ECO ANM 1997

PRESS BRIEFINGS (General)

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BOX 1

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Western Hemisphere Department

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Economic Subject Files

1997

ECO-ANM Press Briefings

INTERNATIONAL MONETARY FUND

September 17, 1997

To: Mr. Loser

Subject: **Managing Director's Briefing Book - Question on Mexico**

The Managing Director has requested language that describes in somewhat greater detail the negotiations underway with Mexico on a three-year program. I would grateful if you could supply it as soon as possible.

SJA

S.J. Anjaria
(5F03, ext. 3442)

70. What is your assessment of Mexico's economic prospects and how urgently is another IMF program needed?

- Mexico's economic prospects are very favorable. Real GDP growth was 7 percent in the first half of 1997 (compared with the same period of 1996). Growth should average about 5 percent in the coming years. Inflation has declined from 52 percent in 1995 to under 20 percent at present. It is expected to reach single digits in the next two to three years.

- This favorable outlook assumes that the government will continue with its sound fiscal and monetary policies. The current round of structural reform is of major significance because it touches two critical areas: the social security regime and the nontradables sector. These reforms will provide an important impetus for further capital market development and lead to increased investment and modernization, ultimately lowering production costs.

- Improved access to international capital markets has permitted the authorities to liquidate their obligations under the U.S. Exchange Stabilization Fund and make some advance repayments to the IMF. Through the availability of longer-term credits, Mexico's medium-term debt-service profile has improved considerably and now looks manageable. The IMF stands ready to support Mexico's medium-term stabilization and structural reform efforts, as needed.

eco – Op. Budget / Design Plans

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Office Memorandum

To: The Managing Director
The Deputy Managing Directors

September 12, 1997

From: David Williams DW

Subject: **Draft Board Paper on the Assessment of Members' External Strength for Inclusion in the Operational Budget--Role of Supplementary Indicators**

Attached for your approval is the draft Board paper on supplementary indicators to be used in the assessment of member's external strength for inclusion in the operational budget and designation plan. The paper responds to the Board's request for greater transparency and specificity in the process of selecting currencies and sets out a range of quantiative indicators with particular focus on financial flows and the structure of the balance of payments. The paper proposes to use these indicators in conjunction with the traditional criteria as a basis for the judgements whether countries are sufficiently strong for inclusion in the budget. Overall, the application of the supplementary indicators and proposed reference points would lead to greater stringency in the selection of currencies. The proposed indicators are listed in Table 4.

Area departments and PDR generally agreed with the basic thrust of the paper. Given the more intensive data collection and analysis required for the supplementary indicators, they also agreed with the proposal in the paper to move the budget and designation plan from the current quarterly to a semi-annual basis, which could be put into effect after the review of the early repurchase policy (which is now directly linked to quarterly assessments). The review of the early repurchase policy is scheduled for later this year.

The Board discussion of the paper is tentatively scheduled for October 15, 1997, and your approval (perhaps in Hong Kong) not later than Friday, September 19, 1997 would be useful for issuance in Washington and Hong Kong in the week starting September 22.

Attachment

cc: Mr. Boorman
Mr. Calamitsis
Mr. Chabrier
Mr. Deppler
Mr. Gianviti
Mr. Loser
Mr. Neiss
Mr. Odling Smee

INTERNATIONAL MONETARY FUND

The Assessment of Members' External Financial Strength for Inclusion in the Operational Budget—Role of Supplementary Indicators

Prepared by the Treasurer's Department

(In consultation with other departments)

Approved by David Williams

September [--], 1997

Contents Page

I. INTRODUCTION

1. At EBM/97/55 (5/30/97), the Executive Board reviewed the methodology used in projections of the Fund's liquidity and financing needs, including, in that context, the criteria guiding the selection of currencies for inclusion on the transfer side of the operational budget. In the course of the discussion, Executive Directors generally endorsed the staff's proposal to explore further the possibilities for complementing the current approach with a broader range of quantitative indicators that bear on the assessment of members' external financial positions, and requested a paper outlining how such supplementary indicators could be used in the assessment of external strength.[1]

2. This paper is organized as follows: Section II briefly recalls the basic principles underlying the selection of currencies for the operational budget, and the procedures that have been followed in assessing members' external strength. Section III sets out systematically the factors the staff has found relevant in the assessment of relative strength, and develops a series of supplementary quantitative indicators within the broader context of countries' overall external asset and liability positions and corresponding balance of payments flows. Section IV outlines how the staff would intend to use these supplementary indicators in selecting currencies for future operational budgets. A summary is contained in Section V.

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[1]See *Methodology Used in Reviews of the Fund's Liquidity and Financing Needs,* EBS/97/60 (4/2/97) and *The Acting Chairman's Summing Up of the Discussion,* BUFF/97/60 (6/10/97).

3. The supplementary indicators are intended to extend and improve on current procedures. It should be noted, however, that the use of more broadly based quantitative indicators would require significantly more extensive data collection and analysis, and many of the relevant indicators cover variables for which high-frequency data are normally not available for a broad range of members. It is therefore also for consideration whether the operational budget (and the designation plan) should be moved to a semi-annual basis, following the upcoming review of the early repurchase policy.[2]

II. PRINCIPLES AND CURRENT PROCEDURES

Principles

4. Article V, Section 3(d) of the Articles of Agreement sets out the guiding principles for the inclusion of currencies on the transfer side of the operational budget, requiring the Fund to "adopt policies and procedures on the selection of currencies to be sold that take into account, in consultation with members, the balance of payments and reserve position of members and developments in the exchange markets, as well as the desirability of promoting over time balanced positions in the Fund."[3] The Executive Board reviewed these basic principles in 1978

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[2]The guidelines on early repurchase under Article V, Section 7(b) specify that a member's balance of payments and reserve position will be deemed normally to have improved sufficiently for early repurchases to be expected if the member's position is judged sufficiently strong for the purposes of the quarterly operational budget.

[3]Similar considerations apply to the inclusion in the designation plan to accept SDRs through designation as set out in Article XIX, Section 5(a)(i): "a participant shall be subject to designation if its balance of payments and gross reserve position is sufficiently strong."

(in the context of the Second Amendment) and adopted in 1979 specific guidelines for the selection of currencies.[4]

5. According to the guidelines, a member's balance of payments and gross reserve position are to be seen as a combined concept, under which strength in one element may compensate for moderate weakness in the other. The guidelines also specify that the assessment of sufficient strength of a currency be based on consideration of all relevant factors, and require in particular an assessment of recent and prospective movements in gross reserves, balance of payments developments, the relationship of members' gross reserves in relation to imports and Fund quota, and exchange market developments.

Current procedures

6. In assessing members' external strength in the context of the quarterly operational budgets, the staff has tended to focus on the current level of and changes in gross reserve positions, and has analyzed the reasons for such changes.[5] Account has been taken of

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[4]*The Selection of Members for Inclusion in the Operational Budgets and Designation Plans*, SM/78/276, and Decision No. 6273-(79/158) G/S, adopted September 14, 1979 (*Selected Decisions, Twenty-First Issue*, pp. 234-5). The guidelines were slightly modified in 1990 and have since been reviewed on a number of occasions. The last review took place in December of 1996 at EBM/96/107 on the basis of EBS/96/172 (11/13/96) which discussed issues relating to the allocation of currencies in the operational budget. These issues are not addressed in the current paper which focuses on the process of selecting currencies for inclusion on the transfer side of the operational budget.

[5]The staff has used (and presented in the relevant documents) the data published in IFS for members' gross reserves defined as holdings of gold (at SDR 35 per ounce), foreign exchange, reserve positions in the Fund, and holdings of SDRs.

members' policies regarding reserve accumulation, as well as the particular position of reserve center countries. The analysis included the following specific quantitative indicators:[6]

- **changes in gross reserves**, with a decline of 10 percent or more over the latest six-month period seen as a possible indication of a weakening external position (which could be offset by a comfortable level of reserves or a strong external current account position).
- the **level of gross reserves**, with reference points of 250 percent of quota and 3-5 months of imports;
- the level and evolution of the **external current account deficit**, with a reference point of a moderate deficit of 3-4 percent of GDP; and
- developments in **nominal and real exchange rates**, and changes in members' exchange rate regime.

7. The assessment of the circumstances of individual countries considered potential candidates for inclusion in the operational budget has also included a range of additional quantitative and qualitative information regarding balance of payments and exchange market developments. Although the use of such information included important elements of judgment, these elements have been consistent with the assessments put forward, inter alia, at Executive Board sessions on country matters and World Economic and Financial Developments.

[6] As described in the annex to the last operational budget paper (EBS/97/87, 5/20/97).

8. While it has long been recognized that the "strength" implied by a particular level of reserves is largely a matter of judgment, the recent increase in capital mobility and global financial integration has raised two interrelated questions. First, are indicators relating reserves to current transactions still an appropriate measure of external strength? Second, could a quantitative approach based on supplementary indicators increase the objectivity and transparency of the selection process of currencies for inclusion into the operational budget?

III. Analytical Framework for the Assessment of External Strength

9. This section aims to set out in a systematic fashion the analytical and quantitative framework the staff may use in its assessment of the external financial positions of members. As has been increasingly recognized, broad-based access to and participation in global financial markets has become an important element in achieving and maintaining a fundamentally strong external position. The supplementary indicators developed in this section therefore aim at placing members' reserve and balance of payments positions into the broad context of their overall external asset and liability positions and the corresponding financial flows, while taking into account the different stages of integration into financial markets and differing approaches to capital mobility. The framework makes explicit the impact of financial integration and presents a more data-oriented analysis of the effects of financial flows on countries' reserves and balance of payments positions.[7]

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[7]It should be noted that quantitative assessments of external strength within a cross-country framework continue to be hampered by the lack of timely and consistent data on balance of
(continued...)

Country coverage and country groups

10. Since a comprehensive assessment of external strength for all 181 Fund member countries is well beyond the scope of this paper (and subsequent operational budget papers), the following selection criteria were used to reduce the number of country cases to a more manageable level, while ensuring that all potentially strong members are covered:

- All countries that have established reasonably secure access to international financial markets—as measured by an investment-grade sovereign credit rating—were included, regardless of their reserve positions.
- Also included were other countries with reserve positions exceeding the relatively low cut-off point of 3 months of imports or 2½ months of current payments.[8]
- Excluded from further examination were members with current Fund arrangements.[9] Also excluded were countries with prospective ESAF arrangements and those with SAF/ESAF loans outstanding. However, to capture the broadest range of potential

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[7](...continued)
payments and capital market developments. Given the current availability through *IFS* of the relevant underlying data (as described in Appendix II), the use of a larger number of indicators would need to rely on staff estimates for a wider range of country-specific data with all attendant trade-offs between timeliness on the one hand and the ability to derive consistent cross-country comparisons on the other.

[8]Although some countries with weak reserve positions could nevertheless have a strong balance of payments, these members would not be considered for inclusion in the operational budget until continued balance of payments strength had resulted in more comfortable reserve levels.

[9]With the exception of Egypt and Hungary which have not drawn under their arrangement, as well as Uruguay which is not expected to draw.

candidates, and in light of the revolving nature of Fund's general resources, this criterion was not applied to countries with prospective stand-by or extended arrangements or outstanding purchases from the General Resources Account (GRA).[10]

11. The sixty-four countries identified for further analysis on the basis of the above criteria were then classified into three groups with broadly similar characteristics regarding the structure of their balance of payments and the degree of integration into international financial markets (Table 1). As further discussed below, this classification was based on a combination of measures, including notably the structure and relative size of overall external investment assets and liabilities, with sovereign credit ratings providing an additional and market-based indicator to cross-check the analytical consistency of the country groupings (Box 1).

- **Group I** consists of the advanced economies with broad-based access to international capital markets, and high-grade credit ratings (Aaa or Aa).
- **Group II** comprises all other countries with an investment-grade rating (A to Baa).
- **Group III** includes the remaining countries with reserve levels above 2½ months of current payments.[11]

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[10]The differential treatment for purposes of the analysis would seem reasonable because the protracted balance of payments difficulties of countries with recent or prospective ESAF arrangements are likely to preclude inclusion into the operational budget for some time to come. In this context, it should be noted that the basis for exclusion from further consideration was not ESAF eligibility per se but rather actual or prospective use of ESAF resources.

[11]Nigeria reported gross reserves at end-1996 equivalent to over 7 months of 1995 current

(continued...)

Table 1. Country Grouping, Reserves and Credit Ratings

	Reserves (months of curr. payments)	Credit Rating (score[1])	Operat. Budget (status[2])
Group I			
Australia	1.8	3	x
Austria	2.5	1	x
Belgium-Luxembourg	1.3	2	x
Canada	1.0	2½	x
Denmark	1.7	2	x
Finland	1.9	2½	x
France	0.8	1	x
Germany	1.6	1	x
Ireland	1.7	2½	x
Italy	1.8	3½	x
Japan	4.2	1	x
Netherlands	1.5	1	x
New Zealand	2.8	2	x
Norway	5.9	1½	x
Singapore	6.0	1½	x
Spain	4.4	3	x
Sweden	2.2	3	x
Switzerland	4.5	1	x
United Kingdom	1.0	1	x
United States	0.8	1	x
Group II			
Bahamas, The	1.1	7	-
Chile	8.4	7½	x
China	9.0	7½	x
Colombia	5.6	10	x
Cyprus	3.9	5	+
Czech Republic	4.3	7	-
Greece	6.9	10	+
Hungary [3,4]	5.7	10	+
Iceland	1.9	4½	-
Indonesia	3.2	9	x
Israel	3.2	7	-
Korea	2.2	4½	x
Kuwait	3.2	8	+
Malaysia	3.5	5	x
Malta	5.5	5½	x
Mauritius	4.3	9	+
Oman	3.2	9½	+
Poland	5.7	10	-
Portugal	4.3	4½	x
Qatar	1.5	9	+
Saudi Arabia	1.7	10	+
Slovenia	2.5	6½	-
Thailand [3,4]	5.0	6½	+
Tunisia [4]	2.5	10	-
U.A.E.	3.2	8	x
Uruguay [3]	3.6	10	-
Group III			
Bahrain	3.1	11	+
Barbados	2.9	11	-
Botswana	28.5	nr	x
Brazil [4]	9.0	13½	-
Costa Rica	2.7	11	-
Ecuador [4]	3.6	nr	-
Egypt [3]	10.1	11	-
Fiji	4.0	nr	-
Guatemala	2.8	nr	-
India [4]	4.5	10½	-
Lebanon	9.7	13½	-
Mexico [4]	2.7	12	+
Morocco	3.7	nr	-
Paraguay	3.6	13	-
Swaziland	2.7	nr	+
Turkey [4]	3.8	14½	-
Venezuela [4]	6.8	14	-

[1] Average sovereign credit rating by Moody and Standard and Poor: AAA=1; AA=3; A=6; BBB=9; BB=12; B=15; Investment grade ratings range from 1 to 10 (=BBB- or Baa3); nr = not rated.

[2] x=included on transfer side of current operational budget; + included at some time during past decade.

[3] Current SBA/EFF arrangement.

[4] Country has Fund credit outstanding.

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Box 1: Credit Ratings

Credit ratings are the most visible and widely used indicator of countries' standing in international capital markets. Credit ratings by international rating agencies, generally seen as a pre-condition to the issue of sovereign bonds, are currently available for 81 countries. The two major international credit rating agencies (Moody and Standard & Poor) typically issue ratings for both long-term and short-term sovereign debt.

The sovereign ratings are primarily assessments of governments' capacity and willingness to repay debt, but take into account a wide range of economic and financial as well as political factors.[1] While the agencies employ different criteria and weighting schemes, their ratings are highly correlated within the major rating categories (Appendix I, Table 5). Moody's ratings cover the largest number of countries and Moody's notation is used below.

The **investment-grade** rating scale consists of the four major categories from Aaa, Aa, A and Baa and is further divided into:

- High grade (Aaa and Aa) ratings cover 21 advanced countries. The difference between the top rating (Aaa) and the second category (Aa) reflects largely differences in countries' economic performance. Rating changes are relatively infrequent with the last major changes in 1993 when Finland, Italy and Sweden were downgraded.

- Lower investment grade (A and Baa) cover another 29 countries. Obligations issued by countries in the upper range (A) are considered to have adequate repayment security, but agencies perceive elements that suggest possible future impairment, particularly during an economic downturn. Obligations issued by countries rated in the lower range are seen as having some speculative characteristics, reflecting in part agencies' assessment of political factors.

The **non-investment grade** (Ba and below) ratings cover countries whose obligations have speculative elements.

Sovereign ratings are an important determinant of countries' overall access to capital markets because private sector borrowers are never rated better than their sovereign (though an exception has recently been made for some companies in Argentina). Moreover, as credit ratings both reflect and influence market sentiment, they are also a prime determinant of the cost and terms of borrowing and are highly correlated with spreads over benchmark interest rates.

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[1] A recent study on the determinants of credit ratings found that sovereign ratings are broadly consistent with macroeconomic fundamentals, and that ratings effectively summarize information contained in macroeconomic indicators (R. Cantor and F. Packer, "Determinants and Impact of Sovereign Credit Ratings" Federal Reserve Bank of New York, Economic Policy Review, October 1996).

Countries in Group I

International investment positions

12. The most comprehensive measure of countries' integration into global financial markets is the international investment position which covers all sectors and all types of investment instruments.[12] International investment asset and liability positions are shown in Figure 1 for all advanced economies for which such data are currently available. Net positions range from net liability positions of more than 75 percent of GDP (New Zealand) to net asset positions of close to 100 percent of GDP (Switzerland).[13]

13. The scale of financial integration is evident from the underlying gross asset and liability positions which exceed annual GDP by significant margins in most cases. The bulk of external assets is owned by the private sector, including notably commercial banks. Official reserve assets are relatively small in relation to total external assets, although there are wide differences among countries and reserve assets remain significant in most cases (both in

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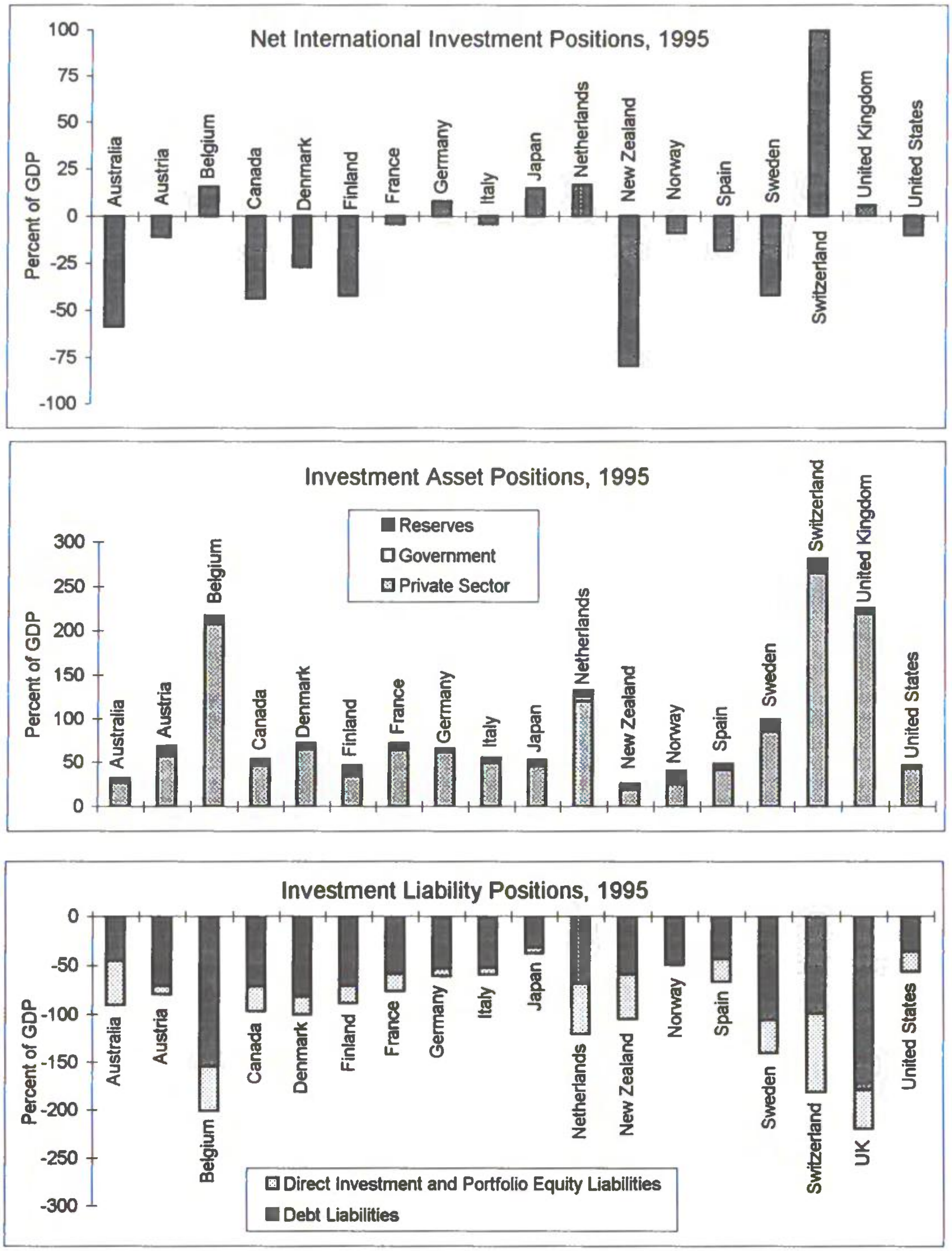
[11](...continued)
payments, but was excluded from further consideration here because the gross reserve levels reflect in large part the nonpayment of external debt.

[12]The net international investment position represents (conceptually) the sum of past external current account balances and thus provides an analytically useful link between financial stocks and flows. Statistically, net investment positions cannot be built from current account time series because of valuation effects, which, given the size of net positions, can dominate annual flows.

[13]Data on international investment positions were published for the first time in the April 1997 issue of the *IFS* but are currently available for only a limited number of countries.

Figure 1: International Investment Positions, 1995[1]
(In percent of GDP)



Source: IFS (see Appendix I, Table 6 and Appendix II).
[1]Data refer to 1994 for Belgium and 1993 for Norway.

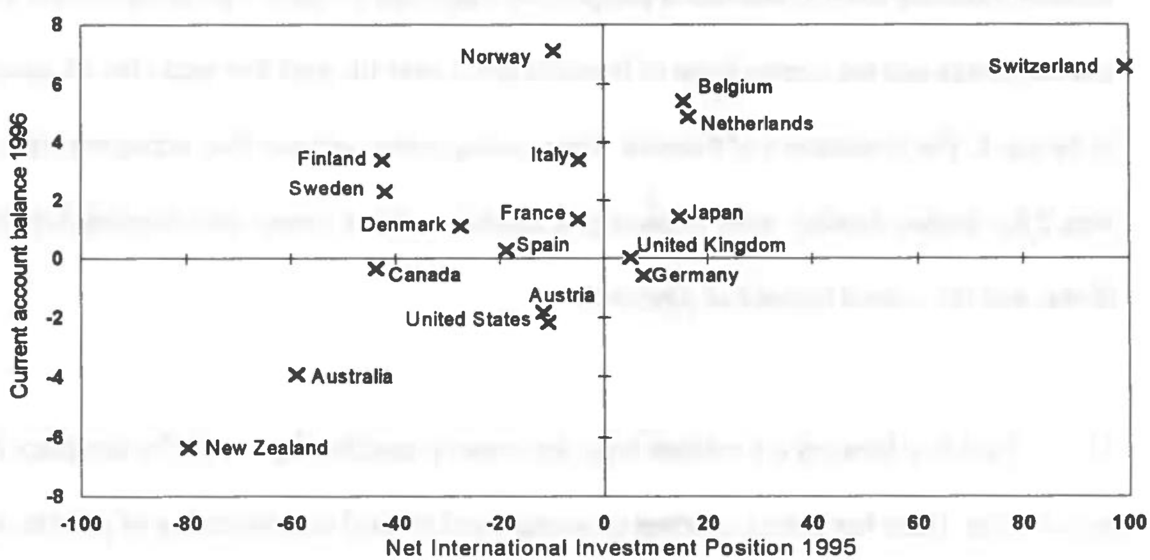
absolute terms and as a percent of GDP); other government assets are negligible. External liabilities are also held mostly by the private sector.

Investment positions and external current accounts

14. Linking stocks and flows, Figure 2 compares the net international investment positions of these countries at end-1995 with their external current account balances for 1996. Countries with current account surpluses (upper half) are either building further on existing net asset positions (such as Switzerland) or reducing net liabilities (such as Finland and Sweden), albeit at a gradual pace, given the difference in scale. Countries in the lower half with current account deficits are reducing existing net assets (Germany) or increasing further their net liabilities (Austria, Australia, Canada, New Zealand, and the United States).

Figure 2. Net International Investment Positions and External Current Account Balances, 1995-96[1]

(In percent of GDP)



Sources: IFS; and staff estimates.

[1]Data on net international investment positions refer to 1994 for Belgium and 1993 for Norway.

15. A net asset position combined with a current account surplus would be an unambiguous indicator for external strength. A less stringent criterion would be a combination of a moderate net liability position combined with a surplus or a small current account deficit. Countries with sizable net liability positions would generally be considered in a relatively weaker position, unless offset by a current account surplus or very small deficit. Most of the countries with relatively large net liabilities have in fact moved to current account surpluses in recent years (Denmark, Finland, Spain, and Sweden). Thus, all high-rated countries are currently either in current account surplus or have moderate deficits in the context of relatively strong overall net external positions, with the two notable exceptions of Australia and New Zealand.

Balance of payments financing flows

16. To help assess this snapshot of relative overall net external positions and current account balances from a time-series perspective, Appendix I Figure 1 presents current account developments and the composition of financial flows over the past five years for all countries in Group I. The breakdown of financial flows distinguishes between four categories (see Box 2 for further details): asset transactions, nondebt liability flows, debt-creating liability flows, and the overall balance of payments.

17. Two key features are evident from the country-specific charts and the summary chart below. First, there has been a continuing strong trend toward diversification of private sector portfolios; all countries saw their overall external asset positions increase over the past years,

Box 2. Structure of Balance of Payments Financing

The breakdown of financial flows used in this paper corresponds to the major classifications in the *Balance of Payments Manual (5th edition)*. As published in the *IFS*, the analytic presentation of the balance of payments distinguishes in the financial account between transactions in assets and in liabilities within each of the three broad categories direct investment, portfolio investment, and other investment. For the purposes of this paper, financial flows are grouped under the following four main headings:

- **Asset transactions,** comprising the net change in countries' gross asset holdings, excluding reserve assets (with negative asset transactions representing an increase in net asset positions).[1] Assets consists of direct foreign investment abroad, portfolio assets in the form of debt and of equity, and the net purchase of other external financial assets (including notably credits extended abroad). Also included in this category are net errors and omissions as well as net capital transactions (which are both comparatively small for most countries).

- **Nondebt financial flows**, consisting of direct investment in the reporting country and the net sales of portfolio equity liabilities.

- **Debt-creating financial flows**, comprising the net sales of portfolio debt liabilities and net changes in other debt instruments.

- The **overall balance**, which is for essentially all cases (among the advanced countries) equivalent to the change in gross international reserve assets. A positive overall balance represents in increase in reserves.

The relationship between these financing flows and the external current account are illustrated for the cases of Japan and the United States in the table below.

Structure of Balance of Payments Financing, 1996

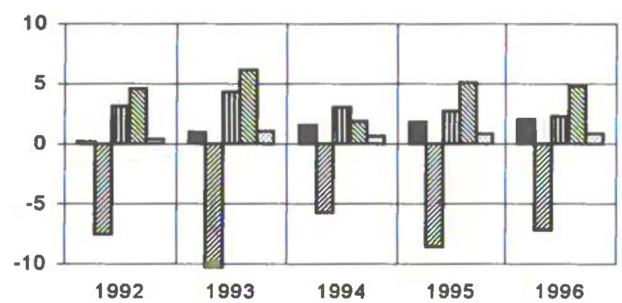
	United States		Japan	
	US$ billions	Percent of GDP	US$ billions	Percent of GDP
Current account balance	-165	-2.2	66	1.4
Financing flows (net)	158	2.1	-31	-0.6
Asset transactions	-355	-4.7	-135	-2.9
Nondebt liabilities	84	1.1	49	1.1
Debt-creating liabilities	429	5.7	55	1.2
Overall balance	-7	-0.1	35	0.8

Sources: *IFS*

[1]The measure is a net concept in the sense that it covers the net effect of purchases and sales of external assets within the various categories of assets. It does not measure net flows of assets and liabilities within a given category (such as portfolio flows), which can be useful for other analytical purposes.

with net asset purchases financed largely through increases in debt-creating liabilities.[14] Second, changes in reserve assets have generally been small compared with private sector financial flows (except for Japan, Singapore, and Spain).

Group I (average): External Current Account Balance and Structure of External Financing, 1992-96
(In percent of GDP)



Legend	
■	External current account balance
▨	Asset transactions
▥	Nondebt liability flows
▧	Debt-creating liability flows
□	Overall balance of payments

Source: IFS; and staff estimates

Are reserve asset positions a relevant indicator of external strength?

18. The more limited role of reserve asset movements in the face of large-scale private sector financial flows raises the issue whether gross reserve positions continue to be an adequate indicator of external strength. Unrestricted capital market access by the private sector can indeed reduce the monetary authorities' need to hold reserve assets as the primary safeguard against external shocks, provided that (i) the private sector can be relied on to provide the requisite financing for the current account through changes in its external asset and liability position, (ii) financial markets are sufficiently deep to manage large portfolio

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[14]Exceptions are Sweden in 1992 and Denmark in 1994 with net asset sales. Also notable is Sweden's relatively sharp decline in debt liabilities during the past year.

changes, and/or (iii) exchange rates are sufficiently flexible. In such circumstances, the authorities' policy strategy could be based on a broader approach toward the economy's external asset and liability position with a lesser focus on the management of reserve assets. Relatively low reserves would then--by themselves--not be considered as inconsistent with external strength.

19. Nevertheless, most countries in Group I continue to consider that reserve assets have a critical role to play, particularly in foreign-exchange market interventions. Even though most of these countries could probably meet their intervention demand for reserves through active liability management rather than reliance on gross reserve holdings, there is little evidence that their perceived need for gross reserves has declined in recent years. While the level of reserves varies widely, ranging from around 1 month of current payments (Belgium, Canada, France, the United Kingdom, and the United States) to well over 4 months of current payments (Japan, Norway, Singapore, and Spain), reserve holdings have remained relatively stable or increased in all countries, notably those with large overall net liability positions.[15] Similarly, while the charts suggest that recent shorter-term changes in gross reserve positions cannot be easily linked to a weakening or strengthening of the balance of payments, developments in the ERM in 1992 demonstrated the need for intervention on a sufficiently large scale to result in significant changes in gross reserves of some countries (Ireland, Italy, and Spain).

[15]Although reserves declined by over 20 percent for Finland and Sweden during the last year (Appendix I, Table 1).

Assessment of external strength

20. All countries in Group I are currently included on the transfer side of the operational budget, and the majority have been included without interruption for the past decade. In light of this and the above considerations, the assessment of relative external strength for Group I countries would continue to focus mainly on current and prospective external current account balances, with particular attention to countries with relatively large net international liability positions. The staff would also continue to take into account developments in foreign-exchange markets, particularly for countries with limited exchange rate flexibility and thus potentially greater vulnerability to tensions in exchange markets.[16] Given the experience of 1992, exchange market developments will continue to require close attention, particularly if uncertainties arise during the run up to EMU.

21. The move to EMU will also raise a number of new issues with important implications for the assessment of external strength for EMU participants and the inclusion of the euro in the operational budget. These issues include, notably, the definition of external reserve assets to be used in assessing external positions and the definition of external and balance of payments positions more generally. These conceptual issues are being discussed in the series of papers on the EMU that are currently under preparation. While it would be premature to draw operational conclusions at this stage, it should be noted that some aspects of the

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[16]The relevance of indicators relating to exchange market developments are further discussed in paragraphs 36-39 below.

approach outlined in this paper might need to be reassessed in the light of developments toward EMU.

Countries in Groups II and III

22. The countries classified in Groups II and III, although characterized by a wide variety of country circumstances, have a number of features that distinguish them from countries in Group I:

- Overall external assets and liabilities are considerably smaller, reflecting the generally less advanced stage of economic and financial integration into global markets.
- Given the financing requirements of economic development and the attendant current account deficits, the net international investment positions tend to be dominated by liabilities (both debt and non-debt).
- With overall external asset positions relatively small in most cases, reserve assets constitute the main form of external asset holdings.[17]

Role of reserve positions and approach to reserve management

23. Reserve assets for many of the countries in Groups II and III have been increasing rapidly in recent years. As a result, there are marked differences in reserve levels in relation to

[17]This has not been the case for some of the oil-exporting countries that experienced large current account surpluses in the past. While stock data on non-reserve asset holdings are not available, data on recent balance of payments flows for Saudi Arabia, for example, show very substantial drawdowns of external assets (as shown further below).

current payments between these countries and the high-rated countries with broad-based access to capital markets in Group I. The difference is particularly striking for countries in the upper rating range of Group II.[18] The precautionary demand for reserves appears to be especially high at this intermediate stage in the development of more mature market access for two main reasons. First, adequate gross reserves continue to be needed as a safeguard against current account shocks, which the private sector is less able to absorb given its more limited participation in global financial markets. Second, a substantial reserve cushion is required as a safeguard against the potentially large and sudden shocks to financial flows, as was clearly demonstrated by the recent turmoil in foreign exchange markets of some emerging economies.

24. In this context, it needs to be borne in mind that the relatively high reserve levels for some of the emerging economies at an early stage of capital market access have been associated with recent surges in capital inflows and the use of sterilized intervention[19]. The high level of—essentially borrowed—reserves can impose substantial costs. High reserve levels need to be maintained, however, in part because market participants could perceive reserve declines as a sign of weakness which could, in turn, contribute to a sudden reversal of flows.[20]

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[18]See Table 1 and Appendix I Table 1 which presents a range of reserve indicators.

[19] In order to keep the nominal exchange rate from appreciating either because the exchange rate is used as a nominal anchor or to preserve competitiveness.

[20]The benefits and risks of surges in capital flows and the complications that can arise for macroeconomic management have been discussed extensively. See, for example, recent studies in the *World Economic Outlook*, the semi-annual reviews of capital market

(continued...)

Structure of external liabilities

25. The markedly different approach to reserve asset management by countries with less secure market access highlights the importance of assessing the strength imparted by a particular reserve position not only against current payments but also against the financial obligations (and potential shocks) that can arise from the nature and composition of external liabilities. The size and maturity structure of external indebtedness remains a critical factor, with particular dangers arising from heavy reliance on external short-term debt. Although short-term credits are indispensable for normal trade transactions, the levels of short-term external indebtedness in a number of countries well exceeds the level that would generally be associated with external trade.

26. Figure 3 shows short-term external debt in relation to both exports and reserves at end-1996 for selected countries as well as the change in external short-term indebtedness during 1996.[21] Particularly vulnerable are countries in the upper right part of the chart with high ratios of short-term debt to both exports and reserves. For example, short-term debt exceeded the level of gross reserves and was larger than 50 percent of exports in the cases of

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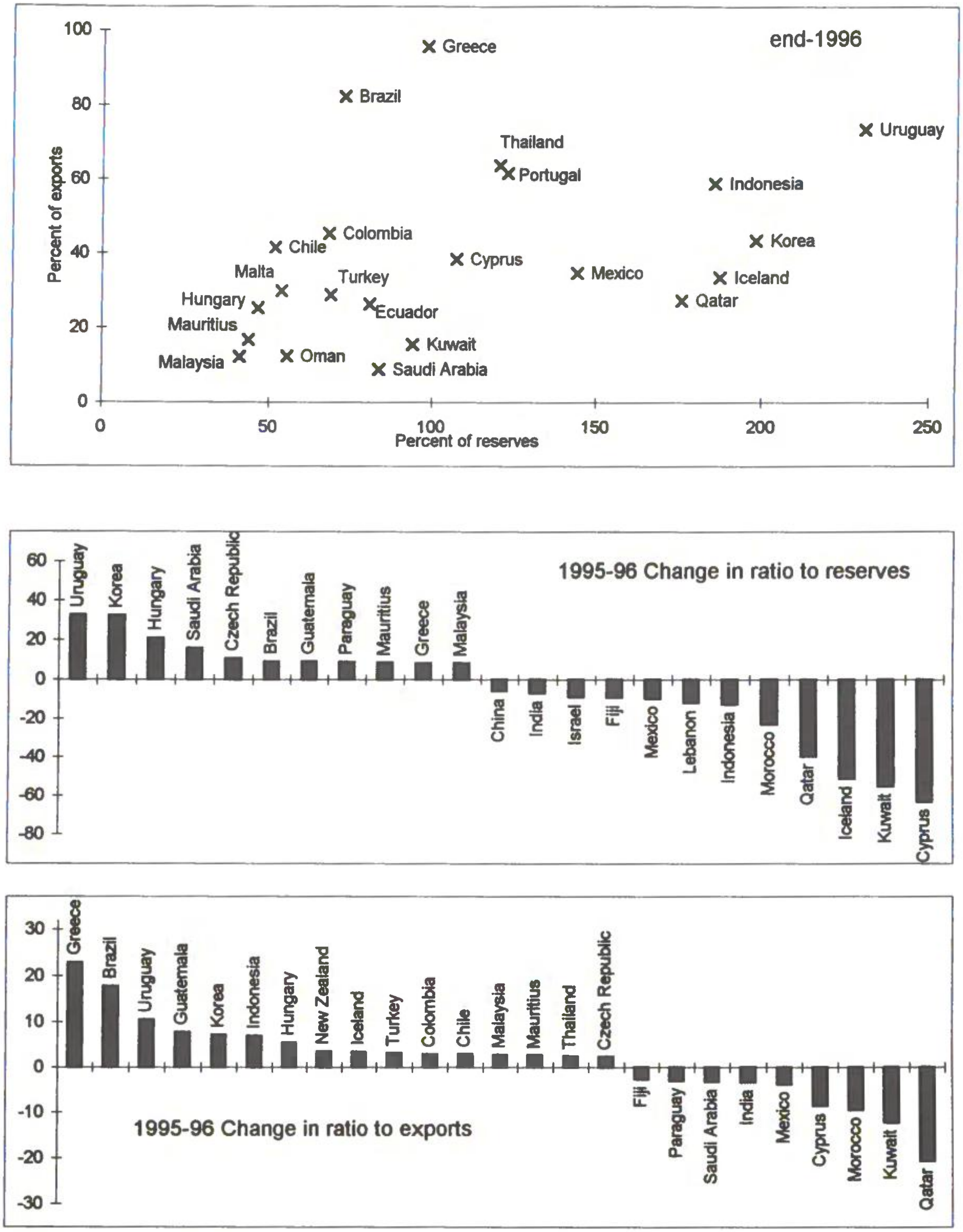
[20](...continued)
developments, and other staff studies in the *Occasional Papers* series.

[21]The data used here are short-term cross border liabilities as reported by BIS-reporting banks in the semi-annual report on the *Maturity, Sectoral and Nationality Distribution of International Bank Lending* which are generally more comprehensive than data provided by debtor countries. An alternative measure would be the external liability positions of the banking system, as reported in the IFS, though this measure would include long-term borrowing and exclude short-term indebtedness for which local banks have provided guarantees but not the financing.

Figure 3 . External Short-term Debt and Reserves, 1995-96[1]



Source: Appendix I Table 2.

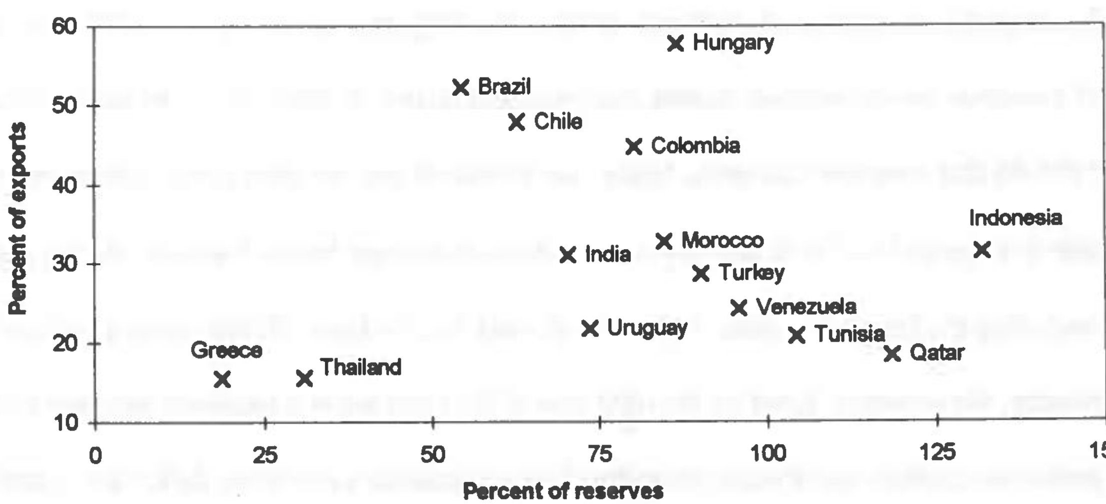
[1]Changes shown in the second and third panel include only percentage changes that were larger than 5 percent for the ratio to reserves and 2 percent for the ratio to exports.

Indonesia, Portugal, Thailand, and Uruguay, while short-term indebtedness of around twice the level of reserves characterized the situations of Iceland, Indonesia, Korea, Qatar, and Uruguay. As shown in the lower panel, short-term debt increased during 1996 in relation to both exports and reserves in Brazil, Greece, Korea and Uruguay, while the two short-term debt ratios declined both relatively sharply for Cyprus, Kuwait, and Qatar.

27. The adequacy of reserve levels should also be assessed in relation to external debt servicing obligations and overall external indebtedness. Figure 4 compares the traditional ratio of debt service to exports with the ratio to reserves (showing the countries whose debt service to export ratio exceeded 15 percent in 1996). External debt service obligations exceeded the stock of reserves in the cases of Ecuador, Indonesia, Mexico, Qatar, and Tunisia. Debt service

Figure 4. External Debt Service Ratios[1]

(In percent)



Sources: IFS; and staff estimates (see Appendix I Table 3).

Countries with debt service to export ratios exceeding 15 percent in 1996. Not shown are Ecuador and Mexico with debt service to export ratios of 80 and 67 percent, respectively.

obligations of Brazil, Chile, Colombia, and Hungary were particularly high in relation to exports with only marginally better coverage in terms of reserves.[22]

Balance of payments positions

28. As discussed above, increased financial market integration implies that the assessment of balance of payments positions cannot reliably be based solely on changes in gross reserve assets as an indicator of strength, but rather requires a closer focus—in line with the focus of market participants—on reserves in relation to the external current account deficit and the composition of its financing. Figure 5 shows current account balances in 1995 and 1996 for the countries with relatively high deficits in relation to GDP and reserves. Table 2 summarizes recent current account developments for all countries in Groups II and III. Countries whose external current deficits in 1996 exceeded 4 percent of GDP (the upper end of the traditional benchmark) are listed on the left side of the table. Of particular concern would be the first set of countries whose external deficits have widened further in 1996 above the average during 1993-95 (for example Colombia, Malta, and Thailand) and the third group whose external deficit widened in 1996 to above 4 percent from an average below 4 percent during past years (including the Czech Republic, Chile, and Korea). On the basis of their current account balance, the countries listed on the right side of the table are in a relatively stronger balance of payments position, particularly those that have maintained a moderate deficit for some time.

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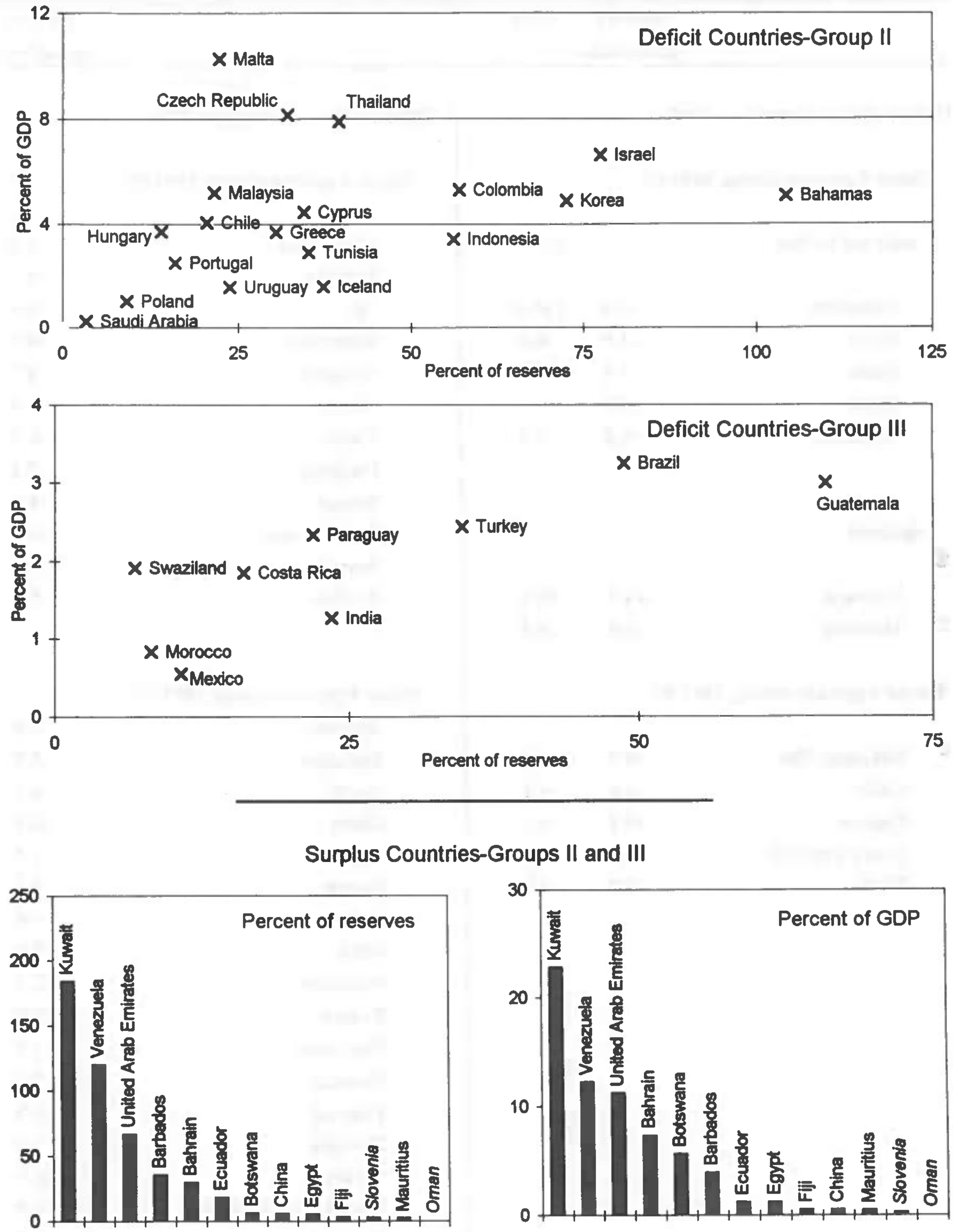
[22]See Appendix I Table 3 for indicators on the stock of external debt.

Figure 5. External Current Account Balances and Reserves, 1996[1]

(In percent)



Source: *IFS*; and staff estimates.

[1] Reserves at the beginning of the period. Lebanon and Qatar, which had current account deficits in 1996 of over 35 percent and close to 15 percent of GDP, respectively, are not shown.

Table 2. External Current Account Balances, 1993-96

(In percent of GDP)

	1993-95 annual basis	1996
Deficit above 4 percent in 1996		
Above 4 percent during 1993-95		
widened further		
Colombia	-4.6	-5.3
Israel	-4.8	-6.6
Malta	-7.4	-10.3
Qatar	-13.2	-14.5
Thailand	-6.9	-8.2
declined		
Lebanon	-44.7	-36.8
Malaysia	-6.6	-5.2
Below 4 percent during 1993-95		
Bahamas,The	-0.8	-5.1
Chile	-1.6	-4.1
Cyprus	-0.1	-4.5
Czech Republic	-0.7	-8.1
Korea	-0.9	-4.9
Deficit below 4 percent in 1996		
Above 4 percent during 1993-95		
Costa Rica	-4.0	-1.8
Ecuador	-4.3	1.6
Fiji	-6.6	0.5
Guatemala	-4.9	-3.0
Hungary	-8.7	-3.7
Mexico	-4.8	-0.5
Oman	-8.1	0.0
Paraguay	-7.1	-2.3
Poland	-4.2	-1.0
Saudi Arabia	-9.1	-0.2
Swaziland	-4.2	-1.9
Tunisia	-5.4	-2.9
Below 4 percent during 1993-95		
Bahrain	5.4	7.3
Barbados	5.9	3.9
Brazil	-1.1	-3.2
China	-0.2	0.5
Egypt	1.3	1.2
Greece	-1.2	-3.7
Iceland	0.8	-1.8
India	-1.0	-1.3
Indonesia	-2.2	-3.4
Kuwait	11.9	22.8
Mauritius	-3.4	0.4
Morocco	-3.1	-0.8
Portugal	-0.5	-2.5
Slovenia	1.5	0.3
Turkey	-1.3	-2.4
United Arab Emirates	10.5	11.2
Uruguay	-2.2	-1.6
Venezuela	1.4	12.2

Sources: *IFS*; and staff estimates.

29. Country-specific information on the interrelation between current account balances, changes in reserves assets, and the composition of external financing flows is provided in the Appendix I Figures 2 and 3. The breakdown of financial flows shows again asset transactions, nondebt liabilities, debt-creating liabilities, and the overall balance of payments (as described in Box 2).[23] Not surprisingly, given the range of country circumstances and underlying policies, the charts reveal a wide diversity of financing structures across countries and over time, underlining the importance of assessing balance of payments strength both from a cross-country perspective and in the context of country-specific experience and prospects.

30. A number of indicators can be derived from the structure of balance of payments financing and changes in the financing composition over time. Typically, the sources of financing would consist of increases in nondebt and debt-creating liabilities while uses of such financing would be the current account deficit, increases in the asset position of the private sector (or the public sector in the form of non-reserve external assets), and a buildup in external reserves of the monetary authorities. A current account surplus would provide additional financing from own resources for the acquisition of external assets (or a reduction in indebtedness). A second, though more temporary source of additional financing would be the liquidation of existing external assets, as, for example, in the case of Saudi Arabia over the past years (shown as positive net asset transactions in the charts). The third, and least

[23]It should be noted that in a number of cases in Groups II and III, the overall balance cannot be equated to reserve asset changes because it also includes exceptional financing items, including Fund financing. For some cases, such as Egypt and Poland, debt relief has also played a major role in balance of payments financing.

sustainable, element of additional financing would be a reduction in official reserves (shown as negative overall balance).[24]

Balance of payments categories

31. On the basis of the financing structure of their balance of payments, countries can be classified into four broad categories as shown in Table 3 for the Group II countries in 1996: (i) countries with an external current account surplus; (ii) countries in external current account deficit, but an overall surplus and sufficiently large inflows to accumulate net external assets; (iii) countries in external current account deficit requiring a reduction in net external assets to generate an overall surplus; and (iv) countries with deficits on both the external current account and the overall balance.

32. These four categories could be used as a broad ranking of balance of payments strength, although it should be recognized that the assessment would also need to take into account the size of the financial flows involved relative to GDP and reserves. Countries with an external current surplus would normally be considered in a relatively strong position. At the other end of the spectrum, countries in category four with deficits on both the current account and the overall balance would be considered weak because their financing pattern is unlikely to be sustainable. In fact, all countries in category four during 1993-95 moved to a less

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[24]Conversely, a reduction in net debt liabilities adds to the uses of funds (such as, for example, in the cases of Egypt, Malaysia in 1994, and Hungary in 1996). Net reductions in nondebt liabilities have not occurred in the period under consideration, reflecting the more stable nature of direct investment and portfolio equity flows.

Table 3. Sources and Uses of External Financing, 1996

	Sources/Uses		Share in sources			Share in uses		
	(US$ mill.)	(percent of GDP)	Nondebt flows	Debt flows	Other (as noted)	Current account	Asset transact.	Overall balance
1. Current account surplus					Current account			
China	50,100	6.1	87	6	8		37	63
Kuwait	7,204	24.2	0	6	94		100	0
Mauritius	96	2.4	77	5	18		49	51
Slovenia	1,007	5.4	18	77	5		41	59
United Arab Emirates	5,259	11.8	5	0	95		88	12
2. Current account deficit and overall surplus, asset transactions net use of financing								
Chile	7,700	10.7	62	38		38	30	33
Colombia	6,628	7.6	53	47		70	6	24
Indonesia	14,174	6.3	43	57		54	16	30
Korea	33,009	6.8	20	80		72	25	3
Malaysia	9,219	9.3	35	65		56	16	28
Poland	4,646	3.5	59	41		29	5	66
Portugal	20,647	19.3	12	88		13	85	2
Thailand	25,829	14.1	39	61		58	34	8
Uruguay	827	4.4	20	80		36	47	17
3. Current account deficit and overall surplus, asset transactions net source of financing					Asset transact.			
Greece	8,769	7.1	12	87	1	52		48
Israel	9,741	10.2	21	35	45	65		35
Malta	435	12.5	7	55	38	82		18
New Zealand	5,646	8.9	2	-13	111	72		28
Qatar	1,948	23.5	0	-6	106	62		38
Tunisia	977	5.0	2	64	34	58		42
Oman	141	0.9	0	-464	564	0		100
4. Current account deficit and overall deficit					Overall balance			
Bahamas, The	115	3.1	54	39	7	163	-63	
Cyprus	550	6.2	35	3	62	72	28	
Czech Republic	7,316	13.3	28	61	11	61	39	
Hungary	939	2.1	211	-244	132	180	-80	
Saudi Arabia	1,836	1.4	0	0	100	16	84	

Sources: IFS; and staff estimates.

precarious balance of payments position in 1996 (see Table below). Serious questions about the sustainability of the structure of financing would also arise for countries in category three because of the reliance on the liquidation of non-reserve external assets, particularly if accompanied by a build-up of external indebtedness.

Balance of Payments Categories: 1996 Outcome Relative to Average for 1993-95

	Category			Category	
Improvement	From	To	Deterioration	From	To
China, Mauritius	2	1	Czech Republic, Cyprus	2	4
Poland	3	2	Greece, Tunisia	2	3
Australia, Portugal	4	2	Hungary, Saudi Arabia	3	4
New Zealand, Oman	4	3			

Source: Table 3 and Appendix I, Table 8.

33. Countries in category two might be considered strong, provided that the size of the financing requirement is moderate, and that the sources of financing are reasonably stable. Warning signals would include a widening of the financing requirement, a shift in liability flows from nondebt financing to debt-creating flows, and shifts within debt-creating flows from longer to shorter maturities, particularly in the context a widening current account deficit, and even if accompanied by continued reserve accumulation.[25]

[25]The vast literature on the combination of factors that make countries vulnerable to changes in market sentiment is comprehensively discussed and assessed by G. Kaminsky, S. Lizondo, and C. Reinhardt in "Leading Indicators of Currency Crises", IMF Working Papers, WP/97/79, July 1997. In addition to the external indicators of vulnerability discussed earlier, relevant risk factors cover a wide range of domestic variables not presented in this paper. In particular, fiscal developments can provide further useful information about both the potential source of external difficulties and the scope for using fiscal policy as part of the solution. Other indicators relate to the soundness of the financial system, as well as overall economic conditions, with a slowdown in economic growth—which could limit the authorities' room for more active monetary policy—an additional sign of potential vulnerability.

34. The analysis of balance of payments financing confirms from a flow perspective the elements of vulnerability for countries identified earlier in the discussion of reserve positions. Specifically, a number of countries currently included in the operational budget show signs of considerable weakness in their balance of payments despite relatively strong reserve positions, including notably Colombia, Indonesia, Korea, Malta, Malaysia, and New Zealand, and to a somewhat lesser extent Australia and Chile.

35. The analysis also brings out a number of cases that have shown signs of increasing external balance of payments strength. Specific signs of strength would be the combination of a current account surplus or moderate deficit, a relatively large share of nondebt flows in external financing, and a strong reserve position in relation to both current payments and the various indicators discussed above. This situation broadly characterizes the situations of China, Kuwait, Mauritius, Slovenia, and the United Arab Emirates among Group II countries, and, to a lesser extent, Barbados and Bahrain as well as more recently Egypt and Venezuela among countries in Group III.

Exchange market developments

36. It has long been recognized that financial market integration and capital mobility raises particular challenges for exchange-rate management and the maintenance of orderly conditions in exchange markets. The severe downward pressures in recent months on the currencies of several countries in Asia and Eastern Europe have demonstrated the rapid and intense impact

on exchange markets of changes in market sentiment. The factors that increase countries' vulnerability to exchange market pressures have been the subject of a vast and growing number of studies (see footnote 25). While these studies identified a range of significant variables, including the indicators discussed above, there is no single indicator that captures the timing of speculative attacks and the extent of spillover effects on other countries. Even if it was possible to construct reasonably reliable indicators of future exchange market pressures (and work is continuing toward this end), the assessment of whether countries have sufficient external strength for inclusion into the operational budget should probably not be based on fine-tuned triggers regarding their vulnerability to speculative attacks but rather on indicators that signal the normally earlier changes in the relative strength of their external positions.

37. From this perspective, changes in nominal and real effective exchange rates remain important and useful exchange market indicators. On both theoretical and empirical grounds, however, exchange rate developments need to be assessed against a wide range of country-specific characteristics (including cyclical positions and underlying fiscal and monetary policies). Quantitative indicators cannot substitute for the exercise of Fund surveillance over members' exchange rate policies in the context of Article IV consultations.

38. A second useful indicator is the exchange regime which has a direct bearing on the assessment of the adequacy of the reserve position. There has been a marked shift toward more flexible exchange arrangements during the past decade, with the majority of countries in Groups II and III currently classified as "other managed floating" or " independently floating".

This has not resulted in a decline in the relative importance attached to reserves by monetary authorities, partly because exchange rates continue to be informally pegged in many countries. The declared arrangement can therefore be a poor guide to the actual conduct of exchange rate policy and thus the strength of the underlying reserve position. Issues regarding the appropriate level of reserves also arise in the context of a change (not in response to market pressures) from a fixed to a more flexible regime, particularly for countries trying to exit from a policy regime relying on the exchange rate as a nominal anchor. To the extent that markets perceive greater uncertainty, reserve levels might well need to be significantly higher during the changeover period to a new regime than will be required once market participants have fully adjusted to the new regime.

39. The third indicator the staff has found useful in interpreting exchange market developments is information on official exchange market intervention, although such data is rarely available on a timely or consistent basis. Intervention activity shows up in gross reserve data only to a limited extent, because of the use of inter-central bank or other credit lines. Data on net reserves would capture these effects, but are less readily available than gross reserve data, and have similar limitations to the extent that interventions take place in the forward markets. These considerations on exchange market developments lend further support to approaching the assessment of members' external positions on the basis of strong fundamentals rather than finely tuned quantitative indicators.

IV. THE USE OF SUPPLEMENTARY INDICATORS IN FUTURE OPERATIONAL BUDGETS

40. The discussion in the preceding section confirms the fundamental relevance of the three main criteria for the selection of currencies laid down in the Articles: the balance of payments and reserve positions and exchange market developments. The analysis identified a series of supplementary quantitative indicators that provide information of direct relevance to the assessment of external financial strength, and the staff would propose to make more explicit use of this wider range of indicators in future operational budgets. As suggested by the analysis, the specification and interpretation of quantitative indicators needs to apply to a wide range of country circumstances. Moreover, in light of the evidence that the relative importance of indicators varies across country groups, there are no clear-cut thresholds for most indicators, though reference points that constitute strong warning signals have been identified. While further work and experience with indicators could help form more definitive judgments, it should also be recognized that external strength is a relative concept and continues to be heavily influenced by overall global economic conditions and developments. It would therefore seem unlikely that a set of indicators and weighting schemes could be devised that could provide a consistently reliable basis for triggering "automatic" inclusion in or exclusion from the operational budget.

41. Nevertheless, and despite the inevitable degree of arbitrariness involved in cross-country comparisons, the supplementary indicators presented in this paper would seem to

provide a reasonably objective and transparent basis for the judgments whether countries are sufficiently strong for inclusion in the operational budget. The supplementary indicators could help in particular in identifying emerging strength of potential candidates for inclusion and in giving early warning signals of emerging weaknesses in external positions of countries currently included in the operational budget.

42. Operationally, the staff would propose to proceed as follows in preparing future operational budget proposals. The traditional quantitative criteria followed by the staff as set out in paragraph 6 would continue to be the basis of the assessment as broadly agreed by the Executive Board in May 1997, and the staff would provide the latest information on these variables in the relevant papers for all members that provide data to the Fund. However, all countries with an investment-grade credit rating not otherwise meeting the traditional criteria would be included for further examination. As outlined in paragraph 10, the staff would exclude from further consideration countries with outstanding SAF/ESAF loans, but not countries with outstanding purchases from the GRA, unless they have a current non-precautionary Fund arrangement.

43. In the second step, the staff would classify potential candidates into the three major country groups that reflect the particular relevance of countries' degree of integration into global financial markets. The high-rated countries in Group I would generally be presumed to be in relatively strong positions, unless there are indications to the contrary, arising in

particular from prospective external current account developments or exchange market tensions.

44. For the relatively large number of countries in Groups II and III, the assessments would based on the full range of traditional and supplementary indicators. Countries in Group III with ratings below investment grade would generally be in a relatively weaker position, in part because they have yet to consolidate access to more stable and more broadly based financial flows. However, since credit ratings in this range provide more limited and sometimes misleading guidance for the assessment of external strength, the staff would consider carefully the situation of those countries that have seen significant improvements in their ability to tap capital markets which is not fully reflected in credit ratings.

45. The staff papers would present indicators based on the latest available data, including staff estimates, where necessary. It should be recognized, however, that data availability varies across countries and that the required data have been subject to frequent and often large revisions in the past. The reference points and thresholds outlined below would therefore need to be applied with some flexibility.

- The assessment of the **balance of payments position** would continue to focus primarily on developments and prospects for the external current account and the composition of external financing, including changes in reserves. The evidence from recent experience suggests that the reference point of a moderate current account deficit of 3-4 percent of GDP remains a reasonable benchmark, unless historically a country had normally exceeded this ratio. For countries with current deficits below this threshold, the staff would look for a financing structure characterized by relatively strong inflows in the form of foreign direct investment rather than debt-creating flows. Moreover, in line with the balance of payments classification used in this paper, the staff would normally consider that countries experiencing overall balance of payments deficits and countries with large reliance on financing through the liquidation of non-reserve assets as having insufficient external strength for inclusion in the operational budget.

- The assessment of the external **reserve position** would be based, in addition to the traditional indicators relating to current transactions (as well as members' quota in the Fund), on reserve positions in relation to external deficits and external debt indicators. In this respect, a stock of short-term indebtedness exceeding 50 percent of reserve assets would be seen as a strong warning sign and short-term debt in excess of reserves would be considered as indicating a relatively weak position. The staff would focus closely on developments in external short-term debt, including signs of a high or increasing share of short-term flows in total financing. Moreover, and in line with the assessments on the sustainability of external debt situations of the heavily indebted countries, external debt service ratios of 20 percent or above in terms of exports or 50 percent in terms of reserves would be seen as important warning signs, particularly in the context of high or rising short-term indebtedness.

- Regarding **exchange market developments**, the staff would continue to look at developments in nominal and real effective exchange rates, with particular focus on country situations characterized by increasing current account imbalances and an appreciating real exchange rate. In light of recent experience, a strong weight would also be placed on the Executive Board's assessment of exchange rate policy in the context of the Article IV consultation. Specifically, the staff would not propose for inclusion in the operational budget member countries whose exchange rate policies have not been fully endorsed by the Executive Board, especially in cases where Executive Directors raised concerns about a lack of nominal exchange rate flexibility or about the exit from a policy regime relying on the exchange rate as a nominal anchor.

46. The staff would continue to base its assessment of strength on a combined concept, with moderate weakness in one set of indicators offset by strength in others. Given the currently strong overall access to international capital markets and generally favorable external conditions, but also taking account of the recent turmoil in exchange markets of several emerging market economies, the staff would look for considerable strength in a range of indicators before proposing inclusion in the budget. In particular, the staff would carefully monitor developments in countries that are potential candidates for inclusion on the basis of supplementary indicators but show the signs of vulnerability that have been closely associated with disruptive changes in market sentiment.

47. Overall, the staff would continue to be guided by the principle that countries included in the operational budget should show sufficient external strength so that they could reasonably be expected to continue to be included for some time. The staff would also continue to follow past practice and not propose exclusion from the operational budget at the first sign of emerging external weakness. At the same time, however, the staff would argue that such signs of weakness, including in the form of heightened vulnerability to regional contagion effects, should not be ignored for long.

48. A few Executive Directors have suggested a modification of the current approach with more frequent changes in the composition of countries included in the operational budget than was the case in the past, and greater automaticity based on strict application of quantitative indicators. If Executive Directors agreed to include the supplementary indicators in the assessment of external strength, the two approaches may converge in practice. As noted in discussion above, a number of relevant indicators do not lend themselves to frequent re-evaluations because they cover economic and financial variables for which high-frequency data is not normally available. Moreover, the use of supplementary indicators would require more intensive data collection and analysis by the staff in preparing operational budget proposals. The indicators-based approach would thus involve less frequent, but more comprehensive assessments of members' external positions which, in turn, may well imply more frequent changes in the composition of countries than was the case in the past. However, the difficulties in applying reference rates and thresholds arising from the relatively frequent revisions of the underlying data would continue to preclude any fine-tuning.

49. In light of these considerations on the frequency of conducting assessments of members' external positions, it would seem reasonable to move the operational budget from the current quarterly to a semi- annual basis. If during the course of a six-month period, members' situations were to change substantially, the staff could, as at present, propose an amendment to the budget to provide for the exclusion or inclusion of a particular currency or currencies. The practice currently followed by the staff already provides that, if the external position of an included member deteriorates substantially in a quarterly period, the currency of that member would no longer be used. A move to semi-annual operational budgets and designation plans would require a change in the early repurchase guidelines, and the staff would therefore propose that move of future operational budgets and designation plans for six-month periods be put in place following the upcoming review of the guidelines on early repurchases.

V. SUMMARY

50. Responding to Executive Directors' request, this paper explored the possibilities of supplementing the current approach to the selection of currencies for inclusion on the transfer side of the operational budget with a broader range of quantitative indicators. The paper examined the balance of payments and reserve position of member countries within a broad analytical framework that takes into account the varying degrees of members integration into global financial market and the structural differences in the financing of their balance of

payments. The analysis identified a range of supplementary indicators of direct relevance for the assessment of the strength of members' external positions, which could be used in conjunction with the traditional indicators. Table 4 lists the proposed indicators in summary form.

51. The main operational conclusions of the paper may be summarized as follows:

- The supplementary indicators would appear to provide a reasonably objective and transparent basis for the judgment whether a members' position is sufficiently strong for inclusion in the operational budget. The supplementary indicators could be particularly useful in giving early warning signals of emerging weaknesses in external positions of members that are included in the operational budget and in helping to identify cases of emerging strength of potential candidates for inclusion.

- It would appear unlikely, however, that the supplementary indicators could be used as a consistently reliable basis for triggering "automatic" movements of member countries into or out of the operational budget. The relative importance of indicators varies considerably across country groups, and there are no clear-cut thresholds for most of the indicators.

- In preparing future operational budget papers, the staff would propose to follow a two-step approach. As broadly agreed by the Executive Board in May 1997, the initial assessment would continue to be based on the traditional quantitative criteria, although the

Table 4. Summary of Proposed Indicators for the Assessment of External Strength

1. **Traditional indicators** (paragraph 6)

a. Gross reserve position in relation to imports (greater than 3-4 months) and Fund quotas (greater than 250 percent)

b. Balance of payments position: moderate external current account deficit not exceeding 3-4 percent of GDP and decline in gross reserves less than 10 percent over the past six months.

c. Exchange market developments: nominal and real exchange rates and changes in members' exchange rate regime.

2. **Supplementary indicators**

a. Differentiation by country groups based on structure of balance of payments, relative size of international investment position and external current account balance, and degree of integration into global financial markets.

b. Balance of payments position

- External current account deficit: smaller than 4 percent of GDP
- Overall balance: surplus
- Structure of financing flows for countries with a current account deficit:
  - i. Significant share of foreign direct investment and other nondebt flows relative to debt-creating liability flows
  - ii. Small share of short-term debt in total debt-creating flows
  - iii. No reliance on net liquidation of non-reserve assets
- Balance of payments category (paragraphs 31-33): 1 and 2

c. Reserve position in relation to

- Current payments: greater than 2½ months
- External short-term debt: larger than 50 percent
- External debt service: larger than 50 percent
- External deficits and financing requirement

d. Exchange market developments

- Intervention activity not reflected in gross reserve data
- Actual exchange rate policy in relation to declared regime
- Vulnerability indicators (paragraph 33)

e. Other

- Sovereign credit rating: investment grade (Baa3 or BBB- and above)
- External debt service: ratio to exports smaller than 20 percent.

staff would include for further examination all countries with broad-based access to international capital markets that would not otherwise meet the traditional criteria. In the second step, the staff would classify potential candidates into the three major country groups identified in the paper (based on the balance of payments structure and the degree of integration into financial markets), and make use of the supplementary indicators in coming to specific proposals regarding the composition of currencies to be included in the operational budget.

- The use of supplementary indicators would entail considerably more intensive data collection and analysis, and a number of relevant indicators cover variables for which high-frequency data are not normally available. The staff would therefore also suggest to move the operational budget from the current quarterly to a semi-annual basis, following the review of the guidelines on early repurchases.

Table 1. Summary of Indicators of Reserve Positions, 1995-96
(In percent; unless otherwise indicated)

	Gross reserves							Balance of payments financing requirement[1] (percent of reserves)	
	(Billions of SDRs)		Change 1995-96	Import coverage (months)		In percent of			
	1995	1996	(percent)	1995	1996	Quota 1996	GDP 1996	1995	1996
Group I									
Australia	8.3	10.4	25	2.0	2.3	445	3.8	231	147
Austria	13.0	16.3	25	2.3	2.8	1,370	10.3	101	59
Belgium-Luxembourg	17.4	18.0	4	1.7	1.7	557	9.9	204	152
Canada	10.2	14.3	40	0.9	1.2	331	3.5	157	129
Denmark	7.5	9.9	32	2.4	3.0	925	8.1	25	96
Finland	6.8	4.9	-29	3.2	2.2	565	5.6	2	107
France	20.9	21.5	3	1.1	1.1	290	2.0	148	74
Germany	60.5	61.2	1	1.8	1.8	742	3.7	177	167
Ireland	5.8	5.7	-2	2.5	2.1	1,089	11.6	186	245
Italy	25.8	34.3	33	1.8	2.3	747	4.1	94	171
Japan	124.1	151.5	22	5.3	5.9	1,838	4.7	48	32
Netherlands	23.9	19.8	-17	2.1	1.7	576	7.3	76	115
New Zealand	3.0	4.1	40	3.1	3.8	637	9.3	104	68
Norway	15.2	18.5	22	5.8	6.4	1,673	16.8	surplus	surplus
Singapore	46.2	53.4	16	6.2	6.6	14,944	81.8	surplus	surplus
Spain	23.7	40.8	72	3.2	5.0	2,110	10.1	114	4
Sweden	16.3	13.5	-18	3.6	2.7	834	7.7	123	0
Switzerland	27.4	29.6	8	4.5	4.8	1,200	14.6	26	surplus
United Kingdom	28.9	28.4	-2	1.6	1.4	383	3.5	436	826
United States	59.5	53.7	-10	1.2	1.0	202	1.0	451	674
Group II									
Bahamas, The	0.1	0.1	-1	1.2	1.0	126	4.7	75	109
Chile	9.6	10.4	8	9.5	8.9	1,670	20.8	7	35
China	51.2	74.9	46	6.7	9.1	2,213	13.2	24	14
Colombia	5.5	6.7	22	6.0	7.1	1,191	11.0	55	53
Cyprus	0.8	1.1	42	3.1	4.0	1,088	17.7	123	35
Czech Republic	9.4	8.7	-8	5.6	4.4	1,469	22.6	26	59
Greece	10.1	12.3	22	7.3	8.3	2,092	14.4	21	26
Hungary	8.1	6.8	-16	7.6	5.8	903	21.6	21	17
Iceland	0.2	0.3	52	1.7	2.1	372	6.2	18	25
Indonesia	9.3	12.8	37	3.1	3.5	855	8.1	68	55
Israel	5.5	7.9	45	2.7	3.6	1,192	12.0	65	55
Korea	22.0	23.7	8	2.5	2.3	2,962	7.0	83	94
Kuwait	2.5	2.5	2	3.5	3.4	255	12.2	surplus	12
Malaysia	16.1	18.9	17	3.3	3.6	2,266	27.3	36	24
Malta	1.1	1.1	4	5.5	5.7	1,671	46.5	79	22

Table 1. Summary of Indicators of Reserve Positions, 1995-96
(In percent; unless otherwise indicated)

	Gross reserves							Balance of payments financing requirement[1] (percent of reserves)	
	(Billions of SDRs)		Change 1995-96 (percent)	Import coverage (months)		In percent of Quota	In percent of GDP		
	1995	1996		1995	1996	1996	1996	1995	1996
Mauritius	0.6	0.6	7	4.2	3.9	853	23.4	3	3
Oman	0.8	1.0	26	2.8	3.1	818	9.1	85	0
Poland	10.0	12.4	25	5.2	5.9	1,257	13.4	29	9
Portugal	11.2	11.6	3	5.1	4.8	2,082	15.6	83	121
Qatar	0.6	1.2	95	2.9	4.5	621	19.1	156	76
Saudi Arabia	6.0	4.9	-18	2.4	1.7	95	5.3	60	26
Slovenia	1.2	1.6	30	2.1	2.6	1,061	12.4	32	16
Thailand	24.3	26.3	8	5.3	5.4	4,587	20.9	51	69
Tunisia	1.1	1.3	22	2.2	2.7	641	9.7	73	30
United Arab Emirates	5.1	5.6	11	3.5	3.5	1,436	18.1	surplus	surplus
Uruguay	0.8	0.9	12	4.3	4.1	413	7.1	46	51
Group III									
Bahrain	0.9	0.9	6	3.7	3.9	1,114	25.4	surplus	surplus
Barbados	0.1	0.2	37	2.5	3.9	412	14.5	32	surplus
Botswana	3.2	3.5	11	28.3	28.5	9,686	106.1	surplus	surplus
Brazil	33.6	40.7	21	9.5	10.7	1,874	7.8	41	51
Costa Rica	0.7	0.7	-1	3.2	2.8	585	11.0	14	17
Ecuador	1.1	1.3	18	3.9	5.1	596	9.9	74	107
Egypt	11.0	12.2	11	11.4	10.7	1,796	26.5	3	1
Fiji	0.2	0.3	27	3.6	4.1	581	20.8	32	surplus
Guatemala	0.5	0.6	28	2.3	2.8	398	5.6	80	89
India	12.5	14.5	16	4.8	4.9	474	6.0	30	21
Lebanon	3.4	4.4	32	9.5	11.3	3,047	49.2	99	75
Mexico	11.4	13.5	19	3.7	3.4	771	5.8	56	42
Morocco	2.4	2.7	9	3.9	4.2	623	10.5	42	25
Paraguay	0.7	0.6	-12	4.7	3.8	840	9.0	28	41
Swaziland	0.2	0.2	-12	3.4	3.2	484	23.8	17	19
Turkey	8.5	11.6	36	3.8	4.1	1,801	9.2	19	33
Venezuela	4.6	8.6	86	5.0	7.8	441	18.3	surplus	surplus

Sources: *IFS*; and staff estimates.
[1]The financing requirement equals the current account deficit and net asset transactions if they represent a net outflow. Alternatively, the financing requirement can be seen as the sum of nondebt and debt-creating financial inflows plus inflows from the sale of net assets (if any) plus the overall balance of payments.

Table 2. Indicators of Short-Term External Debt, 1995-96[1]
(In U.S dollars and percent)

	Millions of U.S.dollars		Percent of exports2		Percent of reserves	
	1995	1996	1995	1996	1995	1996
Group II						
Chile	7,446	7,762	38.8	41.6	52.3	52.0
China	23,028	26,879	15.6	17.5	30.3	25.0
Colombia	5,806	6,590	42.4	45.3	71.5	68.6
Cyprus	2,009	1,681	47.1	38.4	176.1	107.5
Czech Republic	3,839	4,744	13.6	16.0	27.5	38.1
Greece	13,488	17,376	72.8	95.7	90.2	98.3
Hungary	3,150	4,581	19.9	25.3	26.1	46.7
Iceland	743	856	30.0	33.4	239.2	187.6
Indonesia	27,578	34,248	51.8	58.7	198.8	186.1
Israel	2,178	2,020	8.1	7.1	26.8	17.7
Korea	54,275	67,506	36.2	43.4	166.0	198.2
Kuwait	5,532	3,436	27.8	15.4	149.8	94.3
Malaysia	7,913	11,191	9.5	12.2	33.1	41.3
Malta	875	876	28.8	29.8	54.5	54.0
Mauritius	310	395	14.2	16.8	35.8	43.9
Oman	660	782	12.6	12.3	57.2	55.7
Poland	2,004	2,511	6.2	7.2	13.5	14.1
Portugal	20,083	20,554	62.3	61.6	120.4	123.1
Qatar	1,512	1,233	48.1	27.3	168.0	72.5
Saudi Arabia	6,074	5,909	12.1	8.8	68.5	84.1
Slovenia	342	347	3.3	3.3	18.8	15.1
Thailand	43,606	45,704	61.3	63.7	120.8	120.7
Tunisia	528	635	6.6	7.8	32.7	33.4
United Arab Emirates	3,075	3,289	9.8	9.3	40.9	40.6
Uruguay	2,457	3,086	62.9	73.3	198.3	230.6

Table 2. Indicators of Short-Term External Debt, 1995-96[1]
(In U.S dollars and percent)

	Millions of U.S.dollars		Percent of exports2		Percent of reserves	
	1995	1996	1995	1996	1995	1996
Group III						
Botswana	173	235	7.1	9.1	3.6	4.6
Brazil	32,099	42,835	64.6	82.3	64.3	73.2
Costa Rica	400	349	10.4	8.7	38.2	34.9
Ecuador	1,394	1,526	26.1	26.2	84.5	81.2
Egypt	2,463	2,413	17.0	15.8	15.1	13.8
Fiji	43	13	3.8	1.1	12.3	3.0
Guatemala	585	800	20.4	28.1	82.1	90.9
India	7,729	7,140	20.4	16.9	41.6	34.3
Lebanon	1,914	1,674	178.4	137.7	38.2	26.2
Mexico	26,017	28,080	38.5	34.7	154.2	144.4
Morocco	2,109	1,334	23.8	14.1	58.0	34.8
Paraguay	1,150	911	10.4	6.7	77.7	11.4
Swaziland	758	717	31.8	28.7	73.7	82.3
Turkey	10	1	1.1	0.1	3.4	0.4
Venezuela	8,965	11,515	25.8	28.9	70.9	69.3

Sources: *BIS,IFS*; and staff estimates.

[1] Short-term debt data used here are short-term cross border liabilities as reported by BIS-reporting banks (see Appendix II). The offshore banking centers (the Bahamas, Bahrain, and Barbados) are not shown here.

[2] Exports of goods and services.

Table 3. External Debt and Debt Service, 1995-96

(In percent)

	External debt				External debt service			
	Percent of GDP		Percent of exports[1]		Percent of exports[1]		Percent of reserves	
	1995	1996	1995	1996	1995	1996	1995	1996
Group II								
Bahamas, The	11.2	9.8	24.1	20.8	4.1	3.4	38.4	33.1
Chile	35.1	34.2	123.1	131.8	41.5	47.9	60.4	62.8
China	13.6	13.0	64.8	69.3	10.6	10.9	29.3	22.1
Colombia	30.4	31.2	179.8	187.1	37.1	44.9	65.4	80.4
Cyprus	25.0	23.8	50.7	48.1	9.2	7.5	26.5	28.8
Czech Republic	34.6	37.7	61.0	70.0	9.3	12.9	42.0	27.4
Greece	26.8	25.1	165.2	169.5	13.4	15.5	17.0	18.8
Hungary	70.4	60.8	199.8	152.6	53.1	57.8	123.5	86.8
Iceland	62.2	...	175.6	...	...	...	...	...
Indonesia	52.3	47.8	197.4	185.7	31.5	31.4	136.7	131.9
Israel	36.4	35.3	118.3	118.7	...	...	...	...
Korea	17.2	...	52.3	...	5.5	...	32.0	...
Kuwait	15.2	3.0	20.1	4.0	3.2	2.8	17.7	17.1
Malaysia	38.3	38.6	40.1	41.9	6.9	5.9	22.7	22.5
Malta	26.0	23.4	28.0	27.8	6.6	6.3	10.9	11.5
Mauritius	23.9	25.2	41.1	41.2	8.8	9.3	25.6	25.2
Oman	8.3	7.4	22.0	18.1	4.2	5.2	22.2	28.6
Poland	37.2	30.4	136.0	116.0	5.5	6.2	30.5	14.7
Portugal	8.0	11.5	25.3	36.9	2.8	3.0	5.5	6.0
Qatar	60.1	82.5	143.4	162.5	23.8	18.4	106.8	92.2
Saudi Arabia	1.0	0.9	2.4	1.8	7.2	1.8	47.3	13.5
Slovenia	15.8	21.6	28.7	38.3	7.1	8.9	49.3	51.4
Thailand	50.4	50.7	116.2	127.8	11.6	15.6	28.0	30.9
Tunisia	54.8	50.8	123.8	122.0	20.6	20.8	111.0	104.5
United Arab Emirates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Uruguay	33.6	33.9	152.2	152.6	25.3	21.7	93.7	73.7

Table 3. External Debt and Debt Service, 1995-96
(In percent)

	External debt				External debt service			
	Percent of GDP		Percent of exports[1]		Percent of exports[1]		Percent of reserves	
	1995	1996	1995	1996	1995	1996	1995	1996
Group III								
Bahrain	68.4	71.3	67.6	64.3	11.6	10.5	50.3	47.2
Barbados	25.2	21.6	40.3	32.8	12.0	10.1	71.5	60.2
Botswana	12.6	11.4	25.5	21.2	3.4	2.3	1.9	1.3
Brazil	26.6	28.0	383.5	403.5	47.2	52.2	63.0	54.4
Costa Rica	45.4	44.4	107.9	100.8	15.7	13.9	67.8	53.2
Ecuador	77.7	76.6	260.6	250.6	191.3	79.6	548.3	280.8
Egypt	56.9	47.1	231.5	203.9	13.5	12.9	14.4	12.1
Fiji	12.3	12.8	21.6	22.6	4.6	3.1	18.9	10.3
Guatemala	16.1	14.5	82.0	79.8	13.5	10.8	44.4	43.3
India	29.1	27.2	247.6	223.8	27.7	31.0	51.8	70.4
Lebanon	11.6	14.3	120.2	152.6	16.5	11.6	4.1	2.8
Mexico	58.0	47.1	245.9	194.8	59.0	66.6	631.8	319.3
Morocco	70.9	59.5	259.3	229.3	38.2	32.7	77.3	84.9
Paraguay	14.7	13.8	55.8	53.5	9.6	8.1	22.5	19.5
Swaziland	17.9	19.7	22.8	24.0	2.6	2.6	8.0	7.6
Turkey	43.8	44.3	211.1	200.2	34.3	28.7	161.5	90.4
Venezuela	49.7	50.1	166.1	124.1	25.4	24.2	66.9	95.9

Sources: *IFS*; and staff estimates.
[1]Exports of goods and services.

Table 4. Structure of External Financing, 1995-96
(In percent of GDP)

	Current account		Asset transactions		Non-debt flows		Debt flows		Overall balance	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
Group I										
Australia	-5.5	-3.9	-2.7	-1.7	4.8	1.8	3.4	4.4	0.1	0.6
Austria	-2.1	-1.8	-6.3	-4.2	0.8	2.8	8.2	3.7	0.6	0.4
Belgium-Luxembourg	5.2	5.5	-23.9	-20.6	3.4	15.0	15.5	0.1	0.2	0.0
Canada	-1.5	-0.4	-2.7	-4.2	1.4	2.1	3.3	3.3	0.4	0.9
Denmark	0.9	1.1	-2.5	-8.9	2.4	0.4	0.7	9.4	1.4	2.0
Finland	4.3	3.4	-4.4	-9.4	2.4	2.5	-2.6	1.0	-0.3	-2.4
France	1.1	1.3	-4.1	-2.8	2.0	2.1	1.0	-0.6	0.0	0.0
Germany	-1.0	-0.6	-5.6	-5.7	0.4	0.4	6.5	5.8	0.3	-0.1
Ireland	2.7	2.0	-27.6	-30.5	2.2	3.5	26.3	25.0	3.6	-0.1
Italy	2.3	3.4	-5.6	-10.3	0.9	1.1	2.6	6.8	0.3	1.0
Japan	2.2	1.4	-3.9	-2.9	1.0	1.1	1.9	1.2	1.1	0.8
Netherlands	4.5	4.9	-11.4	-13.3	2.6	2.6	3.8	7.2	-0.5	1.4
New Zealand	-5.9	-6.3	-2.0	9.8	5.2	0.2	3.3	-1.2	0.6	2.5
Norway	3.4	7.1	...	...	...	...	...	...	...	...
Singapore	17.6	15.5	-12.9	...	8.5	...	-3.2	...	10.0	7.9
Spain	0.2	0.3	-7.4	-0.7	1.9	1.1	4.2	3.4	-1.1	4.2
Sweden	2.0	2.3	-14.9	-2.3	7.0	3.8	5.5	-6.3	-0.5	-2.5
Switzerland	7.1	6.6	-10.6	0.0	2.8	0.0	0.7	0.0	0.0	0.0
United Kingdom	-0.5	0.0	-16.3	-29.1	2.5	3.3	14.3	25.8	-0.1	0.0
United States	-2.0	-2.2	-3.4	-4.7	0.8	1.1	4.8	5.7	0.1	-0.1

Table 4. Structure of External Financing, 1995-96
(In percent of GDP)

	Current account		Asset transactions		Non-debt flows		Debt flows		Overall balance	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
Group II										
Bahamas, The	-3.8	-5.1	1.4	2.0	3.0	1.7	-0.6	1.2	-0.1	-0.2
Chile	0.2	-4.1	-1.7	-3.2	2.1	6.6	1.1	4.1	1.7	3.5
China	0.2	0.5	-2.8	-2.3	5.1	5.3	0.7	0.3	3.2	3.9
Colombia	-5.1	-5.3	-0.4	-0.5	3.1	4.0	2.9	3.6	0.4	1.8
Cyprus	-2.5	-4.5	-13.7	-1.8	1.4	2.2	10.6	0.2	-4.2	-3.9
Czech Republic	-2.8	-8.1	-4.5	-5.2	7.7	3.7	14.6	8.1	15.0	-1.5
Greece	-2.5	-3.7	-0.3	0.1	0.9	0.9	1.8	6.2	0.0	3.4
Hungary	-5.6	-3.7	3.1	1.6	10.0	4.4	4.5	-5.0	12.0	-2.7
Iceland	0.7	-1.6	-1.5	0.0	0.1	0.0	0.8	0.0	0.1	0.0
Indonesia	-3.5	-3.4	-1.2	-1.0	2.9	2.7	2.6	3.6	0.8	1.9
Israel	-6.1	-6.6	1.8	4.6	1.8	2.1	4.0	3.6	1.4	3.6
Korea	-1.8	-4.9	-4.1	-1.7	1.5	1.4	6.0	5.4	1.5	0.2
Kuwait	17.4	22.7	-16.9	-24.2	0.0	0.0	-0.8	1.4	-0.3	0.0
Malaysia	-8.4	-5.2	-1.5	-1.5	4.7	3.2	3.2	6.1	-2.0	2.6
Malta	-12.3	-10.3	-26.5	4.7	3.0	0.9	26.4	6.9	-9.5	2.2
Mauritius	-0.6	0.4	3.2	-1.2	1.1	1.9	-0.8	0.1	2.9	1.3
Oman	-7.1	0.0	3.7	5.1	0.3	0.0	0.1	-4.2	-3.1	0.9
Poland	-3.6	-1.0	6.8	-0.2	3.3	2.1	1.7	1.4	8.2	2.3
Portugal	-0.2	-2.5	-13.2	-16.3	0.4	2.4	12.7	16.9	-0.3	0.5
Qatar	-18.7	-14.5	10.9	24.8	0.0	0.0	10.6	-1.3	2.8	9.0
Saudi Arabia	-4.3	-0.2	6.6	-1.2	-1.5	0.0	0.1	0.0	1.0	-1.4
Slovenia	-0.2	0.3	-2.9	-2.2	0.9	1.0	3.4	4.2	1.2	3.2
Thailand	-8.3	-7.9	-2.9	-6.6	2.6	5.6	13.0	10.2	4.4	1.2
Tunisia	-4.1	-2.9	-2.5	1.7	1.5	0.1	5.6	3.2	0.5	2.1
U.A.E.	10.8	11.2	-9.6	-10.4	0.7	0.6	0.0	0.0	1.9	1.4
Uruguay	-2.0	-1.6	-1.2	-2.1	0.7	0.9	3.8	3.5	1.3	0.8

Table 4. Structure of External Financing, 1995-96
(In percent of GDP)

	Current account		Asset transactions		Non-debt flows		Debt flows		Overall balance	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
Group III										
Bahrain	11.0	7.3	-2.3	-5.9	-0.5	-0.6	-6.2	0.1	1.9	0.8
Barbados	4.7	3.9	-8.4	1.9	0.6	0.6	5.3	-2.1	2.2	4.3
Botswana	7.0	5.6	-5.5	-2.7	1.5	1.4	1.1	0.5	4.2	4.9
Brazil	-2.5	-3.2	-0.3	-0.8	1.1	2.1	3.6	3.0	1.8	1.2
Costa Rica	-1.6	-1.8	0.9	0.0	4.3	3.5	-1.1	-1.2	2.5	0.4
Ecuador	-4.1	1.6	-2.7	-12.1	2.6	2.3	6.2	4.6	2.0	-3.6
Egypt	-0.4	1.2	-0.4	-1.6	1.0	1.6	-3.3	-0.4	-3.1	0.8
Fiji	-5.7	0.5	6.6	1.0	3.5	0.5	0.2	1.8	4.7	3.8
Guatemala	-3.9	-3.0	0.2	-2.0	0.5	0.5	2.2	5.7	-1.0	1.2
India	-1.7	-1.3	0.4	0.1	1.2	1.4	0.0	0.8	-0.2	1.1
Lebanon	-44.7	-36.8	19.6	19.7	22.1	19.1	5.3	4.1	2.3	6.0
Mexico	-0.2	-0.5	-3.1	-1.9	2.6	3.1	-4.6	-1.4	-5.3	-0.7
Morocco	-4.7	-0.8	2.5	-1.8	1.0	1.4	-1.2	1.9	-2.4	0.7
Paraguay	-2.1	-2.3	-1.1	-1.3	2.0	2.3	1.5	1.3	0.2	-0.1
Swaziland	-4.5	-1.9	2.0	-2.6	5.0	2.8	0.0	0.7	2.6	-1.0
Turkey	-1.4	-2.4	0.8	-0.7	0.6	0.9	2.7	4.7	2.8	2.5
Venezuela	3.0	12.2	-2.6	0.0	1.5	2.6	-3.6	-5.2	-1.7	9.7

Sources: *IFS*; and staff estimates.
As detailed in Appendix II, asset transactions include net errors and omissions; nondebt flows include direct investment in the reporting country plus portfolio equity securities; debt flows are comprised of portfolio debt securities and other investment liabilities.

Table 5. Investment Grade Sovereign Credit Ratings

	Average Rating[1]	Long- term Moody	Long- term S&P		Average Rating[1]	Long- term Moody	Long- term S&P	Short-term[2]
High grade				**Lower grade**				
Austria	1	Aaa	AAA	Iceland	4½	A1	A+	P-1
France	1	Aaa	AAA	Korea	4½	A1	AA-	P-1
Germany	1	Aaa	AAA	Portugal	4½	A1	AA-	P-1
Japan	1	Aaa	AAA	Cyprus	5	A2	AA-	P-1
Luxembourg	1	Aaa	AAA	Malaysia	5	A1	A+	P-1
Netherlands	1	Aaa	AAA	Malta	5½	A2	A+	P-1
Switzerland	1	Aaa	AAA	Slovenia	6½	A3	A	--
United Kingdom	1	Aaa	AAA	Thailand	6½	A3	A	P-2
United States	1	Aaa	AAA	Bahamas	7	A3	--	--
Norway	1½	Aa1	AAA	Czech Rep.	7	Baa1	A	P-2
Singapore	1½	Aa1	AAA	Israel	7	A3	A-	P-2
Belgium	2	Aa1	AA+	Chile	7½	Baa1	A-	P-2
Denmark	2	Aa1	AA+	China	7½	A3	BBB-	P-2
New Zealand	2	Aa1	AA+	Kuwait	8	Baa1	--	P-2
Canada	2½	Aa2	AA+	U.A.E.	8	Baa1	--	P-2
Finland	2½	Aa1	AA	Indonesia	9	Baa2	BBB	--
Ireland	2½	Aa1	AA	Latvia	9	--	BBB	--
Australia	3	Aa2	AA	Mauritius	9	Baa2	--	P-2
Spain	3	Aa2	AA	Qatar	9	Baa2	BBB	P-2
Sweden	3	Aa3	AA+	Oman	9½	Baa2	BBB-	P-2
Italy	3½	Aa3	AA	Panama	9½	Baa1	BB+	--
				Colombia	10	Baa3	BBB-	--
				Croatia	10	Baa3	BBB-	P-3
				Greece	10	Baa3	BBB-	P-2
				Hungary	10	Baa3	BBB-	P-3
				Poland	10	Baa3	BBB-	--
				Saudi Arabia	10	Baa3	--	P-3
				Tunisia	10	Baa3	--	--
				Uruguay	10	Baa3	--	--

[1]Average score derived by assigning numerical values from 1-10 for the ratings Aaa =1, Aa1=2, Aa2=3,Aa3=4, A1=5,...,Baa3=10 on Moody's scale and for AAA=1, AA+=2,AA=3,...,BBB-=10 on Standard and Poor's scale.
[2]Moody's ratings on a three-point scale from P-1 to P-3.

Table 6. International Investment Position, 1995
(In billions of U.S. dollars)

	Assets				Liabilities			Net Position
	Total	Reserve assets	Other public	Private	Total	Nondebt	Debt	
Australia	112	15	2	94	318	159	159	-207
Austria	160	26	1	133	187	22	165	-27
Belgium[1]	533	23	1	509	496	116	380	38
Canada	302	15	23	264	551	147	404	-249
Denmark	126	12	2	112	174	32	142	-48
Finland	58	11	4	43	111	23	88	-53
France	1,105	59	62	984	1,178	276	902	-74
Germany	1,672	85	100	1,488	1,484	195	1,289	187
Italy	599	60	0	538	650	82	568	-52
Japan	2,725	185	183	2,357	1,975	349	1,625	750
Netherlands	544	47	22	474	479	209	270	65
New Zealand	15	4	0	11	62	27	34	-47
Norway[1]	46	16	2	29	58	4	54	-11
Spain	270	37	0	233	375	133	243	-105
Sweden	228	26	6	196	325	81	244	-97
Switzerland	861	49	1	811	556	253	304	304
United Kingdom	2,490	49	21	2,419	2,432	455	1,977	58
United States	3,353	176	82	3,095	4,127	1,528	2,598	-774
Total	15,199	895	513	13,791	15,538	4,091	11,447	-339

Source: *IFS*

[1]Data refer to 1994 in the case of Belgium and 1993 in the case of Norway.

Table 7. Outstanding Use of Fund Credit, 1995-97

	End-1995		End-1996		End-July 1997	
	SDR Millions	% of Quota	SDR Millions	% of Quota	SDR Millions	% of Quota
Group II						
Hungary	259	34.3	119	15.7	119	15.7
Israel	112	16.8	22	3.4	--	--
Slovenia	3	1.8	1	0.6	--	--
Tunisia	197	95.7	165	80.1	141	68.6
Uruguay	14	6.2	6	2.7	--	--
Group III						
Barbados	25	51.0	7	13.3	0.4	0.8
Brazil	95	4.4	47	2.2	31	1.4
Costa Rica	16	13.7	1	0.4	--	--
Ecuador	117	53.2	101	46.0	99	45.1
Egypt	70	10.2	11	1.6	--	--
India	1,967	64.4	1,085	35.5	751	24.6
Mexico	10,648	607.3	9,234	526.7	6,932	395.4
Morocco	35	8.1	2	0.5	--	--
Turkey	461	71.7	461	71.7	461	71.7
Venezuela	1,506	77.2	1,527	78.3	1,349	69.1

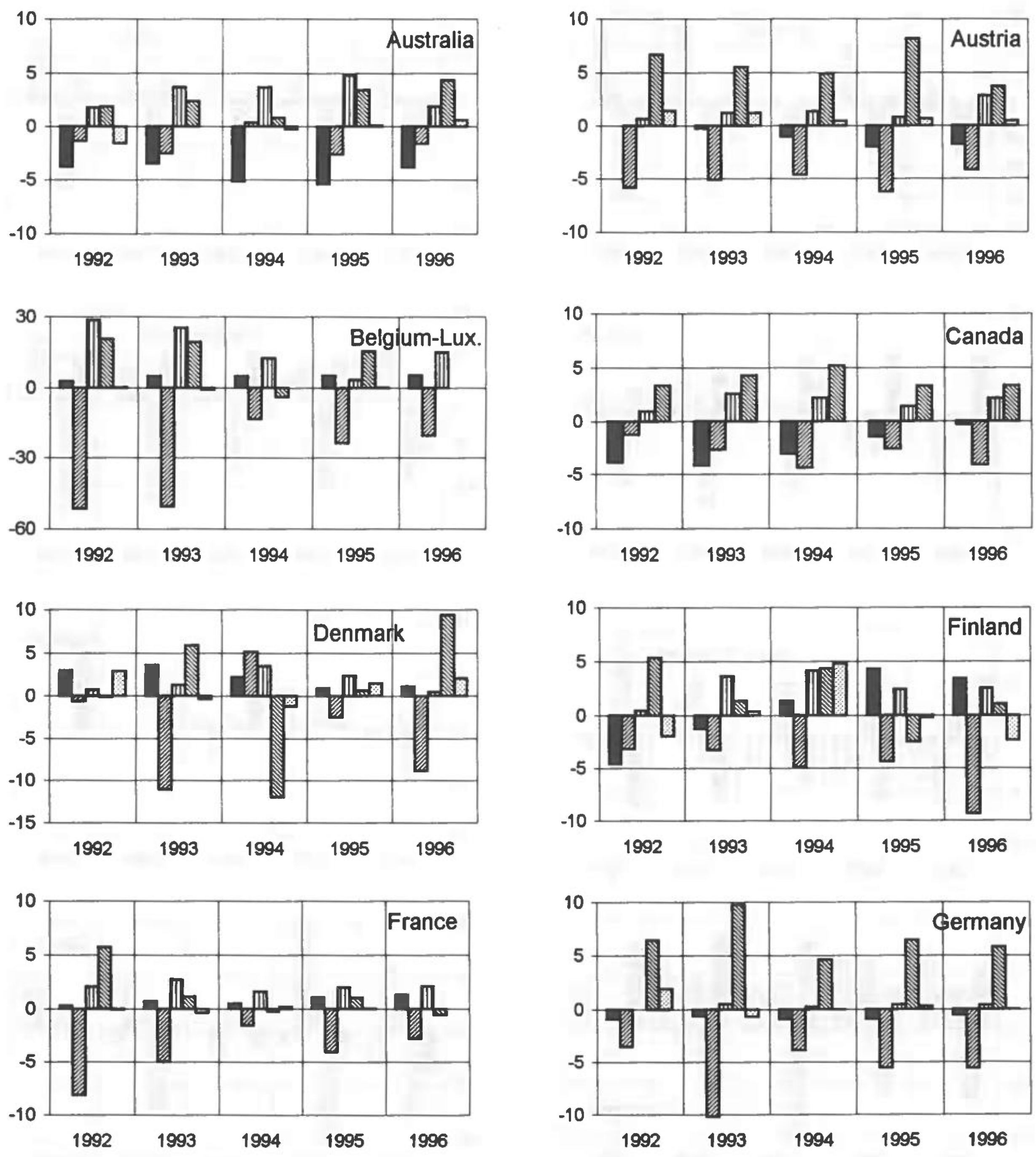
Table 8. Sources and Uses of External Financing, 1993-95

	Sources/Uses		Share in sources			Share in uses		
	Annual average							
	(US$ mill.)	(percent of GDP)	Nondebt flows	Debt flows	Other (as noted)	Current account	Asset transact.	Overall balance
1. Current account surplus					Current account			
Iceland	53	0.8	7	-6	99		230	-130
Kuwait	3,251	12.9	0	8	92		116	-16
Slovenia	680	4.5	20	45	34		51	49
United Arab Emirates	4,050	10.8	2	0	98		102	-2
2. Current account deficit and overall surplus, asset transactions net use of financing								
Bahamas, The	53	1.5	101	-1		54	31	15
Chile	3,588	6.5	56	44		24	32	44
China	35,827	6.4	90	10		3	46	51
Colombia	4,108	6.0	42	58		77	15	8
Cyprus	558	7.4	17	83		2	97	2
Czech Republic	8,171	20.9	31	69		3	40	57
Greece	4,961	4.9	20	80		25	9	65
Indonesia	7,142	4.0	64	36		56	31	14
Korea	21,226	5.4	29	71		17	60	23
Malta	441	15.7	21	79		47	37	16
Thailand	17,741	13.1	18	82		53	19	29
Tunisia	1,392	8.7	31	69		62	21	17
Uruguay	553	3.5	23	77		63	5	32
3. Current account deficit and overall surplus, asset transactions net source of financing					Asset transact.			
Hungary	6,107	14.7	45	36	19	59		41
Israel	4,580	6.1	19	71	10	80		20
Malaysia	7,099	9.5	63	28	9	70		30
Mauritius	139	4.1	19	29	52	83		17
Poland	6,196	6.2	40	6	53	68		32
Saudi Arabia	11,882	9.8	0	8	92	93		7
4. Current account deficit and overall deficit					Overall balance			
Oman	898	6.9	9	11	80	117	-17	
Portugal	12,482	13.6	12	76	12	4	96	
Qatar	727	10.0	0	78	22	132	-32	

Sources: IFS; and staff estimates.

Figure 1. Group I: External Current Account and Structure of Financing, 1992-96

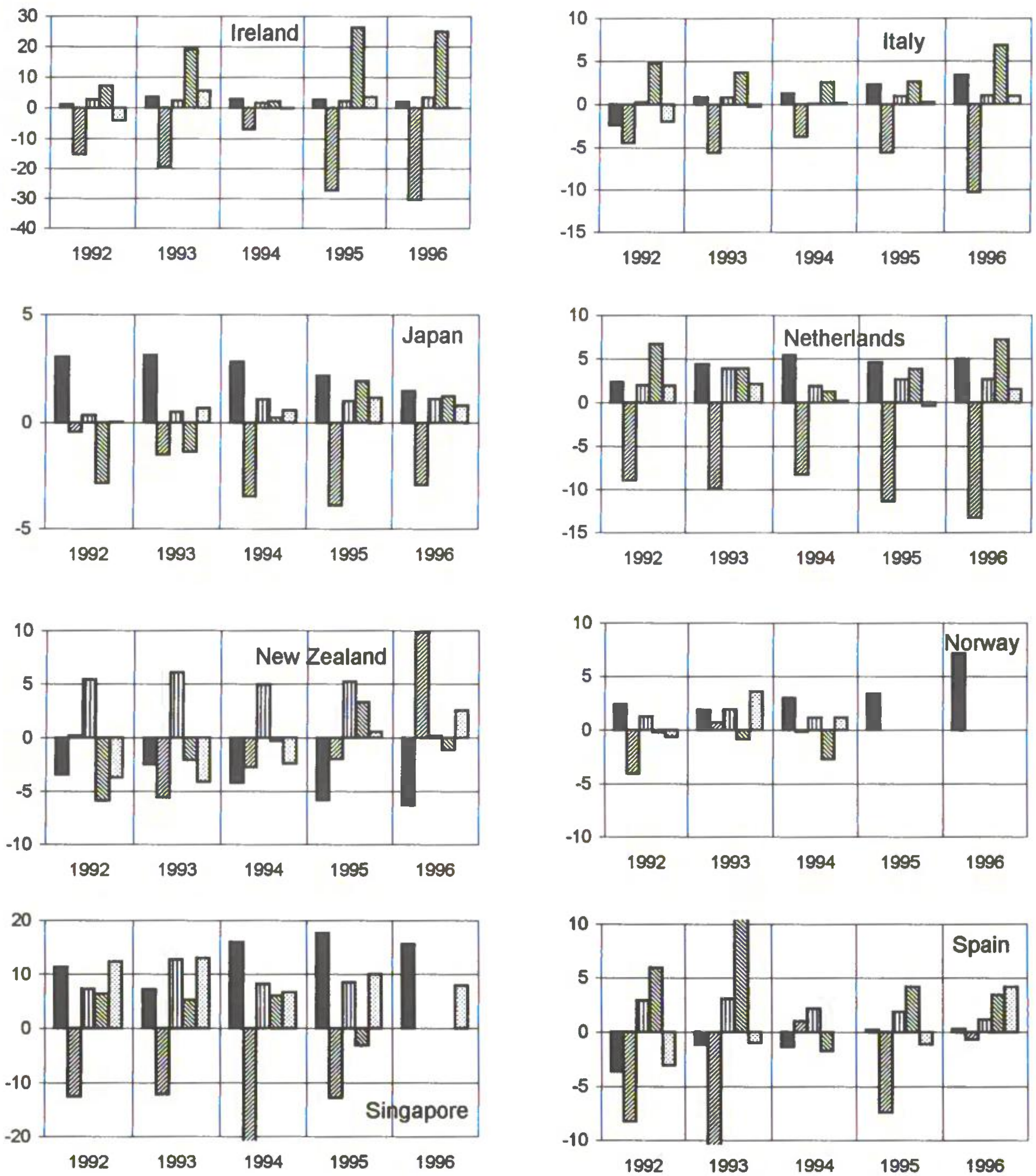
(In percent of GDP)



Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▩ =Overall balance.

All in percent of GDP. For data sources and definitions see Appendix II.

Figure 1. Group I: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)



Legend: = Current account = Asset transactions =Nondebt flows =Debtflows =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

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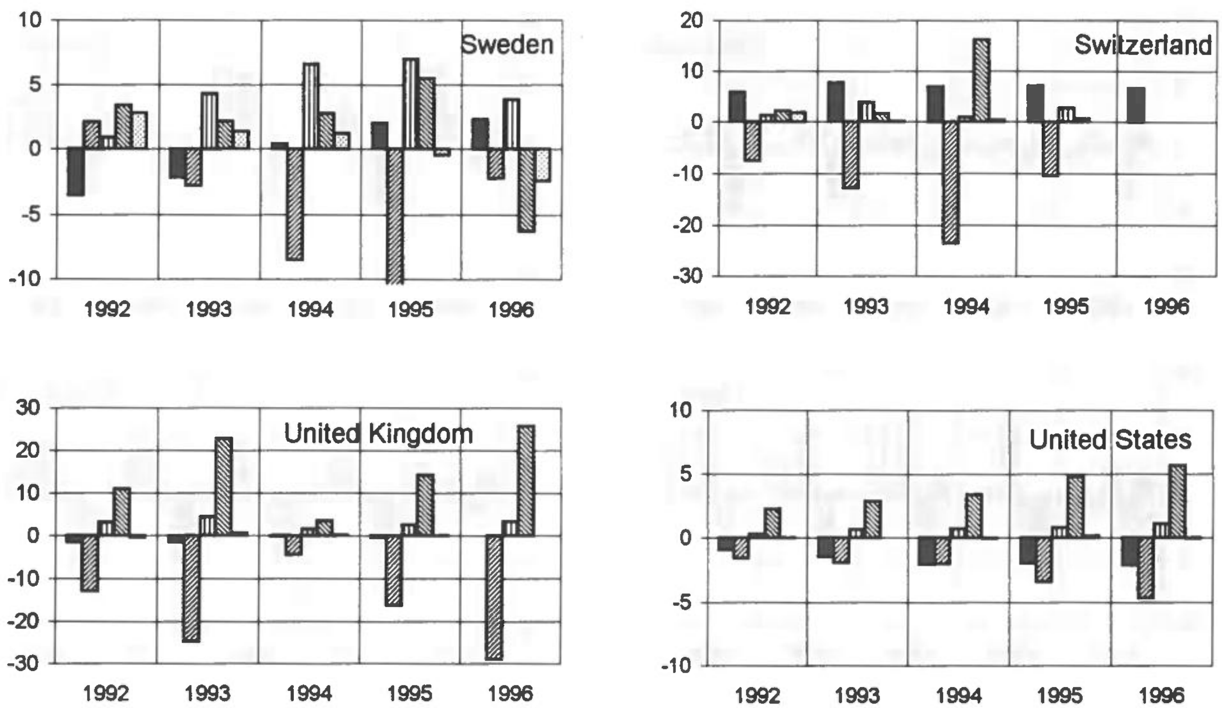
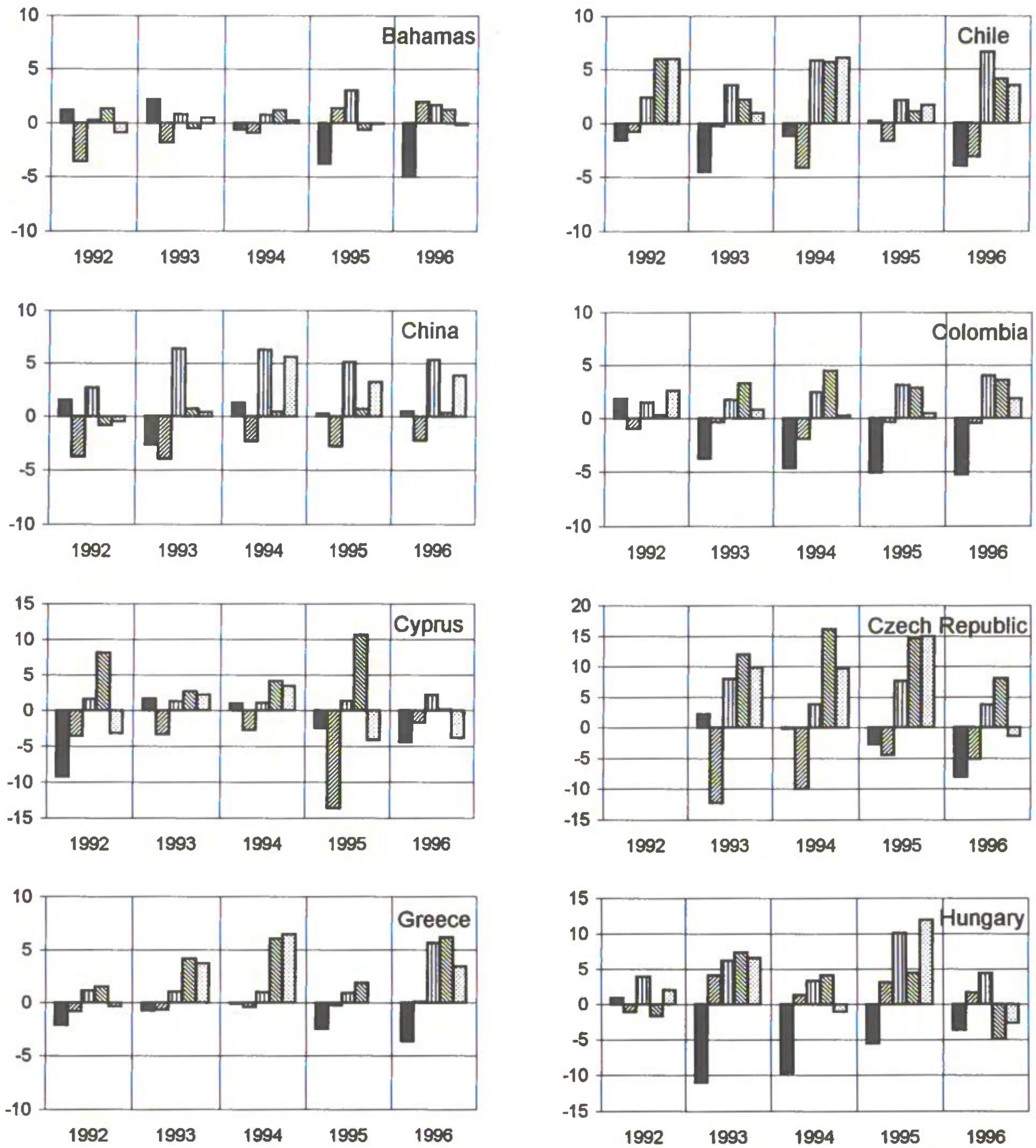
(In percent of GDP)



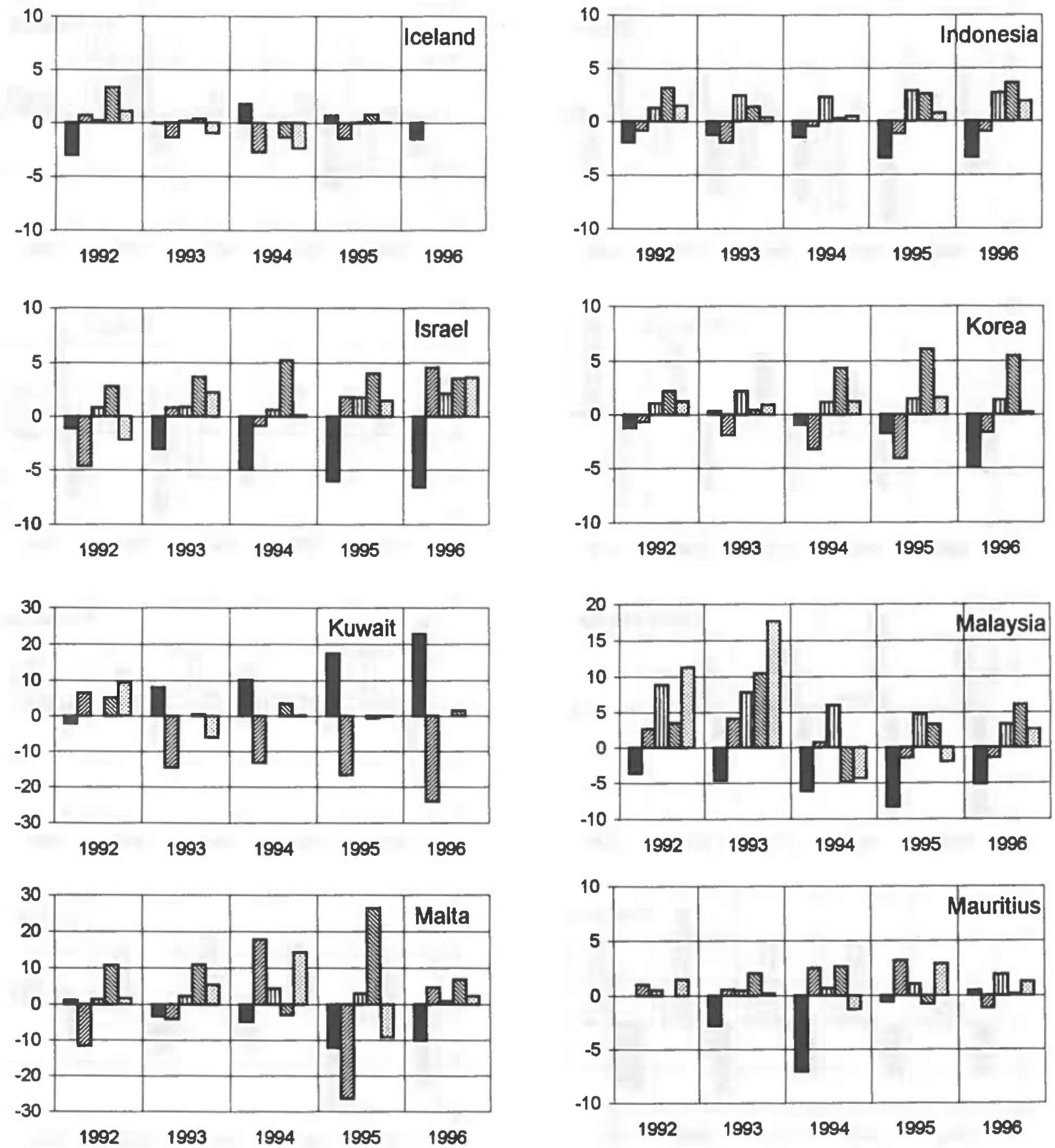
Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▩ =Overall balance. All in percent of GDP. For data sources and definitions see Appendix II.

Figure 2. Group II: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)



Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▩ =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

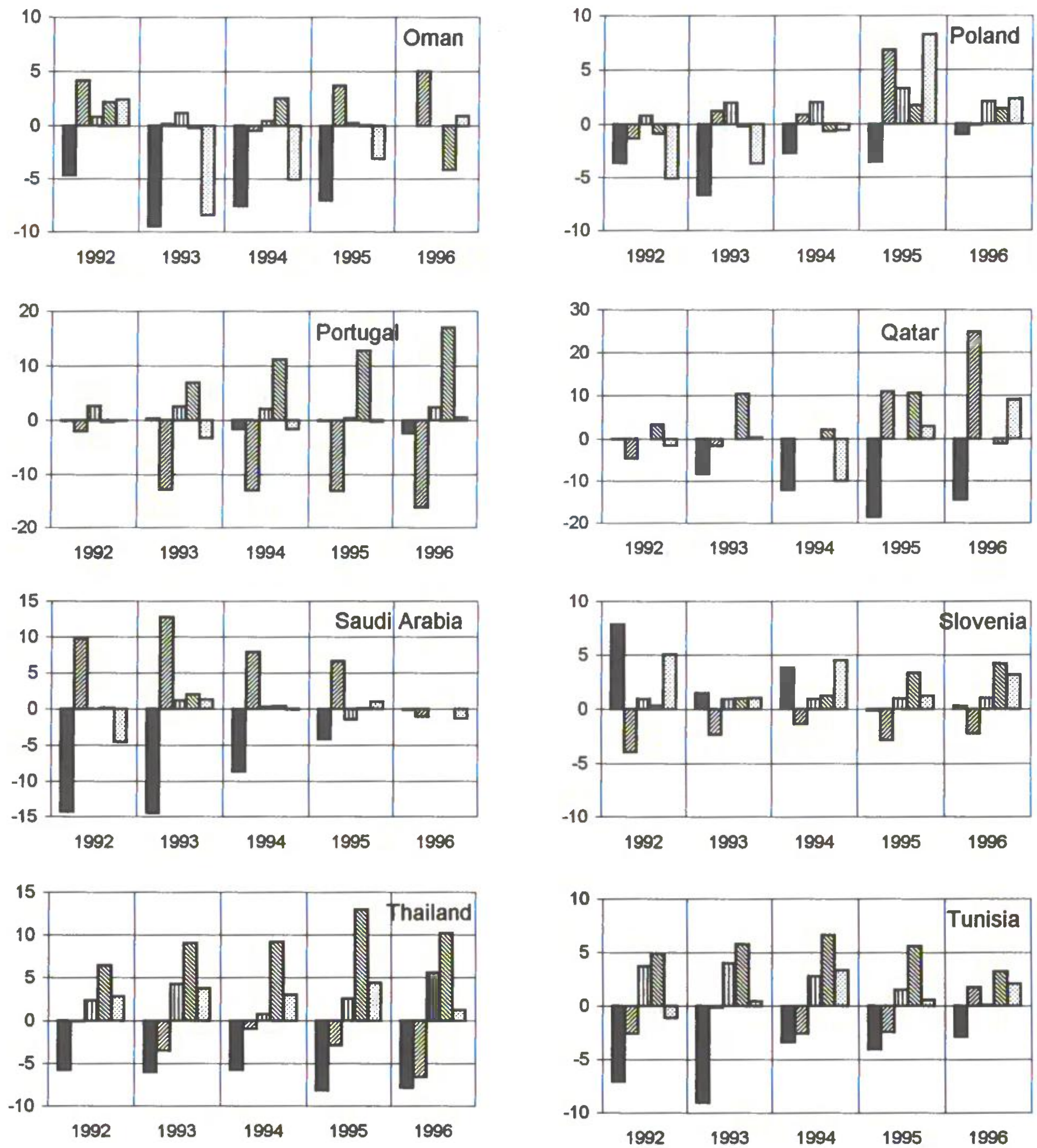
Figure 2. Group II: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)



Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▩ =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

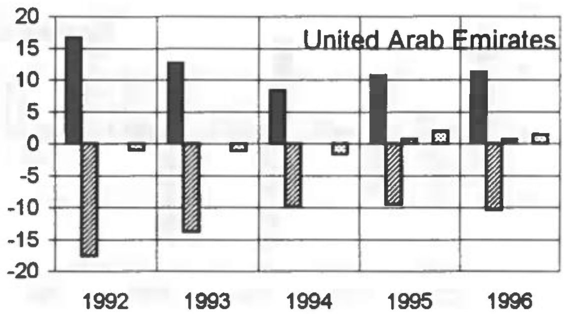
Figure 2. Group II: External Current Account and Structure of Financing, 1992-96

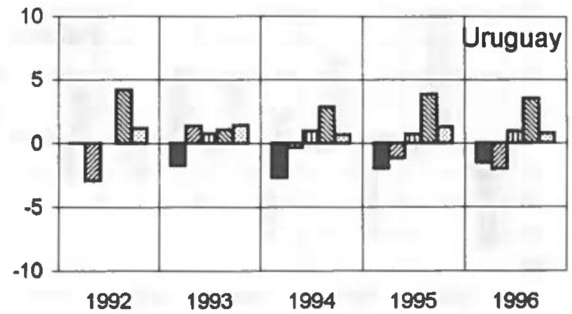
(In percent of GDP)



Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▢ =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

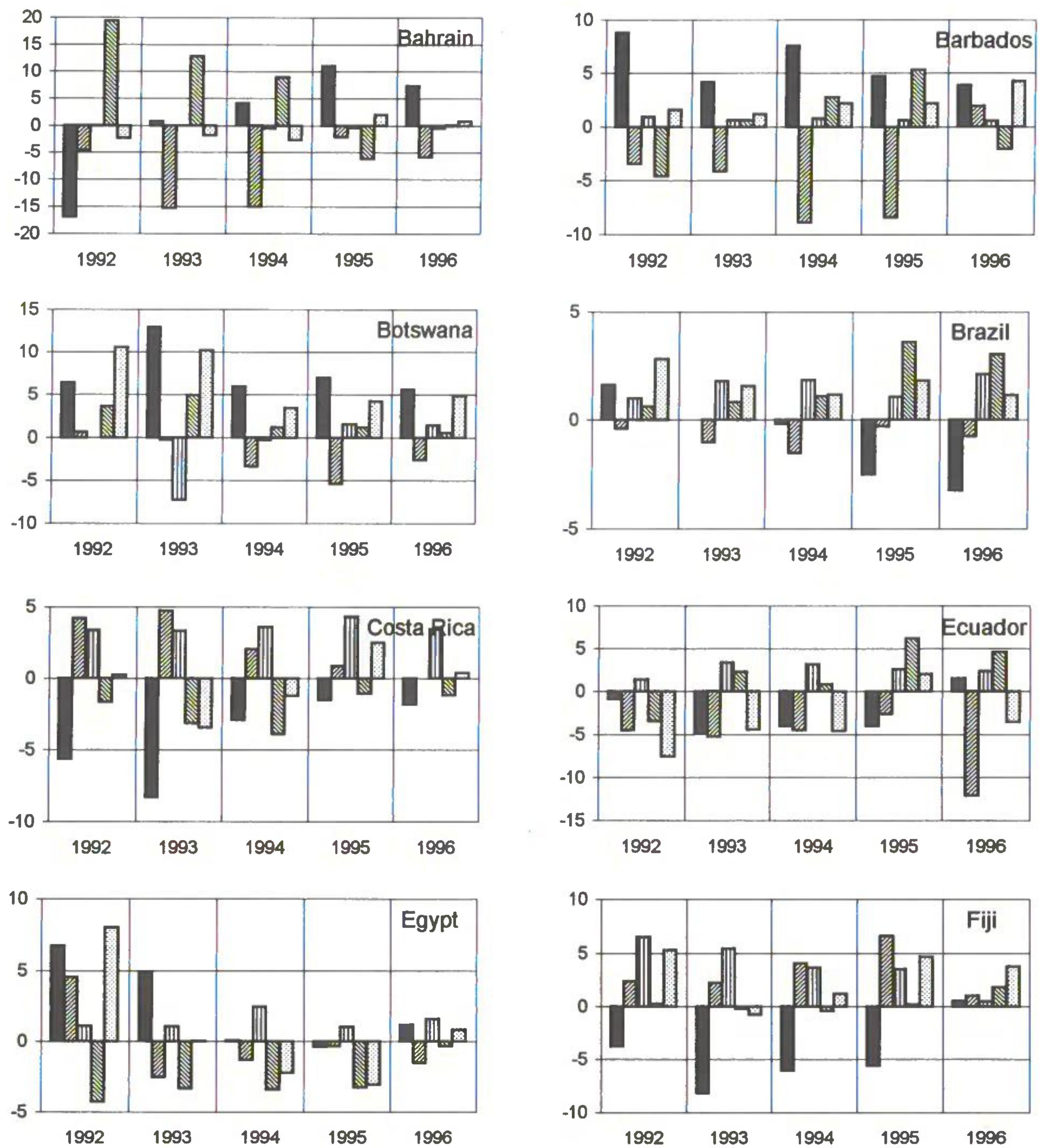
Figure 2. Group II: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)





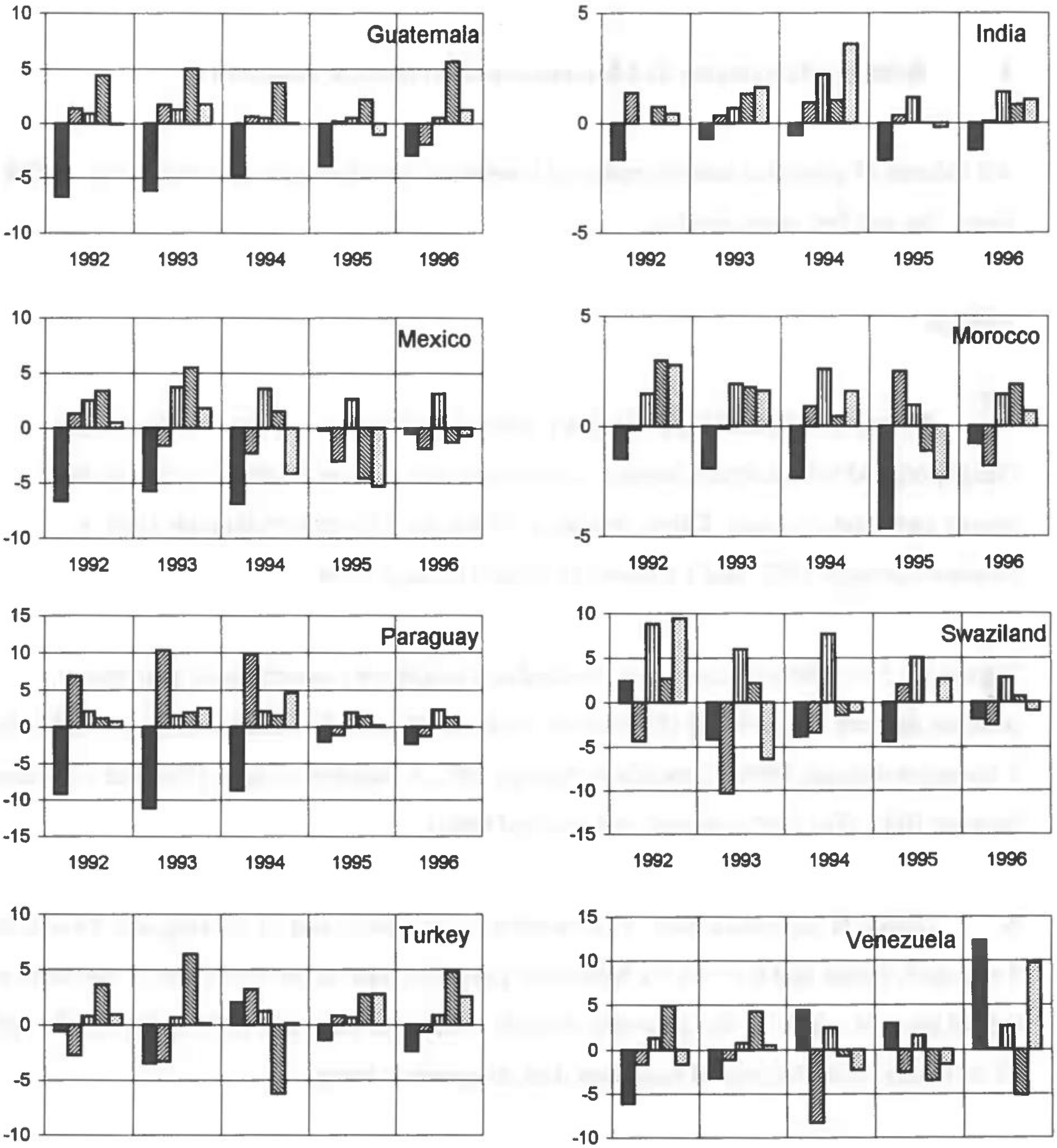
Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▩ =Overall balance. All in percent of GDP. For data sources and definitions see Appendix II.

Figure 3. Group III: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)



Legend: = Current account = Asset transactions =Nondebt flows =Debtflows =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

Figure 3. Group III: External Current Account and Structure of Financing, 1992-96
(In percent of GDP)



Legend: ■ = Current account ▨ = Asset transactions ▥ =Nondebt flows ▧ =Debtflows ▦ =Overall balance.
All in percent of GDP. For data sources and definitions see Appendix II.

Supplementary Indicators: Data Sources and Availability

I. Balance of Payments and International Investment Positions

All balance of payments and international investment positions data are obtained from **IFS** (lines 78s and 79s, respectively).

Groups

A. **Group I** includes 21 industrial and advanced economies. Except for 2 members (Singapore and Switzerland), balance of payments statistics are available in IFS on both annual and quarterly basis. Latest data are available for 17 members through 1996, 4 members through 1995, and 1 member (Norway) through 1994.

Except for 3 members (Luxembourg, Ireland and Singapore), international investment position data are available for 18 members on annual basis only. Latest data are available for 4 members through 1996, 13 members through 1995, 1 member through 1994 and 1 member through 1993. (For further details, see attached table).

B. **Group II** includes a total of 26 members (3 industrial and 23 developing). Except for 2 members (Qatar and the U.A.E), balance of payments data are available for 24 members on annual basis of which 10 are presented through 1996 and 14 through 1995. Of group II, only 13 members report balance of payments data on quarterly basis.

The latest international investment position data are available for 6 members of which 4 members (i.e., the Czech Republic, Iceland, Malaysia, and Slovenia) have data through end-

1995. For the remaining two members (i.e., Colombia and Korea), data are shown through end-1992 and 1994, respectively.

C. **Group III** covers 17 developing members. Except for Lebanon, balance of payments data are reported on annual basis by 4 members (Ecuador, Egypt, Fiji and Turkey) through 1996, 11 members through 1995, and 1 member through 1994. Quarterly balance of payments data are available for 5 members only.

International investment position data are reported by 3 members (Swaziland, Turkey and Venezuela) through end-1995.

Data Definitions

- Current account line 78ald (includes goods, services, income and current transfers, n.i.e.).

- Asset transactions include, capital account (78bcd) + direct investment abroad (78bdd) + portfolio investment assets (78bfd) + other investment assets (78bhd) + net errors and omissions (78cad).

- Direct investment and other non debt flows cover direct investment in reporting economy (78bed) + equity securities (78bmd).

- Debt-creating flows include, other investment liabilities (78bid) + debt securities (78bnd).

- Overall balance of payments (78cbd).

II. Reserves, GDP and External Debt Indicators

- Reserves data for all members are obtained from IFS (line 1. SZF in million of SDRs and converted into U.S. dollars using an end of period exchange rate, i.e., U.S. dollar/SDR rate line sa).

- GDP, Gross Domestic Product at market price. Main source was staff estimates from the World Economic Outlook database (WEO).

- External Debt Outstanding, for industrial members data are not generally available. However, to the extent that data are reported in IFS, external debt were estimated by adding (external liabilities (79led) + other investment (79lfd)). In certain cases, staff estimates were used. For developing members, the main source was staff estimates from WEO.

- Short-term debt. Data were obtained for 45 members from Bank for International Settlements "The Maturity, Sectoral and Nationality Distribution of International Bank Lending," Basle, July 1997, and staff estimates.

- Debt Service. Data were not available for industrial members, except for 4 members where data were based on staff estimates. For developing members, the primary source was staff estimates from WEO. The ratio of debt service to reserves were calculated using reserves in the preceding year.

- Exports of goods and services, data were obtained from IFS (Goods: Exports f.o.b (78aad) + services (78add)).

- Imports of goods and services, data were obtained from IFS (Goods: Imports f.o.b. (78abd) + Services (78acd)).

- Current payments, data were obtained from IFS (Goods: Imports f.o.b. (78abd) + services (78aed) + income (78ahd)).

III. Country Ratings

Country credit ratings were obtained from Moody's Investors Service, Global Credit Research Service, May 27, 1997, and Standard & Poor's Sovereign Reports, Sovereign Ratings History, May 1997.

Table 1. Supplementary Indicators: Balance of Payments and International Investment Positions—Data Availability*

	Balance of Payments		Investment Position
Frequency	Annual	Quarterly	Annual
Group I			
1. Australia	1996	I 1997	1995
2. Austria	1996	IV 1996	1995
3-4. Belgium & Luxembourg	1996	IV 1996	1994 1/
5. Canada	1996	IV 1996	1995
6. Denmark	1996	IV 1996	1995
7. Finland	1996	IV 1996	1996
8. France	1996	IV 1996	1995
9. Germany	1995	I 1997	1995
10. Ireland	1996	IV 1996	...
11. Italy	1996	IV 1996	1996
12. Japan	1996	I 1997	1995
13. Netherlands	1996	I 1997	1995 2/
14. New Zealand	1996	IV 1996	1996
15. Norway	1994	IV 1994	1993
16. Singapore	1995	...	...
17. Spain	1996	I 1997	1995
18. Sweden	1996	IV 1996	1995
19. Switzerland	1995	...	1995
20. United Kingdom	1996	IV 1996	1996
21. United States	1996	IV 1996	1995

* IFS, September 1997.
1/ Belgium only.
2/ Partial coverage.

Table 1. Supplementary Indicators: Balance of Payments and International Investment Positions—Data Availability* (continued)

	Balance of Payments		Investment Position
Frequency	Annual	Quarterly	Annual
Group II			
1. Bahamas, The	1996	IV 1996	...
2. Chile	1996	IV 1996	...
3. China, PDR	1995	...	...
4. Colombia	1995	...	1992
5. Cyprus	1995	...	...
6. Czech Republic	1996	IV 1996	1995
7. Greece	1996	IV 1996	...
8. Hungary	1996	IV 1996	...
9. Iceland	1995	I 1996	1995
10. Indonesia	1995	I 1996	...
11. Israel	1996	IV 1996	...
12. Korea	1995	IV 1995	1994
13. Kuwait	1996	...	...
14. Malaysia	1995	...	1995 1/
15. Malta	1995	...	...
16. Mauritius	1996	...	
17. Oman	1995	...	...
18. Poland	1995	II 1995	...
19. Portugal	1995	IV 1995	...
20. Qatar	...	...	...
21. Saudi Arabia	1995	...	...
22. Slovenia	1996	I 1997	1995
23. Thailand	1995	IV 1995	...
24. Tunisia	1995	...	...
25. United Arab Emirates	...	...	...
26. Uruguay	1996	...	...

* IFS, September 1997.
1/ Partial coverage

Table 1. Supplementary Indicators: Balance of Payments and International Investment Positions—Data Availability* (concluded)

	Balance of Payments		Investment Position
Frequency	Annual	Quarterly	Annual
Group III			
1. Bahrain	1995	...	...
2. Barbados	1995	...	...
3. Botswana	1995	...	1995
4. Brazil	1995	IV 1995	...
5. Costa Rica	1995	...	...
6. Ecuador	1996	...	...
7. Egypt	1996	...	...
8. Fiji	1996	...	...
9. Guatemala	1995	II 1996	...
10. India	1995	IV 1995	...
11. Lebanon	...	...	...
12. Mexico	1995	I 1996	...
13. Morocco	1995	...	...
14. Paraguay	1994	...	...
15. Swaziland	1995	...	1996
16. Turkey	1996	IV 1996	1995
17. Venezuela	1995	...	1995

* IFS, September 1997.

ECO- AM
Press Briefing

Table 1. Western Hemisphere: Selected Economic Indicators

	1992	1993	1994	1995	1996	1997
Percentage Change from Preceding Year						
Inflation (period average)	153.2	212.5	213.9	41.7	20.5	13.5
Real GDP	3.1	3.7	5.0	1.3	3.4	4.1
Real GDP per capita	1.1	1.7	3.2	-0.5	1.6	2.3
Terms of trade	-3.3	-1.4	2.6	3.4	1.3	-1.7
Percent of GDP						
Gross investment	20.4	20.3	20.3	20.0	20.2	20.7
Gross national savings	17.7	17.1	17.3	18.0	18.1	17.4
External current account	-2.7	-3.2	-3.0	-2.0	-2.1	-3.3
Central government deficit	-0.3	-0.3	-0.5	-1.5	-1.5	-1.1
Public sector balance	-0.9	0.0	-1.0	-2.6	-1.4	-1.6
External debt	37.1	35.5	32.7	33.6	32.8	32.2

Sources: World Economic Outlook and Fund staff estimates.

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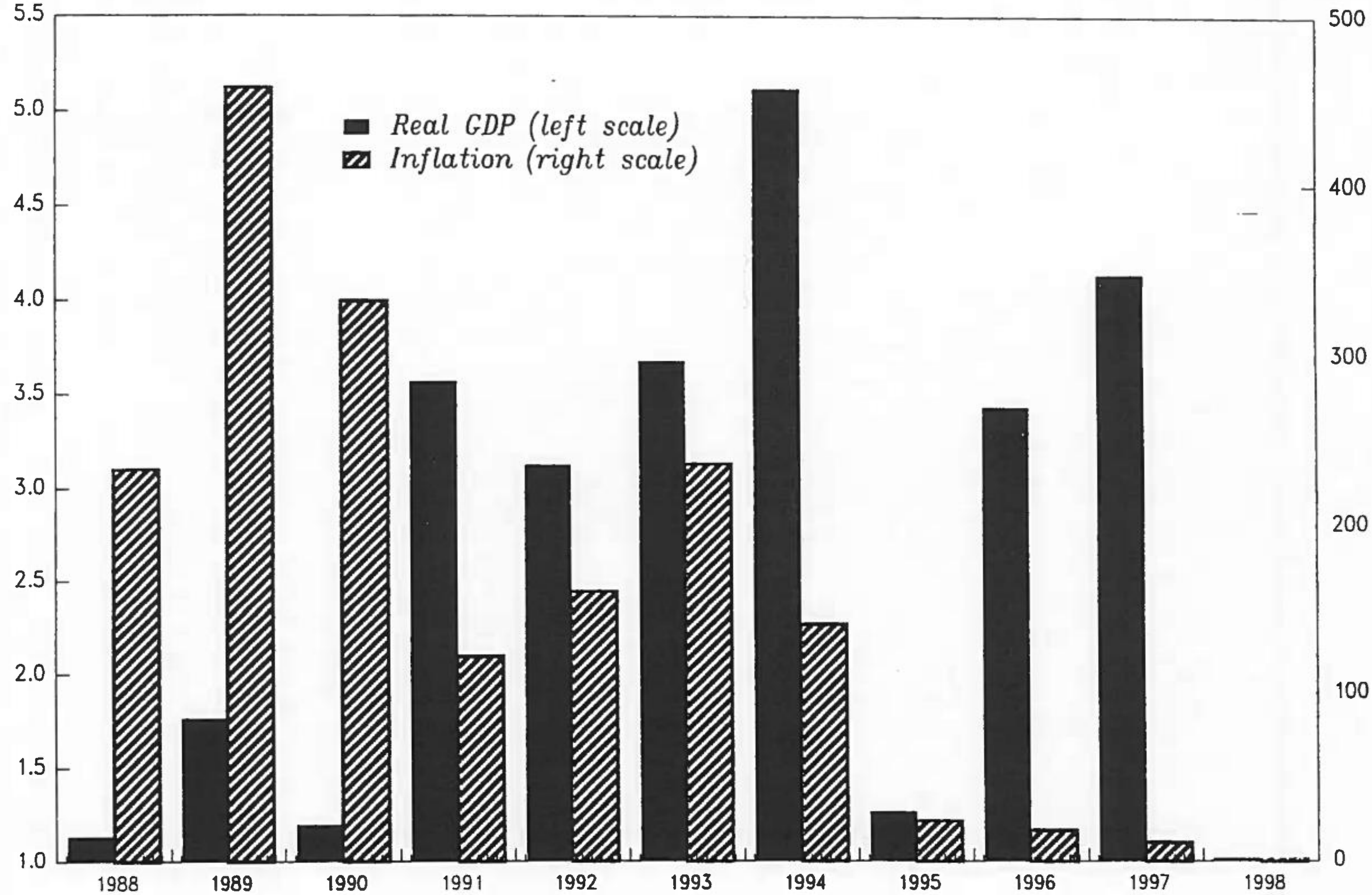
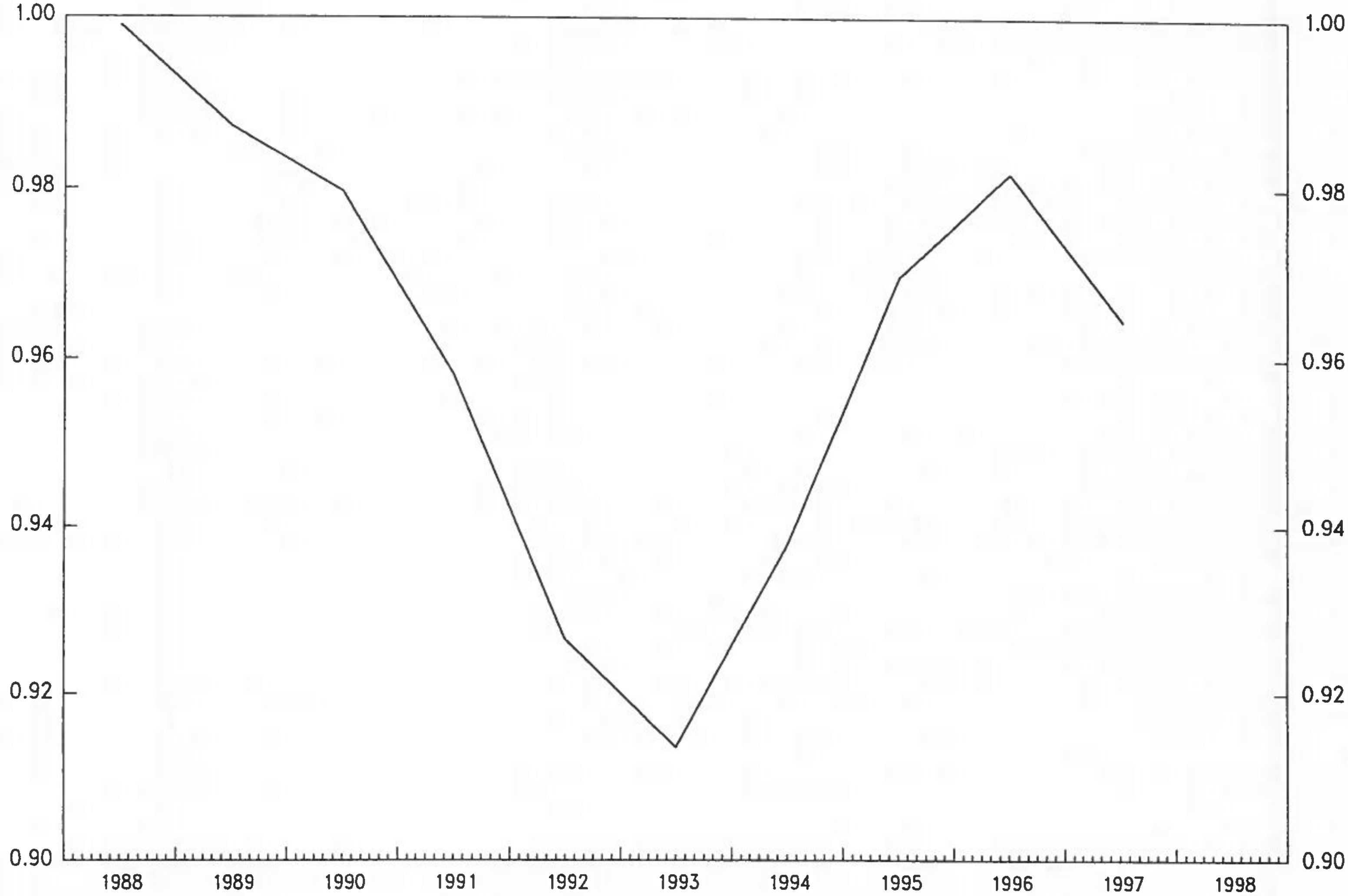
Figure 1
Real GDP and Inflation
(In percentage change)



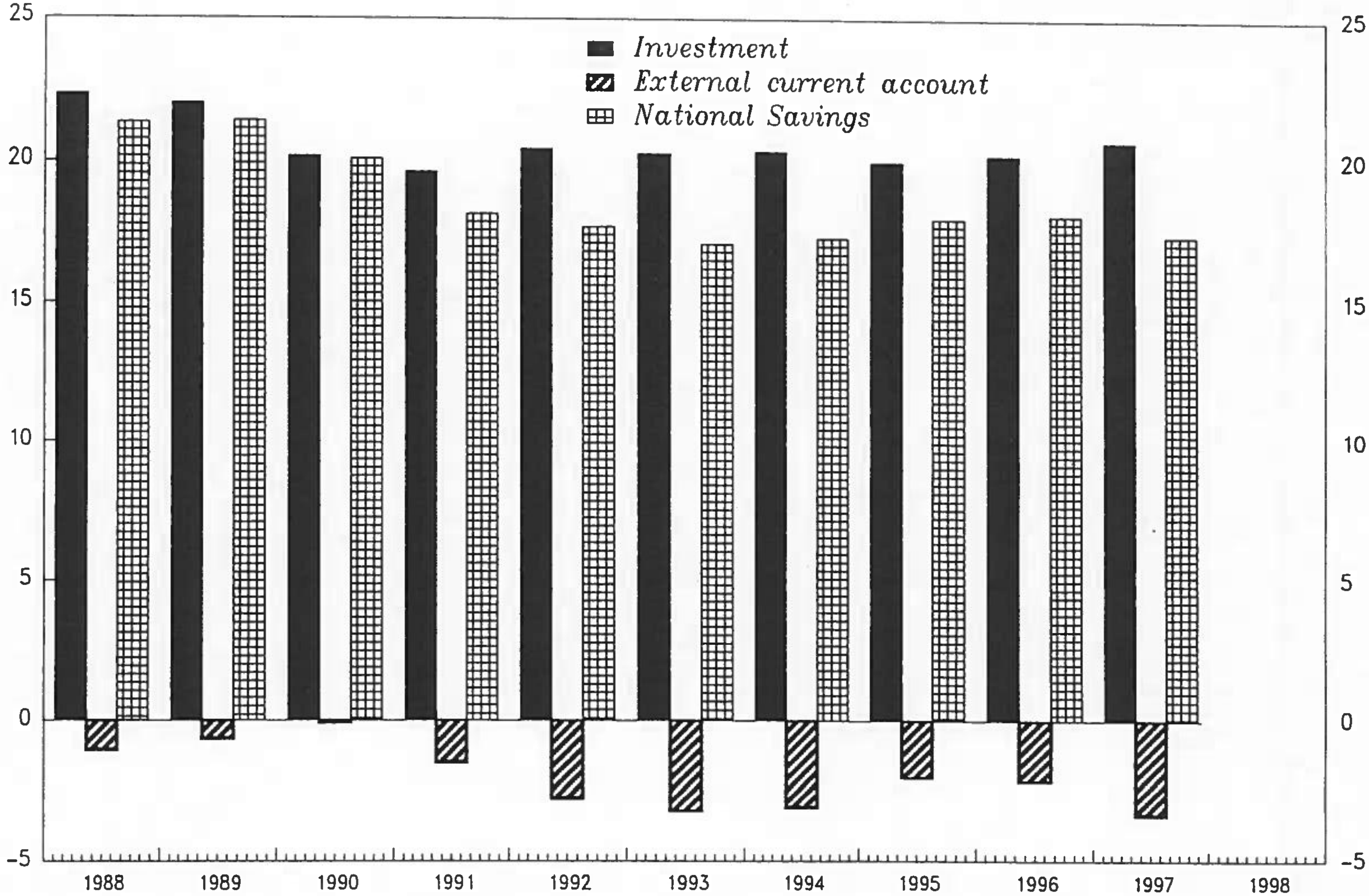
Sources: World Economic Outlook and Fund staff estimates.

Figure 2
Terms of Trade
(In percent)



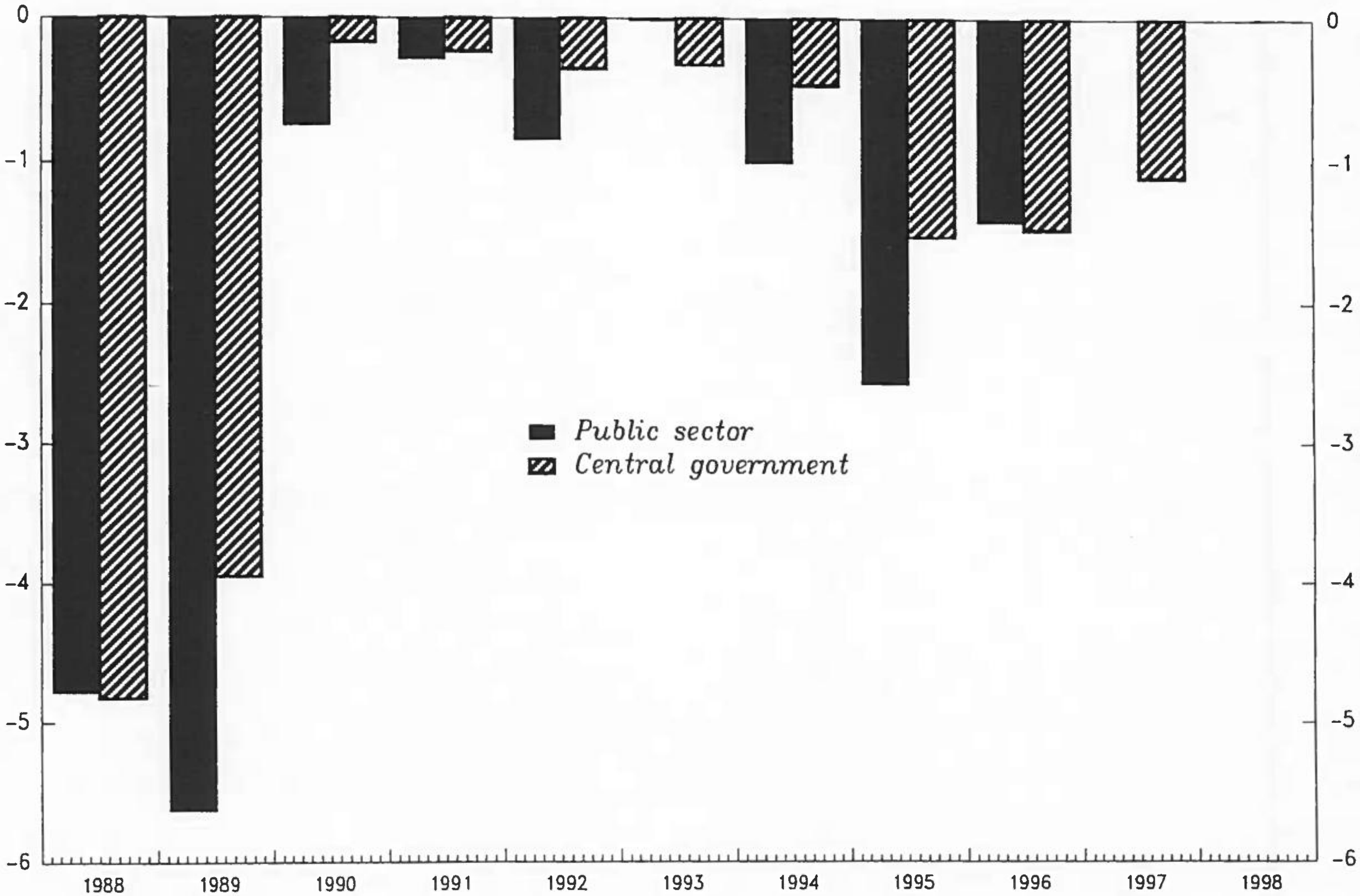
Sources: World Economic Outlook and Fund staff estimates.

Figure 3
Savings and Investment
(In percent of GDP)



Sources: World Economic Outlook and Fund staff estimates.

Figure 4
Public Sector and Central Government Positions
(As a percentage of GDP)



Sources: World Economic Outlook and Fund staff estimates.

Ew - An. mtgs -
Press Briefings

From: Ana Jesus Stevens
To: MLH1S.PO20.HPUENTES
Subject: Response to Question 58-MD Briefing Book

Please see attached file.

CC: ALINDE

Question 58. What is preventing the agreement with Argentina on an EFF?

We have had very fruitful discussions with the authorities and great progress has been made in the formulation of the economic policies and the identification of the structural reforms that will be supported by the extended arrangement.

However, establishing a three year program is not an easy task and it requires time to specify in detail the different measures that form part of such a program.

We have agreement on the overall structure and objectives of the program and have identified the areas of structural reform that the program will emphasize. The latter include, among others, a flexibilization of labor markets along the lines of the agreement the government reached with the unions last May; a tax reform aimed at making the tax system more equitable and conducive to efficiency; and reforms in various social areas (in particular education, health care and social assistance), the financial markets, the actions of the judiciary in the economic area, and governance. Similarly, there is agreement on the broad outline of the financial policies of the next three years, including on the need for expenditure restraint as evidenced in the 1998 budget proposal that has just been submitted to Congress.

Nonetheless, the task is not yet completed and Fund staff continues to work with Argentinean officials on the details of these issues, with a view to finalize the program in a further round of discussions to be held in Buenos Aires later this year. I am following these discussions with great interest and I am satisfied with the progress that has been made so far. I look forward to be in a position to send this program to our Executive Board with my endorsement as soon as possible.

Eco - Annual mtgs - Press Briefs

Office Memorandum

To: Mr. Anjaria

September 8, 1997

From: David Williams DW

Subject: **MD's Press Briefing Book – Questions on Arrears Countries**

In view of recent developments related to the three major areas cases, the attached notes could be added to the MD's Press Briefing Book.

The notes have been cleared with AFR (Congo and Liberia) and MED (Sudan).

Attachments

cc: Mr. Mussa
Mr. Boorman
Ms. Carson
Mr. Calamitsis
Mr. Chabrier
Mr. Deppler
Mr. Gianviti
Mr. Guitián
Mr. Loser ✓
Mr. Neiss
Mr. Odling-Smee
Mr. Quick

DEMOCRATIC REPUBLIC OF THE CONGO

Q. President Kabila's government has taken over in Congo. Do you expect them to honor the debts incurred by the corrupt Mobutu regime?

A. As is well appreciated, the challenges facing the new administration in the Democratic Republic of the Congo are daunting ones.

Following the end of the internal conflict, the authorities have begun extensive stock-taking operations with the aim of preparing a program of economic recovery in the context of normalized relations with the international financial community. In particular, they have indicated their commitment to normalize relations with the Fund.

Fund staff have met with the new administration for a preliminary assessment of the situation and we have noted that the initial emergency measures adopted by the authorities have already had some positive results, including a substantial decline in inflation and a reversal of the previous sharp depreciation of the currency.

The Executive Board has expressed its support for the provision of technical assistance to the Congo for the design and implementation of a comprehensive economic stabilization and recovery program. We are actively engaged in intensifying the dialogue with the authorities to this end, together with other multilateral organizations and bilateral donors.

LIBERIA

Q. President Taylor has formed a new government in Liberia. Will the Fund be prepared to reschedule Liberia's debt under its post-conflict policies?

A. I very much welcome the formation of a new government in Liberia following the national elections. The task of economic recovery in the aftermath of the long civil war is extremely challenging.

I am also pleased to note that one of the first act of the new administration was to establish contact with the Bretton Woods institutions, and, indeed, Fund staff have met with the authorities for a preliminary exchange of views

While the Fund cannot provide new financial resources to the country until its arrears to the Fund are cleared, we are prepared to provide technical assistance and policy advice to Liberia at an early stage to assist in the design and implementation of an economic stabilization and recovery program. We are working very closely with our colleagues in the World Bank and the UNDP in this regard.

SUDAN

Q. In February, the Executive Board said there was a basis for expelling Sudan. Is that still true or has the Board changed its position?

A. In February 1997, the Executive Board decided it would not make a recommendation to the Board of Governors concerning the compulsory withdrawal of Sudan if Sudan met a number of conditions, defined in terms of the adoption and implementation of appropriate economic policies and of payments to the Fund according to a specified schedule.

In the period since February, Sudan has met these conditions and therefore on August 29 the Board again decided to refrain from making such a recommendation.

Sudan is making efforts to demonstrate to the Fund a willingness to improve its cooperation in addressing the problem of the arrears. Since February, Sudan has been implementing policies in the context of a program being monitored monthly by the staff. While much remains to be done, performance under the program has been broadly satisfactory and the Board has urged the authorities to build on this positive momentum by firmly implementing the program in the remainder of this year, and by strengthening policy implementation and payments performance into 1998.

Eco - A. Mtg - Bil Mtg File

Office Memorandum

ACTION

To: Division Chiefs — September 4, 1997

From: A. Linde

Subject: **Annual Meetings—Bilateral Meetings with Management**

1. As regards bilateral meetings with management, so far only **Venezuela, Mexico, and Guatemala** have asked for such meetings, but **Brazil and Argentina** probably soon will follow suit. In addition, Mr. Sugisaki would like to meet with authorities of **Dominica, Paraguay, and Trinidad and Tobago**.

For these eight countries, we should go ahead and prepare the usual special briefs. The briefs should be kept to one page. The principal points which the Managing Director or the Deputy Managing Directors are to make should be displayed prominently (in bullet form). Also, please provide a three or four line summary at the top of the page. The briefs should be accompanied by an economic indicators table formatted along the lines of the one attached.

As usual, IO reviewers should review these special briefs before they are finalized. I would appreciate receiving the **final** version of the briefs for the eight countries by **c.o.b. Wednesday, September 10**.

2. Please, also let me know if authorities of other countries are likely to request meetings with management, or whether such meetings in your view are **essential**. I would appreciate your response on this by **c.o.b. Friday, September 5.**

Thank you.

Attachment

cc: Mr. Cha

VENEZUELA

	1992	1993	1994	1995	Proj. 1996
National accounts			(percent change)		
Real gross domestic product	6.1	0.3	-2.8	2.2	-1.0
Real domestic demand	12.7	-4.8	-9.6	3.5	-3.8
			(percent of GDP)		
Gross domestic investment	23.7	18.8	13.2	15.9	18.6
Gross national savings	17.6	15.0	18.1	18.5	25.8
Prices and unemployment			(percent change)		
Consumer prices (annual average)	31.4	38.1	60.8	59.9	97.4
Consumer prices (end period)	31.9	45.9	70.8	56.6	92.8
			(percent of the labor force)		
Unemployment	7.8	6.7	8.7	10.3	...
Balance of payments			(billions of US$)		
Merchandise exports, f.o.b.	14.0	14.6	15.7	18.6	21.6
Merchandise imports, f.o.b.	12.7	11.4	8.1	11.5	11.6
Interest payments	2.8	2.7	2.8	3.1	2.7
Current account	-3.8	-2.0	2.5	2.0	4.6
Overall balance	-1.2	-0.6	-1.5	-1.1	5.0
Gross official international reserves 1/	13.0	12.7	11.5	9.7	14.3
Net official international reserves 1/	9.2	8.3	7.3	6.2	10.5
			(percent of GDP)		
Current account	-6.1	-3.7	4.9	2.6	7.2
			(percent change)		
Terms of trade (deterioration -)	-20.7	-10.3	0.7	-0.9	6.5
Nominal effective exchange rate (depreciation -)	-10.2	-12.1	-28.5	-18.6	...
Real effective exchange rate (depreciation -)	4.0	4.8	-4.6	25.0	...
External debt			(percent of GDP)		
External public debt (end of year)	53.7	55.3	56.9	43.5	50.0
			(percent of exports of goods and nonfactor services)		
Debt service ratio	22.0	31.3	26.0	27.6	21.8
Interest payments	15.2	14.1	13.7	13.5	10.4
Public sector finances			(percent change)		
Revenue	9.6	42.1	71.1	37.9	186.2
Expenditure	24.3	18.5	143.9	22.5	86.0
			(percent of GDP)		
Current account balance	5.4	8.6	8.3	6.1	15.8
Underlying balance 2/	-6.3	-1.4	-1.2	-4.3	4.3
Overall balance	-6.3	-1.3	-13.9	-8.3	4.7
Money and credit			(percent)		
Deposit rate (per annum) 3/	35.3	54.7	33.5	24.0	...
Lending rate (per annum) 4/	42.7	60.8	55.1	41.0	...
			(percent change)		
Money and quasi-money (M2)	18.6	29.5	56.2	28.7	38.9
Net domestic assets of the banking system 5/	27.3	35.4	62.3	39.2	-16.1
Credit to the public sector (net)	6.8	13.7	47.6	17.3	-53.7
Credit to the private sector	18.9	6.8	-6.2	14.2	34.9

Relations with the Fund (as of August 31, 1997)

Quota	SDR 1,951.3 million
Total Fund credit	SDR 1,678 million (86.0 percent of quota)

1/ Includes only reserves of the Central Bank of Venezuela.
2/ Excluding net assistance to banks.
3/ Commercial banks' average nominal interest rates on 90-day term deposits.
4/ Commercial banks' average nominal interest rates on loans, excluding those for the agricultural sector.
5/ As a percent of liabilities to the private sector at the beginning of the period.

Elo- H. Mtgs - Press briefing

Office Memorandum

To: Mr. Anjaria September 4, 1997

From: David Williams

Subject: **The Managing Director's Press Briefing Book**

Attached are answers on topics directed to TRE. Question 7 on ESAF/Gold as agreed with PDR has already been sent to you. We will send an answer on Question 1 (Quotas) as early as possible next week.

On Question 9, two other bullets on SDRs and Quotas would be required. On SDRs, I would suggest "The Interim Committee will welcome the completion of work on the special one-time allocation of SDRs that would result in an equitable share in cumulative allocations to all members." We will provide the second bullet point on Quotas as soon as possible.

Attachments

cc: Mr. Boorman
Ms. Carson
Mr. Calamitsis
Mr. Chabrier
Mr. Deppler
Mr. Gianviti
Mr. Guitian
Mr. Loser
Mr. Mussa
Mr. Neiss
Mr. Odling-Smee
Mr. Russo

Question 2: What is the status of the equity allocation of SDRs?

☞ **The Executive Board has reached agreement on an amendment of the Articles to provide all members with an equitable share of cumulative allocations of SDRs. The draft amendment will be proposed for adoption by the Board of Governors and, if agreed, will need to be ratified by three-fifths of the membership having 85 percent of the total voting power. The amendment provides for a special one-time allocation of SDRs so as to equalize members' ratios of cumulative allocations to their Ninth Review quotas at 29.32 percent. This will result in an effective doubling in the SDR 21.4 billion of SDRs already allocated. [The Board of Governors will be requested to vote on the draft Resolution on the amendment at the Annual Meetings later this week.]**

- The Interim Committee endorsed the equity allocation approach last September and at its April meeting requested the Executive Board to finalize its work as soon as possible. The Executive Board has now completed its work.

- The main points of the proposed amendment are:

(i) to provide for a special one-time allocation of SDRs to all members that would raise their ratios of net cumulative allocation of SDRs to their Ninth Review quotas to a common benchmark ratio. The agreed ratio is 29.32 percent, which would effectively double the amount of SDRs that have been allocated to date;

(ii) if a participant is in arrears to the Fund at the time it receives the special allocation, the SDRs allocated to the participant would be held in an escrow account in the SDR Department and will be released to that participant upon discharge of all overdue obligations to the Fund. It was also agreed that the escrow mechanism for the special allocation for countries in arrears would not apply to general allocations; and

(iii) the allocation would be based on the quotas agreed under the Ninth General Review, including for those participants that have not yet been able to consent to the increase provided under that review. The Executive Board also agreed that in the future, new participants will be able to share in this allocation on comparable terms.

- It is also important to note that the Interim Committee has emphasized that the proposed amendment would not, in any way, affect the Fund's existing power under the present Articles to allocate SDRs on the basis of a finding of a long-term global need to supplement reserves as and when that need arises.

- I am particularly pleased by this decision of the Executive Board. The special one-time allocation will not only meet its objective of putting all participants in the SDR on the same footing, but will also help revitalize the SDR as a useful monetary instrument. I very much hope that the legislative process needed to put the amendment into effect will be relatively short.

Question 5: When will the NAB come into effect?

☞ **The amount of resources available to the IMF under the NAB will be up to SDR 34 billion (US$46 billion). The NAB will enter into force when 85 percent of the total (SDR 28.9 billion or US$39 billion) is committed, including the five largest creditors of the 25 potential participants in the NAB. Eleven participants (with credit arrangements totaling almost SDR 10 billion) have so far adhered to the NAB Decision.**

- The decision on New Arrangements to Borrow was agreed on January 27, 1997. The NAB enables the Fund to borrow under those arrangements when supplementary resources are needed by the Fund to enable it to respond to financial emergencies.

- A large number of potential participants require legislative approval, including in some cases budgetary approval and authorization, before they can adhere to the NAB decision. These legislative and budgetary actions are in process in a number of countries who have not yet adhered and several are, I understand, well advanced in their domestic processes. I would hope that **the NAB will enter into force in the coming months.**

- The amount available under the General Arrangements to Borrow (GAB) and its associated agreement with Saudi Arabia remains unchanged at SDR 18.5 billion

(US$25 billion). However, the maximum combined amount of outstanding drawings and commitments under the NAB and the GAB cannot exceed SDR 34 billion.

NAB Participants and Amount of Credit Arrangements

(in millions of SDRs)

Australia	810	Luxembourg	340
Austria	412	Malaysia	340
Belgium	967	Netherlands	1316
Canada	1396	Norway	383
Denmark	371	Saudi Arabia	1780
Deutsche Bundesbank	3557	Singapore	340
Finland	340	Spain	672
France	2577	Sveriges Riksbank	859
Hong Kong Monetary Authority	340	Swiss National Bank	1557
Italy	1772	Thailand	340
Japan	3557	United Kingdom	2577
Korea	340	United States	6712
Kuwait	345		

Eo - An. mtgs
Press Briefings

From: Ann Greasley
To: PO13.CCARSON, MLH3S.PO06.FGIANVITI, MLH4S.PO12.JOD...
Date: 9/4/97 3:18pm
Subject: MD's press briefing book -Forwarded

Please find attached, MAE's comments on the MD's Press Briefing Book.

No hard copy will be sent.

CC: MLI2S.PO17.VSAMSON, MLH3S.PO06.SYMAR, MLH3S.PO05.O...

AL

Question 3: What is the status of the proposal to amend the Fund's Articles to give it jurisdiction over the capital account? Given Asia's financial crisis, will the IMF slow down its quest for capital account liberalization?

At its April 1997 meeting the Interim Committee agreed that the Fund's Articles should be amended to make promotion of capital account liberalization a specific purpose of the Fund and to give the Fund appropriate jurisdiction over capital movements. In response to the request of the Interim Committee at that meeting, the Executive Board held a number of discussions with a view to making specific recommendations on the key aspects of the amendment and will report [has reported] to the Interim Committee during the Annual Meetings on the progress and the areas where further work is needed. [The Interim Committee has requested that the Executive Board to complete its work with a view to proposing a draft amendment to the Board of Governors by the time of Committee's next meeting in the Spring of 1998.]

With respect to the second part of the question, the recent developments in the Asian financial markets do not change the basic assessment of the benefits of capital account liberalization. On the contrary, these developments underscore the importance of the appropriate pace and sequencing of capital account liberalization with other structural reforms and the implementation of an appropriate mix of macroeconomic and exchange rate policies. In other words, the Fund is interested in promoting an orderly liberalization of capital movements rather than ad hoc, disorderly liberalization initiatives. That is why Directors have attached particular importance to providing sufficient flexibility under an amendment, through transitional provisions and approval policies, to take account of the varying circumstances of individual members. [Rather than slowing down the Fund's work on the capital account, the recent experiences in Asia serve to underline the need to complete speedily the work on amending the Fund's Articles.]

I would like to emphasize once again that the Fund's objective is not capital account liberalization at any cost, but the orderly liberalization of capital movements. Capital account liberalization provides enormous opportunities and potential benefits in terms of economic growth and welfare, which is why it is worthwhile for countries to face the significant challenges of liberalization. Achieving the benefits and reducing the risks is the central objective of the Fund's role in this area, and the motivation for the amendment to the Fund's Articles of Agreements.

Question 4: What is the IMF doing to deal with increased market turbulence that the emerging markets of Latin America, Eastern Europe, and Asia face because of more open capital markets?

More open capital accounts have well recognized benefits in the form of improved economic efficiency and growth that result from better resource allocation and greater access of newly emerging markets to the pool of global savings. Nevertheless, it is inevitable that as countries participate more fully in expanding global financial markets, private agents will scrutinize more carefully their macroeconomic and structural policies and the soundness of their financial institutions and react when doubts arise about the sustainability of appropriate financial policies or the safety or liquidity of financial assets. The increasing speed and intensity of such reactions, which are a function inter alia of more efficient infrastructure for effecting financial transactions and the degree of global integration of financial markets, constitute one of the costs of more open capital accounts.

In view of the trend toward more open capital accounts, the work of the Fund has emphasized the importance of an orderly liberalization of capital flows through attention to proper sequencing consistent with sound macroeconomic policies and appropriate structural reforms. In particular, the Fund has, in the context of surveillance, emphasized the importance of maintaining a policy mix that would avoid creating the conditions leading to market turbulence. The Fund has also placed increased emphasis on promoting the transparency of member country economic situations and policy frameworks to reduce uncertainty that may give rise to sudden shifts in market sentiment. This includes such actions as establishing a voluntary special data dissemination standard and more recently encouraging member countries to permit on a voluntary basis the public release of information concerning Executive Board assessment of their economic policies under annual Article IV consultation procedures. Furthermore, as part of its multilateral surveillance activities, the Fund staff regularly monitors and assesses developments in international capital markets that affect access of all countries to private market financing, especially the outlook for the terms and conditions of market borrowing and the prospects for other capital market flows. This information is disseminated to the general public through the publication of the International Capital Markets Report.

The Fund has been placing increasing emphasis on supporting the implementation of structural policies aimed at strengthening the efficiency of domestic financial markets and promoting the soundness of financial institutions. This is reflected in actions being undertaken to incorporate financial sector issues as a routine component of its surveillance activities to alert members to potential structural problems. To address structural weaknesses that might hamper macroeconomic management or result in financial sector distress, the Fund also provides advice and technical assistance in the areas of central banking, monetary and foreign exchange management, and financial regulatory frameworks, including assessments of the merits of the use of capital controls. In circumstances where financial sector stress threatens to impair macroeconomic management, financial sector conditionality is often incorporated in Fund-supported adjustment programs and technical assistance has contributed to the design of strategies for systemic reform and restructuring of banks to support the restoration of market confidence.

Question 16: How will the IMF apply the guidelines on best banking practices and will the IMF "go public" when guidelines are not respected?

- The Fund welcomes the efforts of the Basle Committee to establish and publicize best practices in this field. The Basle Committee is clearly well positioned to establish such practices.

- The Fund, in collaboration with the Basle Committee and several other international organizations, is active in propagating regulatory and supervisory best practices as they are established. This we intend to accomplish through our surveillance processes and country programs, supported by technical assistance where needed.

- The Fund's objective is to encourage sound financial systems, and this objective extends beyond better supervision of banks. It includes, among other things, higher standards of competition among banks, as well as of financial disclosure for banks and other financial institutions, proper bank governance and more discriminating use of financial safety nets.

- Recent events in South East Asia indicate how important it is to address financial system weaknesses in time and decisively before crises occur, and underscore that disclosure of accurate information is important to allow markets to perform their proper role. For this reason, the Fund has fostered more transparency in the dissemination of economic and financial data, and on the results of its Article IV consultations.

- Nevertheless, there are clearly limits to what the Fund or countries themselves can or should do to publicize weaknesses in countries' policies.The timing of disclosure is also sensitive. There are instances when disclosure of negative information can damage an already weak financial system, and particularly an unsound banking system. The

Fund must be aware of such situations and refrain from exacerbating them. The best way of avoiding such problems is for countries themselves to provide the markets with regular, timely, and accurate public information about economic policies and developments.

Question 20: Give the financial sector fragility in East Asia, what is the IMF doing to strengthen the banking system in Thailand, Korea (and other specific cases)?

- Financial fragility is not peculiar to East Asia. The recent problems in the region are merely the latest in a long series of cases. Furthermore, the degree of financial sector vulnerability varies markedly between countries in the region.

- In Thailand, the strengthening of the banking system is crucial to reestablishing domestic and external confidence. The IMF, along with the World Bank, have provided and continue to provide technical assistance with the development of a three-part strategy to address weaknesses in financial institutions.

- The first element of the strategy, which has already begun, has been to isolate unviable finance companies from the rest of the financial system. The costs to government of this intervention will be strictly minimized through burden sharing among the various claimants of unviable institutions, starting with a write-down of the capital of existing shareholders and losses for the creditors. Other financial institutions are also being required raise additional capital to meet stricter provisioning requirements.

- The second element of the strategy is to restore confidence in solvent institutions. Accordingly, the government has announced that it stands behind these institutions' obligations to depositors and creditors, and that liquidity support will be provided as necessary. Eventually, a deposit insurance scheme will replace this guarantee.

- The third part of the strategy involves comprehensive institutional reform aimed at strengthening the efficiency, profitability, and competitiveness of the financial system. To achieve this, measures will be introduced to improve internal governance, allow greater competition and play of market forces, and strengthen prudential regulation and supervision.

- In Thailand, the Fund is assisting the authorities to:

    - develop a strategy for the recapitalization of banks that fail to meet the stipulated capital adequacy ratio;

    - develop a system for asset classification and provisioning more in line with best international practices;

    - establish mechanisms for the exit of insolvent and undercapitalized banks and finance companies;

    - set up a system for deposit protection.

- The volatility of capital flows also exposes other countries in the region to risk. The Fund, therefore stands ready to help if the need arises, and is in active discussion with many of them.

Eco - An. Mtgs -
Press Briefing

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
97 SEP -4 AM 9:35

To: Mr. Anjaria — September 3, 1997

F

From: Jack Boorman

Subject: **The Managing Director's Press Briefing Book**

Attached are PDR's contributions towards answering possible questions to be addressed to the Managing Director during the press events connected with the Annual Meetings.

Attachment

cc: Mr. Mussa
Ms. Carson
Mr. Calamitsis
Mr. Chabrier
Mr. Deppler
Mr. Gianviti
Mr. Guitian
Mr. Loser ✓
Mr. Neiss
Mr. Odling-Smee
Mr. Williams
Mr. Russo

Questions for the Managing Directors Press Briefing Book, Annual Meetings, 1997

3. What is the status of the proposal to amend the Fund's Articles to give it jurisdiction over the capital account? Given Asia's financial crisis, will the IMF slow down its quest for capital account liberalization?

- At its April 1997 meeting the Interim Committee agreed that the Fund's Articles should be amended to make promotion of capital account liberalization, a specific purpose of the Fund and to give the Fund appropriate jurisdiction over capital movements. In response to the request of the Interim Committee at that meeting, the Executive Board held a number of discussions with a view to making specific recommendations on the key aspects of the amendment and will report [has reported] to the Interim Committee during the Annual Meetings on the progress and the areas where further work is needed. [The Interim Committee has requested that the Executive Board to complete its work with a view to proposing a draft amendment to the Board of Governors by the time of Committee's next meeting in the Spring of 1998.]

- With respect to the second part of the question, the recent developments in the Asian financial markets do not change the basic assessment of the benefits of capital account liberalization. On the contrary, these developments underscore the importance of the appropriate pace and sequencing of capital account liberalization with other structural reforms and the implementation of an appropriate mix of macroeconomic and exchange rate policies.

In other words, the Fund is interested in promoting an orderly liberalization of capital movements rather than ad hoc, disorderly liberalization initiatives. That is why Directors have attached particular importance to providing sufficient flexibility under an amendment, through transitional provisions and approval policies, to take account of the varying circumstances of individual members. [Rather than slowing down the Fund's work on the capital account, the recent experiences in Asia serve to underline the need to complete speedily the work on amending the Fund's Articles.]

- I would like to emphasize once again that the Fund's objective is not capital account liberalization at any cost, but the orderly liberalization of capital movements. While capital account liberalization provides enormous opportunities and potential benefits in terms of economic growth and welfare, it also entails significant challenges. Achieving the benefits and reducing the risks is the central objective of the Fund's role in this area, and the motivation for the amendment to the Fund's Articles of Agreements.

6. Which countries are now benefiting from the *HIPC Initiative* and specifically how? Which countries will be eligible for the *HIPC Initiative* in the next 12 months and when? How much relief will the Fund provide in total?

NB: NOT FOR USE BEFORE 12 SEPTEMBER AND SUBJECT TO CORRECTION IN THE LIGHT OF THE BOARDS' DECISIONS

- Decisions have been reached by the Executive Boards of the Fund and Bank to provide exceptional assistance under the *HIPC Initiative* for three countries: **Bolivia, Burkina Faso** (decisions in principle made just this September) and **Uganda** (decision in April and recently confirmed by other creditors). Assuming continuing good policy performance, these countries will receive assistance as follows:

			Assistance (in present value at completion point)		
Country	Decision point	Completion point	% reduction in debt	All creditors (US$mn.)	IMF (US$ mn.)
Bolivia	Sept. 97	Sept. 98	13 percent	448	29
Burkina Faso	Sept. 97	Sept. 99	14 percent	106	10
Uganda	Apr. 97	Apr. 98	19 percent	338	69

- The IMF will provide its assistance to these countries in the form of a grant from the ESAF/HIPC Trust to an escrow account which will be used to make debt service payments to the Fund.

- Within the next twelve months, the Boards will likely decide on assistance for a number of other countries. Preliminary discussions have already been held for **Côte d'Ivoire, Guyana** and **Mozambique**, and final decisions on eligibility and assistance could be made by end-97. Countries which could be considered for assistance in 1998 include **Ethiopia, Guinea-Bissau**, and **Mauritania**--dependent of course on agreement on the necessary reform policies.

- On the basis of recent estimates made in July 1997, the **costs to the IMF** of its participation in the *HIPC Initiative* could total US$0.8 billion, in 1996 US dollar terms. However, these estimates rely on a number of assumptions, and final costs will be determined based on country-specific analyses.

7. What is the status of commitments to the Interim ESAF and when will you recommend the sale of IMF gold?

- We are in the process of firming up bilateral pledges to the ESAF and HIPC Initiative (the total funding requirement is now expected to be somewhat higher than the SDR 2.5 billion estimated earlier, reflecting the higher costs of the HIPC Initiative). These pledges and the need to fund upcoming special ESAF commitments to a number of HIPCs will determine whether and when to "optimize the management of the IMF's reserves."

- In February, the Board established the ESAF-HIPC Trust for financing both interim ESAF subsidy operations and special ESAF operations under the HIPC Initiative, and some resources have started to accumulate for these purposes. The total funding requirement of ESAF-HIPC would be somewhat above the SDR 2.5 billion estimated earlier, reflecting revised costs estimates of the HIPC Initiative this summer. While interim ESAF subsidy requirements remain unchanged at SDR 1.7 billion, the costs of the Fund's participation in the HIPC Initiative are expected to increase by over a third.

- Since the agreement on ESAF-HIPC financing in the Board last September, we have had a number of rounds of exchanges with our members to secure their contributions and many have responded favorably. We are in the process of firming up members' bilateral contributions to the ESAF-HIPC Trust, and I trust that during these Annual Meetings decisive progress will be made towards our goal.

- In light of the indications we obtain from members, we will have to assess the need for additional resources. You will remember that last September, the IMF Executive Board agreed on carefully worded compromise language regarding the **"optimization of our reserves management"**, on which a decision would be made only after all efforts to secure maximum feasible bilateral contributions have been exhausted. As you know, such optimization would entail sales of up to 5 million ounces of the IMF's gold and the investment income on the profits of such gold sales would benefit the ESAF-HIPC Trust. Whether and when we will need to return to this issue will depend on the pledges from our members in the not too distant future and the timing of their contributions. I should note also that the ESAF-HIPC Trust will need further resources by around end-1997 to permit the Trust to continue making special ESAF commitments in 1998 to HIPC countries reaching their decision points under the Initiative.

9. What would like to see come out of the Interim Committee meeting?

- The Executive Board has submitted its report to the Interim Committee on the liberalization of capital movements under an amendment of the Fund's Articles. We would hope that the Committee would endorse the report which highlights the progress the Board has made in forging a consensus in this area and indicates those aspects where further work is needed. Such an endorsement could come in the form of a declaration of the Committee solidifying the agreement reached at the Board on the broad outlines of an amendment to make capital account liberalization a specific purpose of the Fund and to extend Fund jurisdiction over capital movements.

- [Renewed commitment to provide the necessary bilateral support for the ESAF/HIPC Trust, which is a crucial element of our strategy of assistance to our poorest members.]

10. Do the IMF's newly published guidelines on good governance mean that the IMF has crossed the line from economics into politics?

- No. Indeed, the guidelines reflect genuine concerns within the Fund that we do **not** stray into political areas outside the Fund's mandate, and are designed to achieve this.

- The new guidelines are very explicit that, consistent with our mandate and expertise, the Fund's involvement will be limited to economic aspects of governance. Thus our involvement will arise principally in improving the management of public resources through reforms covering public sector institutions and administrative procedures, and supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities.

- Furthermore, the Fund's involvement in governance issue within our annual Article IV consultation with all our members and in Fund-supported programs, will be guided by an assessment of whether poor governance has a significant current or potential impact on macroeconomic performance, and on the ability of the government to credibly pursue policies.

11. You have interrupted the program in Kenya because of corruption; would you do so in Thailand, Indonesia, and other East Asian countries?

- The new guidelines state that "financial assistance could be suspended or delayed on account of poor governance, if there is reason to believe it could have significant macroeconomic implications that threaten the successful implementation of the program, or if it puts in doubt the purpose of the use of Fund resources."

- Would we interrupt programs in East Asia? Yes, if the situation warranted it. Indeed, the new guidelines will help us ensure an evenhanded treatment of governance issues relevant to the Fund in all our member countries. [In fact, concerns about the transparency and governance in logging and the use of revenues from this activity has led us to interrupt our program in Cambodia.] Of course, it is my sincere hope that Kenya [and Cambodia] are indeed an exception[s] rather than the rule.

12. Would the IMF be willing to invoke good governance standards in a larger country such as Russia, as it has done in a smaller country such as Kenya?

- The need for good governance is present in all our member countries. Of course, this need and the scope for improvement will differ across our member countries reflecting the great diversity of their situations.

- In considering whether Fund involvement in a governance issue is appropriate, the IMF is guided by an assessment of whether poor governance has a significant current or potential impact on macroeconomic performance in the short and medium term, and on the ability of the government to credibly pursue policies.

- Therefore, if a specific governance issue is found to invoke the above criteria, we would take up the issue with the relevant authorities during the Article IV consultation discussions or in program negotiations, irrespective of the size of the member country.

13. Does your concern with good governance extend to human rights in China?

- Our concern with good governance is limited to its economic aspects. That is whether current or potential impact on poor governance has a significant adverse macroeconomic performance, and on the ability of the government to credibly pursue policies. Our new guidelines, and the Fund's mandate do not allow us to get involve in human right issues.

15. What does the IMF mean by "*the second generation of reforms*" and what are you doing to bring them about?

- The first generation of reforms, that growing number of countries have succeeded in implementing, aimed at restoring basic macroeconomic equilibria and establish more open market-based economies to revitalize their economies. Measures include price decontrol, liberalization of the exchange and trade systems, the introduction of market-determined interest rates, and public enterprise reforms.

- It should be stressed that the Fund continues to attach primary importance to the implementation of sound financial policies: macroeconomic stability is the bedrock of sustainable growth. However, experience shows that one cannot be satisfied with the establishment of sound financial policies: achievement of sustainable economic growth has additional requirements.

- The second generation is geared more toward achieving high-quality growth that would be sustainable over the long term in our ever globalizing world economy. At the core of these reforms is a redefinition of the role of the state as a positive force for private sector activity and growth. In other words, to provide a market framework that is conducive to private sector activity, as well as ensuring a more equitable sharing of the benefits of growth to be the crux of the second generation of reforms.

- This second generation will involve broader and deeper reform. A bold approach is needed that truly set things in motion. It would include the establishment of a simple, transparent regulatory system, a sound financial system, a professional and independent judicial system, and improvement of the quality of resource management and public expenditure, with a focus on human resource development (health and education).

- The growing attention on "second generation of reforms" was reflected in the "Partnership for Sustainable Global Growth" adopted a year ago in Washington by the Interim Committee of the Board of Governors which called for actions that focus on the quality of fiscal adjustment, bolder structural reforms, better governance and strengthened financial systems.

- The Fund, in close collaboration with the World Bank and other international institutions, has been working with its members to foster the adoption of this second generation of reforms; it has done so in the context of its surveillance activities, its provision of financial support to reform programs, and its technical assistance.

- We are already engaged in supporting these types of reforms, and are in the process of strengthening our efforts further, for example, in the area of financial institutions, and our new guidelines on governance. Of course, this does not mean we have completed the first generation of reforms. We must still maintain the emphasis on macroeconomic stability and market-oriented reform as we press ahead into the second generation.

17. **Could you give an update on the *Special Data Dissemination Standard* and the General Data standard? How many countries are now hyper linked on the Data Dissemination Bulletin Board?**

- The Special Data Dissemination Standard (SDDS) was approved by the Executive Board in April 1996 and the companion Dissemination Standard Bulletin Board (DSBB) was launched in August 1996.

- Experience had shown that increasing transparency of economic policies was in the best interests of members, and the Standard was created to guide members —particularly those participating in international capital markets—in the timely provision of economic and financial data to the public.

- The SDDS, which operates in a transition period until end–1998, has attracted substantial interest: At end–August 1997, 42 members had subscribed to the SDDS, of which 34 have already completed the metadata included in the DSBB.

- Recently, efforts have been made to enhance the information on members' statistical practices maintained on the DSBB, by adding hyperlinks to actual country data maintained by national statistical agencies; currently, 9 such hyperlinks have been established—with, among them, a link to economic statistics of Hong Kong, China—and 4 more are expected shortly.

- In March 1997, the Executive Board endorsed proposals on the framework for the General Data Dissemination System, whose primary focus will be to encourage all members to improve data quality and systems for the production and dissemination of statistics. Participation in the GDDS will also be voluntary and should involve provision of metadata to facilitate assessments by data users.

Asia

21. **Do you agree that ASEAN countries should rely on each other for financial support rather than the IMF? Does the IMF advocate creating a *mutual surveillance mechanism in Asia*? What role should China and Hong Kong play in regional monetary cooperation?**

- In an era of global capital markets and open economies, "no nation is an island unto itself"but what is more, "no region is an island unto itself": developments in a given country can be affected and affect developments half-way around the world; international (multilateral) economic cooperation remains as vital today as at the times of the creation of the Bretton Woods institutions more than fifty years ago.

- It is also true that, in certain circumstances, positive or negative “contagion effects” may be mostly felt within one region of the world; countries may thus have a particularly keen interest in economic developments in their own region.

- What does this mean in practice? Multilateral and regional surveillance efforts can complement one another in the promotion of sound policies designed to achieve sustainable growth. Multilateral and bilateral creditors may be able to work together, in times of need, to jointly provide required assistance.

- The financing package assembled in support of Thailand’s stabilization program illustrates the benefits of cooperation between the IMF, ASEAN countries, other countries of the region, and (through the BIS) countries outside the region.

- In this perspective, the Fund favorably views any initiative that aims at strengthening regional surveillance. It has itself been devoting increasing attention to surveillance at the regional level, in Asia and in other regions of the world. In Asia, this process will be facilitated by the opening of a Fund regional office in Tokyo.

- China and Hong Kong are in a position to play an important role in regional monetary cooperation, as has just been seen.

22. **Doesn't the crisis in Thailand show that the *IMF's advance warning system* is still inadequate?**

- The crisis in Thailand did not take the IMF by surprise. For some time, the IMF had been concerned about Thailand's economic policies and had warned the Thai authorities that policies, including exchange rate policy, could prove unsustainable. From this perspective the early warning system was adequate.

- Given that the first pressures in foreign exchange markets were felt long before the latest period of crisis, some market participants appear to have harbored similar concerns for some time.

- The crisis in Thailand cannot be assigned to a lack of warning but a lack of timely action. As an institution founded upon the cooperation and goodwill of it's members, the Fund cannot force national authorities to take our advice against their will.

- Nevertheless, we are not complacent. We are aware that our surveillance procedures must be continuously adapted as the international monetary system itself evolves:

  - The introduction of Press Information Notices (PIN) and the Special Data Dissemination Standard both recently approved by the Executive Board will provide a new channel for dissemination of the IMF's views on the policies of member countries and for the provision of data to the public.

- There does remain the question of the role of the IMF in publicly identifying problems in member countries, including exchange rate misalignments. In considering this question, we must respect a delicate balance between warning a member and making those concerns public against the risks of thereby triggering a crisis. The IMF Board and management will be examining these questions more in–depth.

- In the final analysis, no early warning system can prevent crises from happening altogether. Our objective must be to avert them when we can, and to contain them if they do occur. The latter means preventing crises from becoming long–lasting as well as minimizing their contagion effects. We believe our response to the Mexican crisis ultimately achieved this and our expectation is that the Thai package will do the same.

24. **What lessons can be drawn from Thailand in order to limit future crises?**

- The recent experience of Thailand has shown once again the increased need in a globalized environment for policy makers to respond quickly and forcefully to financial imbalances, policy inconsistencies, and structural weaknesses, especially in their financial systems, in order to avoid financial market reactions that may be quite costly.

- The importance of containing external deficits and reliance on foreign borrowing has been demonstrated once more. And strengthening financial systems has been shown again to be a priority, as weak financial systems increase the vulnerability of the whole economy to domestic and external shocks.

- The Thai experience has shown again that the timely provision of accurate and comprehensive economic and financial data to the public is in the best interest of national authorities: it is conducive to timely policy corrections and has the potential to limit sudden shifts in market sentiment.
- Thailand has reinforced lessons that we already knew and which have been at the root of many of the Fund's recent initiatives to improve the help it gives its members to avoid financial crises (SDDS, financial sector surveillance, capital market focus)

- The support of the international community -including the IMF and regional partners- is important to contain the damage from such crises, including contagion effects on other countries.

Eco - Am. mtgs - Press briefing

F

From: alinde (Hilda Scioville)
To: kwhite, torefice
Subject: WHD--Responses Questions for MD's Press Briefing Book

Please see the attached responses. Note that the response to question 58 on Argentina will be e-mailed to you tomorrow. attached

NON-ASIAN COUNTRY/REGIONAL ISSUES

37. **Should the U.S. authorities raise interest rates further?**

- The performance of the U.S. economy has been outstanding, reflecting the successful implementation of fiscal and monetary policy in recent years. While resource utilization has reached historically high levels, and growth has exceeded potential in recent quarters, at present there is no compelling evidence of rising inflation in prices or labor costs. However, monetary policy must be forward looking if it is to keep inflation low and support the economy's continued expansion.

- Recent data suggest that economic growth has not slowed to a rate more in line with the economy's supply potential as members of the FOMC expected it would. Moreover, the influence of factors that have restrained inflation (including wage restraint, appreciation of the U.S. dollar, and increased external competition with weak growth in other major markets) is likely to wane in the period ahead. Hence, there are significant risks that inflationary pressures could emerge, and they point to the need for the monetary authorities to remain vigilant and to be prepared to raise interest rates further in coming months.

55. What is your assessment of **Mexico's** economic prospects and how urgently is another IMF program needed?

- Mexico's economic prospects are very favorable. Real GDP growth was 7 percent in the first half of 1997 (compared with the same period of 1996). Growth should average about 5 percent in the coming years. Inflation has declined from 52 percent in 1995 to under 20 percent at present. It is expected to reach single digits in the next two to three years.

- This favorable outlook assumes that the government will continue with its sound fiscal and monetary policies. The current round of structural reform is of major significance because it touches two critical areas: the social security regime and the nontradables sector. These reforms will provide an important impetus for further capital market development and lead to increased investment and modernization, ultimately lowering production costs.

- Improved access to international capital markets has permitted the authorities to liquidiate their obligations under the U.S. Exchange Stabilization Fund and make some advance repurchases to the IMF. Through the availability of longer-term credits, Mexico's medium-term debt-service profile has improved considerably and now looks manageable. The IMF stands ready to support Mexico's medium-term stabilization and structural reform efforts, as needed.

56. What is the status of **Venezuela's** relations with the Fund?

- The 12-month stand-by arrangement in support of Venezuela's program of economic adjustment and structural reform launched in April 1996 expired in mid-July this year. The authorities have indicated their interest in entering into a new arrangement covering the remaining period of the administration of President Caldera, which runs through end-1998. For that purpose, since early 1997 the authorities and the staff have been working very closely on a new economic program that could be supported by the Fund, but negotiations have advanced at a slower pace than originally envisaged, due in part to political difficulties. Recently, the authorities took some positive measures in the area of fuel prices, and currently they are refining their fiscal projections for 1998 and the timetable for a new round of important structural reforms with the view of continuing the discussions on the new program after the Annual Meetings. To that end, a Fund mission is expected to visit Caracas in October.

57. What is your view of speculation that **Brazil** may face the next major financial crisis due to the continuous deterioration in its current account balance?

- The Thai crisis is a reminder of the importance of having a sound macroeconomic environment: In this regard Brazil has many strengths: Over the past three years, there has been an impressive reduction of inflation, continued increase in per capita income, a reduction in poverty and growth in investment and productivity.

- However, the current account deficit has grown rapidly, reflecting, in part, insufficient fiscal adjustment. This rapid growth in the current account deficit presents risks for Brazil, makes the country more vulnerable to changes in market sentiment, and thus needs to be arrested, notwithstanding the continued strength of the capital account (especially foreign direct investment) and high level of international reserves.

- First and foremost, the public finances need to be strengthened further. Indeed, there has been significant progress so far this year, but more action is needed to reach the 1997 fiscal target. Moreover, the 1998 budget should aim at a stronger fiscal stance than this year's target, and efforts should be redoubled to get meaningful structural reforms passed in Congress in the fiscal area.

- A stronger fiscal stance will allow for lower interest rates and, together with Brazil's flexible exchange rate policy, for an improvement of the current account while continuing to make progress on the inflation and economic growth objectives.

Question 58. What is preventing the agreement with Argentina on an EFF?

- We have had very fruitful discussions with the authorities and great progress has been made in the formulation of the economic policies and the identification of the structural reforms that will be supported by the extended arrangement.

- However, establishing a three year program is not an easy task and it requires time to specify in detail the different measures that form part of such a program.

- We have agreement on the overall structure and objectives of the program and have identified the areas of structural reform that the program will emphasize. The latter include, among others, a flexibilization of labor markets along the lines of the agreement the government reached with the unions last May; a tax reform aimed at making the tax system more equitable and conducive to efficiency; and reforms in various social areas (in particular education, health care and social assistance), the financial markets, the actions of the judiciary in the economic area, and governance. Similarly, there is agreement on the broad outline of the financial policies of the next three years, including on the need for expenditure restraint as evidenced in the 1998 budget proposal that has just been submitted to Congress.

- Nonetheless, the task is not yet completed and Fund staff continues to work with Argentinean officials on the details of these issues, with a view to finalize the program in a further round of discussions to be held in Buenos Aires later this year. I am following these discussions with great interest and I am satisfied with the progress that has been made so far. I look forward to be in a position to send this program to our Executive Board with my endorsement as soon as possible.

Eco- An. Mtgs - Press Briefings

ACTION

INTERNATIONAL MONETARY FUND
EUROPEAN II DEPT.
27 PM 6:30

Office Memorandum

To: Mr. Mussa
Mr. Boorman
Ms. Carson
Mr. Calamitsis
Mr. Chabrier
Mr. Deppler
Mr. Gianviti
Mr. Guitián
Mr. Loser
Mr. Neiss
Mr. Odling-Smee
Mr. Williams

August 27, 1997

From: S. J. Anjaria SJA

Subject: **The Managing Director's Press Briefing Book**

Attached is a list of possible press questions (Attachment I), answers to which will form the basis of the Managing Director's briefing book for his press events connected with the Annual Meetings. We would like to request that your department suggest responses to the questions indicated in Attachment II. Where more than one department is indicated, may we request that the concerned departments coordinate their suggested responses? Depending on developments, we may send you additional questions or requests for updated responses in the days leading up to the Managing Director's opening press conference, scheduled for September 18, 1997 in Hong Kong.

I would be most grateful if your office could e-mail your contribution, which should aim at concision and be in bullet-point form, to Ms. White (Kwhite) and Ms. Orefice (Torefice) of the Information Division by c.o.b., Wednesday, September 3.

sent to NAD 8/28
MLC
MTD
ATD
RL for comments.

Attachments (2)

cc: Mr. Russo

ATTACHMENT I

Questions for the Managing Director's Press Briefing Book, Annual Meetings, 1997

GENERAL

1. What progress do you expect during the Annual Meetings on the Eleventh General Review of **Quotas**? (TRE)

2. What is the status of the **equity allocation** of SDRs? (TRE)

3. What is the status of the proposal to amend the Fund's Articles to give it jurisdiction over the **capital account**? Given Asia's financial crisis, will the IMF slow down its quest for capital account liberalization? (LEG, MAE, PDR, RES)

4. What is the IMF doing to deal with increased market turbulence that the emerging markets of Latin America, Eastern Europe, and Asia face because of more open capital markets? (MAE/RES)

5. When will the NAB be activated? (TRE)

6. Which countries are now benefiting from the **HIPC** debt initiative and specifically how? Which countries will be eligible for the HIPC initiative in the next 12 months and when? How much relief will the Fund provide in total? (PDR)

7. What is the status of commitments to the interim **ESAF** and when will you recommend the sale of IMF **gold**? (PDR/TRE)

8. What advice do you have for **G-7** finance ministers at their meeting? (RES)

9. What would you like to see come out of the **Interim Committee** meeting? (PDR/RES)

10. Do the IMF's newly published **guidelines on good governance** mean that the IMF has crossed the line from economics into politics? (PDR)

11. You have interrupted the program in Kenya because of **corruption**; would you do so in Thailand, Indonesia, and other East Asian countries? (PDR)

12. Would the IMF be willing to invoke **good governance** standards in a large country such as Russia, as it has done in a smaller country such as Kenya? (PDR)

13. Does your concern with good governance extend to **human rights** in China? (PDR)

14. One year ago the Interim Committee pledged in the **Washington Declaration** "to improve the quality and composition of fiscal adjustment." Has there been any quantifiable success? How can you make sure that countries, both with and without IMF programs, **reduce military spending** and shift resources to social expenditures? (FAD)

15. What does the IMF mean by "the **second generation of reforms**" and what are you doing to bring them about? (PDR)

16. How will the IMF apply the **guidelines on best banking practices** and will the IMF "go public" when guidelines are not respected? (MAE/RES)

17. Could you give an update on the **Special Data Dissemination Standard** (SDDS) and the General Data standard? How many countries are now hyperlinked on the Data Dissemination Bulletin Board (DDBB)? (PDR/STA)

ASIA

18. Is the **financial crisis** in East Asia over? Which countries/sectors have made the most progress in overcoming the crisis and what are the remaining weak spots? (APD)

19. Is the **Asian miracle** over? How will the recent crisis affect Asian growth prospects in 1997 and 1998? (APD/RES)

20. Given the **financial sector fragility** in East Asia, what is the IMF doing to strengthen the banking system in Thailand, Korea (and other specific cases)? (APD/MAE)

21. Do you agree that ASEAN countries should rely on each other for financial support rather than the IMF? Does the IMF advocate creating a **mutual surveillance mechanism** in Asia? What role should China and Hong Kong play in **regional monetary cooperation**? (PDR/RES)

22. Doesn't the crisis in Thailand show that the IMF's **advance warning system** is still inadequate? (PDR)

23. Malaysian authorities have blamed **currency speculators** for sparking and fueling the East Asia crisis. How does the IMF intend to stop them in future? (RES)

24. What **lessons** can be drawn from Thailand in order to limit future crises? (PDR/RES)

25. Does the current **Thai government** have the ability and will to implement the economic program or are further personnel changes needed? Do you expect Thailand to pay back ahead of schedule as Mexico has done? (APD)

26. How long until the **Philippines'** long-awaited graduation from the IMF, after the major set-back caused by the regional currency crisis? (APD)

27. What advice is the IMF giving **Indonesia** on macroeconomic stability and structural reform, and are they heeding it? (APD)

28. Do you expect further pressure on the **Hong Kong dollar**, and would you agree that the HK dollar should remain pegged to the US dollar? (APD)

29. Do you expect the recent **exchange rate volatility** to continue affecting the currencies of Korea, Malaysia and Singapore? (APD)

30. How has the handover affected the economies of **Hong Kong** and **China**? (APD)

31. Apparently many IMF staff are unhappy about **Mr. Hong**'s continuing plight. What is the status of your discussions with the Chinese authorities and what actions do you intend to take? (APD/LEG)

32. What do you think about **Taiwan** joining the IMF, and what is required?(APD)

33. Is **North Korea** preparing to join the IMF, and what is required? (APD/SEC)

34. How do you assess the pace of reform in **India** currently? (APD)

35. Do you expect talks with **Bangladesh** to lead to an ESAF? (APD)

NON-ASIA COUNTRY/REGIONAL ISSUES

36. Are the **G3 exchange rates** in line with fundamentals? (RES)

37. Should the **US** authorities raise interest rates further? (WHD/RES)

38. How urgent is the task of fiscal consolidation in **Japan**? (APD/RES)

39. Do you expect **Germany** to qualify for EMU? (EU1/RES)

40. How will the **French** government's policies affect qualification for EMU? (EU1/RES)

41. Is **Italy** doing enough to qualify for EMU? (EU1/RES)

42. Will EMU be **delayed**? If so, do you expect the **UK** to join? (EU1/RES)

43. How is the IMF preparing for EMU and how will **IMF exercise surveillance** over the "ins" and the "outs"? (EU1/RES)

44. Are EU countries making progress in tackling the problem of **structural unemployment?** What policy advice is the IMF offering in this area? (EU1)

45. When will real growth materialize in **Russia**? How confident are you that an acceptable 1998 budget will be agreed? (EU2)

46. What must **Ukraine** do to move from the stand-by to an EFF and don't you fear that the upcoming elections will make an EFF impossible? How does the failure to agree an EFF affect the Donors' pledge of US$3.5 billion for 1997? (EU2)

47. In **Romania** there have been serious public demonstrations against the IMF and the authorities backtracked on closing several state-owned enterprises. How does this affect Romania's economic program and what other weaknesses are there? (EU1)

48. Please comment on the IMF's role in prompting Romania to suspend a major purchase of Bell helicopters. Will you take a similar tough line on the other NATO applicants that intend to update their military to **NATO** standards? (EU1).

49. What is the status of the program with **Bulgaria**? (EU1)

50. How long until the Federal Republic of **Yugoslavia** joins the IMF? (EU1/LEG)

51. What is holding up an agreement between **Bosnia** and the IMF? (EU1)

52. What are the conditions and timing for **Albania** to enter a Fund-supported program, and is replacement of the Central Bank head a requirement? (EU1)

53. How soon do you expect **Turkey** to enter a Fund program? (EU1)

54. What is the status of a program with **Pakistan**? (MED)

55. What is your assessment of **Mexico**'s economic prospects and how urgently is another IMF program needed? (WHD)

56. What is the status of **Venezuela's** relations with the IMF? (WHD)

57. What is your view of speculation that **Brazil** may face the next major financial crisis due to the continuous deterioration in its current account balance? (WHD)

58. What is preventing the agreement with **Argentina** on an EFF? (WHD)

59. Do you expect **South Africa** to seek a Fund program this year and would corruption be a concern? (AFR)

60. When do you expect to resume ESAF negotiations with **Kenya**? (AFR)

ATTACHMENT II

	AFR	APD	EU1	EU2	FAD	LEG	MED	MAE	PDR	RES	SEC	STA	TRE	WHD
1													+	
2													+	
3						+		+	+	+				
4								+		+				
5													+	
6									+					
7									+				+	
8										+				
9									+	+				
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21									+	+				
22									+					
23										+				
24									+	+				
25		+												
26		+												

August 27, 1997

	AFR	APD	EU1	EU2	FAD	LEG	MED	MAE	PDR	RES	SEC	STA	TRE	WHD
27		+												
28		+												
29		+												
30		+												
31		+				+								
32		+												
33		+									+			
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55														+

August 27, 1997

	AFR	APD	EU1	EU2	FAD	LEG	MED	MAE	PDR	RES	SEC	STA	TRE	WHD
56														+
57														+
58														+
59	+													
60	+													

August 27, 1997

Eco - A. Mtg - Press Briefs

CL
TTH
BCS
FvB
SD
CM

Office Memorandum

To: Heads of Departments, Bureaus and Offices

April 18, 1997

LP
TR
EW
~~IO~~
~~F~~

From: fr S.J. Anjaria (MA

Subject: **Press Briefing Book**

Attached is the Managing Director's briefing book for his contacts with the press in the days ahead.

Attachment

Managing Director's Press Briefing Book
April 1997

Contents

1. What progress do you expect during the Spring Meetings on the Eleventh General Review of Quotas? Does improved IMF liquidity reduce the need for a quota increase?

☞ **The Executive Board concluded technical aspects; there is progress on the distribution of ad hoc quota increases. We look forward to Interim Committee guidance on the size of a quota increase. Current IMF liquidity (120 percent) does not reduce the medium-term need for quotas to reflect growth of world economy, and the need to manage unexpected crises and impact of capital account convertibility.**

- Since the 1996 Annual Meetings, the Executive Board has made further progress on the Review and has concluded technical considerations. It has also made progress on the issue of the distribution of quota increases, including broad agreement for a number of ad hoc increases for members whose quotas are far out of line with their relative positions in the world economy. There has also been a narrowing of views on the size of the equiproportional element and on the way the selective element may be distributed. The size of the quota increase needs further work and we look forward to the Interim Committee's guidance on this.

- The Executive Board has also agreed to consider further the issue of **basic votes** in the IMF when we conclude the quota review. I am hopeful that the Interim Committee could ask the Executive Board to submit appropriate proposals during the next Annual Meetings. I am confident we can complete the quota review in a timely fashion.

- The **IMF's liquidity position** and financing needs have recently been reviewed by the Executive Board. The current position is strong with the liquidity ratio on the order of 120 percent. Although the IMF's liquidity position has strengthened considerably since September 1996, Executive Directors feel that the current strengthening does not reduce the need for an increase in quotas. The adequacy of IMF quotas should be considered in a medium-term context. Major uncertainties lie ahead, before the quota increase would come into effect. Furthermore, many Directors feel the need to bring quotas better into line with the growth of the world economy and to better reflect members' relative economic positions. The impact of capital account convertibility and the IMF's ability to deal with unexpected crises from its own resources must also be taken into account. While not all Directors have come to a firm view on the size of the quota increase or its distribution, there is no dissent from the view that the quota review aims to ensure that the IMF's resources are adequate to meet the challenges of the globalized economy in the early years of the 21st century.

2. Will the Meetings agree on an equity allocation of SDRs, and, if so, of what size?

(TRE will provide text after April 23 Executive Board Meeting)

3. Can you bring us up to date on a proposal to amend the IMF's Articles to give it jurisdiction over the capital account?

☞ **Broad agreement in the Executive Board for amending Articles to make capital account liberalization a mandate of the IMF. A specific amendment may be ready for the fall meeting of the Interim Committee.**

- The question of an amendment of the IMF's Articles to reflect the increased importance of international capital movements is being actively considered by our Executive Board. At this juncture, there is a considerable meeting of the minds on a number of broad principles:

  - There is **broad agreement in favor of amending the IMF's Articles** to make promotion of capital account liberalization a mandate of the IMF.

  - There is a general sentiment in support of **giving the IMF jurisdiction over an appropriate set of capital account payments and transactions** closely related to its role in the international monetary system.

  - There is strong consensus that any amendment of the Articles should allow for **sufficient flexibility**—through transitional provisions and approval policies—to help ensure that capital account liberalization is orderly and sustainable, and that members can impose temporary restrictions in dealing with destabilizing surges of capital inflows and outflows.

  - The Executive Board has submitted its report to the Interim Committee indicating the progress made to date. Depending upon the recommendations of the Committee, the Executive Board is expected to consider specific proposals for an amendment of the Articles over the next few months with a view to making specific recommendations on an amendment, possibly before the next meeting of the Interim Committee.

4. **On the NAB, what is still missing for it to enter into force, and when will it?**

☞ **NAB enters into force when 85 percent of the total (SDR 28.9 billion or US$40 billion) is committed, including five largest creditors. Process of legislative/ budgetary approval is now occurring, with six participants in place to date. I hope NAB will enter into force in the coming months.**

- As you know, the Executive Board adopted a decision on New Arrangements to Borrow on January 27, 1997. The decision was taken in the light of the agreement by the **25 potential participants** in the NAB on the terms and conditions under which they will be prepared to make loans to the IMF when supplementary resources are needed to enable the IMF to respond to financial emergencies. The amount of resources available to the IMF under the NAB will be **up to SDR 34 billion**.

- The NAB will enter into force when potential participants with credit arrangements amounting to 85 percent of the total or no less than SDR 28.9 billion, including the five members or institutions with the largest credit arrangements, have adhered to the decision.

- So far six of the participants have indicated adherence to the IMF's decision. (Their credit arrangements in the NAB total about SDR 3.5 billion--cannot divulge which six countries.)

- **Most potential participants require legislative approval**, including in some cases budgetary approval and authorization, before they can adhere to the NAB decision. These legislative and budgetary actions are in process in a number of countries and will take some time to complete. I would hope, nevertheless, that **the NAB will enter into force in the coming months**. The amount available under the General Arrangements to Borrow (GAB) and its associated agreement with Saudi Arabia remains unchanged at SDR 18.5 billion (US$26 billion). So, the NAB, together with the GAB, will provide an important backing to the financial resources that are available to the IMF.

NAB Participants and Amount of Credit Arrangements
(in millions of SDRs)

Australia	810	Luxembourg	340
Austria	412	Malaysia	340
Belgium	967	Netherlands	1316
Canada	1396	Norway	383
Denmark	371	Saudi Arabia	1780
Deutsche Bundesbank	3557	Singapore	340
Finland	340	Spain	672
France	2577	Sveriges Riksbank	859
Hong Kong Monetary Authority	340	Swiss National Bank	1557
Italy	1772	Thailand	340
Japan	3557	United Kingdom	2577
Korea	340	United States	6712
Kuwait	345		

5. When do you expect to see implementation of the debt initiative for HIPCs and for which countries? How do you react to criticism that the IMF is dragging its feet over this issue and is not being sufficiently generous? How much relief will the IMF provide?

☞ **On April 21 and 22 IMF and Bank Executive Boards approved Uganda's eligibility under HIPC, and in April 1998 Uganda will receive $US400 million in assistance from the international community. Assistance to Bolivia, Burkina Faso and Côte d'Ivoire is being discussed soon.**

- I am very pleased to be able to say that implementation of this extremely important Initiative has well and truly begun. The Executive Boards of the IMF and Bank approved on April 21 and 22 Uganda's eligibility for assistance under the Initiative for Heavily Indebted poor countries. The international community is committed to provide nearly US$400 million of assistance to Uganda in April 1998, subject only to Uganda's continuing strong performance.

- The Executive Boards have also had preliminary discussions on assistance for **Bolivia, Burkina Faso, and Côte d'Ivoire** and I expect we shall have decisions soon on these countries.

- Are we dragging our feet? If you were on my staff working on the HIPC Initiative you might not think so. However, the **devil is in the details**, and we have been working to reach **acceptable compromises** on these details as quickly as we can.

- The Initiative aims to ensure an exit from unsustainable debt burdens and reschedulings for HIPCs with sustained records of adjustment and reform. The Initiative is **not a substitute for aid**: many HIPCs will continue to need further reforms and continuing concessional assistance from bilateral and multilateral agencies.

- On the IMF's own contribution to the HIPC Initiative, I want to reemphasize our very strong support for the Initiative, and commitment to provide our share of assistance for each qualifying country. The **IMF's own contribution will be principally in the form of grants**, or exceptionally, in the form of highly concessional loans where particular help is needed to meet large debt-service payments.

6. What is the status of commitments to the interim ESAF? When will you recommend the sale of a portion of the IMF's gold?

☞ **Bilateral contributions of member countries toward total funding requirement of SDR 2.5 billion (US$3.5 billion) will determine whether to optimize our reserves management.**

- In early February, the Executive Board established the ESAF-HIPC Trust for financing both Interim ESAF subsidy operations and Special ESAF operations under the HIPC Initiative, and resources have started to accumulate for these purposes. Our current estimates for the **total funding requirement for the ESAF-HIPC** initiatives is on the order of **SDR 2.5 billion** (US$3.5 billion).

- Following the agreement in the Executive Board last September, the membership is fully committed to securing the financing for the ESAF and HIPC Initiative. We are in the process of **firming up member countries' bilateral contributions to the ESAF-HIPC Trust**, and I trust that we will make considerable progress on this during these Spring Meetings.

- In light of the indications we obtain, we will have to evaluate whether there is a need for additional resources. You will remember that last September, the IMF Executive Board agreed on carefully worded compromise language regarding the **"optimization of our reserves management"**, on which a decision would be made only after all efforts to secure maximum feasible bilateral contributions have been exhausted. As you know, such optimization of reserves management could entail sales of **up to 5 million** ounces of the IMF's gold, with investment income on profits of such gold sales being used for the benefit of the ESAF-HIPC Trust. Whether and when we will need to return to this issue will **depend on the pledges from our members** in the not too distant future.

7. **Has the SDDS worked out as expected and are there electronic links to country data yet? What is the progress on the General Data standard?**

☞ **42 countries now subscribe to the Special Data Dissemination Standard and links between the DSBB and country data are now opening. Last month the Executive Board agreed on the General Data Dissemination System aimed at improving data quality for all 181 member countries; it should be working by September 1997.**

- The response of the membership to the SDDS has been most encouraging. To date we have had 42 subscriptions (see box), which is largely in line with our early expectations. Over time, we expect the number to grow.

- Just as important as the numbers is the fact that those who have signed up are clearly taking the obligations that come with subscription very seriously. For a number of them, we have already seen improvements in practices as these countries make use of the transition period to move closer toward full observance of the standard.

- We have just opened the first electronic links between the DSBB and country economic data available on members' own Internet sites. These links will permit users to move quickly and easily between the DSBB and the actual data. Many subscribers have indicated their intention to develop such links in the near future.

GDDS

- Last month the Executive Board agreed on the framework for the General Data Dissemination System, which is aimed at improving data quality and systems for the production and dissemination of statistics for *all* members. Work on the General System will be completed soon, with the goal of putting it in place by September 1997.

Subscribers to Special Data Dissemination Standard (SDDS)

Argentina*	Croatia*	India	Latvia	Philippines*	Sweden*
Australia	Denmark*	Indonesia	Lithuania*	Poland*	Switzerland*
Austria	Finland*	Ireland*	Malaysia*	Singapore*	Thailand*
Belgium	France*	Israel	Mexico*	Slovak Republic	Turkey*
Canada*	Germany	Italy	Netherlands*	Slovenia*	United Kingdom*
Chile*	Hungary	Japan*	Norway*	South Africa*	UK-Hong Kong
Colombia	Iceland	Korea	Peru*	Spain	United States*

*indicates subscribers for which metadata are posted on the DSBB.

8. What advice do you have for G7 finance ministers at their meeting on the margin of the Spring Meetings?

☞ **Further efforts toward sustainable budgets concerns all of G7 countries. Labor and market rigidities concern the Europeans; liberalization concerns Japan.**

- **Global economic conditions are generally favorable**. Among the major industrial countries, cyclical conditions and policy requirements differ considerably. The **United States** and the **United Kingdom** are in relatively advanced stages of expansion and face the challenge of preventing an upturn in inflation, and it seems likely that in both countries monetary conditions will need to be tightened further during the year to **contain inflationary risks**. In **Canada**, a strong recovery is underway, but considerable **slack remains**. In **Japan**, the recovery has gained momentum, but **confidence remains fragile** and weaknesses in the financial sector are still of concern; monetary policy should continue to support the recovery while the government proceeds with its necessary fiscal consolidation. In **continental Europe**, while prospects for stronger growth have improved, **unemployment rates have reached record highs**, and monetary conditions need to remain supportive.

- Considerable progress has been made in reducing fiscal imbalances in most G7 countries in recent years, and considerable further progress is expected--and needed--this year. Particularly notable are the efforts of EU members to meet the Maastricht criteria, and the actions of the Japanese authorities to begin restoring a sustainable budgetary position. I would advise the **EU finance ministers to persevere with their efforts to meet the Maastricht targets**, not only for the sake of EMU, but also because their countries need improved budgets. In the case of **Japan**, I would say that **correction of their fiscal imbalance** is essential, even though there may be need for some flexibility in the consolidation program if the economic recovery falters. Additional efforts will be needed to balance budgets over the medium term. In the **United States**, the Administration and Congress need to agree on and to implement quickly the measures required to meet their objective of **balancing the federal budget by FY 2002**. In **Canada**, the Government needs to continue to hold to its planned fiscal policy course, which would **balance the federal budget at least by 2000**.

- In **continental Europe, labor market rigidities** will need to be tackled more vigorously for the high levels of unemployment to be reduced significantly over the medium term. Also, in **Japan**, the authorities have made it clear that they appreciate the need for **further liberalization** of their economy.

- The current constellation of exchange rates reflects, in part, divergent cyclical positions. **Movements of the major currencies in recent months have generally been helpful in redistributing world demand toward those economies with relatively weak cyclical positions.** Assessments of the implications of these exchange rate changes for current account positions should take into consideration that some of the recent exchange rate movements will tend to be reversed as cyclical positions adjust.

9. What would you like to see come out of the Interim Committee meeting?

☞ **Cooperation to strengthen fragile financial systems and structural reform; liberalization of capital flows; preparation for EMU.**

- The strategy set out in the Interim Committee's September 1996 **Declaration on Partnership for Sustainable Global Growth** has served as a valuable guidepost for progress in policy implementation. Progress has been achieved in a number of areas, notably in maintaining **price stability in industrial countries**. On the other hand, structural reforms remain high on the agenda in several countries, especially in Europe.

- While the world economy is perhaps stronger than it has been in many years, there are risks calling for vigilance, and I would expect the Interim Committee to call for continued strengthening of our efforts. **IMF surveillance** will need to focus in particular on:

  - **Fragile financial systems** in a large number of countries. In close cooperation with others (Basle Committee, BIS, World Bank) the IMF has a role in promoting the acceptance and implementation of sound banking principles and practices.

  - **Massive capital flows** to emerging market countries. These have reflected both the growing shift to a more open global financial system and the successful policies of many recipient countries. At the same time, the emergence of large current account deficits in some of these countries has made them vulnerable to shifts in investor sentiment and has put a premium on sustained sound policies. IMF surveillance will continue to encourage sound fundamental policies in an environment of continued liberalization of capital flows.

  - Preparations for **Economic and Monetary Union in Europe**. These are entering their final phase. Successful completion of EMU represents an historic step in post-war European unification. 1996 has seen a marked convergence of EU economies, despite unfavorable cyclical circumstances for some countries. The forthcoming year will be a crucial one, and IMF surveillance will play an important role in encouraging policies aimed at ensuring that the transition to EMU is smooth, both for participating countries and those outside.

10. What further actions do you propose to take in the case of Mr. Hong?

- Last August, the Beijing Intermediate Court upheld the conviction of Mr. Hong, but reduced his sentence from eleven to five years. No further judicial action is planned.

- We continue to monitor the situation in light of our general concern for Mr. Hong and his family. We are in continuing contact with the Chinese authorities in order to resolve that issue in a mutually satisfactory way so that we can put this unfortunate incident behind us.

11. Do you feel G3 exchange rates are in line with fundamentals?

- Movements of the major currencies since mid-1995 have generally been **helpful both from a cyclical viewpoint and to correct previous misalignments** in exchange rates in terms of medium-term fundamentals. The movements to date have been helpful in reversing the previous overvaluation of the yen and, to a lesser extent, the deutsche mark and in **redistributing global demand pressures** among the major economies towards those with relatively weak cyclical positions (including Japan and Germany). Although policy responses to divergent cyclical pressures in the near term could give rise to some further strengthening of the U.S. dollar, under more symmetric cyclical conditions some reversal of recent movements of the multilateral values of the major currencies should probably be expected.

12. Should the U.S. raise interest rates further?

- While evidence of a pick up in inflation has been largely absent in the U.S., **monetary policy needs to be forward looking** if a low and stable inflation rate is to be maintained.

- The U.S. economy has been operating persistently at a very high level of resource use. **Short–term prospects are for the economy to continue to grow at a pace that exceeds the growth of capacity, raising the risk of higher inflation**. Moreover, the influence of those factors that recently may have had restraining effects on wages and prices is likely to diminish. In particular, job insecurity should have less of an impact on wage demands as labor market conditions are expected to become tighter, and competitive pressures, which have limited price increases, may ease somewhat with the anticipated cyclical recoveries in other industrial countries.

- In these circumstances, the monetary authorities in the United States will need to **be prepared to raise interest rates further in the coming months if required to slow economic growth** to a level that would ensure that significant inflationary pressures do not emerge.

13. How urgent is the task of fiscal consolidation in Japan?

- The **current fiscal position in Japan is clearly unsustainable**. The FY 1996 deficit of the general government (excluding social security) was more than 7 percent of GDP and government debt is rising rapidly as a ratio to output. From these perspectives, Japan has the most serious fiscal problem amongst the G7 countries.

- The **short-term issue is one of timing**. Is the economy sufficiently robust to handle fiscal retrenchment at the present time? The government believes that it is, and has proposed a budget for FY 1997 which will reduce the deficit by around 2 percent of GDP, with further consolidation being planned for the next few years.

- The **IMF supports this policy**. As long as the recovery continues, the planned consolidation in FY 1997 is appropriate. Nevertheless, the authorities need to maintain a **flexible** stance, and there would be scope for relaxing budget cuts if clear evidence emerges that the economic recovery is faltering.

- Even with the FY 1997 measures, the Japanese deficit will continue to be unsustainably large, particularly in the light of the **pressures on spending coming from population aging**. Hence, the IMF believes that decisive **further moves to consolidation will be necessary in the years ahead**.

14. Do you believe Germany will qualify for EMU?

- This question will be **decided by the EU** heads of state and government in the first half of 1998 based on whether Germany meets the criteria specified in the Maastricht Treaty.

- Substantial economic convergence (in terms of inflation, exchange and interest rates, and also in fiscal policy) has been achieved within the EU. As you know, Germany's budget deficit was equivalent to 3.8 percent of GDP in 1996. The 1997 budget aims at reducing the fiscal deficit below 3 percent to meet the Maastricht deficit criterion. Under present policies, Germany's fiscal deficit is projected by the staff to slightly exceed the reference value. The authorities have, however, **indicated their firm preparedness to implement further policy actions** as needed to satisfy the Maastricht fiscal deficit criterion. I encourage the German authorities to follow through on their policy intentions, particularly as uncertainties related to EMU may contribute to a dampening of business and consumer confidence that could undermine the incipient recovery.

- The staff also projects that Germany's gross public debt at end-1997 will exceed the 60 percent of GDP reference value; but it may be considered an exceptional circumstance owing to the assumption of east German debt.

15. Do you believe France will qualify for EMU and why?

- This question will be **decided by the EU** heads of state and government in the first half of 1998 based on whether France meets the criteria specified in the Maastricht Treaty.

- Now it **seems certain that France will satisfy the requirements regarding inflation, interest rates, and exchange rate stability.** Moreover, the public debt remains below the 60 percent reference value; and through determined consolidation efforts, the government deficit has been brought down sharply in the last three years. The current *WEO* projection shows a **deficit that is still somewhat higher than the reference value**; however, the French government has made it clear that it will do whatever is necessary to qualify for monetary union in the first round.

16. Are the latest fiscal measures proposed by Italy enough to qualify for EMU?

- The effort undertaken by the Italian authorities with the 1997 budget, together with the measures announced on March 27* is considerable: it is estimated to bring the deficit to close to the Maastricht reference value. How close, will depend on a number of factors, including any changes that Parliament may make to these measures and the strength of the recovery during the year.

- The effort for 1997 relies, however, to a large extent on measures whose effects will expire in 1998 or 1999 at latest. It will therefore be **important to ensure the sustainability of that effort** by promptly replacing these measures with **structural reforms**--in particular in the area of pensions, health, and public employment.

- The need for further **reform of the pension system** is well recognized. The share of expenditure on pensions in GDP in Italy is among the highest in the world, and its progression in the near future raises questions regarding the fiscal burden imposed on future generations. In this regard, we welcome the government's intention to start a thorough review of pension and social spending in the coming period, and hope that a constructive spirit will lead to early agreement on permanent cost-saving measures. This is the way for Italy to successfully crown the adjustment efforts undertaken since 1992, and to ensure a smooth transition to EMU.

* March 27 mini-budget included, for example:
- advanced taxation of severance payments funds
- six-month deferral of civil servant separation allowance
- advancement of receipts from banks and collection agencies
- cut in ministries' cash authorization

17. Do you think a Labour victory in the forthcoming British elections could threaten the economic achievements of recent years? Should the U.K. try to join the first round of EMU?

- Both major parties are **committed to further deficit reduction** and the existing control totals for government spending, and both support the present monetary policy framework's emphasis on price stability. Neither party is seeking to reverse the path-breaking labor market reforms of the 1980s that increased **labor market flexibility**, largely accounting for the fact that the United Kingdom's unemployment rate has recently (at some 6 percent) been well below the EU average. Labor has indicated that it does not intend to reverse any of the **privatization** undertaken in recent years.

- The EMU project would **benefit from the widest possible participation** by those who qualify, and participation by a large, well-performing economy such as the United Kingdom would certainly be a source of strength. That said, whether the United Kingdom chooses to join in the first round is a **sovereign decision** that will be based on both political and economic considerations.

18. Do you regard the timetable for EMU as feasible? If so, which countries do you believe will achieve the Maastricht criteria on time? What role will the IMF have in exercising surveillance over the "ins" and "outs"?

- Monetary union in keeping with the Maastricht timetable is **not only feasible but is also within close reach**. Already EU members have achieved a high degree of convergence. Inflation in the 15 members of the EU--now projected at 2¼ percent in 1997--is lower than at any point in the last 35 years. Based on full implementation of already announced policies and our current expectations for economic growth, almost all countries would satisfy in 1997, or come relatively close to, the Maastricht Treaty's 3 percent of GDP reference value for the general government deficit. Indeed, were it not for the large output gaps, deficits in 1997 would be significantly under 3 percent of GDP for all EU countries but one (Greece). While I do not think that it would be appropriate for me at this stage to predict which countries will qualify, I would note that all countries wishing to participate in EMU at its inception have declared their intention to satisfy the Treaty's requirements.

- EMU marks a crowning achievement of four decades of European economic integration. The conditions for its successful start are largely in place and it would be foolish at this stage to risk the dangers that could stem from a delay. It is therefore vital that governments follow through with their policy commitments in a determined fashion so as to complete the project within the agreed time frame. This should **remove any lingering doubts** about the future of EMU, boost confidence, and allow countries to realize the full potential benefits of the convergence that has already been accomplished.

- On surveillance of the "ins" and "outs", the IMF will continue exercising its surveillance over the policies of all member countries. However, the move to Stage 3 of EMU will entail a substantial shift of authority from participating member states to central organs of the euro area and/or the EU in the areas of monetary and exchange rate policies. Thus, in order to fulfill its surveillance mandate, the IMF will need to complement its regular discussions with national authorities with discussions with the institutions of the euro area. The precise modalities and mechanisms for such discussions will be examined over the next several months.

19. Do you see any progress in EU countries in tackling the problem of structural unemployment? What policy advice is the IMF offering in this area?

☞ **Failure to resolve structural employment will impede Europe's ability to realize benefits of global integration. Fundamental reform is required, but depends on greater public understanding of the nature of the problem.**

- Unemployment in the EU (projected at 11½ percent of the labor force in 1997) is largely structural in nature and thus only a small part will be absorbed through cyclical recovery alone. Moreover, if rigidities in the EU's labor markets are not adequately addressed, they are likely to cause problems for the operation of monetary union and impede Europe's ability to realize the potential benefits of continued global integration.

- It is clear that the problem has been recognized throughout Europe and that countries have already taken steps to address it, including through providing scope for more flexible work arrangements, strengthening training, reducing non-wage labor costs, and reforming elements of social benefits systems.

- But the measures that have been taken already fall far short of what is needed in most countries. The IMF's view is that there is a need for **more comprehensive and sustained efforts** to increase incentives to work, to acquire skills, and to create jobs. This will **require fundamental reform of social benefits systems and the relevant aspects of tax systems, of minimum wage regulations,** and of other regulations affecting the wage structure and severance procedures.

- There is a difficult balance to be struck between, on the one hand, increasing the efficiency with which labor markets operate and, on the other hand, ensuring that economically vulnerable groups are protected. Some of the social concerns can be alleviated through well targeted social programs and improvements in education and training. However, in the final analysis, the existing systems of social protection in Europe entail unacceptably high budgetary costs and the current level of unemployment cannot in the long run be good for the skills and welfare of European workers.

- There is a need to **promote greater public understanding** of the nature of the problem in order to pave the way for the required policy initiatives.

20. How concerned are you about the fragility of the financial sector in a number of emerging markets? What role will the IMF have in strengthening financial systems in emerging markets?

- A number of countries (not just emerging markets) are experiencing difficulties in their banking systems, and we are concerned that such problems, besides **constraining the conduct of policy in these countries**, could have regional and international **spillover effects**. Fortunately, there is a growing awareness of the macroeconomic risks posed by financial sector fragility and I am encouraged by the effort made by many countries to come up with remedies suited to their institutional frameworks.

- Central to this effort will be the work of various multilateral official and industry groupings, notably the **Basle Committee on Banking Supervision**, in compiling principles, best practices, and guidelines covering relevant financial activities or arrangements.

- The **IMF, with its near universal membership, is particularly well placed** to support those efforts of its member countries. In this regard, the role of the IMF will be to focus on assisting members in identifying potential vulnerabilities in their financial and supervisory systems, in formulating corrective policies, and in encouraging countries to adopt standards developed by the international supervisory community. While the **main instrument of support will be the IMF's bilateral and multilateral surveillance** processes, the IMF will also use its lending and technical assistance programs to assist individual member countries in achieving these goals.

- However, I must **warn against unrealistic expectations**. The IMF neither can nor should certify financial systems as "sound" (that is the job of the market). Instead, the objective must be to increase awareness of financial sector problems, their potential consequences, and their appropriate solutions in selective instances where they may become a major concern.

21. Many economies in transition have made considerable progress toward macroeconomic stabilization. What are the key policy challenges they now face?

☞ **Growth has resumed in most of these countries, but more effort is needed to cut inflation and consolidate stabilization. Much remains to be done on the structural front.**

- Although **growth has now resumed** in most transition countries, a sustained and vigorous recovery is needed to raise standards of living toward those of other European countries. This will require macroeconomic and structural policies to strengthen domestic savings and investment and increase efficiency.

- In most cases, **inflation must be further reduced** to establish a stable macroeconomic environment conducive to investment and growth. This will necessitate further declines in fiscal deficits and the continued pursuit of an appropriately tight monetary policy.

- The stabilization gains must be consolidated to ensure sustainability. This will require greater efficiency in the use of public resources to achieve social and redistributive objectives, and the reallocation of resources to growth enhancing expenditure (infrastructure, and the education and training) as well as to the improvement of public services. It is important to foster a recovery in tax revenue/GDP ratios through better tax administration and broadening of the tax base while avoiding punitive rates of taxation. Further strengthening of central bank independence and of market-based monetary policy instruments are also called for.

- Much remains to be done in other structural areas. First, there is the need to **deepen enterprise reform, including privatization**, especially for larger enterprises where progress has been lagging in many countries, and strengthening of enterprise governance. Establishment of an environment that will facilitate the early absorption of redundant labor by new private sector enterprises remains a major challenge for the near future. Effective implementation of basic legal frameworks for business and commerce, land privatization, greater competition, tax reform, and confidence-building policy vis-à-vis domestic and foreign investors will be part of that environment, as well as the strengthening of the social safety net through better targeting.

- Second, there is the need to **develop efficient financial systems** through improving the incentives and the capabilities of banks to mobilize savings and allocate them effectively in support of the transformation. In many instances, this will require **addressing the situation of problem banks** which need to be restructured or placed into receivership.

22. How soon do you expect to agree on Russia's 1997 program? Isn't the IMF taking too large a risk in continuing with lending, given the country's poor revenue performance?

- A staff mission is visiting Moscow during April 21–24 and is expected to reach understandings on the remaining issues outstanding with regard to the 1997 program. We are **confident that all prior measures** slated to be taken by the end of this month will indeed be implemented as planned. On that basis, the Executive Board is scheduled to consider the 1997 program in mid-May.

- The **new government has already demonstrated its will to deal with the poor revenue collection** through a range of measures aimed at strengthening tax administration, improving the tax system, and enforcing tax laws. Moreover, the government has presented to the Duma a more realistic spending plan for 1997 that takes account of lower-than-anticipated revenue collections. On this basis, we are confident that the fiscal targets under the EFF-supported program for 1997 can be reached. In fact, I would argue that *not* supporting the new government at this juncture would put Russia's achievements in macroeconomic stabilization and structural transformation at a greater risk.

23. Why can't the IMF get the Ukrainian parliament to pass a budget that would allow approval of the EFF?

- The political situation in Ukraine is very complicated, with the **government and parliament engaged in a power struggle**. This power struggle is related to early positioning for parliamentary elections in 1998 and Presidential elections in 1999. Parliamentarians object, amongst others, to proposals to eliminate VAT exemptions on electricity and coal, the introduction of a 2 percent property tax, and abolition of certain social benefits for some groups of the population. They are, however, also unhappy with the way the adjustment package was presented to them.

- The **IMF has been actively engaged** through the resident representatives and frequent missions in **explaining the reasons for and the importance of the tax measures and the budget to parliament**. Recently a seminar was organized in Vienna by the IMF for Ukrainian parliamentarians. The IMF has also been urging the President and the government to do everything possible to speed up parliamentary approval, pointing out that international financial support depends on it. This has included letters from the Managing Director and the First Deputy Managing Director to the President.

- We are satisfied that the parliament is fully aware of the implications of not approving the budget, and beyond that there is nothing more that the IMF can or should do.

24. Do you expect Turkey to need an IMF program and has it asked for one?

- Chronic **high inflation** and substantial **fiscal and external deficits make the Turkish economy vulnerable**. On the other hand, international reserves are large, public debt maturities are lengthening, interest rates (though high) are declining, and the ambitious privatization program promises to generate substantial resources over the next year or two.

- We believe that Turkey needs a coordinated program of reform aimed at controlling inflation and putting the economy on a sustainable path. In our view, such a coherent medium-term program should include: a strong fiscal adjustment; a monetary policy stance aimed at reducing inflation; an incomes policy set to **break the inflation inertia of backward indexation**; and structural reforms aimed at addressing the ballooning social security deficit, broadening the tax base and strengthening tax administration, and completing the privatization process within an appropriate regulatory framework.

- A mission visited Turkey last week to conduct regular consultations. And we will definitely discuss the authorities' policies with them at the time of the Annual Meetings. It would be premature, however, to say whether these discussions would be for a possible use of IMF resources or, indeed, whether the authorities would be interested in using IMF resources at that time.

25. How soon do you expect to see membership of the Federal Republic of Yugoslavia in the IMF? What are the remaining conditions?

☞ **Over the past year, the staff has had several meetings with delegations from the FRY to discuss membership issues. The FRY government has already taken steps to satisfy some of the conditions for membership in the IMF but there still remain a number of outstanding conditions that have to be met. We hope that these can be met soon.**

The FRY may become a member of the IMF once the following four conditions have been met (specified in a 1992 Executive Board decision):

- acceptance by the FRY of its share in the Socialist Federal Republic of Yugoslavia's assets and liabilities in the IMF (*condition met January 1993*);

- notification to the IMF that it agrees to FRY to succeed to the membership of the SFRY in accordance with the 1992 Decision (*some progress has been made. The authorities adopted needed legislation in August 1996, but have not yet submitted supporting legal documentation that would be acceptable to the IMF's Legal Department. This pertains to a notification of succession to the IMF and a memorandum of law signed by the Justice Minister. Even though the FRY authorities have accepted in substance the 1992 Executive Board Decision, they are reluctant to acknowledge explicitly in these documents that the FRY is one of five successors to, rather than the sole continuator of, the SFR*);

- settlement of outstanding arrears to the IMF (about SDR 81 million or 24 percent of the FRY's quota under the 9th Review) (*no progress*); and

- an Executive Board finding that the FRY is able to meet its obligations under the Articles of Agreement (*no progress so far)*.

26. Are IMF policies to blame for the unrest in Albania? Why did the IMF not warn the authorities publicly about the risks of pyramid schemes?

- The unrest is due to the failure to halt the growth of pyramid schemes and associated fraud and criminal activity. It is *not* due to IMF efforts to promote fiscal prudence, tax reform, and the modernization of the banking system.

- The IMF warned the authorities about the risks posed by pyramid schemes, in rather stark terms, last August and urged prompt action.

- The IMF's misgivings -- there was little hard information -- were made public *by the authorities* in early October. However, with investor mania at its peak, the warnings had little effect. An IMF mission to Albania held a press conference in November where it called again for the rapid investigation and closure of insolvent companies.

27. What are the prospects for Bulgaria?

☞ **On April 11 the Executive Board approved a stand-by and CCFF, worth a total of SDR 480 million (about US$657 million). Prospects are good. Key is currency board (mid-year) as tool for financial discipline. Lev is already stronger and inflation is down.**

- Bulgaria is implementing a major program that is being supported by a stand-by arrangement with the IMF, approved on April 11. The program represents a **break with the past** and aims at **restoring confidence in Bulgaria's public institutions** and putting Bulgaria firmly on the path to a market economy.

- The basic strategy is one of **rapid stabilization of the economy underpinned by durable structural reforms**. Key to this strategy is the implementation of a currency board arrangement, expected around midyear, as a tool to instill financial discipline throughout the economy and establish policy credibility. Structural reforms aim **to restore the soundness of the banking system and to revitalize the enterprise sector**, including through an ambitious privatization program.

- With this program, the prospects for Bulgaria's economy are very favorable. There are already early signs that **the stabilization is taking hold**; the **lev has strengthened** in the past few weeks and monthly inflation fell sharply in March (from 243 percent in February to 12 percent in March). The central bank has been able to purchase large amounts of official reserves, while interest rates on government securities have been falling, creating breathing space for the budget.

- With continuing adherence to the program, economic growth is expected to resume from the second quarter of this year onward and inflation is expected to fall to monthly rates of around 2 percent before year-end. Together with the liberalization of the economy and continued privatization, this should lay the foundations for sustainable economic growth.

28. Does the IMF loan to Bulgaria just before elections reveal political bias, even intervention, and aren't you taking excessive risks considering Bulgaria's poor track record? Is there equal treatment for the rest of the Balkans?

☞ **The IMF applied its standards strictly. Assurances were given that policy implementation would continue beyond the April 19 elections are: the outgoing parliament mandated the caretaker government to reach an understanding with the international financial institutions, and all political parties committed to implement the agreed policies.**

- IMF standards were strictly applied in the case of Bulgaria as they are in all other cases. The requirements were that there be a program sufficiently strong to address Bulgaria's problems and assurances that the program would be implemented.

- The program agreed with the caretaker government in Bulgaria is a major program of stabilization and structural reforms, which addresses in particular problems in the banking system and the enterprise sector, where lack of sufficient (or even any) earlier action was responsible for Bulgaria's deep economic problems.

- The IMF could not have proceeded, however, without being satisfied that there would be continuity in policy implementation beyond the Bulgarian elections. These assurances were provided by the mandate given by the outgoing parliament to the caretaker government to reach understandings with the international financial institutions and the commitment of all political parties to implement the agreed policies.

- The IMF's involvement in Bulgaria is simply a part of a larger involvement in the Balkans. It is in fact closely involved with all its members in the Balkans: with arrangements recently approved for Croatia, former Yugoslav Republic of Macedonia, and this week Romania; continuing intensive work with Bosnia and Herzegovina to develop the institutional framework for the implementation of macroeconomic policies; and close consultations with Slovenia. Discussions have also been held with the new government of Albania, but the formulation of a new program clearly must await the restoration of social order. In each case, the IMF's involvement is intended to be that which might best help the member achieve sustained noninflationary growth. It is in this sense that there is equal treatment. But the circumstances facing the members vary widely and hence the IMF's involvement must be tuned to those differences.

The IMF is closely involved with all Balkan countries:

BALKANS	
ALBANIA	Ongoing discussion with government. New program awaits restoration of social order.
BULGARIA	Stand-by SDR 372 million and CCFF SDR 108 million approved April 11, 1997.
BOSNIA AND HERZEGOVINA	Intensive work ongoing to develop institutional framework for macroeconomic policies.
CROATIA	3-year EFF SDR 353 million approved March 12, 1997
MACEDONIA, FORMER YUGOSLAV REPUBLIC OF	3-year ESAF SDR 55 million approved April 11, 1997.
ROMANIA	Stand-by SDR 302 million approved April 23, 1997.
SLOVENIA	Close consultation.
YUGOSLAVIA, FEDERAL REPUBLIC OF	Ongoing meetings to discuss membership conditions.

29. **Pakistan: status of program.**

☞ **Stand-by is inoperative. Now staff-monitored program. Government strategy is stabilization, consolidation (agricultural taxation and financial sector), and structural actions (budget and public enterprises) as basis for multi-year ESAF and EFF later in 1997.**

- Because of weak fiscal policy and rapid domestic credit expansion, demand pressures resulted in a much weaker than programmed balance of payments outcome in the first nine months of the current fiscal year ending in June. The balance of payments has relied for its financing on a substantial draw-down of external reserves and short-term borrowing. As a result, the stand-by arrangement has become inoperative. It was approved December 13, 1995 and expires September 30, 1997 for SDR 563 million (US$776 million).

- The Government elected in February has embarked on a **bold economic strategy consisting of three main elements**: (1) immediate **stabilization** measures to address the vulnerable macroeconomic situation; (2) **consolidation** of key reforms initiated by the caretaker Government on agricultural taxation and the financial sector; and (3) a range of new **structural actions** regarding the budget and the public enterprises. This strategy is being evolved and monitored under a staff-monitored program.

- In the budget area, the authorities' strategy includes the recently announced **overhaul of the tax system**, whose thrust is a reduction in the tax rates concurrent with aggressive efforts to broaden the tax base. In this regard, we attribute the utmost importance to combining the rationalization of tariff, GST, and income tax rates with taxation of agriculture, elimination of exemptions and concessions, and compulsory filing of income and wealth tax returns.

- IMF Management and staff view the authorities' strategy, if implemented fully and accompanied by macroeconomic tightening, as capable of significantly improving the structure of Pakistan's economy and providing the basis for rapid and sustained economic growth. We are in close dialogue with the Pakistani authorities and will be monitoring implementation of their policies over the next few months. As we indicated earlier, satisfactory implementation would provide the basis for a resumption, later in 1997, of IMF financial support to Pakistan in the context of multi-year arrangements under the ESAF and EFF.

30. **Are you concerned that political uncertainty in India will prevent the government from taking the remaining reform steps? What are the policy priorities for India over the next 12 months.**

- Although political instability is always a matter of some concern, I am confident that the recent events in India will not have a major impact on the thrust of economic policies. The **reform process is now well entrenched and has the broad support of the major political parties**. It appears likely that any new government in India would adopt most of the budget's key proposals, including the bold cuts in tax rates that were proposed. Furthermore, despite recent political developments, the authorities have continued with a number of policy announcements including the lifting of certain quantitative restrictions and the liberalization of external commercial borrowing regulations.

- India's recent economic performance has been impressive, and the reform measures pushed through in recent months have been very welcome. Nevertheless, sustaining high rates of growth and making more rapid progress towards poverty alleviation still depends on achieving **deep fiscal consolidation** and **bold further structural reforms**, particularly in areas that have so far lagged behind.

- Regarding **fiscal policy**, the authorities must ensure that the objective of lowering the central government deficit to 4 ½ percent of GDP in 1997/98 is achieved while pushing forward with fiscal reforms that will allow the overall public sector deficit to be brought down decisively over the next several years. Priorities for the next year include:

  - Tight **tax administration and base broadening measures**. Pushing forward the **disinvestment** program, supported by public enterprise reform.

  - Establishing a **program to reduce public employment** in tandem with the large salary increase recommended by the Pay Commission.

  - Improved **cost recovery at the state level**.

  - **Increases in petroleum product prices** to close the deficit in the oil pool account.

- **Monetary policy** should be geared towards meeting the announced objective of lowering inflation to 6 percent over the next 12 months.

- **Immediate priorities on the reform front** include:

  - **Dealing with infrastructural bottlenecks** (particularly in power) by ensuring an attractive environment for private participation.

  - Establishing a program to **phase out remaining quantitative restrictions on imports** within a short period.

  - Continuing efforts to **strengthen the public sector banks**, a key requirement for moving toward full capital account convertibility.

  - Strengthening the framework for **exit policy**, including revamping bankruptcy procedures and liberalizing labor and land laws.

31. **Do you expect the talks between the IMF and Bangladesh to lead to an ESAF?**

☞ **Mission is now in Dhaka for an Article IV consultation, also discussing a possible ESAF. Far-reaching reform depends to a large extent on the Awami League government's ability to build political consensus.**

- The Awami League government, which assumed office last summer, has clearly indicated that it is **committed to pursuing prudent macroeconomic policies and market-oriented reforms** to achieve faster economic growth and poverty reduction. On our side, we are ready to help design and implement a growth-oriented program of macroeconomic adjustment and structural reform in Bangladesh and we have welcomed the new government's policy pronouncements.

- In that context, we quickly established a close policy dialogue with the new government and initiated discussions toward a possible ESAF last November. I am pleased to report that a **mission is now in Dhaka** to continue these discussions while also conducting the Article IV consultation.

- I am convinced that Bangladesh will be an excellent candidate for an ESAF as soon as the government is ready to undertake a bold reform effort. I hope that our ongoing discussions can be concluded soon but, as you know, this depends to a large extent on the **government's ability to build the political consensus required for the undertaking of a far-reaching reform program**.

32. **Do you think China will live up to its commitments to Hong Kong?**

- **We have great confidence in Hong Kong's future and in reassurances given by the Chinese authorities to maintain Hong Kong's legal, economic, and monetary systems intact** after the handover in July 1997. I am confident that all elements critical to Hong Kong's past success—prudent budgetary principles, the free flow of trade and capital, a soundly supported exchange rate link to the U.S. dollar, and free flow of information—will continue after July 1.

- **Transitions always present some degree of uncertainty**; that is their nature. But the pragmatic and far-sighted approach to the organization of economic management during and after the transition that has been shown by the Chinese, Hong Kong, and United Kingdom authorities will help ensure that the transition runs smoothly and the uncertainty is short-lived.

33. What is your assessment of Mexico's economic prospects? Is another IMF program needed?

☞ **Real GDP growth 5 percent in 1996. Inflation 25 percent now, from 52 percent in 1995. Favorable outlook assumes continued sound fiscal and monetary policies, and structural reform (banking, deregulation, pension and health). International capital access has improved.**

- Mexico's economic **prospects are very favorable**. Real GDP growth was 5 percent in 1996 and should be able to rise somewhat from this level in the next few years. Inflation has declined from 52 percent in 1995 to 25 percent currently and is projected to reach single digits in the next two to three years.

- This favorable outlook assumes that the government will continue with its sound fiscal and monetary policies. It will also **need to expand its structural reform** agenda, which currently includes the reform of the **pension and health regime**; the restructuring of the **banking system**; the **privatization** of certain infrastructural facilities; and **business deregulation**.

- **Improved access to international capital markets has permitted the authorities to liquidate their obligations** under the U.S. Exchange Stabilization Fund and make some advance repayments to the IMF. Through the availability of longer–term credits Mexico's medium–term debt–service profile has improved considerably and now looks manageable, albeit with a **modest hump of repayments in 1999.** However, assuming the continued implementation of sound policies, there is no reason that this hump should present any problems. Nonetheless, the IMF stands ready to support Mexico's medium–term stabilization and structural reform efforts, as needed.

34. What is your assessment of progress under Venezuela's economic program?

☞ **Venezuela entered a stand-by program providing SDR 976 million in July 1996 and it expires July 1997. Developments under the program were generally favorable in 1996. Many distortions that affected the economy early in the year were eliminated, privatization resumed, and the banking system has been strengthened.**

- Confidence has improved, and there are signs of economic recovery; however, progress in the inflation area has been less rapid than expected.

- The objective of the government is to consolidate the stabilization gains achieved last year and to **deepen structural reforms**. In this regard, a political consensus has already been reached for the reform of the severance payments and the social security systems. However, **significant wage pressures in the public sector** have affected adversely the outlook for the public finances in 1997.

- The authorities have expressed strong interest in maintaining a close relationship with the IMF. Discussions for the second review of the program are continuing and the authorities also are considering requesting an **extension of the current stand-by arrangement**. I am confident that the government will adopt a strong program that would permit the continued support of the IMF.

35. **Is the deterioration of the trade balance in Brazil a cause for concern and does it call for an adjustment of the exchange rate?**

- The authorities need to keep the trade deficit under review, although current estimates suggest that the external **current account deficit** for this year should be manageable.

- A **weaker trade deficit** in the first quarter of 1997 reflects in part strong domestic demand, and there are some indications that the rate of growth of **economic activity** is beginning to slow.

- Foreign direct investment flows have continued to be strong in 1997 and there has only been a small decline in **net international reserves** so far this year, from a very high level. Also, one can expect that imports of capital goods will contribute to the modernization of the tradable good sector which will tend to improve the trade balance in the future.

- In any event, the authorities need to continue their efforts to strengthen **fiscal policy** to control domestic demand and keep the external deficit at a sustainable level, and there are indications that some progress is being made in this respect. However, if the trade deficit were to continue to weaken, the authorities would need to tighten credit and fiscal policies further, which would also facilitate a gradual and moderate depreciation of the currency within the band system.

- On March 25 the authorities introduced **restrictions on the use of short-term foreign financing of imports** which make imports more expensive and reduce the scope for importers to arbitrage the difference between domestic and foreign interest rates. This is not the kind of measure we generally would recommend. It will be important for Brazil to ensure that the measure is not applied in a discriminatory manner, and that it is kept in place only until any needed strengthening of fiscal and general credit policies takes hold.

36. Argentina: status of program

☞ **Performance under stand-by satisfactory with growth 4½ percent in 1996 and inflation almost zero. Stand-by expires in January 1998; third review mission in May will also discuss new longer-term program giving attention to taxation, financial markets, and labor legislation.**

- Performance under the program remains satisfactory; real GDP grew by almost 4½ percent in 1996 while inflation was virtually nil. All program targets for end-1996 were met and, on the basis of preliminary information, it seems that March 1997 targets were met as well.

- The current stand-by arrangement expires in January 1998. The authorities and the IMF staff are working on the design of a longer-term program to cover the period 1998-2000.

- Such a longer-term program would seek to complete the key macroeconomic and structural reforms that Argentina has embarked upon in the past few years, particularly in the areas of taxation, financial markets, and labor legislation. Preliminary discussions on this program are to take place in May, when an IMF mission will visit Buenos Aires to conduct the third review under the current program.

38. Do you expect South Africa to seek an IMF program this year?

- The South African authorities have not requested financial support from the IMF. In March 1997, the first repayment of SDR 77 million was made in respect of a **CCFF loan of SDR 614 million that was disbursed in late 1993**. The remainder falls due in 1997 and 1998.

- The rand has strengthened substantially in the early part of 1997, following its real effective depreciation of 16 percent during 1996. This strengthening reflected a recovery of investor confidence based on a narrowing of the external current account deficit, the prudent government budget for 1997/98 which was presented in mid-March, progress in the privatization program, and other steps taken to implement the authorities' medium-term policy program, the **Growth, Employment, and Redistribution Strategy** (GEAR). Confidence is expected to strengthen further as implementation of the GEAR proceeds, particularly as progress is made with fiscal consolidation, labor market reform, and trade liberalization.

- Nevertheless, the challenges facing the authorities are still considerable, and the IMF remains ready to support the authorities' reform efforts.

Continued

37. Why do you continue to be optimistic in your projections for strong growth in Africa?

- As African countries move forward with their economic reforms and integrate into the global economy, it will be important for the international community to support that process. Industrial countries can contribute to Africa's development by improving market access and eliminating trade barriers to products in which Africa has a potential comparative advantage. They can also support the reforms of African countries by providing appropriate amounts of financial assistance and debt relief on concessional terms.

- The IMF, as you know, has taken steps to ensure the continuation of its concessional Enhanced Structural Adjustment Facility (ESAF), which will remain the centerpiece of our strategy for helping our African members address the economic problems which they face. The IMF and the World Bank are also working within the framework of the Debt Initiative for the Heavily Indebted Poor Countries (HIPCs) to achieve a decisive resolution of their external debt problems. This combination of strong policy implementation by African governments, including efforts to develop the private sector, and a cooperative strategy of support from Africa's international partners will ensure that Africa can sustain and intensify its development efforts into the next century.