bank.

³Bilateral commitments to Indonesia are an estimate and do not include the \$8 billion pledged at the Consultative Group on Indonesia meeting on July 29–30, 1998.

Data: IMF

The crisis was unexpected in that it unfolded against the backdrop of several decades of outstanding economic performance in Asia. Moreover, the difficulties that the East Asian countries face are not primarily the result of macroeconomic imbalances. Rather, they stem from weaknesses in financial systems and, to a lesser extent, in governance. A combination of inadequate financial sector supervision, poor assessment and management of financial risk, and maintenance of relatively fixed exchange rates led banks and corporations to borrow large amounts of international capital, much of it short-term, denominated in foreign currency, and unhedged. As time went on, this inflow of foreign capital tended to be used to finance poorer-quality investments.

Response to the Crisis

Since the IMF is charged with safeguarding the stability of the international monetary system, its central role in resolving the Asian financial crisis is clear and has been reaffirmed by the international community. The IMF's priority has also been evident: to restore confidence to the economies affected by the crisis.

In pursuit of this immediate goal of restoring confidence in the region, the IMF responded quickly by:

capital markets. Transparency is being increased, both in terms of data (on external reserves and liabilities in particular) and in the fiscal, banking, and corporate sectors.

These reforms have been aided by the World Bank, with its focus on the structural and sectoral issues that underpin the macroeconomy, and by the Asian Development Bank (ADB), with its regional specialization.

Additional Measures

In addition to the IMF's first line of response—assisting in the design of the programs and providing financial resources for their support—the following steps have also been taken:

- The IMF's Executive Board has made use of the accelerated procedures established under the emergency financing mechanism to meet the exceptional needs of the member countries in terms of approval time and access.

- The Supplemental Reserve Facility was created for the special circumstances of members experiencing exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden loss of market confidence (see *IMF Survey*, January 12, page 7).

- IMF coordination with other international financial institutions, notably the World Bank and the Asian Development Bank, and with bilateral donors has been intensified.

- A dialogue has been initiated between the IMF and such constituencies in the program countries as labor groups, the press, and the public.

- IMF programs have been followed by coordinated efforts between international creditor banks and debtors in the affected countries to resolve the private sector financing problems at the heart of the crisis, and the IMF has supported this process as appropriate.

- Indonesia, Korea, and Thailand are among the IMF member countries that have attained new levels of transparency through releasing the letters of intent and memoranda of economic and financial policies describing their economic reform programs. These documents have also been posted on the IMF's web site. Korea and Thailand have also issued Public Information Notices (PINs), which make public the views of the IMF Executive Board on national economic policies.

Early Results and Outlook

In Korea and Thailand exchange rates have stabilized and the external financing situation has improved. In Indonesia, the social disturbances and political uncertainty of May 1998, which had impeded economic reform in Indonesia and had further worsened economic conditions, have subsided; policy implementation has improved; and the rupiah has appreciated.

Recognizing that much hard work remains to be done in the affected countries in terms of economic restruc-

turing, the IMF is focusing on its intermediate goal of shortening and easing the adjustment period, through:

- increasing budgetary flexibility so as not to worsen the output loss;
- mitigating the effect of credit tightness and reductions in trade financing on exporters and small and medium-sized enterprises; and
- alleviating the social costs of adjustment, including through strengthening the social safety net and encouraging a social dialogue among employers, employees, and government.

Lessons from the Crisis

Although the Asian financial crisis is still unfolding, the IMF has already begun to draw lessons on how to strengthen the architecture of the international financial system, so as to lessen the frequency and severity of future disturbances. It has identified six major areas where initiatives already under way should be strengthened:

- more effective surveillance over countries' economic policies and practices, facilitated by fuller disclosure of all economic and financial data;
- financial sector reform, including better prudential regulation and supervision;
- orderly and properly sequenced capital account liberalization;
- the promotion of regional surveillance;
- a worldwide effort to promote good governance and fight corruption; and
- more effective structures for orderly debt workouts, including better bankruptcy laws at the national level.

These efforts will have to be supported by adequate financial resources for the IMF, supplemented in case of need by other bilateral and multilateral resources, that can be deployed in support of strong adjustment programs. ■

Lynn Aylward
IMF External Relations Department

This article is based on material contained in a fact sheet, "The IMF's Response to the Asian Crisis," which is available on the IMF web site: <http://www.imf.org>.

Public Information Notices

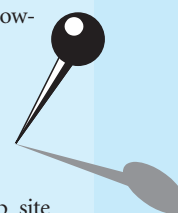
Public Information Notices (PINs) are IMF Executive Board assessments of members' economic prospects and policies issued—with the consent of the member—following Article IV consultations, with background on the members' economies. Recently issued PINs include:

Cyprus, No. 61, August 14

Azerbaijan, No. 62, August 17

Algeria, No. 63, August 24

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



August 31, 1998

Following is an excerpt of a recent IMF press release. The full text is available on the IMF's web site (<http://www.imf.org>) under "news" or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

Mozambique: ESAF

The IMF has approved the third annual loan for Mozambique under the Enhanced Structural Adjustment Facility (ESAF) in an amount equivalent to SDR 25.2 million (about \$33 million) to support the government's economic program for 1998/99. The loan will be disbursed in two equal semiannual installments, the first of which is available on September 1, 1998.

1998/99 Program

Mozambique's medium- and long-term goals are to create the conditions for poverty-reducing sustainable economic growth while lowering the country's dependence on external aid. The government's medium-term strategy is to capitalize on gains achieved in both macro-economic stabilization and economic liberalization to encourage rapid private sector expansion.

The program for 1998/99 aims at a real GDP growth (excluding large projects) of about 7 percent in 1998 and 1999, an end-period inflation of 6–8 percent in 1998 and 1999, and the maintenance of net international reserves at about three to four months of projected imports.

Structural Reforms

The authorities' program of structural reforms seeks to remove impediments to economic growth and stabilization that remain, despite progress achieved in economic reform and liberalization in the past decade. The program focuses on increasing private investment through the privatization of state enterprises and elimination of administrative barriers to trade and investment, improving public sector saving by strengthening tax administration and widening the tax base, and stimulating private sector saving through the development of financial instruments and markets and maintaining low tax rates.

Addressing Social Needs

The government's medium-term social objective is to improve poverty indicators to levels that at least match the average of sub-Saharan Africa through the implementation of medium-term expenditure programs on education and health, backed by an increase in the share of budgetary resources going to these areas.

Mozambique joined the IMF on September 24, 1984; its quota is SDR 84.0 million (about \$111 million); and its outstanding use of IMF credit currently totals SDR 144 million (about \$190 million).

Press Release No. 98/35, August 25

Mozambique: Selected Economic and Financial Indicators

	1994	1995	1996	1997	1998 ¹	1999 ²	2000 ²
	(annual percentage change, unless otherwise specified)						
National income and prices							
Real GDP	7.5	4.3	7.1	12.4	9.1	9.6	6.9
Consumer price index (annual average)	63.1	54.4	44.6	6.4	3.3	7.7	6.0
Consumer price index (end of period)	70.2	54.1	16.6	5.8	6.5	6.0	6.0
Government budget³							
Total revenue	14.0	14.0	13.4	14.4	14.9	14.5	15.3
Total expenditure and net lending	37.7	29.9	26.1	28.7	28.7	29.2	28.7
Overall balance before grants	-23.7	-15.9	-12.7	-14.3	-13.8	-14.7	-13.4
Total grants	17.1	12.1	8.8	10.1	9.1	9.1	8.4
Overall balance after grants	-6.6	-3.8	-3.9	-4.2	-4.7	-5.5	-5.0
	(percent of exports of goods and nonfactor services)						
Net present value of total external debt outstanding⁴							
	...	4,308.3	1,887.3	691.4	644.3	443.2	402.3
Total external debt service⁵							
Scheduled, including IMF debt ⁶	131.7	103.7	74.4	71.6	80.0	74.5	86.5
Actual, including IMF debt	33.0	27.5	28.1	24.9	33.5	36.9	39.9
Actual, excluding IMF debt	29.9	23.7	21.3	22.5	29.0	32.2	35.6
	(percent of government revenue)						
External nonfinancial public debt service⁷							
Scheduled ⁶	176.7	132.9	91.9	72.6	74.0	66.6	77.1
Actual	19.1	25.8	31.4	21.0	22.9	24.6	24.6
	(months of imports of goods and nonfactor services)						
Gross international reserves (end of period)	2.2	2.7	4.4	6.2	5.3	4.4	4.0
	(million U.S. dollars)						
External current account (after grants)	-300	-338	-337	-263	-464	-727	-706
Overall balance of payments	-377	-280	-49	-67	-256	-270	-430
Total external debt (end of period)	8,671	8,911	9,279	7,432	7,150	7,051	7,297
External arrears (public sector, end of period)	2,508	2,895	2,830	619	0	0	0
Gross international reserves (end of period)	209	225	383	532	571	590	534

Note: For price, exchange rate, and trade data, percentage changes are over the preceding 12 months; for fiscal data, they are over the same period a year earlier. Fiscal and monetary data are cumulative for the year.

¹Program.

²Projections.

³In percent of nonenergy GDP.

⁴Refers to public and publicly guaranteed debt after rescheduling, in percent of three-year export average.

⁵Including nonguaranteed private sector debt.

⁶Before debt relief.

⁷Excludes IMF debt.

The annual *IMF Survey Supplement on the IMF* will be published on September 14, 1998. The next regular issue of the *IMF Survey* will be published on September 28, 1998.

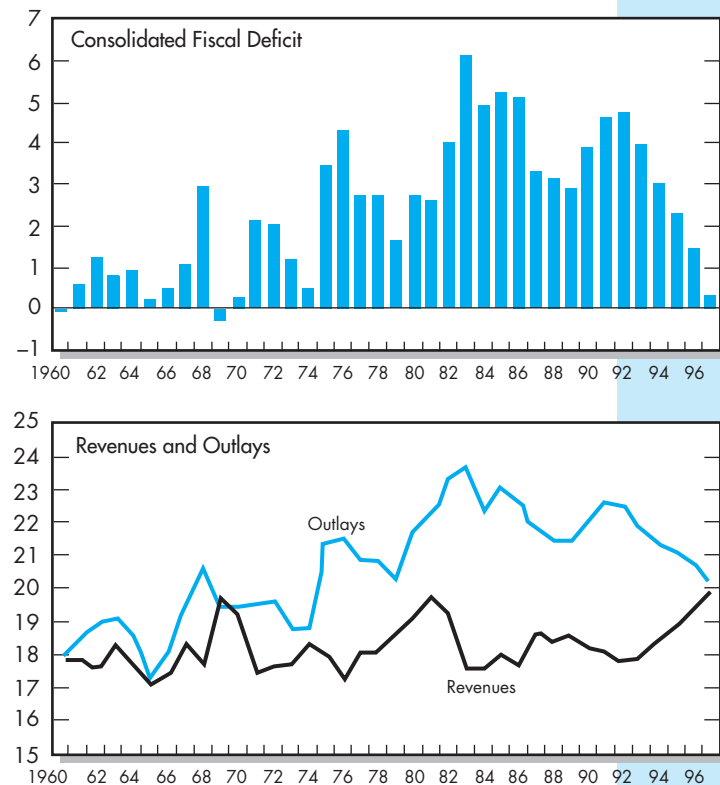
United States Applied Strong Deficit Reduction Policies to Achieve Fiscal Balance

Since 1991/92 (the U.S. fiscal year extends from October 1 to September 30), the U.S. unified federal fiscal deficit has dropped rapidly, falling to 0.3 percent of GDP in 1996/97 from 4.7 percent (see chart, this page). Some of the improvement in the fiscal situation is attributable to the strength of the economic recovery since the 1990–91 recession, but policies enacted with the Omnibus Budget Reconciliation Act of 1993 and subsequent legislation have also been major contributing factors. Most estimates indicate that significantly less than half of the improvement in the fiscal deficit that has taken place since 1992 is attributable to the cyclical recovery of the economy. The remaining improvement is attributable to tax increases that raised the structural revenue-to-GDP ratio by an estimated 2 percentage points and to cuts in defense and nondefense discretionary spending of 1½ percentage points and almost ½ of a percentage point of GDP, respectively.

Business Cycle

Estimates of the contribution made by the business cycle to the improvement in the federal fiscal deficit can vary considerably, since they depend on the estimated size of the output gap (actual minus potential GDP) and the estimated elasticities of tax revenues and outlays with respect to GDP. In its 1998/99 budget document, for example, the U.S. administration estimates that 35 percent of the reduction in the budget deficit between 1991/92 and 1996/97 resulted from the cyclical improvement in the economy. The U.S. Congressional Budget Office estimates that just under 40 percent of the reduction in the actual budget deficit resulted from the cycle. In order to eliminate one source of uncertainty affecting estimates of the structural balance, identical elasticities (1.1 and -0.2 for revenue and expenditure elasticities,

United States: Fiscal Balance
(percent, fiscal year)



Data: Budget of the United States Government, 1998/99

respectively) were applied to alternative estimates of the U.S. output gap prepared by the IMF, the Congressional Budget Office, and OECD economists (see chart, page 284). These estimates show that the lion's share of the reduction in the deficit over the period 1991/92–1996/97 occurred for reasons other than the cycle. Based on these estimates, the improvement in the structural balance accounted for between 3.4 and 3.7 percentage points of the total improvement of 4.4 percentage points of GDP.

Revenues

Unlike outlays, total revenues in the United States tend to rise and fall roughly in line with relatively small percentage changes in GDP and, thus, actual tax revenues and revenues adjusted for cyclical developments (structural revenues) move more or less identically. Structural revenues as a percent of GDP have risen steadily since 1991/92, from 17.8 percent of GDP in 1991/92 to 19.8 percent in 1996/97. The strength of revenues has largely reflected measures adopted under the Omnibus Budget Reconciliation Act of 1993, including increases in the top marginal income tax rates for households and corporations, and a 10 percent surtax on taxable household income over \$250,000, which

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
August 17	4.26	4.26	4.56
August 24	4.25	4.25	4.55

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (the U.S. dollar, weighted 39 percent; deutsche mark, 21 percent; Japanese yen, 18 percent; French franc, 11 percent; and U.K. pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 107 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF web site (<http://www.imf.org/external/np/tre/sdr/sdr.htm>).

Data: IMF Treasurer's Department



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caused both personal and corporate income tax revenues to climb. Other revenues, including social insurance taxes and contributions, were essentially unchanged in relation to GDP during the period. The increase in total (structural and actual) tax revenues accounts for about 45 percent of the actual deficit reduction since 1991/92. Questions have been raised whether the strength of revenues, particularly in 1995/96 and 1996/97, might be the result of temporary factors including realized capital gains associated with the rising stock market. Of the \$106 billion by which the administration's 1997/98 current services deficit projection exceeded the actual deficit in 1997, the Council of Economic Advisers estimates that just \$20 billion were unanticipated capital gains tax receipts.

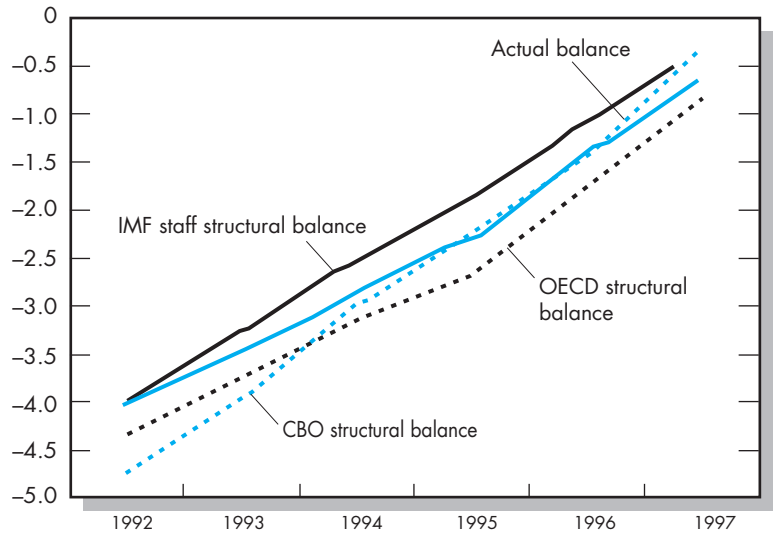
Outlays

Outlays adjusted for cyclical developments (structural outlays) also declined, from about 22 percent of GDP in 1991/92 to about 20 percent in 1996/97, according to IMF staff estimates. The reduction in outlays reflects a relatively steep decline in discretionary spending (annually authorized spending on such items as national defense, transportation, energy and water development, administration of justice, agriculture, veterans affairs, and international affairs) and comparatively small declines in mandatory spending (Social Security, Medicaid, Medicare, and other entitlement programs) and interest outlays. Discretionary outlays declined from 8.7 percent of GDP in 1991/92 to 6.9 percent in 1996/97, while "programmatic" mandatory spending (mandatory spending, less undistributed offsetting receipts, including from the sale of government assets) fell from 11.2 percent of GDP in 1991/92 to 10.8 percent in 1996/97.

At 8.7 percent of GDP in 1991/92, total discretionary outlays were the lowest they had been since at least World War II, and were significantly lower than the 10 percent level maintained from the mid-1970s through the mid-1980s. During the defense buildup of the early to mid-1980s, nondefense discretionary spending slowed significantly, declining from 5.2 percent of GDP in 1980 to 3.5 percent in 1986/87. The consolidation in nondefense discretionary spending began to show some signs of reversal between 1988/89 and 1992/93, rising to 3.8 percent of GDP in 1992/93; however, nondefense discretionary spending fell to 3.4 percent of GDP in 1996/97. The capacity to maintain control over this category of spending appears to be largely attributable to the statutory spending caps established under the

United States: Actual vs. Estimated Structural Federal Fiscal Balances¹

(percent of exports)



¹Structural balances are obtained by applying OECD estimates of U.S. revenue and outlay elasticities to staff, Congressional Budget Office, and OECD estimates of the output gap from 1992–97. The elasticities applied are 1.1 percent and –0.2 percent for revenues and outlays, respectively.

Data: OECD (1995), Congressional Budget Office (1998), and IMF staff estimates

Omnibus Budget Reconciliation Act of 1993. Cuts in defense outlays were the single largest direct contributor to the reduction in discretionary spending as a share of GDP since 1991/92. Defense spending declined from 4.9 percent of GDP in 1991/92 to 3.4 percent in 1996/97. This so-called peace dividend, other things being equal, is 35 percent of the reduction in the actual budget deficit and 41 percent of the IMF staff's estimate of the decline in the structural budget deficit since 1991/92.

The reduction in "programmatic" mandatory spending from 11.2 percent of GDP in 1991/92 to 10.8 percent in 1996/97 was a significant reversal of the sharp increase in such spending in the years just prior to 1991/92. This reversal, however, is almost entirely the result of a decline in income security outlays, largely attributable to a cyclical drop in unemployment compensation of almost ½ percent of GDP from 1992 to 1997. At the same time, Medicare outlays continued their steady upward climb, from 1.9 percent of GDP in 1992 to 2.4 percent in 1997, while Social Security outlays were roughly stable at 4½ percent of GDP over the same period. Total programmatic mandatory spending on a cyclically adjusted basis was stabilized at about 10 percent of GDP from 1991/92 to 1996/97.

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Some of the material in this article is also covered in a forthcoming IMF Staff Country Report, "United States—Selected Issues."