IMF Publication

In a paper examining the size and composition of capital flows for 25 transition economies between 1991 and 1997, Pietro Garibaldi, Nada Mora, Ratna Sahay, and Jeromin Zettelmeyer of the IMF reported that total capital inflows to transition countries rose to significant levels by developing country standards, and early reliance on exceptional finance gave way to foreign direct investment and other flows. But the distribution of the inflows was markedly uneven, with Central and Eastern European countries and the Baltics accounting for 80 percent of total inflows and Russia remaining a net exporter of capital.

Ratna Sahay

To determine what prompted this differentiation, the IMF study first weighed the impact of growth, inflation, and economic liberalization, but found limited evidence of an important direct effect of these on foreign direct investment. Legal and political climates and market-based assessments of risk, by contrast, correlated very highly with levels of foreign direct investment.

Fundamentals still matter, argued Sahay, who presented the paper, and policymakers can take comfort in the fact that fundamentals tend to be reflected in risk ratings. But a sound macroeconomic environment, though a key to growth, may not be sufficient to encourage investment. The study's findings, she said, make a strong case for institutional reforms and point to the need to move these reforms to the top of the transition agenda.

Don't Underestimate the Underground Economy. The underground economy is a mainstream economic issue, Simon Johnson (Massachusetts Institute of Technology) said, presenting a paper co-authored with Daniel Kaufmann (World Bank). Drawing on electricity-based measurements of the unofficial economic activity—as well as independent assessments of taxes, regulations, and corruption—the authors estimated that the underground economy accounts for more than 40 percent of total GDP in Azerbaijan, Georgia, Russia, and Ukraine, and 20 percent or more in many other economies.

Simon Johnson

What drives firms underground, they suggested, was not high taxes but excessive regulatory discretion, weak rule of law, and corruption. This "underground trap" has become a vicious cycle in which regulatory discretion leads, in turn, to corruption, hidden firm activity, reduced public revenues, weakened legal institutions, greater opportunities for corruption, and so forth. To break this cycle, governments needed to reduce regulatory discretion, reform bureaucracies, simplify and enforce laws, create an independent judiciary, and enhance transparency and public oversight.

Changing Role of Government. The changes wrought by shock therapy, Vito Tanzi of the IMF cautioned, are the easy ones. They have dismantled a command economy, but cannot, in themselves, create a new market economy. The development of a market economy will entail new institutions, changes in incentives, and a complete rethinking of the government's role. According to Tanzi, these institutional changes, which lie at the heart of the transformation process, are profound steps that require deep, difficult, and lengthy structural reforms.

Government's revamped role will be embodied in new tax, budgetary, and regulatory systems, Tanzi explained. Permits and authorizations, which characterized the old system and gave rise to widespread corruption, must be replaced by legal and regulatory environments that set the rules of the game and enforce competition. There will also be, he said, a more positive role for government in addressing growing income inequality. He urged special attention be given to fiscal reform and warned that government attempts to deal with large fiscal deficits by delaying wage or pension payments in effect corrupted the whole budgetary process.

Vito Tanzi

Increased Income Inequality. The transition from planned to market economies has been accompanied by a very large shift in income inequality, Branko Milanovic of the World Bank observed. In countries such as Bulgaria, Russia, and Ukraine, where inequality has risen most sharply, the rapidity of the increase in income inequality was three to four times greater than that experienced in the United Kingdom and the United States in the 1980s.

What is propelling this striking gap in incomes? Milanovic found greater income inequality in the new private sector, and noted that income from self-employment and property—traditionally unequal—now figured more prominently in total income. Additionally, a segment of former state employees remained unemployed, and social transfers, though a larger part of total income, were not reaching the poor.

Key Lessons

At the end of three days, two things seemed clear: the experience of transition economies with privatization, income inequality, and institutional needs is becoming increasingly diverse (with historical and geographical differences being credited for part of this diversity); and the achievement of macroeconomic stabilization, widely recognized as necessary, is only a first step in the transition process. The vital next stage for these coun-

Debating the lessons (left to right): John Odling-Smee, Nicholas Stern, Mohsin Khan (chair of the panel and Director of the IMF Institute), Richard Portes, Darius Rosati, and Michael Deppler. Also participating in the panel, but not in the photo, was Marcelo Selowsky.

tries will be to strengthen or create the legal, fiscal, and regulatory infrastructures—and incentives—needed for the operation of a market economy.

In a concluding panel discussion, participants Richard Portes (London School of Business), Darius Rosati (Central Bank of Poland), Nicholas Stern (European Bank for Reconstruction and Development (EBRD)), Michael Deppler (IMF), Marcelo Selowsky (World Bank), and John Odling-Smee (IMF) reviewed the conference findings and offered their perspectives on country and international financial institution priorities in the coming years.

Both Portes and Selowsky noted that the future course for the more advanced Central and Eastern European economies will largely be guided by accession requirements for the European Union. Portes cautioned against proceeding too quickly toward monetary union (given the pressures for real appreciation of these currencies), but the lead-up to accession should, he said, drive down the perception of risk and increase the attractiveness of these countries for foreign direct investment.

The diverse performance of transition economies, Rosati said, underscored the role of policy mistakes and initial conditions. He emphasized that it is "absolutely important" that transition countries develop a new state that is a "market maker, and a maker and enforcer of laws."

Stern agreed. Repeating themes first laid out in a luncheon address, he acknowledged that the difficulty of creating basic institutions for a market economy had been greatly underestimated. Enterprise reform is the key next step, he stressed, and finding foreign strategic owners and shifting social responsibilities to the state would be among the crucial requirements in carrying out this reform. More broadly, Stern said, it will be important for the EBRD and other international financial institutions to help transition countries develop a new mind-set—a new willingness and readiness to change.

From the World Bank's perspective, Selowsky said, there will be greater efforts to address the size of the public sector and banking sector weakness. Breaking the vicious cycle in Russia will, he added, require increased revenues to finance social spending and an improved environment to attract increased investment.

Deppler urged participants not to be misled by the old shock therapy versus gradualism debate. In truth, bold policies had proven the most effective way to stabilize, whereas structural reforms are by their nature gradual. But even here, the attitude of the authorities had much to do with the outcome: those who forced the pace reaped the better results. Deppler added that financial crises should be avoided through prudent macropolicies.

Odling-Smee suggested that progress in the Commonwealth of Independent States (CIS) countries would be determined by the outcome of the struggle between authorities attempting to impose macroeconomic discipline and enterprises eager to avoid hard budget constraints. After 10 years, what did the score card look like? He observed that the CIS countries had reduced inflation; achieved good, but fragile, growth; and strengthened their central banks. But enterprises had failed to move into the market economy, corruption had become a major concern, and external viability had yet to be established. There was clearly still much to be done. ■

Sheila Meehan
Senior Editor, *IMF Survey*

A Decade of Transition

Papers presented at the conference

"Disinflation in Transition Economies," by Carlo Cottarelli and Peter Doyle

"Growth Experience in Transition Economies," by Oleh Havrylyshyn and Thomas Wolf

"Inflation and Growth in Transition: Are the Asian Economies Different?" by Sanjay Kalra and Torsten Sløk, with David J. Robinson

"Time to Rethink Privatization," by John Nellis

"What Moves Capital to Transition Economies?" by Pietro Garibaldi, Nada Mora, Ratna Sahay, and Jeromin Zettelmeyer

"Banking Sector Reforms in Eastern Europe," by Lajos Bokros

"In the Underground," by Simon Johnson and Daniel Kaufmann

"The Changing Role of Government During the Transition," by Vito Tanzi

"Explaining the Increase in Inequity During the Transition," by Branko Milanovic

Ingves Stresses Need for Effective Standards

(Continued from front page) issues we are working on in MAE are, therefore, very familiar to me.

When it comes to the IMF, what strikes me is that in a world with increasing free capital flows, information becomes more and more important—the story you tell people about what you are doing becomes more and more important. Thirty or forty years ago, in a world with heavily regulated capital flows, the IMF talked mainly to governments about what they were doing when they had a balance of payments problem. But in a world with free capital movements and widespread and instantaneous flows of information, you end up talking to everybody. Also, things used to move more slowly, and there was more time to adjust. Today, the focus is instantaneous. We have to live with that because that is the way the world works.

The IMF has a long history and has done things in a particular way for many years. In this situation, a certain institutional vocabulary or shorthand develops to describe what the institution is doing. But for outsiders not used to working with the IMF, words like "ESAF" and "HIPC," for example, may be difficult to understand. Given that there is a growing focus on what the IMF is doing, not only from government officials or experts in different countries, but also from market people, there is a need to keep talking clearly about what we are doing.

There is a need for the IMF to keep talking clearly about what we are doing.

IMF Survey: *A year ago, the IMF Executive Board was considering an amendment to the Articles to extend IMF surveillance to capital account liberalization. Where does this initiative stand now, and have the crises in Asia, Russia, and Brazil had any effect on current thinking about capital account liberalization?*

Ingves: It is true that the formal discussions on these issues have been put on the back burner, but I believe that the initiative will be revived because of the way the markets have been evolving over the past decades. My guess is that regardless of what has happened in Asia and elsewhere, these issues are going to continue to be discussed. It seems reasonable that some agency should keep track of what countries are doing in the area of capital controls and that this information should be collected in a systematic and standardized way.

It makes sense for the IMF to be dealing with capital account issues, because it has a history of keeping track of what countries are doing. Looking at the capital account goes hand in hand with the IMF's general surveillance, because if a country has capital controls in place, somebody in this organization is already thinking about what the country is doing under all circumstances.

IMF Survey: *Do you see a trend toward more capital controls?*

Ingves: In the end, it is up to individual countries to decide. But if a country wants the opportunity to use other people's savings—and I'm talking about foreign savings—it is hard to see why it would choose to maintain strict capital controls for any period of time. My view is that a country benefits from not having controls in place, because a liberalized system allows the country to be a part of the international community and gives it the possibility of borrowing abroad.

IMF Survey: *One of the criticisms leveled at the IMF, according to its recent assessment of its response to the Asian crisis, was that it placed too heavy an emphasis on structural reform as a condition for its support. What are your views on this?*

Ingves: In the Asian crisis, the banking sector ran into difficulties, basically because banks did not have enough equity capital. Whenever this happens and no effort is made to address the problem, people want to get their money out of the bank, and they want it immediately. My specialty is not structural reform in general, but it is hard for me to see how you can address serious banking problems without implementing structural measures in the banking sector. If a problem arises in the banking sector, it is better to recognize that there is a problem, rather than ignoring it and hoping it will go away. You end up having to deal with the restructuring in one way or another. A sensible and timely restructuring will probably lower the cost of dealing with banking problems, because the cost is already in a troubled system and it is not going to disappear.

IMF Survey: *According to the December 1998 update of the* World Economic Outlook and Capital Markets *(see* IMF Survey, *January 11, page 1), the turbulence experienced in mature markets that were apparently grounded in sound fundamentals raised questions about the working and design of financial markets. What efforts need to be made by all participants to improve the performance and enhance the stability of international banks?*

Ingves: There is plenty of work to be done in dealing with what I call the "plumbing." When markets evolve or when the "rules of the game" change, there is always some learning by doing involved, and that takes time. One has to think about how this new evolving environment operates and to get used to it. That usually means having to put a new risk-control system in place, which means having to think hard about what sorts of risks one is taking and what it means to take risks outside of familiar areas. This work needs to be done in many countries.

Markets tend to function worst when you need them most. If everybody is heading to the door at the same

time, risk-control systems that seem to work under normal conditions are not really going to be fully operational under extreme conditions. So you need to think more about abnormal conditions, devise stress tests, come up with really bad scenarios, and figure out whether your system would survive under these scenarios.

IMF Survey: *The IMF has been working with other multilateral institutions, like the Basle Committee on Banking Supervision, to coordinate sound banking practices, risk-management systems, supervisory oversight, and legal and institutional frameworks. How can the IMF work with these organizations to get the best results?*
Ingves: This is largely an issue of how to develop standards and come up with international best practices. It is very hard to develop standards in isolation. You need a process that lets people talk to each other about what seems reasonable, particularly since what seems reasonable as an international best practice at a certain moment in time is not necessarily written in stone but rather changes over time. One needs to know how those changes evolve, and it is difficult for one organization to know everything by itself. The Basle Committee and other agencies can serve as a sounding board—keeping us informed about what is going on and how people are looking at how things should be done.

One way of looking at it is to say, OK, there's this universe of ideas out there about dealing with standards and how the financial sector is functioning or should be functioning. The IMF acts as a facilitator or translator, communicating the material coming out of the multinational discussions to countries in an understandable way. If, for example, country *X* wants its banking sector to evolve in a certain way, it needs to understand how the sector measures up against the international best practice to see how it differs and what needs to be done to move up to whatever the standard happens to be.

Many of the issues taken up in the Basle Committee and other forums are highly technical. Some of this is really nitty-gritty stuff, rather than general statements about what needs to be done. The devil is hidden in the details, so the IMF needs to be able to communicate these thoughts and ideas in specific and practical terms. The IMF's role, therefore, is to know what is going on, be able to participate in all the international discussions about what constitutes a best practice, try to translate that into something usable locally, and help countries to implement whatever action is necessary.

IMF Survey: *At the beginning of the year, we had a truly epochal event with the launching of the third stage of European Economic and Monetary Union (EMU). The European Central Bank (ECB) has been given oversight over the conduct of monetary policy. At the same time, fiscal policy remains decentralized. How do you see this relationship evolving over time and will there be problems developing out of the different responsibility for monetary and fiscal policy?*

Ingves: It is very hard to develop standards in isolation. You need a process that lets people talk to each other about what seems reasonable.

Ingves: There is something about the EMU process that tends to make people skeptical. I have given more than one hundred speeches over the past two or three years on EMU, and I have heard this sort of question many times. At first, the question was, do you really think that EMU is going to come about? And now that it exists, the question, is do you really think that it is going to work?

What has struck me in the work on EMU I have done is that the existence of the project rests on the very strong political consensus in Europe—this is something that Europeans want. For that reason, it has been possible to deliver EMU, in the sense that the ECB is up and running. Political consensus is also very important to fiscal policy coordination, because the ECB is not operating in a vacuum. If the politicians in Europe want EMU—as they seem to do—it is up to them to deal with the challenge of fiscal policy. If there is political consensus, it doesn't really matter what the people dealing with the technical stuff think about it. Take, for example, the Stability and Growth Pact, which sets limits on fiscal deficits.

For many years before the third stage of EMU, discussions centered on the Maastricht convergence criteria and how countries could comply with them. But when it started to become clear that more countries than originally expected would become members of EMU, the convergence criteria began to be seen as a one-time-only eligibility check. It was understood that something more was needed to maintain convergence and stability, which is why the EMU countries have agreed to the Stability and Growth Pact.

IMF Survey: *MAE is a major provider of technical assistance. Do you envisage any changes in the technical assis-*

tance you provide, particularly as a result of recent events and in the context of discussions about the reform of the international financial system?

INGVES: When I talk to people about the history of the department and what they have been doing over the past 10 years, I am struck by how much the department's reach has grown. At the beginning, the department was concerned solely with central banking—what central banks do, how to put one together, how to conduct monetary policy, how to manage foreign exchange reserves and sell government bonds in the markets, and what sort of infrastructure is needed to run a central bank.

In recent years, countries have started asking more general questions, not only about central banking but about the features of a good payments system. In the banking system, they are asking how one should look at what banks are doing, what they should be doing, what is dangerous, and what kind of infrastructure is appropriate. As markets have evolved, the subject has become even broader.

MAE's activities have also changed in tandem with the move away from quantitative measures and controls, which in the 1950s and, in some cases, through the 1970s and into the late 1980s, were the basic tools used by central bankers. In a small country like Sweden, for example, all that was basically needed was to call the bankers to the central bank, have them sit around the table, and tell them how much they could lend and what they could and could not do.

As markets have evolved, however, the banking system has become increasingly market-based. It is up to the banks themselves to lend and to find deposits and capital, but there is still a need for a legal infrastructure and an understanding of how a market-based banking system should operate. Many people think such systems operate totally without rules. But this is not the case. Rather, it is a case of a totally different set of rules replacing the old quantitative measures. MAE has become increasingly involved with this new set of rules—what the rules, and the financial infrastructure, should look like in different countries.

We are, in effect, dealing with the equivalent of the national power grids that send electricity back and forth. In our case, what is sent through the wires is money. We look at the system to see what it is producing, what it is not producing, and how it should function. But although our involvement has grown from central banking issues into many new areas, in one sense, the issues remain the same: it always has to do with the financial infrastructure in a country.

IMF SURVEY: *What major challenges face MAE and the IMF in the difficult period that lies ahead?*

INGVES: To borrow a word from the private sector, we have to think hard about what our product is and how we are producing it. How can we best help countries to formulate workable ideas about what a financial sector is and what it should do? How can we—that is, MAE in particular and the IMF in general—put to use what people are talking about in countries and in various international forums and translate that into specific recommendations? How can we say, this is the way it should be done, not that way, and this is how you change? We are something like a public sector version of a large consulting firm. We are, in effect, consultant to the financial world, and it is therefore important that we, first, keep current with all the thinking that is going on in the financial world and, second, be able to transmit this information in specific and understandable language to our clients. ■

Recent Publications

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

No. 174: *Impact of EMU on Selected Non-European Union Countries*, R. Feldman, K. Nashashibi, R. Nord, P. Allum, D. Desruelle, K. Enders, R. Kahn, and H. Temprano-Arroyo

Working Papers ($7.00)

99/6: *Privatization in Transition Countries: A Sampling of the Literature*, Oleh Havrylyshyn and Donal McGettigan

99/7: *Inflation Targeting in Korea: An Empirical Exploration*, Alexander W. Hoffmaister

99/8: *REPMOD: A Smaller Sibling for MULTIMOD*, Guy Meredith

99/9: *Implications of EMU for Exchange Rate Policy in Central and Eastern Europe*, George Kopits

99/10: *"Enemy of None but a Common Friend of All?" An International Perspective on the Lender-of-Last-Resort Function,* Curzio Giannini

99/11: *Sectorial Macroeconomic Interdependencies: Evidence for Latin America, East Asia, and Europe*, Norman Loayza, Humberto Lopez, and Angel Ubide

99/12: *The Euro and the Production Structure and Export Performance of Middle East and North African Countries*, Jean François Ruhashyankiko

99/13: *The Morning After: Explaining the Slowdown in Japanese Growth in the 1990s*, Tamim Bayoumi

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Economic Integration May Strengthen Case for Central Fiscal Authority

The third stage of European Economic and Monetary Union (EMU) was launched on January 1, 1999, with the creation of a single currency, the euro. Monetary and exchange rate policies have been fully centralized, but EMU fiscal policy will remain largely a national responsibility. The Maastricht Treaty and the Stability and Growth Pact (adopted in July 1997) provide for a certain degree of fiscal policy coordination among EMU member countries, but unlike existing federations, such as the United States or Canada, the fiscal framework of the European Union does not incorporate a central fiscal authority. In a recent IMF Working Paper, *Will Fiscal Policy Be Effective Under EMU?* Marco Cangiano and Eric Mottu—both of the IMF's Fiscal Affairs Department—suggest that as economic integration in Europe proceeds, the case for a central fiscal authority may become stronger.

Fiscal Policy in Federations and in EMU

The European Union (EU) fiscal framework, according to Cangiano and Mottu, is one of coordination of fiscal policies rather than a federation comprising a central fiscal authority. In existing federations, the three basic functions of fiscal policy—allocation, redistribution, and stabilization—are carried out largely by central governments, with varying degrees of participation from intermediate and local governments. To address vertical and horizontal imbalances, federations rely on transfers, mostly from central to regional levels of government. These arrangements tend to increase the effective degree of centralization by creating financial dependency on the part of regional governments.

In contrast, the EU philosophy is underpinned by the "subsidiarity principle," which was introduced into European law in 1992 by the Maastricht Treaty. By expressing the presumption that the primary responsibility for public policies lies in the hands of EU member countries, the principle recognizes that countries are not yet ready to yield more fiscal authority to the EU. Thus, although allocative efficiency is pursued mainly through the establishment of a single market, the redistribution and stabilization functions are left largely to member states. Within this framework, the EU budget provides for limited redistribution, mainly through structural funds, aimed at financing regional and social policies designed to raise employment levels and close income gaps among EU regions.

Although it is much less centralized than a federation, the EU framework is nevertheless closer to a federation than the other monetary unions, such as the CFA franc zone and the currency union between Belgium and Luxembourg, the authors note. The euro area, moreover, is characterized by much closer political, judicial, and economic integration than other monetary unions; a central budget; a process of harmonization of regulations and taxes; and policy coordination mechanisms.

Marco Cangiano

EMU and Fiscal Policy

The policy framework envisaged under EMU will not alter significantly the way basic fiscal policy functions are assigned in the current EU institutional setting, according to the authors. It remains to be seen, however, whether the EMU policy framework, embodied in the Maastricht Treaty and the Stability and Growth Pact, provides clear procedures to ensure that fiscal policy is carried out effectively, or whether more centralization will be needed to address redistribution and stabilization issues.

Excessive Deficit Procedures. The Maastricht Treaty makes the stabilization function the prerogative of each member state, but subject to multilateral surveillance and excessive debt procedures, which have been clarified by the Stability and Growth Pact. The pact calls for a medium-term fiscal position for EMU participating states that is close to balance or in surplus. A government deficit exceeding 3 percent of GDP is considered excessive and should be corrected or financial sanctions will be imposed. Except in the event of exceptional circumstances, an excessive deficit must be corrected by the year after it has been identified or the European Council may apply financial sanctions against the member.

Eric Mottu

Tax Harmonization. Under a common currency, tax competition is likely to increase. Tax-inclusive prices will become more transparent and, with the loss of the monetary and exchange rate instruments, the role of tax policy in attracting business and enhancing competitiveness will become prominent. It has become increasingly evident, according to the authors, that excessive competition could lead to harmful tax practices. These could, in turn, lead to lower revenue or change the structure of tax systems in directions not always desired by member states. Harmful tax compe-

tition could seriously undermine the capacity of member states to conduct independent fiscal policy.

European Structural Funds. The EU budget performs some interregional redistribution, mainly through its structural funds, whereas interpersonal redistribution and social security are left to member states.

As long as mobility, solidarity, and central intervention remain limited within the European Union, redistribution policies appear sufficient, the authors observe. But in the medium to long run, as European integration proceeds, demands for a larger central redistribution function—including social security—may emerge and put pressure on the limited size of the structural funds.

An expanded central redistribution function may face strong resistance, however, at least in the short term, especially from member states reluctant to finance large and permanent transfers to specific countries or regions.

Should Macroeconomic Stabilization Be Centralized?

In a federation, the federal budget has an automatic stabilizing effect in the event of shocks affecting local economies. In the case of a local recession, federal taxes paid by local residents decrease, and federal transfers increase, thus having a countercyclical effect. Some observers have suggested that a separate EMU budget would be necessary to achieve the same effects in case of asymmetric shocks. Others have pointed out that local fiscal policies are sufficiently well equipped to handle these shocks by running temporary deficits and surpluses.

To the extent that member states maintain balanced budgets over the medium term, there appears to be some agreement that the Stability and Growth Pact would allow automatic stabilizers to operate, the authors note. In addition, economic and monetary integration should increase the positive correlation of output fluctuations among EMU members and therefore reduce the likelihood and importance of asymmetric shocks. But to the extent that new member states will enter EMU at the upper limit of the Stability and Growth Pact fiscal criterion, there may be little room initially for the normal operation of automatic stabilizers, which could lead to weaker stabilization and greater output volatility than has been the historical norm. This outcome could be aggravated as member states see the range of discretionary policy tools—notably tax policy—reduced by EU integration, and since the magnitude of automatic stabilizers is likely to have diminished in the past few years—a somewhat neglected issue, according to the authors. Under such circumstances, there may be calls for stabilization through the EU budget, which could result in large and lasting transfers.

Role for Central Fiscal Authority?

In the current EU fiscal framework, coordination relies exclusively on exchange of information, publicity, and peer pressure. No EU institutional body is equipped with the necessary instruments to handle policy coordination, while the imposition of sanctions against noncompliant member states provided for in the Stability and Growth Pact does not substitute for the lack of appropriate policy coordination.

The European Central Bank has been vested with a high degree of independence, which is essential to the credibility of the EMU. However, credibility risks being undermined if the framework designed to coordinate fiscal policies is perceived to be weak. The ECOFIN Council (comprising economic or finance ministers of the European Union) coordinates fiscal policies for all EU member states and not strictly those of the euro area. In addition, the ECOFIN Council does not have the necessary instruments to enforce its decisions on coordination. The Stability and Growth Pact, although it provides a clear and strict framework for fiscal convergence and stability, sets no binding rules for member states that stay within these limits. In addition, there is some skepticism about the ability and willingness of EU authorities to strictly enforce the sanctions for noncompliance envisaged by the Stability and Growth Pact. Imposing sanctions and fines on a country facing genuine economic difficulties, which would have already been penalized by market mechanisms through higher

Camdessus Offers Condolences on Death of King Hussein

IMF Managing Director Michel Camdessus expressed his formal condolences on the death of the King of Jordan. Following is the text of news brief 99/6, issued on February 7.

I learned with deep sadness of the passing away of H.M. King Hussein of Jordan. On behalf of the IMF and myself, I have conveyed our sincere condolences to the royal family and the people of Jordan.

H.M. King Hussein of Jordan

Over many years, the Kingdom of Jordan and the IMF have developed a very close and productive relationship. We will take every possible step to maintain and strengthen it. It is in this spirit that the IMF staff mission currently visiting Amman will remain at the disposal of the government to complete the negotiation of a three-year Extended Fund Facility and contribute to the IMF's role in catalyzing international support for Jordan in the present tragic circumstances.

interest rates, could only worsen its situation. Also, sanctions are not automatic, requiring majority approval among participating members. As a result, decisions of this sort will certainly be highly politicized, undermining the accountability and transparency of enforcement. If transitional frictions were to arise, the credibility of the EMU might be severely challenged from the beginning.

Decentralized stabilization policies may also entail free-riding behavior, and member states may not be willing to provide necessary fiscal stimulus or restraint if a large part of the benefit would accrue to other countries or if their fiscal position already satisfies their domestic needs.

The need to coordinate discretionary fiscal policies within EMU may arise in a number of situations, such as a risk of overheating, a severe EU-wide recession, or a supply shock. The envisaged policy response is that the European Central Bank would carry out an EU-wide stabilization policy through monetary policy. But if inflation is already high, monetary policy might end up following conflicting objectives, since it is supposed to focus primarily on price stability. Discretionary fiscal policy measures may then become necessary.

In the short term, enhanced coordination may be able to address most of the above-mentioned issues effectively, but over the longer term, decentralized fiscal policies may not be able to provide the degree of macroeconomic stabilization required by the euro area. Creating a central fiscal authority and providing it with a larger budget may not be feasible in the short term because of the absence of political agreement and the delays inherent in the European Union's institutional process. But although EMU has been launched in a favorable economic upturn, the business cycle may change direction in the medium term and lead to economic difficulties. These may reveal that the Stability and Growth Pact does not achieve as much cohesion as intended and may require either more flexibility in its procedures or a more strongly coordinated policy response.

In this context, the authors conclude, a central fiscal authority, endowed with some funds, may prove an effective instrument for macroeconomic stabilization. And although the current flexible framework may be sufficient in the short and medium term, as integration proceeds and a sense of European unity grows, it may have to be strengthened progressively in the long run to address the demands and needs of fiscal policy. ■

Copies of IMF Working Paper 98/176, *Will Fiscal Policy Be Effective Under EMU?* by Marco Cangiano and Eric Mottu, are available for $7.00 from IMF Publication Services. See page 56 for ordering information.

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).

Tanzania: ESAF

The IMF approved the third annual loan for Tanzania under the Enhanced Structural Adjustment Facility (ESAF), providing the equivalent of SDR 58.8 million (about $82 million) to support the government's 1998/99 program. The loan, which has been augmented by SDR 20 million (about $28 million), is available in two equal semiannual installments.

Tanzania: Selected Economic Indicators, 1994/95–1998/99[1]

	1994/95	1995/96	1996/97	1997/98	1998/99[2]
	(annual percent change)				
Real GDP	2.6	4.1	4.0	3.4	4.3
Consumer prices (end of period)	21.1	22.8	16.4	12.0	7.5
	(percent of GDP)				
Current account (excluding official transfers)	–21.1	–16.2	–12.0	–14.2	–14.1
	(months of imports of goods and nonfactor services)				
Gross official reserves	1.6	1.5	2.8	3.0	3.7

[1]The fiscal year runs from July to June.
[2]Projections.

Data: Tanzanian authorities and IMF staff estimates and projections

Medium-Term Strategy and 1998–99 Program

The Tanzanian government's medium-term development strategy aims to consolidate macroeconomic stability, reduce inflation, and attain sustainable high economic growth that will reduce poverty and raise the overall living standards of the population. The government will continue to center macroeconomic policies on rigorous fiscal management and prudent monetary policies. The macroeconomic objectives for 1998/99–2000/01 are to achieve real GDP growth of at least 4 percent in 1998/99, rising to 6 percent in 2001; reduce the annual rate of inflation to 7.5 percent in 1998/99, dropping to about 4 percent in 2001; build gross international reserves to four months of imports of foods and services by June 2000, and maintain that level thereafter; and achieve an external current account deficit that is sustainable in terms of external assistance and long-term private inflows.

Members' Use of IMF Credit
(million SDRs)

	January 1999	January 1998
General Resources Account	**455.72**	**2,084.40**
Stand-By Arrangements	0.97	1,500.00
SRF	0.00	1,500.00
EFF Arrangements	45.73	584.40
CCFF	409.02	0.00
ESAF Arrangements	**41.53**	**10.86**
Total	**497.25**	**2,095.26**

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

Data: IMF Treasurer's Department

For 1998/99, the principal macroeconomic objectives are designed to achieve the following: increase real GDP growth to 4.3 percent; reduce the inflation rate from 12 percent in 1997/98 to 7.5 percent; and limit the current account deficit to 14.1 percent of GDP while increasing gross international reserves to 3.7 months of imports of goods. To back these objectives, Tanzania will deepen and accelerate economic reforms in strategic areas.

Structural Reforms

The government's agenda of structural reforms is designed to achieve sustained rates of economic growth and to improve living standards. Over the next year, the restructuring and privatization of public utilities will receive the highest priority. At the same time, the government has developed a medium-term strategy for public service reform. Financial sector reform will

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

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

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
Stand-By Arrangements			**32,858.97**	**12,612.67**
Bosnia and Herzegovina	May 29, 1998	May 28, 1999	60.60	36.36
Brazil[1]	December 2, 1998	December 1, 2001	13,024.80	9,605.79
Cape Verde	February 20, 1998	April 19, 1999	2.10	2.10
Djibouti	April 15, 1996	March 31, 1999	8.25	0.98
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	1,450.00
Latvia	October 10, 1997	April 9, 1999	33.00	33.00
Philippines	April 1, 1998	March 31, 2000	1,020.79	728.41
Thailand	August 20, 1997	June 19, 2000	2,900.00	600.00
Uruguay	June 20, 1997	March 19, 1999	125.00	10.80
Zimbabwe	June 1, 1998	June 30, 1999	130.65	91.45
EFF Arrangements			**24,414.26**	**14,651.50**
Argentina	February 4, 1998	February 3, 2001	2,080.00	2,080.00
Azerbaijan	December 20, 1996	December 19, 1999	58.50	15.80
Bulgaria	September 25, 1998	September 24, 2001	627.62	523.02
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	1,882.40
Jordan	February 9, 1996	February 8, 1999	238.04	35.52
Kazakhstan	July 17, 1996	July 16, 1999	309.40	154.70
Moldova	May 20, 1996	May 19, 1999	135.00	72.50
Pakistan	October 20, 1997	October 19, 2000	454.92	379.09
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	1,400.00
Yemen	October 29, 1997	October 28, 2000	105.90	87.90
ESAF Arrangements			**3,896.86**	**2,081.62**
Albania	May 13, 1998	May 12, 2001	35.30	29.42
Armenia	February 14, 1996	September 14, 1999	109.35	20.93
Azerbaijan	December 20, 1996	January 24, 2000	93.60	23.40
Benin	August 28, 1996	August 27, 1999	27.18	14.50
Bolivia	September 18, 1998	September 17, 2001	100.96	84.13
Burkina Faso	June 14, 1996	September 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	161.98
Ethiopia	October 11, 1996	October 22, 1999	88.47	58.98
The Gambia	June 29, 1998	June 28, 2001	20.61	17.18
Georgia	February 28, 1996	July 26, 1999	166.50	27.75
Ghana	June 30, 1995	June 29, 1999	164.40	27.40
Guinea	January 13, 1997	January 12, 2000	70.80	23.60
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
Malawi	October 18, 1995	December 16, 1999	50.96	7.64
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	August 30, 1999	57.96	9.66
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	59.50
Senegal	April 20, 1998	April 19, 2001	107.01	71.34
Tajikistan	June 24, 1998	June 23, 2001	100.30	60.00
Tanzania	November 8, 1996	November 7, 1999	161.59	38.76
Uganda	November 10, 1997	November 9, 2000	100.43	43.52
Yemen	October 29, 1997	October 28, 2000	264.75	176.75
Total			**61,170.09**	**29,345.79**

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

Data: IMF Treasurer's Department

continue, with the aim of fostering competition and efficiency, narrowing the spread between lending and deposit interest rates, and strengthening the mobilization and allocation of financial resources.

Social Issues

Tanzania's social and demographic indicators are slightly more favorable than the average for sub-Saharan Africa. The government is implementing a policy-based sector development approach in the social sector. The key aspects here include further development of plans for a substantial transfer of resources and responsibility to local governments.

Tanzania joined the IMF on September 10, 1962. Its quota is SDR 146.9 million (about $205 million). Tanzania's outstanding use of IMF financing currently totals SDR 190 million (about $265 million).

Press Release No. 99/6, February 8

Occasional Paper

Transition Countries Overall Make Progress Toward Macroeconomic Stabilization

In 1991, the Baltics, Russia, and the other countries of the former Soviet Union began an arduous journey toward free market economies, grappling with the legacy of decades of central planning. In a new IMF Occasional Paper entitled Macroeconomic Developments in the Baltics, Russia, and Other Countries of the Former Soviet Union, 1992–97, *Luis M. Valdivieso of the IMF's European II Department describes the progress toward macroeconomic stabilization these countries made in the first six years of transition and explains how they were initially affected by, and responded to, the Asian financial crisis.*

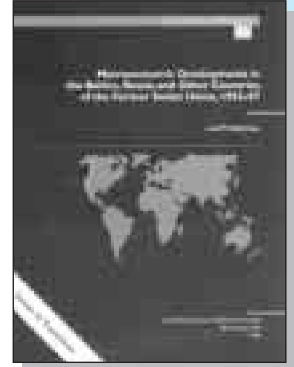
The 15 countries that comprised the Soviet Union until its dissolution in 1991 have collectively made significant progress toward macroeconomic stabilization. Individually, though, some countries have done better than others for a number of reasons:

- different initial conditions,
- uneven factor endowments (land, labor, capital, and entrepreneurial skills),
- differences in financial policies, and
- differences in how quickly they implemented comprehensive structural reforms.

This progress can be seen in a number of recent trends in these countries as a group: inflation is down, growth is up, monetary management has improved, nominal exchange rates are stabilizing, payments and settlement systems have been enhanced, and bank restructuring is under way.

Despite the evidence of progress, however, Valdivieso acknowledges that sources of vulnerability persist that, if left unattended, may complicate macroeconomic management in these countries. Among them, he lists fragile public finances, weak banking systems, and concerns about the sustainability of the sizable external current account deficits that exist in a number of the countries.

To present his findings, Valdivieso classifies the countries into four groups: advanced, intermediate, and slow reformers, and countries that have experienced some measure of military conflict during the transition (see box). Countries may implement sound macroeconomic policies, he notes, but unless they also institute comprehensive structural reforms, the stability they have achieved is threatened and their vulnerability to external and domestic shocks is increased. Valdivieso cites evidence that countries that acted quickly and decisively to lower inflation and implement structural reforms have benefited the most in terms of output growth, exchange rate stability, and access to private international capital markets. Countries that have not consistently exercised financial restraint and whose implementation of structural reforms has been tentative have fared less well.



Macroeconomic Indicators

One key achievement of the 15 countries as a group, he notes, is the sustained and significant reduction in inflation. In 1997, inflation in the region—measured on the basis of the consumer price index—averaged 29 percent, down from more than 1,500 percent a year in 1992–94 (see chart, page 62). The three advanced reformers brought inflation down to 9.5 percent in 1997. The intermediate reformers and those countries that have emerged from a period of civil unrest have also made considerable progress, unlike the slow reformers, where price stability has proved elusive.

Enhanced price stability, accompanied by structural reform, has laid the foundation for a revival of economic activity throughout the region, although growth in the slow reformers continues to be erratic. The most

Country Classification

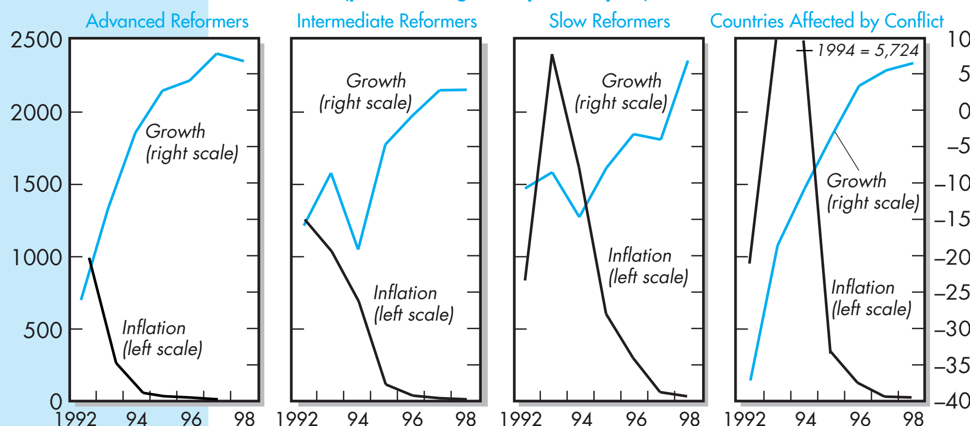
Advanced reformers
Estonia • Latvia • Lithuania

Intermediate reformers
Kazakhstan • Kyrgyz Republic • Moldova • Russia

Slow reformers
Belarus • Turkmenistan • Ukraine • Uzbekistan

Countries affected by conflict
Armenia • Azerbaijan • Georgia • Tajikistan

advanced reformers not only reestablished growth the earliest but have been able to sustain it at relatively high levels (chart). The diverse experiences of the 15 countries during 1992–97, Valdivieso notes, support the widely held belief that, although low inflation is necessary for growth, it is not enough to ensure it. He reiterates that countries must tackle the structural weaknesses that underlie their macroeconomic imbalances.



Data: IMF Occasional Paper 175, *Macroeconomic Developments in the Baltics, Russia, and Other Countries of the Former Soviet Union, 1992–97*

Those countries that have had the greatest success lowering inflation and rekindling growth are those that have also exercised greater financial restraint. For the region as a whole, the general government deficit declined to about 3 percent on average in 1997 from 10 percent in 1992–94. Advanced reformers have generally recorded low fiscal deficits, while the intermediate reformers and countries affected by conflict reduced their deficits to 5–8 percent of GDP during 1995–96 from 10–40 percent in 1992–94 through fiscal retrenchment. Among the slow reformers, Ukraine's deficit exceeded 5 percent of GDP in 1997. The others had relatively low average deficits, but not because of a deliberate fiscal effort. Rather, less direct budget financing and the practice of subsidizing other economic sectors through the banking system kept these countries' deficits down.

In 1997, for the first time in six years, all 15 countries recorded deficits in their external current accounts, with different factors underlying the deficits in the different groups. For example, the advanced and intermediate reformers resorted increasingly to external savings to meet their rising investment needs—associated with the resumption of output growth—because of low domestic private savings and, in most cases, public sector consumption that exceeded current income. However, external developments in these countries as a group have occurred in the context of a trend toward relative stability in nominal and real exchange rates.

By the end of 1997, the region's external debt picture appeared generally favorable, with total external debt for the 15 countries amounting to about $150 billion, or 31 percent of GDP on average. However, in 5 of the 15 countries, the debt burden approached or exceeded 50 percent of GDP and remains a source of concern.

Some of the countries in this region have gained access to international private capital markets and have been able to attract foreign direct investment. During 1992–97, flows of foreign direct investment amounted to almost $27 billion, most of which has been directed

IMF and World Bank Solicit Views on HIPC Initiative

The IMF and the World Bank are seeking the views of the international community on the Heavily Indebted Poor Country (HIPC) Initiative, which they joined forces to launch in 1996 to reduce the external debt of the world's poorest countries. In the first stage of a two-part consultative process, to be conducted on the Internet, the two organizations are soliciting general comments on the HIPC Initiative as well as input on specific technical questions about debt sustainability, financing, and fiscal targets. The deadline for responses is March 15. In the second stage, to be completed by June 18, they are requesting input on poverty reduction, debt management within the HIPC countries, and the current approach for delivering debt relief, with its focus on the long term.

The challenge for the IMF and the World Bank is to ensure that the views that emerge from these consultations can be considered in policy discussions leading up to a summit of the seven major industrial countries scheduled for early June in Cologne, Germany. Through the Cologne summit, the leaders are expected to provide fresh impetus to the HIPC Initiative, which stands to benefit from the different ideas and perspectives of the international community.

The HIPC Initiative has accomplished a lot in a short time. So far, Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mozambique, and Uganda have qualified for assistance under the initiative by implementing social and economic reforms as part of an integrated approach for achieving durable growth. The assistance extended to these five countries is estimated to reduce their debt service by some $5 billion.

The joint IMF-World Bank note appears on the IMF's website (www.imf.org). Responses may be sent to either organization at hipc@imf.org or hipc@worldbank.org.

to the advanced and intermediate reformers and to countries developing their natural resources.

Initial Impact of the Asian Crisis

The study, which covers developments through early 1998, notes that the Asian crisis had a significant initial effect on the financial and foreign exchange markets of a number of the countries in this region, with the impact varying according to the level of development and degree of international integration of domestic financial markets, preexisting economic weaknesses and policy problems, and the importance of their economic links with the crisis countries. Estonia, Russia, and Ukraine were the hardest hit; the other countries were less affected because domestic financial markets and international integration are at an early stage of development. The Asian crisis initially also hampered these countries' access to international bond and credit markets by causing the cost of issuing international bonds to increase markedly. Ultimately, though, the study suggests that the region's rising growth trend is not expected to be halted. In the preface to his study, Valdivieso qualifies these projections, saying that subsequent events are expected to worsen inflation and short-term growth prospects in Russia and have a negative impact on growth in the rest of the region. Nonetheless, he maintains that the current crisis in Russia does not invalidate the main views advanced in this study. ■

Copies of Occasional Paper 175, *Macroeconomic Developments in the Baltics, Russia, and Other Countries of the Former Soviet Union, 1992–97*, by Luis M. Valdivieso, are available for $18.00 each from IMF Publication Services. See page 56 for ordering details.

IIF Press Briefing

New Approaches Are Needed to Address Weaknesses of Global Financial System

"The financial crises of the 1990s differ from those of the 1980s and require a 1990s approach." With these words, William Cline, Chief Economist and Deputy Managing Director of the Institute of International Finance (IIF) announced the publication of *Financial Crises in Emerging Markets*—prepared by an IIF working group, which he chaired. In a press briefing held on January 22, Cline, along with Charles Dallara, the institute's managing director, discussed the IIF's recommendations for reforming the global financial system, adding that all the major players—including the seven major industrial countries, the Group of 22 industrial and developing countries, and the IMF—agreed with this objective.

"It is time," said Dallara, "to look at the weaknesses as well as the strengths" of the global financial system "and to address the weaknesses" so as to prevent future crises.

Crisis Periods Compared

Unlike the debt problem of the 1980s—which was perceived to be largely one of liquidity (short term) but was eventually recognized as one of solvency (longer term)—the problem of the 1990s was more compellingly one of liquidity, the report states. The ratio of debt service due to exports of goods and services averaged 83 percent for Argentina, Brazil, and Mexico in 1982, but only 22 percent for Mexico in 1994 and for Indonesia, Korea, and Thailand in 1996. Another difference between the two crisis periods, according to the report, is that sovereign debt dominated the 1980s, whereas private corporations and banks were responsible for a greater share of obligations in the 1990s (see table, page 64). Similarly, the bulk of claims in the late 1980s took the form of long-term bank loans, whereas by the late 1990s the composition of claims had shifted to short-term bank loans, bonds, and local currency obligations. Furthermore, today's capital markets involve more diverse sources of finance, which can hasten the return of flows to the markets as confidence rebuilds.

IIF Recommendations

The hallmark of the 1990s approach to crisis resolution, as outlined in the IIF report, is the prompt restoration of private sector confidence through large—but temporary—public sector support of countries' domestic policy adjustment and a greater reliance on voluntary market response. In con-

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
February 8	3.47	3.47	3.71
February 15	3.49	3.49	3.73

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

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trast, the approach of the early 1980s emphasized formal debt rescheduling and, eventually, debt reduction by private banks. It ultimately became clear that full-fledged debt rescheduling tended to choke off voluntary new lending for some time. It took almost a decade after the 1980s crisis, says the IIF report, for capital flows to emerging markets to revive.

Cline described a number of other innovations of the 1990s approach. Fundamental, he said, is a dialogue between private international creditors and investors and the authorities of borrowing countries. Such a dialogue can enhance the stability of the system by ensuring that the authorities are made aware of growing private sector concerns and can institute policy reforms early to avoid a crisis. The IIF strategy would place country authorities rather than IMF officials—as in current practice—at the center of the dialogue with the private sector. The issue, Cline said, is greater transparency, which would reveal problems at an earlier stage—thus avoiding "rude surprises"—and make it possible to minimize major market disruptions. The report outlines a number of ways to lure the private sector to participate voluntarily in crisis resolution efforts. One reason for the new approach is the concern that a protracted financial crisis and disruption of debt servicing could impose a severe shock on emerging capital markets globally.

The IIF report notes that the 1990s approach has been criticized for calling for large amounts of official support, which detractors say will increase moral hazard in international lending by giving private sector creditors the impression that they can lend without risk. It concludes, however, that the benefits resulting from the restoration of private sector confidence engendered by official support outweigh the possible distortions from moral hazard.

The IIF report also discusses the IMF's lead role in international surveillance, but describes the IMF's influence as weak in countries that do not have a program of financial support. It reiterates, however, an earlier IIF finding that IMF programs were not outdated recipes for austerity that were inappropriate for the East Asian situations, as some critics have charged. The report also calls for countries to be allowed to publish their IMF Article IV reviews without Executive Board approval and opposes IMF lending to countries with arrears to private creditors, which it says can undermine the confidence of the private sector.

Composition of External Debt for Major Emerging Market Economies

	1988	1997
Total (billion dollars)	944.7	1,882.7
	(percent)	
By creditor[1]	100.0	100.0
International financial institutions	14.7	12.6
Official bilateral creditors	27.5	21.2
Commercial banks	45.3	34.3
Other private creditors	12.5	31.9
By borrower[2]	100.0	100.0
Public sector	75.5	49.5
Deposit money banks	11.2	23.7
Other private sector	13.2	26.8

[1]For 29 emerging market economies.
[2]For 18 emerging market economies with total debt of approximately $1.4 trillion in 1997. Includes some estimates for 1996 or 1995.

Data: Institute of International Finance, 1998, *Report of the Working Group on Financial Crises in Emerging Markets* (Washington).

Conclusion

The IIF report lists six major examples of what can now be seen as the 1990s approach to resolving financial crises: Mexico in 1995; Indonesia, Korea, and Thailand in the second half of 1997; Russia in July 1998; and Brazil in December 1998. In all six episodes, it observes that the countries involved instituted forceful economic adjustment programs, with the common goal of creating the necessary conditions for restoring private sector confidence and renewing the inflow of private capital. Mexico, Korea, and Thailand are success stories, whereas Indonesia and Russia represent defeats, attributable to the absence of the domestic political conditions necessary for prompt implementation of adjustment measures. The jury, Cline said, is still out on Brazil.

Within the working group, the view dominated that the existing institutional arrangements, especially with the recent IMF quota increase, should be adequate to deal with and minimize crises, as long as private market participants, national authorities, and international official agencies adopt more astute behaviors and policies in light of the lessons from the recent crises. ■

Elisa Diehl
Assistant Editor, *IMF Survey*

Copies of the working group report *Financial Crises in Emerging Markets* are available for $25.00 each from the Institute of International Finance, 2000 Pennsylvania Ave., NW, Washington, DC 20006. Call (202) 857-3616.

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