

Contents

353	Support Package for Brazil
353	IMF Releases Data on Resources
355	Camdessus on Financial Reform
355	IMF Approves Credit for Indonesia
356	Selected IMF Rates
356	Use of IMF Credit
358	UNCTAD Report on Foreign Direct Investment
359	Recent IMF Publications
360	Group of Seven on Financial Reform
362	Memo from Group of Seven IMF Executive Directors
363	IMF Arrangements
364	From the Executive Board
365	Financial Sector Developments in Sub-Saharan Africa
353	

\$41 Billion Support Package

Brazil and IMF Announce Successful Conclusion To Negotiations on Economic, Financial Program

At a press briefing on November 13, IMF Managing Director Michel Camdessus announced that the Brazilian authorities and an IMF team had successfully concluded negotiations on

a "strong three-year program of economic and financial reform." Following is the text of Camdessus's statement.

Brazil's program first and foremost addresses the chief source of its external vulnerability, namely its chronic public sector deficit, which the country is now tackling in a serious and sustainable manner.

The program combines a large up-front fiscal adjustment of over 3 percent of

GDP with reforms of social security, public administration, public expenditure management, tax policy, and revenue sharing that will confront head on the structural weaknesses that lie at the root of the public sector's financial difficulties. Within this framework of structural reforms, Brazil's three-year fiscal program targets primary surpluses of 2.6 percent of GDP in 1999, 2.8 percent in 2000, and 3 percent in 2001. The Brazilian authorities are also committed to further opening up the economy, ensuring firm monetary discipline and macroeconomic stability, and maintaining the current exchange rate regime.

The way is now open for the international community to provide financial support to Brazil that will enhance market confidence in the government's economic policies and help ensure the success of the country's program. Official creditors, multilateral and bilateral, will provide support totaling more than

(Continued on page 358)

Monthly Updates

IMF Begins Regular Release of Information on Financial Resources and Liquidity Position

Following is the text of an IMF News Brief issued on November 5.

The IMF Executive Board has decided to publish regularly information on the IMF's financial resources and liquidity position, in addition to data already available in the institution's *Annual Report* and other publications.

The Executive Board's decision reflects increased public interest in the IMF's financial position and responds to the desire of shareholders for enhanced operational transparency. The data on resources, liabilities, and liquidity will be updated monthly on the IMF's website (www.imf.org) and published regularly in the *IMF Survey*.

Data cover total usable and nonusable resources, net uncommitted usable resources, balances available under borrowing arrangements, liquid liabilities, and the IMF liquidity ratio.

The data for the latest period available, which ended October 31, together with an explanatory note, follow.

Explanatory Note

The accompanying table (see page 354) summarizes the IMF's financial resource and liquidity position expressed in SDRs, the IMF's unit of account. The following items are included:

I. Total Resources. The largest component of the IMF's resources is its holdings of members' currencies (currently SDR 145.8 billion). Under the Articles of Agreement, the IMF's gold is valued at SDR 35 an ounce, and thus, gold holdings amount to SDR 3.6 billion. (At the market price on October 30, 1998—\$293.10 a fine ounce—the holdings would be valued at SDR 21.5 billion, about \$30 billion.) The IMF's holdings of gold are not readily usable because a decision to sell gold requires a majority of 85 percent of the total voting power in the Executive Board. Holdings of SDRs currently amount to SDR 1.2 billion; "other assets" (SDR 0.3 billion) reflects

(Please turn to the following page)



Camdessus: The program addresses the chief source of Brazil's vulnerability.

(Continued from front page) sundry assets (such as building and receivables) net of sundry payables. In addition to the IMF's own resources, SDR 4.9 billion is currently available under the activation of the General Arrangements to Borrow (GAB) agreed on July 20, 1998.

II. Nonusable Resources. Resources that are considered nonusable to finance the IMF's ongoing operations and transactions are (1) its holdings of gold; (2) the currencies of members that are using IMF resources and are

under the GAB). Amounts committed under arrangements, which reflect undrawn balances committed under operative Stand-By and Extended Arrangements, other than precautionary arrangements, are deducted from the total of usable resources, as are one-half of the amounts committed under precautionary arrangements. Minimum working balances required for the IMF to be able to make payments that must be made in specified currencies are also deducted. The Executive Board has decided that such balances be set

at 10 percent of the quotas of members deemed sufficiently strong for their currencies to be used.

IV. Net Uncommitted Usable Resources (resources available to meet reserve tranche purchases and new commitments). Currently usable resources minus resources already committed under existing arrangements and working balances as described above. This amount represents the resources available to meet requests for use of reserve positions in the IMF and new requests for use of IMF resources (see footnote to table).

V. Balances Available under the GAB and the Associated Agreement with Saudi Arabia. The IMF since October 1962 has entered into General Arrangements to Borrow from the major industrial countries. Under the GAB, which have 11 adherents, and the associated agreement with Saudi Arabia, the IMF can borrow a total of up to SDR 18.5 billion when supplementary resources are needed to forestall or cope with an impairment of the international monetary system. The GAB were activated in July 1998 for an amount of SDR 6.3 billion (of which SDR 1.4 billion has been drawn), leaving up to SDR 12.2 billion potentially available to the IMF under the remaining credit lines.

VI. Liquid Liabilities. The IMF's liquid liabilities consist of (1) reserve tranche positions of members, which a member acquires when the IMF uses the member's currency in its operations and through reserve assets paid by the member in connection with quota payments, and (2) the amount of outstanding borrowing by the IMF; for example, under the GAB. Both reserve tranche positions and outstanding lending under the GAB (together called reserve positions of members in the IMF) are part of members' international reserves. The IMF cannot challenge a request by a member to draw on its reserve position in the IMF when developments in its balance of

IMF's Financial Resources and Liquidity Position, 1996–Present

(billion SDRs unless otherwise indicated; end of period)

	1996	October	October 1998	
		1997	SDRs	US\$
I. Total resources	149.0	149.1	155.8	219
Members' currencies	143.4	144.6	145.8	205
Gold holdings	3.6	3.6	3.6	5
SDR holdings	1.7	0.6	1.2	2
Other assets	0.3	0.3	0.3	0
Available under GAB activation	—	—	4.9	7
II. Less: Nonusable resources	87.9	86.7	109.0	154
III. Equals: Usable resources	61.1	62.4	46.8	66
Less: Amounts committed under arrangements	9.7	7.5	17.7	25
Less: Minimum working balances	11.9	12.3	9.5	13
IV. Net uncommitted usable resources (resources available to meet use of reserve tranche positions and new commitments) ¹	39.5	42.6	19.6	28
[Allowance for use of reserve positions]	[9.5–11.4]	[9.2–11.0]	[14.5–17.4]	[20–24]
V. Balances available under the GAB and associated agreement with Saudi Arabia	18.5	18.5	12.2	17
VI. Liquid liabilities	38.0	36.8	58.0	82
Reserve tranche positions	38.0	36.8	56.5	80
Outstanding borrowing (GAB)	—	—	1.4	2
VII. Liquidity ratio (percent) (IV divided by VI)	103.9	115.8	33.8	33.8
Memorandum item: US\$ per SDR	1.43796	1.38362	1.40835	

Note: Details may not add because of rounding.

¹The IMF does not formally apportion its available net uncommitted resources (and resources remaining under the GAB) between the amounts that might be needed to meet encashment of reserve tranche positions and resources to meet new commitments. However, the first claim on the IMF's resources is to meet requests to liquidate members' positions in the IMF—hence, the importance of the liquidity ratio (that is, the ratio of net uncommitted usable resources to liquid liabilities). It is difficult to project members' propensity to use their reserve positions (reserve tranche positions and outstanding lending under the GAB) at any particular time, though the likelihood that all the IMF's liquid liabilities would be encashed during a short period of time is relatively small. However, it is incumbent on the IMF to be in a position to meet any request for an encashment of reserve positions. For that purpose, the IMF needs to maintain an amount of usable resources that bears a reasonable relation to its liquid liabilities. While this ratio is neither a fixed nor a minimum ratio, historically it has not fallen below 25–30 percent of liquid liabilities for any length of time, thereby maintaining the IMF's capacity to meet members' requests. Application of this range to the IMF's outstanding liquid liabilities is illustrated above.

therefore, by definition, in a weak balance of payments or reserve position; (3) the currencies of other members with relatively weak external positions; and (4) the other assets noted above. The use of IMF credit by a member increases the IMF's nonusable resources and reduces its usable resources by equivalent amounts.

III. Usable Resources. These consist of (1) holdings of the currencies of members considered by the Executive Board to have a sufficiently strong balance of payments and reserve position for their currencies to be used in transactions, (2) holdings of SDRs, and (3) any unused amounts under credit lines already activated (such as

payments or its reserve position make this necessary, and the IMF must be in a position to meet such requests. At present, reserve tranche positions amount to SDR 56.5 billion, and outstanding borrowing under the GAB amounts to SDR 1.4 billion (out of total authorized calls of SDR 6.3 billion). The vast bulk of liquid liabilities reflects credit extended by the IMF, amounting to SDR 57.1 billion on October 31, 1998.

VII. Liquidity Ratio. The liquidity ratio is a measure of the IMF's liquidity position, represented by the ratio of its net uncommitted usable resources to its liquid liabilities. ■

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

World Affairs Council Address

Camdessus Outlines Agenda for International Monetary and Financial Reform

Following are edited excerpts of an address given by IMF Managing Director Michel Camdessus to the World Affairs Council in Philadelphia on November 6. The full text is available on the IMF's website (www.imf.org).

Since mid-1997, when the Asian crisis first broke, we have seen almost unprecedented turmoil in international financial markets. After its onset in Thailand, the contagion spread to other countries in east Asia with a speed that caught everyone by surprise. The second round erupted in mid-August with Russia's moratorium on its debt servicing, leading to renewed, stronger pressures on many emerging countries around the world. Simultaneously, Japan, to which many had looked to help recovery in the east Asian countries, found itself in a deepening recession exacerbated by a severely stressed banking system. Even the other industrial countries were not immune. The emerging market crisis was a factor in the sharp third-quarter equity market correction in North America and Europe.

As the year progressed, it was clearly no longer appropriate to speak of a crisis affecting just Asia, or even emerging markets alone. Instead, we faced a crisis of the system of global finance that had not yet developed sufficiently to reconcile the needs of all participants—investors seeking new opportunities, emerging market economies seeking resources for investment, and governments seeking to ensure that markets operate safely and efficiently. Even if, in the past few weeks, an air of calm has begun to return to global markets, we could argue that the crisis in the functioning of the global financial system is certainly not over yet and that we now have a better opportunity to press ahead with fundamental reform.

The IMF-World Bank Annual Meetings last month focused world attention on the functioning of the international monetary system, bringing together three aspects of the responses to the crisis. While guarding against any premature sense of relief, it is possible to discern encouraging developments on all three fronts.

• *Individual countries* in crisis are courageously implementing policies to strengthen their economies

and to warrant international support. Korea, Thailand, and even Indonesia are continuing to show promising signs that recovery could be around the corner. Throughout Latin America, countries have signaled their readiness to do whatever is necessary to maintain their access to international capital markets. This preemptive action is helping to defuse a potential crisis in the region. I hope that soon we will hear convincing announcements from Russia in its effort to tackle a most severe crisis.

• Measures are also being taken by the *major economies* to diminish the risk of the global economy slip-

IMF Approves \$960 Million Credit For Indonesia

On November 6, IMF Managing Director Michel Camdessus announced that the IMF Executive Board had completed the second review of Indonesia's economic program under the Extended Fund Facility (EFF).

"I am pleased to announce," Camdessus said, "that the IMF's Executive Board, in support of the Indonesian government's economic program, approved the completion of the second review and the release of the next SDR 684.3 million (about \$960 million) credit tranche for Indonesia. Due to good policy implementation, the Indonesian economy is showing welcome signs of stabilization. The rupiah has strengthened considerably over the last month, notwithstanding some slippage in recent days. The steep fall in output is showing signs of bottoming out. Inflation has slowed sharply, with the price level declining in October, as a result of improvements in the food situation and the strengthening of the rupiah. It is also welcome that interest rates have begun to decline."

Camdessus emphasized that the Indonesian authorities need to continue to make rapid progress in several key structural areas, particularly in domestic banking and corporate debt restructuring. "Together with consolidation of the progress in stabilization, these reforms will create the basis for a sustained recovery of output," he said.



Ginandjar Kartasmita,
*Indonesia's Coordinating
Minister for Economics,
Finance, and Industry.*

ping into recession. After a September statement in which the industrial countries acknowledged a shift in the balance of risks away from inflation, several policy steps have improved the prospects for sustaining growth. Japan has been moving vigorously to deal with its banking crisis and is considering further fiscal stimulus. In other countries, notably the United States and Europe, interest rate reductions have been announced.



Camdessus: *The adoption and dissemination of standards permeates all other aspects of the agenda for reform.*

- Active consideration of a wide range of proposals for *international monetary reform* has been taking place, and progress is being made, including at the highest level among the major economies. The statements on reform by the heads of government and by the ministers of

finance and central bank governors of the Group of Seven represent a clear signal of the economic leadership from the major economies that is so essential to move forward [see page 360].

Reforming the Global Economic System

I shall concentrate on the elements of the reform on which I see a consensus emerging. These include minimizing the risk that systemic crisis will recur; promoting a more orderly working of the international monetary and financial system; and, when isolated crises do happen, ensuring that we have early warning, effective policy tools, and adequate resources and broad support to assist countries in trouble.

This is an agenda that is truly challenging. A starting premise is that significant development and integration of the international financial markets already exists and

has contributed to higher investment and stronger growth in many countries. But this integration has not always taken place in the most orderly or optimal fashion. The objective is to promote an integrated financial system based on stable economic policies, sound national financial systems, open capital accounts, transparent behavior by market participants, and equitable socioeconomic policies. The agenda addresses seven broad domains.

Adoption of Standards and Codes of Good Practice. The best functioning economies and financial markets operate within the context of transparent standards and codes of good practice that have been developed and adapted over the years. Often, these rely on compliance that is voluntary or market-based, but reinforced by a strong institutional framework of regulation and supervision. Much of the work of reforming the international monetary system will consist of extending to the global level the same principles and similar rules and codes of conduct that have long existed at the national level in the best developed financial systems. This principle—the adoption and dissemination of standards—permeates all other aspects of the agenda for reform.

Transparency. Without guarantee of timely and accurate information, markets and economic policymaking just cannot work. The highest priority must be assigned to an all-round improvement by government and the private sector, including financial institutions.

Capital Account Liberalization. Capital markets have been developing with almost breakneck speed. Many financial institutions have extended their operations into these new markets, often developing sophisticated new financial instruments, and, in some cases, emerging markets were eager to benefit from the available flows, but to do so they tended to liberalize at the short, riskier end rather than at the longer end. No wonder, then, that a broad debate has emerged about the risks and benefits of capital liberalization.

Selected IMF Rates			
Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
November 2	3.75	3.75	4.01
November 9	3.85	3.85	4.12

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 website (www.imf.org/external/np/tre/sdr/sdr.htm).

Data: IMF Treasurer's Department

Members' Use of IMF Credit (million SDRs)			
	Oct. 1998	Jan.–Oct. 1998	Jan.–Oct. 1997
General Resources Account	10.00	14,089.77	4,880.30
Stand-By Arrangements	0.00	7,232.74	2,060.65
Supplemental Reserve Facility	0.00	5,125.00	0.00
EFF Arrangements	10.00	4,700.48	2,712.05
Supplemental Reserve Facility	0.00	675.02	0.00
CCFF	0.00	2,156.55	107.60
ESAF Arrangements	58.59	711.98	450.81
Total	68.59	14,801.75	5,331.11

Note: 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

During the past half-century, liberalization has proceeded in trade and payments for trade flows within institutional frameworks. But the equivalent for the capital account began to be considered for emerging countries only recently. The international community took an important step at the 1997 IMF-World Bank Annual Meetings in Hong Kong SAR in recognizing that the purposes of the IMF should be formally extended to encompass capital convertibility and that the IMF's jurisdiction should be extended as necessary to supervise this process. We believe that an orderly progression toward liberal capital flows is appropriate and desirable when the preconditions are right within the country.

Financial Sector Reform. One of the essential preconditions to liberalizing capital flows is to ensure the soundness of national financial systems and of private institutions engaged in international capital flows.

A sound *international* financial system requires sound and resilient *national* systems, monitored according to transparent and consistent standards. High on the agenda for all countries will be to promote strong banks and other financial institutions, prudent regulation, and effective supervision.

The IMF will have a key role in monitoring the implementation of standards in the area of financial sector soundness within the framework of surveillance. Our membership is no longer hesitant to invite us to develop our work in this domain. In deepening its capacity, the IMF will need to continue to work closely with many other institutions that have the relevant expertise.

Private Sector Involvement. Rather than bailing out investors—something we are always careful to avoid—we would seek solutions that contribute to “bail in” the private sector under voluntary and market-based arrangements to work out, when needed, a country's debt problem. One example of the dilemmas involved is that the private sector would be deterred by the risk that a country might default too readily. By reducing moral hazard in the case of creditors, we must not increase it in the case of debtors.

Social Policies and Support for the Most Vulnerable. Reform of the international monetary system can be regarded as complete only if it is consistent with the social goals endorsed by the international community. We must adopt policies to assist the poorest countries to develop and to become integrated with the global economy, while ensuring that the poorest people within these countries see rising living standards. Our task as a monetary institution is precisely to promote such sound policies, but we must also look to others to assist these countries in developing their economies, with a particular emphasis on alleviating poverty and providing debt relief in the most serious cases of indebtedness.

Adapting the IMF. The IMF has a central role in the global economic and financial system. If the global system is reformed, then the IMF too should be adapted. Although the IMF has received strong support from its

membership for its responses to the immediate crises, harsh criticism has been heard, principally from those who see the IMF as a kind of scapegoat for all the problems of the world. But, more important, many legitimate questions and suggestions have been raised. Let us consider a few of the issues we face in adapting the IMF.

The IMF has been called upon to assume an ever-increasing range of responsibilities, including surveillance of countries' financial systems; to promote ambitious but orderly capital account liberalization; and to administer a precautionary facility, using the IMF's resources to assist countries that are pursuing appropriate policies but come under pressure because of difficulty in obtaining financing owing to world market conditions.

To perform these responsibilities, we need appropriate authority and adequate resources. And the IMF should reciprocate through an acceptable level of political accountability.

The question of *authority* arises in many areas of the IMF's operations, and in a fast-changing environment, mandates need to be kept under continuous review. Of particular importance is the need for an amendment to the IMF's Articles of Agreement to include capital liberalization among its purposes.

The IMF's financial position had been a source of growing concern as the use of our *resources* grew to unprecedented levels. Now that the U.S. Congress has ratified its contribution to the increase in the IMF's quota, I am confident that the rest of the membership will now proceed quickly to finalize this issue.

The IMF is often questioned as to the *transparency* of its operations and its *accountability*. The governing bodies of the IMF recognize that we have already made rapid progress on transparency but are increasingly persuaded by the argument that it is necessary for many of the operations of the IMF to be subject to more extensive disclosure and evaluation. I do agree with this objective. At the same time, we must recognize that the calls for more IMF transparency are, in many respects, calls on the member countries; it is their policies that will be opened to scrutiny when documents are published. For that we need their consent. Once consensus is established, we will proceed enthusiastically. To promote accountability, we have proposed strengthening the Interim Committee of the IMF—the ministerial-level committee that gives policy guidance to the IMF's Executive Board—including the possibility of converting it into a council with decision-making powers accountable to the full membership.

The task ahead of us is challenging indeed, but it is an essential one if we are to underpin the gains made over the past half-century and encourage the trend to continue.

The IMF has been called upon to assume an increasing range of responsibilities.

Support for Brazil's Economic Program

(Continued from front page) \$41 billion over the next three years, roughly \$37 billion of which is available, if needed, in the next 12 months. I believe that the soundness of Brazil's program and the authorities' commitment to it, together with the strong support demonstrated by the official international community, provide the conditions for Brazil's private creditors now to act to help ensure its success.

I will be asking the IMF's Executive Board to support the program with a three-year Stand-By Arrangement, augmented in the first year by the Supplemental Reserve Facility (SRF), for a total amount of SDR 13.0 billion, equivalent to about \$18 billion. Around 70 percent of these funds will be under the SRF, thus ensuring the early availability of a very significant sum.

James Wolfensohn, President of the World Bank, has assured me of his readiness to recommend to his Board provision of up to \$4.5 billion in support of Brazil's program. Similarly, Enrique Iglesias, President of the Inter-American Development Bank [IDB], has recommended to his Board an IDB support package of \$4.5 billion.

Brazil's program will also receive strong support from a large number of industrial countries in North America, Europe, and Asia, whose governments or central banks will provide through the Bank for International Settlements [BIS] additional financing totaling approximately \$14.5 billion.

The recent passage by the Brazilian Congress of the social security reform law is a significant and long-awaited achievement. Together with the recent submission to the Congress of a revised budget for 1999, in which every effort has been made to spare basic social programs from the expenditure cuts that fiscal discipline requires, this reassures me that Brazil will implement the rest of its program rigorously. And in turn, the success of Brazil's efforts will greatly brighten the economic prospects of the region as a whole. ■

The Brazilian Government's letter of intent, setting out the economic reform program, is available on the IMF's website (www.imf.org).

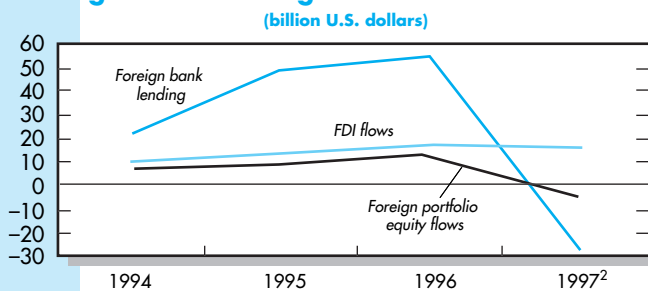
UNCTAD Report

Worldwide Foreign Direct Investment Reaches Record Levels in 1997 and 1998

Despite the ongoing financial turmoil in east Asia and its effects on other parts of the world, foreign direct investment (FDI) flows are projected to increase by as much as 10 percent to reach a record level of \$430–440 billion in 1998. Much of this investment will be concentrated in the industrial countries, central and eastern Europe, and

flows rose by 27 percent to \$424 billion. The report defines FDI as an investment involving management control of an enterprise in one country by an enterprise resident in another country. This long-term relationship distinguishes FDI from foreign portfolio flows and much foreign bank lending, which are inherently short term in nature and which have declined sharply (see chart, page 353).

FDI Flows, Foreign Portfolio Equity Flows, and Foreign Bank Lending to Asian Crisis Countries¹



¹Indonesia, Korea, Malaysia, Philippines, and Thailand.

²Estimates.

Data: UNCTAD, *World Investment Report, 1998: Trends and Determinants*

Latin America and the Caribbean, according to *World Investment Report, 1998: Trends and Determinants*, published by the United Nations Conference on Trade and Development (UNCTAD).

This rise follows a substantial increase during 1997, when FDI flows rose by 19 percent to \$400 billion and out-

Determinants

Traditionally, the features that made a country a desirable destination for FDI have been a favorable investment regime, market size, natural resources, market growth prospects, and labor market conditions. Although these remain important, they no longer constitute a significant point of differentiation, the report states. The existence of a favorable investment regime, for example, is now commonplace. Over the past 15 years, the overwhelming majority of countries have introduced measures to liberalize their FDI frameworks, the UNCTAD study observes, making them even more accessible to transnational corporations. Among the measures taken are:

- macroeconomic policies—including sound monetary policies that ensure price stability and affect the costs of capital;
- tax policies that favor investment;
- exchange rate policies that affect the value of transferred profits, acquired assets, and exports; and

• corporate organizational issues that explicitly address the evolving needs of transnational corporations and domestic firms.

In a world increasingly characterized by liberalization and globalization, firms are looking for places to invest that offer specific advantages or “created assets,” including communications infrastructure, marketing networks, and intangibles such as attitudes to wealth creation and business culture, innovative capacity, the stock of information trademarks, and goodwill. These have become critical for firms’ competitiveness and can make countries without more traditional advantages attractive locations for FDI.

FDI Flows and Asian Crisis

For the first time since 1985, FDI flows to and from Asia in 1998 are not expected to increase. They are projected to remain roughly the same as in 1997, when they rose by about 8 percent to an estimated \$87 billion. The Asian financial crisis changed a number of the determinants of FDI, it notes, and raises the question of how the crisis is likely to affect FDI flows in this region. The question is relevant because FDI has become the single most important source of private development financing for these countries and plays an important role in their economic growth and development.

Although there is a consensus that economic growth will be slower in 1998 and maybe 1999, the effects of the crisis are not entirely negative. For example, in those countries that were hit the hardest—Indonesia, Korea, Malaysia, Philippines, and Thailand—firms’ costs for establishing and expanding production facilities have declined. Regulatory frameworks, which were open to FDI before the crisis, have become even more so, facilitating the establishment and promotion of new businesses. Thus, although the report concludes that it is difficult to assess the overall impact of the crisis on FDI to and from Asia in the short and medium terms, it states that “the fundamental features of the region as a destination for FDI remain sound.”

Moreover, it adds, these may improve as countries strengthen their economies in response to the crisis. If transnational corporations take advantage of the crisis to position themselves strategically in the region, “FDI flows to Asia will continue on their upward trend without serious interruption.”

Africa

This relatively sanguine global picture obscures disparate regional performances, notably that of Africa, which trails other developing regions in attracting FDI. Flows to Africa amounted to about \$4.7 billion in 1997, almost the same as in 1996, but twice as high as at the beginning of the decade. Nonetheless, they remain low, representing only 3 percent in total FDI flows into developing countries, which is comparable to those of a single Asian developing economy—Malaysia. Within Africa, however, seven countries—Botswana, Equatorial Ghana, Guinea, Mozambique, Namibia, Tunisia, and Uganda—can be considered success stories, performing above the average for all developing countries. These countries have all made progress toward political stability, have worked to improve their policy framework for FDI, and are doing better than most of the rest of the Africa in terms of privatization. They have also made efforts to reduce “red tape” and appear to be less affected by corruption than other African countries. Their performance demonstrates, the report observes, “that being located in Africa...does not rule out success in attracting foreign firms.” It concludes that countries must offer a combination of policies, facilities for conducting business, and economic factors that appeal to foreign investors. ■

The *World Investment Report, 1998* may be obtained by the public at the price of \$45.00 a copy from United Nations Publications, Two UN Plaza, Room DC2-853, New York, NY 10017. Information on the report is also available on the UNCTAD website (<http://www.unctad.org>).

Recent IMF Publications

Working Papers (\$7.00)

98/128: *The East Asian Crisis: Macroeconomic Developments and Policy Lessons*, Kalpana Kochhar and others. Draws preliminary policy lessons from a review of developments during the first year of the east Asian crisis.

98/129: *Increasing Dependency Ratios, Pensions, and Tax Smoothing*, Efraim Sadka and Vito Tanzi. Examines the implications of increasing dependency ratios for pay-as-you-go, defined-benefit pension programs.

Papers on Policy Analysis and Assessment (\$7.00)

PPAA/98/13: *Corporate Debt Restructuring in East Asia: Some Lessons from International Experience*, Mark R. Stone. Summarizes lessons from international experience for corporate debt restructuring in east Asia.

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.

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 (<http://www.imf.org>). The full texts of all Working Papers, Papers on Policy Analysis and Assessment, and Public Information Notices (PINs) are also available on the IMF’s website.

Group of Seven Unveils Plan for Financial Reform, Calls for Enhanced IMF Line of Credit

On Friday, October 30, the Group of Seven industrial countries (comprising Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States) unveiled proposals for far-reaching reforms aimed at shoring up the global financial system and ending the turmoil that has rocked the world economy. The measures detailed in a statement from Group of Seven finance ministers and central bankers—and endorsed by a supporting statement from Group of Seven leaders also released on October 30—emphasize reforms to the international financial system, crisis prevention, and strengthened arrangements for dealing with the threat of contagion from the current global financial disruptions. A central element of these arrangements would be the establishment of an enhanced IMF facility that would provide a contin-

gent short-term credit line for countries pursuing strong IMF-approved policies.

The Group of Seven also pledged to support a broad range of reforms—outlined in a memorandum addressed to IMF Managing Director Michel Camdessus issued on October 30 by IMF Executive Directors representing the Group of Seven countries—to improve the IMF's effectiveness through greater transparency and accountability.

Excerpts from the declaration of the Group of Seven finance ministers and central bank governors and the memorandum from the IMF Executive Directors representing the Group of Seven countries follow. The statements are also available on the IMF's website (www.imf.org).

Group of Seven Pledges Support for Strengthened Financial Sector Surveillance

The financial problems that began in Asia last year have exposed weaknesses in emerging market countries and in the international financial system.

At our meeting in Washington on October 3, we, the Finance Ministers and Central Bank Governors of the Group of Seven countries, agreed on the importance of intensified cooperation among us in meeting the challenges of the current situation and on the need to work together quickly on a wide range of reforms to strengthen the international financial system. Today, our leaders announced agreement on a number of follow-up steps to this end that we will be implementing as rapidly as possible.

Meeting the Challenges of the Current Situation

We welcome the positive developments since our meeting on October 3. As we said following that meeting, we reaffirm our commitment to create or sustain the conditions for strong, domestic demand-led growth and financial stability in each of our economies. The authorities will continue to be vigilant in the light of the shift in the balance of risks on a global basis. There has also been important progress in a number of other areas:

- We welcome the positive steps that have been taken toward the implementation of the IMF quota increase and the New Arrangements to Borrow. We call for these to be implemented as soon as possible. Together, they will provide additional resources of \$90 billion for the

IMF, which should be used to ensure the stability of the international financial system.

- In consultation with our partners, we further commit ourselves to supplement the IMF's resources where necessary through the activation of the New Arrangements to Borrow and the General Arrangements to Borrow.

- In response to the current exceptional circumstances in the international capital markets, we are agreed that strengthened arrangements for dealing with contagion are needed. The central element would be the establishment of an enhanced IMF facility that would provide a contingent short-term line of credit for countries pursuing strong IMF-approved policies. This facility could be drawn upon in times of need and would entail appropriate interest rates along with shorter maturities. The facility would be accompanied by appropriate private sector involvement. In appropriate circumstances the facility could be complemented, in individual cases, by bilateral contingent financing activated alongside the IMF facility. It would remain up to individual Group of Seven governments and other governments concerned to decide in each case whether to provide such bilateral financing.

Reforms to the International Financial System

Following detailed discussions, including with colleagues from other industrial and emerging market economies, we are now agreed on the following specific reforms to strengthen the international financial sys-

tem. We have agreed to carry these forward through our own actions and in the appropriate international financial institutions and forums.

These reforms are designed to increase the transparency and openness of the international financial system; identify and disseminate international principles, standards, and codes of best practice; strengthen incentives to meet these international standards; and strengthen official assistance to help developing countries reinforce their economic and financial infrastructures. They also include policies and processes to ensure the stability and improve the surveillance of the international financial system. Finally, they aim at reforming the international financial institutions, such as the IMF, while deepening cooperation among industrialized and developing countries.

Crisis Prevention

We agree on the need for greater transparency and openness in the financial operations of individual countries, of financial and corporate institutions, and of the international financial institutions. The cornerstone for this is stronger and more comprehensive internationally agreed principles, standards, and codes of best practice, as well as the extension of international surveillance of their implementation.

We agree in the public sector to deliver greater transparency in economic policymaking and in disclosure of economic statistics and key indicators. We therefore commit ourselves to:

- Comply with the IMF's Code of Good Practices on Fiscal Transparency.
- Comply with an internationally agreed Code of Conduct on Monetary and Financial Policy. We urge the IMF quickly to complete its work on the code by the 1999 spring meetings.
- Disseminate regular and timely information about the aggregate foreign exchange liquidity position of our public sectors and to work cooperatively to improve the compilation and dissemination of similar information in relation to financial and corporate sectors.
- Support efforts under way in the IMF to reach decisions by the end of 1998 on steps to strengthen the SDDS [Special Data Dissemination Standard], including the provision of more comprehensive information on reserves and improving statistics on external debt and a country's international investment position.

Stability of the International Financial System

We agree that better processes are needed for monitoring and promoting stability in the financial system and for the international financial institutions, working closely with the international supervisory and regulatory bodies, to conduct surveillance of national financial sectors and their regulatory and supervisory regimes with all relevant information accessible to them.

We agree therefore that we will support the establishment of a process for strengthened financial sector surveillance using national and international regulatory and supervisory expertise, including through a process of peer review, and the IMF's regular surveillance of its member countries under Article IV; and, to this end, bring together the key international institutions and key national authorities involved in financial sector stability to better cooperate and to coordinate their activities in the management and development of policies to foster stability and reduce systemic risk in the international financial system and to exchange information more systematically on risks in the international financial system.

IMF Reforms

As our Executive Directors at the IMF have outlined [see page 362], we have agreed to support a broader range of reforms to improve the effectiveness of the IMF, including transparency and accountability of the IMF, changes in lending, policies and terms of lending, and improved conditionality.

In particular, we call upon all international financial institutions to adopt a presumption in favor of release of information except where this might compromise confidentiality, and the IMF to develop a formal mechanism for systematic evaluation, involving external input, of the effectiveness of its operations, programs, policies, and procedures.

Next Steps

We agree to take immediately the actions to which we have committed ourselves. These measures will strengthen the fundamentals of the international financial system and assist crisis-affected countries to find a route out of their current difficulties.

We will initiate further work on a number of other important areas to identify additional concrete steps to strengthen the international financial architecture. These include:

- Examining, in addition to the measures already described, the scope for strengthened prudential regulation in industrial countries to encourage sound analysis and careful weighing of risks and rewards, including consideration of appropriate transparency and disclosure standards for all financial market participants;
- Further strengthening prudential regulation and financial systems in emerging markets by examining the scope for measures to increase the resilience of financial systems and to promote the adoption of international standards and best practice, for example by maximizing market disciplines and other legal and regulatory means to motivate countries to adopt and enforce international standards and practices;
- Consideration of the elements necessary for the maintenance of sustainable exchange rate regimes in





Thomas Bernes
Canada



Bernd Esdar
Germany



Riccardo Faini
Italy



Karin Lissakers
United States



Jean-Claude Milleron
France



Stephen Pickford
United Kingdom



Yukio Yoshimura
Japan

emerging markets, including consistent macroeconomic policies that promote stability in individual countries and in the system as a whole;

- Assessing proposals for strengthening the IMF, so as to improve its programs and procedures in crisis prevention and resolution, and assessing proposals for strengthening the Interim and Development Committees of the IMF and World Bank; and

- Minimizing the human cost of financial crises and encouraging the adoption of policies that better protect the most vulnerable in society.

IMF Executive Directors for Group of Seven Present Program on Strengthening IMF

Excerpts of a memorandum to IMF Managing Director Michel Camdessus from the Group of Seven IMF Executive Directors follow.

The leaders of our countries and our finance ministers and central bank governors have issued statements today on the world economy and reforms to the international financial system. As representatives of our countries in the IMF, we would like to take this opportunity to propose some priority reforms for consideration as we develop the work program of the Executive Board to address these issues. Working in close cooperation with other members of the Executive Board, we will support and act to implement the following reforms to improve the effectiveness of the IMF, including transparency and accountability of the institution and its lending policies.

Standards

The importance of standards and codes of good practice in improving the functioning of markets and promoting transparency and good governance in the public sector is widely recognized. The IMF plays a leading role in developing standards on data dissemination and monetary, financial, and fiscal policies. We look forward to decisions by year-end on strengthening the Special Data Dissemination Standard (SDDS), particularly the publication of timely, accurate, and comprehensive information on official foreign exchange reserves, including forward positions. We should also complete work on the proposed code on monetary and financial policy by the spring 1999 meetings. Finally, the Executive Board should consider the publication, in a timely and systematic way, of the results of IMF surveillance and of the degree to which each of its member countries meets internationally recognized codes and standards of transparency and disclosure in the form of a transparency report.

Transparency and Accountability

There is growing awareness that public institutions, including the IMF and other international financial institu-

tions, need to enhance their accountability through greater transparency about their operations, objectives, and decision-making processes. We believe that, as a general principle, the IMF should adopt a presumption in favor of the release of information, except where release might compromise confidentiality. The IMF should establish, announce, and periodically review an agreed definition of the areas in which confidentiality should apply and the criteria for applying it in order to facilitate the release of information.

The Interim Committee has endorsed increased IMF transparency, including wider use of Public Information Notices (PINs), broader publication of letters of intent and policy framework papers, and more public information on and evaluations of the IMF's operations and policies. The discussions in the Executive Board suggest that concrete actions are both desirable and feasible which could build on the substantial progress achieved in recent years to make the IMF a more open institution. To this end, IMF policies should provide that full written summaries on a broader range of Executive Board meetings are made available to the public by issuing PINs following a discussion of an IMF program or program review in which there is a letter of intent, memorandum of understanding, or policy framework paper; changes in general IMF policy; and Article IV consultations. IMF policies should also make provision for the timely release of letters of intent, memoranda of understanding, or policy framework papers following Board consideration.

The concerns that have been raised in previous discussions about the potential effects of a wider publication policy could be addressed by providing flexibility in the timing of PINs and relevant document release, possibly involving delays of up to three months following the Board discussion, and by deleting market-sensitive, national security, or proprietary information.

The IMF should also develop a formal mechanism for systematic evaluation, involving external input, of the effectiveness of its operations, programs, policies, and procedures.

Terms and Conditions on IMF Loans

The pursuit of sound monetary, fiscal, and exchange rate policies is an essential prerequisite for crisis prevention and resolution. However, recent experience demonstrates that structural reforms and a solid institutional framework are also needed to make markets more flexible and open to competition; to eliminate systemic government subsidies and regulations that distort the

allocation of resources; and to provide a well-functioning financial infrastructure.

The IMF plays an important role in this effort both through its consultations and surveillance activities as well as its financial support. The recent review of IMF programs indicated, inter alia, that greater emphasis needs to be given to reducing trade barriers and unproductive expenditures. Moreover, one of the key lessons

Stand-By, EFF, and ESAF Arrangements as of October 31

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
(million SDRs)				
Stand-By Arrangements			19,834.17	4,240.41
Bosnia and Herzegovina	May 29, 1998	May 28, 1999	60.60	36.36
Cape Verde	February 20, 1998	April 19, 1999	2.10	2.10
Djibouti	April 15, 1996	March 31, 1999	8.25	2.93
El Salvador	September 23, 1998	February 22, 2000	37.68	37.68
Estonia	December 17, 1997	March 16, 1999	16.10	16.10
Korea ¹	December 4, 1997	December 3, 2000	15,500.00	2,175.00
Latvia	October 10, 1997	April 9, 1999	33.00	33.00
Philippines	April 1, 1998	March 31, 2000	1,020.79	1,020.79
Thailand	August 20, 1997	June 19, 2000	2,900.00	700.00
Uruguay	June 20, 1997	March 19, 1999	125.00	125.00
Zimbabwe	June 1, 1998	June 30, 1999	130.65	91.45
EFF Arrangements			24,414.26	16,328.38
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	17.56
Bulgaria	September 25, 1998	September 24, 2001	627.62	575.32
Croatia, Republic of	March 12, 1997	March 11, 2000	353.16	324.38
Gabon	November 8, 1995	March 7, 1999	110.30	49.63
Indonesia	August 25, 1998	November 5, 2000	4,669.10	3,251.00
Jordan	February 9, 1996	February 8, 1999	238.04	35.52
Kazakhstan	July 17, 1996	July 16, 1999	309.40	309.40
Moldova	May 20, 1996	May 19, 1999	135.00	97.50
Pakistan	October 20, 1997	October 19, 2000	454.92	398.06
Panama	December 10, 1997	December 9, 2000	120.00	80.00
Peru	July 1, 1996	March 31, 1999	300.20	139.70
Russian Federation ¹	March 26, 1996	March 25, 2000	13,206.57	7,426.86
Ukraine	September 4, 1998	September 3, 2001	1,645.55	1,455.55
Yemen	October 29, 1997	October 28, 2000	105.90	87.90
ESAF Arrangements			4,535.17	2,314.26
Albania	May 13, 1998	May 12, 2001	35.30	29.42
Armenia	February 14, 1996	February 13, 1999	101.25	33.75
Azerbaijan	December 20, 1996	December 19, 1999	93.60	23.40
Benin	August 28, 1996	August 27, 1999	27.18	18.12
Bolivia	September 18, 1998	September 17, 2001	100.96	84.13
Burkina Faso	June 14, 1996	June 13, 1999	39.78	6.63
Cameroon	August 20, 1997	August 19, 2000	162.12	81.06
Central African Republic	July 20, 1998	July 19, 2001	49.44	41.20
Chad	September 1, 1995	April 28, 1999	49.56	8.26
Congo, Republic of	June 28, 1996	June 27, 1999	69.48	55.58
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	202.47
Ethiopia	October 11, 1996	October 10, 1999	88.47	58.98
The Gambia	June 29, 1998	June 28, 2001	20.61	17.18
Georgia	February 28, 1996	February 27, 1999	166.50	27.75
Ghana	June 30, 1995	June 29, 1999	164.40	68.50
Guinea	January 13, 1997	January 12, 2000	70.80	35.40
Guyana	July 15, 1998	July 14, 2001	53.76	44.80
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Kyrgyz Republic	June 26, 1998	June 25, 2001	64.50	53.75
Macedonia, FYR	April 11, 1997	April 10, 2000	54.56	27.28
Madagascar	November 27, 1996	November 26, 1999	81.36	54.24
Mali	April 10, 1996	August 5, 1999	62.01	10.34
Mongolia	July 30, 1997	July 29, 2000	33.39	27.83
Mozambique	June 21, 1996	August 24, 1999	75.60	12.60
Nicaragua	March 18, 1998	March 17, 2001	100.91	84.09
Niger	June 12, 1996	September 1, 1999	57.96	9.66
Pakistan	October 20, 1997	October 19, 2000	682.38	454.92
Rwanda	June 24, 1998	June 23, 2001	71.40	59.50
Senegal	April 20, 1998	April 19, 2001	107.01	89.18
Tajikistan	June 24, 1998	June 23, 2001	96.00	78.00
Tanzania	November 8, 1996	November 7, 1999	161.59	38.76
Uganda	November 10, 1997	November 9, 2000	100.43	60.26
Yemen	October 29, 1997	October 28, 2000	264.75	176.75
Zambia	December 6, 1995	December 5, 1998	701.68	40.00
Total			48,783.60	22,883.05

¹Includes 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

Adjustment measures under ESAF-supported programs are expected to strengthen a country's balance of payments position and foster growth.

from the current crisis is the importance of having robust insolvency arrangements as a means of achieving an orderly and equitable resolution of debt problems. Therefore, the policies on the use of IMF resources should include requirements that the borrower, in accordance with a schedule for action, adopt policies to:

- liberalize restrictions on trade in goods and services, consistent with the terms of all international trade agreements of which the borrower is a signatory;
- eliminate the systemic practice or policy of government-directed lending on noncommercial terms or provision of market-distorting subsidies to favored industries, enterprises, parties, or institutions; and
- provide a legal basis for nondiscriminatory treatment in insolvency proceedings between domestic and foreign creditors and for debtors and other concerned persons.

All members, including our countries, should be encouraged to adopt such policies.

Achieving greater involvement of the private sector is also of critical importance in both preventing and resolving financial crises. We recognize that the issues involved in this area are complex but believe it will be essential to develop effective mechanisms to involve the private sector in crisis management, with an appropriate financing role. In this connection, the Executive Board should consider how to, under carefully designed conditions and on a case-by-case basis, extend the IMF's policy on lending into arrears.

The terms on which the IMF extends financing can also help to reduce moral hazard, provide an incentive for early IMF repayment, and encourage a return to private market financing. Therefore, IMF policies to provide loans from general resources to countries experiencing balance of payments difficulties due to a large short-term financing need resulting from a sudden and disruptive loss of market confidence should provide for the imposition of a surcharge of at least 300 basis points as an adjustment for risk and shorter maturities of one to two years. ■

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:

- Portugal, No. 82, November 2
- Tonga, No. 83, November 9
- France, No. 84, November 11

Full texts are available on the IMF's worldwide website (www.imf.org/pins).

From the Executive Board

Following are excerpts of recent IMF press releases. Full texts are available on the IMF's website (www.imf.org) under "news" or on request from the IMF's Public Affairs Division (fax: (202) 623-6278).

Dominican Republic: Emergency Assistance

The IMF approved the Dominican Republic's request for financial assistance equivalent to SDR 39.7 million (about \$56 million), under the IMF's policies on emergency assistance related to natural disasters, to support the government's economic adjustment program, and associated relief and rehabilitation efforts in the aftermath of Hurricane Georges.

The authorities' adjustment policies are based on a deepening of structural reforms and a continuation of prudent macroeconomic policies over the medium term, while allowing for accommodation of financial policies in the short term because of the damages sustained from the hurricane. The aim is to achieve a sustained increase in real GDP, reduce inflation, increase international reserves, gradually reduce quasi-fiscal losses, and eliminate domestic arrears.

The adverse impact of the hurricane on GDP growth and inflation is expected to be short-lived and limited. The 1998 growth rate of output is likely to be about ½ percentage point less than the originally forecast rate of 7½ percent, with, however, most of the lost output to be recuperated in 1999 as a result of reconstruction efforts. The inflation rate is expected to be about 6 percent in 1998 and 4.5 percent in 1999, compared with 8.4 percent in 1997. The current account deficit is expected to widen to 3 percent of GDP in 1998 and to 4 percent in 1999, compared with 1.5 percent in 1997, and reflects a sharp acceleration of imports associated with reconstruction efforts, which are only partially financed by insurance payments and private remittances from abroad.

Fiscal policy includes already-planned expenditure cuts of about 1 percent of GDP, as well as additional revenue measures and further expenditure cuts to achieve virtual balance in the fiscal accounts in 1999. In addition to a continued reduction of inflation, monetary policy will aim at a modest buildup in international reserves during 1998–99.

The government is determined to press ahead with its ambitious structural reform agenda, which includes pension reform, trade liberalization, a new monetary and financial code, and a securities market law that will support a deepening of domestic capital markets.

The Dominican Republic joined the IMF on December 28, 1945, and its quota is SDR 158.8 million (about \$224 million). Its outstanding use of IMF financing currently totals SDR 1.6 million (about \$2 million).

Press Release No. 98/53, October 29

Sierra Leone: Postconflict Assistance

The IMF has approved a loan for the Republic of Sierra Leone equivalent to SDR 11.6 million (about \$16 million) under its emergency postconflict assistance policy to support the government's economic program for 1998/89 (July–June).

1998/99 Program

The 1998/99 program aims at promoting a resumption of economic growth, reducing financial imbalances, and continuing to normalize relations with external creditors. The rebuilding of Sierra Leone's institutional and administrative capacity should lay the ground for a more comprehensive program of reforms, possibly supported under an Enhanced Structural Adjustment Facility arrangement, beginning from mid-1999. Real GDP is expected to rise by only 0.7 percent in 1998 and by 5.9 percent in 1999, after falling by 20.2 percent in 1997. The 12-month rate of consumer price inflation is targeted to fall to 6.0 percent by the end of 1999 from 43.5 percent in the last quarter of 1997. However, reflecting the planned expansion in reconstruction activities, the external current account deficit, excluding grants, is projected to widen to 12.2 percent of GDP in 1998 and to 26.5 percent in 1999, from 4.2 percent in 1997.

To attain these goals, a key objective of fiscal policy is to reduce the basic primary fiscal deficit to 2.8 percent of GDP in 1998 and to 0.6 percent in 1999, from 4.2 percent in 1997.

Structural Reforms

The structural measures include the privatization of oil import operations from the fourth quarter of 1998, the establishment of an independent revenue authority from mid-1999, the rationalization of the tariff system beginning in the last quarter of 1998, and a review of the civil service and pensions payrolls to remove "ghost" workers and pensioners in the first quarter of 1999.

Addressing Social Needs

The program accords priority to the health and education sectors and will help the most vulnerable segments of the pop-

ulation, specifically displaced persons, while laying the basis for the reconstruction of the country and its economic recovery.

Sierra Leone joined the IMF on September 10, 1962, and its quota is SDR 77.2 million (about \$108 million). Its outstanding use of IMF financing currently totals SDR 124 million (about \$173 million).

Press Release No. 98/55, November 9

Sierra Leone: Selected Economic Indicators

	1995	1996	1997 ¹	1998 ²	1999 ²
	(annual percent change)				
Real GDP	-10.0	5.0	-20.2	0.7	5.9
Consumer prices (end of period)	34.5	6.4	66.9	12.5	6.0
	(percent of GDP)				
Current account balance (excluding official transfers)	-13.9	-18.3	-4.2	-12.2	-26.5
Primary fiscal balance ^{3, 4}	-5.3	-1.6	-4.2	-2.8	-0.6
	(percent of exports of goods and nonfactor services)				
Debt service due ⁵	54.0	38.5	29.9	33.3	31.9
External interest due ⁵	33.4	18.3	8.6	11.5	9.9

¹Estimate.

²Program.

³Fiscal year ending June for data through 1994, and calendar-year basis thereafter.

⁴Domestic revenue minus total expenditure and net lending, excluding interest payments and externally financed capital expenditure.

⁵Before debt relief.

Data: Sierra Leonean authorities and IMF staff estimates and projections

Occasional Paper

IMF Assistance Helps African Countries To Modernize Their National Financial Sectors

In recent years, there has been a distinct improvement in the economic performance of many of the countries of sub-Saharan Africa. Growth rates have increased, inflation has declined, and financial imbalances have narrowed. This improvement is largely attributable to sound economic, fiscal, and financial policies, as well as fundamental structural reform. One aspect of this progress is the modernization of the financial sector, an area that is discussed in IMF Occasional Paper No. 169, Financial Sector Development in Sub-Saharan African Countries. Two of the authors of the paper, Hassanali Mehran, Senior Advisor, and Piero Ugolini, Advisor, both of the IMF's Monetary and Exchange Affairs Department (MAE), recently discussed with the IMF Survey their study and its lessons for financial modernization in Africa.

IMF SURVEY: *Why did you undertake this study?*

MEHRAN: For some time, we in MAE had been thinking about intensifying the department's technical assistance program in Africa. This was done after the seven major industrial countries announced the Initiative on Global Partnership for Growth in Sub-Saharan Africa in Lyon, France, in June 1996. The goal of the initiative is to help these countries participate fully in the expansion of global

prosperity and to spread the benefits of globalization throughout their societies. The overall strategy emphasizes trade and investment, the mobilization of global private capital flows, and the buildup of human resources. One aspect is to build healthy and competitive financial supervision standards to ensure stability. MAE undertook this study in the context of the partnership to determine the status of the financial sector in 32 sub-Saharan African countries (see map, page 367) and to recommend steps to sustain and accelerate the modernization of the sector.

IMF SURVEY: *What main changes have occurred in the financial sector in sub-Saharan Africa?*

UGOLINI: In the 1970s and 1980s, a combination of poor policy choices and internal and external economic shocks—and political shocks in some cases—worked against the early development of the financial sector and led to a deterioration of the monetary policy formulation and implementation and the soundness of the financial sector. During those two decades, the newly independent countries began to view financial systems as conduits for financing government expenditures, both fiscal and quasi-fiscal, and as instruments

for directing credit to “priority” sectors of the economy. Their policy choices reflected a desire to speed up their economic development, and they considered the government the best vehicle for achieving rapid growth.

During this time, sub-Saharan African countries emphasized developing and protecting the real sector through government intervention and protectionism. Their primary instrument was direct preferential credit to the real sector, in particular agriculture, and to public enterprises. In other words, the financial sector was given only a secondary role in the development process—to channel credit to the government and preferential sectors without assessing its risk and efficiency.

These developments had a negative effect on the financial systems. Financial institutions were weakened, financial instruments became ineffective, the credibility of financial policy was eroded, and the parallel markets effectively marginalized the formal financial sector. The central banks were seen as part of the government machinery—their job was also to provide credit to the government. Because monetary policy initiative wasn’t involved, the issue of central bank autonomy didn’t even arise. Whatever financial market there was existed only to sell and buy government treasury bills, often at predetermined interest rates. But the bulk of the loans to government were granted through ways and means advances—that is, direct credits at zero interest. The commercial banks had become poorly capitalized and were stuck with nonperforming loans in their portfolios. Capitalization of state-owned banks had direct budgetary implications and was ignored. Virtually all development banks became insolvent and illiquid. There were controls on most, if not all, prices, including interest rates and exchange rates, and so competition in the banking system was limited and sometimes nonexistent.

By the late 1980s and early 1990s, sub-Saharan African countries set out to adjust their economies and dismantle controls and restrictions. Their efforts were part of the stabilization and structural adjustment programs supported by the IMF and the World Bank. They included fiscal and financial measures to reduce inflation, price liberalization, production and marketing of most goods and services, and the opening up of the trade and payments system. They also included structural measures to avoid repeated depreciations of the domestic currency and restore confidence in domestic markets. The goal was to establish a market-based system where the private sector would drive growth without leading to inflation.

Within the overall adjustment program, a lot of sub-Saharan African countries also set about reforming their financial sectors. They liberalized interest rates and eliminated the administrative allocation of credits, gave central banks more autonomy to conduct monetary policy, and began moving from direct to indirect monetary policy instruments. As a second step, these countries began

paying more attention to restructuring commercial banks to restore their solvency, developing financial markets—mainly primary markets for government securities—and improving financial infrastructures, including bank supervision, auditing, and accounting practices.

IMF SURVEY: *What were the principal conclusions of your study?*

MEHRAN: Our basic conclusion is that sub-Saharan Africa as a whole has made a lot of progress in a short time in modernizing the financial sector and moving from a controlled economy to a market-based system. Growth is beginning to pick up—real GDP growth has, on average, doubled from 1.5 percent a year since the reforms began—and per capita incomes are rising. Even though the adjustment period has been relatively short, these countries, as a group, have achieved significant results since the mid-1980s, considering their situation before they began the reforms. Despite this progress, the study shows that sub-Saharan Africa still has a lot to do.

In most of the countries, the central bank has limited autonomy to perform appropriate monetary and supervisory functions. The government’s role in credit extension, bank licensing, and supervision interferes with the central bank’s ability to fulfill its main functions—maintaining price stability and ensuring the soundness of the financial system.

The financial sector lacks competition because of the monopolistic position of large government-owned banks. The lack of a level playing field impinges on the performance of small private banks. The large share of nonperforming loans on the balance sheets of the mostly government-owned commercial banks and the weak position of small private banks impede the development of interbank markets because sound banks don’t want to deal with unsound banks. The nonperforming loans, the lack of competition, high administrative costs, and high reserve requirements are responsible for the large spread between deposit and lending rates.

The incomplete array of monetary instruments and dearth of expertise make it hard for central banks to deal with the excess liquidity created by government expansionary policies. Also, the shortage of well-trained and qualified nationals limits the formulation and implementation of sound financial policies. This problem has persisted because of a lack of specialized institutions that will cater to the needs of the financial sector.

The regulatory framework for supervision is not entirely satisfactory, and supervision isn’t always effective. The authorities are slow to deal with insolvent financial institutions, largely because of political interference. Loan recovery is also hampered by bottlenecks in the judicial system.

Because of the uncertainties surrounding the political and economic situation of some countries, investors prefer short-term speculative investments, and this dis-



courages saving and long-term credit expansion. The crowding-out effect of government borrowing raises interest rates and discourages borrowing for long-term investment.

Finally, in many countries, payments systems are inefficient, which hurts financial sector development, keeps risks high, and hampers the smooth implementation of monetary policy.

IMF SURVEY: *What role has the IMF played in promoting financial sector reform in sub-Saharan Africa?*

UGOLINI: A number of departments in the IMF—Fiscal Affairs and Statistics, in particular—have been active in providing technical assistance to member countries on the basis of their expressed needs. MAE, for its part, played a key role in the sub-Saharan African economies, particularly in the 1960s and 1970s—in collaboration with the Legal Department—establishing central banks and developing central banking functions. With the introduction of the IMF's Structural Adjustment Facility and Enhanced Structural Adjustment Facility arrangements, MAE has supported the African Department in policy formulation and implementation, with monetary, exchange, and banking aspects of the programs. Concurrent with these activities, we work closely with the African Department in surveillance of these countries' financial sectors.

IMF SURVEY: *What is the scale of MAE's technical assistance in this area and what is its main purpose?*

MEHRAN: MAE assistance to the African region represents about 30 percent of total MAE assistance. Its main purpose, taking a broader view of financial globalization, is to form a professional class of central bankers, financial regulators, supervisors, and operational managers who will be able to maintain high professional standards in their countries.

IMF SURVEY: *What recommendations does the study make to the 32 countries it covers?*

UGOLINI: Experience elsewhere shows that reform should start with controlling the fiscal deficit and establishing macroeconomic stability. Reforms can't be carried out against an unstable macroeconomic background. The government should implement policies that will increase efficiency and competition in all areas of the economy, particularly the financial sector. The experiences of industrial, developing, and transition economies clearly indicate that an unsound, uncompetitive banking system and an inadequate institutional and regulatory framework make credit allocation inefficient, distort interest rates, disrupt monetary policy signals, and impose significant fiscal costs. Macroeconomic stability and financial sector soundness are interdependent, justifying the need for governments to address both at the same time.

To address their current problems, most sub-Saharan African countries need to take bold measures in several areas. They must establish a strong and efficient financial system on the basis of an appropriate legal and regulatory framework. The authorities must have autonomy and be accountable for the operations of the financial system. A well-conceived legislation, though necessary for central bank autonomy, is not enough.

Government commitment is necessary

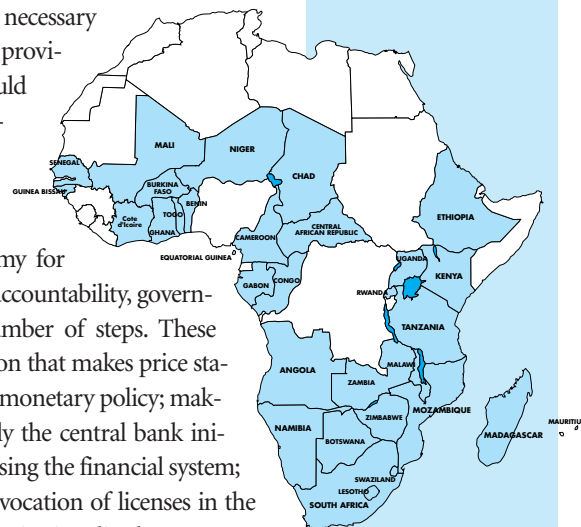
to ensure compliance with the provisions of the legislation. It could be useful to set up independent, specialized courts that deal only with matters relating to the financial sector.

To ensure suitable autonomy for central banks and to provide accountability, governments should also take a number of steps. These include promulgating legislation that makes price stability the primary objective of monetary policy; making one institution—preferably the central bank initially—responsible for supervising the financial system; consolidating licensing and revocation of licenses in the central bank; requiring an institutionalized, transparent mechanism for resolving divergences between fiscal policy and monetary policy; ensuring that governors of central banks and members of boards of directors do not come under undue political influence; placing explicit and reasonable limits on the amount of credit that the central bank can grant to the government and ensuring that these credits are collateralized by income-yielding assets and bear market-determined rates; not requiring the central bank to take on quasi-fiscal activities; and ensuring the financial viability of the central bank.

As economic stabilization has progressed and inflation has come down, commercial banks need to strengthen their balance sheets, increase provisioning for nonperforming loans, and strengthen their credit and market risk analysis. These countries will have to adopt international best-practice accounting standards, comply with the basic supervisory standards relating to prudential regulations—as indicated by the Basle Committee's Core Principles for Banking Supervision—and put in place examination procedures, including on-site inspections and off-site surveillance, that are capable of identifying weaknesses.

Besides South Africa, which has a fairly well established payments system, and the Southern African Development Community countries, which are starting to address the strategic issues of payments system policies and procedures, the modernization of payments systems in the rest of the region has been neglected, and these systems are in dire need of restructuring to avoid systemic risks and failures.

Central bank accounting and internal audit reforms are moving slowly in sub-Saharan Africa. This was one





Ian S. McDonald
Editor-in-Chief

Sara Kane • Sheila Meehan
Senior Editors

Elisa Diehl
Assistant Editor

Sharon Metzger
Senior Editorial Assistant

Lijun Li
Editorial Assistant

Jessie Hamilton
Administrative Assistant

Philip Torsani
Art Editor

Victor Barcelona
Graphic Artist

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 23 times a year, plus an annual *Supplement on the IMF* and an annual index. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on National Geographic's *Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Material from the *IMF Survey* may be reprinted, with due credit given. Address editorial correspondence to Current Publications Division, Room IS9-1300, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to imfsurvey@imf.org. The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere. Private firms and individuals are charged \$79.00 annually. Apply for subscriptions to Publication Services, Box XS800, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430. Fax: (202) 623-7201; e-mail: publications@imf.org.

of the early areas in which MAE provided technical assistance, and other institutions continue to provide it. A few good examples of accounting education and practice can be identified, but for most of the countries progress has been slow.

Good economic policy requires a sound banking system. Unsound banks threaten the real sector, weaken monetary policy, impose fiscal costs, and produce exchange rate instability. Given how vulnerable the financial sector is to flawed policies, the authorities should create a level playing field where competition can guarantee efficiency and better services to the population. In most of the region's countries, banks that are even partly owned by the government dominate the financial sector. Their inefficiency can be seen in the large spreads between deposit and lending rates and weak financial intermediation. Injecting competition in the financial sector by splitting and privatizing government-owned banks is crucial for the development of the interbank market and secondary trading activities.

To ensure and preserve soundness in the financial sector, these countries must emphasize transparency of banking activities by providing discipline and incentives for good management. They will also have to emphasize sound bank management and limit public sector distortions.

IMF SURVEY: *Countries' individual experiences have differed. Which countries do you consider the greatest success stories and why?*

MEHRAN: Almost all the countries, except for those affected by civil strife and unrest, have made tangible progress—some faster than others. Progress has been more rapid in the area of introducing indirect instruments of monetary policy implementation than in restructuring the banking sector, improving payments systems, or providing more autonomy for the central bank.

Our study shows that progress has been uneven. We don't rank the countries overall, but some have done better than others—particularly those that have introduced reforms simultaneously in several areas of the financial sector. The synergy created by the comprehensive approach to technical assistance has been tried and tested in other countries—such as Poland, and the Baltic countries—and has proved to be significantly more effective than the piecemeal approach many sub-Saharan African countries have adopted.

IMF SURVEY: *Are there some general lessons from the sub-Saharan experience that can be applied to other regions?*

UGOLINI: The post-independence experiences of sub-Saharan African countries confirm that, in the long run, there is no alternative to a market-based system.



Ugolini (left) and Mehran. *Unsound banks threaten the real sector, weaken monetary policy, impose fiscal costs, and produce exchange rate instability.*

The failure of the economic policies that many of the African countries adopted after independence, as well as government intervention and interference with economic activities, offers tangible proof that financial sector development must go hand in hand with macroeconomic stability and a strong legislative and supervisory framework providing for the rule of law.

IMF SURVEY: *Has the Asian crisis affected your conclusions regarding economic performance in the region?*

MEHRAN: No, if anything it has reinforced our belief that there is no alternative to macroeconomic stability and a sound financial sector. The recommendations that we made to address the weaknesses identified in this study should help these countries move in the right direction—toward creating a strong, well-regulated financial sector that serves as their springboard to a more prosperous future.

IMF SURVEY: *Despite recent progress, direct investment in Africa remains very low. What are the reasons for this?*

UGOLINI: Overall, we believe that there is a lot of misunderstanding about sub-Saharan African countries; often, social and political problems in a few countries give the impression that the entire continent is in turmoil, discouraging direct investment. Our study, on the contrary, highlights that the majority of sub-Saharan African countries are making strong progress in stabilizing their structure and building a solid financial and economic sector to attract more direct investment and accelerate economic growth. ■

Copies of IMF Occasional Paper 169, *Financial Sector Development in Sub-Saharan African Countries*, by Hassanali Mehran, Piero Ugolini, Jean Philippe Briffaux, George Iden, Tonny Lybek, Stephen Swaray, and Peter Hayward, are available for \$18.00 (academic rate: \$15.00) from IMF Publication Services. See ordering information on page 358.