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Contents

Adapting IMF Surveillance to a Changing Global Economy

Every two years, the IMF's Executive Board reviews the principles and procedures underlying IMF surveillance over its member countries' policies, as well as the formal 1977 Surveillance Decision. The following is a summary of the 1997 review that took place earlier this month, prepared by Robert Kahn and Dominique Desruelle of the IMF's Policy Development and Review Department.

IMF surveillance over its members' policies is not a static concept but one that has evolved to meet the new challenges posed by a changing global environment. Events in Mexico in late 1994 and early 1995 dramatically illustrated the striking speed with which markets could react to shifts in sentiment about a country's economic situation or the sustainability of its financial policies. In turn, this episode highlighted the need for the IMF to monitor economic developments continuously on the basis of accurate and up-to-date data, particularly in a world with increasingly integrated financial markets, and to consult promptly with members when problems arise. Consequently, in 1995, the Executive Board adopted a strategy to strengthen IMF surveillance, a key goal of which was to improve the IMF's ability to detect emerging financial tensions at an early stage.

The Singapore stock exchange. Integrated financial markets underscore the need for sound economic policies (in countries that have or wish to gain access to financial markets) and the importance of IMF surveillance of the international monetary system.

This strategy crystallized around four themes:

• *Improving the flow of economic and financial data*. The Mexican crisis illustrated that delays in the provision of key information could detract from discipline over policy and contribute to disorderly and disruptive market adjustments. Consequently, the IMF and its members recommitted themselves to working jointly to ensure that information provided to the IMF and the public would be regular, timely, comprehensive, and of high quality.

• *Continuity of surveillance*. Delayed adjustment that is forced by the markets can be more costly and disruptive than prompt implementation of corrective measures. This puts a premium on the early detection of risky or unsustainable economic situations. By making its surveillance more continuous, the IMF can play a key role in this regard.

• *Focus of surveillance*. The changing global environment has pointed to the need for more attention in IMF surveillance to new issues such as large flows of private capital. At the same time, the Board believed a more selective focus was necessary—both with respect to countries and issues—to ensure core areas of IMF responsibility are covered fully and effectively in discussions with national authorities.

• *Candor of surveillance*. All member countries favor tougher and more candid surveillance for others, but not necessarily for themselves. Consultation reports must therefore balance the advantages to the membership as a whole of more candor and transparency and the sensitivities of the member country involved. If IMF views are too ambiguous or nuanced, the staff's true concerns in particular (Please turn to the following page)

situations could be lost. In light of this, the Board encouraged the IMF staff to present its recommendations with frankness and candor, make sure that opportunities exist for timely discussions of these developments and, if necessary, bring concerns promptly to the attention of the relevant national authorities.

These insights have served as the basis for numerous initiatives over the past two years aimed at increasing the effectiveness of IMF surveillance over members' policies (see *IMF Survey*, May 22, 1995, page 153). Regarding data issues, the IMF in March 1996 established the Special Data Dissemination Standard (SDDS) for the voluntary dissemination of economic and financial data by member countries that have, or seek, access to international financial markets. A cornerstone of the SDDS is easy public access to information on subscribers' data dissemination practices, which is provided through the Dissemination Standard Bulletin Board (DSBB), an electronic bulletin board maintained by the IMF on the Internet (http://www.imf.org). The DSBB is designed to provide interested users with the sort of credible information they need to make informed assessments. The SDDS and the DSBB should thus provide subscribers with incentives to implement and maintain sound data dissemination practices. As of April 15, 1997, 42 countries had subscribed to the SDDS.

Defining IMF Surveillance

The current arrangements for IMF surveillance were formalized in 1977, following the breakdown of the Bretton Woods system of fixed exchange rates. The IMF was charged with exercising firm surveillance over the exchange rate policies of members in order to oversee the international monetary system and ensure its effective operation. It was recognized from the start that surveillance requires an assessment of both domestic and international economic policies to ensure orderly underlying conditions necessary for financial and economic stability.

To this end, Article IV, Section 3, of the IMF's Articles of Agreement gives the IMF the mandate to oversee each member's efforts to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, to promote orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions, and to follow exchange policies compatible with these undertakings.

To fulfill this mandate over the years, the IMF has adopted several procedures. These include a regular consultation with all its members—in principle annually—and twice-a-year reviews of worldwide economic developments in the context of the World Economic Outlook exercise (consisting of a semiannual Executive Board discussion of member country policies in a multilateral context, as well as the release of the results in a publication by the same name).

To improve the continuity of surveillance, the IMF has increased country coverage in Article IV consultations, as well as provided for greater follow-up contacts between consultations. The IMF also introduced new procedures to make it easier for the Executive Board to address critical issues between Article IV consultations.

Regarding the focus of surveillance, exchange rate issues have remained a central focus, but other questions have received increased attention as well, including financial market and capital account issues. The Interim Committee, in its September 1996 Declaration on Partnership for Sustainable Global Growth, highlighted the complementary and reinforcing nature of the monetary, fiscal, and structural policies required to sustain noninflationary growth over the medium term, stressing the need to implement sound macroeconomic policies that consolidate success in bringing inflation down, strengthen fiscal discipline, enhance budgetary transparency, and improve the quality of fiscal adjustment. The Declaration also stresses the need to foster financial and exchange rate stability and avoid currency misalignments; to maintain the impetus toward trade liberalization and current account convertibility; to tackle labor and product market reforms more boldly; and to encourage sounder banking systems and promote good governance in all its aspects. Although the importance of these issues varies across countries, the Declaration also embodies efforts to ensure that surveillance is evenhanded in its application (see box, page 115).

The period since April 1995 has provided the IMF with new challenges, even in the absence of a major event of the caliber of the Mexico crisis. Over the last two years, the effective exercise of surveillance required attention to issues such as European economic and monetary union (EMU); the overheating in Southeast Asian economies, which, often in the context of large and volatile capital inflows, has presented a particular challenge to policymakers; the emergence of widespread banking and financial sector fragility; and the implications of a more determined effort by members to restore discipline to their fiscal positions. These issues have received special focus in the IMF's World Economic Outlook exercise, as well as in the internal work of the IMF.

Assessing the Surveillance Record

The IMF's Executive Board conducts a formal review of IMF surveillance practices generally every two years. On April 15, the IMF's Executive Board completed a review of principles and procedures of IMF surveillance during 1995–96, and adopted a number of steps to enhance further the effectiveness of surveillance. The Board noted that steady progress had been made in strengthening surveillance—including its ability to detect incipient financial tensions.

The Board's review confirmed that regular and timely reporting of economic data to the IMF remains critical for effective surveillance. The last two years have seen some improvement in the reliable flow of information from members to the IMF; in this connection, the Board decided to continue reviewing periodically the provision of data to the IMF to keep this issue at the forefront of the policy agenda. The Board also welcomed the introduction of the SDDS and encouraged additional members to subscribe. As a next step, the IMF-sponsored Dissemination Standards Bulletin Board on the Internet will introduce electronic links to members' actual data. In parallel with the SDDS, the IMF is progressing toward the establishment of a General Data Dissemination System (GDDS) to improve the production and dissemination of core economic data by all IMF members.

The Executive Board cited efforts to improve the continuity of IMF surveillance and the candor of the dialogue with member countries—which facilitated more timely discussion of emerging problems. To make further progress, while recognizing budget constraints, the Board approved new procedures affording the IMF greater flexibility to adjust the frequency of its consultations with members, the size of staff missions, and the materials prepared by the staff,in response to fast-breaking developments.

Although the priorities and focus of IMF surveillance continue to be largely appropriate, to remain effective surveillance must be both comprehensive in treating issues at the core of the IMF's responsibilities and selective in handling other issues—depending on the individual country's situation. Echoing the Partnership for Sustainable Global Growth, Directors highlighted the importance of the staff's work on exchange rate issues and supported increased attention to capital account and banking sector issues as a complement to the staff's usual macroeconomic analyses. And, in view of the growing importance of policy formulation at the regional level, the Board stressed the need for the IMF to pay increased attention to regional surveillance (see *IMF Survey*, April 7, page 100).

Greater IMF Openness

A key issue for the Board's surveillance review was the progress toward greater transparency in the IMF's work. Over the past few years, the IMF has become more open in several dimensions. First, its policy on the release of IMF documents has evolved toward the greater provision of information. Furthermore, the IMF has encouraged members to release documents

Evenhandedness of Surveillance

During the Executive Board's 1995 biennial review, held in February 1995, some Directors expressed concern about an apparent lack of evenhandedness—or symmetry—in IMF surveillance. In particular, some regarded IMF surveillance as less effective in some important country cases; they saw a need for the IMF to strengthen its surveillance over its larger members whose policies had systemic implications affecting all IMF members. Similar concerns have also been raised outside the IMF.

To some extent, it may be inevitable that IMF members receive different degrees of attention in surveillance. Perhaps the largest difference is between members implementing IMF-supported programs and those that are not—a difference explained mainly by the IMF's need to safeguard its financial resources and the close monitoring associated with an IMF-supported financial program. There is also an inevitable distinction between attention devoted to some members' policies and the IMF's degree of influence on these policies. Arguably, some of the IMF's largest members receive as much attention as many IMF borrowers, as reflected, for example, in the prominent treatment of the policies of the IMF's largest members in the World Economic Outlook discussion. But although IMF financial support is provided in the context of adjustment programs entailing policy conditionality—thus ensuring a measure of congruence between the views of the IMF and a member's economic policies—the extent to which the IMF's views are taken into account in nonprogram countries depends largely on the willingness of the member.

At the same time, in a world of massive cross-border capital flows, few countries can implement economic policies without taking account of the views of the international community, often exemplified in the advice provided through IMF surveillance. In this sense, developments in recent years may have provided more leverage to IMF surveillance as an element in increased market discipline over countries' policies.

Recent initiatives to strengthen surveillance may have improved its evenhandedness.

Also, a number of initiatives in the past two years aimed at strengthening surveillance may well have improved the symmetry of surveillance. For example, the Special Data Dissemination Standard sets an ambitious standard for the publication of economic and financial data for countries having, or seeking, access to international markets—mostly countries without IMF-supported adjustment programs. Publicity regarding subscribing members' dissemination practices should reinforce market discipline of these members' policies.

on their economic reform programs, such as policy framework papers (documents of members, drawn up with IMF and World Bank assistance, that outline the member's economic objectives and policies in return for IMF concessional financing) or letters of intent (which describe member's policy intentions, to qualify for IMF ordinary financial support). The increased openness has also been reflected in more frequent press contacts by IMF staff. Finally, since 1994, the IMF has released most background material to Article IV consultation reports, and it has liberalized access to its archives.

To be effective, IMF surveillance must be both comprehensive and selective.

These changes in the IMF's openness parallel a trend toward greater transparency in economic policymaking in many member countries, with more statistical information and policy-related information provided to the public. Momentum for increased transparency comes from the recognition that:

- comprehensive information is needed for the efficient functioning of markets;
- transparency in economic policymaking increases accountability and ownership of economic policies by the public; and
- increasing the market's oversight could contribute to more timely policy adjustment and minimize policy surprises and associated market disruptions.

In addition, as a further step important toward greater transparency, the IMF is expected to initiate soon an expanded policy of releasing information containing the IMF's assessment of a member's policies and prospects.

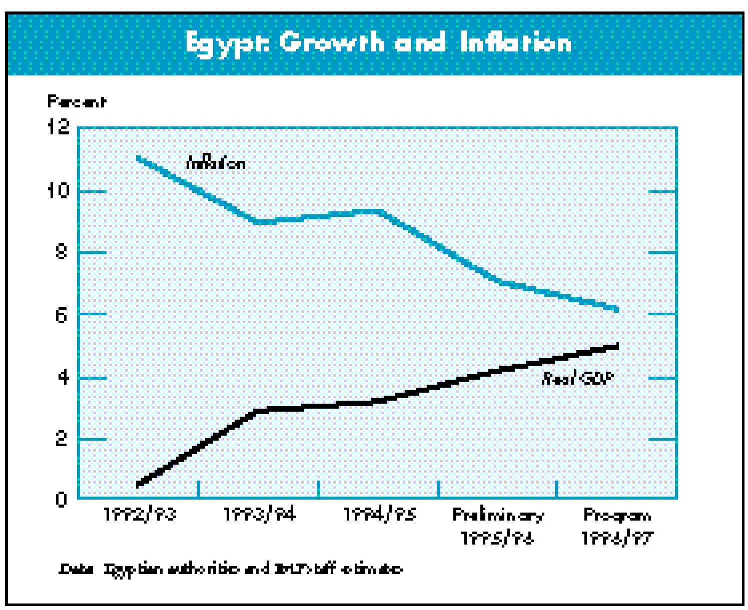
In conclusion, the Executive Board's review of the 1995 strategy to strengthen surveillance reaffirmed the measures implemented under this strategy over the past two years. At the same time, the Board recognized that strict vigilance was needed, as experience had repeatedly shown that challenges to economic stability often come in the most unexpected manner. ■

Egypt's "Home-Grown" Reforms Spur Growth and Investment

After the formation of a new government a little more than a year ago, Egypt embarked on a new and decisive phase of adjustment and economic reform. The enthusiastic response of international investors has sharply increased capital inflows and fueled a booming stock market. For international investors, Egypt's attractiveness is linked to stronger economic growth in an environment of macroeconomic stability, a widespread perception of a strong political commitment to reform, better information about Egypt's economic progress and investment opportunities (notably through the Middle East-North Africa Economic Conference held in Cairo in November 1996), and the recent assignment of an investment-grade rating for Egypt's sovereign debt by Standard & Poor's. Egypt has vigorously pursued its economic reforms and the impact, in terms of growth and foreign investment, has been impressive. Challenges remain, however, if the country is to sustain and broaden its reform process, foster a vibrant private sector, and create employment opportunities for its young and growing population.

Background

As recently as the early 1990s, Egypt faced severe financial imbalances evidenced by high inflation, large external deficits, and an accumulation of external arrears. With the support of two successive IMF



financial arrangements (1991 and 1993), the country made important progress toward reducing these imbalances, but economic performance remained below potential.

Against this backdrop, and in the context of the new challenges and opportunities presented by the evolving regional and international environment, Egypt adopted an ambitious reform program in support of which the IMF approved a two-year stand-by arrangement in October 1996. (In light of Egypt's strong reserve position, the authorities view the arrangement as precautionary and have no plans to draw under it.) This medium-term program seeks to achieve a sustained higher rate of growth and a gradual reduction in unemployment, while further lowering inflation and maintaining a strong external reserve position. To these ends, the program focuses on:

- consolidating the gains on macroeconomic stabilization;and
- broadening and intensifying the structural reform agenda through privatization, deregulation, trade liberalization, and a revamping of the financial sector.

Macroeconomic Performance

In the context of sustained policy implementation and growing confidence in the government's ability to adhere to its adjustment and reform program, macroeconomic performance has exceeded expectations. Fueled by strengthened private sector investment, real GDP growth is set to reach 5 percent in the current fiscal year (ending June 1997). Meanwhile, inflation has continued to decline, dipping to 5.4 percent for the 12 months ended February. In the external sector, a small current deficit (equivalent to less than 1 percent of GDP) is forecast; with larger portfolio and foreign direct investment, official international reserves have risen to more than $19 billion—the equivalent of almost 15 months of imports.

On the monetary front, the recent surge in capital inflows has posed new challenges for monetary management. Nonetheless, the authorities have not allowed the unforeseen rise in international reserves to derail their monetary objectives:through sterilization, net domestic assets of the central bank have been contained and monetary growth remains broadly on track. Meanwhile, the budget deficit this year is expected to be below 1 percent of GDP (excluding privatization receipts) and should gravitate toward balance over the next few years.

Structural Reforms

Consolidation of macroeconomic stability has set the stage for a deepening of reforms that aim to create a decentralized and outward-oriented economy in which the private sector plays the central role. In this regard, the Egyptian authorities have adopted a comprehensive structural and institutional reform. The main elements of this reform include:

- *Privatization.* During the six months ended December 1996, the government divested its majority holdings in 22 companies and minority holdings in another 8. These privatizations represented around one-sixth of the total net worth of state-owned enterprises and have generated proceeds amounting to about $1.3 billion—the equivalent of about 3½ percent of GDP at an annual rate. The program envisages the divestiture of most nonfinancial public enterprises over two years.
- *Deregulation.* New legislation has decontrolled rent on new and vacant property as well as on occupied commercial property; the authorities have liberalized procedures for investment approval; and the private sector is being invited to operate and manage energy sector projects. A draft investment law before Parliament would reaffirm basic guarantees for investors, and unify and rationalize the framework for investment incentives. At the same time, a new corporate law and commercial code are being established.
- *Financial sector reform.* The Central Bank of Egypt is strengthening its regulatory and supervisory regimes and is expanding the range of instruments through which it conducts monetary policy. Concurrently, competition in the financial sector is being strengthened through privatization of joint-venture insurance companies and banks. Of the lat-

Egypt: Basic Economic Indicators

	1992/93	1993/94	1994/95	Preliminary 1995/96	Program 1996/97
	(annual change in percent)				
Growth and inflation					
Real GDP	0.5	2.9	3.2	4.2	5.0
Inflation (average)	11.1	9.0	9.4	7.1	6.2
Monetary accounts					
Broad money	16.4	12.4	11.1	10.5	10.1
	(percent of GDP)				
Fiscal accounts					
Fiscal balance	–3.5	–2.1	–1.3	–1.3	–0.8
Financial liabilities of the government	136.0	125.5	117.0	103.3	93.3
External debt	65.8	58.0	55.7	47.1	41.2
External accounts					
Current account	4.6	0.4	2.3	–0.2	–0.9
Capital account	1.6	4.2	–0.4	1.2	1.6

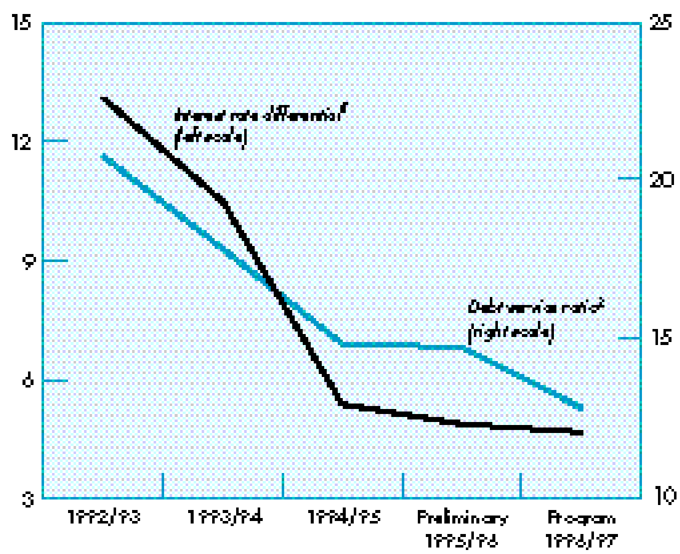
Note: Fiscal year is July 1–June 30.
Data: Egyptian authorities and IMF staff estimates

ter, only four of the original nine joint-venture banks are still majority-owned by public sector banks and the privatization process is moving forward. Also, steps are under way to privatize one of the big four public sector banks as well as one of the state-owned insurance companies.

• *Trade liberalization.* To foster outward orientation of the economy and to complement the privatization program, the authorities reduced the maximum tariff rate to 55 percent from 70 percent in October 1996, with concurrent reductions in lower rates. This represented an important step in a medium-term trade liberalization pro-gram. Egypt's exchange system remains virtually free of restrictions for current as well as capital transactions.

• *Fiscal reform*. While Egypt's overall budgetary position continues to be healthy, the authorities have decided to further strengthen the underlying fiscal structure. The general sales tax is to be extended to the retail and wholesale levels and converted into a full-fledged value-added tax. A reform of the income tax is to be initiated in the new fiscal year. On the expenditure side, a restructuring of the civil service is under way. As an element of this, civil service employment is to be reduced by 2 percent starting this year, notwithstanding expanded employment in the priority health and education sectors. Further cutbacks in nonessential public sector personnel are foreseen in the coming years.

Egypt: Interest Rate Differential and Debt-Service Ratio
(Percent)



[1]Exchange rate adjusted difference between Egyptian and U.S. three-month treasury bills. For 1996/97 for June–December.
[2]As a ratio of exports of goods and nonfactor services.

Data: Egyptian authorities and IMF staff estimates

Challenges

Egypt has successfully embarked on a comprehensive reform program, but the country still faces a long journey before it completes the structural transformation of its economy. Egypt will need to sustain and deepen the key elements of the structural reform program—privatization, trade liberalization, and fiscal and financial sector reform—if the remaining weaknesses in the economy are to be redressed. It will take time and effort to increase investment to the level needed to sustain substantially higher rates of output growth and to generate an estimated 400,000 to 500,000 new employment opportunities every year. In this endeavor, further steps will be needed over a broad front to foster the required expansion of domestic savings.

In addition, key reforms will now be entering a more difficult phase. For instance, following the successful sale of profitable public enterprises, the challenge now is to dispose of state-owned entities that require major restructuring or even liquidation. Similarly, despite recent cuts, Egypt's tariff rates remain high relative to those of other countries in the region and rapidly growing developing countries elsewhere. Non-oil exports and foreign direct investment in Egypt will need to grow sharply. Likewise, the authorities will need to consolidate their efforts to strengthen Egypt's performance on the socioeconomic front. In this regard, the authorities have appropriately emphasized increasing spending on health and education,improving the quality of these services,and strengthening and refocusing the social safety net.

Egypt's potential is considerable. The country is already reaping the benefits of its stabilization and reform programs. Sustaining the momentum of this homegrown effort, particularly at this early stage, will bring the promise of high economic growth, expanding job opportunities, and rising living standards. ■

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Members' Use of IMF Credit
(million SDRs)

	During March	Jan.–Mar. 1997	Jan.–Mar. 1996
General Resources Account	159.0	1,015.0	1,592.5
Stand-by arrangements	130.2	246.0	908.8
Extended arrangements	28.8	769.0	683.6
CCFF	0.0	0.0	0.0
SAF and ESAF arrangements	12.1	97.0	119.7
Total	171.1	1,112.0	1,712.1

Note: EFF = extended Fund facility.
CCFF = compensatory and contingency financing facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals shown owing to rounding.

Date:IMF Treasurer's Department

Worldwide Military Expenditures Continue to Fall, but at Slower Pace

Worldwide military expenditure has continued to fall, but at a much slower pace than reported a year earlier (see *IMF Survey*, June 3, 1996), according to a recent IMF staff analysis of data for 132 countries from the World Economic Outlook database for 1996, combined with revised data for earlier years. The earlier study reported a fall in worldwide military spending of 1.3 percentage points of GDP between 1990 and 1995, reflecting widespread reductions across all regions. The revised data show that worldwide military outlays fell to 2.4 percent of GDP in 1995 and 2.3 percent in 1996 from 3.5 percent in 1990 (see Table 1).

Data from other sources confirm this slowing in the pace of military spending reductions (differences in the figures reflect varying coverage of military spending and number of countries). For example, data from the Stockholm International Peace Research Institute (SIPRI)—whose coverage varies by year from 63 to 117 countries and includes up to 15 transition economies (see Table 2)—show a decline in worldwide spending to 2.5 percent of GDP in 1994 and 2.3 percent in 1995 from 4.2 percent in 1990, compared with the results reported in 1996—2.7 percent in 1994 from 4.2 percent in 1990 (see *IMF Survey*, June 3, 1996, page 181). SIPRI data show a similar result for 59 countries for which data were available for every year between 1990 and 1995.

Data collected by the London-based International Institute for Strategic Studies (IISS) also provide support for the decline in military spending in 1996. IISS data show that budgeted military spending for 1996 was lower than actual spending in 1995 by some 0.6 percent of GDP (see Table 3). These figures should be interpreted with caution, however, since actual spending can deviate from what is projected in the budget.

Based on the IMF's World Economic Outlook database, global resource savings—that is, the peace dividend—amounted to $324 billion between 1990 and 1995. The peace dividend is defined as the difference between the dollar amount that would have been spent in 1995 if the 1990 ratio of expenditures to GDP had been maintained and the actual outlays for 1995. The decline in military spending in 1996 implies a further increase in the peace dividend of about $18 billion.

Military expenditure as a share of GDP fell or stayed constant in all country groups in 1996 (see Table 1), although in one subgroup—the newly industrializing economies of Asia—spending rose by 0.1 percentage point of GDP for the three countries in that category.

Spending as a share of GDP remained broadly constant in the industrial countries, Asia, and the Western Hemisphere in 1996. In the industrial countries, however, the marginal reduction in GDP terms (2.29 percent in 1996 from 2.34 percent in 1995) translates into a substantial reduction of $10.6 billion in absolute spending. Among country groups recording more sizable reductions in 1996, Africa's military outlays fell by 0.2 percent of GDP ($0.4 billion). Outlays in the developing countries in Europe and the Middle East fell by 0.3 percent of GDP ($2.8 billion), about half as fast as they did between 1994

Table 1. Military Expenditures, 1990–96

	1990	1994	1995	1996	Change 1995–96
		Percent of GDP			(billion U.S. dollars)
All countries	3.5	2.6	2.4	2.3	–2.0
Industrial countries	3.3	2.5	2.3	2.3	–10.6
Developing countries	3.2	2.7	2.6	2.5	9.2
Africa	3.2	2.6	2.3	2.1	–0.4
Asia	2.9	2.6	2.4	2.4	5.9
Newly industrializing economies[1]	4.1	3.9	3.6	3.7	2.9
Middle East and Europe	8.4	7.2	6.7	6.4	2.8
Western Hemisphere	1.3	1.2	1.3	1.2	0.9
Countries in transition	6.5	3.2	2.2	1.9	–0.6
Former Soviet Union	6.8	3.9	2.3	1.8	–1.1

Note: Sample comprises 132 countries. Data weighted by country GDP.
[1]Korea, Singapore, and Taiwan Province of China.
Data: IMF, World Economic Outlook database, 1997

Table 2. Military Expenditures, 1990–95: SIPRI Data

	1990	1994	1995
		Percent of GDP	
All countries	4.2	2.5	2.3
Industrial countries	3.3	2.4	2.2
Developing countries	3.2	3.0	2.6
Africa	3.3	2.9	3.3
Asia	2.9	2.8	2.7
Newly industrializing economies[1]	4.3	4.1	4.0
Middle East and Europe	8.0	6.6	5.7
Western Hemisphere	1.2	1.2	1.2
Countries in transition	19.8	4.8	2.9
Former Soviet Union	22.5	6.0	3.0

Note: Sample includes from 63 to 117 countries. Data weighted by country GDP, according to World Economic Outlook database, 1997.
[1]Korea, Singapore, and Taiwan Province of China.
Data: SIPRI, *World Armaments and Disarmaments: SIPRI Yearbook, 1996* (London: Oxford University Press, 1996)

and 1995. Military expenditure in the countries in transition also fell by 0.3 percent of GDP ($0.6 billion), led by a ½ percentage point decline in spending by countries of the former Soviet Union ($1.1 billion). Data on military expenditures in many transition economies are likely to understate the true level of these outlays, since they do not measure all expenditure commitments. ■

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Table 3. Military Expenditures, 1990–95: IISS Data

	1990	1995	1996 (Budget)
	Percent of GDP		
All countries	3.3	2.7	2.1
Industrial countries	3.2	2.5	2.1
Developing countries	4.0	3.7	2.4
Africa	3.0	2.9	2.1
Asia	3.6	4.0	2.3
Newly industrializing economies[1]	4.8	4.0	3.9
Middle East and Europe	10.7	7.1	6.5
Western Hemisphere	1.4	1.7	1.1
Countries in transition (excluding the former Soviet Union)	3.2	2.4	2.0

Note: Sample comprises 89 countries. Data weighted by country GDP, according to World Economic Outlook database, 1997.
[1]Korea, Singapore, and Taiwan Province of China.
Data: IISS, *The Military Balance* (London: The International Institute for Strategic Studies), various issues

Fiscal Policy Plays Fundamental Role In Long-Run Growth

Issues relating to the appropriate scope, nature, and conduct of fiscal policy—both in the context of easing macroeconomic instability in the short run and fostering growth in the long run—have taken on a new urgency in policy debates. Although economists working in public finance have always believed that fiscal policy—that is, the manipulation of fiscal instruments to achieve specific objectives—can affect economic growth, the idea that policy matters for long-term growth has only recently been established in mainstream economic thinking. The basic premise of this literature is that a country's growth performance in the

Composition of Fiscal Adjustment Is Crucial for Growth

To set the stage for sustained growth, countries suffering from high inflation and balance of payments difficulties must pursue what can be a wrenching fiscal adjustment to resolve internal and external financial imbalances. The goals of fiscal policy, however, should go beyond simply reducing the size of the fiscal deficit. The way deficit reduction is achieved—the composition of fiscal adjustment—is as important as the quantity of the adjustment and has a critical bearing on whether reforms will be sustained and whether the adjustment will undermine a country's long-run growth prospects, according to a new IMF Occasional Paper, *The Composition of Fiscal Adjustment and Growth: Lessons from Fiscal Reforms in Eight Economies*, by G.A. Mackenzie, David W.H. Orsmond, and Philip R. Gerson.

How fiscal adjustment is achieved is as important as the magnitude of adjustment.

The staff study examines the composition of fiscal adjustment—tax and expenditure policies and administrative procedures, and some aspects of public enterprise reform—in a sample of eight countries (Bangladesh, Chile, Ghana, India, Mexico, Morocco, Senegal, and Thailand) during a recent period (usually 1978–93) within the context of broader efforts to increase growth. In looking at the composition of fiscal adjustment in these countries, the authors ask why some countries enjoyed more success than others. Their objective is to determine whether, and to what extent, these fiscal reforms fostered growth over the adjustment period.

One of the criteria used in the study is the degree to which countries engaged in IMF-supported adjustment programs protected social expenditure—in particular, spending for primary education and public and primary health care. Other criteria include how rapidly countries addressed other aspects of expenditure policy, basic tax reform, and administrative reforms; and how they dealt with public enterprise reform. The eight cases include both low- and middle-income countries and countries with public sectors of varying sizes at the outset of the adjustment periods. The group includes countries forced to make a draconian fiscal adjustment in a crisis environment and countries whose adjustment efforts were more gradual.

Major conclusions of the staff study include the following:

• Stabilization need not play havoc with a growth-promoting fiscal strategy. Once stabilization takes firm hold and revenue-raising measures take effect, cuts can be at least partially restored.

• The initial adjustment undertaken by the eight countries under review tended primarily to emphasize expenditure cuts—particularly expenditures on capital goods and other long run is endogenously determined by a set of variables that are responsive to—and affected by—policy.

In an IMF Working Paper, *Fiscal Policy and Long-Run Growth*, Vito Tanzi and Howell H. Zee survey the literature—much of it based on the new endogenous growth theory—on the impact on long-run growth of the three main instruments of fiscal policy—taxation, public expenditure, and aggregate budgetary balance from the perspective of allocative efficiency, macroeconomic stability, and income distribution.

Allocative Efficiency

Taxation. Both tax policy and the structure of the tax system can have implications for long-run growth. Some of the most direct conceptual links between fiscal policy and growth have traditionally been associated with tax policy because the allocative impacts of taxation (for example, on the choice between leisure and labor, consumption and saving, and the relative profitabilities of different industries) are readily apparent. One of these links rests on the idea that the allocative decisions of private economic agents facing taxes are different from decisions that would be made in the absence of taxes. This tax-induced distortion in economic behavior results in a net efficiency loss to the whole economy—the so-called excess burden of taxation.

Another link is the impact of taxation on factor accumulation, particularly capital. A tax on income from physical capital lowers the after-tax return to savings and is, therefore, a disincentive to accumulate physical capital. The ultimate impact on growth, however, is ambiguous, since it depends on how other factors, such as human capital, are affected by the tax.

The overall design of the structure of the tax system could have important implications for growth. For a given total tax level, a relative shift from income to consumption taxation would reduce the disincentive to save and, consequently, boost capital accumulation. A heavy reliance on trade taxes could impede an economy's capacity to absorb or develop new technologies—thus harming its growth prospects—by reducing the exposure of domestic industries to international markets and competition.

Fiscal policy can play a fundamental role in long-run economic growth.

Tax incentives—for promoting investment and research and development activities—are an additional channel through which tax policy could have a significant impact on resource accumulation and technological progress. However, because they create distortions, they may not always have a positive effect on long-run growth.

The empirical evidence on the impact of tax policy on growth is mixed, despite some suggestion of a negative relationship between the tax level and growth. The

goods and services. Such cuts would have been potentially damaging had they not been reversed subsequently.

• Whatever the pattern of expenditure reduction or tax increase initially adopted, structural reform within the fiscal sector remains an essential component of sustainable and growth-oriented fiscal adjustment. An early start to structural reforms that over the medium term frees up budget resources is particularly important, since these reforms enable a reversal of the initial emphasis on cuts in potentially productive expenditure.

• Certain structural expenditure reforms considered important, if not crucial, to the long-run success of adjustment efforts frequently take time to come to fruition—and may realize only limited budgetary savings in the short run (for example, civil service reform).

• Countries starting the adjustment period with adequate public expenditure management systems were usually more successful in preserving expenditure with a high social rate of return. The prevailing pattern of adjustment, with its initial emphasis on expenditure reduction, meant that the public expenditure management system was tested early in the adjustment process. In general, the better the system was able to set priorities and enforce the changes in the composition of expenditure that was consistent with them, the more productive the expenditure outcome.

• Substantial reform of the tax policy regime went hand in hand with administrative reforms; countries implementing structural tax reforms usually had a well-functioning tax administration to begin with. Retaining, or creating, a critical minimum level of administrative capacity is key.

• Increases in the tax ratio can be accomplished without resorting to major tax hikes. Conversely, decreases in rates do not inevitably presage a decline in revenue. Except for Ghana, the countries that achieved substantial increases in their tax ratios did so by broadening the effective tax base.

• Successful implementation of tax and expenditure policy reform in IMF-supported adjustment programs requires closer integration of improvements in tax administration and public expenditure management; these programs should be sensitive to the risk that the initial heavy emphasis on expenditure restraint may become permanent and, by suppressing growth-fostering expenditure, inadvertently damage a country's long-term growth prospects.

James McEuen
IMF External Relations Department

Copies of IMF Occasional Paper No. 149, *The Composition of Fiscal Adjustment and Growth: Lessons from Fiscal Reforms in Eight Economies*, by G.A. Mackenzie, David W.H. Orsmond, and Philip R. Gerson, are available for $15.00 (academic rate: $12.00) from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org.

main difficulty in isolating the impact of taxation on growth, according to Tanzi and Zee, is that key nontax fiscal variables that are not independent of tax policy—such as public expenditure and budget policies—can also affect growth.

Public Expenditure. The financing of public expenditure involves the public sector's absorption of real resources that would otherwise be available to the private sector. From an allocative point of view, this absorption would improve overall efficiency if the social return—that is, the benefit—from public expenditure exceeds its private opportunity cost (that is, the resources forgone by the private sector). Public expenditure may displace private sector output (the "crowding-out" effect), but it may also improve private sector productivity (the externality or public good effect). Although the recent focus has been on spending on public infrastructure, the authors say there is no reason why the public good effect could not be extended to a range of public expenditures that enhance human capital, such as elementary education and vocational training.

Uncertainty about tax regimes can discourage investment and hamper growth.

The opposing nature of the crowding-out and externality effects implies that the structure of public expenditure could also have an impact on growth. Public expenditure has traditionally been classified as either public consumption or public investment, with the former tending to retard growth, and the latter promoting it. But, as the authors note, many public investment projects can be wasteful, while many public consumption expenditures—such as training and spending on existing infrastructure—can be beneficial. Public expenditure might more usefully be reclassified as productive (that is, growth-inducing) and unproductive (growth-retarding).

As was the case with taxation, the empirical evidence on the growth effects of public expenditure is inconclusive, partly because of the similar difficulty in isolating its impact from other policy variables.

Budget Policy. The level of public revenue relative to that of public expenditure—that is, the budget balance—may have growth effects that are separate from those related to the absolute level of taxation or public expenditure. One effect is the possible behavioral response from the private sector that a budget imbalance may trigger. If the private sector regards budget deficits as simply taxes delayed, it may choose to increase its own savings to neutralize the public dissavings, thereby keeping the level of national savings unchanged. If budget deficits do not induce a response in private sector savings, however, national savings would be reduced and growth hampered.

Whether there is neutrality between debt and tax financing has been the focus of much recent research, according to Tanzi and Zee, but the empirical evidence is mixed. It is now widely recognized that strict neutrality depends not only on the existence of operative private transfers between generations—so that the implied tax burden of public dissavings on future generations is not ignored by the current generation—but also on the absence of tax distortions, income uncertainties, and imperfect credit markets.

Stability

There is strong empirical evidence that growth can be negatively affected by uncertainty in several fiscal variables, such as revenue levels, public expenditure, and budget deficits.

An uncertain tax regime, for example, injects volatility into the returns to an investment project. Increased uncertainty to returns will generally lead to a reduction in investment. Hence, uncertainty about the tax regime, which in turn leads to uncertain after-tax returns, is likely to discourage investment and hamper growth.

Tax regime uncertainty could be attributable to a number of variables, including:

- difficulty in forecasting the direction of prospective tax reforms under political debate;
- possible changes necessitated by unexpected shocks to income or interest rates or unforeseen public expenditure needs;
- uncertain real effective tax rates in an unstable inflationary environment with a tax system that is unindexed or has significant collection lags; and
- uncertainty whether the government would maintain the same tax regime over time, if the optimal regime changes from one period to the next.

Some measures that might alleviate the adverse impact on growth of tax regime uncertainty include:

- precommitting the government in a given period to maintain an optimal policy over time;
- instituting an appropriate debt management policy that could obviate the need to alter the tax regime as a response to unexpected shocks to income and interest rates or unforeseen public expenditure needs; and
- implementing appropriate policies to reduce macroeconomic instabilities.

The relevance of budget policy sustainability for growth is twofold. If the current policy is deemed unsustainable, either a regime change in tax and/or expenditure policy would be expected to occur, or monetary financing would be resorted to. The former would increase policy uncertainty; the latter would lead to inflation. According to Tanzi and Zee, there is increasing empirical evidence suggesting a significant and negative correlation between high inflation and growth.

Income Distribution

According to traditional economic thinking, a tradeoff is involved between the allocative and distributional objectives of fiscal policy. Policies aimed at redistributing income toward equality exact a price of aggregate output loss that is likely to rise disproportionately to the reduction in income inequality.

The validity of this view has been challenged in recent years by various research strands, say the authors. Taken together, these strands suggest that the trade-off between the allocative and distributional objectives of fiscal policy is not absolute: growth with redistribution is possible. Further, much of the empirical evidence supports the existence of a negative correlation between income inequality and growth.

According to one research strand, redistributive taxation and the expenditure it finances are a form of social insurance against certain types of risk for which private insurance may not be available. Another research strand emphasizes the impact of financial market imperfections. According to this view, the potential productivity of the poor cannot be fully realized unless they are given the opportunity. Redistributive policies are needed to raise the poor's standard of living sufficiently for them to become productive members of society and, consequently, to contribute to output growth. Once gainfully employed, the poor could begin to acquire assets, accumulate human capital, and gain access into financial markets to further raise their earnings potential. The financial markets, in turn, benefiting from the increased participation by economic agents in the intermediation process, would become more developed, and the growth prospects for the whole economy would be enhanced.

Fiscal Policy Recommendations

The literature on the relationship between fiscal policy instruments and economic growth, although extensive, fails to reach definitive conclusions about the way taxes, public spending, and budgetary policy can influence growth by affecting the allocation of resources, the stability of the economy, and the distribution of income. The empirical literature, in particular, is somewhat disappointing in its support of theoretical conclusions.

While acknowledging these shortcomings, however, Tanzi and Zee conclude that from the perspective of the new endogenous growth theory, fiscal policy can play a fundamental role in affecting the long-run growth performance of countries. Thus, they maintain, economists should not hesitate to recommend changes in public finance instruments in directions that theory has deemed important for enhancing growth, including policies to improve the neutrality of taxation, promote human capital accumulation, and lessen income inequality. ■

Copies of IMF Working Paper 96/119, *Fiscal Policy and Long-Run Growth*, by Vito Tanzi and Howell H. Zee, are available for $7.00 from Publication Services, Box XS700, IMF, Washington, DC 20431 U.S.A. Telephone: (202) 623-7430; fax: (202) 623-7201; Internet: publications@imf.org.

From the Executive Board

Following are excerpts of recent IMF press releases. The full texts are available on the IMF's web site (http://www.imf.org) under "news" or on request (fax only, please) from the IMF's Public Affairs Division (fax: (202) 623-6278).

Georgia: ESAF

The IMF approved the second annual loan under the enhanced structural adjustment facility (ESAF), in an amount equivalent to SDR 55.5 million (about $76 million), to support Georgia's economic program in 1997. The loan is available in two semiannual installments, the first of which will be available on April 4 of this year.

1997 Program

The key macroeconomic objectives of the 1997 program are to achieve a real GDP growth rate of at least 8–10 percent; bring down the 12-month inflation rate to 10–12 percent; further reduce the current account deficit to about 7 percent of GDP; and reach a level of gross official international reserves equivalent to 2.5 months of imports. To achieve these objectives, fiscal policy will aim at reducing the overall deficit, on a cash basis and including grants, to 3.5 percent of GDP in 1997 from 4.4 percent in 1996.

Georgia: Selected Economic Indicators

	1995	1996[1]	1997[2]	1998[3]	1999[3]
			(percent change)		
Real GDP	2.4	10.5	8–10.0	10.0	8.0
Consumer prices (end period)	57.0	14.0	10–12.0	9.8	7.0
			(percent change)		
Overall fiscal balance (cash basis and including grants)	–4.6	–4.4	–3.5	–1.9	–1.3
External current account balance (excluding official transfers)	–14.1	–7.6	–6.7	–6.0	–4.4
			(months of imports)		
Gross official reserves	2.7	2.5	2.5	2.7	2.9

[1]Preliminary estimates.
[2]Program.
[3]Projections.

Data: Georgian authorities and IMF staff estimates and projections

Structural Reforms

The authorities are committed to accelerating the implementation of structural reforms. In addition to the reforms under way in the banking sector and in tax administration, the agenda for 1997 includes restructuring the energy sector; pursuing an ambitious privatization program for medium- and large-scale enterprises; accelerating agricultural land reform; developing a legal framework for the privatization of urban and industrial land; and further developing the enforcement of existing laws and regulations.

Addressing Social Needs

Since early 1995, the government has made continuous attempts to improve the standard of living of the population. The monthly minimum wage in the budgetary sector has quadrupled in real terms since January 1995, and average real pensions have doubled over the same period. Several measures have already been implemented to improve the targeting of the social safety net, including a flat-rate pension system and a new assistance program for the disabled. The government intends to continue to increase the share of budgetary outlays on education in the next few years, and has embarked on an ambitious health care reform program.

Georgia joined the IMF on May 5, 1992, and its quota is SDR 111.0 million (about $153 million). Its outstanding use of IMF financing currently totals SDR 133.2 million (about $183 million).

Press Release No. 97/13, March 24

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

Member	Date of Arrangement	Expiration Date	Amount Approved	Undrawn Balance
			(million SDRs)	
Stand-by arrangements			3,811.57	2,471.40
Argentina	April 12, 1996	January 11, 1998	720.00	321.00
Bulgaria	July 19, 1996	March 18, 1998	400.00	320.00
Djibouti	April 15, 1996	June 14, 1997	4.60	1.73
Egypt	October 11, 1996	September 30, 1998	271.40	271.40
El Salvador	February 28, 1997	April 27, 1998	37.68	37.68
Estonia	July 29, 1996	August 28, 1997	13.95	13.95
Hungary	March 15, 1996	February 14, 1998	264.18	264.18
Latvia	May 24, 1996	August 23, 1997	30.00	30.00
Lesotho	September 23, 1996	September 22, 1997	7.17	7.17
Pakistan	December 13, 1995	September 30, 1997	562.59	267.90
Papua New Guinea	July 14, 1995	December 15, 1997	71.48	36.14
Romania	May 11, 1994	April 24, 1997	320.50	226.23
Venezuela	July 12, 1996	July 11, 1997	975.65	625.65
Yemen	March 20, 1996	June 19, 1997	132.38	48.38
EFF arrangements			10,183.93	6,684.34
Algeria	May 22, 1995	May 21, 1998	1,169.28	506.48
Azerbaijan	December 20, 1996	December 19, 1999	58.50	53.82
Croatia	March 12, 1997	March 11, 2000	353.16	324.38
Gabon	November 8, 1995	November 7, 1998	110.30	66.18
Jordan	February 9, 1996	February 8, 1999	238.04	127.74
Kazakstan	July 17, 1996	July 16, 1999	309.40	309.40
Lithuania	October 24, 1994	October 23, 1997	134.55	41.40
Moldova	May 20, 1996	May 19, 1999	135.00	112.50
Peru	July 1, 1996	March 31, 1999	300.20	139.70
Philippines	June 24, 1994	June 23, 1997	474.50	438.00
Russia	March 26, 1996	March 25, 1999	6,901.00	4,564.74
ESAF arrangements			3,993.72	1,685.21
Armenia	February 14, 1996	February 13, 1999	101.25	67.50
Azerbaijan	December 20, 1996	December 19, 1999	93.60	73.12
Benin	August 28, 1996	August 27, 1999	27.18	22.65
Bolivia	December 19, 1994	December 18, 1997	100.96	33.65
Burkina Faso	June 14, 1996	June 13, 1999	39.78	26.52
Cambodia	May 6, 1994	May 5, 1997	84.00	42.00
Chad	September 1, 1995	August 31, 1998	49.56	24.78
Congo	June 28, 1996	June 27, 1999	69.48	55.58
Côte d'Ivoire	March 11, 1994	June 13, 1997	333.48	—
Ethiopia	October 11, 1996	October 10, 1999	88.47	73.73
Georgia	February 28, 1996	February 27, 1999	166.50	111.00
Ghana	June 30, 1995	June 29, 1998	164.40	109.60
Guinea	January 13, 1997	January 12, 2000	70.80	59.00
Guinea-Bissau	January 18, 1995	January 17, 1998	9.45	3.68
Guyana	July 20, 1994	July 19, 1997	53.76	17.92
Haiti	October 18, 1996	October 17, 1999	91.05	75.88
Honduras	July 24, 1992	July 24, 1997	47.46	13.56
Kenya	April 26, 1996	April 25, 1999	149.55	124.63
Kyrgyz Republic	July 20, 1994	July 19, 1997	88.15	32.25
Lao P.D.R.	June 4, 1993	May 7, 1997	35.19	—
Madagascar	November 27, 1996	November 27, 1999	81.36	67.80
Malawi	October 18, 1995	October 17, 1998	45.81	22.91
Mali	April 10, 1996	April 9, 1999	62.01	41.34
Mauritania	January 25, 1995	January 24, 1998	42.75	14.25
Mozambique	June 21, 1996	June 20, 1999	75.60	50.40
Nicaragua	June 24, 1994	June 23, 1997	120.12	100.10
Niger	June 12, 1996	June 11, 1999	57.96	38.64
Senegal	August 29, 1994	January 12, 1998	130.79	17.84
Sierra Leone	March 28, 1994	December 31, 1997	101.90	10.11
Tanzania	November 8, 1996	November 7, 1999	161.59	135.88
Togo	September 16, 1994	September 15, 1997	65.16	32.58
Uganda	September 6, 1994	November 17, 1997	120.51	23.43
Vietnam	November 11, 1994	November 10, 1997	362.40	120.80
Zambia	December 6, 1995	December 5, 1998	701.68	40.00
Total			17,989.22	10,840.95

EFF = extended Fund facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals owing to rounding.

Data: IMF Treasurer's Department

Kyrgyz Republic: ESAF

The IMF approved the third annual loan under the enhanced structural adjustment facility (ESAF), in an amount equivalent to SDR 32.3 million (about $44 million), to support the Kyrgyz Republic's economic program in 1997.

The recovery in output in the Kyrgyz Republic has exceeded expectations, with real GDP growth rising to 5.6 percent in 1996 from 1.3 percent in 1995, led by a sharp increase in agricultural output. On the other hand, there was no progress in reducing inflation, which increased to 35 percent in 1996 from 32 percent in 1995, despite a steep reduction in the budget deficit and its domestic borrowing requirements.

Kyrgyz Republic: Selected Economic Indicators

	1994	1995	1996[1]	1997[2]
		(percent change)		
Real GDP	–20.0	1.3	5.6	6.9
Consumer prices (end of period)	95.7	31.9	35.0	17.4
		(percent change)		
Cash budget balance	–7.7	–13.5	–6.4	–5.3
External current account balance[3]	–11.2	–18.0	–22.0	–13.6
		(months of imports)		
Gross international reserves	2.5	2.5	2.0	2.8

[1]Estimate.
[2]Program.
[3]Including the operations of the Kumtor gold project.

Data: Kyrgyz authorities and IMF staff estimates and projections

The Kyrgyz Republic has carried out an ambitious structural reform program, which in 1996 included a comprehensive restructuring of the financial sector, further advances in privatization and enterprise restructuring, as well as a range of reforms in the legal system and the agricultural sector.

1997 Program

The government's 1997 economic program, which is supported by the IMF under the third annual ESAF loan, builds on the Kyrgyz Republic's achievements in macroeconomic stabilization. The key objectives for 1997 are economic growth of about 7 percent; a reduction in end-of-period inflation to 17.4 percent in 1997 from 35 percent in 1996; and a buildup in the coverage of gross international reserves from the equivalent of 2.0 months of imports in 1996 to 2.8 months in 1997.

To achieve these ends, the cash budget deficit is targeted to decline to 5.3 percent of GDP in 1997, from 6.4 percent in 1996.

Structural Reforms

The 1997 economic program contains a wide range of structural reforms covering privatization and the breakup of monopolies, enterprise restructuring and governance, and agriculture. The privatization program for 1997 envisages the completion of the coupon and cash auction under the mass privatization program by end-1997. To address the issue of corporate governance, the government has initiated a program to improve the management and accountability of public enterprises.

Addressing Social Needs

Reforms of the system of social protection are being undertaken to enhance the efficiency and cost-effectiveness of the delivery of social services. Reforms will focus on refining the targeting of benefits while improving the quality of basic social services.

The Kyrgyz Republic joined the IMF on May 8, 1992; its quota is SDR 64.5 million (about $89 million); its outstanding use of IMF credit currently totals SDR 96 million (about $132 million).

Press Release No. 97/14, March 27

Bulgaria: Stand-By and CCFF

The IMF approved credits totaling SDR 479.5 million (about $657 million) for Bulgaria. Of the total, the equivalent of SDR 107.6 million (about $147 million) is available under the cereal element of the compensatory and contingency financing facility (CCFF) because of increased import costs prompted by a significant decline in cereal yields and production during 1996/1997. A further SDR 371.9 million (about $510 million) is available over the next 14 months under a stand-by credit to support the government's economic program for 1997–98.

1997–98 Program

The authorities' program, supported by the new stand-by credit, represents a break with the past and aims to restore confidence in public institutions and to put 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 commitment to establish a currency board arrangement by mid-year. The program aims to limit the decline of real GDP to 4.8 percent in 1997,as growth turns positive by midyear; reduce monthly inflation to 2 percent by the end of the year; maintain a small surplus in the current account; and double official reserves to the equivalent of three months of imports of goods and nonfinancial services.

Fiscal policy has been designed to support the objective of rapid stabilization by cutting the overall budget deficit to 3.8 percent of GDP in 1997 from 10.9 percent in 1996 and by eliminating the need for central bank credit to the government.

Structural Reforms

Bulgaria aims to underpin its stabilization efforts and prepare for the adoption of a currency board with a comprehensive program of structural reform designed to strengthen the

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banking system, harden budget constraints on state-owned enterprises, and liberalize the economy to provide the basis for development of a healthy private sector. The authorities are committed to privatize all commercial enterprises and half of the country's utilities within two years. The liberalization of the agricultural sector by removing price controls, trade restrictions, and any remaining impediments to foreign direct investments is expected to contribute to the establishment of a private market economy.

Addressing Social Needs

The dramatic fall in real pensions and wages in the budgetary sector over the past six months has caused extreme hardship for large segments of the population. In the course of 1997, the government intends to restore wages and pensions to levels that meet the basic requirements of the recipients and to restructure the social safety net through consolidation of programs into a well-targeted system of income transfers to the poor, old-age pensions, and unemployment insurance.

Bulgaria joined the IMF on September 25, 1990; its quota is SDR 464.9 million (about $637 million); its outstanding use of IMF credit currently totals SDR 380 million (about $520 million).

Press Release No. 97/15, April 11

Bulgaria: Selected Economic Indicators

	1994	1995	1996[1]	1997[2]	1998[2]
			(percent change)		
Real GDP	1.8	2.1	–9.0	–4.8	5.7
Consumer prices (end o f period)	122.0	33.0	311.0	769.0	14.0
			(percent change)		
Overall general government balance	–5.8	–5.7	–10.9	–3.8	0.0
External current account balance	–2.1	–0.5	0.5	0.1	0.4

[1]Estimate.
[2]Program.

Data: Bulgarian authorities and IMF staff estimates and projections

F.Y.R. of Macedonia: ESAF

The IMF approved a three-year loan for the former Yugoslav Republic of Macedonia (FYRM) under the enhanced structural adjustment facility (ESAF), in an amount equivalent to SDR 54.6 million (about $75 million), to support Macedonia's 1997–99 economic reform program. The first annual loan, equivalent to SDR 18.2 million (about $25 million), is available in two equal semiannual installments, the first of which is available immediately.

Medium-Term Strategy and 1997 Program

Over the next three years, the FYRM aims to achieve sustainable growth and reduce unemployment and poverty by further restructuring the economy along market lines and maintaining a stable financial environment. Over the medium term, the program targets annual GDP growth of about 5 percent, inflation of 2–3 percent yearly, and a decline in the external current account deficit to 5.3 percent of GDP from about 12 percent in 1996. Financial policies will be underpinned by tight budget discipline, which will aim at balance in the general government accounts.

In the context of the medium-term strategy, the 1997 program aims for real GDP growth of 5 percent,annual year-end inflation of 2 percent, and an external current account deficit of 8.5 percent of GDP.

Structural Reform

A crucial condition for reviving economic growth in the FYRM is the further restructuring of the enterprise sector. Effective enterprise ownership will be encouraged by eliminating restrictions on secondary share transactions and selling remaining government-owned shares. Tax and other incentives for the conversion of wage arrears into equity are planned, as is the reform of legislative and judicial procedures regulating commercial contracts and bankruptcy procedures. By end-1997 the program aims to privatize all eligible enterprises, including 70 percent of agricultural enterprises. The FYRM will also continue to liberalize its trade regime by reducing average import taxes and discretionary exemptions.

Addressing Social Issues

Under the program, additional resources will be channeled to social assistance and the Employment Fund, which the government considers vital in providing an adequate safety net to support the process of economic restructuring. Spending on education as a share of GDP will be maintained at the 1996 level, and health benefits will be restructured to restore the financial balance of the Health Fund and clear outstanding arrears.

The FYRM succeeded to the membership in the IMF of the former Socialist Federal Republic of Yugoslavia, effective December 14, 1992. Its quota is SDR 49.6 million (about $68 million), and its outstanding use of IMF credit totals SDR 47 million (about $64 million).

Press Release No. 97/16, April 14

F.Y.R. of Macedonia: Selected Economic Indicators

	1994	1995[1]	1996[1]	1997[2]	1998[2]	1999[2]
			(percent change)			
Real GDP growth	–4.0	–1.4	1.1	5.0	5.3	5.3
Consumer price index (end of period)	55.0	8.6	–0.7	2.0	3.0	3.0
			(percent of GDP)			
General government balance	–3.2	–1.3	–0.4	1.5	0.0	0.0
Current account balance	–6.4	–6.2	–11.9	–8.5	–7.3	–5.3
			(months of imports)			
Official gross reserves	1.3	1.9	2.0	2.3	2.5	2.8

[1]Preliminary.
[2]Projections.

Data: Authorities of the former Yugoslav Republic of Macedonia and IMF staff estimates and projections

Surveillance, IMF Quota, and Debt Issues To Be Featured at Spring Meetings

Finance ministers and central bank governors will gather on April 28 in Washington for the forty-eighth meeting of the IMF's principal advisory body, the Interim Committee of the IMF's Board of Governors on the International Monetary System (the Interim Committee)—under the Chairmanship of Belgian Finance Minister Philippe Maystadt. The Interim Committee will consider global economic prospects and recent adaptations of IMF surveillance over the policies of its member countries, given efforts to reinforce surveillance in response to the challenges of globalized financial markets. It will also discuss the status of the eleventh general review of IMF quotas, a special "equity" allocation of SDRs, and financing to continue the IMF's enhanced structural adjustment facility (ESAF)—the IMF's concessional financing facility for poor countries engaged in growth-oriented macroeconomic and structural adjustment—and the associated IMF-World Bank debt initiative to reduce the external debt burden of heavily indebted poor countries (HIPCs).

The Interim Committee session will be followed by the fifty-fifth meeting of the Joint Bank and Fund Committee on the Transfer of Real Resources to Developing Countries (the Development Committee), on April 29. The Development Committee will be chaired by Moroccan Finance Minister Mohamed Kabbaj. The first item on the agenda is a discussion of proposals to strengthen support for development cooperation—including ways to enhance the effective use of declining flows of official development assistance. The Development Committee will also consider progress in implementing the HIPC initiative, resources for the Bank's Multilateral Investment Guarantee Agency (MIGA), and ways to facilitate private involvement in infrastructure.

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
April 7	4.04	4.04	4.42
April 14	4.04	4.04	4.42

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (the U.S. dollar, weighted 39 percent; deutsche mark, 21 percent; Japanese yen, 18 percent; French franc, 11 percent; and U.K. pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 109.4 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171.
Data: IMF Treasurer's Department

The spring meetings of the Interim and Development Committees will be preceded by meetings of the Group of Ten industrial countries, Ministers of the Group of 24 developing countries, and Deputies of the Group of 24. Also, on April 23, Michael Mussa, Economic Counsellor and Director of the IMF's Research Department, will brief the press on the spring 1997 edition of the IMF's *World Economic Outlook*.

IMF Surveillance

The Interim Committee will discuss IMF surveillance of member country policies with the benefit of a report on the Executive Board's recent biennial review of surveillance practices and procedures (see page 113). Over the past two years, the IMF has strengthened its surveillance through more continuous and candid dialogue with member countries; an effort to ensure members' regular and timely data reporting of higher-quality data; greater attention to banking and financial sector soundness—with the aim of early detection of financial problems; more attention to capital account developments; and consideration of regional issues, notably, the implications of the impending European economic and monetary union (see *IMF Survey*, April 7, page 100).

The Interim Committee will have a full exchange of views on globalization.

On the multilateral surveillance front, the Interim Committee will assess the world economic outlook in the light of the Declaration on Partnership for Sustainable Global Growth, adopted at the Committee's September 1996 meeting. The Declaration outlines a comprehensive medium-term strategy, consisting of mutually reinforcing principles of policymaking to achieve sustained noninflationary growth in both industrial and developing countries and the full participation of all countries in the global economy. The Committee will be holding its discussions amid generally favorable prospects for continued expansion of global output and trade, with low or declining inflation and, in many countries, a reduction in fiscal imbalances and the pursuit of supportive structural reforms. Risks on the horizon that are likely to be discussed include high unemployment and weak growth in Europe, fragile banking sectors in a number of economies, and uneven economic performance in developing and transition economies—with some poor developing countries facing the prospect of marginalization and some transition economies facing prolonged economic weakness owing to delayed and incomplete policy reforms. The Committee is expected

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to have a full exchange of views on the implications of globalization—specifically, how countries could benefit from globalization by aligning their policies to it, while addressing any short-term adverse effects that may be associated with the process.

The Committee will have before it a progress report on implementation of the special data dissemination standard (SDDS), and the general data dissemination system (GDDS). The SDDS, developed and launched by the IMF last September, aims to guide member countries having, or seeking, access to world capital markets in publishing timely and accurate economic and financial data. At present, metadata (that is, information on various statistical practices of member governments) for 28 member countries are on the Dissemination Standards Bulletin Board on the IMF's Internet web site (http://www.imf.org), compared with 18 countries in September 1996. The IMF is progressing with the development of the GDDS, which will provide a broad framework to guide all other member countries in improving the quality of data, as well as its production and dissemination.

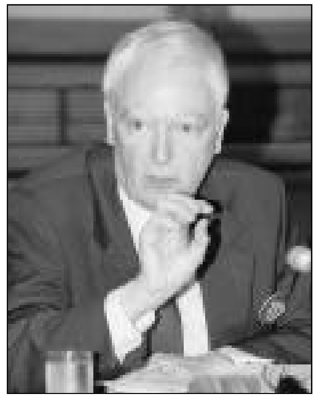
IMF Quotas and SDR Allocation

The Interim Committee is expected to ask the IMF's Executive Board to expedite the Eleventh General Review of Quotas, to ensure the adequacy of IMF quotas to respond over the medium term to unexpected developments—and potentially large demands on its resources—in a globalized economy with integrated financial markets. Although the Executive Board adopted New Arrangements to Borrow (NAB) on January 27—under which 25 industrial and developing countries and institutions stand ready to lend the IMF up to SDR 34 billion to supplement its regular quota resources when needed to forestall or cope with an impairment of the international monetary system (see *IMF Survey*, February 10, page 33)—the Committee has emphasized that expanded borrowing does not substitute for a quota increase, since quotas are the IMF's primary source of liquidity.

Ministers will also discuss the idea of an "equity" allocation of SDRs so as to achieve the full participation of all IMF members in the SDR system, including those members that have joined since the last SDR allocation in 1981. Such a limited allocation would require a fourth amendment of the IMF's Articles of Agreement, providing for a one-time SDR allocation based on a common benchmark ratio of cumulative allocations to quotas.

Financial Sector Issues

The rapid growth and increasing integration of international capital markets have heightened the importance of IMF surveillance of the international monetary system—increasing, in turn, the IMF's attention to banking and financial sector, and capital account, issues. The Committee is expected to discuss the IMF's role in the ongoing international effort to promote the adoption of sound banking principles and practices across its membership. This effort entails close cooperation with other relevant international institutions and bodies, such as the Basle Committee on Banking Supervision, the Bank for International Settlements, and the World Bank.



Interim Committee Chairman Philippe Maystadt.

Development Committee Chairman Mohamed Kabbaj.

Also on the agenda is a consideration of the need for an orderly and sustainable process of capital account liberalization—given that an open and liberal system of capital movements contributes to an efficient allocation of global savings and investment—as part of a broad reform effort involving sound macroeconomic policies and strong financial systems. In this connection, the Committee will examine the possibility of extending the IMF's jurisdiction to include capital account, as well as current account, issues.

Debt Initiative

The ESAF has been endorsed as the centerpiece of IMF support for low-income countries and as the basis for IMF participation in the HIPC initiative to reduce to sustainable levels the debt burden of heavily indebted poor countries. The Interim and Development Committees will discuss progress in implementing the HIPC initiative, including potential candidates. ■

David M. Cheney
Editor, *IMF Survey*

Spring Meetings Information on Internet

For updated information emerging from the spring meetings of the Interim and Development Committees and related events—including transcripts of press conferences and briefings, public statements and communiqués—please visit the IMF's web site (http://www.imf.org).

The next issue of the *IMF Survey*, which will cover the IMF-World Bank Spring Meetings, will appear on May 12.