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November 30, 2000
Approval: 12/7/00

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 98/43

4:00 p.m., April 9, 1998

Contents

Executive Board Attendance

M. Camdessus, Chairman
S. Fischer, First Deputy Managing Director
A.D. Ouattara, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A.A. Al-Tuwaijri	
T.A. Bernes	
R.F. Cippa	W. Szczuka
B. Esdar	
	A. Giustiniani, Temporary
D.Z. Guti	J.P. de Morais
K.A. Hansen	
A. Kafka	H.F. O'Brien
W. Kiekens	J. Prader
	B.S. Newman
	R. Fernandez
A. Mirakhor	
A.V. Mozhin	
	J. Shields
A.S. Shaalan	
M.R. Sivaraman	
G.F. Taylor	
J.J. Toribio	J. Guzmán-Calafell
J. de Beaufort Wijnholds	
	S. N'guiamba, Temporary
Y. Yoshimura	H. Ono
Zamani, A.G.	S. Joyosumarto
	Han M.
A.G. Zoccali	N. Eyzaguirre

R.H. Munzberg, Secretary
P. Kunzel, Assistant

Strengthening the Architecture of the International Monetary System—Prevention, Management, and Resolution of Crises—Draft Report of Managing Director to Interim Committee

Staff representatives: Boorman, PDR; Hicklin, PDR

Also Present

European II Department: I. Kapur. External Relations Department: S.J. Anjaria, Director; M.E. Hansen. Fiscal Affairs Department: P.S. Heller, Deputy Director. Legal Department: W.E. Holder, Deputy General Counsel. Monetary and Exchange Affairs Department: B.R. Johnston. Policy Development and Review Department: J.T. Boorman, Director; T. Leddy, Deputy Director; M. Fisher, J. Hicklin, R.H. Nord. Research Department: M. Mussa, Economic Counsellor and Director; F. Larsen, Deputy Director; B. Eichengreen. Secretary's Department: P. Gotur, K. P. Moran, A. Mountford, M.J. Papin, E. Ray. Statistics Department: C.S. Carson, Director. Treasurer's Department: D. Williams, Treasurer. Office of the Managing Director: M. Russo, Special Advisor; M. Cross, Personal Assistant; B. Christensen. Advisors to Executive Directors: J. A. Costa, S.S. Farid, H. Kaufmann, B. Konan, M.F. Melhem, H. Mori, H. Ogushi, E. Rodriguez, O. Sein, M. Sobel. Assistants to Executive Directors: H.W. Cocker, D.A.A. Daco, C.K. Duenwald, , J.K. Honeyfield, M. Kell, K. Lai, J.P. Leijdekker, A. Lucenti, M.Z. Maatan, W. Merz, A.R. Palmason, J.L. Pascual, Phan M.H., H. Rosni, S. Rouai, O. Schmalzriedt, I. Zakharchenkov, Zubir bin Abdullah.

1. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Joyosumarto on the completion of his service as Alternate Executive Director for Brunei Darussalam, Cambodia, Fiji, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Singapore, Thailand, Tonga, and Vietnam.

2. STRENGTHENING THE ARCHITECTURE OF THE INTERNATIONAL MONETARY SYSTEM—PREVENTION, MANAGEMENT, AND RESOLUTION OF CRISES—DRAFT REPORT OF MANAGING DIRECTOR TO INTERIM COMMITTEE

The Executive Directors considered the draft report of the Managing Director to the Interim Committee on Strengthening the Architecture of the International Monetary System—Prevention, Management, and Resolution of Crises (EBS/98/67, 4/3/98; and Rev. 1, 4/8/98).

Mr. Mirakhor noted that there was a concern of developing countries over the last 15 years regarding the asymmetry of surveillance, as expressed in most communiqués of the G-24 and in the Caracas Declaration. It would be important to reflect those concerns in the staff report.

The Chairman shared the concern expressed by Mr. Mirakhor, and noted that the issue of asymmetry would need appropriate consideration in the staff report. He proposed that a sentence could be included in the section on Fund surveillance to stress the need to pay greater attention to policy interdependence, the risks of contagion, and developments in the monetary and exchange rate sphere.

Mr. Fernández noted that while the staff report covered the issue of closer Fund contact with the private sector, it referred only to staff interaction with market participants. He suggested that the Executive Board should not be excluded from interacting with market participants.

Mr. Toribio wondered whether it would be possible to accompany the staff report by a series of questions to the Ministers to facilitate the discussion.

The Chairman noted that he intended to organize the discussion with the Chairman, Mr. Kiekens, and the Secretary by presenting a series of questions and items for discussion to the Ministers.

Mr. Cippa welcomed the new version of the staff report, as it indicated possible mechanisms by which to fulfill the mandate of increased surveillance of financial markets. While it would have been preferable to include an Appendix on international financial standards in the staff report, that item could be removed for the time being. However, the issue of international standards would need to be discussed again in the near future, as it represented an integral part of transparency. A clear mandate from the Interim Committee to the Board on that issue would be useful.

Mr. Zoccali favored the incorporation of the Appendix on international financial standards into the main portion of the staff report, but cautioned that it would be important to avoid giving the impression that meeting minimal standards would be sufficient to achieve greater financial stability. Financial vulnerability was country-specific and protection against contagion needed to be judged on a case-by-case basis.

It would be beneficial if the Interim Committee directed the Board to search for solutions to prevent and resolve crises which revolved around greater reliance on market-based instruments rather than on institutional solutions, Mr. Zoccali remarked. Categorizing market-based instruments as being more expensive should be avoided in the staff report, as the maintenance and usage costs were not fully explored.

Mr. N'Guiamba considered that a direct link between exchange rate policy and capital mobility should be avoided in the staff report, as it would imply that capital account liberalization and exchange rate flexibility go hand in hand.

The Chairman considered that a sound pegged exchange rate system could coexist with capital account convertibility, if accompanied by appropriate safeguards.

The Director of the Policy Development and Review Department noted that the staff report could be qualified to include the notion that increases in capital mobility had made pegged regimes more difficult to manage.

Mr. Han noted that the Asian crisis reflected the importance of strengthening the financial sector to allow for a more effective intermediation of savings. The key aspect of financial sector strengthening was to develop domestic capital markets, including the bond and equity markets, to provide direct channels of financing for corporations and to encourage corporate governance.

The Chairman noted that the staff report could place more emphasis on the need for monitoring short-term credits by the regulatory authorities of both debtor and credit countries to provide a degree of symmetry in the regulation of short-term credits.

Mr. Shields wondered whether the publication of the staff appraisals of Article IV consultations should be included in the staff report in an effort to promote greater transparency.

Mr. Kiekens did not consider that the publication of the staff appraisals should be included in the staff report because differences of view between what was expressed in a staff report and what was expressed in a summing up could confuse public opinion. Furthermore, the staff appraisal was the property of the Fund, not that of the authorities. Their publication should therefore not be considered a right of the authorities.

The Chairman noted that, in practice, many countries had considered it their right to publish the staff appraisals.

Mr. Kiekens welcomed the staff report's discussion of Fund transparency, and the importance attached to the issuance of PINs. However, the staff report suggested that the Fund's purpose was to have concise and analytically sound staff papers, as well as frank and comprehensive assessments by the Board, as key ingredients to an effective PIN process. That suggested that the ultimate purpose of the Fund was to issue PINs, which overemphasized their importance.

Mr. Mirakhor considered that analytically sound staff reports were an important ingredient to the PIN process, and thought that that needed to be reflected in the report.

The Chairman noted that while surveillance was the first priority of the Fund, concise and analytically sound PINs were needed to adequately communicate the Fund's position.

Mr. Esdar said that it would also be important to stress the importance of timely publication of PINs.

Mr. Kafka considered that the paper gave the impression that the Fund was always right, which he considered to be an unfortunate conclusion. The paper should indicate that the Fund could also be wrong.

Mr. Shields suggested that Mr. Kafka's concern could be addressed in part in the context of surveillance. While the effectiveness of surveillance depended on the willingness of members to take the Fund's advice, it also depended upon the quality of the Fund's analysis. That notion could be incorporated into the staff report.

The Chairman agreed that the wording proposed by Mr. Shields would help to address the concern expressed by Mr. Kafka.

Mr. Sivaraman considered that while private creditors had shared in the losses of the recent crisis, they did not share the burden of financing, as mentioned in the staff report.

The Chairman agreed with Mr. Sivaraman and proposed that the report should be altered to state that private creditors had shared the cost of the crisis, but not the burden of financing.

Mr. Giustiniani suggested that the staff report should be more explicit about the measures Chile had adopted to avoid currency and maturity mismatches.

Mr. Zoccali noted that the prevention mechanisms that Mr. Giustiniani mentioned involved tax measures and particular prudential regulations.

The Chairman noted that the prevention measures used by Chile would be included in the report.

Mr. Giustiniani remarked that caution should be used when addressing the issue of stand-by lines of credit from commercial banks. While consideration of those types of arrangements should not be precluded, they had not been tested in a crisis situation. Furthermore, there was a problem of shifting the burden of lender of last resort from domestic to commercial banks and ultimately to the central bank.

The Chairman agreed that the Fund did not have enough experience with lines of credit, and that a word of caution in the staff report would be warranted.

Mr. Zoccali noted that while it was best to err on the side of caution, the Fund should not shy away from trying to devise new mechanisms by which market-based solutions are used to diversify risk.

Mr. Yoshimura noted that while the staff report discussed the bail-ins process of banks, it did not specifically address the crisis situation of corporate debt in Indonesia. That issue, and what could be learned from it should be included in the report.

The Chairman stressed the importance of studying corporate debt issues, not only as they applied to Indonesia, but also to draw on the experiences with FICORCA in the case of Mexico.

Mr. Mirakhor noted that all aspects of the crisis had been included in the staff report with the exception of the credit rating agencies, and wondered whether it might be worth including them in the staff report.

The Chairman indicated that while the problem of the credit rating agencies was important, it was beyond the role of the Fund to analyze their performance.

Mr. Newman considered that the staff report's treatment of interaction between the Fund and the private sector could give rise to preferential treatment and moral hazard issues. A closer look at relations with the private sector should be considered before the Fund exchanged views with a subset of the financial market; that issue should be treated more carefully in the staff report.

Messrs. Taylor, Zoccali, Yoshimura and Esdar agreed with Mr. Newman that care should be taken in building relationships between the Fund and the private sector. Mr. Taylor emphasized that the relation should not only be based on providing information, but on receiving information as well.

Mr. Fernández did not consider that the Fund's involvement with a subset of the private sector would create substantial problems. The financial market committee of the OECD regularly convened with a subgroup of banks three times a year, and did not create major problems.

Mr. Sivaraman noted that the staff report focused primarily on the role of the Fund in interacting with private creditors – the role the authorities could play should not be omitted from the staff report.

Mr. Giustiniani considered that due to the sensitive nature of Fund involvement with the private sector, it would perhaps be appropriate to have a tentative proposal for private sector interaction.

The Chairman noted that the report needed to reflect the concerns expressed by Executive Directors. First, it would be necessary to have a tentative proposal for the reason described by Mr. Giustiniani. Second, the serious risk of creating insider-outsider problems needed to be carefully examined. Third, the report needed to take into account the possibility of country involvement with the private sector, and how the Fund could assist countries in that matter.

In the context of crisis situations, the Chairman remarked that Executive Directors could consider whether it might be suitable for the central banks of important financial centers to see to it that their banking community appoint a convener, who could liaise with the international community. The convener would have the responsibility, on short notice, to coordinate with representatives of financial institutions to reorganize debt operations as needed.

Mr. Kafka considered that the idea of a convener proposed by the Chairman could be extremely helpful, but wished to be presented with the text of the proposal prior to endorsement.

Mr. Bernes and Esdar considered that it might be preferable to have a convener elected by the financial community rather than being appointed by the central bank.

Mr. Newman said that the convener should be able to reach a wide range of financial institutions, including banks, investment brokers, insurance companies, pension funds, and bondholders.

The Chairman noted that the ownership of the report on strengthening the architecture of the international monetary system would lie with the Managing Director, speaking on behalf of the Board.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/98/42 (4/8/98) and EBM/98/43 (4/9/98).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAM/98/63 (4/7/98) is approved.

APPROVAL: December 7, 2000

SHAILENDRA J. ANJARIA
Secretary