Box 1
The IMF’s Response to the Asian Crisis

In seeking to restore confidence in the region in the wake of the Asian crisis, the IMF responded quickly by:

• helping the three countries most affected by the crisis—Indonesia, Korea, and Thailand—arrange programs of economic reform that could restore confidence and be supported by the IMF. The Philippines’ existing IMF-supported program was extended and augmented in 1997, and a Stand-By Arrangement was approved in 1998;

• approving some SDR 26 billion of IMF financial support for reform programs in Indonesia, Korea, and Thailand and spearheading the mobilization of some $77 billion of additional financing commitments from multilateral and bilateral sources in support of these reform programs in 1997. In mid-1998, the IMF’s committed assistance for Indonesia was augmented by SDR 1 billion, with an estimated $5 billion from multilateral and bilateral sources. Of the commitments to all three countries, some SDR 18 billion had been disbursed by the IMF by July 23, 1998. (See table.); and

• intensifying its consultations with other members both within and outside the region that, although not necessarily requiring IMF support, were affected by the crisis and needed to take policy steps to ward off contagion.

To implement its response to the crisis, the IMF:

• used the accelerated procedures established under the Emergency Financing Mechanism and the exceptional circumstances clause to meet the exceptional needs of the member countries in terms of approval time and access. This was followed by close monitoring of performance under the programs on a continuing basis and the approval of a number of adaptations to the original programs in light of developing circumstances;

• created the Supplemental Reserve Facility to help members experiencing exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden loss of market confidence;

• stepped up coordination with other international financial institutions, notably the World Bank and the Asian Development Bank, and with bilateral donors, to augment international support for the affected countries’ economic reform programs;

• strengthened its dialogue with a variety of constituencies in the program countries, including consultations with opposition and labor groups and extensive contacts with the press and the public;

• provided staff support to coordinate efforts by international creditor banks and debtors in the affected countries to resolve the severe private sector financing problems at the heart of the crisis;

• posted on the IMF website—with the consent of the governments of Indonesia, Korea, and Thailand— their Letters of Intent, describing in detail their IMF-supported programs, so that details of the programs would be readily available to all interested parties; and

• reinforced means of communication with officials and support for their efforts at consensus building through the appointment of former IMF Deputy Managing Director Prabhakar Narvekar as Special Advisor to the President of Indonesia; the establishment of resident representative posts in Korea and Thailand (in addition to the existing post in Indonesia); and the work of the IMF’s new Asia and Pacific Regional Office (see Chapter VI).

worsening the external positions and growth performance of the countries in deepest crisis. Also, international investors, in their drive for higher rates of return, had underestimated the risks in some emerging market economies.

Directors agreed, however, that policy weaknesses in the affected countries had been the most important contributor to the sudden shifts in market sentiment. In particular, inflexible exchange rate arrangements had been maintained for too long—even when fundamentals no longer supported them—constraining the response of monetary policy to overheating pressures. Investors had also viewed pegged exchange rates as implicit guarantees of exchange value, which, together with implicit guarantees of support to the banking sector, had encouraged external borrowing and excessive foreign exchange exposure, often at short maturities. Inadequate banking regulation, supervision, and prudential rules had contributed to the inefficient intermediation of these funds, resulting in fragile balance

### Commitments of the International Community and Disbursements of the IMF in Response to the Asian Crisis, as of July 23, 1998¹

<table>
<thead>
<tr>
<th>Country</th>
<th>IMF</th>
<th>Multilateral²</th>
<th>Bilateral³</th>
<th>Total</th>
<th>IMF Disbursements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>11.2</td>
<td>10.0</td>
<td>21.1⁴</td>
<td>42.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Korea</td>
<td>20.9</td>
<td>14.0</td>
<td>23.3</td>
<td>58.2</td>
<td>17.0</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.0</td>
<td>2.7</td>
<td>10.5</td>
<td>17.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Total</td>
<td>36.1</td>
<td>26.7</td>
<td>54.9⁴</td>
<td>117.7</td>
<td>24.8</td>
</tr>
</tbody>
</table>

¹IMF commitments to the Philippines are not included.
²World Bank and Asian Development Bank.
³Bilateral contributions to Indonesia and Korea were a contingent second line of defense.
⁴Estimate; amount of new commitments not finalized as of July 23, 1998.
Box 2
Second-Generation Reforms

Although macroeconomic stability, liberalization, and the basic institutional framework of a market economy are essential for strong growth, the IMF’s experience with its member countries has shown that deeper and broader-based reforms are necessary to achieve high-quality growth that is sustainable and more equitably shared. Such reforms—so-called second-generation reforms—cover a number of areas highlighted most recently by the Asian financial crisis.

The IMF, in collaboration with the World Bank, has been contributing to second-generation reforms in member countries through its surveillance (along with other international organizations as appropriate), technical assistance, and financing, on several fronts:

- helping members strengthen the efficiency and robustness of their financial sectors, including through appropriate prudential oversight;
- helping members enhance the transparency of fiscal policy and practices and the quality, timeliness, and dissemination of economic and financial data to reduce the risk of disruptive changes in investor confidence when economic or financial problems appear;
- helping members improve governance by establishing a simple and transparent regulatory environment and a professional and independent judicial system that will uphold the rule of law, including property rights;
- assisting members in redefining the role of the state in the economy as a positive force for private sector activity, including through the restructuring and privatization of state-owned enterprises and by generally reducing government intervention in areas where market forces provide greater efficiency;
- helping improve the quality of public expenditure in member countries, for example, through greater attention to education and health spending; and
- helping members promote greater flexibility of labor markets.

These initiatives, thereby boosting confidence in them. They also assure the country that IMF resources will be available if needed and provided the agreed conditions are met.

- Informal Staff-Monitored Programs. IMF staff monitor the country’s economic program and regularly discuss progress under that program with the authorities; however, there is no formal IMF endorsement of the member’s policies.
- Enhanced Surveillance. This also does not constitute formal IMF endorsement of a member’s economic policies. Rather, the emphasis is on close and formal monitoring by the IMF. The procedure was initially established to facilitate debt-rescheduling arrangements with commercial banks but has been used occasionally in other situations.

In a few cases, the intensified monitoring described above has been a prelude to an IMF-supported adjustment program. More often, monitoring provides the authorities with a framework to reassure interested third parties, such as donors, creditors, or financial markets.

Lessons for Surveillance from the Asian Crisis

In March 1998, the Executive Board undertook its regular review of members’ policies in the context of surveillance, this time focusing on the lessons for surveillance from the Asian crisis. In their review, Directors noted that the IMF’s performance in identifying emerging tensions in crisis-affected countries at an early stage had been mixed.

In the case of Thailand, the IMF had expressed serious concerns about economic developments beginning in 1996—concerns conveyed to the authorities in several ways, including through confidential contacts at the highest level. Indeed, the IMF appeared to have been more aware of the risks in Thailand’s economic policy course than had most market observers. In other cases in Asia, however, the IMF—while having identified critical weaknesses, particularly in the financial sector—had been taken by surprise, owing in part to the lack of access to requisite information and also to an inability to see the full consequences of the combination of structural weaknesses in the economy and contagion effects. In particular, in the case of Korea, the IMF had not attached sufficient urgency to the financial tensions that had begun developing in early 1997.

With hindsight it was clear that the affected countries’ vulnerabilities had been underestimated, including by the markets. Directors also remarked that some other emerging market economies had taken timely and sustained policy measures in the face of market pressures and had been able to fend off spreading turmoil successfully. In those cases, close IMF surveillance had been helpful. Some Directors stressed that it was unrealistic to expect IMF surveillance to detect all problems early and prevent all crises, and that the contagion effects of the crisis in Thailand were, to a large extent, unpredictable. Nevertheless, they encouraged the staff, in exercising surveillance, to place increased emphasis on the risks of contagion effects.

Directors agreed that the experience of the past nine months had provided valuable lessons for the IMF and for the international financial community. Events were still unfolding, and many issues would need revisiting, including the design and implementation of IMF-supported programs; the role of the IMF and other official financing for these programs; collaboration between the IMF and other international institutions, especially the World Bank; the role of the private sector in crisis situations; and the IMF’s policy on public information. To this end, it was agreed early in the new
financial year 1998/99 that a review of the experience with IMF programs in the Asian crisis countries should be undertaken before the October 1998 Annual Meetings to address questions of program orientation and design, implementation, and, to the extent possible, early program results. The experience with the Asian crisis countries would also be examined in 1998/99 as part of the world economic outlook exercise and in the context of the annual report on international capital markets. The lessons from the Asian experience would be reflected in several papers addressing various aspects of the international monetary system, focusing on the availability and the dissemination of economic data, transparency in members’ policies and in IMF surveillance, and the role of international standards in assessing countries’ policies and practices. There would also be further Board discussion on establishing appropriate incentives for international financial flows by involving the private sector in forestalling or resolving financial crises. The IMF would be incorporating lessons from the Asian crisis in its continuing work on orderly and appropriately sequenced capital account liberalization. In addition, the experience with World Bank–IMF collaboration, notably in the area of financial sector reform, would be reviewed with the aim of identifying areas with scope for improvement.

In March 1998, looking at IMF surveillance, Directors identified five main lessons.

**Lesson One**

The effectiveness of surveillance depended critically on the timely availability of accurate information. Directors saw some improvement since 1995 in members’ provision of data, both to the IMF and to the markets, but felt that further progress was essential. The Asian crisis had revealed the critical importance of certain data that had not been available, either because the authorities had been reluctant to provide them, such as reserve-related liabilities of the central bank, or because systems did not exist to produce timely data, such as that on private short-term debt. The crisis had also demonstrated that adequate provision of data to the public was important for promoting transparency and strengthening market confidence. Directors emphasized that further efforts to strengthen members’ provision of data to the IMF and to the public could be realized through the Special Data Dissemination Standard; in both domains, the monitoring of compliance had to be strengthened. Several Directors cautioned that access to highly sensitive data or data for which appropriate standards were not yet universally adopted, such as prudential indicators, had to be handled carefully. Directors particularly stressed the importance of compiling timely and accurate data on short-term external debt, while recognizing that this would require substantial statistical efforts on the part of most countries concerned. It was agreed that, in cases where countries were unable to collect the required data, technical assistance—including from the IMF in its areas of competence—was important. In the meantime, more attention should be paid to using and improving existing data sources, including data from the Bank for International Settlements.

More generally, considering the changing architecture of the international financial system and the variety of data sources, some Directors felt that the IMF needed to begin work with other international organizations, including national regulatory authorities and market participants, toward developing a conceptual framework for data compilation and dissemination.

Directors strongly urged the staff to bring to the Board’s attention cases where its inability to obtain the necessary data had hampered effective surveillance, and they suggested that ways to strengthen the IMF’s reaction to such cases be explored. Some Directors suggested that consideration be given to not concluding Article IV consultations where members’ willingness to provide the IMF with the data required for surveillance was in question. This view was endorsed by the Interim Committee, which in its April 1998 meeting recommended that if persistent deficiencies in disclosing relevant data to the IMF seriously impede surveillance, conclusion of Article IV consultations should be delayed.

**Lesson Two**

The focus of surveillance had to extend beyond short-term macroeconomic issues, while remaining appropri-
of market sentiment. A few Directors cautioned that such contacts should take into account the confidentiality of the IMF’s dialogue with members.

**Lesson Four**

The crucial role of credibility in restoring market confidence underscored the importance of transparency. In this regard, Directors welcomed the decision by the authorities in Indonesia, Korea, and Thailand to release the Letters of Intent to the IMF detailing their adjustment programs. Several Directors also welcomed the fact that an increasing number of countries were agreeing to the release of Press (now “Public”) Information Notices, summarizing the content of Article IV consultations in the Board, and felt that it would be desirable if as many countries as possible could agree to do so. Some Directors felt that the IMF could go further in disseminating its views on the economic policies of its members; they suggested revisiting the issue of publication of staff reports for Article IV consultations. Some other Directors, however, advocated a more cautious approach, noting that maintaining confidentiality was key to effective surveillance. A few Directors also supported the suggestion that if, after a period of time, a member continued to ignore IMF warnings expressed confidentially, the IMF should, as a last resort, make use of the provision of Article XII, Section 8, of its Articles of Agreement, to make its concerns known to the public. But most Directors doubted that more public warnings would increase the effectiveness of surveillance. They were particularly concerned that the threat of publicity would jeopardize the frank dialogue between the IMF and member countries and that public warnings could accelerate crises rather than prevent them.

**Lesson Five**

The effectiveness of IMF surveillance depended crucially on the willingness of members to take its advice. A candid dialogue and the ability of the IMF to focus on the issues of importance to individual members were vital for effective surveillance. In addition, Directors emphasized the opportunity for IMF staff to harness the opinions of the international community by engaging in regional forums more actively; they believed the IMF should work closely with such forums in Asia and elsewhere (Box 4). Some Directors noted the importance of peer pressure both in regional forums and through the Board. Directors welcomed the IMF’s involvement in the discussions of the Asia-Pacific Economic Cooperation Council and the Second Manila Framework Meeting in Tokyo.

**Government Transparency and Accountability**

The IMF has long provided advice and technical assistance to help foster good governance in member countries, including by promoting public sector transparency and accountability. In recent years, increased attention has been focused on issues associated with good governance. In particular, in its Declaration on Partnership for Sustainable Global Growth, adopted in September 1996, the IMF’s Interim Committee identified “promoting good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption” as essential for helping economies prosper. Similarly, at its April 1998 meeting, the Interim Committee, in an effort to enhance the accountability and credibility of fiscal policy as a key feature of good governance, adopted a Code of Good Practices on Fiscal Transparency: Declaration on Principles.

In 1997/98, the IMF’s Executive Board met a number of times to develop guidance for the institution regarding governance issues and a code of good practices for member countries in the area of fiscal transparency.
the practical issues that could arise. They also suggested that the code be subject to periodic review and revision.

Directors pointed out that implementation of the code should be tailored to individual country circumstances, with recognition of the legitimate differences in approach that countries might take to improving fiscal transparency. For countries with weaker institutions or binding legal constraints, progress toward achieving fiscal transparency consistent with the code might take time. The IMF had to be prepared to provide technical assistance, in cooperation with other international organizations, to those countries that requested it.

At its April 1998 meeting, the Interim Committee adopted the Code of Good Practices on Fiscal Transparency—Declaration on Principles (Box 5; the full text is reproduced in Appendix VI), recognizing that implementation would be affected by diversity in fiscal institutions, legal systems, and implementation capacity.

Data Issues
Economic policymakers and financial institutions and markets—public and private—rely on information. When underlying information about the true economic and financial situation of countries, banks, and enterprises is poor, when disclosure of available information is limited, and when potentially damaging information can be disguised or withheld, national and international financial systems work less efficiently. Thus, the international community encourages the development and promulgation of sound information practices, in accord with broadly accepted international norms.

For its part, the IMF has paid increasing attention in recent years to data issues—the comprehensiveness, quality, frequency, and timeliness of the data that members provide to it, and the data that members disseminate to the public. To guide members in the latter, the Board has endorsed a two-tiered approach: a Special Data Dissemination Standard (SDDS), established in March 1996, to guide member countries that have or might seek access to international financial markets, and a General Data Dissemination System (GDDS), approved by the Board in December 1997, to guide all member countries. In September 1996, the IMF opened an electronic bulletin board on the Internet that provides public access to information about the data dissemination practices of members that subscribe to the SDDS (Box 6).

Members’ Provision of Information to the IMF
In December 1997, the Board conducted its third review of progress by members in providing data to the IMF for surveillance. Directors noted the provision of core indicators by member countries to the IMF had continued to improve modestly (this refers to data on exchange rates, international reserves, reserve or base money, broad money, interest rates, consumer prices, exports and imports, external current account balance, overall government balance, gross domestic product or gross national income, and external debt). But they expressed concern that some members did not provide these data regularly or in a timely way, and that, in a number of cases, lags in data provision had continued or even increased. Directors urged members to improve the timeliness and frequency of their data reporting.

Recent experience had also suggested that the core indicators needed to be complemented by other data in light of the circumstances of individual countries, so as to increase the effectiveness of surveillance in the period between Article IV consultations and to identify emerging financial market tensions. Directors identified reserve-related liabilities, central bank derivative transactions, private sector external debt, and prudential-type bank indicators as desirable supplementary data. Within these broad categories, Directors identified a number of specific data items—including forward

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**Box 5**  
**Code of Good Practices on Fiscal Transparency: Declaration on Principles**

The Code’s main provisions are as follows:

**Clarity of Roles and Responsibilities**
- The government sector should be clearly distinguished from the rest of the economy, and policy and management roles within government should be well defined.
- There should be a clear legal and administrative framework for fiscal management.

**Public Availability of Information**
- The public should be provided with full information on the past, current, and projected fiscal activity of government.
- A public commitment should be made to timely publication of fiscal information.

**Independent Assurances of Integrity**
- The integrity of fiscal information should be subject to public and independent scrutiny.

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**Open Budget Preparation, Execution, and Reporting**
- Budget documentation should specify fiscal policy objectives, the macroeconomic framework, the policy basis for the budget, and identifiable major fiscal risks.
- Budget estimates should be classified and presented in a way that facilitates policy analysis and promotes accountability.
- Procedures for the execution and monitoring of approved expenditures should be clearly specified.
- Fiscal reporting should be timely, comprehensive, and reliable and identify deviations from the budget.
Dissemination Standards Bulletin Board

The DSBB is a tool for market analysts and others who track economic growth, inflation, and other economic and financial developments in countries around the world. It describes the statistical practices—such as methodologies and data release calendars—of countries subscribing to the Special Data Dissemination Standard (SDDS) in key areas: the real, fiscal, financial, and external sectors. It also describes steps subscribers have taken to improve practices to move toward full observance of the SDDS by the end of the transition period.

Beginning in April 1997, electronic links (hyperlinks) between the bulletin board and actual data on national data sites have been established, enabling users to move directly from the bulletin board to current economic and financial data on an Internet site maintained by the subscriber. (The links do not indicate IMF endorsement of the data.) The bulletin board can be accessed on the Internet at http://dsbb.imf.org, or through the IMF’s website, http://www.imf.org.

Subscribers to the SDDS as of the end of April 1998 are listed below; those for which hyperlinks were in place are indicated by an asterisk:

<table>
<thead>
<tr>
<th>Argentina*</th>
<th>France</th>
<th>Korea</th>
<th>Singapore*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Germany</td>
<td>Latvia</td>
<td>Slovak Republic</td>
</tr>
<tr>
<td>Austria</td>
<td>Hong Kong SAR*</td>
<td>Lithuania</td>
<td>Slovenia*</td>
</tr>
<tr>
<td>Belgium</td>
<td>Hungary</td>
<td>Malaysia</td>
<td>South Africa*</td>
</tr>
<tr>
<td>Canada*</td>
<td>Iceland</td>
<td>Mexico*</td>
<td>Spain</td>
</tr>
<tr>
<td>Chile</td>
<td>Indonesia</td>
<td>Netherlands</td>
<td>Sweden</td>
</tr>
<tr>
<td>Colombia*</td>
<td>Ireland</td>
<td>Norway</td>
<td>Switzerland*</td>
</tr>
<tr>
<td>Croatia</td>
<td>Israel*</td>
<td>Peru*</td>
<td>Thailand</td>
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<tr>
<td>Czech Republic</td>
<td>Italy</td>
<td>Philippines</td>
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<td>Denmark</td>
<td>Japan*</td>
<td>Poland</td>
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</tr>
<tr>
<td>Ecuador</td>
<td>Portugal</td>
<td>Portugal</td>
<td>United States</td>
</tr>
<tr>
<td>Finland</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Transactions (outright or arising from swaps), the maturity structure of external debt, the composition of short-term external debt, information on foreign exchange reserves, and information on the financial sector. Some Directors suggested that the definition of core data should be expanded to include these additional data, given their critical importance in identifying emerging tensions at an early stage. And some Directors suggested consideration of a common standard for timeliness and frequency of data provided to the IMF.

On the related issue of data quality, inadequate coverage and deficiencies in compilation methods had often compromised the usefulness of the reported data and posed problems for the design and monitoring of members’ programs, particularly with regard to national accounts, government finance, and balance of payments statistics. Directors therefore urged the staff to continue its work on the assessment of data quality.

Several Directors stressed the high cost of technical assistance and suggested monitoring recipient countries’ implementation of recommendations. Directors agreed that efforts to improve data quality must be part of a broad effort to build solid statistical frameworks in member countries, consistent with efforts undertaken for the Special Standard and the General System. Some Directors suggested that staff papers indicate clearly data adjustments to help identify for the authorities the data deficiencies and required improvements.

Members’ Dissemination of Data to the Public

Review of Special Data Dissemination Standard. In their first review of the Special Data Dissemination Standard, in December 1997, Directors noted that the number of subscribers (43) had been about as expected and hoped that, over time, more members would subscribe. They welcomed the growing external use of the Dissemination Standards Bulletin Board, especially since the introduction of hyperlinks from the bulletin board to national data sites (see Box 6). Directors believed the SDDS provided incentives and a structure for improvements in data dissemination practices; subscribers’ views on their initial experience with the Special Standard had been generally positive.

Directors agreed that the proposals for updating the SDDS were timely, given the economic and financial developments in Southeast Asia and elsewhere. They endorsed the procedures for modifying the SDDS, which were in keeping with the consultative and transparent process underlying the Special Standard. These entailed the shifting of the data components for countries’ reserve-related liabilities from an “encouraged” to a “prescribed” component and adding a prescribed component for net commitments under derivative positions. Some Directors expressed reservations in this regard, pointing to definitional problems and issues of confidentiality.

Directors agreed that the procedure for modifying the SDDS to include indicators of financial soundness should await the development of standards for the disclosure of macroprudential data and should draw on the work of other organizations, including the BIS. They also agreed to consider in the next review of the SDDS the possibility of establishing a more precise timetable for the dissemination by subscribing countries of data on international investment positions, which would include data on the short-term external indebtedness of the private nonbank sector.

Directors considered that in the period ahead, the credibility of the IMF and of the SDDS subscribers would depend on ensuring that subscribers had imple-
Box 7  
How the GDDS Will Work

Participation in the General Data Dissemination System (GDDS), which is voluntary, consists of three steps:

• commitment to using the GDDS as a framework for statistical development;
• designation of a country coordinator; and
• preparation of descriptions of current statistical production and dissemination practices, and plans for short- and long-term improvements in these practices that could be disseminated by the IMF on the Internet.

The GDDS will be implemented in two phases. The first will focus on education and training, and the second on direct country work. The training phase will include eight regional seminars and workshops, beginning in mid-1998 and ending in the fall of 1999, for up to 120 member countries. Following the training phase, IMF staff will work directly with member countries to assist them in assessing their practice against those of the GDDS and developing plans for improvement.

As of April 1998, some 25 countries had indicated preliminary interest in the GDDS by appointing a country coordinator. Formal invitations to participate have been sent to all member countries that have not subscribed to the Special Data Dissemination Standard (SDDS) following completion of the training phase, IMF staff will work directly with member countries to assist them in assessing their practice against those of the GDDS and developing plans for improvement.

sectoral policy recommendations be fully coordinated. In this context, the two institutions would also have to pay due regard to the responsibility of the Basle Committee in the area of banking supervision.

Many Directors remarked that they would have liked a clearer delineation of the spheres of responsibility of the two institutions, while recognizing that overlap in some areas—especially banking supervision and regulation, and banking legislation—was probably unavoidable. Most Directors stressed that banking system restructuring was the primary responsibility of the World Bank. Nevertheless, many Directors felt that the IMF had to play a role in banking system restructuring in crisis situations, especially in countries where it had been more actively involved. They emphasized, however, that those instances were expected to be rare, that the IMF’s involvement in such cases should be temporary, and that the implementation of restructuring programs should be handled by the Bank. In light of the IMF’s mandate, some Directors expected the IMF to focus on the macroeconomic implications of such reforms. But Directors hoped that the Bank, by strengthening its financial sector activities—including the establishment of the Financial Sector Board—would be better able to respond quickly and flexibly to help design financial sector restructuring programs in crisis situations. Directors also emphasized the Bank’s role—and early involvement—in helping to identify specific benchmarks for banking system restructuring to be incorporated in IMF financial programs.

Exchange Rate Issues

The Board considered two surveillance-related exchange rate issues in 1997/98: the methodology for assessing exchange rates and strategies for moving from a fixed to a flexible exchange rate regime (“exit strategies”).

Exchange Rate Assessments and IMF Surveillance

In discussing the methodology of exchange rate assessments and its application in IMF surveillance over major industrial countries, the Board emphasized in October 1997 that the IMF, as the central institution of the international monetary system, must continuously seek to strengthen its analysis and surveillance over exchange rate policies. The IMF had the advantage of a global perspective and a blend of technical expertise and practical policy experience that enabled its staff to add value in advancing the analytical framework and making judgments on exchange rate issues. In this context, Directors also pointed to the need for cooperation with the academic community.

Directors concurred with the view that the macroeconomic balance methodology used by IMF staff (Box 8) complemented rather than substituted for the various measures of international competitiveness and financial market conditions that had traditionally played a major role in IMF surveillance over members’ exchange rates and exchange rate policies. Directors generally agreed it was not possible to identify precisely “equilibrium” values for exchange rates and that point estimates of notional equilibrium rates should generally be avoided. Nevertheless, they agreed that a rigorous, systematic, and transparent methodology was important to underpin IMF surveillance. They considered the existing methodology to be a useful starting point.

Directors emphasized that it was essential to consider the appropriateness of exchange rates against the background of prevailing cyclical positions and the attainment of overall macroeconomic objectives. Deviations of exchange rates from their medium-term equilibrium levels might be warranted, and even helpful, in cases of divergence in the cyclical positions of the major industrial countries. For these reasons, Directors advocated a case-by-case approach in considering what actions, if any, should be taken when exchange rates appeared to deviate substantially from their medium-term equilibrium values.

Many Directors considered that the current methodology for assessing exchange rates could be applied more broadly, in particular to nonindustrial countries of regional importance with access to international capital markets. Some Directors recognized,
however, that data deficiencies and the diversity of economic conditions might limit the applicability of the methodology in the case of emerging and developing economies.

Exit Strategies: Policy Options for Countries Seeking Greater Flexibility

In January 1998, in their discussion of a staff paper10 on strategies for exiting from relatively fixed exchange rate regimes to regimes of greater exchange rate flexibility, Directors acknowledged that the choice of exchange rate regime was a complex issue that depended on the specific circumstances of individual countries. Particularly relevant were the structural characteristics of the economy and its historical inflation performance, the degree of vulnerability to shocks and the nature of those shocks, the extent of export and import diversification, and the degree of capital account liberalization and exposure to global capital markets. More generally, whatever regime was chosen, macroeconomic and structural policies needed to be credibly consistent with the regime, and the authorities needed to be transparent about policy objectives and how they intended to achieve them.

Several Directors noted that currency pegs, currency unions, or currency boards have served countries well in a number of cases, including small, open economies and a number of developing and transition economies, at least at some stage of their development and stabilization efforts. In the case of transition economies, a few Directors noted that the balance of costs and benefits tended to shift in favor of greater exchange rate flexibility as inflation subsided and the transition proceeded.

Most Directors were of the view that the increasing globalization of financial markets had made pegged regimes more difficult to manage. Many Directors particularly cited the heightened risk posed by fixed rates in encouraging unhedged exposure by borrowers. While some countries, with the appropriate supportive policies, would continue to benefit from a fixed rate—it being emphasized that there was no presumption that all countries would be better off with flexible rates—Directors noted that some countries with fixed or relatively fixed exchange rate regimes might now wish to move to more flexible arrangements. It was therefore desirable to consider the best ways to engineer an exit.

Directors emphasized that careful attention needed to be given, when exiting a peg, to the design of the new macroeconomic policy framework. In light of the many, often complex, considerations in the decision to exit—even from a position of strength—Directors believed that the IMF could play an important role in providing timely and candid advice to member countries on the appropriate exit strategy and the timing of such action. Too rapid an abandonment of the peg could be as harmful to credibility as too protracted a defense of the peg was to the level of foreign exchange reserves. It was suggested that the IMF’s regular Article IV consultations with its member countries should, when appropriate, give greater priority to discussing these issues.

Most Directors agreed that if a case for moving to a flexible regime existed, the best time to do so was during a period of relative calm in exchange markets or when there were pressures for appreciation of the currency, rather than when the exchange rate was under downward pressure. They noted, however, that much judgment was involved and it was often difficult to make such a decision when times were good and there seemed no reason to tinker with an apparently successful regime.

There was no question, Directors agreed, that it was much more difficult to exit a peg during a crisis, when some degree of exchange rate volatility was likely. To minimize depreciation and bolster policy credibility in such circumstances, it was essential that a country implement a strong and credible package of policy measures, including macroeconomic policies and accelerated structural reforms, and ensure the complementarity of those measures. Directors also

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Box 8

A Methodology for Exchange Rate Assessments

Oversight of members’ exchange rate policies is at the core of the IMF’s surveillance mandate. The methodology used for assessing the appropriateness of current account positions and exchange rates for major industrial countries embodies four steps:

• applying a trade-equation model to calculate the underlying current account positions that would emerge at prevailing market exchange rates if all countries were producing at their potential output levels;
• using a separate model to estimate a normal or equilibrium level of the saving-investment balance consistent with medium-run fundamentals, including the assumption that countries were operating at potential output;
• calculating the amount by which the exchange rate would have to change, other things being equal, to equilibrate the underlying current account position with the medium-term saving-investment norm; and
• assessing whether the estimates of exchange rates consistent with medium-term fundamentals suggest that any currencies are badly misaligned.
World Trade Organization would be important toward achieving that end. There was also a need to promote trade liberalization in nonprogram countries through the IMF’s surveillance activities. Trade reform was important in promoting transparency and good governance—reducing the scope for administrative discretion, incentives for lobbying for protection, and opportunities for rent seeking.

Since most countries covered by the staff’s review had started out with restrictive trade regimes, trade liberalization had clearly been needed. Directors observed that broader and more rapid liberalization should have been targeted in a significant number of the programs and urged the staff to aim for further liberalization in future programs. Many Directors supported front-loaded liberalization measures as well as the use of prior actions, performance criteria, structural benchmarks, and reviews to monitor implementation of trade reforms, in order to signal their importance in accelerating economic growth. Other Directors cautioned that trade-related conditionality should be applied flexibly and should take into account each country’s initial conditions, the degree of political support, and the authorities’ own commitment to reforms. Far-reaching trade reform was a long-term process; it demanded a well-specified, comprehensive, and publicly announced program of measures and the avoidance of policy slippages.

Directors underscored the importance of mutually reinforcing trade and fiscal reforms. Trade liberalization did not have to affect the government’s fiscal position adversely; the effects would depend on a country’s circumstances and the mix of components in the reform package. For trade reform to succeed, Directors remarked that it should be broadly based and should initially replace nontariff barriers with tariffs, while eliminating customs duties exemptions and trade-related subsidies, all of which would tend to strengthen the government’s fiscal position, or at least avoid revenue losses.

**Policy on Sovereign Arrears to Private Creditors**

A key outcome of the Executive Board’s February 1998 discussion of IMF policy on sovereign arrears to private creditors was the emphasis given to involving private creditors at an early stage of a crisis, both to ensure adequate burden sharing and to limit moral hazard. The globalization of international capital markets and improved market access had increased the importance of private capital as a source of external financing for many developing countries; at the same time, such access had made these countries more vulnerable to shifts in market sentiment. This underscored the need for early, forceful adjustment measures on the part of borrowing countries in the face of emerging difficulties; for restraint in both public and private foreign borrowing, particularly at the shorter maturities; and for a cautious approach to the waiver of sovereign immunities, particularly by central banks.

With regard to how the IMF could respond to a liquidity crisis that posed the risk of a member defaulting on international sovereign bonds within the existing legal and institutional frameworks, Directors noted that a balance had to be struck between promoting effective balance of payments adjustments and orderly debtor-creditor relations and limiting moral hazard with respect to both creditor and debtor behavior. Many Directors called for consideration of extending the IMF’s policy on providing support by “lending into arrears,” that is, continuing to provide financing to countries even when they were behind in their debt payments to some private creditors. They recognized that such lending should be limited and provided only where prompt IMF support was essential for the successful implementation of the member’s adjustment program; where negotiations between the member and its private creditors on a restructuring had begun; and where there were firm indications that the sovereign borrower and its private creditors would negotiate in good faith to agree on a debt-restructuring plan. All drawings under an IMF-supported adjustment program with a member with sovereign arrears to private creditors had to be subject to financing reviews to allow the Executive Board to monitor closely unexpected developments—including any litigation—in creditor relations. Some Directors opposed lending into arrears, at least in the absence of further protection. This strategy, they believed, would risk aggressive litigation by individual creditors, thus adversely affecting safeguards on the IMF’s resources.
ESAF and the HIPC Initiative. In view of the current and expected future commitments under the HIPC Initiative, and the significant costs resulting from delay in mobilizing the necessary financial resources, the Committee urged all members to move quickly to complete the financing of these initiatives as soon as possible and asked the Executive Board to report back to it on this issue at the Committee’s next meeting in October 1998.

**Progress in Implementing the HIPC Initiative**

To obtain assistance under the HIPC Initiative, a country must be eligible for concessional assistance from the IMF and World Bank, face an unsustainable debt burden even after the application of traditional debt-relief mechanisms, and establish a track record of reform and sound policies through IMF- and World Bank–supported programs. Stages in the decision-making process under the Initiative are set out in Figure 4; these include a so-called decision point, when the Board of the IDA, which administers funds for the Initiative for the World Bank Group, and the Board of the IMF formally decide on a country’s eligibility and precommit assistance under the Initiative; and a completion point, when the two Boards decide that a country has met the conditions for assistance, allowing that assistance to be disbursed.

In April 1998, Uganda became the first country to reach the completion point under the HIPC Initiative, as performance under its ESAF- and IDA-supported programs remained strong, and Uganda’s other creditors pledged satisfactory assurances of action. Uganda would receive assistance equivalent to approximately $350 million in net present value terms. This amount would reduce Uganda’s ratio of net present value of debt to exports to 196 percent, well within the 192–212 percent target range agreed at the decision point; the saving in nominal debt service would be nearly $650 million. The IMF’s assistance would lower the present value of its claims on Uganda by $69 million; this would cover 22 percent of Uganda’s annual debt service to the IMF on average over the next nine years.

In addition, during 1997/98, five countries reached the decision point: Burkina Faso (in September 1997), Bolivia (in September 1997), Guyana (in December 1997), Côte d’Ivoire (in March 1998), and Mozambique (in April 1998). The assistance committed to these five countries at the decision point totaled about $2.6 billion in net present value terms, which was estimated to reduce debt service in nominal terms by some $5.0 billion. The five countries were scheduled to reach their completion points under the Initiative at various dates between September 1998 and March 2001 (see Table 8).

In March and April 1998, the Boards of the IMF and IDA discussed preliminary HIPC documents for Mali and Guinea-Bissau and indicated that the countries were approaching their decision points and could qualify for assistance under the Initiative. Based on the guidance of the Boards, final HIPC documents were expected to be presented to the Boards after consultation with other creditors.

**ESAF Resources for Commercial Debt- and Debt-Service-Reduction Operations**

In June and July 1997, the Board discussed the use of ESAF resources for commercial debt- and debt-service-reduction operations for members qualifying for assistance under the ESAF. Most Directors agreed to the use of ESAF resources in the few cases where resources available under the IDA Debt-Reduction Facility and from donors and the member might not be sufficient to finance the up-front costs of such operations, and for which the use of the IMF’s General Resources Account would be inappropriate.

Such use of ESAF resources would be guided by the same general principles of the existing policy for supporting debt- and debt-service-reduction operations, including, among other things, conditionality, the efficient use of IMF resources, and market-based operations. In addition, the use of ESAF resources would complement the highly concessional resources available from IDA and other sources and be provided only in the context of appropriately ambitious ESAF-supported programs.

To ensure that the use of ESAF resources for debt- and debt-service-reduction operations would be strictly limited, consideration was given to restricting such
assistance to countries that had qualified for assistance under the HIPC Initiative. Several Directors expressed concern about the possible resource implications of the proposal, as the financing of the interim ESAF and IMF participation in the HIPC Initiative had not yet been secured. It was noted, however, that the use of ESAF resources for debt- and debt-service-reduction operations would be decided by the Board in each individual case. In addition, the overall use of ESAF resources for these operations would be subject to Board review if the aggregate resource use for that purpose appeared likely to exceed a predetermined level. Directors expressed the view that ESAF financing for debt- and debt-service-reduction operations should be used in a subsidiary, or “last resort,” role, only if other financing options were not available. And there should be no strict rules on burden sharing; each case should be subject to discussion, considering both the prospects for bilateral contributions and the use of the country’s own resources.

In dealing with the possibility that a debt- and debt-service-reduction operation might materialize at a time that was not well synchronized with the disbursement of ESAF resources, most Directors favored the option of incorporating into the ESAF Trust Instrument a provision for a special disbursement for the sole purpose of financing part of such an operation. This provision was expected to be used only when the disbursement for that operation could not be part of a normal semiannual disbursement.

**Review of Experience Under ESAF-Supported Arrangements**

In July 1997, the Board discussed a staff study assessing the experience of 36 countries that had availed themselves of SAF and ESAF financing in support of 68 multyear programs during 1986–95. This internal review was complemented by an external evaluation that was discussed by the Board in March 1998 (see below).

**Internal Evaluation of the ESAF**

Directors, in their review of the internal evaluation (see Box 11), agreed that most countries that had undertaken reform and adjustment programs with the support of the SAF and ESAF now had economies that were materially stronger and more market oriented than a decade earlier. Fiscal imbalances had been reduced, and macroeconomic policies had eliminated almost all instances of very high inflation. Liberalization and structural reforms had taken hold and, in some instances, had gathered momentum in recent years. Furthermore, economic growth and living standards had improved, with progress toward external viability in many countries.

At the same time, progress had been uneven, and most countries continued to perform below their potential—in many cases despite multiple ESAF-supported programs. Per capita GDP growth in many ESAF countries remained below the average in developing countries, indicators of openness remained relatively weak, and inflation had not been brought down to acceptable levels on a sustained basis in a number of countries. Moreover, debt-service burdens remained unmanageably high in several countries.

Directors noted that this disappointing performance largely reflected shortcomings in a number of policy areas, both macroeconomic and structural. A widespread failure to move ahead decisively with civil service reform and reduce the direct and indirect burdens of public enterprises on the state budget had contributed to missed fiscal targets. Hesitant reforms to the administration of tax systems and countries’ banking systems had failed to address fundamental operational weaknesses. Significant barriers to international economic integration had also remained, while the development of the private sector had been held back by problems of poor governance, excessive regulation, and ill-defined or inadequately enforced property rights. Several Directors emphasized the importance of developing institutional capacity while recognizing the difficulties that this entailed. Future ESAF-supported programs should tackle persistent weaknesses in these crucial areas, Directors concluded.

**Box 11**

**Strengthening ESAF-Supported Programs**

The main recommendations of the internal review of ESAF for the design of future programs called for:

- stronger and reoriented fiscal adjustment based on durable cuts in budget outlays, particularly from civil service reform and reduced support for public enterprises, while protecting growth-enhancing expenditures on health and education;
- more resolve in reducing inflation to single-digit levels through the use of monetary or exchange rate anchors where appropriate;
- a more concerted effort to adopt so-called second-generation reforms, especially enhanced trade liberalization, public enterprise reform, bank restructuring, and strengthened property rights; and
- steps to reduce policy slippage and encourage more sustained policy implementation, including through more intensive program monitoring in selected cases, greater use of contingency planning in program design, and more proactive technical assistance to build institutional capacity.

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Box 12
Key Findings of External Evaluators of the ESAF

In reviewing the ESAF, the external evaluators offered the following recommendations:

Social Impact
- The IMF should seek ex ante assessments by the World Bank of the likely impact that ESAF-supported programs would have on the incomes of the poor and of the real projected value of social service provision.
- These impact assessments could be taken into account at the program design stage and should be updated during program implementation.
- In program design, the IMF should explicitly analyze trade-offs between the short run and long run. The analysis would address sequencing issues, front-loading of structural reforms, and the efficiency costs of revenue measures.
- In the area of fiscal policy, IMF–World Bank collaboration should be increased to allow for more joint analysis and to address overlaps concerning the macroeconomic concerns of the IMF and the microeconomic concerns of the Bank.
- The ESAF should have a new role in the poststabilization environment to help reforming governments build reputations and to enable the IMF to play a role in potential ESAF countries that currently reject the facility.

External Viability
- ESAF financing should be provided as budget support, rather than to central banks.
- Equal or more weight should be given to indicators that relate total debt and debt service to GDP rather than to the traditional export-based indicators, as the latter are overly sensitive to an economy’s openness.

Ownership and Governance
- Countries have primary responsibility for economic reform programs and should develop and build a consensus behind a program capable of achieving sustainable growth. The IMF should make the negotiation process and conditionality regime more supportive of country ownership.
- Specifically, the IMF should ensure greater flexibility in the negotiating frameworks (e.g., formulate alternative program paths through negotiation, leaving it to the country to decide, with IMF staff advice, what best suits its circumstances); develop systematic mechanisms for ex post support for country-initiated programs; strengthen resident representative missions in ESAF countries; engage in regular informal policy dialogue with the country’s political leadership; and find ways to improve the IMF’s image.
- Countries should create economic management teams comprising representatives of economic and social sector ministries and political leaders to oversee the reform process and hold national conferences where alternatives and trade-offs can be openly debated.

Disbursements and program monitoring along the lines of Extended Arrangements, with quarterly performance criteria and half-yearly reviews in selected cases. Directors asked the staff to offer concrete proposals for stronger monitoring.

Most Directors agreed that more focused technical assistance, contingency planning, and program monitoring, although constructive and worthwhile, were unlikely by themselves to reduce significantly the incidence of program interruptions. The record suggested that many discontinuities or weaknesses in policy implementation were related to political factors. In view of such difficulties, and taking into account administrative limitations, some Directors felt that programs needed to anticipate a slower pace of reform and adjustment than in the past. Many Directors, however, felt that more selectivity was needed in approving arrangements. They favored greater use of prior actions by member countries and indicators of commitment by governments to forge a political consensus for change and aggressively pursue the objectives of the program.

External Evaluation of the ESAF

In the spring of 1997, a panel of outside experts began work on an independent evaluation of SAF/ESAF-supported programs. This was the first time that an external evaluation of aspects of the IMF’s work had been commissioned by the Executive Board. The panel—Dr. Kwesi Botchwey, Harvard Institute for International Development and former Finance Minister of Ghana; Professor Paul Collier, Oxford University; Professor Jan Willem Gunning, Free University, Amsterdam; and Professor Koichi Hamada, Yale University—completed its study in January 1998. On the basis of the terms of reference for the study adopted by the Executive Board, the evaluators used a case-study approach to examine social policies and the composition of government spending; developments in countries’ external positions; and the determinants and influence of differing degrees of national ownership of ESAF-supported programs. The Board discussed the external evaluation (Box 12) in March 1998.

Directors saw a high degree of complementarity between the report of the external evaluators and the IMF staff review. All supported the fundamental view underlying the evaluators’ findings that the ESAF was a valuable instrument to assist low-income countries and
1. It is time to add a new chapter to the Bretton Woods agreement. Private capital flows have become much more important to the international monetary system, and an increasingly open and liberal system has proved to be highly beneficial to the world economy. By facilitating the flow of savings to their most productive uses, capital movements increase investment, growth, and prosperity. Provided it is introduced in an orderly manner, and backed both by adequate national policies and a solid multilateral system for surveillance and financial support, the liberalization of capital flows is an essential element of an efficient international monetary system in this age of globalization. The IMF’s central role in the international monetary system, and its near universal membership, make it uniquely placed to help this process. The Committee sees the IMF’s proposed new mandate as bold in its vision, but requiring cautious implementation.

2. International capital flows are highly sensitive to, among other things, the stability of the international monetary system, the quality of macroeconomic policies, and the soundness of domestic financial systems. The recent turmoil in financial markets has demonstrated again the importance of underpinning liberalization with a broad range of structural measures, especially in the monetary and financial sector, and within the framework of a solid mix of macroeconomic and exchange rate policies. Particular importance will need to be attached to establishing an environment conducive to the efficient use of capital and to building sound financial systems solid enough to cope with fluctuations in capital flows. This phased but comprehensive approach will tailor capital account liberalization to the circumstances of individual countries, thereby maximizing the chances of success, not only for each country but also for the international monetary system.

3. These efforts should lead to the establishment of a multilateral and nondiscriminatory system to promote the liberalization of capital movements. The IMF will have the task of assisting in the establishment of such a system and stands ready to support members’ efforts in this regard. Its role is also key to the adoption of policies that would facilitate properly sequenced liberalization and reduce the likelihood of financial and balance of payments crises.

4. In light of the foregoing, the Committee invites the Executive Board to complete its work on a proposed amendment of the Fund’s Articles that would make the liberalization of capital movements one of the purposes of the Fund and extend, as needed, the Fund’s jurisdiction through the establishment of carefully defined and uniformly applied obligations regarding the liberalization of such movements. Safeguards and transitional arrangements are necessary for the success of this major endeavor. Flexible approval policies will have to be adopted. In both the preparation of an amendment to the IMF’s Articles and its implementation, the members’ obligations under other international agreements will be respected. In pursuing this work, the Committee expects the IMF and other institutions to cooperate closely.

5. Sound liberalization and expanded access to capital markets should reduce the frequency of recourse to Fund resources and other exceptional financing. Nevertheless, the Committee recognizes that, in some circumstances, there could be a large need for financing from the Fund and other sources. The Fund will continue to play a critical role in helping to mobilize financial support for members’ adjustment programs. In such endeavors, the Fund will continue its central catalytic role while limiting moral hazard.

6. In view of the importance of moving decisively toward this new worldwide regime of liberalized capital movements, and welcoming the very broad consensus of the membership on these basic guidelines, the Committee invites the Executive Board to give high priority to the completion of the required amendment of the Fund’s Articles of Agreement.
and financial management capacities. This has given rise to the practice of preparing large-scale, integrated, multiyear technical assistance programs cofinanced with other donors. Such technical assistance programs have now been implemented—or are being implemented—in such postconflict countries as Angola, Cambodia, Haiti, Lebanon, Namibia, Rwanda, and Yemen; plans are under way for a similar approach for Liberia. These programs are usually closely coordinated with, and cofinanced by, the United Nations Development Programme and the European Union. In collaborating with these centers, the Institute continues to place emphasis on “capacity building” by training trainers, both in financial macroeconomics and in managerial fields linked to teaching.

To respond to the growing need for training in Africa, the Institute helped establish in 1997 the nine-member Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI) in Zimbabwe and the West African Institute for Financial and Economic Management (WAIFEM) in Nigeria.

Asia. Effective May 4, 1998, the IMF-Singapore Regional Training Institute (STI) commenced the offering of training on policy-related economics to selected government officials, mainly from developing countries in the Asia and the Pacific region. In 1998/99, 13 courses and seminars are scheduled on macroeconomic adjustment and reform policies, financial programming, the problems of transition economics, monetary and exchange operations, public finance, banking supervision, and macroeconomic statistics. The STI is viewed as a precursor to similar regional training centers in other parts of the world.

South-East Asian Central Banks Research and Training Center (SEACEN). Relations between the IMF Institute and SEACEN (Kuala Lumpur, Malaysia) developed in the 1970s when the Institute began to send senior staff to assist SEACEN in the formulation of its training program. Since the early 1980s, the Institute has also provided lecturing assistance to SEACEN and coordinated lecturing assistance from other IMF departments, and in the early 1990s began to conduct joint courses.

The Arab Monetary Fund. The IMF Institute has maintained a close relationship with the training branch of the Arab Monetary Fund (AMF), the Economic Policy Institute (EPI), since its inception in 1988. Since then, it has regularly provided the EPI with lecturing assistance in connection with the AMF course on Macroeconomic Management and also participated in the AMF course on External Sector Management, first offered in March 1995. Cooperation between the IMF Institute and the AMF includes joint courses and seminars and participation by Institute staff in AMF-sponsored seminars.

In addition, the Institute has been providing lecturing assistance for courses organized by the Center for Latin American Monetary Studies for several years; has been cooperating with the Islamic Development Bank on regional training courses since 1994; and conducted its first cooperative training venture with the Asian Development Bank in 1995.
Box 15

**Operational Budget**

The quarterly operational budget is the mechanism through which the IMF makes its resources available to member countries. Reflecting the cooperative character of the IMF and the revolving nature of its resources, IMF financial assistance is provided through the use of SDRs and the currencies of a wide range of members—large and small, including advanced, developing, and transition economies. Members whose balance of payments and reserve positions are judged sufficiently strong for their currencies to be included in the operational budget make foreign exchange available to members with weak balance of payments positions in need of external financing. In return for the use of their currencies through the operational budget, members receive a liquid claim on the IMF that earns a market-related rate of return.

Guidelines underlying the preparation and implementation of the operational budget are established by the Board. During 1997/98, the Board reviewed the procedures governing the assessment of members’ balance of payments and reserve strength. It concluded that assessments should continue to rely on a relatively simple system, based on criteria set out in the Articles of Agreement (balance of payments and reserve positions and developments in exchange markets), supplemented by a small set of additional indicators bearing on a member’s external financial strength, including in particular indicators of short-term external debt and debt service.

**Borrowing**

The IMF is a quota-based institution. At the same time, it has authority under its Articles of Agreement to borrow to provide temporary supplements to its usable quota resources, if needed.

**General Arrangements to Borrow.** During the financial year, the IMF renewed the General Arrangements to Borrow (GAB) for a further five-year period from December 26, 1998.

The GAB is a set of arrangements under which 11 industrial countries or their central banks have agreed to provide resources to the IMF to forestall or cope with an impairment of the international monetary system. The amount potentially available under the GAB is SDR 17 billion, with an additional SDR 1.5 billion available under an associated agreement with Saudi Arabia. Table 10 shows the amounts of credit arrangements of participants in the GAB.

**New Arrangements to Borrow.** The amount of resources potentially available to the IMF through borrowing in circumstances similar to those covered by the GAB was enhanced by the Board’s adoption on January 27, 1997, of a decision on the New Arrangements to Borrow (NAB). The NAB represents the culmination of intensive efforts since the June 1995 Halifax meeting of the Group of Seven countries, which called for doubling the amount of resources available to the IMF under the GAB to respond to financial emergencies.

The New Arrangements do not replace the General Arrangements, which remain in force. The NAB will be the facility of first and principal recourse, unless a GAB participant (all GAB participants are also participants in the NAB) requests the use of IMF resources. A proposal for calls may be made by the IMF under either of the arrangements, and if a call under the NAB is not accepted, then such a proposal may be made under the GAB. The amount potentially available under the NAB is up to SDR 34 billion, which is also the maximum combined amount available under the two arrangements. Table 11 shows the amounts of credit arrangements of participants under the NAB, which are based on relative economic strength—as measured by the actual IMF quotas of the participants as a predominant criterion. The credit arrangements under the NAB may be activated for the benefit of an IMF member, either a participant or a nonparticipant, under circumstances similar to those specified in the GAB, except that activation of the GAB for the benefit of a nonparticipant requires additionally that, after consulting with the participants, the Managing Director judges that the IMF faces an inadequacy of resources.

The NAB will enter into force when the decision has been adhered to by potential participants with credit arrangements amounting to not less than SDR 28.9 billion, including the five members or institutions with the largest credit arrangements. As of April 30, 1998, two-thirds of the participants, representing some 55 percent of the potential resources under the arrangements, had adhered to the decision.

**Access Policy and Limits on Use of IMF Resources**

The IMF’s current policies on access to its resources reflect the Board’s decision in 1994 to raise the annual access limit under the credit tranches and the Extended Fund Facility (EFF) for a period of three years to 100 percent of quota from 68 percent, while keeping the cumulative access limit unchanged at 300 percent of quota. The Board reviews access policies annually. At the November 1997 review, it decided to maintain the annual and cumulative access limits set in 1994 until the next review of access policies, to be held not later than October 1998.

The access policies and limits applicable to the credit tranches and the EFF do not apply to the IMF’s special facilities, including the Supplemental Reserve Facility, established in December 1997. Under the SRF, the IMF makes financial assistance available to member countries for a period of up to one year in case of exceptional balance of payments difficulties attributable
(SDR 1.0 billion). Contributing to the increase in transfers among participants and prescribed holders was a significant reduction in the SDR holdings of prescribed holders. Summary data on transfers of SDRs by participants, the GRA, and prescribed holders are presented in Table 16 (see also Appendix II, Table II.12).

Transfers of SDRs from participants to the GRA fell to SDR 4.8 billion in 1997/98 from SDR 6.0 billion in 1996/97, reflecting mainly a fall in repurchase obligations discharged in SDRs to SDR 2.9 billion in 1997/98 from SDR 4.4 billion in 1996/97. Because the expansion of credit outstanding took place in the second half of the financial year, charges paid in SDRs increased only slightly, to SDR 1.9 billion in 1997/98 from SDR 1.6 billion in 1996/97.

Transfers of SDRs from the GRA to participants and prescribed holders were constrained by the lower receipts of SDRs from participants, but rose slightly to SDR 5.6 billion in 1997/98 from SDR 5.4 billion in 1996/97. Members’ purchases made in SDRs of SDR 4.2 billion represented the largest category of transfer, followed by remuneration payments of SDR 1.2 billion to members with creditor positions.

Transfers among participants and prescribed holders rose to SDR 9.8 billion in 1997/98, from SDR 8.4 billion in 1996/97, largely reflecting increases in transactions by agreement and in IMF-related operations.27 Transactions by agreement totaled SDR 8.6 billion during 1997/98, compared with SDR 7.4 billion in 1996/97. Participants continued to acquire substantial amounts of SDRs in transactions by agreement in order to discharge their financial obligations to the IMF; they also sold in transactions by agreement most of the SDRs they received in purchases and ESAF loan disbursements. For the most part, transactions by agreement continued to be conducted with the assistance of 12 members with standing arrangements with the IMF to buy or sell SDRs for one or more freely usable currencies at any time provided that their SDR holdings remained within certain limits. These “two-way” arrangements accommodated a very substantial proportion of desired acquisitions and sales of SDRs, obviating the need for recourse to the designation mechanism (Box 16). In this regard, the reduction in the holdings of prescribed holders during the year (by SDR 0.9 billion) was accommodated largely through transactions by agreement with members with two-way arrangements and had the effect of making more SDRs available for use by participants. Despite the improved supply of SDRs for transactions by agreement, requests for acquisitions totaling SDR 0.2 billion by a number of participants could not be met as of the end of the financial year. IMF-related operations, representing the use of SDRs in connection with the SAF and ESAF, increased to SDR 0.9 billion in 1997/98 from SDR 0.6 billion in 1996/97.

**Pattern of SDR Holdings**

The distribution of SDR holdings among various groups of holders changed somewhat in 1997/98, reflecting transfers during the year, with the IMF playing the major role in the circulation and redistribution of SDRs. In making transfers of SDRs under the quarterly operational budgets, the IMF has sought since early 1993 to maintain its SDR holdings in a range of SDR 1.0–1.5 billion by transferring each quarter the SDRs it receives to debtor members in connection with their purchases and to creditors in the payment of

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27IMF-related operations are those between members and the IMF conducted through the intermediary of a prescribed holder.

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**Box 16**

**Designation Plan**

Article XIX of the IMF’s Articles of Agreement provides for a designation mechanism under which participants whose balance of payments and reserve positions are deemed sufficiently strong are obliged, when designated by the IMF, to provide freely usable currencies in exchange for SDRs up to specified amounts. The designation mechanism ensures that, in case of need, participants can use their SDRs to obtain freely usable currencies at short notice. To ensure that such use is not for the sole purpose of changing the composition of reserves, a participant wishing to sell SDRs in a transaction with designation is required to make a representation to the IMF that it has a need to use its SDRs.

The designation mechanism is executed through quarterly designation plans, approved by the Board, which list participants subject to designation and set maximum limits to the amounts of SDRs that they can be designated to receive during the quarter. Apart from a participant being “sufficiently strong” for designation, the amounts of designation for individual participants are determined in a manner that over time promotes equality in the “excess holdings ratios” of participants (i.e., SDR holdings above or below allocations as a proportion of participants’ official gold and foreign exchange reserves).

Since September 1987, there have been no transactions with designation because potential exchanges of SDRs for currencies have been accommodated through voluntary transactions by agreement with other participants, primarily the 12 participants that have established with the IMF standing arrangements to buy or sell SDRs for one or more freely usable currencies at any time, provided that their SDR holdings remain within a certain range. These arrangements have helped accommodate members’ desires to both buy and sell SDRs and have facilitated the circulation of SDRs in the system.
context of surveillance and requests for the use of IMF resources, the Monetary and Exchange Affairs Department works with area departments in its areas of expertise. It also contributes to the exercise of IMF jurisdiction on exchange practices and restrictions.

The Policy Development and Review Department plays a central role in the design and implementation of IMF financial facilities and operations, in surveillance policies, and in other areas. Together with the Research Department, it takes the lead in multilateral surveillance, policy coordination, and associated review and support activities. With area departments, the Policy Development and Review Department helps mobilize other financial resources for member countries using IMF resources, including work on debt and program financing (through the Paris Club and international banks).

The Research Department conducts policy analysis and research in areas relating to the IMF’s work. The department plays a prominent role in the development of IMF policy concerning the international monetary system and surveillance and cooperates with other departments in formulating IMF policy advice to member countries. It coordinates the semiannual World Economic Outlook exercise and prepares the annual International Capital Markets report, as well as analysis for the Group of Seven policy coordination exercise and the Executive Board’s seminars on World Economic and Market Developments. The department also maintains contacts with the academic community and with other research organizations.

The Statistics Department maintains databases of country, regional, and global economic and financial statistics and reviews country data in support of the IMF’s surveillance role. It is also responsible for developing statistical concepts in balance of payments, government finance, and money and financial statistics, as well as producing methodological manuals. The department provides technical assistance and training to help members develop statistical systems and produces the IMF’s statistical publications. In addition, it is responsible for developing and maintaining standards for the dissemination of data by member countries.

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**Box 17**

**IMF Resident Representatives**

At the end of 1997/98, the IMF had 70 resident representatives in 64 countries. These posts—typically filled by a single staff member—are intended to enhance the provision of IMF policy advice and are often set up in conjunction with an IMF-supported adjustment program.

To evaluate their effectiveness, the IMF’s Office of Internal Audit and Inspection reviewed the program in 1997. The review concluded that resident representative positions have a major impact on the quality of the IMF’s country work; in particular, resident representatives alert the IMF and the host country to potential policy slippages and facilitate program implementation. The review highlighted the importance of placing broadly equal emphasis on policy and program support and activities to strengthen underlying macroeconomic capacities and institutions and enhance transparency. It also underscored the need to view these posts as transitional.

At their discussion, many Directors cited the exceptional access that resident representatives had to key national policymakers, which was an important asset for the IMF. Directors were generally highly satisfied with resident representatives, but there were problems in about one-third of the posts, which undermined their effectiveness. Directors urged the IMF staff to implement recommendations to improve this record. Most Directors agreed there should be no single model for the situations in which a resident representative could be used, but they supported a greater focus on the resident representatives’ comparative advantage—that is, in providing on-site macroeconomic advice and program support. Directors stressed the need to ensure a consistently high quality of staff in these posts, with particular attention to strong economic policy and communication skills, self-confidence, and initiative. Given high start-up costs, Directors favored two-to three-year assignments. They also emphasized that member country receptiveness was vital to the success of a resident representative; the IMF staff needed to work closely with the national authorities to define objectives for the post and prioritize joint work.

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The Treasurer’s Department formulates the IMF’s financial policies and practices; conducts and controls financial operations and transactions in the General Department, SDR Department, and Administered Accounts (including the ESAF Trust and related accounts); effects and controls expenditures under the administrative and capital budgets; and maintains IMF accounts and financial records. The department’s responsibilities also include quota reviews, IMF financing and liquidity, borrowing, investments, the IMF’s income, and operational policies on the SDR.

**Information and Liaison**

The External Relations Department edits, produces, and distributes the IMF’s nonstatistical publications; provides information services to the press and general public; maintains contacts with nongovernmental organizations and parliamentary bodies; and manages the IMF’s website.

The IMF maintains four offices—in Asia and the Pacific, in Europe, in Geneva, and at the United Nations—to foster close contacts with other international and regional institutions.