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Group of Seven Meeting

Ministers Consider Ways to Curb Market Volatility; Approve Setting Up Financial Stability Forum

On February 20, the finance ministers and central bank governors of the Group of Seven industrial countries met in Bonn to review developments in the world economy and to discuss issues of the international financial

architecture. In their communiqué, the Group of Seven urged Japan and Europe to contribute to world growth through a strengthening of their economies. The communiqué also affirmed the Group of Seven's commitment to pursue "policies to help avoid excess volatility and significant misalignment of exchange rates of major currencies" and pledged to "continue to monitor developments in exchange markets and cooperate as appropriate" (see text of communiqué, page 66).

Debt Issues

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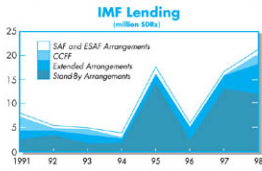
Group of Seven finance ministers (from left) Paul Martin (Canada), Kichii Miyazawa (Japan), Carlo Campi (Italy), Robert Rubin (United States), Oskar Lafontaine (Germany), Dominique Strauss-Kahn (France), and Gordon Brown (United Kingdom)

Disbursements Total \$29.2 Billion

IMF Lending in 1998 Reaches Record Levels As Members Tackle Effects of Global Crisis

Drawings on IMF resources by member countries rose to a record level of SDR 21.5 billion (\$29.2 billion) during 1998, as countries sought the IMF's financial support to help them tackle the impact of the prevailing global economic crisis (see chart, right, and table, page 77). The volume of this assistance easily outstripped the previous record of SDR 18.4 billion (\$25.0 billion) set in 1995 and was an increase of almost SDR 5 billion (\$6.8 billion) over the SDR 16.8 billion (\$22.8 billion) drawn in 1997. The sharp increase in lending was primarily a response to the urgent needs of the countries affected by the global crisis as the IMF continued in 1998 to provide large amounts of financial support for the adjustment programs of Indonesia, Korea, and Thailand. The IMF also acted to support economic programs in the Russian Federation, in August 1998, and Brazil, in December 1998.

The spread of the crisis led to drawings from the IMF by Korea, SDR 5.9 billion (\$8.0 billion); Indonesia, SDR 4.3 billion (\$5.8 billion); Russia, SDR 4.6 billion (\$6.3 billion); and Brazil, SDR 3.4 (Continued on page 77)



Date: IMF Treasury Department

Camdessus addresses Institute for International Banks on enhanced role for private sector in new financial architecture. See page 74.

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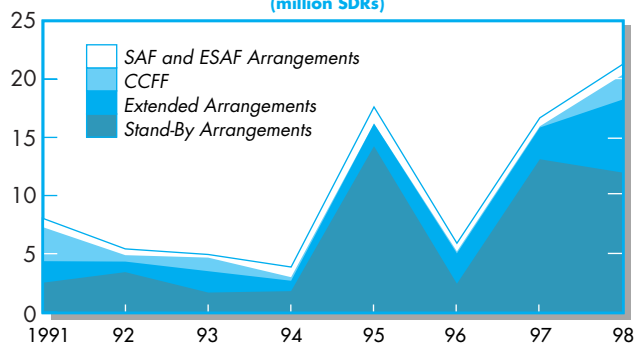
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IMF Lending (million SDRs)



Data: IMF Treasurer's Department

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Ministers Consider Ways to Curb Market Volatility

(Continued from front page) HIPC Debt Initiative and discussed proposals from a number of Group of Seven partners for achieving this, for example, by reviewing the duration and criteria for debt reduction.” They added that they would discuss these issues with a view to reaching agreement by the June summit meeting of the leaders of the major industrial countries in Cologne, Germany.

International Financial Reform

Concerning the reform of the international financial system, the Group of Seven participants noted the important progress that had been made since their previous meeting in October 1998. In particular, they

- agreed on a comprehensive format for including full information on reserves in the IMF’s Special Data Dissemination Standard (SDDS) and asked the IMF to further strengthen the SDDS by including more complete information on external debt and investment;
- supported the progress made in developing a code of best practices for monetary and financial policy transparency;
- welcomed the progress made in developing an enhanced IMF facility providing a contingent short-term line of credit, accompanied by private sector involvement; and
- agreed to consider ways to improve IMF programs and procedures in crisis prevention and resolution, as well as appropriate institutional reforms, including

reform of the Interim Committee and the Joint IMF-World Bank Development Committee.

Financial Stability Forum

The Group of Seven endorsed a proposal by German Bundesbank President Hans Tietmeyer that the Group of Seven should establish a “financial stability forum.” This forum would meet regularly and establish more formal coordination among finance ministers, central bankers, and other financial regulators to more effectively promote international financial stability, improve the functioning of the markets, and reduce systemic risk. The first chairman of the forum will be Andrew Crockett, General Manager of the Bank for International Settlements, who will serve a three-year term. The initial meeting of the forum will be held in the spring of 1999. (For details of Tietmeyer’s proposal, see page 69.)

On March 11, the issues of reform will be discussed at a seminar in Germany of industrial and emerging market economies. This seminar will focus on exchange rate regimes, private sector involvement in crisis resolution, and proposals for strengthening the IMF and the World Bank. A second seminar will be held in the United States in April to discuss issues of prudential oversight in industrial countries, strengthening systems in emerging market economies, and minimizing the human cost of crises and encouraging policies to protect the most vulnerable. ■

Group of Seven Communiqué

Countries Urged to Strengthen Their Economies And Shore Up Defenses Against Instability

Following is the text of the communiqué of the Group of Seven finance ministers and central bank governors from their meeting in Bonn on February 20.

We the finance ministers and central bank governors of the Group of Seven countries and Wim Duisenberg, President of the European Central Bank, met today with IMF Managing Director Michel Camdessus to review recent developments in the world economy. Ministers and governors also discussed international financial architecture issues.

Developments in the World Economy

We discussed developments in our own economies and in the rest of the world. Since our last statement of October 30 [see *IMF Survey*, November 16, 1998, page 360], there have

been some encouraging developments, such as the economic and financial stabilization in Asia; calmer financial markets in industrial countries; interest rate cuts in the United States and Europe; and most recently in Japan, progress made to implement policies to strengthen the financial system and stimulate the economy; and the successful introduction of the euro. But financial market conditions have worsened in some regions, and the outlook for global economic growth is somewhat less favorable. The impact of financial crises is now felt beyond the regions where the crises occurred. Against this background, it is of the utmost importance to strengthen in all countries the foundations for sustainable growth of output and employment, social stability, and the macroeconomic conditions for financial market stability.

Group of Seven Economies

We remain committed to a domestically based growth strategy that would contribute to achieving more balanced growth among our countries, reducing external

Photo Credits: Denio Zara and Padraic Hughes for the IMF, pages 69, 72, and 74; Michael Urban for Reuters, page 65.

imbalances, and supporting recovery in emerging market economies. The outlook for price stability in our countries as a whole remains favorable.

In view of the challenges facing each of our economies, we reaffirm the importance of intensified cooperation among us:

- In the United States and Canada, economic growth is expected to slow gradually, but the overall economic outlook remains favorable. In these countries, policy should be directed at maintaining necessary conditions for sustainable growth.

- In the United Kingdom, growth is expected to be lower than last year but to recover thereafter. With a less inflationary outlook, interest rates have been reduced sharply, and economic policies will continue to help create the conditions for sustainable growth.

- In the euro area, growth expectations for 1999 have been lowered. The magnitude of the slowdown may differ among these countries. They agree on the importance of pursuing an appropriate mix of macroeconomic policies and structural measures aimed at promoting strong and sustainable domestic-led growth and fostering employment.

- In Japan, short-term prospects remain uncertain. The Japanese authorities have adopted important steps to strengthen the financial system and macropolicies to reinforce growth led by domestic demand and need to push ahead with the implementation of their policies directed to those ends.

We welcome the successful introduction of the euro in 11 member states of the European Union. The euro has been well received in the international financial and foreign exchange markets. The introduction of the euro helped avoid spillovers of turbulence to financial markets in Europe. Economic and monetary policies of the euro area will have significant implications for the stability of the global financial and monetary system.

Exchange Rates

In view of the increasing integration of the world economy and financial system, we have a special responsibility with regard to improving the conditions for a proper functioning of the international financial and monetary system and, in particular, enhancing sound fundamentals necessary for exchange rate stability. To this end, we will maintain strong cooperation to promote stability of the international monetary system and to promote exchange rates among major currencies that are in line with fundamentals.

We discussed developments in our exchange and financial markets since our last meeting. We reaffirmed our view on the importance of pursuing policies to help avoid excess volatility and significant misalignments of exchange rates of major currencies. We will continue to monitor developments in exchange markets and cooperate as appropriate.

Open Markets

We confirm our strong commitment to open, fair, competitive, and dynamic international trade. The rules-based international trading system has shown its potential to create the necessary demand and underpin sustainable growth and stability in the global economy. We look forward to the launch of a new round of trade negotiations in the United States in November, with a balanced agenda of interest to all World Trade Organization member countries. We support a World Trade Organization and trade agreements that are responsive to the challenges of global markets and the concerns of citizens throughout the world.

Emerging Market Countries

We discussed financial and economic developments in emerging markets. We welcome the progress in restoring financial stability and strengthening the foundations for economic growth in many Asian countries. In other regions, notably Latin America, the outlook for growth has deteriorated since last year, while the external financing environment has become more difficult. It is crucial for the countries in the region to pursue appropriate policies, including institutional, structural, macroeconomic, and exchange rate policies and, where necessary, to reinforce existing economic programs, as the best way to respond to financial markets pressure.

Russia

We met with representatives of the Russian Federation to discuss recent developments in Russia. The economic situation in Russia continues to give cause for concern. In the absence of a concerted policy response to ongoing financial and macroeconomic instability, the country is increasingly faced with the serious risk of accelerating inflation, further exchange rate weakening, and continued economic contraction. A viable budget for 1999, significant improvement in government revenues, and sufficient progress in institutional and structural reforms are necessary for an agreement with the IMF and for economic recovery. We expressed once again our concern regarding the accumulation of arrears on debts due by Russia. Russia's debt would only be considered by Paris Club creditors in the context of an agreement on an economic program supported by the IMF. Ministers and governors of the Group of Seven also stressed the importance they attach to Russia's treating its obligations to all creditors comparably.

Brazil

Concerns about the implementation of the Brazilian reform program led to renewed pressures on the exchange rate of the real and eventually to an abandonment of the exchange rate peg. We welcomed the commitment of the Brazilian authorities to a strengthened economic program designed to prevent an initial rise in

prices associated with the sharp depreciation of the real from leading to a general inflationary spiral and to pursue a strong program of fiscal adjustment. Under present circumstances, it is of utmost importance to restore confidence. Thus, we urge the Brazilian authorities to continue with their reform efforts while paying due attention to social needs. We reaffirm our commitment to support a strong IMF program and recall the importance of a strong involvement of the private sector creditors in restoring financial stability in Brazil.

Cologne Debt Initiative

We had an exchange of views about the situation of the poorest heavily indebted countries and reiterated our continuing view that maximum progress should be made in the next year. We agree that the fundamental review and the development of the HIPC [heavily indebted poor countries] Debt Initiative provide the appropriate framework to address the debt problems of these countries. We stressed the importance of improving the HIPC Debt Initiative and discussed proposals from a number of Group of Seven partners for achieving this, for example, by reviewing the duration and the criteria for debt reduction. We will discuss these issues with a view to reaching agreement by the time of the Cologne summit. We stressed the importance of fair burden sharing among creditors and of ensuring that sufficient resources are available to finance the share of the multilateral creditors, using existing resources insofar as possible, and agreed to work to this end.

International Financial and Monetary System

We reviewed progress of the ongoing work on strengthening and increasing the transparency of the international financial architecture. Since our statement of October 30, there has been important progress in the following areas:

- The IMF quota increases and the New Arrangements to Borrow have become effective. Together, this provides the IMF with additional resources of SDR 66 billion to be used to safeguard the stability of the international monetary system.

- To strengthen the IMF's Special Data Dissemination Standard (SDDS), we agreed on a comprehensive format for full information on reserves and urge action by the IMF's Executive Board to adopt its standard in advance of the April Interim Committee meeting. We ask the IMF to further strengthen the SDDS by including more complete information on the external debt and international investment position of a country.

- We support the progress made by the IMF, working in close cooperation with the BIS [Bank for International Settlements], central banks, and other relevant authorities, in developing a code of best practices for monetary and financial policy transparency, the completion by the

IASC [International Accounting Standards Committee] of its core set of internationally agreed standards, and the progress the OECD [Organization for Economic Cooperation and Development] has made on its principles of corporate governance.

- We welcomed the substantial progress in developing an enhanced IMF facility providing a contingent short-term line of credit, accompanied by appropriate private sector involvement. We will work at the IMF to ensure this facility is introduced as soon as possible.

- We agreed that the international financial institutions must play a prominent role in facilitating cooperation among all countries, especially in the area of macroeconomic and monetary issues that are the center of the IMF's mandate as stated in Article I of its Articles of Agreement. To this end, we all agree to consider ways to improve IMF programs and procedures in crisis prevention and resolution, and appropriate institutional reforms, including the Interim and Development Committees.

We discussed the effects of the economic adjustment on the most vulnerable groups in society and reaffirmed the importance we attach to the work on the general principles of good practice in social policy being taken forward in consultation with other organizations. We will work together to ensure that these principles can be brought into operational use as quickly as possible, to be used in the design of adjustment programs by the World Bank, the IMF, and their member countries.

We discussed and endorsed the recommendations by the Basle Committee on Banking Supervision on how to mitigate risks involved in dealing with highly leveraged institutions, including hedge funds. We also noted that IOSCO [International Organization of Securities Commissions] and other relevant bodies were also working on issues [pertaining to] highly leveraged institutions and look forward to receiving their reports shortly. We agreed with the Basle Committee that adequate risk management by financial institutions is particularly important when they deal with highly leveraged institutions. We are committed to considering, in a broad context, implications arising from the operations of the highly leveraged institutions and of offshore centers on the framework of financial supervision, including whether additional reporting and disclosure by the highly leveraged institutions themselves are warranted or feasible.

Financial Stability Forum

We are grateful to Hans Tietmeyer for his report on international cooperation and coordination in the area of financial market supervision and surveillance. We welcome his proposal that the Group of Seven should take the initiative in convening a financial stability forum to ensure that national and international

authorities and relevant international supervisory bodies and expert groupings could more effectively foster and coordinate their respective responsibilities to promote international financial stability, improve the functioning of the markets, and reduce systemic risk.

While the forum will initially be the initiative of the Group of Seven countries, we envisage that over time additional national authorities would be included in the process. The issues to be addressed affect all countries, including both industrial and emerging market economies, and the Group of Seven regards this initiative as a step toward broader participation.

- We agreed that the forum will meet regularly to assess issues and vulnerabilities affecting the financial system and identify and oversee the actions needed to address them, including encouraging, where necessary, the development or strengthening of international best practices and standards and defining priorities for addressing and implementing them.

- We agreed that the forum will comprise 10 representatives of national authorities responsible for financial stability, the relevant international financial institutions and organizations, and the relevant international supervisory bodies and expert groupings. Its first chairman will be supported by a small secretariat located in Basle. Its first chairman will be Andrew Crockett, General Manager of the BIS, for a term of three years. We ask our deputies to make the necessary prepara-

tions so that the first meeting of the forum could be held in the spring of 1999.

We will continue to work to ensure implementation of all the reforms that we agreed to in our Declaration of October 30, 1998. . . . Our work between now and the Cologne summit will focus on the scope for strengthened prudential regulation and supervision in industrial countries and on further strengthening financial systems in emerging market economies; exchange rate regimes in emerging market economies; crisis response and greater participation by the private sector in crisis containment and resolution; proposals for strengthening the IMF and the Interim and Development Committees; and minimizing the human cost of financial crisis.

We will intensify the discussion of these issues among ourselves, but also with other industrial and emerging market economies. A first seminar involving a representative group of industrial and emerging countries will take place on March 11 in Germany. This seminar will be devoted to exchange rate regimes, private sector involvement in crisis resolution, and proposals for strengthening the IMF and the World Bank. A second seminar will take place in the United States in April to discuss issues of prudential oversight in industrial countries, strengthening systems in emerging market countries, and minimizing the human cost of crisis and encouraging the adoption of policies that better protect the most vulnerable in society. ■

Tietmeyer Proposal

Financial Stability Forum Convened to Promote Cooperation in Supervision of Global Markets

Following are excerpts of the proposals made by Bundesbank President Hans Tietmeyer on ways to improve coordination between global authorities that monitor financial developments.

In considering ways of strengthening the international financial system, the finance ministers and central bank governors of the Group of Seven countries asked me at their meeting on October 3, 1998, "to consult with other appropriate bodies and to consider with them the arrangements for cooperation and coordination between the various international financial regulatory and supervisory bodies and the international financial institutions interested in such matters, and to put to us expeditiously recommendations for any new structures and arrangements that may be required." This mandate was restated and extended in the declaration by the Group of Seven finance ministers and central bank governors on October 30, 1998 [see *IMF Survey*, November 16, 1998, page 360].

In order to fulfill this mandate, I have held thorough consultations with representatives of all the Group of Seven countries, the international financial institutions,

and various international bodies. These consultations were helpful in identifying key areas in the international financial system where improvements are essential in order to safeguard the proper functioning of the markets. A broad consensus emerged during this consultation process and is reflected in this report.

Current Arrangements for Supervision and Surveillance

Various international organizations share responsibility for the current arrangements concerning the supervision and surveillance of the international financial system. The international financial institutions contribute in various ways to strengthening the global financial system:

- The IMF has responsibility under its Articles for surveillance of all member countries and monitors developments in the global economy and financial markets.
- The World Bank under its mandate uses its expertise to assist countries in the design and implementation



*Bundesbank
President
Hans Tietmeyer*

March 8, 1999

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of reforms to strengthen financial systems, including banking, capital markets, and market infrastructure.

In addition,

- The Bank for International Settlements (BIS) provides analytical, statistical, and secretariat support for various official groupings working to strengthen the global financial system.

- The Organization for Economic Cooperation and Development (OECD) participates in the process of macroeconomic and financial surveillance and formulates guidelines for evaluating and improving the framework for corporate governance.

The cooperation and coordination of supervisory practices are affected by various sector-specific international groupings of regulators and supervisors, in particular:

- The Basle Committee on Banking Supervision serves as an important rule-setting body in the field of banking supervision.

- The International Organization of Securities Commissions (IOSCO) provides mutual assistance in order to promote the integrity of securities and futures markets worldwide.

- The International Association of Insurance Supervisors (IAIS) cooperates with supervisors in promoting high standards in the field of insurance supervision.

Current arrangements have made a significant contribution to raising standards of soundness and risk awareness in financial systems. These are remarkable achievements, even though they are sector-specific in their approach. However, the pace of change in markets and financial intermediaries brought about by the process of global financial integration has increasingly exposed the limitations of such an approach. The establishment of the Joint Forum on Financial Conglomerates represented an initial response to the dichotomy of fragmented supervisory structures and increasingly integrated markets. The rationale behind such an approach now has to be applied in a comprehensive manner.

There are three aspects to this: first, overcoming the separate treatment of microprudential and macroprudential issues; second, bringing together the major international institutions and key nationals in financial sector stability; and third, integrating emerging markets more closely in this process.

Systemic threats can also arise from unsupervised financial service providers, notably major highly leveraged institutions. Additionally, spillover effects could arise from difficulties at nonbank financial institutions and large insurance companies. Developing an appropriate response will require the involvement of the various regulatory groupings and the national authorities of the markets in which these equities are domiciled and operate.

Developing and Implementing Standards

Strengthening financial systems will demand a systematic approach to ensuring that gaps in international standards

or codes of conduct are identified and effectively filled. This calls for intensified cooperation and coordination between the national authorities, international regulatory bodies, and the international financial institutions charged with monitoring and fostering implementation. In particular, national authorities and the regulatory groupings need to ensure that the process of developing standards benefits from the wide-ranging information obtained by the international financial institutions in their surveillance and assistance activities in individual countries. Greater involvement in these processes of the emerging market economies to which those standards would apply is needed to augment their commitment to implementing them.

A significant challenge for the international community in the years ahead will be to foster and monitor the worldwide implementation of accepted best practices and, in particular, of compliance with the core principles issued by both the Basle Committee on Banking Supervision and IOSCO and those being developed by other international groupings. The international financial institutions, using their established procedures for consultations, will need to assist countries in strengthening their financial systems. The information and expertise available to national authorities and international supervisory groupings can enhance the effectiveness of the international financial institutions in these tasks, and vice versa.

National and international regulatory authorities must also develop procedures to ensure that market participants heed the standards that have been developed in managing and pricing the risks they incur with respect to their counterparties. Strengthened procedures will be needed to coordinate and promote efficiency in this effort, as well as to avoid overlaps between the international financial institutions, and also with the rule-making capacities of the international supervisory bodies.

Improvements in Financial Supervision

The international regulatory groupings have made considerable progress in harmonizing and strengthening national financial regulation and supervision. Minimum standards have raised levels of soundness and helped to create a more level playing field, and the continuing issuance of risk-management guidance improves defenses at individual institutions. These efforts, including the work of the joint forum, should be sustained. At the same time, further efforts are required to address issues raised by the blurring of distinctions between different types of financial operations and institutions.

Advances on issues, such as consistent rules for the treatment of risk, arrangements for the pooling of information, and closer cooperation between different supervisory authorities, continue to be hampered by the fact that countries have different financial and supervisory systems.

The functional bodies also need to take account of the work being done by private sector groupings and to assess, in cooperation with national authorities, the

question of the appropriate prudential and regulatory response to significant players operating outside existing regulatory arrangements, including the adjustment of prudential policies governing those within their purview.

Specific Issues to Be Addressed

From the current standpoint, action is required in the following areas:

- Improving arrangements for the surveillance of global vulnerabilities, including the pooling of information available to the international financial institutions and the international regulatory groupings, the development and assessment of macro early warning indicators, and the creation of procedures to ensure that information reaches the relevant parties.
- Creating procedures for coordinating the work of national and international regulatory groupings and for the exchange and pooling of information among them.
- Assessing the need for the regulation of nonregulated entities.
- Strengthening and, when appropriate, encouraging the development and implementation of international best practices and standards, including fostering improved in-house risk management at financial institutions in the wake of recent market events, and promoting appropriate transparency and disclosure rules for all market participants.

Convening a Financial Stability Forum

The previous sections set out a number of specific areas in which existing arrangements for the supervision and surveillance of the international financial system could be strengthened. Sweeping institutional changes are not needed to realize these improvements; instead, a process in line with the mandate should be set in motion to ensure that national and international authorities and groupings can coordinate efforts to promote the stability of the international financial system and to improve the functioning of the markets in order to reduce systemic risk.

The following approach would appear to be suitable: The Group of Seven should take the initiative in convening a Financial Stability Forum. Such a forum should meet regularly to assess issues and vulnerabilities affecting the global financial system and to identify and oversee the actions needed to address them.

The forum would report to the Group of Seven ministers and central bank governors. It would replace the series of ad hoc groups that have been convened by the Group of Seven over the past few years, with a view to strengthening the international financial system.

The forum should be limited to a size that permits an effective exchange of views and the achievement of action-oriented results within a reasonable time frame. In developing objectives, priorities, and programs for action, the forum would work through its members, taking into account their comparative advantages.

The members of the forum would be representatives of national and international authorities responsible for questions of international financial stability. It would initially comprise the ministries of finance, central banks, and senior supervisory authorities of the Group of Seven countries. In addition, the international financial institutions and key international regulatory groupings would participate. Representation should be at a high level. Participation could, over time, be extended to include representatives from a small number of additional (that is, non-Group of Seven) national authorities that could contribute substantially to the process, or to invite them to attend meetings as guests.

The chairperson should be appointed in a personal capacity for a period of time that is adequate to ensure continuity in the work of the forum. I would like to suggest the appointment of Andrew Crockett, General Manager of the BIS, for a term of three years.

The forum would meet as often as needed to achieve its objectives. Initially, two meetings a year could be envisaged.

The first meeting of the forum could be held in spring 1999. ■

Available on the Web

News Briefs

- 99/7, February 24. IMF Completes Review and Approves \$129 Million Credit Tranche for the Philippines
- 99/8, February 25. IMF Seminar Discusses Revenue Implications of Trade Liberalization

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

- 99/11 Kuwait, February 22
- 99/12 Nepal, February 24
- 99/13 Mali, February 25
- 99/14 Switzerland, March 1
- 99/15 Madagascar, March 2

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

- Mali, February 18
- Nicaragua, February 19

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

- Tanzania, February 24

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

French President Advocates Solidarity Among Nations to Tackle Debt, Poverty

During a visit to Washington on February 18, French President Jacques Chirac addressed staff members of the IMF, the Inter-American Development Bank (IDB), and the World Bank at the IMF. An edited translation of his speech appears below.

It is with great pleasure that I greet and offer warm thanks to Michel Camdessus, [World Bank President] Jim Wolfensohn, and [IDB President] Enrique Iglesias,



French President Jacques Chirac addresses IMF, IDB, and World Bank staff. Also pictured (l to r): IDB President Enrique Iglesias, World Bank President James Wolfensohn, IMF Managing Director Michel Camdessus, and French Finance Minister Dominique Strauss-Kahn

who have afforded me this occasion to meet with you. My visit is the first by a French head of state to the Bretton Woods organizations, and it is not just a courtesy visit. For me, it is an event charged with great significance. It is both a demonstration of confidence and an urgent plea to the institutions you represent.

I would like, first, to recognize the work already accomplished. I fully realize the difficulties and responsibilities involved. Your organizations have served global development well. France has confidence in them and fully supports their efforts at adapting themselves to better serve the needs of the twenty-first century.

The world of today is very different from the postwar world that led to the creation of your institutions. The globalization of markets, capital, and economies has become a reality, and the need for cooperation, coordination, and risk sharing is more necessary than ever. This new world confers important new responsibilities upon you.

We need to better organize the global economy, and you must be at the forefront of this effort. Representing the whole community of nations legitimizes your role. This is why France is in favor of increasing the resources necessary for your mission, whether it be for quotas and for financing the Enhanced Structural Adjustment Facility at the IMF, for IDA [International Development Association] at the World Bank, or for the resources of the IDB.

But there must be something to counterbalance the expansion of your roles and the confidence that governments place in you: the general policy orientation of your institutions must be defined by the political authorities of your shareholders. Ministers in the governing bodies must act side by side with the respective Boards of Directors, whose roles are irreplaceable, to give impetus to, and provide democratic oversight for, the policy directions adopted. This is the spirit in which France has proposed transforming the Interim Committee of the IMF into a decision-making body, as provided for in its statutes. The same should go for the Development Committee of the World Bank.

Financial Stability and Growth

I would also like to take advantage of our meeting to tell you my thoughts on the need to increase international financial stability and on the crucial struggle against poverty and exclusion. The world needs stability to achieve growth. We will never completely avoid crises, but we must do everything in

our power to anticipate them and to limit their effects. The financial crisis that developed over the past two years illustrates the fragility of our system. In today's globalized world, no country is safe from the shocks that strike its neighbors.

The financial community, it is true, has been able to mobilize and face up to the situation, thanks to strong intervention by the IMF and the World Bank and to the financial support of the Group of Seven. Europe and France were, as you know, neither inactive nor indifferent. We have fully assumed our share of the requisite efforts. But, beyond the short term, more far-reaching responses are called for, which must withstand two temptations. The first is to blame globalization for all our troubles. I do not think this is justified. We must not stigmatize a development that is the source of the exceptional recent growth of world trade. Globalization has permitted countries that only 10 years ago were still part of a rigid system of state-run, centralized economies to be rapidly integrated into the world economy.

The second stumbling block we must avoid is the temptation to resort to backward-looking and inappropriate solutions. Let us acknowledge that market liberalization has occurred in a disorderly manner. Banking systems have often been too fragile to carry out the tasks incumbent upon them. Even so, the way out is not to be found in fear, or retrenchment, or outmoded

approaches. The problems we must solve call for pragmatic solutions, not ideological responses. It is not a question of backing away from free capital movements and repartitioning economic life. Nor is it a question of seeking a new financial protectionism, which would be rapidly followed by a new trade protectionism, making victims of us all.

New Financial Architecture

Let us rapidly build the “new financial architecture” we so need. Let us reform the Bretton Woods system. We know the reforms that must be achieved. Of course, we must first implement good economic policies in each of our countries. But, it is also necessary to increase transparency, both in member countries and in the international financial institutions. We must increase our capacity for crisis prevention. We must adopt a veritable “traffic code” or “highway code” for capital flows, a code that applies to all, including hedge funds and offshore establishments. The private sector must participate in the resolution of crises. We must identify and define the role of “lender of last resort” for the world financial system.

Nineteen ninety-eight was a year for reflection and for stemming the crisis; 1999 must be the year of decision and reform. I am counting particularly on the IMF to take the lead in this field, for the world remains fragile.

I expect much from the next meetings of the Interim Committee of the IMF and the Development Committee of the World Bank and from the annual meeting of the IDB, which I will have the pleasure of welcoming to Paris. This will be an occasion for me to pay special and sincere tribute to Enrique Iglesias.

At the summit in Cologne next June, the Group of Seven will dedicate a major part of its work to the reforms being prepared. And, you are aware that France has proposed a summit in Paris to bring together, notably, the heads of state or government of the IMF Interim Committee member countries, if possible this autumn. Its purpose would be to officially adopt the reforms and to give them the requisite international legitimacy.

Expectations are great. These are the spheres where the heads of state or government must squarely face their responsibilities. I intend to fully exercise my own responsibilities. Since January 1, 1999, our country, along with 10 of its European Union partners, has a new currency—the euro—whose creation contributes to international stability. The euro holds out the promise of growth and employment if we implement the appropriate economic, structural, and social policies. Europe must be a high-growth zone. As the leading world economic power, Europe must play its role as the engine of world growth.

Shifts among the euro, the yen, and the dollar will dominate the international scene. One cannot hope for world financial stability while, at the same time, accept-

ing unstable exchange rates. We must aim for more stable relations between currencies. This is a daunting task. At a time when so many emerging countries are making a considerable effort to surmount their difficulties, we must move forward together to maintain a global environment that fosters growth.

Social Consequences

Strengthening stability goes hand in hand with the fight against poverty and the social consequences of crisis. This is a political problem. Growth and economic development are the foundations of democracy: we know that demagogues find fertile ground when confidence in the future is shaken. That is why the IMF, the World Bank, and all development banks must take concerted action. A globalization that does not benefit humanity and help it flourish is unjustifiable. We must take care that globalization leaves no country by the side of the road.

This is the intent of France’s course of action in support of public development aid. Concerned by the worrying decrease in contributions, France is advocating, in every forum, real solidarity between nations on this issue. This is the intent of our initiatives and proposals aimed at finding a solution to the painful, chronic problem of debt in the poorest countries. We have made progress, but not enough. We must push ahead. I hope the Cologne summit will help us. There, I want us to express, in a decisive way, our determination to alleviate the burden of the poorest countries. This problem, which is dealt with in the Paris Club, is increasingly becoming a multilateral debt problem. Balanced and shared efforts will thus be necessary to find a solution.

At the next meeting of Group of Seven finance ministers, Dominique Strauss-Kahn [French Minister of Finance] will propose, on behalf of France, an initiative based on three principles: greater generosity toward indebted countries; a sharing of effort among creditor countries, which is only just; and a serious effort on the part of the countries concerned to strive for better management and better governance.

I would like to acknowledge the generous vision and action of Jim Wolfensohn. He gave the impetus to the Bank’s new global strategy, highlighting the social and environmental dimensions of development. Yes, we must give priority to education and human development. Develop the rule of law in all countries. Fight corruption. Assist in better public sector management. This international solidarity must translate into a real priority for the poorest countries, notably in Africa.

So, here are France’s goals: to fight poverty, prevent crisis, and better ensure financial and monetary stability and, through these efforts, to achieve stronger, more balanced world growth that will benefit everyone and, above all, democracy. In a word, as U.S. President Clinton so rightly put it, “to humanize globalization.” ■

Camdessus Outlines Role for Private Sector in New Financial Architecture

Following are edited excerpts of remarks by IMF Managing Director Michel Camdessus to the Institute of International Bankers in Washington, DC, on March 1, 1999. The full text of the speech is available on the IMF's website (www.imf.org).

You have invited me to discuss international efforts to address the current difficulties confronting the global economy and financial markets. I will dwell on just one aspect: the private sector's role within the new financial architecture we are trying to put together. How can we create conditions for the private sector to benefit more from the opportunities of the globalized markets, while being a more efficient and responsible intermediary for channeling financial resources to their best use?

These conditions confront us with an imposing agenda, but not an idealistic dream. These are achievable objectives, provided we try to base the reforms on three straightforward principles: the universal promotion of free market mechanisms strengthened by a set of standards and principles of good conduct; a mature partnership between banking and financial institutions and their sovereign and corporate clients; and a cooperative approach to crisis management in the mutual interest of all market participants.

Let me elaborate on these three objectives and how the IMF intends to contribute to their implementation.

Standards and Principles of Good Conduct

To optimize the opportunities and reduce the risks of globalization, we must head toward a world with open and integrated capital markets, achieved through a gradual process of liberalization supported by good macroeconomic policies and sound financial institutions. This is a world where financial institutions in the emerging markets—as elsewhere—will be better managed and more robust, as internationally accepted standards of regulation and supervision are implemented. Financial markets will be less prone to volatility, because participants will have more information, and they will be able to assess risk more realistically. This is a world where market participants and governments will operate according to higher standards of transparency and governance. And, of course, this is a world where the benefits of globalization will be more widely dispersed through efforts to ensure that no countries are marginalized and through social policies designed to make sure that people in each country have equitable access to education, health, a livelihood, and social protection in times of crisis. And last, but not least, this is a

world that will rely primarily on the private sector to mobilize resources for investment and growth. All this implies that it will be a world where markets must be able to function efficiently, with risks being assessed realistically and the rewards of success and the cost of failure fairly distributed.

This set of objectives is straightforward. In spite of the nostalgia for state intervention of a few observers and, fortunately, even fewer policymakers, the immense majority of the world community wants to achieve these objectives through the active promotion of well conceived standards and principles of good conduct. After all, markets are about liberty and responsibility; they are about transparency, timely information, and equality of conditions for all players; and they are about enterprises' decisions, accountability, and profits—but also losses as a sanction against bad or ill-informed decisions. Of course, we know only too well that in international markets these conditions are unevenly fulfilled. Therefore, our aim must be to create, at world level, the well-functioning markets you enjoy here and in your home countries. This imposes, without question, the tasks of defining essential standards and of strengthening the agencies charged with disseminating and monitoring their implementation. Within the IMF, we are pressing our members to adopt a new code on transparency in their fiscal policies, and we are working with other agencies and members to design a similar code for monetary and financial policies. We are also on the verge of a consensus on an important enhancement to the IMF's established standard for data dissemination that will strengthen the reporting of countries' international reserves and related liabilities.

We will have to make sure that progressively—with due regard to the situation of individual countries—steps are taken for the use of these standards to become generalized. This is where the IMF, with its unique and exclusive mandate for universal surveillance, will become more relevant than ever. The IMF's permanent surveillance of its members will have to focus more on capital movements, on countries' progress toward transparency, and on implementation of the principle of good governance to which they should voluntarily subscribe. Also, together with other international financial institutions and bilateral donors, we will need to mobilize technical assistance to help emerging and developing countries, including the offshore centers, to adapt themselves to these new standards. This, over time, should promote more efficient, more orderly, and more mature markets—at world level. In the final analysis, nothing could be more important.



IMF Managing Director Michel Camdessus

Institutions and Clients: A Partnership

In such mature markets, more mature relationships could be expected between banking and financial institutions and their clients. This would mean trying to avoid the excessively risky behavior that has recently taken such a toll on both financial institutions and recipient countries. Surges in capital inflows have tended to end badly when bankers and portfolio managers follow each other without assessing adequately the structural weaknesses of the financial system of the recipient countries. The interests of both the creditors and the recipient countries call for strengthening lending relations as much as possible.

Ideally, this calls for two basic, straightforward changes in the recent pattern of international financing. These changes would do the following:

- Put more emphasis on non-debt-creating flows, especially direct investment. These are perhaps the most constructive of all the flows for emerging markets, since by their very nature they are less volatile and less prone to sudden withdrawal because of a shift in sentiment—although they are by no means immune to such shifts. For such flows, the crucial issue is the need for an environment that encourages foreign investment for the long haul: sound macroeconomic policies, good governance, a robust financial system, and a transparent legal framework. This is an enormous agenda that the IMF and other institutions must strive to promote. It is one that we will indeed promote, whatever the clamor from those who consider that combating “crony capitalism” is not our business.

- Encourage a shift from short-term to longer-term lending. Most of the crises have developed around the “rush for the exits” that was led by short-term creditors and the threat to liquidity that this posed. To guard against future stress, excessive short-term borrowing should be avoided in the first place. Prudential limits on banks’ borrowing should be introduced. In particular, standards should be more tightly defined to reduce the mismatch of maturities, so that banks would perform their traditional role of “borrowing short and lending long” in a safe and balanced fashion.

Closely related to this, and perhaps one of the most workable innovations, is that proposed by the Chairman of the U.S. Federal Reserve Board, Alan Greenspan, to adjust the pricing of debt. On the debtor side, the monetary authorities could charge domestic borrowers for sovereign guarantees that, in my view, should be avoided anyway. On the creditor side, it could be done by revising the risk-weights attached to various types of lending under the Basle capital adequacy standards. This approach is being explored by the Basle Committee on Banking Supervision. Market-based measures to raise the cost of short-term capital imports have already been adopted in several countries.

Beyond these changes, the very nature of the relationship between creditors and debtors should be helped to mature and to adapt to this new world. This means that

- Contracts should be honored. If extreme circumstances prevent debtors from making payments, then orderly amendments to loan contracts should be sought.

- Investors should expect to face an element of risk; therefore, they should have the opportunity and the responsibility to assess that risk, and they should accept the consequences of occasional failure. This should entail, on the debtor side, a greater readiness to share information with their creditors. At the request of any member government, the IMF would be ready to assist with this provision of information.

- In a cooperative effort to avoid crisis, investors could equip their borrowers with appropriate means to forestall the need for drastic measures—provided they maintain a responsible macroeconomic stance. For instance, three countries (Argentina, Indonesia, and Mexico) have negotiated with foreign banks to provide contingent credit lines, which are voluntary, market-based arrangements intended to be drawn on only if conditions were to deteriorate. Thus far, Indonesia and Mexico have drawn successfully on these lines.

Governments should also be ready to adopt new attitudes and take initiatives to avoid the risk of crisis or to promote an orderly handling of crises if they occur. Let me mention two:

- Governments need to avoid creating the impression of offering implicit guarantees, including those associated with exchange rate management. Thailand’s long peg to the U.S. dollar and Indonesia’s predictable crawling peg are examples of arrangements that outlived their utility, encouraging excessive levels of unhedged foreign exchange exposure. But this takes us into the contentious arena of exchange rate policy—a topic for another occasion.

- Governments—and financial institutions—should also reflect on a legal issue that can seriously disrupt the resolution of a country’s external liabilities, notably its bonds. To restructure them may involve a very large number of unidentifiable bondholders. Under U.S. law, any creditor can pursue full, immediate payment by legal action. Such an event can completely disrupt a country’s restructuring and jeopardize its policy adjustment efforts. To avoid this possibility, bond contracts could contain clauses that would permit majority voting, sharing, and other provisions that are found under other legal systems.

The interests of creditors and recipient countries call for strengthening lending relations.

From the Articles of Agreement of the IMF

“Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.”

—Article VIII, 2(b)

We in the IMF are ready to contribute to countries' efforts to avert crisis, with an important innovation. We are now working to put in place a facility under which the IMF would commit resources—on a contingency and conditional basis—to countries in jeopardy of contagion from crises in other emerging markets. This could, and should, parallel the private instruments I have just mentioned. But we are wrestling with some difficult issues. For instance, how can large amounts of money be committed and possibly disbursed, while at the same time keeping the private sector “on board”? What types of policy commitments would be sought from the authorities? Will the countries most likely to need assistance be able to meet the conditions that will have to be stipulated to pre-qualify them? And what assurance is there that, once the funds are committed, the country would continue to implement sound policies?

The discussion about “involving” the private sector is concentrating on how to anticipate a potential crisis, how to head it off, and how to react if it does strike. “Prevention is better than cure,” and that is why the international community is trying to reform the international financial system. And that is why it is so important that the IMF, the new forum for financial stability [see page 69], and all the relevant international agencies keep up an active dialogue with countries to ensure that they implement sound policies and keep their institutions and practices up to date and in line with accepted standards and codes of best practice. But crises will occur from time to time, and crisis resolution should always favor voluntary, market-based options.

Cooperative Approach to Managing Crises

Many proposals have been made to resolve crises in an orderly fashion. The debate is still alive—and lively. One suggestion emerging from recent experience is that creditor councils or committees can be critical in smoothing the process. They are worth establishing, since they can effectively contribute to mutual understanding and pragmatic solutions.

But what of the worst-case scenario? How can a country unable to service its debt in the near term but wishing to stabilize its economy and restructure its debt avoid descending into a vicious spiral of default, the loss of access to all forms of financial flows, and poverty? For such circumstances, the IMF accepts its role—exceptional and risky as it may be—to stand ready to lend into a situation already characterized by arrears to nonpreferred creditors. If the country is clearly trying to address its problems, including efforts to normalize relations with its creditors, the IMF is able to extend financial assistance under prudent safeguards. But this, of course, can make sense only if such

IMF lending triggers reasonable cooperative contributions from other creditors, including from the private sector. The aim is not simply to provide near-term balance of payments support but also to catalyze financial flows from other sources, including debt restructuring, and thus speed up the restoration of normal credit flows. This objective is so important that, in times of crisis, the IMF has to define the conditions of its loans in a way that ensures the private sector's exposure is maintained or increased.

But even under extreme circumstances, legal action by individual “dissident” creditors can disrupt an otherwise orderly restructuring. Therefore, to maintain order, the international community may need to sanction a temporary halt to payments to all creditors, under clearly defined conditions. An effective means of doing this would be by explicitly recognizing the IMF's role—already suggested in its Articles of Agreement—of endorsing a stay on litigation while a debt restructuring is in process. To make this role safe and unquestionable, it could be wise to amend Article VIII 2(b) of the IMF's Articles of Agreement, where a basis for such a role exists. The purpose of this action would not be to alter creditors' rights permanently but instead to oblige all creditors to accept a common procedure, refraining from litigation in circumstances where it would be both disruptive and not necessary. This is a controversial proposal, and so far no consensus has emerged. I am nevertheless personally of the view that such an initiative would be in tune with the cooperative approach of crisis situations that is called for in a world of globalized finance where serious market members—including on the creditor side—have every interest in an orderly and prudently handled procedure to allow for an early restoration of debtors' payments capacity. Such a device—equally protective of creditors and debtors against the risk of panic-stricken, asset-destructive episodes—should merit more attention from those who are particularly concerned about creditor interests.

We are developing a comprehensive, but achievable agenda. If we are to avoid periodic country crises, erratic contagion, and even threats to global financial stability, we cannot go for less. We must create this new framework to facilitate a constructive engagement among the players in each country: private sector, public sector, and multilateral institutions alike.

I would also like to see you, as private sector representatives, seize every opportunity to have a say in this extensive process of deliberation and consultation. The diversity and resourcefulness of the private sector can be a key ingredient in the debate over the structure of the financial system we envisage for the next century. More important, it is the private sector that will provide the dynamism and impetus for renewed growth and progress as we enter the new century. ■

Drawings Rise in 1998

(Continued from front page) billion (\$4.76 billion). The arrangements with Korea, Russia, and Brazil included amounts drawn under the Supplementary Reserve Facility, which was established in December 1997 (*IMF Survey*, January 12, 1998, page 7). Drawings by the four countries amounted to over 57 percent of total IMF disbursements during 1998.

Stand-By Arrangements accounted for most of IMF lending during 1998, totaling SDR 12.1 billion (\$16.5 billion) by year's end. Of this amount, SDR 2.9 billion (\$3.9 billion) represented funds that the IMF borrowed from participants in the New Arrangements to Borrow and disbursed under the Supplemental Reserve Facility. SDR 6.3 billion (\$8.4 billion) was disbursed under the Extended Fund Facility, while member countries drew SDR 0.9 billion (\$1.2 billion) under the Enhanced Structural Adjustment Facility. The Compensatory and Contingency Financing Facility registered the largest increase in disbursements, rising from SDR 0.1 billion (\$0.13 billion) in 1997 to SDR 2.2 billion (\$3.0 billion) in 1998, owing entirely to a large drawing by the Russian Federation.

On December 31, 1998, the IMF had Stand-By, Extended Fund Facility, or Enhanced Structural Adjustment Facility Arrangements (the principal IMF lending facilities) with 62 member countries. The cumulative amount approved under these facilities was SDR 61.2 billion (\$83.2 billion), an increase of 37 percent over the previous year's total. Of the 1998 amount, SDR 32.9 billion (\$44.7 billion) was approved under Stand-By Arrangements, SDR 24.4 billion (\$33.2 billion) under Extended Fund Facility Arrangements, and SDR 3.9 billion (\$5.3 billion) under Enhanced Structural Adjustment Facility Arrangements. Of the SDR 61.2 billion approved, the undrawn balance on December 31, 1998, amounted to SDR 29.4 billion (\$40.0 billion). ■

Press Releases

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

Kyrgyz Republic: ESAF Augmentation

The IMF has approved a request by the government of the Kyrgyz Republic to augment by SDR 8.9 million (about \$12 million) the IMF's financial support under the current three-year Enhanced Structural Adjustment Facility (ESAF), approved by the Executive Board on June 26, 1998, in the amount of SDR 64.5 million (about \$88 million). (See Press Release No. 98/27, *IMF Survey*, July 6, 1998, page 217.) The augmentation,

Kyrgyz Republic: Economic Indicators

	1995	1996	1997	1998 ¹	1999 ²
	(percent change)				
Real GDP	-5.0	7.0	10.0	2.0	3.0
	(percent of GDP)				
Overall government balance	-17.0	-10.0	-9.0	-9.0	-8.0
Current account balance	-16.0	-23.0	-8.0	-17.0	-12.0

¹Estimates.
²Projections.

Data: Kyrgyz authorities and IMF staff estimates

which is intended to help counter the impact of the Russian financial crisis on the Kyrgyz economy, will be available as part of the second loan under the first annual ESAF arrangement. The Executive Board made the decision in conjunction with the completion of the midterm review of the first year of the ESAF.

The Kyrgyz Republic joined the IMF on May 8, 1992. Its quota is SDR 88.8 million (about \$121 million). Its outstanding financial obligations to the IMF currently total the equivalent of SDR 124 million (about \$170 million).

Press Release No. 99/7, March 4

Use of IMF Credit (million SDRs)

	1996	1997	1998
General Resources Account	5,270.96	16,112.86	20,586.19
Stand-By Arrangements	2,471.06	13,255.39	12,098.01
Supplemental Reserve Facility	—	4,100.00	8,726.31
EFF Arrangements	2,625.29	2,749.87	6,331.63
Supplemental Reserve Facility	—	—	675.02
CCFF	174.29	107.60	2,156.55
SAF and ESAF Arrangements	708.64	730.59	895.96
Total	5,979.60	16,843.45	21,482.15

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

Data: IMF Treasurer's Department

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
February 22	3.49	3.49	3.73
March 1	3.54	3.54	3.79

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

Further Liberalization Takes Effect in WAEMU Zone Countries

The progress of 32 sub-Saharan African countries, from independence through December 1997, in liberalizing their financial sectors is the subject of IMF Occasional Paper 169, *Financial Sector Development in Sub-Saharan African Countries*, published in September 1998 (see *IMF Survey*, November 16, 1998, page 365). The paper also recommended how these countries could sustain and accelerate the modernization that is under way in many of them. Since the release of the Occasional Paper, the countries of the West African Economic and Monetary Union (WAEMU) (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo) have implemented a number of measures that modify the overall picture of financial sector development.

In September 1998, a regional stock exchange was established in Abidjan, Côte d'Ivoire, which will open new opportunities to investors. In November 1998, the Council of Ministers of the WAEMU adopted a regulation that unified the exchange regulations for all member countries, with the ultimate objective of achieving greater liberalization of external financial transactions. These are important steps that should encourage direct investment and boost the development of capital markets in these countries. Below is a brief review of the new regulatory framework for exchange transactions.

Regarding current account transactions, the freedom of transfers within the WAEMU remains a fundamental principle in the new framework. While most other features of the original regulatory framework remain in place, the new regulations ease the screening of selected current account transactions and liberalize forward cover for imports and exports. In particular, indicative limits for tourist allocations to resident travelers have been abolished, and the ceiling for transfers abroad

without supporting documents was raised from CFAF 100,000 to CFAF 300,000. Also, residents are now free to make forward cover, provided it is for the currency stipulated in the commercial contract and the maturity of the contract does not exceed the maturity stipulated in the commercial contract.

Concerning the capital account, controls on inward flows of direct investment were already fairly liberal in the WAEMU zone. In particular, credit extended by non-residents is essentially free of restrictions, as is commercial credit to nonresidents. The November 1998 common exchange regulations establish total freedom of payments and transfers between member countries: the domiciliation and repatriation requirements for exports within the union are eliminated, as is prior approval for all capital account transactions between member countries. More important, the transfer abroad of the proceeds of the liquidation of foreign direct investments is no longer subject to prior approval, and residents of the WAEMU are allowed to purchase foreign securities listed in the regional stock market. Also, under the regulations, authority for allowing the sale or placement of foreign securities in the WAEMU has been transferred to the Regional Council of Public Saving and Financial Markets. However, transfers of foreign exchange to non-residents for outward direct and other investments are subject to prior approval, which may be granted more easily for transfers within the franc zone. ■

Piero Ugolini and Bernard Laurens
IMF Monetary and Exchange Affairs Department



Copies of Occasional Paper 169, with a revised Section V, are available for \$18.00 (academic rate \$15.00) from IMF Publication Services. See ordering information below.

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PDP/99/2: *Tax Policy and the Asian Crisis*, David C. Nellor

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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, Policy Discussion Papers, and Public Information Notices (PINs) are also available on the IMF's website.

Education and Health Spending Continues Rise In Countries with IMF-Supported Programs

The most recent review of data on government expenditure on education and health care in countries with IMF-supported programs (see *IMF Survey*, July 21, 1997, and February 23, 1998, for previous assessments) shows that such spending has continued to increase in the course of the programs. There has also been steady progress with indicators of education attainment and health status under IMF-supported programs. But the latest study, prepared by the Fiscal Affairs Department in collaboration with other IMF departments, also indicates that substantial scope exists for improving the allocation of public resources within the education and health sectors to obtain better social outcomes. This would accelerate social development and promote long-term economic growth. The current study covers 145 developing and transition countries, including 65 countries with IMF-supported programs during 1986–97, and is part of an ongoing effort to compile and analyze data on government spending in the education and health sectors. For 109 countries, the data refer to the central government; for 2 countries, they comprise the entire public sector; and other observations are mostly for the general government.

IMF-Supported Programs

In 65 countries supported by various types of IMF programs, average government spending on education and health care has increased since the year preceding the program—a period of eight years on average—by 2½ percent a year in real per capita terms (chart, upper right). Education and health expenditure also increased as a percentage of GDP. This progress with social spending occurred against a background of fiscal adjustment and was typically accomplished through a reorientation of budget allocations. Compared with countries without IMF-supported programs since 1986, program countries had lower education spending as a percentage of GDP (chart, lower right).

Social Spending and Social Indicators

Rising social spending in program countries has been accompanied, on average, by improvements in social indicators, although these indicators are influenced by many other factors, such as general economic conditions and the activities of nongovernmental organizations and other private sector providers of social services (upper chart, page 80).

Developing countries and economies in transition on average allocate a relatively large share of their education budget to tertiary education, and an even larger part of health outlays to curative services (lower chart, page 80). This suggests that the poor would ben-

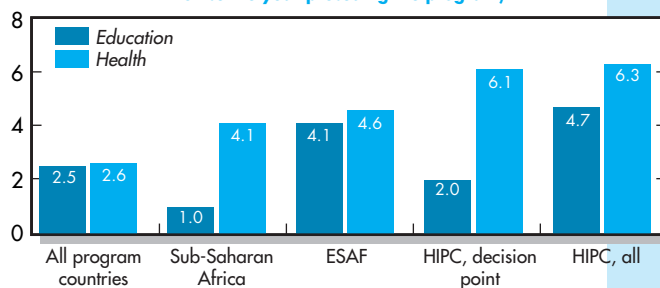
efit from a shift in budgetary resources toward primary education and basic health care.

Regional Patterns

The averages of social spending hide substantial variations among program countries. In sub-Saharan Africa, the average annual rate of increase in real education spending per capita has been lower than in other program countries. Increases in primary and secondary enrollment rates in

Social Spending in Countries with IMF-Supported Programs, 1986–97

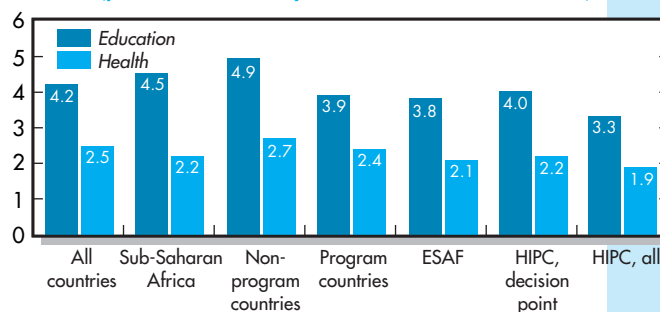
(annual average percent change in real per capita spending; since the year preceding the program)



Data: National authorities and IMF staff

Average Social Spending Levels in Developing and Transition Countries

(percent of GDP; latest year for which data are available¹)



Note: Countries with and without IMF-supported programs.

¹Mostly 1997.

Data: National authorities and IMF staff

sub-Saharan Africa have lagged behind averages for program countries. In contrast, the growth of government spending on health care in sub-Saharan Africa has been higher than in other program countries, albeit from a relatively low level (in terms of the GDP share).

Program countries in Asia (which are not included in the charts) have achieved relatively high growth of social spending and greater-than-average progress in many social indicators. At the other end of the spectrum, social spending in transition countries has been declining, on average, in real per capita terms. At the



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same time, these countries have experienced declines in enrollment rates in secondary education and immunizations, while progress with other social indicators has been relatively modest. However, transition countries generally had much higher preprogram levels of social spending and social indicators than countries in other regions.

Structural Adjustment

The IMF's Enhanced Structural Adjustment Facility (ESAF) supports structural adjustment programs of low-income countries. In these countries, the average growth rate of real social spending per capita has been higher than other program countries (upper chart, page 79). But progress in social indicators has, on average, not been very different from that in other program countries (chart, upper right). This suggests that further increases in budget allocations for the education and health sectors should be accompanied by efficiency-enhancing measures and a reorientation of social spending toward basic services.

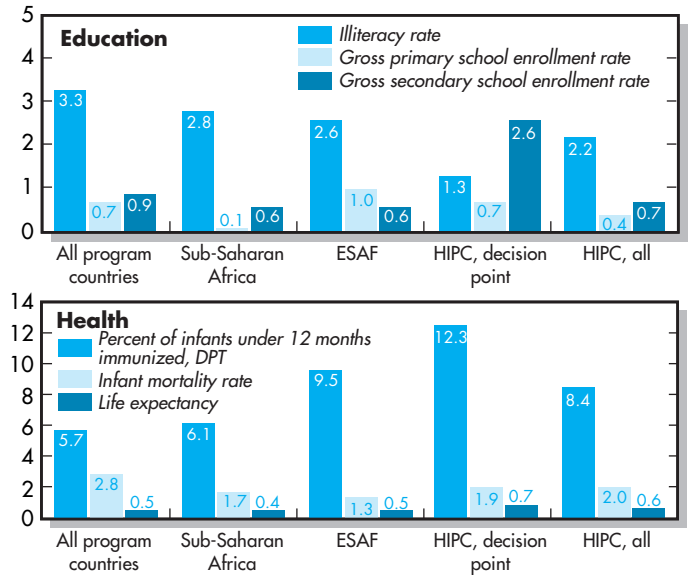
Heavily Indebted Poor Countries

There is an increased focus on social spending in heavily indebted poor countries (HIPC) that have been officially considered by the World Bank and IMF for eligibility under the new initiative—that is, countries that have reached the decision point. For five of the countries to which the World Bank and IMF have agreed to extend assistance, average spending on education under IMF-supported programs that preceded the initiative has evolved in line with other program countries (upper chart, page 79). Spending on health care has increased at a relatively high pace (although health spending in terms of GDP is still relatively low). This is reflected in progress in many indicators of education attainment and health status (chart, upper right). However, the level of social indicators in these countries still lags behind averages in other program countries.

In 19 countries for which data on social expenditure are available, out of a total of 41 that are eligible for HIPC assistance under the current criteria, increases in both education and health spending have outstripped, on average, spending growth in other countries with IMF-supported programs. At the same time, progress with social indicators has been broadly similar in HIPC and in other program countries. These results suggest that the extent of future progress in the HIPC will not only depend on the size of budget allocations to the education and health sectors, but also on whether the efficiency and composition of social spending by governments can be enhanced.

Improvement in Social Indicators in Countries With IMF-Supported Programs, 1986-97

(annual percent improvement since the year preceding the program)

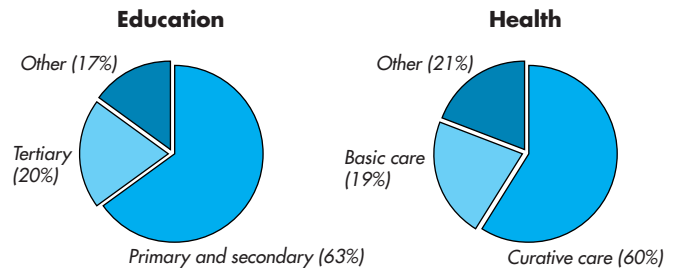


Note: The social indicators presented here are included in the working set of core indicators recently identified by the OECD/Development Assistance Committee, the UN, and the World Bank to measure social development.

Data: World Bank, *World Development Indicators* database (Washington, 1998); and UNESCO, *UNESCO Statistical Yearbook* (Paris, various issues)

Average Intrasectoral Social Spending in Developing and Transition Countries

(percent of total sectoral spending; latest year for which data are available)



Note: Countries with and without IMF-supported programs.

Data: IMF, *Government Finance Statistics* database (Washington 1998); World Bank, *Public Expenditure Review and Poverty Assessment* (Washington, various issues); and IMF staff estimates

Conclusions

Results from the above assessment should be interpreted with care. Direct comparison of spending levels in different groups of countries is hampered by inconsistencies in definitions and variations in data coverage. These caveats notwithstanding, the analysis shows that, on average, spending on education and health has increased and social indicators have improved under IMF-supported programs. Except in transition countries, social spending has increased across regions. Further progress can—and should—be made by reorienting outlays toward basic services and increasing the efficiency of social spending. ■

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