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Folder Title:	President Wolfensohn - Media Coverage and Interviews - Press Clippings - Emerging Markets Publication - An International Media - Partners Publication - International Monetary Fund [IMF] - World Bank Daily Edition - October 1995
Folder ID:	30486813
Series:	Media coverage and engagement
Dates:	10/08/1995 – 10/12/1995
Subfonds:	Records of President James D. Wolfensohn
Fonds:	Records of the Office of the President
ISAD Reference Code:	WB IBRD/IDA EXC-13-10
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B. SUBJECT: EMERGING MARKETS PUBLICATON - AN INTERNATIONAL MEDIA - PARTNERS PUBLICATION - IMF-WORLD BANK DAILY EDITION - WASHINGTON D.C. OCTOBER 1995 (ANNUAL MEETING 1995)

DATE: 01/27/97

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E. COMMENTS: Issues dating:
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File Location	Cleared By	Date:
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EMERGING MARKETS

IMF/WORLD BANK DAILY EDITION • WASHINGTON, D.C. • SUNDAY, OCTOBER 8, 1995

Bank Calls for People Power

BY KEVIN RAFFERTY

World Bank president James Wolfensohn appealed for "people power" to come to his aid in seeking replenishment of the International Development Association (IDA), the bank's soft-loan arm which lends money to the poorest countries in the world. His direct request, made at one of the pre-meeting seminars, was the strongest indication yet of the deep trouble that IDA is in.

Wolfensohn told delegates to an environment seminar that IDA should provide funds of $6 billion a year but was under threat of being cut to $3.7 or $2.7 billion a year. He declared: "This is not just a cut; it is a blow that could be almost fatal." He asked delegates to lobby their congressmen, MPs and other political leaders to provide new funds so that the poorest people in the world do not suffer the greatest harm from budget cutbacks.

Wolfensohn met with U.S. President Bill Clinton this week, and reported that Clinton had assured full support from the White House. The problem is that although the president proposes, the Congress disposes — and so far has not been disposed to do so.

Key members of the Senate and House of Representatives will meet on Thursday to hammer out compromise negotiations on how much money to grant for the delayed tranche of the tenth replenishment of IDA (IDA 10). The House bill offers $575 million and the Senate $775 million, but even the Senate sum is less than half of the $1.6 billion that the U.S. still owes from its pledges to IDA. This sum is composed of $1.25 billion due for the third tranche of IDA 10 plus arrears from the previous tranches.

The problem is that Congress' delay in voting has led other donors to reconsider their own support for IDA. "Hopes that other donors might make up some of the U.S. shortfall are being dashed," said one of the officials involved in negotiations just started for the eleventh replenishment of IDA.

But the other donors, which also face budgetary constraints, have firmly said that they will not go ahead without the U.S., and the administration wants to get the votes for IDA 10 before making promises on IDA 11. Treasury secretary Robert Rubin (see Profile, page 58) spoke in the warmest terms of the Clinton administration's backing for the World Bank but added that it was "too early" to make pledges for the eleventh replenishment.

"The cruelest irony is that never has there been such a full consensus about IDA's mission, what it needs to do and how it needs to be improved," said Paula Donovan, the bank's director responsible for the replenishment. Unfortunately, when it comes to budget cuts, the world's poorest people have no votes.



G7 in jovial mood: Treasury's Rubin (waving hands) tells a joke to Italy's Dini, Fed governor Greenspan and Canada's Martin) while Takemura of Japan and Trichet of France (far right) swap private stories about beleaguered currencies

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G7 v. THE MARKETS

BY PETER KOENIG, ANTHONY ROWLEY AND HENRY COPELAND

In the face of currency turmoil in Europe and persistent unease about the dollar-yen exchange rate, Group of Seven (G7) finance ministers and central bankers sought yesterday to reassure traders and investors that they, not the markets, retain the upper hand in determining the direction of the global economy.

In a statement issued at the end of a four-and-a-half hour session at the U.S. Treasury, G7 representatives "welcomed the orderly reversal in the movements of the major currencies that began following their April meeting." They added, they "would welcome a continuation of these trends," and reaffirmed their commitment "to cooperate closely in exchange markets."

Amplifying on the official text, U.S. Treasury secretary Robert Rubin, who chaired yesterday's G7 session, declared that "on exchange rates, I was very impressed that everyone came into the meeting looking at the issue in ways similar to our perspective."

Taking a shot at those who blamed the Clinton administration for letting the G7 process unravel before and during the Mexican peso crisis earlier this year, Rubin tied U.S. optimism about the global economic outlook to the spirit of unity he said prevailed at the G7 meeting.

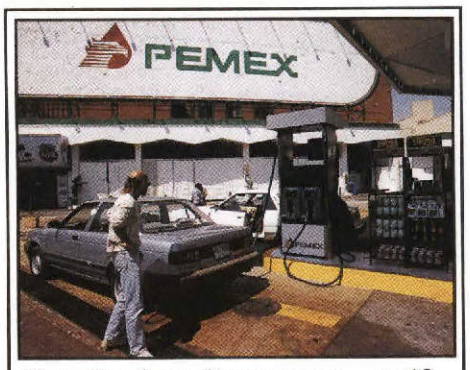
Win the Whisky–p. 4

Lending support to this position, Japanese finance minister Masayoshi Takemura downplayed recent tensions between Tokyo and Washington over the yen-dollar exchange rate and the havoc it has wreaked on Japanese exporters. Takemura last night declared that he was "fully satisfied" with the wording of the G7 communique, and denied reports that Japan had sought a commitment to achieve a higher level for the dollar against the yen.

The Japanese minister, who held a bilateral meeting with Rubin immediately before the G7 plenary session, told reporters, "we have not discussed any desirable or specific level of exchange rates, and nor have we asked for any." There were "no differences of view on this issue," he added.

British Chancellor of the Exchequer Kenneth Clarke flatly declined to comment on currencies and offered a similarly upbeat perspective on the G7 process, while Italian

(*Continued on page 62*)



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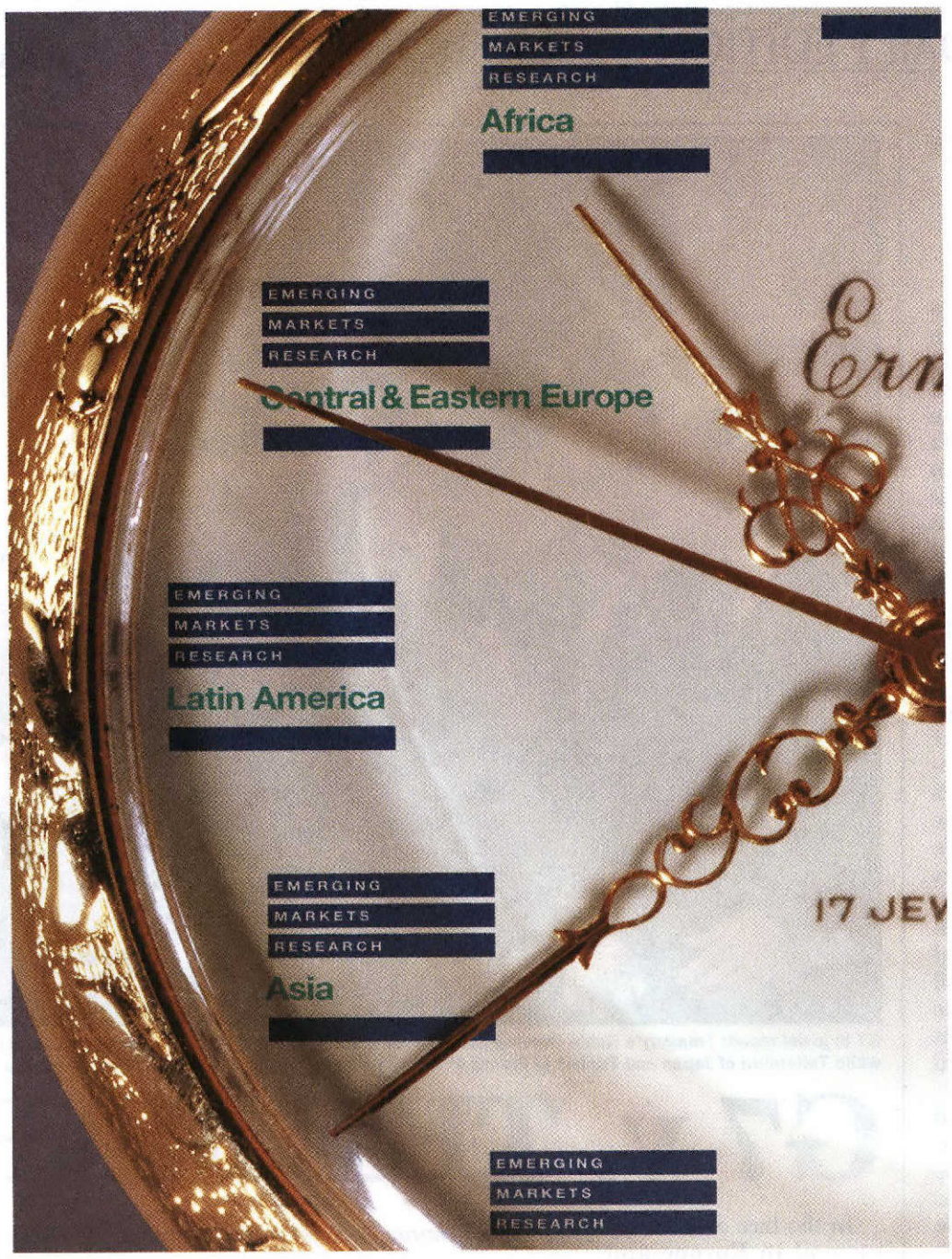

A TIMELY APPROACH TO GLOBAL EMERGING MARKETS.

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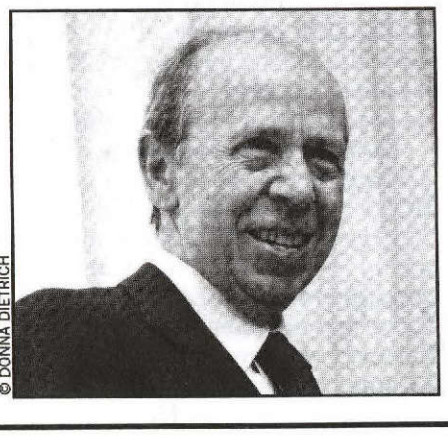

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"Basta! That is four questions about our finances! No more questions about finances!"

— Lamberto Dini, prime minister of Italy

THE G7 AND THE WORLD

The progress of the G7 leaders towards getting the world economy onto a smooth growth track was disturbed yet again by the vexing issue of currencies. In one sense it is understandable. The shock to the French franc on Friday following revelations about prime minister Alain Juppe was severe. It showed the nervousness of currency markets and the fragility of faltering attempts at European unity.

Even within Germany there are differences of opinion between the view of Chancellor Helmut Kohl, who regards it as of major importance to forge political unity and to accept that some concessions must be made as the price, and those who do not want to sacrifice the strength of the Deutsche mark for any reason.



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The determination of the new government of French President Jacques Chirac to conduct fresh atomic tests and then to go ahead and explode the bombs, one might say, right in the face of international opposition shows how far from united Europe is. Politicians might try to brush it aside, but all these tensions have their fallout in the forex markets.

Add to this the question of what should be the appropriate level for the yen and you have an impossible mix. In the past seven months the Japanese currency has soared to 80 against the dollar, then dropped — at first slowly until the summer, then sharply until it touched 105 briefly. Japanese ministers have been anxious to see a further fall. The powerful Ryutaro Hashimoto, who has just taken on the mantle of deputy prime minister, has publicly said that he wants the yen at 110, at which level even Japan's small companies will go back into profit.

So what should currency market traders make of the G7 communique? One news agency, Bloomberg, immediately leapt in and reported, "Top policymakers of the G7 called for further appreciation in the dollar, and said they stand ready to back the U.S. currency in foreign exchange markets." This was not quite the same interpretation of Lamberto Dini, Italy's prime minister, who said that the ministers were not planning any concerted action in the dollar-yen market. U.S. treasury secretary Robert Rubin also steadfastly refused to elucidate exactly what the communique really meant by "the orderly reversal in the movements of major currencies that began following their April meeting" and "they reaffirmed their commitment to reduce imbalances and cooperate closely in exchange markets."

Just to take the yen-dollar relationship, do they mean they want the yen at 90 to the dollar, which it was in summer, or at 100, where it is now, or at 105 or at 110? At the 110 level that will satisfy Hashimoto and small companies, it is likely that Japanese exports will begin to soar. Will Washington be comfortable with Tokyo's trade surplus rising again from a base of $100 billion a year? Will the U.S. like it if this means that Tokyo postpones deregulation measures to stimulate its economy and relies again on export-led growth?

In a sense, of course, the G7 are trying to have their cake and eat it, to show the currency markets that they are the boss without having to pay the price of putting their money on the table. Total foreign exchange dealings in London, New York and Tokyo combined are about $850 billion a day, which makes anything the central banks can put up look puny. If they combine their strengths, they can get the message across. By itself, the Bank of Japan bears the scars of a record $180 billion foreign currency reserves, up 40 percent in the last few months, in the struggle to weaken the yen.

What should be a matter of greater concern is that the preoccupation with currencies is a sign of inward-looking attitudes. The G7 did find the time to discuss Russia and invited first deputy prime minister Anatoly Chubais in to join their talks. They also endorsed the reform package to deal with Mexican-style crises, and this is expected to be approved today by the interim committee. But the rest of the world got left out.

This comes during a time of crisis in the poorest countries of the world because the funds to the International Development Association are threatened with savage cuts. At a time when many weak economies are struggling to reform themselves and encourage private enterprise, it nothing short of a disaster. The G7 might say that the subject of IDA is a matter for the development committee, not due to meet until tomorrow, but it would have been reassuring if the leaders of the G7 had found a sentence to remember the plight of the rest of the world threatened by their budget cutting.

The body language of the leaders assembled for the photographs on the U.S. treasury steps was not very reassuring. They stood safely apart. When our photographer asked if they could not be persuaded to group themselves better, say one behind another on the steps, she was sharply told by one of the sherpas: they are world leaders and you'd never get one to stand lower than another.

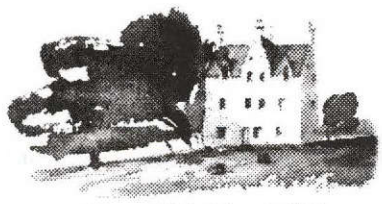
Kevin Rafferty, Editor

News

Horse Sense Better than Dollars and Cents

Ordinary farmers sometimes know better than all the wise men, political leaders and bank presidents about the problems of economic development. Bolivia's President Sanchez de Losada was visiting some of the more remote areas of his country, where an Indian farmer gave him one of the best lessons about respecting the environment. "God always forgives," he assured the leader, "human beings sometimes forgive. But Nature never forgives."

HELP EUROPE: WIN A BOTTLE



It is obviously time for guests at the IMF/World Bank annual meetings to lend a hand to the beleaguered ministers of the European Union who have found it so difficult to choose a name for the new Eurocurrency. We invite readers of *Emerging Markets* to send us their suggestions — and the winner chosen by a distinguished panel of judges will receive a bottle of The Macallan malt whisky for his or her success.

Confusion over the coinage in Europe is so bad that yesterday Hans Tietmeyer, president of the Bundesbank, invented a new three-sided coin when talking about economic prospects in the U.S. On one side of the coin, he said, growth is good; on the other side, savings are poor; on the third side is the trade deficit.

Many suggestions have already been made for the name of a common European currency, but have fallen down on national arguments. In the end, ministers decided that the currency would be called Euro-franc, Euro-mark, Euro-pound and so on, with Euro prefixed to the national currency. This has the advantage of keeping the existing familiar name in an effort to win over the millions of Euro-skeptics of all nationalities, but is a cop-out because a true European currency will have to have its own name.

That's why we thought the bankers and ministers could lend an imaginative idea.

Dresdner Bank chairman Juergen Sarrazin, who was the first to suggest that the new European currency should include the word Euro, has kindly agreed to be one of the judges, as has Yoh Kurosawa, president of Industrial Bank of Japan. Larry Summers, deputy secretary of the U.S. treasury has been asked. The judging panel will include the editor and managing editor of *Emerging Markets*. Closing date and time for faxes is Tuesday, October 9 at 4:00 p.m. The name of the winner will be announced in Thursday's paper.

All you have to do is fax your entries to *Emerging Markets* in Room 334 at the Hotel Washington. The number is (202) 824 9797. Write your name and contact numbers and the name you would give for the new currency. Also, in order to help decide in the event of a tie, describe the design you would like to see on the obverse and reverse of the new Euro-coin.

Bosnians Demand Money to Fund Peace

BY HENRY COPELAND

On the eve of the latest cease fire, Bosnian officials are canvassing potential donors for an assistance package of at least $3 billion for their war-torn country. Commitments of money are a precondition for peace, the officials said yesterday.

"We need a very strong guarantee that this will be realized and implemented," said Kasim Omicevic, governor of the National Bank of Bosnia and Herzegovina, in an interview with *Emerging Markets*.

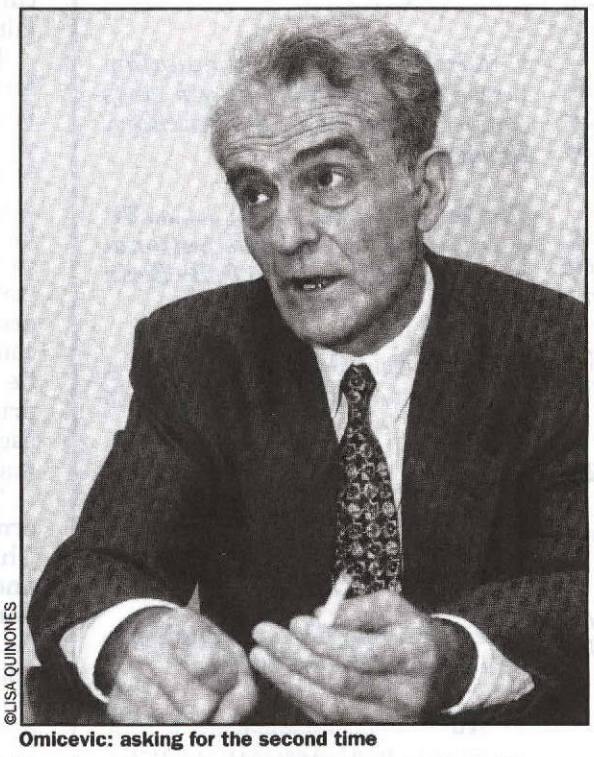
The Bosnian delegation is meeting with a who's who of international financial leaders this week to explain the assistance package they need. Assuming the peace process continues apace, the country is counting on concrete pledges of money by early December, said finance minister Neven Tomic.

The package grows out of a study paid for by the Netherlands and completed by World Bank staffers in August. The study put the price for repairing infrastructure in Bosnia Herzegovina over the next three years at $3 billion.

In its meetings, the Bosnian delegation is stressing that land under its control has grown by 60 percent since that study was completed, and that their needs will be correspondingly larger. The study notes in a footnote, however, that the original area is "where a lot, though not all, of the war damage occurred."

The assistance package's largest item is $600 million for the reconstruction of the country's energy sector, and includes an anticipated $392 million in spending on health facilities. In addition, the package would include $200 million for mine clearing. The Bosnians, along with their Dutch sponsors, are using the meetings to stress that they will be responsible recipients of assistance.

World Bank executive director Eveline Herfkens of the Netherlands has been leading this campaign. "It is very important that during these annual meetings, people get the good news that while we were sitting on our comfortable couches watching the television and reading the newspapers, there was this economic team on the ground in [Bosnia Herzegovina] which has been following a strict monetary and fiscal policy of which many countries in the region would be jealous.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Omicevic: asking for the second time

"From a World Bank/IMF point of view," she concluded, "if anyone ever deserves support, they do."

National Bank governor Omicevic lists the achievements over the last year: industrial production is up fourfold, albeit from a very low base; the government's budget is balanced, and inflation has been nil in the last year.

The Bosnians met Friday with representatives of 35 countries and institutions in a two-and-a-half hour meeting to outline their case, and are conducting numerous unilateral meetings seeking assistance.

A cease fire agreement brokered last week by U.S. assistant secretary of state Richard Holbrooke will take effect on Tuesday, provided that gas and electricity are flowing to Sarajevo. Many obstacles to peace remain, however, as both sides continue to jockey to optimize land positions ahead of a final settlements.

Bosnian officials traveled to the IMF/World Bank meetings last year in Madrid on much the same mission, but the time was not ripe for resolution.

Irfan Ljubijankic, then the country's foreign minister, argued strongly for assistance as part of that delegation. He told *Emerging Markets* in Madrid, "We are facing a period of months or years where the other side does not accept the peace plan. And the world keeps telling us, 'have patience.'" Ljubijankic died this spring when the plane he was flying in was shot down over Bosnia.

Scramble to Clear Arrears to Allow Reconstruction

A scramble is on to clear Bosnia's arrears with the IMF and World Bank without diverting donor resources from the country's reconstruction.

"In the face of the human suffering in Bosnia and the terrible needs there, it is unthinkable that first claim and call on available donor resources would be going back into the pockets of the World Bank," said World Bank executive director Eveline Herfkens of the Netherlands.

According to the bank and IMF's charters, assistance can only be given to countries which are members, and countries which have payments in arrears cannot be members. Thus, clearing Bosnia's $500 million in arrears is crucial to facilitating assistance to the country.

The obvious precedent for settling the war-torn country's arrears with the IMF and World Bank — thus opening the door for their assistance — is Macedonia, which cleared its arrears of $110 million last February with money given by a consortium of nations and institutions.

But supporters of the Bosnians are waging a campaign to ensure that donor money does not end up going to pay the arrears. "The situation is unprecedented. The country has been devastated by war," a U. S. official said. "What we are asking everyone to do is think creatively and not to be tied to past examples."

Other alternatives to having international donors pay off the bank might be bilateral agreements, concessions, or a rescheduling, said the official, who added that "there was no single proposal on the table."

The clearing of Macedonia's arrears required nine months, but for Bosnia, money must begin to flow quickly to grease the wheels of peace.

"In the case of Macedonia, the Netherlands led a support group to clear the arrears, but in this case, obviously the problems are of a totally different dimension. The arrears are much bigger and there is massive destruction," said Monique Koning, an assistant to Herfkens, "so there has to be a lot thinking about new solutions."

The key is not to set "unhappy precedents," said Koning. "There is a financial department here in the bank. They have the interest in having sound financial policies for the bank, and, of course, they want to have the money back to pay them off, because you don't want to set unhappy precedents for another country."

Koning says forgiveness of the arrears would be "no go" and added that a rescheduling would be bad for the Bosnians. She offers one example of a "creative solution" worth considering: "The West Bank and Gaza are not members of the bank, however, we provide money from net income for them."

— Henry Copeland



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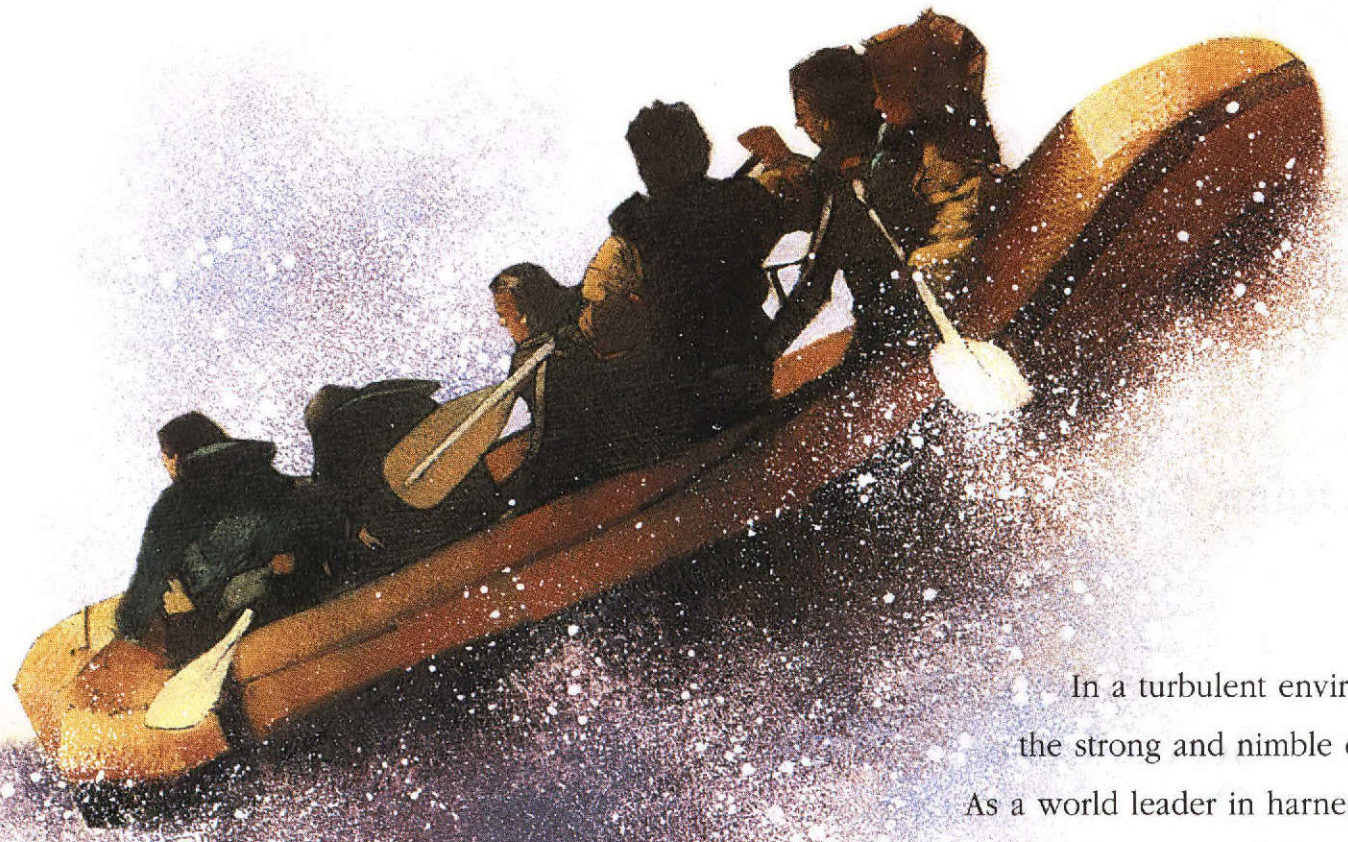

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News

SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 7

Moscow Drops 10% After Bombshell

BY CRAIG MELLOW

Rumors flew in Moscow and bankers fretted in Washington over Russian Prime Minister Viktor Chernomyrdin's surprise announcement that he would not seek the presidency next year. Chernomyrdin, who dropped his bombshell off-handedly to the press this week, had been considered the front-runner to succeed Boris Yeltsin and the most reliable guarantor of continued economic reform.

Chernomyrdin's bow-out comes at a critical juncture for Russia's economic stabilization program, which is backed by $6.4 billion in IMF loan commitments. Autumn is traditionally the season when inflation accelerates in Russia, thanks largely to government payments to the agricultural sector. "I think Chernomyrdin's decision is very regrettable," Dresdner Bank chairman Juergen Sarrazin told *Emerging Markets*.

Moscow's stock market dropped by 10 percent in reaction to the news, and Russian political circles were abuzz with speculation. "It's hard to understand how, as soon as he has formed his political bloc, the prime minister suddenly ends his own career," commented Vladimir Gurevich, economics editor of *Moscow News*.

Earlier this year at Yeltsin's urging, Chernomyrdin formed the political party Our Home is Russia. Ordinary Russians quickly dubbed it "the party of power," for all the officials and people of influence who signed up. Yet Yeltsin grew clearly uncomfortable with the idea that the premier was superceding him as a political figure, particularly after Chernomyrdin won accolades for ending the Budyonovsk hostage crisis last summer.

Yeltsin publicly criticized Our Home after it flopped in its first electoral test, a race for governor in Sverdlovsk Oblast. The party subsequently showed poorly in Volgograd Oblast as well, where Communists took 20 of 22 seats in the provincial legislature.



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Former presidential candidate Chernomyrdin

Some investors accordingly took comfort in the theory that Yeltsin had cleared the way for his own reelection bid. "I think either Yeltsin or Chernomyrdin could win the election," noted Jonathan Hoffman, chief economist for CS First Boston in London. "The important thing is that they not stand against each other."

But most Russian analysts had considered Chernomyrdin a stronger candidate than Yeltsin; the prime minister struck Russians as literally a more sober figure than his boss. He also remained largely untainted by the bloody debacle last winter in Chechnya.

Meanwhile Russia has been stretching the parameters of its lucrative agreement with the IMF. The fund's original inflation target of 1-2 percent per month has grown to 6-7 percent, even in summer when food prices drop.

The autumn promises much stronger inflationary pressures, as the worst harvest in a decade will almost certainly necessitate large grain imports. The bill for reconstruction in Chechnya rises each time Parliament meets, and the temptation to hand out populist goodies will probably prove irresistible in the run-up to December's parliamentary elections. On the revenue side, little of the $2 billion Russia was supposed to take in from privatization will actually appear this year.

Of course, rumors of impending disaster in Russia have often proved exaggerated. "The important thing is that they have the foreign reserves to keep the ruble steady for the rest of the year, instead of collapsing in the winter like it always has," said Christopher Wood, emerging markets equity strategist at Deutsche Morgan Grenfell. "This could change the way Russians look at their own currency and pave the way for positive GDP growth next year."

But Russians themselves felt less assured that the center would hold without the bulky figure who has done so much to glue it together. "It's not excluded that Yeltsin could be re-elected instead of Chernomyrdin," Gurevich said. "But there are other variants, too. For instance, the variant that there will not be an election altogether."

RUSSIANS HAVE HIGH HOPES OF $70bn DEAL

Russian officials arrive at this year's annual meeting with high hopes of reaching final agreements for repayment of nearly $70 billion in foreign debt. But bankers say they are in no hurry to reinvest in Russia, whether or not a flurry of recent negotiations comes to fruition.

"I see a weak government, a lot of underground economy, and a lack of security around most activities," Bayerische Vereinsbank managing director Albrecht Schmidt told *Emerging Markets*. "This makes me feel very unsure about Russia."

Still, Moscow will get an important psychological lift if a preliminary London Club deal made public earlier this week gains final approval. The private creditors, who are owed some $30 billion, appear to have ceded Russia's longstanding demand that payment be stretched over 25 years instead of 20. They extracted a higher interest rate than Russia wanted, however, 81.25 rather than 50 basis points above London interbank rate. And no debt will be written off.

Whether or not to seek debt forgiveness has been the subject of sharp internal debate in Russia. The official view has always been that such pleading was an insult to the country's dignity as a world power. Financial dissidents urged the state to swallow its pride and take the cash. The most outspoken dissident, Oleg Davydov, is now Russia's senior debt negotiator, but the majesty of office seems to have changed his views.

Davydov told the Russian press on meeting's eve that he expected both Paris and London Club agreements by year's end. The country's Paris Club debt is estimated at $38.7 billion. Both public and private arrears were inherited from the former Soviet Union. Russia has repaid the modest credits it has taken since regaining sovereignty in 1991.

Russia boosters point out that in terms of GDP and exports it is no more than a moderately indebted nation. Yet both government and creditors have feared that stiff payments could destabilize the country's shaky domestic order. "We reserved against our Russian debt already," Schmidt observed. "So every mark they repay will be a gift."

The debt question has taken on new urgency this year thanks to the structure of Russia's ambitious fiscal stabilization program. Moscow is supposed to close its still significant budget gap through non-inflationary borrowing in the bond markets, rather than having the central bank print more money. It is doubtful whether domestic securities issues can raise enough funds. Therefore the government is eager to reenter the international market.

Yet the gates of multinational finance may not swing open as wide as the Russians hope. "We support the IMF program in Russia, and call for more official support as well," one prominent London Club member remarked. "But I don't know if conditions are sufficient for new bank lending."

— Craig Mellow

Crockett Calls for Greater Capital Adequacy

BY ROB WRIGHT

Raising reserve ratios beyond current levels would be a strong first step in avoiding further crisis in Latin American banking, Bank for International Settlements head Andrew Crockett said yesterday.

Speaking at a conference on the topic at the Inter-American Development Bank (IDB), Crockett backed ex-Venezuelan central bank governor Ruth de Krivoy's suggestion that Latin banks should follow even higher capital standards than the Basle accord sets for developed country lenders.

Basle terms require banks from wealthy countries to set aside at least 8 percent capital adequacy. They do not apply to developing country institutions. De Krivoy — an outspoken critic of government policies that have mired Venezuela in one of Latin America's worst banking crises — said it was time to enact Basle principles in her part of the world as well, but with even tougher standards in order to promote solvency.

De Krivoy argued that factors like high market volatility and weak government supervision mean Latin banks need a bigger cushion against risk than their counterparts in the U.S., Western Europe and Japan. Basle's 8 percent standard, de Krivoy said, "works under the assumption that the quality of the assets is well known to the supervisors and is accurately measured, but this is not the case in many Latin American countries."



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Crockett

Crockett, a key voice in global banking supervision debates, quickly agreed in his response to De Krivoy's keynote speech at the IDB-G30 conference. He said the 8 percent standard existed as a minimum for G10 country banks, and that Latin ones should aspire to "a ratio that is well above that figure." He did not propose a specific target, but said de Krivoy's speech had been of "great value to those trying to strengthen banking supervision in emerging economies."

After Venezuela's weak supervisory bodies failed to detect growing bank troubles in 1993, leading Venezuelan institutions began to collapse in January 1994. The Caldera regime's interventionist economic policies have largely scared foreign investors away ever since. The government's $4.7 billion emergency banking bailout has contributed to a fiscal deficit officially at 7 percent of GDP, but thought to be much higher by New York bankers.

News

DID HE MEAN BRIBES?

Would Mark Mobius, one of the world's most astute emerging markets investors, buy stock in a construction company? "We tend to look very carefully and twice at construction companies," Mobius said during the World Bank's seminar, "Portfolio Flows After Mexico." He continued: "There are — how shall I say it — a lot of extracurricular activities required to get contracts from governments, and they don't show up on the balance sheet."

BANK-FUND SEEK JOINT DEAL ON DEBT

BY PATRICK SMITH

A major debate on poor country multilateral debt is on the table at this year's annual meetings after details of a radical $11 billion debt relief scheme were leaked last month. A joint World Bank-IMF task force is working on a series of options for debt relief in time for next spring's meetings. But any substantive progress depends "on achieving a political consensus," a senior bank official said. He added that "some philosophical questions on debt" would have to be answered before the proposals could be taken forward.

Bank president James Wolfensohn's decision to set up the task force marks a major shift in bank attitudes. In the past, neither the bank nor the fund has seen multilateral debt as a fundamental block to development; now they are in the center of the debate. Poor debtor countries and NGOs see the bank as breaking tradition and pursuing a new line on debt while the fund is seen as obstructing it.



© IMF PHOTO

Wolfensohn and Camdessus

The leaked proposal envisages setting up a fund with contributions from the bank and individual governments to disburse up to $11 billion over 15 years to reduce reforming countries' debts to multilateral institutions. The program would only be open to those countries that have credible reform records and have already reduced their debts to commercial banks and the Paris Club of official creditors.

Both Wolfensohn and IMF managing director Michel Camdessus are ambivalent about public discussion of the debt proposals. Wolfensohn condemned the original leak and Camdessus referred to the discussion as "the non-status of this non-paper." But another senior bank official said a public debate on the issues "may prove useful," although he emphasized much would depend on the bank's senior management: "If the president decides multilateral debt is going to be one of his top three priorities for his five or 10 year stint at the bank, then it will, at least, move much faster."

Having aired several reservations about the proposals, fund officials are reluctant to reject them out of hand. Acknowledging that his staff is working with the bank on the issue, Camdessus said last week: "I hope that the interim committee and the development committee will agree on the work program my colleagues at the bank and fund have put together...in order to be able to formulate a credible answer by the time of the April 1996 meeting."

Camdessus also emphasized the statutory differences between the two institutions: "The bank is a bank, the fund is a fund, contrary to what Keynes may sometimes have said. The bank is a multilateral development institution with the possibility of using its income for good purpose; the fund is a monetary institution that does not have the same liberty in using its income. We cannot act in the same way even if we have the same purpose".

African countries, which have the most to gain, are strongly backing the debt proposals. Francophone finance ministers meeting last week in Mali endorsed the proposal, as did Uganda's Yoweri Museveni. But it is the major creditor countries that will be listened to most carefully. Asked whether the debt scheme will take off next year, a fund official replied: "We have made a start. Once we get a technical consensus — we are looking at many imponderables: the U.S. Congress, Japan's moral problems with debt relief, the German economy — I wouldn't want to gamble on it."

Doubts Raised About Plan to Prevent Future Mexicos

BY PETER KOENIG

Even as IMF managing director Michel Camdessus defended the official response to the Mexican peso crisis, some experts raised fresh doubts this week about the fund's blueprint for preventing future Mexican-style crises from undermining confidence in the global capital market.

Camdessus told an audience of 200 bankers and economists at a symposium on the Latin American banking crises that without the unprecedented $37.5 billion bailout by the IMF and the U.S., "Mexico might have declared a moratorium, or imposed restrictions on capital and trade flows, or both" and that the resulting panic could have "spread to other countries in a few hours or a few days."

The IMF chief maintained that the peso crisis was "the first financial crisis of the 21st century" and suggested that the IMF's plan to improve the quality of economic data published by emerging market nations, coupled with a doubling of its capacity to borrow in emergencies to $50 billion, shows that world leaders have learned the lessons of Mexico.

Joking that the IMF's enhanced surveillance of emerging market economies "will make me even more popular in Latin America, I am sure," Camdessus argued that both the inflows of foreign capital to Mexico leading up to its crisis last December and its speedy return to the global capital market after the crisis highlight Mexico's progress since its default in 1982. He concluded: "My main message is that the countries of the region have no choice but to retain access to international capital markets if they are to continue their path to economic growth and prosperity."

Meanwhile, however, speakers at the same symposium — jointly sponsored by the Inter-American Development Bank (IDB) and the Group of 30 — focused on the problems in Mexico and other Latin countries that could still trigger runs on their foreign reserves following swings in sentiment in the global capital market.

"Latin America is two to three times more shock-prone than industrial nations," declared Ricardo Hausmann, the IDB's chief economist.

IDB economic adviser Liliana Rojas-Suarez noted that another problem is the weakness of many Latin American banking systems. Explaining the periodic runs on Latin banks, she singled out poor legal frameworks in the region, poor accounting standards, weak bank regulation, and fluctuations in economic policy.

Ruth de Krivoy, president of the Venezuelan think tank Sintesis Financiera, added that banking crises in Latin America have recurred with disturbing frequency because governments subscribe to "the myth of endless profitability of banks" and so are tempted to plunder them, undermining prudent banking practice for political reasons.

Guillermo Calvo, an Argentine economist teaching at the University of Maryland, suggested that until policymakers find a way to tame the fickle, herd-like behavior of international investors, more Mexican-style crises will occur, despite the plans of the IMF to enhance surveillance and double its General Arrangements to Borrow.

Hausmann warned that many smaller nations face a "volatility trap" which stacks the deck against local governments forced to coexist with global markets. "Maybe, just maybe," he concluded, "it may not be the right framework to have national banking systems. Maybe globally chartered banks would be better."

Frankness Pledge on Africa Policy

Next month the World Bank plans to release its most frank report yet on its record on Africa. Described by one bank official as "self-analytical rather than self-congratulatory," the report includes a large addendum which runs through Africans' main criticisms of bank policy. It is a matter of "adjusting the adjustment," according to the bank's vice-president for the Africa region, Kim Jaycox.

Titled "A Continent in Transition," draft copies of the report were first circulated throughout Africa and among development activists at the beginning of the year in one of the bank's most thorough consultation exercises to date.

The report assumes a broad consensus in Africa about macroeconomic reforms such as exchange rates and tariffs — reforms where there has been "noticeable progress." But it says there has been much less progress "on the deeper, structural elements of the development agenda" — education, health, public sector reforms where the record is much patchier.

This is reflected in the long list of criticisms of bank policy in the addendum such as: "structural adjustment hurts the poor; structural adjustment leads to reduced public expenditure in the social sectors; conditionality imposed by donors would be eliminated; free market macroeconomic liberalization leads to deindustrialization; the private sector is not responding to economic policy reform; donor assisted growth despoils the environment...."

Lending conditionalities are a major part of the problem, Africans told the bank. Conditionalities may work well on macro-reforms such as liberalizing exchange rate regimes, the bank concedes, but there are major problems with more specific reforms such as privatization. Funding for a country's entire reform program has been held up because the government fails to meet conditions on a specific sector program.

The bank agrees that in some cases "conditionality has been excessive" and wants to reform it. Moving to a "contractual relationship between contented partners" may help, the bank says. This would mean that lending conditions could be subdivided — meaning that a government's failure to privatize its airline would not derail the financing of its entire reform program. Another solution mooted is the "single tranche operation" which worked successfully in Indonesia in the late 1970s. Instead of a series of mini-consultations about adherence to adjustment reforms conditions, there would be one major review a year to assess the level of overall support for the country's economic program. —*P.S.*

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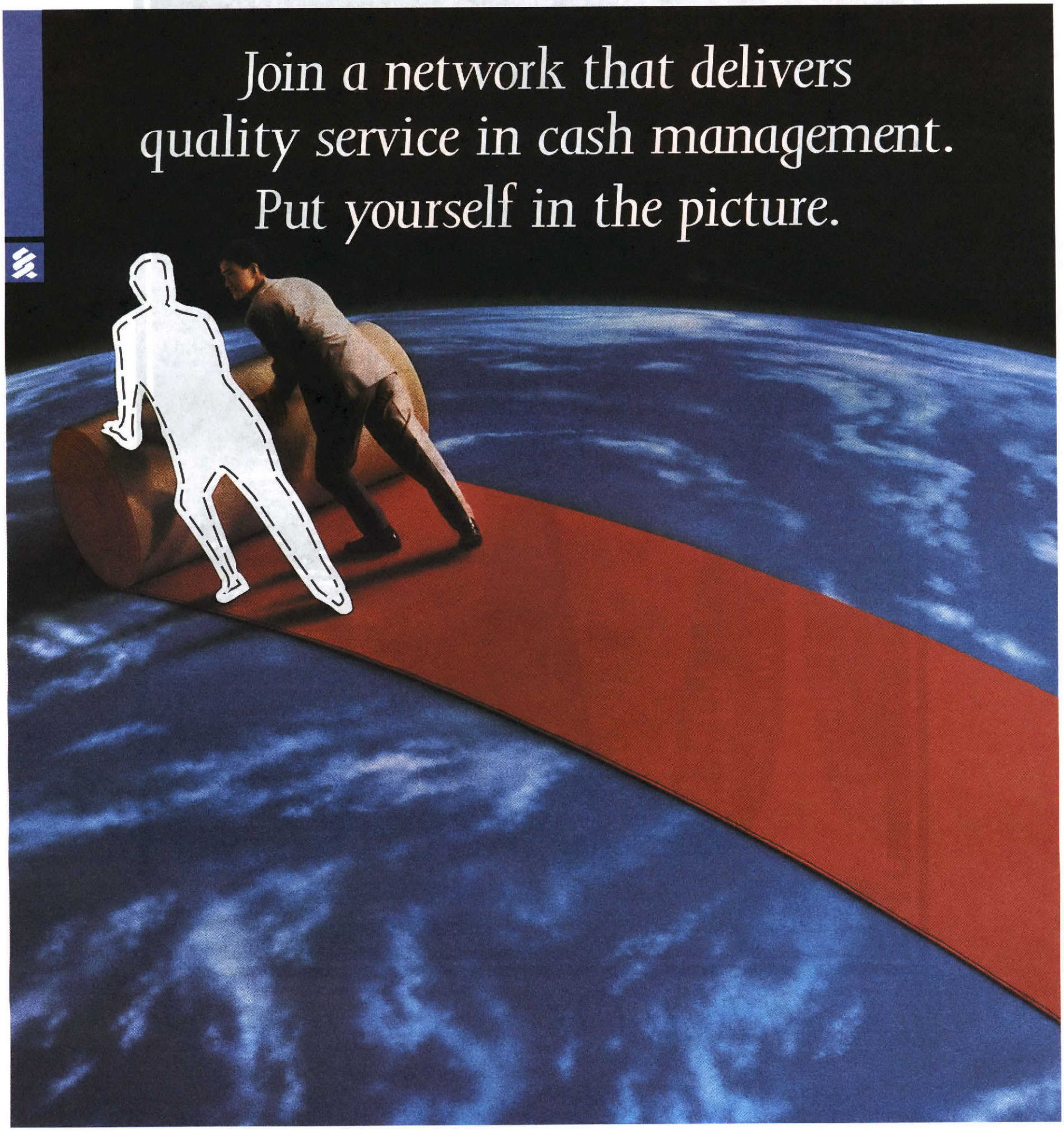

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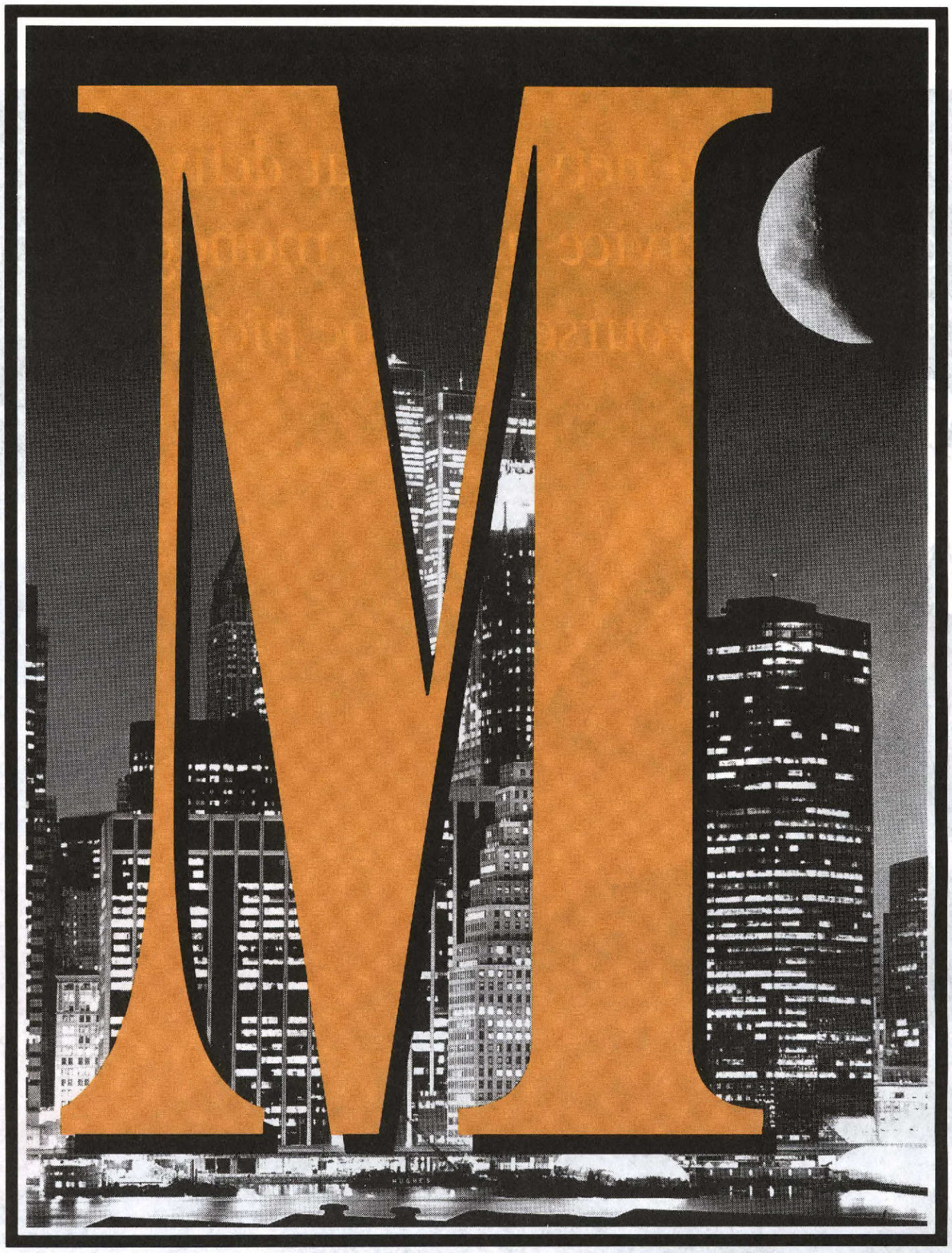

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Kabbaj Boosts Development Committee

BY JON MARKS

After tomorrow's meeting of the World Bank/IMF joint development committee, the 24-member group will likely be given a bigger role in the shaping of bank policy.

According to this year's chairman, Moroccan finance and investment minister Mohammed Kabbaj, approval of changes in the committee's working practices is expected this week. Taking time off from working on his controversial austerity program, Kabbaj has been coordinating with World Bank, IMF and committee officials to make the joint committee less of a talking shop and increase its ability to respond to real problems.



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Kabbaj: down to business

Consideration had been given to abolishing the committee altogether or merging it with the IMF's interim committee. But, according to Kabbaj, a consensus has been reached for the body to adopt a more businesslike approach, with the committee hammering out real policy in an acceptable timespan. It will examine more closely the impact of lending and other operations on bank policy, as well as the effectiveness of their implementation.

Kabbaj has taken a leading role in the task force, created to restructure the role of the development committee. According to the IMF, when the committee was established in 1974, its purpose was to advise and report to the bank and fund governors on "aspects of the broad question of the transfer of real resources to developing countries and to make suggestions for their implementation." In the future, the development committee's position in relation to the bank should be stronger, similar to the interim committee's relationship with the IMF.

"We had to wait on the nomination of a new World Bank president [to achieve consensus]," Kabbaj said. Confirming his reputation as a market-oriented problem solver, Kabbaj is committed to making the development committee work better. The Moroccan minister says the reforms have been helped by support from World Bank president James Wolfensohn — even though the changes will add to external controls on the bank.

"While the interim committee has become a controlling body — a surveillance committee for the IMF — the development committee has lost its influence over time," Kabbaj told *Emerging Markets*. In the past, "the World Bank refused to submit itself to any controlling or watchdog body," Kabbaj argued. "That's rather human — no one likes that. But in practice the bank's staff have taken a lot of power, preferring to work directly with the board."

Officials sitting on the development committee have not had the same influence as their counterparts on the IMF's interim committee, Kabbaj said: "Everyone wondered about this institutional curiosity where the development committee, despite its name, had no specific role, either in the IMF or the World Bank."

Only in periods such as the debt crisis of the early 1980s did the committee take on a higher profile. "But as soon as the situation is over, the committee's work no longer attracts attention," Kabbaj noted. "Meetings have become no more than a catalogue of speeches that ministers got over as quickly as possible, knowing well that the effect would be minimal."

Kabbaj gave an example of how the changes will work: "Supposing that debt is on the agenda, there will be a meeting specifically on how it effects the World Bank's work, with practical decisions, and another meeting which would cover these problems in liaison with IMF policy — a meeting which would produce recommendations."

IFC, ARABS TO LAUNCH RATING AGENCY

BY K. MICHAEL FRASER & JON MARKS

The International Finance Corporation (IFC), the Arab Monetary Fund (AMF) and the London-based IBCA credit rating agency are backing the creation of agencies in the Middle East and North Africa to rate Arab corporate debt.

The new Inter-Arab Rating Company (IARC), which will act as a holding company, is to begin operations through affiliates in Egypt, Jordan and Tunisia. As other markets evolve, the IARC will set up additional agencies. Lebanon is another country under consideration.

The IARC will be based in a Gulf banking center: Bahrain. But at first most operations will be outside the Gulf, where business practices still often tend towards secrecy.

"We will be setting up ratings agencies in Arab countries where the market is ready for ratings," IBCA managing director Robin Munro-Davis was recently quoted as saying.

The joint venture agreement creating the IARC is to be signed today at 2:00 p.m. in the Nathan Hale Conference Room in the Wardman Tower of the Washington Sheraton, during a ceremony attended by Middle East government officials and central bank governors.

The IARC has authorized capital of $5 million and will be owned 60 percent by IBCA, whose main operations are in Europe, and 20 percent each by the IFC and the AMF, a regional multilateral development agency.

"Setting up the Inter-Arab Rating Company is in line with the IFC's strategy to broaden the scope of financial markets in the Middle East and North Africa," says Andre Hovaguimian, the IFC's director for the Middle East, Central Asia and North Africa.

The IARC project was conceived as a means of filling the gap left by international rating agencies and a need for greater transparency in local business, especially as more Arab economies are seeking external investment and banks are coming to terms with tighter prudential requirements.

Moody's Investors Service, Standard and Poors and other agencies have traditionally stayed away from assessing Arab debt issues and corporates. Until recently, the only agency providing systematic analysis of Arab banks and corporates was the Cyprus-based Capital Intelligence.

However, the market is heating up. This fall, Moody's new Middle East operation — based in Cyprus, with a team in part headhunted from Capital Intelligence — will start operations.

Unlike the IARC, Moody's is mainly focusing on rating banks and institutions active in the inter-bank market. Its operation will concentrate on Gulf-based banks.

"The IARC will further the development of nascent debt markets in the region, where there is growing need for better information on the creditworthiness of local debt issuers and classification of assets," Hovaguimian said.

By introducing international debt rating standards to the region, the IARC will encourage local companies to improve their financial structures and reporting, and increase the availability of market information coming out of the Middle East.

Similarly, Arab states are taking the question of banking reform seriously. At an early September meeting in Damascus, Arab central bank governors from the Gulf states announced that they would establish a joint committee to improve the auditing of central and commercial banks in the region.

Emerging Markets Index Goes Daily

BY ROB WRIGHT

The International Finance Corporation's emerging markets database is about to go daily.

After 14 years in operation as a weekly service tracing capital markets in developing countries worldwide, the IFC plans to announce tomorrow that it will start releasing data every day. The reason: it's what the fee-based service's clients want.

"Our international investors are demanding it," said the newly appointed head of the database, Bob Shakotko. "Our indexed funds don't necessarily require a daily index, but for more sophisticated products like derivatives we're absolutely out of business [without an index], especially in applications to things like futures, options, swaps and warrants."

Subscribers worldwide pay up to $18,000 a year for a proprietary version of the IFC's data on 27 markets around the world with a total market value of $1.1 trillion. Electronic and hard-copy data is provided on 1,650 stocks representing 65 percent of the market capitalization in those markets, and will now be updated to indicate daily movements under a new distribution agreement with Reuters.



IFC head Lindbaek

Going daily is expected to improve the database's competitive position against the Morgan Stanley Capital International emerging market index, whose service differs in that it covers fewer markets in greater detail. Shakotko said linking up with Reuters added "immediate credibility" with brokerages worldwide that receive the IFC data, as it was an improvement over the previous distribution through the IFC's own electronic bulletin board system.

From tomorrow the database will also start reporting data from the Czech Republic for the first time. That makes Prague the 27th market to be included in the system. Local analysts from Zivnostenka Banka will be supplying price movements and market commentary on 65 Czech stocks with aggregate market capitalization of $10 billion.

China was added to the index seven months ago, and discussions are reportedly under way about expanding to include Russia and other markets in the future.

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TASK FORCE RUNS INTO THICK JUNGLE

BY ANTHONY ROWLEY

A high-powered task force examing the roles of multilateral development banks (MDBs) has become caught in a jungle of overlapping and competing interests. Although the task force is due to release its interim report this week, its blueprint for reform is more likely to underline the complexity of the problem than solve it.

The most striking discovery the task force has made is just how prominent and aggressive regional and national organizations have become in the aid game.

The task force, set up by the joint development committee of the World Bank and IMF, consists of 18 senior government officials under the chairmanship of former Kuwait finance minister Abdlatif Yousef Al-Hamad. Its original jurisdiction covered the priorities and activities of the World Bank and its four regional counterparts in Asia (ADB), Africa (AfDB), the Americas (IDB) and Europe (EBRD).



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ADB head Mitsuo Sato and EBRD chief Jacques de Larosiere: their banks compete with World Bank initiatives in Central Asia

The development committee decided to extend the focus of the task force, however, beyond the role of this "inner circle" of MDBs. It ordered a probe of overlaps and conflicts between the multilaterals and regional financial institutions owned by more than one country, such as the European Investment Bank (EIB) or the Arab Fund, as well as of bilateral agencies having major official development assistance programs like Japan's Overseas Economic Cooperation Fund (OECF) and Germany's KFU.

For example, the EIB, an organ of the EU, claims to lend three times more than the World Bank, while the EU's Lome Convention, an aid link to former European colonies, lends more in Africa than the bank.

The EU has both Mediterranean and Latin American programs, not to mention its economic accession treaties with Eastern Europe, all of which bring it into direct competition with both the World Bank and the EBRD. In Central Asia, the EBRD and the ADB take their turns competing with World Bank initiatives. Meanwhile, Japan's OECF provides more concessional financing in Asia than does the International Development Association (IDA), the World Bank's soft-loans agency.

On top of these global and regional rivalries, there is the thorny question of public versus private sector ideologies for the task force to contend with. Because the World Bank's lending is limited to governments while its affiliate the International Finance Corporation (IFC) deals with the private sector, it is caught more on the horns of this dilemma than the regional development banks, which are structured to deal more nimbly with both sectors.

"Growing tension" is the forecast from a source close to the task force on the relationship between the bank and the IFC. The source also predicts that "the relative importance of both in terms of money may decline." Also facing the task force is the wider issue of "[reassessing] the MDBs in the face of a rapid increase in private sector flows to developing countries," the source added.

The source also noted that the task force, comprised of government bureaucrats, is unlikely to come up with drastic reforms of the current MDB system. "Since they have worked within the system, they are unlikely to wish to destroy it," says one observer. He stresses that the key goal is preventing wasteful competition, and the real challenge is achieving a "synergy" from the system. The task force will probably recommend in its final report next March that this be achieved through cooperation among individual aid powers, rather than through appointing a global overseer.

New bank president Wolfensohn will be meeting with Al-Hamad at the end of next week in Washington to exchange ideas and discuss initiatives.

Tunisia Courts U.S., European Bond Markets

BY JON MARKS

Tunisia seems ready to borrow on the European and U.S. bond markets in the coming months, diversifying its source of commercial financing after raising three samurai bonds in Tokyo this year, senior officials and bankers say.

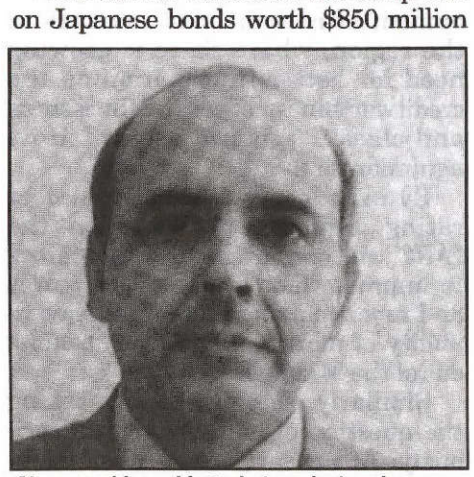
"We have mastered our financial balance and are now borrowing over $300 million a year in the capital markets to increase our foreign exchange reserves," Mohammed Ghannouchi, Tunisia's minister responsible for foreign borrowing, told *Emerging Markets*.

Tunisia's latest ¥15 billion ($150 million) samurai bond — a 10-year issue, launched in September — was oversubscribed. It received a BBB+ rating from the Japanese Bond Rating Institute. Other agencies have also given investment grade ratings.

"We expect the Tunisians to approach the U.S. market, or perhaps Europe, very soon," said an international banker based in the region. "They can't just borrow yen, not least because there isn't the swap capacity."

A first $300 million samurai, raised by Banque Centrale de Tunisie (BCT), was hedged in French francs and Deutsche marks. Other samurais are also understood to have been hedged as BCT exploited the lower margins on offer in Japan.

The banker calculates the swap risk on Japanese bonds worth $850 million at around $200 million. "They will have to hit other markets — but it was smart to go into yen this year," he concludes.



Ghannouchi: seeking what analysts adore

Tunisian officials know they will be courted by banks in search of mandates and potential investors at this year's meetings. "We receive a lot of offers, but we will keep a realistic policy, maintaining our debt service ratio in line with solvency ratios," Ghannouchi said. "We are looking forward to hearing what the U.S., European and other markets can offer."

Since Tunisia returned to the capital markets in 1993, in the Arab-African world only South Africa and Gulf Cooperation Council states have gained access.

Tunisia met debt repayments of $1.5 billion in 1994 and must repay $1.6 billion in 1995. This target can be met comfortably, despite the negative effects of drought and an opening of the local market to increased imports from the EU, the country's dominant trading partner.

"We have kept things in balance, but the problem is how to increase our reserves, which are now equivalent to about 70 days of imports," Ghannouchi said. "Building our reserves is important for the country's liberalization." Not only that, "it will further help our rating," he concluded. "Analysts just adore that indicator."

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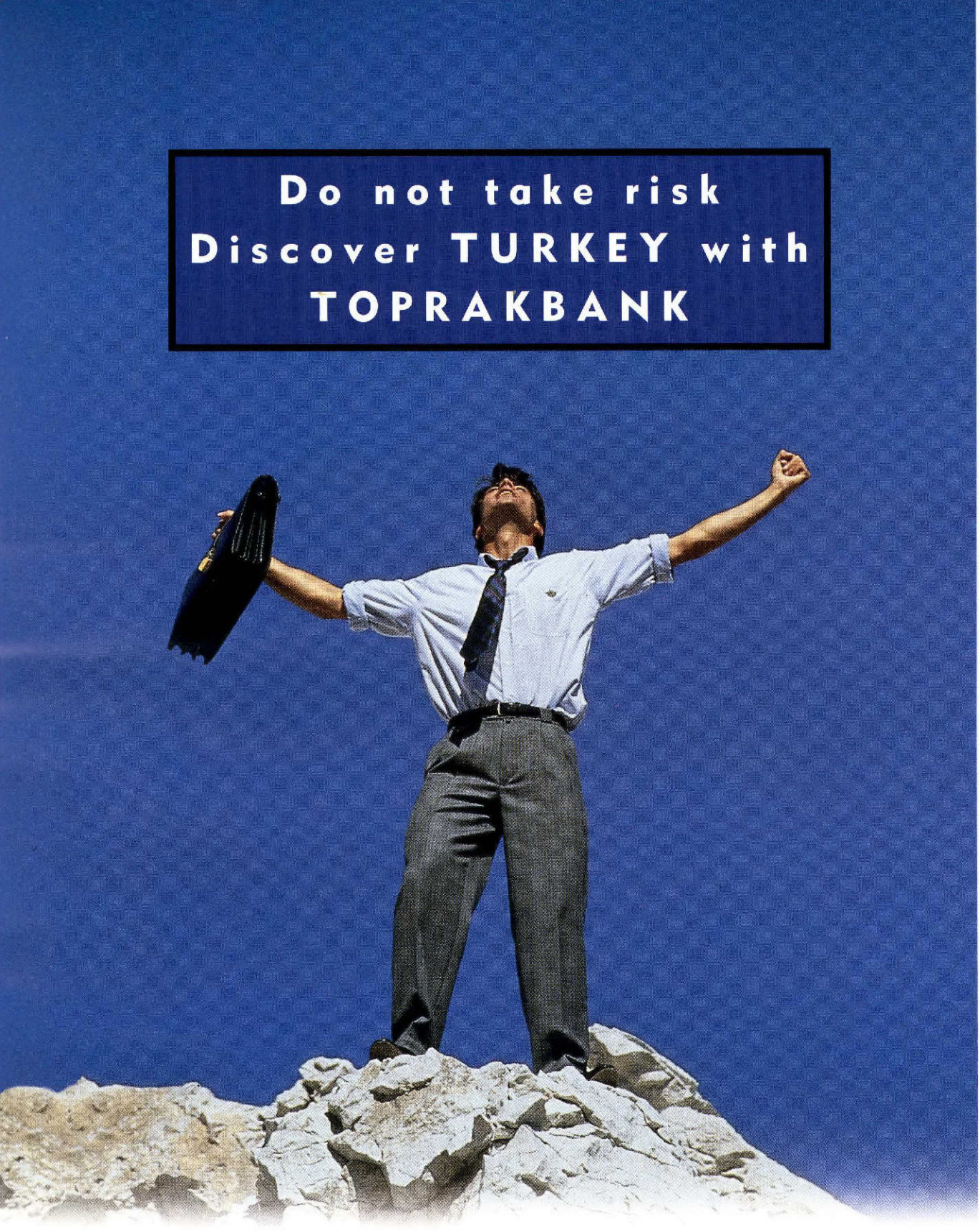

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DAILY BULLETIN
AUG 25.1995

MONEY MARKET

INTERBANK	I.S.E RE-PO MARKET			
O/N	O/N	WEEKLY	MONTHLY	3-MONTH
70%	61%	57%	60%	67%

Activity in foreign currency market caused cash shortage in the system. Meanwhile, Turkish Central Bank lent banks TRL 2.4 trillion at 75% in order to meet their cash needs.

FX MARKET

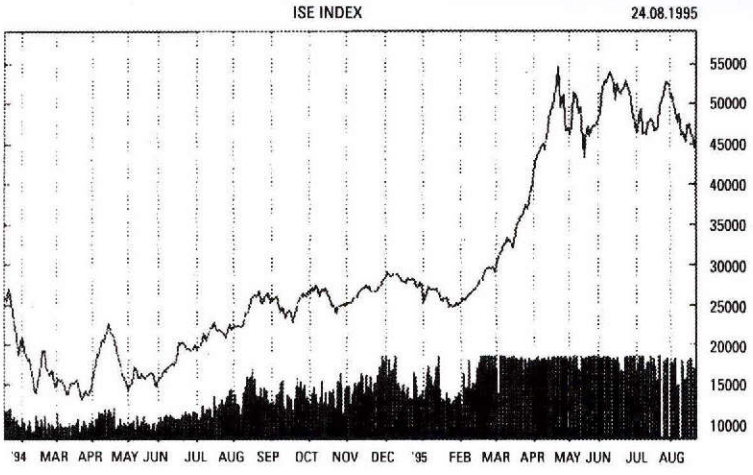
DEM/USD:1.4940

	BANK		MARKET	
	BID	ASK	BID	ASK
USD	48120	48170	47850	47950
DEM	32210	32240	32250	32350

In line with the rising DEM/USD parity in international markets after Buba's rate cut, the demand for USD in the domestic market caused USD to firm 48120 against TRL from Wednesday's 47930.

EQUITY MARKET

	COMPOSITE	FINANCIAL	INDUSTRIAL	VOLUME(Million TRL)
1.SESSION	45548	36542	51620	4.928.638
2.SESSION	46032	36650	52327	5.061.601



Our expectation for the Istanbul bourse is that the ISE index will continue its upward movement in the coming weeks as Turkish economy shows great strength in 1995. The considerable rise in the capacity utilisation rate in the manufacturing industry approves our thoughts about this remarkable economic recovery. Meanwhile, in spite of rising DEM/USD parity in international markets after the BUBA's rate cut, Turkiye's record high FX reserves will easily enable Turkish Central Bank to control this short-term surge in FX rates. In addition, Treasury Undersecteriat's well-positioning in TRL market will not only allow them to maintain interest rates at these level but also to extend the maturity of borrowing structure as well. In conclusion, we are confident that Turkiye will reach targets set by the International Monetary Fund (IMF) at the and of 1995.

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AN INTERNATIONAL MEDIA PARTNERS PUBLICATION

EMERGING MARKETS

presents

"TAKING STOCK IN TURKEY: ISTANBUL AS A REGIONAL FINANCIAL CENTER"

on the occasion of the

1995 IMF/World Bank Joint Annual Meeting Forum
Omni Shoreham Hotel • Washington, D.C.
Monday, October 9, 1995
7:30-9:30 a.m. — Breakfast and Panel Discussion

Investing in Turkey's capital markets is never dull: the Istanbul Stock Exchange (ISE) was the world's second best performer in 1993 and the worst performer in 1994. This year, however, Turkey appears to have turned the corner: in the first half of 1995 the ISE was the world's best performing stock market. Foreign investors continue to be drawn by Turkey's strong but often undervalued range of private companies, a promising privatization program as well as its geographic position at the crossroads of Europe and Asia. Moreover, the recent formation of the Federation of Euro-Asian Stock Exchanges, which encourages cross-listings among its members, as well as the expected introduction of the ISE's international market for foreign securities, promise additional liquidity and depth for the Exchange and a leading role for Turkey among the region's capital markets. In this panel session, policy makers and stock exchange executives will be joined by prominent investors to examine recent economic reforms in Turkey, discuss opportunities for the global investor and propose scenarios for Turkey's economy for the next year.

— List of Confirmed Speakers —

- **Kaya Didman** — Director, Baring Securities International
- **Yavuz Canevi** — Chairman, Association for Foreign Capital Coordination (Yased), Turkey and ISE Executive Council Member
- **Ata Koseoglu** — Managing Director, Bear, Stearns & Co. Inc.
- **Aril Seren** — Senior Vice Chairman, Istanbul Stock Exchange and Secretary-General, Federation of Euro-Asian Stock Exchanges

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Istanbul Stock Exchange

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EMERGING MARKETS

presents

"TWO YEARS AFTER THE FALL: SOUTH AND SOUTHERN AFRICA"

on the occasion of the

1995 IMF/World Bank Joint Annual Meeting Forum
Omni Shoreham Hotel • Washington, D.C.
Wednesday, October 11, 1995
7:30-9:30 a.m. — Breakfast and Panel Discussion

More than two years since the signing of the draft constitution heralded a new era for South Africa, the promise that the countries of the southern region will be able to ride their wealthy neighbor's coattails towards development remains. Under the surface however, the reality is riddled with questions. Some of these, including concerns about energy and transportation, are being addressed by organizations such as the Southern African Development Community. Still other important issues like unemployment continue to be overlooked. Top private and public sector players from South Africa and the region offer their views on what has been achieved to date and what steps need to be taken.

— List of Confirmed Speakers —

- **Chris Liebenberg** — Minister of Finance, South Africa
- **L.B. Monake** — Deputy Executive Secretary, Southern African Development Community
- **Babacar Ndiaye** — Former President, African Development Bank
- **Ronald Penza** — Minister of Finance, Zambia
- **Tomaz A. Salomão** — Minister of Planning & Finance, Mozambique
- **S. Tawengwa** — Chairman, Zimbabwe Electricity Supply Authority

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Preview

October 8-9, 1995 AGENDA

SUNDAY, OCTOBER 8

7:45 A.M.
Group of 10 ministers meeting chaired by Lamberto Dini of Italy. IMF board room.

9:00–10:30 A.M.
World Bank Group country seminar, "Kazakhstan: new openings for foreign investment." Sheraton Washington Hotel.

9:30 A.M.
Interim committee meeting chaired by Philippe Maystadt of Belgium; press conference with Maystadt and IMF managing director Michel Camdessus to follow. IMF Meeting Hall.

10:00 A.M.–3:00 P.M.
The Bank of New York hosts a small informal lunch at the Griffiths' country farm 60 miles outside the city. Transportation will be provided.

11:00 A.M.–2:00 P.M.
World Bank Group country seminar, "Southern Africa: market potential of a region in transition." Sheraton Washington Hotel.

11:30 A.M.
World Bank press briefing: ECA countries. M-1200

12:00 P.M.
The Industrial Bank of Japan holds a private luncheon. Mt. Vernon Salon, Madison Hotel.

1:00–4:00 P.M.
Chase Manhattan Bank hosts a luncheon cruise aboard The Cherry Blossom in Old Town Alexandria, Virginia. Torpedo Factory Pier, North Union Street at Cameron Street (casual dress).

2:00 P.M.
World Bank SABC Live TV Debate.

2:00–4:30 P.M.
Institute of International Bankers holds a seminar on the business and legal implications of Glass-Steagall reform legislation. Willard Inter-Continental Hotel. By invitation.

2:30–4:00 P.M.
World Bank Group country seminar, "Morocco: broadening the scope for private enterprise and investment." Sheraton Washington Hotel.

3:00 P.M.
Per Jacobsson lecture, "Economic transformation: the tasks still ahead." Blue Room, Omni Shoreham Hotel.

3:30 P.M.
World Bank press briefing. LAC-J. H Auditorium Annex.

4:30–6:00 P.M.
World Bank Group seminar, "The World Bank guarantee: a catalyst for private finance." Sheraton Washington Hotel.

5:00–6:30 P.M.
World Bank Group seminar, "Getting bureaucrats out of business: pitfalls and successes in reforming state-owned enterprises." Sheraton Washington Hotel.

5:00–7:00 P.M.
Reception hosted by the chief executives of Commonwealth Development Corporation, DEB and FMO. Diplomat Room, Omni Shoreham Hotel. By invitation.

6:30–10:30 P.M.
Emerging Markets Traders Association cocktail reception. East Hall, Union Station. By invitation.

7:00 P.M.
Salomon Brothers dinner. The Benjamin Franklin State Dining Room, Department of State Building.

8:45 P.M.
Deutsche Bank hosts a concert and reception at the John F. Kennedy Center for the Performing Arts. Terrace Theatre.

MONDAY, OCTOBER 9

7:30–9:30 A.M.
Emerging Markets Annual Meeting Forum, "Taking stock in Turkey: Istanbul as a regional financial center." Breakfast and panel discussion with: Kaya Didman, director, Baring Securities International; Yavuz Canevi, chairman, Association for Foreign Capital Coordination; Ata Koseoglu, managing director, Bear Stearns; and Aril Seren, senior vice president, Istanbul Stock Exchange. Omni Shoreham Hotel. All delegates and guests are welcome.

ALL DAY
Dean Witter's Washington information service will offer market news and data throughout the week at 1850 K St. NW Suite 900. Bloomberg, Knight Ridder, Dow Jones news services available. For further information call Ms. Sevilla at 202.862.9116

7:30–9:30 A.M.
The Institute of International Bankers hosts its annual breakfast dialogue. Salon A, Four Seasons Hotel. By invitation.

8:00 A.M.
ING Group hosts a breakfast presentation, "Current trends in the emerging markets." Speakers include: Sir William Ryrie, director, Baring Holding Company; Michael Howell, head of global strategy, Baring Securities London; and Arturo Porzecanski, managing director, ING Capital New York. Park Hyatt Hotel. By invitation.

8:30 A.M.
Breakfast hosted by Banco Pontual, followed by a discussion with former central bank of Brazil presidents Affonso Celso Pastore and Ibrahim Eris. Madison Hotel.

8:00-9:30 A.M.
Standard Chartered Bank hosts a breakfast. The Carlton Hotel.

8:30 A.M.–2:30 P.M.
Eighth annual Brazil economic conference, sponsored by the Brazilian-American Chamber of Commerce. Guest speakers include Brazil's finance minister, central bank president and ambassador to the U.S. Omni Shoreham Hotel.

9:00 A.M.
Development committee meeting chaired by Mohamed Kabbaj of Morocco. Press conference with Kabbaj, IMF managing director Michel Camdessus, and World Bank Group president James Wolfensohn to follow. IMF Meeting Hall.

9:00–10:30 A.M.
World Bank Group country seminar, "Bangladesh: a new horizon for investment." Sheraton Washington Hotel.

9:00 A.M.–2:30 P.M.
The Harvard Institute for International Development and the Carnegie Endowment for International Peace host the first joint conference for economic ministers, "New ideas in economic management." Carnegie International Center.

10:30 A.M.–12:00 P.M.
World Bank Group country seminar, "Moldova: stability and reform." Sheraton Washington Hotel.

11:00 A.M
IFC press briefing: developments in emerging stock markets. H Audit. Annex.

12:00 P.M.
ABN AMRO Bank hosts a luncheon at The National Museum of Women in the Arts.

12:00–2:00 P.M.
Euromoney magazine hosts a reception for the presentation of the Finance Minister of the Year award. Shoreham Hotel, Suite 100.

12:00–2:00 P.M.
The Institute of International Bankers hosts a luncheon. Four Seasons Hotel. By invitation.

12:00–2:30 P.M.
Chemical Banking Corporation hosts a buffet luncheon at The Corcoran Gallery of Art. By invitation.

12:30 P.M.
Creditanstalt-Bankverein hosts a luncheon. John Hay Room, Hay Adams Hotel.

2:00 P.M.–4:00 P.M.
World Bank Group Nobel laureates panel, "Nobel perspectives on the policy frontiers of environmentally sustainable development." Sheraton Washington Hotel.

2:30–4:00 P.M.
World Bank Group country seminar, "Peru: a comprehensive reform program is paying off." Sheraton Washington Hotel.

4:00–5:30 P.M.
World Bank Group country seminar, "The Philippines: a dynamic business community is leading the new growth era." Sheraton Washington Hotel.

5:30–7:30 P.M.
Bank of Tokyo hosts a reception. Corcoran Ballroom, Four Seasons Hotel.

5:30–7:30 P.M.
Brown Brothers Harriman & Company hosts a reception. The Corcoran Gallery of Art.

5:30–7:30 P.M.
Unico Banking Group hosts a reception and viewing at the Renwick Gallery.

5:30–8:00 P.M.
Reception hosted by the World Gold Council. Diplomat Room, Omni Shoreham Hotel. By invitation.

6:00–8:00 P.M.
Citicorp/Citibank hosts a reception at The National Museum of Women in the Arts.

6:00–8:00 P.M.
Bank of America hosts a reception at The Woodrow Wilson House Museum.

6:00–9:00 P.M.
Reception hosted by Arab Banking Corporation. Park Ballroom, Park Hyatt Hotel.

6:30–8:30 P.M.
The Korea Development Bank hosts a reception. Palladian Room, Omni Shoreham Hotel.

7:00 P.M.
Emerging Markets CEO of the Year awards dinner, sponsored by International Media Partners and ING Bank. Awards will be presented to Asea Brown Boveri's Percy Barnevik and Acer's Stan Shih. Willard Inter-Continental Hotel.

7:00 P.M.
The IMF and World Bank host a concert by the National Symphony Orchestra. John F. Kennedy Center for the Performing Arts. By invitation only.

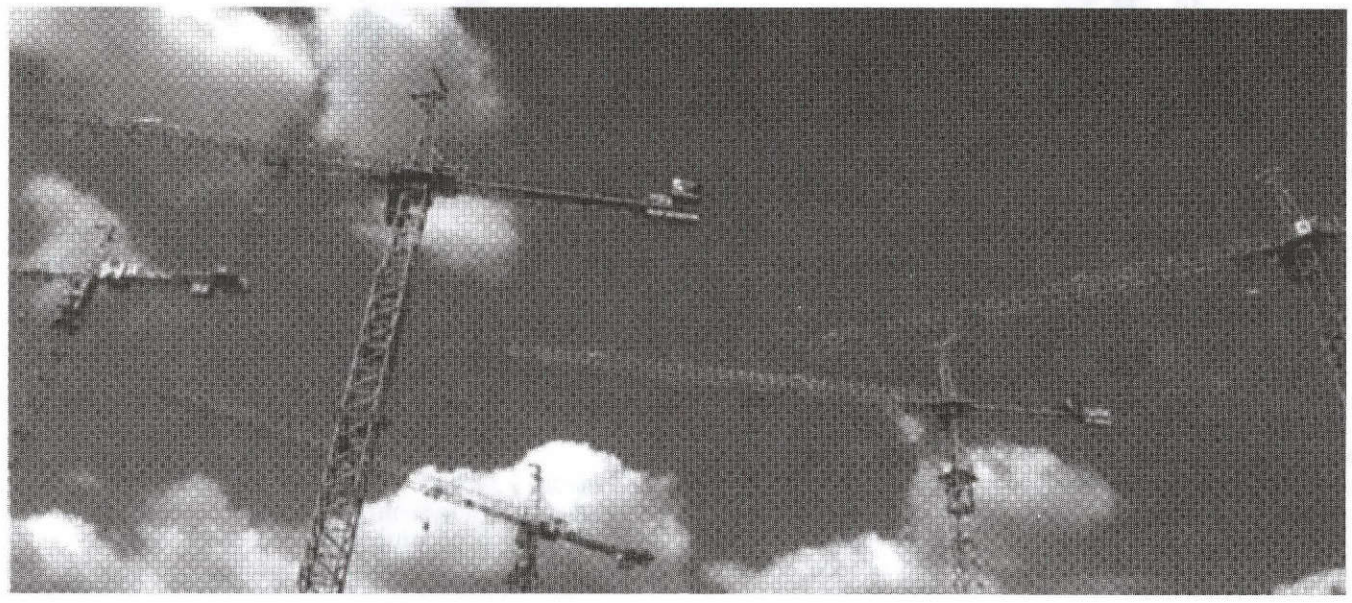
7:00 P.M.
ChinaTrust Commercial Bank hosts a dinner banquet. Twin Oaks, 3225 Woodley Road.

8:00 P.M.
Chase Manhattan Bank hosts a dinner. Decatur House, Lafayette Square.

8:00 P.M.
First Chicago Bank hosts a dinner party. Meridian House, Meridian International Center.

8:00 P.M.
Morgan Stanley hosts a dinner party. Phillips Collection.

Promoting Economic Progress.



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Africa

ONCE A SHINING EXAMPLE, BANK FINDS IMAGE TARNISHED

BY PATRICK SMITH

A decade ago, the notion of the African Development Bank (AfDB) as a metaphor for the continent would have been seen as unstintingly complimentary to Africa. The AfDB was regarded as a shining example of the new Africa: an expanding haven of technocrats working on development programs to transform the region's economy. Then a French official described it as "an island of credibility in a beleaguered continent." Now some would regard the comparison as an insult to Africa.

The bank is less a metaphor for Africa than a repository for its political and business interests. Officials and politicians have ruthlessly used the bank to advance individual careers, for personal enrichment and even to win national elections in the past. Battles fought elsewhere are given a new home in the bank.

The presidential elections in Abuja this May were stalemated by Nigeria, apparently unable to accept defeat on its home turf — particularly at the hands of what it regarded as a negative political campaign by Washington and other non-regional members of the AfDB.

Just as important, most of the smaller African shareholders and Southern African members of the bank supported Lesotho's Timothy Thahane for the presidency at the Abuja elections and in the extraordinary elections in Abidjan on August 26. This vote was in part because they distrusted big countries and in part because they thought it was time for a Southern African to have a turn.

But the matter was eventually decided by the big battalions — Nigeria (whose 10 percent shareholding gives it the swing vote in any AfDB election) and Morocco, which, backed by a solid francophone bloc, supported Omar Kabbaj, the eventual winner after nine rounds of voting.

Thahane, who keeps his job as vice president and secretary of the World Bank, says that making sure the bank hierarchy is representative of Africa is important: "One would hope to see a Southern African appointed as vice president to keep the balance." New president Kabbaj is cognizant of the political pressures on him and the need for some healing after the bank's calamitous last year, officials say. Regarded by both regional and non-regional members of the bank as a committed reformer, Kabbaj's style is described as brisk and businesslike.

Less than a month after taking over at the bank, Kabbaj heard the good news that New York rating agency Fitch reaffirmed the bank's triple A rating. Previously, Standard and Poors, a bigger rating agency, lowered its rating on the bank's senior debt from triple A to double-plus because of what it called "politicization of the bank." Fitch disagreed with Standard and Poor's analysis and offered a glowing commendation of Kabbaj: "The new president [elected in August with 63 percent of the vote] appears to have even greater popular support from both regional and non-regional [shareholders] than the election results would suggest. One of the president's first acts will be to appoint a non-regional vice president, a step which should garner further support from non-regional donor nations."



© PHOTOS BY ERICA LANSNER

New bank president Omar Kabbaj

Visibly pleased by the Fitch rating, Kabbaj told journalists in Abidjan that the bank's executive board had approved the launch of two bond issues this fall. First, a DM300 million bond in the Euro-Deutschemark market with Dresdner Bank and Salomon Brothers acting as joint bookrunners, and second, bonds of $300-400 million in the Yankee market, to be handled by Merrill Lynch.



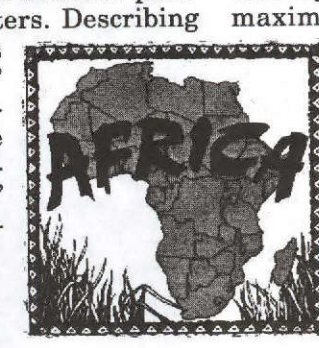
Also-rans: Nigeria's Abdulai (r) and Lesotho's Thahane

Before the launch, Kabbaj's team will go on the road to make presentations in Europe, Asia and the U.S.

Kabbaj also confirmed that terms for South Africa's membership had been agreed on by the board and sent to Pretoria for approval. Although South Africa is to join with a nominal 1 percent, officials say this stake is likely to increase sharply after substantive negotiations for the bank's fifth general capital increase due to start next year. More is expected of South Africa in banking expertise and financial credibility than major borrowings, although Pretoria's director of finance Eltie Links says the bank's lending terms make it "an attractive form of finance."

On the negative side, Kabbaj had to announce that some 240 of the bank's 1,200 workforce would be shed over the next three to four months. This is part of a wide-ranging restructuring process agreed on earlier in the year but not implemented because of animosity between former bank president Babacar Ndiaye and the executive board.

The restructuring has reduced the number of vice presidents from five to three. It puts projects and programming functions together within five regions — north, west, central, east and southern — and aims to increase coordination between planners and implementers. Describing the new structure as "leaner and meaner," one non-regional official said that the bank was not expecting "major ructions" following the redundancies as staff had already been consulted on the issue several months before.



But the relationship between new president Kabbaj and the executive directors will come under particular scrutiny. The prolonged dispute between former president Ndiaye and the executive board culminated in a showdown just before this May's annual meeting when vitriolic and accusatory memos were exchanged. In the event, Ndiaye won two victories: the annual meeting removed the executive board's right to suspend the president, and restricted the executive directors to a maximum of two three-year terms.

Kabbaj inherits a stronger presidency and appears to have established a good rapport with the board. He is said to take control of the once long-winded board meetings, which now start on time and deal with their agenda at a brisk pace. Kabbaj returns the compliment: "The board of directors have been very cooperative. We have established the best relations of trust."

At the World Bank and IMF annual meeting, Kabbaj will have to put flesh on his plans. He is meeting with 19 governors of the bank to review negotiations on the capital increase with the knowledge that several non-regional governors are skeptical about the bank's need for a further 50 percent capital increase. Kabbaj is likely to make the case that the ability of his own country, Morocco, to absorb capital together with that of new member South Africa justifies an expansion, given the stringent credit guidelines agreed on this April.

Kabbaj will also update governors on the seventh replenishment of the African Development Fund (AfDF). Discussions on the fund's replenishment will reopen in October, when the regional and non-regional negotiators expect to reach agreement. "Whichever way you cut it, the total is likely to be sharply down," a non-regional source said, "compared to the past and compared to expectations." Refusing to be drawn on a precise figure, he said it would be a maximum of $2 billion over three years, but may be as low as $1.5 billion. Because negotiations over reforming bank policy, voting powers, and monitoring procedures have not concluded, the AfDF negotiators are likely to split the pledges into two tranches.

The first tranches could be drawn down almost immediately after final agreement is reached — probably January 1996 — and the second tranche will be held in reserve and drawn on the basis of the bank's performance on reforms. Non-regional shareholders show no signs of letting up on their reform agenda, such as tougher internal audit controls, or keeping a tighter rein on countries in arrears. Kabbaj's choice of a new vice president for finance will be important: already the names of a German and a Swiss candidate have been forwarded to him.

But Kabbaj is keeping silent on one of the trickiest issues ahead — the suggestion that non-regional shareholders should increase their stake in the bank from 33 to 50 percent. Some non-regionals, mainly Europeans, argue that the move would boost the ability of the bank to raise funds, and hence the profile of the institution at a time when all multilateral institutions, particularly Africa's, are under pressure. What is clear is that Nigeria (which supported Kabbaj by withdrawing its presidential candidate in favor of him) regards more non-regional control as anathema. Finance minister Anthony Ani refers to the scheme as "stealing the bank," which takes us back to the starting point. However technocratic Kabbaj and his team are, their air-conditioned headquarters in Abidjan will not insulate them from Africa's steamy politics outside. EM

Americas

SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 18



MEXICO FORECAST:



©PETER STONE/BLACK STAR

Mexico's unemployment rate has doubled in the last six months

A Less Hazy Tequila Sunrise

BY JONATHAN E. HEATH

Mexico has come a long way following last December's devaluation and the ensuing crisis that shook the world's markets. Since the announcement of the March 9 program, and with the backing of the International Support Program, inflation has gone from 8 percent in April to 1.7 percent in August; the current account balance showed a surplus of $455 million in the second quarter (compared to a $7.1 billion deficit in the same period last year); the tesobono amortization scare is basically over; the fiscal surplus for the first half of the year is well above target; and Mexico has returned successfully to the international capital markets. Progress has been sufficient that one can start looking at Mexico's medium-term possibilities instead of concentrating solely on the short-term issues.

There is, however, a considerable downside: the open unemployment rate, which understates Mexico's labor problem, has more than doubled in the last six months from 3.2 percent last December to 6.6 percent last June; the second quarter GDP took a walloping 10.5 percent drop, indicating that employment generation is not around the bend; the banking crisis has been addressed with a muddling-through policy, lacking the intensity of a true, deep solution; the political scenario remains as complex as ever, with headline events occurring quite frequently; and the government provides full disclosure of information out of obligation, instead of by conviction.

Most of Mexico's current problems were not caused by the fall of the peso at the end of last year, but rather existed before and were aggravated by the devaluation. The current low job generation capability of the economy originated when Mexico unilaterally started opening up its economy eight years ago. The growth in non-performing assets held by the banks dates back to 1992, right after the banks were privatized. The short-term structure of Mexico's debt has been a growing problem for some time. Now, as a result of the peso crisis and the current recession, Mexico's market-oriented strategy has come under sharp attack.

A major debt restructuring some time in the future seems very probable.

In order to understand most of Mexico's problems and its failure to avoid another devaluation, one must understand that the country is no longer a highly protected, closed economy with massive government intervention. But at the same time, it is not a market-oriented, open economy, with an efficient industrial base. The Mexican economy is currently in a transition phase, going from the former to the latter. This is a necessary phase if Mexico wants to emerge as a relatively efficient market-oriented economy. This transition cycle, initiated in 1986-87 when Mexico joined Gatt and unilaterally reduced tariffs, should last anywhere from 15-20 years. This means that the economy must endure another 7-12 years with a very low job-generation capability. Recent studies addressing the GDP elasticity of job creation have grossly understated this fact. Mexico will have a very hard time producing a modicum number of the necessary jobs even if growth rates are well in excess of the 5 percent minimum target set by the government.

Exports have grown 32.1 percent during January-July compared to the same period a year ago. This growth, while impressive, has been attained mostly through sectors which could revert quickly back to the domestic market once a recovery is in the making. Although import growth has been curtailed, the average monthly level is still higher than it was in 1993. Many of these imports are necessary inputs for either domestic or export activity, which means that the trade balance could relapse back into a deficit quickly once the economy starts to recover. The main problem arises once future amortization payments three to four years down the line by both private and public sectors are examined. Mexico must either attract large capital flows or maintain a strong trade surplus for some time to come.

A very powerful segment of the population has a lot at stake and is opposed to the proposed mutation in the political system.

While portfolio capital may increase over current levels, it will hardly represent an important source of financing in the future. Foreign direct investment may increase back to the levels of 1994, but it seems unlikely to provide all the capital Mexico will need. Will Mexico be able to attract enough capital to finance growth? The alternative of maintaining a current account surplus would condemn the economy to a very low growth scenario, complicating the unemployment picture even more.

Important policy decisions must be made immediately in order to avoid a future balance of payments crisis. The problem in itself is not a heavy debt burden per se, but rather a skewed amortization schedule which results in very high payments over the next three to four years. This means that a major debt restructuring some time in the future seems very probable. At the base of these decisions is the future exchange rate policy. Both government and monetary authorities must commit themselves to a realistic exchange rate policy, which can avoid an overvaluation. However, recent history shows a deep displeasure inrooted with policymakers in Mexico to confide in such a policy, in spite of a more open economy. It always seems that sooner or later, the government regresses back to some sort of fixed rule exchange rate policy which anchors the exchange rate in order to help reduce inflation. The result is an overvalued currency.



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Zedillo: cabinet change is good

A final thought has to be given to the implications of Mexico's changing political system, which has become a perplexing, enigmatic process. Just as the economy is going through a transitional phase, the political system is starting to evolve from a very authoritarian regime with little regard for the rule of law to a much more democratic society. President Ernesto Zedillo has made a very strong commitment to modernizing the political system, in the same way that President Carlos Salinas committed himself to changing the economy during the previous administration. However, the current system is very deep-rooted, affecting almost every aspect of life in the country. A very powerful segment of the population has a lot at stake and is opposed to the proposed mutation.

As Mexico struggles through political change we will more than likely continue to observe both expected and unexpected political events on a regular basis. A new electoral reform is on top of the agenda. The Chiapas peace negotiations are still in progress. Regional problems in Tabasco, Guerrero and Yucatan have yet to be addressed. The issue of more federalism as opposed to centralism has been promised by the president. Some sort of a separation between the government and the PRI (the Institutional Revolutionary Party — in power for 65 years) has been pledged. Zedillo has already made 10 major cabinet changes in his first nine months, a strong sign of the political transition. EM



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Asia Pacific

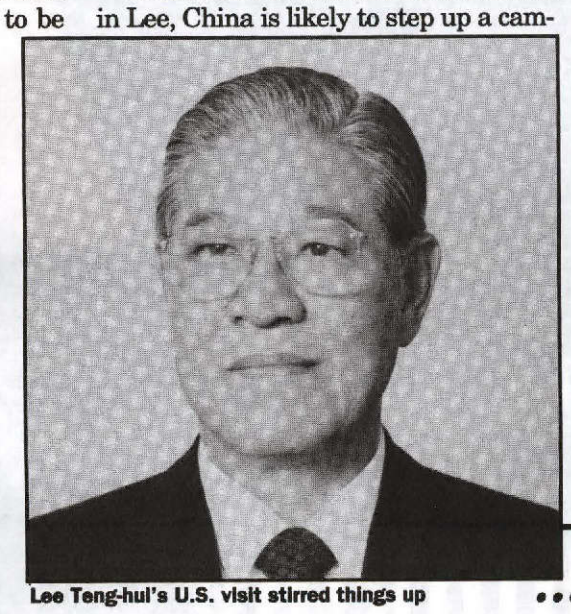
SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BA

Democratic Taiwan Stirs China's Wrath...

BY LAURA TYSON

Taiwan's campaign to join the UN, revived at the opening of the general assembly late last month, was met with a decisive cold shoulder just as it has been in years past. But when that August body convenes one year hence, Taiwan will be a fully-fledged democracy, complete with a president who is directly elected by the public. Will that make Taiwan's case more likely to be taken seriously?

Probably not. This is hardly surprising as just 30 mostly tiny countries actually accord formal recognition to Taipei. The rest more or less tacitly agree with Beijing's view that Taiwan is a province of China, eventually to be recovered to the bosom of the motherland. (That doesn't, of course, stop Taiwan's healthy trade relations worldwide.) The fact that China has a permanent seat on the UN's security council — and thus can veto Taiwanese membership — makes Taipei's hopes to participate in the UN little more than wishful thinking.



Lee Teng-hui's U.S. visit stirred things up

This means that Taiwan, a newly emerged democracy with a free press, foreign exchange reserves hovering around $100 billion, a per capita gross domestic product of roughly $12,000 and one of Asia's most powerful economies, is excluded from the International Monetary Fund and the World Bank, both UN satellite organizations.

None of this has slowed Taiwan from moving ahead economically or politically. But political freedoms have given rise to popular demand for a greater role for Taiwan on the world stage. Taiwan's leadership, necessarily mindful of the ballot box, has responded by fighting to expand Taiwan's international profile — a strategy which has aroused the wrath of Beijing.

Chinese leaders are not likely to be pleased by events in Taiwan in coming months. On March 23, 1996, Taiwanese voters will directly elect a president for the first time. The defining issue of the elections will be Taiwan's national identity and its uneasy relations with its giant neighbor which is at times bullying, at times benevolent, but always threatening.

The two sides have been separated since China's civil war in 1949 and democratic reforms in Taiwan during the 1980s have given strength to a growing independence movement on the island. Beijing fears that Taiwan is drifting ever further away from the cherished dream of reunification and hopes to frighten the Taiwanese into backing off a campaign for greater international recognition. Chinese leaders repeatedly threaten to use force against the island should it declare formal independence.

The current president, Lee Teng-hui, is extremely popular and appears likely to win the race, for which he declared his candidacy in August. This is expected to enrage Beijing, which has repeatedly vilified him in official media as secretly promoting Taiwanese independence, although he constantly reiterates publicly that he supports eventual reunification.

In an effort to undermine confidence in Lee, China is likely to step up a campaign of hostile military maneuvers and psychological games leading up to legislative elections on December 2 and the presidential polls. But this strategy may have the opposite of the desired effect, making the Taiwan public still more mistrustful and fearful of China and possibly boosting support for Lee.

The parliamentary elections, held every three years, will also be closely watched by Beijing. These polls are especially crucial for the ruling Kuomintang, or Nationalist Party. The Nationalists may for the first time lose their absolute majority in the 161-seat Legislative Yuan to opposition candidates and independents. The ruling party has until now relied on the ability to mobilize its legislators to push through controversial legislation. With no party occupying more than 50 percent of the seats, the policymaking process could become more confrontational and arduous.

It now appears likely that military elements in the leadership in Beijing have taken the upper hand in shaping policy toward Taiwan and the result has been an increasingly aggressive and hostile stance toward the island in recent months. President Jiang Zemin made a friendly, doveish "eight-point" address to Taiwan in January, but conciliatory gestures were replaced with threatening missile tests near Taiwan in July and August, sending jitters through the local stock market.

The ostensible reason for Beijing's ire is that the U.S. permitted Lee, against the vehement opposition of Beijing, to make a private, unofficial trip to the U.S. in June, the first time a Taiwanese head of state has done so since the U.S. broke diplomatic relations with Taipei in favor of Beijing in 1979. In repeatedly denouncing Lee, Beijing appears to have committed itself to getting rid of him whatever the cost. Thus it is quite possible that China will take drastic measures, most likely in the form of more ominous military maneuvers, but possibly even blockading the Taiwan Strait or lobbing shells in the direction of an outlying island controlled by Taiwan. Most observers discount the likelihood of a full-scale invasion as China's military is not strong enough and the political and economic costs would be too great. EM

China's sound and fury over the visit to the U.S. in June of Taiwan's President Lee Teng-hui reflects the continuing extreme sensitivity of the Taiwan issue in Chinese politics.

Indeed, no other issue is likely to generate so much angst in Beijing. The reasons for this are, of course, historical, but also have to do with internal Chinese politics which are now at a particularly sensitive stage. No aspiring Chinese leader could afford to appear "soft" on the Taiwan question, hence what might be regarded in some quarters as Beijing's overreaction to the Lee visit.

China's present crop of leaders, referred to locally as the "third generation," find themselves under intense scrutiny in this transitional phase with the patriarch, Deng Xiaoping, fading from the scene. President Jiang Zemin, who unveiled an eight-point program earlier this year aimed at drawing Taiwan closer to the mainland, has much to lose if prospects for reunification appear to be diminishing, and the Taiwanese make further gains internationally. Indeed, one explanation for China's seeming overreaction was that Jiang was responding almost personally to the rebuff he had suffered in response to his diplomatic initiative of January which had hinted at the desirability of higher-level contacts across the Taiwan Strait.

Chinese missile tests into waters north of Taiwan in protest were aimed crudely at reinforcing the message that Beijing would not tolerate Taiwanese moves towards independence, or indeed actions designed to undermine prospects for reunification, which remains Beijing's cherished goal.

The row over Lee's visit to the U.S. has for the time being short-circuited negotiations on "housekeeping" matters between the "non-official" bodies representing the two sides — Beijing's Association for Relations Across the Taiwan Strait (Arats) and Taipei's Straits Exchange Foundation (Sef).

China is clearly making significant inroads into the Taiwanese market.

That dialogue, which was making progress on such issues as opening direct air, shipping and mail links between Taiwan and the mainland, has been suspended. Beijing also postponed indefinitely plans to host a meeting in July between Koo Chen-fu, chairman of the Sef, and his Chinese counterpart, Wang Daohan.

The first "Wang-Koo" talks were held in Singapore in April 1993, and helped launch negotiations between Arats and Sef that made extremely slow progress in the intervening two years, but nevertheless provided an important forum for ongoing discussions.

In light of the row over Lee Teng-hui, concern has been expressed that economic ties between China and Taiwan may suffer, but at this stage there is little evidence of a pullback by Taiwanese investors who have poured between $15-20 billion into enterprises on the mainland in the past few years. Altogether, Taiwanese businessmen are involved in some 25,000 enterprises in China.

Trade is also flourishing. In the first five months of this year Taiwan's indirect trade with China (mostly through Hong Kong) jumped 39.7 percent compared with the same period last year, according to Taiwan Board of Trade figures. Taiwanese exports were up 32.8 percent to $7.41 billion while imports surged 99 percent to $1.99 billion. China is clearly making significant inroads into the Taiwanese market, and the Chinese market for Taiwan is looming larger all the time. China is now Taiwan's second largest trading partner after the U.S.

The question in the run-up to presidential elections to be held in Taiwan next March is whether tensions across the Taiwan Strait will again flare. The situation remains volatile, and Beijing has indicated that it is in no mood to ignore real or imagined slights. EM

...Economies Play Romeo and Juliet

BY TONY WALKER

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Eastern Europe

SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 23

HUNGRY HUNGARIANS TURN TO PROSTITUTION

BY HENRY COPELAND

They have become a common sight along the tiny roads that crisscross Hungary. Outside many villages, young women stand in pairs, one on either side of the road. They weren't there six months ago; now, with midriffs bared and lycra shorts pulled tight, the women wait patiently for a passing truck driver to pull over and follow one or both into the woods.

Some see the sudden proliferation of prostitutes as one result of the austerity package introduced by the Hungarian government last March. The package, which slashed spending and upped taxes, is transforming Hungary's political and economic landscape.

It has been a truism about Hungary's post-communist economy that no matter how bad the macroeconomic numbers seemed to be, the black economy kept life tolerable for the man and woman on the street. Now that adage has been turned on its head; though the country's macro numbers look tolerable — at 11 percent, unemployment is two percentage points off its high two years ago and GDP is projected to grow at 1 percent this year — many of Hungary's poor seem to have been pushed across some invisible yet very palpable line.

Prostitution in Hungary's villages is one sign that for those at society's underbelly, the bottom dropped out this spring. But there is other compelling evidence. Since March, construction is down 30 percent in real terms, according to the Central Statistical Office; and consumer consumption of gasoline is off by 15 percent, oil companies report.

The upswing in misery surprises economists sitting in Budapest watching the macroeconomic data. "I'd never imagine that roads to places like Berettyoujfalu [a tiny village in the east of Hungary] would be filled with prostitutes. But everybody has to make a living I guess," Gyorgy Jaksity, director of Concorde Securities, says.

There are other more obvious expressions of Hungary's burgeoning misery; most significantly, in the political arena, there is the sudden popularity of a party called the Independent Smallholders. The party is, if not exactly far right, undeniably far out.



© LISA QUINONES

Bekesi's ouster hurt Hungary's image

The Smallholders are led by Jozsef Torgyan, a roly-poly 62-year-old lawyer who comes across as a Central European version of U.S. commedian Rodney Dangerfield. At once full of charisma and buffoonery, Torgyan spends his days promising to solve Hungary's problems.

"People like being given promises no matter how crazy it sounds. 'If you elect us we'll double GDP per capita in three years, and you can buy a BMW,' that kind of thing," comments Jaksity.

Parliamentary elections are nearly three years away, and handicappers predict that Torgyan and his party have little chance of winning enough votes to govern alone. But for now, the Smallholders are riding high. While they received just under 10 percent of the vote in elections last May, the Smallholders' poll has jumped from 11 percent in April to 18 percent in August. Conversely, prime minister Gyula Horn and his Socialist party have dropped from 27 percent in April to 19 percent at the end of August, according to a survey conducted by pollsters Median Hungary.

The Smallholders seem blithely unaware of the contradictions in their program. The party's MPs say they are not antisemitic, but frequently express concern over the possible negative influence of Jewish money. The party is very much in favor of foreign investment; Hungary just needs to be sure that the foreigners promise to only add jobs at the factories they buy.

On one issue, the Smallholders seem united: Hungary's $31 billion debt should be rescheduled. Much of the money was borrowed by a communist Hungary and lent to other communist countries, the Smallholders argue, and a democratic Hungary has no moral obligation to fulfill those commitments.

To a growing number of Hungarians, such talk sounds better than the shock therapy prescribed March 12 by new minister of finance Lajos Bokros. In March, Hungary was on the verge of being unable to make interest payments on its domestic debt, and its image among the international investors whom Hungary relies on to refinance its foreign currency debt had been sliding dangerously after ouster of economic reformer Laszlo Bekesi.

March 12 is now known as "Black Sunday." Bokros announced that he was slashing Ft150 billion ($1.1 billion) out of the government's budget deficit through a combination of spending cuts and tax hikes. He introduced an 8 percent import tariff and devalued the forint by 9 percent.

Such measures may help Hungary stay solvent and squelch a trade deficit which spiraled to nearly 10 percent of GDP in 1994. But for families in villages, the Bokros package does anything but balance the books. That may be why today, Horn is favored by just 36 percent of voters, while 43 percent favor Torgyan. And Bokros, the man who started it all, gets a 15 percent approval rating. EM

Unfinished Czech Reform Creates Inflationary Bubble

BY JOE COOK

Abstract works of art by Kandinsky and Miro are not usually found hanging in the offices of Czech executives. But Jiri Zagora, the 52-year-old general director of Vertex, a privatized glass fibers and fabrics maker, is not the usual Czech executive. Unlike many of his counterparts (or, indeed, his country's politicians), he does not bluster about economic triumph: "Economic reforms have been too soft and are unfinished."

"Many Czech firms are earning their living by inflation, but they forget that there will come a moment of truth, and that moment is approaching," he warns.

By this he means that many companies have so far survived the post-communist turmoil by simply upping prices in order to turn a profit, rather than focusing on increasing efficiency through restructuring, and that in doing so they are gradually erasing their price advantage over Western rivals.

To support this theory, Zagora cites the "immense technical backwardness" of many manufacturers, over-manning (the country has an unemployment rate of 3 percent) and a productivity rate which he estimates to be "about 10 times less than in Western Europe or the U.S." He points to the country's ballooning trade deficit — which, according to the Czech industry minister, Vladimir Dlouhy, could reach 80 billion korunas ($2.96 billion) by year's end — and wonders how many exporters are aware of how much tougher things are going to get. And if they are aware, he doubts "whether they are doing anything about it."

Many firms have survived by simply upping prices in order to turn a profit.

The same doubts cannot be expressed about Vertex. Although Zagora admits that his firm's productivity is "about five times less than Western competitors," that its equipment is "technically backward" and that its products remain below Western quality standards, he and his colleagues are pursuing change.

The company has five factories which supply both industry and the construction business. Due to a slump in domestic demand and the collapse of Comecon (the old communist trading bloc), Vertex lost 50 percent of its market in 1991. "We were hit like lightning from the sky, and that's when we learned for the first time such hard steps as dismissing 1,000 people out of 3,000," recalls Zagora.

Vertex quickly went after new Western markets by "hiring young, dynamic people who had practically no experience but who had a knowledge of languages," said Zagora. The gamble paid off: Vertex now generates more than 70 percent of its revenues through exports, mainly to Western Europe and the U.S.

Domestic sales also recovered thanks to an upturn in construction, and last year Vertex returned to its pre-1990 production level. The company now has a full order book for the next 12 months. In 1994, the firm posted a net profit of 32 million korunas on sales of 1.2 billion korunas, up 90 percent and 20 percent respectively in 1993. Annual sales are forecast to increase by 40 percent this year and by 30 percent in 1996.

In order to service those sales, the company last year moved to double annual capacity to 32,000 tons by mid-1996 with a decision to invest 1.1 billion korunas in new technology licensed from Nitto Boseki of Japan. When the new equipment comes onstream, Vertex will be positioned to serve 2 percent of the global market with products which, says Zagora, will match Western quality at a price 5 percent cheaper than those of its competitors. Hardly surprising, therefore, that stockbrokers in Prague are now recommending the company.

Despite the tremendous turnaround which Zagora and his team have so far pulled off, he warns that Vertex will remain in a "sensitive period for at least the next two years," adding that, "basically no company here is yet prepared to enter the EU, not even our company." He reckons that it may take Vertex another five years. And unlike the colorful shapes that decorate his office, there is nothing abstract about that. EM

G7

SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY

Bundesbank Fights "Subsidy Mentality"

Deutsche Bundesbank's warning against a "subsidy mentality" developing in eastern Germany has unleashed a wave of economic debate as well as public soul searching.

In its July monthly report the powerful central bank argued that "high and lasting subsidies would not only hamper the requisite consolidation of public sector budgets but also give rise to serious allocative distortions." The report added that "any subsidization of the capital input should remain an exception as a matter of principle.

"Over the medium term it will be desirable to curb the total volume of financial assistance and successively to confine the relevant measures to what is absolutely essential," the Bundesbank continued. It concluded by recommending a "credible announcement of temporary assistance, tapering off after a certain time."

The bank's finger wagging provoked an emotional outcry. Westerners expressed resentment about the high taxes required to pay for the unprecedented flow of funds to the east and apparent ingratitude in some quarters. The easterners vented their spleen about second class citizenship and painful financial insecurity.

Eastern Germany will have received a total of some DM840 billion ($564 billion) in public sector payments over the five years ending 1995, according to Bundesbank calculations. This year alone the payments are expected to climb 10 percent to DM200 billion.

BY LAURA RAUN

Some private sector economists dispute those figures, arguing that transfer payments actually peaked in 1993 and will fall to DM155 billion this year.

While the Bundesbank obviously felt concerned enough to single out the issue in its monthly report, economists and bankers are divided over the prospects of a "subsidy mentality" developing.

"There is a real risk," warns Guenther Thumann, who recently returned to the German economics ministry after a stint in the private sector. "If you subsidize investments and other activities then the mentality can become entrenched and hard to get rid of." As early as 1990 — the year after reunification — Thumann cautioned against excessive subsidies. At that time he was working for the IMF on the German desk.

Eastern Germany will have received DM840 billion over the five years ending 1995.

"An even bigger problem is if the subsidies are biased toward certain activities," he adds. "Then the whole production structure becomes biased. If it's not in line with market forces you could find out later — when the subsidies are removed — that the production structure is not sustainable."

Thumann admits it's hard to know exactly how much of a subsidy is too much. But he says a lot depends on wage levels and unfortunately those in the new *Lander,* or states, have risen too fast.

Others are more sanguine. Ulrich Beckmann, senior economist at Deutsche Bank in Frankfurt, says the Bundesbank has issued a "self-defeating" prophecy. By warning now against the pitfalls of excessive transfers the central bank will avoid the worst later, he argues.

"A 'subsidy mentality' is not a serious danger," he insists. "The subsidies are coming down. It's money well spent. For me it's a success story."

He rejects the concern that some industries may become dangerously dependent on subsidies. "If some sectors aren't profitable then others are. The economy is making substantial progress."

Looking ahead, Thumann laments what he sees as the lack of a government plan for systematically scaling back transfer payments over time. "What should be done is to give a clear blueprint of what is going to happen with subsidies over the next decade...so companies know what's coming. You can't cut it off from today to tomorrow."

Beckmann is more confident about the future of subsidies: "There will be a gradual decline until 2005 when they will be negligible." EM

Prison With Freedom

Driving through the villages in the gently rolling hills of Thuringen it's hard to see what the Bundesbank is complaining about. Subsidies seem to have helped this eastern German state achieve a comfortable — if modest — prosperity.

But on closer inspection the Bundesbank's concern becomes more understandable. The empty buildings left from a closed dairy suggest the big, overstaffed operation couldn't profitably sell enough milk in the free market.

I was riding through Thuringen with my cousin Uwe who lives in Buerden, a village of 13,000 located about seven kilometers from the former West German border. Uwe and the rest of the family have undoubtedly benefitted from unification and the generous transfer payments from western Germany: new car, mobile phone and foreign holidays.

But they've also paid a price: lost jobs, little hope of new ones and lengthy retraining programs with no guarantee of a job thereafter. Wages have risen but not as fast as prices.

"Before the Wall came down we were living in a prison: we could see out but couldn't get out," Uwe explains. "Now we're in a different kind of prison because we can see everything here but can't have it because we don't have enough money."

But Uwe has welcomed the new freedoms associated with capitalism. Shortly after the Wall came down he and his partner Ute traveled to Texas to meet the branch of the family who emigrated from Thuringen 150 years ago. EM

— Laura Raun



©LANGEVIN/SYGMA

Chirac and Juppe threatened by fallout

CHIRAC STANDS BY HIS BOMB

On September 5, France detonated a Hiroshima-sized nuclear bomb at its Mururoa test site in the South Pacific in breach of a three-year-old international moratorium on nuclear testing and in defiance of worldwide opinion.

It was the first nuclear test carried out by France, the world's third most important nuclear power, since July 1991 and the 205th since it first began testing in 1960. The U.S. has carried out a total of 1,030 tests, Russia 715, Britain 45, and China 43.

In May 1994, a year before leaving office, former Socialist president Francois Mitterrand, who launched the world moratorium on testing in 1992, solemnly declared that France would never again carry out any nuclear explosions.

BY DIANA GEDDES

"Certain people say: as soon as he is gone, we'll see what we shall do," Mitterrand said. "But I can tell you that after me, they will not do it. Because France will not want to offend the world by relaunching the nuclear arms race."

Even at the time, it was considered a rash prediction. Within a month of taking over from Mitterrand, Jacques Chirac, the new Gaullist president, had announced that France would carry out a new series of seven or eight underground tests, beginning in September and ending next May. His decision, he added, was "irrevocable."

Chirac had consulted no one, not even the French parliament or France's partners in the European Union with whom, under the terms of the 1993 Maastricht treaty, France was supposed to be developing a "common defense and security policy." It appeared to be a typically arrogant, Gaullist gesture of "devil-take-the-hindmost" isolationism.

Chirac claimed that it was the "unanimous" advice of all the experts he had consulted that a final limited series of tests was indispensable to check the safety of France's aging nuclear arsenal, certify a new warhead to be used on a submarine-launched missile, and to develop the computer simulation technology which would enable France to dispense with live testing altogether once the present series was completed. Strangely, Mitterrand had received much different advice.

The new French government had been expecting some hostile reaction. But the scale of the worldwide storm evidently took it by surprise. Over 150 nations, including eight of France's 14 European Union partners, lodged official protests. Anti-test demonstrations spread around the globe.

French consulates were bombed (Australia); French high-speed trains set alight (Switzerland); French champagne and perfume poured into the sea; millions of anti-bomb signatures collected; an international "peace flotilla" was dispatched to the Mururoa test site; even a French plane was hijacked (Spain).

In France, the tests were pretty unpopular too, though the reaction was more muted. While a majority of the French continued to support nuclear deterrence as the keystone to their national defense, some 60 percent declared themselves opposed to the resumption of testing. Chirac's popularity ratings slumped in the polls.

But the Gaullist president vowed to remain "absolutely firm" despite the growing chorus of disapproval. "There are times," said Prime Minister Alain Juppe the day after the tests resumed, "when the greatness of a statesman is to face up to temporary unpopularity in order to preserve the essential, medium- and long-term interests of the country. History will judge."

But just in case the judgment falls the wrong way, France has begun making a number of propitiating gestures towards its critics. While insisting that the tests will go on, Chirac has suggested that the series could be curtailed if scientists gather all the data they need before the proposed tests have been completed, and he has now gone much further than he originally had intended by announcing that France, following the lead of the U.S. and U.K., was also prepared to accept a "zero option" ban on all nuclear explosions, "however small." EM

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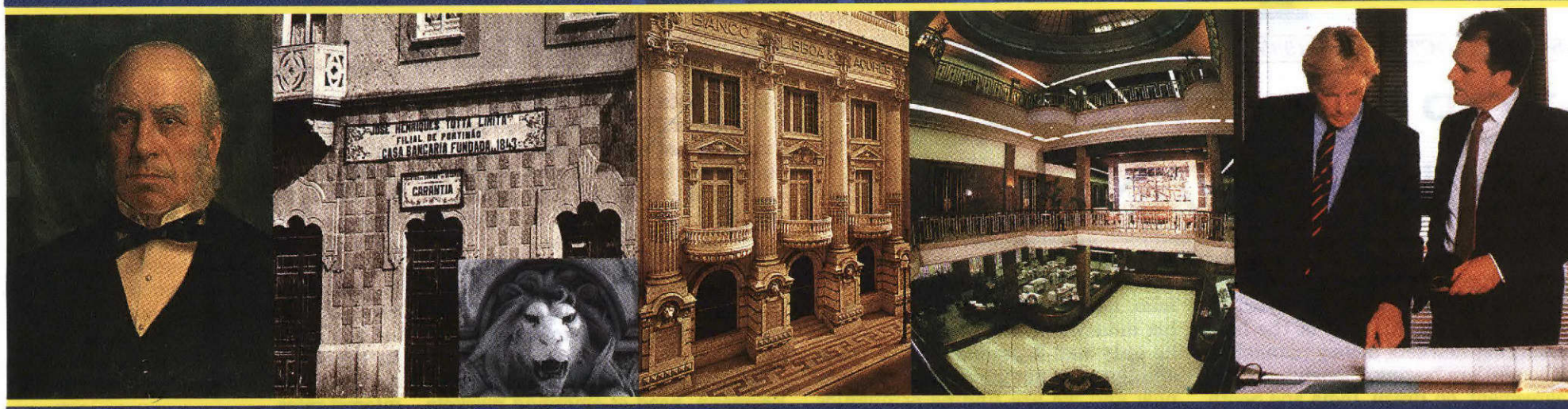

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Capital Markets

SUNDAY, OCTOBER 8, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 26

TOP FUND MANAGERS PICK TAIWAN, CHINA

BY K. MICHAEL FRASER

Taiwan and China are favorites these days among some of the best emerging markets money managers, who also are betting, though with less agreement, on Brazil, India and South Korea. And they have some quirky picks for big bets, such as Greece, Israel and the Czech Republic.

Emerging Markets Fund Research, based in Glen Allen, VA, calculates the undisputed leader in global emerging market investing has been City of London Investment Management. It showed a gain of 135 percent over the last three years versus 74 percent for runner-up Schroder Investment Management, also in London.

City of London, which manages $200 million in emerging markets, follows a unique strategy: it invests only in closed-end country funds. The strategy can multiply profits because a fund's discount usually declines when a country does well. "When we get it right, it goes very right," says City of London's founder and senior manager, Barry Olliff.

In mid-September Olliff was shifting from Southeast Asia into funds that invest in Brazil, Taiwan and East Europe. His favorite was the Czech Republic because of the combined prospects for its equity market and for smaller discounts on Czech funds. He had 10 percent of his flagship £36 million Investment Trust Portfolio in funds that invest there.

In mid-September, Taiwan represented 10.7 percent of City of London's portfolio versus 11.3 percent in the IFC's global index. Olliff was significantly underweight in Indonesia (1.0 percent versus 2.5 percent), Malaysia (3.3 percent versus 13.8 percent), the Philippines (0.5 percent versus 3.2 percent), South Korea (7.6 percent versus 11.4 percent), Thailand (6.3 percent versus 9.6 percent), Mexico (1.1 percent versus 5.5 percent) and South Africa (3.9 percent versus 13.0 percent).

For Giles Neville, a senior emerging markets fund manager at Schroder, which manages $6 billion in emerging markets, Taiwan and South Korea were the best near-term bets. "We like them largely because of their export competitiveness versus equivalent Japanese companies, despite the recent weakness of the yen," said Neville, a bottom-up investor (one who chooses companies with little regard to country as opposed to top-down investors who chose countries they expect to perfom well).

London-based Douglas Polunin, the senior investment manager at third-place Pictet, which manages a $1.5 billion emerging markets portfolio, had slightly over 12 percent of his money in Korea. But in Taiwan, he only had 2 percent. "That could change. We are reviewing Taiwan now and we are finding companies that are quite cheap," Polunin said, who is a bottom-up investor.

However, Richard Saler, head of international investment strategy at eighth-ranked Lexington Management, which manages $300 million in emerging markets, was not about to buy in Taiwan. "There are a lot of problems in their relations with China," said Saler, a top-down/bottom-up investor. "If they don't behave, China steps on them. Investors don't like that."

Like other top performers, Philip Ehrmann, head of emerging markets investing at ninth-ranked Invesco Asset Management in London, placed less importance on Taiwan's problems with China. "Concern about China is overshadowing a well-balanced economy and market in Taiwan," Ehrmann said. He had increased his Taiwanese holdings from 7.5 percent of Invesco's $250 million emerging markets portfolio in June to close to 9 percent in mid-September and was still buying. And he was buying in South Korea, where he expected strong economic performance supported by declining local interest rates.

China and India also were attract-



The Top Global Emerging Equity Fund Managers

Rankings based on weighted 3-year returns

Rank	Fund Management Group	% Return (Yrs. ending July 31) 3 Yr.	1 Yr.
1	City of London (1)	134.85	3.75
2	Schroder Investment Management	74.06	–0.04
3	Pictet Asset Management	70.14	3.05
4	Capital International	67.47	–5.53
5	Morgan Stanley	66.03	–10.93
6	Global Asset Management (2)	63.91	–2.12
7	Templeton Investment Management	57.24	2.84
8	Lexington Management	54.68	–4.55
9	Invesco Asset Management	52.24	–9.18
10	John Govett	52.07	–7.99
11	Fidelity Management & Research	51.00	–4.57
12	Genesis Investment Management	50.16	–0.18
13	Montgomery Asset Management	49.70	–1.29
14	Merrill Lynch Asset Management	46.05	–5.26
15	Kleinwort Benson Investment Management	43.96	–1.71
16	Foreign & Colonial Emerging Markets	43.66	–9.23
17	Batterymarch Financial Management	40.45	–10.47
18	Martin Currie Investment Management	38.59	–16.14
19	State Street Global Advisors	38.51	–5.46
20	Emerging Markets Investment Corporation	38.04	–7.50

Notes: Returns are in U.S. $ terms and are NAV to NAV with gross income reinvested. (1) The City of London global emerging market equity funds is a fund of funds, i.e., it only invests in other country funds rather than in individual equities. (2) Global Asset Management uses a multi-manager approach for their emerging market funds. They allocate assets to various fund managers with expertise in different areas, e.g. Latin America, Asia, etc.

Source: Micropal Emerging Market Fund Monitor

ing many top money managers. "I believe both India and China will remain committed to liberalization policies," said Schroder's Neville. "We think the austerity program may be relaxed in China, and we can find a range of well managed companies in India. Our Chinese and Indian portfolios should perform well over 12 to 18 months," he said.

Pictet's Polunin also was investing in China, mostly through locally listed companies, and was about to move money into India. "We find a lot of small and medium companies that are very cheap in India. It is an area where we could be increasing a lot," Polunin said.

Ehrmann had 4 percent of Invesco's portfolio in China, anticipating the country would stabilize its economy and markets had discounted risks surrounding the takeover of Hong Kong. He was underweight in India, where he expected attempts to control inflation ahead of a general election, likely next March, would hurt the economy. "The ability of the administration and bureaucracy to choke things off is not to be underestimated," he said.

In Southeast Asia, Schroder's Neville was neutral on Indonesia, Malaysia, the Philippines and Thailand, largely for fear their economies were overheating. Pictet's Polunin was underweight in Malaysia and Thailand, while Invesco's Ehrmann was neutral in Thailand, underweight in Malaysia, where he expects poor economic performance, and underweight in the Philippines, where inflation is rising. "I am concerned that the leopard hasn't changed its spots in the Philippines. They seem to be about to wriggle out of their IMF agreement," says Ehrmann.

Although several of these top fund managers are hesitant about Southeast Asia now, they expect to make most of their money in the longer term. "Looking forward five years, countries of Southeast Asia should sustain some of the highest growth rates in the emerging markets universe, because of their high savings," says Neville.

Latin America is viewed less favorably. Not only have Latin markets soared since March, but there is a general agreement that risks have risen. Lexington's Saler warns that decreased foreign investment in the region will depress growth and raise the risk of a return to populist spending: "They will have a difficult time trying to weigh unemployment against fiscal restraint and reform."

In mid-September, Saler's largest relative overweighting was in Israel, where he had invested 8.5 percent of his portfolio.

Polunin had another odd-ball favorite: his largest relative overweight position was in Greece, where holdings totaled 12 percent of Pictet's portfolio. He also had a large stake — 9 percent of the portfolio — in East Europe, Russia and the former Soviet Union.

Turkey, on the other hand, was out of favor. Ehrmann had cut his holdings there to 2.5 percent of Invesco's portfolio from 4 percent in January. Largely because of political instability and lack of vision and commitment to reform among the country's political leaders, Lexington's Saler said, "We don't see Turkey moving in the right direction."

South Africa was another country in disfavor. Schroder's Neville argues that to sustain high growth, the country will require large foreign investments because of its low savings rate. But high labor costs make it unattractive to foreign investors. EM

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Bankers

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Tabuchis – and Bulls?– Back on Tokyo Exchange

BY ANTHONY ROWLEY

Which is the surer sign that the Tokyo Stock Exchange (TSE) is headed back toward a bull market — the fact that the Nikkei 225 average is now some 30 percent above its bear market lows or the fact that the "Tabuchi twins" are making a comeback at Nomura, Japan's biggest brokerage?

Probably the latter because it signals an end to Nomura's long period of penance after the bubble burst and the securities house was plunged into financial scandal.

The Tabuchis — Yoshihisa or "Little" Tabuchi and Setsuya or "Big" Tabuchi — occupied the positions of president and chairman of Nomura during the bubble days. The two men are not related. But when a series of financial scandals swept the securities industry in 1991, and when Nomura (as well as Nikko, third largest of the big four) was found to have had dealings with the head of one of Japan's three largest *yakuza* organized crime syndicates, "Little" Tabuchi stepped down. "Big" Tabuchi later followed suit.

They virtually disappeared from public view until April this year when shareholders voted them back on to the board of the brokerage as "counselor-directors," a semi-honorary position. They will give active advice to President Hideo Sakamaki.

"Personally speaking, I am very happy to have them back," Nomura managing director Shimpei Matsuka told *Emerging Markets*. Last year, Nomura plunged into the red, and so the firm needs to "use all our resources" to recover, said Matsuka. This means tapping the Tabuchi talent again, in the hope that they still have the Midas touch.

By September, some people in Kabutocho — Tokyo's Wall Street — were already talking of a return to the good old days with the Nikkei 225 average rising above 18,000 for the first time in many months.



Nomura's Hideo Sakamaki

"I think that the long downward trend for [Japanese] stocks is over and that we have now entered a long-term upward trend," says Matsuka. The market will not come up "abruptly," he predicts, but he is hoping to see 25,000 on the Nikkei average by next year. "It may take two years," adds Matsuka, "but some companies' share prices may appreciate five to 10 times during this period while others stay still."

Which will be the market leaders? Hi-tech stocks (especially those producing semiconductors, for which domestic demand in Japan has soared with the boom in personal telephones) plus housing and construction-related stocks that will benefit from successive fiscal stimulus packages in Japan, says Matsuka.

Many foreign investors who have been snapping up Japanese stocks avidly in recent weeks would probably agree with Matsuka's analysis — and with his stock picks. But what of Japanese investors who doggedly continued selling for years after the Nikkei average crashed from its late 1989 peak of around 39,000?

The market will not come up "abruptly."

"The fear that the Tokyo market will go down further is over," claims Matsuka, pointing to the fact that what he calls "experienced [Japanese] individual investors" — others might prefer the term speculators — are now back in the market. Pension funds and investment trusts have also become net buyers, though troubled Japanese banks and life assurance companies continue to be net sellers, says Matsuka.

He denies that there is any return to the good-old, bad-old bubble days when Nomura led the way in pushing stocks aggressively among small investors (including Japanese housewives) who bought as though there were no tomorrow. There was a tomorrow, and it proved to be a savage "morning after" once the bubble burst.

Tabuchis or no, Nomura's approach seems somewhat more cautious now. "Our strategy is to draw attention to historically low interest rates in Japan and the fact that the dividend yield is higher." In other words, a share even in sedate Tokyo Electric Company now yields around 3 percent or ten times the return on a bank deposit.

But Nomura is also plugging "growth stocks" again with small investors (information software and new business situations especially). Kabutocho may not yet be resounding the pounding of bulls' hooves but the "thundering herd" at Nomura are beginning to paw the ground eagerly again. EM

COAST-TO-COAST BANK NEXT STOP ON MERGER TRAIL

BY BRENDAN MURPHY

The continuing flurry of U.S. bank mergers has led consolidation to become a common phenomenon. What is different about the current wave of purchases and mergers is that it could ultimately result in coast-to-coast mega-institutions.

It remains to be seen just which major banks would be willing to take subordinate roles in a takeover without substantial pressure from institutional shareholders, given the stakes and executive egos involved.

Pressure from shareholders, of course, tipped the balance in Chase Manhattan Corporation's decision to merge with Chemical Banking Corporation to dethrone Citicorp as the nation's largest bank. Institutional investors will not automatically assume bigger is better, however. Many speculators would love to see every major U.S. institution put into play. On the other hand, once the desirability of a nationwide franchise becomes evident, a chorus of U.S. institutional investors would make its voice quickly heard.

Pressure from institutional shareholders tipped the balance in Chase's decision to merge with Chemical.

"We will probably see a few banks with a national franchise," says Cynthia Glassman, managing director at Furash and Co., a Washington bank consulting firm. U.S. legislation authorizing interstate branching doesn't take effect until September 1997, but it has been a powerful propellant for the current merger wave, even if it has gotten much less attention than the earnings and stock price implications of recent deals.

The phenomenon of disintermediation — that is, companies going straight to the capital markets instead of borrowing from banks — is pressuring banks to build businesses and revenues downmarket, remarks consultant John Danforth of the Secura Group in Washington. With margins trimmed to a razor edge in commercial lending and other "commodity" businesses, banks are looking to offer "high touch, high feel" services to consumers as well as to small to medium-sized companies over the new electronic media.

That's where the argument for national banking institutions accumulates force. When banks must battle for the business of the consumer and small businessperson, they will need to raise the visibility of their brand name, as other financial services like Visa or American Express have done. A nationwide bank cobbled together from regional components can't count on meaningful economies of scale, except perhaps in the systems area — and in aggressively marketing its brand and services across the country.



Rosenberg: "zero" inclination

If coast-to-coast banking is taken as inevitable, the question turns to the identities of merger-target institutions. Frank Anderson, a Dallas-based senior financial analyst at investment bank Stephens, Inc., scoffs for now at recent talk that NationsBank and BankAmerica are circling each other in contemplation of an east-west deal. "I don't see NationsBank doing a merger of equals," Anderson explains. For its part, BankAmerica feels "zero" inclination to merge with another major bank, according to Richard Rosenberg, its chairman and chief executive.

But Rosenberg conceded recently that this might change if investors decided to penalize the San Francisco-based institution for not expanding its reach nationally. Moreover, it's possible that BankAmerica might find partners more suitable to its culture than the hard-charging NationsBank. One possibility would be BancOne of Columbus, Ohio, which like BankAmerica has been aggressive in snapping up regional banks in its zone of influence.

That raises the prospect that BankAmerica and NationsBank, despite their current cooperation in acquiring financial software company Meca, may in time head down the national franchise route on separate tracks. Each has the capital and management acumen to see it through, and investors, even institutional sceptics, might reward such a bold initiative. This is why it could be extremely interesting if BankAmerica or NationsBank succeeds in a bid for Bank of Boston, generally considered in play. BostonBank would make an excellent toehold in the Northeast banking market. EM

From School Failure to World's Best Fund Manager

BY K. MICHAEL FRASER

The world's best global emerging markets fund manager was a failure at school. At the end of the equivalent of high-school in London, Barry Olliff failed all his O-level exams, except technical drawing, and he never went to university. Perhaps that's why his global emerging markets funds returned 135 percent total over the three years to July 31, according to Emerging Markets Fund Management.

"Maybe I have pushed so hard to be successful, because I did so badly in school," says the 50-year-old Olliff, who spends much less time contemplating his own inner workings than the workings of the market. And he thinks about the market in a unique way.

Olliff is the only global emerging-markets fund manager who does all his investing through closed-end funds, or investment trusts, as they are called in the U.K.

He began to study closed-end funds 32 years ago when he got his first job, as a messenger and filer at the Rowe Swann brokerage in London.

"I read everything I filed that had to do with investment trusts," Olliff said.

By the time he was 23, five years later, he had jumped to Denney Brothers and was making a market in investment trusts. He eventually became an associate of the company, but he stayed in the investment trust department. And he stayed with investment trusts when he moved at 36 to Laing and Cruickshank, then London's fourth-largest stockbroker. In 1984, he became director in their investment trust department.

"I wasn't up to it at school. A requirement of the education system was to conform and to pass exams. I wasn't able to concentrate. I was too interested in sport," says Olliff.

"Once I started working I had a goal. I wanted to be a success. When I started to work, my target was to become a clerk. That seemed like the ultimate success. But when I became a clerk, I wanted to become what they called then a 'red button,' then a 'blue button,' then an authorized dealer, then a member, then an associate of my firm.

"Each target seemed to be the ultimate success, but it never was, because there was always another target."

In June 1987, he established Olliff and Partners, which specializes in researching and broking closed-end funds around the world. In 1990 he found a new asset class: 70 closed-end emerging markets country funds with assets of $5 billion.



Olliff: always another target

"It was an opportunity for me, because they hadn't been researched before," says Olliff. "Many of these funds weren't correctly priced. I thought I could use the anomalies to provide disproportionate returns."

In 1991, he set up City of London Unit Trust Management as a money-management firm within Olliff and Partners. Olliff gave up day-to-day responsibility for Olliff and Partners and devoted himself to the new venture, which now manages $200 million.

Olliff's universe has grown to 1,000 emerging markets closed-end funds with assets over $40 billion. His strategy is to find a market he likes and then use his experience to choose a fund whose net asset value will track the market.

The trick is to find a fund that is selling at an unusually large discount. If the discount narrows, which usually happens when the underlying market performs well, Olliff's returns are multiplied.

In describing how his strategy works, Olliff says, "When everyone is getting worked up about the Czech Republic, most people don't know there are 200 funds in Prague. We were buying these funds at discounts of up to 65 percent."

"I have found a niche," says Olliff.

Is this the ultimate success? "Now my target is to continue to consistently remain in the first quartile [in performance of global emerging markets funds]," says Olliff, who works 60-70 hours a week and spends three months a year on the road.

"I do it because I love it, because I am doing what I dreamt I would do one day — something really well. It goes back to being able to do nothing in high school." EM

Appetite for New Latin Equity Dismal, Says Santander's Hariharan

BY DANIELLE ROBINSON

Despite considerable efforts by bankers to bring Latin equity deals to the international markets, there is still very little to attract investors into new Latin stock issues, says Hari Hariharan, head of global asset management at Santander Investments.

"I think the appetite for new Latin equity issuance is pretty dismal," he says. "The generic argument for putting new money into Latin equity is just not there."

Hariharan argues that there has been a fundamental change in the way U.S. and other international investors are treating the emerging equity markets, due to changes in the flow of funds into their portfolios and other global market events.

"To know what is going to create appetite for new Latin equity issues you have to look at the investor base," explains Hariharan. "The investor base is divided between purely dedicated emerging market equity portfolios and non-dedicated portfolios.

"If you look at the dedicated funds it's my opinion that they are not necessarily getting new money, and most of them are already fully invested." These investors, he argues, would have to rebalance their portfolios and divest themselves of some existing positions to raise the funds for new issues. "This is not an exciting prospect right now, given where prices are [in the secondary market] and given that liquidity is very bad in some Latin markets."

As for non-dedicated buyers of Latin equity: "They clearly have the ability to allocate money to Latin America, but the point is they have too many compelling alternative investments, one of which is in Latin American fixed income instruments," says Hariharan.

"Uncertainty surrounds the economic growth of two of the major economies in the region."

Investment bankers have been arguing that anything can be sold — at a price. Hariharan, however, does not entirely agree.

"There is that possibility [that the new issue market would pick up if launch prices dropped] but you still have to go to the same wells and those wells are not brimming at the moment. You also have to be mindful of the fact that if you reduce your price too much it creates suspicion about the true motives behind the capital raising. Anyway, I don't think anybody today is not looking at deals because the pricing is outrageous. It's just the availability of money that is causing a certain amount of hesitancy."

A series of macroeconomic and global market events need to occur before international funds will once again flow into Latin new issues, says Hariharan.

"The first thing is clearly that the market needs to be convinced that Mexico has bottomed. People also need to be convinced that Argentina's slowdown has bottomed. When you have uncertainty surrounding the economic growth of two of the three major economies in the region it is a very difficult environment to go in and buy equity."

Hariharan adds that global liquidity conditions also need to alter dramatically to make Latin markets more attractive alternatives to other developed equity markets. For that to occur, the imbroglio over the U.S. federal budget deficit needs to be resolved and interest rates need to stabilize.

Also, Latin American fixed income instruments continue to be more attractive investments. Hariharan gives the example of Brazil, where the macroeconomic outlook is on more positive ground than Mexico and Argentina at the moment. "In Brazil if you had invested in short-term local fixed income instruments your gross return over the last year could be around 47 percent. For equity in the same period it would be approximately negative 25 percent in U.S. dollar terms," he says.

Hariharan does not foresee any of the more fundamental changes required to boost investor flows into new equity issuance for at least another three months. EM



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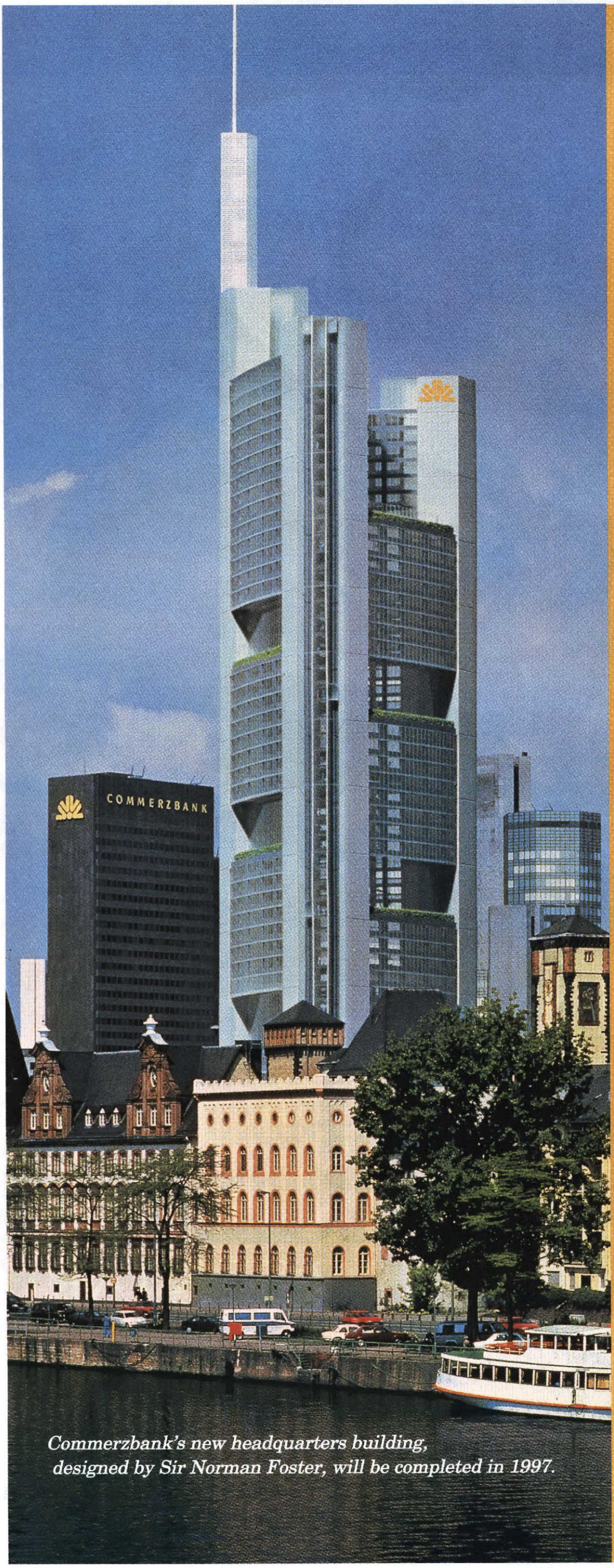

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German know-how in global finance

HK$ Is Proxy for Yuan Convertibility

BY ANTHONY ROWLEY

Deng Xiaoping promised that China would adhere to a principle of "one country, two systems" after 1997 when Hong Kong is re-absorbed into China. But what about the idea of one country, two currencies — the Chinese yuan and the Hong Kong dollar (three after 1999 when Portuguese colony Macao rejoins China, bringing its pataca with it)?

Impossible, claim people like economist Milton Friedman. Within two years of the hand-over, the Hong Kong dollar will have been absorbed by the yuan and Hong Kong's reserves will have been taken over by China. Perfectly possible, argue others like Thomas Chan, head of the Hong Kong Polytechnic's China Business Center. China needs the Hong Kong dollar as a "buffer" currency.

Even assuming that pragmatism prevails in China after the aging Deng (now 91) finally quits the scene and that the Hong Kong dollar survives intact, businessmen and bankers still worry over what will happen to the present fixed link between the Hong Kong dollar and the greenback (at a parity of HK$7.8 to $1).

Under the current (British) administration in Hong Kong, investors have every reason to "put their hearts at ease," as the net international reserves of Hong Kong amount to around $45 billion, or 37 percent of Hong Kong's M3 money supply. Comparable levels are 6 percent in Germany and only 2 percent in the U.S. and Japan. (If the foreign exchange reserves of private banks were included, the "cover" in Hong Kong would be much greater still.)

This is why repeated speculative attacks on the HK dollar/U.S. dollar link (such as that led by U.S. hedge funds following the Mexico crisis) have failed to break it. For the moment at least, the Hong Kong dollar looks like one of the most stable and safe currencies in the world.

China itself has $60 billion of foreign reserves and has committed publicly to using them to defend the link after 1997.

"It makes sense" says Chan (who travels frequently to Beijing and claims to be privy to central bank thinking in China). So long as the link remains, China does not need to worry about the danger of massive capital flight, such as occurred in 1993 and 1994. Hot money fleeing China is happy to stay put in Hong Kong because the local currency can always be converted freely into other international currencies.

This is exactly what has happened to most of the flight capital exiting China in 1993-94 — and this year a good deal of it flowed back again into China, attracted by high interest rates and other investment opportunities. If mainland Chinese had any reason to doubt the maintenance of the link — let alone the continued existence of the Hong Kong dollar — they would quickly find other places to park their funds and Beijing knows it, says Chan.

Other economists note that Hong Kong's money supply is now roughly one quarter as big as China's. Between 25-30 percent of Hong Kong's monetary base is believed to be circulating in south China, where Hong Kong has spread its manufacturing and business tentacles over the past decade.



Through 1997, Hong Kong currency looks quite stable

The argument is that China would be cutting off its nose to spite its face if it interfered with the relative independence of the Hong Kong dollar and cast covetous eyes upon Hong Kong's rich reserves. Beijing has every incentive to retain the status quo well beyond 1997. To endanger the Hong Kong dollar would be to put not only Hong Kong's prosperity at risk but southern China's too.

The Hong Kong dollar gives China a kind of proxy for convertibility that the yuan cannot hope to achieve for a decade or two. (China has pledged full convertibility in current account transactions by the year 2000 but has given no date on capital account convertibility). It has the best of both worlds — a fully convertible "local" currency without risking a disruptive dash for convertibility of the national currency.

Even so, some bankers and businessmen still worry that, in the aftermath of Deng's death, an increasingly nationalistic leadership may well be prepared to cast logic to the winds and extend the principle of renewed political sovereignty over Hong Kong to regaining full control over its economic and financial independence. EM

U.S. BOOSTS JAPAN BY WEAKENING YEN

Is the great deflation in Japanese asset prices — land, real estate and stocks especially — finally at an end now that the yen has reversed its remorseless appreciation and nominal interest rates are at historically low levels in Japan? The answer, says one leading Japanese economic guru, is yes — and no.


Masunaga: brighter prospects

At least the pressure will stay off the yen, predicted Rei Masunaga, deputy head of the Japan Center for International Finance. A former advisor to the governor of the Bank of Japan and director of the central bank's foreign department, Masunaga is considered something of an insider on such matters.

"The yen will remain at around its current levels for some time," he predicted in early September when the rate was hovering between 97-98 to the dollar. It is more likely to nudge above 100 than it is to fall below 90 again, he added — suggesting that the acute pain Japanese industry felt after the yen soared above 80 to the dollar earlier this year may be at an end.

Masunaga attributes the welcome decline of the yen against the dollar largely to what he calls a "complete change of attitude in Washington." The U.S., he explains, "is now apprehensive that its benign neglect of the dollar was putting both the Japanese economy and the global economy at risk."

The weaker yen has already brought comfort to Japan's hard-pressed manufacturing sector while the sharp recovery in Tokyo stock prices since early July has brought relief to the financial sector, notes Masunaga. This means that while Japan's long-stagnant economy is "not out of the woods yet, prospects have become somewhat brighter."

But what of the outlook for land and real estate prices in Japan, which have been falling almost without interruption since the end of the bubble economy in 1991? Here Masunaga is somewhat less optimistic.

"Probably we should expect some further fall in commercial property prices, though residential prices have probably bottomed out," Masunaga said. Meanwhile "there is a good possibility that land prices in Japan will remain low," he predicted.

If this prognostication proves correct, that will be bad news for Japan's debt-burdened banking system, which is heavily dependent upon land as loan collateral. It also spells bad news for the seven housing-loan corporations in Japan which are mainly owned by banks and which are teetering on the verge of a potentially dangerous bankruptcy.

Land prices in Japan fell for a fourth straight year in 1994, which meant that the average value of land in major cities was just one half of levels reached during the bubble economy (though Tokyo residential land values are still 30 times higher than in New York and 10 times higher than London's). Land prices have continued to soften this year.

Masunaga sees one ray of hope amid the encircling gloom over land and real estate prices. For a long time there have been fears overhanging the property market that Japanese banks might start failing in droves and dumping land collateral on the market, thus sending it into further tailspin.

The relatively decisive (by Japanese standards) and effective way that financial authorities dealt with the collapse of Hyogo Bank and Kizu Credit Union in one single day early in September has raised hopes that the banking crisis can be handled without too much trauma. "If this means that problem banks will not need to dump land...then the real estate market may enjoy a positive reaction," says Masunaga.

What of the outlook for capital outflows from Japan (needed to keep the yen from appreciating again)? Here he is optimistic. The July 7 measures announced by the finance ministry to stimulate both private and official flows will work, he believes. Already the Euroyen note market has taken off sharply and Japanese life companies are beginning to lend overseas again, he notes. EM

— Anthony Rowley

New Issue

This information appears as a matter of record only. The bonds described below have already been offered for sale.

September 27, 1995

International Bank for Reconstruction and Development

Washington, D.C., USA

DM 3,000,000,000
6 1/8 % Deutsche Mark Global Bonds of 1995/2002

Dresdner Bank
Aktiengesellschaft

Morgan Stanley Bank AG

CS First Boston Effectenbank
Aktiengesellschaft

Deutsche Bank
Aktiengesellschaft

Goldman, Sachs & Co. oHG

Merrill Lynch Bank AG

SBC Warburg
Schweizerischer Bankverein
(Deutschland) AG

ABN AMRO Bank
(Deutschland) AG

Bank of Tokyo (Deutschland)
Aktiengesellschaft

Banque Paribas
(Deutschland) oHG

Bayerische Vereinsbank
Aktiengesellschaft

Commerzbank
Aktiengesellschaft

Schweizerische Bankgesellschaft
(Deutschland) AG

Bayerische Landesbank
Girozentrale

Bear, Stearns International
Limited

Caisse des Dépôts et
Consignations GmbH

DG BANK
Deutsche Genossenschaftsbank

Industriebank von Japan
(Deutschland)
Aktiengesellschaft

J. P. Morgan GmbH

Nikko Bank
(Deutschland) GmbH

Salomon Brothers AG

Société Générale S.A.

New Issue

This information appears as a matter of record only. The bonds described below have already been offered for sale.

June 8, 1995

Inter-American Development Bank

Washington, D.C., USA

DM 500,000,000
7 % Bearer Bonds of 1995/2005

Dresdner Bank
Aktiengesellschaft

Commerzbank
Aktiengesellschaft

Deutsche Bank
Aktiengesellschaft

Merrill Lynch Bank AG

ABN AMRO Hoare Govett

Bank of Tokyo (Deutschland)
Aktiengesellschaft

Caisse des dépôts et
consignations GmbH

DG BANK
Deutsche Genossenschaftsbank

Goldman, Sachs & Co. oHG

Lehman Brothers Bankhaus AG

Morgan Stanley Bank AG

Schweizerische Bankgesellschaft
(Deutschland) AG

Schweizerischer Bankverein
(Deutschland) AG

Westdeutsche Landesbank
Girozentrale

N-250 Puts Indonesia on New Flight Path

BY KEVIN RAFFERTY

Just a few weeks ago, a new twin turboprop aircraft soared into the skies on its successful maiden flight, and lifted with it Indonesia's ambitions to join the world's exclusive jet set of makers and sellers of civil airliners. There can be no doubt about the ambition — since it was expressed by no less than President Soeharto himself.

The president embraced his research and technology minister B.J. Habibie, who masterminded the new civil aircraft and declared that Indonesia's next target was to put a medium-haul jet aircraft in the air by the year 2003 or 2004. He estimated the cost would be $2 billion and said, "We have to start now if we don't want to lose the momentum and the market opportunities." The minister added, "This is the national awakening of higher technology in Indonesia."

Some Westerners watching were skeptical, with one noting wryly that, "It's logical for ministers to have sky-high ambitions because the streets are clogged with traffic so that it's hardly possible to move, almost as bad as Bangkok." Becoming serious, he added, "Trying to get into the jet aircraft business is really playing in the big league, alongside Boeing, Airbus and McDonnell Douglas, and it is already an overcrowded marketplace. The Japanese are still trying to make it but haven't succeeded and are really only parts suppliers to the big boys."

Indonesians proudly point out that their country has a bigger population than that of Japan, and add that if neighboring Malaysia, with 18 million people, can support a car industry, then Indonesia, 10 times bigger, can surely develop an aircraft production line.

Indonesians say that, if Malaysia can support a car industry, then Indonesia, 10 times bigger, can surely develop an aircraft.

But Habibie, very much the controversial driving force behind the new industry, told a Bandung press conference that the aircraft plan was essential for a sprawling country of 7,000 islands spread across a wide area of ocean, further than from San Francisco to New York or London to Moscow, and was "the main motivation to have an aerospace and maritime industry." He also asserted, "It's not because of prestige we're doing this. It's an economically calculated undertaking."

The N-250, which will seat 70 passengers, was originally scheduled to fly in April, but was delayed "as first ventures inevitably are," said one of those working on it, but still made it in time for celebrations of Indonesia's 50 years of independence. It was followed by a fleet of aircraft with passengers scrambling to get pictures of the first flight. Habibie claimed that the N-250 has 192 firm orders, only 67 short of the break-even point, and that its development so far has cost only $400 million, well short of the $650 million budgeted. Among the foreign orders are some from the U.S. and from Europe, and there are plans to build the aircraft in Mobile, Alabama.

Soeharto said the proposed jet would be called the N-2130, and would have electronic controls of its rudders, ailerons and elevators. From the information booklets given out, it seems likely that the N-2130 will be twin-engined and will be running directly into a host of already proven competitors including the British Aerospace BAe 146, the Fokker-100 and even the McDonnell Douglas MD-95 and smaller versions of the Boeing 737. Japan has been struggling to break into this medium-sized jetliner market, so far unsuccessfully.

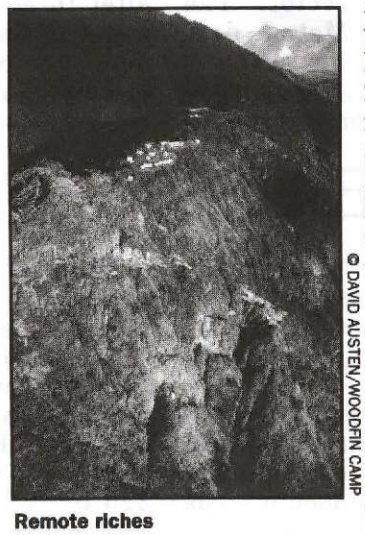
The president said that the cost of developing the jet would be met by selling two million bonds each worth $1,000 to Indonesians. The public announcement of the plans to enter the jet world are very much a victory for Habibie, the most ambitious and aggressive of several generations of technocratic ministers who have served under Soeharto. Habibie was educated in Germany and trained as an aeronautics engineer and was a vice president of Messerschmitt-Boekow-Blohm. EM

GOLD MINING CAUSES ERUPTIONS IN PNG

Papua New Guinea is going full steam ahead with the world's biggest, most exciting and dangerous unexploited gold mine outside South Africa, and it seems that potential investors have been bitten by the gold bug in spite of warnings that exploration might be disturbed by exploding volcanoes, difficult geology, not to speak of political disturbances.

When retail investors were offered a slice of the equity in the Lihir Gold flotation last month, they flocked to the issue, which was oversubscribed by almost 20 times. "Everyone's gone completely Lihir crazy," said one leading Sydney stockbroker. "Everyone's talking about it. Demand is over the top. It's gold, it's sexy and it's got that magic."

One of the world's last unexplored frontiers, the development of Papua New Guinea promises to be the wilder Wild East than ever the Wild West could have imagined, with hostile territory, greedy prospectors, modern corporate giants, and political activists and environmentalists to be encountered. The lure of untapped mineral resources like the gold and copper at Lihir, an island off the northeast coast of the country, is made the more difficult by the terrain, which features some of the world's densest jungles at mountain top level. At Ok Tedi, another major PNG mine close to the border with Indonesia's Irian Jaya province, engineers literally had to slice the top off a mountain to scoop out the mineral riches.



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Remote riches

Some of the country's jungles are so remote that the local people have had hardly any contact with modern civilization before the late 20th century. A person might see smoke from a jungle fire 40 miles away and know that he would never meet those who had lit the fire because it would involve a six-day trek, and when he got there they would not be able to communicate because their languages were very different. Much of Papua New Guinea where the minerals are hidden is so remote that missionaries only recently made it there, and penis gourds are the only dress worn by men of some jungle tribes.

Yet political activists and environmentalists have come snapping hard on the heels of the mineral prospectors, engineers and their rich corporate sponsors. Panguna copper mine, perched on the edge of a cliff on Bougainville island, was brought to a standstill in 1990 when rebel soldiers fighting for independence of the island from PNG captured the mine. At that time, just after Ok Tedi had been opened but before Lihir development plans had been drawn up, Panguna accounted for 15 percent of the PNG government's revenues and 40 percent of its foreign exchange earnings. It was four years before government troops recaptured the mine.

"Everyone's gone completely Lihir crazy. Demand is over the top. It's gold, it's sexy and it's got that magic."

Action involving Ok Tedi has been in the courts. Broken Hill Proprietary (BHP), the Australian company that operates the mine, faced a A$4 billion ($3 billion) court case in Australia from landowners and villagers who claimed that pollution from the mine had seriously damaged the Fly river ecology and had hurt their livelihoods. BHP agreed with the government to pay A$110 million to landowners over the remaining 15-year life of the mine, and got a deal for the government to make it a criminal offense for anyone else to seek compensation from the company or to assist with any such legal action.

There was an outcry from environmentalists, in which U.S. activist Ralph Nader joined. "It's utterly breathtaking," said one of the lawyers contesting BHP. "It provides that if you go to court in any kind of action seeking damages or compensation relating to Ok Tedi, you're a criminal." Last month BHP was found guilty of contempt of court on the grounds that it had interfered with the administration of justice by denying villagers access to the courts.

At Lihir the Wild East seems rather tame by comparison. The mine has an estimated 42 million ounces of gold, enough for 36 years of production. RTZ, the multinational operating the mine and owner of a 23 percent stake, warns of the high degree of risk associated with mining projects, the difficult geology and the volcano where the mine sits. But the volcano is extinct — so far. EM

— Kevin Rafferty

Turkey

SPECIAL REPORT TURKEY

SUNDAY, OCTOBER 8, 1995 *EMERGING MARKETS IMF/WORLD BANK DAILY*

Ciller's Reappointment Fails to Calm Election Jitters Over Economy

BY JIM BODGENER

Turkey's economy faced the worrying possibility of early general elections following the resignation of Prime Minister Tansu Ciller on September 20 after the collapse of her weak coalition government. Economists fear election-year pressures will encourage inflation, which will defeat the main aims of an IMF-endorsed recovery program. Elections are not due until late 1996.

"Turkey's economic stability demands that determined policies should continue," Ciller stressed in an address the next day, just before her reappointment by President Suleyman Demirel. "At this stage, it would be quite wrong to create a preelection economy...what Turkey needs is not a preelection government but a government which will provide solutions."

Analysts feel nevertheless that early general elections now seem inevitable. But they also believe Ciller will struggle to hold out until next May, to safeguard Turkey's probable entry into an EU customs union on January 1, 1996, and firmly entrench a budget and economic program.

Two days prior to Ciller's resignation, the IMF released the fifth $116 million tranche of a $948 million standby facility first approved in July 1994. Ankara met end-June criteria in the extended program, fund officials stated, though stressing the combat against high inflation would continue, and also calling for progress in flagging privatization.

Notably, the first-half budget deficit at 153 trillion Turkish lira ($3.14 billion) came in under the IMF-agreed limit of 205.3 trillion lira at the end of June, registering a primary surplus net of interest payments. Budget deficits far outstripping targets have been the primary contributor to Turkey's corrosive inflation since the late 1980s.

However, some macroeconomic trends had taken a worrying turn. Recovery seemed to be overreaching the program's austerity, reflected in a soaring 12.4 percent expansion in GDP in the second quarter compared with April-June 1994, and a deep 6 percent contraction overall last year. Surging imports driven by rebounding domestic demand lay behind an 89.1 percent increase in the first-half trade deficit to $4.9 billion compared with January-June 1994.

> *"At this stage, it would be quite wrong to create a preelection economy."*

The inflation rate, after declining gradually from all-time January peaks, registered an unseasonal, late-summer upturn to 89.6 percent in consumer terms by the end of August. An acceleration during the month as well in lira depreciation on the forex markets threatened to breach staged limits agreed with the IMF.

The country's treasury had also entered a steep domestic debt servicing hump spanning August and September totaling around 209 trillion lira, fueling lira liquidity. Toward the end of August the central bank was forced by secondary market pressure to accept higher benchmark yields for interest rates at its regular auctions of government paper. Previously, it had managed an easing downward of yields from the first quarter onward, while deferring the roll-over of much of its onerous domestic debt totaling 1,800 trillion Turkish lira out of this year's budgetary accounts into 1996.

Record foreign exchange reserves, excluding gold, held by the central bank of around $15 billion could psychologically deter excessive speculation against the lira, and prevent any spiral from becoming a run on foreign currency like that that triggered the 1994 crisis. But on the IMF's advice, the central bank halted its previous reserve growth by a monetary squeeze including the temporary suspension of all its foreign exchange purchases, thus injecting lira liquidity. At the same time, the institution slapped in curbs on inflows of volatile, so-called "hot money," which in late 1993 had also contributed strongly to the early 1994 financial turmoil. Other measures such as hiked special fund levies on consumer credit were brought into cool the economy.

Though criticized by some as too abrupt, these measures bolstered the financial markets against the initial impact of the political upheaval. The central bank had taken the necessary measures to protect the lira from a major devaluation, said Cihan Pacaci, chairman and general manager of state-owned Ziraat Bankasi (Agricultural Bank). "There was an immediate shock that lasted for a few hours after the prime minister handed in her government's resignation, but the recovery was quick," he added.

The authorities have so far weathered the initial impact of the political changes. However, Ankara diplomats say the longer term outcome is still indexed to the date settled on for early general elections. EM



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Ciller: in...out...in

PRIVATIZATION IS STATE POLICY BUT PROBLEM IS IMPLEMENTATION

The fallout from the collapse of a weak coalition government probably means yet more delays for Ankara's ambitious but badly flagging privatization program. It seems more unlikely than ever that the government can meet year-end target for receipts from privatization of $2.7 billion. These have already been revised downward by 46 percent early this summer after a poor first-half performance.

"We are carrying on as normal," says a spokesperson for the government's privatization administration, OIB. "Privatization now is almost a state policy."

But independent observers say uncertainty while a new government is formed with early general elections on the near horizon could mire the program in bureaucratic inertia once again. Though privatization and rationalization of Turkey's top-heavy and loss-making state sector has been a key plank of free-market government platforms since the mid-1980s, progress has been erratic and slow. Under IMF tutelage following the economic crisis, however, the government finally managed to push a framework privatization law through parliament.

Its attached schedule envisaged the sale of state economic enterprises from refineries to banks, and included a massive telecoms sell-off. At the same time, at last there seemed to be a general public consensus following the economic crisis in 1994 that something needed to be done about the overweening state sector.

Yet many of the deals actually concluded in the first half aroused public controversy, particularly the sale of steelmaker Metas to Rumeli Celik Sanayi, owned by the Uzan family, notorious for asset-stripped past privatizations in the cement sector. The Metas deal was suspended recently through a court case brought by a rival bidder. Major deals remained stalled in September, snared by issues such as market versus book valuations and product pricing autonomy following sale — a key concern for telecoms.

One example is the protracted bidding for the government's 51.66 percent stake in the Eregli Iron and Steelworks, for which opening bids in late spring ranged between $180-300 million. The company's first half profits might look impressive at around 6.5 trillion Turkish lira. However, Turkey's accounting regime permits the impact of interest payments and depreciation in a $1.5 billion capacity improvement and expansion program since the early 1990s to be deferred into 1996.

Recently, the OIB has managed to sell more cement plants, and finally the first state bank, Sumerbank, after three unsuccessful attempts. But OIB chairman Ufuk Soylemez admitted in mid-August that legal and infrastructural problems might delay further sales until early 1996.

Many doubts about Turkey's privatization program might be assuaged by a decision on Eregli and the appointment of a consultant from a short-list of six groups of merchant banks and other institutions for the telecoms sale. It is expected to raise much of the overall $20 billion target for receipts in 1996. But how far any government will push politically sensitive privatization deals during an election year is debatable. EM

—Jim Bodgener



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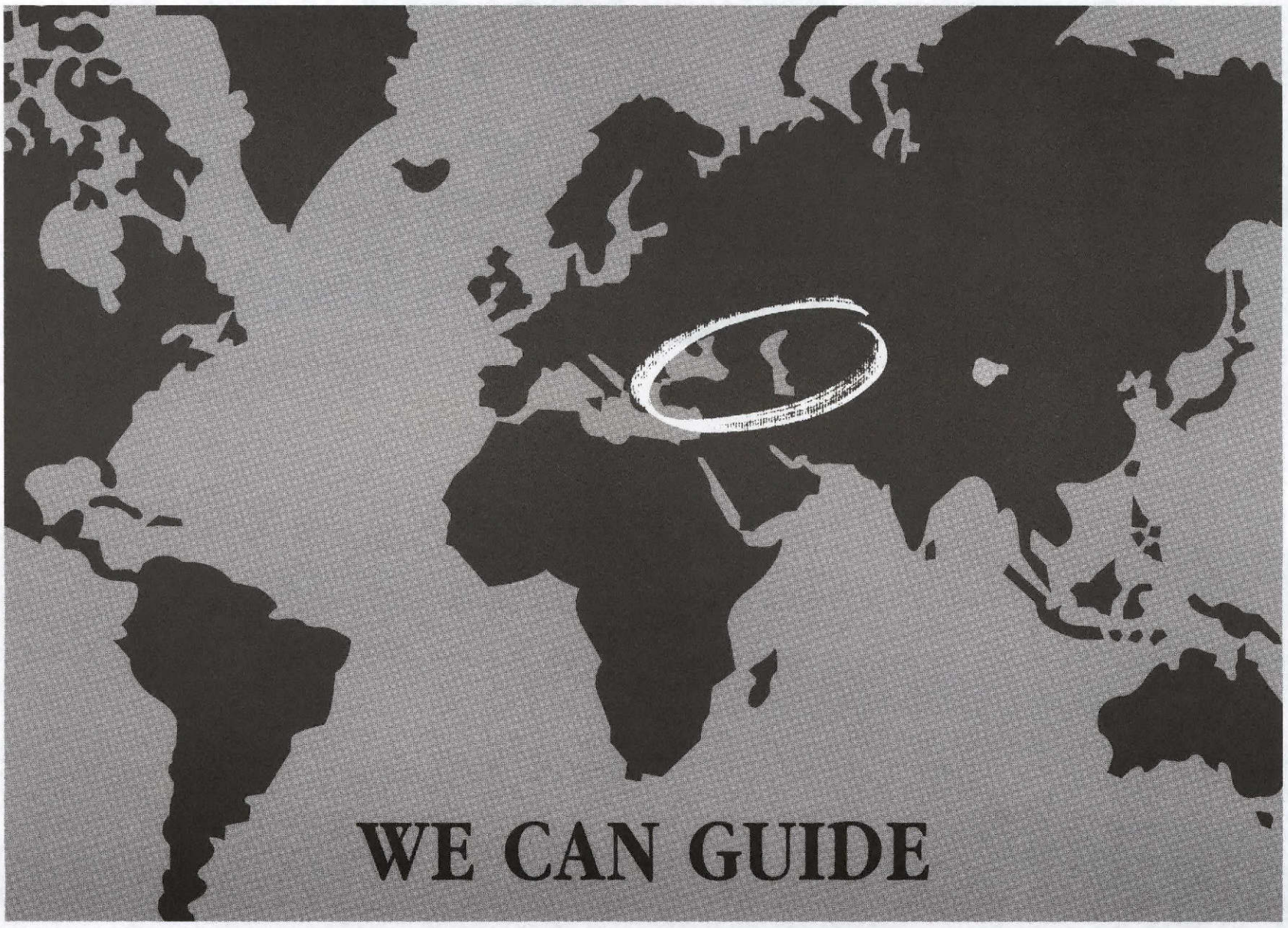

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Istanbul Exchange Prospers Despite Political Turmoil

BY JIM BODGENER

Turkey's capital markets met the collapse of Prime Minister Tansu Ciller's weak coalition government with a resilience imbued by rapid expansion and diversification since the late 1980s. Worst-hit was the Istanbul Stock Exchange (ISE), but it recovered quickly as foreign funds and institutions in search of blue-chip bargains waded back into the fastest growing emerging market globally.

"You can't do badly in this market," says Mehmet Kutman, chief executive officer of Istanbul-based brokerage house Global Securities. "The future is very bright." In the first-half the ISE, with its 76.96 percent increase in its index of 100 leading shares, led the 44 members of the Federation of International Stock Exchanges in terms of price rises.

Trading at around eight times 1995 earnings, the market is still extremely cheap, Kutman believes. A $2 billion corporation, the Koc Group, was rated by the market according to its parent Koc Holding's share price at only $1.2 billion, he points out. On average, and forgetting a lost year during economic crisis in 1994, average earnings to mid-September this year had grown by around 30 percent when compared with 1993, he said.

This was despite the fact that the ISE languished in summer doldrums under clouds of political apprehension, and in the early autumn under fears of rising interest rates as the central bank tightened monetary policy to curb rising inflation and accelerating lira depreciation on the foreign exchange markets.

"The equity market is going to be really volatile in the last quarter of the year," however, warns Volkan Sari, assistant director of Global Securities.

How the bourse could perform in the right and stable conditions was amply demonstrated in a bull run from February to mid-April, when yields from stocks and shares outpaced other short-term investment avenues such as foreign exchange. The ISE index soared to an all-time peak, nudging 55,000 on daily trading volumes over $400 million.

Even the level of around 41,000, at which the index emerged from the political crisis on September 23, was 49 percent up from the start of 1995 and 67 percent up in year-on-year terms. The market capitalization likewise had expanded by 16 percent in the year to date in U.S. dollar terms to reach $25.3 billion.

The ISE was buoyed during the summer by a flurry of initial public offerings, notably of Bossa, Turkey's largest vertically integrated textile manufacturer and a subsidiary of the leading Sabanci industrial and banking conglomerate. Since the end of 1994, the number of listed companies on the exchange's national market has grown to more than 190 from 180.

Despite suffering through last year's economic crisis, the exchange has, over the past 18 months, developed considerably under its chairman, Tuncay Artun. Introduced last year were separate morning and afternoon sessions and two instead of one day settlement terms, mainly for the benefit of foreign investors in different time zones. The fully computerized trading system installed last December has boosted daily volumes.

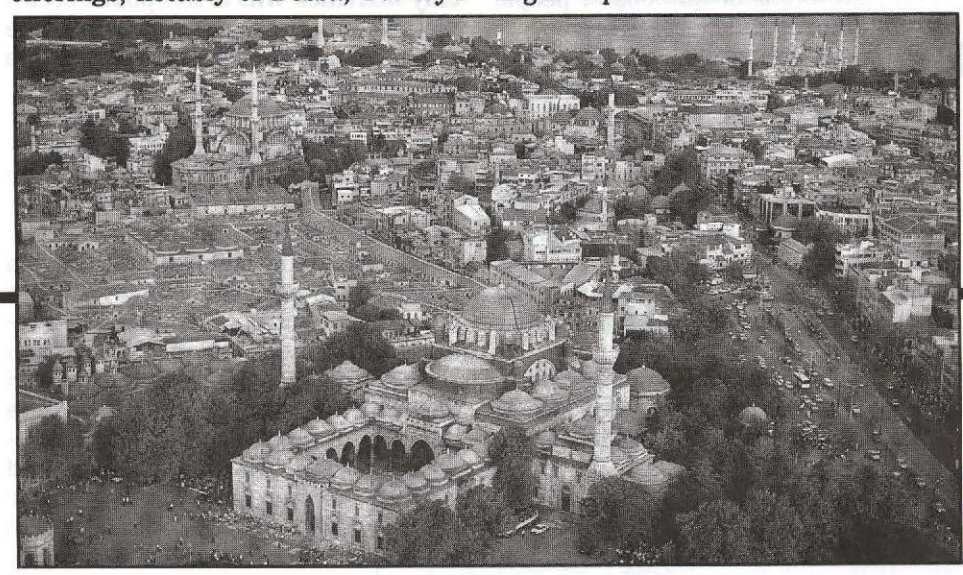
On May 16, the exchange moved to a new, modern premises in the suburb of Istinye. The facility has around 800 screens on two trading floors, compared with only 450 screens in the exchange's previous congested floor in its old building at Tophane near the docks.

The ISE also launched a new companies market in the spring for securities issued by firms with no historical data, to add to the national market and a regional market catering to companies with a strong provincial interest. Sometime in 1996, the ISE plans to open a futures and options market where securities initially will be index-linked to the above three arenas.

A secondary market for government and corporate bonds operates under the ISE's roof, as does trading in reverse-repurchases (repos). In fact, the latter's daily trading volume of around $600 million outstrips equities, while that for bonds and bills averages between $150-200 million. Compared with volatile equities, investment in treasury bills, despite short-term corrections, will give a real return so long as the paper matures before March, after which early general elections could lead to a crash, says Sari.

The ISE also aims to become a regional hub for emerging markets. On the same day as the move to Istinye, the exchange presided over the founding charter of a Federation of Euro-Asian Stock Exchanges, which initially is working towards the standardization of listing, trading and disclosure regulations, and eventually cross-listings.

Next will be the establishment of an international market probably toward the end of the year. Operating on a tax-free, dollar-denominated basis, the international market will serve as a conduit for investors to less-developed regional markets like those in Central Asia. EM



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Istanbul

A Prodigal Returns to the International Markets

One of Turkey's success stories this year has been a managed return to the international lending markets. The return comes after more than a year of deliberate absence by both private and public sector borrowers during economic crisis. By the end of September, the country's treasury had raised most, if not all, of the $2 billion required in 1995 for a total external debt-servicing bill of around $6 billion.

At the same time, the treasury has been careful not to soak up all the revived appetite for Turkish risk. "We don't want to squeeze every penny from the markets," says Aydin Karaoz, the treasury's general director of foreign economic relations, and the man in charge of its foreign borrowing program.

"Six months ago, Turkey was trying to borrow as much as it could, and now they're saying, 'Sorry guys.'"

Indeed, a yardstick of market demand for Turkey's revived creditworthiness has been the oversubscription of most facilities. At the same time, interest rates have fallen on both public and private sector facilities since the treasury reopened the international markets in April with a $500 million, three-year syndication with an average life of two years. Before September's political crisis, terms were approaching levels attained during a boom in 1993 for external loans contracted by Turkish borrowers.

The all-in cost of a $300 million, three-year Eurobond launched and placed by lead manager J.P. Morgan just before September's domestic political crisis is around 300 basis points above the London interbank offered rate (Libor), compared with 345 basis points for the April door-opener.

Generally, private sector institutions have been able to obtain better all-in costs including fees than state borrowers. Although a $75 million loan for the private Kocbank pays the same margin of 75 basis points over Libor as a loan for the state-owned soil products office (TMO), the all-in costs on the Kocbank deal work out at around 100 basis points, and for the TMO deal at around 110 to 115 basis points over Libor.

However, international appetite for private sector risk is still restricted to the short one- to two-year terms, and for state institutions backed by the republic's sovereign guarantee to around three years. This is not expected to change until the political outlook stabilizes, says a Western banker based in Istanbul.

The impact of Prime Minister Tansu Ciller's resignation was immediately registered by a hike in the secondary market pricing of the Eurobond placed only a day before to U.S. treasuries plus 340 basis points. However, two days later the rate had settled back to around 300 basis points.

Some difficulties from heightened political risk could be experienced for further short-term trade-financing facilities, say Istanbul bankers. But most regular borrowers have already sourced their requirements.

And just prior to the government's collapse, the central bank effectively shut the door on new private borrowers by raising special fund levies to 6 percent temporarily on short-term, external borrowing to curb inflows of volatile so-called "hot money." "It's amazing that only six months ago, Turkey was trying to borrow as much as it could, and now in effect they're saying, 'Sorry guys,'" said Anjum Iqbal, general manager of Citibank in Istanbul. EM

— Jim Bodgener

Featur

RYRIE'S BOOK NO GIVEAWAY AT $65

Sir William Ryrie's experience with his book *First World, Third World* (St. Martin's Press; Macmillan in the U.K.) suggests that private enterprise publishing has become all too bureaucratic, if not sclerotic. Surely even a half awake publisher would seize the opportunity of selling such a challenging and controversial book at the World Bank meeting. Instead it will come out on October 26, two weeks after everyone has departed. By then the dust of his controversial arguments will have settled. And the price, a hefty $65, ensures that it won't be read by too many of the lefty radicals who would challenge his promotion of the private sector.

DEVELOPMENT ASSISTANCE

Part I: Aid Has Lost Its Way

BY KEVIN RAFFERTY

The principles and policies of official development assistance — ODA or aid — need to be completely rethought. Aid should be redirected away from governments — which have wasted too much money — and towards the private sector. Aid can be harmful if it supports bad anti-market policies involving state ownership and control. Africa in particular may have been given too much aid, which has simply been frittered away. Apart from relief supplies to avert famine or clean up after natural disasters, aid should not be a subsidy but should have the character of investment. The objective of all aid must be self-reliance, not dependence.

These challenging assertions, which are likely to provoke intense argument in Washington and capitals around the world, come from Sir William Ryrie, former British official and chief executive of the IFC, now vice chairman of Baring Holding Company. He has written them in a book, but also took time out from his London office overlooking insurers Lloyd's of London to expand on his views developed over a lifetime as a national and international civil servant.

He sets the scene by pointing out in his blunt Scottish way that, "International aid is in crisis." There is a mixture of disillusion and cynicism about aid. The challenges come from several directions at once, and from critics many of whom are violently opposed to one another.

From the political right, there are demands to reduce or stop aid completely, either because donor countries have enough problems of their own — "charity begins at home" — or because aid is harmful because it conflicts with sound economics. From the left, there is opposition to the big aid-giving institutions as agents of capitalism trampling on the Third World and the poor, and to aid itself for lining the pockets of corrupt dictators. Radicals would like to cut out governments and to channel money directly through non-governmental organizations (NGOs) which are in direct touch with the poor. Environmentalists feel so strongly about aid being provided to build dams that they have resorted to direct action (including disrupting the opening ceremonies of the IMF/World Bank annual meetings last year in Madrid by raising a banner and showering the King and Queen of Spain with fake "dollars for destruction").

Aid may be unpopular, but the aid business, Ryrie wryly observes, is booming and provides jobs to thousands of people in governments, the international financial institutions, universities and think tanks galore and in a proliferation of NGOs of all sizes and causes under the sun.

He disagrees with the critics, including former London School of Economics professor Lord Bauer, that aid is economically bad. Interestingly, though, the first of his "21 propositions about aid and development" gives the moral case for aid prime importance: "There is a strong moral and political case for the rich countries of the world to try to help the poor countries of the world achieve higher standards of living and reduce poverty." But Ryrie is appalled by the waste and at the fact that 50 years after the World Bank was founded and so many billions of dollars of aid have been spent, hundreds of millions of people are marooned in abject poverty.

His solution, probably not surprising for someone who for nine years was head of the IFC, the World Bank's arm dedicated to promoting private enterprise, is that the main thrust of aid must be to build up markets and develop entrepreneurs. This of course invites the question that if private enterprise and markets are so good then why distort them by providing aid?

His faith in markets is neither absolute nor blind, and indeed as a former senior British treasury official, Ryrie appreciates the powers and the limitations of governments. "Efficiency and fairness in a market economy require the role of the state to be well defined and competently performed. While keeping out of decisions which should be left to the markets, the state must provide the framework within which the market economy can work, including infrastructure and essential services, legal and regulatory systems and a sound macroeconomic policy," he argues. Nevertheless, he concedes, "The unfettered play of market forces can cause social problems which are more difficult to deal with in poor countries."

> *"Aid can do harm by creating a mentality of dependency or pauperization, as appears to be happening in much of Africa now."*

Extremes of wealth and poverty should be curbed, but by increasing the productivity of the poor rather than by subsidy, urges Ryrie. When push comes to shove, "reducing poverty is more important than equalizing incomes."

His conclusion is that, "As a general rule, all aid [apart from disaster relief] should take the form of investment designed to increase productive capacity and contribute to faster growth." He leaves room for aid to governments, "provided it supports the growth of a market economy, and is highly selective. As a rule such aid should support only activities which the public sector will not or cannot do, or where there are compelling reasons why the state should undertake them."

This does not mean, adds Ryrie, that aid cannot be provided to governments, but that extreme care must be taken. "Investments in the public sector need to be appraised with particular rigor to make sure they will earn a proper return for the country." What is a proper return, he admits, is sometimes a tricky question. "Where you are dealing with commercial projects the return on that is genuine. There has been a great deal of soft calculation, wishful thinking and ex-ante optimism, and we have to be much tougher [in assessing rates of return]."



©RAFOTO

Ryrie: sure to provoke argument round the world

Because Ryrie was a lifetime bureaucrat, the vigor with which he asserted private enterprise as the flagship of development surprised many of his World Bank colleagues. "He was the archetypal colonial civil servant and mandarin before he came to the World Bank, so it might be regarded as a Damascene conversion, but Bill Ryrie was the most energetic head that IFC has ever had," recalls a long-time bank official. "He was so successful a salesman for private enterprise that it helped the bank's cause with the U.S. administration, though it provoked rivalry among some people in the bank itself who thought that he had too much power and was setting IFC up in opposition to its parent."

This energy perhaps should not come as such a surprise. Ryrie's career indicated a hard-driving and ambitious man, but one who had much to be ambitious about given his proven track-record in bureaucracy and knowledge of the way the world worked. He was born in Calcutta, then part of the British Raj. He spent time in Malaya as a young army officer doing national service before joining the colonial office and being posted to Uganda, and then to the international relations department in London. After Prime Minister Harold Macmillan's "Winds of change" speech, it was clear that the British colonial empire did not have long to live, and Ryrie made the considerable leap to the treasury. There he distinguished himself sufficiently to become second permanent secretary and thought to be heading for the very top until he clashed with Prime Minister Margaret Thatcher — in itself a considerable claim to fame.

But if aid in general gets Ryrie's blessing, then he also draws stern attention to the waste and calls for a reassessment of principles and more discipline in its provision. "The market philosophy requires that the intellectual basis of aid activity be reexamined. The doctrinaire view that any kind of aid is inconsistent with market principles is wrong; but misguided forms of aid can retard the development of a market economy... Aid can also do harm if it continues for long periods in large amounts by creating a mentality of dependency or pauperization, as appears to be happening in much of Africa now."

He contrasts "the spectacular success in some countries in the Far East, moderate success in places like India — where you can argue that the failure has been due to excessive heavy-handed state intervention and control — and spectacular failures in Africa."

He issues a clarion call for a rethink: "I believe the whole aid business has lost its way. They don't know what they are driving at or what their objectives are. They have not really criticized themselves properly. Africa has had enormous quantities of aid and has achieved terribly little. [It is important to rethink] the philosophy of the right role for the state and be far stricter. That would mean a reduction in aid to Africa. I don't go along with those people who say that Africa is in a mess and needs more, more, more. People have been saying that for 20 years and the situation has been getting worse. It is time to ration aid to countries [that don't follow the prescriptions]." EM

Next — Part II: A World Without Aid

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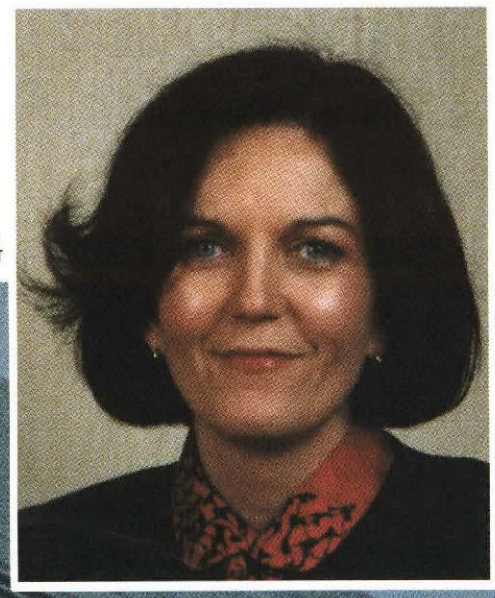

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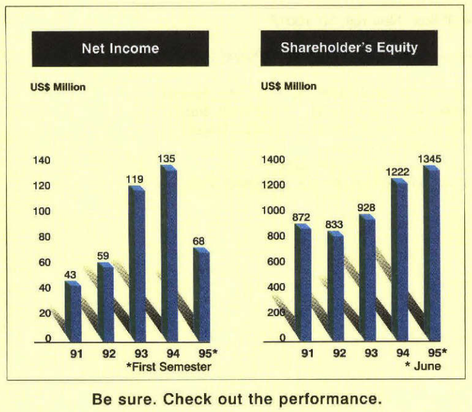

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Features

Part I

Challenge to THE SYSTEM

JIANG STRUGGLES TO BE FIRST AMONG EQUALS

BY TONY WALKER

When Deng Xiaoping turned 91 in August newspapers and magazines in the West marked the anniversary in a way that has become something of a ritual. Deng's birthday provided not so much a moment for celebration of the old man's accomplishments, but an occasion to pose the perennial question: what of China after Deng?

Seventeen years after Deng launched China's economic revolution his symbolic importance to the success of the enterprise remains critical, but his ability to influence events is much diminished. Old age and bad health have taken their toll.

But there is also no doubt that Deng's looming departure from the scene — what he describes as his meeting with Karl Marx — will provide a historical watershed in the world's most populous country and fastest-growing major economy.

The end of a dynasty approaches and uncertainty surrounds the capabilities of Deng's successors. China is moving from rule by those who launched the revolution to a new, more technocratic cadre. In some ways, the situation is similar to that which prevailed in the Soviet Union when the apparatchiks took over.



©SYGMA

Deng: waiting to meet Marx

China's new rulers lack the revolutionary credentials of their predecessors, and will have to find other ways to shore up their authority. In this, they will be under considerable pressure to continue delivering improving living standards, and perhaps more critically to find ways of marrying economic liberalization with gradual political relaxation.

The next period in China is likely to prove highly testing for the new generation of leaders, who are now being openly referred to in the Chinese media as the "third generation": late Chairman Mao Zedong and Premier Zhou Enlai represented the first, Deng Xiaoping the second and Jiang Zemin, the current president and general secretary of the Communist Party, the third.

"China after Deng?" The question implies an abrupt moment in troubled Chinese history, but as the shadows over Deng Xiaoping's lingering departure lengthen the odds on a relatively smooth transition shorten.

There is no reason to believe that any significant disruption will accompany Deng's demise; although it would be surprising if differences within the leadership group do not surface sooner or later. Disagreements over the pace of liberalization, not to mention the ebb and flow of personal ambition, will inevitably cause tensions.

After Mao's death in 1976, his designated successor, the dour Hua Guofeng, remained in office for about four years before being swept away by the reformists. Will those anointed to succeed Deng fare better, and more importantly, will Dengist policies of reform and opening remain intact?

At this point, the chances of a collective post-Deng leadership under Jiang staying the course until early in the next century would appear to be reasonably good, assuming that China's economy continues to grow rapidly, and inflation can be curbed.

Much hope for an orderly transfer is being pinned on factional balance in the leadership — between those who might favor speedier reform and those worried about the risks to continued communist rule posed by the liberalization process.

At the head of the collective, what Chinese refer to as the "core" of the leadership, Jiang Zemin appears to have strengthened his position in the past year or so, weeding out opponents and promoting supporters.

He has also been cultivating the military, an acknowledgment that no Chinese ruler can hope to retain control without the strong backing of the army. In the case of Deng, who had served as a battlefield commander in the revolution, this was his by divine right.

But for Jiang such support cannot be taken for granted, hence his conspicuous efforts as chairman of the central military commission (he holds this position concurrently with that of president and Communist Party chief) to secure the loyalty of senior military commanders. In this, he appears to have made headway, and can count among close allies Chi Haotian, the defense minister.

General Liu Huaqing, the senior military figure on the seven-member standing committee of the ruling politburo is also a supporter, calling in recent speeches on the army to guarantee stability in this next phase.

Jiang Zemin may have appeared like a stop-gap figure when he took over as head of the Communist Party in 1989 after the sacking of Zhao Ziyang — who was deemed to have been too lenient with pro-democracy agitators — but he now appears to have settled more comfortably into his task.

That said, it is most unlikely that he will prove to be a "strongman" in the post-Deng era. He will serve as "first among equals," and his survival will depend on China's continued economic success.

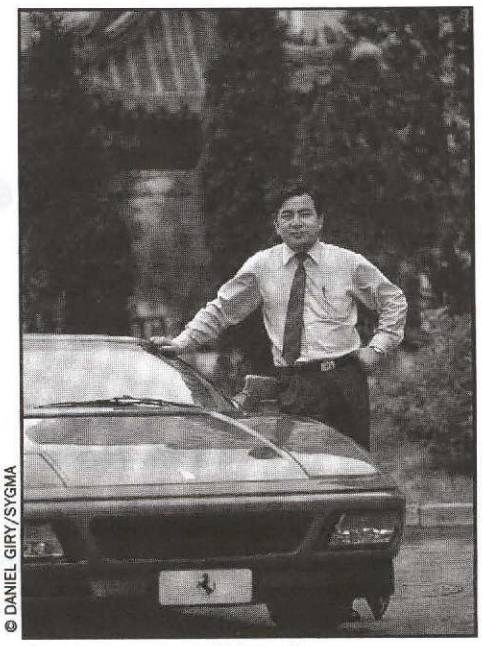
Among risks is that a nervous leadership group in the new era will place such a high premium on internal stability that it will shy away from continuing the process of reform and opening initiated by Deng. Change inevitably creates its own tensions, but to stand still carries greater risks.

The situation is similar to that which prevailed in the Soviet Union when the apparatchiks took over.

China appears set on a course of sweeping market-based economic reforms, but serious structural problems in the state sector, where about half of all government-owned enterprises are losing money, are proving a drag on the reform effort.

The authorities have quietly designated 1,000 key enterprises, among more than 14,000 medium and large state-owned firms, that are to be nurtured, but these reforms are being implemented gingerly because of concerns about growing unemployment in China's northeast industrial heartland, and in industrialized Yangtze river towns like Wuhan and Chongqing.

Among other significant challenges to central authority is the growth of regionalism — the increasing strength and autonomy of wealthier coastal provinces like Guangdong and Fujian in the south, Jiangsu and Zhejiang in the center, and Shandong in the north.



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Some are more equal than others

The growing economic power of the regions has prompted a number of scenarios predicated on the belief that the power of the center will weaken in the face of strong regional challenges, leading eventually to the breakup of the state. But chances of this happening appear slim, unless the Communist Party goes the way of its counterpart in the former Soviet Union.

While the party may be held in generally low esteem, and be regarded as a corrupted instrument of power, there is no obvious replacement except chaos, and that is something most Chinese fear more than anything. In the absence of a credible rival, the party probably has time to reform itself and the system, but whether it has either the will or the ability to do so is another matter.

The death of communism as such has left China without a guiding ideology, and Chinese leaders have been seeking alternatives. Jiang Zemin himself has been flirting with Confucianism as a means of providing respectability for an oriental-style authoritarianism along the lines of Singapore, and South Korea and Taiwan in the earlier stages of their political development.

But this approach cannot be more than a stop-gap measure. If it continues to open to the outside world and liberalize its economy, China cannot put off indefinitely genuine political reform — as opposed to the present tinkering with the system. EM

Next: Part II — Democracy Still Defied

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Features

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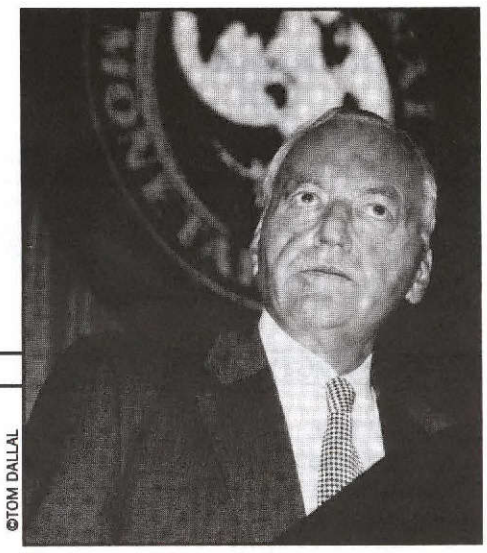
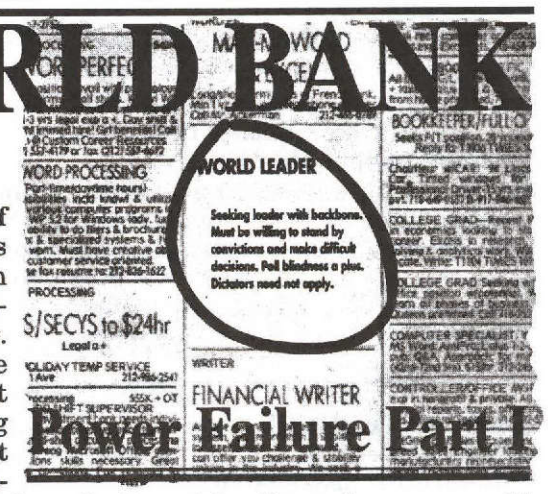


Preston: samizdat cartoons

THE FUTURE OF THE WORLD BANK



Power Failure Part I

BY MICHAEL PREST

James Wolfensohn is more than half way through the six month public silence about the World Bank's future he declared on becoming president. Recusing himself from public comment until he knew more about the bank's byzantine intricacies was wise. But as he has doubtless been learning, grasping the future of the bank is like chasing soap in the bath.

It is a slippery task principally because there is no agreement on the purpose of the bank, let alone how it can fulfill that purpose. Neither the bank shareholders, its member countries, nor its critics, who have gone strangely quiet of late, can reasonably claim to have mapped out a convincing future for one of the international system's vital organs.

There is much more agreement on the problems, however. Leadership tops the list. The main reason for the bank's prolonged drift into the 1990s is that nobody has really been in charge. The bank's shareholders should be the defining influence, but the swelling membership, the general decline of American leadership (its voting share in the bank has declined from about 40 percent to 17 percent), and the increasing power of developing countries in the bank's councils have fragmented the owners.

The bank's presidents — from whom staff expect leadership — have not been much better. When I joined the bank in 1990 many colleagues still harked back nostalgically to the halcyon days of Robert McNamara, although he retired in 1981. Poor Tom Clausen was already airbrushed like Trotsky from the collective memory. Barber Conable, whatever his virtues, was identified as the author of the disastrous 1987 reorganization.

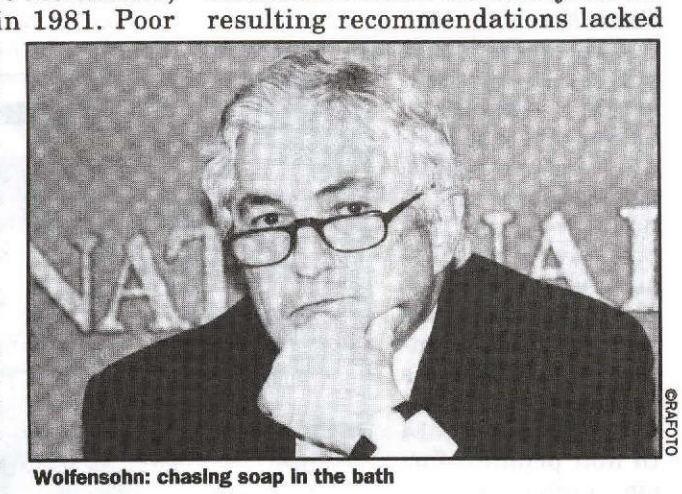
That McNamara could be a tyrant, and that his Ford Motor Company approach to rolling the loans off the production line underlay many of the bank's present difficulties, were beside the point. Bureaucrats want to be led. What is the point of a hierarchy without a leader? Unfortunately, the reserved Lewis Preston was not the right man to stamp his authority on the bank either. It wasn't for nothing that samizdat cartoons circulated asking "Where's Lew?"

The result has been that the inmates were running the asylum. Some senior staff appear to have forgotten that they are international civil servants and not feudal lords squabbling over territory and taxes. In effect, as Wolfensohn has shrewdly observed, for several years the bank was run by Ernie Stern, latterly in theory just one managing director among three, through a series of bilateral relationships.

Everyone agrees on the problems — but when the most important problem is leadership, who will lead the way to a solution?

Lack of leadership has contributed greatly to low staff morale, depressed in any case by the Chinese water torture of external criticism. Plain mismanagement and the current wave of redundancies, which will cut the number of regular and fixed-term staff by about 10 percent, have further eroded the internal social compact.

In important respects, however, these difficulties of leadership and definition only reflect immense changes in the world. Research commissioned by the bank on public attitudes towards it — an unprecedented and welcome move — revealed the institution as identified with an old and discredited syndrome of aid, dependency and sclerotic government. The bank was not seen as an agile, innovative agency able to help its clients manage change in a new world of rapid technological advance, fast moving capital, and the information revolution. Neither the survey nor the resulting recommendations lacked political guidance, but the portrait painted is a sufficient likeness — and widely recognized by staff — to guide the reshaping of the institution.



Wolfensohn: chasing soap in the bath

What then should Wolfensohn do when his six month's purdah are up? First, he should make very clear who is boss. All incoming presidents enjoy a brief respite from a staff accustomed to considering its duty to be protecting the institution from interlopers. Wolfensohn needs to assert his authority over the organization, if necessary by moving and removing senior managers. Staff will welcome the smack of firm government. So will shareholders, who are desperately looking for someone to take responsibility.

Second, Wolfensohn must carry the staff with him. His campaign to win hearts and minds by meeting staff and traveling to far-flung outposts is an excellent start. But individual energy — however frenetic — is no substitute for systematic communications, internal and external. If bank staff feel that their view is not being effectively presented externally, hearts and minds will not be won.

Third, by establishing leadership and commanding support, Wolfensohn can set about transforming the bank into a 21st century organization. At the moment, it feels almost Victorian in structure and culture, characterized too often by an old-fashioned public sector ethos of process and production instead of creativity and the customer. Its attempts to exploit information technology have been slow, mismanaged and unforgivably costly. But just as market forces have driven many corporations to adopt less rigid structures and working practices, so the bank must become more flexible and responsive, breaking down the hierarchy which impedes serving the customer in the information age.

And fourth, Wolfensohn must focus the bank's resources on clearly articulated objectives. Proclaiming a commitment to reduce poverty is not enough; the question is how. Contrary to what many people think, the bank's most valuable resource is not the $180 billion of authorized capital. It is the skill, experience and knowledge of bank staff. The paradox of the bank not looking like an information-age organization is that it is quintessentially an information organization. Wolfensohn's priority should be to mobilize this tremendous asset.

Certainly, it can be focused on the traditional lending business. But that business is in relative decline. Capital is available from other sources, and the bank's lending portfolio is distinctly mature. A far more inventive use of the bank's huge information resources would be to carve out a much bigger role as a prime provider of advice and expertise to members, including industrial countries to whom recent bank reports on subjects as diverse as education, health and financing old age have applied almost as much as to developing countries.

Recasting the bank as a global management consultant is not simple. It takes the bank into new areas of competition, raises tricky questions about how to charge for services which at the moment are financed by the spread on loans, and challenges deep-rooted definitions of work and success in the organization. But members such as Chile and South Africa have already effectively told the bank that they want its memory rather than its money. If the bank is to remain competitive and useful to its members, it must respond to market demand.

Wolfensohn is no slouch, and he has already taken steps in this direction. Recently he has set up two "change committees," which released a brief report in September — in time for these meetings. One committee, run by Johannes Linn, vice president for financial policy and resource mobilization, and Russell Cheetham, vice president for East Asia and Pacific Region, was charged with reporting on "professional excellence." The other, overseen by Jean-Francois Rischard, vice president for finance and private sector development, and Caio Koch-Weser, vice president for the Middle East and North Africa region, has looked at the results, responsiveness to clients, and responsibility for decisions.

Official emphasis is being placed on results rather than process. Goaded by the board of executive directors and external critics, staff are increasingly aware that justifying generous benefits and tax-free salaries will become harder if the institution is regarded as failing to meet its members' needs.

Time is short, however, and the bank is not known for being fleet of foot. Wolfensohn, a denizen of the private sector, has made little secret of his exasperation with the bank's more hidebound ways. Indeed, he has warned that the bank risks slipping into irrelevance if it does not change. He is right. But only he can catch the soap. EM

Next: Part II — West Found Wanting in Bosnia

Hotel Guide

ANA HOTEL
2401 M Street NW
Phone: (202) 429-2400 or
(800) 228-3000
Fax: (202) 457-5010

415 rooms, including 10 suites and 29 mini-suites. Business facilities: 16 meeting rooms, including a 5,400 sq. ft. ballroom, a 186-seat auditorium, six hospitality suites and an outside courtyard for receptions; multilingual staff; child care and transportation available; full service business center with one secretary and two IBM PCs (8:00am-5:00pm Mon-Fri, extended hours during the meeting). Health club facilities: sauna, steam room, jacuzzi, racquetball and volleyball (Mon-Fri 6:00am-10:00pm; Sat-Sun 9:00am-7:00pm); 52 ft. lap pool; exercise room with full array of equipment.


The Ritz-Carlton

THE CANTERBURY
1733 N Street NW
Phone: (202) 393-3000 or
(800) 424-2950
Fax: (202) 785-9581

99 rooms: all junior suites. Business facilities: three conference rooms, 10 to 30 people; limited front desk business services, otherwise guests are referred to a sister property, the Hampshire Hotel, which has office facilities available 24 hours. Health club facilities: complimentary guest passes to adjacent YMCA/Capital Health Club. Indoor track, fitness center, raquetball, squash courts available (Mon-Fri 7:00am-1:00pm; Sat-Sun 9:00am-9:00pm); pool; exercise room with universal weights, nautilus, treadmills, stairmasters, stationary bicycles, free weights, etc.

CAPITAL HILTON
16th and K Streets NW
Phone: (202) 393-1000
Fax: (202) 639-5784
Telex: (710) 822-9068

541 rooms, including 25 suites. Business facilities: 11 meeting rooms (six to 1,200 people); multilingual staff; child care services available; airport shuttle service; business center (8:30am-5:00pm). Health club facilities: Exercise room with state-of-the-art equipment, cardiovascular room and steam room (Mon-Fri 6:00am-10:00 pm).

THE CARLTON
923 16th Street NW
Phone: (202) 638-2626
Fax: (202) 638-4231
Telex: 440650

193 guest rooms, including 12 suites. Business facilities: nine meeting rooms from 650 to 2,500 sq. ft. (total of 10,000 sq. ft. for groups from 40 to 500 people); multilingual staff; valet parking; full 24-hour concierge; complete business services including translation, copying, secretarial services, computers and faxes. Health club facilities: fitness center with computerized treadmill, stationary bicycles, rowing machine, stairmaster and free weights (24 hours); access to University Club (1.5 blocks away): full-length pool (25 meters long; five lanes); large exercise room; sauna, steambath and whirlpool. Other facilities: All rooms are soundproof and come with safes, honor bar, and three direct-dial telephones with call waiting and voice messaging system; 24-hour in-room dining; traditional tea is served in the tea lounge (3:00-5:30pm); Allegro Restaurant offers continental cuisine for breakfast, lunch and dinner daily, and special Sunday brunch; Allegro Bar offers evening entertainment.

SHERATON CITY CENTRE
1143 New Hampshire Avenue NW
Phone: (202) 775-0800
Fax: (202) 775-6953
Telex: (710) 822-9209

353 rooms, including kings, queens, double-doubles and 18 suites. Business facilities: 12,000 sq. ft. of meeting rooms; multilingual staff; a list of recommended sitter services available; underground parking; business center. Health club facilities: newly added health and fitness center available.

DUPONT PLAZA
1500 New Hampshire Avenue NW
Phone: (202) 483-6000 or
(800) 841-0003
Fax: (202) 328-3265

220 one-bedroom rooms, 94 two-bedrooms. Business facilities: audio-visual convention facilities available; nine meeting rooms (up to 400 people); translation services can be provided; business center and child care services available. Health club facilities: complimentary passes to YMCA (three blocks away); full-service club with pool, nautilus, universal weights, stairmasters, aerobics and lifecycles.

EMBASSY INN
1627 16th Street NW
Phone: (202) 234-7800 or
(800) 423-9111
Fax: (202) 234-3309

38 rooms: 35 doubles, three twins.

EMBASSY ROW HOTEL
2015 Massachusetts Avenue NW
Phone: (202) 265-1600 or
(800) 424-2400
Fax: (202) 285-1600

195 rooms: 161 doubles; 33 suites. Business facilities: audio-visual convention facilities; five meeting rooms (10-300 people); no translation services; limited business services at front desk; business center and child care services available. Health club facilities: newly added fitness center.

EMBASSY SQUARE SUITES
2000 N Street NW
Phone: (202) 659-9000 or
(800) 424-2999
Fax: (202) 429-9546

255 suites. Business facilities: meeting rooms (30 to 100 people); business center available; limited front desk services. Health club facilities: pool; exercise room with stairmasters, bicycles, Nautilus, step aerobics (6:00am-10:00pm).

EMBASSY SUITES DOWNTOWN
1250 22nd Street NW
Phone: (202) 857-3388 or
(800) 362-2779
Fax: (202) 293-3173

318 rooms: 293 one-bedroom suites; 15 one-bedroom executive suites; five one-bedroom deluxe suites; three one-bedroom boardroom suites; two two-bedroom suites; four suites contain business centers (fax, computer). Business facilities: eight meeting rooms (14 to 300 people); foreign exchange; business center available; limited front desk business services. Health club facilities: sauna, jacuzzi (6:00am-11:00pm); pool; exercise room with stairmasters, rowing machines, treadmills, universal weights, lifecycles and free weights.


The Grand

THE FOUR SEASONS HOTEL
2800 Pennsylvania Avenue NW
Phone: (202)342-0444 or
(800) 332-3442
Fax: (202) 944-2076

196 rooms: 166 one-bedroom suites; 30 luxury suites. Business facilities: audio-visual convention facilities available; six meeting rooms (up to 800 people); Japanese, French, German, Swahili and Spanish translation available; foreign exchange; baby-sitting available (bonded); complimentary limousine in D.C. (Mon-Fri 8:00am-8:00pm); business center available; limited front desk services. Health club facilities: jacuzzi, steam room, sauna (6:00am-9:00pm); large lap pool; exercise room with stairmasters, lifestyles, treadmills, nautilus, universal weights, and bicycles.

THE GEORGETOWN INN
1310 Wisconsin Avenue NW
Phone: (202) 333-8900 or
(800) 424-2979
Fax: (202) 625-1744

95 boutique-style rooms; 10 one-bedroom suites. Business facilities: one boardroom (up to 22 people), one meeting room (up to 100 people, theaterstyle); business center and child care services available. Health club facilities: fitness center available. Other facilities: continental breakfast; daily *Washington Post* delivery; turn-down service.

THE GRAND HOTEL
2350 M Street NW
Phone: (202) 429-0100 or
(800) 848-0016
Fax: (202) 857-0127 or
(202) 429-9759
Telex: 904-282

263 rooms: 200 singles; 18 double-doubles; 31 one-bedroom suites; two

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SANTIAGO DE CHILE

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Hotel Guide

two-bedroom suites. Business facilities: audio-visual convention facilities available; seven meeting rooms (11,500 sq. ft.; up to 300 people); bilingual staff; child care and business center available; limited front desk services. Health club facilities: nautilus, aerobics, treadmills, stairmasters, etc. (24 hours). Recently updated.

DOUBLE TREE GUEST SUITES
(Two locations)
2500 Pennsylvania Avenue NW
Phone: (202) 333-8060,
Fax: (202) 338-3818
801 New Hampshire Avenue NW
Phone: (202) 785-2000, F
ax: (202) 785-9485

Penn Avenue location: 123 one-bedroom suites with separate bedroom, living room, bath and full kitchen. New Hampshire Avenue location: 101 of the same. Business facilities: translation and child care services available. Business services include computer, copy, and fax. Health club facilities: nautilus exercise equipment available nearby.

HOTEL HAMPSHIRE
1310 New Hampshire Avenue NW
Phone: (202) 296-7600 or (800) 368-5691
Fax: (202) 293-2476

82 rooms, all junior suites offering full kitchen, living room, bedroom with one or two beds and adjacent dressing room. Business facilities: two rooms (up to 50 people, theater-style); full service business center is available on a 24-hour basis with computer capability. Health club facilities: access to nearby, full-service YMCA.

HAY ADAMS
One Lafayette Square NW
Phone: (202) 638-6600
Fax: (202) 638-2716

143 rooms, including 18 suites. Business facilities: six meeting rooms — includes 175 reception, 125 theater-style; French, Arabic, Spanish, Japanese translation available; child care services available; no business center. Health club facilities: affiliated with nearby City Fitness Health Club. Pool, racquetball, weights, aerobics (7:00am-9:00pm).

HENLEY PARK HOTEL
926 Massachusetts Avenue NW
Phone: (202) 638-5200 or (800) 222-8474
Fax: (202) 638-6740

96 rooms, including 17 suites. Business facilities: one meeting room (60 people theater-style or 35 classroom-style), 10 suites and parlors (up to 30 people each); complimentary limousine each morning; no business center on premises, but fax machine and copy machine are available for guests and arrangements for other services are available. Health club facilities: access to Morisson Clark Inn facilities.

WASHINGTON HILTON AND TOWERS
1919 Connecticut Avenue NW
Phone: (202) 483-3000 or (800) 445-8667
Fax: (202) 265-8221

1125 rooms, including 82 suites. Business facilities: 30 rooms (from six to 3,100 people for banquets, 4,200 for a meeting theater-style in international ballroom), 45,000 sq. ft. exhibit hall; translation services available; employees speak 30 languages; child care services available; airport shuttle stops at hotel; Summit business center full service business center on the hotel premises. Health club facilities: full-service exercise room (Mon-Fri 6:30am-10:00pm; Sat-Sun 8:00am-8:00pm); olympic-size pool, (lifeguard 7:00am-11:00pm); three lighted tennis courts.

HOLIDAY INN CENTRAL
1501 Rhode Island Avenue NW
Phone: (202) 483-2000 or (800) Holiday
Fax: (202) 797-1078

213 rooms: 101 double-doubles; 104 kings; eight one-bedroom suites. Business facilities: audio-visual convention facilities available; two



The Park Hyatt

meeting rooms (up to 200 people); translation services available; child care, transportation and business services available; limited services available at front desk. Health club facilities: small exercise room with nautilus equipment (8:00am-10:00pm).

MARRIOTT METRO CENTER
775 12th Street NW
Phone:
(202) 737-2200 or
(800) 228-9290
Fax: (202) 347-0860

456 rooms. Business facilities: Convention center available; limousine service available; 12 meeting rooms (12 to 530 people). Health club facilities: complimentary to all guests.

HOLIDAY INN GEORGETOWN
2101 Wisconsin Avenue NW
Phone:
(202) 338-4600 or
(800) holiday
Fax: (202) 333-6113

296 rooms: 288 standard rooms; four one-bedroom suites. Business facilities: audio-visual convention facilities available; five meeting rooms (five to 350 people; 5,200 sq. ft.); translation, child care and business services available; limited services at front desk. Newly added Health Club available.

HOTEL WASHINGTON
15th Street & Pennsylvania Avenue NW
Phone:
(202) 638-5900 or
(800) 424-9540
Fax:
(202) 638-4275

350 rooms: 91 double-doubles; 59 queens; eight kings; 65 twins; 84 doubles; 16 suites with adjoining bedrooms; seven junior suites. Business facilities: 11 meeting rooms (10 to 650 people); audio-visual convention facilities available; valet parking service available. Health club facilities: exercise rooms with stairmaster, universal weights, bicycles, sauna.

HYATT REGENCY WASHINGTON
400 New Jersey Avenue NW
Phone: (202) 737-1234
Fax: (202) 737-5773
Telex: 897-432

834 rooms, including 31 suites.



The Jefferson Hotel

Business facilities: business center, valet parking. Health club facilities: pool; sun deck; health club with weight room, sauna and steam bath.

THE INN AT FOGGY BOTTOM
824 New Hampshire Avenue NW
Phone: (202) 337-6620 or (800) 426-4455
Fax: (202) 298-7499

95 rooms, including 47 suites. Business facilities: one meeting room (30 people) with catering service; Spanish, Farsi, Urdu, and Portuguese translation available. Other facilities: complimentary continental breakfast; within walking distance of Georgetown, Foggy Bottom Metro and the Kennedy Center.

THE JEFFERSON
16th and M Streets NW
Phone: (202) 347-2200 or (800) 368-5966
Fax: 223-9039
Telex: 248-879

100 rooms, including 32 suites. Business facilities: six rooms (160 to 1947 square feet); Spanish and French translation available; child care and transportation services available; no business center but arrangements can be made and fax and copy machines are available to guests. Health club facilities: access to full-service University Club (across street): exercise rooms, pool and tennis courts.

JW MARRIOTT
1331 Pennsylvania Avenue NW
Phone: (202) 393-2000
Fax: (202) 626-6991

772 rooms: 34 suites. Business facilities: 22 meeting rooms, from 700 to 13,680 sq. ft.; multilingual staff; outside baby sitting service through concierge; full business center, includ-

Hotel Guide



Sheraton Washington Hotel

ing fax, copying, typing and other services. health club facilities: sauna, steam bath, jacuzzi, aerobics room (6:00am-10:00pm); indoor pool (25 x 36); exercise room with nautilus, free weights, rowing, bicycles.

THE LATHAM HOTEL OF GEORGETOWN
3000 M Street NW
Phone: (202) 726-5000 or (800) 368-5922
Fax: (202) 337-4250

143 rooms: 16 single/doubles; 57 kings; 52 double-doubles; 12 junior suites; six one-bedroom suites. Business facilities: audio-visual convention facilities available; eight meeting rooms (15 to 350 for reception); translation, child care and business services by special request, limited services available at front desk.

LOWES L'ENFANT PLAZA
480 L'Enfant Plaza, S.W.
Phone: (202) 484-1000
Fax: (202) 646-4456

370 rooms: 233 kings and queens; 115 double-doubles and 22 suites. Business facilities: 20,000 sq. ft. of meeting space, ballroom is 5355 sq. ft.; 14 meeting rooms (smallest holds 20 people); multilingual staff, 10 languages spoken; babysitting available through concierge; business center for word processing, faxing, copying, courier service (typist is on duty 8:00am-6:00pm, after hours the concierge will open the business center for self service). Health club facilities: exercise room with nautilus, stationary bicycles, weights; (Mon-Fri 6:00am-9:00pm; Sat-Sun 10:30am-5:00pm; year-round rooftop pool (25 yards long).

BEST WESTERN NEW HAMPSHIRE SUITES
1121 New Hampshire Avenue NW
Phone: (202) 457-0565 or (800) 762-3777
Fax: (202) 331-9421

76 units, all suites. Business facilities: one meeting room (up to 30 people classroom-style.) Health club facilities available. Other facilities: free breakfast; kitchenettes in all suites with microwave, refrigerator, coffee maker and sink. Within walking distance of all major attractions.

THE MADISON HOTEL
15th & M Streets NW
Phone: (202) 862-1706 or (800) 424-8577)
Fax: (202) 785-1255

353 guest rooms. Business facilities: 14,000 sq. ft. of banquet space. Health club facilities: state-of-the-art fitness center and sauna. Other facilities: The Montpelier serves continental cuisine at lunch and dinner; The Retreat serves breakfast, lunch and dinner; the Lobby Lounge serves light fare, afternoon tea and cocktails daily.

RADISSON-BARCELLO
2121 P Street NW
Phone: (202) 293-3100 or (800) 843-6664
Fax: (202) 857-0134

294 rooms: 229 singles/doubles; 60 one-bedroom suites; five presidential suites. Business facilities: eight meeting rooms (three to 100 people); translation, child care and business services available limited services available at front desk. Health club facilities: sauna, fitness center (8:00am-9:00pm); exercise room with nautilus, stairmasters, treadmills, bicycles, rowing machine, and free weights.

ONE WASHINGTON CIRCLE
One Washington Circle NW
Phone: (202) 872-1680 or (800) 424-9671
Fax: (202) 887-4989

151 suites: 16 connecting. Business facilities: audio-visual convention facilities available; five meeting rooms; translation, child care and business services by special request; limited services available at front desk.

OMNI SHOREHAM
2500 Calvert Street NW
Phone: (202)234-0700 or (800) 843-6664
Fax: (202) 332-1373

770 rooms, including 50 suites. Business facilities: 25 meeting rooms (25 to 1,200 classroom style, up to 2,400 people theater style), 40,800 sq. ft. exhibition hall; translation by special request, over 40 different languages and dialects spoken by employees of the hotel; child care services available; limousine available ($35/hr); business center (8:00am-6:00pm), secretaries available by special request, computers available; four fax machines. Health club facilities: sauna, fitness center (6:30am-9:00pm); outdoor pool (10:00am-8:30pm); two tennis and one volleyball court (Mon-Fri 7:00am-9:00pm; Sat-Sun 8:00am-7:00pm); exercise room with nautilus, universal weights, treadmills, stairmaster, bicycles, etc.

PARK HYATT WASHINGTON
24th Street and M Street NW
Phone: (202) 789-1234, (800) 922-PARK or (800) 233-1234
Fax: (202) 457-8823
Telex: 897-105

224 rooms, including 132 suites.



Savoy Suites

Business facilities: ten meeting rooms (18 to 440 people). Health club facilities: full service health club; pool, jacuzzi, private sauna and steam rooms, massage.

SOFITEL
1914 Connecticut Avenue NW
Phone: (202) 797-2000
Fax: (202) 462-0944
Telex: 204-798

145 rooms, including 36 suites. Business facilities: 2,000 sq. ft., dividable into three rooms (180 theater-style, 100 classroom-style); one of the concierges (on duty from 8:00am-5:00pm) speaks 11 languages, many employees speak several languages in addition to English; child care services can be acquired; business center with computer capability (9:00am-6:00pm); secretaries available; can accommodate special situations where guests have access to the equipment, but prefer to have their employees do the work. Health club facilities: access to nearby Washington Sports Club.

WASHINGTON COURTYARD BY MARRIOTT
1900 Connecticut Avenue NW
Phone: (202) 332-9300
Fax: (202) 328-7039

147 rooms: 15 queens, 50 regular kings, 16 kings, 65 double-doubles. Business facilities: one meeting room (40 to 60 people), one suite; some of the staff is bilingual; business center arrangements can be made. Health club facilities: access to nearby health club; pool available in summer.

THE RITZ-CARLTON
2100 Massachusetts Avenue NW
Phone: (202) 293-2100
Fax: (202) 293-0461
Telex: 263758

206 rooms: 32 suites. Business facilities: nine meeting rooms (388 to 2,600 sq. ft.); multilingual staff; child care and business services available. Health club facilities: full service (6:00am-11:00pm; flexible); public pool three blocks away; public tennis courts three blocks away.

RIVER INN
924 25th Street NW
Phone: (202) 337-7600 or (800) 424-2741
Fax: (202) 337-6520

127 suites. Business facilities: two board rooms (14 people each), one conference room (30 people conference style); translation services available; child care available; hotel office secretary is available (8:30am-5:00pm); two fax machines. Health club facilities: guest pass to YMCA. Other facilities: Spanish, Portuguese, French, Arabic and Amharic spoken at front desk.

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June 1995

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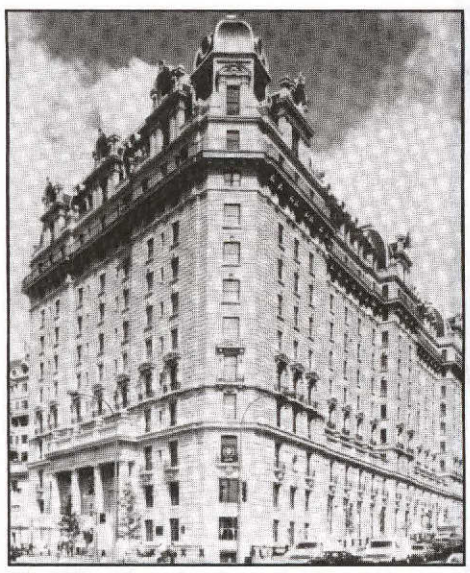
Hotel Guide

SHERATON WASHINGTON
2600 Woodley Road (at Connecticut Ave) NW
Phone: (202) 328-2000
Fax: (202) 234-0015

1,505 rooms: 10 percent suites, 40 percent doubles, 50 percent kings. Business facilities: 33 rooms (60,000 sq. ft.), 95,000 sq. ft. exhibit hall; staff is multilingual; child care arrangements can be made with outside services. The Lancaster Business Center (328-2769) is a full service center which is open Mon-Fri 8:00am-8:00pm, Sat 10:00am-2:00pm, Sun noon-6:00pm).

STATE PLAZA HOTEL
2117 E Street NW
Phone: (202)861-8200 or (800) 424-2859
Fax: (202) 296-6481

218 rooms, all one-bedroom suites with full kitchens. Business facilities: audio-visual convention



The Willard Inter-Continental

facilities; three meeting rooms (up to 100 people); translation, child care services and business center by special request. There are limited services available at front desk.

ST. JAMES
950 24th Street NW
Phone: (202) 457-0500
Fax: (202) 466-6484

196 rooms, all suites. Business facilities: three rooms (30 to 40 people each classroom style), two meeting suites (up to 12 people each boardroom style); French, Italian, Spanish, Arabic translation available, other language speakers can be accessed; child care services are available; no business center on premises — all services can be provided upon request. Health club facilities: 4 ft. deep outdoor pool (lifeguard 10:00am-8:00pm). There is an exercise room with freeweights, 18-circuit universal machine, stairmaster, stationary bikes and rowing machine.

STOUFFER MAYFLOWER HOTEL
1127 Connecticut Ave
Phone: (202) 347-3000 or (800) 468-3571
Fax: (202) 466-9082

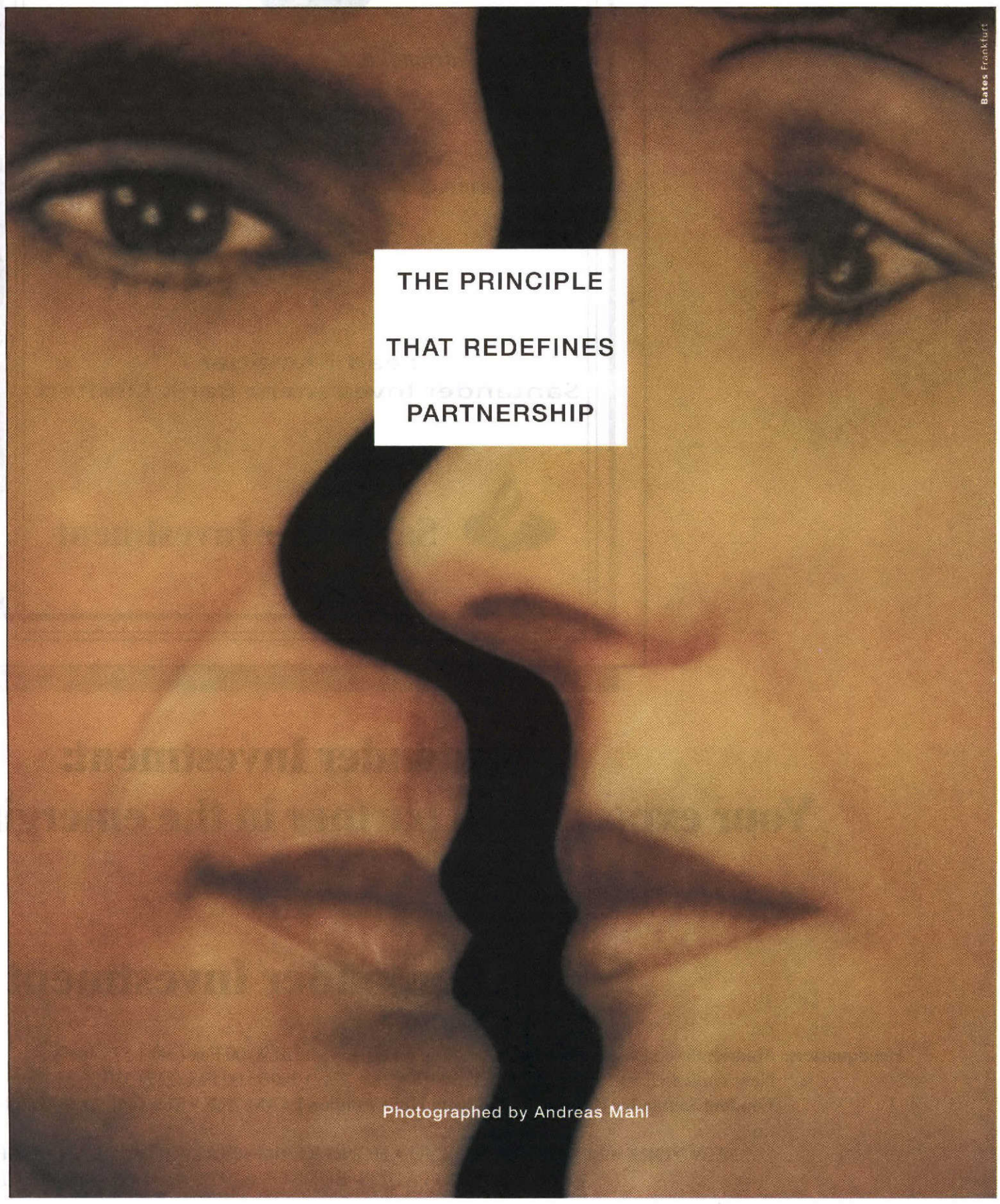
659 rooms plus two luxurious suites. Business facilities: 17 meeting rooms (34,000 total sq. ft.; 10-1,000 people); multilingual concierge service and the hotel staff speaks over 26 languages; use outside childcare service; Executive Express business center; services are also provided through the concierge (7:00am-11:00pm). Health club facilities: health club on premises.

TABARD INN
1739 N Street NW
Phone: (202) 785-1277
Fax: (202) 785-6173

40 rooms. Business facilities: three individual meeting rooms; French, Spanish, Portuguese, German, Japanese translation available. There is no business center and one fax machine.

WASHINGTON MARRIOTT HOTEL
1221 22nd Street NW
Phone: (202) 872-1500
Fax: (202) 872-1424

418 rooms: 240 kings/queens; 174 doubles; four suites. Business facilities: 16 meeting rooms (12,000 sq. ft.); the hotel subscribes to the AT&T Language Line has a multilingual staff and is part of the Japan Assistance network; outside service babysitting; no business center but offers typing and computer services through the executive



offices (Mon. thru Fri.) as well as copying and faxing. Guests can use equipment. Health club facilities: jacuzzi and sauna (Mon-Fri 6:30am-10:00pm; Sat-Sun 7:00am-10:00pm); indoor pool (40 x 20 ft.); exercise room with nautilus, bicycles, free weights.

WASHINGTON VISTA HOTEL
1400 M Street NW
Phone: (202) 429-1700,
(800) VISTA DC, (800) 847-8232 or
(800) 223-1146
Fax: (202) 728-0530
Telex: 440-237

400 rooms, including suites. Business facilities: multilingual staff; 24-hour valet parking; fax; 13 ballrooms and meeting rooms (20 to 600 people); business services available. Health club facilities: Finnish sauna; exercise equipment.

THE WATERGATE HOTEL
2650 Virginia Avenue NW
Phone: (202) 965-2300
Fax: (202) 337-7915
Telex: 197-691

235 rooms, mostly suites. Business facilities: 10 meeting rooms (12 to 580 people); multilingual staff; complimentary morning limo; business services available. Health club facilities: sauna, steam bath, jacuzzi, sundeck, aerobics classes and full fitness center (Mon-Fri 6:00am-10:00pm; Sat-Sun 9:00am-7:00pm); 25 x 50 ft. pool. Dining: The Jean-Louis Restaurant, Washington's only Mobil five-star restaurant; Palladin, casual French-American bistro.



Thw Watergate Hotel

THE WILLARD INTER-CONTINENTAL
141 Pennsylvania Avenue NW
Phone: (202) 628-9100 or
(800) 327-0200
Fax: (202) 637-7326

341 rooms: 303 single/double rooms; 37 one-bedroom suites. Business facilities: audio-visual convention facilities available; 15 meeting rooms (20,000 sq. ft. available); translation available by special request; currency exchange; Japanese,French menus translations; child care services and business center. Health club facilities include a fitness center open 24 hours a day with free weights, bicycles and rowing machines as well as access to JW Marriott pool next door.

THE WINDSOR INN
1842 16th Street NW
Phone: (202) 667-0300,
(800) 423-9111
Fax: (202) 667-4503

46 rooms, including two regular suites and four junior suites. Business facilities: one meeting room for 10 people; French translation available (3 to 11 p.m. Sun-Thurs); transport services. Other facilities include: complimentary continental breakfast, daily newspaper and evening sherry.

WYNDHAM BRISTOL
2430 Pennsylvania Avenue NW
Phone: (202) 955-6400
Fax: (202) 955-5765

239 rooms, including 37 one-bedroom suites, one presidential suite and one ambassadorial suite. Business facilities: seven individual meeting rooms (4,000 sq. ft., seating from 30 to 60 people classroom-style); one boardroom; translation of French, Spanish, German, Italian; child care services available; executive office offers secretarial services during business hours. Health club facilities: health club available on premises.

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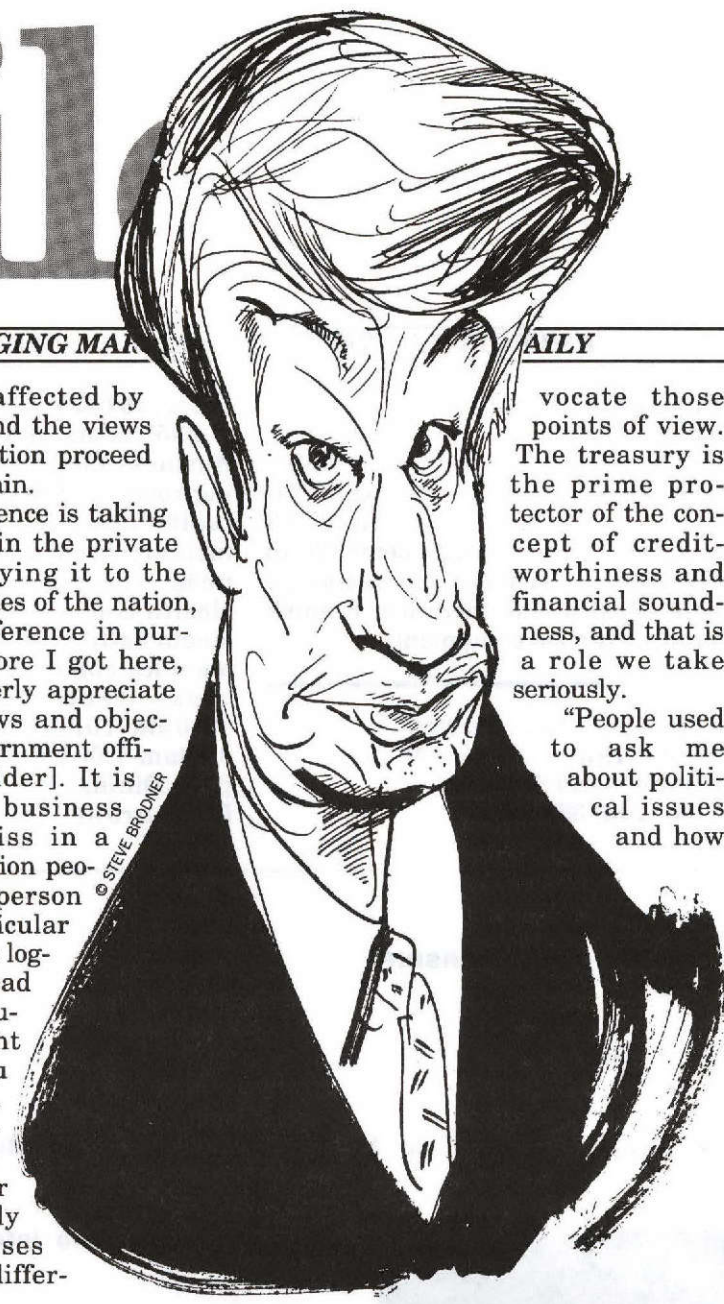

RUBIN

The unassuming U.S. treasury secretary has brought his experience massaging Wall Street egos inside the Beltway.

BY KEVIN RAFFERTY

Robert Rubin is probably the richest man in U.S. President Bill Clinton's cabinet, but he is also the one who best comes across as the nice guy from down the street, the one without pretensions or airs and graces. "He keeps an open door," said one of his junior staff, meaning it both metaphorically and literally since both the outer door and that to the U.S. treasury secretary's own office were wedged wide open. A woman who works elsewhere in the building was cheerfully given permission to show a couple of visiting relatives around Rubin's office to imbibe its historic atmosphere.

It is hard to imagine that this is the power center of one of the top five people running the United States. The space is light and airy. A full length portrait of first treasury secretary Alexander Hamilton gives it a sense of history and importance, while a computer screen blinking to life with the latest currency rates conveys a sense of urgency. There are no pictures of Rubin with the great and good, like those that clutter the sanctums of others climbing the greasy pole of power.

CREDITWORTHINESS

True to form, Rubin is graciousness itself, almost to the point of being self-effacing. He wears a smart suit and polished shoes, but is not a power dresser. His dark eyes are almost soulful. When asked about the differences between his previous job as co-chairman of Goldman, Sachs and his Washington posts, first as head of Clinton's National Economic Council and now as treasury secretary, the very first thing he mentions is "the extraordinarily high quality of the people. One of the great pluses is the character of the people and the way they work together." He says it about the White House staff; he says it about his treasury colleagues. In this power-hungry city where people will do anything to boast of their connections with the inner loop, Rubin doesn't make a song and dance. Indeed, when he was at the White House he went to dinner at the Hay Adams with some colleagues, reached for the check and presented an American Express card. The waiter came back and whispered that the card had been rejected. "That's what happens when you take a 99.5 percent pay cut," Alan Blinder, now vice chairman of the Federal Reserve board, joshed him. It was of course the machine checking the card that was at fault, not Rubin's creditworthiness. He didn't make a fuss but quietly paid by Mastercard.

The transition from Wall Street to Washington included a drop in pay — from eight figures ($26 million in his last year at Goldman) to barely six — and much more. "At Goldman, the whole point was to keep your profile as low as possible and to play defense when you had a problem. [In Washington,] the media is such an integral part of doing your job, because your job is so much affected by how the issues and the views of the administration proceed in the public domain.

"Another difference is taking your experience in the private sector and applying it to the problems and issues of the nation, so there is a difference in purpose. I knew before I got here, but I didn't properly appreciate the range of views and objectives [senior government officials must consider]. It is something that business people often miss in a nation of 250 million people. A business person might see a particular issue and say that logically it should lead you to this conclusion, and it might be true — if you had their purpose. But [in government] you have all sorts of other people with vastly different purposes who put vastly different weights on different objectives.

"[There's also] pace. Even though I was used to a very fast-paced world, I would say that the pace here is greater."

Rubin thinks carefully before he responds to each question, naturally politically correct each time, courteous, never badmouthing anyone even though there were plenty of people who swung below the belt at him when he reached the treasury. He shrugs and says, "I don't think you can be deterred by the inevitable muckiness that sometimes exists around what you are doing."

One thing that Wall Street and Washington have in common is ambition, which Rubin handled adroitly by careful massaging of the egos of his staff, a technique that won him many friends at Goldman and in the White House, where he was quite happy to give up time with Clinton if he had nothing special to say to the president.

About the treasury job he says, "I think that above all the secretary has to maintain the professionalism of the treasury. You can certainly speak to the issues, and when the administration has points of view you can advocate those points of view. The treasury is the prime protector of the concept of creditworthiness and financial soundness, and that is a role we take seriously.

"People used to ask me about political issues and how I was going to deal with them. They said, 'You won't have as much political experience as Lloyd Bentsen' who had a very distinguished and effective career in the Senate. My answer was, and I think it has proven to be correct, that if you deal with people in a serious way and in an honest fashion, you can deal very effectively with them. I have found that to be very effective and treasury enjoys very good relations with the Hill."

Here Rubin is letting good manners get the better of him, since Congress will be somewhere between $800 million and $1 billion short of fulfilling the Clinton administration's commitments when it finally decides on the amount the International Development Association will get from the foreign aid bill. If it is $775 million, the amount in the Senate bill, then Washington will be only $860 million short; if the $575 million in the House bill, then more than $1 billion. Either is more than pocket money even to a rich man like Rubin — though not a lot to a U.S. government for which total foreign aid is 1 percent of its budget and IDA represents 8 percent of that 1 percent.

Rubin claims it is too early to say how much money the U.S. is willing to pledge for the next replenishment of IDA — even though it is important to get the pledging wrapped up before the end of the year so that governments can commit the money in their next budgets. Although aid is such a small part of the American budget, it looms much larger in the popular imagination. The public, opinion polls have shown, believes that aid is 15 percent of the budget and should be cut. In addition, 50 percent of the foreign aid bill also goes to just two countries, Israel and Egypt. However erroneous the popular perceptions, aid still presents a soft target for cutting. Rubin responds to demands from British foreign secretary Malcolm Rifkind that countries should pay interest on their overdue international dues, "It is not a subject I have thought about," — a useful deaf ear when the U.S. owes $1.2 billion to the UN.

THE BEST RATE OF RETURN

For all this, he pledges continuing commitment to aid and to U.S. economic leadership. "We are in a global economy. Our economic interests and those of all the countries of the world lie in recognizing the interdependence of nations. I think that is key, the starting point, and going from there to working together in making this global economy work as effectively as possible. I break that into three pieces: free trade or open markets; support for the developing nations to grow, which means we need to support the World Bank and its sister banks; and global markets in which capital can move freely to where it is going to get the best rate of return.

"From time to time, this [system] will lead to problems, and the United States needs to take a leadership position in dealing with those problems. Mexico was the obvious example. The whole Halifax set of initiatives is another example of an effort on our part to work with the other G7 nations in order to develop mechanisms for dealing with problems. So we have been fighting very vigorously for adequate funding for the MDBs [multilateral development banks] and the United Nations.

"It's true that many in the Congress have a different point of view, and that's where the debate lies. I am not discouraged, but that is a question of how one deals with life. My view, is to work together for the best deal you can get."

Rubin asserts that "the G7 has really reenergized, and it is very important that we continue working with each other and sharing views as to macro conditions, financial conditions, foreign exchange conditions, because when we do that it does lead to activity." That neatly sums up the secret of the man, a nice guy with no magic solutions, no great slogans, no memorable catchphrases. It is an abiding impression of someone who is prepared to put a lot of patience into making things work out. EM

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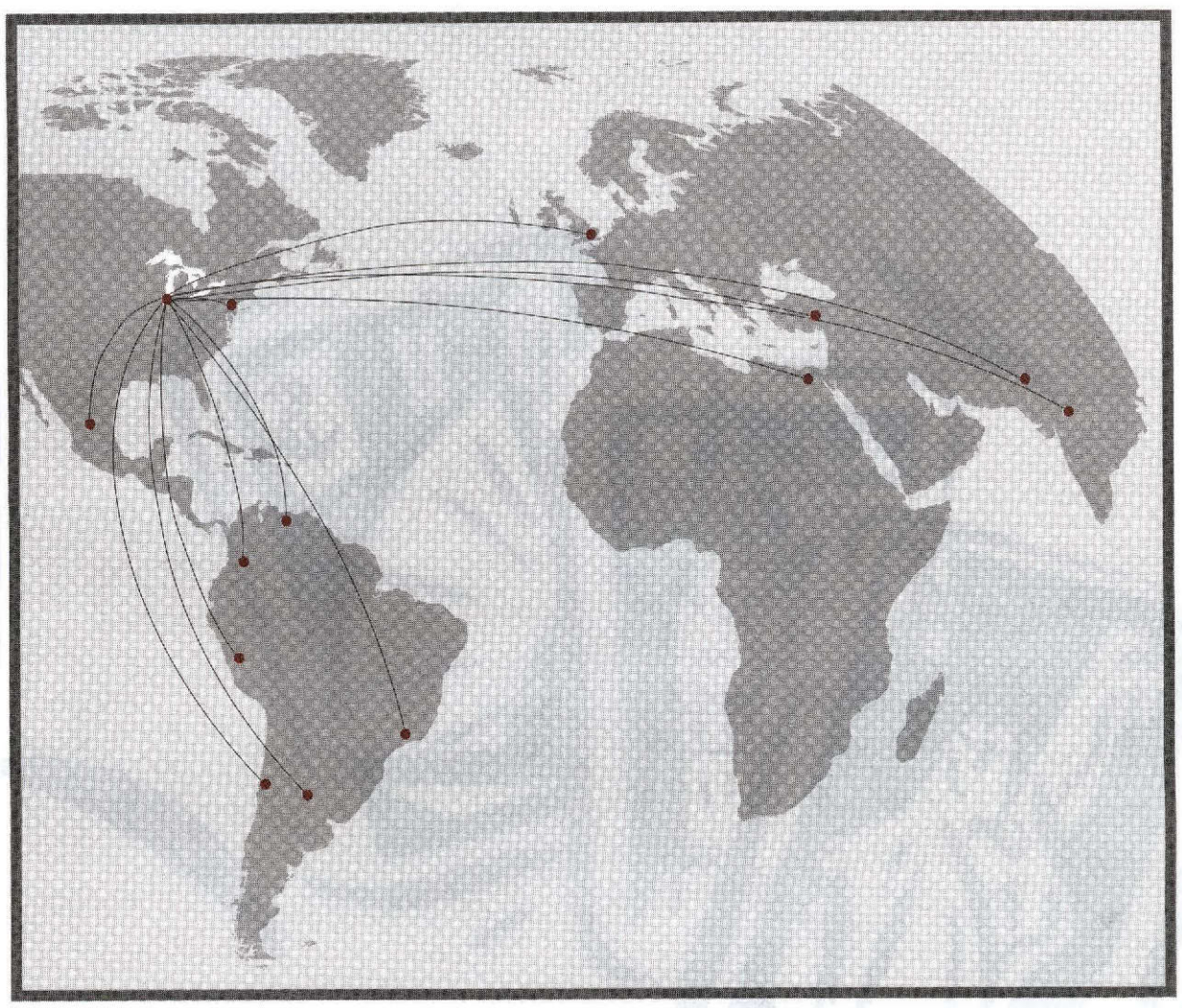

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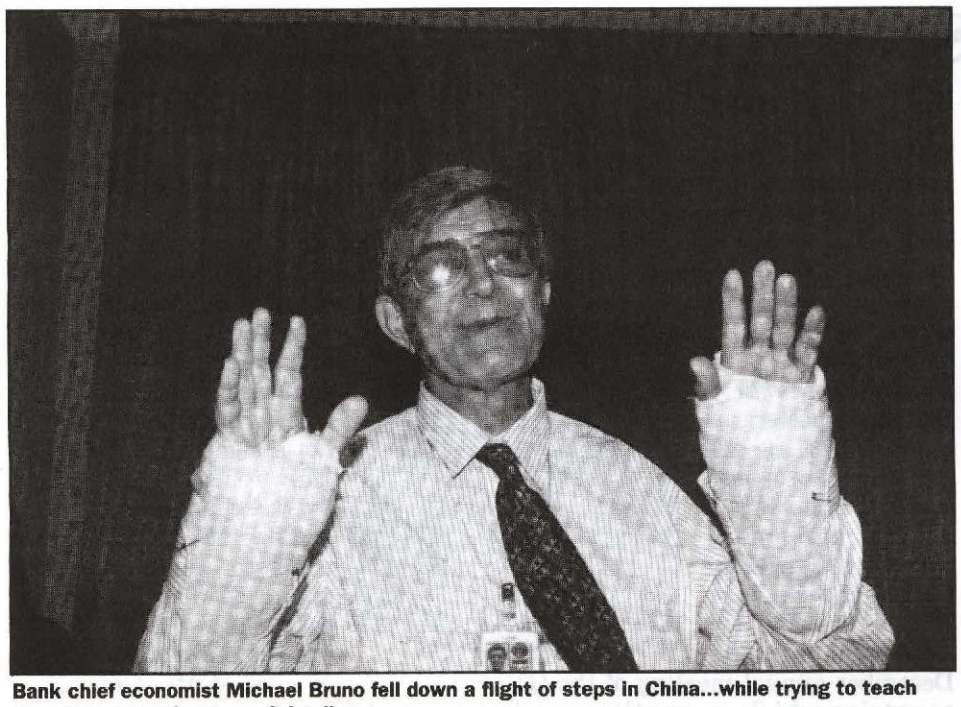


Bank chief economist Michael Bruno fell down a flight of steps in China...while trying to teach them how to engineer a soft landing



Fund managing director Camdessus enjoys one of a slew of O.J. jokes



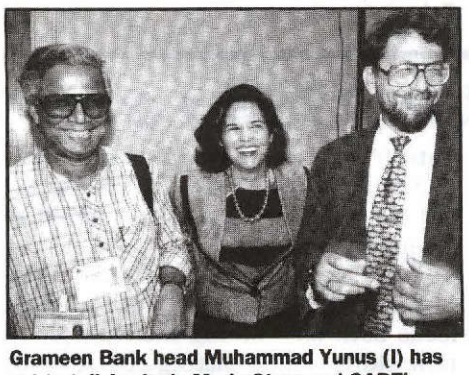
Bankers dream of how to solve the crisis in Latin America



Goldman's Gerry Corrigan finds the Latin American crisis a daunting one



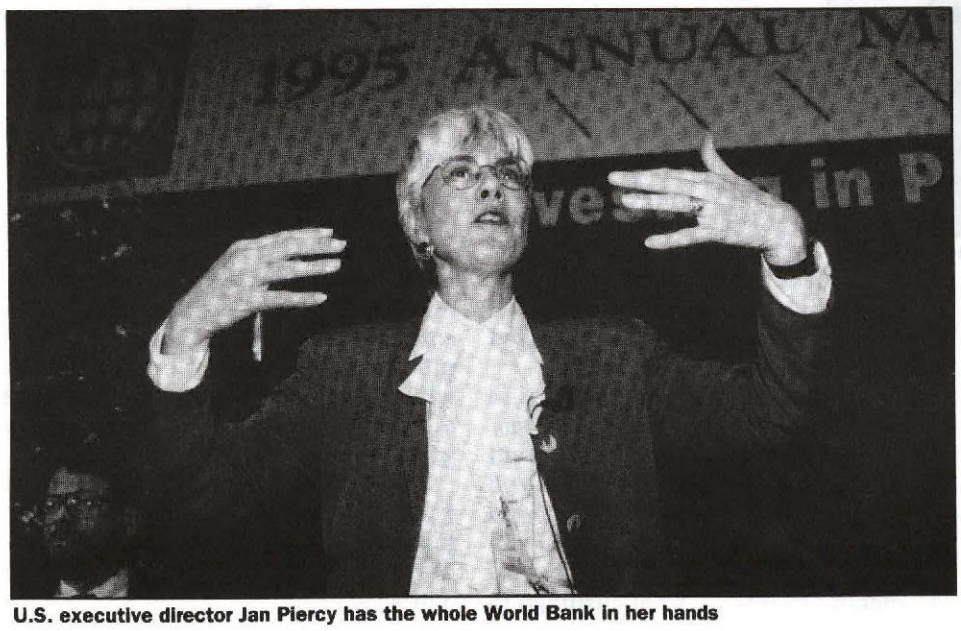
An annual meeting veteran, Inter-American Development Bank president Enrique Iglesias offers some on-the-record advice to rookie James Wolfensohn



Grameen Bank head Muhammad Yunus (l) has yet to tell Accion's Maria Otero and CARE's Marc Lindenberg that they don't qualify for loans

WHETTING THE APPETITE

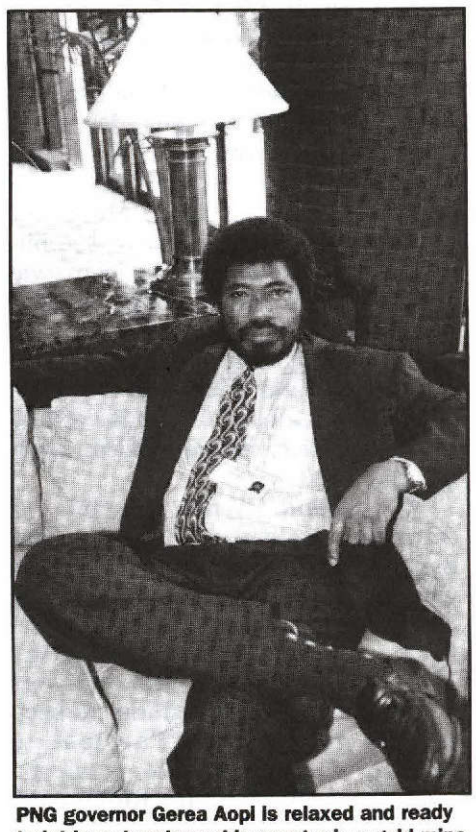
Photos by Donna Dietrich, Erica Lansner & Lisa Quinones



U.S. executive director Jan Piercy has the whole World Bank in her hands



Toyoo Gyohten spruces up for his favorite annual meeting



PNG governor Gerea Aopi is relaxed and ready to let investors know his country is a gold mine

News

Wolfensohn Will Leave Cello at Home

James Wolfensohn has come to the rescue of the annual symphony concert which the World Bank's governors wanted to axe as too expensive. The concert is going ahead according to a bank spokesman because of the generosity of a donor who wishes to remain anonymous. But insiders say that it is Wolfensohn himself. The eclectic program includes works by Bartok, Brittan, and Mendelssohn as well as Barber's *Adagio for Strings*, but the bank president has resisted the temptation to take his cello along to join in.

G7 v. Markets

(Continued from page 1)

prime minister Lamberto Dini, attending the G7 session in his capacity as his government's finance minister, deflected questions about the lira's weakness against the Deutsche mark by reporting that "the issue of European monetary union was not discussed."

The G7's show of unity prompted some analysts to predict they would push up the dollar when conditions were right to intervene effectively. Others, however, suggested that the rhetorical show of unity came in lieu of a consensus for action.

Italy's Dini conceded that concerted action to strengthen the dollar against the yen was "not currently under consideration." He added that, "it appears that the global evaluation [of the G7] is in the sense that a strengthening of the dollar is desirable...But we will have to see if the markets accept this view."

Pushed to spell out Washington's position on the dollar, the U.S.'s Rubin reiterated that the Clinton administration "believed in a strong dollar." But he refused to be more specific or to say what steps the U.S. was prepared to take to back up its belief.

Rubin declined to comment on the strength of the Deutsche mark against the French franc, which weakened dramatically Friday on reports that Prime Minister Alain Juppe might be forced to resign as a result of reports that his son had gained improper access to state housing in Paris, or the lira, which has been weak since a row broke out in Germany between those who wish to defend the Deutsche mark against Southern European inflation at all costs and those who see European Monetary Union as a mechanism for binding together Europe politically.

In keeping with the June communique issued by G7 heads of state at their Halifax summit in June, G7 finance ministers endorsed plans to double the International Monetary Fund's capacity to borrow to $55 billion to preempt future Mexican-style crises of confidence in the global capital markets.

But they glossed over differences of opinion over whether the IMF should be made into a lender of last resort in case of future Mexican-style emergencies.

At the end of their session G7 ministers welcomed Russia's first deputy prime minister Anatoly Chubais as a visitor, applauded the Yeltsin government's efforts to satisfy the conditions attached to the IMF's $6.5 billion dollar one-year standby loan, and urged him to keep up the good work. "The feeling toward Chubais was very warm," U.S. Treasury secretary Rubin commented.

IMF SAFETY SET TO GET GREEN LIGHT

BY ANTHONY ROWLEY

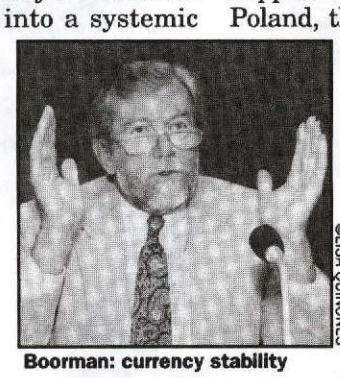
In an attempt to reverse what IMF treasurer David Williams yesterday called a "dramatic fall" in the fund's liquidity, the IMF's policymaking interim committee is expected today to endorse a far-reaching package of measures which will also equip it to provide a global safety net against future Mexico-type crises.

The package would provide a massive boost for IMF resources through doubling both its main source of funds — members' quotas — and its borrowing resources, resulting in a total of SDR334 billion ($498 billion). This would restore the IMF's size — relative to that of the world economy — to what it was in the 1960s.

Heavy commitments (totaling SDR28 billion) to Mexico, Russia and Argentina over the past year have seriously depleted IMF resources, just when it faces an paramount task of coping with balance of payments crises caused by massive private capital flows along with a range of other new challenges.

IMF officials predicted yesterday that the interim committee would give the green light to a series of the fund's new actions designed to cope with this situation, and that things would move quickly from there. There is already a consensus among the IMF's 179 members on the size of the quota increase needed to cope with a planned major expansion of the fund's activities.

According to Williams, agreement to increase the size of IMF quotas to SDR300 billion should be "wrapped up within the next 12 months." This would be an unprecedented achievement for what is normally a very lengthy negotiation, and reflects the level of international concern over the dangers of one country's financial problems escalating into a systemic threat.



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Boorman: currency stability

Williams told *Emerging Markets* that he expected an even faster agreement on a proposal to double the IMF's general agreement to borrow (GAB) up to SDR34 billion. This should be approved by the December annual meeting of the G10 countries which currently provide emergency credit lines to the GAB, he said.

Agreement on widening the net of countries making such credits available also appears virtually assured. The G10's most industrialized are expected to be joined by emerging nations that enjoy "structural balance of payments surpluses," such as South Korea and Singapore, according to Williams.

The interim committee's other major initiative will be to endorse a plan set in motion at this year's G7 summit. The plan will provide for the IMF to establish an "emergency financing mechanism" to allocate funds to problem countries on "strict conditionality." This will enable the IMF to react quickly in future Mexico-type situations.

IMF director for policy development Jack Boorman disclosed yesterday that the IMF plans to set up a currency stabilization fund. This fund will support countries, such as Russia and Poland, that peg their exchange rates in order to stabilize their economies and bring inflation under control. Boorman warns that "this is not a signal of a change in IMF attitudes in favor of fixed exchange rates."

The IMF is also planning to move into the arena of what Boorman called "post-chaos" financing in countries emerging from war or civil strife. Cease-fire negotiations in such situations often involve pledges to down-size military spending and to make other reforms, and underwriting these commitments requires an emergency assistance policy from the IMF.

The interim committee is also expected to endorse moves to make the IMF's extended structural adjustment facility(ESAF), which provides balance of payments finance to the poorest and most indebted countries on highly concessional terms, permanent. Before this can be done, the IMF must find ways to bridge a financing gap between 1998 — when ESAF's current resources are due to run out — and the year 2004, when repayments should make the ESAF self-sufficient.

Infobahn May Earn Developing Countries $180bn a Year

BY ROB WRIGHT

The latest reason for developing countries to hitch a ride on the Infobahn: $180 billion in potential annual export earnings.

That's how much the World Bank projects its borrowers could be earning from "information service industries" — a new catch-all development term covering everything from designing software and inputting data to taking airline reservations and offering back-office support for big insurance companies. In a seminar yesterday, bank staff praised small countries like Mauritius, El Salvador and Jamaica for setting precedents in this area, and unveiled a new initiative it is overseeing from Washington to help others to do the same.



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Knight looks to more forward

"The information revolution is different from the industrial and agricultural revolutions, because instead of transforming energy and material, it transforms time and distance," bank vice president Jean-Francois Rischard said. "Knowledge is becoming the most important factor of production, more important than others like land, labor and exchange rates," he stated, concluding, "Everything will now change."

Rischard said a few nations have already positioned themselves as offshore information service-providers, using their low operating costs to attract investors in a new generation of support industries. He applauded their efforts, since advanced technology allows many data-related functions in the health care, finance, tourism, insurance and other industries to be carried out anywhere in the world, with the end product instantly transmitted back to the client's home office.

To bring home the point, the bank connected the seminar via live videoconference hookups to executives from MCI, Cable and Wireless, Netscape Communications and other firms who participated in the session from Geneva. The bank has no clear sense of developing countries' total earnings to date from these new industries, but doubts it could be more than 5 percent of the $180 billion that it says could be attained each year.

Bank experts stressed that in order to reach this plateau, countries must focus both on training their people in new skills, and enacting the reforms needed to attract the private capital necessary to finance communications infrastructure. Even though the costs of technology are fast decreasing, they are still considered beyond the grasp of most poor countries' governments.

To help bridge the gap, the bank launched a new program last week called "InfoDev" to share knowledge on the development applications of information technology. Governments pledged an initial $2 million, and more is expected to come from corporate donors in November. All pledges must be united, so donors will have no control over the specifics of where their money eventually goes.

"We have an incredible opportunity from all this to move our economies forward," said Gloria Knight, president of the Mutual Life Group in Jamaica.

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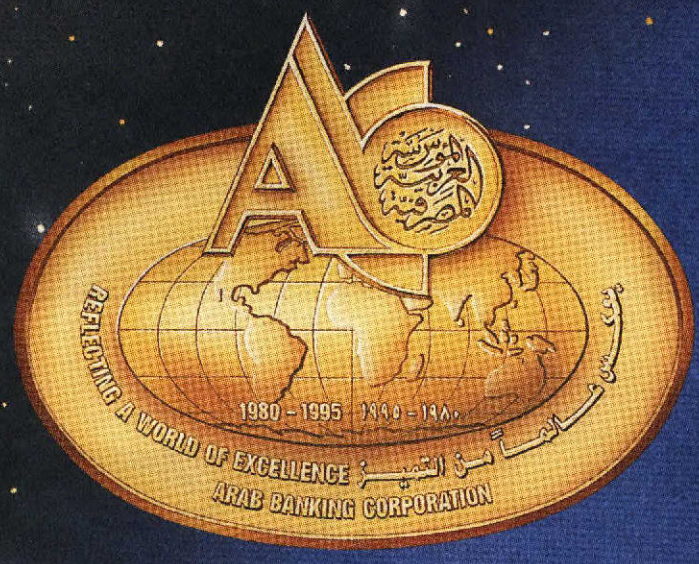

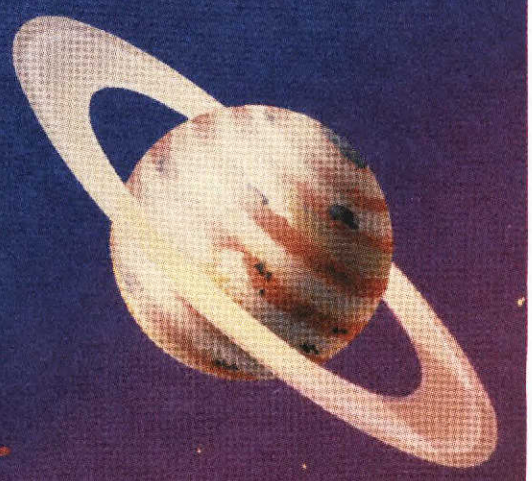

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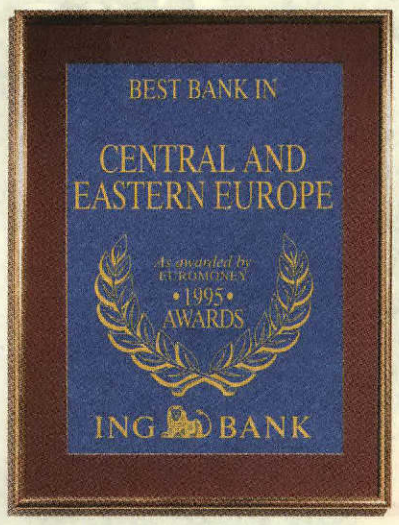





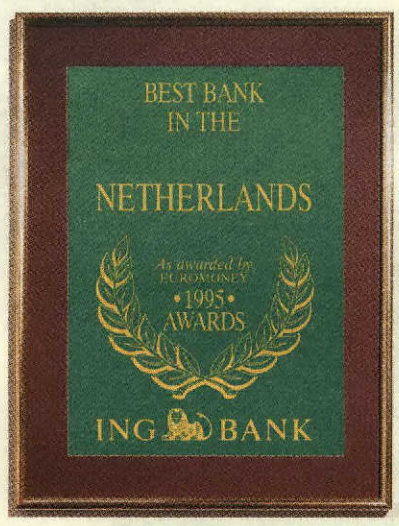





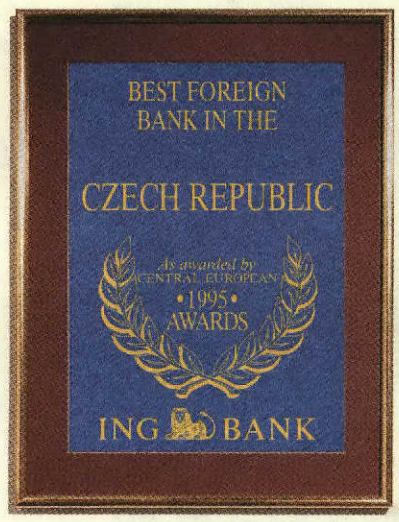

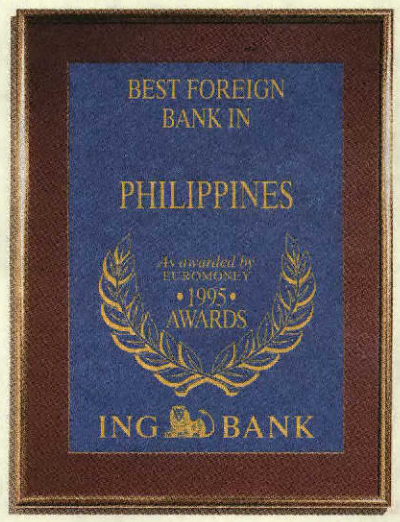

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Forex Markets Nervous After G7

BY KEVIN RAFFERTY AND HENRY COPELAND

Foreign exchange markets opened nervously in Tokyo today in reaction to political developments at the G7 meeting and in France. Encouraged by the ministers' support for the dollar, the greenback immediately gained almost a full yen to 101.40 before slipping back as some dealers bought the dollar.

More than an hour after trading began, the dollar was changing hands at 101.10 against the yen. One dealer said, "Though there was support for the dollar in the G7 communique, it was very general, so the market is unsure."

There was also nervousness about the relationship between the Deutsche mark and the French franc, with initially strong demand for the German currency. But after an hour's trading, the two currencies were at the same level as in New York late Friday, with one DM worth a little over 3.51 francs. This was itself a blow to the franc fort, which had been savaged by revelations about Prime Minister Alain Juppe.

In Washington, pundits offered mixed views about where the currencies were headed. Yoh Kurosawa, president of Industrial Bank of Japan, said "I don't think there will be any major movement between the dollar and the yen. What happened in the first half of the year was not yen appreciation but dollar depreciation caused by the handling of the Mexican crisis. Handling was not so good, so there was a loss of confidence in the dollar."

He described the hopes of Japanese politicians and small exporters for a yen in the 110-120 range as "wishful thinking." He also advised politicians not to want to weaken their currencies. "No country in history has deteriorated or disappeared because of a strong currency, but a number have suffered because of a weak currency. Look at the sterling pound which 30 years ago was at 1008 yen for one

Zedillo arrives — p. 4

sterling pound; now it is worth 150."

Thomas Berger, a director of Mercury Asset Management, which manages $105 billion in assets, forecast: "We think the dollar is going to go up over the next six to 12 months. Our targets are 110 yen against the dollar, and DM1.5. I think the G7 is realizing that a strong dollar is good for global growth. We think the G7 will push that, and the markets will recognize that, and the dollar will gently appreciate."



Bank president Wolfensohn prepares for his big day

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DRAGONS BREATHE FIRE

BY ANTHONY ROWLEY

U.S. treasury secretary Robert Rubin yesterday strongly endorsed a plan by the IMF's policymaking interim committee for a major boost in the fund's resources so that it can cope with future Mexico-type crises. But he warned against creating a "global bankruptcy court which might make default an attractive option for sovereign debtors." The smooth sailing of the meeting was spoiled by demands from several up and coming economies including the Asian "dragons" economies of Asia that if they got bigger quotas, they wanted a bigger say.

Chairman Philippe Maystadt of Belgium said, "There will be no second calss citizens in discussions on quotas."

Rubin stressed the U.S. view that the emergency financing mechanism proposed by the IMF to give it a rapid-reaction capability in times of crisis should be used only "rarely" and that it must be subject to "substantial policy conditionality." Interest on emergency IMF loans must include a "risk premium" and a penalty rate to encourage early repayment, he said.

Part of a package designed to double the IMF's resources to nearly $500 billion — so that its resources match international capital flows — involves bringing a group of advanced developing countries into the ranks of lenders

(*Continued on page 62*)



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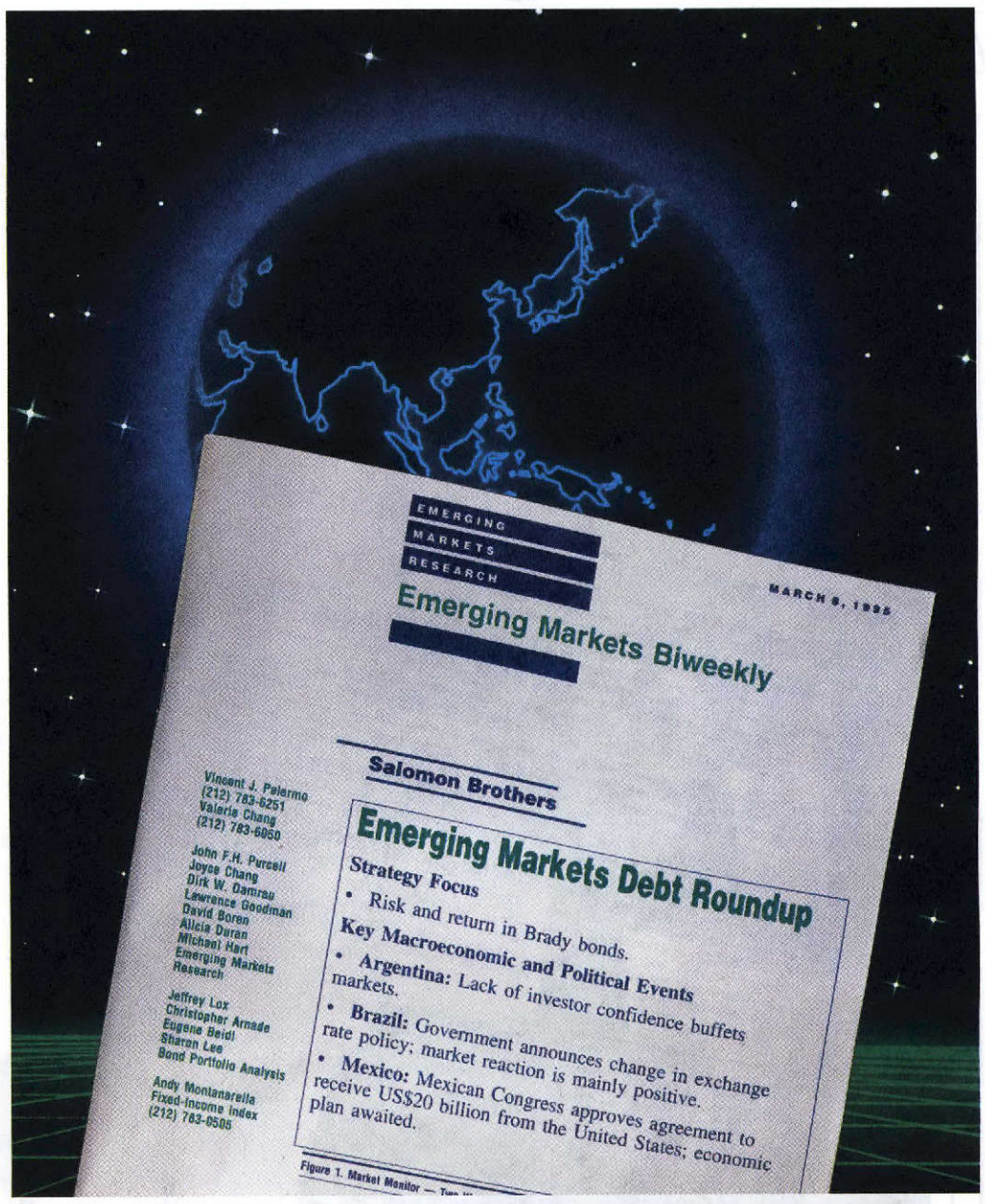

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"When I retire, my wife says she will have twice the husband and half the money. I think she prefers it this way."

— Yoh Kurasawa, President, Industrial Bank of Japan

WOLFENSOHN'S BIG DAY

One of James Wolfensohn's biggest tests will come today when the development committee meets. In a sense it is his first public appearance, even though he has carefully cultivated this meeting — speaking at an environment seminar, in a television broadcast relayed to South Africa, at a seminar on World Bank guarantees, and in general being seen meeting and greeting people.

Indeed, for someone who has yet to face his first press conference of the annual meetings, Wolfensohn and his advisors have done a masterful job. He has spent much of his first four months in office on whirlwind trips to 25 countries, demonstrating that the world is his parish. In Washington in these last few days, he has been seen smiling, touring the far-flung halls of the World Bank and the Sheraton Hotel, and demonstrating that this is all his domain. He has met and welcomed the great and the good, ministers, bank governors, bankers as rich as Croesus, the African caucus, even pausing for a few words with the waitress who poured him a cup of coffee.

Naturally he has been a target of attention, and he has lapped it up, smiling all the way. His sometimes self-deprecating jokes at the environment seminar showed a man with quick wit and great charm who deservedly has a wide range of friends — and he was not afraid to drop a name or two, notably that of U.S. President Bill Clinton, to make sure people understood who his friends are. The only time when he was not pleased to see a photographer at his side was — interestingly — as he was being made up for his television appearance yesterday. (South Africa's finance minister Chris Liebenberg, appearing in the same discussion, did not mind, but the bank president shooed the photographer away from the sight of having powder smeared on his face.)

But there is clearly much more to Wolfensohn than good public relations. Although he has said he will spend his first six months (which lasts until December 1) just looking, listening and learning, he has evidently been making plans. Today's meeting of the development committee, under his influence and with the help of chairman Mohamed Kabbaj, is going to be more businesslike than before. Previously, countries have been allowed to read their long-winded speeches for the benefit of their constituents back home. This year, the promise is of summaries of speeches, after which the ministers will kick out their entourage of aides and hangers on so that serious discussions can take place.

This itself will be a relief after the long wait yesterday for the interim committee to finish its discussions. The press conference after the end of the meeting was earmarked for 4:30 p.m., but then postponed half-hour by half-hour, until almost 9:00. There was no crisis, said IMF officials; all the ministers simply wanted to have their say, and many of them overran their allotted four minutes. It says little for the chairman or the members or the future prospects for world economic cooperation that they ran over by four hours when there was no particular problem.

In the case of the development committee, there is a real problem: the replenishment of the International Development Association. For the moment IDA has plenty of funds, but they will begin to run out by the end of next year, and sooner if some of the countries eligible for IDA aid put their economic houses in order.

Ernest Stern, who knows the bank and its problems better than most people inside or outside the institution, yesterday gave a gloomy prognostication for IDA over the next few years. He could not see the rest of the donors being willing to cough up the money to subsidize the U.S. Congress for its failure to honor the commitments made by the Clinton administration. No one who knows the workings of Congress can see more than $775 million being approved later this week or early next.

Unless some miracle occurs, this will leave IDA short by $935 million immediately, including arrears, and will open up the prospect of a tiny IDA over the three years from 1996 and probably an even tinier one in the foreseeable future. However aid has been wasted in the past, these sums are needed for IDA. As Wolfensohn said, this is a potentially fatal blow to the prospects of more than a billion of the very poorest people in the world. It also makes a mockery of the reform efforts that the bank and fund and the rich donors have been urging developing countries to conduct. Without the backing of soft-loan finance, many of these countries will be discouraged from embarking on their arduous journeys to open up their economies.

The sadness is that the sums required are not large, especially not against military spending. Whether Wolfensohn can persuade his friends around the world to hold the line, persuade the finance ministers that whatever they cut, the lives of the world's poorest people must be sacred, is the question. Can he tell Robert Rubin to stop being the nice guy who lets everyone have their shout and boldly say that if the foreign aid bill has to be cut, then it should start with a cut in military support to Israel and Egypt? That would pay for reinstating IDA's full commitment.

Kevin Rafferty
Editor

News

ANNUAL MEETINGS 35, KUROSAWA 1

Poor Yoh Kurosawa, president of Industrial Bank of Japan, has brought his tennis racket to Washington but has no time to play. Apart from a game on Saturday, "Which we won 6-0," he remembers happily, "I have a series of breakfast meetings, then the days are full with meetings and lunches and the evenings with receptions." His assistants count 35 individual meetings with bankers and ministers from almost every continent plus literally hundreds of conversations at cocktail parties. It is such a complicated schedule that it is arranged in a grid, with just a few white spaces for sleeping hours.

ZEDILLO IN D.C. TO BUILD CONFIDENCE

BY PETER KOENIG

Using the IMF/World Bank meetings as camouflage to escape negative attention from Washington politicians opposed to the $37.5 billion bailout of Mexico last February, Mexican President Ernesto Zedillo will arrive at Andrews Air Force base this evening and meet president Bill Clinton in the White House tomorrow. This will be Zedillo's first official visit to the U.S. since his inauguration last December.

The state visit follows by five days the early repayment of $700 million of the $12.5 billion Mexico owes the U.S., and is part of a complex diplomatic exercise. The delicate balance is designed to publicly demonstrate good will between the two countries and bolster global capital markets' fragile confidence in Mexico, but at the same time avoid exposing Clinton to attack from Republican congressional leaders who claim the Mexican bailout is a waste of U.S. taxpayers' money.

"It would have been difficult for Zedillo to come earlier, while the bailout was still news," declared Nora Lustig, a Mexican expert at the Brookings Institution. "But later would be more difficult, because then the visit would get caught up in the [1996 U.S. presidential] campaign."

Mexican officials spent the weekend putting the final touches on reports demonstrating that their government has met the conditions attached to the $17.5 billion emergency loan extended to the country by the IMF last February when the U.S. advanced $20 billion.

But 20 officials from the 200-strong international division of the U.S. treasury have been monitoring Mexico's financial condition daily since the peso crisis, according to a treasury source, so the visit is designed as much to send a signal to financial markets as it is to pursue bilateral business.

Mexico surprised skeptics by successfully regaining access to the global capital markets last July, a mere four months after the peso collapsed. By last week, it had raised the $700 million needed to repay the U.S. through a DM1 billion bond issue. Mexico hailed the issue as further evidence of its financial rehabilitation.

But one European banker claimed that Mexico's selection of Dresdner Bank, not Deutsche Bank, to lead manage the issue showed how hard Mexico is promoting its refurbished creditworthiness. "Deutsche Bank thought Mexico should go slow in returning to the markets," this banker said. "It thought Mexico should attempt to raise less money than Dresdner was willing to go for."

Other analysts pointed out that the Clinton administration, as well as the Zedillo government, is promoting Mexico's financial rehabilitation. "[U.S. treasury deputy secretary Lawrence] Summers keeps asking the credit rating agencies when they are going to upgrade Mexican paper to investment grade," said a Wall Street banker.

The $700 million Mexico repaid last week is part of $2 billion in 90-day debt owed to the U.S. due October 31. The $1.3 balance of this loan will be rolled over for another three months.

"Zedillo's visit serves as a reaffirmation of Mexico's commitment to deliver on its economic adjustment program," declared William Clines, a Mexican expert at the Institute of International Economics.

U.S. officials said that in addition to reviewing Mexico's economy, Clinton and Zedillo will also discuss drug control, immigration, and the extradition treaty between the two countries. But, cautioned Brookings' Lustig, "nobody expects anything significant to be announced."



Zedillo: stealth mission



Dresdner's Sarrazin

Sarrazin: Money Talks

BY KEVIN RAFFERTY

Juergen Sarrazin, chairman of Dresdner Bank, yesterday pointed to a string of recent loans in which his bank acted as the arranger or lead manager as proof that his bank is playing an important role "in introducing or reintroducing emerging market countries to the international capital markets."

He cited the DM1 billion ($700 million) deal launched last week for Mexico, where Dresdner snatched from its bigger rival Deutsche Bank the traditional role of arranging Mexico's Deutsche mark issues, which allowed the country to prepay some of its debts; the DM1 billion deal for Brazil, the country's first since the debt crisis 15 years ago; the DM500 million offering for the Inter-American Development Bank; and the mandate for a DM400 million deal for the African Development Bank. In addition, Dresdner is looking after the European placement of a $225 million Chase Manhattan syndicated loan for Colombia.

"We, the international banking community, must make sure that there is a steady flow of capital to the emerging market countries to restore stability in those countries and allow them to redevelop their economies after the so-called 'lost decade.' It is essential to the interest of all of us that economic development, free trade, opening of our frontiers and liberalization be continued," he added.

AfDB Returns to U.S. Market

BY ROB WRIGHT

New African Development Bank president Omar Kabbaj and his treasurer James Ranaivoson are in Washington this week to help promote their bank's upcoming return to the international capital markets. After talks with the World Bank, the duo departed on a U.S. and European roadshow scheduled to wind up before the target pricing date of a combined $300 million/DM300 million bond offering that will be issued later this month.

The battered Abidjan-based multilateral has not done a U.S. offering since March 1992 or an issue of any kind since a DM offering in last October, and was stripped of its prized AAA credit rating by Standard & Poors last month.

In spite of the bank's difficulties, investors are showing faith in its ability to meet long-term obligations. S&P was the only major rating agency to downgrade the bank, and since the others re-affirmed its AAA status recently, the bank hopes this new issue can reach the goal of obtaining maturities of 20 years or more.

South Africa Not About to Borrow from Bank

South Africa is not about to borrow from the World Bank, finance minister Chris Liebenberg told a live TV discussion linking Washington and South Africa yesterday. The panel, moderated by Charlayne Hunter-Gault of The MacNeil/Lehrer News Hour, included Liebenberg, World Bank president James Wolfensohn and Lehman Brothers' managing director Ernest Green.

Responding to reports that the World Bank had prepared loans worth $850 million for South Africa, Liebenberg said, "I have never discussed any loan with Mr. Wolfensohn," and cast a glance to the bank president sitting on his right. He continued, "...when we have a project that is suitable and bankable, it will be discussed with the World Bank."

When Andre Roux of the Development Bank of Southern Africa asked why Pretoria had taken so long to contract loans from the World Bank despite detailed consultations between the two sides for the past four years, Liebenberg replied: "It is a result of the discipline of government, on one hand, to define a lending program and priorities and keep to them; on the other, it is a lack of capacity to absorb more loans."

One of South Africa's most active black businessmen, Mohale Mohanyele, raised concerns about the bank's lending conditions, and Wolfensohn replied: "We have been very impressed with your government's program...there will be no attempt on our part to infringe on your government's practice."

On the possibility of the bank group providing soft finance to help alleviate South Africa's housing crisis, Wolfensohn emphasized that the country was ineligible for concessionary loans, given that its per capita income, at over $2,000, stands way above the $580 IDA ceiling. Both Liebenberg and Wolfensohn did suggest ways the bank could work with some of the country's existing programs, such as the provision of government guarantees for high risk borrowers in the housing sector.

Phiroshaw Camay of Operation Hunger said the bank's dialogue with South Africa was too government-centered and had excluded NGOs. Wolfensohn replied that dialogue with civil society was a priority for the bank, in South Africa and elsewhere. "I have visited 25 countries since taking over as president, and in each country I have been talking to civil society," he told Camay. "We talk to the NGOs and the local governments...I am concerned to get the best possible advice because we are concerned about poverty."

Benjamin Mouchope, president of the black business lobby, Nafcoc, told Wolfensohn that his black colleagues were somewhat "disheartened" when international organizations sent delegations to South Africa but ignored local small businesspeople. Identifying this as a priority area for the bank, Wolfensohn said the IFC was already making investment capital available to small-scale businesses. Calling the marginalization of black entrepreneurs a "historical reality for South Africa," Liebenberg said the government was determined to address the issue: "Trade minister Trevor Manuel has just introduced a white paper designed to help entrepreneurs get access to capital and to expertise."

— Patrick Smith



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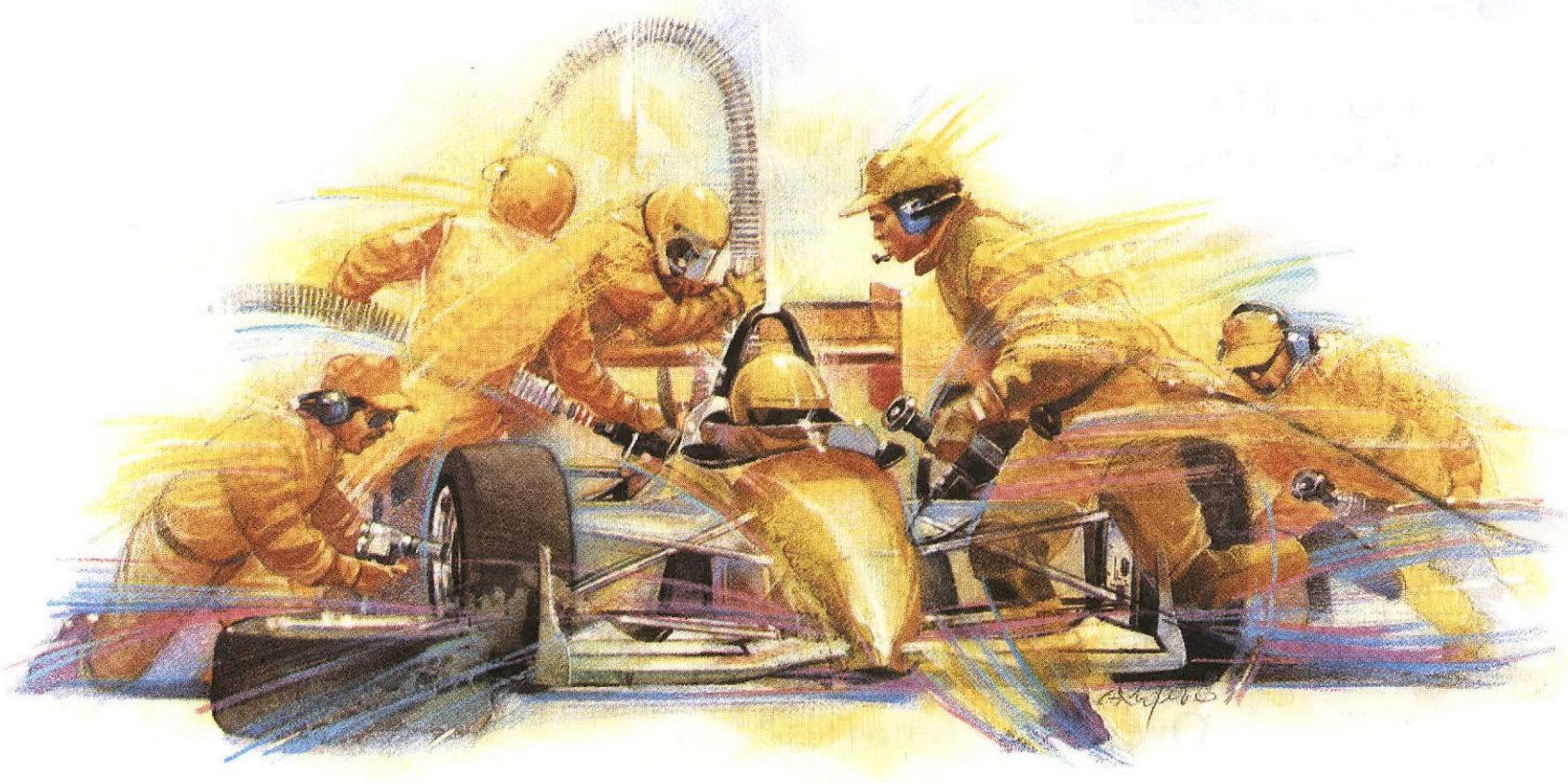

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News

WHAT PRICE INTERNATIONAL JAPAN?

Masayoshi Takemura will leave for Tokyo today before the annual meeting opens. Fellow Japanese say it is not disrespect for the World Bank or IMF but demands of his own parliament from which he needs special permission to be away while it is in session. "This time he could stay an extra day because Tuesday is a holiday in Japan," said an undiplomatic diplomat. "Poor fellow is in trouble because a finance official ran a business from his office." Non-Japanese were not impressed. "When is Tokyo going to learn that there is a big world outside and start to pay some respect?" asked a European delegate.

Bureaucrats Accused of Holding Poor for Ransom

BY KEVIN RAFFERTY

The progress of economic reform in developing countries is being held for ransom by bureaucrats who are still losing vast sums of money running inefficient state-owned enterprises, hindering economic reform and keeping millions of poor people marooned in poverty, claims the World Bank in a report* that is a stinging rebuke to many of its member governments.

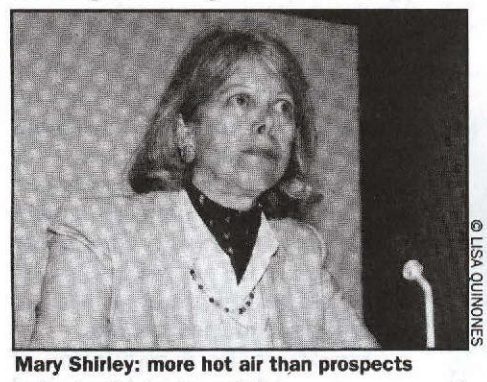
"The so-called decade of divestiture has produced more hot air than hot prospects," said Mary Shirley, the leader of the team that produced the report at a press conference.

"Our research shows that loss-making state-owned enterprises are a significant burden on government budgets and scarce resources in many countries," added Michael Bruno, the bank's chief economist. "These enterprises hinder growth, impede market liberalization, and thus limit efforts to reduce poverty."

The study shows that there has been rapid selling off of state enterprises in Eastern Europe and Russia, but elsewhere "ambitious reform programs are the exception rather than the rule." In the rich industrial countries the share of state ownership in gross domestic product has declined from almost 9 to 7 percent; but in developing countries apart from the former Soviet bloc, it has remained steady at 11 percent; and in the very poorest countries it is highest of all at 14 percent.

As just a few examples of bureaucrats in businesses that they are not qualified to run, government employees operate a casino in Ghana, bake cookies in Egypt, assemble watches in India, mine salt in Mexico, make matches in Mali and bottle cooking oil in Senegal. Many of these state-run enterprises are lumbering white elephants that greedily eat precious resources.

In Bangladesh, state-run companies grab 20 percent of domestic credit, even though they produce fewer than 3 percent of the country's output. In Indonesia, government factories discharge five times as much water pollution per unit of output as private factories of the same age and size making the same products.



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Mary Shirley: more hot air than prospects

Worst of all, many governments feed these loss-making companies with more resources than they can spend on essential services like education and health. In Tanzania, such subsidies are 72 percent of government spending on education and 150 percent of health spending; in India, state enterprises gobble up almost seven times as much money as the central government spends on health.

Overall, the researchers counted Chile, Korea and Mexico as successful reformers; Egypt, Ghana and the Philippines as providing mixed results; and put India, Senegal and Turkey at the bottom of the class. Three of the so-called "transition economies," China, the Czech Republic and Poland, were given a "mixed to good performance" rating.

Perhaps more worrying, the report finds that reforms only work when three conditions are all fulfilled: the reforms must be politically desirable — meaning that the political leadership wants them; they must be politically feasible — that is, the leadership must be able to overcome opposition; and they must be credible — meaning promises made, for example, to compensate employees and not renationalize companies, must be believed. If even one of these conditions is not met, then embarking on reforms could be counterproductive.

Another finding that pours a bucket of icy water on some of the bank's own policies to reform state-run companies without privatizing them. The report gives the thumbs down to performance contracts, some of which have been backed by aid. In Senegal, the state electricity company's performance got worse because the government went back on promises to make other state companies pay their bills. Management contracts have been better and regulatory contracts have generally worked. The clear lesson is that regulation works best when there are rewards for better performance and penalties for failures.

But the clear message of the report is that selling state companies to the private sector helps to raise growth and create new jobs — but can only work if the conditions are right.

* Bureaucrats in Business: *The Economics and Politics of Government Ownership*; $24.95; available from the World Bank bookstore.

CASPIAN OIL GROUP MOVES TO BYPASS RUSSIA

BY CRAIG MELLOW

A top World Bank official praised as "Solomonic" the decision by a Caspian Sea oil consortium to split its early export between two pipelines, one going through Russia and one bypassing it. A formal announcement of the move is expected today in Baku, Azerbaijan.

The 11-company alliance, led by BP, Amoco and Exxon and including Norwegian, Russian, Saudi Arabian and Turkish partners, reached agreement with the Azeri government last year to sink an estimated $7.4 billion into exploiting the country's offshore deposits. But the issue of how the crude would reach world markets remained unresolved. The Caspian is an inland sea surrounded by four former Soviet states and Iran.

The simplest solution logistically was expanding an existing pipeline to the Russian Black Sea port of Novorossisk. One of Moscow's hidden motivations for last winter's invasion of Chechnya, observers speculated, was securing this pipeline route, which runs through Grozny.

But Azerbaijan and some consortium members chafed at what they saw as Russia's extractive stance during negotiations. Turkey further complicated matters with its reluctance to allow an increase in tanker traffic through the Bosporus. Ankara has pushed hard to replace Moscow as the leading outside power in all the Muslim ex-Soviet republics, and particularly in Azerbaijan, which is linked to Turkey linguistically and culturally.

Last week the consortium decided to spend some $250 million on a new pipeline leading west through Georgia, then south to one of two Turkish ports on the Mediterranean. But members said they would also use the Novorossisk route.

"Remember we are so far only talking about 5 million tons of oil per year," observed Wilfried Thalwitz, Bank vice president for the Europe and Central Asia Region. "But I find the preliminary decision Solomonic."

Bank officials on the ground in the Caspian region have made no secret of their support for breaking the Russian monopoly. The Clinton administration has also supported the alternative pipeline, and the firmest backing for it within the consortium came from the American members, including Exxon, Amoco and Pennzoil.

A no less weighty vote of confidence came from Kazakhstan's ambassador to the U.S., Tuleutai Suleimenov. "There are many options for export," he remarked. "But I would say this option suits us."

Kazakhstan, which controls the Caspian's eastern shore, has even greater estimated underwater reserves than Azerbaijan. A $20 billion agreement with Chevron Corporation to exploit its enormous Tengiz field is also stalled by uncertainty over transport. The ambassador indicated that Kazakhstan would consider building a pipeline under the Caspian, which could join the Azerbaijani network on the other side.

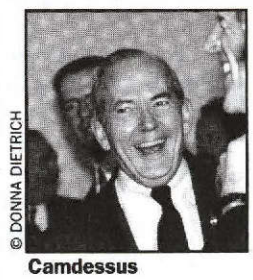
Plus ca Change at the IMF

BY ANTHONY ROWLEY

The seductive arguments being advanced now about the need to reintroduce capital controls in the wake of the Mexico crisis were first heard back in the 1960s, when the post-war era of free capital flows began and the transfer of funds across national frontiers increased dramatically. This is one of the findings of a major new study, entitled *International Monetary Cooperation Since Bretton Woods*, published today and commissioned by the IMF to mark its 50th anniversary. In it economics professor Harold James of Princeton University reveals just how little has changed for the IMF since 1945.

At that time too, there were voices ready to claim — as they do now with the burgeoning of emerging market investment — that private capital flows render the IMF's role as a global lender of last resort redundant.

History exposed the shortsightedness of such views. Far from being reversed, the liberalization of capital flows spread from the developed to the developing world and underpinned a dramatic increase in world trade and in global economic prosperity, James argues. "Capital movements are an essential part of the development process," he says, noting that the IMF might usefully introduce a "code for capital liberalization."



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Camdessus

Desirable though they are, liberal capital flows inevitably increase the "extent of sensitivity and vulnerability" of the system to Mexico-type shocks, James allows. That being so, the role of the IMF becomes more necessary than ever in financing short-term imbalances and restoring stability. This remains as true today as it was in the 1960s, he argues, and there is no substitute for the IMF to fill this lender of last resort function.

James experiences a sense of deja vu in examining recent episodes of (export-boosting) benign neglect of the dollar on the part of the U.S. These look positively innocent, he says, compared to U.S. "manipulation" of its exchange rate in the 1960s to secure "national advantage."

While he finds the flexible exchange rate system that allows such adjustments is "not undesirable," James asserts that in order to prevent abuse it needs to be underpinned by increased international coordination of long-term macroeconomic policies. Here again, he suggests that there is no substitute for the IMF to act as watchdog and policeman — though its mandate will need to be more strongly endorsed by international consensus.

News

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Brace for Wild U.S. Budget Debate, Warns Leach

BY PETER KOENIG

James Leach, chairman of the U.S. House of Representatives banking committee, told a gathering of international bankers yesterday that "if the U.S. does not get its fiscal house in shape, it will have a revolution," and warned that debate over the U.S. budget this autumn could take America into historically uncharted waters.

"There will be vetoes," Leach predicted, adding that in the face of Republican efforts to cut the U.S. budget, U.S. President Bill Clinton will use his veto power "to keep the level of government spending up."

The lawmaker reminded those watching the U.S. economic outlook in the run-up to the 1996 elections that America has "very little experience with an executive branch more liberal than the legislative branch." Leach characterized congressional threats to drive the U.S. government into technical bankruptcy if the Clinton White House blocks budget cuts as a "fairly dangerous game." He added, "There is no historical base for how things are going to work out."



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Leach is worried

Speaking at a symposium organized by the Institute of International Finance, a big bank trade group, the 10-term Republican from Iowa, who is a graduate of the London School of Economics, conceded that the failure of the U.S. "to live within its means [at a time of relative prosperity] is a scandal for the rest of the world." He expressed hope that the White House and Congress would own up to this fact and that, over the upcoming 10 weeks of debate, Clinton would be prepared to "compromise more" than Congress on the grounds that regarding tax and spending issues, Congress traditionally enjoys the benefit of the doubt.

One of America's leading authorities on financial systems, Leach asked the bankers listening to him to recognize their role "as among the politically most important peacemakers in the world, more important than people elected to high muckety-muck offices." He argued that international finance was overshadowing geopolitics as the dynamic most influencing world events.

Leach painted a picture of American banks emerging from a period of weakness to become a powerful force in global finance. Speaking as the point man on efforts to reform the Glass-Steagall Act, the Depression-era U.S. law that builds firewalls between different types of financial institutions, Leach outlined a wide array of measures being worked on to increase the efficiency and competitivity of American banks.

Describing the deregulation of savings and loans which resulted in a $220 billion bill for U.S. taxpayers as "perhaps the worst policy mistake of the century." Leach argued somewhat paradoxically that one of the great strengths of the U.S. was "the honesty of its banking system based on competition."

Cavallo's Optimistic Outlook Unconvincing

BY K. MICHAEL FRASER

Argentine economy minister Domingo Cavallo brought his dog and pony show to Washington, but he failed to infect many of the world's top bankers attending the Institute of International Finance (IIF) meeting yesterday with his optimism.



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Cavallo: starry-eyed

Cavallo, who is on the road trying to soothe the international financial community's concerns about Argentina's economy, predicted close to 1 percent GDP growth for this year, based on a fourth quarter recovery after two quarters of decline. For 1996, he predicted 5 percent growth.

The IIF, an international association of banks, predicts a 0.5 percent decline for this year and a fall of 0.3 percent in 1996.

After Cavallo spoke, a former Argentine government finance official told *Emerging Markets,* "5 percent is overly optimistic. It's not impossible, but I don't see it happening unless we have some pleasant surprises." Without pleasant surprises such as significantly lower U.S. interest rates, which are beyond Argentina's control, he also expects a small decline next year.

A New York-based money manager who invests in Argentina said that with domestic consumption soft, investment down and the government refusing to increase spending to stimulate the economy, he sees little reason to expect 5 percent growth next year. Exports are growing, but they alone can't stimulate such a quick and strong turnaround. "Cavallo's optimism is predicated on the engine of growth speeding up, but we don't see any of the cylinders firing," he said.

The run on Argentina's banking system following the Mexican devaluation has forced Cavallo to relax controls on the money supply. Cavallo cut banks' reserve requirements early in the year and has delayed government regulations requiring them to return to higher reserve levels for three months, until February. The minister also has allowed small and medium companies to delay tax payments.

But allowing money supply increases puts pressure on Cavallo's peso convertibility plan, which is the key to his strategy for stabilizing the economy.

Saulo Blauth, managing director and chief executive of London-based BB Securities, which trades Argentine debt as part of the Banco do Brasil Group, said, "Cavallo has been forced into a balancing act."

A former U.S. banker turned consultant who follows Argentina closely, warned, "Cavallo doesn't have much room for unexpected problems."

Still, bankers and analysts generally agreed Argentina was not teetering on a crisis, even if growth falls short of Cavallo's projections. The New York-based fund manager said, "Less than 5 percent growth does not mean another crisis." The former Argentine government official said that even a small decline in the economy would not be a disaster. Daniel Marx, who heads Darby Overseas Investments in Washington, shared this view, saying "I am not concerned about the banking system as a whole. There will be consolidation, but it is relatively well capitalized and liquid."

He added, "People have to understand that the reform process continues, and that there is good management of the process."

"Argentina has weathered the very difficult crisis of March and April," concluded the consultant. "It's not nearly so fragile now. Unless there are some really nasty surprises, it should pull through."

Stiglitz Outlines Clinton Strategy

Joseph Stiglitz, chairman of the U.S. Council of Economic Advisers, yesterday offered a tantalizing glimpse into not only the Clinton administration's battle plan for the 1996 presidential election, but also its position on the behind-the-scenes debate taking place this week over the reforms needed to improve international economic coordination.

"There are two key long-term challenges facing the Group of Seven: fiscal consolidation and the reform of international organizations," the leading American academic declared, and launched into a beguiling mix of analysis and political campaigning.

Characterizing Japan's problems as "most challenging" (and then joking, "This is the euphemism the administration prefers me to use,") Stiglitz urged Tokyo's ministry of finance to "confront" the estimated $400 billion to $1 trillion in bad loans weighing down its banks.



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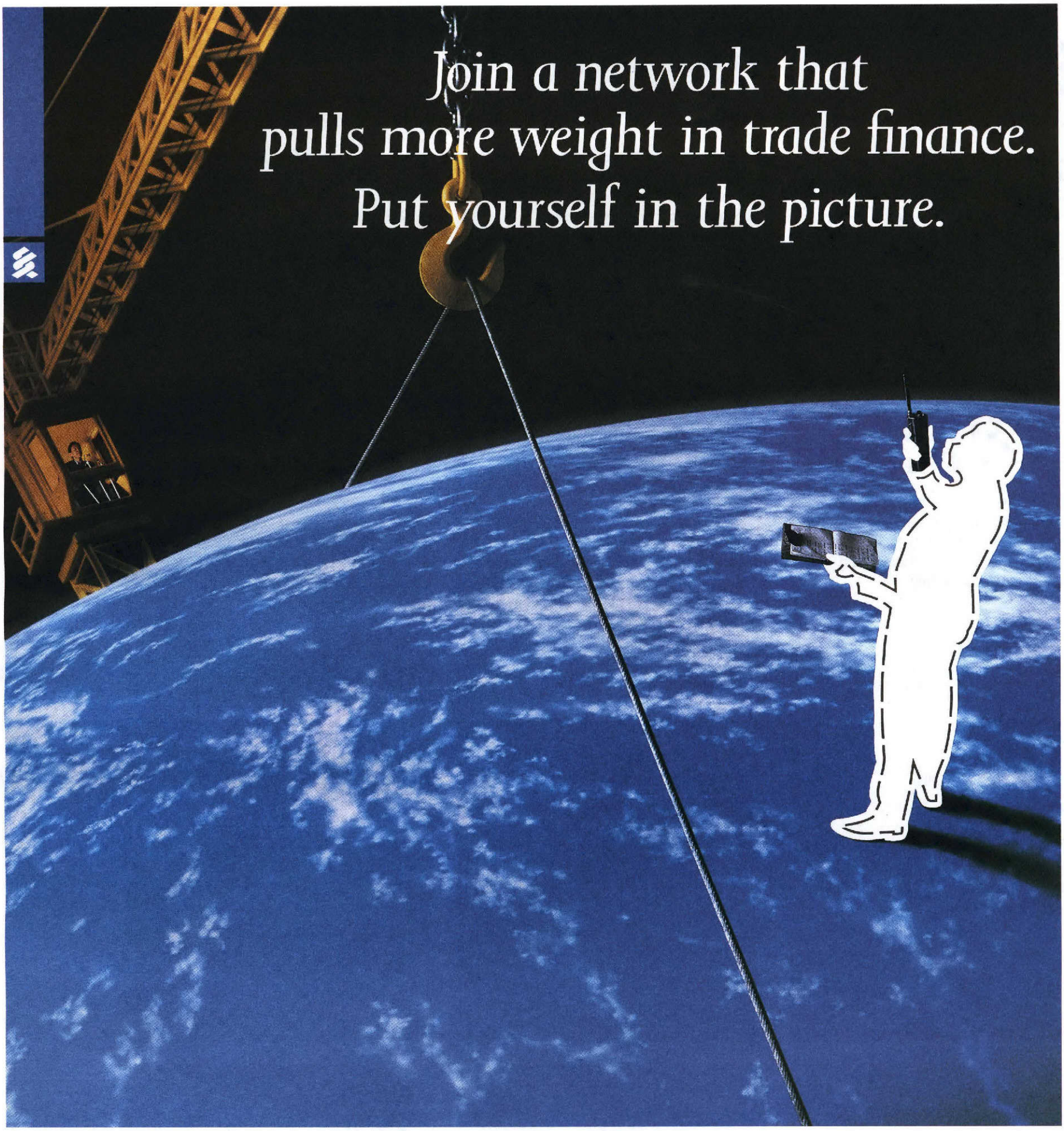
Stiglitz

The chairman cited unemployment as a key problem facing Europe. He suggested there was consensus on the need for industrial nations to reduce government budgets, but warned that only the "right kind" of cuts would raise growth and improve living standards.

Stiglitz boasted that by reducing the U.S. government budget deficit to $160 billion in 1995, the Clinton administration has turned the U.S. into the star deficit-reduction performer — as measured by government debt as a percentage of GDP — among the G7. "But," he warned, "you need the right kind of deficit reduction." He argued that, led by Republican House spokesman Newt Gingrich, the U.S. Congress was intent on stealing the mantle of fiscal probity from the White House by slashing education and health at the expense of America's long-term productivity.

The chairman also suggested that supranational organizations like the IMF, World Bank, and United Nations could improve their productivity by "working to avoid duplication." The previous day, U.S. treasury secretary Robert Rubin made remarks spotlighting the importance Washington attaches to the process of institutional reform initiated at the Halifax G7 summit. Coupled with this, some analysts interpreted Stiglitz's comments as further evidence that Washington is pushing for a more radical reform of the Bretton Woods system than is publicly acknowledged.

— Peter Koenig



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BZW acted as co-arranger and administrative agent of the US$500 million Tranche A Construction and Term Facility of the total US$950 million senior debt project financing for FLAG Limited of Hamilton, Bermuda.

July 1995

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June 1995

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BZW was arranger in the US$120 million securitization of equipment leases through Sheffield Receivables Corporation for Tokai Financial Services, Inc., a subsidiary of the Tokai Bank, Limited.

June 1995

Italpet reforme s.p.a.

BZW acted as debt structurer, arranger and agent bank for Italpet Preforme SpA, in a DM241.8 million project financing of a plastic resin production plant in Italy.

April 1995

NPC

BZW acted as financial adviser to National Petrochemical Public Company Limited for the restructuring of its US$315 million project finance facilities, and arranger and sole underwriter for the US$150 million offshore refinancing facility.

March 1995

IFC
INTERNATIONAL FINANCE CORPORATION

BZW was joint lead manager to the International Finance Corporation in the issue of US$400 million 7 7/8 per cent notes due 2005.

February 1995

Caisse Française de Développement

BZW was lead manager to Caisse Française de Développement in the issue of US$290 million 8 per cent guaranteed notes due 2000.

January 1995

GROUPE BERGER

BZW advised shareholders of Compagnie de Gestion Mobilière S.A., holding a majority interest in Berger, in the 100 per cent sale of their shares to Marie Brizard et Roger International.

January 1995

BZW was lead manager to the Japan Development Bank in the issue of £250 million 9.125 per cent bonds due 2005.

January 1995

Rabobank Nederland

BZW was lead manager to Rabobank Nederland in the issue of US$200 million 7 7/8 per cent notes due 1997.

January 1995

RJB

BZW was financial adviser, broker and debt arranger to RJB Mining in its £815 million acquisition of English Coal.

December 1994

GR
GRASIM

BZW was lead manager of the US$100 million issue of global depositary receipts by Grasim Industries Limited.

June 1994

INVESTMENT BANKING. FROM A TO BZW

News

WHAT'S COOKING ON THE FRINGE

In the Wolfensohn era, campaigners and World Bank management are sitting down together. But direct action protest will not go away, even if both sides are taking tea. *Emerging Markets* sighted Danny Kennedy, the self-styled "radical youth activist" who was ejected from the 1994 Madrid meetings for trying (and failing) to deliver the late Lewis Preston a cake in the face. Danny won't reveal what antics he plans this year, but confirms that the fringe is planning some big-time theater.

More in the mainstream, a demonstration is planned for 10:00 a.m. today, starting at Dupont Circle and marching up Connecticut Avenue to the Sheraton Hotel. Protesters will deliver the BAP — beans, aspirins and pencils — symbolizing IMF and World Bank-inspired budget cuts.

NGOs: Will Wolfensohn Show Teeth?

BY JON MARKS

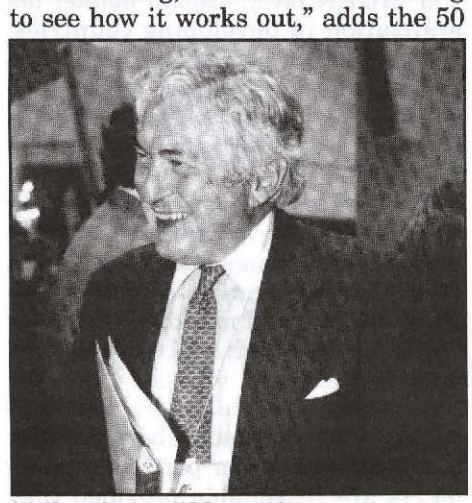
The sternest critics of the Bretton Woods institutions say that new World Bank president James Wolfensohn could be an unexpected ally. In a week when the 50 Years is Enough campaign and other NGO groups will gain an international audience, campaigners are increasingly confident that nongovernmental organizations (NGOs) are finally making an impact on development policy.

"Mr. Wolfensohn has taken some initial decisions that suggest he may take hold of the World Bank and shake it hard," said Juliette Majot of International Rivers Network, an NGO founding member of the 50 Years campaign.

Majot cites the cancellation of the controversial Arun III hydropower project in Nepal, a focus for NGO criticism during the 1994 annual meetings in Madrid, as evidence: "Everything about the project said that Arun should be cancelled, but senior management in the bank didn't want that. Wolfensohn used Arun to establish that he is boss...the question now is how is he going to follow up and show his mettle?"

Moves towards debt relief and plans to change the much-criticized internal incentive system are other positive signs for the NGOs. "Whether he will be able to shake any sense into it will depend on the breadth of vision, the depth of his commitment to a substantial shift in the bank's policies and programs, and the strength of his power internally," Majot said.

"What Wolfensohn has done so far is interesting, but we're still waiting to see how it works out," adds the 50 Years campaign's media coordinator Ross Hammond. "The NGO community has been burned before; we've seen good intentions revealed as no more than PR."



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Wolfensohn has NGO appeal

From an original 30 groups, the 50 Years is Enough campaign has grown to 160 groups in the U.S., plus 170 partner organizations in more than 60 other countries. This week it is coordinating meetings in Washington that will bring together NGO representatives from over 30 countries, including an alternative forum held at American University this weekend.

Among issues on the NGO agenda this year, campaigners say, are the need for greater transparency in the International Finance Corporation (IFC), the Multilateral Investment Guarantee Association (Miga) and other multilaterals promoting the private sector.

Methods of scrutinizing traditional public sector projects funded by the World Bank group and other multilaterals do not necessarily apply when it comes to their burgeoning private sector activities, Majot claims. "When it comes to the IFC and Miga, a lot of rules which were hard fought for by NGOs don't apply," Majot said.

Among cases for close scrutiny are Miga-backed projects involving Freeport mining in Iryan Jaya and a polluting gold mine in Guyana. According to Majot, "Miga is coming under the magnifying glass."

Campaigners and World Bank management are finally sitting down together to discuss such issues. But activists and bank officials say there remain clear limits to how far the new relationship can go, despite Wolfensohn's determination to hear what critics are saying.

AFRICANS SLAM PRIVATIZATION POLICIES

BY PATRICK SMITH

African ministers and central bank governors gave bank president James Wolfensohn a ringing personal endorsement, but were sternly critical on bank privatization policy at a closed-door meeting over the weekend. "He's open, frank, to the point and unambiguous...he has a clear-cut vision of what he wants to achieve," was the assessment of Ronald Penza, Zambia's finance minister, after Wolfensohn's first meeting with the African governors' caucus over the weekend. Ghana's central bank governor Kportuphy Agama praised Wolfensohn's "realistic and immediate responses" to the questions raised at the meeting.

The meeting's dominant issue was the new pressures on International Development Association (IDA) and other aid flows from the U.S. Congress and from other industrialized countries. Agama said that Wolfensohn "raised a challenge that [the bank and Africans] should all work together to persuade the donors to keep their commitments." The Africans asked the bank "to intensify its communication outreach campaign and highlight the mutual benefits of aid for both donor and recipient countries."

Penza stressed that Africans must realize there is a quid pro quo for support on aid flows: "We know resources are short, domestic demands on [industrial country] budgets are very high," he said. "We need to reorient ourselves and manage within the new environment. It is up to Africans to contribute to the sustainability of the World Bank."

Wolfensohn also won plaudits at the meeting for the bank's initiatives on multilateral debt reduction, particularly from Ugandan and Zambian officials. "We wish to encourage you, Mr. President, and the bank to take the lead in finding a comprehensive strategy that will speed up the resolution of of this problem," the governors said in a prepared statement. Wolfensohn emphasized that countries wanting debt relief would have to show they could perform. In subsequent discussion, there were doubts about how fast progress could be made in the current climate. Particular concerns were expressed that donor concessions on multilateral debt might be traded off for lower contributions to IDA coffers.

Prior to the meeting, South Africa's finance minister Chris Liebenberg expressed reservations about how the debt initiative might work, saying that he was worried about what would happen "further down the road" in terms of the indebted countries' credibility and how they would spend the resources saved from any debt deal.

In their statement, governors voiced disagreements over the bank's advocacy of privatization in Africa: "Our differences with many of our development partners primarily center on the pace at which many responsibilities in the development process can be transferred to the private sector, given that the private sector in many of our countries is almost either non-existent or in the early stages of development."

The Africans also urge the International Finance Corporation to play a much more strident role in the region, "to take the lead in seeking creative ways to do business in Africa." Likewise, the governors asked Miga to be "more aggressive in their promotional activities to attract foreign investment and technical assistance to improve the business environment."

Governors expressed strong disagreement over the bank's push towards privatization of tertiary education: "Our view is that this level of education is a key change agent which should be encouraged to play a leading role in society, particularly in those countries where the private sector is almost non-existent."

Nepalese Dam Victory Opens Floodgates

The repercussions of a successful grassroots campaign to halt a huge dam project from flooding an isolated valley in Nepal's Himalayas are being felt this week in Washington. Campaigners hope this summer's decision by World Bank group president James Wolfensohn to cancel the Arun III hydropower project will prove a defining moment in his presidency and lead to radical changes in the way projects evolve.

World Bank policy towards Nepal has completely changed in the last year, said Arun III activist Gopal Siwakoti. He told *Emerging Markets* that bank officials agreed that local groups should be involved in planning, implementing, screening and analyzing the benefits of future loans, although he noted, "The bank has said they want to do this, but really they have no criteria and guidelines to see how it is done."

Siwakoti spoke at a meeting analyzing the lessons of Arun III as part of the alternative forum, which took place over the weekend at Washington's American University and was organized by the 50 Years is Enough campaign.

Arguing for "endless pressure, endlessly applied," U.S. campaigner Lori Udall paraphrased the South American Guarani saying and declared, "We should come with spears from all sides." The Arun III campaign successfully lobbied the both the U.S. Congress and German government to put pressure on the World Bank. The project was officially shelved after co-financier Germany pulled out of what would have been its biggest ever bilateral project grant. Heffa Schuecking of Urgewald said the German federal audit office came to the same conclusion as the NGOs — that the German lending agency was too optimistic on benefits and ignored the negative factors.

Groups should mobilize to combat corruption and other ills, Siwakoti added: "It is very important to show the outside world how its taxpayers' money is being spent."

Division within the bank also helped. Vice president for South Asia Joseph Wood argued that cancellation would undermine all projects; Meanwhile, bank official Marvin Karsher resigned over the debate. The new inspection panel proved "an extremely important tool" in gaining time, Udall argued. Wolfensohn's willingness to act in face of opposition from his senior management was a final, essential element, she concluded.

— Jon Marks

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Printing: Smith Lithographic Corp., 1029 E. Gude Drive, Rockville, MD. James Brown, Account Executive Phone: (301) 424-1400/1 (800) 622-2577

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BARONS AND GURUS BACK CAPITAL CURBS

BY ROB WRIGHT & ANTHONY ROWLEY

Some of the gray-suited barons and gurus of high finance have begun to extol the merits of capital controls. The liberalization of investment codes is usually cited as holy writ at Bretton Woods gatherings, but in light of Mexico's ongoing currency doldrums, some now agree that it might not be a bad idea for developing countries to limit the amount of money that foreign investors can pour into their capital markets.

The re-examination of capital controls started gathering steam in August. That's when the IMF's annual capital markets report appeared with surprising sections saying that at times there could be good arguments for limits on capital inflows — but not on capital outflows.



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Cagey Malan

Brazilian finance minister Pedro Malan, for one, sees nothing wrong with that. At a World Bank seminar over the weekend on post-Mexico capital flows, he was asked about rumors that he might be considering a few surprises to keep investor money out, such as higher capital gains tax rates or mandatory holding periods. The cagey Malan gave no direct answer, but agreed it was hard to argue with the record of the Santiago bolsa, which has terms limiting the degree of foreign participation.

Many are pointing to the example of Chile, Latin America's best-performing stock market over the last 10 years. In addition to the bolsa's participation limits, Chile's early privatization of pension funds built up a sizable domestic investor class that financed extensive privatization without as much reliance on foreign capital as has been the case elsewhere. Korea and Taiwan are often cited as similar high-performing markets who have no shame in saying that they didn't let in all the foreign investors who wanted to attend their parties.

At the same day's IDB Latin banking crisis seminar, the Institute of International Economics' John Williamson raised a similar point to a group that included Bank of International Settlements managing director Andrew Crockett. Given all the money that flew out of Mexico so quickly this spring thereby leaving that exchange vulnerable, Williamson asked, shouldn't there be further consideration of restrictions as a general tool? Like Malan, Crockett was circumspect, but admitted that one lesson is that rapid liberalization of investment regimes can be dangerous.

"One of the things we all learned from the Mexican crisis is that there is a need for balance between local savings and foreign investment," said Citibank vice chairman William Rhodes at an IFC conference yesterday.

Despite the traumas that occurred in the wake of the Mexico crisis, the IMF still strongly favors capital market liberalization in developing countries. However, it is prepared to tolerate capital controls in the short term while countries adjust their domestic structures to cope with sudden surges in inflows or outflows.

The IMF believes that developing countries have everything to gain — increased efficiency and a lower cost of capital, for example — from opening their financial markets. But managing director Michel Camdessus says he understands the need for "prudence," and recognizes that controls against short-term borrowing by banks or short-term portfolio investments are reasonable provided they represent "necessary protection during a period of consolidation" and not a disguised strategy for controlling capital flows in the longer term.

Camdessus believes the Mexico experience was a healthy one because it made global investors more "selective" in their approach to emerging markets. This signals a healthy preoccupation with avoiding the risks of "too rapid a success," Camdessus says.

Bank Cartographers Map Road to Billions

BY KEVIN RAFFERTY

Economists at the World Bank have just embarked on a vital study in hope of drawing a road map for developing countries planning to open their capital markets to the huge but often turbulent flows of international private capital. These capital flows now swamp official aid by about three to one, totaling more than $155 billion a year against aid, which has dropped to $50 billion.

Amar Bhattacharya, economic advisor in the international economics department, told *Emerging Markets*: "We see the recent surge in private capital flows as a structural shift, reflecting not merely cyclical changes, such as responses to lower U.S. interest rates, but globalization of the capital markets in which developing countries are increasingly participating.

"The general shift towards market economies has been accompanied by huge technological changes and the information revolution," Bhattacharya added. The issue is "what are the driving forces and where is this world leading. Secondly, it is a relatively easy process to open up markets, but much more difficult to build up the macro foundation so that you can maximize the gains and minimize the risks of opening up," he cautioned.

At the moment, about a dozen countries account for 90 percent of the total private capital flows to the developing world. The expectation of economists both in the World Bank and outside is that these flows will increase. This trend will be driven by demand from developing countries for new sources of funds as their economies see the benefits of open markets, private enterprise and higher growth and by the need for institutional investors in the West, particularly the big pension funds, to find higher returns than are available in their own maturing economies.



©RAFOTO

Bhattacharya

Another recent development has been the move away from banks as the prime source of private capital. "The share of the commercial banks is now down at about 14 percent as foreign direct investment and portfolio equity flows have grown," continued Bhattacharya.

There is a distinct difference between the fast growing Asian markets — where foreign direct investment is the major factor and accounts for more than 50 percent of the total capital — and more erratic Latin America, where portfolio equity is the biggest supplier of foreign capital with 45 percent, followed by debt.

Hence the need for a road map, said Bhattacharya, to provide answers to such questions as what are the macroeconomic instruments, the institutions, the accounting and disclosure rules, the legal framework and the specific asset markets for stocks and shares, bonds, venture capital and leasing that are needed. Equally important is what should be the priority agenda and the correct sequence for opening up a market to foreign capital.

He notes that "it is easy to leapfrog the technology [to open a market to capital flows], but not so easy to leapfrog the institutional and policy framework".

Some of the countries that are already receiving or are ripe for receiving private capital, such as China (already the biggest recipient with $36 billion in 1993) and India will benefit from such a road map. China has an underdeveloped legal system, which is already bringing complaints from investors, and these are likely to grow. India has a well developed legal and institutional framework, but in the words of one leading banker who deals with the country, "It is autarkic and archaic, slow-moving and attuned to domestic needs, not to a modern international environment."

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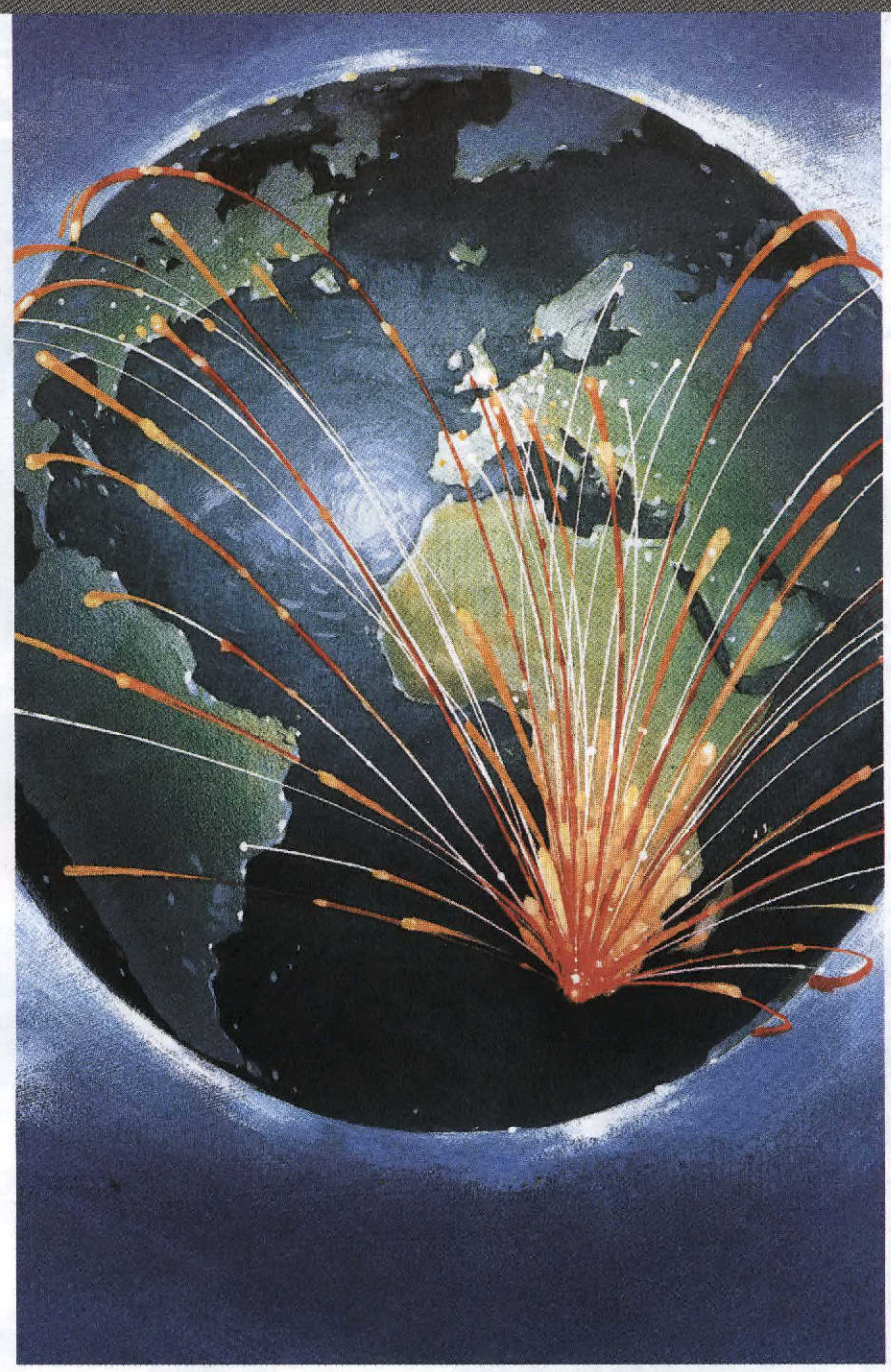

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Preview

October 9-10, 1995 AGENDA

MONDAY, OCTOBER 9

7:30–9:30 A.M.
Emerging Markets Annual Meeting Forum, "Taking stock in Turkey: Istanbul as a regional financial center." Breakfast and panel discussion with: Kaya Didman, director, Baring Securities International; Yavuz Canevi, chairman, Association for Foreign Capital Coordination; Ata Koseoglu, managing director, Bear Stearns; and Aril Seren, senior vice president, Istanbul Stock Exchange. Omni Shoreham Hotel. All delegates and guests are welcome.

ALL DAY
Dean Witter's Washington information service will offer market news and data throughout the week at 1850 K Street NW, Suite 900. Bloomberg, Knight Ridder, Dow Jones news services available. For further information call Ms. Sevilla at (202) 862-9116

7:30–9:30 A.M.
The Institute of International Bankers hosts its annual breakfast dialogue. Salon A, Four Seasons Hotel. By invitation.

8:00 A.M.
ING Group hosts a breakfast presentation, "Current trends in the emerging markets." Speakers include: Sir William Ryrie, director, Baring Holding Company; Michael Howell, head of global strategy, Baring Securities London; and Arturo Porzecanski, managing director, ING Capital New York. Park Hyatt Hotel. By invitation.

8:00-9:30 A.M.
Standard Chartered Bank hosts a breakfast. The Carlton Hotel.

8:30 A.M.
Breakfast hosted by Banco Pontual, followed by a discussion with former central bank of Brazil presidents Affonso Celso Pastore and Ibrahim Eris. Madison Hotel.

8:30 A.M.–2:30 P.M.
Eighth annual Brazil economic conference, sponsored by the Brazilian-American Chamber of Commerce. Guest speakers include Brazil's finance minister, central bank president and ambassador to the U.S. Omni Shoreham Hotel.

9:00 A.M.
Development committee meeting chaired by Mohamed Kabbaj of Morocco. Press conference with Kabbaj, IMF managing director Michel Camdessus, and World Bank Group president James Wolfensohn to follow. IMF Meeting Hall.

9:00–10:30 A.M.
World Bank Group country seminar, "Bangladesh: a new horizon for investment." Sheraton Washington Hotel.

9:00 A.M.–2:30 P.M.
The Harvard Institute for International Development and the Carnegie Endowment for International Peace host the first joint conference for economic ministers, "New ideas in economic management." Carnegie International Center.

10:30 A.M.–12:00 P.M.
World Bank Group country seminar, "Moldova: stability and reform." Sheraton Washington Hotel.

11:00 A.M
IFC press briefing: developments in emerging stock markets. H Audit. Annex.

12:00 P.M.
ABN-AMRO Bank hosts a luncheon at The National Museum of Women in the Arts.

12:00–2:00 P.M.
Euromoney magazine hosts a reception for the presentation of the Finance Minister of the Year award. Shoreham Hotel, Suite 100.

12:00–2:00 P.M.
The Institute of International Bankers hosts a luncheon. Four Seasons Hotel. By invitation.

12:00–2:30 P.M.
Chemical Banking Corporation hosts a buffet luncheon at The Corcoran Gallery of Art. By invitation.

12:30 P.M.
Creditanstalt-Bankverein hosts a luncheon. John Hay Room, Hay Adams Hotel.

2:00 P.M.–4:00 P.M.
World Bank Group Nobel laureates panel, "Nobel perspectives on the policy frontiers of environmentally sustainable development." Sheraton Washington Hotel.

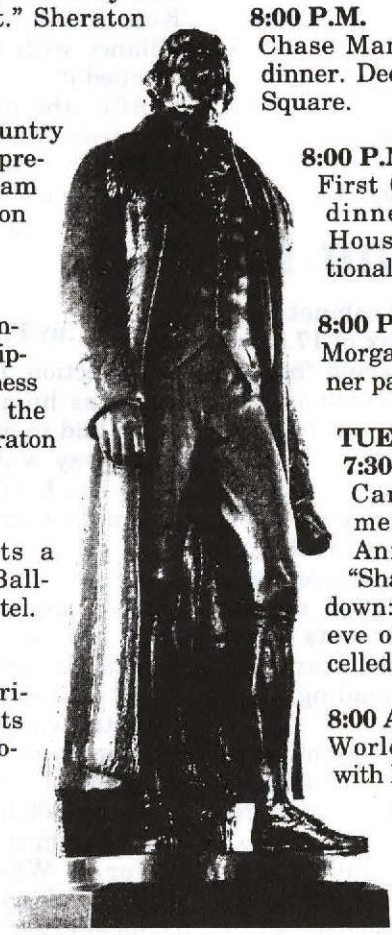
2:30–4:00 P.M.
World Bank Group country seminar, "Peru: a comprehensive reform program is paying off." Sheraton Washington Hotel.

4:00–5:30 P.M.
World Bank Group country seminar, "The Philippines: a dynamic business community is leading the new growth era." Sheraton Washington Hotel.

5:30–7:30 P.M.
Bank of Tokyo hosts a reception. Corcoran Ballroom, Four Seasons Hotel.

5:30–7:30 P.M.
Brown Brothers Harriman & Company hosts a reception. The Corcoran Gallery of Art.

5:30–7:30 P.M.
Unico Banking Group hosts a reception and viewing at the Renwick Gallery.



5:30–8:00 P.M.
Reception hosted by the World Gold Council. Diplomat Room, Omni Shoreham Hotel. By invitation.

6:00–8:00 P.M.
Citicorp/Citibank hosts a reception at The National Museum of Women in the Arts.

6:00–8:00 P.M.
Bank of America hosts a reception at The Woodrow Wilson House Museum.

6:00–9:00 P.M.
Reception hosted by Arab Banking Corporation. Park Ballroom, Park Hyatt Hotel.

6:30–8:30 P.M.
The Korea Development Bank hosts a reception. Palladian Room, Omni Shoreham Hotel.

7:00 P.M.
Emerging Markets CEO of the Year awards dinner, sponsored by International Media Partners and ING Bank. Awards will be presented to Asea Brown Boveri's Percy Barnevik and Acer's Stan Shih. Willard Inter-Continental Hotel.

7:00 P.M.
The IMF and World Bank host a concert by the National Symphony Orchestra. John F. Kennedy Center for the Performing Arts. By invitation only.

7:00 P.M.
ChinaTrust Commercial Bank hosts a dinner banquet. Twin Oaks, 3225 Woodley Road.

8:00 P.M.
Chase Manhattan Bank hosts a dinner. Decatur House, Lafayette Square.

8:00 P.M.
First Chicago Bank hosts a dinner party. Meridian House, Meridian International Center.

8:00 P.M.
Morgan Stanley hosts a dinner party. Phillips Collection.

TUESDAY, OCTOBER 10

7:30–9:30 A.M.
Cancellation announcement:*Emerging Markets* Annual Meeting Forum, "Shakeup, shakeout, shakedown: global banking on the eve of 2000" has been cancelled.

8:00 A.M.
World Bank press briefing with President James Wolfensohn. Room 2, Sheraton Washington Hotel.

10:00 A.M.
Opening ceremonies and addresses by board of governors chairman and Benin finance minister Paul Dossou, James Wolfensohn and Michel Camdessus. Plenary Hall, Sheraton Washington Hotel.

12:00–2:00 P.M.
Reception hosted by *Euromoney* magazine for the presentation of the Central Banker of the Year award, Shoreham Hotel, Suite 100.

12:15 P.M.
HSBC Holdings hosts a lunch party. Douglass Room, Smithson Room, Four Seasons Hotel.

12:30 P.M.
Korea Exchange Bank hosts a luncheon. Willard Inter-Continental Hotel.

3:00 P.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

5:00–7:00 P.M.
The Industrial Bank of Japan hosts a reception. Sheraton Carlton Hotel.

5:30–7:30 P.M.
Abecor hosts a reception. Grand Promenade and Courtyard, The Grand Hotel.

6:00 P.M.
The Saudi Arabian Banks host a reception. The Palladium Room and Veranda, Omni Shoreham Hotel.

6:30–8:00 P.M.
The World Savings Bank Institute and European Savings Banks Groups host a cocktail reception. Ritz-Carlton Hotel.

6:30–8:30 P.M.
Credit Suisse and CS First Boston host a reception and private viewing at The Library of Congress. Great Hall, Thomas Jefferson Building.

6:30–9:30 P.M.
Merrill Lynch hosts a buffet reception at The National Air and Space Museum.

6:30 P.M.–Midnight
Republic National Bank of New York hosts a reception at the National Gallery of Art.

7:00–9:00 P.M.
The Kuwaiti Banks host a reception. Corcoran Ballroom, Four Seasons Hotel.

7:30 P.M.
The Institute of International Bankers' board of trustees hosts a dinner for government officials. Metropolitan Club. By invitation.

8:00 P.M.
J.P. Morgan hosts a black tie dinner. 3050 Avon Lane, NW.

10:00 P.M.
Bankgesellschaft Berlin hosts late night cocktails followed by a live show: "Broadway Meets Berlin." Sequoia Restaurant, 3050 K Street.



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RWANDA'S VICTIMS TIRE OF INTERNATIONAL LIP SERVICE

BY MARK HUBAND

More than one year after Rwanda's genocide was halted by the victory of the Rwandan Patriotic Front (RPF), the failure to procure justice for the victims has worsened the instability of the African great lakes region and severely tarnished the reputation of international institutions.

At each stage of the international investigation into the deaths of one million Tutsis and moderate Hutus at the hands of government death squads between April and June last year, new hurdles have exposed a lack of will and resources, rather than a sincere determination to bring the killers to justice.

The bulk of the killers identified by the RPF are thought to be in Zaire. But Zaire has enacted no legal processes to find and arrest them, despite promises that it would do so. Instead, Zairian troops have chased thousands of Rwandans from the refugee camps in eastern Zaire back into Rwanda, simply to get rid of them.

But Zaire's experience is perhaps not so out of the ordinary. The government in Kinshasa has been provided with no legal instruments with which to enforce prosecution against known perpetrators of the genocide, as the international tribunal established to try them has yet to identify the accused by name.

The widely-held view that Zairian President Mobutu Sese Seko's sympathy lies with the Hutus whose extremist wing was responsible for the slaughter, and that as such there is no will in Zaire to arrest the killers, is difficult to prove. But even if Zaire wanted to see the killers brought to justice it would have difficulty facilitating the process, as the tribunal established by the UN Security Council last November is still discussing its rules of procedure.

The worldwide lack of legal instruments was what allowed a Rwandan priest, Wenceslas Munyeshayaka, to walk out of a French prison on August 14. He had been accused of involvement in genocide, torture, ill-treatment and degrading acts at the Saint Famille church in Kigali. Despite being a high-profile suspect, prosecutors at the French court in Nimes had no power to hold him, though he was ordered to stay in the French town where has lived since fleeing Rwanda last year.

Throughout Rwanda, there is strong correlation among the stories of survivors. There is no shortage of evidence to support cases. But the best evidence of all comes from those who are guilty, as government radio broadcasts promoting the genocide while it happened are proof that there was a policy of slaughter.

The Rwanda War Crimes Tribunal says it has a list of 400 suspects for possible prosecution. Richard Goldstone, the South African judge heading the prosecution team, said in April that he intends to issue the first indictments in the second half of this year. So far none of the 400 names has been given out. No suspects are yet in the custody of the tribunal, even though Rwanda's prisons are overflowing with up to 40,000 inmates accused of involvement by the RPF-led government.

Despite the horror of the genocide, however, it has only been through Goldstone's open criticism of the investigation's shortcomings that sufficient resources have been made available to the tribunal. It took seven months for the current 32 investigators to install themselves in Kigali, and several more weeks for them to be granted their $6 million budget.

Goldstone said recently that trials would help Rwanda "embark on the path of national reconciliation by bringing to justice those responsible. Some are still in Rwanda, and others are in several African countries, as well as Europe and North America." However, the tribunal only intends to prosecute "those responsible for giving orders to kill, rather than those carrying out those orders," he said.

This policy, which will barely satisfy thousands of survivors who lost families, has increased the potential for individual acts of revenge and raised doubts about the contribution the trials will make to the process of reconciliation.

"We're disgusted with the international community. Their talk of support for us is just lip service, because they tell us to form a broad-based government with the killers, in order that we lose the moral justification for demanding the trial of those killers. I don't think the international community knows what reconciliation means," said Wilson Rotisserie, director of communications for the government in Kigali. EM



New Ghana Finance Chief Has Big Shoes to Fill

BY PATRICK SMITH

Ghana's new finance minister Kwame Peprah has a hard act to follow at this year's annual meetings. Last month Peprah took the reins from Kwesi Botchwey, who had been serving out his notice after resigning in July. Peprah has to win the confidence of investors and donors grown used to Botchwey over the past 13 years and convince them he can hold down government spending in the run-up to Ghana's elections next year.

Botchwey had become almost an institution at the annual meetings. Named finance minister of the year by various banks and publications, he was in demand as a speaker to explain the story of Ghana's turnaround. As finance supremo, he took Ghana from virtual bankruptcy in the early 1980s to annual growth rates of more than 6 percent over the last decade. In the early 1980s when economic reforms were widely rejected in Africa, Ghana made a lot of hard choices.

Botchwey and President Jerry Rawlings' government opted for massive currency devaluations, redundancies for tens of thousands of government workers and sweeping liberalization of the trade and financial sector. The trade off was more than $4 billion in donor funding and massive inflows of investment in Ghana's mining and timber sectors.

Ghana's growth was touted as proof that World Bank and IMF economic reforms can work in Africa. But this year the picture began to change. Under pressure as budgetary pressures rose, Botchwey introduced — with full cabinet backing — a value added tax of 17.5 percent. He said the tax would "become the single most important instrument of revenue in the coming years."

But the introduction of the tax was mishandled. The price of almost everything — regardless of whether VAT should have been charged on it — began to rocket. Inflation, already worsened by poor harvests and a growing budget deficit, started to get out of control — heading above 50 percent.

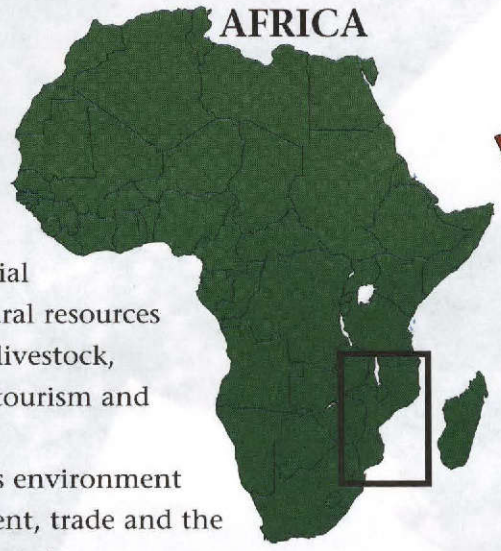
An anti-VAT opposition group known as the Alliance for Change capitalized on the government's discomfort and organized huge demonstrations across the country. Faced with such strong shows of public discontent, several members of parliament started to question the new tax, while the vice president Nana Kow Arkaah (whose party is in alliance with Rawlings) openly condemned it.

After the demonstrations, Rawlings took Botchwey along to a meeting with soldiers in the capital, Accra, telling them: "We are subject to correction. I ask you to accept my faults as human." The ground was being laid to drop the tax. Overseas, Botchwey was the financial engineer-in-chief; in Ghana, he was becoming a lightning rod for popular discontent.

The other problem was uncontrolled spending by some government agencies. Attention focused on Ghana's national oil company headed by Rawlings' confidant Tsatsu Tsikata, which borrowed some $125 million from the central bank and proceeded to make losses on the borrowings, Botchwey says. Tsikata and his chairman and former ambassador to Washington Joe Abbey strongly deny the figures and the claimed losses. But in the absence of a public inquiry or audit, it is difficult to establish who is right.

For many Ghanaians, particularly their iconoclastic private press, it was the battle with Tsikata that led to Botchwey's exit. But Botchwey remains diplomatic. He tells friends he has "no intention of sniping from the sidelines" and that economic development issues should not be "personalized or politicized." After handing the baton to his successor and former energy and mines minister Peprah, who has worked closely on the expansion of Ghana's mining sector, there are few hints as to Botchwey's future. Financial and academic institutions are making offers, but so far one project stands out — his promised book on the inside story of Ghana's economic recovery. EM

MOZAMBIQUE





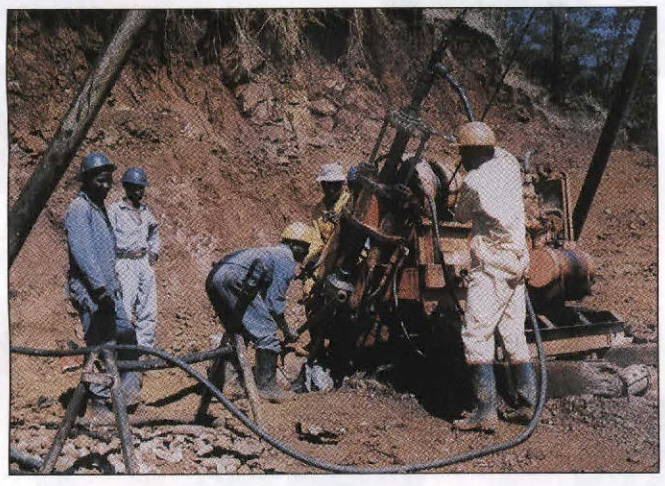
In Peace and Democracy Mozambique Welcomes Foreign Investment

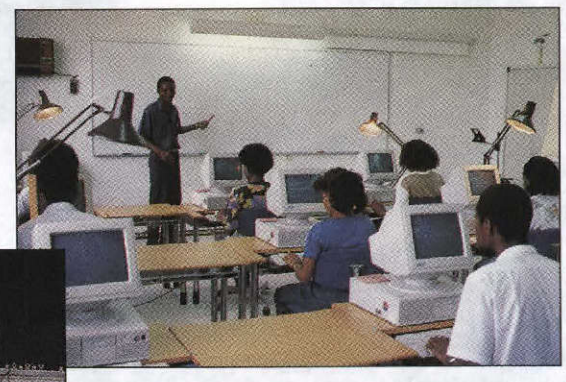
It offers a number of important advantages, including:

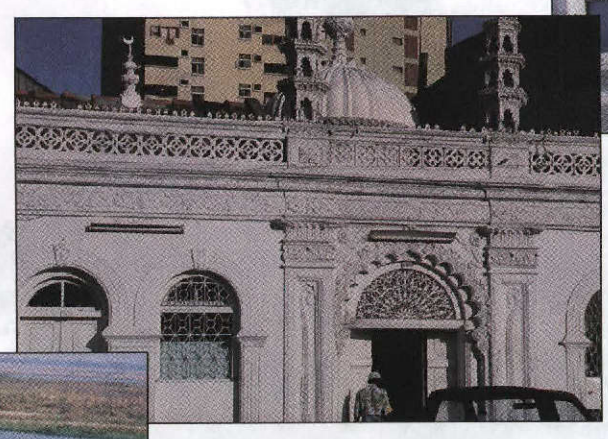
- enormous economic potential based on its abundant natural resources in the areas of agriculture, livestock, forestry, fisheries, mining, tourism and wildlife;
- a new political and business environment which encourages investment, trade and the development of the private sector.
- a liberal and attractive investment code, including a number of important investment guarantees and incentives;
- newly rehabilitated port and railway infrastructure giving excellent access to regional and international markets;
- a wide range of locally produced agricultural and mineral products which can be utilized for manufacturing and export;
- favorable trading regime under WTO, Lome and PTA arrangements; and
- an inexpensive, easily trainable and dedicated workforce.

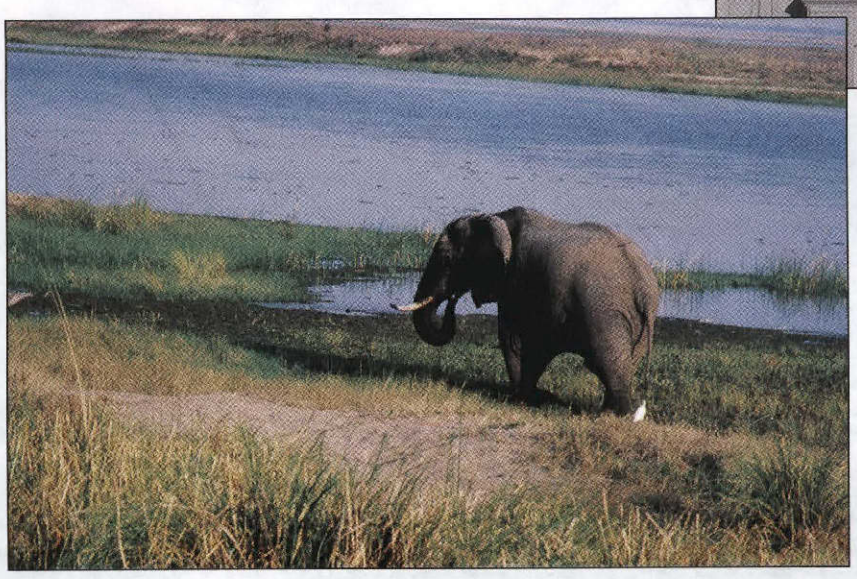
Investment Upturn Continues in 1995

Private investment levels rose sharply in 1994, with a total of 124 projects being registered by foreign and national investors worth US$412 million. This brings the total investment approved in Mozambique since 1985 to over US$1 billion. This trend has continued in 1995 with 67 projects worth US$155 million registered by CPI in the January-July period. The main sectors for investment activity in 1995 thus far are industry (US$79 million) and agriculture & agro-industry (US$37.7million).











Recent Investors

Some of the international companies who have recently chosen to invest and operate in Mozambique include: CIMPOR (Portugal) in the cement industry; SOSUN & South African Breweries (South Africa) producing and bottling Coca-Cola and beer, respectively; Nutrinveste, Lacticoop & Higest (all Portugal) in edible oil, milk products and animal feed industries; Mascareignes &PROPARCO (France) in prawn aquafarming; Colgate-Palmolive (USA) in consumer goods industry; Kenmare Resources (Ireland) in graphite mining and processing; Edlow Resources (USA) in the mining sector; IMPERIO (Portugal) in insurance services; EDESA-Edfund (Switzerland) and UDC (Zimbabwe) in financial and leasing operations; Mediterranean Shipping Co. Ltd. (South Africa) in marine transport; Equator Bank (USA) and BFE, BPA & BCP (all Portugal) in the banking sector.

CPI Investment Promotion Centre

Av.25 de Setembro No. 2049, First Floor, P.O. Box 4635 Maputo, Mozambique
Telephone: 258-1-422-456/7 Facsimile: 258-1-422-459



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ARGENTINE REFORM GETS BURIED IN MUDSLINGING

BY JUDITH EVANS

While Mexico remains roiled by political murders, Argentina's political environment is suffering from rampant attempts at character assassination. In the six months since Carlos Menem was reelected president by a landslide, the still-unfinished reform agenda has been buried by an avalanche of mudslinging. Unlike Mexico, no real blood has been shed, but both Menem and economics minister Domingo Cavallo are among the walking wounded and Argentina has proven — yet again — as former U.S. secretary of state Henry Kissinger put it, to be a "political enigma."

The paradox this time has less to do with the well known and publicly demonstrated strains between Menem and Cavallo than with timing of the attacks and counterattacks lobbed at each other by pro- and anti-Cavallistas and myriad other opportunists. The antipathy between the two has long been factored into risk and investment calculations, as well as in public opinion. At the time of the elections in May, a date that now seems light years ago, the two appeared to have buried their differences and were heading for another four years of triumphs. Victory at the polls came even as the Tequila Effect was hitting Argentina's economy. As West Merchant Bank economist Peter West points out, the low point in capital flight was hit on May 15, by which time Argentina had lost $8.4 billion since December 1994. Worse still, May's unemployment figure of 18.6 percent left the government reeling and desperately searching for excuses for its inaction when any number of business chambers had proposed programs over the previous 18 months.


Menem: assassinated character?

"The unfortunate and frustrating aspect of this crisis," explained economist Pedro Lacoste of Alpha Consulting, "is that it has exploded when the economy is beginning to come out of the slump and leave behind the Tequila Effect." The government was able to place two bond issues, one in yen and one in marks, which allowed it to buy back debt paper held primarily by Argentines. Moreover, it plans to repurchase a sizable chunk of the BIC domestic bonds in October. This, plus the more flexible fiscal targets agreed on with the IMF, have made it possible to inject liquidity and place a floor under the recession's quicksand. In addition, the private sector continues to demonstrate the productivity gains made in the last four years by piling up a significant positive trade balance. Exports grew by 42 percent in the first seven months of this year, creating a $1.2 billion trade surplus. In addition, the composition of exports proves that Argentina can hold its own in non-traditional areas like oil and petroleum products and intermediate goods.

The banking system, which appeared on the verge of a meltdown a few months ago, has cooled down, although smaller, weaker banks have been frozen out as stronger institutions account for the recuperation of 60 percent of capital losses. In addition, the current account deficit is predicted to end the year at 1.4 percent of GDP, considerably less than 1994's 3.5 percent. In short, as West states with daring certainty, "Argentina can no longer be said to have a balance of payments-current account problem."

With all this good news, why have analysts begun to fear for Cavallo's tenure and why have Argentine Brady bonds led the market in underperformance over the past two months?

The short answer is that Cavallo's attacks on "mafias" smashed the gentlemen's agreement to go easy on charges of corruption that had lasted for over a decade. For every Alfredo Yabran, the man who was denounced by Cavallo for his attempt to influence the much questioned privatization of the postal service, Cavallo's enemies will impugn an Aldo Dadone, the Banco de la Nacion official who resigned as a result of bribery charges against IBM.

So far, the corruption accusations have gained Cavallo a 13-point rise in his public approval ratings. Menem, however, as the elected president, has by definition the stronger hand. Bets are on that Cavallo stays until a successor that is considered acceptable by his supporters is found. That could be as soon as the end of the year when the new congress, with far more members favorable to Cavallo, is sworn in.

There is, unfortunately, a deeper and more disturbing line of thought. In their understandable determination to keep hard won stability, Argentines as well as foreign observers never bothered to ask the critical question: What kind of president will Carlos Menem be when he is no longer restrained by an election campaign? EM

Titans Clash in Chilean Energy Market

BY HOLLY JOHNSON

The benefits of free market economic policies could become a tangible reality for Chilean electricity consumers if today's competition between international giants to stake a claim in the country's fast-growing energy market continues. A refusal so far by two international consortia — one led by Nova Corporation International of Canada, and the other by Tenneco Gas and British Gas USA — to back down in the race to build a natural gas pipeline from Argentina's Neuquen province to Chile's central region, could mean that the market will face an excess capacity in electrical generation by the end of the century and rates could easily fall by 10-20 percent.

This scenario of titans fighting it out to get into the market is new for Chile. While investors have taken on billion-dollar risks before, these have been in sectors like mining where the game is to be low-cost suppliers in huge international commodity markets. In the pipeline war, they could each sell about $300 million worth of natural gas a year, according to Tennaco. In September, the economy ministry assigned gas transport concessions to both projects. Early on in the process, the authorities promised to grant concessions to "whomever asked, as long as they comply with security and environmental regulations," according to Juan Manuel Cruz, head of the economy ministry's market development division.

The Tenneco-British Gas project, called Transgas, entails building an 806 kilometer pipeline from the Loma de la Lata reserves in Neuquen across the Andes at 2,000 meters above sea level to Concepcion, Chile, and up the center of the country to Santiago. At maximum capacity, the pipeline will transport up to 17 million cubic meters of natural gas per day. The total investment for transport and distribution will be about $850 million.

Nova's project, GasAndes, includes linking up to and expanding the Centro Oeste gas pipeline in Argentina, to bring up to 20 million cubic meters a day directly to Santiago via Mendoza, Argentina. Total investment would near $460 million.

Natural gas is important for Chile in many ways. Whether one or both pipelines are built, electricity tariffs will fall and industries that convert fuel sources will be able to lower fuel costs and meet the 1997 deadline for reducing particle emissions. That is especially important for the coal-fired electrical generators around Santiago. With gas, new power plants will be less contaminating and more efficient. To meet the national energy commission's timetable, at least 350 megawatts of new power is necessary per year starting in 1998.

Power plants will use nearly half of the pipelines' transport capacity. Both projects have signed 25-year supply contracts with electrical generators. GasAndes was the first to settle the deals, signing on four plants. Transgas pulled through at the last minute with three surprise customers, including the U.S.'s Entergy, a newcomer to the Chilean electrical sector. The total of seven new plants coming on line between now and the end of the century nearly doubles the commission's estimated demand.

These international players are fitting puzzle pieces together.

No one appears willing to back down. Even so, Nick Kangles, a Nova senior vice president, believes "there will be only one pipeline." But, competitor Ewell Muse III, senior vice president for Tenneco Gas, says: "We are willing to go ahead even if there are two pipelines."

Despite the numbers involved, getting into the Chilean energy market makes sense in that Chile has an open market with clear-cut rules of the game. And these international players are fitting puzzle pieces together: GasAndes would hook up to a Nova affiliate's pipeline in Argentina; Entergy already has plants in Brazil and Argentina, and wants into Peru; Tenneco and British Gas plan a $2 billion pipeline from Bolivia to Brazil. British Gas has other investments in Argentina as well. Tenneco's Muse sees "an enormous amount of opportunity in Tenneco's building a base business here." Dioclecio De Araujo, president of British Gas Americas, concedes that in another 10 years or so, all of these isolated initiatives could hook up into "an interconnected network of gas pipelines." In the meantime, it is the Chilean consumer who is being rewarded. EM

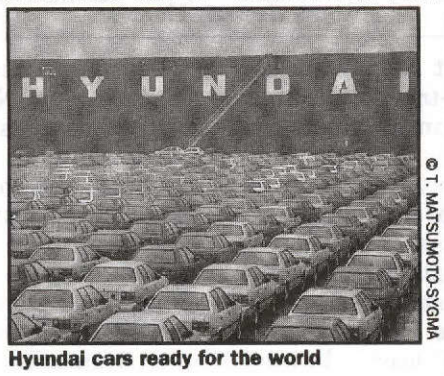
Asia Pacific

MONDAY, OCTOBER 9, 1995 EMERGING MARKETS IMF/WORLD BANK TODAY

Chaebol Bosses Angry at Kim's Return to Nanny State

BY KEVIN RAFFERTY

South Korea's budding international entrepreneurs are fuming over the brakes that they claim the "nanny" state has recently applied to their global ambitions. Until this summer one of the biggest stories on the international economics scene was the rapid industrial advance of South Korea's conglomerates, called *chaebol*.



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Hyundai cars ready for the world

Names like Daewoo, Hyundai, LG, and Samsung were beginning to make major advances in the U.S. and in both Eastern and Western Europe. Major international magazines ran cover stories predicting that South Korea was on the way to becoming the first new advanced industrial power since Japan. In Tokyo, business leaders were becoming concerned about the rise and rise of South Korean companies as competitors, not only in consumer electronics but in advanced semiconductors and information processing areas such as liquid crystal display, which the Japanese had hitherto regarded as their own.

> *"We are investing overseas to make money, not for publicity."*

In automobiles too, Koreans are making great strides with ambitious plans to displace the U.K. and France and become the world's fourth biggest automaker early in the 21st century. Daewoo shocked the world's top producer — mighty General Motors — by winning the bid to negotiate for 60 percent of FSO, a Polish state-owned carmaker. Kim Woo-choong, Daewoo's chairman, triumphed by offering to spend $1.1 billion to modernize the antiquated factory and produce 200,000 cars a year by 2001.

The deal brought Daewoo's planned investments in Eastern Europe alone to $3.5 billion. In addition, it is active in the Czech Republic, making lorries; in Hungary, with a bank and securities house; in Poland, making white goods; and in Romania, making cars as well as involvements in a shipyard, petrochemicals and hotels. These developments all show that the Koreans have targeted a growing consumer market and a way into Western Europe.

But the chaebol have also been busy splashing out on more hi-tech business on the other side of the world. South Korean companies bought $1.5 billion worth of plants in the U.S. last year and were planning to spend $2 billion there this year. Hyundai Electronics Industries spent $150 million buying Maxtor, an American maker of hard disk drives. LG Electronics, formerly called Goldstar, paid $350 million for a majority stake in Zenith, the last independent color television maker in the U.S. Microsoft founder William Gates and Lawrence Ellison, head of Oracle, are among recent visitors to LG headquarters.

But the prize for the most ambitious chaebol in the high-tech heartland probably goes to Samsung. Daringly, it has surprised the Japanese by buying Lux Corporation and then Union Optical, two small loss-making Japanese concerns. This year it had bigger, splashier ambitions: it paid $375 million for a 40 percent stake in AST Research, the world's sixth biggest maker of personal computers, and had drawn up plans to announce a $1.5 billion semiconductor chip factory, probably in Oregon or Texas.

Then the government stepped in and declared that unless a company puts 20 percent of its own money into a deal, it will not be allowed to make an investment abroad. Lee Suk-chae, the vice finance minister, described the restriction as necessary, "considering the effect foreign debt can have on the economy." The government noted with alarm that foreign debt had risen from $10 billion at the start of the year to $14 billion three months later. It was also worried both about weakening South Korea's own domestic manufacturing base and about South Korean companies biting off more than they can chew, especially if they buy loss-making companies.

The curbs brought expressions of outrage from business leaders who accused the government of "trying to play nanny" and of rolling the clock back to days when the bureaucrats ran the economy. An additional problem is the cost of funds: borrowing in international capital markets at 6 or 7 percent is nearly irresistible when Korean interest rates are at 15 percent. "We should be able to make our own mistakes," declared one chaebol director. "We are investing overseas to make money, not for publicity," said another. EM

Floods Threaten Grip of Kim Jong Il Regime

The vast gulf between North and South Korea has widened in the last few weeks as devastating floods reduced the already poverty-stricken "Hermit Kingdom" of the Stalinist north to begging for emergency supplies of food and other assistance from the rest of the world. Estimates place flood damage at $15 billion — in a national economy thought to be worth only $21 billion. Some South Korean experts are now questioning whether the Kim Jong Il regime can survive much longer.


© SYGMA

Kim: his thinking is 80 proof

Knowing exactly what goes on in Pyongyang, let alone in the North Korean countryside, is difficult enough in normal times because of the secrecy that is part of normal life. But since the death last year of "Great Leader" Kim Il Sung, there is doubt and uncertainty about his son's ability to control events.

Government propaganda continues to call Kim junior, at one point the single largest purchaser of Henessey Cognac in the world, the "Dear Leader." The newspaper *Nodung Sinmun* last month sang his praises poetically: "His thinking is an energetic one in which nobody can match him. It is his distinguished trait of leadership to continue thinking while working and lead the revolution and construction while engaging in thinking...His thinking is a miraculous one whereby he has the world under his thumb."

But not yet North Korea, or not as far as taking over his father's position is concerned. Now more than 15 months after Kim Il Sung died, North Korea has no president, nor has anyone taken over as leader of the official Korean Workers Party. Fresh advertisement hoardings have appeared in Pyongyang extolling the cult of the dead leader and proclaiming "Our Great Leader will be with us forever." Wild theories are going round, including new suggestions of a power struggle — though only a minority of South Korean and U.S. analysts have joined the conspiracy bandwagon — or that Kim junior is seriously ill or that he doesn't want the ceremonial duties of president but cannot find anyone else to take over without posing a threat to himself.

North Korea's economy meanwhile is going from bad to worse. In spite of the outpourings of propaganda about the sweetness of life in the worker's paradise, a succession of reports from defectors even before this year's problems told of political repression and economic deprivation. North Korean radios and televisions are jammed to receive only government stations which tell constantly of the heroic thoughts of the leaders, so North Koreans live in dangerous ignorance of the world.

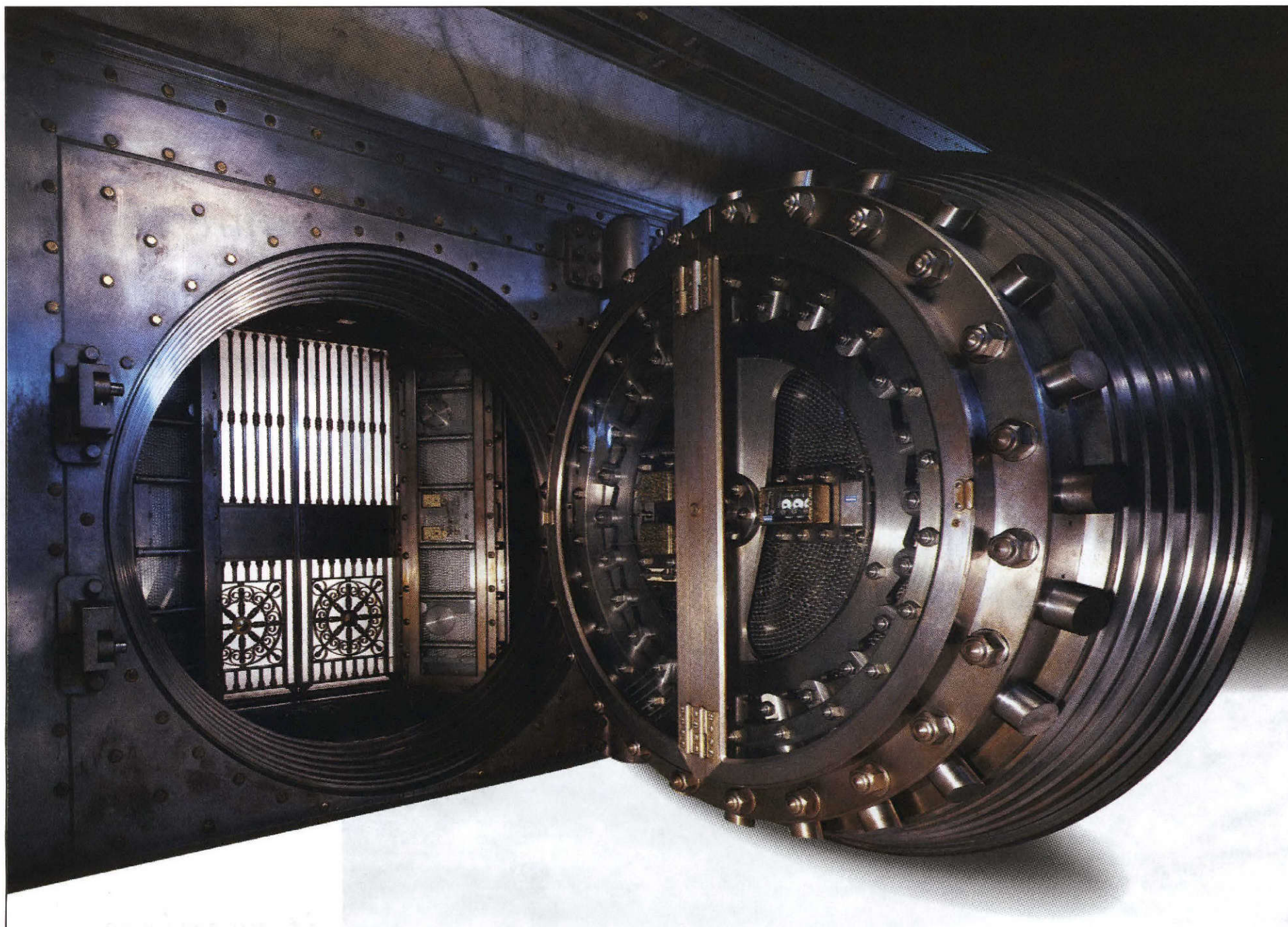
One family which fled to South Korea via China last year told of the well-off having to sell their few cherished possessions to get food, of mothers having to stitch homemade bras for their growing daughters and to make reusable sanitary napkins out of old clothes. South Koreans have been nervous of stirring up scare stories about the state of the North Korean economy, knowing that unification of the two halves of the peninsula is in theory a glorious prospect; but the South is less prepared to handle a collapsing, impoverished North than West Germany was to cope with a relatively prosperous East.

President Kim Young Sam told Jim Hoagland of the *Washington Post* recently that: "Once you are on a slippery slope down into economic decline, it will develop very quickly. And for the last two years, North Korea has wasted time and its economy has declined to the absolute poverty level." South Korea's per capita income will pass $10,000 this year and Kim has set his sights on $20,000 by the century's end.

Floods have been so bad that Pyongyang has sent appeals to 120 countries, including some with which it has no diplomatic relations. It has accepted rice from Japan and South Korea, both grave blows to the spirit of *juche* or self-reliance that is the basis of government propaganda.

South Korean newspapers have begun to carry reports that army units have been looting for food in some areas — when soldiers have always been given priority — and that corpses of North Korean military that floated down the Imjin river to the South included those below ordinary weight for a normal man. EM

— Kevin Rafferty



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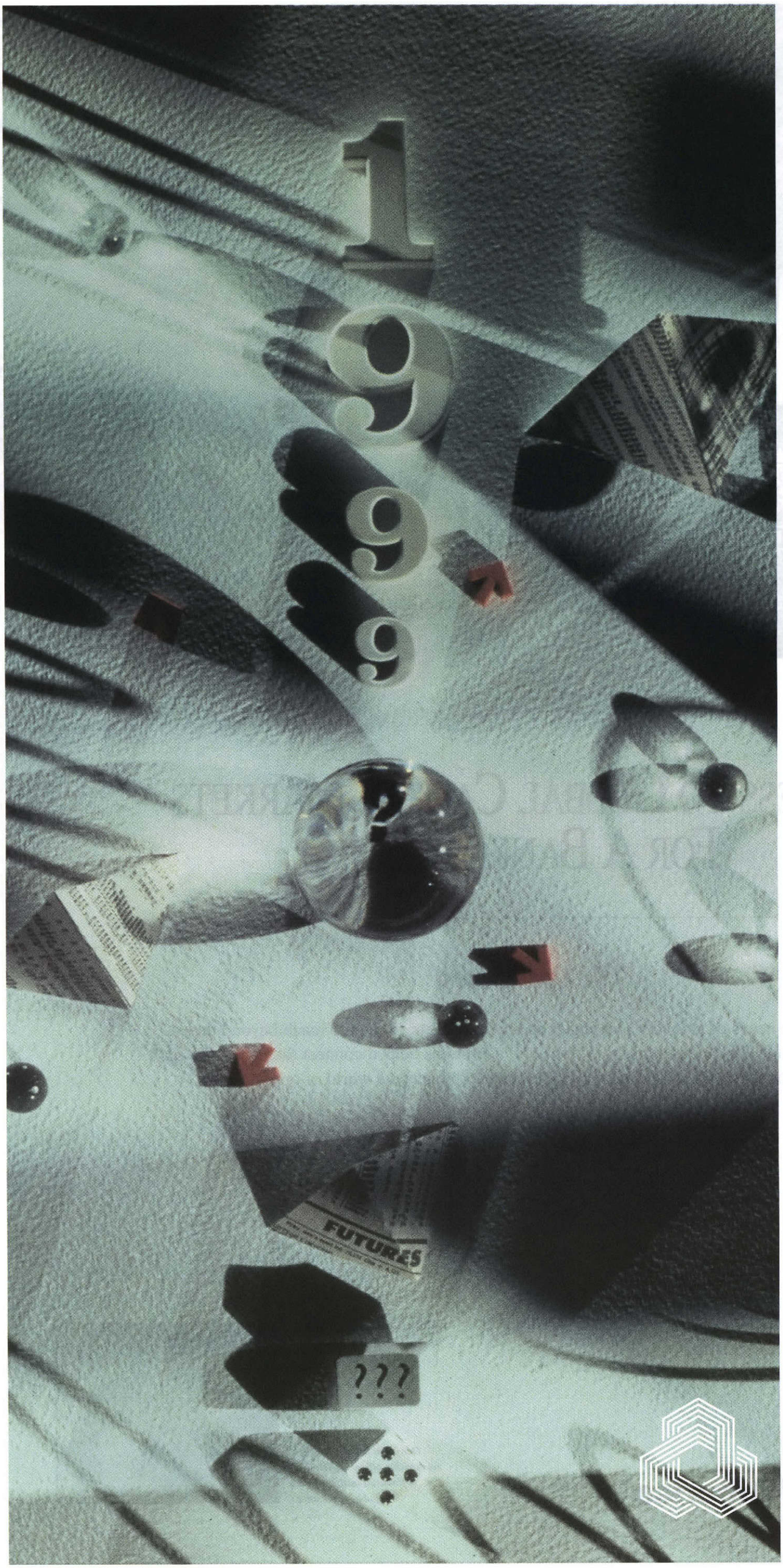

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BLACK STAR

Yeltsin surrounds himself with some real bullies

Russia's Power Behind the Throne

BY CRAIG MELLOW

Deprived of its all-powerful Communist Party, Russia sometimes seems bent on inventing a new one. The post-communist variant has little use for its predecessors' hysterical utopianism. But it strongly recalls the old party's penchant for murky non-government which mirrors the formal state organs, leaving bureaucrat and citizen alike to guess about who is really in charge.

The new organization is the Presidential Party, a vast nationwide web of political and armed force answerable to no one but Boris Yeltsin, and many suspect not even him. Russians hope the president's men lack the communists' murderous lust for power, but few feel entirely confident.

Just how out of hand the Kremlin *apparat* had gotten became clear last December, when masked men armed with Kalashnikovs laid siege to Moscow's Most Bank. The mystery assailants nearly beat several guards to death, and fired on police who came to disband them. Credit for the escapade was finally claimed by the presidential bodyguard, headed by Yeltsin's long-time protector and confidant Alexander Korzhakov.

A few weeks later Korzhakov was publicly parading as one of the masterminds of the invasion of Chechnya. His partner in folly was defense minister Pavel Grachev, who though a member of the cabinet, proudly flouts any authority save Yeltsin's.

Alarm bells rang again this summer when Korzhakov's close ally, Mikhail Barsukov, was named head of the Federal Security Service (FSB), successor organ to the KGB. Korzhakov himself took charge of the KGB's former "ninth department," 40,000 troops deployed across the country purportedly to protect public officials. A judicial inquiry into the Most Bank incident was meanwhile dropped for lack of witnesses, although the assault took place in broad daylight on one of Moscow's busiest streets.

Yet the overgrowth of presidential power in Russia goes far beyond one creepy officer. It has been watered and manured steadily since the Soviet Union's collapse, almost always with the enthusiastic support of the free-world democracies.

Perhaps Yeltsin's deepest paradox is that the only way he knew to build democracy was through authoritarian, or at least paternalistic, methods. For him it was perfectly logical to snap up promising liberal legislators in 1992 and give them "real jobs" on the president's side. The absence of eloquent moderate reformers like Vladimir Shumeiko (drafted to vice-premier) and Sergei Filatov (Kremlin chief of staff) contributed significantly to parliament's reckless radicalism in 1993.

Yeltsin pushed an analogous policy in the regions. Instead of cultivating and wrangling with elected legislatures, he tried to marginalize them through his appointed governors. After the short war of October 1993, the anti-democratic drift greatly accelerated. Yeltsin virtually ruled by decree for about a year, and the constitution he rammed through in December 1993 would have won kudos from Juan Peron (and did win them from extremist Vladimir Zhirinovsky). The president continued to appoint the cabinet, and could disband a parliament cheeky enough to vote no-confidence.

The opinion guardians in Western capitals applauded all these strong-arm tactics as the building blocks of freedom and prosperity. Some of them at least were necessary counter-insurgency measures at the time.

But times have changed. Russia's second parliament, though not so different from the first ideologically, has proved much more mature and capable. The government's key economic organs have developed creditable cadres, under the stern supervision of Prime Minister Viktor Chernomyrdin and vice premier Anatoly Chubais. Ministries and ministers also work under the glare of Russia's feisty and increasingly sophisticated press.

More and more, it is the presidential apparat which seems the sick man of public policy. Yet the sicker it gets, the more power it seems to grab for. EM



In Central Europe, Fewer Nyets to Russian

BY HENRY COPELAND

At the Berlitz language school on Vaci utca, the fashionable pedestrian street in the heart of Budapest, English lessons are in big demand. Young and old, business executives and students, "everybody wants to learn English," says staffer Marianna Domoki. Fifty people a day study English at the Vaci utca school.

Russian is another matter, says Domoki. "We've given eight Russian classes in the two years we've been open."

In 1990, Russian was the lingua franca of the Soviet empire, the grease on Comecon's gears. Across the region, Russian was compulsory for students, de rigour for anyone aspiring to power.

But today, from Sofia to Budapest to Krakow, Russian seems to have vanished. Most people in the region treat the language like a memento from a marriage that ended in an ugly divorce — as something to be hidden, if not thrown away. Twenty-five-year-old Domoki took Russian for eight years in primary and secondary school. She says: "I can't speak it. I have no use for it."

So vigorous is the backlash that just five years after Russian became an option rather than a requirement in schools, only 13 percent of Hungarians say they speak the language, a recent poll showed. In contrast, 12 percent claim already to speak English, the same poll showed.

Andras Zoltan, head of the department of Russian philology at Hungary's elite Eotvos Lorand University, is not dismayed by the current unpopularity of his field, even though his department's first year class has dropped from 120 in the 1980s to 34 this year. "I think it will have to make a comeback as the Russian economy revives," he says.

Indeed, there is mounting evidence that the Russian language is already making a modest comeback across Central and Eastern Europe. As unpleasant memories of the old empire fade, Russia's demographic and geopolitical heft are reasserting themselves.

The idea that Russian might return as a language of commerce elicits strong negative reactions, not only from generations of Central Europeans that gagged on memorizing "collective" and "comrade" in Russian, but from Western business people with a vested interest in doing business in their native tongues.

Russian as a lingua franca? "The chances are nil," says Mark Bowmas, a senior manager at KPMG Hungaria. The team of auditors which Bowmas heads conducts its interoffice meetings in German. Bowmas, who also interviews applicants for positions in the company, says Russian fluency adds nothing to a resume. "We find either English or German does the trick," he says.

Yet even as most in the region turn a cold shoulder to the language of Lenin and Stalin, Russian already is staging a revival in politics. Hungary's prime minister, Gyula Horn, spent several years in Moscow on a scholarship, as did many members of the Socialist Party that holds 54 percent of seats in Hungary's parliament.

And trade between the countries in Eastern Europe and Russia, which collapsed with Comecon, is regaining momentum. Polish trade with Russia grew only 15 percent between 1992-94, but is on track to grow 25 percent in 1995, according to figures compiled by the Vienna Institute for Economic Studies.

"I hear more and more company directors are saying 'I wish I had taken Russian seriously,'" says Spencer Jakob, an analyst at CS First Boston in Budapest. "The generation that said, 'I took Russian for 8 years, and I know nothing' with pride in its voice, is going to regret not speaking better."

A Russian population of 150 million constitutes by far the biggest language block on the continent of Europe, and, in the long run, they will be a market worth selling to. Jakob predicts that "the stigma will disappear. Russian will be a language at least as useful as German in 10 years."

At light bulb manufacturer GE Tungsram in Budapest, executives are busy sizing up the Russian market. Western Europeans consume between $8-12 worth of light bulbs a year per person, while Russians consume less than $2 worth each, says Peter Wohl, marketing director for Eastern Europe. Wohl estimates that the Russian lighting market will double in the next 10 years, making it far more dynamic than that in Western Europe.



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Enough Russian for 30 years

Still, Wohl says GE Tungsram is not desperate to recruit Russian speakers just yet. "We have enough staff who speak Russian to last for the next 20 or 30 years," he says. EM


© THE BETTMANN ARCHIVE
Republican leaders Gingrich (r) and Dole (l) won't forget the GOP lost the White House in '92

TO REPS AND DEMS, THREE'S A CROWD

BY RONALD D. ELVING

With the first events of the 1996 presidential nominating process less than four months away, the compelling story is neither the standing of the incumbent Democrat nor the teeming pool of potential Republican challengers. The buzz is about the public's all but unprecedented interest in contenders who may shun the two-party nominating system altogether and run as independents.

Leading the list of such prospects are retired General Colin Powell, whose book tour and media blitz have vaulted him to the forefront of speculation, and Ross Perot, the mercurial Texas billionaire who collected 19 percent of the vote on his own in 1992.

Perot had faded after his high-profile efforts to block Nafta flopped in 1993. But with another election in the air, Perot gathered his quasi-party, United We Stand America, in Dallas in August. The entire field of Republican hopefuls paid homage in person. Then, on September 25, Perot announced his intention of forming a third party to compete with the majors in 1996 — possibly with himself as its candidate. Once again, he bypassed the conventional news media by making his move on CNN's *Larry King Live*.

The nation has not had a brace of alternatives this potent since 1951, when World War II titans Dwight Eisenhower and Douglas MacArthur loomed over Harry Truman in the White House and Ohio Republican Robert Taft in the Senate. In that instance, the party system prevailed. Only Eisenhower ran, and he got to the White House only after wresting the GOP nomination away from Taft.

Powell is the first to insist that he

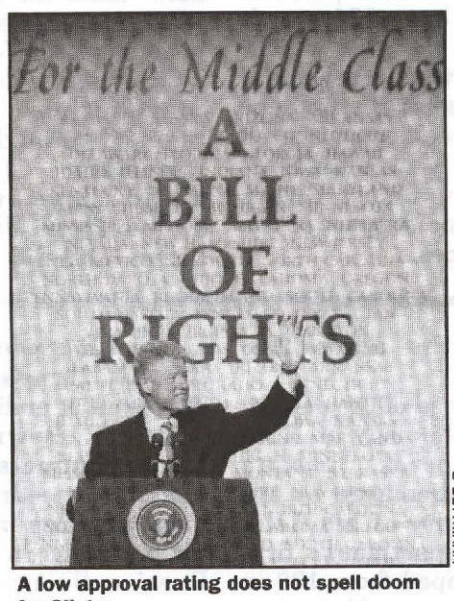

© BETTMANN
The independent option is an expensive one for Powell

is no Ike, and surely his achievements as a soldier and statesman are of a lesser magnitude. But some polls have begun to show the hero of Desert Storm outpacing both President Clinton and Republican front-runner Bob Dole of Kansas in a three-way race.

Unlike Perot, Powell has no apparent source of money on which to run and no visible organization. The current moment may represent a high point from which he will only descend once his personal appeal and compelling story lose some luster. Some insist he will not run at all.

Yet Powell's standing attests to two factors that will affect the 1996 outcome whether he runs or not. One is the public's apparent dissatisfaction with both the incumbent and the field of Republican challengers. The other is its increasing willingness to look beyond the two parties when searching for political saviors.

The current crop of outside runners is less interested in breaking into the major parties than in breaking their grip on the nation's politics, an arrangement that has lasted nearly 140 years. Civil rights activist Jesse Jackson, unwilling to take on Clinton in the primaries, has spoken of airing his grievances in the fall. Announcing his retirement from the Senate in August, Democratic Senator Bill Bradley of New Jersey said he would think about running outside his party.



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A low approval rating does not spell doom for Clinton

Polls show roughly three Americans in five would like to see a third party. And unlike years past, these sentiments are voiced not just by strong conservatives or dedicated liberals but by lifelong occupants of the political middle.

THE CLINTON CHANCE

Clinton completed his 32nd month in the White House with an approval rating of 46 percent in the Gallup Poll. Setting aside the moment of national support that followed the Oklahoma City bombing in April, Clinton's Gallup has not grown appreciably since his early months in office — remaining roughly commensurate with the 43 percent share of the vote he had received in November 1992. But the raw Gallup can be a poor predictor of elections. Both Richard Nixon and Ronald Reagan were below 50 percent in the Gallup after 32 months in office, yet both won reelection carrying 49 states.

Clinton's strategy is to pose himself against the excesses of the new Republican majorities in Congress, as symbolized by Speaker of the House Newt Gingrich of Georgia. In this context, says political scientist Stephen Wayne of Georgetown University, Clinton becomes "a mainstreamer...a non-ideologue...a moderate."

When Republicans think about 1996, they like to think about November and the tote board for the Electoral College. Based on elections over the past 30 years, they assume they will carry the South, the Plains and the Mountain West. Outside this giant "L" shape, state polls also show Dole leading Clinton in Ohio and Indiana, which would add 33 more electoral votes.

Clinton appears in good shape in a dozen states with 105 electoral votes. He needs a virtual sweep of the toss-up states, including California, Pennsylvania, Illinois and Michigan, in order to reach 270. Still, many Republicans remain anxious about dislodging Clinton. While openly contemptuous of Clinton's performance, even Gingrich concedes that the president has "a realistic chance of reelection." And while the party line says any Republican will beat Clinton, the private fear is that Dole or one of his rivals could come up short.

THE GOP FIELD

Dole offers the very model of a modern front-runner. He has the seniority, the resume, the national campaign experience. He has the endorsements and the organizational support that gravitate to the presumptive winner. He has plenty of money and he has dominated the polls both nationally and in the key early states. But Dole also offers the classic front-runner target. He seems borne on his own inevitability, so even perceptions of faltering hurt. Every story about his age questions his fitness (he would be 73 when inaugurated, the oldest new president in U.S. history).

In sizing up his rivals, Dole has concentrated on Senator Phil Gramm of Texas, who has raised even more money than Dole and has logged as many miles in recent years, helping other Republicans raise money and win elections. He is unassailable in his conservative voting history, compiling a rating of 96 from the American Conservative Union during his decade in the Senate (Dole's was 89 over the same period) and he entered the 1996 cycle assuming he would be to the liking of the party's core social-issue activists.

Running third in the polls is Patrick Buchanan, a former speechwriter for both Reagan and Nixon who took on President George Bush in the primaries in 1992. Buchanan never won a primary or a state caucus that year — one reason his current campaign is woefully underfunded — but he hobbled the president for the course of the campaign. He connects with audiences with a blend of populism and nationalism, and he can blister his rhetorical targets as well as anyone.

If Dole should stumble, his lane may be taken by someone from the second tier of Republican aspirants, which includes senators Arlen Specter of Pennsylvania and Richard Lugar of Indiana, and former Tennessee governor Lamar Alexander. California governor Pete Wilson dropped out of the race last month.

If Dole disappears and Gramm's drawl fails to ignite the faithful, the nominee might not come from the ranks of the early contenders. Gingrich has said he "may give a look" after Congress gets through its docket this fall.

There also remains the possibility that Powell will make himself available as a Republican. Early reactions to his stated views on sensitive questions — he favors legal abortion, accepts some restrictions on gun owners and some provision for affirmative action — were not as harsh as some expected. Significant majorities of Republicans said that his ideas seemed close to their own.

If he does not enter the primaries, Powell can seek the independent line on the ballot state by state route taken in 1992 by Perot. Others who could appear as independents include Buchanan, who has said he will bolt the party if it nominates an abortion-rights candidate. And some on the left still hold out hope that former California governor Jerry Brown, a three-time loser in the primaries as a Democrat, might take another shot at the White House as the standard bearer for a new coalition of workers and environmental activists. EM

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MidEast

MONDAY, OCTOBER 9, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 27

Israel and Palestinians Make Grudging Progress to Peace

BY DAVID LANDAU

The signing late last month in Washington of the Israeli-Palestinian Interim Agreement has, perhaps predictably, heightened the criticisms of Israeli Prime Minister Yitzhak Rabin's peace policy within his own deeply divided country.

Detractors on both sides focus on the phased, gradual structure of the peace process — which has already fallen far behind its own schedule. Both press for an immediate definition of the final goals. The Interim Agreement provides for the extension of Palestinian self-rule throughout the West Bank (apart from the Jewish settlements and military areas). The Israeli army is to "redeploy" out of the major towns within six months; Palestinian elections are set for April 1996; there will be further "redeployments" over the following 18 months.



© TODD FRANCE

Not everyone is amenable to peace

The right says Israel's strength is being whittled away in a series of "salami" concessions to the Palestinians. The left argues that the drawn-out interim period, fraught with terrorist attacks and diplomatic impasses, sets the entire process at risk of imploding in a welter of public despair and disillusionment. The criticisms are mirrored in the Palestinian camp, where Yassir Arafat and his supporters face grassroots disappointment over the poignant disparity between the euphoria surrounding the White House talks and the frustratingly slow improvement in daily life in Gaza and the West Bank.

Under the original Declaration of Principles, signed in September 1993, the parties deliberately postponed the toughest issues — borders, Jerusalem, the Jewish settlements — to "permanent status negotiations" that are due to begin only next May, and to end, hopefully, in 1999. Despite the acrimony in both camps, however, the step-by-step approach seems to be vindicating itself.

Out of months of stubborn haggling in hotel rooms and tense confrontations between Israeli and Palestinian military men on the ground, an archive of compromise is gradually, grudgingly, being built up. Those toughest issues would certainly have destroyed the process had they been tackled immediately. Now they seem that much less intractable, that much more amenable to creative diplomacy.

On the Israeli side, Rabin himself, hitherto implacably opposed to Palestinian independence, now says he rejects a sovereign Palestinian state only "now — and I stress the word 'now.' In the future, we can consider all sorts of solutions." Israeli policymakers, in private conversation, contemplate some sort of "Vaticanization" for Muslim shrines and other areas in Jerusalem — this despite the official Israeli position that the city must remain exclusively Israel's capital. Israeli policymakers speak publicly of reducing the Jewish settlements on the West Bank to two or three blocs. Israeli settlers wishing to stay on outside these blocs could do so only as citizens of the Palestinian state. There is even talk — this too private — of a possible land swap in which Israel would cede land adjacent to the Gaza Strip in exchange for the settlement blocs to be annexed on the West Bank. Not all these positions satisfy Palestinian aspirations, and arduous negotiation lies ahead. But they are a far cry from the previous doctrines of Rabin's Labor Party.

Among Palestinian policymakers too, despite their public rhetoric, there is a discernible parallel revolution. There is a discreet realization, for instance, that the 130,000-odd settlers cannot simply be swept away. That is politically undoable for any Israeli government.

Terrorism, however, could quickly destroy this evolving hope. Public reaction to terrorism, unlike even the most intractable political issues, is not amenable to negotiation or to the evolution of compromise and trust. It is a gut reaction, a turning in fury against the government — any government — that fails to discharge its most basic duty towards its citizens: to protect their lives. EM

Foreign Money Chases into Silicon Wadi

BY PINCHAS LANDAU

Press reports regarding a tentative deal whereby U.S. pharmaceutical giant Johnson and Johnson is to invest $360 million in a start-up Israel biotechnology company provide the most stunning evidence of the intensity and scale of the influx of foreign direct investment into Israel.

While Medinol, a company founded in 1992 and valued at $1.7 million barely a year ago, is hardly typical even of the hi-tech end of the Israel spectrum, its story carries a wider message. The company brings together Russian-Jewish immigrant to Israel Gregory Pinchasik, inventor of a technique that avoids the need for by-pass surgery for some heart disease patients, with Israeli venture capitalist Kobi Richter. Johnson and Johnson, which has been engaged in research along similar lines, is prepared to spend hundreds of millions of dollars to obtain the sole distribution rights to the Medinol product. If consummated, the deal would represent the epitome of what is attracting major multinationals to Israel in increasing numbers — the emergence of an Israeli "silicon wadi" in which a marriage between scientific and technological achievements and entrepreneurial zest generate potentially world-beating products.

But the timing of the surge in foreign interest in Israel stems from political rather than business reasons. For decades, the only major foreign corporations willing to do business in, and sometimes even with, the Jewish state, were American, especially in the computer and technology sectors.

IBM, Motorola, Intel and others reaped major benefits (such as the development of the 486 generation chip) from their Israeli units. However, European, and especially Japanese, corporations stayed clear of Israel, preferring to toe the line of the Arab boycott rather than lose customers in the Arab world.

Only in the wake of the 1991 Gulf War, and as the Middle East peace process moved forward over recent years, did the boycott crumble. After the signing of the Israeli-PLO agreements and the conclusion of peace between Israel and Jordan in September 1994, the barriers finally lifted and the result has been an unprecedented wave of foreign investment into Israel beginning in 1994 and picking up steam this year.

Financial investment by fund-managers and institutions was estimated at a mere 3 percent, or about $1 billion, of the Tel Aviv Stock Exchange's market capitalization at the end of 1994. By mid-1995 this had tripled and for the first time foreign players became a major factor in the Israeli market. The inclusion of Tel Aviv in the Morgan Stanley world and emerging market indices clearly put Israel on the map in a general sense. Specifically, the effort by U.K.-based telecommunications conglomerate Cable and Wireless to build up a stake in the Israeli telecom monopoly, Bezek, involving an estimated $150 million so far, showed that the local market could be used for direct as well as financial investment.

Hardly a week now passes without a big foreign player arriving on the Israel scene. Both Nestle and Unilever have announced in recent weeks the purchase of minority stakes in large Israeli food firms, and Philip Morris is reportedly in negotiations with the remaining large local company in this field.

On the heavy industry front, Volkswagen is to invest $250 million in two stages to buy a 40 percent stake in a new magnesium production joint venture, while other German heavyweights such as Thyssen and Henkel have become involved in smaller projects.

But Israel's biggest and sexiest draw has been its burgeoning hi-tech sector. In addition to the dozens of Israeli technology companies that have found foreign capital through public offerings via the U.S. over-the-counter market (Nasdaq), hundreds of millions of dollars have been raised in the last three years by Israeli and foreign venture capital funds.

It's easy to see why. George Soros invested $50 million in Indigo in 1993, when that company's revolutionary computerized printing technology was not yet at the production stage. Even then his 12.5 percent stake gave Indigo an imputed value of $400 million, but only a year later, Lehman Brothers took Indigo public on the Nasdaq at a market capitalization of $1 billion, or $20 a share. Earlier this summer, the stock hit $63 before slumping back to the low 30s — all on the basis of projected profits in a company that has yet to report a quarter in the black. This was denounced by many analysts as "absurd" — but that was before the Medinol deal wrote a new chapter in the history of overnight rags-to-riches. EM



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PROTECTIONISM HITS LATIN COMEBACK TRAIL

BY ANA JULIA JATAR

Since the Mexican crisis last December, many Latin American countries seem to be backtracking on the aggressive process of trade liberalization that they put in place in the early 1990s. On March 29, Brazil increased tariffs on more than 100 products to 70 percent. Argentina, in a desperate attempt to close its current account deficit, tried to convince its Mercosur partners to increase the region's common external tariff which had been set only three months before. After failing in this attempt, the Menem administration imposed its own 3 percent tariff on imports which it called a "statistical levy." Costa Rica, purportedly for fiscal reasons, announced a tariff increase of 8 percent in spite of its announced commitment to the Central American Common Market established tariffs. Mexico has announced tariff increases on textiles, apparel, shoes and leather goods. So has Guatemala for a large variety of products.

Are Latin America's heralded economic reforms stalling? Has the regional commitment to liberalization weakened? What does this mean to the multiplicity of trade agreements in the region?

The answers lie partially in the external context in which Latin American countries undertook their market-oriented reforms. Liberalization was designed to eliminate the distortions caused by import substitution and to set the stage for developing an outward-looking strategy of export-led growth. Regional integration, on the other hand, reflected the need to find new markets for those industries created during the import substitution period. Only by increasing market size could these firms have a chance to survive, grow and eventually become competitive in the international marketplace.

Latin America and the Caribbean: Balance of Payment Indicators ($bn)

BALANCE	1988	1989	1990	1991	1992	1993	1994
Current Balance	-11.2	-6.9	-3.6	-18.8	-37.1	-46.0	-49.7
Capital Account	5.5	9.9	17.7	38.0	61.7	65.1	56.6

SOURCE: ECLAC PRELIMINARY OVERVIEW OF THE LATIN AMERICAN AND THE CARIBBEAN ECONOMY

This trade liberalization process was accompanied in most Latin American countries by stabilization programs based on fixed or nearly fixed exchange rates. In using this particular policy combination, countries faced important trade-offs. Increasing competition from imported goods keeps the price of domestic substitutes in check, inflation is kept down and consumers happy. For the same reasons, a consumption boom usually follows, as consumers doubt the new currency which, in turn, becomes overvalued, leads to an enjoy-it-while-it-lasts attitude — and a trade deficit.

Since all these reforms took place during a period of unusually low interest rates and ample international liquidity, consumption booms across Latin America were financed by foreign capital inflows. That lucky confluence ended when, in the first quarter of 1994, interest rates began to soar, and when the Mexican collapse reminded investors of emerging market risk. Some estimates put the decline in capital inflows this year at close to 4 percent of the region's 1995 GDP.

What are the constraints that Latin American governments have had to deal with in meeting this crisis? Take, for example, Brazil. It needed to cut short its consumption boom and had limited options. Interest rates were already very high. Brazil opted for a mix of tariff increases for goods from outside Mercosur and a devaluation of the real. The government was harshly criticized by some of its trading partners. It has argued back that the measures are only temporary.

Argentina, even harder hit by the Tequila Effect, also has fewer policy options because of the peso's peg to the U.S. dollar. In early March the government adopted a tough fiscal package, pension and labor market reform and wage and spending cuts. In this context, the 3 percent tax on Mercosur imports served as an expenditure switching mechanism.

Despite the trade policy fallout from Mexico's crisis, the setbacks have respected each country's major trade agreements. This means they are making regionalism less open and more vulnerable to trade diversion. As a consequence, efforts to widen trade agreements are likely to be delayed in favor of those oriented toward deepening existing accords. By creating a constituency for protection and trade diversion, the measures may become harder to reverse over time. Moreover, further fiscal tightening to compensate for lost revenues generated by higher tariffs could aggravate the situation.

Although modest compared to the intensity of the crisis, the backsliding underscores how vulnerable Latin America still is to external shocks. EM

Korean Electronics Giants Break Ground in Brazil

BY MICHAEL KEPP

Japanese electronics and household goods giants like Sony, Panasonic and Toshiba have been producing in Brazil for some time. Now, their Korean counterparts are beginning to do the same.

Previously, Korean companies like Samsung, Lucky-Goldstar (LG) and Daewoo have acted as original equipment manufacturers for local Brazilian electronic and household appliance producers. These Korean giants have been among the main suppliers for firms importing semi-knocked-down kits (mounted parts on printed circuit boards) or completely knocked-down kits (circuit board and unmounted parts). Local producers then assemble these kits into VCRs, sound systems, televisions and microwave ovens, and market them under their own brand names.

Samsung and LG plan to build Brazilian factories where they will assemble their own brand-name electronic goods from their shipped-from-Korea kits and parts. Daewoo has plans to build a washing machine plant.

While attracted to the size of Brazil's domestic market, Korean firms were jittery about investing because of high inflation. But an economic stabilization program launched in July of 1994 dramatically reduced inflation (currently at 1.43 percent per month) in the second half of 1994. The spending boom that followed caused the Korean firms to reexamine penetrating this huge market.

"Reduced inflation made [Brazil] a more predictable place to make investments," said John Sohn, president of Samsung Electronics' Brazilian subsidiary. "The resulting increase in consumer spending that followed made the big domestic market even more attractive."

Finally, import duties on foreign-made consumer durables were raised in April 1994 to 70 percent, ruling out the possibility of Korean electronic exports.



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Brazilians eagerly await Korean products

Samsung, the 14th biggest private group worldwide, is investing $34 million in 1995-96 to turn out electronic and household goods. The factory space will be rented from Germany's Bosch company in the duty-free Amazon port city of Manaus.

Samsung's factory will start production by October and will turn out 60,000 items (color televisions and VCRs) by the end of 1995 and 335,000 items (color televisions, VCRs, sound systems, microwave ovens, and camcorders) in 1996. Samsung's Brazilian operation expects to earn $20 million in 1995 and $100 million in 1996, capturing 4 percent of the television market and 7 percent of the VCR market by the end of 1996.

Samsung is also studying plans for a $650 million color television picture tube plant to supply its television production line in Manaus. The government of southern Rio de Janeiro state has offered Samsung fiscal incentives to build the two plants there. Construction is scheduled for 1997.

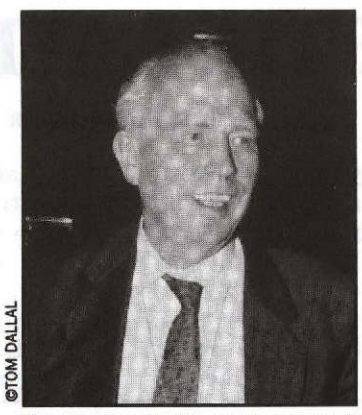
LG is planning to invest $50 million in a factory (also likely to be located in Manaus) where by mid-1996 it will turn out 700,000 items per year (televisions, VCRs, microwaves and computer monitors) under its own brand name.

Miguel Kang, president of LG's Brazilian subsidiary explained, "Low inflation and the increasing prohibitiveness of import taxes weighed in our decision to invest here." He added that while LG was prepared to enter the Brazilian market alone, it was looking for a local partner "to help us better understand the market."

Zenith, bought by LG in June as part of a $60 million joint venture with Brazil's Dreams Group, plans to build a factory in southern Rio de Janeiro state which, by October, will produce Zenith TVs in Brazil for the first time. The joint venture will import components from Zenith operations in Mexico and picture tubes from Zenith's U.S. headquarters, and expects to take in $250 million in earnings in 1996.

Daewoo is planning to do the opposite of LG by entering the Brazilian market first with washing machines, and perhaps later electronic goods. Daewoo is on the verge of forming a joint-venture partnership with a local electronic goods producer to turn out 100,000 washing machines a year by 1996 under a joint Daewoo-CCE brand name. EM

Currencies







European central bank governors (l to r) Tietmeyer of Germany, Trichet of France and George of the U.K.

For Now, EMU Remains Funny-Looking Bird

BY MARK MILNER

Later this year the European Monetary Institute will deliver its first formal report on the progress of the 15 members of the European Union towards meeting the criteria enshrined in the treaty of Maastricht for monetary union.

The Institute's verdict on the preparations for the single currency, including setting up a central bank, will be a "could do better."

Back in December 1991, when the Maastricht treaty was signed, European monetary union (EMU) looked an odds-on bet, if not by 1997 when a majority of the membership had to sign up, at least by 1999 when any country which was ready could join.

Sadder and wiser after the debacle of 1992 when the pound and the lira were forced out and the exchange mechanism (ERM) was buried, the planners of EMU went back to basics, the Maastricht criteria. The optimists at the European Commission continued to speak bravely of EMU in 1997. Few believed. The accession of Sweden, Finland and Austria to the original 12 EU members meant that, under the Maastricht rules, eight countries had to meet the criteria. At the Cannes summit last year the idea of EMU in 1997 was finally laid to rest. Now all eyes are on 1999 when, in theory, any two from 15 could join up.

Maastricht embodies four key economic tests prospective members will have to pass:

- government deficits must not exceed 3 percent of gross domestic product while official debt should not be more than 60 percent of GDP;
- inflation must be within 1.5 percent of the average of the three member countries with the best, i.e. lowest, inflation rates;
- long-term interest rates must be within two percentage points of the average of the three countries with the lowest inflation rates;
- countries should have been in the ERM without being forced to realign, i.e. devalue, for at least two years.

Though the criteria are relatively clear-cut and, supporters have argued, worth following in their own right, there are hints of revisionism in the air. There have been suggestions that because unemployment is such a serious problem and it has such an impact on government spending, it should form the basis of a fifth criteria. The idea, however, has found little support among EMU planners.

The ERM conditions could prove tricky. Since 1993, currencies have been allowed to fluctuate by 15 percent either side of their central rates, rather than the 2.25 percent most adhered to when the criteria were drawn up. Which rule will apply?

There are also indications that the deficit and debt conditions will prove problematic. There will be those who will seek to interpret the terms to allow countries which are within hailing distance of the targets and which are moving in the right direction to join. Expect reactions from Germany, not least from the Bundesbank.

The debate and the difficulties have moved well beyond Maastricht, however. Opponents of monetary union have been heartened by the difficulties in achieving it and have argued more strongly against it. They have not been short of emotive symbols to use. The British are reluctant to give up the pound sterling; with Euroskeptics arguing that its loss encapsulates the transfer of "British" sovereignty to Brussels. The Germans are equally loath to abandon the mark which, for many, has come to symbolize the country's economic success in the period since the end of the World War II.

The choice of the name for the new currency is contentious too. The ECU, from the initials of the European Currency Unit, is beloved of the Brussels bureaucrats who use it for their accounting. But an ersatz currency has little appeal in Germany, where public opinion will insist on something with the same sort of strength as the mark.

One thing that does look clear is that those countries which do sign up will go not for a "big bang" approach but for a transitional period of three years. A recent European Commission green paper described the process as a series of mounting waves.

The two key issues are the form of the institution that will have responsibility for the currency and the membership of the single currency club. The Bundesbank, a crucial voice in the debate, will want a European central bank with clout. But it will not want to be forced into a position where, in effect, it becomes Europe's lender of last resort.

As to the likely line-up of the initial single currency club if one is formed in 1999: ironically Denmark and the U.K. (if ERM membership is discounted) are both likely to meet or be close to meeting the Maastricht criteria, but both can opt out of the whole process. Germany will be the core, bringing along a de facto deutsche mark block — Holland, Austria, Luxembourg and (public sector debt aside) Belgium. Ireland and Finland are also possibilities. But France would have to be there if the single currency was to have real meaning to provide a Franco-German economic axis to reflect the political relationship which has done so much to shape the European Union.

Even then there would be a problem. Some observers are already worrying that the likely balance of membership would be heavily tilted towards northern Europe, with little representation from the Mediterranean end.

In sum, progress towards the day when a traveler through the EU would be able to spend his money in every country, without half of it being swallowed up in bureau de change commission charges, is unlikely to be much smoother than it has been in the past. EM

Czech Landmark on Way to Market Economy

BY JOE COOK

After an absence of nearly 60 years, the Czech national currency, the koruna, returned to convertibility on October 1 after the Czech parliament passed a new foreign exchange act which complies with Article 8 of the IMF's Articles of Agreement.

The move is a landmark in the Czech Republic's remarkably smooth transition from communism to a market economy. Referring to the koruna's new-found international status, Klaus-Peter Muller, a board member with responsibility for Central and Eastern Europe at Germany's Commerzbank, said during a presentation in Prague on September 27 that, "It took Germany 20 years to achieve what the Czech Republic has achieved in five."

The Czech koruna now joins the Polish zloty and Slovenia's tolar as convertible currencies in accordance with the IMF's Article 8. The Hungarian forint is scheduled to make the move to convertibility later this month. By November, Slovakia's parliament is expected to have passed a new foreign exchange act which will then clear the way for its koruna to become convertible for the purpose of current account transactions, as laid down in Article 8.

In the words of the IMF, Article 8 obliges fund members to "refrain from imposing restrictions on the making of payments and transfers for current international transactions." This basically means that companies, banks and individuals should be free to move their money around as they see fit, thereby facilitating the expansion and balanced growth of trade and services. Why the regional rush to comply with Article 8?

"It took Germany 20 years to achieve what the Czech Republic has achieved in five."

"Essentially, what has pushed these countries towards convertibility is strong upside pressure on their currencies," says Suzanne Gahler, an economist with J.P. Morgan. Another incentive, says Zoltan Bodnar, a board member of the National Bank of Hungary, is that the Czech Republic, Hungary and Poland each hope to become members of the OECD within the next 12 months.

The region's currencies have come under pressure from both strong capital inflows and increasing trade. The Czech Republic, for example, had by August accumulated official forex reserves of $10.2 billion, almost double that held one year ago. Poland now has more than $11 billion in the central bank. Slovakia and Slovenia each have more than $3 billion in forex reserves, increases of about 100 percent and 60 percent, respectively, over 1994.

The only remaining restrictions on Central European companies, banks, and individuals will center on outward portfolio investment and overseas lending by domestic banks. EM

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Capital Markets

MONDAY, OCTOBER 9, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 34

Forget Boring Mexico, Invest in Exotic Cote D'Ivoire

BY HENRY AVIS-VIEIRA

When investing in emerging markets sovereign debt, obtaining the greatest return requires patience, good timing, and faith in the cycles of economic development. Traditionally, investors follow a low-risk plan by concentrating on structured economies with strong stability potential.

For this reason, the great majority of debt investment activity involves Mexico, Brazil, Argentina and Venezuela. Between 1985 and 1990, these countries captured well over 80 percent of secondary market transactions, and in 1994 they still claimed 65 percent of the transactions.

However, these cautious investors, who deal in safe, generic options, are not the ones who record the largest profits in sovereign debt. The most impressive gains are made by those who invest in spicier second-tier exotic debt of non-mainstream countries. The strategy is to identify promise, enter early when prices are cheapest, carefully track the changes in the country's economic development and sell to maximize returns.

Second-tier exotic debt consists of syndicated and direct bank loans as well as trade instruments from countries in the early stages of the economic developmental cycle. There are also many non-mainstream nations that do not technically qualify as emerging markets, but share the fundamental quality of considerable natural resources and above-average potential for rapid and extended growth.

In this category is a large part of Africa, some areas of the Caribbean, and Asian countries such as Cambodia, Laos, Myanmar and North Korea. Debt from second-tier exotic countries has some disadvantages: poor liquidity, periods of extreme volatility and, by comparison to generics, low trading volume.

Yet, despite the drawbacks, second-tier exotics offer outstanding opportunities to gutsier investors with the endurance and the ability to judiciously time their plays in environments with high variability.

For example, in roughly three years, the failed debt of Vietnam (once non-mainstream) has risen from under 10 cents on the dollar to a present market value in the high 60s. Equally spectacular has been the skyrocketing value of sovereign loans from Peru, another former second-tier nation. In 1991, Peruvian sovereign loans were quoted in the 4 to 5 range and today market prices are touching 70.

While the major investment houses have dealt in these assets on a very minimal basis because of the risks, investors who purchased Vietnamese and Peruvian debts several years ago have enjoyed returns far superior to those achieved in the generic arena.

The crucial element in successful second-tier LDC debt investment is recognizing the stages of a country's developmental cycle. These stages provide clues to the direction of a country's economy, signaling when to buy in and when to flee.

In the earliest and least developed phase, the economy is unstable and economic stagnation, capital flight, and a severe lack of investor activity are typical. As conditions improve, and the country moves into an embryonic stage of growth, industry begins to show some strength, foreign exchange reserves increase, capital begins to be repatriated and the investment climate brightens.

When the economy reaches the intermediate phases of development, unemployment decreases, credit expands, tourism rises and capital spending jumps substantially. In the development cycle's more advanced stages, growth rates attenuate, capital investment levels off and recession starts to surface.

The challenge for sovereign debt investors is to buy bargain-priced debt of highly underdeveloped countries that have abundant natural resources and are moving into initial stages of economic development. An ability to recognize the development stages helps guide the timing of this




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Cote d'Ivoire: promising exotic debt

effort. Studies in developmental economics indicate that an economy moving into a very early stage of growth will almost always progress to at least a moderately higher plane.

Economic conditions will theoretically become increasingly stable over time, bringing in more investment and allowing further development of the country's resources, ultimately yielding a net benefit for timely investors.

Of the present second-tier debt possibilities, the most promising non-mainstream countries are in Africa. Cote d'Ivoire is now undergoing an impressive economic upturn, and has just entered a lower intermediate stage in its economic developmental cycle. Cote d'Ivoire's debt, mainly because of secondary market aberrations, is very undervalued given Africa's recent economic progress and overall stability. The IMF and the World Bank are increasingly sanguine about Cote d'Ivoire, and this year committed to new financing for privatization and other key reform programs.

Plenary London Club meetings of considerable importance will begin in October and will be the forum to negotiate the nation's commercial bank outstandings; finalization of a Brady-style agreement is projected for sometime in 1996. Successful results from these talks will certainly positively influence Cote d'Ivoire's secondary market prices.

In the south, Angola and Mozambique are promising. Angola is potentially one of the richest countries on the continent and holds a bounty of underdeveloped natural resources. The most important of these are hydrocarbons, minerals (including major diamond, gold and platinum deposits), coffee and timber.

Several months ago, Angola established a fragile peace after decades of civil war, and is anxious to bring about economic reform and attract long-term direct commitments from foreign capital. If peace holds (and there are growing signs that it will) Angola can offer great advantages to aggressive and more strategically cognizant investors.

Unlike Cote d'Ivoire, Angola is early on in its developmental cycle and faces massive reconstruction after 30 years of armed conflict. But considering the substantial long run promise of Angola, playing the debt card now could well produce lucrative results in the relatively near future.

Mozambique is also recovering from the ravages of a long war and starting on its recovery path. Although not as wealthy, Mozambique looks serious about decentralizing its economy fully and opening up to foreign investment.

Take a closer look at North Korea, which could embark on a free market program.

In Asia, the bold and the daring might take a closer look at North Korea. Having reached rock bottom and appearing ready to reduce isolationist tendencies, North Korea could well embark on a free market program similar to China's purely for reasons of survival.

In addition, many Asian emerging market experts believe that before the end of the century, North and South Korea will agree on some form of economic unification, motivating South Korea to assume the North's foreign debt load. For the investor who can afford to be patient in the long term, North Korean debt could well engender returns far better than any other second-tier paper.

The one country in the western hemisphere to watch for debt investment is Cuba. Havana is desperately seeking outside investment to resuscitate an economy destroyed by the cut-off in aid from the former Soviet Union. Rumors are surfacing more frequently that the government is seriously considering increasing the number of projects where debt can be used in conversion. Any noticeable increase in debt swaps will boost demand for Cuban assets in secondary markets. EM

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VIEWPOINT

Commerzbank's focus on German and European economic issues

Should the fiscal criteria for Emu be relaxed?

The Maastricht treaty envisages a number of EU countries forming a European Monetary Union (Emu) by January 1, 1999. This implies a single monetary policy and irrevocably fixed exchange rates for the members. In addition, the European Commission wants to see a "critical mass" of transactions in the new currency in order to convince people that this is a monetary union of no return. However, this is not the only "critical mass" problem: will there be a sufficiently large group of countries that meet the convergence criteria?

WHILE INFLATION continues to be a problem in some member states, the crucial issue is fiscal policy. At the moment, only Germany and Luxembourg comply with all the ceilings set forth in the treaty. And even some "hard-core" countries would have to undergo a painful process of fiscal consolidation, with both output and employment falling in the course of adjustment, in order to achieve anything like the prescribed ratio of 60% for gross public debt to GDP.

THIS RAISES two questions: do we really need a strict interpretation of the fiscal criteria? And are the criteria set out in the treaty sensible? The key issue here is the sustainability of fiscal positions.

IN A MATURE ECONOMY, the only way to achieve fiscal consolidation without fuelling inflation is by reducing the primary budget deficit. In view of the high tax burdens in many Western European countries, their governments have no option but to cut public expenditure. Not surprisingly, countries whose public deficit and gross debt to GDP ratios are well above the target levels would prefer the fiscal standards of the Maastricht treaty to be relaxed.

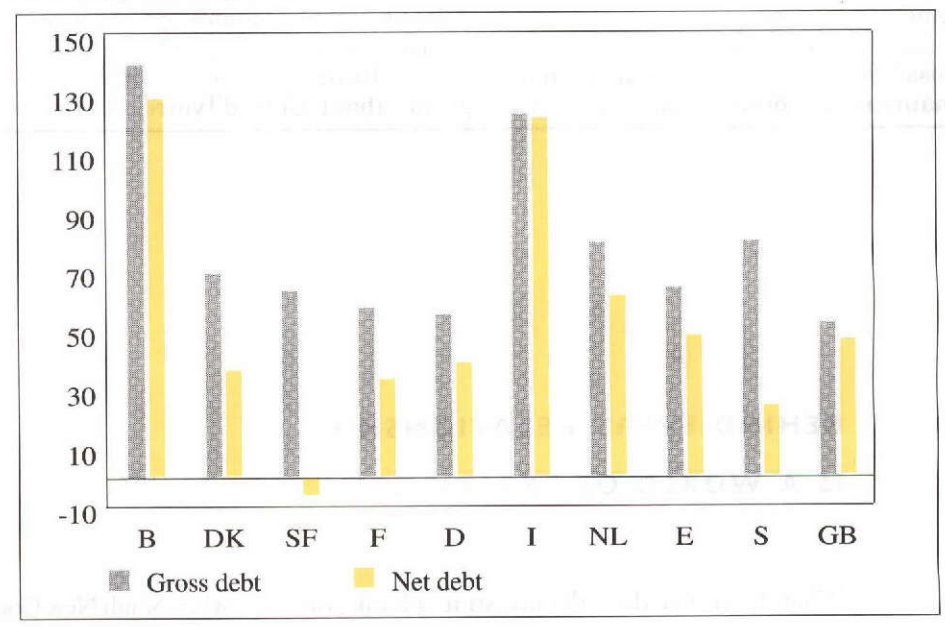
MOREOVER, it is often claimed that these criteria do not accurately reflect a government's fiscal stance anyway. And, in fact, fiscal sustainability means different things in different countries, namely a balanced structural budget, deficits not exceeding public investment, or a stable debt to GDP ratio that can be readily financed. The treaty, however, stipulates that achievement of the fiscal objectives shall be measured in terms of the actual budget deficit and gross public debt. The focus on gross debt makes it possible, for example, for a government to meet the criteria by selling public financial or real assets, even though this would not improve its fiscal position.

THE ASSETS HELD by public pension schemes are the main source of discrepancy between gross and net public debt. But these funds and the income from them are affected by current and future liabilities, which would have to be taken into account as well. The use of additional criteria, however, would result in only marginal changes in the assessment of most countries' fiscal stance. France, for example, which has a high actual deficit, tends to have a high structural deficit, while countries like Belgium with high gross debt tend to have high net debt as well.

ALL IN ALL, the Maastricht fiscal criteria do not seem so bad. If applied strictly, they will yield the right candidates for Emu. After 1999, they should be used as a minimum standard to ensure that national fiscal policies do not undermine a European monetary policy committed solely to maintaining price stability.

General government debt indicators

1994, as percentage of GDP



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Silver Plating Wiped Away, Japan's Banks Prove Tinny

BY KEVIN RAFFERTY

Toshihide Iguchi, a bond trader in New York, this summer sat down and wrote a 30-page letter to his boss, the president of one of the world's top 20 banks, calmly informing him that over a period of 11 years he had been cooking the books, forging securities to cover up a whopping $1.1 billion he had lost in trading U.S. treasury bonds. That works out at about $400,000 in losses for each and every trading day.

When the default was revealed last month, Japanese officials immediately said that Iguchi was not even a challenger for the *Guinness Book of World Records*. After all, unlike Barings' Nick Leeson, 44-year-old former car salesman Iguchi did not bring down Daiwa Bank. "A billion dollars is only one eighth of Daiwa's capital," said a ministry of finance (MoF) official.

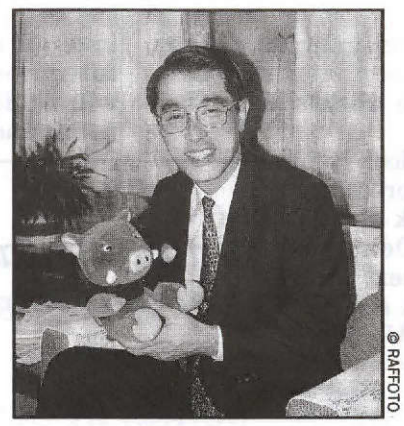
There are reasons why the Japanese don't want to get too upset about Iguchi and Daiwa's losses — because they have 500 times as many problems in the shape of ¥50 trillion ($500 billion) in bad debts that litter the Japanese financial system.

Clues to some of the problems of that system can be found in the international league tables of banks, but not in the headlines. Those show the Japanese leading the world. The top nine banks by assets are all Japanese, led by Sanwa with $582 billion. When Mitsubishi Bank merges with Bank of Tokyo next year it will have assets of $800 billion, making it twice as big as its nearest non-Japanese rival.

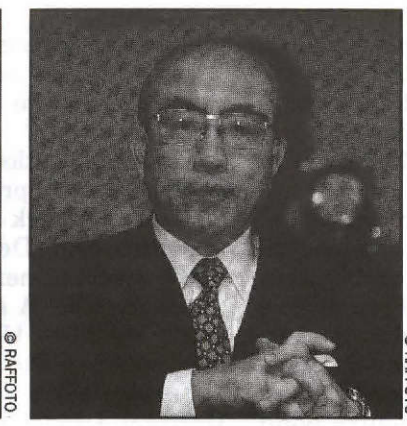
Sophisticated analysts these days prefer to look at a bank's capital base as a guide to strength rather than mere assets. But there again the Japanese lead the world, with the top six slots. Sanwa again leads on $22.6 billion, with HSBC Holdings seventh on $18 billion, and Citi ninth on $17.2 billion. You have to look beyond the headlines though, to banks' rates of return on their assets, to see that the top 20 Japanese banks come in from 749th place (Bank of Tokyo with a 0.33 percent return on assets) to 959th (Sumitomo with a return of *minus* 0.64 percent thanks to write-offs) in the world's top 1,000 banks. Sanwa was 912th.

The story of the crippling bad loans is well enough known. In the late 1980s, Japan experienced the so-called "bubble economy" when prices of land, property and stocks all soared. Banks fell over themselves to lend huge sums of money, taking as collateral property whose value was soaring by the day.

Then the bubble was pricked, property and stock market prices plummeted and have kept on falling and the banks realized that the collateral they were holding was worth 60, 50, 40 percent of the value in their books. Today, the official line is that the worst is over and the ¥50 trillion figure is absolute tops. Yoshimasa Nishimura, director general of the MoF's banking bureau, is optimistic: "I think that we have just passed the situation where we were crawling up a steep cliff face in the dark as bad loans were increasing. Now we can see the road we are heading on, though there is a gentle slope and a long journey ahead to the final destination."



Nishimura waiting for his bull to run



Hashimoto: 60-70 percent resolved

Toru Hashimoto, president of Fuji Bank and chairman of the Federation of Bankers' Associations of Japan, also believes that the bad debt problem has been "60 to 70 percent resolved. We will reach a crucial point in the disposal of bad debts over the next year."

The situation now poses a complicated mixture of financial, economic, political and even cultural problems. The proud boast of Japanese bankers never to have had a bank failure has already been rudely shattered. A string of credit unions has already gone down. Hyogo Bank closed its doors in August.

The authorities reject the idea of just letting unwise financial institutions go bust. There is precious little money in the insurance kitty to hand out to depositors, and there is general agreement that, as Hashimoto says, depositors don't have enough public information to be able to choose their bank and take their own risks.

> *"I think that we have just passed the situation where we were crawling up a steep cliff face in the dark."*

All too slowly, the government has been trying to prepare for a bailout. But its task has been made the more difficult by discoveries that some of the credit unions that have gone bankrupt not only lent heavily to politicians but ignored both prudential and legal limits on loans.

Last month a government panel urged that public money should be used to clean up the mess over a five-year period. The recommendation came just in time before a debate in parliament over the *yusen*, housing loan companies, which account for ¥8,400 billion of the bad debts and owe big sums to the politically powerful agricultural cooperatives. But as yet the panel has put forward only the vaguest of outlines. Some leading bankers, including Yoh Kurosawa, president of Industrial Bank of Japan, would like to see a government agency set up to buy land and prop up property prices.

David Threadgold, banking analyst with Barclays de Zoete Wedd, is appalled at the prospect of attempts to prop up property prices, comparing it to the ministry of finance-orchestrated share buying two years ago to boost the stock market and save banks from falling below international capital adequacy ratios. It worked in the short term, "but killed the stock market." For all the slump in the property market, he adds, "real estate prices are at their 1987 levels." But the Japanese banks have been reluctant to test the bottom. They set up the Cooperative Credit Purchasing Corporation to allow banks to offload non-performing assets: today it is sitting on ¥8 trillion worth and has managed to dispose of 1.3 percent of them.

The BZW analyst says that the government should follow the American example after the savings and loan crisis and set up a Resolution Trust Corporation, or perhaps two — one for troubled banks, the other for non-banks, both adequately funded to assume the assets of financial institutions unable to carry on without distorting normal accounting practices.

Threadgold agrees with Hashimoto and Kurosawa that "the core credit system is not in danger of collapse. The major commercial banks do not need taxpayer funds in order to perform their credit clearing functions. We are not talking of a cancer attacking the vital organs of the financial system. The worst consequences are a very expensive cleanup, which will be more costly if it is delayed." Nevertheless, some of the biggest banks may fold or be forced into mergers.

More important, the financial mess and the Iguchi billion dollar loss raise questions as to whether the Japanese banks are ready to face the 21st century. Alicia Ogawa of Salomon Brothers has her doubts, comparing major Japanese banks to "pawn shops" in their fixation with collateral as a basis for loans. Threadgold spiritedly defends pawnbrokers against such a rude comparison, declaring that "pawnbrokers are entrepreneurs and a darned sight more profitable since they know the value of the assets they accept. The Japanese banks see themselves more as utilities. They view the business like an electricity supply company, with a fixed set of customers to whom they offer a standard service for a utility-type fee."

Such attitudes were encouraged by "nanny Kasumigaseki" as irreverent analysts refer to the MoF in the post-war years when the main job was channeling credit to get the economy moving, so they built a series of restrictions and barriers and rules and regulations over which the mandarins presided. Now officials are afraid of deregulating completely because they don't trust the bankers to run their own businesses nor do they want to relinquish their own powers.

Leading bankers say they are changing. Hashimoto presents as proof a unit that Fuji Bank has set up to promote new areas of lending, such as software and multimedia. Kurosawa says that IBJ is also keenly promoting new businesses. Threadgold sniffs skeptically: "So banks are learning to lend against cash-flow and looking at business plans. But this is 1995; if it were 1895 when they made the leap it would be more impressive."

Japanese business culture is against any rapid move to catch up with the times. It is after all unheard of for a bright young man to graduate from university, learn the banking business with, say, Shizuoka Bank, one of the sounder regional banks, then move to Sanyo Securities to broaden his experience, then to Fuji International. You join a bank, you stick with it until you retire. Threadgold doubts whether a bank executive who has spent 20 years climbing the corporate ladder before being made manager of a small branch will have the training or stomach for assessing or taking risks, even if his bosses allowed it. "That's why our parent appointed a weaver to take the big decisions," he jokes referring to the appointment of the then 40-year-old Martin Taylor from Courtaulds to be chief executive of Barclays Bank. Japanese bankers look blank at the appointment of such a young non-banker. EM

Investors

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Alliance's Kreicher Sees Bond Market Upturn

BY DANIELLE ROBINSON

With the exception of Japan, most major developed and certain emerging countries' bond markets should perform well in the next six months, according to Alliance Capital, one of the world's biggest bond investors with over $57 billion under management.

The reasons for being optimistic, says Lawrence Kreicher, chief global investment strategist and global research director for Alliance, are two-fold: the recent decision by Germany, the U.S. and Japan to drive the greenback up and the odds falling in favor of the U.S. treasury bond market performing well — albeit in a volatile fashion — over the next six months.

The G3's concerted efforts in the third quarter to prop up the U.S. dollar "betrayed considerable concern on the part of Japan, on the part of Germany and certainly a residual concern on the part of the U.S. that global economic growth was simply too weak. If you don't have the major economies of the world growing with sufficient vigor there will be problems for the smaller developed countries and by extension the emerging markets," explains Kreicher.

The G3's demonstration of economic and financial leadership "manifested itself in their [dollar-supporting] intervention and it will...shape our view of where value lies in the world's bond markets," he says.

Kreicher's outlook is for a 10 percent appreciation of the greenback against the yen and Deutsche mark over the next three to six months. A stronger dollar will boost U.S. treasury bonds at the margin. "A somewhat weaker Deutsche mark should also help to take pressure off other currencies in Europe," says Kreicher. "Less pressure on currencies elsewhere will make it easier for other countries in Europe to also lower their interest rates. That, coupled with a favorable inflation outlook makes us feel that there is a bond-friendly environment for Europe."

"The fundamental backdrop is friendly to bonds in the U.S."

Although the prospects of a stronger dollar could boost U.S. treasuries by attracting foreign investor interest, Kreicher says the future performance of treasuries will be dominated by domestic economic and political events.

"The U.S. bond market itself is really going to be driven by what is going on in terms of the Federal Reserve's policy on interest rates; in terms of economic strength and also in terms of the outcome of budget discussions in Washington," he explains.

He believes that, despite expectations of considerable volatility over the next several months, caused in large part by partisan bickering over the federal budget and politics in 1996, "the fundamental backdrop is friendly to bonds in the U.S." That in turn is good news for other major global markets, which have proven in the past to be adversely affected by signficant price weakness in treasuries.



Kreicher advises fund managers to be prepared for treasury yields to trade in a wide range over the next six months as political wrangling over the budget continues. "But that said, we would maintain a more bullish overall view," he adds. "In other words we would be looking to buy on weakness."

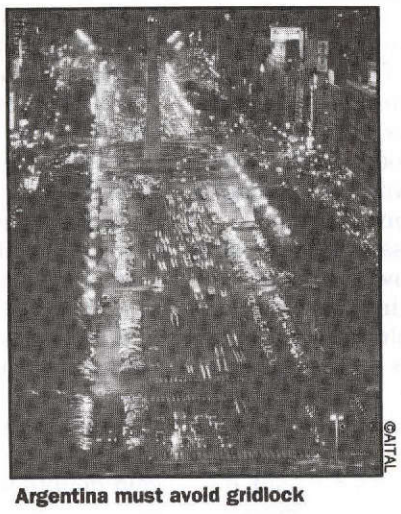
His positiveness is based on the U.S.'s low inflationary environment, the expected appreciation of the U.S. dollar, stable interest rates and a likely 2-3 percent U.S. GDP growth rate.

"There is no shortgage of risks in the U.S. outlook at this point in time, but where we start our view is with the economy, and despite a natural reluctance on our part to whole-heartedly embrace this soft landing scenario we really don't see any compelling alternative to this view at this point in time," he says.

Kreicher's best bond investment bets include Canada, Australia, Finland, Denmark, Poland and Brazil. He advises fund managers to stay out of the Japanese bond market, where he thinks yields could rise by 100 basis points in the next six months. EM

EMERGING MARKETS AT MERCY OF U.S. TREASURY MARKETS

The outlook for emerging fixed income markets remains positive as the potential for credit rating upgrades in some countries and country buybacks of debt in others augurs well for spread tightening in the fourth quarter, says Ashwin Vasan, vice president and portfolio manager at Oppenheimer Management Corporation.



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Argentina must avoid gridlock

"The things that are motivating the [emerging fixed income markets] right now is the prospect that Poland will get an investment grade rating [from Moody's Investors Service] and debt buybacks in Brazil and Argentina," he says.

Last month the Argentine government had the first of a series of $100 million auctions to buy back debt using the proceeds from its recent DM1 billion ($715 million) Eurobond issue. In Brazil the senate passed legislation permitting the government to prepay Brady bond collateral that was to be phased in by April 1996, thus removing the only obstacle to the country going in and buying back its Brady bonds as a way of tightening spreads.

Brazil has received a number of proposals from Wall Street firms for a debut American bond issue. Gustavo Franco, the director of international affairs at Brazil's central bank confirms that they are keen to set a benchmark in U.S. dollars. However, bankers who have lodged proposals with Franco say a major obstacle is the huge spread differential between what Brazil would be prepared to issue a dollar bond for and where Brazilian Bradies are trading.

Vasan warns, however, that emerging market fixed income instruments will continue to be at the mercy of movements in the U.S. treasury market.

"If U.S. economic growth picks up over the second half of this year then treasury yields will increase and that will impact negatively on the emerging markets," he says, adding that his outlook is for another bout of weakness in the treasury market in the near term.

"I feel that treasuries are due for a setback going into the fourth quarter. I just think that U.S. growth will be faster than expected."

Vasan has adopted the defensive strategy of shortening the duration of his portfolio. "We are shorter in duration than we normally would be. Our overall duration would be about four years in the emerging markets."

Short-term floating rate notes would be his choice of investment in the event of rising U.S. treasury yields. "Bonds like Brazilian IDUs, for example," Vasan adds.

Cetes, dollar-determinated bonds, are also looking good for the fourth quarter: "The outlook for cetes is for them to continue to be attractive, for no other reason other than the fact that it is expected that rates will continue to be reasonably high," says Vasan. His break-even analysis suggests that the Mexican peso would have to weaken to a level of around eight pesos per U.S. dollar before dollar London interbank rate investments of the same duration provided more attractive returns than cetes.

Vasan, however, does not expect substantial flows of international capital into Latin America until the major countries in the region overcome fundamental economic and political obstacles.

"Every major Latin country unfortunately has some pretty serious challenges to overcome," he says. "In Ecuador you have elections and that means a continuance of volatility in the market. In Brazil, the government has to continue to inch forward with fiscal reform. Argentina also still has to resolve issues surrounding fiscal policy. It will be as tough for Argentina in 1996 as 1995 because the government will not only have to maintain a balanced budget but continue to finance significant debt amortizations. Mexico has to nurse its banks back to health and return to growth and that will be a serious challenge." EM

— Danielle Robinson

Mediocredito Centrale SpA

This announcement appears as a matter of record only

THAILAND 1993

Caltex Trading and Transport Corporation

Petroleum Authority of Thailand

STAR PETROLEUM REFINING Co.

US$ 1,700,000,000

Refinery Finance

Lead Manager
Mediocredito Centrale

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PAKISTAN 1994

HUBCO

US$ 1,711,000,000

Power Station Finance

Joint Co-ordinator of the SACE Facility
Mediocredito Centrale

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QATAR 1994

QAFCO

US$ 477,300,000

Fertilizer Production Plant Finance

Co-Arranger
Mediocredito Centrale

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RUSSIA 1994

GAZPROM

US$ 1,615,000,000

Gas Pipeline Finance

Joint Arranger
Mediocredito Centrale

This announcement appears as a matter of record only

INDONESIA 1995

P.T. KIA SERPIH MAS

US$ 76,350,000

Ceramic Production Plant Finance

Lead Manager
Mediocredito Centrale

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ITALY 1995

ITALPET

DM 241,800,000

PET Production Plant Finance

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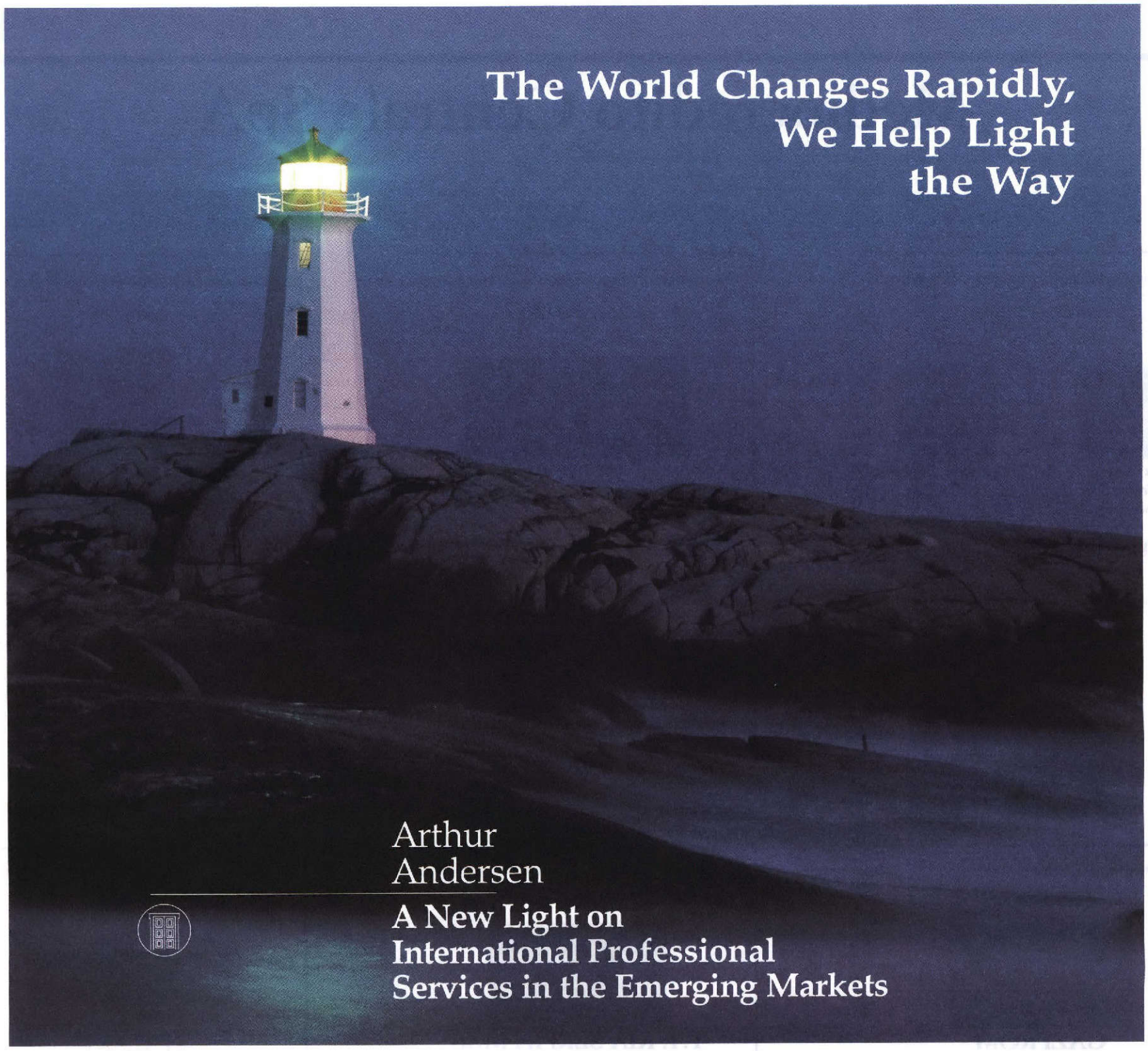

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World Bank

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VP FORESEES HIGHER SCORES IN GEOGRAPHY

BY KEVIN RAFFERTY

World Bank vice president Jean-Francois Rischard asserts confidently that "in a few years' time no one will talk about 'emerging markets' because they will be able to differentiate between various countries."

Not all his colleagues think that Rischard is right. "Have you heard about the investors who were asked where Subic Bay is? Almost 80 percent said it was in the United States," chortles one senior manager. (Subic is the former U.S. naval base in the Philippines.) "Or the institutional investors who thought that Thailand is a communist country," chuckles a colleague. (Thailand is a monarchy that was the buffer against communism in Indochina and is one of the leaders of the next wave of Asian "tiger" economies.)

Private investment flows now account for 75 percent of the more than $200 billion a year going to developing countries.

One of the first points new World Bank president James Wolfensohn made on taking office was that countries even in the same region, let alone the same continent, can be strikingly different. A colleague chips in that Chile, for example, has marked economic resemblances to the fast-growing Asian countries, whereas the Philippines behaves more like many Latin American countries.

The lesson is that investors will increasingly realize that national boundaries can make a big difference to the return they will get on their money. Similarly, policymakers in developing countries have to understand that they must devise policies to be attractive to investors, especially as the sums of official aid continue to decline.

The World Bank's statistics show that private investment flows now account for 75 percent of the more than $200 billion a year going to developing countries, dwarfing official aid. Equally important, about a dozen countries get almost 90 percent of these private capital flows, according to bank economists. China dominates: in 1993, the last year for which statistics are available, it received $36 billion in private flows on top of $5 billion in aid. India, the other giant in population terms, received just $4.5 billion in private investment and less than half China's official development aid.



©RAFOTO

India, still a country of tomorrow

A high percentage of inflow funds doesn't necessarily mean that a country is on the verge of takeoff. Sub-Saharan Africa scored the highest in terms of regions in receiving 9.01 percent of gross domestic product in foreign capital, but most of this was official aid just to keep economies ticking over.

Masood Ahmed, director of the World Bank's international economic department, believes that there are "good housekeeping rules" which developing countries should follow — and investors should check — if they are to prosper. "In the long run, policies matter," he says, laying down the first rule, which is to get macro-economic policy right, keep inflation low and develop an open trade regime. Second, the external environment is important. Third is the ability to respond quickly to shocks. "It helps to have a good education system, particularly female education, to build a social consensus and to have good institutions," he adds.

He contrasts East Asia and Africa. "The East Asian countries have a very sound and conservative macroeconomic policy, with budgets under control, inflation low, good export promotion and small balance of payments gap." On the other hand, Ahmed asserts, government intervention has created "white elephants all over Africa." He hesitates when asked if democracy is essential for good development and instead uses the expression "greater openness which increases the number of stakeholders who have to be brought into the decision-making process."

Ahmed adds that, on the demand side, developing countries need to step up the pace of their reforms to make them more open to foreign capital; while on the supply side pension funds and institutional investors from the industrialized countries will have to seek higher returns than are available in their own slow-growing, developed economies.

The great test, according to economists in Asia, is in savings rates and capital flight. In fast-growing Asia, savings rates typically top 30-35 percent. "On the whole Asians look to their own country as their home and the place to invest their own money," comments a World Bank economist. "That's the best sign. Latin Americans on the other hand, often have one eye on Florida or Switzerland. If they won't commit their money to their own country, why should anyone else?" EM

IFC Equity Lending Expands Even as Bankers Grumble

BY ANTHONY ROWLEY

A decade or so ago, private investment bankers were happy to let the International Finance Corporation do most of the hustling in emerging markets — while they picked up whatever business they could by sheltering under its protective mantle. But times have changed and now these same bankers are challenging the IFC's right to virtually monopolize large areas of emerging market business.

Even a former senior IFC executive (and former World Bank senior vice president), Moeen Qureshi, says he feels there is a "danger for the IFC that it may begin to compete with and take business away from others who are perfectly capable of doing it."

Meanwhile, IFC executive vice president Jannik Lindbaek claims that "our policy is not to displace the private sector," but at the same time he admits that, "we shall have to be more cautious in future" about competition between the IFC and the market. The private deal-making arm of the World Bank is currently "developing internal guidelines" to deal with this issue of demarcation lines.

The most "contentious area" is advice to governments on privatization, says Lindbaek. This is a highly lucrative business nowadays and one in which some London merchant banks and Wall Street investment banks feel that they would have an obvious edge if only the IFC would move over. The IFC has been doing brisk business advising governments on structuring and implementing privatization deals.

"I have met many project promoters who tell me that the equity in a particular project is no longer available because IFC wants it."

Lindbaek claims that there is "very little irritation" between the IFC and private banks in other areas — loan syndications or equity investment in developing country projects. Even in the area of privatization, "we can still have a role as an investor without giving advice," he insists. "In the poorest countries we can still do everything."

Qureshi does not appear to agree. "I have met many project promoters who tell me that the equity in a particular project is no longer available because IFC wants it, or that IFC is not prepared to provide loan finance unless it also has a piece of the equity," he says. Lindbaek, however, defends the IFC's pursuit of deals and claims that there is plenty of business for all in the world's emerging markets.

"We are meeting unprecedented demand," he says. "Our portfolio grew by 17 percent last year in terms of project value and will continue to grow by between 13-18 percent in the foreseeable future." In the year to June 30, the IFC board approved just under $3 billion in loans and equity investments for 213 projects in 67 countries.

A large part of the IFC portfolio — as much as 25 percent in some years — takes the form of infrastructure financing in developing countries. This role is important at a time when the IMF is trying to find new solutions to the acute problem of securing sufficient long-term debt for such projects. There is plenty of private sector equity chasing infrastructure projects but precious little private term debt as yet, notes Lindbaek.

The IFC is trying to redress the imbalance by setting up bond-insurance firms to rate the debt of emerging market infrastructure issuers, and is examining various schemes for credit enhancement of such debt. It is also giving a lot of attention to developing emerging market private pension funds capable of channeling domestic savings into infrastructure via local bond markets.

In the area of country funds for emerging markets, Lindbaek claims that the IFC has now virtually left the field to private fund-management groups — except in Russia and parts of Africa. "The market has overtaken us in this area," he says. "It is much more difficult to launch country funds now," notes Lindbaek. EM

SINGH HAS MANY DREAMS TO FULFILL BEFORE INDIA TAKES OFF

BY KEVIN RAFFERTY

It started with an image of the elephant headed god Ganesh, in south Delhi just before dawn one September morning when a worshipper offered milk and saw it disappear. Soon almost all the gods in the Hindu pantheon all over the capital and north India were reported to be lapping up milk. The "miracle" spread to temples in Hong Kong and London where hundreds of people queued to offer milk, full cream, UHT, pasteurized and even semiskimmed and low fat. "The lesson is clear," exclaimed one pundit. "The Hindu gods have spoken in support of revival of Hinduism. The Bharatiya Janata Party is heading for election victory."

Time will tell whether it was miracle or hoax, superstition or a political portent. But the political scene in India today is suffering from election paralysis. "Everyone is waiting for the elections due early next year" said a banker who is a frequent visitor to the country, but who left quickly, exasperated by failure to get anything done "because everyone is making electoral calculations and no one is taking decisions."

That's not how they put it in the North Block of the secretariat in New Delhi where finance minister Manmohan Singh and his economic team sit, though some officials sotto voce will accept the phrase "period of consolidation" to describe the current state of economic reforms. Minister Singh himself is reported to be weary of constant political sniping and infighting. "We have to remind him that there are miles still to go and many dreams still to be achieved," said one colleague.

Singh painted a rosy economic picture last month: real growth at 6 percent in the current year; inflation falling below 7 percent; and the fiscal deficit reduced from a peak of 8.5 percent to about 5.5 percent of gross domestic product. Though the trade deficit is expected to double to 1.2 percent of GDP, Singh commented that the rise was largely because of rapidly growing imports of capital goods, components and raw materials "necessary" to sustain industrial growth of about 10 percent a year. "We can finance that kind of deficit," Singh added.



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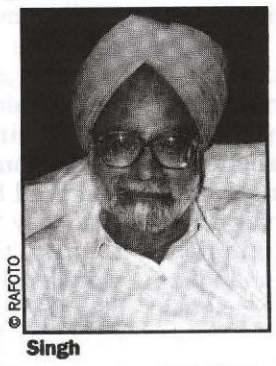
Coca-Cola and Pepsi fight Indian battles

Montek Singh Ahluwalia, the country's finance secretary, also brushed aside ideas that India was in any danger of "going the Mexican way." Its debt service ratio had come down from 31 percent of foreign exchange earnings in 1990-91 to 27 percent and is expected to fall to 20 percent by century's end.

That is the good news, which shows the strides that India has made in opening up to the rest of the world. But it still has a long way to go. Its growth rates have been edging up, and 6 percent is much more respectable than during the years of "self reliance," but is still half the rates of rapidly growing Asian neighbors, including China. Its share of world trade is below 1 percent and still less than Malaysia's. Foreign investment attracted last year by India was $1 billion, tiny compared to the $26 billion inflow to China.

Merrill Lynch recently predicted increasing competition for capital between Asia's two giants, China and India, which together account for 40 percent of the world's population. "While China would still have substantial attraction for investors, increasingly it would not be seen as the only choice for low-cost manufacturing investment or the only billion-consumer emerging market," wrote senior economist Nicholas Kwan.



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Singh

Kwan assessed the respective attractions of China and India: China gets large amounts of investment from its overseas diaspora and has been a main magnet for manufacturing plants from all over Southeast Asia; its economic growth has been in double digits, and double India's. India has a more developed capital market and banking system, a better road and rail infrastructure, and a larger middle class, totaling 250 million people, plus democracy. The Bombay Stock Exchange is 107 years old against the four year history of Shanghai and Shenzhen; Bombay's market capitalization at the end of 1994 was almost four times China's total.

This is where India's political paralysis is particularly harmful. Last month privatization plans for four big companies were revealed, but these are only partial schemes with the government keeping a majority. Political analysts doubt whether there is going to be much progress until after the elections. Then the prospect is that no party will emerge with a clear majority and politicians of all sorts and hues will squabble for the spoils.

Most observers agree that P.V. Narasimha Rao and Congress are finished, at least for the time being, and not even any of the Gandhis could produce a miracle to revive their fortunes. The expectation is that the Hindu nationalists who have already taken control of Bombay will do well. But Mukul Shukla, a senior journalist with the *Hindustan Times*, cautions against taking only the views from the cities since 70 percent of India's 900 million people live in rural areas. There the trend is the rise of the backward classes, resentful of political domination by the Brahmins of the Nehru-Gandhi dynasty and the privileges given to the Harijans (literally Children of God or untouchables).

This could well lead to stalemate, continuous squabbling punctuated by outbursts of nationalism, as already seen in cancellation of the Enron power contract by the new Hindu rulers of Maharashtra state. There is plenty of popular antipathy towards foreigners, also seen in outbursts against Kentucky Fried Chicken and Pepsi, newcomers to India. India does not have China's luxury of investment funds on tap from overseas Chinese — Indians abroad tend to be professionals rather than megarich.

The comfortable urban middle classes promise that they will see that the liberalization is not rolled back. Even hardened nationalists learned the hard way that the old policies would not work when treasuries were empty. "Remember, when Manmohan Singh took office, we had less than two weeks' foreign exchange reserves and today we have $20 billion," says a finance official.

But liberalization needs backing with competition as well as social programs to raise literacy and pull the have-nots into the modern economy. Political fighting may make it an orphan with no one to offer the special care and guidance it needs in sight of awkward adolescence. EM

Midas Soros Upset by Enron Failure

George Soros is widely regarded as the modern man with the Midas' touch. He has made mistakes, but you only have to ask the Bank of England about Soros' ability to predict and move markets to realize the awe in which he is held. Soros is reportedly rethinking his commitment to India after the Maharashtra state government's decision to cancel a contract with the U.S. company Enron to build a $2.8 billion power plant near Bombay.

One aspect is the money which India may lose: at the start of the year Soros was talking of a $1 billion investment fund to take advantage of India's financial deregulation and privatization. Now he has quietly dropped the proposal and is talking only of ad hoc investments.

Of greater concern is whether Soros represents international market sentiment. The scrapping of the Enron deal has brought mixed reactions. The U.S. company itself has held out hopes of renegotiating. Most Western companies have tried to play down the implications — cynics say because they have large sums of money tied up in India's reform program. Enron's failure has not stopped both Ford and Honda from announcing big investment plans for India last month, Ford for $800 million and Honda for $280 million.

But Western bankers and, privately, senior Indian officials are appalled at the potential damage done by the Enron cancellation. "The contract had been signed," says one banker. "Does this mean that no contract is sacred, and that any deal can be put up for renegotiation, if a state government changes, or if a rival chips in and claims there was something wrong with the original deal?"

In Orissa state another power plant planned by EAS Power is being challenged. Environmentalists have forced DuPont to relocate a nylon plant and are agitating against a paper plant by Sinar Mas, an Indonesian company. George Soros apparently doubts the political commitment of the Indian government to reform. In his biography last month he warns that "a crisis is unfolding in the emerging markets" and apparently fears that India may be in the firing line. EM

— Kevin Rafferty



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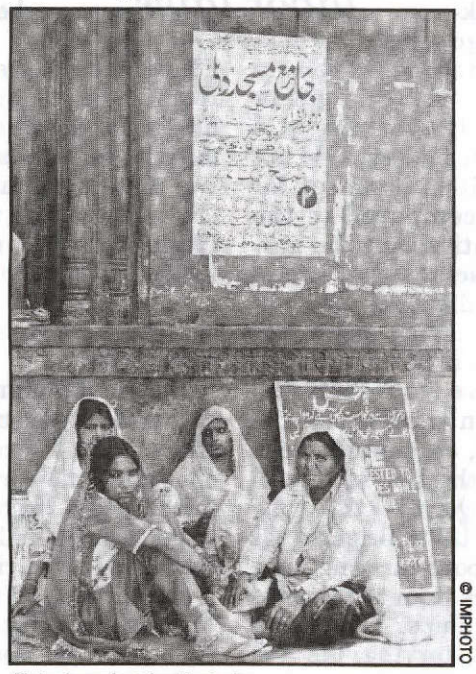
In SPECIAL REPORT India

MONDAY, OCTOBER 9, 1995 EMERGING MARKETS IM

Middle Class Rush for Goodies Leaves India's Poor Behind

BY KEVIN RAFFERTY

Almost nothing better illustrates the confident march of India's growing middle class than some of the foreign newcomers planning to enter the marketplace, such as Jockey International, St. Michael, Triumph, and Gruppo la Perla. Well-heeled women in Bombay and Delhi are looking forward to being able to buy international designer underwear, priced, say retailers, at anything from Rs245 to Rs1,500 (up to $50). In a country where most women spend Rs10 apiece on their lingerie, that neatly captures the progress — and the distance to travel.



© IMPHOTO

Not shopping for lingerie

The size of the middle classes is a matter of definition and some dispute. Some economists say 200 million, others go as high as 300 million, out of a population of 900 million. Westerners might quibble about whether they would be counted as middle class in their country, but anyone who can pay Bombay rents, has a telephone, television, refrigerator, possibly a washing machine, certainly a motor scooter, if not a car, has arrived.

You have only to spend a few minutes on the streets of Bombay, Delhi, Madras or Calcutta to be quickly overwhelmed by the garish advertising and the fumes of the traffic to realize the explosion of purchasing power. But India, more than any other place in the world, has a terribly split personality, where enormous riches sit cheek by jowl with grindingly wretched poverty. Per capita income is still $300-400 a year.

Disregard, if you can, the sprawling slums and the stench of human beings trying to put together a life on the hard harsh sidewalks, and go to the villages where more than 70 percent of Indians live. From a distance it looks idyllic or romantic, but this is what the urban slumdwellers have fled from. Apart from the rich and the politically wellconnected, rural life revolves round the seasons and can be tough even when nature is well behaved. For the most part, rural India has yet to receive the benefit of Manmohan Singh's reforms.

Gautam Kaji, managing director of the World Bank, notes that agriculture still employs 70 percent of the Indian workforce, though it contributes only 35 percent of gross domestic product. More worrying is the backwardness of rural India in education and health, two key ingredients if the country is to put the majority of its people in touch with the modern economy. Kaji charges that "about half the students in Indian primary schools drop out before graduation — and only half of those who graduate can read and write." Similarly depressing, India spends only 1.3 percent of GDP on public health care, lower than in many improverished African countries.

Going back to urban India and the strains of traffic and clogged infrastructure, you have to wonder about the environmental costs and whether or for how long India can handle the strains of an economy where one class of people can pay $50 for underwear, while for the masses of the population $50 is two months' income. EM

BOMBAY OFFICE SPACE BOMBSHELL

Which is the most expensive city in the world in which to rent an office? It is no longer New York, at a modest $420 per square meter in midtown and a cheap $246 downtown. Nor is it London, with a slightly pricier $714 for the West End and $546 for the City. China's capital Beijing is now more expensive than either, costing $950 per square meter for prime office space. Hong Kong beats them all at $1,480. Even falling land prices have not created any bargains in central Tokyo, which comes in at $1,545. But this only gives Tokyo second place — to Bombay.

Prime office space in Bombay costs $1,566 per square meter, according to real estate agents Richard Ellis. Actual costs are much higher than these bare figures because tenants are expected to pay hefty rent in advance, sometimes up to five years before they are allowed to move in. According to a local official, "The returns on real estate are higher than in industry." Housing prices have risen at the same rocket pace, with modest three-bedroom flats in a pleasant area costing $5,000-6,000 a month with a whopping security deposit on top.

Real estate agents can't see any quick reduction. The densely packed island city needs a million new low-cost homes to meet existing demand and is being pressed by the arrival of 600 new migrant families every day. You can't miss them with their makeshift homes lining the airport road.

Sonia Speech Hints at Revival of Gandhi Dynasty

Sonia Gandhi climbed the platform in front of thousands of adoring, chanting supporters. "You people can well understand my agony," she said in fluent Hindi in her dead husband's constituency of Amethi in Uttar Pradesh state.

She then delivered herself of what the Indian press described as an outburst or devastating blow against the government of Prime Minister P.V. Narasimha Rao, accusing it of dragging its feet in investigating her husband Rajiv's murder by suspected Sri Lankan Tamil separatists.

She went on to complain that the government was departing from the principles that her husband Rajiv, mother-in-law Indira Gandhi and Indira's father Jawaharlal Nehru had laid down for a secular, democratic India. "It is an irony that separatism has pervaded every sphere of life," she moaned in a twin-barreled attack on both the government and the rising Hindu-nationalist Bharatiya Janata Party, which defeated the Congress Party in state elections and is part of the coalition running Maharashtra state, including Bombay.

After that she departed, leaving Congress rebels against Rao to gloat. Everyone puzzled over whether she was laying the markers for the next generation of the Nehru-Gandhi dynasty to enter the political lists and, if so, whether it would be Sonia Gandhi herself, her 25-year-old son Rahul or 23-year-old daughter Priyanka who would pick up the family standard.

Son Rahul "would be a terrible politician."

As an Italian by birth, Sonia would have a hard time, particularly against the rising nationalist politicians. Friends say that as a wife and a mother she has grieved too often over the murders of her mother-in-law and husband to want to play the dirty political game. Son Rahul, notably absent from the Amethi gathering, "has few political instincts and would be a terrible politician," according to an Indian who went to university with him.

But daughter Priyanka was by her mother's side, and commentators have compared her to grandmother Indira Gandhi in her feistiness and even in her looks. However, she is too young to contest elections to be held next year — the minimum age for candidates is 25.

It is a measure of the political bankruptcy of the Indian ruling classes that so much store is set in untried neophytes whose political views are not known. A few more thoughtful commentators say that the chattering classes are wrong to give so much attention to the dynastic issue. As one of them puts it, "Even if the Gandhis are brave enough to take the risk of assassination threats, they will be bypassed by the new politics which are centered around Hindu nationalism and the backward castes. It may be sad, but clean Brahmin politics are over." EM

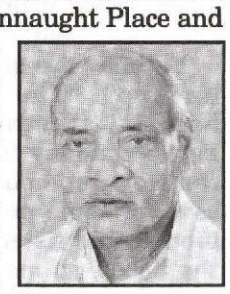
— Kevin Rafferty

Delhi Protests Cynical Rao

It was a busy Friday towards dusk at the capital's most congested, throat-roaring, traffic-fuming time — yet the very heart of New Delhi had stopped beating. Almost everything was closed, boarded and barricaded with just a few women sitting on the ground selling paintings and trinkets. The small boys seeking income by dropping manure on shoes of passing tourists and then offering to clean the "bird droppings" had vanished.

What had happened? It must be a major national disaster or a public funeral of a national figure that had closed the department stores, clothing and shoe emporia, budding designer boutiques, the coffee shops, the endless tourist stalls selling everything from antiques and silk and tea to gaudy clanking jewelry.

No — the government had announced it was changing the names of the two major areas at the heart of New Delhi from Connaught Place and Connaught Circus as they had been known from the very foundation of the city to Rajiv Gandhi Chowk and Indira Gandhi Marg. The shopkeepers had revolted against the act of "latter-day imperialism, the government deciding without consulting us," as one put it.



Rao

Diehard British blimps should not delude themselves that the shop closures, which lasted three days, represented nostalgia for the days of the Raj. It was a protest against the cynical behavior of their rulers. The Congress government is in trouble and the sudden decision to rename the two roads was perceived as a political exercise to win a few votes and perhaps to shut up Sonia Gandhi.

"It's been CP forever," said one trader. "Everyone knows it as Connaught Circle and CP: it's part of Delhi's history and the Gandhis were in power only a short time in CP's life," added another majestically. "Very much in [Prime Minister] Narasimha Rao's style," comments Prabhash Joshi, editor of the Hindi daily *Janasatta,* "he never explained or defended the decision or commented on the protests. He can also change his mind more easily that way." EM

— Kevin Rafferty

Landed on the Street by Do-Gooders

BY KEVIN RAFFERTY

Fatima Bibi wipes the tears from her eyes and tells her tiny brother and sister, each dressed only in a pair of dirty baggy pants, to carry on picking up leaves and twigs. "Picking discarded things is the only way we have of earning money now that I have lost my job in the garment factory," says the 14-year-old family rice winner turfed onto the streets by a combination of do-good American pressures and the harsh realities of poverty-stricken Bangladesh.

Until a few weeks ago Fatima worked long hours in a factory making shirts for export to the U.S. and earning 700 taka ($17.50) a month. Then she was told to pack up and go with just one day's notice, no redundancy money — "nothing after nearly two years of work," she says. Now she has no job and few prospects of one.

She says she is tempted to join her former factory colleague. "Kamala's out now. She makes her money making men happy," says Fatima coyly. The two girls live in the same slum in nearby houses made of assorted bricks that have been begged, borrowed or stolen and covered by a plastic sheet that at least keeps most of the rain out — except during the torrential monsoons when the only thing is to enjoy the downpour for the relief it brings from the enervating heat.

Fatima says she feels desperately unhappy. "The factory work was hard, but it meant that I could get enough money for food and to pay rent for this house. I was trying to save for some proper clothes for my brother and sister, a proper cover for the house, so many things we need. Now there is nothing." She can't read or write. Her mother died shortly after giving birth to her sister Noor, now three, and her father was killed when the cycle rickshaw he pulled was hit by a car. "No, we received no money. The owner of the rickshaw took it, blaming my father for destroying the rickshaw."

"I know that men are horrible, but she gets money, and when she is dressed up, she looks so pretty."

Kamala learned about prostitution the hard way, says Fatima. Her parents sold her to a group of men, but "they made her cry by beating her if she did not please them, so she ran away to work in the factory. I know that men are horrible, but she gets money, and when she is dressed up, she looks so pretty."

The two girls are victims of a U.S. campaign to stop child labor in the burgeoning 1,800 garment factories which employ 800,000 workers, mostly women and many of them children. Originally, child labor was to have been outlawed by 1997, but the Bangladesh manufacturers decided to stop the practice by this month, saying that importers already won't buy goods they suspect of being made by children. "We can't keep the child laborers on jobs until 1997 while we are facing an immediate import ban," says Redwan Ahmed, president of the Bangladesh Garment Manufacturers and Exporters Association.

Thousands of children have been sacked and left — like Fatima and Kamala — to fend for themselves with no redundancy money, no social security, no other source of income and little chance of schooling. The dismissals are in defiance of agreements with the United Nations that child workers would be given 300 taka ($7.50) a month, and put into school. The obvious reasons for the sackings are that more children have been employed than factories are willing to admit.

The money put up by factory owners and Unicef — just over $400,000 altogether — would provide for fewer than 5,000 children, but some aid groups put the number of workers aged 14 or younger at 100,000, and say that 50,000 have been dismissed in the past few weeks, They are appalled by the action of the manufacturers and are considering calling for a boycott of their goods.

The real losers are the exploited children: "The awful choices for the girls may be between hunger and selling themselves," says one aid worker. "For the boys, it is bad enough but easier — they'll drift into a choice between petty crime and criminal gangs." The manufacturers will find new workers easily enough.

This zeal to protect Bangladesh's children causes finance minister Saifur Rahman to lament that the West is showing colossal ignorance of the real life of a poor country. "I fear that those pressing for change may make things worse for the very children they are trying to protect. The West, particularly the Americans, are overzealous. In trying to protect the children from hardship, they are making them undergo even worse hardship," Rahman asserts. "As for a girl or boy of 12 working in a garment factory, I do not think it is harmful for them, compared to the alternatives. In the garment factory, they are in air-conditioned environments cutting or putting stitches in garments.

When people are starving, life and survival are more important than labor laws.

"Have you seen the children working on the streets, chopping bricks under the hot sun, with the danger that they may smash their fingers? Or young boys carrying huge boulders from the river to put on ships? When people are starving, life and survival are more important [than laws saying that you can't work under 15]."

Rahman and others point out that Western industrialized countries took centuries to mature and pass laws protecting children from working, but expect Bangladesh to adopt their standards overnight. The minister thinks that a more realistic start would be to ensure that children do not work 12 to 14 hour days but have some time for play and schooling. But he says that Bangladesh has to go along with the powerful U.S. views and outlaw child labor. America takes 50 percent of the country's $2 billion annual garment exports.

The garment factories have proved a lifeline to a previously desperate country that had almost no modern exports and few employment opportunities. It is not just the production and export earnings, but the extra income that has been generated and created consumer demand for more goods and more jobs in a virtuous circle. "The women workers have great pride, and their work has given them a vision of hope, and ability to see ahead and save for clothes, better food, schooling for their children," says a former government minister. Even with the 800,000 garment jobs, paying between 300 to 1,800 taka per month, per capita income is still about $225 a year for the 120 million people. Proper figures for the jobless do not exist, but rough estimates say that at best half of the population has a recognizable regular job. Everyone has to earn what he or she can wherever opportunity can be grabbed.

On every street of Dhaka, there are children at work from morning to night, chopping bricks into fragments to be the foundations for roads, with tiny tots of two and three imitating their mothers and brothers wielding hammers. Other children count themselves lucky if they can find work and a few pennies pushing rickshaws, lending a hand at corner stores or cycle repair shops.

Saifur Rahman pleads that he is desperate to get children into school, "since the main cause of underdevelopment is the curse of illiteracy." He introduced a "food for school" scheme under which children who turn up at school are given rice or wheat rations if they attend 80 percent of the time. "School enrollment has gone up tremendously, from 12.6 million children in 1991 to 17 million in 1995 at primary school."

In another initiative, he is giving scholarships to girls from grade 6 to 10 (aged 11 to 15). Almost 2.5 million girls are getting scholarships and the ratio of girls to boys is 50:50. "This year I have spent more on education than the total budget when I was finance minister in 1980." But he needs time and more resources and the ability to reach out to Fatima and Kamala — who are beyond the government net and have to work out their own salvation. EM



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The West is ignorant of real life in a poor country



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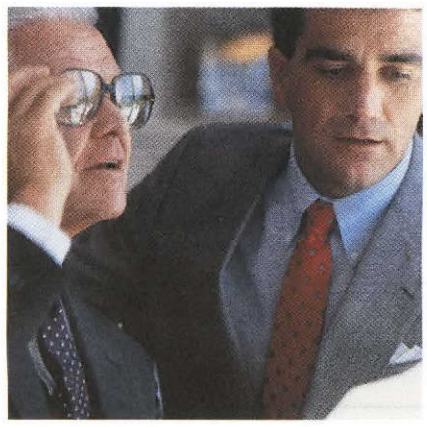







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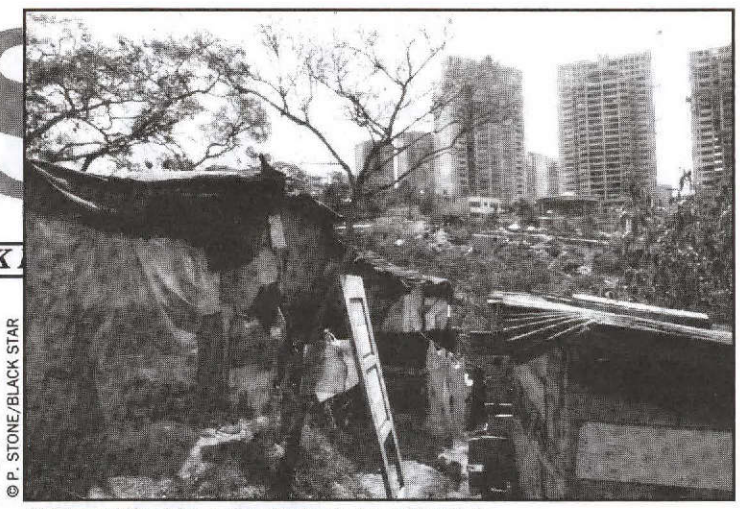

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Aid has shifted from the strategic to guilt relief

DEVELOPMENT ASSISTANCE

PART II: A WORLD WITHOUT AID

COMMENTARY BY MARK FALCOFF

With the end of the Cold War, most of the countries of the world have lost leverage with the superpowers — or so goes the conventional wisdom. There is no longer a Soviet bloc to write an insurance policy on new "revolutionary" governments, and the U.S. is so absorbed in its own problems that it has plainly lost interest in what used to be called the struggle for the world. The result is strategic neglect of scores of nations that once were on the aid circuit, and with this neglect, so we are told, will come de-development, starvation, hunger, misery and ecological disaster.

Like most bits of conventional wisdom, these notions are not wholly without foundation. The American public isn't much interested in other countries any more, and even before the recent elections, Congress was looking around for ways to eliminate budget items without domestic constituencies. Western Europe is troubled by the growing presence of immigrants from Africa, Asia and the Middle East, and anti-foreign feeling of a different type has resurfaced in Japan.

It is true as well that the end of the Cold War hasn't solved all the world's problems. The human condition in many parts of the world remains deplorable, a point brought home by increasingly vivid television coverage of natural disasters and civil conflict in places like Mexico, Somalia and Bosnia. Meanwhile, the prospect of the rapid decomposition of the Russian Federation or the rise of Islamic fundamentalism in North Africa and the Middle East arguably poses as great a threat to Western security as the communist challenge ever did. In the absence, however, of an overarching logic, it's difficult to make sense of world events. Confusion and a sense of impotence — far more than selfishness or reckless disregard — are the twin forces shaping Western opinion today.



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Does aid for Africa buy disaster?

Cold War or no Cold War, however, a world without aid is still very far off. The numbers alone tell the story. Taken together, the OECD, World Bank, IMF and regional banks continue to dispense some $55 billion a year in development assistance. Paradoxically, the fastest growth area is the region which has lost the most political leverage in recent years — sub-Saharan Africa. Aid disbursements to this region have been steadily rising since the mid-1980s, and now hover in the area of $20 billion annually (not including the Republic of South Africa). Likewise, Israel and Egypt are both heavily dependent upon annual infusions of U.S. largesse, and in spite of some complaints, no end to the gravy train seems in sight.

The presumptions upon which aid policies are based have changed. Not so long ago, Western aid agencies and governments dispensed resources on the optimistic grounds that "development" was a blessed state that could be reached through large infusions of external resources. If the recipients failed to show progress, then it was obviously because the West — particularly the U.S. — was not being sufficiently generous.

Today it is generally conceded that aid can serve (or misserve) many purposes — strategic, political and psychological. But it cannot assure, or even significantly promote, development. This is the tacit consensus today of most Western governments, though diplomatic expediency and good manners have prevented it from being shouted from the rooftops.

This change of perspective is the result of more than three decades of experimentation, which has since established that no country can be developed through aid alone. If that were possible, Cuba — with a population of 11 million — would be Latin America's most advanced nation, since it received more than $60 billion in transfers from the Soviet Union between 1960 and 1990.

Conversely, two of the more important newly-industrializing countries, South Korea and Taiwan, actually began their ascent to self-sufficiency and prosperity after U.S. aid was drastically reduced. Or there is the even more dramatic case of Chile, which rose to leadership in Latin America over a brief 15 years, during all of which time it was virtually embargoed by Western governments.

Today the globe has been implicitly divided into different kinds of aid recipients based on different expectations of their ultimate prospects. Sub-Saharan Africa is presumed (rightly or wrongly) to be incapable of development, so the money thrown at it is intended to stave off the worst of human and natural disasters or to assuage the Western conscience — not much more. The same applies to much of South Asia.

Some countries, like Egypt, are deemed too strategically important to be allowed to go down the drain, even though their massive dependence on external resources seems to be undermining their economic viability and the regimes' credibility as well. The countries of the former Soviet bloc are hoped to be capable of making the transition to free markets and democracy — and maybe some of them are. But nobody is anxious to impose a standard of performance so rigorous that these countries cannot be expected to meet it.

It is conceded that aid cannot assure, or even significantly promote, development, though diplomatic expediency and good manners have prevented it from being shouted from the rooftops.

We also have different kinds of aid, packaged under new labels. The emergence of a whole new group of countries formerly part of the old Soviet Union or the Soviet bloc has called for the creation of "policy reform loans." These contrast quite sharply with assistance tools of decades past. In the 1960s and 1970s, development assistance was normally based on project proposals, and disbursed in tranches over time. Policy reform loans today are intended to bribe governments to take politically unpopular steps toward open markets; in exchange, they are allowed to draw their cash more or less immediately.

The multilateral banks have also introduced a large grant element into their loan policies. A case in point is the World Bank's International Development Association, whose loan window is the softest of the soft: those who borrow there are assured of an interest rate well below commercial rates, which they do not even have to begin paying back for the first 10 years — by which time, of course, inflation will have liquidated most (if not all) of the debt burden.

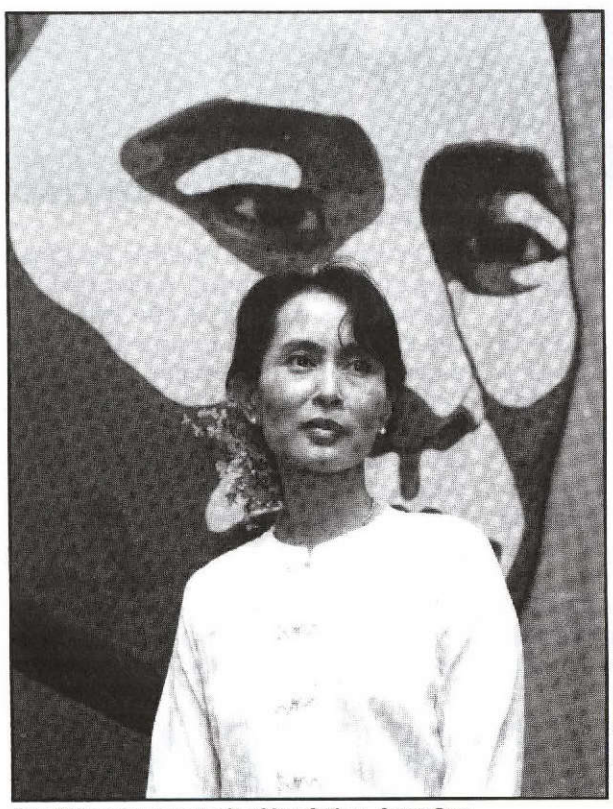
The large private banks have returned to many areas they formerly avoided — to the tune of $40 billion a year. For some countries, of course, these loans are not aid but strict commercial transactions, particularly for borrowers like Thailand, Chile or Argentina, who have recovered (or never lost) their creditworthiness. But such loans have a way of sometimes becoming disguised forms of assistance — either because they are guaranteed by home governments or because of subsequent defaults or debt-for-equity swaps. Indeed, much of today's private banking in Latin America is based on collateralizations rather than on new loans.

Resource transfers from rich countries to poor will continue, and some of them may actually turn out to be worthwhile propositions, particularly in those places where policy reforms take hold. Even the outright acceptance of some regions as charity cases is a good thing, to the extent that it at least clears the air and relieves societies of obligations they cannot reasonably be expected to meet.

The decoupling of the concepts "aid" and "development" is a large advance, both conceptually and in practice. With a bit of luck, by the beginning of the next century we might find that we have more of both. EM

Next — Part III: The U.S. Anti-Aid Thrust

Features



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Suu Kyi under a portrait of her father, Aung San

Part II

Challenge to THE SYSTEM

DEMOCRACY STILL DEFIED

Aung San Suu Kyi Is Released, but Slorc Isn't Worried

COMMENT BY THE INTERNATIONAL INSTITUTE FOR STRATEGIC STUDIES

Despite the considerable international attention that surrounded the release of opposition leader Aung San Suu Kyi, there are few signs of substantial change in the political life of Myanmar (Burma). On the contrary, Suu Kyi's release is not evidence of weakness on the part of the State Law and Order Restoration Council (Slorc), which assumed power in 1988, but of the growing self-confidence of Myanmar's military leaders.

Unlike fellow Nobel laureate Nelson Mandela, Suu Kyi has not been freed to take part in a national reconciliation. Despite growing international support, she has been released as an ordinary citizen, subject to the same draconian security laws as everyone else. Slorc officials depict her as an irrelevant voice in domestic politics, in sway to Western allegiances (she has a British husband). In such a hostile environment, her future re-arrest cannot be precluded.

In response, Suu Kyi has attempted to maintain a conciliatory pose. She has concentrated on reviving her near-moribund party, the National League for Democracy (NLD), which won a landslide victory in the 1990 election. Significantly, she has spent much time with retired military supporters, notably former defense minister Tin Oo, and has adopted an appeasing stance towards the Army, which her late father founded. Suu Kyi's strategy is clearly to pave the way for talks with the two key Slorc figures, chairman General Than Shwe, and military intelligence chief Lieutenant General Khin Nyunt.

Slorc, however, has shown little interest in responding. Eventual talks cannot be ruled out as national reconciliation will one day be essential. But unless such talks occur soon, a confrontation is widely predicted. Many supporters believe Suu Kyi must make her mark quickly to prevent further erosion of the democracy movement. In the coming months, there will be two main points of contention.

The first concerns international investment in Myanmar. Suu Kyi's assertion that any international investment is premature without democratic reform has been met with stinging criticism in the state-controlled press.

Slorc is staking its long-term survival on economic progress, and should it feel that her words are being heeded, hardliners in the regime will undoubtedly respond. Slorc's "open-door" policy is slowly attracting international investment to the country, especially in tourism and natural gas. However, Myanmar is still considered a financial risk and, after years of conflict and misrule, most sectors of the economy are in a parlous state.

The second point concerns Slorc's reform process which, after much delay, is now reaching a critical stage. During Suu Kyi's detention, Slorc overruled the 1990 election result and inaugurated its own national convention to draw up the new constitution. Most elected parties have been barred, but several NLD members, on Suu Kyi's instructions, have continued to attend. Despite continuing arrests, this has allowed Slorc to present the convention as a forum for democratic debate.

Slorc has also accelerated an increasingly successful cease-fire policy in ethnic-minority regions. By June 1995, it had agreed to military cease-fires with 16 key ethnic insurgent groups, bringing the first peace in four decades to several borderland war zones. A number of these groups have been attending the convention.

Thus, the next scheduled meeting in October will bring numerous issues to a head. With the constitution reportedly near completion, Slorc will force both Suu Kyi and the ethnic opposition to deal with them or risk being marginalized.

Suu Kyi's long-term potential as a unifying symbol for democratic change can never be discounted. However, as evidenced by her release, Slorc leaders are now confident in their ability to control the situation.

Internally, Slorc is aiming for the Indonesian model. The armed forces must have the "leading role" in politics, Myanmar's future president must have military experience, and 25 percent of seats in parliament must be reserved for military candidates. Equally striking after the poor showing of its National Unity Party in 1990, Slorc has formed the mass movement Union Solidarity and Defence Association in likely imitation of Indonesia's ruling Golkar party.

Meanwhile in Myanmar's restive ethnic-minority states, Slorc is planning to reform local government while retaining central military rule. New administrative regions will be created in which leaders who have signed cease-fires have been promised important positions.

Clearly, Slorc hopes to dissipate ethnic opposition through cease-fires and its calculation that many insurgent commanders put local interests before broader national concerns has been proved correct. The main armed opposition fronts, the National Democratic Front and Democratic Alliance of Burma, have virtually disintegrated.

This does not mean that Myanmar's long-running ethnic problems are by any means solved. Fighting still continues against the Mong Tai Army of the opium kingpin, Khun Sa. But after years of conflict, veteran ethnic leaders want to be on the inside of the process in such a pivotal era. For this reason, cease-fires are expected to endure.

Slorc is staking its long-term survival on economic progress, and should it feel that her words are being heeded, hardliners in the regime will undoubtedly respond.

Also delighted by the cease-fire movement and Suu Kyi's release are Myanmar's Southeast Asian neighbors, who share many concerns over refugees, narcotics and Aids. In the xenophobic world of Myanmar politics, internal security is always paramount. Many regional governments claim Suu Kyi's release as the result of their "constructive engagement" with Slorc, in sharp contrast to the West's isolation tactics.

The greatest public support for Slorc has come from the Association of South East Asian Nations (Asean), which invited the regime to attend (as observer) its last two annual meetings. There have been several diplomatic visits, and with the signing of Asean's Treaty of Amity and Cooperation in July, Myanmar's future membership is virtually assured.

If Myanmar is ineluctably moving into the Southeast Asia orbit, China remains the most powerful presence on Myanmar's borders. The country's entry into Asean, however, will not worry China, whose policy towards Myanmar has undergone a major shift. Following its 1989 cut-off in support to the now-defunct Communist Party of Burma, Chinese trade has come to predominate across the northeast of the country. Today China is Myanmar's largest arms supplier and trading partner, and although large-scale Chinese immigration is fueling resentment, diplomatic relations were publicly cemented by Chinese premier Li Peng's 1994 visit to Rangoon.

Significantly, however, the greatest international influence on Suu Kyi's release was probably neither Asean nor China but Japan, which has made her freedom the main precondition for resuming aid. Slorc first announced the news to the Japanese embassy and, in response, ministers in Tokyo have already intimated that full development assistance will shortly be restored.

By contrast, the release of Suu Kyi has left Western governments increasingly wrong-footed. Western oil companies are the largest sectoral investors in Myanmar, but concern over continuing human rights abuses is still pervasive. Sanctions have been mooted unsuccessfully in the U.S., where there is particular worry over the thriving opium trade. With few local points of leverage, most Western governments will have to settle for maintaining pressure through the UN as well as caution on any large-scale resumption of aid.

Given Myanmar's troubled past, future volatility can never be ruled out. Something remains amiss at the heart of the country's politics, and will only be resolved with the passing of the old dictator, General Ne Win. Nevertheless, after seven years of opposition and crisis, the Slorc generals will breathe more easily. Huge problems still lie ahead. But while international attention has focused on Suu Kyi, Myanmar's military strongmen have once again ensured that they have the dominant say and Western governments will have to adjust their policies to this reality. EM

Next: Part III — The Next Stage in Latin Reform

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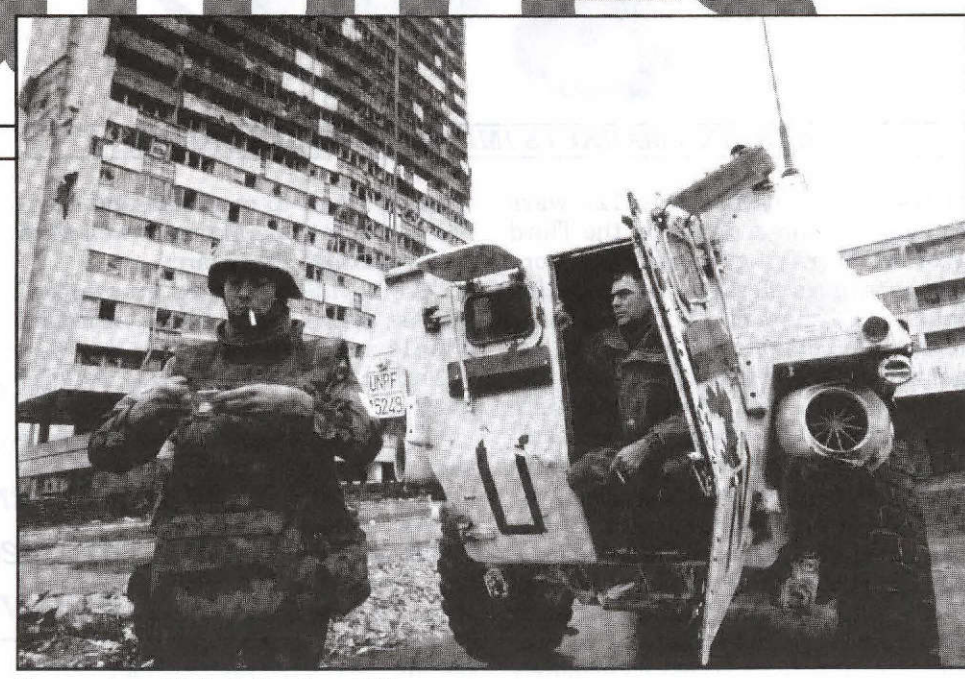

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How much credibility do they have left?

WEST FOUND WANTING IN BOSNIA

BY IAN BLACK



In downtown Sarajevo, opposite the metal stalls of the old Markale market, a cairn of stones topped by a crude, hand-lettered sign stands in the middle of Marshal Tito Street — named for the man who held Yugoslavia together. Markale II, says the sign. No one needs to ask what it means.

Markale I was the mortar bomb that fell there on February 5, 1994, killing 66 people in one of the worst atrocities of the Bosnian war. Number II was on August 28 this year. It killed 37 people and brought unprecedented Nato air strikes and a flurry of U.S.-led diplomacy that may, at last, be ushering in a peace of sorts.

Both massacres, blamed on the Serbs, marked turning points in the confused response of the West to this most complex of post-Cold War crises — a bloody, 41-month reminder of the weaknesses and inadequacies of international institutions, not in faraway Africa, but in Europe's very backyard.

The elements of confusion have been analyzed many times: Yugoslavia began to break apart in the spring of 1991, just as the attention of the U.S. and its Western allies was focused on the aftermath of their Desert Storm victory over Saddam Hussein.

And there was disarray closer to home. European Union nations were struggling to forge common foreign policies, but did not agree: when Germany pushed to recognize Croatia and Slovenia, the others followed. Bosnia, fatally, was next.

Since its independence in April 1992, the unfolding Balkan crisis has been subjected to mountains of comment in the Western media — that first rough draft of history — but as the outlines of a final settlement swim into focus, one thing is certain: without an active role by the U.S., nothing can move.

That much was clear this September, when Richard Holbrooke, the U.S. envoy, shuttled endlessly — a Balkan version of Henry Kissinger — to nail down the emerging deal, sidelining European diplomats who were suddenly grateful for even a briefing on his progress.

This represented a remarkable change: the U.S. and its European allies began to coordinate more closely after Markale I, using Nato aircraft to enforce an exclusion zone that removed Serb artillery from around Sarajevo. But their differences remained sharp as long as France and the U.K. had troops serving with the UN on the ground and America did not.

U.S. calls to lift the UN arms embargo in favor of the beleaguered Bosnian Muslims and to bomb the Serbs were rejected by Europeans: "Lift and strike," as this option was called, would in the words of then British foreign secretary Douglas Hurd create only "a level killing field."

So when the Clinton administration finally accepted that and, more crucially, that there would have to be an ethnic partition which would not reverse much Serb aggression, the way was clear for a more active role in the Balkans. No one imagined quite how active it would be — until Markale II. Yet Europeans now seem relieved rather than resentful, acknowledging that they need U.S. power but at the same time wasting no opportunity to remind Washington that it is their pragmatic "realism" that has won the day.

Undoubtedly the UN emerges most bruised, its limits as peacekeeper cruelly exposed.

In Europe, suspicions linger as to whether this interest can last — and stand the test of committing U.S. troops to help implement a peace settlement. Will U.S. policy again be driven by domestic calculations as the 1996 elections get closer? "It's good to see the U.S. running with the ball," says a senior British diplomat. "But will they stick with it?"

But none of the outside participants in this crisis is covered in glory: "Western governments," argue journalists Laura Silber and Alan Little in their new book, *The Death of Yugoslavia*, "dealt with the war as though it were a flood or an earthquake, enthusiastically addressing the symptoms of the conflict without making any real effort to challenge its causes."

And the international institutions that have tried to grapple with Bosnia's agony can have no doubt that they have been tested — and found badly wanting. It has not been easy for any of them: for the UN, the European Union and Nato, the conflict has brought challenges in humanitarian relief work, diplomacy, peacekeeping and the use of force — often simultaneously.



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Daily life in Sarajevo

But it is undoubtedly the UN that emerges most bruised, its limits as peacekeeper cruelly exposed, with the unclear distinction between that and peace enforcement — the so-called "Mogadishu line" that the U.S. crossed in Somalia — dangerously blurred.

Privately, UN military officials now accept that much criticism of the organization is fully justified: from their sandbagged headquarters in Sarajevo, the maneuverings of the security council in New York — or the diplomats in Zagreb — often seems a world away. Fundamental errors were made early on: lightly-armed soldiers were placed in a hostile environment under a mandate made vague because of the need to compromise to make agreement possible in the first place. "Safe areas" were declared but there were never enough troops provided to actually protect them, while the cumbersome "dual key" arrangements for calling in Nato air strikes brought paralysis, recriminations and buck-passing — all too easy for the Serbs to exploit.

Yasushi Akashi, the senior UN diplomat in the former Yugoslavia, was sidelined after the fall of Srebrenica and Zepa this July, but the problem was not one of personality: the organization itself was shunted aside when Nato occupied center stage. Humiliation awaited the UN at every turn: from sneaking in relief convoys to Sarajevo by night to negotiating with General Ratko Mladic, the Bosnian Serb commander, for the freedom of blue berets seized as human shields.

For many the grim lesson is that the sheer complexities of the UN make effective operation impossible: only a multinational force, led by the U.S. and a small determined group of well coordinated Western powers, can hold the ring. "It's more about competence than politics," says one key official. "The UN is okay for sitting on a green line in Cyprus. Otherwise it's a busted flush."

Yet Nato, still feeling its way in the post-Cold War world, has no magic solutions. Its credibility improved when it did finally go beyond its previous pinprick attacks with the air strikes that followed Markale II — but even these were only partially effective. In Bosnia, the world has never really taken off its gloves.

And the furious reactions from Russia — however much these were intended for internal consumption before December's elections — point to dangers ahead and difficulties for the Nato-led peace implementation force which Moscow is expected to approve. On the diplomatic front the Bosnian endgame seems a setback for both the UN and the EU: the Vance-Owen initiative, endorsed by both, gave way to the five-nation Contact Group, which includes Russia. But as expectations got progressively lower, the contact group quietly faded until it was effectively replaced by the U.S.

European hopes for developing common foreign and security policies have not been helped by the experience of Bosnia. At crucial times, like the summer of 1991, governments spoke together but acted alone. "It might not have made any difference even if we had had a common policy then," admits a senior German official ruefully. "But it might have made us all look a bit better." EM

Next: Part III — Lights Out in Tokyo

Dialogue

Robert the Peacemaker

BY KEVIN RAFFERTY

Close your eyes, sit back and listen to the commanding voice, the global vision, the international range of contacts and it is hard to imagine that it is 15 years since he dominated these Washington meetings. From a distance he has the same distinguished presence as ever, and his listeners testify to the same powerful intellect and persuasive use of words. "He took command and was the single dominant speaker, far more compelling than the Nobel laureate or any of the other internationally renowned economists," praised one Japanese banker at a Tokyo meeting.

Close up, the dark hair once swept nobly back has now turned salt and pepper and thinned, the neck has an old man's creases, the eyes have mist to clear before they light up. But Robert McNamara can still deliver the passion and the fire that were his distinguishing marks.

He has a new crusade: at the end of the 20th century he sees an historic opportunity of putting an end to destructive global conflicts. Not before it is time: the 20th century, he points out, was the bloodiest by far in human history, with 160 million people killed in its wars. "We must not permit the 21st century to repeat the slaughter of the 20th," he says with feeling.

No one could ever accuse McNamara of being a starry-eyed optimist. In his successive posts as head of Ford Motor, U.S. defense secretary during the Vietnam War buildup and then president of the World Bank, he learned the hard way about politics, realpolitik and war. Even now, he makes no attempt to pretend that there is a possibility of doing away with bloody conflicts. He then reels off a frightening list of potentially destructive forces.

"As the Iraqi invasion of Kuwait, the civil war in the former Yugoslavia, and the turmoil in Northern Iraq, Somalia, Haiti, Sudan, Rwanda, Burundi, Armenia and Georgia make clear, the world of the future will not be without conflict. Racial, religious and ethnic tensions will remain. Nationalism will be a powerful force across the globe. Political revolutions will erupt as societies advance. Historic disputes over political boundaries will endure. And economic disparities among nations will increase as technology and education spread unevenly round the globe.

"The underlying causes of Third World conflict that existed long before the Cold War began remain now that it has ended. They will be compounded by potential strife among states of the former Soviet Union and by continued tensions in the Middle East. It is such tensions that in the past 45 years have contributed to 125 wars causing 40 million deaths in the Third World." Terrifying, but all the more reason, argues McNamara, for putting in place a system of collective security to contain conflict and to reduce and get rid of nuclear weapons.

McNamara says he does not share the views of the so-called "realists" like former U.S. secretary of state Henry Kissinger who see the post-Cold War world as similar to the Europe of the 18th and 19th centuries. Kissinger has written: "The absence of both an overriding ideological or strategic threat frees nations to pursue foreign policies based increasingly on their immediate national interest. In an international system characterized by perhaps five or six major powers and a multiplicity of smaller states, order will have to emerge much as it did in past centuries from a reconciliation and balancing of competing national interests."

It is easy to see the early signs of such a struggle. China is already flexing its muscles to be the dominant Asian power with classical imperial ambitions and strict limits on dissent — witness its determination to squash the results of Hong Kong's democratic elections. India and Japan may feel inclined to contest such hegemony for their own economic security. In Europe, the Bosnian bloodshed shows the limits of outside powers to impose a solution until they are prepared to pay with the lives of their own young men.



©RAFFOTO

McNamara: dropping new kinds of bombs

In such a kaleidoscopically clashing world, McNamara asserts the need for global common sense: "No nation, not even the United States, can stand alone in a world in which nations are inextricably entwined with one another economically, environmentally, and with regard to security."

He suggests "a vision — a conceptual framework" for a new world and suggests five goals that balance a global security in the widest sense, having regard to economic and environmental considerations as well as to political issues. These are:

"1. Provide all states guarantees against global aggression — frontiers should not be changed by force;

"2. Codify the rights of minorities and ethnic groups within states — the Kurds in Iran, Iraq and Turkey, for instance — and provide them with a means to redress their grievances without resorting to violence;

"3. Establish a mechanism for resolving regional conflicts and conflicts within nations without unilateral action by the great powers;

"4. Increase the flow of technical and financial assistance to developing nations to help them accelerate their rates of social and economic advance;

"5. Assure preservation of the global environment as a basis of sustainable development for all. In sum, we should strive to create a world in which relations among nations would be based on the rule of law, a world in which national security would be supported by a system of collective security."

He sees a "reorganized and strengthened United Nations" along with stronger regional organizations as the backbone of this new order, but admits: "The goal is clear, but how to get there is not. I have no magic formula, no simple road map to success." It will be achieved, he says, "slowly and by a series of small steps."

As defense secretary, McNamara was a key player when the world trembled on the brink of a nuclear war during the Cuban missile crisis of 1962. He says firmly that there is an urgent need to get rid of nuclear weapons. "So long as we and other great powers possess large inventories of nuclear weapons, we will face the risk of their use. The risk is no longer — if it ever was — justifiable on military grounds."

His optimism doesn't quite crumble, but is a blow in the face to attitudes in his own country, the U.S. Replenishment of the International Development Association, the World Bank's soft loan fund for the poorest countries, he says, "is in deep trouble politically in the United States. The Republicans have cut back the administration's commitment by 80 percent. That is a disastrous move." It is particularly damaging because "we, the world, have a tremendous opportunity when, for the first time in my adult life, we don't have this dangerous ideological clash hanging over our heads. It not only relieves us of the terrible military risk — in my seven years as secretary we came very close to war between East and West on three occasions, Berlin in August 1961, Cuba in October 1962 and over the Middle East in June 1967 — but leaves us free to focus on moving the rest of the world toward a more rapid advance economically and socially and toward addressing the generational problem of sustainable development.

> *"The U.S. can only be strong domestically if it is strong internationally, and that requires U.S. leadership."*

"These are the great opportunities. To realize them will require leadership. If the U.S. fails to lead, the world will be severely penalized. Others can and will come forward, the Scandinavians and Canadians, some of the Europeans (on aid), hopefully the Japanese or Western Europe on the environment. But in security and other matters the U.S. must lead. I am very sad as an American that the U.S. is not fulfilling the role. I just hope we may be in hiatus for a few years."

McNamara denies that the defeat in Vietnam sparked isolationism. "We are beyond that. The major problem of the U.S. leadership internationally is the weakness of our domestic situation, leading the average American to turn inward. They see so much in their own society that requires attention and action, whether it is education or health or deterioration of infrastructure or crime and disorder in the cities.

"It is not whatever we are doing abroad that makes it impossible for us to deal with our domestic problems. We can do both. Leadership in the international field does not require a great diversion of resources. It is some feeling of compassion, of responsibility, some feeling of, in the broader sense of the world, self-interest. The U.S. can only be strong domestically if it is strong internationally, and that requires U.S. leadership.

He goes back to the immediate post-war world: "and you look at what the U.S. did to rebuild Japan and help Europe rebuild, and that was done with an income per capita of less than half what it is in real terms today. Nobody can convince me that — in terms of resources — we cannot address both our domestic and international requirements with an income twice that of the time of [President Dwight] Eisenhower.

"What is missing is a sense of our place in the world. That is what needs to be created." EM

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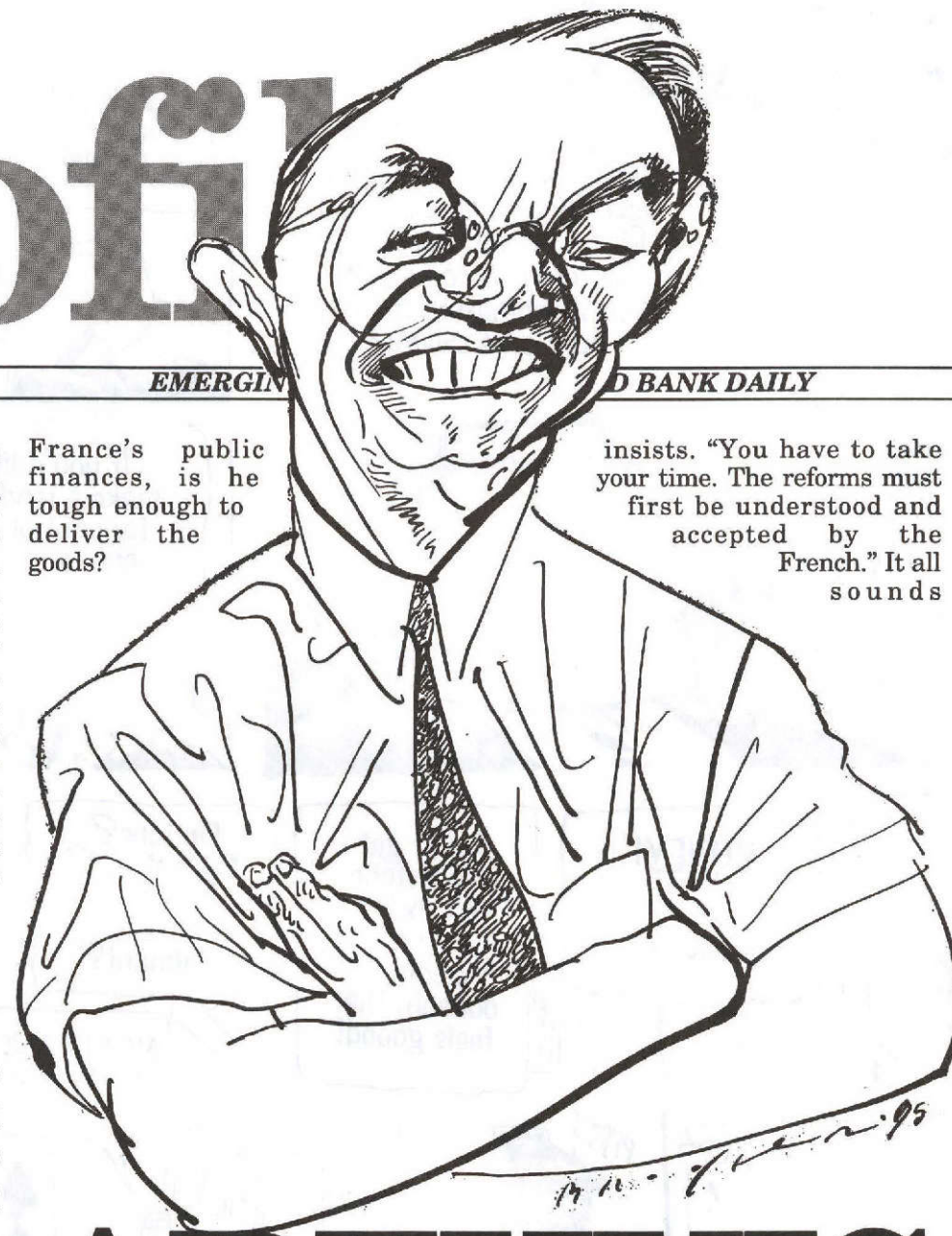


ARTHUIS

The "monarch of the Mayenne" may not have Madelin's magnetism, but his iron will and despotic efficiency may be what France needs.

BY DIANA GEDDES

The Wall Street Journal had no doubts about the implications of the sacking of Alain Madelin, France's free-marketeer finance minister, on August 25. "Sans Madelin, adieu reform!" it cried in a curious mixture of French and English. France's new finance minister, Jean Arthuis, was considered to be a gray, unimpressive little man in comparison to his flamboyant, iconoclastic predecessor. How could this reserved chartered accountant be expected to push through the radical economic reforms so urgently needed by the country when the pugnacious Madelin had failed?

But some say that Arthuis should not be written off too quickly. It was not for nothing, they suggest that he, the son of a modest poultry farmer from the Loire country, managed to obtain degrees in chartered accountancy and political science from the elitist Institut d'Etudes Politiques in Paris, before getting himself elected mayor of Chateau Gontier (population 8,000), 160 miles west of Paris, at the age of 26, and then senator for the departement of the Mayenne (in which Chateau Gontier lies) at the age of 38 — making him the youngest member of the upper house of the French parliament.

By the age of 41 he had been given his first ministerial post in Jacques Chirac's short-lived government of "cohabitation" (1986-88), first as junior employment minister and then as minister for consumer affairs. Since then, he has continued to accumulate prestigious positions: president of the departmental council of the Mayenne since 1992; chairman of the Senate budget commission 1992-1995; vice-president of the centrist Centre des Democrates Sociaux party (part of the ruling center-right coalition) since January 1995; minister for economic development and planning, May 1995-August 1995; and now, at the age of 50, head of France's powerful finance ministry.

A RELATIVE UNKNOWN

Yet, until his latest appointment, Arthuis remained almost unknown to the French public. He evidently does not have Madelin's flair (or is it failing?) for attracting media headlines. That does not, however, mean that his ambition or determination is any less great, his admirers say. Behind the neat gray suits and austere, technocratic exterior, there supposedly lies a will of iron. In the Mayenne he is known as "the monarch" for the despotically efficient way in which he is alleged to run the department. Unlike Madelin, the courteous and ever-prudent Arthuis is said to prefer to work by stealth rather than head-on confrontation. But faced by what prime minister Alain Juppe has himself described as the "calamitous" state of France's public finances, is he tough enough to deliver the goods?

Arthuis has certainly started off by making all the right noises. He says that he shares "without reservation" Madelin's aim to bring down France's crippling public deficit from a forecast 5 percent of GDP to 3 percent by 1997 in order to bring down interest rates and meet the conditions for entry into the European monetary union by January 1, 1999. In the face of spiraling national debt, he has promised to introduce "without delay" the deep structural reforms required to bring public spending under control, overhaul France's costly and inefficient social welfare system, and revamp the archaic and socially unjust tax system. He has declared himself in favor of a purge on public waste, a massive reduction of employers' payroll charges, lower interest rates, a sharp cut in the top level of income tax, and an attack on unfair privileges.

So where is the difference between Arthuis and Madelin? "Fundamentally, there is no difference in our policies," he replies: "It is more a question of temperament and mode of expression." Madelin had wanted swift, brutal reform. "But you can't change everything overnight," Arthuis insists. "You have to take your time. The reforms must first be understood and accepted by the French." It all sounds extraordinarily like the once-castigated, cautious pragmatism of Edouard Balladur, the former Gaullist prime minister and Chirac's unhappy rival for the presidency. (Arthuis is one of the few of the present government ministers who supported Balladur during the presidential campaign, before switching his support to Chirac during the second round of voting.)

Even Chirac, who was elected on a ticket of swift and radical change, now admits in the face of growing signs of public impatience that he has "no magic wand." It was clear from the outset that he would not be able to honor his many contradictory campaign promises: more public spending, particularly on social welfare and job creation measures, higher wages, lower taxes, and deep cuts in the public deficit. Something had to give: taxes did.

By the government's own estimates, France's tax burden, already the highest of any of the leading industrial nations, will go up by a further 0.5 percentage points next year to a record 44.7 percent of GDP as a result of tax increases included in last June's mini-budget and the planned 1996 budget announced on September 20. Juppe has now admitted that there can be no question of a general reduction in taxes for at least two to three years. At the same time, government spending is due to rise by over 4 percent in money terms (around 2 percent in real terms) next year.

For many observers, this is just not good enough. The international financial markets remain highly skeptical about the government's economic policies, while at home, there has been a sharp fall in both Chirac's and Juppe's popularity ratings. There are fears that the higher taxes will put a brake on France's fragile economic recovery — the growth rate has already slowed to just under 3 percent, having been growing at an annual rate of 4 percent at the end of last year. Further, the failure to make effective cuts in either government spending or the separately managed social welfare fund calls into question the government's ability to meet its public deficit targets (4 percent next year, 3 percent in 1997). Germany, already worried about the present government's commitment to economic rigor, has pointedly started calling for "supplementary guarantees" on budget discipline after the introduction of the single European currency.

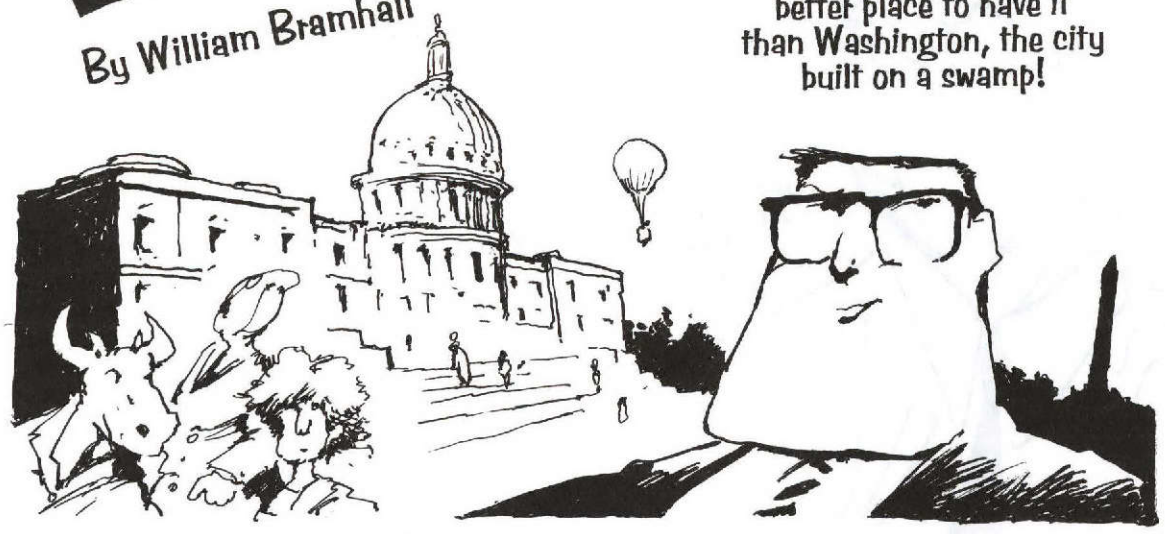
SOCIAL ADVANTAGES

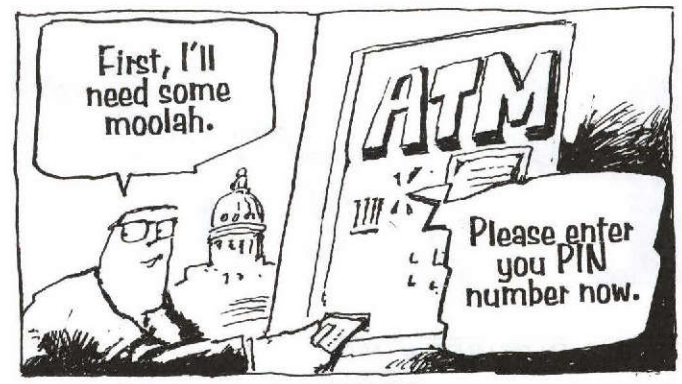
As part of its efforts to control public spending, France has said it will halve the FFr60 billion ($12.3 billion) annual deficit in social welfare spending next year before wiping it out altogether in 1997. But it has not yet said how it will do so. The government has announced a "great debate without any taboos" on the reform of social welfare and fiscal systems, starting with a series of meetings with unions and employers in October, with a view to introducing legislation early next year. But the unions, who together with the employers are responsible for managing France's social welfare fund, have already declared their opposition to such a debate, fearing that it will reduce their power, lower benefits, and undermine the "acquired social advantage" (*acquis sociaux*).

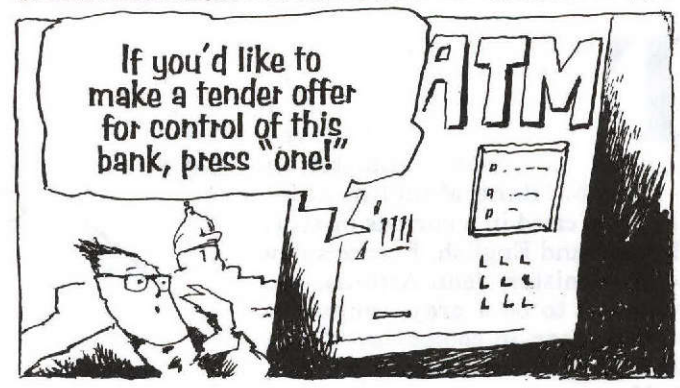
Chirac has always promised to protect these advantages, while declaring war on unfair "privileges." But, as Arthuis admitted in an unguarded moment, "One person's privilege is simply another's acquired social advantages." It is all a matter of perception. So the "great debate" does not promise to be an easy affair. The seven main union federations, angered by government plans for a "freeze" on public sector workers' pay next year, have already announced a 24-hour, all-out strike tomorrow in protest, and more trouble almost certainly lies ahead. Madelin lasted three months in the job. Many are already beginning to wonder openly how long Arthuis will last. EM

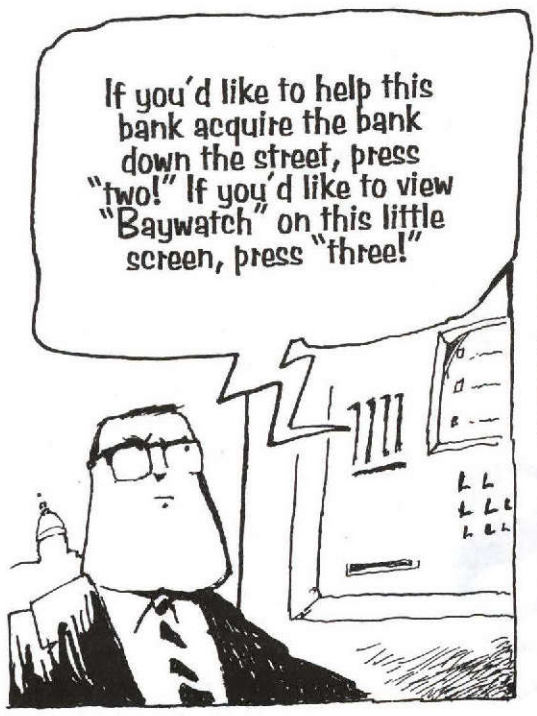
THE ADVENTURES OF BANKERMAN

By William Bramhall









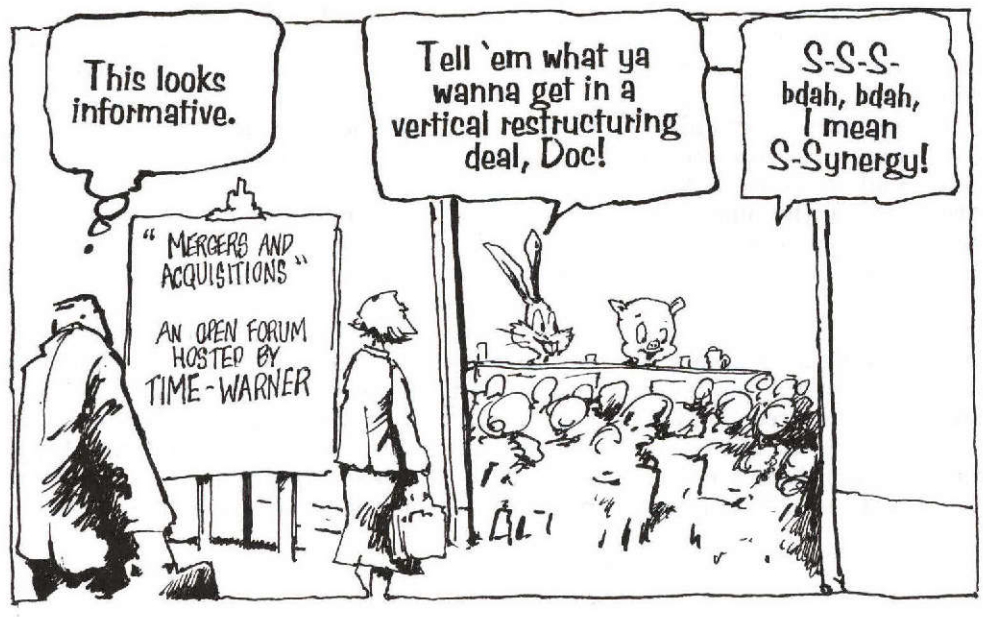


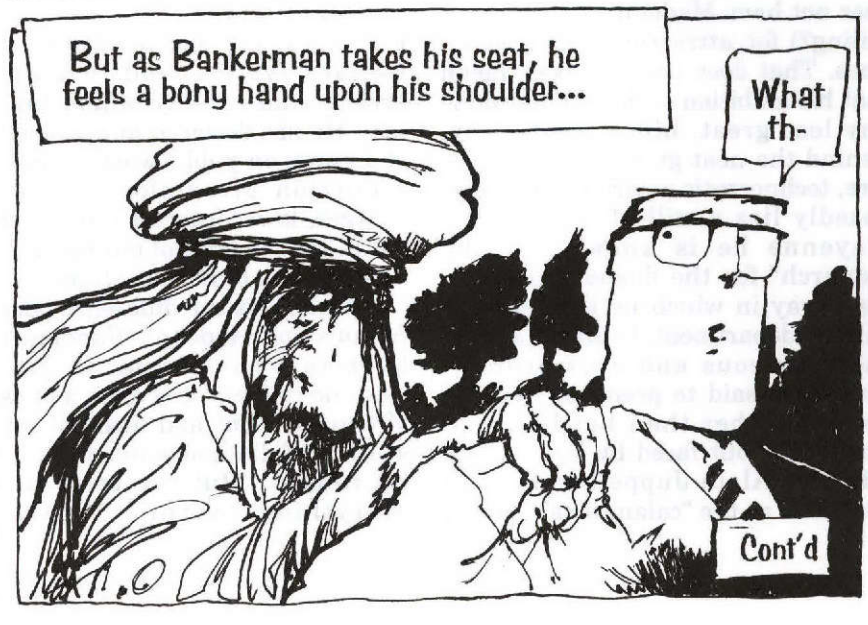












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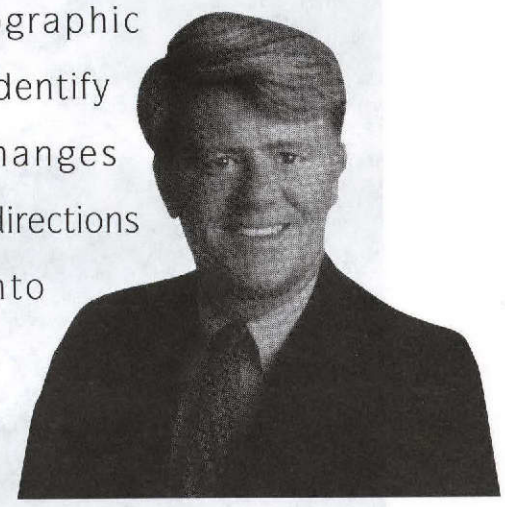
Bill Linnenbringer

Tailoring their approach to meet the unique needs of each client, Price Waterhouse professionals can draw on a wide range of client experience across both industry and geographic boundaries. They also identify the organizational changes required to convert new directions and new programs into successful action.



Bob Bench

If your organization needs help in overcoming the complexities of operating in a changing financial services marketplace, contact the professionals at Price Waterhouse.

For more information, call Bill Linnenbringer (212) 596-8575 in New York or Bob Bench (202) 414-4300 in Washington, D.C.

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People



Italian P.M. Lamberto Dini: not keen on the possible imprisonment of hero Giorgio Armani



Bank of France governor Jean-Claude Trichet: bidding adieu to his franc fort?



German MoF Theo Waigel has an idea for who to put on the new European currency



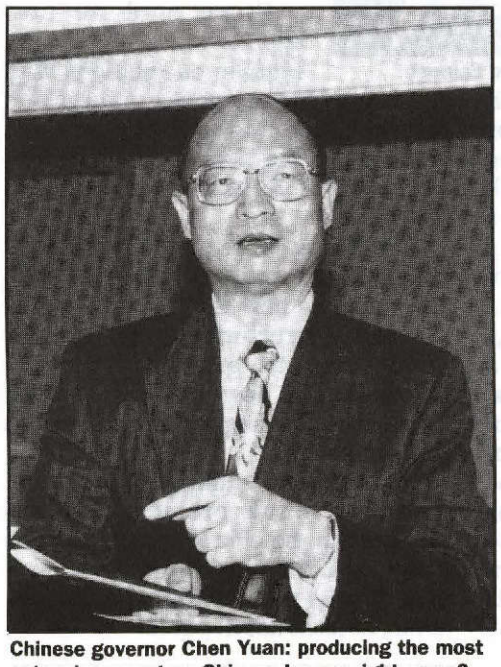
Japanese MoF Masayoshi Takemura is the hottest thing for the Japanese press this side of Dodger pitcher Hideo Nomo



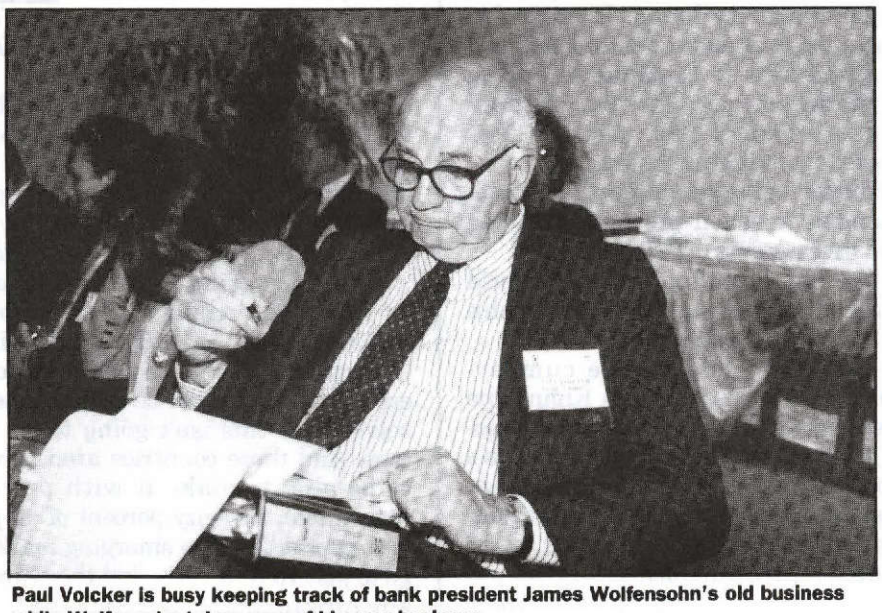
Mexican finance secretary Guillermo Ortiz buddies up to EBRD chief Jacques de Larosiere: looking for a new source of funding?

FINANCIAL CONCERNS

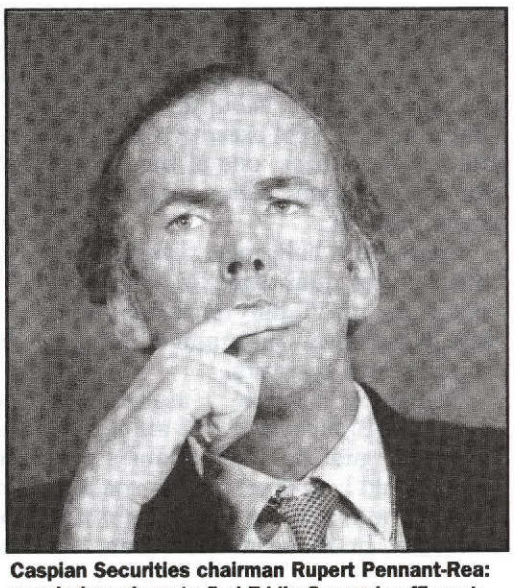
Photographs by Donna Dietrich, Erica Lansner & Lisa Quinones



Chinese governor Chen Yuan: producing the most extensive report on Chinese human rights ever?



Paul Volcker is busy keeping track of bank president James Wolfensohn's old business while Wolfensohn takes care of his new business



Caspian Securities chairman Rupert Pennant-Rea: wondering where to find Eddie George's office at the meeting

News

MONDAY, OCTOBER 9, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 62

Dragonfire

(Continued from page 1)

to the IMF. Some of these want a stronger voice in IMF policymaking in return. Their demands delayed the conclusion of the Interim Committee meeting well into last night.

The committee's agenda included a proposed doubling of IMF members' quotas — the IMF's main funding source — to SDR300 billion and a doubling also of its General Agreement to Borrow (GAB) to SDR34 billion. Part of the new GAB money is supposed to come from a group of 16 emerging countries in Asia and Europe with traditional providers — the G10 industrialized nations — contributing the rest.

British chancellor Kenneth Clarke welcomed the idea of bringing emerging nations with a "sound economic track record" into the GAB process — IMF officials identified South Korea and Singapore as two candidates — but he stressed that they should also be able to make a "policy contribution" to the IMF. South Korea and others have voiced strong dissatisfaction with the limited voice they have under the IMF's system of weighted voting.

The proposed doubling of the IMF's borrowing resources appears likely to be adopted by the majority of IMF members. Canadian finance minister Paul Martin said yesterday that " a doubling of the resources currently available under the GAB now appear to be broadly accepted as appropriate."

Wolfensohn Aims to Re-create Bank Group

BY K. MICHAEL FRASER

Since James Wolfensohn took over as World Bank president, he has made clear things are no longer business as usual. As part of his overhaul, he is pushing members of the group to cooperate — radical change for an organization whose members have operated with near complete independence.

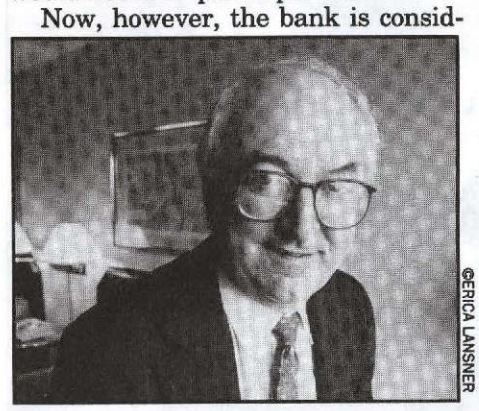
"As one of our key priorities, Mr. Wolfensohn is asking us to figure out how the World Bank Group can better facilitate development using markets and the private sector," says Richard Frank, a World Bank managing director.

Frank is exploring strategies to coordinate the International Finance Corporation (IFC), which finances private-sector projects, the Multilateral Investment Guarantee Agency (Miga), which guarantees foreign investors against political risk, and the bank itself, which makes loans to governments, mostly for infrastructure, social and reform projects.

At this early stage, proposals are tentative, but they are taking shape. One of the important changes under consideration is to begin looking for projects in which numerous members of the group can cooperate, rather than leaving each member to develop proposals independently.

For instance, the bank is now considering support for a $600 million power project in Pakistan. In the past, the bank would have loaned the Pakistani government as much as $400 million for a state-owned project, and other members of the group would not have participated.

Now, however, the bank is considering a $60 million investment to be made not as a loan to finance the project, but as a guarantee against the risk the government will not live up to agreements it makes with private-sector investors. And the IFC is considering a $50 million loan and investment in the project, which would help bring in foreign investors.



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Richard Frank

"This is the type of operation we want to do on an increasing scale. We want to use the financial markets and the other members of the group to the full extent possible first, and for the bank to do only what is necessary so the project works," says Frank. "To do that, the members of the group will have to be in much greater contact."

The bank also is considering ways members can coordinate project analysis. Traditionally, when the bank, the IFC and Miga considered investments in the same project, each did its own analysis.

Frank explains the problem in terms of the group's internal logic. "Legally and financially, Miga and the IFC are freestanding. Any risk they take goes on their balance sheet. They have to make their own investment decisions."

This logic, however, has meant duplication and a major headache for companies proposing projects, because group members make different and sometimes conflicting demands. And occasionally they have ended up competing for projects.

The chief financial officer of an American company that has built power projects around the world says that when he has sought participation from IFC and the World Bank he has had to walk through a virtual mine field: "You have to be very careful not to step on anyone's toes,"he says.

In response Frank answered, "we are starting to put together joint appraisal teams. It happened occasionally before. We will try to do it routinely."

Guarantees Time Has Come — Rhodes

"World Bank guarantees are an idea whose time has come," Citicorp vice chairman William Rhodes said yesterday during his introduction to the World Bank's seminar on its program to provide guarantees as a catalyst to attract private finance.

Governments, bankers and private sector companies told the bank they love the bank's new program to guarantee risks that have made raising private capital for infrastructure projects difficult. But as in any loving relationship, there were complaints and suggestions as to how the loved one could improve.

"The program is a very big step in the right direction," said Kenneth Lay, chairman and chief executive officer of Enron Corporation, one of the largest private developers of emerging market power projects.

Guarantees help raise private capital in larger quantities and at lower cost than previously possible, said Toru Kusukawa, Chairman of Japan's Fuji Research Institute.

Ronaldo Schmitz, a member of Deutsche Bank's board of managing directors, said the World Bank's program would help open the international bond markets to infrastructure projects, because guarantees can relieve investors of completion risk, which bond markets abhor.

Bank guarantees make it possible to attract investors, such as life insurance companies, that demand high credit quality and have put little money into emerging country infrastructure projects. Under the new program, the bank guarantees risks that a government will fail to live up to contractual agreement, such as promises to set realistic prices for electricity generated by new power projects.

The bank will also guarantee some commercial risks, such as the risk a project will not be able to pay off longer-maturity loans. It may also guarantee that shorter-term loans will be rolled over to continue financing long-term projects. The new program is an overhaul of older practices that allowed more limited guarantees.

Rhodes said guarantees have been extended to seven projects involving total investments of $10 billion.

"We are eager to do more," World Bank president James Wolfensohn told seminar participants.

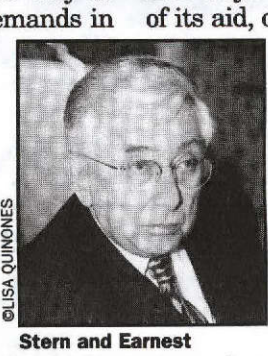
"Bank procedures are cumbersome," said Shahid Hassan Khan, who as special assistant to the prime minister of Pakistan described Pakistan's experience with World Bank Guarantees. Jin Liqun, China's assistant minister of finance, said it takes 12-18 months to structure deals.

— K. Michael Fraser

Stern Warns of Grim IDA Prospects

Vast reductions in future World Bank concessional lending may be inevitable, since there is no way to replace the cuts Congress demands in U.S. funding to the IDA, says former World Bank managing director Ernest Stern.

If current trends continue, there is little alternative to "a substantially reduced level of support for the low-income countries," said Stern, who left the bank in March and is now a managing director at J.P. Morgan. He said it will be "extraordinarily difficult" for the U.S. to come up with $3.75 billion for IDA, as it did three years ago. With the other OECD nations that would normally be asked to fill in the gap also facing tough fiscal budget problems, he saw no grounds for optimism.



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Stern and Earnest

"Nobody's going to make that up," he said. "The result is going to be a serious impact on Africa, Indochina, Central America, Haiti and a few others — nobody should be kidding themselves that this isn't going to be the case. And those countries aren't going to be able to make it with private investment. Seventy percent of all private capital flows to emerging markets go to just 10 countries, and there aren't any African countries on that list."

Stern dismissed arguments that cutting back IDA could force the bank find ways to increase the effectiveness of its aid, or to free up more money for Africa by taking market-eligible countries like China and India off the IDA roles. "Even taking away the small contributions reserved for China and India wouldn't make up for the U.S. shortfalls."

Stern said he now spends his time helping Morgan on relations with emerging market governments and corporations, and had been closely involved in the firm's recent underwriting of Polish and Turkish Eurobonds.

"I'm trying to help our people with cross-border projects that may be complex, such as new issues — especially in terms of structuring them, thinking about how to promote them to investors, and how we ourselves will think about managing all the various elements of risk."

But while he admitted he had met with new bank president James Wolfensohn, he offered him no tips on how to get through this week's meetings. "I don't give advice to bank presidents, at least not in public," he said.

— Rob Wright

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EMERGING MARKETS

IMF/WORLD BANK DAILY EDITION • WASHINGTON, D.C. • TUESDAY, OCTOBER 10, 1995

Takemura Flies Back to Crisis

BY KEVIN RAFFERTY

Japan's finance minister Masayoshi Takemura flew home to Tokyo yesterday to face a barrage of questions about Japan's financial supervision and his own political future after new revelations of multimillion dollar losses, irregularities and deceit forced the resignation of the president and top executives of Daiwa Bank.

Daiwa was already in trouble for massive $1.1 billion losses racked up by rogue trader Toshihide Iguchi on U.S. treasury bonds over an 11-year period. Yesterday the bank admitted that its trust banking arm in the U.S. had also lost $97 million in bond trading, but the loss had been hidden for several years.

Equally damaging, Daiwa disclosed that it had informed the Japanese ministry of finance about its problems six weeks before telling the U.S. authorities, a matter which is likely to anger the Americans when they return from the Columbus Day holiday today. Evidence also emerged of a deliberate attempt by Daiwa to cover up and deceive a Federal Reserve inspection team about the way it was running its operations.

President Akira Fujita announced his resignation at a nationally televised press conference. "I would like to apologize for causing such serious trouble," he said. "The incident shows that New York management was slovenly. As the person ultimately responsible, I have decided to step down." A deputy president and a managing director also resigned and chairman Sumio Abekawa said he would

CEO of the Year: pp. 4, 54 & 57

resign in March after he overseeing settlement of the problems. The new president will be deputy president Takashi Kaiho.

"The finance ministry is basically on trial by the rating agencies and everybody else, and the last thing they need is to be found being economical with the truth," said David Threadgold of Barclays de Zoete Wedd in Tokyo.

Takemura met with a select group of leading Japanese bankers for breakfast yesterday before going to the airport. Daiwa was not discussed, according to the participants.

The minister threw the blame squarely on the bank, saying: "The incident was very regrettable, and there is no room to excuse Daiwa." But after a whole string of financial failures, his parliamentary colleagues may not be easily disposed to excuse him for failures in supervising the bank.

Yoh Kurosawa, president of Industrial Bank of Japan argued, "Daiwa is a special case, just as Barings was. Did anyone ask if the whole of the British banking system was in danger when Barings collapsed?"

(*Full story page 4*)



Japanese MoF Takemura in the limelight before flying home

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GUNS FOR BUTTER

BY PATRICK SMITH

Rich and poor countries yesterday gave their warmest support for the International Development Association (IDA) and expressed "great concern" that planned reductions in its funding "were likely to jeopardize its future." Those who would suffer would be more than a billion of the very poorest people in the world.

Bank president James Wolfensohn said that ensuring support for the third tranche of IDA10 was "the single most important challenge to development assistance" and the most pressing job for his presidency. He added that he had received no assurances that Congress would approve the $1.25 billion commitment of the Clinton administration.

U.K. chancellor Kenneth Clarke called on the U.S. and others to "show leadership and responsibility as they have in the past."

There was less consensus on military spending and how to tackle the deepening multilateral debt burden facing many poor countries. U.S. treasury secretary Robert Rubin and German development minister Carl-Dieter Spranger led the charge by rich countries to pressure poor countries to cut military spending.

"I urge both institutions [bank and fund] to work closely in developing accurate, transparent data on government expenditures, including that for military purposes," said Rubin. "They should work jointly through program design and their policy dialogue to promote allocations of public expenditure in borrowing countries which are both equitable and efficient."

Spranger joined Rubin in urging that non-social spending "including military spending, must be examined critically and put in relation to special spending." Several of the developing country representatives on the committee regarded this as interference by rich countries. China's finance minister Liu Zhongli countered sharply: "It is our view that reviewing the so-called non-productive expenditures should not become a pretext for any interference in the internal affairs of a country, nor should it be used by any developed countries as an excuse to cut aid."

Nigerian finance minister Anthony Ani was more specific: "The issue of military expenditure, for us, clearly lies outside the mandate of the Bretton Woods institutions...the bank and fund do not have capacities that are required to assess the security situa-

(*Continued on page 62*)



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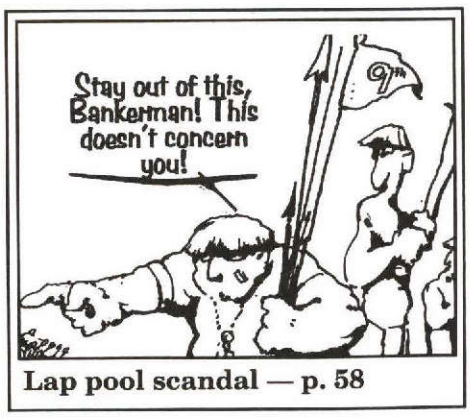
Billion dollar verse — p. 41



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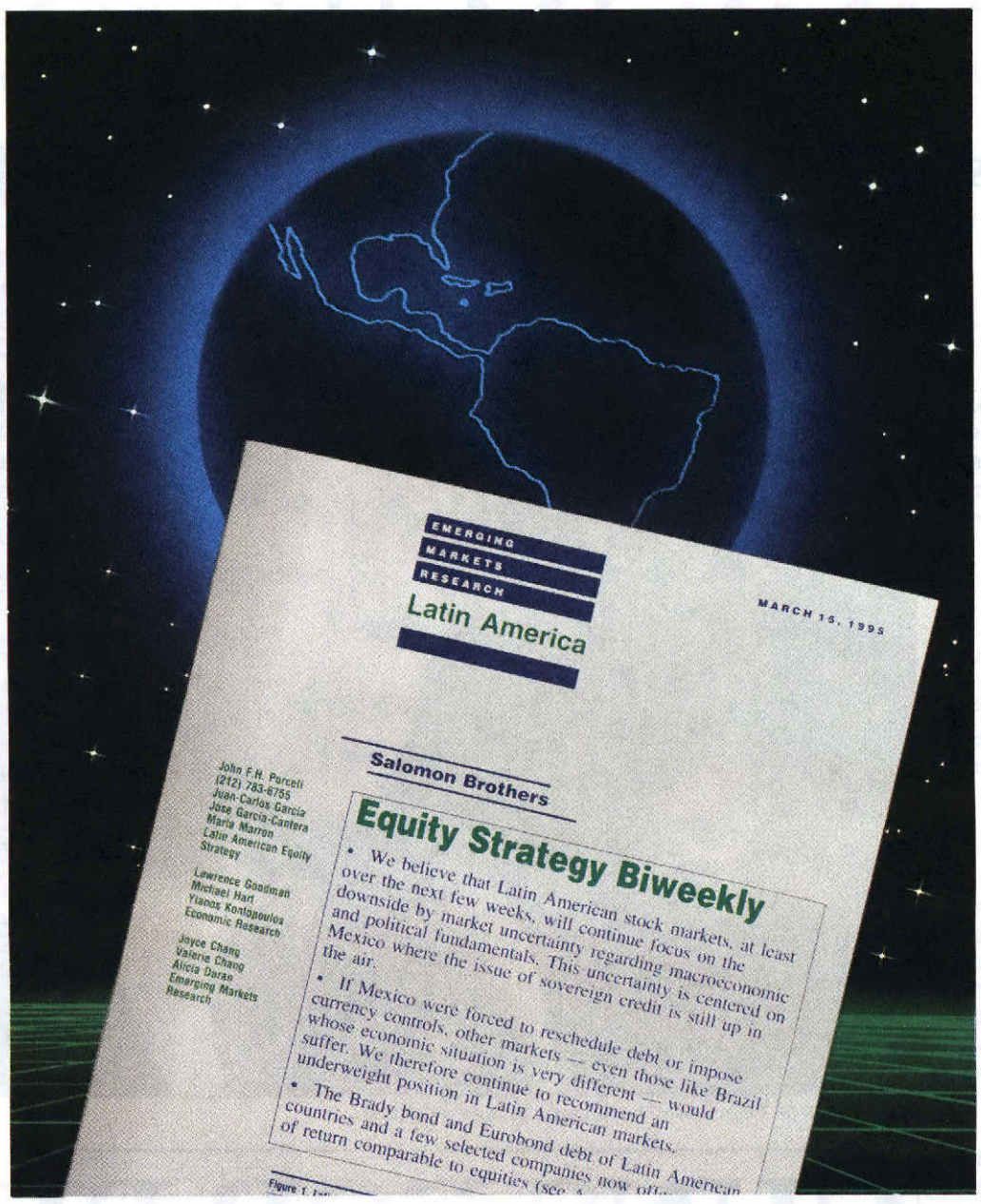

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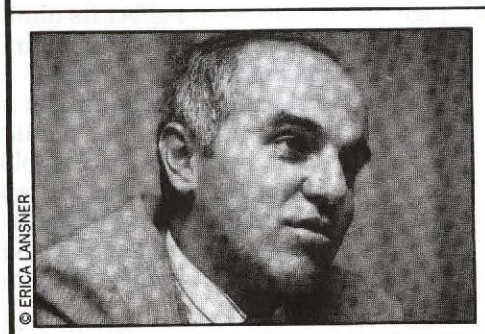

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"I think a financial stabilization program without a banking crisis is not a financial stabilization program."

— Sergei Vasiliev, Russian deputy finance minister

Not Ready for the Big Leagues

Finance minister Masayoshi Takemura flew home yesterday to face a barrage of criticism over Japan's financial mess after new revelations about irregularities and multimillion dollar losses at Daiwa Bank. This was not an emergency trip home in response to the crisis: all along, Takemura was planning to miss the opening of the IMF/World Bank annual meetings to be in Japan while parliament is in session.

The first point is that if Japan wants to be a grown-up global power, it should take its international responsibilities seriously, and its finance minister should be in Washington for the full meetings just as other ministers are — to make their speeches, to be seen, to be lobbied, to face the press, to answer questions. As it is, the Japanese minister traditionally remains in his cozy cocoon surrounded by his officials and his quasi-official press and comes out only to meet the rest of the G7.

Japanese will of course reply that it would be disrespectful to parliament if Takemura were not there when it is in session. But other ministers manage to spend time away, and meetings of parliament could be rescheduled to excuse him or to realize that his attendance at the IMF/World Bank is part of Japan's global responsibility. It is disrespectful to the rest of the world that Takemura scurries home after a furtive weekend with the G7 — or doesn't Japan care?

The financial mess to which Takemura is going home is a more serious concern, which can no longer be shrugged off with claims that there will not be a financial meltdown. It is not a meltdown that is the issue, but the integrity of the finance ministry and its ability to supervise the system or, indeed, run the economy.

The huge losses at Daiwa indicate not only extraordinarily slack management of the bank, but also an incompetent supervisory system. Neither Daiwa nor the Japanese financial authorities managed to spot or weed out losses that were hidden and accumulated over a period of 11 years. Moreover, the dangerous practices continued even after the U.S. Federal Reserve had drawn attention to the dangers. The new revelation that Daiwa did a temporary conversion job to turn a trading room into a storeroom to dupe the Fed is most disquieting, involving deception at one of Japan's biggest banks. Daiwa confessed to the Fed. Did the ministry of finance know then? Why didn't it take action to check that the practice hadn't already caused a scandal? Yet the Japanese authorities visited Daiwa in New York and gave it a clean bill of health in October last year, two years after the admission of duping the Fed.

It is only a partial excuse to say that the Japanese career system encourages generalists and not people who do boring "technical" jobs like auditing and supervising the accounts. The history of banking is littered with failures because simple precautions were not taken to check greed and stupidity. Did the Japanese think they were superior to the rest of the world? Or do finance ministry officials really believe that they are minor gods, as signified by the expression to describe their retirement to ordinary companies — *amakudari*, literally meaning descent from heaven.

The recent case of the senior finance ministry official who took huge sums in gifts and soft loans and ran businesses from his office show that there is at least one fallen angel in the ministry. This was a senior official, one of the supposed high-fliers. The reaction of some of his colleagues was most disquieting. They played down the favors as "gifts from friends" as if they were baubles of no consequence. The consequence is that the integrity and honesty not just of one man but of the whole system has been called into question.

Then there is the financial mess. No, a meltdown is not likely. As Toru Hashimoto and Yoh Kurosawa have been at great pains to point out, the big banks are sound and have considerable capital strength as well as billions of dollars in hidden assets. But the banks lent foolishly, even the biggest and most reputed of them. And the ministry of finance is still dithering and dallying over putting together a rescue package. Again one has to ask if the ministry can be trusted to do its job properly.

Then there is the running of the economy which has been more or less halted in its tracks for the past five years, thus making the financial cleanup more difficult and costly. If Japan had realized its mature growth potential over these past five years, it would have created output worth much more than the accumulated bad loans all over the financial system.

The biggest fault lies — again — in the finance ministry, in its failures to deregulate and to trust markets. The officials did not want to lose their powers. But by their refusal they are digging their own graves. It is not just the bureaucrats who will suffer. It is the people of Japan and of the world who are denied all the good things that the energy and imagination of a growing economy can produce, the free flow of goods and capital to a world hungry for so many things. It is time for the MoF mandarins to come down to earth and accept their failings — and do something about setting things right.

Kevin Rafferty
Editor

News

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Go Local, Say CEO Winners

In the face of the financial powers gathered in Washington this week, two industrialists active in developing countries yesterday advised bankers they could profit most in emerging financial markets by relinquishing control of regional bourses to native professionals familiar with the local culture.

"If you are in India and you have Indian management, you will enjoy a competitive advantage," declared Percy Barnevik, chief executive of the Zurich-based power company, Asea Brown Boveri.

"I come from Taiwan," said Stan Shih, chief executive of the Taipei-based computer manufacturer Acer, "so I know that professionals in a developing country want to learn the global way. But they also want the companies they are working for to appreciate the local culture."

The two were in Washington as recipients of the CEO of the Year awards, held annually by International Media Partners and sponsored by ING Bank. The awards are given to company heads whose corporate operations have most distinguished themselves in emerging markets.

— Peter Koenig

Cavallo Answers His Doubters

Argentine economy minister Domingo Cavallo predicted yesterday that domestic interest rates would drop significantly by year's end, and said that preliminary data indicate consumer demand has begun to recover.

Cavallo said he expected domestic rates to fall from their current levels of 300-1,000 basis points over U.S. treasury bond rates to 200-800 basis points over by the end of this year. "We expect the spread to be about 150-500 basis points by the end of 1996," Cavallo said.

Over the weekend, he said he expected the Argentine economy to grow about 5 percent next year after an increase of approximately 1 percent this year. Bankers and investors were skeptical because he gave no indication what economic sectors would provide growth.

Yesterday, Cavallo said that there are figures, which hadn't yet been made public, that indicated consumption was beginning to increase after slumping strongly in the second and third quarters.

"Consumer credit is returning to normal," he said during his speech on the economy. "Consumer perceptions have changed. They are more optimistic. We are seeing the beginnings of a recovery."

— K. Michael Fraser

NEW DAIWA LOSSES ROCK TAKEMURA

BY KEVIN RAFFERTY

Questions were being asked in Tokyo and Washington last night about how long Japan's finance minister Masayoshi Takemura could survive after new revelations of multimillion dollar losses, irregularities and deceit at Daiwa Bank.

The international storm set off last month when the bank disclosed that rogue trader Toshihide Iguchi had covered up losses of $1.1 billion on U.S. treasury bonds over 11 years by forging 30,000 trading slips seems bound to grow. It could even reach cyclonic force and threaten both the ministry of finance and the minister, and possibly even the government.

The new revelations yesterday included claims that Iguchi had accomplices who helped him to cover up the losses; new $97 million losses by Daiwa's trust offshoot in New York, which may have been sanctioned by the top management; and the successful duping by Daiwa in New York of Federal Reserve inspectors.

When the Fed came to inspect Daiwa's offices three years ago, the bank disguised its securities trading area to look like a storeroom, president Akira Fujita admitted in announcing his resignation. He added that this was to prevent the regulators from discovering that both trading and auditing were being done in the same office. Daiwa confessed the ruse to the Fed a year later when it separated the two activities.

Much more serious is the failure to tell the American authorities about the massive losses and fraud until six weeks after Fujita had informed Yoshimasa Nishimura, head of the banking bureau at the ministry of finance.

Bankers in Washington for the IMF meeting said that Daiwa could lose its New York license, and suspicions about the weaknesses of Japanese supervision would only grow. "Daiwa could be used to force the Japanese authorities to be far tougher and to take vigorous and quicker action to clean up the $500 billion in bad loans debilitating the whole financial system," said one European banker who did not want to be named. "They have been very slack and trust in Japan is running low."

Daiwa's president told Nishimura on August 8 about the rambling 30 page letter he had received late the previous month from Iguchi confessing to the losses. Neither the bank nor the ministry told the U.S. authorities at that time. Daiwa then gave more information to its own ministry on September 12 and only told Japan and the U.S. formally six days later.



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Matsushita: in the public eye

Details of the second scandal at the trust banking arm are also likely to prove embarrassing. The first loss was made in December 1984 when a locally hired Japanese lost $31 million on treasuries after betting more than his limits. Later attempts to recoup the money led to further losses and in 1987, when the losses had grown to $97 million, Daiwa executives transferred the problem treasury bonds to an offshore company they created in the Cayman Islands. The question now is what Daiwa's directors knew about this cover up. A finance ministry official accused the bank of deliberately trying to hide the loss from the Japanese and U.S. authorities. Daiwa chairman Sumio Abekawa admitted that "I knew that there was a company established to deal with the losses."

A buck-passing game was going on with finance ministry officials throwing the blame squarely on the bank. Minister Takemura himself said: "The incident was very regrettable, and there is no room to excuse Daiwa." Yasuo Matsushita, governor of the Bank of Japan, added that: "Bank managements are involved in highly public jobs, therefore they must be judged strictly, so I accept this resignation according to that."

In Tokyo, vice minister Kyosuke Shinozawa defended banking chief Nishimura, saying, "He advised Daiwa's president to investigate quickly, especially since U.S. interests were involved." But in Washington, other bankers said that the two affairs cast the ministry supervision in a bad light and questions would be asked about the ability of the Tokyo authorities to handle things.

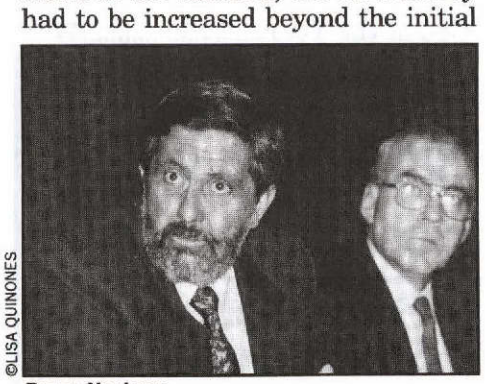
If the Daiwa affair were the only problem the ministry faced, Takemura might be able to let the storm blow over. But it follows the poor economic performance, the massive $500 billion in bad loans overhanging the financial system, claims of scandals in lending money to politicians and even that a leading finance ministry official was running a business from his office. The government is already reeling over the resignation of justice minister Tomoharu Tazawa yesterday over allegations that he made a secret deal with opposition MPs to avoid parliamentary questions on an unreported loan.

Colombia Plans to Borrow $400m by Year End

In the next weeks, Colombia plans to launch two new international bond offerings worth up to $400 million, finance minister Guillermo Perry said yesterday.

Perry said he hopes to issue a 20-year Yankee bond for $150-200 million by early November, followed about two weeks later by an estimated DM280 ($200 million) issue that will be the republic's first borrowing in German currency. The minister and his delegation will start talking to investment banks interested in managing the deals next week in Bogota.

Those issues are expected to keep up the momentum from a new five-year, $225 million syndicated commercial loan facility priced at 125 basis points over the London interbank offered rate and signed yesterday by Perry. The borrowing is Colombia's first voluntary commercial bank deal in more than a decade, and drew participation from 21 banks in North America, Asia and Europe. Because of the strong enthusiasm that Chase Manhattan, which arranged the deal, found in the markets, the loan facility had to be increased beyond the initial $150 million target. Moody's recent decision to raise its Colombia sovereign rating to investment grade, as Standard and Poors had done long before, reportedly helped build market interest to record levels.



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Perry: Yankees

"The financial conditions are very good for Colombia," Perry said. "We are very happy."

Political conditions, however, are not so good. President Ernesto Samper is battling accusations that his presidential campaign accepted contributions from the country's notorious drug cartels, and may have to leave office before the end of his term. Nevertheless, bankers at yesterday's signing ceremony voiced full confidence in the country, having no fear that Colombia's political turmoil or ongoing violence would affect its ability to meet debt obligations and maintain a strong image in the markets.

"Our view is that Colombia has a very stable bureaucracy that would be able to continue things on a stable basis even if the president has to step down," said Yutaka Endo of Industrial Bank of Japan, a co-arranger in the loan facility along with J.P. Morgan and Dresdner Bank.

— Rob Wright



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News

CAN YOU SPARE A QUARTER?

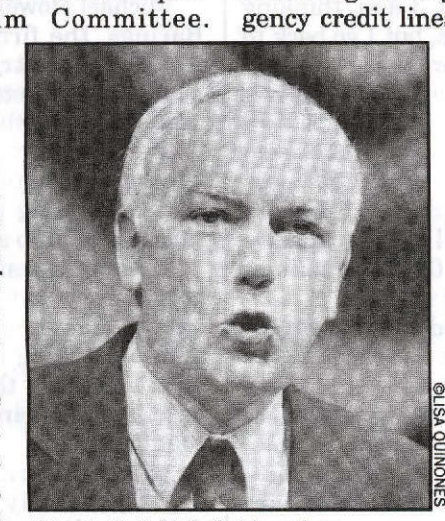
Peter Sutherland — former Irish minister, European comissioner, Gatt and World Trade Organization boss and now chairman of Goldman, Sachs International— went to the Sheraton in a posh limousine and smoking a fat cigar, the very image of the successful plutocratic investment banker he has become. But when he needed to make a telephone call, he turned out his pockets to find that he had no cash at all; he had left it with his driver. Luckily, Sutherland, unlike some other big shots, is not too proud to talk to a members of the press, one of whom was happy to oblige him a quarter for a quote.

Emerging Nations Call in their Bargaining Chips

BY ANTHONY ROWLEY

For a group of more advanced emergent nations at the IMF, the time has come to "call in their bargaining chips" to have a bigger say in the affairs of the fund's inner caucus, the Group of Ten (G10), and also on the sensitive question of quota distribution and voting rights with the IMF itself.

These contentious issues flared at a weekend meeting of the IMF's policy-making Interim Committee. *Emerging Markets* learned yesterday from IMF sources and country delegations that there will be some hard horse-trading over these issues before the planned doubling of IMF resources to $500 billion can be achieved.



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Maystedt: "club" of rich nations

Negotiations are underway between the G10 and a group of 16 Asian, European and Latin American countries that are being asked to contribute to a doubling of the G10's General Agreement to Borrow (GAB) by way of a "parallel arrangement." But it may be impossible unless new lenders are admitted to what IMF Interim Committee chairman Philippe Maystadt called the G10 "club" of rich nations.

The 16 are also expected to use to current negotiations over doubling IMF quotas to press for a bigger share of quotas and voting rights. A South Korean finance ministry source said yesterday that Seoul will "not make a direct linkage between our readiness to contribute funds to the GAB and the quota issue. But we hope the international community will recognize our claim."

The GAB was established 30 years ago as a mutual balance-of-payments financing facility (to provides emergency credit lines for financing Mexico-type crises) among a handful of the most wealthy nations, but now has a global remit. Apart from South Korea, the group of countries being asked to help boost the resources of the GAB includes Singapore, Malaysia, Thailand, Indonesia, Australia, Austria, Colombia, Chile, Denmark, Finland, Ireland, Norway, Portugal, Spain and the UAE.

They all appear willing in principle to join. In return, however, they expect to gain more say in the affairs of the G10 and of institutions such as the Bank for International Settlements (BIS) that are currently controlled by the exclusive club.

Maystadt said at the weekend meeting that there would be "no second-class citizens" in the GAB enlargement process, and the Interim Committee communique emphasized that "all participants should be treated fairly." Even so, one IMF official acknowledged yesterday that there is still "concern on the part of potential contributors to the GAB that they may be asked to part with money without having equal rights."

Ewen Waterman, Australia's executive director at the IMF, told *Emerging Markets* that Australia prefers to see a straight expansion of the GAB without a parallel facility. "We don't want to be a second [team]," he stated. Waterman also represents South Korea, New Zealand, the Philippines, and several South Pacific economies at the IMF.

The 16 are expected to press their claim for equal rights within the G10 immediately as negotiations move into high gear to get the GAB enlargement wrapped up by the group's December meeting. They will also insist that the enlarged borrowing facility is not used as a substitute for a proposed major increase in IMF quotas.

Negotiations on the eleventh increase in IMF quotas are also on a fast track, and are scheduled to be completed within a year from now. IMF external relations director Shailendra Anjaria said yesterday that those countries being asked to contribute to the parallel borrowing arrangement would likely press to be included in a "selective" quota increase that will accompany the general increase.

They will probably be joined by Switzerland and Austria, two other countries which feel that they have a right to a larger share of the IMF quotas which, said Anjaria, constitute the "determinant of a country's voting and borrowing rights within the IMF."

Hang Seng is Guide to Bradys

BY PETER KOENIG

Economists at Deutsche Morgan Grenfell in London have identified a close correlation between the performance of emerging market bonds in general and the performance of Hong Kong's Hang Seng stock market index in particular.

"There is no easy way of measuring appetite for [emerging market] risk," Deutsche Morgan Grenfell researchers point out. "However, we believe there is a proxy: the Hang Seng index."

Looking for ways to call turns in emerging market securities, the bank found that "most of the big turns in the Brady market have been foreshadowed by changes in the Hang Seng." Deutsche Morgan Grenfell researchers verified this by comparing the Hong Kong stock market index with the J.P. Morgan Brady bond index since January 1991.

Rick Haller, DMG's London-based director for emerging markets, explains the relationship as follows: "Emerging markets rise or fall on international flows of speculative capital. So does the Hong Kong stock market."

On this basis, he notes, the outlook for Brady bonds is bullish. In mid-September, the Hang Seng pushed through the critical 9,500 level to a new high for 1995. At the same time, the volume of shares traded in Hong Kong was high. Local brokers' commentaries cite sizable foreign inflows.

IMF Crusade to Bring Infobahn to the World

Beginning next week, IMF missions will fan out across the world as part of the fund's crusade to bring emerging markets into the information age and to help prevent further Mexico-type financial crises. Their job is to get developing countries online in a planned international network of statistical data.



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Boorman

The Mexico crisis "focused attention on things that were neglected" by way of providing vital country statistics, said John McLeneghan, director of the IMF's statistics department yesterday. Director for policy development Jack Boorman noted that timely data on market-sensitive information was lacking, citing Mexico's reserve position and its tesebono issues.

Other IMF officials stopped short of saying that Mexico's crisis could have been avoided if the markets had known more, but allowed that some of Mexico's "contagion effects" on other emerging markets could probably have been avoided. The crisis revealed gaps in the IMF's own data collection and a massive black hole for market access to official data.

The drive for greater disclosure of official data ranges from a country's official reserve position and short-term debt liabilities to data on prices and trade. Initially, the IMF will focus on the approximately 60 countries, of a total 178 members, that enjoy access to global capital markets.

The IMF will urge — they cannot "compel," noted Boorman — these countries to publish timely and reliable statistics at regular intervals to the IMF as well as to banks, securities houses and other market players — who nowadays provide much larger aggregate flows of money to developing countries than do official sources.

How those statistics will be disseminated to the markets once they are published by central banks, finance ministries and national statistical agencies remains to be decided. It will probably result in a whole new industry for financial news agencies and for Internet operations, Boorman acknowledged. The IMF plans its own electronic bulletin board, but only to divulge which countries have agreed to provide vital statistics.

Initially, there will be a tw- tier system that with less stringent disclosure standards of less developed countries, such as those on the Indian sub-continent or in Africa, than for more advanced emerging markets. Disclosure is planned in a dozen core data categories which cover areas such as money supply, external debt, debt service ratios and interest rates and will later be expanded.

— Anthony Rowley

The Rogues' Gallery

If half a century in banking has taught Dennis Weatherstone anything, it is to watch out for rogues.

The former chairman of J.P. Morgan said that character has become an even greater safeguard of a bank's reputation than capital, and that today's hi-tech temptations make strong internal auditors more important than ever. "You'd better have a class A person in that position," he said. "If you don't, you'll be sorry."

Although he didn't mention them by name, Weatherstone clearly had the recent scandals at Kidder Peabody, Barings and Daiwa Bank in mind when he warned of five ways managers can fall prey to internal fraud: getting into businesses they don't understand, expanding too fast, not watching what is happening at distant offices, accepting unreconciled accounts as standard practice, and tolerating a stretching of the rules. Once the rascals are uncovered, he said, the boss must act quickly and decisively, or risk the devastation of his entire institution.

— Rob Wright

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PREDICTABLE RESPONSES AND RED TAPE

An obvious question is missing from the World Bank's questionnaire about its interactions with the private sector, said Brazilian investment banker Genesio Carvalho Filho. "They should have asked us if there is too much red tape," he said. Filho had just finished filling out the 38-question survey. Christopher Bumcrot, a principle of Arc Consulting, helped design the survey. "Should we have asked whether there is too much red tape? From the research perspective, questions that are as loaded as that are not useful," he said. "If you can predict the response too easily, it is not a useful question to put on a questionnaire. Everyone, of course, would prefer that there is less red tape."

Istanbul Prepares to Float Offshore Market

BY JON MARKS

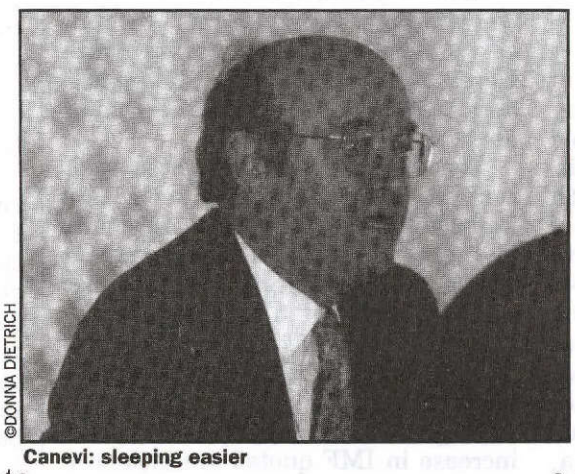
The Istanbul Stock Exchange (ISE) is poised to create an offshore securities market that will promote the Turkish economic capital's claims to leadership in the emerging Central Asian market. The market will operate as a tax-exempt free zone.

"All the infrastructure is in place, and the international exchange will probably start at the beginning of 1996," ISE senior vice chairman Aril Seren told *Emerging Markets* yesterday. "It will be a showcase for regional stocks."

Serin says start-up is waiting only on an opinion from the Turkish Markets Board. The only element blocked by the authorities so far was a plan that the free zone would exist mainly as separately demarcated trading files on the ISE computer. It has been decided that initially the zone must be in a physical entity, situated next to the exchange's state-of-the-art trading floor in the ISE building. "But they are coming to terms with how it's going to work in reality: on screen," Serin said.

The speed of settlement through the ISE will attract issuers in what Serin calls "the GMT plus two" region. "We have decided we want to standardize our accounting principles, disclosure principles and trading standards," he added.

"There is strong demand from countries like Iran and Pakistan to give their companies international exposure, and the foreign presence in the Istanbul market can give them that access," he said. The ISE is growing fast, and is now "getting ready to accommodate joint east/west companies," Seren said.



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Canevi: sleeping easier

The market has taken political turbulence in stride in the wake of Prime Minister Tansu Ciller's September 20 resignation. At a breakfast meeting yesterday organized by *Emerging Markets* and sponsored by the ISE, Yavuz Canevi, ISE executive council member and chairman of the Association for Foreign Capital Coordination, underlined the Turkish economy's new resilience: "In the 1970s, we had crises but we didn't have deregulation. Today, I may wake up at 3 a.m. thinking about my business, but I go back to sleep much quicker now."

Ata Koseoglu, a managing director of Bear, Stearns and Company, noted that portfolio investment in the primary market was approaching $1.5 billion, but was still well below capacity at only around 0.25 percent of the ISE's trading volume.

"Turkey missed the opportunity of drawing in investment as emerging markets investors diversified following the Mexican bond crisis," said Maziar Minovi, a former World Bank official and currently vice president of Putnam Investments. Turkey's relations with Central Asia were much less important for institutional investors than its "almost unparalleled record of debt repayment," he said.

Hungary Impatient for IMF Standby Agreement

BY HENRY COPELAND

Although he austerity measures introduced by Hungarian minister of finance Lajos Bokros have made him the most unpopular politician in Hungary, that has not translated into a particularly friendly reception for Bokros at the IMF.

Asked yesterday when Hungary might reach a standby agreement with the IMF, Bokros said, "it's very difficult, very difficult; we are negotiating all the time. We are closer and closer to such an agreement, I can say."

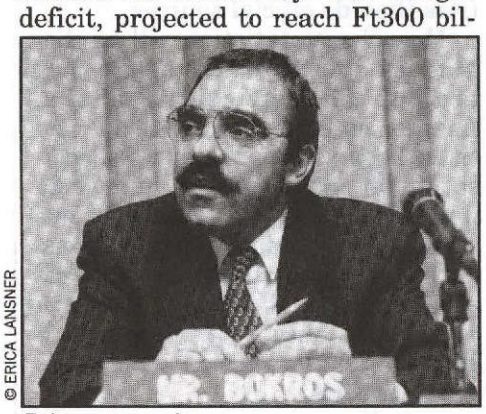
An agreement had better come soon, said one Hungarian observer of the negotiations. "If it doesn't come now, when can there be an agreement in the future? This is the IMF's chance to support reform in Hungary."

Germany seems to agree with this view, he said. On Sunday, German finance minister H.E. Theo Waigel told the IMF's interim committee that "on their difficult road, many successful countries in transition have profited from the realistic and result-oriented assistance of the IMF. I hope that Hungary will make use of this opportunity again soon."

Last week, on the fifth anniversary of its union, Germany and two of its states approved a DM1 billion infrastructure loan to Hungary. Originally proposed after Bokros' austerity program was announced last March, the package was originally to have been contingent on an IMF standby agreement.

The Hungarian observer argued that Hungary offers the IMF a chance to prove itself a supporter of reform. "The fund missed the chance to detect financial problems in Mexico. Now they may miss the chance to help a country which is making heroic steps."

This spring, Hungary seemed headed for insolvency. The budget deficit, projected to reach Ft300 billion ($2.7 billion) on the year, had already reached that figure at the end of March. On March 12, Bokros announced a package of measures — tax hikes, an 8 percent import tariff, a 9 percent devaluation, and wage restraints — that have largely reversed that trend.



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Bokros: unpopular

In the month of July, for the first time in three years Hungary registered a current account surplus, after a deficit of $1.4 billion in the first quarter and $600 million in the second. The success has been achieved in part because real wages will fall by an estimated 11 percent this year. The downside of this is that Bokros gets positive marks from only 15 percent of the Hungarian electorate, a record low in popularity among politicians.

Bokros' budget proposal for 1996, which targets a deficit of just under 4 percent for next year, is currently being considered by the country's parliament. Social spending is the weak point, and the IMF has identified potential deficits in social security funds as source of concern. But this may be missing the point, the Hungarian observer said.

"Our program for next year is actually somewhere in the middle of what the fund usually finds acceptable for a standby agreement," he said. "Some of our achievements are very remarkable by any standard. Next year, our primary budget surplus will be 5 percent of GDP. There is, and will be a huge real wage cut. We have preannounced the crawling peg."

Hungary's bloated social spending can best be reformed with World Bank loans that are contingent on IMF agreement, he added.

"Our economy is already turning, so we do not need the help financially, but it would help with the ratings agencies, and with the international donors." he explained.

G9: Timely Idea or Beggars Banquet?

BY ROB WRIGHT

Baring Securities says it's almost time to face international economic and political reality and refigure the Group of 7 as the Group of 9, with Russia and China invited in as equal members.

Michael Howell, global strategist at Barings, the firm generally seen as having the strongest worldwide emerging markets research team, said yesterday that the two are only a few years away from achieving economic superpower status. He saw no chance that expanding the guest list would turn the G7 into a beggars' banquet.

"China's certainly not coming as a beggar now, and soon Russia won't be either," Howell told *Emerging Markets* after addressing investors at the Park Hyatt Hotel. "I think in the next few years, you're going to have to expand that forum."

Barings distributed charts predicting a radically different list of the world's seven largest economies in the year 2010. It estimated that the U.S. would still be on top, but with its share of world GDP dropping from 26.5 percent to 17.4 percent, followed in order by China, Japan, Taiwan, Russia, Germany, India and Indonesia. France will only rank ninth by that calculation, with the U.K., Italy, Canada and others not even meriting consideration.



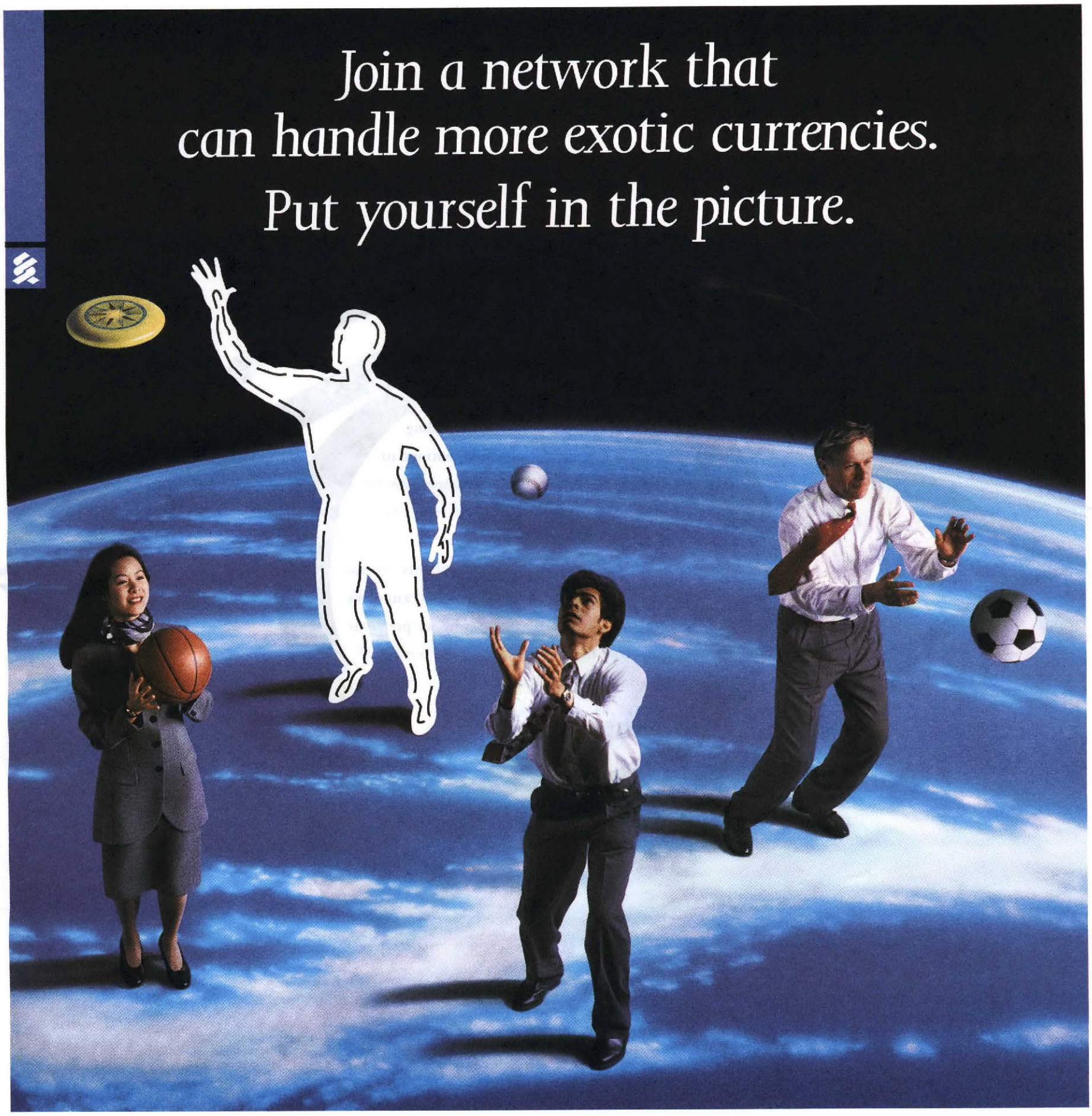
Howell said his estimates were based largely on Beijing's growing trade surplus and hard currency reserves and his strong suspicions that recycled money from the People's Republic was already being mingled with other funds from Hong Kong and Taiwan and being invested all over emerging Asia.

"By this definition, Chinese capital, broadly defined, is already far more important in Asia than Japanese capital," he said. "People tend to forget that."

More boldly, Howell predicted that at some point after July 1, 1997, China would unify the Hong Kong dollar with its own currency. A new China backed by huge forex reserves and continued hard currency inflows from foreign investors, he contended, would have to be allowed to join the G7's midst.

"Economic power always follows currency power," he asserted. "It's happened before."

Andrew Sheng, the deputy head of the Hong Kong monetary authority, damned the idea with the very faintest of praise, calling it "highly imaginative."



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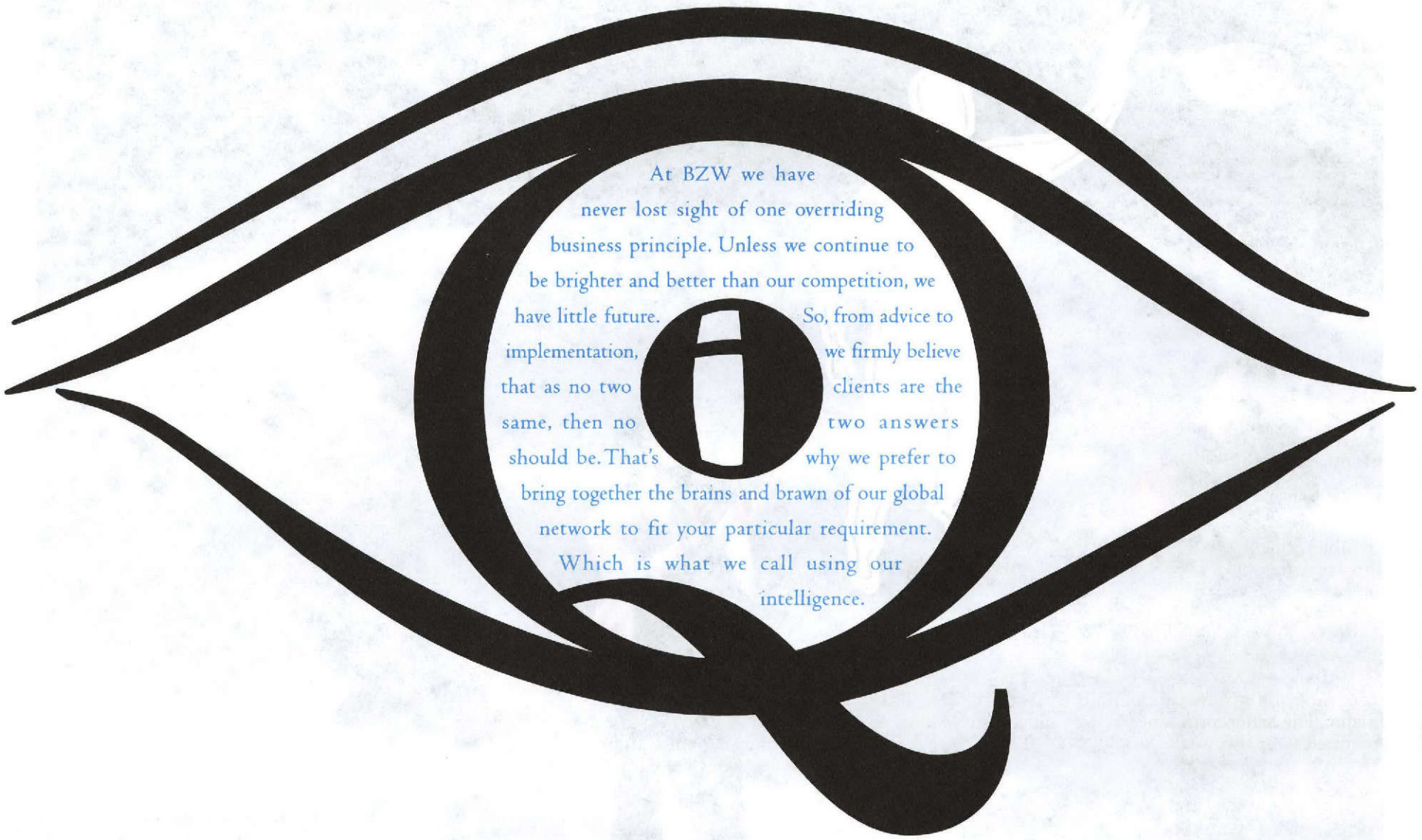

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News

MARKETS GROW OUT OF BROWNING OF AMERICA

To some it may seem obvious but the World Bank considers it worth a report: African-Americans like to buy Afro-centric products. Fortunately for Africa, designs such as Ghana's Kente cloth and Nigeria's Adire cloth are "hot" this season. The bank reckons market share of African designs and textiles will increase alongside the "browning of America" — that is the growth of minority groups (African-Americans being the biggest) from about 25 percent of the population to 32 percent in 2010. Currently the Afro-centric market is between $300-400 million a year. Production for export is expanding — selling to companies like the Associated Merchandise Corporation in the U.S. And African textiles (apart from Lesotho and Mauritius) don't face quotas in the West.

JAYCOX PRAISES SOUTHERN AFRICA

BY PATRICK SMITH

Regional integration, often demanded but rarely forwarded by African governments, is firmly on the World Bank agenda this meeting. The bank wants to publicize positive changes in Africa's regional economies — particularly Southern Africa: "There is a big lag between perceived risk and actual risk in Southern Africa," bank vice-president for Africa Kim Jaycox said.

Accepting that South Africa's GDP of more than $130 billion a year make it a natural regional leader, Jaycox said that regional integration had gone from an ideal to being critical to national development strategies: "There have been major improvements in transport and power linkages in the region — the port development in Mozambique for example." Jaycox was speaking via satellite link to Johannesburg with South African finance minister Chris Liebenberg and former Zambia central bank governor Dominic Mulaisho. The videoconference is to be broadcast later this week.


© IMPHOTO

Jaycox: from ideal to strategy

Trading and investing in the region has become much easier, Jaycox said, following the decision by several states to float their currencies. Malawi's kwacha recently joined other floating currencies such as Zambia's kwacha, Botswana's pula and Zimbabwe's dollar. Apart from trade liberalization, there were other signs that the regional economy is pulling together. South Africa's scientific and technical advances could help, Jaycox said, in the same way that Korea and Singapore benefited from Japan's leap forward in the 1950s and 60s.

Opening markets, particular labor markets was causing problems. W.C. Lacey from South Africa's chamber of commerce said rising unemployment in the region was attracting labor far faster than South Africa could absorb it. The most effective solution, Jaycox advised was "to create economic opportunities in the rural areas, improve health and education facilities." Dominic Mulaisho was more sanguine about the migratory shifts: "You should see it as a compliment — we cannot just have free movement of capital, there is also free movement of labor to go with it."

This year's Southern African Development Community summit in Lilongwe, Malawi reflected new thinking on integration. Each member country was given a specific area of responsibility and a time frame for reform — South Africa's was finance and investment. South African banks have rapidly developed their networks in the regions since last year's elections. While South African breweries have invested in Zambia and Tanzania in recent months, and its mining companies are expanding operations in Zimbabwe, Zambia and Zaire.

Demand from Africans is also pushing the bank to get involved in integration efforts according to its new policy paper, "A Continent in Transition," due to published next month. The document speaks of "remarkably powerful, and often emotional consensus in favor of various forms of regional integration." While the bank agrees that Nigeria and South Africa would be key players, it stresses the fastest growth would occur by "improved links of African countries to the world markets."

These reservations aside, the bank strongly endorses regional integration as a way of locking in economic reforms: "Reciprocal liberalization agreements between African countries are likely to provide a stronger incentive to maintain reforms than does donor-inspired conditionality." For other countries, the bank says, regional integration may provide the first steps towards liberalization of markets "initially in regional neighborhoods." The bank has also decided to support the cross border initiative which aims to rationalize trade regimes in Eastern and Southern Africa.

Morocco Set to Launch Privatization Bonds

BY JON MARKS

A raft of measures which launch a new phase of economic liberalization and complement tough budget cuts necessitated by a severe drought, announced by Morrocan ministers in Washington, have led to a bout of heated criticism at home.

At a World Bank seminar this weekend, finance minister Mohamed Kabbaj and privatization minister Abderrahmane Saaidi looked forward to a debut of privatization bonds and private sector telecoms projects, and the creation of an interbank exchange market and capital account convertibility.

Privatization bonds will probably be introduced into the local market in November, according to Saaidi. With privatization issues averaging above 2.5 times over-subscribed, "demand has been too strong for supply," he said. The bonds will give holders priority in subscription for offers, but will pay interest at rates lower than those set by the treasury.

"Details have still to be finalized, but studies by local and international banks are very advanced. The first bonds could be on the local market by the end of November," Saaidi said.

Sale of the bonds will help Morocco over a period when budget deficits are higher than forecasted, due to a drought wracking the economy. According to finance minister Mohamed Kabbaj, drought has knocked 8 or 9 points off GDP growth this year.

Saaidi ruled out debt swaps as a means of financing selloffs. Kabbaj added that debt swaps of any kind were off the agenda. "We think we'll handle debt in other ways," the finance minister said.


© IMPHOTO

Kabbaj: coping with drought

A draft law to privatize telecommunications will go to parliament in early 1996. State monopoly Office National des Postes et Telecommunications (ONPT) will be converted into a joint stock company, and Saaidi is looking for a foreign partner to take a strategic stake. An independent regulatory body will be established, helping to protect new private operators from being muscled out of the market by a commercialized ONPT, which will still be virtually monopolistic for some time.

So far privatizations have met little resistance. The first major battle, opposition by parliament and labor unions to the sale of two state oil refineries, was overcome last January. The first parts of the Samir company will be put on the block soon, Saaidi said.

Kabbaj announced that the foreign exchange market will start operations early in the new year, another step towards full capital account convertibility before the end of 1996.

"The state's privileges in the market will disappear; it will become a customer like any other," Kabbaj said. Interest rate fixing by the state will disappear. If there is intervention, it will take an indirect route, "as in any other economy."

Morocco is determined to stay on the liberal path. Despite a bitter struggle with Spain over fishing quotas, Kabbaj spoke positively towards Europe, saying "an agreement will be signed with the European Union, we hope, before the end of this year."

Bank Distributes Wheels Of Fortune

BY HENRY COPELAND

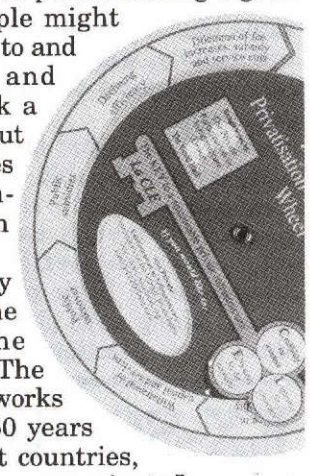
Michael Klein spent part of yesterday passing out four inch-wide plastic disks in the Washington Sheraton. Klein, a manager in the private participation in infrastructure department of the World Bank, was busy promoting sensible regulation of privately-owned utilities.

"Here, take one," he said to a passersby.

"Everybody's handing out papers, so we thought we'd do this," Klein explained. "We're walking the fine line between being too gimmicky and having some sense on there."

Ringed with 10 stages ranging from "privatization" through "consolidation" and on to "public takeover," the Infrastructure and Privatization-Nationalization Wheel is designed to communicate the "historical pattern of shifts between public and private ownership," Klein said.

"We tried to put something together that people might be attracted to and play with, and maybe think a little bit about the messages that are imbedded in it," he said.



Slowly spinning the wheel, he narrated, "The basic thing works like this: 150 years ago, in most countries, infrastructure was private."

Turning the disk, he pointed to the next box. "Then there was a trend toward nationalization or heavy regulation."

The spinning continued. "Then in many cases profitability declines. Then private capital withdraws. Then the state takes over, then subsidies begin, then efficiency declines and they don't have any money anymore, then they privatize again."

In the center of the disk are what amount to tiny advertisements for World Bank services. One reads, "If you would like to find out about a special presentation for your government or institution, please call Sandra Vivas: (202) 458 2809."

The other side of the utility wheel presents, "Ten Design Questions for a Sustainable Regulatory Regime for Infrastructure." It offers questions like "What tier of government should regulate?"

The 2,500 wheels Klein and his colleagues ordered for the meeting are yet another expression of the changes sweeping the bank in recent months, he said. It is part of "the realization that one has to go out and explain a little bit," he said.

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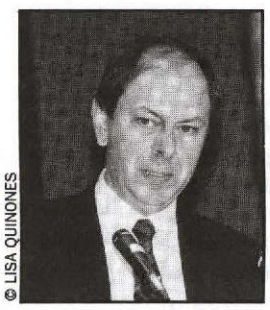
Czechs Warn Speculators to Keep Out

BY HENRY COPELAND

With capital inflows into the Czech Republic approaching an extraordinary 15 percent of GDP so far this year, the National Bank is seeking mechanisms to make the koruna less appealing to speculators.

"The central bank is not happy with short-term capital, and there is a possibility that the central bank will not just watch," bank governor Josef Tosovsky told *Emerging Markets*.



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Tosovsky: cool the money

Speculators have been attracted by the combination of the Czech Republic's fixed exchange rate and high interest rates. "When there is a rate differential, and there doesn't exist exchange rate risk, it means that speculation is very, very safe," Tosovsky said.

He said the National Bank is considering, among other measures, "more flexibility in our fixed exchange rate. More flexibility means at the same time to create a certain limited uncertainty, which would then eliminate some kind of speculations and hot money."

Rate "flexibility" is one of a menu of options available to the central bank to stem the tide of foreign capital, Tosovsky said. The bank now relies on sterilizing foreign inflows with high rates and debt sales, "along with the regulation of short-term positions of commercial banks vis a vis non-residents."

The Czech National Bank's foreign currency reserves have jumped from less than $500 million in January of 1993 to $6.2 billion at the end of 1994. "And when I left on Friday, it was $11.7 billion. So in the last nine months and a few days, we've had $5.5 billion inflow," Tosovsky said.

Asked for specifics about a possible flexible exchange rate, he said, "if we were to have more flexibility, the question is when and how much to use it, and I am not now in a position to give any answer to this." There is no rush to change policy, he said.

The koruna is pegged against a basket which is 35 percent dollar and 65 percent Deutsche mark. Tosovsky notes: "Czech interest rates are 11 percent, Deutsche mark rates are around 4.5 percent. So the interest rate differential is a temptation for some investors, especially when they believe there is very little exchange rate risk."

The inflow was boosted by the $1.4 billion sale of a stake in the national telephone company to an international consortium in June. In the first six months of 1995, $600 million of investment came from foreign speculators, with an even greater part of the inflow coming from borrowing by domestic firms in foreign currency.

"Because of the foreign exchange borrowings of our corporate sector, it would be unhappy to make any sudden change of the policy," Tosovsky stressed. "For the corporate sector, there can be an increase in transaction costs. If they are going to stay in Deutsche marks or dollars, then they would certainly ask for hedging. And that will cost money."

A year ago, the solution to the burgeoning capital inflows might have been to revalue the koruna upward, but the Czech trade deficit has ballooned to $1.7 billion in the first half of 1995. Trade deficit growth, said Tosovsky, "means that for more experienced investors, expectations of future developments can be more balanced than just waiting for a revaluation of the currency. And a more balanced situation is probably...not bad."

But much remains to be done before the koruna is unpegged. Tosovsky asks, "Should we watch developments of the capital account? Should we watch the current account? And what are the main signals for competitiveness, especially for the future: is it export performance, wage development, productivity of labor?"

Tosovsky's comments come as the Czech Republic achieves compliance with IMF Article 8, meaning the country has convertibility for the current account plus liberalizations for direct investments.

EX-SOVIETS LOOK BEYOND STABILIZATION

BY CRAIG MELLOW

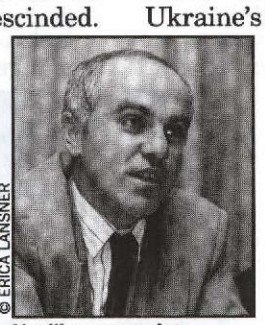
Ministers representing the three largest former Soviet economies said financial stabilization is within their grasp and their attention is now turning to a new host of post-stabilization problems.

Russia, Ukraine and Kazakhstan can all boast of dramatically reduced inflation since this time last year, although they all have relied on substantial multilateral transfers in reducing their runaway budget deficits. The latest monthly price rise figures for the three countries are 5, 5 and 2 percent respectively, and their currencies have largely stabilized. Belt-tightening should restore economic growth in 1996, country and World Bank officials predicted.

Some of the issues dominating the next stage of post-Soviet reform will be rationalizing tax systems, increasing agricultural productivity, and regional economic reintegration.

"Throughout the CIS [Commonwealth of Independent States] there is a need to reduce prohibitive taxes on enterprises," bank vice president Wilfried Thalwitz told a seminar dedicated to the region's future. The most concrete response to his call came from Kazakhstan. Jana Ertlesova, director of Almaty's official Center for Economic Reform, said a range of tax breaks is in the works, particularly for investors in the energy and mineral sectors. She predicted that value-added tax on imported equipment, a particular bugaboo for foreign investors, will also be rescinded.

The country most desperately in need of agricultural reform is Ukraine, where 35 percent of the population still lives on land which should be richly productive. Deputy prime minister Ihor Mitiukov pointed to "revolutionary changes" now under way on Ukraine's collective farms, including the abolition of the state monopoly on grain purchases. "It makes no sense to introduce private property without establishing the conditions for a market beforehand," he remarked.



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Vasiliev: sanguine

Russian deputy finance minister Sergei Vasiliev said his country is ready for land privatization, but the government has had trouble persuading parliament of this. He noted that prime minister Viktor Chernomyrdin is pressing for a referendum "which should settle the question."

Both Ukraine and Kazakhstan expressed their desire to mend economic fences with Russia. "Russia is our largest foreign donor, having forgiven $4.1 billion in debt," Mitiukov said. "Russian prosperity is in Ukraine's interest, and vice versa."

Russian and Ukrainian officials also agreed on the need to untangle the cumbersome web of social services and housing still provided through industrial enterprises which may not be solvent themselves. "Our privatization program has so far been very disappointing," Mitiukov admitted. "And the social costs which enterprises carry is one big reason."

Thalwitz pointed to continued financial sector fragility as a key "second generation" reform issue. But Vasiliev was sanguine on the late-summer liquidity crisis which briefly paralyzed Russia's banking system. "I think a financial stabilization program without a banking crisis is not a financial stabilization program," he said.

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Preview

October 10-12, 1995 AGENDA

TUESDAY OCT 10

7:30–9:30 A.M.
Cancellation announcement: *Emerging Markets* Annual Meeting Forum, "Shakeup, shakeout, shakedown: global banking on the eve of 2000" has been cancelled.

8:00 A.M.
World Bank press briefing with James Wolfensohn. Room 2, Sheraton Washington Hotel.

10:00 A.M.
Opening ceremonies and addresses by board of governors chairman and Benin finance minister Paul Dossou, James Wolfensohn, and Michel Camdessus. Plenary Hall, Sheraton Washington Hotel.

12:00–2:00 P.M.
Reception hosted by *Euromoney* magazine for the presentation of the Central Banker of the Year award. Shoreham Hotel, Suite 100.

12:15 P.M.
HSBC Holdings hosts a lunch party. Smithson Room, Four Seasons Hotel.

12:30 P.M.
Korea Exchange Bank hosts a luncheon. Willard Inter-Continental Hotel.

3:00 P.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

5:00–7:00 P.M.
Industrial Bank of Japan hosts a reception. The Carlton Hotel.

5:30–7:30 P.M.
Abecor hosts a reception. Grand Promenade and Courtyard, The Grand Hotel.

6:00 P.M.
The Saudi Arabian Banks host a reception. The Palladium Room and Veranda, Omni Shoreham Hotel.

6:30–8:00 P.M.
The World Savings Bank Institute and European Savings Banks Groups host a cocktail reception. Ritz-Carlton Hotel.

6:30–8:30 P.M.
Credit Suisse and CS First Boston host a reception and private viewing at The Library of Congress. Great Hall, Thomas Jefferson Building.

6:30–9:30 P.M.
Merrill Lynch hosts a buffet reception at the National Air and Space Museum.

6:30 P.M.–Midnight
Republic National Bank of New York hosts a reception at the National Gallery of Art.

7:00–9:00 P.M.
The Kuwaiti Banks host a reception. Corcoran Ballroom, Four Seasons Hotel.

7:30 P.M.
The Institute of International Bankers' board of trustees hosts a dinner for government officials. Metropolitan Club. By invitation.

8:00 P.M.
J.P. Morgan hosts a black tie dinner. 3050 Avon Lane, NW. By invitation.

WEDNESDAY OCT 11

7:30–9:30 A.M.
Emerging Markets Annual Meeting Forum, "Two years after the fall: South and Southern Africa." Breakfast and panel discussion. Speakers include: Chris Liebenberg, minister of finance, South Africa; L.B. Monake, deputy executive secretary, Southern African Development Community; Babacar Ndiaye, former president, AfDB; Ronald Penza, minister of finance, Zambia; Tomaz A. Salomão, minister of planning & finance, Mozambique; S. Tawengwa, chairman, Zimbabwe Electrical Supply Authority. Omni Shoreham Hotel. All delegates and guests are welcome.

8:00 A.M.
World Bank press conference with James Wolfensohn and NGOs. Room 1, Sheraton Washington Hotel.

8:00 A.M.
Discussion moderated by Stanley Fischer, IMF first deputy managing director, "Lessons from economies in transition." Cotillion Room, Sheraton Washington Hotel.

9:30 A.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

12:30–2:30 P.M.
Macquarie Bank hosts a luncheon. Potomac Room, The Carlton Hotel.

2:00 P.M.
IFC press briefing. South Cotillion Room, Sheraton Washington Hotel.

3:00 P.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

6:00–8:00 P.M.
Bank of China hosts a reception. Grand Promenade, The Grand Hotel.

6:00–9:00 P.M.
The Qatari Banks host a reception. Corcoran Ballroom, Four Seasons Hotel.

THURSDAY OCT 12

7:00 A.M.
Press breakfast hosted by the World Bank Group. Cotillion Rooms, Sheraton Washington Hotel.

8:00 A.M.
Press conference with World Bank president James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.

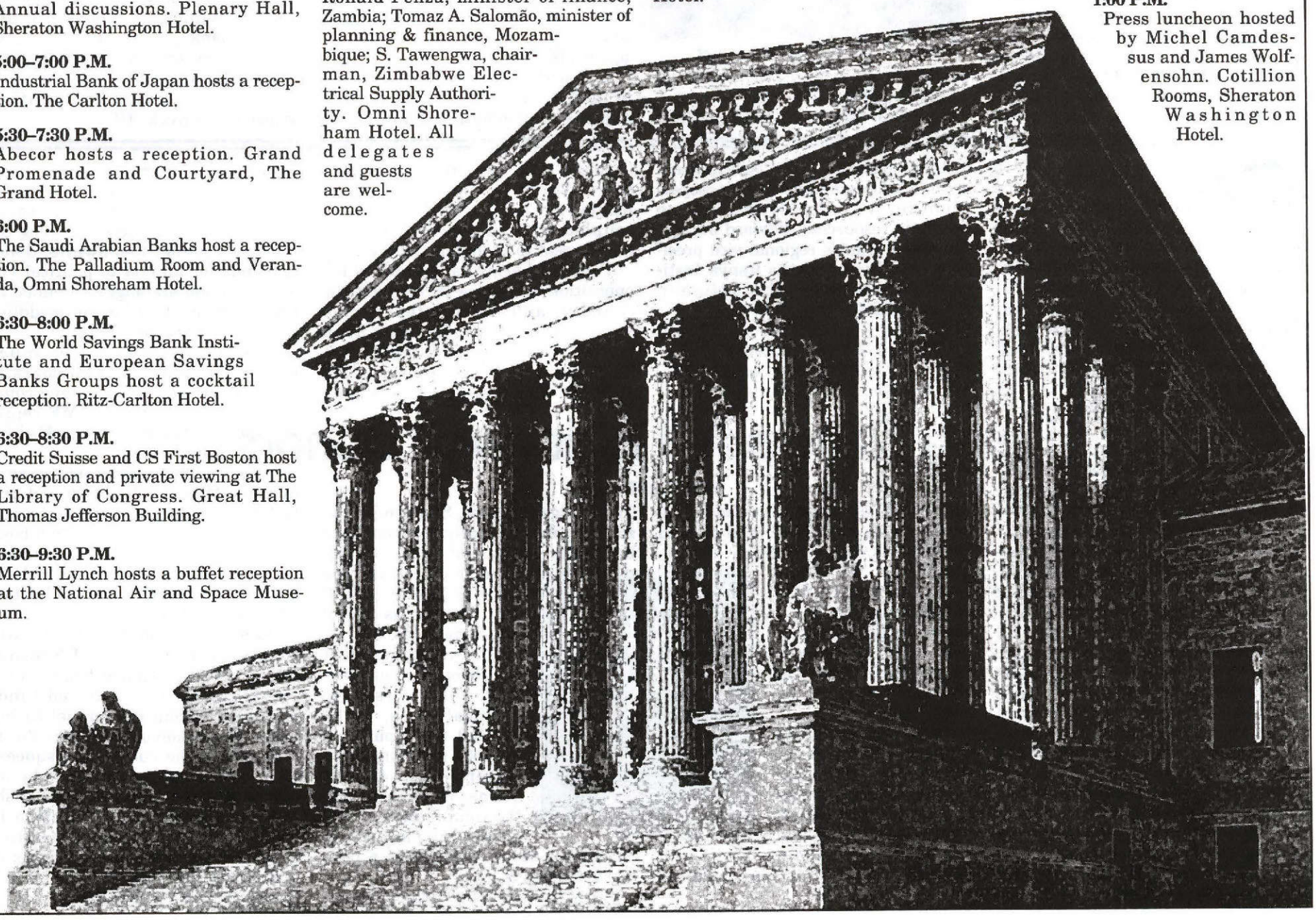
9:30 A.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

11:00 A.M.
Closing ceremonies. Plenary Hall, Sheraton Washington Hotel.

12:00 P.M.
Institute of International Bankers hosts a reception and luncheon with guest speaker Alexandre Lamfalussy, president of the European Monetary Institute in Frankfurt. Grand Ballroom, Plaza Hotel. By invitation.

12:00 P.M.
Press conference with IMF managing director Michel Camdessus. Cotillion Rooms, Sheraton Washington Hotel.

1:00 P.M.
Press luncheon hosted by Michel Camdessus and James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.



Western Activists Confront Nigeria

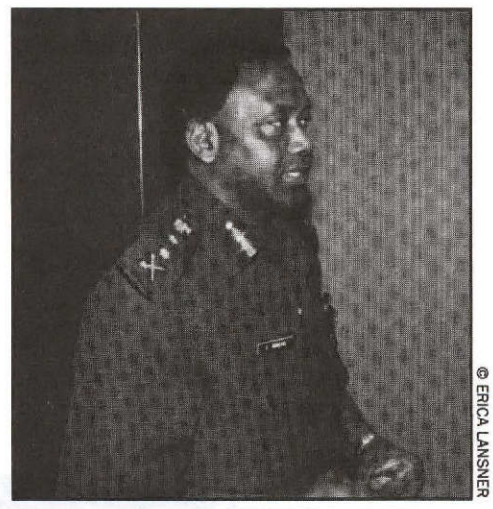
BY PATRICK SMITH

A war of words has broken out between Nigeria's ruling generals and their critics in the West. On one side is Nigerian leader General Sani Abacha and his coterie of civilian and military advisors; on the other are exiled Nigerian oppositionists, backed by human rights groups and dozens of African-American lobbyists — notably Randall Robinson and his Washington-based TransAfrica group. Abacha's opponents doubt his seriousness about handing over to civilians, and want the release of 40 Nigerians tried secretly for coup plotting as well as 1993 election winner Moshood Abiola.

The stakes are high. Robinson (who made his name campaigning against apartheid in South Africa) and the oppositionists want Western governments to freeze the generals' foreign assets and embargo Nigeria's oil exports — worth more than $10 billion a year. Abacha and the generals want the West to lift the current minimal sanctions against his government (such as visa restrictions). They also want Washington to back international credits for a multibillion dollar gas export project and are trying to negotiate a rapprochement with the International Monetary Fund and the World Bank at this year's annual meeting.

Robinson is adamant that: "The generals must be forced to stand down" for the sake of the region. "Africa cannot work without Nigeria. It is the bellwether population and Nigeria cannot be allowed to go on like it is going. Nigeria must be salvaged." Robinson has also gathered a clan of notables in support — such as poet Maya Angelou, producer Quincy Jones, and former U.S. presidential candidate Jesse Jackson.

Nigerian foreign minister Tom Ikimi dismisses Robinson's campaign as "misguided," saying Abacha's critics do not understand the complexity of Nigerian politics. Ikimi, a veteran of those turbulent politics, easily held his own in a U.S. television debate with Robinson but has not yet been able to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Abacha: civilian rule a "future" prospect

persuade Western governments of Abacha's political bona fides.

For this purpose, the Nigerians have hired an array of lobbyists in the U.S. and Europe. In Washington alone, the Nigerian government has spent at least $2.6 million on four companies — Barron Birrell, Washington Strategic Consulting Group, APCO Associates and Washington Public Affairs group — according to U.S. department of justice records. More bizarrely, Lyndon Larouche's Shiller Institute in Baltimore has taken up Abacha's cause, accusing the British government in concert with the World Bank and IMF of trying to break up Nigeria.

The first task for the lobbyists is to get the ban lifted on U.S.-Nigeria flights (the Abacha family is understood to have a stake in a transatlantic airline), and to reverse the Clinton administration's "decertification" ruling which means that the U.S. votes against any Nigerian application for credit from multilateral development banks. Nigeria has been decertified two years running for its failure to control drug traffic — more than 40 percent of the heroin in the U.S. is understood to come via Nigeria. Their second task is to fight attempts to impose an oil embargo against Nigeria.

U.S. and European officials, caught in the crossfire between the generals and their opponents, remain highly skeptical about Abacha's democratic intentions. Equally, they are reluctant to step up the pressure for fear of exacerbating the political crisis and damaging their substantial oil interests: Royal/Dutch Shell lifts more than a million barrels a day of Nigeria's premium light crude while Chevron and Mobil lift a further 700,000 barrels a day. Nigeria has already indicated it will retaliate against any oil embargo.

One U.S. official said there was a reluctance to impose sanctions against Nigeria because it would simply mean "buying Nigerian crude more expensively through a third party." But he accepted that Nigeria-U.S. relations had entered a "nonrational phase" and that sanctions could be part of the worsening relationship. Some oil companies are directly pressuring Western officials to "constructively engage" the Abacha government rather than penalize it. Formal lobbying groups such as David Miller's Corporate Council on Africa are giving the state department the same message.

Their efforts will prove helpful to finance minister Anthony Ani and central bank governor Paul Ogwuma as they try to convince bank and fund officials of the credibility of Nigeria's economic and political reforms this week. EM

Kenya Dances Aid Waltz with Donors

BY MARK HUBAND

One step forward then two steps back seems to be the technique Kenya has come to use in its waltz with the donors. But the question now is how long it can keep the rhythm it has set, before the tune changes altogether?

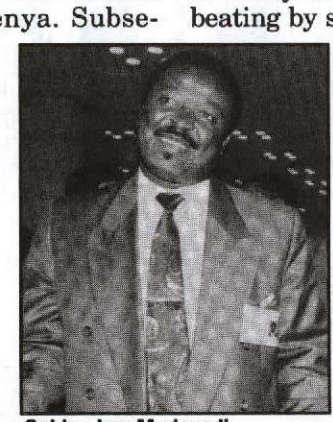
Once it was the case that it was the donors who appeared to be risking the consequences of underdevelopment by applying political conditionality to the allotment of aid. Western demands for multiparty politics led to the suspension of $850 million in aid, which was released after the ruling Kanu party rigged the December 1992 contest and eased its way back into power.

Now, the skill with which President Daniel Arap Moi has played on what has always been the desire of the donors to boost rather than hamper Kenya's development is under the spotlight. Relations with donor countries have rarely been worse. But it is not the economic questions which have raised concern. It is all about power, and the consequences of donor acceptance of the shambolic 1992 political contest.

"Africa requires good governance, without which the state cannot provide an enabling environment for business. Only when citizens have a sense that their government operates on their behalf — in an open and predictable manner — will governments be able to obtain their willing cooperation in, for example, mobilizing domestic resources," Edward Jaycox, the World Bank's regional vice president for Africa, told the Kenya Institute of Management at a lecture in Nairobi in December 1994.

It was Jaycox who, in 1993, announced the resumption of aid to Kenya following the election the previous December. His comments two years later show the aid waltz in full swing, as every word of what he said could be applied to Kenya. Subsequent to his 1994 speech, Kenya has been subjected to the worst period of political violence and intimidation since before the popular clamor for political change in 1990.

"The West is always tempted to look at [Kenya] as a last anchor in a disaster-hit continent. That allows a lot of sins to be forgiven. Kenya knows that and exploits it to the full," one diplomat in Nairobi said.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Golden boy Mudavadi

Since 1992 this process has been characterized by the pursuit of economic reforms to satisfy the West, coupled with increasing political harassment to keep Moi in power.

Police and army harassment of the opposition is routine throughout the country, and culminated during August in the beating by ruling Kanu party thugs of Richard Leakey when he tried to visit supporters of his recently-formed Safina political party. The foreign minister, Stephen Kalonzo Musyoka, officially condoned the beating by saying that Leakey should never have visited the town of Nakuru, which Moi regards as one of his strongholds.

It is with dismay that the donors are now looking at the worsening political crisis, which has left the reputation of Moi's government in tatters. This dismay stems, however, from the continuation of economic reforms which have been forced through at a pace which few can criticize.

Such reforms have reduced donor options: if they criticize the government for political repression, Moi can cite examples of economic reform as proof that his ministers are doing the donors' bidding. Meanwhile, donor demands for an end to political violence can and are angrily rebuffed by the government as foreign meddling in Kenya's domestic affairs.

"Kenya has made as much progress in the past two years in economic liberalization as any country in Africa," IMF representative Walter Mahler said recently.

The reformist finance minister Musalia Mudavadi and central bank governor Micali Cheseram have become the donors' golden boys, and even appear to have overcome doubts that they would be able to keep the hands of corrupt ministers out of state coffers.

Aware that sudden aid cuts will simply harm the mass of Kenyans rather than pressure the government, donors have reduced funds piecemeal to half the annual $1 billion aid provision of the 1980s. But to reintroduce the sudden aid squeeze of three years ago may not be an option, even for donor nations wishing to press for a fair election in 1997. Until then the waltz will continue, while the consequences of accepting the rigged 1992 result come to be fully realized. EM



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Americas

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY



Fiscal Reform Needed to Back Plano Real

BY MICHAEL KEPP

In Brazil, the government's Plano Real economic stabilization program — a dollarization scheme launched in July of 1994 — has lost much of its early luster. While the plan doesn't seem to be steering Brazil towards economic crisis *a la* Mexico, neither has it solved all the country's problems.

By creating a new dollar-linked currency, the real, the program has lowered inflation from 45 percent per month in June of 1994 to single digits. Though the government said one real would be worth one dollar, it refused to fix the exchange rate. And a flood of foreign capital into the local stock markets after the real's introduction so overvalued it that, by early 1995, the real was worth 15 percent more than the dollar.

The Brazilian government, keen to avoid Mexico's misstep in keeping the peso overvalued too long and worried about its mounting monthly trade deficits, began, in March, to slowly devalue the real against the dollar by setting exchange rate bands and intervening in the markets. As a result the real is now worth 7 percent more than the dollar and should reach parity by late 1995 or early 1996.

The devaluation has helped the government register a $2 million trade surplus in July and an estimated $300 million surplus in August, after eight previous monthly deficits (the first since 1986) and a January-July 1995 deficit of $4.2 billion.

To the government's credit the devaluation has decreased the trade deficit without increasing inflation. Both the gradual pace of the devaluation and the tough monetary controls imposed by the government — boosting interest rates sky high (55 percent a year in August) and tightening credit — have helped to curb an inflation-threatening consumption boom (see below).

The tough measures slowed economic growth so much and boosted unemployment so high that inflation dropped from 3.72 percent in July to 1.43 percent in August. But the average is still 2.5 percent a month, and the danger is that in taking those steps to curb inflation, the government could trigger recession.

The other major threat to the Plano Real — also an inflationary one — is the growing federal budget deficit, which could worsen dramatically if the government is forced to bail out numerous states and state banks, now deeply in the hole.

What's more, the federal budget deficit can only be reversed through short- and long-term fiscal reform — reform not built into the Plano Real.

The government, last year, did get Congress to approve the creation of the Social Emergency Fund (FSE) — a one-year fiscal band-aid measure which appropriated 20 percent of all federal taxes, except those destined for the states — arguing that it was the only way to balance the budget.

But even with the short-term FSE, the deficit remains large. From January until the end of August, the government spent $15 billion from the FSE — which only took in $9 billion — thus leaving a $6 billion hole. Congress opposes the extension of the FSE because it gives the president too much budget allocation power.

Congress also opposes the government's long-term fiscal reform, which would take affect in 1997-1998, after the FSE extension has expired. That's because those reforms — in which a national value-added tax (VAT) would replace separate state and federal government VATs — would reduce tax allocations to the states and take away the states' autonomy to fix those taxes. With state governors controlling many congressional delegations, getting the fiscal reform through Congress will be a Promethean battle.

"The lack of fiscal reform is the Achilles heel of the Plano Real," said Brasilia-based economist Paulo Calmao. "And if congressional opposition blocks or sufficiently dilutes this necessary budget-balancing overhaul, then the Plano Real's days are numbered." EM


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"Reform" schoolmaster Cardoso

1995, however, when the consumer boom threatened to become inflationary, the government increased credit restrictions and hiked interest rates, ending that boom.

The working class, nonetheless, continues to support the Plano Real. First, inflation remains low. Second, the cost of basic foodstuffs has stabilized and in some cases fallen because of bumper harvests since the plan went into effect. And, unlike the middle class, the working class hasn't been affected by the high cost of services.

This explains why, despite the Plano Real's structural problems and the threat of rising inflation, Brazil's mostly poor or working class population is still backing the plan and its architect, president Fernando Henrique Cardoso.

Though Cardoso's popularity is slipping slightly, he still enjoyed a 69 percent popularity rating in August (down from 72 percent in July), according to a nationwide poll.

The poll also shows that dissatisfaction with Cardoso and the plan is growing more quickly among the middle class. Among those who make more than $1,000 a month, 27 percent think their situations have worsened since the plan, while only 24 percent of those who make from $100-$500 a month and only 20 percent of those who make up to $100 a month feel worse off. EM

— Michael Kepp

A Step at a Time

Brazilian President Cardoso's greatest success since taking office has been gaining congressal approval of constitutional amendment proposals to open the country to private capital. Aside from easing the outlays of a cash-strapped government, the proposal's passage shows that Cardoso still enjoys a governing majority, but that doesn't guarantee him congressional support for tougher fiscal reforms that lie ahead.

The proposals passed so far will:

- open up the state telecommunications monopoly Telebras, whose monopoly is guaranteed by the 1988 constitution;
- eliminate a constitutional article which bars foreign firms from holding controlling interests in mining ventures;
- loosen the federal monopoly on natural gas pipelines, opening the sector to private investment;
- open coastal passenger transport to foreign companies. Legislation is likely to be proposed to open coastal cargo transport.

And in September, the Brazilian Senate is expected to pass a law to break the state oil monopoly of Petrobras — also guaranteed by the 1988 constitution.

Congress will, in the months ahead, pass regulatory legislation which will detail how the amendments are to be implemented. EM

— Michael Kepp

BRAZILIAN MIDDLE-CLASS HIT IN THE POCKETBOOK

Any visiting tourist will tell you that Brazil's overvalued currency, the real, has made this one of the world's more expensive countries in dollar terms. Even a couple on a cheap night out — pizza for two and a movie — will spend between $40-50. That's why tourism is down to a trickle.

High local prices and the strength of the real compared to foreign currencies, have sent record numbers of Brazilians flocking to the U.S. and Europe, many of them on spending sprees. International carriers have had to schedule special cargo flights just to bring back all the electronic goods.

Returning middle class vacationers practice more fiscal restraint here because of how hard the dollar-linked Plano Real has hit them in the pocketbooks. And not just on their evenings out. The price of middle-class services — everything from private schools and health plans to day maids — has soared way above inflation since the Plano Real went into effect in July of 1994. Why? The plan created a consumption boom that pushed demand up, including demand for services.

The cost of services has skyrocketed because cheaper services, unlike goods, can't be imported to push local services costs down. By contrast, the price of durable goods has remained stable because the government dropped trade barriers, forcing local goods to compete.

During the first seven to eight months of the Plano Real (till January-February of 1995), the trade liberalization initiatives did such a good job of disciplining the market that low inflation and stable or falling prices sparked a spending boom. For many in the working class especially, durable goods became affordable for the first time.

By the end of the first quarter of

Asia Pacific

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD B

Hong Kong Gives Last Huzzah for Democracy

BY KEVIN RAFFERTY

It now looks increasingly likely that the next annual meetings of the IMF and World Bank to be held outside Washington will take place in a city where the rulers will, a mere matter of weeks earlier, have freshly disregarded and scrapped one of the key aims of modern development — democracy.

Host city Hong Kong has long been known as the world's best example of freebooting free enterprise — yet by the time of the 1997 meetings will be experiencing a new life as part of the world's biggest communist empire, supposedly as an autonomous special administrative region of China.

It was intended to have been a smooth handover, a so-called "through train" from British to Chinese sovereignty, after which the annual meetings would have been a celebration of the new look Hong Kong, going from strength to strength under new management. But the events of the last month make it almost certain that it will be a difficult, territorial and turbulent transition. And all because Hong Kong's last British governor gave his colony a taste of democracy.

The events of the last month make it almost certain that it will be a difficult, territorial and turbulent transition.

In mid-September, Hong Kong residents were given the opportunity to elect their legislative council (Legco). Bejing's objections prevented a full-blooded general election as in a normal democracy, but governor Chris Patten threw 20 of the 60 seats on the council open to general election; other seats were chosen by so-called functional constituencies, such as bankers, lawyers, teachers, social workers and so on; even here Patten upset China by widening the franchise as much as possible.

Back in 1984, the Joint Declaration was signed between China and the U.K. allowing Hong Kong to keep its capitalist freedoms for at least 50 years after China regained possession of the tiny 404 square mile territory. This promised that the legislative council would be filled by local people chosen by "elections." But that has proved to be a most Humpty Dumpty word, meaning different things to different people.

To Westerners and to most Hong Kong Chinese, it meant members chosen according to the cherished one person-one vote formula. "In this day and age is there any other kind of election that can respectably be called democratic?" asked one budding local politician, incredulous when he saw Hong Kong colonial authorities in the 1980s busy devising a system of functional constituencies, "rather like the rotten boroughs that the British themselves discarded more than a century ago."

To him, this was an insult, a sign that the ordinary people of Hong Kong could not be trusted and that the governing of the territory should be in the hands of the "fat cats." The initial functional constituencies offered only a narrow franchise. In the banking constituency, for example, one vote was given to each licensed bank. Defenders of Sir David (later Lord) Wilson, governor at the time, said he was using the functional constituencies as building blocks on the road from the old appointed legislative council towards democracy.

From its first days the legislative council had been entirely appointed, gaining its first Chinese member in 1880. Recent British governors introduced majority Chinese membership and a leavening of less wealthy members like school principals. But Father Patrick McGovern, a Scottish Jesuit appointee, joked in the 1970s that it was easy for him to find a parking space for his motor scooter alongside the Rolls-Royces and Mercedes cars of his Legco colleagues.

When the euphoria over the agreement had died down, suspicions began to grow that China might prefer a Legco of the rich that would be easier to manipulate, and indeed was worried about an unpredictable democracy. It labeled Martin Lee Chu-ming, a barrister and one of the leading lights of the movement to full democracy, a subversive and this year denied him a visa to attend an Asian law conference in China.

Beijing conducted a vigorous campaign against Patten's electoral reforms, indulging in the sport of calling him all sorts of rude names, delaying financial approval for the new airport and finally, when the Legco reform bill went through, declaring that it would derail the through train, scrap the elected Legco and appoint its own council after taking over.

Last month, the voters of Hong Kong gave their verdict. In the face of hectoring from China, they gave the democratic parties their clear support and rejected leading pro-China candidates. Martin Lee's Democratic Party won 19 of the 25 seats it contested and with independent allies can probably put together 29 of the 60 Legco members. The chairman and secretary-general of the pro-China Democratic Alliance for the Betterment of Hong Kong both lost, as did a manager of the Beijing-controlled Bank of China who was defeated by a young democrat lawyer in the financial services functional constituency. Altogether, pro-Chinese forces won about 16 seats, with 10 going to the pro-business Liberal Party.



Will the vote last?

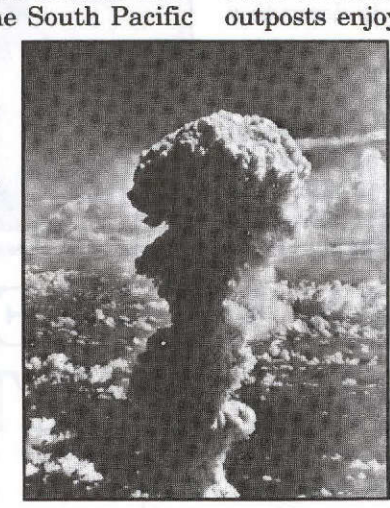
China was upset, branding the elections "unfair and unreasonable" and repeating that none of the newly-elected Legco members would serve when China took over the territory. British officials, though possibly not governor Patten himself, are disappointed that they will no longer have a quiet life in the handover period.

The winners have also declared that they will not lie down and die before the might of China. Martin Lee declared that the results showed that "Hong Kong people voted with their hearts and minds for freedom and genuine democracy." An independent winner, Emily Lau, added: "We have been elected for four years. I don't see why we should be thrown out by the Chinese government in 1997."

But the pro-China newspaper *Ta Kung Pao* quoted a remark of Deng Xiaoping's that popularly elected people are best for governing and that the city should be run by "Hong Kong people who love Hong Kong and China." It echoed comments of Conor Cruise O'Brien, former Irish foreign minister, that the Chinese Communists like the Jacobins in the French Revolution divide people into two

The Economics of France's Atomics

Controversy over the resumption of French atomic testing in the Pacific Ocean has brought both sides to face up to some of the facts of life of modern colonialism. The South Pacific Forum, grouping 16 scattered independent island states, last month prepared for another push to get rid of the French colonialists. The problem is that if they succeed, they may have a heavy bill to present to New Zealand and Australia.



Paying for the privilege

Pierre Lellouche, advisor on foreign policy to France's President Jacques Chirac, almost exploded when asked why France did not conduct its atomic tests in its own country. He claimed that Mururoa Atoll in the Pacific Ocean was a part of France just as Paris, Brittany or the Loire valley are.

That is not the view of most of the Pacific states. They have thrown off their German, Dutch, Portuguese and British colonial rulers and would dearly love to get rid of the French too. But Paris clings not only to French Polynesia, including Mururoa and Tahiti, but also to Wallis and Futuna and to nickel-rich New Caledonia. Thanks to vast sums of French money these colonial outposts enjoy a standard of living that other islands can only dream of — plus French citizenship as Lelouche points out.

Australia and New Zealand have joined the outcry over the testing, but have given only wary support to attempts to throw out the French. It is not just a matter that France is a good customer for Australian uranium and coal. There is also fear that if the French left, then Australia and New Zealand would have to step up their aid.

Paris pays a heavy $2 billion a year for the privileges of its Pacific outposts, of which half goes to maintaining the atomic base. Australia provides $350 million and New Zealand $44 million to the independent Pacific states, and would be expected to pick up much of the hefty tab were Paris to withdraw. EM

— Kevin Rafferty

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Eastern Euro

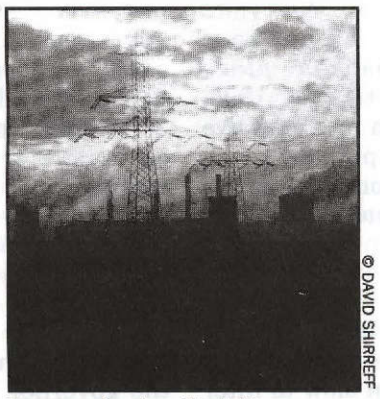
TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY

POLISH PRIVATIZATION SET TO GAIN SPEED

BY CHRISTOPHER BOBINSKI

In a little-noticed if significant transaction for Poland's privatization process, the still state-owned Bank Handlowy, the country's largest bank, recently sold its majority stake in Polgraph, a producer of electrodes for the steel industry, to SGL Carbon, a subsidiary of the German chemical producer Hoechst.

Until then it had been the government and its ministries, headed by the privatization ministry (MPW), as well as local governments which had been the main purveyors of state assets. But the Polgraph sale pointed to another source of supply — state banks which have in the past taken over indebted state sector companies directly or through debt for equity swaps and are now anxious to recoup their losses. What is more, Poland's mass privatization program (MPP), which is finally getting off the ground this autumn, will put another pool of state-owned assets onto the market.



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Power: not yet on the table

Under the MPP the government has established 15 investment funds which are to be run by mixed Western and local fund management groups which are being given a total of 519 state sector companies. Meanwhile the population at large is to be offered shares in the funds at a nominal fee with the promise that the efforts of the fund managers will enhance the value of the stock over the 10 years the funds are to be in existence. "The telephones haven't stopped ringing," says one banker, explaining that potential buyers who have failed to make headway in attempts to purchase these companies from the state in the past are now offering to buy them from the MPP funds.

Indeed the MPW has recognized that the pace it is able to follow won't see the country's state sector significantly reduced even by the turn of the century — though 1994 was a record year with the sale of 38 companies which raised 868 million zlotys ($36 million) in budget revenues. This year the government is looking to the sale of five major tobacco producers to foreign investors to salvage a sales revenue target of 1.5 billion zlotys, but with no more than 10 transactions so far the tempo is clearly too slow.

In response the MPW, ably led by Wieslaw Kaczmarek, is now talking of taking the equity in the 4,000 companies the state still owns (this figure should not mislead as the majority of these are very small while a mere 160 enterprises produce three quarters of the output) and injecting it into new investment fund-type vehicles. Thus equity in these funds would help capitalize the country's reformed pension system and could also be used to compensate those who lost property as a result of the communist takeover in 1945, and those who more recently took losses as a result of cuts made in pensions by the treasury. These cuts were subsequently declared illegal by the courts.

In the meantime the political debates continue inside the establishment over the privatization of key sectors such as oil refineries, gas distribution, and telecommunications. On gas, privatization decisions have been put off until 1998, while the oil refineries, which need capital for modernization to face the competitive challenge from the European Union, are most likely to be opened up to investment in the near term. It seems that conservative opposition to foreign involvement in telecommunications, as well as in utilities such as energy, makes privatization in these sectors a longer-term proposition. EM

Not As Bad As Everyone Fears

A study by the Gdansk-based Institute for Research into the Market Economy shows that, contrary to popular fears in Poland, employment in privatized companies does not fall drastically nor are purchases of state sector companies accompanied by purges of senior management. This is because most of the necessary changes came before privatization as a result of the post-1990 adaptation to free market competition.

At the same time the financial position of privatized companies tended to improve markedly and in companies where foreign strategic investors took control investment rose as plant modernization began. EM

— Christopher Bobinski



Russia's Slippery Stock Syndrome

BY CRAIG MELLOW

Time was when a big Russian enterprise which had cheated a bunch of foreign investors would feel it had done a service to the Motherland. So a major state oil company playing games with its stock and then acting sorry about it has been taken as a sign of progress.

Komineft, which controls the extensive hydrocarbon assets of European Russia's Komi Republic, is most famous in the wider world for producing history's largest oil spill near the town of Usinsk. But Moscow investment circles are more roiled by a different sort of Komineft emission, a supplementary stock issue which the company undertook in May 1994.

The issue was a straight two-for-one split, occasioned by the reevaluation of a book value which had been measured in 1991 rubles. The problems began when the ministry of finance failed to register the issue until November 1994.

The intervening five months were a boom period for Moscow's fledgling stock market, as some $2 billion of capital came in to take advantage of stunningly low valuations. CS First Boston, the most active multinational player in Russia, bought up over 7 percent of Komineft. Most other leading Moscow brokerages took smaller stakes. The sellers were generally company employees who let their shares go at a price way below the market to slick local operators.

Buyer and seller alike remained blissfully unaware that each share would soon become two. The split had been approved at a shareholders' meeting in Komineft's remote headquarters city of Ukhta. The majority shareholder was and remains the Russian government. While some of the Western brokers already held shares at the time, none of them apparently bothered to make the trip.

They regretted this lapse when the issue finally was approved, and the company distributed the new shares among those who had been stockholders at the time of the vote. The international investors who had purchased during the interim ended up with half shares. To their squeals of protest, Komineft responded, accurately, that it was merely obeying the law.

Komineft has gone on a charm offensive, dispatching a dog-and-pony show to American financial capitals.

After most of a year of wrangling, both sides seem willing to try to do better in the future. "I think they realized they made a mistake," says German Zvezdine of the Troika-Dialog brokerage. "And we realized there's nothing we can do, because the new shares have already been sold to good-faith buyers."

Komineft (or more precisely its new holding company KomiTEC) has for its part gone on a charm offensive, sharing financial information with the aggrieved investors, and dispatching a dog-and-pony show to American financial capitals.

"The crisis has passed," declares the director of KomiTEC's Moscow office, Alexander Korsik. Yet charm has its limits. When KomiTEC tried to float an additional 1 percent of its equity last month, no one would touch it. That speaks poorly of the company's plans to privatize over the next few years.

Broker Zvezdine optimistically emphasizes structural changes in the market which should make a repetition of the Komineft foul-up less likely. The Bank of New York, with local partners, has established a depository clearing company to centralize share registry. The Russian securities and exchange commission is up and running under estimable reformer Dimitri Vasiliev. A small group of brokers have established themselves as market makers, and companies seriously interested in capital know they must play by their rules.

Still, Moscow financial hands got a strong feeling of deja vu when word leaked lately that RAO ES, the national utility which is Russia's second most highly capitalized stock, had decided to split its shares 100 times. The goal apparently was to keep the price from sounding too intimidating to the common man.

The company assured brokers that the bureaucracy would digest this within weeks instead of months this time, and trading continued gingerly. But Russia clearly has much trial-and-error still ahead before it is ready for prime-time capitalism. EM

G7

Japan's Package — Sugar but no Protein

BY KEVIN RAFFERTY

In late September the Japanese government unveiled a huge economic stimulus package worth ¥14.2 trillion ($142 billion) in an effort to pull the economy out of four years of economic slump. Currency and stock markets were unimpressed by the hype that accompanied the package. The new package "is big," conceded Robert Feldman of Salomon Brothers. He added, "it has a lot of sugar, but not much protein."

Supporters of the government action argue that it has done all that anyone conceivably could and the economy will come off the bottom, surely, now, at last? Just before the stimulus was announced the Bank of Japan cut its official discount rate from an already record low of 1 percent to 0.5 percent. Who ever heard of such a low rate in the late 20th century?

When bank prime rates are 8.75 percent in the U.S., 6.5 percent in Germany, 7.75 percent in the U.K. and only 1.63 percent in Japan, the pressure to get the economy moving again must surely be overwhelming. With money so cheap, the incentive to borrow must be enormous. Home loans are now available for 2.5 to 3 percent. Keeping money in the bank yields nearly nothing. Investing in the stock market must also be worth another look.

On top of these measures, the Japanese authorities persuaded Washington to pull together in an effort to weaken the yen and strengthen the dollar. The Japanese currency had soared by 20 percent in the spring, reaching 80 against the dollar — at which levels even the biggest and strongest of Japanese companies were squealing that they were losing money — but the faltering recovery was being choked to death.

The Bank of Japan spent billions of dollars in judiciously trying to push the yen down, but it hovered just above 90. The ministry of finance chipped in by relaxing the restrictions on big Japanese institutional investors holding dollar investments. But the clinching factor was what was perceived to be joint determination to strengthen the dollar (though U.S. officials say that the treasury secretary was merely repeating standard policy that Washington wants a strong dollar). The breakthrough was achieved and the yen skidded to, then through, 100 and was at 104-5 when the package was announced. Japanese ministers have said that they want the yen to go to 110 against the dollar, at which levels small Japanese companies will be profitable.

Without deregulation, economic activity may be stalled for a long time.

But as the assessment of the package was made, the yen strengthened and again hovered around 100 as clearly the government had — yet again — offered only half a mess of potage. The cynics pointed out that this was the sixth package since August 1992 and the third of 1995. Altogether, ¥60 trillion or a massive $600 billion was supposed to be pumped into the economy. After the first big package, finance officials gravely declared that in a full year it would add 2.4 percent to growth. Japan would have been so lucky: either the economy was in deeper recession than anyone dared say or the packages have been slow to filter through. In any event, the succession of previous packages and the succession of damp squibs was good enough reason to be blase.

Japanese ministers' demands for a yen at 110 may also turn out to be wishful thinking, especially since at that level the risk would be that Japan would dig itself out by export-led growth, something that would please neither the Clinton administration nor the Japan-bashers on the hill. Forex markets would quickly take note and send the yen back up the see-saw.

The real reason for skepticism is that the package was incomplete. It did nothing to tackle the problems of $500 billion in bad loans overhanging the financial system. Real estate prices have fallen for four successive years, but according to Yoh Kurosawa, president of Industrial Bank of Japan, the fall "may last for another 24 months," meaning that collateral on bubble economy loans is worth even less. Without mechanisms seen to be in place to clean up the financial mess, confidence in the economy will be lacking.

The September package also failed to offer any deregulation measures, something that alarmed even the governor of the Bank of Japan, Yasuo Matsushita, who warned that without economic reforms and deregulation, "there are worries that economic activity may be stalled for a long time." EM



LYONNAIS' RIVALS FUME OVER RESCUE

BY EDWARD CARR

Can one blame Michel Pebereau, the boss of Banque Nationale de Paris, and Marc Vienot, his counterpart at Societe Generale, for showing a little pique? Announcing the first-half results in September of two of France's grandest financial institutions, it became clear that, though a cyclical improvement will ease the difficulties of the French banks, it cannot solve them.

BNP's result was vastly improved by the falling number of corporate bankruptcies and the end of the worst of France's property crisis. Such factors enabled provisions on its loans to fall by almost a third, to FFr2.8 billion ($571 million) and the bank to report a group net profit of FFr966 million, 5.7 percent up on the some period a year earlier. Yet there were disappointments too: net banking income fell almost 10 percent, while a cost cutting program delivered only slight savings. The results at Societe Generale were no better. It reported flat profits of FFr2.26 billion on revenues that had fallen a little to FFr19.5 billion.

"Although there was a slight improvement in the second quarter," says Chris Williams, an analyst on London with Fox-Pitt Kelton, a stockbroker, "the competitive environment remains very, very tough."

With France overbanked and a ferocious battle for market share raging between banks and thrifts, including the state-owned post office, it is no wonder Pebereau and Vienot launched a broadside at Credit Lyonnais, a state-owned bank that dished out loans during the 1980s like so many party favors.

The target of what Vienot called their "outrage" was the French government's rescue of Credit Lyonnais, a plan that they complain could be worth some FFr100 billion. In return for this aid, Credit Lyonnais must sell 35 percent of its banking assets outside France, including half its European banking assets — appropriate punishment for a bank that attempted to become "the biggest" regardless of the cost.


© ERICA LANSNER

Pebereau: outraged


© TODD FRANCE

Trichet: avoid foolish lending levels

And yet it is scant comfort for Credit Lyonnais' French rivals.

The rescue leaves Credit Lyonnais' domestic network intact. Despite regulators' assurances, it will be hard to stop money raised in asset sales abroad from bolstering the bank's position at home. On September 21, Credit Lyonnais reported that, mainly as a result of the plan, during the first half in has scraped into profit for the first time in three years. Its boss, Jean Peyrelevade, hailed the result: "We are getting back to normal. We are once again a normal bank."

Other French banks need such "normal" competition about as much as a rise in German interest rates. They have been put through the mangle by the country's recession. According to the Association Francaise des Banques (AFB), French banks wrote off a total of FFr215 billion in the past three financial years. There has been slack demand for credit from retail customers, who have shown little faith in the recovery, while firms have financed investment out of their improving cash flow rather than borrowing. Shortly before the summer holidays the competition reached worrying dimensions: the AFB says that banks lending to small firms were borrowing, even though the banks were paying more for their capital.

Since then Jean-Claude Trichet, the governor of the Banque de France, has written to the heads of the country's banks reminding them of the dangers of lending money at foolish levels, "The only positive is increasing attention to problems in the French banking sector," believes Susan Leadem, an analyst with Goldman Sachs. And yet change will be hard to bring about. Balance sheets are too weak to permit many takeovers and France's highly regulated labor market does not allow for capacity and jobs to be easily cut. As Vienot laments, "The social and political context...does not help the competitive position of French banks." EM

Edward Carr writes for The Economist *from Paris.*

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MidEast

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U.S., Europeans Divided Over MidEast Bank

BY JON MARKS

Behind the scenes tensions between the EU and the U.S. over the direction of Middle East policy have come into the open over plans to create a Middle East Development Bank (MEDB).

The project — energetically promoted by Israeli foreign minister Shimon Peres and backed, after initial reluctance, by the Clinton administration and powerful allies including Saudi Arabia — would create a regional multilateral to finance public and especially private sector development in the Middle East and North Africa. The MEDB would be a regional multilateral like the European Bank for Reconstruction and Development (EBRD), created to channel loans and investment into Eastern Europe and the former Soviet Union.

Thirty-two nations have been involved in talks within the framework of the multilateral peace process. Bahrain took a lead in offering to house the bank; others have followed. Then-U.S. treasury official Susan Levine, now senior vice president of the Overseas Private Investment Corporation, spoke of creating a bank with $1.25 billion in paid-up capital.

But major European governments and the European Commission remain lukewarm, despite their commitment to increasing financing flows to Europe's troubled southern flank.

"Speaking frankly, I would say that the Americans and the Europeans have divergent views on how to reach the same goals," says an official in Brussels. "They want a Middle East development bank on the sort of pattern that Washington understands. We want to mobilize financing according to a model which fits into the European strategy for the region."



© RAFOTO

Levine: saw a $1.25 billion bank

European strategy now centers on developing a free trade zone in the Mediterranean, to be launched at the November 27-28 Barcelona conference. This will involve 15 EU and 12 southern Mediterranean states, but not the U.S. and other parties who also have a strategic interest in the region.

"We would like to see the U.S., Canada and others at Barcelona to create a real multilateral momentum," says a senior Moroccan official. "The Europeans don't want this — it must be a European show based on institutions created in Brussels."

Both the pro- and anti-MEDB camps agree that some form of new institution is needed to help encourage private capital into the region.

Capital markets investors are starting to structure funds and facilities for the region. These include plans for a project in Egypt, which a major investment bank plans mainly to tap U.S. institutional investors.

But such projects remain few and far between — and the private market alone cannot come close to providing the investment flows even the few genuine emerging markets of the Middle East and North Africa require.

Speaking in Washington in late September, European Commission president Jacques Santer said of the MEDB that "the problem is not so much to create a new bank, but to find the financial instruments to channel existing funds."

Privately, European officials argue that a bank rooted in the Middle East could quickly become embroiled in the region's perennial divisions. The Europeans want a less complicated structure that would focus mainly on leveraging private sector investment. This would leave multilateral lending to existing organizations such as the World Bank and the EU itself. A middle-of-the-road solution would involve the EBRD being enlarged to include the Middle East and North Africa.

Major questions remain to be answered even if the U.S.-Arab-Israeli version of the MEDB is created. Although Saudi Arabia and other Gulf donors have now indicated they would provide support, substantial capitalization will be required from the West. Santer is not alone in questioning whether a budget-cutting, Republican-dominated Congress will vote the necessary funds.

But there is pressure for more to be done to anchor peace in the region — and political imperatives could give the MEDB the momentum it needs.

"From a purely strategic point of view," said senior Egyptian official Raouf Saad, "to have a permanent and just peace, you have to have an institutional framework to bring the parties together." He concluded: "From a practical point of view, the region needs a development institution that will be close to the region." EM

Mediterranean Moves Towards New Deal

In late November, the 15 members of the European Union and 12 southern Mediterranean governments, including Israel, Syria and the Palestine National Authority (PNA), will sit down together in Barcelona to launch the new "Euro-Mediterranean partnership."

To an increasing number of Arabs, the first Euro-Mediterranean conference is no more than another talking shop to debate why the predominantly Arab southern Mediterranean is so much poorer than the north, reflecting European preoccupations with turbulence to the south.

The EU is promising more funds for the region, but its Cannes summit in late June further cut back on the allocation for the next five years, which will now be Ecu4.685 billion ($5.9 billion). This is not the bonanza of Euro-spending Arab governments were looking for. But Barcelona also promises to add a significant new bloc in a world made up of economic interest zones.

"The idea comes from European history and European construction from 1958 to the Maastricht treaty and beyond: a body of countries become integrated economically and then move towards political cooperation," explains senior European Commission official Jean-Paul Jesse. "This is what is happening in the Mediterranean...the neighborhood is coming together."

Just as the North American Free Trade Agreement is becoming the American Free Trade Agreement as poorer Latin economies converge with the powerful north, so Barcelona is intended to lead to a new Euro-Mediterranean free trade zone. "This is the typical European logic," Jesse says.

A series of bilateral economic association agreements are the building blocks of the "Euro-Mediterranean partnership," but the policy also includes political, cultural and (most problematic) security cooperation. Putting Israel and Syria at the same table to discuss security issues is just one of several sensitive areas the Barcelona process must navigate.

"It is a covert attempt to protect the EU from competition."

Tunisia is the first country to sign a new generation association agreement, opening the way for a 12-year transition period in which the free flow of industrial goods and services will be introduced, but not yet politically sensitive agricultural products.

Other countries are expected to follow, including Morocco, Egypt and Jordan. Turkey and Israel have been negotiating complex trade accords which will draw them, with the less-sophisticated Arab economies, into the European Economic Area (EEA).

Membership in the EEA for the Arab south is a radical step. But only Tunisia seems really enthusiastic — even though the accord means further opening its still protected market, which could mean hundreds of local companies going bankrupt.

"We know the cost will be high, but for us the most important thing is anchoring Tunisia in the European context," international cooperation and foreign investment minister Mohamed Ghannouchi told *Emerging Markets*. "In a world of global trading blocs, only by aligning ourselves with the world's largest economy [the EU] can we hope to attract sufficient investment and create a viable partnership with foreign investors."

Morocco also wants investment, but is skeptical about the benefits of a Tunisian-style accord. Rabat is also bound up in a complex dispute with Europe which focuses on differences with Spain over fishing, but which goes much deeper.

Egypt will probably sign following talks in the next few days, but whether its accord will be implemented as Brussels would like is questionable. Mohamed Farid Khamis, president of the Federation of Egyptian Industries, says the accord (especially when it covers rules of origin) gives the EU unfair advantages. "It is really a covert attempt to protect the EU from competition," Khamis wrote in the Cairo daily *Al-Ahram*.

Under pressure from Spanish, French and Italian farmers, agricultural produce is not included in the Euro-Med deal, even though increased exports could help rural populations to stay on the land and consolidate the political stability Europe wants to see in the Arab world.

"Ensuring stability may well involve concessions, particularly over access for agricultural goods, which may be difficult for southern member states of the EU to make," A British parliamentary committee, chaired by former cabinet secretary Lord Hunt of Tanworth, reported recently. EM

— Jon Marks

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Bankers

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WALL STREET AWAITS BUFFETT'S SALOMONIC DECISION

BY BRENDAN MURPHY

Which way will the Sage of Omaha jump on Salomon? By the end of October, Warren Buffett, one-time interim chairman of the troubled investment bank and current chairman of Berkshire Hathaway, the Nebraska-based fund that holds 700,000 preferred shares in Salomon Inc., must decide whether he will redeem one fifth of them for $140 million cash or for common stock.

It's a vexing decision for Buffett, given his 20 percent stake in the Salomon Brothers parent and the negative interpretation certain to be placed on any move other than common stock redemption. In purely mathematical terms, Buffett would do better redeeming for cash if Salomon shares are trading under $38 — they were last seen at 38 3/8. But globally, he'd be shooting himself in the foot, as cash redemption would hammer the 6.6 million Salomon common shares which Berkshire Hathaway holds.

There are, moreover, four more tranches to be disposed of, and a sinking common share price won't help his remaining preferred shares. So Buffett has good reason to want Wall Street to think he believes Salomon can be rehabilitated. So, "he'll pick the stock and not the cash," argues Joan Solotar, an analyst at Donaldson, Lufkin & Jenrette Securities Corporation.

Waiting for Buffett to decide cannot be a pleasant experience for Deryck Maughan, Salomon Brothers' embattled chairman. But, whereas for Buffett Salomon is little more than a blemish on his stunning career investment record, Maughan has much more at stake. Redemption for cash would be seen as a vote of no-confidence in his leadership by critics who say his vacillation has set the bank further adrift.



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Buffett (l) with Maughan

Then again, perhaps Buffett sees promise in Salomon despite the decline of the investment bank that once inspired more fear than loathing along Wall Street. It is hard to imagine Salomon meeting the value criteria Buffett learned at the feet of Benjamin Graham. But he may hope Salomon can be spun off to some ambitious European banking group at a price allowing him to walk away with his initial investment, if not with a profit.

That is, at least, one theory circulating on "the Street," though Salomon, with a market capitalization of $4 billion, would be a large morsel even for European powerhouses like Deutsche Bank, Union Bank of Switzerland and Swiss Bank Corp., which have been building market share and are generally considered to be on the prowl for acquisitions. Still, Salomon's franchise must tempt such institutions, as the purchase would catapult their now-insignificant U.S. underwritings into the top ranks.

"I don't believe Salomon is being dressed for sale," says Michael Flanagan, an industry analyst at Lipper Analytical Securities Corporation. He doubts there is another institution out there that "would be willing to endure and manage the intense inherent risk of the Salomon franchise." More likely, he contends, Buffett will retain his stake and pursue the rehabilitation of Salomon through its conversion from "an impulsive trading culture to a strategic, professionally managed culture."

Acknowledging that he holds a minority view, Flanagan declares Salomon "absolutely a buy" at current levels and forecasts its rebound to $90 a share over five years once it achieves a 15 percent return on equity through an entire interest rate cycle. He adds that "there isn't much risk in Salomon's price (of $38) at 120 percent of book value," and that pessimism on Salomon is overdone. "People are quite impatient with Salomon and it's difficult to turn a big ship around in what's become a crowded harbor."

Still, this won't be easy, even for Buffett, whose heartland investment values haven't exactly been embraced by one-time masters of the universe at Salomon. "I think the Buffett philosophy is most desired on Main Street and quite altruistic on Wall Street," says Flanagan. "The securities industry management process has evolved over the past 10 years, but the fact is that Wall Street in general is still run for the employees and not for the shareholders," he concluded. EM

FLEMINGS BANKS ON SOUTH AFRICAN INSIDE TRACK

BY ALEX BRUMMER

London merchant bank Robert Fleming is moving more rapidly than almost any other corporate finance house to establish a strategic presence in the new South Africa. This year Flemings expects to consolidate its position as the leading offshore fundraiser for South Africa-based companies and will become an integral part of the institutional stockbroking community in Johannesburg when it receives final permission to acquire a 50 percent stake in Martin and Co., the country's largest brokerage house.

"Martin and Co. is the leading institutional broker in South Africa," says Charles Blackmore, operations director of Fleming-Martin for the southern Africa region. Blackmore expects that Flemings will receive final clearance to take up its equity stake on November 24 this year, having signaled its interest in buying Martin and Co. in March 1995. Once permission is granted, Blackmore believes that Flemings will be well placed to share "in the post-Big Bang changes in the South African stock market as well as the privatization drive."

In keeping with current practice overseas, Flemings plans to leave Martin and Co. largely in the hands of local management, although it will be parachuting in small groups of corporate finance experts as and when necessary to provide expertise in the areas of fundraising, privatization and corporate restructuring. "We aim to use our local distribution networks to leverage our global expertise," Blackmore asserted. More than almost any other Western investment bank, Flemings both directly and through Fleming-Martin, its international arm in the region, has sought to build a strategic African presence. It now has broking operations in South Africa, Zimbabwe (where it controls 50 percent of the largest broking house, Edwards and Co.), Botswana, Ghana and Mauritius.

More than almost any other Western investment bank, Flemings has sought to build a strategic South African presence.

Flemings recognizes that the really big prize in South Africa, when the government can resolve the political difficulties surrounding the issue, is privatization. It has recruited two powerful military-diplomatic ambassadors to this task. Former Gulf War General Sir Peter de la Billiere already has made several forays into South Africa on behalf of Flemings to advise on privatizations. He will be joined by Sir Robin Renwick, who has just stepped down as the U.K.'s ambassador in Washington, retiring early (at 57) to join Flemings. As British ambassador in South Africa, Renwick played a critical role in securing the release of Nelson Mandela and in helping guide South Africa into the fold of democratic states. He is regarded as a personal friend by Mandela and could well be a reassuring presence for the skeptical ANC, which has been somewhat suspicious about privatization plans.

The country's early privatization targets include the telecoms monopoly Telkom; the electricity generator Eskom, and the transport concern Transnet, which controls South African Airways.

The assault by the privately-owned merchant bank on the South Africa marketplace was led by a member of the family, Adam Fleming, who established Flemings in Johannesburg in 1991. In 1993, the bank established the joint company Fleming-Martin for the purposes of corporate finance work in the region and is now preparing for its entry into the domestic stockbroking and fundraising markets through Martin and Co. Blackmore believes that the positions which Flemings has established in Johannesburg, together with the connections made by de la Billiere and Renwick, will hold it in good stead: "They have good contacts at ministerial level," he notes.

Among recent successful fundraising operations conducted by Fleming-Martin for South African corporates was a DM125 million issue for Nedcor and a dollar issue for Murray Roberts. In addition, Flemings has made considerable inroads in the fund management sphere. The closed-end New South Africa Fund, launched by Flemings on the New York Stock Exchange, raised $71 million. It also manages the open-ended Save and Prosper South Africa Fund in the U.K., an important vehicle for British and overseas investors seeking a stake in the new South Africa.

Blackmore says that Fleming-Martin is very comfortable with the pace of change taking place in South Africa's financial community since the election of the democratic government. "We are relaxed," he says, "with [Reserve Bank governor] Chris Stals's timetable for the lifting of exchange controls. He is right to take matters cautiously at a time of such momentous change." EM

Investment

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Brazilians Electrify Privatization Program

BY MICHAEL KEPP

The Brazilian government's commitment to its privatization program will be tested by the speed with which it breaks up and sells off Eletrobras, its electricity monopoly, a big state-owned concern attractive to both domestic and foreign investment.

So far, foreigners have been responsible for only $400 million of the just over $8.5 billion paid for 34 state-owned firms privatized since 1991, mostly steel mills and petrochemical companies. But that foreign investment profile is expected to change.

"All over the world, foreigners have invested in public service companies — mostly telecommunications and electric power companies — because the growth potential of these sectors far surpasses that of goods-producing firms like steel mills," says Luis Nelson Porto Araujo, a director of Trevisan Associados, a consulting firm acting as a privatization advisor to the government. "Foreign interest in Brazil's public service companies will be no different. In Brazil you can far more easily double the amount of energy generated than the amount of steel turned out."

The Brazilian electric energy sector reeks of growth potential. Even though private investors will have to invest billions over the next few years — because the government has not invested any capital in years — the utilities are considered attractive because there is an ever increasing need for energy, and there is no competition. Privatization is the cash-strapped government's answer to not having the money to invest in this sector.

In July, President Fernando Henrique Cardoso's new administration began the electric sector privatization by selling off its controlling (just over 50 percent) stake in Escelsa, the regional power company of southern Espirito Santo state, to a commercial-investment bank consortium and a local state pension fund consortium. Escelsa was the Cardoso administration's first privatization and the first utility sell-off.

By late this year or early next year, the government plans to sell its controlling (78 percent) stake in Light, the regional power company of southern Rio de Janeiro state. The government slated Escelsa and Light's sale before that of other Eletrobras subsidiaries because of the comparative ease in selling electricity distributors not connected to state-owned electricity generators — mostly hydroelectric plants. Current laws force private dam owners to use (rather than sell) most of the energy they produce, though the government is trying to change the laws.

After Light is sold, the government will likely try, in 1996, to sell off 18 unfinished hydroelectric plants because of their high maintenance costs of $1 billion a year as well as



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Brazil hopes investors need a Light

the need to generate more electric power as soon as possible. The government will, however, find it difficult to sell off the dams, because of financing problems.

"Buying an unfinished dam means having to sell power through a grid of state distributors, which means having to finance them," said Renata Moraes, a vice president in charge of energy projects at Chase Manhattan's Sao Paulo branch, who said Chase might bid on Light. "Buying into regional power companies — like Escelsa and Light — means selling to the consumer directly."

The government plans to begin privatizing the rest of Eletrobras' holdings in 1996, a sell-off which will likely mean breaking up the monopoly into sellable parts. Eletrobras is studying a plan to split into two separate entities: Eletrobras and Electropart. Electrobras would continue to manage the sector and be kept in state hands. Eletropart, comprising the four regional Eletrobras energy generating-distributing subsidiaries — Chesf, Eletronorte, Eletrosul and Furnas, which runs the government's nuclear power plant — would be sold as a block, or more likely, as four separate companies.

The government would then create a national grid of all transmission assets (which it would keep) and allow all independent power producers (the buyers of Eletrobras energy generating or distributing subsidiaries) access to the grid.

If the four subsidiaries are sold separately and a new law allows private generators to sell most of their energy, they should attract a great deal of investment interest, particularly among foreigners.

"If Chesf or Furnas were to be sold individually, by putting their shares up for sale on local exchanges, foreign investors looking for liquidity might likely invest in these firms," said Ruy Souza e Silva, director of merchant banking at Citibank's Sao Paulo branch. EM

FOREIGN BANKS SEE HAPPY RETURNS FROM UTILITIES

Foreign banks participating in Brazil's privatization program are likely to be far shorter-term investors than the big, local institutional investors participating in the sell-offs, such as local banks and pension funds of state-owned companies. The same seems to hold true for foreign banks, which for the first time are beginning to invest in private Brazilian companies.

Although foreign investors accounted for just under 5 percent of the capital raised in selling 34 state-owned firms — mostly steel mills and petrochemical firms — they are showing more share-buying interest now that more attractive state utility companies are finally being sold.

Citibank, with a 12.5 percent stake in the Iven bank consortium, gained 5.5 percent of Escelsa when Iven boosted its holdings from 20 to 45 percent. It was the first time a big foreign bank was a major participant in a privatization.

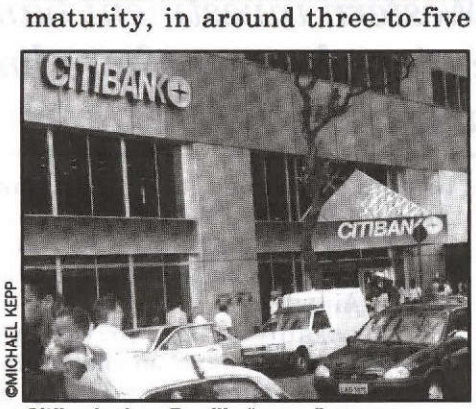
A source at the Citibank subsidiary in Brazil, however, said the bank wasn't interested in Escelsa as a long-term investment and could sell off its interest in Escelsa by selling its stake in Iven, listed on local stock exchanges.

"We don't see our investment in Escelsa as a permanent one," said the Citibank source. "But whether it's a three-year, a five-year or a seven-year investment depends on how Escelsa is doing and what else Iven invests in."

This also likely to be the strategy of Chase Manhattan, which unsuccessfully bid for Escelsa as part of another consortium and which plans to bid on another even larger regional power company, Light, to be sold later this year. Citibank also plans to bid on Light.

"Traditionally, foreign investors play the stock market and don't make long-term investments in private firms here."

"Typically, foreign investors, including foreign banks which want to buy into local Brazilian companies, do so with the intent of selling out when the investment reaches maturity, in around three-to-five years," said a source at the JP Morgan subsidiary in Rio de Janeiro. "And when the foreign investor is a bank, it always has an exit strategy."



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Citibank plays Brazil's "power" game

JP Morgan also has an exit strategy for the minority shares it has bought during the past two years in four private Brazilian firms. A JP Morgan source said, "We plan to sell our minority shares in all four of these firms within three to five years, and are ideally looking for a 35-50 percent return on equity."

Domestic commercial and investment banks, which have spent between $1.5 and $2 billion to buy shares in around half of the 34 privatizations — like the Bozano, Simonsen investment bank which belongs to the Iven consortium — have longer-term investments in mind.

"Local investment banks like Bozano, Simonsen, unlike foreign banks, will likely keep their shares in the state firms they bought," said Rio de Janeiro stockbroker Luiz Sampaio, "because that way they can keep one foot in the local financial sector and one foot in the local industrial sector."

Like local commercial and investment banks, state-owned company pension funds also view their participation in the privatization program with a longer-term investment outlook than foreign banks, in part to match their long-term liabilities.

Eduardo Machado, the commercial manager of the Association of Brazilian Pension Funds, said "Traditionally, foreign investors, including foreign banks, tend to want to make money quickly which is why they play the Brazilian stock market and don't make long-term investments in the private firms here." EM

— Michael Kepp

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Capital Markets

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 34

PERU TAKES ON TWO POPES AT ONCE

BY JUDITH EVANS

Peru's spunky president Alberto Fujimori has taken on the Popes. Shortly before leaving for China where he lambasted the Catholic Pontiff Pope John Paul II on poverty and family planning, his government was revealed to have bought back an estimated $1.2 billion of its own debt thereby heading for a clash with one of Wall Street's most powerful popes, Citibank's John Reed. Or, then again, maybe not.

Although debt buy-backs were taboo in the days when foreign commercial banks were up to their eyeballs in non-performing credits to the developing world, Peru's action raised only mild protest. And it is widely believed among traders that Peru continues to nibble at what little of its paper is available, with the rumored assistance not only of CS First Boston as originally reported, but also of Deutsche Morgan Grenfell (DMG). If that's the case — and neither institution could be reached for comment — it would be yet another of the growing list of examples of "selling your own book" by research units. In a DMG publication dated August 17, Peru's debt was forecast to go above 70 cents on the dollar, on the assumption that its Brady deal would be going through soon.



© RAFOTO

Fujimori

Wall Street insiders are divided on their explanations for why Fujimori's apparent commitment to planning for debt reduction, as opposed to family planning, is not raising more hackles. For some analysts it is proof that the era of the foreign debt crisis is over. With Peru as the last Brady deal still to be done, "The banks no longer have to worry about precedence," said Morgan Stanley's chief emerging market economist, Ernest Brown. "In the old days, we couldn't let the hand carts slide down the track because the freight trains were right behind them," he quipped.

Others see it as a simple matter of petty cash. "It's about a little over a billion dollars. Who cares?" asked one steering committee veteran. If the buy-back has been as significant as most analysts believe, Peru will be left with only a little more than $2 billion of principal plus another $2 billion in post-due interest (if it is valued at 100 percent of face value, given the precedent in the Ecuadoran agreement).

The most obvious candidates for sour feelings ought to be Citibank and Chase Manhattan, the two banks that held on to their Peruvian paper even as the years — now 12, to be exact — passed since former president Alan Garcia cut off interest payments entirely. However, Citibank's William Rhodes claims that a solution to the toughest issues — most likely, placing a value on the past due interest payments, discount and par bonds — is on the horizon. "You could see something around the time of this year's annual meetings," he forecast, while simultaneously scolding the Peruvians. "Of course, the banks holding Peru's debt aren't happy about it."

On the other side of the fence are some who think that the Peruvian debt buy-back operation was a venial sin, at worst. Lawrence Goodman, economist at Salomon Brothers, points out that the lower Peru's debt burden, the lower its cost of capital. "Peru has recently been principally an equity story," he said, "and lower rates on capital will make that even more so."

One thing is undoubtedly certain: the buy-backs damage Peru's position in trying to cut a deal better than Ecuador's. "The banks will go back to the table determined to get the money behind the buy-back," according to Baring-ING's Arturo Porzecanski. The danger, he says, is that the negotiations could get nasty if the Peruvians balk at the terms. EM



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GHANA



THE NEW GATEWAY TO AFRICA

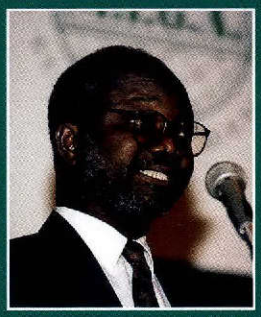


A Special Sponsored Report



J.J. Rawlings, President of the Republic of Ghana

"If we had not been able to reverse the economic, political and moral decline of Ghana in the late 1970s, our nation would have been in no condition to face up to the challenges of the new century."



Kwame Peprah, Minister of Finance

"We've hit a bad patch, but have, I think, shown resolve by taking serious measures — on interest rates especially — which we feel will put our economic management back on course. And we are hopeful that the corrections we are making will result in an easing of the path for the private sector, which alone can provide the push for the accelerated growth of the economy as a whole."

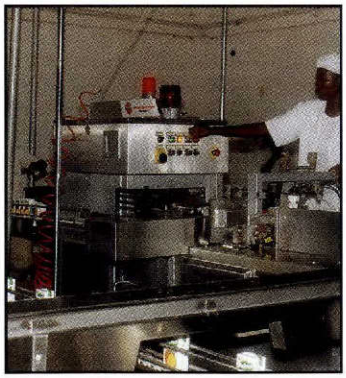


Ghana's Lake Volta — the largest man-made body of water in the world — is harvested for hydropower at Akosombo Dam.

Ghana's record of stable economic and political reform makes it a natural gateway to the West African region. A 12-year economic recovery program has transformed the country's economy through consistently high growth, a boom in mining and other exports, an expanding stock market and an investment climate which has brought long-term commitments from leading multinational corporations. Despite some recent setbacks, the government is still on track for growth rates of over 6 percent up to the year 2000, with an economic program backed by official donors pledging over $1.6 billion over the next two years. Amid these changes, the country has managed a peaceful transition to democratic rule as President J.J. Rawlings enters the final year of his first term as Ghana's elected president.

During a two-week tour of the United States in late October, President Rawlings will address the U.S. business community on opportunities for the private sector in Ghana. Having established a stable political climate and average annual GDP growth of 4 percent in the past 10 years, the government now aims to make the country a gateway for the sub-region, a concept backed by the World Bank, which has worked closely with the government for the past decade.

Ghana has set up the Investment Promotion Centre to help promote a private sector-led boom in manufacturing, energy, mining, agro-processing and tourism. Last year's new investment code guaranteed security and free movement of capital for foreign investors. The government's divestiture program is privatizing all of the banks, the state telecommunications company will soon be for sale and next year the government plans to make Ghana an export free zone, with an "open skies" policy at the airport and EPZ at both major sea ports, Tema and Takoradi. Planned improvements in infrastructure will also assist the tourism sector which, boosted by the interest of African-Americans, is fast becoming a major source of foreign currency earnings.



Pineapple juice containers rolling off the production line at Astek Industries

According to P.V. Obeng, President Rawlings's advisor on government affairs, "Ghana offers the investor competitive and flexible incentives and an environment free of unnecessary administrative controls. It is a free area for the remittance of capital and profits. Ghanaians are friendly towards investors and the labor force is well educated."

The energy sector is a new area of opportunity for private investors. The state-owned power utilities cannot match rising demand and the government is inviting the private sector to exploit natural gas and hydropower for electricity generation, especially in the country's west-



ern region. Japanese investors have already launched one power project in the Tano river basin. Gas exploration in the Tano and the proposed West African Gas Pipeline project from Nigeria could make Ghana the hub of a regional power network, with links west to Cote d'Ivoire, east to Nigeria and north to Burkina.

Ghana's future export free zone, including offshore banking facilities, the expanding stock market, and the forthcoming privatization of all of the major banks and the telecommunications industry, should further stimulate an already thriving services sector, which was the fastest growing sector in 1994, with 6 percent growth.

RECENT ECONOMIC DEVELOPMENTS

Since 1983, the government of Ghana, through its Economic Recovery Program (ERP), has successfully turned the nation's economy around. In the decade prior to the ERP, Ghana suffered negative GDP growth on the average of -2 percent a year. Since 1983, annual growth has averaged a healthy 5 percent. By 1991, the near-hyper inflation of the pre-ERP era had been brought down to 18 percent, and the national budget showed a surplus of 1.5 percent of GDP. In the same year, private investment peaked at 8 percent of GDP.

While this successful transformation was widely applauded and emulated, it was put to the test the following year by a number of setbacks and challenges. Chief among these was the upsurge in government spending and money supply in the run-up to the 1992 general elections, which led to a fiscal shock, widening of the current account deficit, devaluation of the cedi and a drop in private investment. This was followed by a number of setbacks in the agricultural sector and the withholding of some policy-based lending from official donors.

While the picture has improved recently — the national budget produced a small surplus last year — the government is still working to restore and solidify macroeconomic stability.

With presidential and parliamentary elections due next year, the government has made it a prime objective to avoid repeating the mistakes of 1992. The man responsible for making sure of this, minister of finance Kwame Peprah, is well aware of the struggle ahead. "We expect pressure to build up next year. Even this year we have had tough negotiations with labor — we agreed to disagree — and had to go to an arbitrator, which ruled in our favor." Peprah is determined not to let the political climate injure the country's economic future. "We will not let the experience of 1992 recur. We will hold the line, so that we will not have to make up a lot of ground afterwards," he insists.

Beyond working to maintain limits on spending and monetary growth, the government hopes that next year's poll will further legitimize the overall reform effort. "At next year's election the government will be seeking a mandate to consolidate what we have already achieved and to continue development through reforms," says presidential advisor Obeng.



"Our long-term goals have been charted: we want to move to 10 percent annual GDP growth and put the private sector in the front of the process," he continues. "We are improving infrastructure and there will be more involvement of the private sector in the power sector, especially in the western region, and through privatization of telecommunications. We want to move government's resources more into health and education and we are carrying out a reform of the civil service program which will involve a wholesale review of the organization and some retraining."

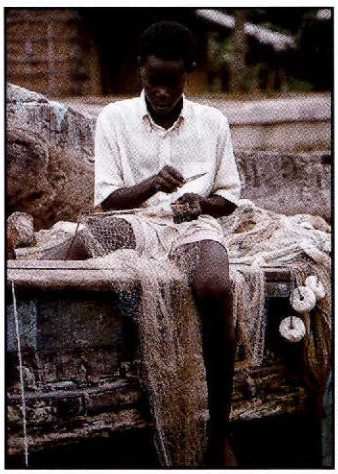
While Ghanaian officials hope the country's relative stability will help to establish it as a gateway to the region, they also feel that the more severe problems of many of its neighbors — and the fragile state of sub-Saharan Africa in general — rub off on Ghana's international image and diminish recognition of its strengths and the considerable achievements of its government and people.

AGRICULTURE

In agriculture, the mainstay of Ghana's economy, new exports like pineapples, tuna fish and cotton are complementing the traditional cash crop of cocoa. Ghana is Africa's second largest producer of cocoa, the country's second biggest national export. And there is greater and almost untapped potential for private investment in the country's agro-processing sector.

Agriculture makes up about 45 percent of GDP (including the fishing industry, which accounts for about 11 percent of agricultural output) and employs, directly or indirectly, about 60 percent of working Ghanaians. Most of these are small farmers growing staple crops, chiefly cassava, maize, rice, yams and plantain. Cocoa, as mentioned, is the dominant cash crop, accounting for 45 percent of exports.

Self-sufficiency is still a goal, and one that the country is close to meeting. "We have the potential to produce all that we eat if we overcome some restraints," says Ibrahim Adam, minister of food and agriculture. "One of the chief obstacles is a lack of credit for small farmers. We are trying to include a credit component in all our smallholder projects and the government is introducing a rural finance project through rural and development banks."



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Development's challenge is applying quality and intensity to all jobs — big and small

According to Adam, non-traditional exports are growing fast, and hold enormous promise. "Cotton has the greatest scope. It is grown in the north, where land tenure is not a problem," he notes. "The Investment Promotion Centre assists investors to acquire land. Ghana has also applied for a 10,000 ton quota for banana exports to the EU."

"The government has a target of an average 3.7 percent growth in agriculture to the year 2020, which would make a small surplus for export — allowing for population growth estimated at 2.6 percent a year. We aim to achieve this firstly by encouraging more private sector investment. Apart from cocoa, where we still have the marketing board, the role of the state in agriculture has been greatly reduced. Secondly, we are revamping research and extension schemes to bring the right technology to the farmer. Finally, we are looking at post-harvest management to reduce seasonal losses. We don't have enough storage and processing facilities," he explains.

Adam believes that the greatest potential is in agro-processing. "We have the land and know-how but we lack the processing plants. For example, we have three high-yielding varieties of cassava, but are not producing cassava chips for export, where there is a market now that Thailand's production is falling," he points out.

Fishing and aquaculture also present major agro-processing opportunities. The American firm Coleman has invested $23 million in freshwater fish farming for export.

Another notable investment is Astek, which produces fruit juice and concentrates at a plant in Nsawan, in the heart of the fruit growing area north of Accra. Astek moved from food canning to producing tetrapak food cartons and local mineral water in 1993, with the help of a loan from the Commonwealth Development Corporation, and by last year reached an annual turnover of about $5 million. "Ghana is the place to do business, especially for the pioneering investor — and agro-processing is one of the best areas," says Stanley Owusu, Astek's chief executive.

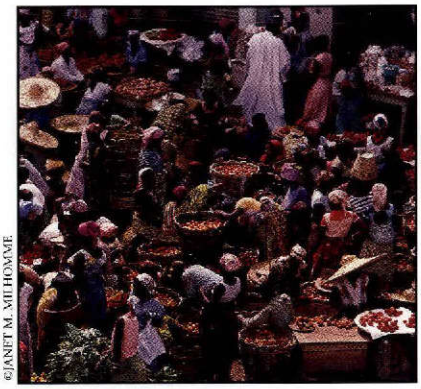
MINING

The mining sector has been a star performer since new laws in 1987 liberalized the industry, which now accounts for almost half of Ghana's exports. New investors from the U.S., Canada, Australia, South Africa and Britain have acquired concessions or rehabilitated old mines.

Ashanti Goldfields Consolidated (AGC) is 100 years old and is still booming. The floating of AGC shares on the Ghana and London stock exchanges has helped the company capitalize on the remarkable success of its mine at Obuasi (the world's 9th biggest) and become the first indigenous pan-African mining company.

Output at Obuasi is set to reach 1 million ounces annually by next year, and AGC's target is to reach 1.5 million ounces annually by the year 2000, making it the world's fifth biggest gold mine. "We have achieved average annual growth of 10 percent every year since 1987. Output is rising at the same time as reserves are increasing and that is very rare," says Sam Jonah, AGC's chief executive. "The mine has tremendous potential. Costs are coming down, and we are finding reserves in places not associated with gold."

According to Jonah, AGC is actively exploring some prospective properties in Ghana and is reaching further afield. "Outside Ghana we find that we are Africa's favored son. We are being offered choice land, many of these opportunities coming on the back of invitations by African heads of government."



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The give-and-take of open markets is a way of life familiar to all Ghanaians

AGC is currently exploring in Niger, Guinea, Mali, Senegal, Eritrea, Ethiopia and Zimbabwe, and is operating a mine in Mali in partnership with JCI of South Africa and the government of Mali. It has also formed a strategic alliance with International African Mining Gold Corporation, based in Toronto, to fund and manage exploration properties in West Africa. AGC recently raised $60 million for these operations. Financing is much easier since the company went public. "Since the flotation we have direct access to capital markets. This saved us about $1 million recently when we raised $185 million from a syndicate backed by Barclays," states Jonah.

Across the country, gold output is set to rise to 1.6 million ounces this year, and the Ghana Minerals Commission estimates that 1996 output will reach 1.84 million ounces.

Diamond production rose an estimated 60 percent last year, to 550,000 carats, and a further boost is expected as Ghana Consolidated Diamond, over which De Beers recently took control, completes its rationalization of the Akwatia mine. Canada's Nora Exploration has also made a fresh discovery.

INDUSTRY AND TRADE

Ghana already has some well-established manufacturing companies, and divestment of the government's holdings has allowed multinationals, such

as Unilever and Guinness, full control of their local operations. High interest rates and inflation have suppressed consumer demand over the past year, which is a major concern to the manufacturing sector after performing below most forecasts in 1994. However, the recently formed Private Enterprise Foundation is forging closer links between government and the private sector.

The state-owned Ghana National Trading Corporation (GNTC) recently divested its bottling company, allowing Coca-Cola to take over the management of its local operation. In September, Coca-Cola began a $19 million investment in a new bottling plant in Accra and training facilities for the whole of its West Africa operations. This follows a $20 million investment by Heinz in its Star Kist tuna canning operation.

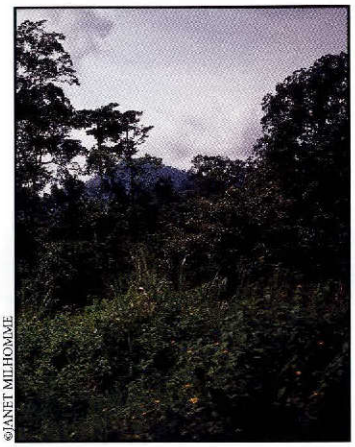
"We find these investments very significant," says Emma Mitchell, minister of trade and industry. "These leading companies are showing confidence in Ghana's investment climate."

"We are also making use of our raw materials," she continues. "We have a comparative advantage in having the only producer of aluminum ingots in Africa — Valco, the Volta Aluminum smelter which is powered by the Akosombo dam. This has brought several aluminum processors into Ghana."

The government is also encouraging local industry to process raw materials, especially in timber (the export of unprocessed timber is banned) and cocoa beans.



Cedi House in Accra is the headquarters of the Ghana Stock Exchange



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Ghana's forests are home to a variety of valuable hardwoods

"Unilever is keen to invest here. It is a safe place to do business," says Ismail Yamson, chief executive of Unilever Ghana, the second largest private company in Ghana after Ashanti Goldfields, with a turnover of over $200 million and profits of about $11 million last year.

Yamson is also president of the Private Enterprise Foundation, an employers association, which covers most sectors and acts as a powerful lobby for private sector interests. And while Yamson believes the reform process still has a long way to go, the investment climate is good — and getting better. "We have improved institutions and the legal framework to allow investors in. The bureaucracy still has not changed its attitudes enough, but that takes time. Most of the laws in Ghana are now transparent, and the new investment code compares well with other countries."

THE GHANA STOCK EXCHANGE

The Ghana Stock Exchange (GSE) began operations in November for trading in corporate equities and bonds and government securities. The flotation of Ashanti Goldfields, jointly listed in Accra and on the London Stock Exchange in April 1994, made the capitalization of the GSE the second largest in sub-Saharan Africa after South Africa. There are currently 18 listed stocks with a total capitalization of $1.9 billion as of the end of August 1995. There are three trading days per week and prices are listed on Reuters.

Nineteen ninety-four brought in local small investors and international fund management groups. "37,000 small shareholders bought AGC shares and most have held them. Social Security Bank will also attract the small investor," says Charles Asembri, marketing manager of the exchange.

"There are also about 20 foreign institutional investors with stocks worth about $50 million in the GSE, excluding Ashanti Goldfields," he added. Leading stockbrokers, such as Databank Brokerage, have already placed large blocks of Ghanaian equity with offshore emerging markets funds.

Privatization, especially in the banking sector, ensures that the market will grow. Shares in Social Security Bank, worth $70 million, will begin trading on October 13. Shares in National Investment Bank, State Insurance Corporation and



Star Kist's canning operation represents a $20 million vote of confidence in Ghana



G.K. Agama, Governor of the Bank of Ghana.

"The government has decided to stop being a large domestic borrower and allow resources to flow into the productive sector and the private sector of the economy. This will also bring down inflation and interest rates and in turn make investment more profitable."



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While the focus today is on technological skills, many traditional, high-skill crafts — like woodcarving — are considered valued and respectable vocations.

Aluworks, an aluminum rolling mill, are due to be offered later this year.

Listings by the private sector will continue to have an impact. The U.S.-based Pioneer Group Inc., is planning to raise up to $170 million by floating Pioneer Goldfields, which owns the Teberebie gold mine, Ghana's second largest. The flotation is due in November on both the Ghana and London exchanges.

The GSE also plans to develop a corporate bond and long-term debt market, and the Commonwealth Secretariat is providing legal advice on the development of mutual funds and unit trusts. In addition, the exchange is also making significant technical improvements. "We are moving towards a centralized clearing and settlement system to be developed by a Canadian computer company and an automated trading system is also planned," says Asembri. "We are currently creating a site on the Internet so that people anywhere in the world can access our database."

INVESTMENT LEGISLATION

The 1994 Ghana Investment Promotion Centre Act, which applies to every sector except mining and petroleum, offers the following:

- freedom for non-Ghanaians to establish and run any enterprises in Ghana, provided they invest a minimum of $50,000, or only $10,000 if in a joint venture with a Ghanaian. The minimum foreign capital must be $300,000 if it is an import-export or trading enterprise;
- a range of tax benefits and incentives, including: customs import duty exception for plant, machinery, equipment and parts; depreciation or capital allowance for non-machinery and equipment up to 50 percent; income tax holidays for 5 to 10 years; capital allowances for some sectors; full tax deductibility for research and development expenditures; and locational tax incentives for areas outside Tema and Accra;
- a corporate tax rate of 35 percent for new enterprises in all sectors except non-traditional exports (8 percent) and hotels (25 percent). In addition, the Investment Promotion Centre, with the approval of the president of the Ghana, may also negotiate special incentives for priority investments;
- guaranteed unconditional transferability in freely convertible currency of dividends or net profits, loan service payments, fees and charges for technology transfers and remittance of proceeds of liquidations;
- a guarantee against expropriation or compulsion of any person to cede his interest in any enterprise.

THE FREE ZONE ACT OF 1995

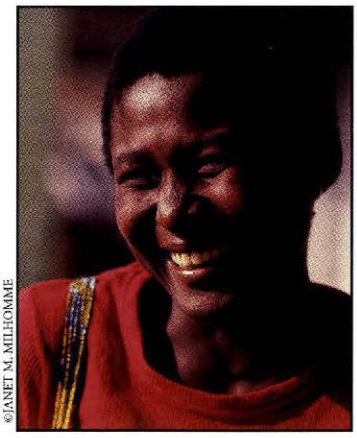
The free zones will be at the main ports, Tema and Takoradi. Under the act, goods between free zones and other countries are exempt from customs duties and laws.

The free zones offer the same guarantees to investors as the Ghana Investment Promotion Centre Act and free zones may be 100 percent foreign-owned. Incentives for free zone developers and enterprises include a 10-year tax holiday, income thereafter to be only 8 percent, with no withholding tax on dividends.

THE PAYOFF

According to Unilever chairman Ismail Yamson, the structural changes sought during the country's long reform era are already apparent — and becoming more evident every day. "We have a good government that is not corrupt and knows what it wants to do. It is an environment that I find very conducive and I think we have passed the stage of instability in Ghana."

The government is currently taking steps to counter the setback over the unsuccessful introduction of the value added tax. "Our track record of persistence in donor-funded programs is clear, and the new finance minister has made it his priority to reduce government borrowing, which will help to bring down inflation," says G.K. Agama, governor of the Bank of Ghana. "Even though there have been some mistakes on the way, our aim is to restore macroeconomic stability and that is why the donor consultative group has shown such positive commitment for the next two years." The continuing commitment of the donor community to Ghana is underscored by the IMF's offer of an Enhanced Structural Adjustment Facility.



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While such assistance can provide crucial budget support and an important show of confidence, the government knows that its ultimate importance is secondary when compared to the efforts coming from within the country. "We do not intend to rely on aid," concludes Agama. "Its purpose is to act as a catalyst." And while the government is proud of its hard won successes, it is keeping an eye on its long-range economic goals — broadly based growth rates raised to 10 percent by the year 2000, and a global reputation as the investment gateway to the entire West African region.

According to finance minister Peprah, truly making Ghana the investment hub of West Africa involves more than just slogans and programs or even laws — it involves changing attitudes. "I remember when I was the minister of transport and communications five or six years ago, I used to consider other airlines' requests to fly in and out of the country in the context of the survivability of the state-owned airline. Now I would be inclined to just make sure that there are enough flights. Our job is clear: to make Ghana the easiest and most friendly place in the region to do business."

SELECTED ECONOMIC INDICATORS

	1991	1992	1993	1994
NATIONAL ACCOUNTS		(annual percentage change)		
Real GDP (constant 1975 prices)	5.3	3.9	5.0	3.8
Agriculture	4.7	-0.6	2.8	1.0
Industry	3.7	5.7	4.8	2.8
Services	6.3	7.7	7.0	6.6
		(percentage of GDP)		
Gross Investment	15.8	12.8	14.8	15.9
Public Investment	7.7	8.5	9.9	11.5
Private Investment	8.1	4.3	4.9	4.4
National Savings	9.3	4.2	1.4	7.3
Public Savings	3.2	-2.2	-0.9	4.7
Private Savings	6.1	6.4	2.3	2.6
MONEY & PRICES		(annual percentage change)		
Broad Money	27.2	50.3	27.4	46.2
Inflation	18.0	10.1	25.0	24.8
Treasury Bill Rate (91-day)	29.2	19.4	31.0	31.0
		(indices)		
Terms of Trade (1984=100)	77.0	71.0	62.5	72.7
Real Exchange Rate (1984=100)	307.0	339.0	423.0	515.0
Exchange Rate (cedis/US$)	375	437	649	956.6
NARROW FISCAL ACCOUNTS		(percentage of GDP)		
Total Revenues & Grants	15.2	12.2	18.3	24.5
Tax Revenue	12.4	10.0	12.9	15.9
Non-Tax Revenue	1.4	1.1	3.8	7.8
Divesture	-	0.2	2.1	5.2
Grants	1.4	1.1	1.7	0.8
Total Expenditure & Net Lending	13.7	17.0	20.8	22.3
Current Account Deficit	3.2	-2.2	-0.9	4.7
Narrow Budget Deficit (IMF)				
Including Grants	1.5	-4.8	-2.5	2.2
Excluding Grants	0.1	-5.9	-4.2	1.4
Enlarged Budget Deficit	-4.0	-10.7	-10.8	-6.8
BALANCE OF PAYMENTS		(millions of US dollars)		
Merchandise Exports (fob)	997.6	986.3	1063.6	1226.9
Merchandise Imports (cif)	-1411.6	-1589.0	-1888.2	-1724.0
Trade Balance	-414.0	-602.7	-824.6	-497.2
Resource Balance	-554.2	-740.3	-964.0	-626.4
Current Account Balance	-454.1	-591.6	-815.1	-466.5
Capital Account (net)	624.9	467.3	856.4	629.4
Overall Balance	170.8	-124.3	41.3	211.0
GDP per Capita (US$)	447.8	436.0	374.1	322.7
Current Account Deficit (Percent of GDP)	-6.6	-8.6	-13.4	-8.6

Note: The narrow fiscal accounts excludes foreign project aid (both loans and grants) but includes program grants. Source: Government of Ghana; World Bank



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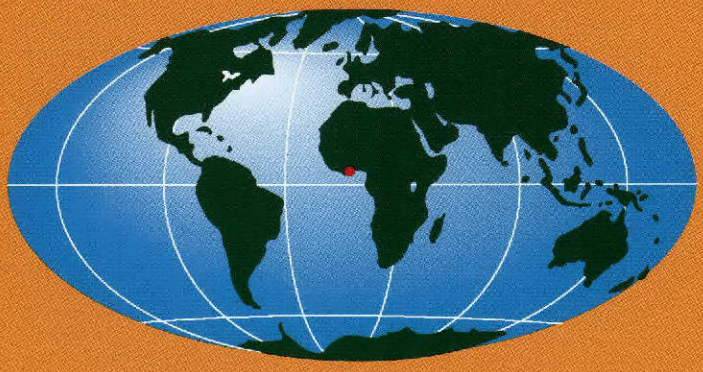


This profile was sponsored by the Ministry of Information of Ghana and written by an independent correspondent specializing in West African affairs.

Art Direction and design by Alexandra Tuller; coordinated and edited by Erik D'Amato; globe graphic by Mark Holechek.

"In the U.S., only about 20 percent of new contracts reach reasonable volume. You have to create about five new contracts to have one success."

U.S. Exchanges Pursue Emerging Market Options

BY K. MICHAEL FRASER

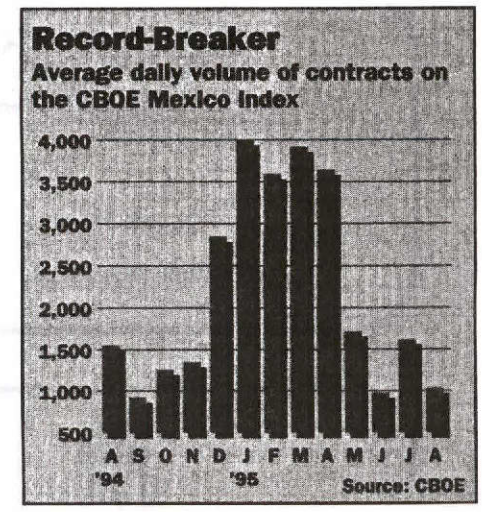
U.S. exchanges are rushing to list futures and options on emerging markets assets, but some of their contracts have been stillborn. To attract traders to its emerging markets contracts, the Chicago Mercantile Exchange (CME) announced plans on September 21 to create a new membership division.

The CME launched its emerging markets business in April, when it listed Mexican peso futures and options. By year's end, the exchange hopes to have regulators' approval to list Brazilian real and Mexican Brady bond contracts.

In the race for a share of the Brady derivatives market, Finex, the financial futures and options division of the New York Cotton Exchange, hopes to beat the CME with a different strategy and an earlier launch. Finex will base its futures and options on its own index comprising Argentine, Brazilian, Mexican and Venezuelan par bonds, rather than on individual bonds. It will trade the contracts in New York and on the Finex Europe floor in Dublin.

Meanwhile, the Philadelphia Stock Exchange, which already lists options on the American depository receipts (ADRs), American depository shares (ADSs) and stocks of close to 80 emerging market companies, is discussing emerging market equity index options. And the Chicago Board Options Exchange (CBOE) is joining with the CME in applying for regulatory approval to list futures and options on their index of 30 stocks listed in Mexico.

The CBOE already lists options on 18 Latin ADRs and ADSs on the CBOE Mexico Index, composed of 10 U.S.-listed Mexican ADRs, ADSs and country funds, and on the Latin 15 Index, which tracks the leading equities in Argentina, Brazil, Chile and Mexico. All these listings don't necessarily translate into viable contracts, however. "In the U.S., only about 20 percent of new contracts reach reasonable volume. You have to create about five new contracts to have one success," said Michael Gorham, the CME's head of international development.



The American Stock Exchange's (Amex) index of 30 Hong Kong-listed companies is only marginally successful, with a daily average of 217 options. And its index of 11 Israeli ADRs and U.S.-listed shares is a dud: after almost a year, volume averages only three options a day. Amex leaps, or long-term options, on its Mexico index also trade about three contracts a day. Amex isn't the only exchange with failed emerging markets contracts. Although the CME's Mexican peso futures are successful, its peso options have gone nowhere: in late September, open interest was 27 and volume was 16.

U.S. exchanges appear to be backing away from plans to list derivatives on emerging market stocks and equity indexes outside their time zone.

"Interest in Asia is very strong," says Leo Melamed, chairman emeritus of the CME and an advisor to its emerging markets committee. "But the Asian markets are very competent in opening their own contracts, and because it's a separate time zone, the chances of an American market succeeding are not great." EM

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Karlsruhe, Federal Republic of Germany

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Hypothekenbank in Essen AG

DM 1,500,000,000

Floating Rate Notes of 1995/2000
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Wilmington, State of Delaware, United States of America

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Munich, Federal Republic of Germany

DM 100,000,000

5,25% Bearer Bonds of 1995/1998

UNIBANCO
Unibanco – União de Bancos Brasileiros S. A.
São Paulo, Federative Republic of Brazil

DM 100,000,000

8 3/4% Bearer Bonds of 1995/1997

DIE ERSTE
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First Austrian Bank
Vienna, Republic of Austria

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DePfa Finance N.V.
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IMF Update

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 37

Fund Admits Need for Better Disclosure

BY ANTHONY ROWLEY

The IMF learned two important lessons from the Mexico crisis — first that the Olympian detachment which the fund has long cultivated toward markets does not exactly help it to judge country risk, and second that emerging markets must ensure that economic regulation marches in step with the easing of capital controls.

"Markets can turn on a dime, so they need routine and continuous provision of economic data," acknowledges IMF director for policy development and review Jack Boorman. The fund is planning to reform the regime of data disclosure among members — developing countries especially — so that markets can make more informed judgments in future.

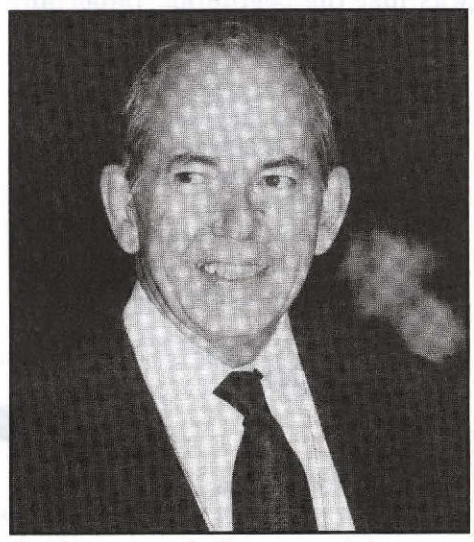
IMF officials claim that they were not taken completely by surprise by the Mexico crash, but if the fund knew more about impending dangers in Mexico than is generally supposed, why did it not sound the alarm earlier? "Because we deal with authorities and not with markets," says one senior IMF official. "That is why we could not reveal Mexico."

Fund officials are now busily engaged in establishing standards for the publication by all IMF members — developed and developing countries alike — of the kind of macroeconomic data essential to an objective appraisal of country risk. At the top of that list are regular disclosure of official reserves and also balance of payments figures and data on capital flows.

IMF articles require member countries to provide the fund with data necessary for it to carry out its "surveillance" function. "But we do not have the legal authority to force countries to publish such data," an official notes. The IMF's economic surveillance is done once a year, in the context of the so-called Article 4 consultations on members' economies and then again for the twice-yearly *World Economic Outlook* publication. A lesson learned from Mexico is that surveillance needs to be continuous if it is to be effective.

To ensure this, the fund is currently working to secure members' agreement on regular publication of country data by national statistical agencies. Some countries do already provide such data — but it is often very patchy with regard both to coverage and frequency so far as developing nations are concerned.

A "layered" program is planned, under which countries will be given a timetable for improving disclosure according to their access to international capital markets. Some 50 countries currently have access and will be at the top of the list. Once markets have access to regular and meaningful data, it will be largely up to them how they use it. The hope is that capital market practitioners will call up the central bank or finance ministry concerned if they spot a sudden deterioration in a country's reserve position or in some other vital statistic.



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Camdessus: pressing for open markets

Some believe that the IMF should publish the entire contents of its confidential Article 4 economic consultations with members countries — for the benefit of private capital markets (which nowadays are much larger aggregate providers of capital to the developing world than are official sources). However, conservatives appear to have gained the upper hand and this information is unlikely to find its way into the public domain.

The IMF may not have blown the whistle on Mexico as early as many would have liked, but managing director Michel Camdessus believes that the fund's action in helping shore up the country's finances prevented what would have amounted to a systemic crisis for emerging market finance around the world, and possibly a general reversion to exchange controls in Latin America.

Instead of being interrupted, however, capital flows have become "more selective" and investors show a "more discerning attitude," says Camdessus. If there are thoughts now about capital controls, they are not prompted by the desire to prevent capital from going out but by worries about the risk of too strong capital inflows into developing countries.

"I prefer this fear because it shows that countries are trying to prevent the risk of too rapid a success. For us what is important is to continue pressing for open markets and to do that reasonably and in line with the progress on macroeconomic stability and consolidation of the monetary systems and financial structure of a country," Camdessus added. EM

DESIRE TO BE LOVED MAY HAVE LED TO FUZZY THINKING

BY CRISTINA KATSOURIS

The IMF has lost much credibility for failing to foretell Mexico's peso crisis last December. Given the fund's privileged access to monetary officials in member countries, it was in a better position than most to read the signals and foresee the crisis. "Yet it did not appear to be of any great use," says one banker.

For many, this is a sign of the times. For much of the 1980s, the institution's importance as key lender to countries lacking commercial bank money gave it clout. However, since the return of voluntary lending to emerging markets in Latin America and Asia, the IMF's influence — and its importance as a prop to country risk practitioners — has diminished.

Some analysts believe that its desire to be loved — embodied in the initiatives and impassioned speeches of its likable managing director, Michel Camdessus — led to some fuzzy thinking and a slackening off in its normal vigilance over potential strayers in the international monetary system.

Many still regard its endorsement as invaluable on countries where it remains a key lender, such as in sub-Saharan Africa. Not just because of its influence, but also because the IMF remains the only source of analysis and information apart from the World Bank.

Elsewhere, it must sharpen up its act and adapt to changing international circumstances, though it has clawed back some respect for its management of the peso crisis.

The IMF has admitted as much in a recent post-mortem of its surveillance procedures post-Mexico. This found that annual Article 4 consultations — the main mechanism for assessing and advising on members' macroeconomic and structural policies — were insufficient for countries at risk.

A recent post-mortem found Article 4 consultations insufficient for countries at risk.

It also found that the IMF relied too heavily on members' data and information on policy matters and on their opinions. In many cases such data is deficient, late and irregular. In Mexico's case delays in reporting to the IMF between the presidential elections and President Ernesto Zedillo's inauguration were a critical factor in the fund's failure to foretell the crisis.

The IMF's executive board has recommended several measures to improve surveillance. The easiest include more focus on countries at risk — particularly those in which developments could have a spillover effect on others — and more attention to capital market developments, particularly private capital flows.

Where risks are identified during annual consultations, the board suggested IMF staff seek prompt follow-up discussions with members' monetary authorities. The board also recommended that IMF staff reports draw its attention to cases where deficient data and delays in its provision hamper IMF surveillance.

If the deficiency is due to lack of local expertise, the IMF could consider putting some technical assistance into the country. If the country refuses to cooperate, persuasion would be applied through different levels of the IMF hierarchy.

Just as important, the board said reports need to be more candid and pointed in analysis and language, with concerns about policies expressed more explicitly, though confidentiality will continue to be respected.

Bankers think the IMF should go further, by sharing more information and encouraging key borrowers to do the same. Some would like the IMF to pressure the latter into making quality data widely available regularly, and in a standard, comprehensible form.

The fund could make a start by bringing its own publications up to date, they say.

"There is often a mismatch between what the IMF desk officers know and what its statistical departments put into official publications," says Anthony Bottril, deputy managing director of the Washington-based Institute for International Finance.

Others would like to see the IMF's lending rationale explained more clearly, arguing that there are too many black boxes in the decision-making process. "We're still not clear why it decided to lend to Ghana mid-year, after the government removed a key plank of fiscal policy, yet more recently refused to lend to Bulgaria," says one London banker. EM

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TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK D



© IMPHOTO

Conable: wanted steak, got hash

The Overarching Purpose of Life on Mars

Even as the bank wrung its hands about the need for better communication, composition by hierarchy was the rule.

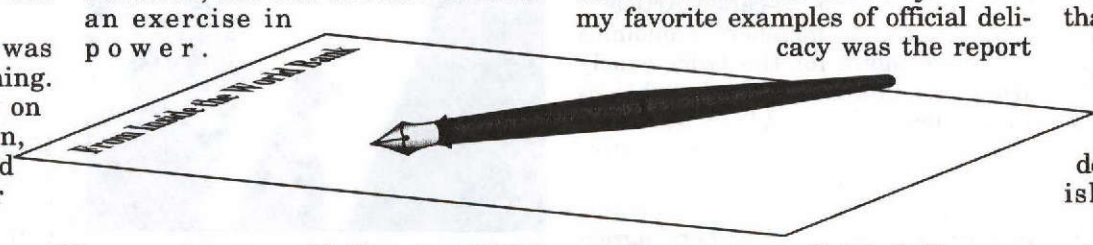
BY MICHAEL PREST

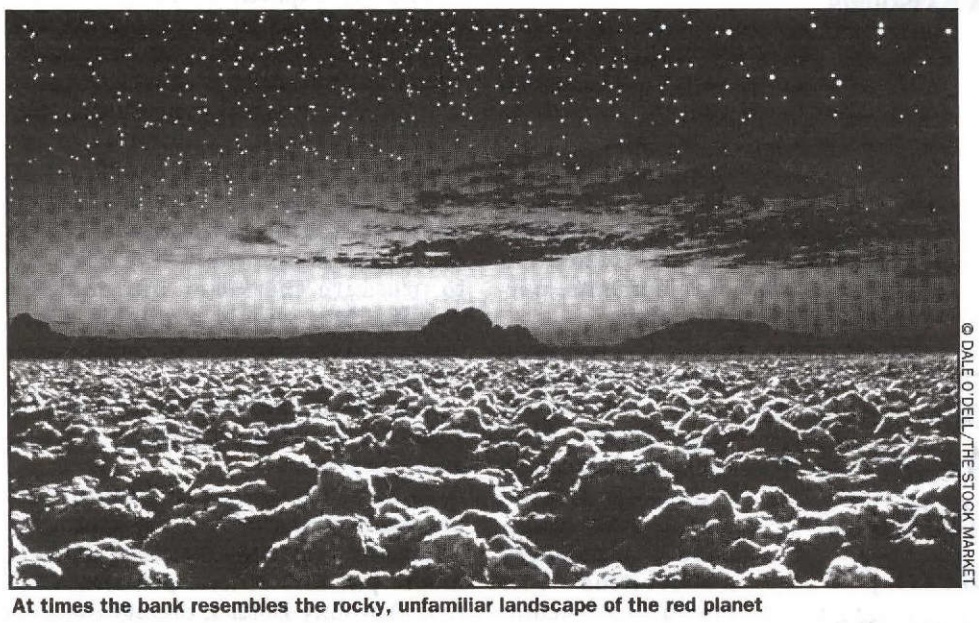
Nobody was more surprised than I when the World Bank offered me a job. As an economics journalist I knew a respectable amount about writing, a little about the bank, and nothing about bureaucracies. That this unpromising combination should qualify me to write speeches for the president of the World Bank was a clear sign that the age of miracles was not past.

But the bank was undeterred and I was unsuspecting. Between 1990 and 1995, when I did the unthinkable and voluntarily resigned, I wrote speeches, ghosted op-ed pieces, edited newsletters, compiled reports, fired off memos — in short, pumped out propaganda of all kinds.

What nagged me, however, was whether I was achieving anything. Here I was, riding comfortably on the bank's infamous gravy train, and I couldn't understand what I'd done to deserve it. Did it matter — a peculiarly arcane instance — whether we urged "poverty reduction" rather than "poverty alleviation?" Who in a developing country would notice or care if I suffered terminal writer's block?

The whole enterprise was imbued with a strange sense of detachment. There were days when we might as well have been on Mars. I'm sure many of my former colleagues feel differently. Working in the field gives you a healthy contact with reality and the results may be literally visible. But closeted back at HQ in the company of a word processor and superiors who always knew better, reality quickly becomes tenuous and even dangerous.





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At times the bank resembles the rocky, unfamiliar landscape of the red planet

Writers, of course, are a notoriously fractious lot who shouldn't be trusted with running anything, let alone a World Bank. And therein lies the problem. The essentially individual nature of writing sits uneasily with the essentially collective nature of bureaucracy. Both are fine on their own. But all too often, combining the two holds out as much prospect of a lasting union as a Hollywood marriage.

For writing was generally more a process than an art. Even as the bank wrung its hands about the need for better communication, composition by hierarchy was the rule. Clearance by unit, division and department heads was just the beginning. Important pieces, especially annual meetings speeches, had to be vetted by the barons who controlled bank politics. True potentates such as Ernie Stern — for too long a substitute president — could scupper anything with one acidic stroke of red ink.

Composition by hierarchy was justified on grounds of collegial consultation, but was at least as much an exercise in power. The result was succinctly summed up by then-president Barber Conable. Soon after I arrived at the bank he groused to me: "I start with a piece of good steak. By the time they've finished" — he waved in the general direction of the rest of the Main Complex — "all I get is a plate of hash."

The charmed circle of bank life is a natural breeding ground for acronyms and other short cuts familiar only to local residents. But even bank staff have difficulty keeping abreast of the latest agglomerations of initials. In April 1992, there thudded onto bemused staff members' desks a publication with the crisp title: *Two Thousand English-Language Acronyms found in World Bank Documents*. The mirth was compounded by the proud announcement on the cover that the volume was the work of a "Terminology Unit."

Impenetrable prose is not just the consequence of internal processes, however. External political sensitivities are equally influential, despite the bank's sometimes impervious appearance. The temptation to avoid calling a spade a spade is especially great when a member country experiences a little local difficulty. One of my favorite examples of official delicacy was the report on the second structural adjustment loan (SAL II to the initiated) to Yugoslavia.

It solemnly informed the bank's executive directors: "The second tranche release was delayed primarily due to the need for the Government to prepare and agree with the bank on a revised macroeconomic framework." You would never have known that war had broken out and the world was being introduced to "ethnic cleansing."

Nevertheless, there is something quite endearing about the bank's habitual circumlocutions. After a while it ceases to be odd that a problem is always a "challenge," or that despite great progress in development, "much remains to be done." Now, apparently, the bank's "overarching purpose" is no longer reducing poverty but being "an agent for change." As the phrases become second nature, writing resembles engineering: the phrases can be manipulated as modules to put a given set of points in the right sequence for a particular audience.

The true tragedy of the bank's unique variation of English is that it obscures the full value of the institution's work. You can rarely tell from what reaches the outside world that the bank is in the thick of events. I remember when the Soviet ambassador telephoned to say that he wanted urgently to see the president and personally deliver an important letter from his government. The letter was duly presented the same day.

It was a formal application to join the bank almost 50 years after the Soviet Union attended Bretton Woods. There was only one problem: the letter was unsigned. The flustered ambassador scurried back to his embassy and another letter was presented, signed with a flourish by one Mikhail Gorbachev. That letter marked a unique moment in history when effectively the entire world for the first time embraced the same economic system. I treasure a copy of that letter.

There were moments of high drama too. One afternoon I received a call from Moeen Qureshi, then senior vice president for operations, a position abolished about one million reorganizations ago. Could I possibly step his way if it were not too inconvenient?

I stepped his way, and Qureshi explained. Rajiv Gandhi had just been assassinated. Not long ago, he had privately assured Qureshi that, should he win the election then pending, he would follow bank advice and launch a sweeping liberalization of the Indian economy. It was crucial that India and the world be reassured that the bank stood behind the government at this difficult time. Could I draft a statement for immediate release?

What added spice to the drama and leavened the bureaucracy was the rumor mill. Modern communications have not always been the bank's strong point, but perhaps that it is because the grapevine is so efficient. With a network like that, who needs the Internet? The rule of thumb was that the more implausible the rumor, the more likely it was to be true.

Thus, stories last year that redundancies were pending became so persistent as to warrant an official denial. That settled it. Everyone knew that their job might be on the line. And sure enough, by the fall the bank reluctantly admitted, partly because of prodding by the staff association, that some 600 staff were to go.

The cumulative toll of such episodes on morale is easy to imagine. Yet many people regard these little ups and downs of institutional life as unavoidable and, in the bank's case, a small price to pay for pursuing the very honorable calling of helping to reduce (or relieve) poverty. I hope they are right and that miracles are indeed still possible. EM

Michael Prest was senior editorial counselor at the World Bank until his resignation in July.



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Dialogue

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 41

JAPAN'S EWING WITH A SOUL

BY KEVIN RAFFERTY

Japan may be an economic superpower, but it has not discovered its place in the world, says Seiji Tsutsumi. It is not a new idea, but what is unusual is to hear it expressed supercritically by one of Japan's richest and indeed legendary businessmen who has also won fame as a poet and man of letters.

"I am concerned about Japan's future in the 21st century. Not about its economic and business outlook, more about the future of Japanese society," he continues. "Right now, Japan is an economy-only society, which is the reason why it is so isolated in the world. Japanese cannot understand or foresee the real changes taking place in the world today because they have no standard or measure by which to judge, save for the value of increasing production capacity and expanding market share. These are no more the measures of judgment."

He is a shy man, nervously playing with a book of matches, though he doesn't produce any cigarettes. It may be the sensitivity of the artist who prefers to ruminate alone (or it may be a distrust of the media.) He has written:

There are monsters called
Mass-Communicationsaurus
They feed on dregs of words
They chuck away
Remains of justice
In old papers

Tsutsumi has a split personality. He writes under the name Takashi Tsujii, preserving his real name for the business from which he has now retired, at least officially, though we are sitting in a room in his Seiyo Ginza Hotel in Tokyo, all understated elegance as almost the most exclusive and expensive — $500 a night upwards — hotel in the world. It has nothing as vulgar as a check-in counter, just a very efficient bilingual manager sitting behind an antique writing desk who clearly knows each of the guests without having to ask their names.

He is the eldest son of the late Yasujiro Tsutsumi, politician and property owner, who built up a fortune on railways and real estate, then became a "Monopoly" style magnate in a series of coups when he prevailed on impoverished princes of the imperial family to sell him their estates immediately after the war. He paid up to a few hundred yen per square meter for land that is today worth billions. Hotels that he built on the imperial land became part of his appropriately named Prince chain.

The founding Tsutsumi retained many of his peasant manners — uncouth, hard-driving, used to getting his own way, womanizing — characteristics that he evidently did not pass on to his natural son Seiji. But then, Seiji Tsutsumi didn't inherit the empire. That was handed to the half-brother, the bastard Yoshiaki, very much a chip off the old block, who got the railways, the land, the hotel chain and the baseball team, which have all made him — give or take the odd billion dollars with rising or falling yen and property prices — the richest or second richest man in the world (the Sultan of Brunei excluded because his wealth, as he admits, belongs to the people of Brunei).

Seiji, the intellectual, who disappointed his father by flirting with Marxism at Tokyo University, got a rather rundown department store.

Not for nothing has the family been called the Ewings of Japan, after the famous telefictional Dallas family (though the Tsutsumis were around first). Art follows life. Seiji, using his pen-name, wrote a novel about a family called Nishigaki. Rape, incest, homosexuality and murder aside, it all seems rather like the Tsutsumi saga. Seiji might be Bobby Ewing, except that he is brainier and much more progressive.

"I always disagree with the status quo," he once said. It stood him in good stead as he built up his own small part of the family fortune, and developed the Saison group of 200 companies. This includes one of Japan's biggest department store chains, a leading supermarket group, the FamilyMart 24-hour convenience stores, a consumer finance arm, the 52-story Sunshine Building and, later, the Intercontinental Hotel chain. Seiji Tsutsumi's ventures had a dash and style lacking in those of other, boring Japanese businessmen. Shibuya became the fashionable place for Tokyo's young with-its because Tsutsumi supplied the trendiness with his Loft and Seed stores, including an indoor diving pool where would-be scuba divers could gain experience without venturing into Tokyo's traffic-infested waters. Four years ago, he quit the chairmanship of a group with sales of $40 billion but loaded with debt. The narrator of his novel, clearly Seiji Tsutsumi, laments: "I thought that it was true that I had no freedom. What imprisoned me was the organization that I myself had built. This organization had become one of the knots in an invisible net cast over the world, enveloping this 52nd floor office."

He regrets most of all that Japan has suffered a lost generation.

Seiji Tsutsumi clearly disagrees with his father's motto, "There is nothing in life but business." Now in his late 60s, though he looks 10 or 15 years younger, he is going public with his concern about the direction in which Japan is headed. His vision is much wider than the view from the top of the Sunshine Building or from one of his trendy stores, since it embraces culture, literature, politics and business.

He regrets most of all that Japan has suffered a lost generation: "Those in their 30s, 40s and 50s now are the products of the time of high growth. To them, economic growth was everything, and they sacrificed everything. I call them a lost generation." He pins his hopes on the young and on older business leaders who can recall the sacrifices during and after the war. He names Tasuku Takagaki, president of Bank of Tokyo, along with Yotaro Kobayashi, head of Fuji Xerox, and Gaishi Hiraiwa, the octogenarian former chairman of both Tokyo Electric and Keidanren, the powerful federation of economic organizations.


© RAFFOTO

"I am writing a book called a criticism of consumption society," Tsutsumi adds, based on his own experiences and lessons during and after the collapse of the bubble economy when, he admits, "Regrettably, in spite of my strong advice, two of my companies were caught up in the collapse of the bubble."

This is not an old man's lament echoing those from the time of the poet Horace that the world is going to the dogs and that the younger generation is worse, wickeder, more corrupt than ever. Tsutsumi pins touching faith in the generation coming up in the hope that money is not their only god.

Nor is it just the comment of a man too rich to understand the problems of making his way in the world. In his business life, Tsutsumi was eminently successful without being as bruising or brutal as his father or brother. He rails against a mere convenience society because he can see where it is leading, and he reels off frightening numbers of where the world is heading: "What will happen if all 1.2 billion Chinese drive cars? What kind of pollution will it create? Then there is the population increase, and the need to feed them and water."

For Japan, Tsutsumi is concerned with strengthening its culture, lest preoccupation with the purely economic lead to self-destruction. He has clearly thought a lot about this, and distinguishes between a "pidgin" or amalgam culture and a "creole" culture, which the U.S. clearly is, fearlessly mixing elements from different places. For Japanese nationalists who boast of its alleged racial purity, he points out that back in history, Buddhism and Polynesian and Eskimo influences helped to create Japan. Admiration for the great vitality of the U.S. is clearly mixed with worries about reducing everything to a lowest common denominator. "Having a strong baseball team is not really high grade culture," he comments.

He regrets the damage done to Japan's film industry and Japanese companies' rush to buy Hollywood studios "at 30 times what it would have cost to support the Japanese industry. Movies give some national identity, and foreigners should be prudent about cultural imperialism," he advises without gloating "told you so" about Sony and Matsushita's costly mistakes in Tinseltown.

These are not the comments of a nationalist, but of an internationalist searching for how Japan can contribute. It should not be by worship of Mammon or by ever greater industrial production; that way lies destruction of the planet, and possibly fatal wounding of the Japanese economy if it is tempted to protect itself by building up its armed forces. Tsutsumi advocates "a path toward creating a strong, cultural nation which is respected in the international community." He is so disillusioned with the country's politicians that he has turned to his business friends and journalists to set up a group that will lobby for change.

For his sake, and probably for Japan's, one must hope that this time, the story will have a happy ending. He says sadly: "In my literary works, my heroes tend to be those who are victims of economic progress." EM

South Afr

SPECIAL REPORT SOUTH AFRICA

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 42

IT'S A TOUGH STRUGGLE TO BUILD AN INVESTOR-FRIENDLY IMAGE

BY HOWARD PREECE

South Africa is still unable to attract more than a token amount of direct foreign investment. There are no official figures yet available even for 1994 — the Reserve Bank expects to have those by December this year — and necessarily, therefore, no clear picture of what has happened so far in 1995.

But Alan Hirsch, chief director for industry and technology at the Department of Trade and Industry, estimates that South Africa obtained direct investment of about 2 billion rand ($550 million) between the late April 1991 general election and mid-1995.

Even so, direct investment continues to form only a small portion both of South Africa's total capital inflows and of total gross domestic fixed investment (GDFI). For the 12 months to June 30, 1995, aggregate GDFI spending was an estimated R55 billion, although the great majority of that was accounted for by depreciation provisions.

In the first six months of 1995 net capital inflows were R9.8 billion. From July 1, 1994, to the end of June 1995 the total was R19 billion.

Net buying by non-residents of South African shares and bonds has been a key feature of capital inflows so far this year. According to the Johannesburg Stock Exchange (JSE) foreigners bought a net R3.85 billion of shares and a net R730 million of bonds in the eight months from January to August this year. However, loan funds for both the public and private sectors — with too large a percentage for comfort coming in the form of short-term potential "hot money" borrowings — accounted for the majority of capital inflows.

Scrap the controls and foreign investment will flow as local companies diversify.

There are important opinion differences about precisely why foreign contributions to new direct fixed investment have so far proved disappointing. The most commonly attributed reasons are that South Africa still has a highly uncertain political future, that it is wracked by horrendous levels of crime and violence, that it has high taxes and militant labor unions and that, overall, it is just not investor-friendly.

There is undeniably a great deal of truth in this claim. On a visit to South Africa in late August this year the prime minister of Malaysia, Mahathir Mohamad, said bluntly that taxation, wages, and inflation were too high and productivity too low for the country in general to be broadly attractive to foreign investors.

Carole Mason, chief economist for Investec, one of the country's most dynamic investment banks, is sharply critical of the government. She observes: "Their ongoing indulgence in a reverie that direct foreign investment will inevitably come South Africa's way independently of any active means of their part to attract it is both arrogant and misplaced." Mason prescribes a crash program of tax cutting, fiscal stringency, and privatization as part of a general package to promote both domestic and foreign investment.

But, as Hirsch has indicated, some direct foreign investment is taking place. Indeed it is notable that in spite of Mahathir's strictures Malaysia is a major source of such investment. Some R500 million is reckoned to have been injected into South Africa from Malaysia into property and leisure developments. In addition, Malaysian interests have taken a R275 million stake in the cape regional Boland Bank.

There have also been a spate of other small to medium fixed investments from a wide variety of countries — and there are many promises for developments to come.

Peter Longworth, the British consul-general to South Africa, says that the value of British direct investments in South Africa rose from R55 billion to R60 billion. But almost all of that increase is the illusory outcome of inflation. A number of leading U.K.-based companies have made new or expanded investment in South Africa, but British officials reckon that over the four years 1991-94 the real aggregate figure was only around R2 billion.

The Japanese government announced in July this year that it will pump R4.3 billion into South Africa in an aid package that will include two major infrastructure projects. However, as with so many of these kinds of promises, there is no indication over what period this money will flow. Nor is there an indication of how much will be in the form of loan credits as opposed to direct grants and, most importantly, how much will effectively be a subsidy to Japanese exporters rather than genuine aid to South Africa.

A similar situation applies with Germany. After a visit to Bonn in late June, minister of trade and industry Trevor Manuel said that German investment in South Africa would rise by R3 billion. Nothing more was heard of this ahead of the visit to South Africa in mid-September of German Chancellor Helmut Kohl.

The Washington-based Investor Responsibility Research Center said that in 1994 the number of U.S. companies with direct investments in South Africa rose by 29 percent to 206. There have been further rises this year with Levi-Strauss leading the way with a statement in August that it is to spend R31 million on a jeans factory in the Cape.

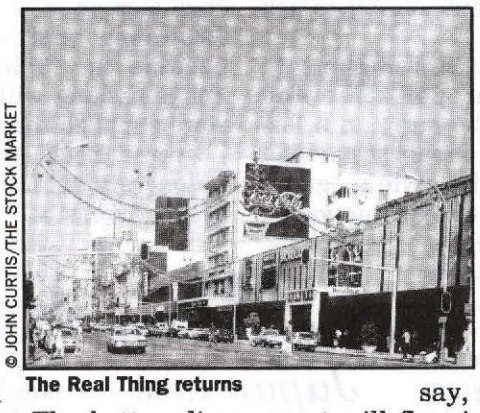


© IMPPHOTO

Barriers irk Manuel

Companies which have already returned to a direct presence in South Africa which they gave up in the sanctions years include Coca-Cola, IBM, Ford, Pepsi and Xerox. Top of the list is Pepsi which says it is ready to spend some R500 million over the next few years on expanding its local production base. Ford paid R100 million to regain control of its Samcor motor plant in South Africa.

Nestle of Switzerland has announced a R600 million expansion and modernization plan for its East London plant, to be completed within a maximum of four years. Hirsch is hopeful that a Taiwanese consortium will invest "over a billion dollars" in a huge synthetic fuel development.



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The Real Thing returns

To date, though, this is all talk and no action. The bottom line is that direct foreign investment in South Africa has been disappointing. The popular view is that the country is both politically and financially suspect. But those criticisms are regarded by many domestic and foreign political and business leaders as too simplistic. This group urges that a massive negative to foreign investment is the extraordinary concentration of economic power within the country. A study by a leading South African investment analyst, Robin McGregor, claims that over 75 percent of the total market capitalization of the JSE is controlled by five mega-groups: Anglo American, Rembrandt, Old Mutual, Sanlam and Liberty Life.

Cyril Ramaphosa, the secretary-general of the African National Congress (ANC), the dominant political party in the country, talks of these five having a "stranglehold" on the economy. That, it is claimed, enables local cartels and monopolies in many areas of business to effectively make it impossible, or at least extremely daunting on a risk-reward basis, for international competitors to set up production in South Africa in opposition to domestic interests.

This argument, which has been particularly pressed from the U.S., has found much support among leaders of the ANC.

Says Manuel: "At a time when elsewhere in the world markets are opening up and boundaries are dissolving, South Africa is raising barriers to entry by perpetuating the unfair domination of the local economy by a clutch of friends from the same neighborhood."

In a similar vein, at the end of July, U.S. deputy assistant secretary of state for African affairs Regina Brown told an American international trade commission hearing that, "the biggest impediment to U.S. investment in South Africa is the cartel structure of the economy."

But the senior executives of South Africa's "big five" strongly reject this attitude. They counter-claim that the Americans in particular are looking for easy pickings and that concentration of economic power arises from 35 years of exchange controls which have forced the South African corporate giants to invest primarily inwards rather than internationally. Scrap the controls, they say, and foreign investment will flow into South Africa as local companies diversify energetically and in billions of rands across the international scene.

For the present however, the government and the Reserve Bank are far too nervous to take that step. So, in the interim stalemate seems likely. EM

For more on South Africa, please turn to ps. 45 and 46.

FIRST NATIONAL BANK IN THE NEW SOUTH AFRICA

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One of the greatest challenges currently facing South African banking comes from the foreign banks which are setting up local operations. But FNB is tackling this head-on through its entrenched position in the local market and its range of offshore operations.

FNB's subsidiaries are positioned in a number of different countries and offer a diverse range of services to clients. Its subsidiaries include the Henry Ansbacher Group, FNB Asia, FNB Zurich, its representative office in New York, FNB Botswana, FNB Namibia and FNB Swaziland. The bank's global reach is further extended by its correspondent relationships with 2000 banks in more than 120 countries.

One of FNB's major strengths lies in its position as a financial intermediary where it handles the financing, payments, collection and disbursements for projects. FNB is an appointed financial intermediary for the European Community Investment Partners Programme, which facilitates the creation and establishment of joint ventures between European Union countries and other developing countries, now including South Africa. FNB is also involved with entrepreneurial development and the development of the emerging business market through direct financing and guarantee schemes.

FNB has participated in a number of large syndicated projects in Africa, including the Lesotho Highlands Water Scheme and aluminum producer Alusaf. It also recently committed billions of rands to the development of infrastructure, education, health and housing in the country over the next five years through its focused Reconstruction and Development drive.

FNB's immense knowledge and expertise in the area of trade — particularly the financing of imports and exports and the assumption of payment risk — has positioned it to serve all the financial requirements of businesses seeking to trade with southern Africa and abroad.

FNB has recently been involved in several international financing deals. In February the bank announced that it had raised more than $200 million (R700 million) through a one-year syndicated revolving credit facility mandated to Fuji Bank. A further $100 million was raised for FNB in a deal mandated by Fuji Bank in August. Both facilities will be used for general funding purposes.

Another deal this year saw FNB reach agreement with Bank of Boston and Export-Import Bank to provide it with a line of export credit funding to the value of $10million (about R35.5million). This was the first agreement for export finance between First National Bank and a U.S. bank. It will facilitate export credit funding for extended periods for imports of new capital equipment from the U.S. — at very competitive rates. There is much more international participation in the structured finance area, where existing and new players now compete for small business. To meet this challenge, FNB is drawing on its extensive network of international links and its state-of-the art technology systems. FNB has been built on the foundation of relationship banking and has always believed that the needs of its clients must be met as efficiently and effectively as possible.



First Place, Johannesburg: the head office of the First National Bank Group.

FNB's Custodial and Securities Services Division was conceived in 1990 following the formalization of the South African securities markets. The division is the principal provider within the Group of custody and settlement services for all types of traded securities to local and foreign institutional investors and fund managers, as well as individuals via the branch network.

FNB, which has been awarded 70% of the total provincial government banking business, now handles banking business for seven of the nine provinces in South Africa. It is sole banker to the Free State, KwaZulu/Natal and the Eastern Cape; primary banker to the Western Cape; handles the paymaster general accounts for the Northwest and Mpumalanga governments; and operates the revenue and exchange account for the Northern Transvaal.

Through its merchant banking arm FirstCorp, FNB is also involved in the pivotal issue of high level black economic empowerment through a dedicated business unit. Its involvement varies from deal to deal and ranges from an advisory role to taking an equity stake in the enterprise, lending money or both. For the emerging entrepreneur, FNB's Small, Medium and Micro Enterprise activities have put hundreds of small businesses on the map, creating thousands of jobs in the process.

FNB maintains an unrelenting pursuit of service excellence and last year was named the top provider for the fourth consecutive year of sub-custodial services in South Africa by *Global Custodian*.

Regarding developments in the electronic banking arena, this is one of the most exciting areas at the moment and has seen great gains through the bank's sophisticated technological innovations. FNB has been rated by a leading stockbroker in an independent report as the leading South African bank from an information technology point of view. FNB has also recently been acknowledged as one of the "Global Top 100" technology user companies in the U.S.'s *Computerweekly* annual survey.

FNB has been committed to the process of change in the country for several decades. Its empowerment drive began with an inward focus some 30 years ago, when it became the first bank to employ a group of colored clerks. Then it was first to appoint a black teller and a woman manager. It was also the first bank to develop an equal opportunity programme and published its affirmative action targets almost a decade ago.

FNB has an unmatched reputation for integrity, reliability and a commitment to providing a quality of service that has gained the trust and respect of all the major players in South Africa and the international trade and financial community.

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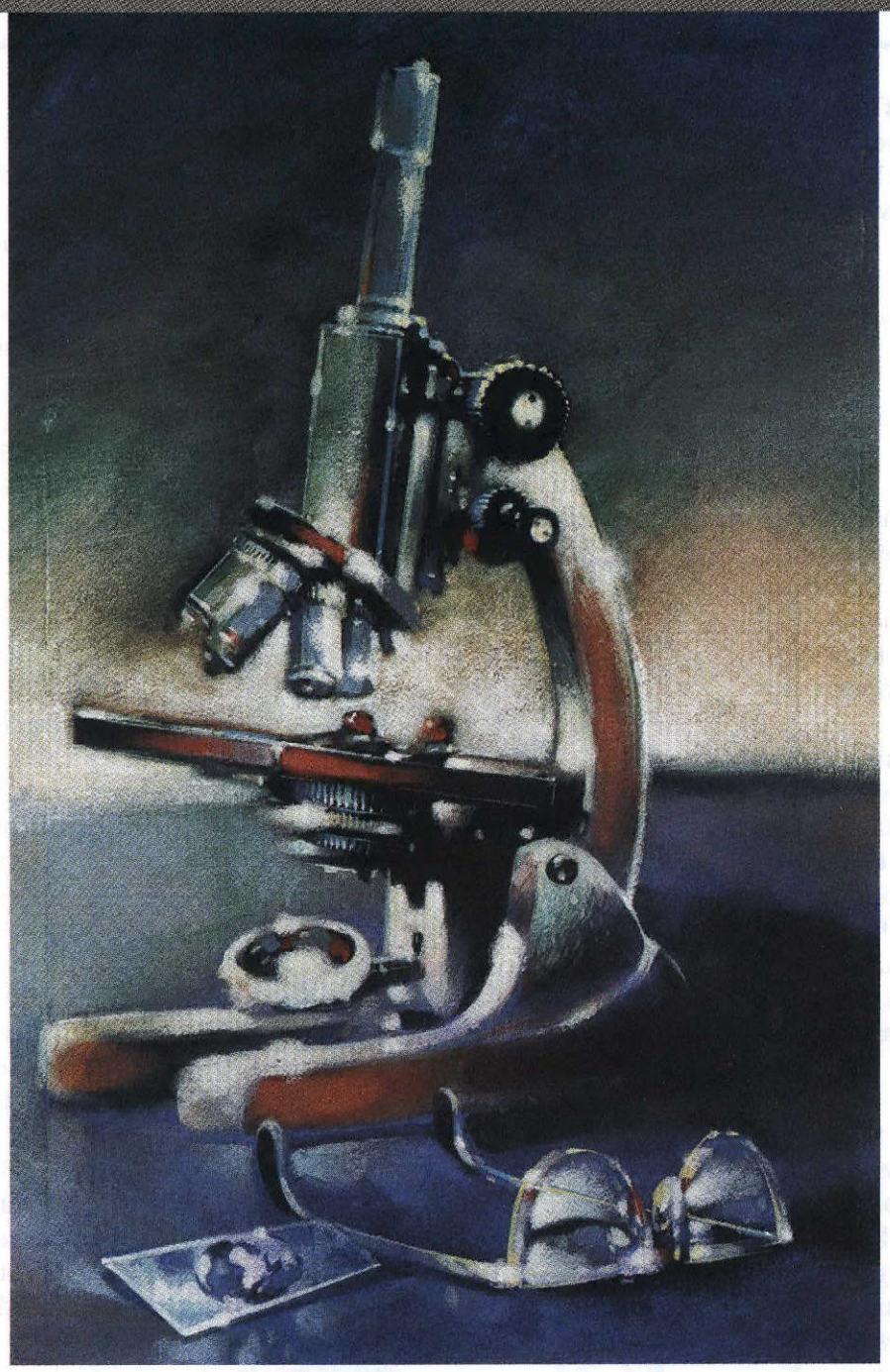

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South Africa

ROW OVER "BIG FIVE" MARKET LOCK HEATS UP

BY REG RUMNEY

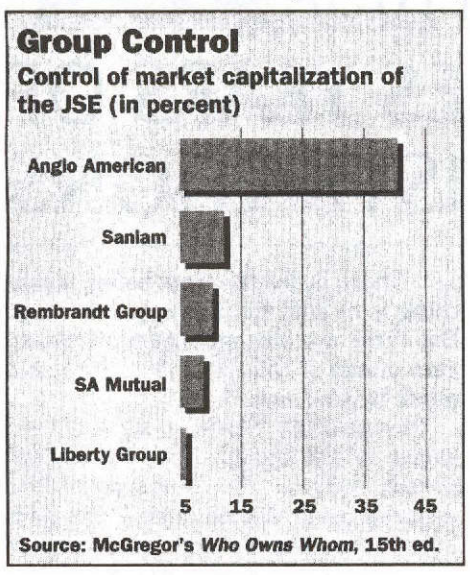
As South Africa's first non-racial local government elections draw near, concentration of economic power in a very few white hands has again flared into public debate.

The controversy has simmered since the African National Congress metamorphosed from a socialist liberation movement into a political party with a more market-oriented outlook. The normally pragmatic trade and industry minister Trevor Manuel has turned up the heat, making threatening noises in recent speeches which critics characterize as vote-grabbing rhetoric.

Manuel's department is drafting a new competition bill to reform South Africa's largely ineffectual anti-trust law. Manuel has promised it will champion small business, particularly black business, against anti-competitive behavior by business giants.

Further, he has targeted conglomerates, charging that concentration of ownership and domination of markets and industries is hindering the new government's reconstruction and development program, a grand plan to right the economic ills left by apartheid.

Ownership of everything from chicken farms to financial services to pharmaceuticals at the factory, wholesale or retail level, said Manuel, was shared by five or six conglomerates. "The conglomerates have ensnared the market. There is no way into the South African economy for foreign direct investors — or local entrepreneurs."



Manuel has relied on Robin McGregor's *Who Owns Whom*, the comprehensive reference on Johannesburg Stock Exchange-listed companies, and one of the few sources not linked to the major companies.

McGregor states that the top five groups — Anglo American, Sanlam, SA Mutual, Liberty Life and Rembrandt Group — control about 76 percent of the Johannesburg Stock Exchange (JSE) market capitalization. Anglo American has absolute control, according to the book, of about 38 percent of the market cap, and significant influence over a further two percent — a figure disputed by Anglo, which has previously admitted to a still high 30 percent.

In reaction, Anglo American Corporation executive director Michael Spicer claimed government, not conglomerates, had a stronghold on the economy through its control of a 50 percent majority of all fixed assets, many of them statutory monopolies.

Anglo American has a market capitalization on the JSE of around R47 billion ($12 billion). Critics, however, charge that size is not the issue. They say the power of conglomerates, such as Anglo, is spread through a web of interlocking shareholdings into every corner of the economy, their clubbiness reinforced by the preponderance on boards of a small group of white males.

Spicer has dismissed complaints about barriers, pointing to investment in South Africa through several recent joint ventures by foreign companies, such as Daewoo, with Anglo and other conglomerates.

U.S. privatization lawyer Ronald Roberts says this is indicative of the problem: the only competition conglomerates are happy with is joint ventures.

Further, he says, the JSE lacks rivalry because of conglomeration and cross-ownership of listed entities. Hostile takeovers which penalize conglomerate inefficiency elsewhere are rare.

Competition board chairman Pierre Brooks notes the only hostile takeover recently, of mining company Randgold, was made possible by the voluntary unbundling of conglomerate Barlow Rand.

The conglomerates are in the spotlight. But to get an idea of what the bill might contain after the rhetoric has died down, one could do worse than note what Brooks has said. Brooks has not ruled out dismemberment of conglomerates — as a last resort.

Brooks thinks a reorganization of the JSE, and of the law, could effect efficiencies. A starting point would be to force any company in control of, say, a distribution network to allow outside companies to use that network.

But he and Manuel have noted that anti-trust law cannot stand aloof from other decisions that impact on policy. This would seem to imply, at the least, exchange control abolition before any dramatic steps are taken. EM

SPECIAL REPORT
SOUTH AFRICA

QUIET REVOLUTION AT ILLIQUID JOBURG BOURSE

The quiet revolution now under way at the Johannesburg Stock Exchange will, it is hoped, not only give investors a level of protection similar to that of major markets. With the expected abolition of exchange control, it will also open the way for the conglomerate grip on the JSE to be loosened.

The JSE is one of the most illiquid bourses in the world. According to Ernst and Young's David Thayser, the value of shares traded as a percentage of market capitalization has historically remained in single figures. For the larger exchanges in the U.S. and U.K., this figure is more than 50 percent. The resultant thin trading raises the question: are the prices on the JSE truly representative of underlying value?

The JSE is now addressing the problem in its new listing requirements, introduced in July this year. Among these are a more stringent definition of what constitutes public share ownership and new minimum spread requirements. Companies now must have a 10 percent public shareholding, with a minimum of 300 shareholders.

Left untouched is the question of pyramid companies, much criticized for allowing control of listed companies by shareholders who actually have a small percentage of the underlying company. Ironically, they are now seen as a vehicle for empowerment of the historically disadvantaged blacks. The JSE's new regulations note only that they "require careful control."

The new listings requirements are part of a timetable of deregulation which so far is right on track, says JSE president Roy Andersen. They are designed, Andersen continues, to bring the JSE in line with international markets as well as the needs of the new South Africa.

On November 6 of this year, brokers will segregate their funds, with a separate trust fund for client's money. On November 8, new capital requirements will be introduced for stock brokers. The requirements will then comply with European Union directives. Also, brokers may move from individual membership with unlimited liability to corporate membership with limited liability.

The JSE still uses the "open outcry" system of trading.

At the same time, banks and other financial institutions, as well as foreign brokers, will be allowed to own broking firms, thus expanding the JSE's membership.

The JSE still uses the "open outcry" system of trading. By March next year, automatic trading on the JSE should begin. On that date, says Andersen, the JSE will also move to fully negotiated brokerage and dual capacity, where brokers act as principals as well as agents.

Many will miss the human interaction of floor trading, but the main advantage of screen trading is greater certainty that the customer gets time price priority because there is an earlier audit trail. It is also quicker, easier and there is a more accurate price fix. It might also make spotting insider trading easier, but Andersen points out that identifying insider trading is not the problem. Faulty legislation is to blame for there never having been a successful insider trading prosecution by the securities regulation panel. However, there are two cases with the attorney general at the moment, and the finance minister has set up a subcommittee to look into the matter.

Andersen says dual capacity, the new listing requirements and screen trading will all help liquidity.

However, it represents a limited solution without the abolition of exchange controls on residents, something which the governor of South Africa's Reserve Bank, Chris Stals, has vowed to do — when the time is right.

Broker David Shapiro of Frankel Pollak welcomes the moves as extremely positive. Dual capacity and automated trading will increase turnover quite dramatically, though making markets does not necessarily mean making money will be easy. Shapiro says they will mean a shakeout among broking firms. "The old rules protected only the weak." EM

—Reg Rumney

South Africa

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 46

SPECIAL REPORT SOUTH AFRICA

END OF SANCTIONS RELEASES YEARS OF PENT-UP HOPES AND FRUSTRATIONS

BY HOWARD PREECE

The South African economy is now showing many positive and much-needed developments. There are still, however, massive sociopolitical problems to be overcome and the country requires years of sustained economic advance before a stable and secure democratic future can be assured. That is a formidable challenge.

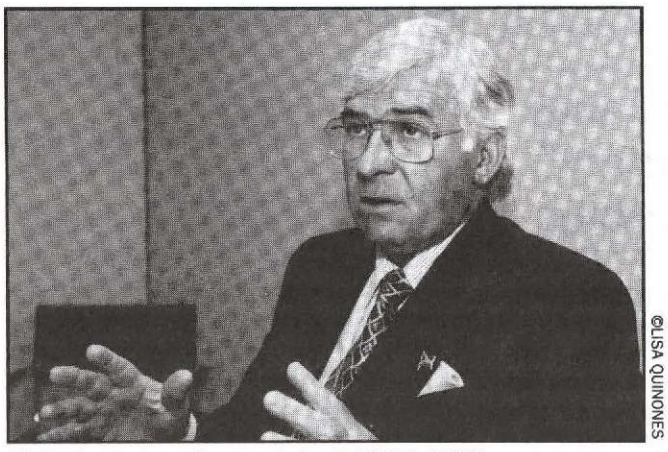
Reserve Bank governor Chris Stals warns: "The macroeconomic limitations on growth, ingrained in the system through many years of distortion and uncertainty, are now being exposed whenever the overall growth rate reaches for levels beyond 3-4 percent. These constraints confine the sustainable growth of the economy to a level that is much too low to create sufficient jobs for the gainful employment of the growing labor force."

For all that, though, there are a number of key features on the plus side of the economy.

Real growth in gross domestic product of around 3 percent now seems attainable in 1995. At worst GDP will increase by some 2.7 percent. Even the lower scenario represents the largest rise in GDP since 1988 and would be only the second year since 1984 that economic growth exceeded 2.5 percent.

Of course, this growth rate is still inadequate. GDP needs to rise by at least 4 percent a year on average to find jobs for the 300,000 new entrants annually to the labor market — and that is without making any consequential reduction in the already horrendous level of unemployment. Over 40 percent of potentially economically active South Africans have no full-time formal employment, although around half of that enormous group have some kind of work in the burgeoning informal sectors of the economy.

Minister of finance Chris Liebenberg offers some measure of hope, however, by predicting a 4 percent rise in GDP in 1996. Liebenberg also observes, accurately but in rather cold comfort: "In a way I am actually quite glad that our growth has so far taken place slowly. That creates opportunities for the necessary infrastructure to be put in place to make higher growth sustainable."



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Liebenberg sees a 4 percent rise in GDP in 1996

Inflation continues to be reined in and is set to be fractionally under 10 percent in 1995 (it was 9 percent for the 12 months to July), the fourth consecutive year in which the rate has just been contained to single-digit levels. That follows 18 straight years (1974-91) during which the annual inflation rate was more than 10 percent, and in which the average yearly rate was close on 14 percent.

Real gross domestic fixed investment (GDFI) picked up significantly in 1994 — there was an increase in real terms of 7.1 percent — and that trend is currently on an accelerating course. The improvement in GDFI this year will approach 10 percent.

The foreign exchange rate of the rand also has been much firmer than generally forecast after the abolition on March 13 of the dual currency financial rand system (finrand).

The finrand effectively operated as an exchange control mechanism to insulate the country's precarious gold and foreign exchange reserves from the effects of the buying and selling of South African assets — trade excluded — by foreigners. This means that non-residents are no longer subject to exchange controls although residents, companies as well as individuals, still face comprehensive controls.

The fact that the exchange rate of the commercial rand depreciated by only 3.9 percent between June 1994 and June 1995 against a weighted basket of major currencies — a depreciation less than the inflation differential — can reasonably be seen as a strong vote of confidence by foreign bankers in South Africa. That should be qualified, though by noting that the rand exchange rate fell sharply in the first half of 1994 and also that real interest rates in South Africa, that is, nominal rates less inflation, are today higher than the levels obtaining in almost all the leading industrial nations.

Curious as it might seem, nearly every leading economist in both the public and private sectors in South Africa warmly welcomes the projected record current account deficit for 1995. The crucial point here is that this deficit reflects two vitally important and fundamental changes for the better in the whole situation of the economy.

The first factor is South Africa's very ability to run a current account shortfall. In the long sanctions years — from 1985 through to 1993 inclusive — it was simply not possible to do this. The country was compelled year after year to make large repayments of foreign debt, and this could be done only by ensuring that the capital outflows on the balance of payments could be financed by continuing surpluses in the current account. In other words, a hefty portion of gross domestic savings had each year to be diverted away from increasing or modernizing the real productive base of the economy and used instead to reduce obligations to foreign creditors.

"The South African economy is growing, real interest rates are high and capital is flowing in. Hosanna!"

In aggregate, net capital outflows for the nine years 1985-93 totalled over R50 billion, approximately $16 billion on the weighted average rand-dollar exchange rate for that period. That overriding constraint on the total conduct of economic policy — which contributed heavily to the severe decline in the ratio of gross domestic fixed investment to gross domestic product from 26.8 percent in 1983 to 15.4 percent in 1993 — has now ended.

South Africa's historic non-racial, universal franchise general election of April 1994, which led to the formation of a government of national unity headed by President Nelson Mandela, resulted in the final removal of all trade and financial sanctions against the country.

That in turn means that South Africa is at last able to attract substantial new capital inflows and can thus use foreign savings to supplement its own resources in rebuilding and strengthening its productive capacity. For the 12 months to end-June 1995 net capital inflow was R18.6 billion (more than $5 billion).

This process must necessarily produce a current account deficit. In the first half of 1995 that deficit was R5.6 billion and a level approaching R10 billion is expected for the full year.

What is primarily fueling this deficit is an explosive rise in imports — the physical quantity soared by 45 percent between the second quarter of 1993, when the economy finally moved out of the recession that began in late 1989, to mid-1995. This important surge has been especially triggered by a major inflow of foreign capital equipment and machinery, an inevitable accompaniment to the fixed investment process of expanding the capital stock of the economy and, equally essential, making the non-primary sectors of the economy far more internationally competitive.

That is why the exploding deficit on the current account of the balance of payments is widely seen as cause for rejoicing rather than regret.

Says Brian Kantor, professor of economics at the University of Capetown: "Households and firms have become confident enough to spend more, especially on investment goods. Spending has grown more rapidly than output and so imports have increased faster than exports. The South African economy is growing, real interest rates are high and capital is flowing in. Hosanna!" There is, for the time being, something to be said for that euphoric view. But there are also great potential dangers ahead if this situation continues much beyond, say, late 1996.

Fortunately Stals is all too well aware of the perils that could befall South Africa. He cautions: "The experience of Mexico during the past year provides a stark warning to other developing countries of the risks involved in the high degree of capital mobility in the present growing, flexible international financial system. The Mexican experience also serves as a warning that the international capital markets can severely punish developing countries when they are perceived to follow non-sustainable domestic policies."

Adds Stals: "Foreign capital is needed to supplement the scarce savings in the domestic economy. But prudence and past experience warn against the imminent danger of a rising tide of short-term international indebtedness. An appreciation of the exchange rate of the rand can make a contribution to the important price stabilization objective, but it will at the same time harm the international competitiveness of the economy." EM

Continued growth from South Africa's largest Merchant and Investment Banking Group.

	31 March 1995	31 March 1994
	US$000	US$000
Capital employed	627 507	340 634
Assets under administration[a]	6 532 799	5 319 640
Total assets	4 240 252	3 152 691
Income after tax	49 626	27 469
Capital adequacy ratio	21,2%	15,8%
World ranking (capital)[b]	495	800

a. Includes on balance sheet assets and assets managed on behalf of third parties.

b. Ranked using qualifying Tier 1 Capital of $200m and $496,8m as at 31 March 1994 and 1995 respectively. US$/ZAR exchange rates of R3,48 and R3,60 as at 31 March 1994 and 1995 respectively were used.

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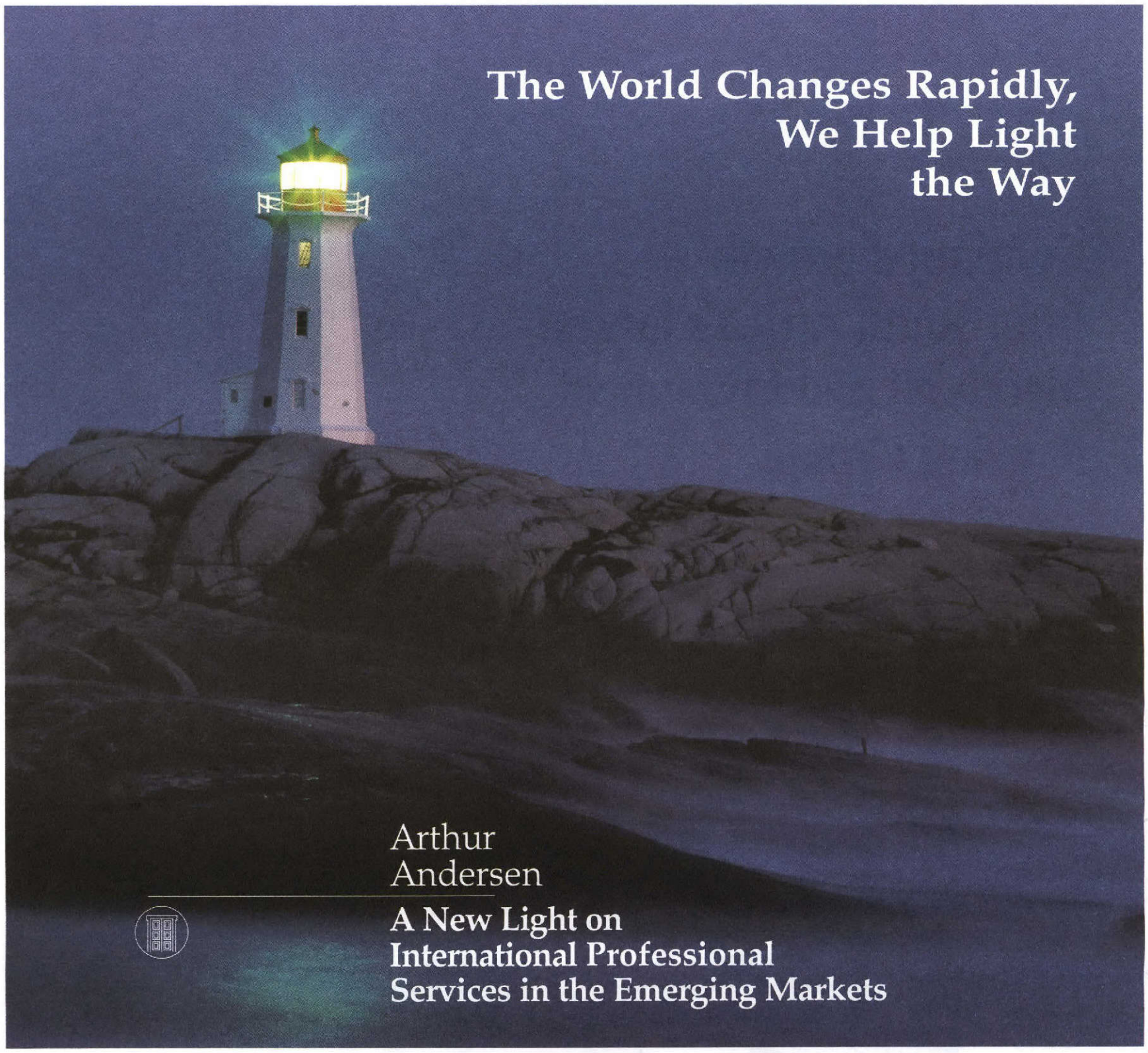

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Features

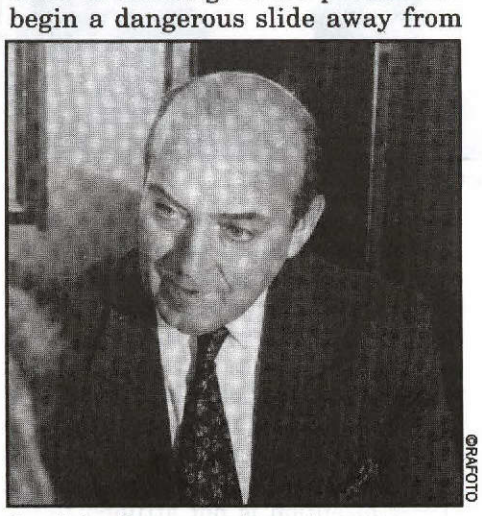
Part III
Challenge to THE SYSTEM

"FREE MARKET DOGMAS" FACE LATIN AMERICA-WIDE CHALLENGES

BY RIORDAN ROETT

While Latin American governments have received — deservedly so — high praise for the macroeconomic reforms of recent years, pockets of resistance remain a potential threat to the "deepening" of the process. And as Latin countries move toward the next stage of reform — institutional changes at the micro-level — can we expect continued and even heightened resistance, given the social costs that accompany such changes?

The challenge for the newly elected governments of the region — new presidents have taken office within the last year in Brazil, Mexico, Argentina, Columbia and Uruguay — is to maintain the pace of reform in the face of persistent, and growing, concern over the social costs to the general population. To the degree that the first stage of reforms was relatively easy — often done by decree, for example — the next set of innovations will require meticulous tinkering at the entrails of administrative, judicial, and regulatory procedures and institutions that have long been immune to change. Governments that falter at this stage in the process will begin a dangerous slide away from consolidating the reform process.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Cavallo's reforms are not so welcome now

A costly oil workers strike ended on June 2 in Brazil after 31 days of escalating violence and demonstrations. The major Brazilian labor confederation (CUT) joined by two influential political leaders — Luis Inacio da Silva ("Lula") and Leonel Brizola — seriously impacted the Brazilian economy and the supply of energy to homes and industry. The thrust of the strike was clear — to stop any privatization efforts in the petroleum sector where the CUT is particularly powerful. While the government stared down the strikers, and public opinion moved against them, the influential public sector workers in Brazil remain a constant threat to the smooth implementation of the ongoing reforms that are supported by President Fernando Henrique Cardoso.

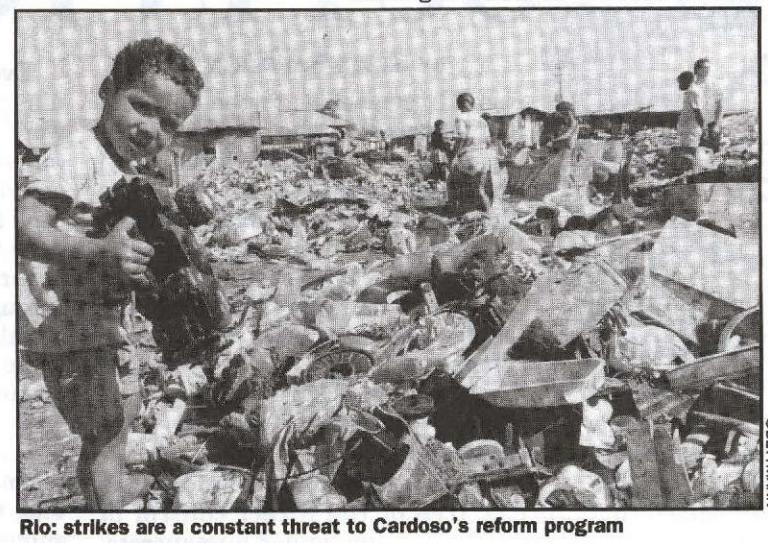
In Argentina, the first general strike since 1989 took place in September. The issue was simple — an unemployment rate of 18.6 percent — three times higher than it was before Domingo Cavallo's adjustment program. On the same day as the general strike, the official CGT union confederation, with close ties to the traditional leadership of the ruling Peronist Party, organized a "March for Jobs" during which an estimated 50,000 people marched in front of the national congress to protect jobs. Spokesmen for the march blamed the current unemployment levels on the excessively rigid free-market reforms of the technocrats brought into government by Cavallo. Raising the ante, Buenos Aires province governor Eduardo Duhalde warned against "free market dogmas," asserting that the state has an important role in creating employment opportunities for Argentine workers.

Furthermore, since 1992, weekly demonstrations have been staged outside the congress in Buenos Aires by pensioners demanding an increase in their retirement benefits. Current levels are at about the equivalent of $300 a month. While the government of President Carlos Menem has said that retirement benefits will not increase, the Roman Catholic Church has become increasingly vociferous in its criticism of the administration for its failure to address the legitimate demands of the aged and the unemployed.

In a little noticed protest in Mexico in September, a major country club-style development in Tepoztlan, Morelos, has been suspended indefinitely after leftist activists stormed and occupied the town hall to protest local officials' approval of the project. Tepoztlan's mayor resigned to prevent further violence. The warning is significant — local politics can disrupt the investment climate even after the central government has supported the initiative as important to regional development. Although the project was to have created 13,000 new jobs in an area of chronic unemployment, opponents claimed that it was environmentally damaging to the region. The Morelos example is one that may be encountered increasingly in Latin America as new investment opportunities emerge but confront local nationalism or opposition to foreign capital. As the second phase of reforms gets underway, this sort of local protest and resistance may become a significant challenge to the successful implementation of the reform process.

As the second phase of reforms gets underway, protest and resistance may become a significant challenge to the process.

The recent experience of the Enron corporation in the Indian state of Maharashtra indicates that local politics are not exclusive to Latin America. A newly elected state government "repudiated" the contracts Enron had negotiated with the previous administration and with the national government in New Delhi.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Rio: strikes are a constant threat to Cardoso's reform program

The government of President Rafael Caldera in Venezuela has used the harshness of market-oriented reforms to justify its current policies of state intervention in the economy, the imposition of controls, and related policies. The president and his program remain popular and the bitter memory of the onset of the reform process under President Carlos Andres Perez in 1989 has given Caldera a justification for his initiatives. Although the recent increase in gasoline prices may dictate a shift in emphasis, it is clear that the people of Venezuela are not enthusiastic about the competitive logic of the marketplace if it means higher transportation costs, more expensive energy, and other sacrifices in an economy characterized by high unemployment and low benefits, if any, for the unemployed.

The argument for market-oriented reforms is as easy to make in boardrooms as in the comfortable environs of a presidential palace.

No one questions the positive strides to introduce market-oriented reforms currently under way in Latin America and elsewhere in the emerging markets. But a word of caution is warranted as newly elected governments in Latin America move towards a more unpredictable agenda of reform — moving from the macro to the micro level reform process — which entails local politics and interests, raises the specter of widespread unemployment, and arouses dormant nationalist sentiments. The argument for market-oriented reforms is as easy to make in the boardrooms of Forbes 500 companies as it is in the comfortable environs of a Latin American presidential palace or ministerial retreat. For pensioners and the aged, the rising ranks of the unemployed, and a new generation of youth with little early prospect of employment, further reform is of little comfort.

Governments will need to balance a realistic response to growing social resistance to further change while maintaining the pace of institutional reform. The second phase is in many ways more important than the first because it will produce the consolidation of the earlier reform efforts and if properly executed will provide for the necessary legitimization of the reform process. To falter now will be to lose years of commitment to change at the national and federal level. To ignore the potential for local and provincial resistance, however, is to risk losing sight of the ultimate justification for the reform process — more job creation, poverty alleviation, and more equitable income distribution which will be a major underpinning of future social and political stability in Latin America. EM

Next: Part IV — Death on the Nile

Features

LIGHTS OUT IN TOKYO

Power Failure Part III

BY KEVIN RAFFERTY

Masayoshi Takemura, then a freshman member of Japan's parliament, complained during the scandals of the 1980s that "our country has a first rate economy, a second rate standard of living and a third rate political system." Takemura is now finance minister and, wags say, is presiding over Japan's transition to a second rate economic power with virtually no growth for four years, a collapsing financial system, sluggish stockmarket and still no idea of its political place in the world. The question that is increasingly being asked is: is this the end of Japan's reign as an economic superpower?

If not wishful thinking, such a sweeping assertion is probably premature. After all, Japan's industrial giants still retain their immense muscle and profitability if the yen stays in the 95-100 range against the dollar. Annual trade surpluses of $100-120 billion still speak of industrial superiority.

What the events of the last few years do illustrate is that Japanese bureaucrats, long praised as superhumans — one recent book claimed that anyone who could get into the ministry of finance had the intellect of a Nobel prizewinner — are as fallible as any humans anywhere. Indeed, by believing in their own majesty, the mandarins deepened and turned recession into crisis. Meanwhile, Japanese politicians have just proved that they are pygmies with no understanding of the world outside their own tribal patches.

The country's industrial strength should still inspire awe. Many of the Japanese giants have shown the world a superior way to produce goods. Toyota, for example, rescued the motor industry from the drudgery of the assembly line. Procedures which it pioneered, such as just-in-time production and *kaizen* (continuous improvement), have now become part of the language not just of the motor industry but of modern management.

Of course, the Japanese are often accused of being copycats, as Americans were by jealous British who saw their ideas for jet aircraft engines and radar being made into commercial successes in the U.S. But the Japanese are developing creativity, sometimes expensively, like the H-II rocket, which costs twice as much as its French competitor; the "flying" Maglev train which can run at 600 kilometers an hour but may never be commercially viable; and the nuclear powered merchant ship whose reactor sprang a leak on its maiden voyage, leaving a hole to be plugged with boiled rice.

Rivals should not laugh. Flash memories, which will do away with bulky computer hard drives, originated in Japan, as did the commercial application of liquid crystal displays, where Intel had to team up with Sharp of Japan in order to get back into the business. In Osaka Bay last year, the prototype of a new generation cargo ship capable of 50 knots, or twice as fast as existing vessels, has completed its trials.

Meanwhile, all sorts of quirky inventions are coming from Japan, including shirts, hats, socks and underwear that not only don't need ironing but can "remember" and mould themselves to the shape of their wearer; the world's first 1,000 meter (3,400 feet) high building, possibly able to house 500,000 people; a suitcase that can be turned into a crude version of a motor car; "beauty toilets" that can analyze and report on the state of your health; and — the ultimate in recycling — a burger that is made from human sewage (though it hasn't yet been passed fit for consumption).

Industrialists have managed to break free of the direct control of Japan's much applauded bureaucrats, and have done their learning in the world's marketplaces taking the lumps that competition and fickle consumers often inflict, learning and thriving.

This is in contrast to Japan's banking and financial services, and indeed of the services sector in general, which are still highly regulated and grossly inefficient. The banks have more than ¥50 trillion ($500 billion) in bad debts, a mammoth hangover from the bursting of the "bubble" economy of the late 1980s. Though the bureaucrats cannot be blamed for the spending binge on which the banks indulged themselves, they encouraged the bubble with low interest rates and did nothing to disturb the euphoria that land and stockmarket prices could go on rising for ever, not even when the 284 acres of the Imperial palace in Tokyo was "worth" more than the whole of California. Even now, bureaucratic dithering is preventing a cleanup of the mess of bad debts.

Where the finance bureaucrats have squeezed the industrialists has been in the failure of their policies which have marooned the economy at nearly no growth, left the financial mess festering, and encouraged the yen to ludicrous levels against the dollar — from which it was recently rescued not by Tokyo but by Washington. The high yen meant that Japanese industry was squealing and planning emergency moves to take production offshore while inefficient services industries were still sitting comfortably.

Perhaps the supreme irony was that as the yen reached 80 against the dollar and was heading ever higher, economists calculated that if it got to 69.75, then the Japanese economy would be bigger in dollar terms than that of the U.S. A better measure of the two economic giants is that, had the U.S. economy been stuck at near-zero growth for nearly four years, the rest of the world would have suffered. As it is, the world has got by without drama or crises, which are confined to Japan.

Even the latest economic stimulus package, the sixth in a series worth a total of ¥60 trillion, has failed to raise enthusiasm that growth will be more than 1 percent this year. What needs to be done to lift the economy is to consider lowering taxes and cut through the maze of red tape and regulations that govern everything from siting bus stops, and opening restaurants (for which a chef's examination, nine licenses plus a sewage license are needed) to importing foreign houses. All told, the rules cost Japanese consumers up to $100 billion a year. Deregulating would give foreign companies a broader playing field to sell to Japan, and allow Japanese consumers a better chance of raising their lifestyles, building something bigger and better than expensive rabbit hutches to live in.

In any other country, the politicians would take direct responsibility. But in Japan the bureaucrats — who see themselves as the direct servants of the emperor and guardians of the nation's integrity — have tried to protect decisionmaking both from the businessmen whose only interest is profits and from politicians whose hands are grubby from cutting deals. The bureaucrats go to great pains to keep politicians out of budget-making because, in their view, "this would be like letting the rats into the granary."

Most other freely elected politicians anywhere else in the world would not permit such indignity. But in Japan, politicians' concerns have been narrowly tribal. Tsutomu Hata, briefly prime minister last year, complained that the system encouraged politicians to place prime consideration on getting new schools, roads, railways and airports for their constituents before any national, let alone international, considerations. It shows.

In this 50th anniversary year of the atomic bombings of Hiroshima and Nagasaki and the end of the war, Japan had a great opportunity of showing its maturity and staking a claim to be regarded as an international political player matching its economic status. The chances were muffed, of course. It would have meant embracing the responsibilty for the war and the atrocities that accompanied it, apologizing and seeking a new beginning as a powerful neighbor in the world's fastest growing region. Socialist prime minister Tomiichi Murayama tried hard to apologize, but he showed himself a prisoner of the conservative Liberal Democratic Party, which is his more powerful coalition partner. And then the bureaucrats ruled the economic roost again.

To most of the rest of the world, the dark times of the 1930s are far away. But Naohiro Amaya, a former top trade bureaucrat who died last year, saw dangerous parallels, claiming just before he died that "The state is walking along a dark road at night. Most of Japan's politicians and political parties resemble the prewar leaders in their perceptions of Japan's national interest, justice and power. Their attention is not attuned to the world. They do not look squarely at history. They are concerned solely with calculating their own gains or losses in a teacup called Nagatacho [where parliament is], in Kasumigaseki [the bureaucratic district] and in their constituencies. They conduct no serious debate on the just cause that Japan should boldly raise in international society...." EM



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What price political leaders?

Inside Japan's Powerhouses *by Kevin Rafferty was recently published by Weidenfeld & Nicolson.*

Next — Part IV: The U.S. Waffles, China Presses On

INTERNATIONAL MEDIA PARTNERS

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are pleased to announce the winners of the

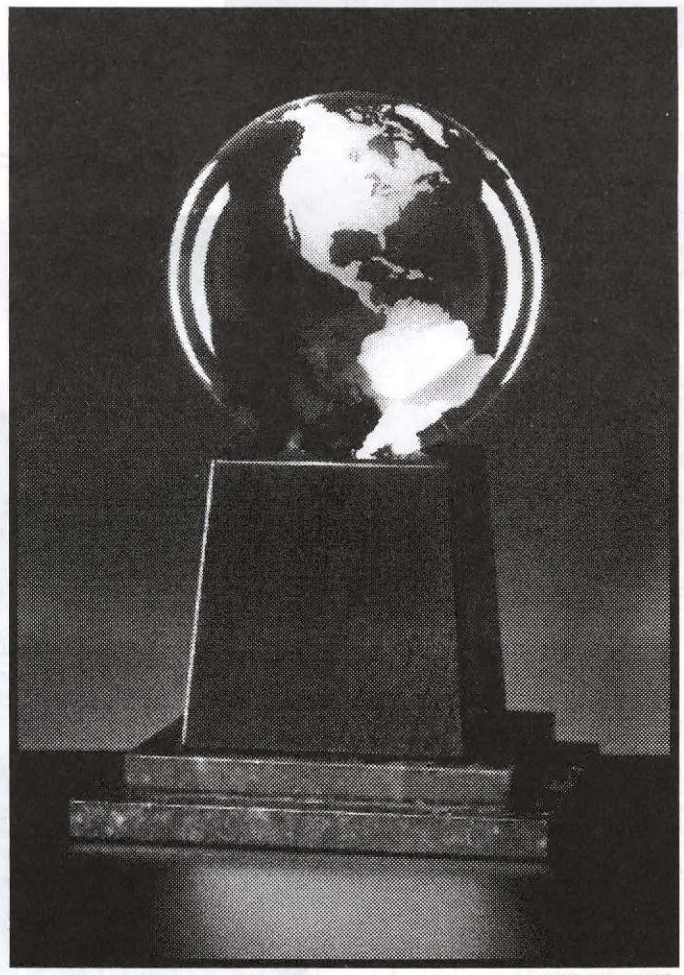
1995 Emerging Markets CEO of the Year Awards

Percy Barnevik
ABB Asea Brown Boveri Ltd.

Percy Barnevik, President and Chief Executive Officer of ABB Asea Brown Boveri Ltd. received the Award for the chief executive of a company headquartered in the developed world, whose expansion into emerging markets has best shown how these markets can contribute significantly to corporate revenues and profitability and has produced benefits for both the countries involved and the corporation in question.

Stan Shih
The Acer Group

Stan Shih, Chairman and Chief Executive Officer of The Acer Group was elected winner of the Award for the chief executive of a corporation headquartered in one of the world's emerging economies whose vision and company performance has best shown the pattern that can be offered as a model to other emerging markets companies around the world.



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Two years ago, International Media Partners, publishers of Emerging Markets and parent company of the CEO Institutes, and ING Bank, the leading financial institution in emerging markets worldwide, joined to establish two important new Awards.

The purpose was to recognize the sea change in developing economies as countries have gone from debt rescheduling and aid support to a new world of liberalization, privatization, trade agreements and stock exchanges. Traditionally, recognition has reflected on the policymakers and planners of these economies. The rational behind these unique Emerging Markets CEO Awards is to reward the true builders of these markets — businesses and business leaders with vision.

Nominations for the Awards were solicited from around the world and the elections were made by an independent Selection Committee comprised of corporate leaders, institutional investors, government officials and multilateral executives. The Committee's decisions were final. The Awards were presented on October 9 during the joint annual meetings of the IMF and World Bank in Washington, D.C.

IMP and ING Bank are delighted to have such worthy recipients of the 1995 Awards and look forward to continuing the tradition in 1996.

Copies of the winners' citations, the list of the Selection Committee members, and details on this and next year's Awards are available by contacting: Richard Burns, President, International Media Partners, The Cable Building, 611 Broadway, Suite 300, New York, NY 10012. Telephone: (212) 995-9595. Telefax: (212) 995-9389.

Features

PART III: THE U.S. ANTI-AID THRUST

DEVELOPMENT ASSISTANCE

BY ERIK D'AMATO

On September 12, the U.S. Senate, as part of a larger bill on foreign assistance, agreed to $775 million in funding for the tenth replenishment of the International Development Association (IDA), the World Bank lending program offering below-market loans for the poorest of the world's nations.

For many supporters of the U.S. commitment to overseas development, the vote offered a mixture of dread, embarrassment and relief. Dread and embarrassment, because the amount was far below the Clinton administration's request for $1.3 billion, a request that was simply the final installment on a pledge made years earlier to the bank — and one the U.S. had already fallen behind in honoring. But also relief, because the $775 million approved was $200 million more than the House of Representatives was willing to part with, and because it came on the heels of a much-publicized move by Senate foreign relations committee chairman Jesse Helms to outlaw U.S. contributions to IDA altogether.

When asked about the House and Senate votes, Representative Lee Hamilton, a veteran Indiana Democrat reflects on the end of a era: "The centrist position that since World War II has supported U.S. leadership in the international financial system is not holding."

For the international financial institutions (IFIs) long accustomed to U.S. leadership and support, like the World Bank, the IMF and the regional development banks, Hamilton's fears are gravely important.

So, then, is U.S. support for the IFIs really coming to an end?

SURROUNDED BY ENEMIES

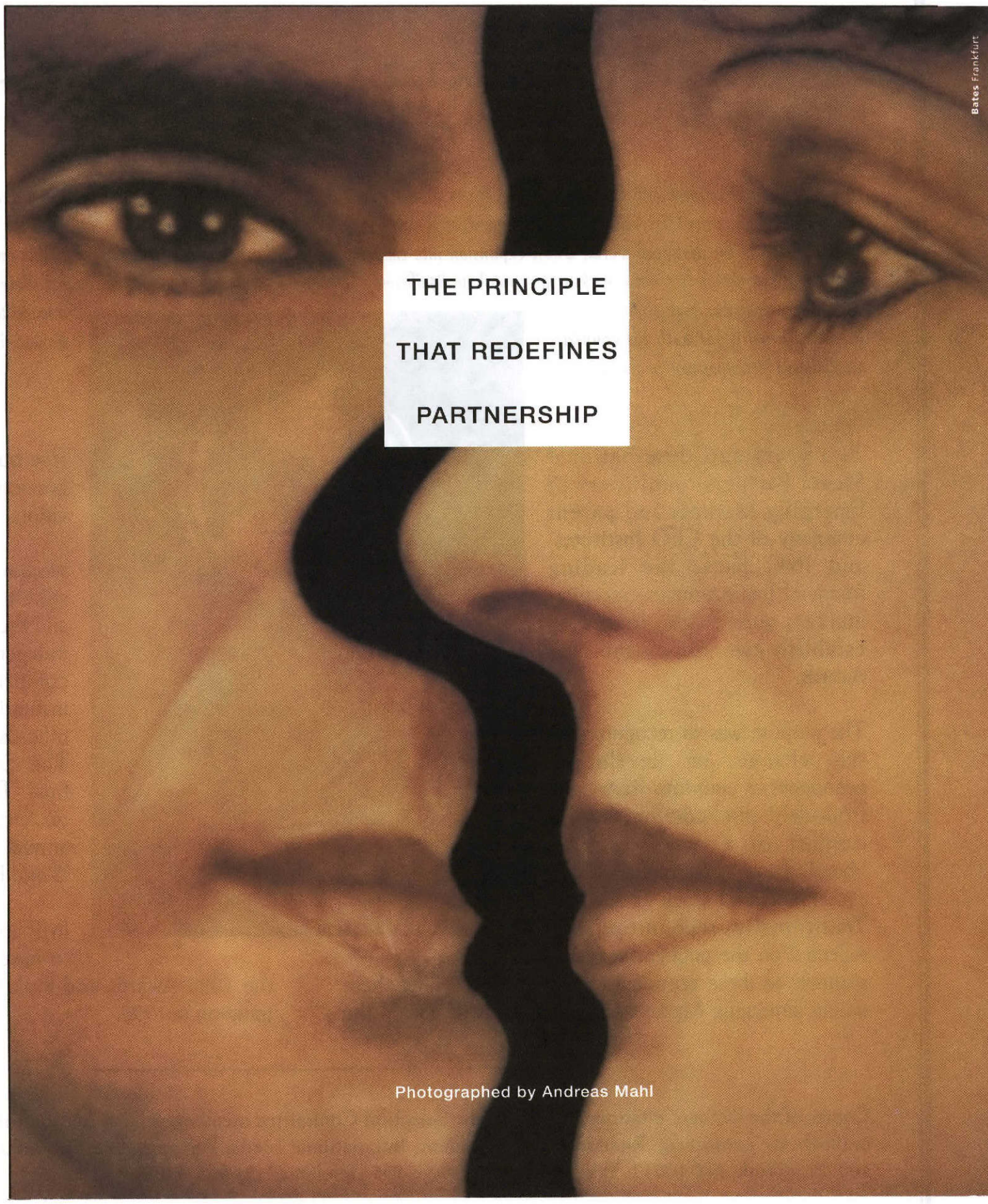
What is interesting is just how unpopular U.S. support for the IFIs is with the American public at large. A poll taken earlier this year showed that, while Americans voters had a wildly exaggerated view of how much money was provided in foreign aid, it was by a large margin the single most unpopular area of federal spending.

This isn't particularly shocking or new — spending abroad has always been unpopular with voters — but in contrast to past years, it comes at a time when members of Congress are themselves likely to be highly skeptical or out-and-out hostile to U.S. support for the multilaterals.

According to Thomas Mann, director of governmental studies at the Brookings Institution, congressional antipathy to the IFIs is real and represents a broader skepticism about American engagement abroad. "I think the threat to the multilaterals is serious, it's long-term, and it goes way beyond Jesse Helms. What has happened is that the new majority party has no interest in development issues — and, quite frankly, little interest in international affairs as a whole."

While the IFIs are but one part of the foreign operations budget, for the "bootstrap" Republicans of the new majority, IDA and other forms of concessional lending are viewed as little more than welfare for foreigners. Likewise, many nationalists see the IFIs as part and parcel of the UN and other "one-world" bodies denounced as grave threats to U.S sovereignty. On the other side of the aisle, more than a few members of the Democratic minority are opposed to the IFIs because of concerns about the environment or the inequity of structural adjustment programs.

However feigned or heartfelt the opposition is, though, it is not a great preoccupation: with the new majority working record hours on a profoundly ambitious domestic agenda, the question of whether or to what degree the IFIs should be funded is small beer. According to several key staffers, as the tsunami of legislative business has increased, so has the influence of conservative think tanks and other outside voices calling for options ranging from deep reductions in IFI support to privatization to simply "zeroing out."



For the "bootstrap" Republicans of the new majority, IDA is viewed as little more than welfare for foreigners.



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Helms at the helm again

One such voice is Bryan Johnson, a policy analyst at the Heritage Foundation and the author of *The Index of Economic Freedom*, which was widely circulated on Capitol Hill and offered a stern critique of U.S. support for the IFIs.

But while critics like Johnson focus their scorn on the concessional lending operations, they are also largely unimpressed by the new private sector focus of the IFIs. "Should our government — or any government, for that matter — subsidize private-sector lending?" asks Johnson. "I don't think so, and I think there is growing [Republican] consensus that this is really not a legitimate function of government."

Even given widespread echoing of this ideological opposition, the real long-term threat to IFI funding is far more prosaic, and can be summed up in one four-letter word: cash.

A congressional wag once famously spoofed the budget process by saying that, "A billion here, a billion there, pretty soon you're talking about real money." With Republicans committed to a seven-year plan to balance the federal budget (and the White House committed to a 10-year program), sooner or later even the occasional $300-400 million for regional bank contributions will become "real money" worth fighting over. And with cherished domestic New Deal programs being led off to slaughter every day, the IFIs shouldn't count on support from cash-craving Democrats. In fact, one key congressional staffer, on the eve of the Senate IDA vote, called it "inconceivable" that Congress would fund the next round of IDA.

As with other areas facing cuts, the supporters of various IFI programs are gearing up to protect their "share" of the overall U.S. foreign aid budget. This is increasing the already high profile of the various ethnic lobbies in Washington, and will likely lead to byzantine alliances and intrigue; for example, the powerful Israel lobby will be forced to compete with other lobbies — like that supporting Africa — for money, but will also work so that Israel (and Egypt) are not left in the vulnerable position of being the only destinations of large-scale U.S. foreign assistance.

One can expect to see the administration and the IFIs step up their own campaigns. Administration officials have gamely pitched the IFIs as revenue-producing investments and tools for opening foreign markets for U.S. exports. For its part, the World Bank has hired two lobbying firms to press its cause and is taking full advantage of bank president James Wolfensohn's impeccable Washington reputation. Some IFI supporters also hope for a "Nixon in China" scenario wherein a Republican is elected president in 1996 and pushes a reluctant GOP congress to keep funding alive.

THE ROCKETS' RED GLARE

All the fireworks and intrigue aside, the future of U.S. commitments to the multilaterals is perhaps best illustrated by the experience of Sonny Callahan, a quiet and folksy Alabaman who earlier this year became chairman of the foreign operations subcommittee of the House appropriations committee. According to one Capitol Hill source, Callahan was "leapfrogged" by the new House leadership over several members with greater seniority in large part because he had never voted for a foreign aid bill. The thinking was that he would be especially aggressive in pinpointing and extracting savings from the foreign operations budget.

Some in the overseas assistance community predicted acrimony, deadlock and disaster. But, to the surprise of many, Callahan's subcommittee successfully voted out a bill, and did so, to the astonishment of many, unanimously. For sure, the bill had something for everyone to hate — while it shaved almost $3 billion off the administration's total request, some influential cutters were reportedly aghast that several programs thought to be consigned to death row (like the U.S. Export-Import Bank) were spared. And the bill was also passed on the House floor by a wide margin, with support from both sides of the aisle. Thus signaled what is probably the likeliest IFI funding scenario for the mid- to long range: a "grand compromise" involving a slowly shrinking budget that spreads the pain, favors "free market" initiatives and programs, and respects the presidential prerogative in conducting foreign affairs.

It is in this context that some hope — and others fear — that support for the IFIs will continue. EM

Tomorrow — Part IV: Japan's Corporations Hit Back at Aid

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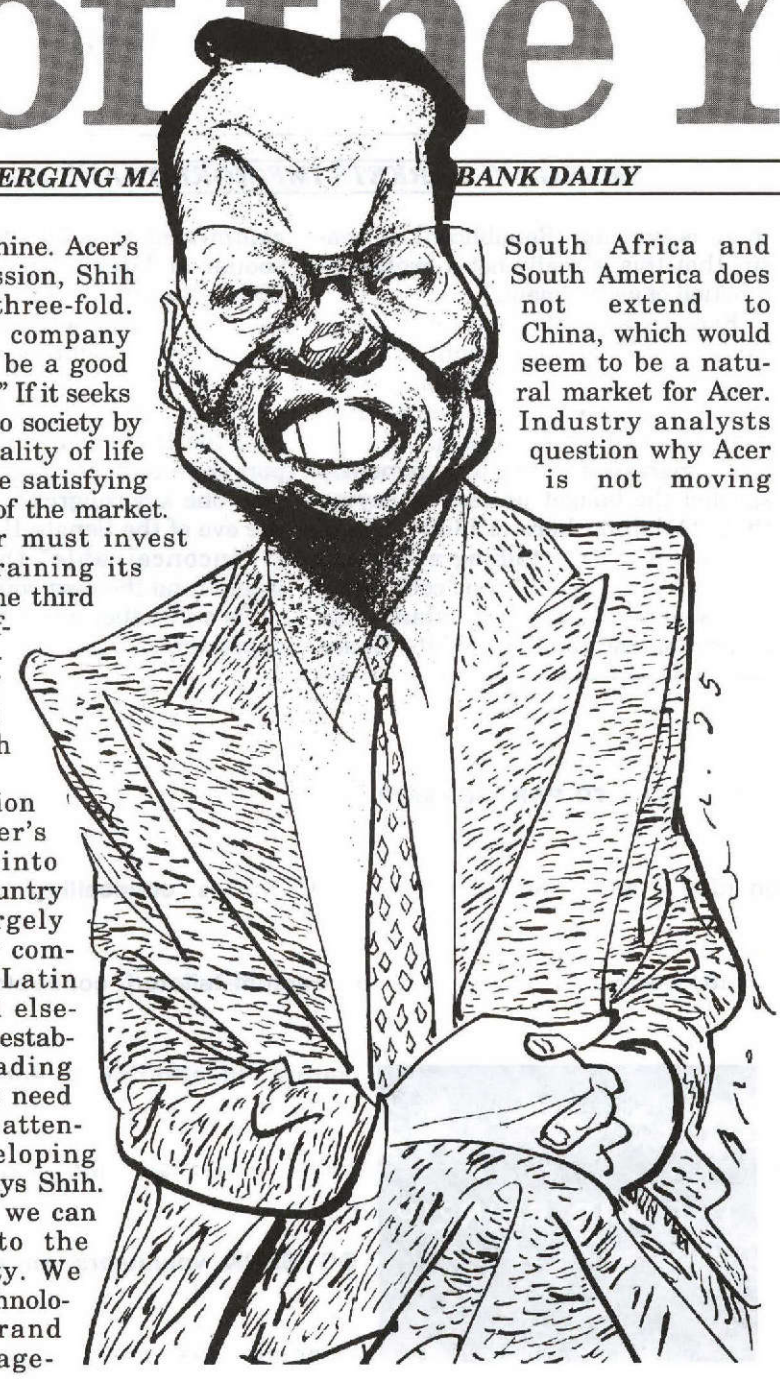

SHIH

Born to a family too poor to afford shoes, Shih has built Acer into Taiwan's only truly multinational company.

BY LAURA TYSON

Acer is different from other Taiwan companies," says Stan Shih, chairman and chief executive officer of the island's premier computer manufacturer. "Our thinking is totally different. Many other companies in Taiwan do not agree with our approach, but we have shown that we can be more effective."

Neither is Shih the stereotypical Taiwanese tycoon. He does not smoke, drink, gamble or play golf, a sport considered de rigueur among Asia's business elite. "I don't need that now," he says when asked what he does for recreation. "I can do that after I retire" — which he says he will do either in the year 2000, when he will turn 56, or in 2004.

"Stan has no hobbies and no vices," explains one ex-staffer. Shih later admitted to playing the occasional game of tennis and practicing his swing at the golf driving range "once or twice a year." He adds: "But at that rate, I won't improve very fast."

AIMING AT NUMBER FIVE

The simple fact of the matter is that Shih lives and breathes Acer. In under 20 years, he has built the group into what was last year the world's seventh largest personal computer manufacturer, according to International Data Corporation. If non-brand name sales were included, the ranking would be even higher. Acer's goal is to climb to number five. Shih believes this is feasible. "[The U.S.'s] AST is number six, and their market share is only 0.1 percent higher than ours. [Japan's] NEC is number five, and they are suffering in the Japanese market."

Unlike some of his tycoon compatriots who are well known for their penchant for micromanagement, Shih is a hands-off manager. In the early 1990s he led Acer through a complete reorganization to decentralize management and make individual business units responsible for their own operations and profits. Through the restructuring, Acer has become Taiwan's only truly multinational company.

Shih's rise from humble beginnings is the archetypal Taiwanese success story and, by now, the stuff of legend. He was born in a fishing village into a family too poor to buy him shoes, and sold goose eggs to augment the household finances.

After graduating from university with a degree in electrical engineering, Shih began his career helping develop Taiwan's first desktop calculator. He went on to found Multitech International, Acer's forerunner, in 1976 with four partners and $25,000 in capital. His wife, Carolyn, also helped found the company and is now in charge of internal auditing. They are said to be very much a team.

With his renowned flair for self-promotion, Acer's indefatigable chairman is the company's own best public relations machine. Acer's corporate mission, Shih explains, is three-fold. First, the company should try to be a good "global citizen." If it seeks to contribute to society by improving quality of life then it will be satisfying the demands of the market. Second, Acer must invest heavily in training its employees. The third objective, profits, is the natural result of goals one and two, Shih believes.

This mission spurred Acer's early drive into developing country markets, largely neglected by competitors. In Latin America and elsewhere, it has established a leading position. "We need to pay more attention to developing countries," says Shih. "In this way we can contribute to the global society. We can share technology, our brand name, management know-how and risk."

Coming from anyone else, such sentiments might sound disingenuous. But sitting over a cup of tea with Shih in his modest, even spartan office at Acer's Taipei headquarters, one gets the impression that he truly believes them and lives by them. Clearly, however, Acer's motives are not pure corporate altruism. The company is investing in building footholds in regions where the potential for growth is high and competition is thin.

Intriguingly, this strategy of diving into places as risky and far-flung as the Commonwealth of Independent States, India, Southeast Asia, South Africa and South America does not extend to China, which would seem to be a natural market for Acer. Industry analysts question why Acer is not moving more aggressively across the Taiwan strait and voice concern that other computer companies, both Taiwanese and international, have gotten a head start.

This is another area in which Shih differs from many of his corporate peers. He takes an extremely cautious, not to say dim, view of China. "This issue is managing risk," he says. "Other companies make their own decision. We choose to manage ours in this way." Although the company does have limited assembly operations there and a smallish marketing presence in Beijing, he feels that the time is not ripe for expansion. Commercial infrastructure is inadequate, import procedures are overly troublesome and the political environment — both within China and across the Taiwan strait — is a major concern, he says.

"Everyone agrees that China is the market with the greatest potential, but that is for the future. My philosophy is that you don't want to rely on any market. When you have developed capability in other countries, then you can afford to put more resources into China," he says. "To American, Japanese or other well-established companies, China is the last potential market. For Acer, potential is everywhere. That's the reason China is low priority for us."

HOME IS STILL BEST

Despite rising production costs and a labor shortage, Acer's main manufacturing base is still at home. "Taiwan is the best industrial environment to put money into for information technology because of the engineering resources and component infrastructure." The second priority is Southeast Asia because "their economic system is more suitable for our way of doing business than China," he says. Acer recently announced plans to invest $20 million in new production facilities at Subic Bay in the Philippines.

The question on the minds of many in the industry is how Acer will stay in the world's top 10 in the highly competitive and mercurial personal computer industry. "Time," says Shih. "Time is our advantage. Step by step, long-term approach. Also our technology is more sophisticated than most PC companies. We have more component manufacturing capability. We have a more localized management structure. Our disadvantage is marketing our image, and that we enhance year by year." Shih is a tireless champion of the government's "Made in Taiwan" campaign to boost the overseas image of locally-made products.

Meanwhile, Acer has turned around dramatically from a few years ago. "We're in the position of gaining market share. That is our priority," he says. Group revenues jumped 70 percent in 1994 to $3.2 billion, with earnings of $207 million, a gain of 139 percent. The company recently forecast sales of nearly $8 billion in 1997.

"I don't seek profits, but still I keep making more money," says Shih. Money is the indication that I do the right thing." So far, at least, he appears to be doing something right. Now all he needs to do is work on his golf game. EM

Stan Shih has been elected Emerging Markets *CEO of the Year by an independent selection committee. The other winner was Percy Barnevik of ABB (see page 57). The awards are sponsored by International Media Partners and ING Bank.*

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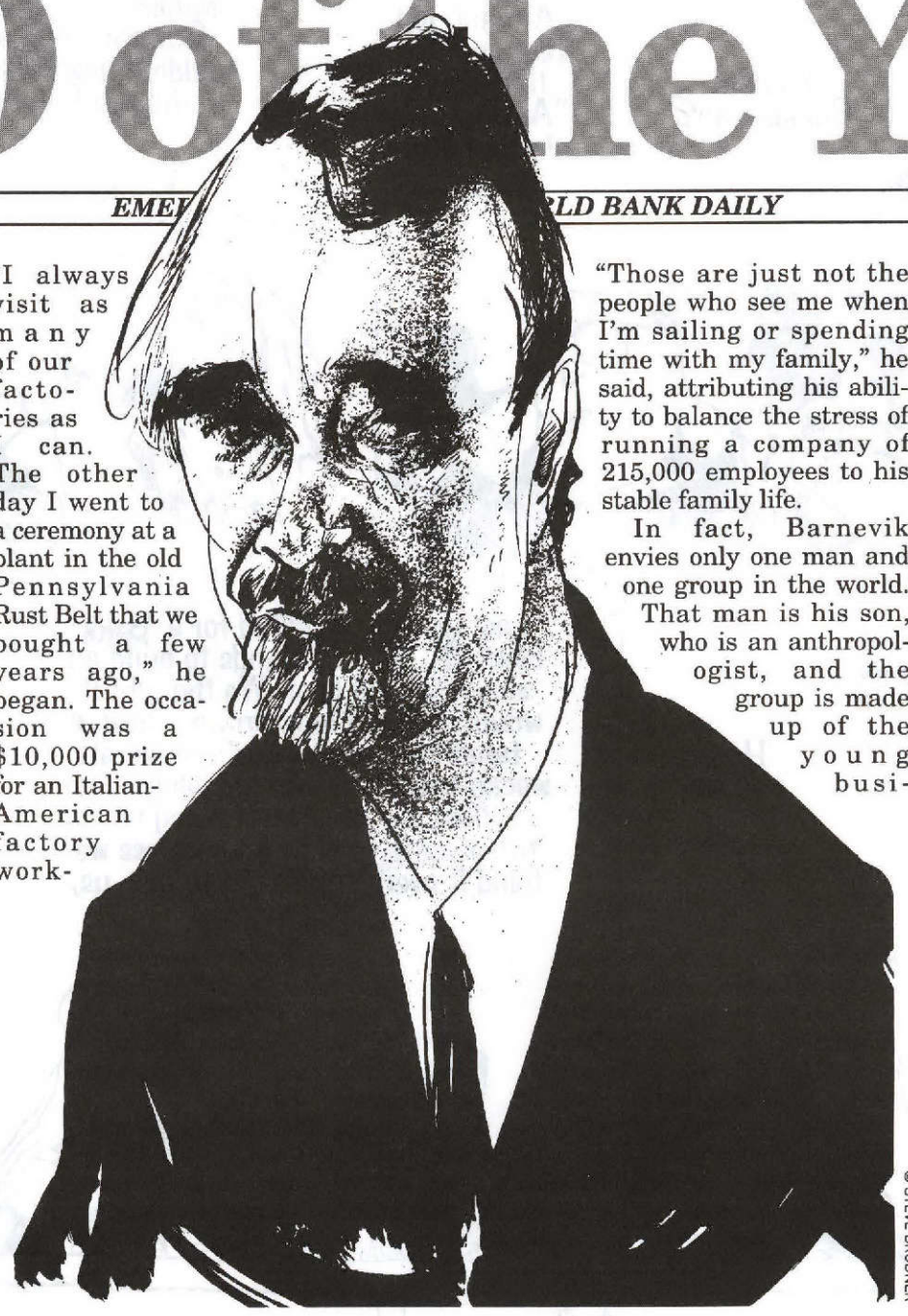
CEO of the Year



BARNEVIK

Outsiders find the approach of the ABB CEO enigmatic. Insiders find it profitable.

BY JUDITH EVANS

Percy Barnevik, Asea Brown Boveri's CEO, spends so much time on planes that his doctor recently told him he has "pilot's disease," a mild hearing loss caused by so many hours logged in flights. But with ABB's ambitious expansion plans on top of its already far flung reach, the tall, impressive 54-year-old Swede has no intentions of scaling back on his travel schedule. In fact, one of the several paradoxical aspects of Barnevik's style of leadership is that he is simultaneously a hands-on and hands-off manager. In much the same baffling way, ABB is both a militantly multinational firm and over 1,300 doggedly domestic firms. It is also an international player in electrotechnical products and power equipment that operates on a matrix model, which gives enormous creative latitude to local employees while maintaining centralized financial support and research and development.

Barnevik is fully aware that outsiders find ABB's approach a bit enigmatic. To explain his vision of the multinational-domestic company, he likes to tell the story of the dinner he had with then French Prime Minister Pierre Rochard. "When we began our conversation, he asked me about our ties to the U.S., complaining about America's attack on European farm policy. I found myself defending the U.S. Then he inquired about ABB's Swiss connection, again criticizing that country's economic policies. I defended the Swiss. The same pattern occurred when he asked about Sweden. I realized that I had to cut this short: I told him that, at this point, ABB has 27 home countries."

AT HOME ANYWHERE

ABB's success since its difficult 1988 merger and its accomplishments on the traditional European turf of both parents, Asea (Sweden) and Brown Boveri (Switzerland), have been lauded throughout the international business community. The logic behind choosing him as a CEO of the year is crystal clear: ABB is the largest foreign investor in Russia; it expects to double its business in Latin America in the next four years; it dominates several important Eastern European markets, such as Poland and the Czech Republic, in the manufacture of power generation equipment; it is moving aggressively in India, China and Indonesia after 15 years of courtship; and, incidentally, has had a 45 percent increase in it stock value in the last 16 years as well as an annual turnover of more than $28 billion last year with over $2 billion in profits.

In a recent and fleeting stopover in Wilmington, Delaware, to fulfill his duties as a board member of EI DuPont de Nemours, Barnevik told an anecdote to capture the meaning and success of what has distinguished ABB's management strategy: decentralization down to the factory floor. "I always visit as many of our factories as I can. The other day I went to a ceremony at a plant in the old Pennsylvania Rust Belt that we bought a few years ago," he began. The occasion was a $10,000 prize for an Italian-American factory worker who had spent 28 years at the plant. He had recommended a change in assembly line production that was a major boost to productivity. "I asked him why he hadn't brought this idea to management before. "Well," he said, "no one ever asked me." Barnevik chuckled with satisfaction, feeling that this story explained precisely what ABB is all about.

But how does he explain what Percy Barnevik is all about? "I think the most important element in my background is that I grew up in a small family business — printing — where you knew your customers, and lived and breathed entrepreneurialism," he said. A year of post-graduate study at California's Stanford University in 1965-66, followed 10 years later by his appointment as president of Sandvik U.S. — making him a CEO at only 33 years of age, gave him early international and leadership experience. Asked about his reputation as a man who fits the definition of a classic workaholic, he denied it. "Those are just not the people who see me when I'm sailing or spending time with my family," he said, attributing his ability to balance the stress of running a company of 215,000 employees to his stable family life.

In fact, Barnevik envies only one man and one group in the world. That man is his son, who is an anthropologist, and the group is made up of the young business people in emerging markets. A fine student himself, Barnevik was almost tempted to become an academic and says that studying the cultures of other peoples is about the most interesting job he can think of — "other than the one I have." In fact, Barnevik's mathematical and systems analysis skills led him, at one point in the 1960s, to Rand Corporation where he worked on creating models to simulate guerrilla warfare.

"When I think about these young entrepreneurs in, for example, Brazil I think of that incredible advantage they have sitting on markets with such rich potential. No one can stop the Chinese, the Brazilians, the Indonesians — they are the future." he predicted.

But Barnevik and ABB plan to be onboard in Asia, Eastern Europe and Latin America. Already the largest Western investor in Russia, attracted in part by the country's one million PhDs and a quarter of the world's engineers, the firm has set a target of sales in and profits from the developing world at one third of its total by the year 2000. In Asia alone, where Barnevik estimates there is a $600 billion infrastructure demand, ABB will spend over $1 billion in the next few years to increase its market share. The strategy will be modeled to some degree on how the firm has operated in other markets: acquisitions. However, privatizations and increasingly deregulated and open markets have increased the lure.

ANOTHER INDUSTRIAL REVOLUTION

Barnevik's Scandinavian reserve disappears when he begins talking about the revolution he sees in the developing world. "This is another Industrial Revolution, but even more of one. Imagine technical societies of six to eight billion people, 60 percent of whom live in cities," he enthused. Moreover, he claims that they have learned from the West's — and particularly from the East's — mistakes. "People in these emerging countries do not want development at any price," he said, "and that makes it a big responsibility for a firm like ABB to bring clean, efficient technology to them." This position has made him a big fan of new World Bank president James Wolfensohn, an old friend. "The bank can make a big difference in critical areas, exercising influences way beyond its money by setting standards, so I am extremely supportive of Jim's ecological thrust."

Cheap, one-off joint ventures are not on ABB's agenda. Barnevik expects to develop the same kinds of structures, like the quality teams, profit centers and training centers that exist in ABB's European heartland. In fact, the company is already running large training centers in Russia and China. In addition, ABB has absorbed the importance of training women as part of its broader development role. "Even though we tend to operate in areas that have not traditionally had much participation from women, that's changing; one of my best power plant managers in Eastern Europe is a young Swiss woman, and we are finding the young women in China and all over the Far East to be extremely capable." Since Barnevik has always insisted that ABB's staff learn to respect cultures by living among them, these young people will soon be assigned to offices and plants from Pennsylvania to Poland.

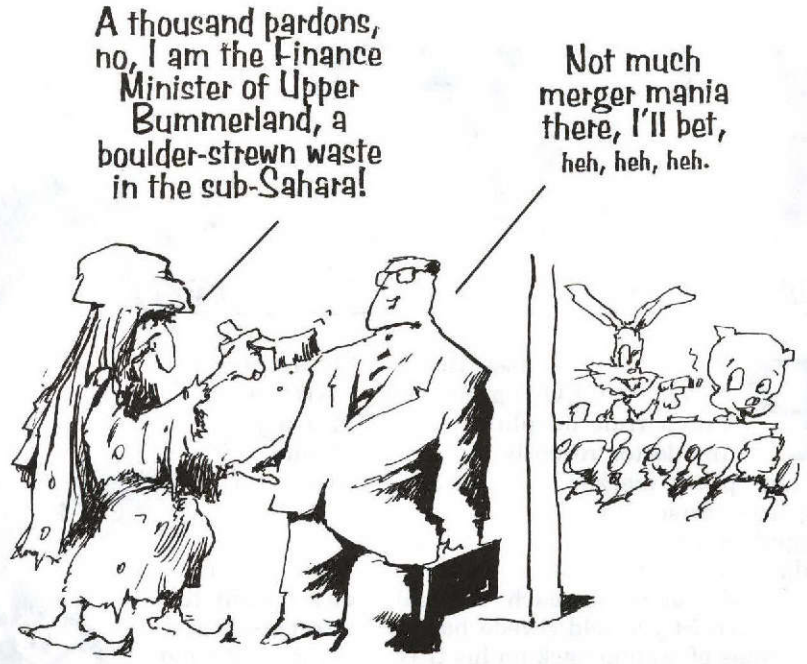
For Barnevik the end results of expanding into emerging markets can be "thrilling." Citing Poland, he explained, "Some countries are proving to all of us that they can turn around very fast." EM

Percy Barnevik has been elected Emerging Markets *CEO of the Year by an independent selection committee. The awards are sponsored by International Media Partners and ING Bank.*

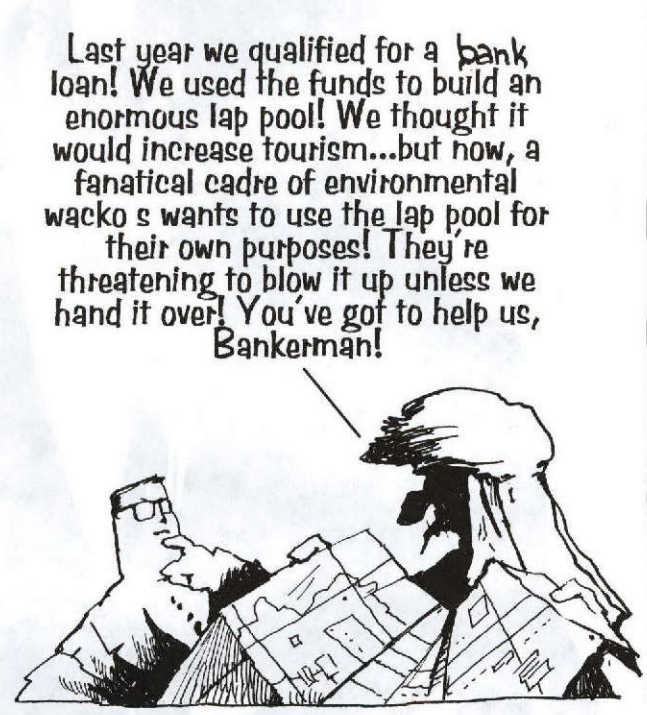
THE ADVENTURES OF BANKERMAN

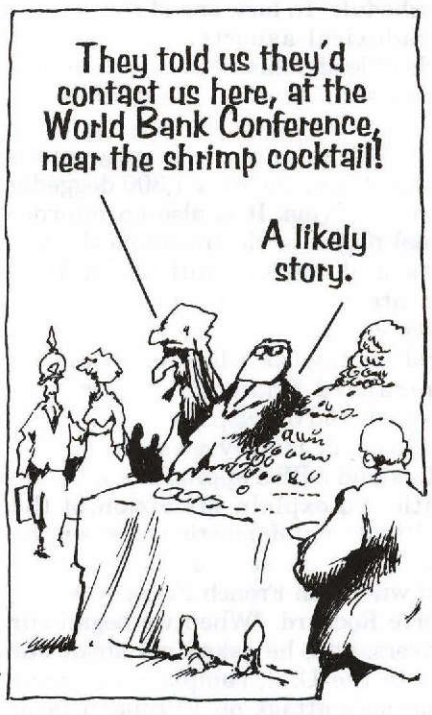
By William Bramhall

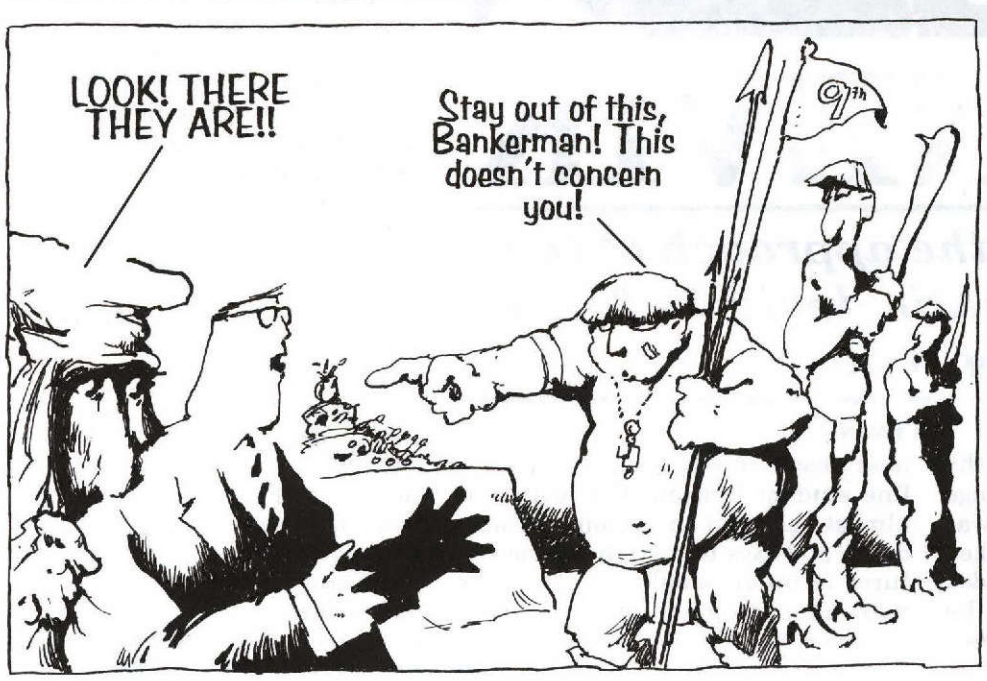


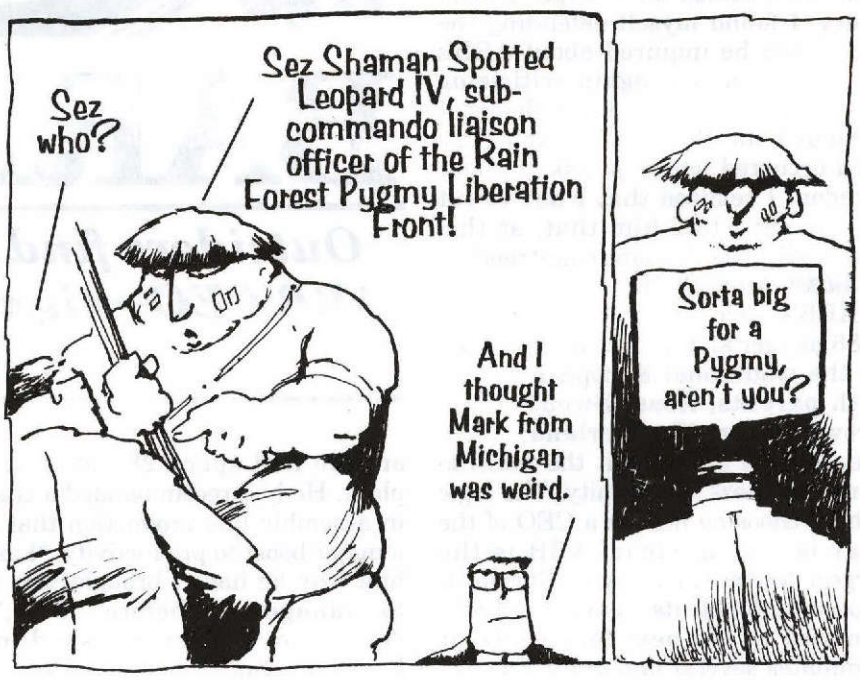


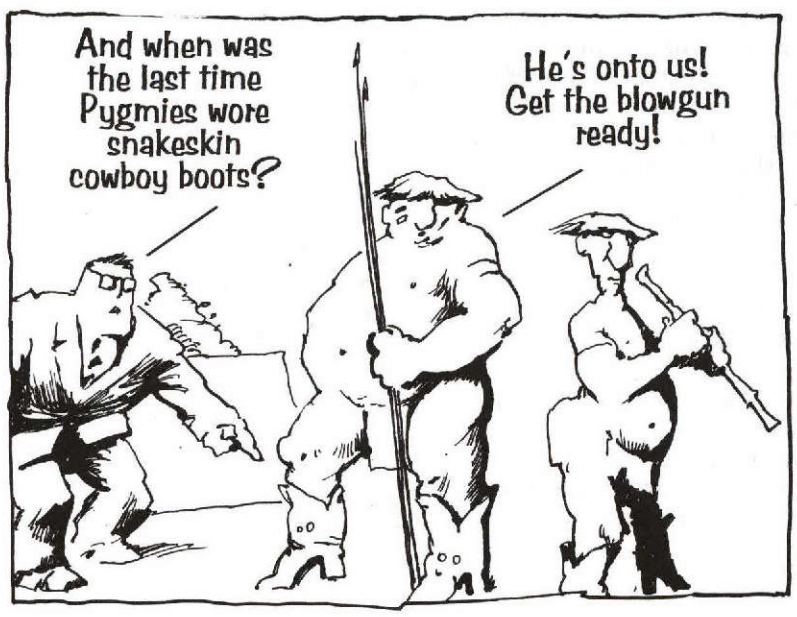




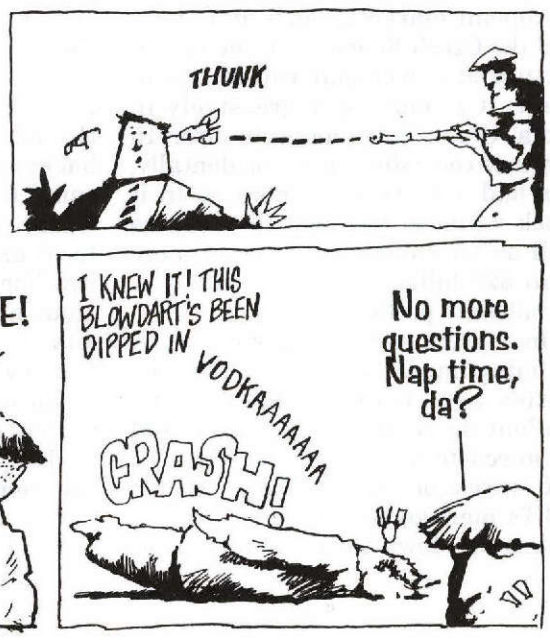












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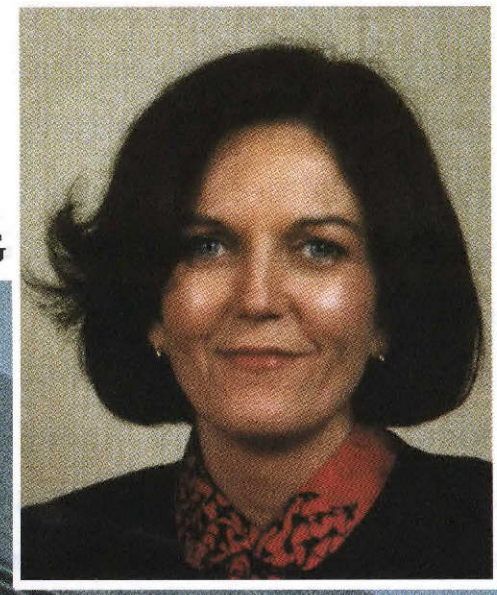

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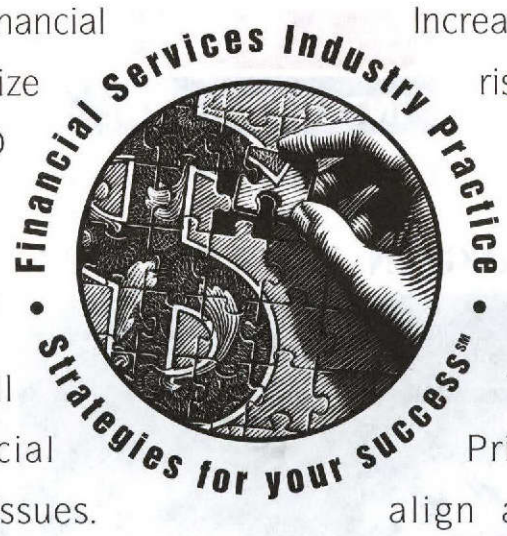

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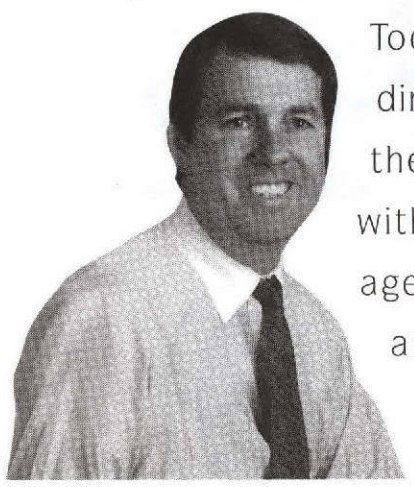

Marty Baumann

Today, senior management and directors rely more heavily upon the finance function to interact with Wall Street analysts, rating agencies and regulators, and to analyze potential mergers or recapitalization plans. Forward-looking CFOs have taken a lead in identifying new organizational performance measures, such as risk-related return, and are becoming increasingly involved in corporate and business unit restructuring efforts to reduce costs and enhance shareholder value. Increasingly, business expansion and business risk analysis should be the majority of the finance function's resource demand, replacing traditional accounting and transaction processing activities.

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Randye Farmer

For more information, call Marty Baumann (212) 596-7840 or Randye Farmer (212) 596-8293 in New York. For a copy of Price Waterhouse's white paper "CFO 2000: The Finance Function for the New Millennium," call (212) 596-8893.

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Former chairman Dennis Weatherstone and managing director Ernie Stern share an inside joke from the House of Morgan



Miga governor Chief Ayo Ogunlade of Nigeria guarantees that no one parks illegally



South Africa's Chris Liebenberg gets the rock star treatment before the SABC video conference



Namibian secretary of finance Godfrey Groset and FMO manager Asia Kidane Mariam at the CDC, DEG and FMO reception: getting a great laugh handing out spoof business cards



The Daiwa news made public, Japan MoF Masayoshi Takemura lets out a primal scream



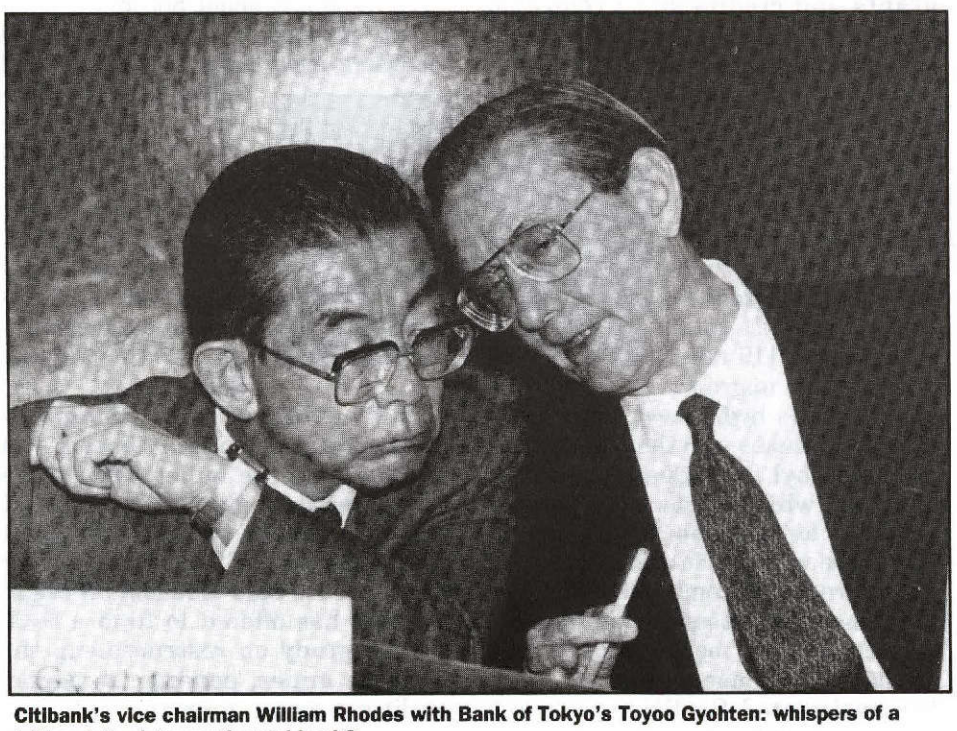
Panelists at the SABC video conference get a good laugh from a whoopie cushion in bank chief James Wolfensohn's seat



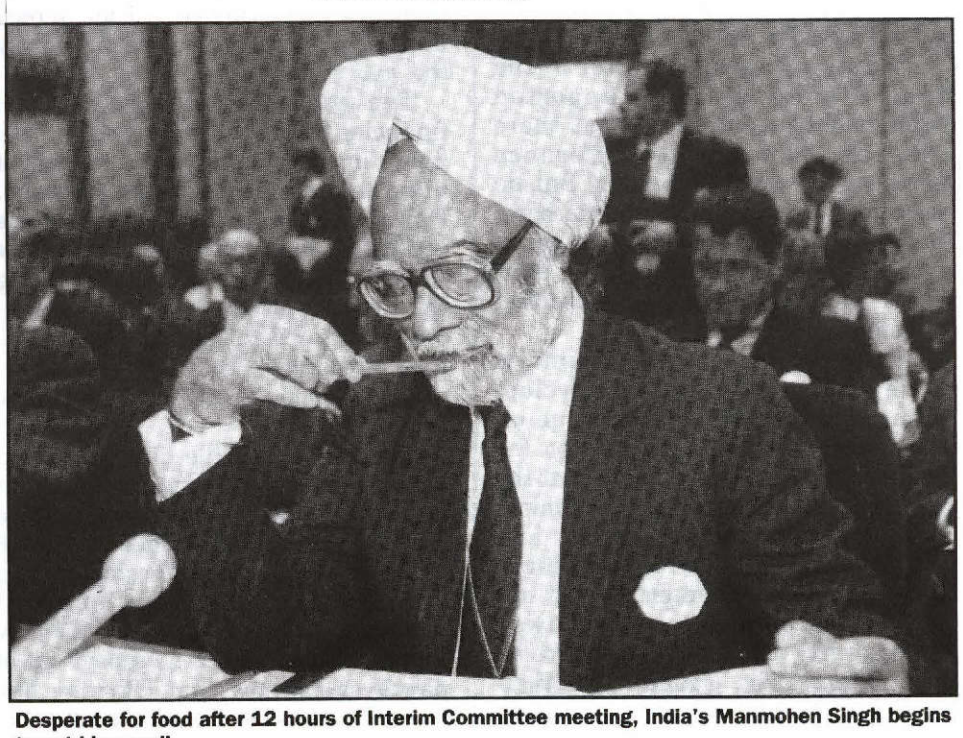
African Exim bank president CC Adordu with Standard Chartered's David Moir: in search of development at the CDC, DEG & FMO gathering

Washington, DC Hustle

Photos by Erica Lansner and Lisa Quinones



Citibank's vice chairman William Rhodes with Bank of Tokyo's Toyoo Gyohten: whispers of a trillion dollar intercontinental bank?



Desperate for food after 12 hours of Interim Committee meeting, India's Manmohen Singh begins to eat his pencil

News

TUESDAY, OCTOBER 10, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 62

STILL TIME TO WIN THE WHISKY

There is still time to enter the *Emerging Markets* competition to win a bottle of The Macallan malt whisky. All you have to do is suggest a name for the planned new European currency and fax your suggestion to us by 4 p.m. today. Among the cheeky entries so far, we have received Eurodollar, Sovereign and even Playdough. **The fax number is (202) 824 9797.**

Guns for Butter

(*Continued from page 1*)

tion in any country, nor do they have the expertise to reduce any tensions that may abruptly ensue."

But Ani appeared much more enthusiastic about cutting rich countries arms exports to the developing world and spoke of "the need for restraint on the part of countries producing arms and military equipment from exporting excessive quantities to developing countries. We fully endorse putting an end to all such military actions and hope the source countries' governments will take serious actions to limit the expansion of arms sales."

Wolfensohn later said that he accepted the development committee's stand on the issue — urging the bank and fund to work closely with member countries to reduce non-productive spending "including excessive military spending" — as "the view of our shareholders." He added that "one of the reasons why donors are not interested in foreign aid is that they think it is going towards buying guns."



James Wolfensohn and Boutros Boutros-Ghali

Wolfensohn was adamant that — contrary to popular perception — there was no major difference between the bank and fund approach to tackling multilateral debt. He said that when a "well known newspaper [*The Financial Times*]" was reporting major differences between the bank and fund over the bank's debt reduction proposals, "Mr. Camdessus and I were on holiday together." But Wolfensohn added that he was unused to working in a public institution where every nuance of a project would be open to scrutiny.

Deputy managing director of the fund Stanley Fischer supported Wolfensohn's contention that there was no substantive difference between the two institutions. But he was unable to explain why the bank had earmarked some 25 poor countries as needing multilateral debt relief when the fund had identified only four.

Many poor debt-ridden countries were disappointed by the development committee's communique on debt, saying that it leaned too far towards the fund's perception that the multilateral debt problem was limited to a small number of countries and did not merit a wide-ranging initiative. Uganda, for example, says it has to divert $100 million a year away from poverty elimination to service its multilateral debt. Uganda's multilateral debt is $2.5 billion, about five times the level of its exports.

Demonstration Stops Traffic, But No Capitalistic Crisis

BY JON MARKS

It wasn't the Million Man March, which is coming to Washington this weekend, but demonstrators against the international financial institutions came in their hundreds yesterday to protest against the Bretton Woods world order.

Except for delegates stuck in very un-Columbus Day traffic they caused, the demonstrators filing up from Dupont Circle made little immediate impression on the bankers and officials sequestered in meetings at the Sheraton Washington Hotel. But the demonstration made its point nonetheless. It showed that an increasing and disparate number of non-governmental organizations (NGOs), community groups and other activists were seeing World Bank and IMF operations as central to their preoccupations.



Protestors

"I've watched these things for 12 years since we started campaigning, and this is the biggest," said Brent Blackwelder, U.S. president of Friends of the Earth, as aging veterans of anti-Vietnam protests mingled with younger concerned citizens and pressure groups from Haiti and other developing countries, including Zapatista sympathizers from Mexico's Chiapas state, who in the afternoon joined a demonstration against the Zedillo visit.

They mingled with the media and chatted with a few World Bank officials who made the effort to cross the yellow "Do Not Cross" tape, strung across the hotel lawn to separate demonstrators from delegates. Relaxed Washington police and less relaxed private security looked on as makeshift drums beat and the committed whooped.

Marcia Burnett of the Springfield, Massachusetts-based Action for Social Justice, which works for the low income community, said to applause, "We have made connections on how structural adjustment programs [from] the World Bank and IMF affect us in this country...welfare reform is nothing more than structural adjustment."

Speaking on a hill outside the Sheraton where demonstrators gathered for speeches and Woodie Guthrie songs, World Bank spokesman Timothy Cullen said, "It is ironic that many of the objectives of the campaign and the World Bank are the same. The World Bank has developed a dialogue with the NGOs. Everywhere he has visited, [World Bank president] Jim Wolfensohn has met with NGOs."

One poster identified the bank and fund as "The New Colonial Masters." Nicaraguan priest Miguel d'Escoto described the institutions as "products of a diabolical system, capitalism, which you people in this country [the U.S.] have been practically taught to worship...it has become easier to challenge the Trinity more than capitalism."

Pointing to campaigns ahead, Witness for Peace's Carol Richardson, who had only recently heard that commercial institutions were also present, offered, "Maybe one of the actions we can take is to talk to commercial bankers and explain why we are here."

Richardson led an attempt to hand over beans, aspirins and pencils — called the BAP by campaigners — to World Bank president Wolfensohn, who was not present.

As a crowd of demonstrators, television cameras and police looked on, the BAP baskets were laid on the pavement outside the Sheraton's main entrance. A bearded man beating a plastic drum chanted, "Watch out for beans, they are dangerous; pencils can poke out your eyes." Then the demonstrators went home, creating less disturbance than when they arrived, while the bankers hurried away to lunch.

UKRAINE PLAYS THE CHERNOBYL CARD

BY CRAIG MELLOW

Ukrainian deputy prime minister Ihor Mitiukov said yesterday his country needs "significant assistance" to close down the Chernobyl nuclear power plant, estimating the cost of shutting the notorious facility, where three of four reactors still function, at $4 billion. G7 donors, led by Germany and France, have so far pledged $700 million. Earlier this year, Kiev agreed in principle to phase Chernobyl out by the year 2000.

The two sides are defining their financial terms differently. The G7's figure includes only the direct costs of dismantling the nuclear plant. Ukraine's wish list adds such costs as replacing lost power, building new waste storage facilities and relocating the plant's workers. "Our experts, of course, wanted to raise the figures as high as possible," Mitiukov told *Emerging Markets*, in a rare bit of diplomatic candor.

Yet a considerable de-nuking gap remains, and Ukraine wants to use its new-found multinational favor to close it. The most immediate demand is for an $890 million credit to complete two new nuclear facilities which will replace Chernobyl's output. Mitiukov claimed the loans can be repaid out of power sales, now that Ukraine has deregulated its electricity market.

A delegation of EU environment ministers visiting Ukraine last May "agreed that this is a complex problem," Mitiukov reported. But their governments have not yet decided how much complexity they will pay for. Ukraine has already received an impressive $3.5 billion in international grants and credits since reformist President Leonid Kuchma took office last year. But the lion's share has come from the IMF and World Bank rather than bilateral donors.



Ihor Mitivkov speaks

The bank, which has a policy of not funding nuclear power, is steering clear of the Chernobyl conundrum. It has approved a $110 million loan for upgrading Ukraine's hydropower production, though. Mitiukov said the human costs of Chernobyl are already straining Ukraine, which levies a 12 percent wage tax for clean-up and compensation to the victims. He also argued that the international community's reasons for demanding closure of the remaining reactors are more symbolic than scientific. Only one of the three is of the antiquated RMBK type which caused the 1986 accident. Meanwhile, 11 RMBK reactors remain in use in Russia, including one just outside St. Petersburg.

While it wrangles for a better deal on Chernobyl, Ukraine is preparing to get tough on bankrupt coal mines. Mitiukov said 38 mines will be shut in the Donbass region, once the engine room of Soviet industry.

Ukraine has about 500 mines altogether, most of them antiquated and inefficient even compared to potential competitors in Russia and Poland. The sector is considered a political time bomb. The miners are mostly ethnic Russian, have a history of political organization, and were treated as an elite in Soviet times.

But Mitiukov, said Kuchma — who is of Russian origin himself — is ready to bite the bullet. "The trade unions increasingly understand that the government cannot just print money for them," the vice premier observed. He said Deutsche Morgan Grenfell has offered to fund a $100 million study on restructuring the Donbass mines, pending an export credit guarantee from the U.K. government.

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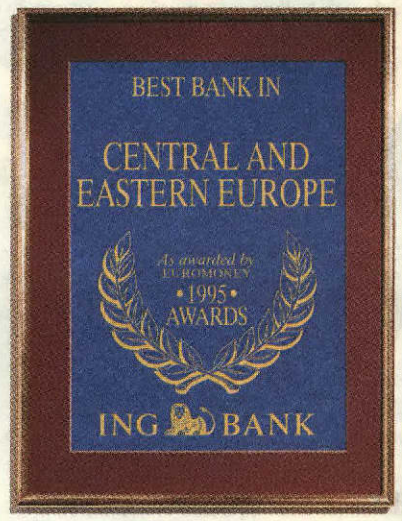





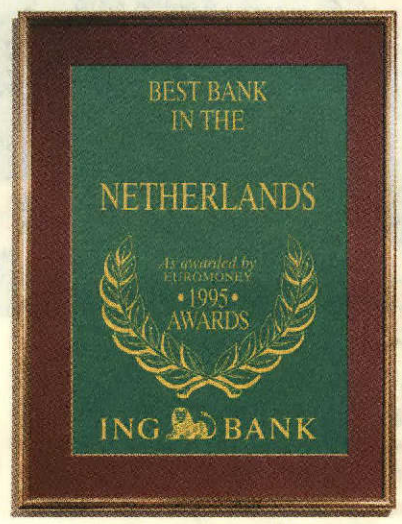

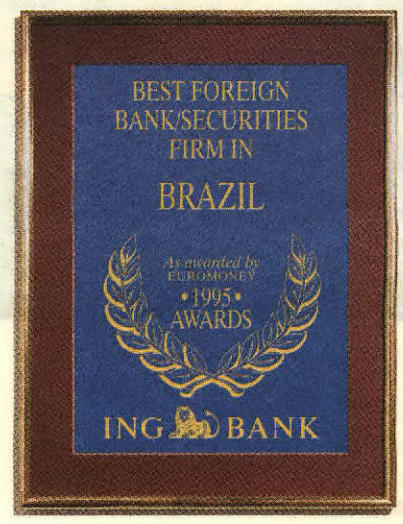

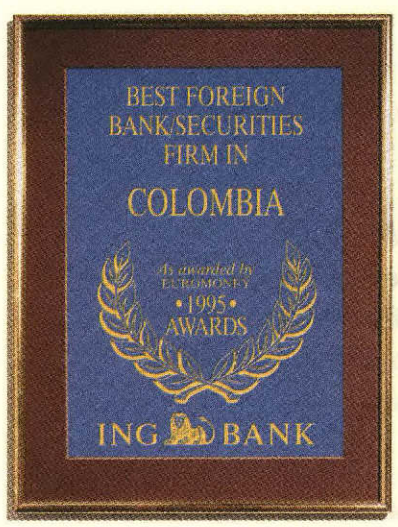



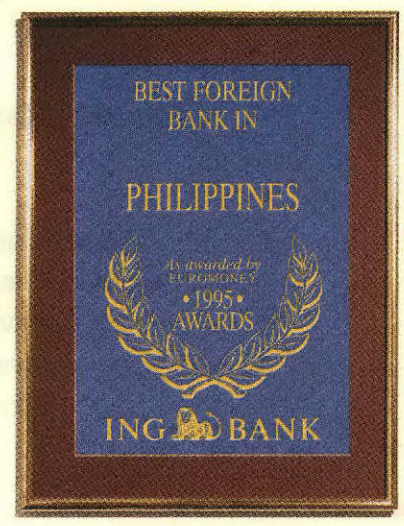

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EMERGING MARKETS

IMF/WORLD BANK DAILY EDITION • WASHINGTON, D.C. • WEDNESDAY, OCTOBER 11, 1995

Clinton Defends Mexico Bailout

BY PETER KOENIG

U.S. President Bill Clinton and Mexican president Ernesto Zedillo joined forces yesterday to defend the U.S. $37.5 billion bailout of Mexico last February on the grounds that it shored up the international financial system.

"If the Mexican economy had been allowed to deteriorate further because of speculation in financial markets, then one of the great experiments in democracy would have been damaged because of a short-term problem, and Argentina, Brazil and other emerging markets in other parts of the world would have been threatened," Clinton declared.

"These decisions [concerning emergency loans to Mexico] were made to safeguard the international financial system," Zedillo added.

Speaking at a joint White House press conference after a morning of meetings involving U.S. treasury secretary Robert Rubin and Mexican financial secretary Guillermo Ortiz, Zedillo forecast a strong economic recovery for Mexico next year. Clinton noted that last week, $700 million of the $12.5 billion Mexico borrowed from the U.S. to stabilize its currency was repaid ahead of schedule.

The meeting between Clinton and Zedillo was billed by both governments as a reaffirmation for the North American Free Trade Agreement (Nafta), which went into effect in 1994, and which the two declared had prevented an even greater loss of trade and jobs in both nations since the peso crisis. In addition, the two leaders discussed sensitive border issues including drug smuggling and illegal immigration, as well as other topics such as the environment and money laundering.

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Clinton said that when Mexico defaulted on its loans in 1982, "it took Mexico seven long years" to regain access to international financial markets. Now, he said, after the peso crisis has just passed, "under President Zedillo's skillful leadership it took just seven months."

The signal, sent by the two heads of state to European finance ministers and central bankers at the IMF, was not well received. Last February, European officials protested that the Mexican bailout was presented to them as fait accompli. These officials argued that Mexico's problems did not generate a crisis of confidence in global capital markets until the Clinton administration suggested that it might.



U.S. treasury's Rubin applauds IDA but cannot promise funds

©ERICA LANSNER

BROKEN PROMISES

BY CRAIG MELLOW AND KEVIN RAFFERTY

The U.S. came under fire from many directions at once at yesterday's opening session of the annual meetings of the IMF and World Bank as governors from rich and poor countries alike slammed Washington for failing to meet its commitments. Treasury secretary Robert Rubin showered warm praise on the operations of the International Development Association, and promised to fight for its funds, but added "I cannot promise results."

Governors for France and Sweden were first to lash out at the U.S. Congress' proposals to withhold funds the Clinton administration has already pledged to IDA. "For France, a significant replenishment of IDA is an absolute and urgent priority," said French finance minister Jean Arthuis. "It calls upon the other donors, and in particular the leading one, not to turn back."

Sweden's finance minister Goran Persson, speaking for the Nordic countries, was more stinging. "The failure of IDA's largest shareholder to honor its commitments puts into question the long-term viability of our best instrument for aiding sustainable development," he said. He noted that Swedish taxpayers contribute four times as much per capita to IDA as Americans.

Germany and the U.K. remained silent on IDA, but seemed generally to sympathize with Washington's drive to get tough on the multilaterals. German finance minister Theo Waigel warned that, "The IMF must not become a financial safety anchor for all sorts of economic problems." Bank of England governor Eddie George added, "The fund has not been tasked with the job of bailing out creditors."

Italy Prime Minister Lamberto Dini sought middle ground, noting, "We will do our best to contribute to the replenishment of IDA. But expectations about transfers must be realistic." Bank of Japan governor Yasuo Matshushita was tamer still. "All countries must make the utmost effort so that agreement on IDA can be reached," he declared.

But the attack was resumed by Switzerland's finance minister Otto Stich, who warned some industrial countries could fail to fulfill their international responsibilities in the area of burden-sharing and thus create a domino effect in the donor community. He also urged other countries which "have achieved a level of pros-

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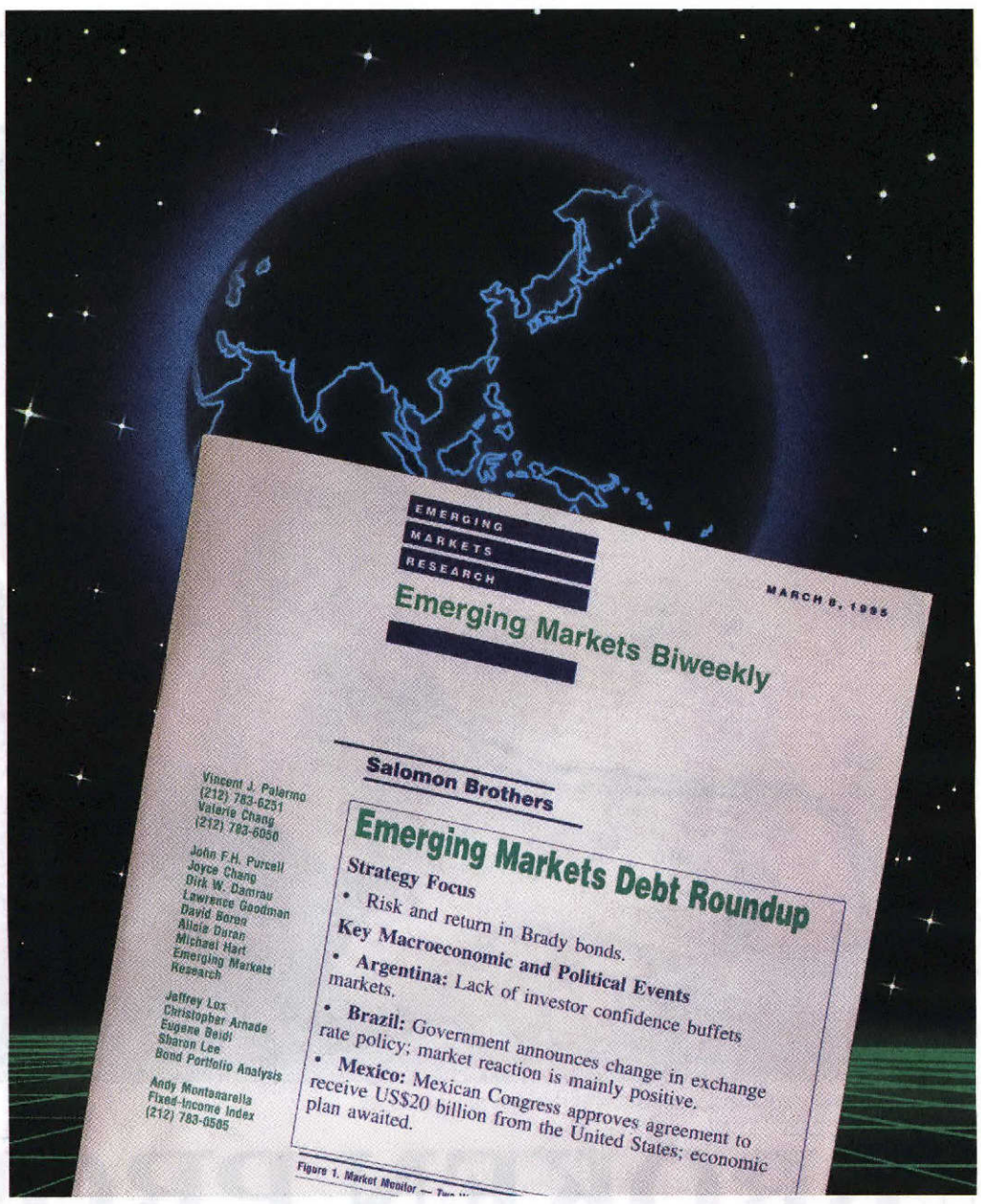

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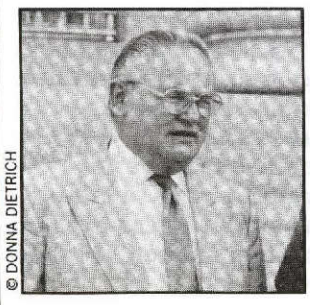

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"We must never give capital markets the impression that financial authorities will ride to the rescue of every sovereign debtor in difficulty over debt service or foreign exchange."

— Bank of England governor Eddie George

Citizen and Friend of the World

In his first speech at the annual meetings as president of the World Bank yesterday, James Wolfensohn presented himself as Jim Wolfensohn, Citizen and Friend of the world. His odyssey — the word he used — to 25 countries in the four months since he took over has clearly given him many rich insights into the lives of ordinary people. Those who have watched him at work have been impressed by the way he broke away from his minders to see for himself how people live at the grassroots, where there is all too often no grass.

It is worth repeating the "image" of just one of the people whom he met, as Wolfensohn himself recalled her: "The woman entrepreneur that I met in the small town of Katwe, Uganda, converting banana peels into charcoal briquets for sale — and using the proceeds to improve her community; she had all the pride of the chairwoman of a multinational company, as she shared with me her pencil-written records."

The bank president met her, and children in Africa "working 10-to-a-book and two-to-a-pencil"; saw the wretched conditions of unemployed Palestinians in Gaza "where incomes have been stagnant for a decade"; and visited South Pacific islands "where our environment is under attack as foreign entities seek to destroy natural forests for profit without any long-term concern for the future of the islanders." His conclusion is that: "I have learned that the real test of development can be measured not by the bureaucratic approval process, but the smile on a child's face when a project is successful."

It is a vital litmus test that can be easily forgotten in power-hungry Washington, and certainly at these jamborees of the annual meetings where the expenditure on a single party is often obscenely high and could keep an African village fed for a month. It is good to know that the bank again has a president who cares and can remind his powerful friends that we are in this world together, and that the future of mightiest and most powerful country is linked to the fate of the poorest, most indigent villager.

Even some of the non-governmental organizations have admitted to being impressed. "Citizens' organizations from around the world have long called for environmental protection, education for girls, public participation, access to microenterprise credit, and debt relief, all points recognized as important by Mr. Wolfensohn today," declared a news release from the 50 Years Is Enough campaign. It went on to express disappointment that the bank president had said nothing about the devastating consequences of structural adjustment programs.

This is a good start, but only a start. The road to hell, it should be remembered, is paved with good intentions. There are also some disappointing signs about Wolfensohn's first few months. The story is that he has intimidated some of his colleagues in the bank by his aggressive manner in asking questions — such that it was suggested that he should carry a sign on his head saying, "I'm only asking questions." At his first formal press conference after the development committee meeting, he was a bit anxious to sneer at the press. One of those present with a long memory of Washington muttered "Richard Milhouse Wolfensohn" — an unfair observation.

He also quickly ducked awkward questions about Indonesia and its occupation of East Timor, condemned by UN resolution, claiming that he had not been there yet. Come now, as a well-informed ex-Australian (who has not forgotten about googlies or bouncers — cricketing terms, equivalent to fastballs and curves in baseball), he could have been more honest.

When it comes to the prospects of the World Bank and the world for taking true development to those dusty grassroots, there are three major problems. One is having sufficient funds. Here, all the good intentions of the White House, U.S. treasury and Congress will lead to hell if the money is not forthcoming. And there is no sign yet that Wolfensohn, for all his high-level contacts, has managed to get the money.

The second problem is the bank's ability to deliver good projects and make good use of its aid. Wolfensohn has shown intelligence and political skills in his approach so far, but we have to await his reshaping of the bank. His speed in espousing the causes of women and children and his concern for the environment are impressive, but perhaps his decision on the Nepal dam was too calculated to win over the environmentalists. There will come a time when the bank has to say no to the environmentalists, too.

Equally important is whether developing countries have the right policies to make proper use of aid. In his book, Sir William Ryrie draws attention to the huge sums that have been wasted. The debate on military expenditure in the development committee was not reassuring, as major developing countries defended arms spending and asserted that it was no business of the bank to ask how they ran their politics. Other disquieting signs include the record of human rights abuses on every continent — and the way that some rich countries and rich multinationals rush to do business with regimes that trample on the faces of the poor and those who dare to have different views. It is to be hoped that Wolfensohn will also treasure the importance of free speech and unconventional opinions as he maps out the future of the bank under his leadership.

Kevin Rafferty, Editor

News

ISRAELI ISSUE SIGNALS LIFE AFTER GUARANTEES

Israel is coming to the U.S. market to raise $250 million "in one or two months," Israeli finance minister Avraham Shochat told *Emerging Markets* yesterday. "It's the first time we're going without guarantees, so it's a test case." For each of the last three years, Israel has raised some $1.5 billion from loans guaranteed by the U.S. to help absorb over 700,000 new immigrants. "We want this issue to help prepare ourselves for the moment when we don't have guarantees," Shochat said. Israel has some $5 billion of U.S. guarantees in hand. Salomon Brothers is arranger, with Lehman Brothers, First Boston and Merrill Lynch as co-arrangers for the 10-year yankee bond. "Now it is for the market to decide the spreads," said David Brodet, finance ministry director-general.

MYSTERY OVER SAUDI MINISTER

BY JON MARKS

There is agreement among officials and analysts that the resignation this week of Saudi Arabia's finance and national economy minister, only two months after taking up the post, was due to ill health.

The question being asked by the Middle East business community present at the annual meetings is why was the ailing Solaiman Abdel-Aziz Al-Solaim appointed in the first place? And who will replace him in one of the G10 country's most powerful and information sensitive positions?

In comments made yesterday in the Sheraton Washington Hotel lobby, Saudi Arabia monetary agency governor Shaikh Hamad Al-Sayari said "the minister was ill. He had to resign due to health reasons." The central bank governor added that, although new to the finance job, Al-Solaim had been commerce minister for 20 years and was aging.

Independent analysts say the word from Riyadh is that Al-Solaim had a heart condition that may be worsening. Or he has found the stresses of a high profile job too much. "The Saudi rumor mill is never really very effective, but most people believe Al-Solaim really did resign through ill health," said one Arab analyst. "Two months in office was probably too soon to be fired."

Al-Solaim's name is not included at the head of the large Saudi delegation attending the meetings. The delegation is headed by Al-Sayari.

Al-Sayari declined to comment on who would replace Al-Solaim — or whether he might be a candidate. "We do not know when a choice will be made, but an acting minister has already been appointed."

The temporary replacement is Abdul-Aziz Bin Abdullah Al-Khoweiter, one of six ministers of state and a trusted aide of King Fahd who has acted as ministerial stand-in before.

Al-Solaim replaced another long-serving minister, the powerful Mohammad Ali Abalkhail who is also said to be suffering from ill-health. When King Fahd announced what was described as "the most fundamental shakeup of government for two decades," it was felt by analysts that Abalkhail would be a hard act to follow.

"The question is now whether we will see someone drawn from the younger generation," said one analyst in Washington. "The finance ministry in Saudi Arabia is very powerful. Everyone will be waiting for the king to decide who is going to gain access to all that information and all that money."

FLOWING GAS FUELS HOPE OF BOSNIAN CEASEFIRE

BY HENRY COPELAND

As gas and electricity flowed to Sarajevo yesterday, Bosnian officials in Washington pressed ahead in their search for $3 billion to help reconstruct their war-torn country.

The Bosnians are seeking to capitalize on world attention to wring commitments out of countries attending the IMF/World Bank meeting. "Everyone wants to make contacts. We are interesting right now," said Neven Tomic, minister of finance of Bosnia and Herzegovina. Last week, Bosnia's Serbs committed to allowing much needed gas and electricity to flow to Sarajevo, where winter is approaching. The implementation of the ceasefire agreement — originally scheduled to begin yesterday — was contingent on, among other things, the resumption of utility services.

Last night, gas and electricity were flowing in parts of Sarajevo, wire services reported, but the ceasefire had not begun. Peace talks are scheduled to begin October 25.

In Washington, the Bosnian delegation is hard at work lining up donors. "All contacts are very successful, we feel," said Tomic. The Netherlands is enthusiastic about helping Bosnia meet the interest payments that will be due six months after settlement of the country's arrears, said Tomic. Kuwait and Malaysia have also expressed interest in the same area, he said. And France wants to help Bosnia clear its debts with the Paris Club, he added.

Bosnia has total foreign debts of $2 billion, which amounts to roughly $1000 for each person. In contrast, the country had a gross domestic product of only $288 per capita in 1993.



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Tomic: connoisseur of fickleness

"The country has lost 90 percent of its GDP since the war began," a U.S. government official noted yesterday. "What Bosnia needs is time, and it will bounce back. It's in no one's interest to saddle them with more than they can repay in a short time frame."

Bosnia owes $500 million to the World Bank and IMF, and these arrears must be cleared before the country receives assistance from either institution. The World Bank will serve as one of the chief conduits for money destined to help rebuild the Bosnia's infrastructure, and clearing the arrears is paramount to letting the assistance flow.

Tomic said the Bosnians take hope from the G7's recent meeting, in which they instructed the IMF and World Bank to settle the country's problems expeditiously and flexibly. The Bosnians have said that aid must be assured before a peace treaty is signed.

A bridge loan now seems a likely solution to the country's arrears, Tomic said.

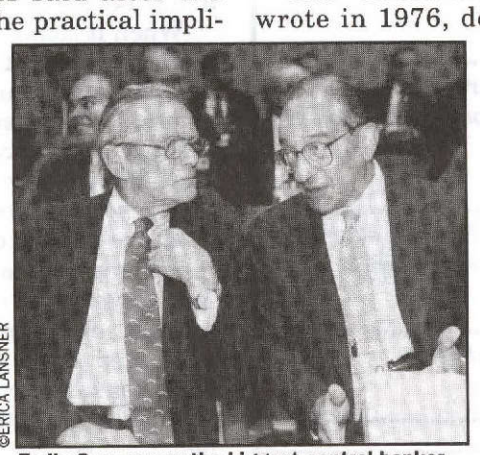
After more than 40 months of war, the Bosnian leaders say they have become connoisseurs of the fickleness of international enthusiasms. The delegation in Washington is pushing hard to solidify commitments of support now rather than later.

"We know that we are now a topic in the newspapers, but if we wait until after the peace process is signed to begin preparing our projects, all these promises cannot necessarily be realized. If we have these projects ready to begin when peace is signed, our chances are good," said Tomic.

Chicago University Laureates 5, Central Banks 0

BY KEVIN RAFFERTY

Robert Lucas, 58 year-old professor at the University of Chicago, was awarded the $1 million Nobel economics prize yesterday, making it the unprecedented fifth year in the past six that Chicago has taken the prize. The choice is something of a rebuff to central bankers attending the Washington meetings because, as Lucas said after the announcement, "The practical implication of my work has been to make us a lot more skeptical about our ability to use monetary policy to fine-tune the economy."



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Fed's Greenspan: the biggest central banker

The citation praised Lucas for "having transformed macroeconomic analysis and deepened our understanding of economic policy." The Royal Swedish Academy of Sciences said that "Robert Lucas is the economist who has had the greatest influence on macroeconomic research since 1970."

His work has been based on the concept of "rational expectations," and looks at the way in which families or companies use information about the future and update and interpret it to make decisions about their own finances. Lucas found, for example, that if workers believe that inflation is increasing, they are likely to demand higher wages, thus fueling inflation, almost like a self-fulfilling prophecy.

The "Lucas critique," which he wrote in 1976, demonstrated that shifts in economic policy often produce a different outcome if the persons effected change their expectations in relation to the new policy. "Rational expectations are genuinely forward-looking," said the citation.

Lars Werin, chairman of the Nobel prize committee, added that Lucas had shown that planners should take into account that individuals and businesses will spend less if the government runs a deficit. "People see that the budget deficit increases — taxes must be raised further ahead — so people start saving instead of consuming."

The Swedish daily paper *Svenska Dagbladet* headlined the award news, "It's Time for a New Generation" because Lucas is part of an up-and-coming group of economists. Economist Hans Soderstrom said the award decision would be controversial because Lucas preached a philosophy that opposes active monetary policy by central banks to influence exchange rates. "The conclusion is that, basically, there's nothing to be done," said Soderstrom. Nevertheless, many governments have recently adopted Lucas's work as the basis for their economic policies.

The economics prize — properly called the Nobel Memorial Prize in Economic Science — was endowed by the Swedish central bank in 1968. Since then, the United States has produced 24 of the 38 winners and Chicago has won eight of them.

THANKS A MILLION DOLLARS

New Nobel economic laureate Robert Lucas said in a radio interview that being an economics teacher is not the way to get rich — not like being an investment banker or a bond trader. The award brought with it about a week of fame. But Lucas does collect 7.2 million kroner, or about $1 million.



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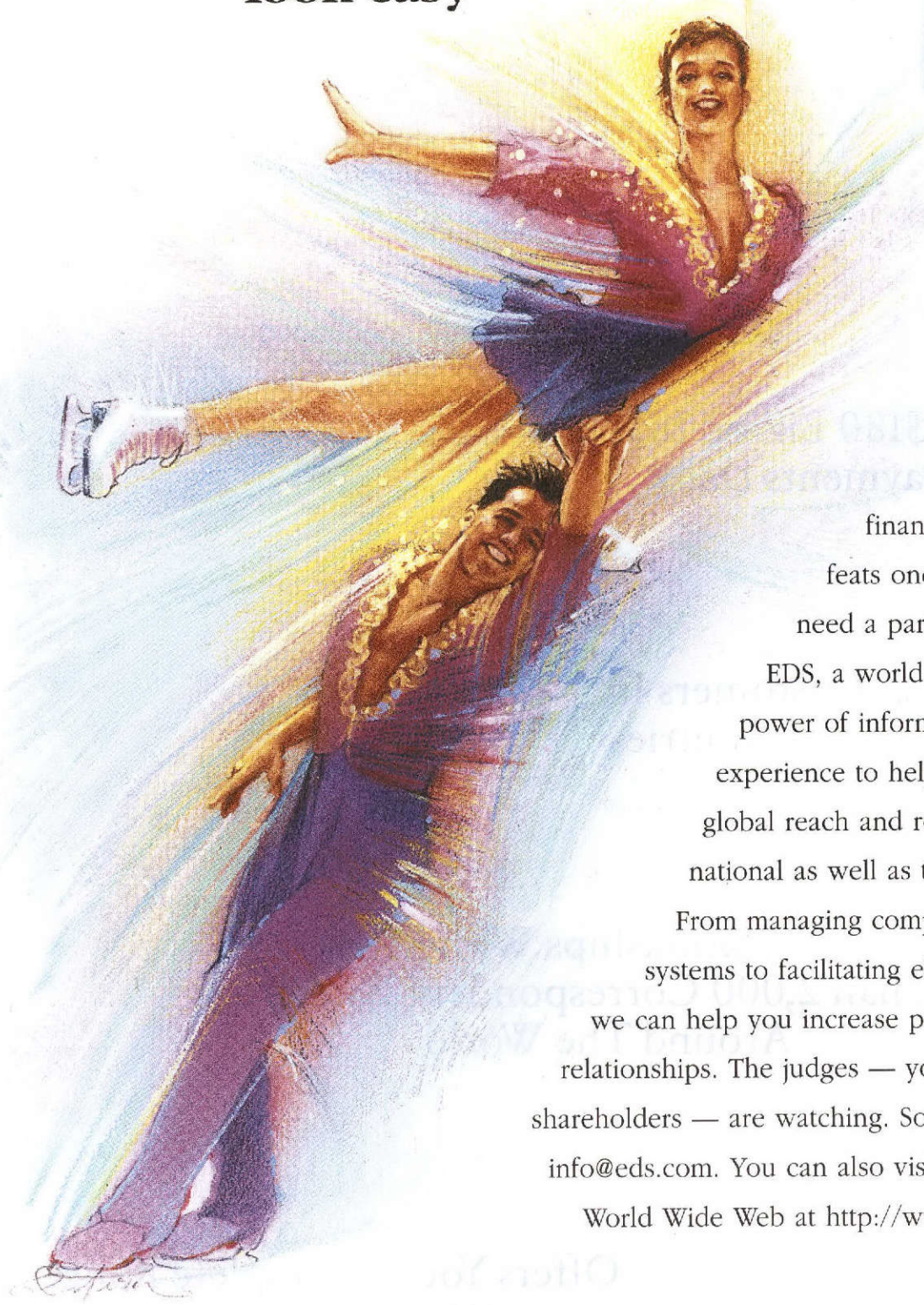

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News

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WHAT'S RUSSIAN FOR FEATHERBEDDING?

The budgetary austerity which the IMF is pressing on Russia has clearly not extended to the government office in charge of buying tickets to Washington. The Russians delegation had 51 members, by far the largest among emerging markets nations. Argentina came in second with 40 indispensable personnel. Moscow's official roster includes four journalists and a raft of officials who rank no higher than deputy department head. Russia and Argentina were by no means alone. Ukraine was no slouch at 26 members. Brazil continued a frequent-flying tradition with 36 delegation members. Poor nations living rich included Bangladesh, which required 16 representatives to address its affairs in Washington, and Benin, which brought 13.

IDA CUPBOARD NOT QUITE BARE

BY KEVIN RAFFERTY

World Bank president James Wolfensohn yesterday repeated his plea to the rich donors to support the full replenishment of the International Development Association and marshaled impressive figures show how important the soft-loan funds are to poor countries and to the U.S. itself. But at the end of the day, he had no new assurances that the donors would cough up the money.

In his speech to the opening session, the president stressed the vital role IDA must play in underpinning vital economic reforms and in giving a helping hand to people who will never see a commercial banker let alone one from the West or a guest at these meetings. There are 1.3 billion people in the world who live on a dollar a day or less.

"IDA's basic constituency is the world's three billion poorest people," said Wolfensohn. "Ninety percent of its lending goes to countries with per capita incomes below $600. Using its global experience, IDA is the advisor to the poorest countries on their economic reforms; the largest investor in their education and environmental programs — and in other vital areas, such as helping to combat Aids."

In the last few years, he added, IDA had helped to reduce malnutrition in 6,000 Indian villages, to distribute more than six million textbooks to primary schools in Africa and to provide basic nutrition to "millions of women and children in Central America."

At his press conference, Wolfensohn expressed the warmest support for the expansion of the private sector but added, "It is hard to get commercial schools, and not every infrastructure project can have a profit mode." IDA projects, he said, "create an environment in which the private sector will move." IDA was an "absolutely crucial" partner for the private sector.

The key, of course, is whether members of the U.S. House of Representatives and Senate meeting together in conference tomorrow to hammer out a compromise on the foreign aid bill will fulfill the full $1.25 billion of the Clinton administration. The house has slated only $575 million for IDA and the Senate $775 million. These are savage cuts to the promises made by Washington. Wolfensohn warned that "for every dollar cut by the U.S., IDA could lose a total of $5 — as other nations reduce their contributions proportionately."

Other countries showed that they were in no mood to make up the U.S.'s shortfall. Germany's finance minister, Theo Waigel, said: "The negotiations for the replenishment of IDA are a decisive test for the donors countries to fulfill their obligations" — meaning that the U.S. had to step up to the plate and meet its promises.

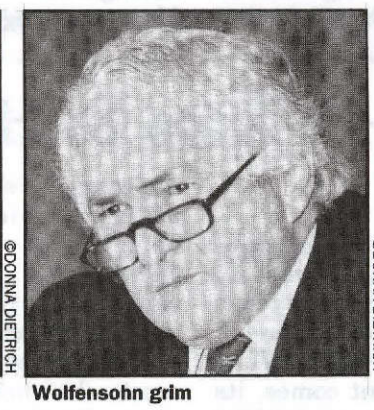
Wolfensohn pleaded that 75 percent of U.S. growth had been contributed by the growth of developing markets, so it was in America's self interest to provide the money for IDA. He said that both President Bill Clinton and treasury secretary Robert Rubin wanted Congress to meet the commitments in full. Later Rubin himself warmly applauded IDA's work.

He denied suggestions that Clinton and Rubin were using Congress as an excuse for not wanting to see IDA fully replenished. He added that congressmen got up in the morning asking themselves how they could balance the budget — not how they could cut IDA. But as the day went on, they got calls from constituents seeking to protect their own interests and "there are not too many calls from Bangladesh. The result is devastating."

If Congress does not come up with the money, IDA will be cut from $6 billion to $2.7 billion if the House vote prevails, or $3.7 billion if the Senate does, a devastating blow, leaving the cupboard not quite bare.



Wolfensohn happy



Wolfensohn grim



Wolfensohn bizarre

Wolfensohn Honeymoon Survives Annual Meeting

BY PATRICK SMITH

Delegates say that James Wolfensohn's annual meeting debut as World Bank president has lived up to the trailers. Officials in Uganda's delegation office watching Wolfensohn's speech on the closed-circuit television were impressed with his grasp of the issues. A cheer went up in the room when Wolfensohn started talking about multilateral debt: "Roughly a quarter of the poorest countries' debt is owed to multilateral institutions. We must...review the options to address the problem of the countries which cannot escape from their debt overhang."

Unsurprising, perhaps. Some 75 percent of Uganda's debt service payments are to the multilaterals, explained Emmanuel Mutebile, permanent secretary in Uganda's ministry of finance. "It is clear that Wolfensohn is behind the change on the debt issue," he added. Uganda diplomat Nimsha Madhvani-Chandaria was similarly impressed when Wolfensohn visited her country earlier this June, "He was determined to find out for himself...to formulate his view independently."

NGO activists, too, are prepared to endorse Wolfensohn. Oxfam America's Rob Buchanan said he expected Wolfensohn to move the bank forward on debt and other development issues: "Wolfensohn was clearly prepared to work with and listen to the NGOs." So far the only mote in the Wolfensohn eye is morale of the bank staff. On this, opinion is divided. Senior officials say those who have had the "Wolfensohn experience" — a balling-out in one of the corridors or being sent out of the room while one's performance is discussed — are predictably unhappy.

Others worry about his plans to break the "stranglehold of bureaucracy" in the bank and to "decentralize operations." But talking to journalists before his speech yesterday morning, he stressed that, although his arrival "sent scare stories through the bank," pruning the center would have strict limits: "We need the experts in water tunnels or micro-credit" and spoke of changes in the bank's bureaucracy being "evolutionary, not revolutionary."

Wolfensohn fans among the bank staff believe he could provide the strong leadership needed. "We are not looking so much at his ideas" one senior bank official said, "as his ability to galvanize and rejuvenate the bank to give it the sort of prominence it had under [Robert] MacNamara — but with better policies."

One European delegate said that the meeting has predictably focused on "Wolfensohn the man" rather than "Wolfensohn the idea." The delegate was impressed by Wolfensohn's "presentational skills...he has succeeded in making his two personal challenges — IDA and multilateral — dominant themes in the meeting."

Although Wolfensohn threw a birthday party for Bill Clinton at his magnificent Wyoming ranch, he remains staunchly bipartisan. He ensured that several Republicans joined the senior democrats at the bash. Asked whether he had spoken to Republican leaders, Bob Dole and Newt Gingrich, on IDA, Wolfensohn replied: "No...but perhaps I should."

Nobody Tells Wolfensohn What to Do

BY ANTHONY ROWLEY

World Bank president James Wolfensohn will be in the hot seat this week, giving an account of his tenure to the task force on multilateral development banks (MDBs) which is busy drafting a new "architecture" for the MDBs. But the World Bank chief made it clear yesterday that he does not intend to be dictated to by the task force.

In his characteristically blunt fashion, Wolfensohn noted that since becoming president of the bank four months ago he has been "working 16 hours a day and seven days a week" working out his plans for the future of the World Bank. "I am not waiting for someone else to tell me [how to run the institution]," he added.

Wolfensohn sees the need to map out future cooperation between his bank and the private sector as a higher priority than cooperating with other multilateral agencies, bank sources said. This is a matter of dollars and cents, since the private sector is putting much more money into development nowadays than all the multilaterals put together, the task force said.

Also presenting their cases this week will be Asian Development Bank president Mitsuo Sato and Inter-American Development Bank president Enrique Eglesias. EBRD president Jacques de Larosiere was grilled recently in London, and it will be African Development Bank president Omar Kabbaj's turn later.

None of the bank presidents seem to fear the possibility that the task force, headed by former Kuwait finance minister Abdlatif Yousef Al-Hamad, will knock heads together and tell them how to run their institutions. Wolfensohn said yesterday he feels "no constraint at all" about shaping the future of the World Bank with the task force looking over his shoulder. When he received reports recently from two internal task forces — on "professional excellence" and project implementation — he made it quite clear to senior aides that the buck stops with him when it comes to making decisions on the bank.

The task force will present an interim report this weekend and a final blueprint at the spring meeting of the joint World Bank/IMF Development Committee. Sources close to the group told *Emerging Markets* that it is unlikely they will opt for global "aid supremo" for aid to ensure that the World Bank and other MDBs all pull together on development. But they do want to devise a "system" to replace the loose "family" of development institutions.

News

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WORLD BANK BOOK-OF-THE-MONTH CLUB

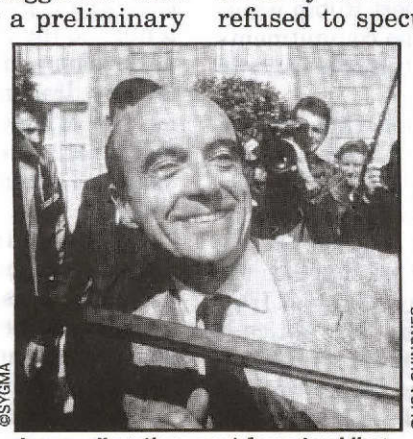
Sir Willam Ryrie's old chums at the World Bank have successfully lent him a hand and persuaded his publishers that there is good business to be done at the annual meetings. Not only did they manage to get a few copies of Ryrie's book, *First World, Third World*, to Washington before the publication date two weeks hence, but it is on sale at World Bank publications at a whopping discount for $31.96. By yesterday morning there were only five copies left, but the stall carries order forms offering the bargain price.

ISSING DISMISSES EMU WITHOUT FRANCE

BY CRAIG MELLOW

French President Jacques Chirac's stumbles on the way to economic reform have not quelled Germany's determination to achieve monetary union with France, Bundesbank chief economist Otmar Issing said yesterday.

Issing dismissed a suggestion that Germany could enter a preliminary union with the Netherlands, the only other EU nation which has so far fulfilled the fiscal probity requirements laid out in the Maastricht Treaty. "No one in Germany doubts that France will be included," he said. "The question is when."



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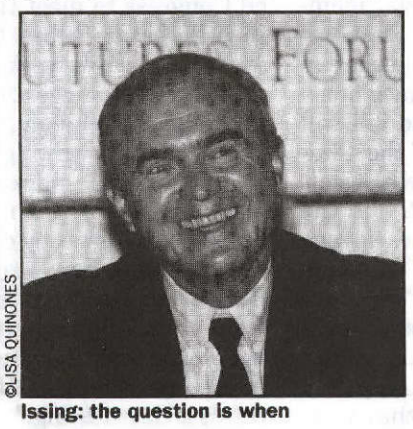
Juppe: allegations sent franc tumbling



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Issing: the question is when

The treaty gives Union members until 1998 to put their finances in order, bringing fiscal deficits below 3 percent of GNP. France's current deficit is about twice that figure. Chirac's promised attack on profligacy has been hampered by the resignation of finance minister Alain Madelin, a scandal over Prime Minister Alain Juppe's subsidized apartment, and international antagonism to France's new round of nuclear tests.

Issing, who spoke at a forum sponsored by the German Marshall Fund, refused to speculate on which other countries might join European Monetary Union (EMU). "So far two are fulfilling the treaty and 13 not," he said. "Let's not make any bets on who else will fulfill it."

Issing sent mixed signals on whether the Bundesbank will further ease interest rates as a spur to Germany's domestic economy. He called 1995 "a lost year for our labor market," and pointed to unemployment as Germany's most pressing problem. The depreciation of the Italian lire meanwhile eased inflationary pressures, allowing for two German interest rate cuts already this year, he said. On the other hand, he cautioned, "The dragon of inflation is never entirely defeated."

Dresdner Bank chief economist Klaus Friedrich said private German banks echo their government's support for EMU, or at least accept the need for new currency. "We have decided this is going to happen, basically for political reasons," he said. "It would be irrational to oppose what is going to happen anyway."

Friedrich told *Emerging Markets* the German financial establishment sees currency union as a means to the larger goal of uniting the continent. "This may sound corny to you, but our main goal is a lasting peace in Europe. Monetary integration is a part of that."

Hungary's Suranyi Says Glass Is Half Full

BY HENRY COPELAND

Unlike most of his countrymen, Gyorgy Suranyi sees the glass half full rather than half empty. And, as the governor of the National Bank of Hungary meets bankers in Washington, Suranyi is busy countering the perception that Hungary's glass is half empty.

"The perception of the external world is somewhat mixed, because the Hungarians are traditionally very willing to speak about their pains, their tensions," Suranyi told *Emerging Markets* yesterday.

"If you put a glass of water in front of Hungarians, then 90 percent will say its half empty; then if you put it in front of Americans, 90 percent will say it is half full," he said.

Suranyi even puts a positive spin on the Hungarian proclivity for complaining. "The negativism has a very positive aspect as well. Hungarian people demand much better life, much better living standards. This demand creates strong incentives to improve the economy," he said.

Hungary's unemployment — quadruple that of the Czech Republic — is actually a good sign, albeit a painful one, asserted Suranyi. The unemployment, he said, is a sign that companies have downsized, increasing efficiency and thus Hungary's competitiveness.

A surge in exports in 1993 and 1994 helped push the country's trade deficit to nearly 10 percent of GDP, but according to Suranyi, the surge actually reflects a boom in productive investments which will ultimately create more exports. Hungary has received nearly $10 billion in foreign direct investment since 1989. "When foreign direct investment comes, its going to generate serious demand for investment goods, and there is a very fast inflow of the most modern technology," he said.



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Suranyi: things aren't what they seem

Hungary's huge government budget deficits in 1993 and 1994 are a tertiary effect of corporate bankruptcies which are, like the country's unemployment, a sign of economic streamlining, he continues. After privatizations and vigorous greenfielding, "our competitive economy is now 85 percent private," said Suranyi.

Hungarians often complain about the country's slow privatization of its utilities, which were originally to have been privatized nearly a year ago. Suranyi notes: "When we are taking about the relative slowness of utilities privatizations, we can't even talk about the privatization of these assets elsewhere in the region. Even more, it's clearly a paradox that the participants of the tenders are basically publicly owned Western companies."

Hungary is currently selling stakes in its gas and electricity utilities, another stake in its national phone company, and the national oil company. Suranyi believes that Hungary has turned the corner after a crisis last spring. After an austerity package introduced in March by his graduate school buddy (now finance minister) Lajos Bokros, real wages will fall by more than 10 percent this year. And exports will grow in dollar terms by 16 percent this year, while imports will grow by only 4 or 5 percent. Post-March, the trade deficit is 50 percent less than the same months in 1993 and 1994, Suranyi noted.

Asked if he concurred with the view that it's now or never for a standby agreement with the IMF, Suranyi said: "It is obvious that this is an especially preferable, an especially adequate period, for negotiating with the fund. Nonetheless, my conviction is this is not the last opportunity. I would not exclude the opportunity for 1996."

Cofinancing Set to Expand

BY PETER KOENIG

Buoyed by a sell-out crowd attending this weekend's seminar on how the World Bank and the private sector can work together in the developing world, Hiroo Fukui, the vice president in charge of the World Bank's cofinancing program, yesterday pledged to "increase market responsiveness."

Fukui said that his department, which to date has helped underwrite seven private sector projects worth $1 billion, is working on reducing the length of time to get joint World Bank/private sector projects through the pipeline, while promoting "greater transparency of policy procedures."



Fukui

As a result of this more private sector-friendly approach, the Japanese civil servant indicated, the pace of project approvals is due to speed up, and the size of projects to increase.

"The program started slowly," Fukui conceded. "But four of our seven projects have been approved in the last year." He added that there were now 30 World Bank guarantee projects in the pipeline.

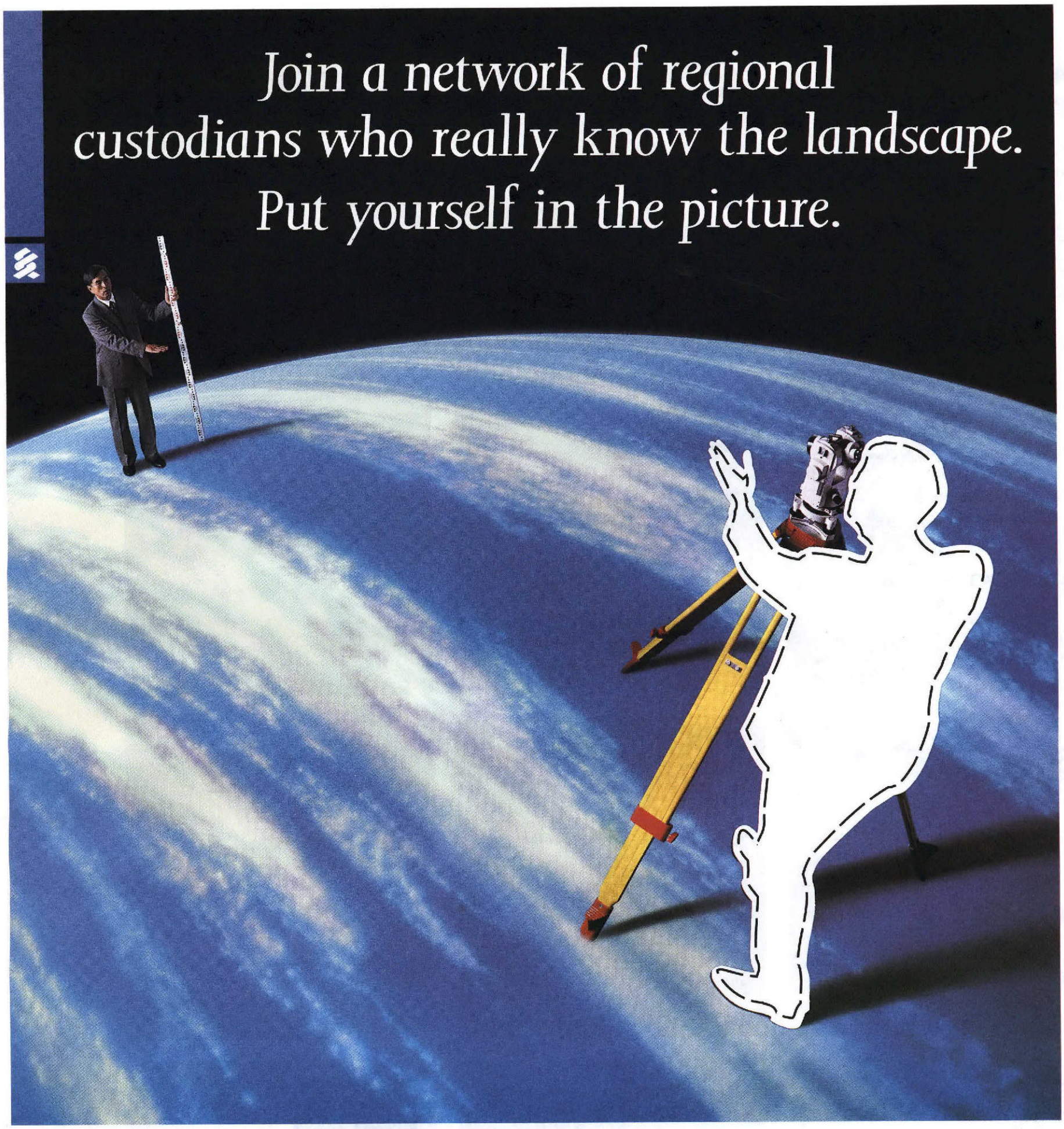
Refuting suggestions that World Bank president James Wolfensohn is lukewarm about World Bank cofinancing with the private sector in emerging market nations, Fukui said there were no constraints on the amount of funds available allowing the World Bank to guarantee private sector projects.

World Bank guarantees decrease the risk private banks assume when lending money in the developing world, because the bank guarantees to make good on bad debts meeting specified criteria.

"At our seminar, some people said that the World Bank would spend no more than 5 percent of its funds on cofinancings," Fukui said. "But this is not true. There is no such limit."

The World Bank officer plans to improve the climate for cofinancings by targeting a handful of nations whose economic programs seem especially suited to bank guarantees. He said the process of identifying these nations was advanced, but declined to provide any names.

Fukui also said that the World Bank was increasingly willing to use research on financings developed by private banks, rather than do all its own due diligence as it has in the past.



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£100m

8.625% subordinated bonds
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Crédit Local de France

ECU150m

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due 1998

SNCF

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C$100m

9.25% bonds
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TOYOTA MOTOR CREDIT CORPORATION TMCC

Toyota Motor Credit Corp

A$125m

10.75% bonds
due 1998

INVESTMENT BANKING. FROM **A** TO BZW

News

WHERE ARE THE PARTIES OF YESTERYEAR?

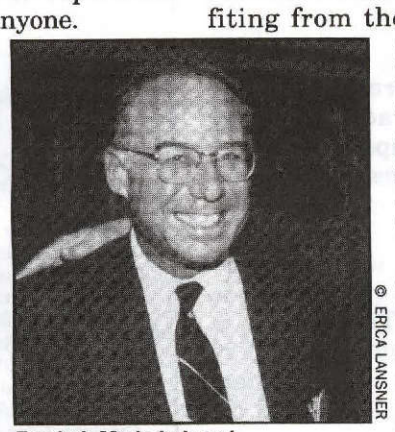
Cutbacks have had even World Bank staffers chomping at the bit (so to speak) and fleeing to private parties. "At the official reception this weekend, there were just a few shrivelled samosas and canapes and nuts to nibble, not proper food as we were used to," grumbled one subcontinental manager unimpressed by the cuisine. (Perhaps that was why Michel Camdessus stayed nearly all night in the interim committee meeting — because he couldn't bear his own reception?) Those hoping to fare better at Citi had a rude rebuff. Attendee-hopefuls without a formal invitation in hand had to queue up and be checked on the street by computer. Those without invitations at all were left on the street.

Frenkel Offers Anti-Inflation Recipe

BY JON MARKS

Jacob Frenkel sees other countries following his model for setting exchange rates and cutting inflation. This week in Washington, Bank of Israel governor Frenkel is focusing on currency stability and tight monetary policies carrying his "Made in Israel" stamp as a potential export, as well as the recipe that Israel needs to emerge from its economic problems. But he wouldn't wish to export the pressures of his job to anyone.

Inflation in 1995 will be under 8 percent, down from an annual average of 18 percent in the late 1980s. This has been achieved during a period when unemployment has fallen to 6.2 percent from 11.2 percent in 1992, despite an influx of immigrants, mainly from the former Soviet Union.



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Frenkel: Made in Israel

"The Israeli experience shows conclusively that fighting inflation correctly does not entail a rise in unemployment," Frenkel told *Emerging Markets* yesterday. "On the contrary, as inflation comes down, economic activity and even employment improved."

Despite this positive outlook, Frenkel's adherence of strict monetary discipline has put him at the center of controversy in Israel. "You don't get anywhere without a few struggles," Frenkel believes. He has yet to say whether he will seek a second five-year term in the pressure-cooker job next year.

The downside is a rising current account deficit and unhealthily low savings levels, which produced strong criticism from the IMF. "The fund's criticism was in 1994. Now they see what we are achieving, and are showing tremendous support," Frenkel claimed. Israel is also benefiting from the Middle East peace dividend. Exports have risen by 15 percent this year, with about one-quarter of sales coming from Israel's hi-tech "Silicon Wadi."

Nevertheless, the current account deficit is causing concern, as the trade gap has widened due to higher inputs of raw materials and investment goods — one consequence of the economy growing by an average 6 percent annually. In addition, import of consumer goods is booming, probably as a result of massive migration.

"How to build national savings is critical: it will be the policy priority for the next year or two," Frenkel said, in answer to a question about IMF concerns. This means further cuts to the budget deficit and "more difficult, how to raise private sector savings." On the deficit, Frenkel joked that "Israel is the only country whose Gramm-Rudman law on the budget has worked."

Capital markets development and privatization are means to increase private savings. Cutting inflation is essential through measures including budget cuts, structural reforms and, above all for the central bank, a rigorous — Frenkel calls it "dramatic" — interest rate policy.

Rates were raised to 17 percent from 10 percent in 1994, but are slipping back to 13.8 percent now.

Frenkel — a director of research at the IMF before moving back to Israel in 1991 — is keen to discuss currency fluctuations. "Here, the G7 has discussed global exchange rates; but for the non-G7, the question of choice of exchange rate policy is still a live issue," Frenkel said following a meeting in which the IMF brought in other countries, including the Czech Republic and Colombia, to hear how his diagonal bend exchange rate system works.

The system involves setting rates based on forward inflation projections and a slope differential between target inflation and rates abroad. Poland and Chile are already following similar models, and Russian central bank governor Tatiana Paramanova discussed it during a recent visit to Israel.

The system "has been extremely helpful in helping us to lower inflation," she said. "It is an explicit statement from the authorities to business and the public saying, this is a target; now you can do your planning. It's not fine-tuning but a full medium-term strategy."

ANALYSTS PIN FAITH ON CARDOSO'S REFORMS

BY K. MICHAEL FRASER

Although Brazilian stock and bond markets are suffering because of fears that President Fernando Henrique Cardoso is losing support for his reform program, several longtime Brazil analysts said that reform will succeed.

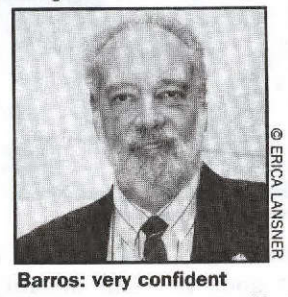
Foreign investors are generally disappointed with Cardoso's inability to move his proposals quickly through the opposition-dominated congress.

"Foreign investors have always expected too much too quickly...[They] have a calendar that has nothing to do with reality," said Brasilia-based Alexandre Barros, one of the country's leading political risk consultants. "Overall, I am very confident."

Peter West, chief economist of London's West Merchant Bank, told *Emerging Markets*, "There is a very good chance Cardoso will push most of the reforms through, with one or two compromises and one or two scares along the way."

One Brazilian analyst warned that the possibility of reelecting Cardoso in 1998 is beginning to be discussed. Reelection is forbidden by the constitution, and an amendment be likely to require increased government spending in return for votes. "We must watch this very carefully," he said.

During a speech at a Brazilian breakfast meeting yesterday, IMF first deputy general manager Stanley Fischer called Cardoso's "real" plan to stabilize the economy "one of the most successfully executed stabilization plans in history."



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Barros: very confident

Fischer said he was also satisfied with Brazil's exchange rate policies, which aim at keeping its currency within a band, currently 91-96 centavos to the dollar, and adjusting the band when trade flows require.

Fischer said Brazil's efforts to shore up its financial system and the several banks tottering on failure have been satisfactory. "In the early phase of the bank cleanup, the right measures have been taken," Fischer said. "I believe the problem will be dealt with correctly."

But Fischer warned, "The risk is in not consolidating the fiscal sector."

One of the most difficult problems facing Cardoso is the overhaul of federal/state relations. Constitutionally, the federal government must transfer much of its tax revenues to the states, leaving Brasilia with restricted ability to control public sector spending. To limit state spending, Cardoso is negotiating reforms with state governors, who are reluctant to cede power.

Fischer said control of public-sector spending is possible without reform: "Fiscal spending has been controlled for the past 15 months. It's not impossible without reform, but it is very difficult."

Like other analysts, Barros said he expected Cardoso to succeed, although perhaps not as quickly as the international financial community would like. "Reforms will come," he stated.

Real Inflation Really Matters

BY ANTHONY ROWLEY

Do high "real" interest rates — rates well above inflation — really matter? The answer is yes, according to a report published yesterday by the Group of Ten (G10) deputies. Real interest rates matter because they reveal a deep underlying economic malaise in many G10 countries, in the shape of low savings and investment rates and high fiscal deficits.

Last year's G10 meeting in Madrid ordered an inquiry into the seemingly arcane subject of currently high real interest rates, to find out what causes them and whether they have implications for economic growth and welfare. The findings are likely to be uncomfortable for at least some G10 members.

A study team led by Mervyn King of the Bank of England suggests that the secular rise in real interest rates — they have risen by around one percentage point (to 4 percent) on average in most G10 countries over the past 35 years — is due to a decline in savings rates in these countries.

In turn, this has mainly been caused by a rise in fiscal deficits, says King's team. They name no names, but a number of G10 finance ministers in town for this year's annual meetings will probably feel the heat of the accusation. Whether they heed the report's advice, that the best way to deal with deficits is through spending cuts rather than raising taxes, is another matter.

"National saving rates have declined by nearly 5 percent of GDP during the 1960s in the G10 countries and are now below 20 percent of GDP on average," the report says. "The drop is due mainly to a reduction in the savings rate of the public sector, though private savings has also declined as a percentage of GDP in most G10 countries." Investment rates as a share of GDP have also declined in most G10 countries, largely as a result of high real interest rates.

The report rejects the argument that high real rates reflect a global shortage of long-term capital: "Despite the growing importance of non-industrial countries in world financial markets, it does not appear that capital demands from developing and transition economies have been a major source of secular upward pressure on global real interest rates."

CORRECTION

Emerging Markets regrets an error that appeared in our profile of ABB's Percy Barnevik. Two zeros were accidentally dropped from the rise in ABB stock price, which has actually gone up by 4,500 percent in the last 16 years.

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Sutherland Warns Against G7 Closed Doors

BY PETER KOENIG

Observing that trade between industrial and emerging market nations is increasingly important in determining global growth rates, Peter Sutherland, chairman of Goldman, Sachs International, yesterday warned the governments of Group of Seven nations not to drag their heels in overhauling the architecture of international economic governance.

"The G7 was supposed to address the question of what becomes of the Bretton Woods institutions at its Halifax summit in June," the former head of Gatt and the World Trade Organization pointed out. "But nothing much seems to have happened."

In their statement over the weekend, G7 finance ministers did not refer to reform of the International Monetary Fund, the World Bank or the G7 itself, although in his capacity as chairman of the session, U.S. treasury secretary Robert Rubin declared, "I think if you look back a decade from now, the actions that are flowing from Halifax will be seen as having made an important contribution to stronger, more stable and better functioning global financial markets. And that, in turn, will contribute to the economic health of all nations in the global economy."

Rubin went on to offer a ringing defense of the industrial nations' talk shop. "The G7 is unique in the sense that it provides a valuable forum for a vigorous exchange of views that can influence policies, and that can help provide direction to the world economy," he said. "No other comparable forum exists that can play this role."

However, there have been rumblings from developing nations about the exclusivity of the G7 in the past. By 2004, developing countries will account for a larger share of world output than the industrial nations, according to the OECD. Developing nation discontent flared up anew over the weekend as the IMF interim committee voted to set up a two-tier emergency fund for responding to Mexican-style financial crises, one tier to be composed of the Group of Ten (the G7 plus three other European nations and Saudi Arabia), and a second tier to be composed of the G10 and surplus emerging market countries like Korea and Taiwan.



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Sutherland: nothing much done

In a weekend meeting, Brazilian finance minister Pedro Malan complained that the two-tier system would set up a G10 "aristocracy" which would exclude the emerging market nations whose financial support was being solicited.

Speaking in more emollient terms, Sutherland pointed out that a recent report of the World Economic Council, a think tank, had suggested that in addition to the G7 there be a G7-plus forum, one that would include the G7, plus permanent and rotational members from the developing world. But, he noted, "the suggestion seems to have been overlooked."

Sutherland also reminded bankers in Washington focusing on the financial dimension of international relations not to forget trade. "Clearly, trade has to play an important part in any debate about changes in the governance of the global economy," he said.

The international bureaucrat-turned-banker said he was "not fearful" of moves aimed at establishing a North Atlantic Free Trade Area, a new regional trade regime, but that this regime should be set up within the existing global regime based on most-favored nation rules.

In his interview with *Emerging Markets*, Sutherland concluded by calling for a review of the relationship between private and public sector financial institutions. "More and more, governments are in daily contact with the people in the global market," he noted. "Gatherings like the Washington meetings provide a further forum for contact. But how that contact should be put on an institutional footing, no one has thought much about."

UGLY DUCKLING SLOVAKS OUTSHINE PEERS

BY HENRY COPELAND

Vladimir Masar and his colleagues from Slovakia stalk the halls of the IMF and World Bank armed with a binder full of colorful charts. Inside its glossy pages are an equally glossy array of economic statistics, some of post-communist Europe's best.

Indeed, it appears that Masar, the governor of the National Bank of Slovakia, has only one problem. "Our problem is really in the public relations. Our situation is much better than our image," Masar said.

To drive the good news home to investors, the Slovak brochure offers some comparable data from Slovakia's better appreciated neighbors in the Visegrad four: Hungary, Poland and the Czech Republic.

Slovak inflation is one third that in Hungary and Poland, running at 9 percent in the last 12 months, down from 23 percent in 1993. Foreign exchange reserves stand at nearly $3 billion, and the country, in contrast to most of its peers, ran a current account surplus of $300 million in the first half of the year. Perhaps most striking, GDP is up 6 percent in the last 12 months, one of the best rates in all of Europe.

Slovakia's performance is indeed exceptional, Zdenek Lukas, an analyst at the Vienna Institute for Comparative Economic Studies, said in a telephone interview. The region's ugly duckling was in fact the second country to receive an investment grade rating from ratings agency Moody's.

"We have to distinguish between the political developments and the economic. It's a completely different story," he said.

Lukas said some of the credit for Slovakia's exceptional performance goes to minister of finance Sergej Kozlik, who has been willing, unlike his predecessor in office, to respect the central bank's legally mandated autonomy.



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Masar: try us, you'll like us

Also, Lukas said, credit goes to Masar and his staff, who have worked diligently to professionalize the bank's operations. When Masar took over the central bank in August of 1993, 70 percent of the Slovak government's budget deficit was funded by the bank; Masar and his staff rolled that number back to zero, where it has remained since.

Slovakia's positive numbers are little appreciated by international equity investors, Lukas said. "The most serious problem is that foreign investors remain very hesitant," he said. "The registered foreign direct investment totaled $585 million in June of 1995, but it was already $552 million at the end of 1994. That is new investment of just $30 million. There has been a very radical deceleration of foreign direct investment."

Equity investors are uncertain about Slovakia's mercurial and authoritarian prime minister, Vladimir Meciar. Again noting the disparity between Slovakia's economy and its politics, Lukas said, "nobody knows how long these completely different developments between the political and economic field will be compatible."

The Slovaks will be negotiating this week with the IMF to open the third of four tranches of an SDR115.8 million ($77.3 million) standby agreement. "We hope that in a short time we can have an agreement," Masar said.

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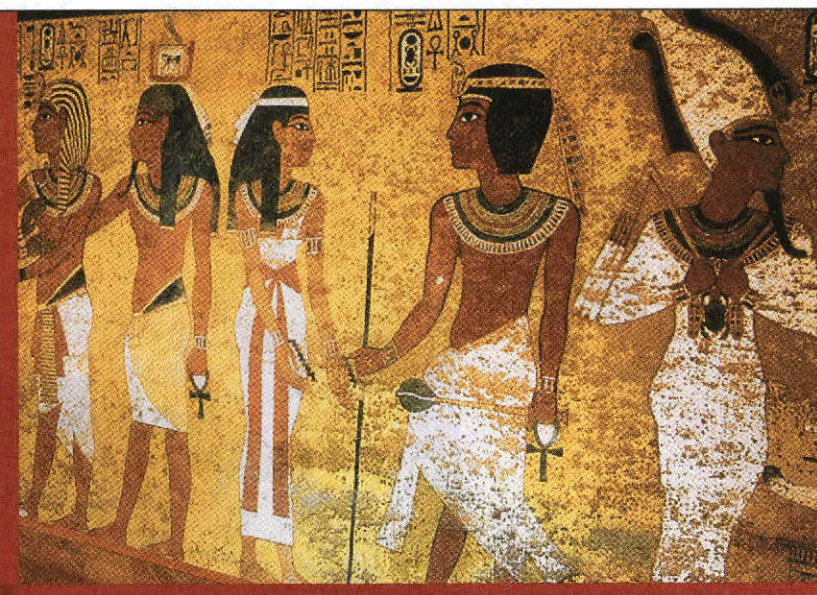



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Preview

October 11-12, 1995 AGENDA

WEDNESDAY, OCTOBER 11
7:30–9:30 A.M.
Emerging Markets Annual Meeting Forum, "Two years after the fall: South and Southern Africa." Breakfast and panel discussion. Speakers include: Chris Liebenberg, minister of finance, South Africa; L.B. Monake, deputy executive secretary, Southern African Development Community; Babacar Ndiaye, former president, AfDB; Ronald Penza, minister of finance, Zambia; Tomaz A. Salomão, minister of planning & finance, Mozambique; S. Tawengwa, chairman, Zimbabwe Electrical Supply Authority. Omni Shoreham Hotel. All delegates and guests are welcome.

8:00 A.M.
World Bank press conference with James Wolfensohn and NGOs. Virginia Suite B, Sheraton Washington Hotel.

8:00 A.M.
Discussion moderated by Stanley Fischer, IMF first deputy managing director, "Lessons from economies in transition." Cotillion Room, Sheraton Washington Hotel.

9:30 A.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

12:30–2:30 P.M.
Macquarie Bank hosts a luncheon. Potomac Room, The Carlton Hotel.

2:00 P.M.
IFC press briefing, "Creating a Private Sector in Ukraine." Congressional Room, Wardman Tower.

3:00 P.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

6:00–8:00 P.M.
Bank of China hosts a reception. Grand Promenade, The Grand Hotel.

6:00–9:00 P.M.
The Qatari Banks host a reception. Corcoran Ballroom, Four Seasons Hotel.

THURSDAY, OCTOBER 12
7:00 A.M.
Press breakfast hosted by the World Bank Group. Cotillion Rooms, Sheraton Washington Hotel.

8:00 A.M.
Press conference with World Bank president James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.

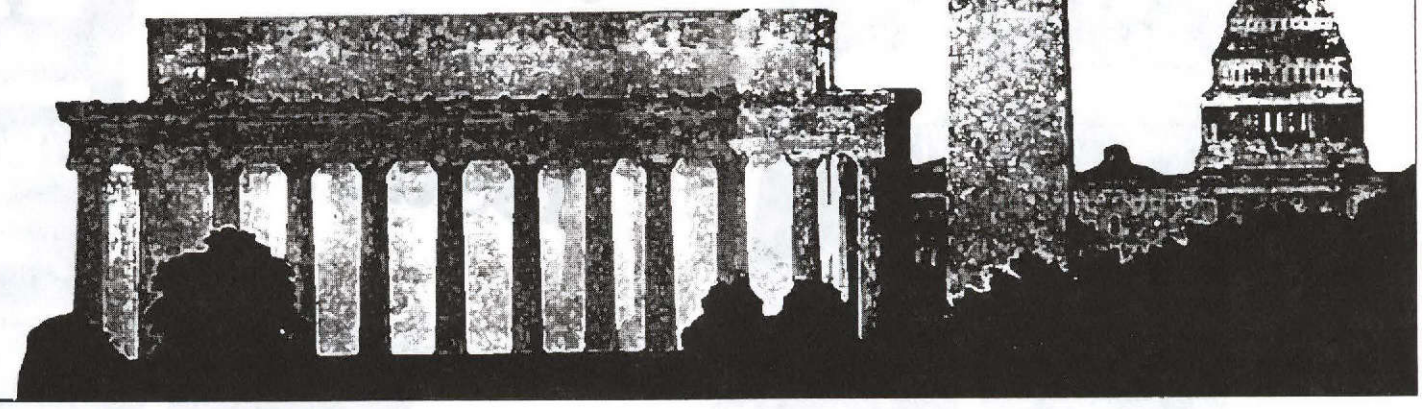
9:30 A.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

11:00 A.M.
Closing ceremonies. Plenary Hall, Sheraton Washington Hotel.

12:00 P.M.
Institute of International Bankers hosts a reception and luncheon with guest speaker Alexandre Lamfalussy, president of the European Monetary Institute in Frankfurt. Grand Ballroom, Plaza Hotel. By invitation.

12:00 P.M.
Press conference with IMF managing director Michel Camdessus. Cotillion Rooms, Sheraton Washington Hotel.

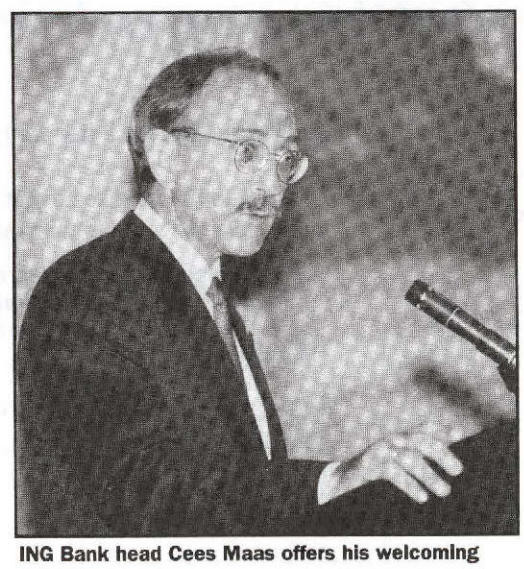
1:00 P.M.
Press luncheon hosted by Michel Camdessus and James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.



CEO of the Year Awards



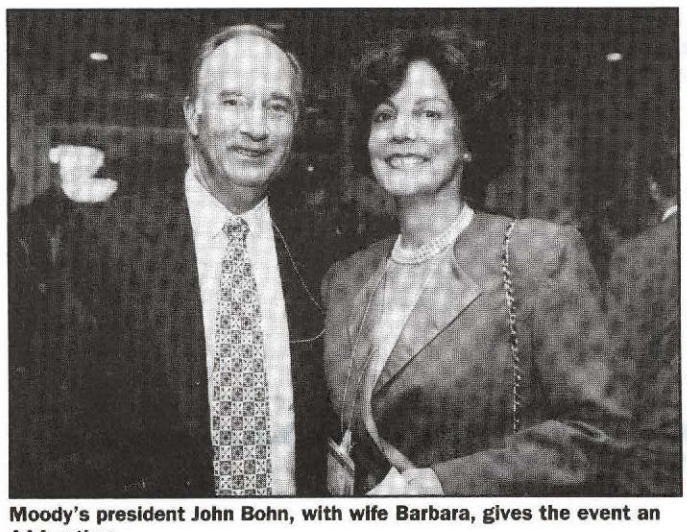
CEOs of the year Stan Shih of Acer and Percy Barnevik of ABB display their award



ING Bank head Cees Maas offers his welcoming remarks



International financial guru George Soros turns to hear the award winners' speeches



Moody's president John Bohn, with wife Barbara, gives the event an AAA rating

Photos by Erica Lansner

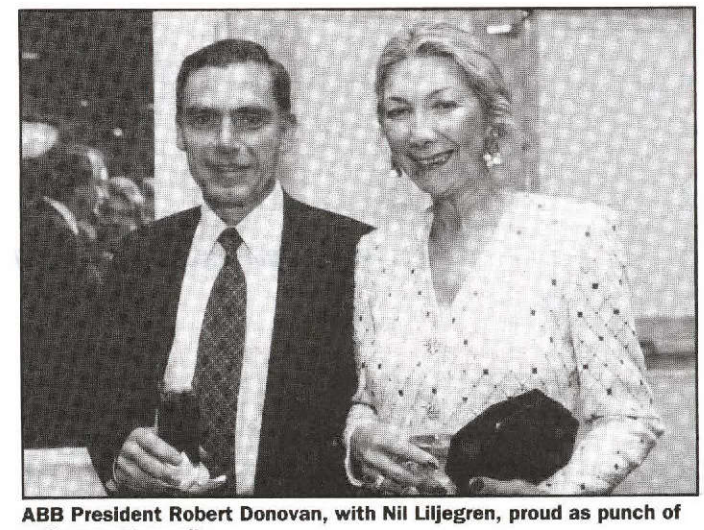


ABB President Robert Donovan, with Nil Liljegren, proud as punch of colleague Barnevik

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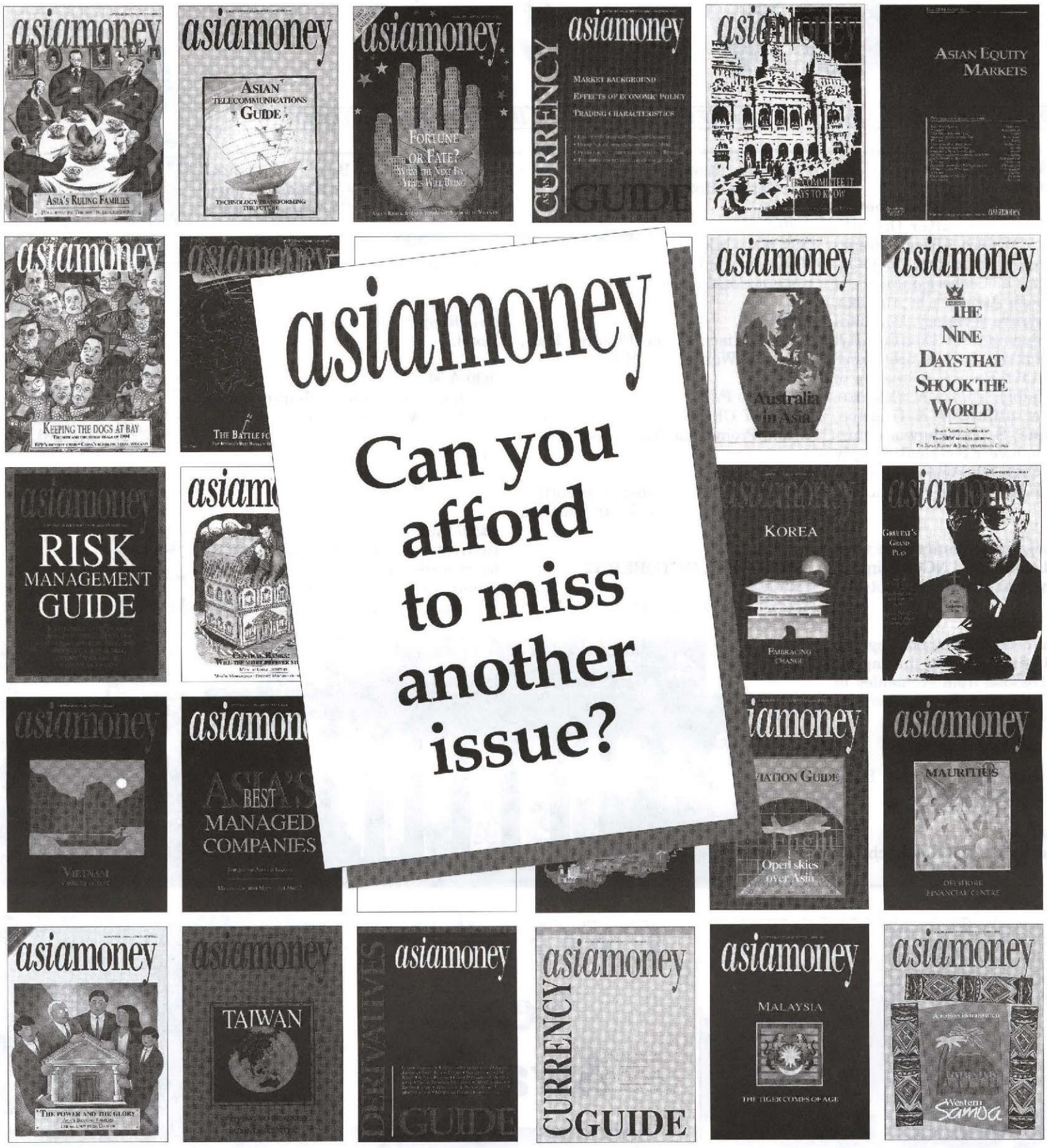

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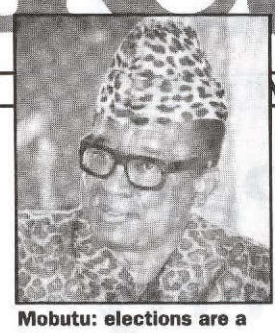
U.S. Bandwagon Rolls for Dialogue with Mobutu

BY PATRICK SMITH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Mobutu: elections are a future matter

Bienvenu Marechal! Is it beyond the realm of possibility that President Bill Clinton may welcome Zaire's president to Washington? There are many in the U.S. capital who think not. Lobbying companies, paid by Kinshasa, are trying to promote just such an official visit, or at least to allow Mobutu Sese Seko a visa for a private visit.

Also lending support is Reverend Pat Robertson, chief of staff of America's religious right, who has extensive business interests in Zaire and neighboring Angola. Senator Jesse Helms, chairman of the foreign relations committee, also favors "dialogue with Mobutu," as does House of Representatives speaker Newt Gingrich who wrote his doctorate, 25 years ago, on education policy in Zaire. But liberal Republicans such as Nancy Kassebaum, who chairs the Senate Africa sub-committee, opposes any overtures to Mobutu. Democrat and congressional black caucus leader Donald Payne takes an even tougher line. U.S. policy, he says, has been "influenced by Mobutu's calculated ploys" and "has ceded power back to him."

But this April, Congress' 262-strong national security caucus invited Mobutu to a "members only" meeting on Zaire and African security issues: "We are not planning to invite the news media," the caucus explained. The state department and the White House reaffirmed their ban on a Mobutu visit. But there are those in the Pentagon and the National Security Council who argue that some new concessions will have to be made to Mobutu — if only to hold off another round of bloodletting, or even genocide in Central Africa's troubled great lakes region.

The threat of the Rwandan war restarting and open conflict breaking out in neighboring Burundi came several steps closer this August. Mobutu and his premier Kengo wa Dondo said they could no longer cope with the more than one million Rwandan and Burundian refugees who fled to Zaire after last year's ethnic massacres. They said the matter was made worse after the UN lifted the arms embargo against Paul Kagame's government in Rwanda. Refugees in Zaire feared a rerun of last year's civil war.

"Zaire has no choice after the suspension by the UN of the arms embargo...but to ask for the deportation of the refugees," Kengo wrote to UN secretary general Boutros Boutros-Ghali. Zaire had to act quickly and would expel all the refugees immediately unless international agencies came up with a convincing plan for a more orderly return, Zaire's ambassador to the UN Lukabu Khabouji N'zaji said. He feared that lifting the arms embargo against Rwanda would encourage more Rwandans to seek refuge in Zaire.

To press the point home, Mobutu sent a contingent of his heavily armed presidential guards to refugee camps in eastern Zaire. Some 80,000 refugees left the camps, but fewer than 15,000 crossed back into Rwanda, while the remainder fled to the surrounding hills where the Zairian soldiers could not be bothered to follow them.

Mobutu's tactics worked. The UN high commission for refugees sent an assessment team to the camps and has drawn up a program to repatriate more than a million refugees to Rwanda by the end of the year — Zaire's new deadline. The European Union has also agreed to a humanitarian aid program to rehabilitate eastern Zaire where the camps are based.

In Zairian terms this is a major victory. There has been virtually no aid money going to the country for fear the corrupt bureaucracy, under Mobutu's control, would swallow it. Kengo admits the state has collapsed: "It can no longer assume its basic responsibility in the fields of justice and security. There is total social and economic disorder," Kengo told the Zairian legislature after his election last July.

Little has changed in the past year except for further indications that the U.S., together with Belgium and France (Zaire's main European interlocutors), are prepared to live with Mobutu some time longer — he has just postponed the promised elections for a further two years and extended Kengo's tenure. Western diplomats argue unenthusiastically that their limited engagement may somehow prevent Zaire from degenerating into a civil war, potentially even more horrific than last year's genocide in Rwanda.

Washington has appointed a new ambassador, John Simpson, after a two-year gap, in recognition of Kengo's economic successes. But an inter-agency working group on Zaire reluctantly concluded: "Although we wish to get rid of Mobutu, we have limited leverage" and that the country was "a black hole for U.S. policy." But it seems improbable that an invitation from Washington to Mobutu will be seen as a way to fill the hole. EM

INTERVENE AT YOUR PERIL

Liberia and Somalia have both been torn by civil wars in which outsiders tried to bring peace. Mark Huband examines the lessons.

It took 11 banquets after 11 summits in seven capital cities across an area from Freetown to Geneva for Liberia's faction leaders finally to realize that their best hope lay in a negotiated end to their six-year civil war.

As the country's warlords were signing their peace deal on August 25 and planning for elections next year, on the other side of the African continent, Somalia was witnessing a return to the same state of upheaval prevalent before the Horn of Africa state became the stage for a failed $1.6 billion international intervention.

Comparison between the two countries — whose wars have run for roughly equal length but whose ability to attract international attention has differed markedly — illustrates the complexity that intervention itself can create.

Both countries had pre-war regimes whose survival had depended on a mixture of foreign arms and vicious dictatorship. Both had played key roles in the American Cold War strategy in Africa.

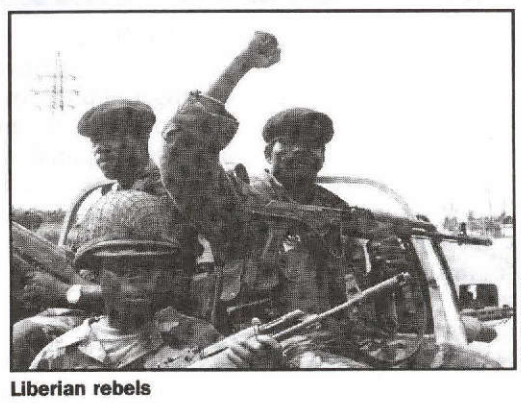
Their differences lay in the character of the people: the Somalis fiercely independent and toughened by their nomadic traditions, which the war brought to the fore as the gun became key to survival; the Liberians faced with solving the riddle of what it means to be an African country which views itself as a part of the U.S.

Both countries plunged into war at about the same time. In Europe the Berlin Wall came tumbling down, and in Africa these Cold War sideshows tumbled into anarchy. Various forms of intervention have been the response in both countries. It is in their variety that the value of the intervention can be most usefully assessed.

West African coalition troops stepped between Liberia's warring sides in the hope that it would give them a chance to talk rather than fight. The peacekeeping troops' frequently combative role against the factions turned them into peace enforcers and occasionally belligerents, but ultimately maintained the pressure to continue talking.

The UN in Somalia was incapable of playing a significant military role — from which to reap political gains — because none of its troops had experience of the urban warfare in which the faction fighters were skilled. Unosom's military strategy was to declare war on the most recalcitrant of the faction leaders, Mohammed Farah Aideed, in the hope that the bullet would make him succumb.

For the West African countries involved in finding peace in Liberia, discussions were greatly complicated by the fact that the countries which had sent troops — particularly Nigeria — were also those playing a leading role in the negotiations. The same West African countries were wielding both the stick and the carrot. But as the U.S. had deserted Liberia by never throwing its weight to force negotiations, regional states had no alternative. Ultimately, their national interest in seeing peace in Liberia became the main source of their commitment to prolonged negotiations.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Liberian rebels

By contrast, in Somalia none of the countries involved in negotiations — notably Ethiopia — had a military role. This actually discredited them in the eyes of the Somali faction leaders, who relish tests of strength. The benefits to the Ethiopians of remaining apparently impartial were few. Meanwhile, the hoped-for political gains from the UN military intervention, which left 64 UN troops dead, were zero as Aideed held out.

In the end, it has been endless patience on the part of negotiators, coupled with attrition, failed attempts by warlords to revitalize their military campaigns and a realization that there is a military stalemate, which has brought the Liberians close to the end of their nightmare.

For the Somalis, however, danger remains everywhere.

The lessons learned from intervention therefore are complicated. East African regional states have neither the weapons nor the will to involve themselves in Somalia as the West Africans did in Liberia. Nor do they have the West Africans' sense of regional purpose and solidarity — which has evolved through the experience of Liberia.

Ultimately, it is clear that, in an era of warlordism, foreign intervention leading to a durable peace is only possible when the warring sides can gain nothing more from war. EM

Fujimori Sets Peru's Sights on Poverty

BY DOUGLASS STINSON

Confident that his country has turned the corner, President Alberto Fujimori's next push is to focus on alleviating Peru's crushing poverty — caused in part by the free market reforms credited with creating the world's fastest growing economy.

The shift marks the increasing conviction of state officials and private investors that the groundwork has been laid for sustained growth. According to Fujimori, production will increase by more than 5 percent annually to the year 2000.



Fujimori

Meanwhile, with the economy stabilized for the first time in several decades, Fujimori is starting to make waves with his social policy. New prime minister Dante Cordova has pledged $3.6 billion of next year's budget to social spending in a Herculean effort to provide jobs and build infrastructure. Defeating poverty and unemployment will be the "axis of government action," said Cordova.

The government's new emphasis on social policy stands in contrast to the whirl of economic insecurity that has plagued the region since the Mexico crisis. This pledge fulfills Fujimori's campaign promises that his neoliberal economic program's side effects would be dealt with during his second term.

Nearly half of the country's 22 million inhabitants live below the poverty line. Only 15 percent of Peruvians work in the formal economy, which does not include street vendors, nannies, farmers etc., and many remain out of work since the drastic "shock" policies implemented by Fujimori in 1991. But government supporters say the conditions are just beginning to exist in which the suffering can be treated.

"We have a peaceful country, hyperinflation is vanquished, there are reserves of several billion dollars and an impressive annual growth rate," Victor Joy Way, a leading congressman from Fujimori's Cambio 90 party, says.

Over the past five years the government has channeled $480 million through its compensation and social development fund (Foncodes), mainly for health, nutrition programs and school building. But that is a paltry sum compared to the $3.6 billion — 40 percent of the annual budget — the government will spend next year on development.

"The government's spending policy over the next five years is oriented towards dynamizing the rural economy, stimulating social development in the provinces and creating the conditions for private investment. We will continue to prioritize public investment in roads, port and airport infrastructure, as well as in electrification, basic sanitation, education and health," Cordova says.

Creation of a national employment program is a "central pillar in the struggle against poverty," he continues.

Infrastructure to connect rural production areas to urban markets is a key part of the government's development strategy. Some 6,000 miles of highways will be constructed at a cost of $1 billion, while creating 130,000 jobs. Electrification will continue at a record pace, and water and sewage lines will be extended to three quarters of the population.

Foncodes is already leading the way in the creation of civilian work corps to string electrical cable across the Andes to light the patchwork of Peru's interior towns and villages. The campaign is part of the development fund's conversion away from charity and entitlement programs.

"We have refocused our efforts since May. This has allowed Foncodes to strengthen financing of economic, social and productive infrastructure, leaving social assistance a bit to the side," Marco Nunez, a Foncodes regional manager, said. The government-sponsored corps has provided electricity to two million Peruvians in the last year, drawing its workforce from local sources and having residents plan and build their own infrastructure. Under such a program, Foncodes estimates that wiring the rest of the country will cost $70 million.

Road-building programs promise to employ a large number of needy individuals in a similar way. EM



Desperate Cuba Seeks Paradise in Tourism

BY CANUTE JAMES

The break-up of the Soviet Union, which was its most important trading partner, has forced Cuba into making a structural adjustment of its economy not unlike that of several countries which have entered agreements with international financial institutions.

While publicly maintaining a commitment to a centrally planned economy, the Cuban government has been loosening controls, allowing greater involvement by private individuals and cooperatives, and opening the economy to foreign investors. The government is contemplating a foreign investment code to attract more.

This coincides with indications that the pressured economy is doing better. Government figures show that GDP growth this year is running at 2 percent, after marginal expansion last year. The performance would have been better were it not for the poor performance of the sugar industry. The non-sugar economy is expanding at 7 percent of GDP.

The government has been forced into fiscal prudence. The budget deficit, which was threatening to suffocate the already weakened economy, is expected to be about 10 percent of GDP this year, one fourth the level of two years ago. This has contributed to reduced pressure on the peso, which has been revalued to rates averaging 25 to the dollar from 150 to the dollar in 1984. More foreign exchange is coming into the country, particularly through repatriated funds from the Cuban diaspora, mainly in the U.S., and from expansion in tourism.

Pressure has increased on the economy with the poor performance of the sugar industry, its most important sector. The 1994-95 harvest yielded 3.3 million tons, the lowest in 50 years, and one third of production in better times. Like all other sectors, the industry suffered from a shortage of inputs such as chemicals. Recent agreements with foreign banks have provided funds for buying what the industry needs, lifting the government's hopes of better harvests over the next five years. The administration is forecasting production of five million tons from the next harvest.

After years of neglecting tourism, the leisure business is now an important part of Cuba's economic plans. From 550,000 tourists in 1993, Cuba is expecting 700,000 this year, with gross earnings of $1 billion. The government expects Cuba to regain its prerevolution position as the leading resort in the Caribbean. To accommodate the expected growth in the number of visitors, hotel room capacity is being doubled to 50,000 in the next five years.

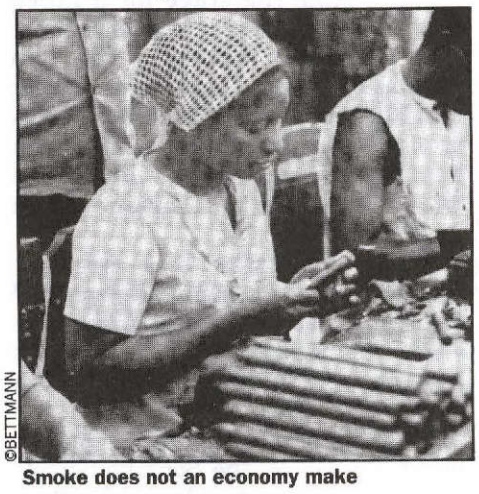
With restrictions on Americans visiting Cuba because of the U.S. economic embargo, just under one half the tourists visiting Cuba are from the EU, with the rest from North America (mainly Canada and Mexico) and from South America.

The economy has suffered from an energy shortage with the ending of supplies from the former Soviet Union. Not only have business and industry been hurt, but the economy has also lost foreign earnings which it once got from reexporting to Western markets some of the 13 million tons of oil which it imported each year from the Soviet Union.

This has forced the government to look more closely at the potential of its domestic oil industry. Foreign companies, mainly from Canada and France, are helping to lift domestic production to about one and a half million tons this year. This is used to fire industrial plants, and the island still has to import about six million tons each year at a heavy cost to its limited finances.

There are also indications of an expansion in nickel production, with foreign companies trying to rehabilitate plants which were built by Eastern Europeans and which have not been efficient.

Cuban officials concede that the U.S. embargo has hurt the country. The U.S. is Cuba's "natural" trading partner, they contend. The government has taken comfort in accepting an invitation from its neighbors to be a member of the Association of Caribbean States — which has the potential to become a significant trade bloc. And, all but a few countries have ignored the U.S. embargo, said a foreign ministry official. "In this respect, the embargo is rapidly becoming of limited effect." EM



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Asia Pacific

WEDNESDAY, OCTOBER 11, 1995 EMERGING MARKETS IMF/WORLD BA



Vietnam's Bureaucracy Flusters Investors

BY JON LIDEN

New investors flocking into Vietnam from the U.S., Europe and Japan are questioning the country's reform process amid the slowness and blunders endemic to a communist bureaucracy.

All agree that the country's pledge to increase its GDP by 2.5 times between 1990 and 2000 is impressive and it is seen as a proof of the Vietnamese leadership's commitment to free market economic reforms. Yet a growing number of investors and consultants are worrying that, while talking tough on the economy, Vietnam's Communist Party does not have the courage to push through with the legal and structural reforms needed to free the economy and ensure investor confidence.

Economic growth for this year is expected to reach 9 or 10 percent, and


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Vietnamese experience changes first hand

the government has received good marks for taking proper measures to rein in a year-on-year inflation rate which reached 21 percent in June. Inflation is now expected to be in the range of 15-18 percent by the end of the year, which the IMF considers "acceptable" under the current conditions.

Negotiations with the London Club of private debtors are expected to yield a rescheduling agreement in October, allowing Vietnam to raise funds through Eurobond issues. At home, plans for the establishment of a capital market are proceeding at a realistic pace. The first treasury bill auctions which took place this year are seen as the government's initial trials for what will develop into a proper capital market by 1998.

The first foreign investors coming to Vietnam in the early 1990s had only China to compare it to. They were prepared for the lack of legal structures, the often ambivalent and self-contradictory bureaucracy and the general lack of knowledge about market procedures they met in a Vietnam just emerging from decades of running an isolated command economy. But for these "old China-hands," Vietnam was a fresh wind after China's reforms had stalled in 1989, and the country's opportunities seemed promising. As Vietnam's reputation grew as the most promising new "tiger" in the region and investors flocked in, expectations of efficiency and clarity in the administrative and legal processes increased.

The "new" investors from the U.S., Europe and Japan often have little experience with a communist country's reform process, and little patience for an entrenched communist-style bureaucracy struggling to cope with rapid change. "It took me six weeks to collect enough signatures from the [Vietnamese] government to secure Vietnam financing on consessionary terms for a commercial project," complained a European trade representative in Hanoi. "They make you feel they are doing you a favor by signing, while it is Vietnam which in the end stands to gain from this. Such attitudes will have to change, because Vietnam is not the only place to invest in Asia, far from it."

These complaints are important, because Vietnam has counted on an inflow of $20 billion of direct foreign investment over the next five years to realize its ambitious growth target. If Vietnam's reputation abroad sours, the investment flow could quickly turn elsewhere.

There is no sign of that happening yet, however. A record $1.1 billion worth of foreign investment was licensed in the month of July, bringing the total foreign investment to $15 billion. Relative to the population of the two countries, last year's investment in Vietnam was double that of China's. Business executives and economists with long experience with Vietnam brush aside any worries, arguing that the country's fundamentals remain firmly positive. They say that among the former east-bloc countries, Vietnam's reforms have been among the boldest and most successful, but that another two to four years will pass before the country can offer a really good investment environment.

A much awaited administrative reform aimed at streamlining government structure has been held up as the Communist Party prepares for its eighth party congress, planned for early next year. The congress is Vietnam's main decision-making forum for long-term, ideological issues and the outcome will show whether Vietnam will continue full steam ahead along its path of reform, or whether the communists falter and lose courage in the face of decisions that can be politically risky, but economically necessary. EM

Asia's Tragic Little Brother Tries to Grow Up

With billions of dollars invested in Cambodia's future, Western governments are trying to suppress their misgivings over recent human rights abuses and increasing political intolerance by focusing on the country's economic progress.

The latest figures are impressive enough to attract attention. Last year saw 4.9 percent economic growth despite a disastrous harvest that forced the country to ask for emergency food aid. Barring new floods or droughts, this year's economic growth is expected to reach 7-8 percent. Year-on-year inflation was 9.6 percent in June, brought down from more than 20 percent last year. The country's currency, the riel, has kept steady against the dollar and even strengthened slightly, trading at an average 2,375 to the dollar. Foreign exchange reserves rose by 8 percent over the first half of 1995.

"The government has kept its commitment to holding the budget together despite extreme pressures for expenditures," says Joshua Charap, resident representative for the IMF in Cambodia. "Enormous progress has been made, but we are not out of the woods yet."

The fund's board in September approved the second part of a $130 million Enhanced Structured Agreement Facility loan, citing satisfactory progress in fiscal policy management by the Cambodian government during the past year.

The positive financial figures tend to draw attention away from the fact that Cambodia's economy is largely kept afloat by foreign aid. Although current expenditures are roughly balanced with revenue, they are almost exclusively made up of civil service salary payments, which range from $10-30 a month. All public investments are financed by aid, including basic health and education items such as medicines, books and teacher training. Even revenues are partly held up by aid, since they mainly consist of duties, most of which are collected on imports paid for by aid.

"Our tax revenue is among the lowest in the world at 6 percent of GDP," finance minister Keat Chon told *Emerging Markets*. "Our aim is to increase tax revenue from 6 percent of GDP last year to 6.6 percent this year and 7.4 percent next year." In comparison, Nepal has a tax revenue rate of 6.3 percent and Thailand 17.4 percent. Although the major cities are being filled up with cars and consumer products, diplomats concede that the boom is mainly fueled by money made on smuggling and illegal logging. And while $69 million of direct investment entered the country in 1994, most of it was in the banking sector. A few manufacturing ventures are being set up, however, and U.S. businesses with a stake in Cambodia say that there is a genuine interest, at least in some quarters of the government, in companies seeking clean, long-term investments, bringing in modern technology and providing manufacturing jobs. This is allaying some observers' concerns over the political leadership's commitment to beneficial, long-term investment after an early spate of investment licenses focused on gaming, unrealistically large tourist developments, environmentally damaging shrimp farming and logging concessions.


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Cambodia's King Sihanouk

The countryside has seen little if any progress over the past five years, however, and aid officials are voicing concerns over the long-term development prospects of the country, unless investments in health and education rise sharply. As a sign of the gravity of the educational situation, Unicef has compiled figures showing that of 306,000 children who entered primary school in 1984, only 715 will complete eleventh grade this year. "This is the human material Cambodia has to build its future managers and administrators, and it isn't much," said a Unicef official.

The Cambodian government has long been seen by donors and diplomats to be split into a conscientious group of technocrats and honest politicians on one side and on the other the political leadership, the army and the party organizations who are mainly concerned with maintaining their power and are widely accused of corruption. These diplomats and aid officials say that although they worry about a decline of political tolerance and an increase in human rights abuses, there is a realization among the leadership that playing by the rules will be necessary if Cambodia is to stop being the hopeless and tragic little brother of Southeast Asia. EM

— Jon Liden

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WEDNESDAY, OCTOBER 11, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY



FOREIGNERS DRIVE HUNGARY'S INDUSTRY

BY HENRY COPELAND

Just five years after General Electric plunged into Eastern Europe with a purchase of a majority stake in light bulb manufacturer Tungsram, foreign firms are on the verge of dominating Hungary's industrial economy.

Hungary got the majority of early foreign investment in Eastern Europe, netting $9 billion in the 1990-95 period. Now those investments are blossoming, even as much of domestic industry, both state-owned and private, stagnates. The gap in dynamism between the two classes of companies is so dramatic that two years from now, Hungary's economy may no longer look Hungarian.

According to the OECD's recent report on Hungary's economy, firms with foreign ownership, which the OECD defines as more than 10 percent, accounted for 50 percent of the country's exports in 1993. Some studies suggest that proportion jumped to nearly 60 percent in 1994, according to Adam Torok, an economist at the Institute for the Study of Industry and Enterprise.

In part, the growing dominance of foreign firms is an outgrowth of privatization. In the next year, the state will have sold significant stakes in three of the four companies with the largest net sales in Hungary, giving foreigners stakes in 12 of the top country's 25 largest companies, according to data compiled by Dun & Bradstreet Hungary.

But if privatizations annoy Hungarian nationalists, they are not the chief engine of their economy's de-Hungarianization.

Foreign firms already on the ground are far outpacing their Hungarian peers in growth. GE Tungsram's revenues grew more than 40 percent in real terms in the last two years, and the company moved from number 18 on the list of revenue earners in 1993 to number 14.

Opel and GE will have competition in the race to rule Hungary.

Revenues at most of Hungary's largest companies are barely keeping pace with inflation; with GE Tungsram predicting real growth in revenues of 25 percent in 1995, the company will be in the top 10 for the year.

Before 1994, there was no significant difference between the performance of companies with foreign direct investment (FDI) and Hungarian companies, notes Andrea Szalavetz, an analyst at the Institute for World Economics in Budapest. Now, she says, "the gap between the two is becoming quite noticeable." The lag between investment and results comes because "it takes several years for FDI to have an impact" she said.

Foreign firms have better technology, better access to financing and "much better management of human resources," says Torok.

While many Hungarians prefer to ascribe the success of foreign firms to the first two causes, management skills should not be underestimated. Torok sites a study done three years ago comparing labor utilization in Hungarian truck and bus manufacturers with that of foreign automotive upstarts. "With about half as much employment, they created 5 or 6 times as much output," he said. "The comparison still stands, except that one of the Hungarian firms is now bankrupt."

And so it goes. Opel Hungary, which produces engines, saw its revenues jump from Ft20 billion ($148 million) in 1993 to Ft43 billion ($318 million) in 1994, moving the company from number 17 on the list of Hungary's top revenue earners to number 6. And Opel's pretax profits of Ft6 billion in 1994 made it the most profitable company in Hungary by a factor of three.

The Opel facility produced 190,000 engines last year, and will produce 250,000 in 1995. With a total investment of DM700 million by 1997, the 65,000 square meter complex will have a production capacity of 460,000 engines and 460,000 cylinder heads. When that production capacity is reached, Opel will be the number two company in Hungary, lagging only behind oil company MOL.

Opel and GE will have competition in the race to rule Hungary: Alcoa's joint venture jumped from 35th in revenues in 1993 to 19th in 1994, and Porsche Hungary entered the list out of nowhere at number 22 in 1994.

Such dynamism may be astonishing, but it alone can't save the Hungarian economy, economists note. Running at close to full throttle, Opel will only employ 1000 people at its factory, hardly denting the country's nearly 500,000 unemployed.

"We need 10,000 such factories and then we are happy people," says Istvan Racz, chief economist at CS First Boston Budapest. EM

First to a Free Market, Kyrgyzstan Looks for Rewards

BY CRAIG MELLOW

Economic success is a relative term in ex-Soviet Central Asia. The average monthly wage in Kyrgyzstan, a young republic of some four million people located where the arid steppe meets the forbidding Himalayas, is 300 som, or about $27. Supporting a minimal living standard requires 500 som, by the government's estimate.

The population of Bishkek, the capital, has swollen by some 40 percent since independence, as young people flee the hardships of a herdsman's life in the mountains. Some of these migrants recently set fire to a field adjoining the city, to lend their campaign for housing and jobs additional emphasis. The southern regional center of Osh, meanwhile, has witnessed bloody ethnic riots between Kyrgyz and Uzbek residents.

Yet for a country whose historical role has been alternately poor relation to Uzbekistan and northern satellite of Afghanistan, independent Kyrgyzstan is showing a great deal of spunk.

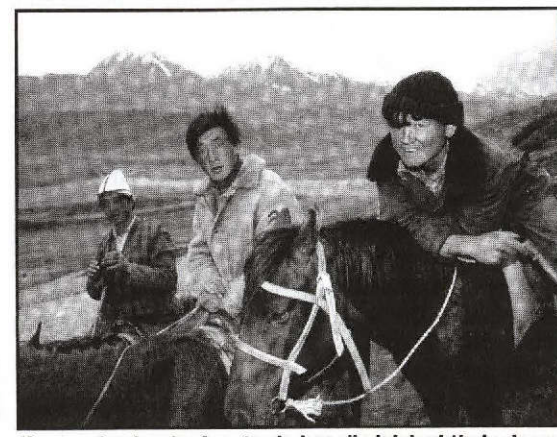
"We had to become a free-market democracy because we have nothing else," observes Jyldyz Galieva, who runs the European Bank for Reconstruction and Development's (EBRD) very active Bishkek office. Kyrgyzstan's larger neighbors, Kazakhstan and Uzbekistan, inherited hydrocarbons and gold, respectively. Their governments have, to different degrees, aimed to keep the political lid on until foreign capital finds its way to the buried treasure.

Kyrgyzstan, where the backbone of the export trade is cow hides marketed through classified newspaper ads, had no such luxury. Instead, physicist-turned-president Oskar Akaev has pushed through probably the most pro-enterprise program in the entire former Soviet Union.

Kyrgyzstan's shops and services are completely privatized, with industry (such as it is) on the way. Tight budgets have brought inflation down to 1-2 percent monthly. The som, which is traded freely, has held steady against the dollar for the past 18 months. Import and export restrictions are, by regional standards, minimal.

The rewards of this virtue are visible. Bishkek bustles with more commercial activity than Kiev, which is six times its size. Half the population seems to be just back from a shopping trip to China, India or Abu Dhabi, and out on the sidewalk with what they bought. Foreign cars are as common as in Moscow, though the selection is a bit more humble.

Less immediately apparent is a corresponding devastation of Kyrgyzstan's industry, which was thrown up arbitrarily by Soviet planners grimly determined that every nation have its proletariat. The factories were dependent on suppliers and customers in the Slavic republics who now have plenty of problems of their own. There is precious little reason why contemporary Russian industry would source automotive or electronic components in Kyrgyzstan, instead of the next oblast. "At the moment there is no production and no export," summarizes Yuri Yudin, chairman of Maksat Bank, the country's second largest.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Kyrgyz shepherds: free trade has diminished their sheep

The few factories which did have a *raison d'etre*, like textile mills, have been caught up in the general cataclysm. Kyrgyzstan's sheep and cattle herds are being perilously diminished to the benefit of Chinese weavers and tanners, all in the glorious name of free trade.

Kyrgyzstan has modest gold deposits of its own, though the places you have to go to mine them make the Uzbek desert seem like Tahiti. Canada's Cameco Corp., backed by multinational lenders, is getting set to dig at an altitude of 4,000 meters, and that is low country by Kyrgyzstan standards.

Remote Central Asia may in fact prove an excellent testing ground for the contemporary orthodoxy that economic development depends more on what men put in the statute books than what God put in the ground. A pre-IMF analysis would hold it self-evident that Kazakhstan, dripping in mineral wealth and with viable basic industry, is the place to look for investment in the region.

Hardcore invisible border types will like Kyrgyzstan for its bootstrap guts and commitment not to meddle with almighty capital. (Assuming Akaev gets past the elections set for next year.) A full roster of outside advisers and project financiers have camped out in Bishkek to help make their prophecy self-fulfilling. But bootstraps are not miracles. EM

Problems Persist for Italian Banks

BY ANDREW HILL

Italy's banking system is a mess: too many retail banks; too few investment banks. But the way in which the sector develops in the next few years will have a decisive impact on the progress of the country's economy.

The problem stems from restrictive legislation, introduced by the fascists in the 1930s, which limited most banks' territorial expansion, their ability to grant loans and to open new branches. These rules were reformed only at the beginning of this decade by then-treasury minister Guiliano Amato, who later became prime minister.

Reform, however, has not resolved the problems inherent in the system. Banks indulged in crazy expansion of their branch networks — from 6,000 in 1990 to more than 22,000 today — but there were comparatively few mergers. There are still more than 1,000 different banks in Italy, many with a few branches concentrated in one or two towns. Even Italy's largest banks are much smaller than their counterparts in Japan, the U.S. or the rest of Europe.

At the same time, some of the biggest institutions are still technically part of the public sector, controlled by charitable foundations which seem reluctant to let go in spite of the incentives to sell off shares in the banks. Amato himself, now head of Italy's antitrust authority, said in an interview this summer that he was beginning to feel, like Dr. Frankenstein, that he had created a monster: "The foundations are like the creature — put together from many different body parts but deprived of a soul."

The difficult evolution of the banking system has punished the bulk of Italian businesses. The banks stand accused of lending too much to big industrial groups — a few of which have gone to the brink of bankruptcy — while failing to cater to the needs of dynamic small businesses which make up the backbone of the system.

Mediobanca, the Milan-based merchant bank, is the champion of big business. Fostered by the same rules which stifled the retail banks, it has built up a network of influence over Italy's largest and oldest companies which is unparalleled in any other market in the world.

In the last few weeks, Mediobanca has again demonstrated its dominance of Italian investment banking by putting itself at the center of two of the biggest and most controversial deals in Italian stock market history.

The bank masterminded plans to merge Gemina, an investment company controlled by Mediobanca and its allies, with the Feruzzi Montedison industrial group. It is also coordinating the record L2,257 billion ($7.4 billion) capital increase launched at the beginning of September by Olivetti, the loss-making computer group.

The foundations are like Frankenstein's monster — "put together from many different body parts but deprived of a soul."

These latest events touched a raw nerve. Romano Prodi, ex-chairman of IRI, the main Italian state holding company, and now leader of the country's center-left political alliance, is worried about the emergence of "a single large economic grouping" in Italy, headed by Mediobanca and allies like Fiat, the carmaker, and Generalli, the insurer.

"There ought to be not one, but three or four large merchant banks competing between themselves," says Massimo D'Alema, secretary of the former communist PDS.

This is easier said than done. The Italian authorities are quietly trying to create an alternative alliance of banks and financial companies around IMI, a former state-owned banking group.

But after decades in chains, Italy's biggest banks are keen to assert their independence, and they may find it awkward to collaborate on investment banking with the same companies they are trying to flatten in the retail market.

On the other hand, if the future of the Italian banking system is left entirely to market forces — including the slow liberalization of the public-sector banks — it may take another few decades for a strong rival to Mediobanca to emerge. In the meantime, expanding Italian businesses will have to rely on their own resources or on Mediobanca's particular brand of corporate finance. EM

EU Moves East: How to Build Europe's New House

BY LIONEL BARBER

The European Union is about to confront its most daunting challenge since its inception. At next year's conference on its constitutional future, the EU must decide how to fulfill a pledge to incorporate the former communist countries of Central and Eastern Europe, expanding the present membership of 15 to 25 or more countries in the early part of the next century.

Enlargement to the east requires preparation on a scale never before undertaken by the EU. True, the rich man's club opened its door in the 1980s to countries such as Greece, Spain, and Portugal, whose incomes were well below the EU average. But in terms of purchasing power parity, the gross domestic products of Poland, Hungary, and the Czech and Slovak republics are around one third the EU average; that of Romania and Bulgaria, one fifth.

Absorbing large numbers of poorer countries will involve huge transfers from west to east; it also means changing the traditional model of political integration. Sensitive areas include the likely dilution of the national veto, the balance between smaller and larger states, the future of the common agricultural policy, and generous regional aid programs which have propped up the Mediterranean countries.

Sir Leon Brittan, chief EU trade negotiator, argues that it is time to view enlargement as an opportunity rather than a threat. Though enlargement is primarily a political process aimed at stabilizing (Germany's) eastern borders, it is also about harnessing the economic potential of the east and building on the EU's progressive (if niggardly) trade liberalization — which will mean unrestricted access to its market for industrial products by 1997.

Brittan has recently called for a study which would quantify the benefits of ending the economic division of Europe, along the lines of the Cecchini report commissioned at the launch of the EU's internal market in 1985. The goal would be to access the dynamic effect, in terms of growth and jobs, of extending the single market to a further 106 million people.

Keith Richardson, head of the Brussels-based European Roundtable of leading manufacturing companies lists the three chief advantages: new markets, natural resources, and a skilled, educated labor force with wage levels often as little as one tenth the level of Western Europe. "These are tremendous assets on our doorstep waiting to be exploited."



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Brittan: sees opportunity, not threat

ARR, the multinational electrical and engineering giant, is leading the way. In the past five years, it has created more than 20,000 new jobs in Central Europe, snapping up companies and transferring production to the east. The cost has been heavy in terms of job losses in North America and Western Europe, but Eberhard von Koerber, head of ABB Europe, argues that the payoff will come in two to three years as the competitive advantages feed through to the company's Western operations.

Moreover, von Koerber insists that the integration of Eastern Europe is a vital part of restructuring "sclerotic" Western European economies which must break loose from their low-growth pattern and compete more effectively with the U.S., Japan and China. The launch of the 1992 single-market program was a useful stimulus, but eastern enlargement will help to complete the process of "competitive reengineering."

Hesitant EU leaders may also care to consider using eastern enlargement as the excuse for radical reform of the common agricultural policy which absorbs almost half of the annual Ecu80 billion ($103 billion) budget. Such a reform would no doubt antagonize powerful lobbies in France and southern Germany, but it would be one big step to building what MIT economist Lester Thurow calls the New House of Europe. EM

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North Afri

WEDNESDAY, OCTOBER 11, 1995 *EMERGING MARKETS IMF/WORLD BANK DAILY*

DESPITE DOUBTS, SUPPORT FOR ALGERIA CONTINUES

BY JON MARKS

The IMF was sufficiently convinced that liberal economic reforms were working that in April it approved a $1.8 billion extended fund facility (EFF). The World Bank, the EU and other multilaterals are providing large flows of funding for the restructuring of public enterprises, housing projects and other priorities.

Running parallel to economic reforms, presidential elections are to be held on November 16, with campaigning to start in October.

This is in Algeria, a country where tens of thousands have reportedly died in the conflict between radical Islamists and the military-backed regime since a second round of general elections was canceled in January 1992 with the Islamic Salvation Front (FIS) poised to form a government.

Atrocities have been committed by guerrilla units fighting for an Islamic republic, many bunched under the Armed Islamic Group umbrella. Military crackdowns on neighborhoods sympathetic to the FIS have produced a level of violence that Amnesty International, which submitted a list of complaints to President Bamine Zeroual in August, says includes hundreds of cases of "extrajudicial executions, torture and 'disappearances' by the security forces." Amnesty claimed that not a single case had been investigated.

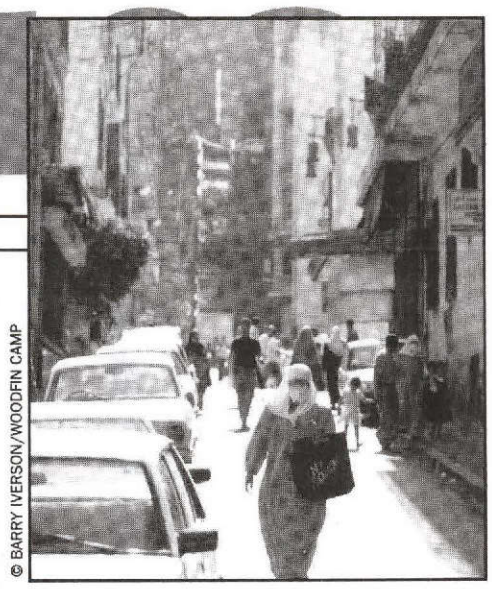
The presidential elections are meant to break the political impasse. Desperate to gain ruling legitimacy and undercut the appeal of the Islamist opposition, massive levels of policing are being put in place by the government, which has even taken the unprecedented step of requesting U.N. monitors.

It is unclear whether Zeroual will stand as the establishment candidate. The president since January 1994 has made little secret of his wish to stand down, going as far as to personally ask one of Algeria's surviving *neuf historiques* (nine historic chiefs), Rabah Bitat, if he would stand. Bitat refused. Another credible potential candidate, former premier Mouloud Hamrouche, is taking his time to consider.

Among the declared candidates is former prime minister Redha Malek, who takes the "eradicationist" line against the Islamist opposition promoted by defense minister Mohamed Lamari and other hardliners.

Victory for an eradicationist candidate would kill any hope of a peace formula involving the FIS. Zeroual's most recent attempt to come to terms with FIS leader Abbasi Madani came to nothing. Attempts both to split the Islamist opposition and the group of leading parties who last January met in Rome to hammer out a platform for Algeria's future — including the FIS, the predominantly Berber Socialist Forces Front and the former ruling party, the National Liberation Front, now in opposition — have had little effect.

Meanwhile the violence continues. But despite doubts, Algeria's main financial backers, led by France (and a more reluctant U.S.) continue to give support. "We are with Algeria to help it reduce the burden of external debt," IMF managing director Michel Camdessus told the official Algerie Presse Service after the EFF was approved. More debt relief was required, said Camdessus, who has been criticized privately by some IMF board members for being too pro-Algerian. "At their current levels, amortization charges on this debt are reducing Algeria's growth potential," Camdessus said. "We therefore want to achieve a progressive reduction in these charges so that Algeria can grow at the highest level possible." EM



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Algeria: the funds are coming, are the Islamists?

Long Distance Accountants Not So Lonely

They call it long-distance accounting, and like Algeria's gas pipelines, the bookkeepers have gone trans-Mediterranean. Algeria's $1 billion IMF extended fund facility and the new funding from the World Bank and other agencies for the strife-torn country's economic restructuring have produced a welter of audit and consultancy contracts.

"With so many World Bank contracts coming through, the market is booming — it's just that we don't often visit it," says the France-based director of a U.S. firm.

According to Algeria's permanent representative to the UN in Geneva, Hocine Meghlaoui, 103 foreigners had been killed and 23 wounded by mid-August in the conflict between radical Islamists and the military-backed regime.

In this environment, "We tend to meet our clients in Paris or Marseilles," says a senior partner with an international accountancy firm.

For many months the World Bank barred its officials from visiting Algiers, a position altered since the summer. "I cannot remember a time when we were so busy with Algeria — we had to restart visiting the country, to show some degree of reciprocity and say we appreciate what they have been doing by way of reforms," an official says.

World Bank president James Wolfensohn has indicated he could visit Algeria by the end of 1995.

Most businessmen are holding back, although the prospect of prompt cash payments is enticing traders. And oil men retain a positive outlook. "We've had no problems. Everything is in the south and the army is keeping very tight control there," says the regional manager of a U.S. major. "We are continuing to explore, but whether that means we would make a major new investment is another matter." EM

— Jon Marks

Dominos Yet to Fall in North African Power Game

It was called the "first single European terrorist movement" following a wave of bomb blasts in Paris and arrests of North Africans across the EU from Sweden to Italy. Even in its native Algeria, the membership of the Armed Islamic Group (GIA) remains shrouded in mystery and terror, but its effectiveness as a guerrilla army fighting the state is undoubted.

There is no concrete evidence to show who is responsible for the Paris bombings, but according to a former head of French intelligence, Pierre Marion, "The finger of suspicion points clearly to Algeria and the group, or rather groups, called the GIA."

Concern about radical Islamist groups operating in Europe mirrors anxiety in North Africa and the Middle East that the sort of Islamist insurgency which erupted in Algeria could spread across frontiers — helped by an "Islamist international," whose center is said to be the Islamist-military regime in Sudan.

Mediterranean Arab and European countries "should forge a common front," to combat the Islamist threat, French interior minister Jean-Louis Debre said in Tunis in early September. Security cooperation is on the agenda for the EU's late-November Euro-Mediterranean summit.

But as yet, Algerian-style violence has not spilled across its neighbors' frontiers to any great extent. An attack on a hotel in Marrakech, Morocco in mid-1994 and a border shoot-out in which Tunisian troops died in February led to anxiety throughout the region but have not been followed by further incidents.

The Egyptian government's conflict with radical Islamists is more violent and made headlines worldwide in August when President Hosni Mubarak narrowly averted death in an attack in Addis Ababa, Ethiopia.

This was followed by yet another wave of arrests in Egypt. Some Egyptians argue this could be a risky policy, as a heavy hand by the authorities drives younger Islamist sympathizers toward more radical parties. According to Fahmy Iloweidy of the semi-official Cairo daily *Al Ahram*, "The difference between Egypt and Algeria until now has been that the government here has been fighting the extremists. If they move to fight the moderates as well, then we are moving closer to an Algerian scenario."

In Morocco, the regime believes "we can work with Islamic charitable organizations who are providing support services in poor areas where the state can no longer provide," says a senior advisor at the royal palace in Rabat. But it would also wield a big stick if the challenge becomes too close to King Hassan.

What would happen if those aided by Islamic organizations were to decide that they should pursue Islamist politics? This form of organization was at the root of the Islamist movement's growth in Algeria. "We would have to see if the policy was still working," the advisor says.

North Africa is holding its breath to see if Algeria can emerge from crisis. The outside world is talking about a domino effect, with established regimes falling to be replaced by Islamic republics.

Tunisian opposition leader Rashid Ghannouchi could expect to benefit if the dominos fall, but from his exile in London, Ghannouchi is skeptical: "Like our brothers in Algeria, we have been wrong to underestimate the importance of the balance of power, locally and internationally."

Despite the Islamists' popular appeal — reflected in those few free elections in which they have participated — established regimes will not disappear overnight. "An exit out of the current predicament may lie in accepting a transitional period...to guarantee power sharing," Ghannouchi said recently. EM

— Jon Marks

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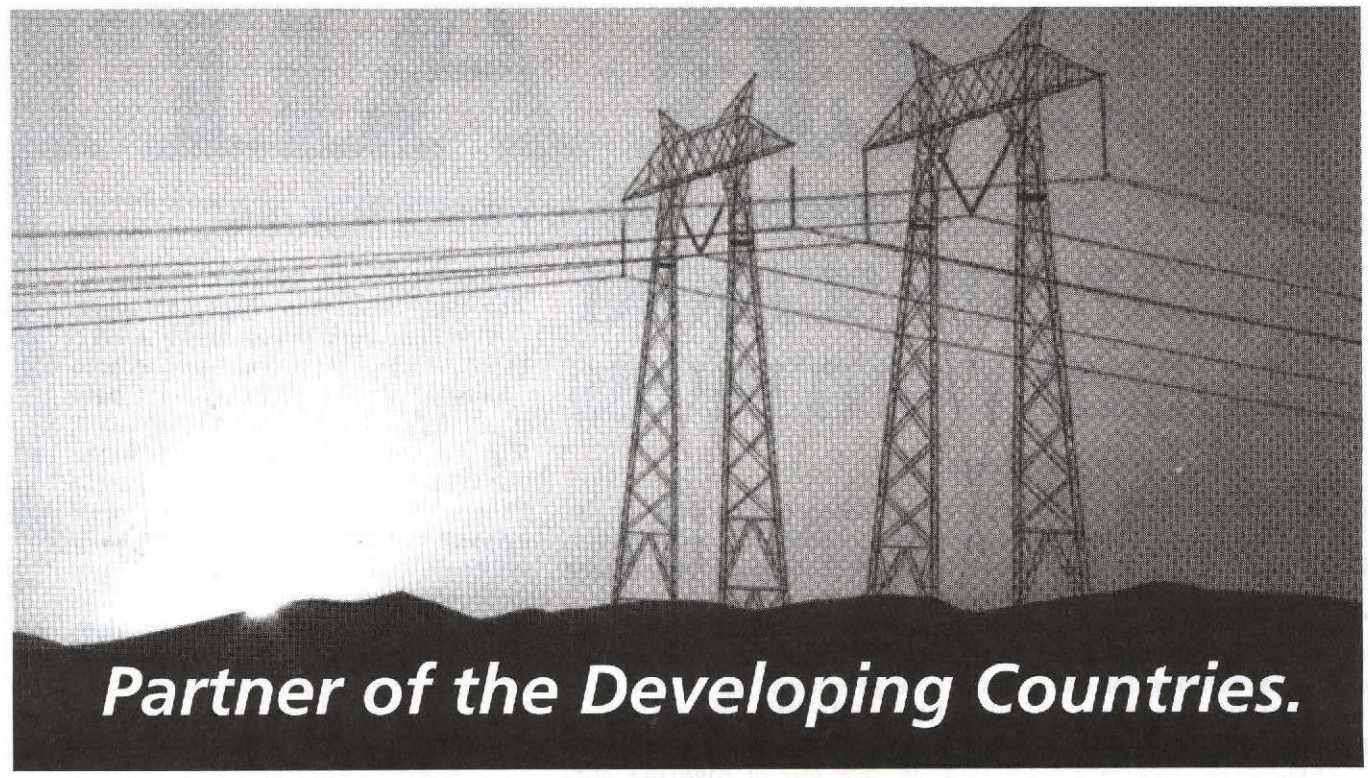

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Capital Markets

WEDNESDAY, OCTOBER 11, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 29

Bank Shakeout May Help Moscow to Become Fully Emerging Market

BY BRENDAN MURPHY

There may be as much reason for encouragement as pessimism in Russia's recent banking crisis. The reason is that it was precipitated by stabilization of the ruble and has given rise to consolidation of the financial sector through the winnowing out of marginal participants. There are no doubt other trials in store for the Russian financial markets, with general elections in December and a presidential election in 1996. But there is reason to believe Moscow is moving into a more mature phase, casting off its pre-emerging chrysalis to become a fully emerging market.

No one can rule out a deepened banking crisis, warns Jonathan Hoffman, economics director for emerging Europe at CS First Boston in London. Yet on a recent trip to Moscow, Hoffman detected "a sense that the central bank is dealing with the crisis better than many had expected." It has revoked the licenses of 80 banks and was expected at the same time to reduce reserve requirements of some 17 percent of those remaining. "As with all emerging markets, Russia is overbanked," he says. "You're seeing the process of consolidation being carried out through the market."

This is taking place among stronger institutions as well, as reflected in the agreement between Stolichny Bank and Menatep Bank, both highly rated, to cooperate closely while carving out individual niches in retail and industrial banking. This is viewed as the prelude to an eventual merger. Meanwhile, notes Hoffman, the Duma this autumn is examining laws on financial institution bankruptcy and the creation of a bank-funded deposit insurance system. Market players at the same time are addressing Moscow's custodial shortcomings.

None of this, of course, can assure that the Moscow Stock Exchange is about to establish a durable uptrend; the banking crisis combined with pre-election caution brought the *Moscow Times* index off its early July high near 200 down to its medium-term trend line near 160. At mid-September the Moscow market was up 7.7 percent for the year to date in ruble terms — but down 14.4 percent in terms of the U.S. dollar. But after the steep correction of September 1994, when the market plunged 60 percent following an overdone speculative rise, this autumn's setback looks distinctly more consolidative, thus permitting an optimistic longer-term outlook.



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Potential political victim Paramonova

"I wouldn't go rushing in until after the [December] elections unless you're going to buy and hold," advises Elizabeth Morrissey, managing partner of Kleiman International Consultants, Washington. Nonetheless, when the emerging markets consultancy surveyed its clients this summer, it found Russia "tops as either the newest place people had gone into or the next place they were hoping" to enter, she says.

"Sentiment is starting to turn around," adds Patrick Aiache, global investment officer at CCF-IFC, New York, parent of Framlington Russia Investment Fund, a $66 million closed-end vehicle. Until recently Framlington stuck to direct investment and joint ventures offering less market and custodial risk, but is now ready to take up equities. The global strategists at Baring Securities, London consider Russia one of "the cheapest markets worldwide" alongside China, a market where foreign investors face uncertainties that are at least as great.

There is, moreover, reason to believe Russia can shake off the lethargic pace of activity to attain economic growth more worthy of the emerging market category. CSFB sees the Russian economy contracting another 3 percent in 1995 but staging a 2 percent expansion in 1996. "Longer term, it will move toward 5-10 percent growth, given Russia's resource wealth," Hoffman said.

Considering the terrain immediately ahead, Hoffman looks for voters to shift towards the Communists and the Agrarians in the December Duma voting but without impeding economic reform. For one thing, the election will not yield a clear alternative to Victor Chernomyrdin or Boris Yeltsin for the June presidential contest; and the Duma will remain every bit as fragmented, thus no more capable of vetoing the president.

Hoffman does see the possibility that central bank governor Tatiana Paramonova, under fire from banks and industry because of her tight monetary policy and refused confirmation by the parliament in July, may fall victim to politics some time in 1996.

Names now in circulation in Moscow as a potential successor include Sergei Rodionov, chairman of Imperial Bank; Boris Fyodorov of Chernomyrdin's Forward Russia party; finance ministry senior official Andrei Kasmin; and IMF representative Dmitri Tulin. But, Hoffman adds, "The likelihood is that the next acting [central bank] governor will quickly gain the confidence of the markets" as Paramonova has.

Setting aside the risk of a surprise political crisis, always possible given Yeltsin's uncertain health and the undercurrents of nationalism and anti-Western sentiment, the ruble remains a question. Hoffman expects it to stay "well within" the official 4,300-4,900/$1.00 band though perhaps weakening towards 4,700/$1.00 this autumn on sales by importers. But the central bank would actually welcome moderate weakening which would let it intervene to reduce ruble liquidity, Hoffman says. He expects the ruble band to narrow in 1996, though possibly in combination with a Hungarian- or Polish-style crawling peg gradual devaluation. EM

FLEDGLING MOLDAVIAN BURSA PLANS 500 SHARES BY 1996

There is still more than a touch of Soviet-era austerity to the shops along the Bulevard Stefan cel Mare, the main thoroughfare of Moldavia's capital Chisinau not to mention the dreary lines of housewives outside offering everything from used clothing to household sundries. Despite this, the country's financial system and capital markets — especially equities — are taking shape.

Tuesdays and Thursdays from 11:00 a.m. to 2:00 p.m. in a cavernous fourth floor hall in a grimy office building on Stefan cel Mare, the 53 members of Moldova's stock exchange assemble to trade shares in six listed companies. Since the Bursa was launched June 26, daily trading volume has crept up to some 1,500 shares for a value of about 4,000 lei ($1,000), according to Bursa vice president Corneliu Dodu.

He's optimistic about the prospects for 1996 and beyond, though, with the latest stage of Moldovan privatization expected to raise the number of privatized enterprises to about 2,000 by the end of 1996 and the number of companies listed on the fledgling exchange to 30 by late this year and "not less than 500" by the end of 1996, Dodu says.

Western diplomats say President Mircea Snegur and Prime Minister Andrei Sangheli should move a lot faster with the privatization of key industries including tobacco and food processing. "They're standing on the edge of the pool," says one, "but they're afraid to jump in." With many Moldovan parliamentarians elected from rural constituencies where they also serve as collective farm chiefs, reluctance to privatize the large agricultural sector in particular is understandable.

Multilateral officials give Moldova top marks for its stabilization program.

Despite such reservations, multilateral officials generally give Moldova top marks for its determined stabilization program, which has brought inflation down into the 10-20 percent range this year against about 100 percent in 1994 and 2,100 percent in 1993. Government belt-tightening has closed the budget gap to 4 percent of GDP from 23 percent in 1992; officials expect growth of 1.5 percent this year after a 22 percent contraction in 1994. The lei, meanwhile, has become one of the most stable currencies in the former Soviet Union.

Moldova's stability drive is "probably unparalleled," remarks Mike Casella, a U.S. Treasury official seconded to Moldova as advisor to the finance ministry on budget and credit policy. He noted that a firm lei has helped generate interest among Moscow investors for Moldova's government security auctions. Adds World Bank resident representative James Parks, "The base for attracting foreign investors is there."

Fund managers aren't yet thronging to Moldova. But a respectable number of Western investment bankers showed up last month for a three-day conference sponsored by the government and multilateral partners, evidence that Moldova — Bessarabia of old — is back on the map. It must work hard to stand out from neighboring Ukraine and Romania, and assure investors the ethnic Russian Trans-Dniester breakaway republic can peacefully be reunited with the Romanian-speaking heartland. But Moldova seems well on its way to recognition as a viable market. EM

— Brendan Murphy

Bankers

WEDNESDAY, OCTOBER 11, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 30

Dresdner Bank's Follow-the-Leader Tactics Pay Off

BY KLAUS ENGELEN

Dresdner Bank has made a habit recently of following rival Deutsche Bank's lead. In June, Dresdner followed Deutsche into the City of London with its friendly takeover of the British merchant bank Kleinwort Benson. Two years ago, when Deutsche became the first German bank to lead a U.S. stock offering, Dresdner quickly followed suit.

But trailing Deutsche from a distance may have some advantages. It has enabled chief executive Juergen Sarrazin and his colleagues not to follow their rival in blunders.

The German giant Deutsche is plagued by sagging morale and a never-ending torrent of bad headlines, reporting a 9 percent drop in operating profits. In the same period the other "big three" bank, Commerzbank, announced that its profits doubled.

And what about Dresdner Bank, Germany's number two?

In August, Sarrazin reported a 5.5 percent decline in six-month operating income, but expected an improvement in year-end results. According to some analysts, Dresdner's conservative, follow-the-leader approach has rewarded investors with higher returns in recent years than Deutsche. Avoiding the organizational turmoil that has struck Deutsche in the wake of the bank's decision to move most investment banking activities to London, Dresdner gets high marks for the efficiency of some of its parts, in particular bonds and foreign exchange. But as analysts concede, Dresdner still remains weak in international equities.

When Sarrazin took over the reins of Dresdner in March 1993 — a banking group with DM400 billion ($287 billion) in assets, DM275 billion in market capital, 45,000 employees, 1,585 branches and offices in 60 countries — he didn't have the image of a chief executive with tight internal controls and organizational efficiency high on his priority list. He was seen more as Dresdner's "foreign minister," roaming the world for new business. And he was greeted as a European banker with a mixture of vision and tenacity.

As Dresdner's point man for the unique — and, in the eyes of some analysts, troubled — cooperation experiment with France's Banque Nationale de Paris (BNP), Sarrazin, now 59, has shown an unflagging resolve and commitment for building a Franco-German platform.

Sarrazin told *Emerging Markets:* "In no way will our investment in Kleinwort Benson diminish the strategic importance of the cooperation agreement we have with BNP."

In the face of mounting criticism in Germany against the country's top bank's investment banking move to London, Sarrazin repeated his earlier assurance that "strengthening our presence in London is no retreat from Frankfurt, as some have suggested.

"We have made no bones about the fact that we are determined to become still more profitable and more effective in the investment banking sector," he continued, "particularly with regard to our international business. There our strategy is based on a strong position in Europe as a prerequisite for building up a significant presence in other key markets and a presence in London, where we have been underrepresented in the past. This also is a prerequisite for maintaining our leading position in Deutsche mark capital market activities."

Dresdner has avoided the organizational turmoil that has struck Deutsche Bank.

Looking ahead, Sarrazin wants "to develop Dresdner's position further as a leading European investment bank with a meaningful presence in New York, Tokyo and other major financial centers such as Hong Kong and Singapore." In his view, there are two ways to achieve this goal, "first by positioning ourselves as an integrated investment bank which can offer a full range of services; and second, further developing our joint skills in mergers and acquisitions and equities."

As to the record so far of Dresdner and Kleinwort Benson "working together" since the acquisition, Sarrazin is convinced that his model works: "We have devised a model that will neither result in Dresdner Bank and Kleinwort Benson working on a parallel basis and effectively competing with each other, nor will it lead to Kleinwort Benson being absorbed as a division of Dresdner Bank. It is extremely important for us that Kleinwort Benson's employees — and not least those in managerial positions — remain motivated and committed to Kleinwort Benson. At the same time, we look forward to Kleinwort Benson employees voluntarily becoming integrated with the Dresdner Bank Group."

Judging from the absence of internal strife — leaking to the outside either from Frankfurt's Dresdner Bank headquarters or from London's Kleinwort Benson organization — Sarrazin's hope might come true. EM

The Merger Bell Tolls for Britain's Merchant Banks

BY ALEX BRUMMER

The days of the independently-owned British merchant banking sector look increasingly numbered after a year which has seen many of the most illustrious names in the City of London absorbed in quick succession by overseas competitors. Even after the disappearance of Barings into the hands of ING, SG Warburg into Swiss Bank Corporation (SBC), Kleinwort Benson into Dresdner Bank and brokers Smith New Court into Merrill Lynch, the small band of remaining investment banks have been subject to almost continuous bid speculation, apart from Lazard Brothers, which is protected by its international links.

Schroders, the largest of the remaining band of independents with assets of £11.36 billion ($17.93 billion), is the subject of continuous takeover speculation with the Dutch bank ABN-AMRO seen among the favored potential buyers. Hambros, with its slightly smaller franchise also is seen as a bid counter. Only the very established niche players such as privately owned NM Rothschild and Cazenove are credited as possible independent survivors. However, even these blue-blooded names could find themselves under pressure "as a result of the new capital adequacy directives being put in place by the European Community in Brussels," according to one leading London merchant banker.

Barings' takeover was precipitated by Nick Leeson's $1.2 billion derivatives gambling losses in Singapore, supported by management and regulatory failure. SG Warburg, after failing to merge itself with Morgan Stanley, suffered an internal crisis of confidence. Nevertheless, the high prices paid for the rump of Barings, SG Warburg and others were no accident. It is the ingenuity and innovation of London-based banking which contrast starkly with the conservatism of what has become known as Rhine-Westphalia-style banking. Thus Dresdner, in buying Kleinworts, was not simply acquiring a name, bricks and mortar and fund under management; it was putting together a team of entrepreneurial managers with proven success in privatization, mergers and acquisitions, derivatives, and bond and foreign exchange trading.



The banks gone, is the monarchy next?

Bids like the SBC takeover of SG Warburg are in some respect a compliment to the City of London vis a vis Frankfurt and Zurich, rather than testimony to the decline of the City as a financial center, as some analysts have claimed. Yet these deals are still viewed as flawed, because they have not given the City-Continental banks the access in Wall Street and the wider U.S. distribution which are now seen as essential for global success.

"The golden prize in investment banking will go the the house which bridges the Atlantic," argues a senior U.S. executive at investment bankers Morgan Stanley in London. "The great weakness of U.K. houses has been the lack of presence in New York," he argues. That, to some extent, was remedied when Merrill Lynch paid £526 million for Smith New Court (SNC) in August 1995. However, SNC as a stockbroking house with strong London, European and Far Eastern franchises could not be considered a full service merchant bank on the lines of Schroders.

The other London-based merchant banking survivors are the investment banking offshoots of the large commercial banks. By far the most impressive of these is BZW — although Midland Global Markets, the HSBC subsidiary which combines the former businesses of Samuel Montagu, Greenwell, James Capel and the treasury business of HSBC, has the largest trading floor in London. It has been suggested that the next best expansion for one of these houses would be a merger with one of Wall Street's second line players such as Lehman Brothers or Salomon Brothers. If the British house were to gain the upper hand, then merchant banking in London would be far from dead. EM

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Trade

Big Three Fight For China Roads

BY TONY WALKER

For the world's automotive giants there is no more glittering prize than the Chinese vehicle market, but securing access is not proving easy for the likes of Toyota, Ford and General Motors.

None of the "big three" among international vehicle manufacturers has established a strong hold on the ground in China, and all are sparing no effort to secure the breakthrough that will see them positioned to take advantage of expected explosive growth in the Chinese market in the next century.

China's automotive industry policy, unveiled in mid-1994, puts a freeze on new entrants until 1997 pending further development of a weak components area and additional steps towards rationalizing a highly fragmented local manufacturing sector.

This "standstill" policy has benefited companies like Volkswagen which are already involved in manufacturing joint ventures on the ground, but representatives of GM, Ford and Toyota say that such is the potential of the market that a slow start will not prove to be a disadvantage in the long run.

The car giants are likely to be proved correct if China's own projections about the size of the local market are borne out. According to an official forecast by a group within the Chinese bureaucracy known as the "Strategic Development Research Team of China's Family Car," numbers of cars in China will rise to 22 million by 2010 compared with 1.7 million at the end of 1994.

China plans to be building up to 4 million cars a year in 2010, against 300,000 now, and 60 percent of all vehicles on the road will be privately owned, compared with less than 5 percent at present. Clearly, a huge change in ownership patterns is envisaged with considerable implications for the ambitions of foreign manufacturers.

The implications for China's economy are also massive, and in line with economic planners' expressed ambitions for the automotive sector to become a "pillar" of the national economy.

Total production value is set, according to the official estimate, to reach Yn420 billion ($51 billion) by 2010, with an extra Yn1,052 billion being generated by associated industries. The industry would yield Yn80 billion annually in tax revenues and create 15 million new jobs.

But in the meantime, China is faced with the daunting task of bringing about a comprehensive restructuring of the industry. Beijing plans to reduce numbers of manufacturers dramatically from the present number of around 120-130, some producing a handful of units a week, to three "large scale" conglomerates and six or seven "backbone" enterprises. Many of China's 4,800 components manufacturers are also expected to be weeded out in a far-reaching consolidation.



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Workers assemble Jeep Cherokees in Beijing

The aim of this is to introduce economies of scale into an industry that for the past more than four decades has effectively been cut off from the outside world. China recognizes there is huge pent-up demand for family sedans, but also understands that developing an industry capable of delivering affordable cars will not prove easy.

The Chinese also face a huge challenge developing the infrastructure required to support car ownership at the levels predicted. China's road system is primitive, parking facilities in Chinese cities are virtually nonexistent, and traffic congestion in larger conurbations like Shanghai is already a serious problem.

But none of this is likely to deter the international automotive sector in its efforts to penetrate the China market. According to some estimates, half of the 45-50 million cars sold annually worldwide by early next century will be marketed in Asia, with China accounting for a big percentage of the new sales. EM

FUJI V. KODAK IN BIZARRE KABUKI THEATER

BY JONATHAN BURTON

The U.S. and Japan are going to the sumo mat again, this time over Eastman Kodak's claim that powerful Fuji Photo Film, with the government's blessing, unfairly controls the Japanese camera film market. Washington is putting muscle into helping Kodak crack Fuji's 70 percent share of Japanese film sales, of which Kodak's share is about 9 percent.

Fuji retorts that Kodak has tripped over its own poor decisions in Japan. Fuji officials point out that Kodak's share of the U.S. film market is also about 70 percent, while Fuji has roughly a 12 percent take. Kodak's response: market access, not market share, is the focus here.

The Kodak-Fuji fight is the latest round in the seemingly endless sparring between the world's two giant economies. Time and again, the U.S. and Japan have come away from the trade bargaining table shaking hands, only to wind up before long in another showdown. More hostile trade adversaries have managed to stitch together agreements, for example in the WTO and Nafta, but for the U.S. and Japan, trade is bizarre kabuki theater, a running drama of innuendo, exaggeration and politics.

"We come from extremely different bases," says Marjory Searing, the commerce department's deputy assistant secretary for Japan. "I am struck every day by how deep the differences are."

This cultural gap has always been challenging for both American and Japanese trade negotiators. But U.S. officials recently have demanded more action and fewer words from the Japanese. Earlier this year, when Japan did not warm to U.S. insistence that it open its markets to U.S.-made autos and car parts, Washington took the matter to the edge. With hours remaining before the U.S. slapped tariffs on imports of Japanese luxury cars, the two sides reached a compromise. Japanese officials promised more access for American auto companies, but didn't attach hard numbers to its commitment, as the U.S. has wanted.

Tough trade talk on both sides of the Pacific makes for good politics, But will every dispute now run the risk of a trade war? The Japanese call this big-stick approach *gaiatsu*, or "foreign pressure." To the rest of the world, it's brinkmanship. This can be a most unsettling — and dangerous — game.

"Japan cannot afford total disagreement with the United States," says Sadahei Kusumoto, chairman of Minolta Corporation, the U.S. subsidiary of the Osaka-based Japanese camera manufacturer, adding: "America needs Japan to help keep order in Asia."

The Japanese call this big-stick approach gaiatsu, *or "foreign pressure." To the rest of the world, it's brinkmanship. This can be a most unsettling — and dangerous — game.*

Both sides know this. They are politically and militarily tied, so on economic and trade issues they inch ahead, one industry at a time. The table can often be confusing. Auto parts are cleared away, replaced immediately by aviation rights, which then makes room for camera film. And these spot fires are not ever likely to disappear. Telecommunications is a new battleground. Automobiles undoubtedly will again take center stage. The only question now is how the two governments will handle problems as they arise.

"We should try very hard to resolve these issues without getting to an acrimonious stage," says Searing. "There will be contention, but we will find a way through."

Even Kodak hasn't completely ignored that message. Last August it contracted with a group of Japanese discount retailers to sell its film for about half the price that most stores in Japan charge. The move could help Kodak increase market share, particularly since Japan's worst economic downturn since the 1930s has transformed many of its hard-to-please consumers into bargain hunters.

And, perhaps unintentionally, that could quiet Kodak's grumblings about unfair trade. After all, when the American company announced its alliance with the Japanese discounters, a Fuji official was quoted as saying that the agreement proved Japan actually does have an open market. EM

That's a question we've heard from senior management at some of the largest financial institutions in the world. They realize that the complexity of the capital markets is steadily increasing, that technology is accelerating change in the financial services industry and that globalization cannot be shrugged off.

While there are few prototypes of successful global organizations, the key issues clearly involve risk management, profitability and the ability to stay abreast of tax and corporate governance systems, both nationally and internationally.



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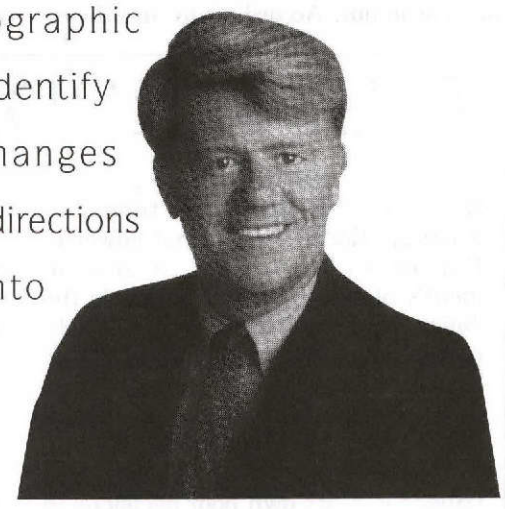

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Financial Services Industry Practice

World Bank

WEDNESDAY, OCTOBER 11, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 37

BANK HOPES TO GUARANTEE PRIVATE SECTOR

BY ROB WRIGHT

Loans are out. Guarantees are in.

Such is the talk at the World Bank these days when the subject is financing large physical infrastructure projects. The institution is stepping up the use of its guarantee program to attract new private financing for big projects, and slowly scaling back its traditional public sector loans to developing country governments for the same purpose.

The trend is especially visible on big dams, where direct involvement leaves the bank especially vulnerable to damaging criticism from environmental groups. Such charges are especially troubling for the institution in the difficult budgetary climate surrounding the current effort to renew funding for its concessional International Development Association (IDA) lending arm.

These issues came to the forefront over the summer in one of James Wolfensohn's most prominent decisions to date as president: the August 3 cancellation of a planned $175 million loan to support Nepal's construction of the Arun III hydropower project.

The loan had been strongly supported by his own South Asian department staff and some board members, and had even appeared to survive inquiries by the bank's independent inspection panel. But Wolfensohn gave it a flat thumbs down after receiving a special assessment from his longtime friend and adviser Maurice Strong, the Canadian environmentalist who had headed the 1992 Earth Summit in Rio de Janeiro. In his ruling Wolfensohn essentially agreed with NGO criticisms that the mega-project likely exceeded Nepal's implementation capacity and risked eating up funds its government needed to spend on the poor instead.

"Under today's circumstances and with the information at my disposal, the risks to Nepal were too great to justify proceeding with the project," Wolfensohn said at the time.

Washington environmental groups who monitor the bank applauded the move, and said they wouldn't be surprised if the political sensitivities involved led it to greatly limit its future direct lending for big dams. They pointed out that most of those loans in its portfolio recently have been confined to China, where the political climate means NGOs have no way to mobilize international protest campaigns.

All the hoopla about privately financed infrastructure has led to few actual completed projects.

Yet all the while the institution is looking for other, more successful ways to get big dams built so developing countries can see the new power generation and water resources they so badly need. In September it issued a report, saying East Asia alone needed to spend up to $1.5 trillion over the next decade on infrastructure development and offering to help find solutions to the financing vacuum such projects face. The report clearly stated that all the recent hoopla about privately financed infrastructure has in fact led to few actual completed projects.

The report said "public-private partnerships" were the only way to resolve the crisis. One big step in that direction the bank said it would take was increasing use of the commercial loan guarantee program it revised just prior to last year's annual meeting in Madrid. The instrument is designed to attract longer-term, less costly private finance for projects than would otherwise be found in the markets. While only used five times so far, an active pipeline is being assembled with 23 potential guarantees over the next two years, branching out beyond power projects to include toll roads, oil and gas ventures and even trade finance.

"We certainly hope the guarantee program will be going forward in a big way," said the World Bank's Farida Mazhar. "Project financings tend to have a long lead time, but we certainly have an active program developing. We're in touch with commercial banks all the time, and they appear to love the program.

"Some definite additionalities are seen here by the financiers and sponsors," she added. "For example, we've just concluded a framework agreement for India's power sector, and that has met with a tremendous reception on the part of financial institutions and developers."

This year the bank has backed up Jordan's first Eurobond issue, which brought in long-term money for telecommunications and leveraged hundreds of millions of dollars in commercial lending for China's large scale Ertan and Zhejiang dams. Pakistan's privately financed $600 million, 586 megawatt Uch power project is also due for a World Bank $60 million partial risk guarantee against government sovereign payment obligations, along with other financing through a bank-backed subordinated debt fund, IFC, and the U.S. Ex-Im Bank. EM

IFC Leads Way to Capital Markets

BY K. MICHAEL FRASER

The International Financial Corporation (IFC) has launched a series of innovative financial deals over the past few months that reflect, in part, George Handjinicolaou's efforts to sharpen its treasury operations.

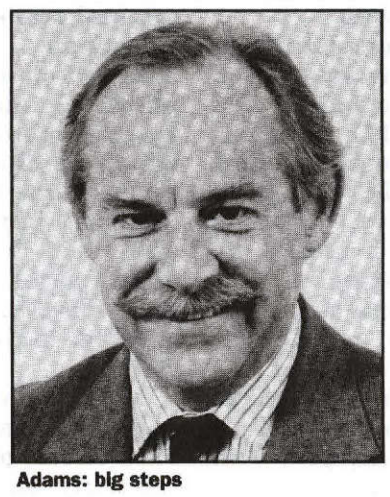
"We are putting in place a modern treasury operation," says Handjinicolaou, who ran Bank of America's derivatives group until the IFC lured him to Washington to head its treasury operations in March 1994. In March this year, the IFC backed the entry of Thailand's Finance One into the U.S. commercial paper market, the first time the IFC had tapped this capital source, which is open to few emerging market companies because of its sensitivity to credit ratings.

To structure the deal, which it hopes will be replicated for other companies and by other investment banks, the IFC loaned Finance One $180 million. Of that, the corporation kept $30 million and is funding the rest through a three-year commercial paper facility.

The deal worked because the IFC is the lender of record and has rarely faced default on its loans. Because of that, Credit Suisse granted a letter of credit to support the facility at an acceptable cost.

"This transaction represents a significant step for companies in emerging markets," said IFC vice president for capital markets Daniel Adams.

In June, the IFC launched another innovative deal when it pooled sub-investment-grade loans totaling $400 million it had made to privately held emerging market companies. The corporation sold participations in the pool to a specially created trust, which divided the total into three tranches and, for each, issued certificates that are similar to bonds.



Adams: big steps

Because the IFC remains the lender of record, rating agencies believe the loans would receive preferential treatment in a foreign exchange crisis. Governments do their best to service loans made by supranational lending agencies such as the IFC because they often are the only sources of foreign capital during hard times.

The deal, which freed up IFC's capital for other investments, went to asset-backed investors that had not been tapped by the IFC before.

In July, the IFC launched a third innovative deal when it securitized a loan to Apasco, a Mexican cement company. The IFC, which again exploited its preferential-lender status to secure an investment-grade rating for the deal, sold participations in $85 million of the $100 million loan to a special purpose company.

The IFC took $5 million of the SPV's certificates, and $80 million worth were sold to U.S. insurance companies that had not previously invested in IFC deals. Insurance companies are an attractive source of capital, because they take long maturities — this deal was for 12 years — and they are buy-and-hold investors who are unlikely to sell in a crisis.

Handjinicolaou is quick to say he is managing an evolution, not a revolution: "The IFC did innovative deals before. The difference is now we are more responsive to the market and much more pragmatic."

Handjinicolaou inherited a structure that was having increasing difficulty coping with rapidly growing international borrowing and lending operations at the IFC, which supports private sector development.

To meet new demands, the IFC's treasury had to become more sophisticated and nimble. Handjinicolaou is upgrading the treasury's talent and computer systems so it can better identify, quantify and hedge risk. And he is making it more responsive to market developments.

Instead of leaving treasury officers to work alone in their offices, Handjinicolaou promotes interaction. "We spend a lot of time talking about the market. We have installed a market-oriented culture." he says.

Decentralizing authority contributed much to creating that culture. "Before, everything had to go through me and the director. People couldn't take a step. You can't react to the market through a hierarchical structure," says Handjinicolaou.

Despite the improvement, the IFC's reputation for innovation should be kept in perspective. "If you look at them as an institution that promotes private-sector development in developing countries, they do a fantastic job," says a managing director at a major U.S. investment bank. "But if look at them as a securities house, they are behind the rest of us." EM

Dialogue

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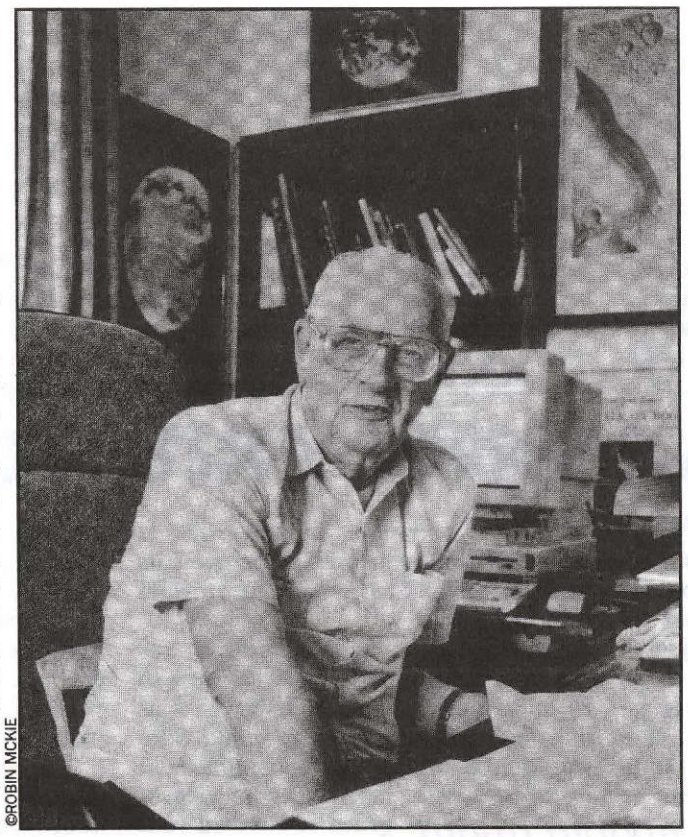
Arthur C. Clarke: Living to 2001

Revered as a visionary who predicted the date of the moon landings, satellite television and nuclear energy, the science fiction master ponders the future from Sri Lanka.

BY ROBIN MCKIE



©ROBIN MCKIE

There is a small notebook with a faded blue cover and crumbling spine on the shelves of Arthur Charles Clarke's elegant study in Colombo, Sri Lanka. On one of its pages is recorded a simple note, written in pencil. "Can Rocket Stations Give Worldwide Radio Coverage?" it states. "Wireless World. October 1945. pounds 15." It is a cryptic message, but a historic one nevertheless — for those few words record the sum of money that was paid to Clarke, in the incarnation of a young British Royal Air Force flight lieutenant in World War II — for an idea, published in the magazine *Wireless World*, that has utterly transformed our world.

Those "rocket stations" we now call communication satellites, and they relay our phone calls, television pictures, and computer data. They are the technological glue which holds late 20th century society together — and they were dreamed up, exactly 50 years ago, by a young lad from Somerset in West England while working in a damp airfield in wartime St. Evals.

Clarke has gone on to fame and a reasonable fortune since then. He is revered as a visionary, with many scientific predictions — such as the date of the moon landings, satellite television pornography, the release of nuclear energy — to his credit. He is also renowned as a science fiction author, having written classics such as *2001: A Space Odyssey*, *Childhood's End*, *A Fall of Moondust*, and many others. Yet it is for the invention of the communication satellite that he will be best remembered.

"The idea of geostationary satellites — which hover, 23,000 miles up, over the same spot on Earth — was not mine. That was already known," Clarke points out in his still distinctive West England accent. "People forget that. My trick was to propose that a minimum of three hovering over the Atlantic, Pacific and Indian oceans could relay signals from any point in the world to any other." The principle was spot on — not bad for a young man who had still to go to university. Clarke's only real mistake was to assume three satellites would be enough to satisfy the world's urge to talk and communicate. Today there are dozens of communication satellites.

Next generation computers will respond directly to brainwaves, from plates attached to our skulls. "My prediction is for the return of the wigmaker."

Clarke also assumed his "space stations" would be manned, of course. His experience of working on radar at St. Evals taught him that valves would burst every day and would have to be replaced. The transistor put an end to that romantic requirement, however — much to Clarke's disgust.

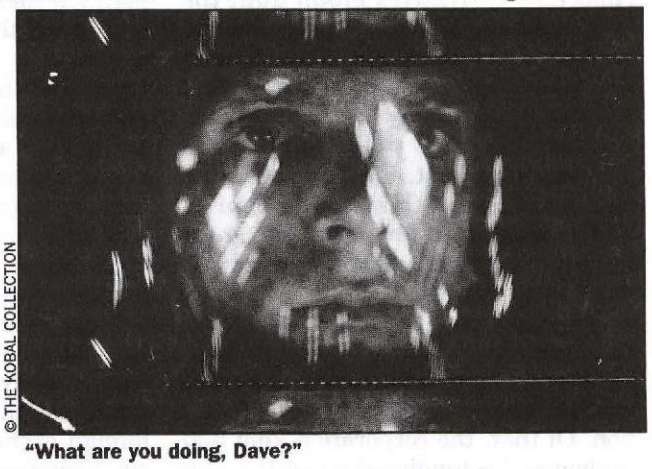
Today, Clarke is completing his 78th orbit of the sun (he was born on December 16, 1917), and although he now walks with difficulty, having been struck by post-polio syndrome late in life, his mind still races ahead into a future that he has embraced enthusiastically all his life. Predictions positively pour from his lavish Colombo study.

Take computers (Clarke has six). These have already replaced the typewriter, slide-rule, logarithm tables, and carbon paper, he points out, and next to go will be the peripherals. Voice-activated keyboards and eye-mounted VDU terminals are coming soon — to be followed by computers that respond directly to brainwaves, from plates attached to our skulls. "That means we will have to shave our heads. So my next prediction is for the return of the wigmaker."

Developments in nanotechnology — the manipulation of tiny molecule sized objects — will lead to the development of replicators which will copy solid objects just as photocopiers copy documents, while his dearest passion, the search for extraterrestrial intelligence will surely bear fruit eventually, he believes.

"Frankly, it is hard to think of a question that is more fascinating or more philosophically important." And if all these prognostications sound far-fetched, a quick survey of Clarke's Colombo study (he moved to Sri Lanka 30 years ago to follow his passion for scuba-diving) will remind any doubters that we are dealing with a forecaster with a distinguished pedigree.

Apart from the video recorders, computers and other paraphernalia that were predicted decades ago in Clarke's writing, the walls are covered with awards, photographs of the Great Seer of Science posing with astronauts, and other mementos. There is even a section of the original transatlantic telegraph cables mounted on a wooden plinth. He also has a videophone (through which he chats with his brother Fred in Somerset) just like the one used by space administrator Heywood Floyd to talk his daughter in the film of *2001*.



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"What are you doing, Dave?"

Not all Clarke's crystal ball gazing has come about, of course. The early sequences of *2001* suggest we should have had manned space stations and lunar bases long ago. "It is sad, I admit. The Cold War took all the impetus out of the space race. But eventually we will be up there — in a serious way. Planes will fly faster and longer until one day they can get into orbit. That will open the door to the planets."

Unfortunately for his fans, Clarke has now renounced his fiction writing — his last novel, *The Hammer of God*, having been published in 1993. (The good news is that Steven Spielberg is considering making a film of it.) "I want to read, enjoy myself, and exercise to keep my strength up so I can make it through to the year 2001 — which is my real aspiration now."

Despite his frailty, however, Clarke remains energetic and good-humored, displaying the same cheery egoism for which he is famed. (An old friend once pointed out that Clarke's first bedsit was so small, his ego had to wait on the landing.)

Visitors are showered with displays of his "trophies" — a signed photograph of Buzz Aldrin, a sample of moondust from Neil Armstrong, a book signed by Yuri Gagarin — and constantly deluged with video clips of his life, including tributes from Rupert Murdoch, Patrick Moore, Margaret Thatcher and the late Isaac Asimov. (Clarke had a particularly close and jocular relationship with Asimov. Once, on reading of a plane crash survivor who was found clutching one of his books, Clarke told Asimov: "He should have been reading one of yours, Isaac, then he would have slept through the whole thing." To which Asimov replied: "No, it should have been one of yours, Arthur. Then, if he had died, it would been a merciful release.")

Most of Clarke's days are now spent in his long, pine-shelved study, through which passes a constant procession of his Sri Lankan retinue, their children and pets — making interviews a tricky business, if nothing else. These are his family, he says, (Clarke was married briefly, and disastrously, in 1953).

The rest of his time is spent at the Otter Aquatic Club of Colombo where he demonstrates a ferocious skill at table tennis despite his disability. He has few plans to travel nowadays — but then why should he? Thanks to his pioneering idea half a century ago, the world can now come to him, direct to that videophone on his study desk. EM



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AN INTERVIEW WITH
GABRIEL C. SINGSON
GOVERNOR, PHILIPPINES CENTRAL BANK

Bangko Sentral ng Pilipinas

Q. The peso has strengthened against the U.S. dollar from as much as P29 in 1993 to the current level of about P26. How can you reconcile this with your government's export-driven growth strategy?

The appreciation of the Philippine peso is a classic case of the supply exceeding the demand for foreign exchange. The much improved economic fundamentals and political stability in 1994 attracted foreign exchange into the country. The $1.8 billion surplus in the balance of payments attests to this. On the part of the BSP, we are aware of the adverse effects of a strong peso on exports in particular and on macroeconomic growth in general. Hence, our initial policy reaction is to moderate the peso appreciation and minimize the exchange rate volatility by direct intervention in the foreign exchange market and fine tuning our credit and interest rate policy.

Moreover, the BSP adopted "market-based" measures to reduce intermediation costs that will ensure lower borrowing costs for exporters. In particular, we have reduced the reserve requirement which accounts for the most part of the banks' intermediation cost. We have also extended assistance to exporters by providing them cheap sources of funds. To top it all, we have adhered to a monetary program that is supportive of the objective of a stable and low inflation rate that will ensure a modest cost structure and price movements not only for exporters but also for the whole economy.

Q. The Philippines has been running significant trade deficits in succession over a number of years. Is this sustainable?

Structurally, the Philippine economy depends heavily on imports. But most of these imports are essential to our production; very little caters to our consumption patterns. The country imports nearly 100 percent of its crude petroleum and also relies heavily on imported equipment and raw materials. Over the five year period from 1990 to 1994, 46 percent of total imports consisted of raw materials and intermediate goods of which inputs used essentially for export production accounted for an average share of 23 percent.

Increasing imports of capital goods for the last decade translated into a high incremental capital output ratio. The reason is that the economic restructuring that has been going on, notably the shift of manufacturing away from protected or sheltered production and toward competitive export-oriented activities, has effectively rendered much of the existing capital stock obsolete and required new and modern equipment. Structural reforms during recent years have led to the improvement in the general economic environment in the Philippines which has enabled the country to lay the groundwork for sustainable growth. The improvement in efficiency is expected to raise exports by an average of 20 percent for the period 1995-1998 and bring down the growth of imports to an average of 16 percent.

Q. Some countries have been responding to large capital inflows which can be potentially destabilizing by putting in some restriction or taxes. Are you considering similar measures?

No. Taxing short-term capital inflows is an indirect way to regulate the influx of capital flows as the tax increases the cost of investing in locally-denominated assets. Moreover, we share the conclusion of an IMF study on the experience of ten Latin American countries that: the impact of taxes on slowing down capital flows is only short-lived and transitory; the affected sector is quick to find ways to circumvent those taxes; and that initial conditions in a country may not always be conducive to implementing a policy that adds barriers to international capital movements. An imposition of any capital account barrier by a country which is under an adjustment program may be interpreted as a signal of a policy reversal, and thus undermine the success of the program.

Q. You are regarded as one of President Ramos' closest economic advisers. Don't you see this as potentially affecting the BSP's independence?

I don't think so. The New Central Bank Act designates the BSP as the official banker and financial advisor of the government. However, I do it only when the president asks me or if the situation warrants it. And my counsel to the president is consistent with the general principles and policies set forth by the Monetary Board.

Q. What are the Philippine government's plans with respect to its relationship with the IMF?

The Philippines shall continue to adhere to the financial and economic policy commitments under the present extended fund arrangement with the IMF. The government, however, may opt not to draw on the scheduled tranches of the facility considering the expected overperformance in the gross official reserves and the overall balance of payments. The Philippines may exit gracefully from the program but would continue to extend cooperation with the Fund particularly in the promotion of a free multilateral system of payments. On September 8, 1995, the Philippines accepted Article VIII status.

Q. The Philippines has obviously improved on its inflation record in recent years. Nevertheless, inflation remains higher than in much of the region. Moreover, inflation appears to be picking up recently even as domestic liquidity has grown at phenomenal rates. Are you planning any policy adjustments?

One can make the case that inflation can be a concern. From 4.9 percent in February 1995, inflation climbed to 8.4 percent in August due to supply-related factors. However, we need to realize that for the first eight months of 1995, inflation averaged only 6.6 percent, well within the program of 7.1 percent for the whole year.

The inflation rate in the country has indeed been higher than those in most of our Asean neighbors, in absolute terms. It may be noted, however, that the country's inflation rate differential vis-a-vis some Asean countries has narrowed in the recent past. It is expected that this improvement in inflation would be sustained given the structural reforms and infrastructure support put in place in recent years to address supply bottlenecks. Despite the phenomenal growth in domestic liquidity, the BSP was able to contain inflation within a single-digit level, an indication of both the county's increasing productive capacity and widespread financial deepening. The BSP is strongly committed to adhere to its present monetary program and will continue to aim at maintaining price stability conducive to balanced and sustainable economic growth.

Q. Peso interest rates have dropped significantly since they were raised at the height of the Mexican financial crisis. What is the Bangko Sentral's target for interest rates?

The rise in interest rates due to the Mexican crisis continued through early April, but reversed thereafter with relative stability in the foreign exchange and money markets as well as the strengthening of the fiscal position of the national government. Higher liquidity in the system and the reduction in the reserve requirement helped soften domestic interest rates. Likewise, the favorable turn-out of the IMF talks also induced an easing of rates.

The benchmark 91-day T-bill rate averaged about 12 percent during January-September 1995. It went down to below 10 percent starting July. For 1996 to 1998, this single-digit level is expected to prevail as inflation slows down and economic growth is sustained. The entry of foreign banks into the country could further contribute to the lowering of future interest rates given the technological ability of these banks to mobilize resources more efficiently and at cheaper costs. Moreover, the country's improved credit ratings offer local firms the opportunity to gain more access to international capital markets.

Q. The Philippine government was widely praised for pushing ahead boldly with foreign exchange liberalization including the liberalization of foreign bank entry. How would you assess the effects so far?

It is still too early to assess the effects of the entry of foreign banks on the Philippine banking system as only seven of the ten banks have started full operations. However, in broad terms, we anticipate that the entry of foreign banks would help attract more foreign investment into the country, promote greater competition and efficiency in the banking system, and bring about technological changes and financial innovations.

Q. What is your vision for the Bangko Sentral and the Philippine banking system?

In the near term, we see a more stable and sound monetary environment conducive to growth. The bank reforms already in place and other measures being worked out will strengthen the banking sector, deepen and expand the scope of financial services and provide safeguards to promote sound bank management. The ongoing financial deepening is a good signal that the Philippines now stands at the threshold of converging financial and real sector growth. We want to make Manila an alternative financial center in Asia. We see a BSP that is stronger, freer, more resilient and more capable of withstanding internal and external shocks. The surpluses in the BSP's net income position beginning middle of 1993 are indicative of its improved capability to better absorb monetary and price stabilization costs.



Philippines

RAMOS LEADS YOUNG TIGER TO INTERNATIONAL MARKETS

BY EDWARD LUCE

As the Philippines enters its eleventh consecutive quarter of economic growth, confidence is growing that it has finally managed to rid itself of its turbulent past. Evidence of the country's new-found vibrancy is not hard to find.

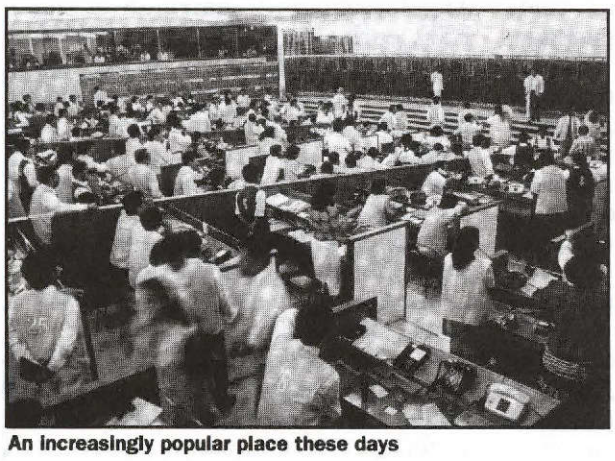
In Makati, the Philippine capital's traffic-clogged business district which played host in 1989 to a bloody coup attempt against the administration of Cory Aquino, the skyline is being transformed. At least 20 grade A office blocks are under construction and due for completion by 1998 — the year President Fidel Ramos formally steps down. Beneath the skyscrapers, the streets of Makati are packed with recently-acquired Toyotas, BMWs and Protons prodding even the most skeptical of observers to note the emergence of a growing Philippine middle class.

Across town at the Manila South Harbor along from the recently privatized Manila Hotel, the international container terminal is working round the clock. Philippine trade has grown by over 25 percent this year while exports for the first seven months have leapt by 30 percent to around $9.5 billion.

Indeed, almost everywhere one looks the impression is inescapable: the Philippines is no longer in the economic doldrums. Whether the country's three-year economic turnaround can be described as the beginning of an Asian tiger-style lift off, however, is a different matter entirely.

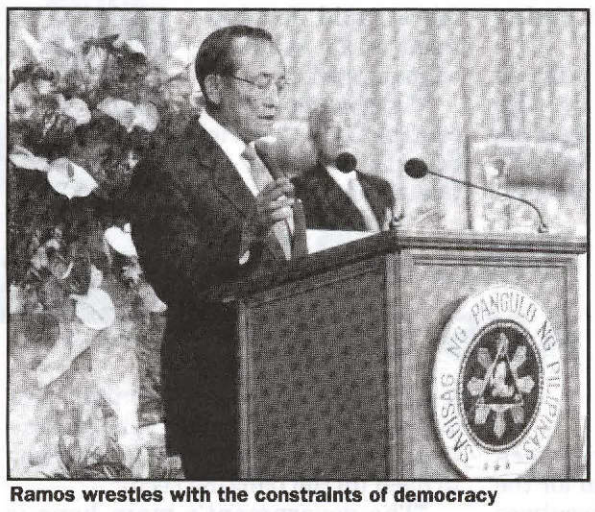
"The Philippines has made dramatic progress since President Ramos came to power in 1992," says Matthew Sutherland, chief researcher at Asia Equity Securities in Manila. "But there is an enormous amount left to do if it is to join the ranks of its more dynamic neighbors," he says.

A brief scan of the macroeconomic check list indicates that the country



An increasingly popular place these days

is half-way there. Gross national product growth is cantering along at above 5 percent for the second year running. The rise in GDP has spawned a salaried middle class with growing disposable incomes and cosmopolitan tastes. Earlier this year the country reached the critical $1,000 per capita threshold which many economists say is the take-off point for greater things. Thailand crossed this Rubicon in 1986.



Ramos wrestles with the constraints of democracy

At $35 billion the country's overseas debt, which not so long ago was high enough to classify the Philippines as "severely indebted," is now under control. Around 15 percent of annual export revenues go to debt interest payments while the total outstanding debt represents just under 150 percent of the country's export revenues — a major feat considering it was running at 300 percent in the late 1980s.

"The country is now in a position where it can borrow money on the international markets at competitive prices," says Howard Handy, International Monetary Fund representative in Manila.

Lower debt service payments and a sweeping privatization program, which has included power generation, military land, national steel, petrol, electricity, telecommunications and part of the Philippine National Bank, delivered the country's first budgetary surplus in a decade last year.

A much-awaited tax reform package, which Ramos is trying to push through congress in the next six months, is aimed at replacing proceeds from the state sell-off program with more regular public income. At the moment fewer than 10 percent of those eligible pay their taxes. And on September 25, the IMF announced that the Philippines had taken the landmark step of accepting Article 8, opening the way to full convertibility of the peso.

"Whichever way you look at it the government is moving in the right direction," says Alex Magno, professor of politics at the University of the Philippines. "The only real concern is how fast it is going."

Unlike Singapore or Indonesia, the Philippine government is not in a position to impose its agenda on the country at will. The constraints of democracy, in other words, have to be taken into account.

Since the pro-administration parties romped home at congressional elections last May, Ramos has been forced on several occasions to back down from introducing controversial measures in the face of opposition from his own ranks.

A popular outcry last month — backed by several leading senators — against the deregulation of oil prices, which would have led to the eventual doubling of gasoline pump prices to world market levels, compelled the government to postpone the measure until later this year and possibly next.

The government's vulnerability to widespread union protest was amply demonstrated last April in the wake of the execution of a Filipina maid, Flor Contemplacion, for double murder in Singapore.

Against his better wishes Ramos sacked Roberto Romulo, the highly regarded secretary for foreign affairs, and described Contemplacion as a "national heroine." Relations with Singapore have yet to be fully restored. The president, however, was successful in defusing the issue in the countdown to national polling day.

A series of vital reforms, among them the reduction of public bureaucracy, cleaning up the Philippine national police and ensuring that tax regulations are properly implemented, could, it is feared, be put in jeopardy by the government's susceptibility to popular backlash. Yet, as pointed out by the IMF at its first annual review of the country's three-year "exit" program in June, the success of these reforms is crucial to maintaining the country's new-found credibility.

Magno is not alone in voicing concerns about the government's will to push through the necessary reforms: "What the government has done in the last three years genuinely needed to be done and it should be applauded for it," he says. "But that was the easy bit, economic deregulation, privatization and so on. Now it must enact the more controversial reforms, such as sacking underemployed bureaucrats and making everybody pay their taxes. It isn't going to be easy and at the moment, there is no guarantee the government will actually succeed."

At Laguna Technopark, a duty-free industrial zone 40 kilometers south of Manila, dozens of recently established Japanese assembly lines tell a more encouraging story. Koji Miyajima, president of Honda Philippines, who last month announced plans to double the plant's annual output to 24,000 vehicles, says that the Japanese have changed their views of the Philippines.

The Philippines SPECIAL REPORT

The stock market's continued popularity suggests that whatever banana skins lie in wait, the private sector has already built up a critical mass of energy.

Honda's partners, most of whom have set up in Laguna over the past year, include all of the car giant's Japanese components suppliers, who have brought in $80 million of new investment. The high yen and the corresponding "hollowing out" of Japanese production to overseas sites has doubtless influenced their decision.

For Miyajima, however, the yen comes second place to what is attractive about the Phillippines. "It takes 60 hours for a worker to produce a car in our Thai plant, 48 hours in Malaysia and only 40 hours in the Philippines," he said. "Filipino workers are very productive and Filipino customers want to buy our cars. What more can you want?"

The growth of foreign direct investment in the Philippines and the stock market's continued popularity suggest that whatever banana skins lie in wait for the government, the private sector has already built up a critical mass of energy. Barring a very unlikely reversion to the coup-ridden era of the late 1980s or another disaster on the scale of the 1991 eruption of Mount Pinatubo, the economic outlook is brighter than it has been for decades. EM

Philippines

FOREIGN BANKS ENTER THE FRAY AS SECTOR DOOR SQUEAKS OPEN

BY EDWARD LUCE

The Philippine banking sector is in the early throes of a radical shakeup in the wake of the government's decision earlier this year to award full licenses to 10 of the world's largest banks.

With 38 commercial banks and more than 800 rural credit houses, nobody could accuse the Philippine banking sector of being lean. Some of the country's larger banks, such as Metro Bank (owned by George Ty, a leading Chinese-Filipino *taipan)* and the Bank of the Philippine Islands, predict that the sector will shrink to between 10 and 15 players within a few years.

The arrival of several of the world's giants, including Bank of Tokyo and Chemical Bank, most of which have already set up corporate banking branches in Manila since the go-ahead was given in February, has had a major psychological impact on local finance houses.

"The only type of bank which is going to succeed in an environment as competitive as this is a bank with real equity — with muscles," says Angelito Vilanueva, vice-president of Metro Bank. "We are already looking at several takeover possibilities."

According to David Hodgkinson, country manager of the Hong Kong and Shanghai Banking Corporation, which was the first foreign bank to set up in the Philippines more than a century ago, the most tangible impact of the new arrivals so far has been on salary levels. "We have evidence that salaries for middle managers have gone up by around 15 percent," he said. "The downside of this is that poaching is becoming increasingly common."

This has been a way of life at Citibank for almost a century. The American bank, which established its first Philippine branch in 1903 shortly after the U.S. took over the colonial reins from Spain, has long been seen as an unofficial training ground for the country's leading bankers. Executives at Citibank's new 38-story tower in Makati, Manila's business hub, reckon that the most far-reaching changes will be in corporate banking.

"The main hope is that the new banks will bring their clients with them and boost foreign investment."

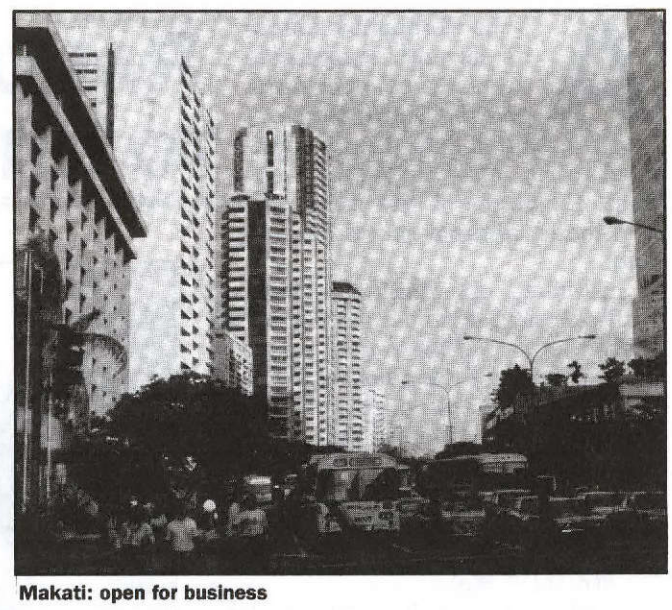
Under the February licensing agreement, the new banks are permitted to establish a maximum of six retail branches each. This suggests that most will concentrate on the lucrative wholesale sector rather than on consumer deposit taking. The result, it is hoped, will be the introduction of more sophisticated financial instruments and a more rapid development of the syndicated loan market.

The governor of the central bank, Gabriel Singson, who says he has attended around eight of the 10 branch opening cocktail parties so far, explains the government's intention behind the decision to open up the banking sector.

"The government's main hope is that the new banks, especially the Japanese, will bring their domestic clients with them and boost foreign investment in the Philippines," he says. "We also expect that increased competition will have a positive effect on the domestic savings rate."

At around 20 percent of GDP, the country's savings rate is well below the Southeast Asian average. The larger banks, which have come under fire recently for setting large spreads between saving and lending rates, blame this on government restrictions such as mandated lending requirements and the 15 percent capital reserve ratio. With the onset of more fierce competition, it is hoped that consumers will benefit from more attractive deposit rates in the medium term.

Whether or not this will give a boost to the country's paltry savings rate and herald the arrival of some of Japan's larger corporate investors, industry specialists are certain of one thing: the days of conservative banking in the Philippines are rapidly vanishing. EM



Makati: open for business

MANILA CAPITAL MARKETS UNCHAINED

The Philippine stock exchange (PSE) has outperformed its Asian neighbors since January 1993. Among emerging markets worldwide, only Peru grew faster in that period. Since 1990, the PSE's market capitalization has risen more than tenfold to $55 billion as foreign portfolio managers have cashed in on the Philippines' corporate earnings recovery.

The market's steep rise, led mainly by blue chip companies such as San Miguel, the brewery group, and the Philippine Long Distance Telephone Company, has not been matched by any equivalent growth in Manila's fledgling debt market. Perhaps the biggest obstacle holding up the development of the Philippine domestic bond market has been the long-running leadership squabble at the Securities Exchange Commission (SEC).

The controversial seven-year leadership of Rosario Lopez, a career civil servant with no market background, was held to blame for the delay of much-needed reforms in the capital markets.

Lopez's widely publicized refusal to cooperate with the other four SEC commissioners effectively froze the introduction of a much-awaited package of capital market reforms. Both the Asian Development Bank and USAID, the American development agency, withheld their $150 million and $13.5 million loan packages respectively on account of Lopez's intransigence.

"There is only one reason and one reason only why the reforms have been delayed: the lack of leadership at the top of the SEC," says Roman Azanza, director of Crosby Securities in Manila and chairman of the capital markets development council. "Now that the problem has been solved, we can get on with the task of creating one of the most modern capital markets in Asia."

"There is only one reason why the reforms have been delayed: the lack of leadership at the top of the SEC."

The solution to the problem came late August when President Fidel Ramos finally agreed to oust Lopez. Immediately afterwards, the ADB and USAID announced that their two-year loan packages would come onstream. As part of the package, which the ADB says will catapult Manila into the leading ranks of emerging markets, a state-of-the-art computer system will be installed at the PSE later this year. The system, which was developed in Chicago, will involve a shift to fully electronic trading between Manila's recently unified trading floors.

"The Chicago system is the best there is on offer," according to Noel Reyes, a market analyst at DBB securities. "After it is in place, Manila will be able to boast of being more hi-tech than Bangkok or Jakarta," he adds.

In addition, Manila will move to the trading of electronically listed bonds, international disclosure practice on the stock exchange and a mandatory "due diligence" obligation on underwriters. Within two years, it is hoped, commercial paper issues and options trading will be as natural to the average Philippine company as share offerings are today.

The acting head of the SEC, Perfecto Yassay, is widely respected in Manila but will probably be replaced by Eduardo De Los Angeles, current chairman of the PSE, early next year. Either way, the change in personnel at the regulatory body has already had a positive effect on foreign sentiment. Under the leadership of Lopez, more than 10 cases of insider trading were submitted to the SEC by the stock exchange surveillance chief, Maricel Lopez (no relation). None as of yet has resulted in a court conviction.

Maricel Lopez resigned in June to become the head of TA Securities, a Malaysian brokerage house, after suffering three kidnap attempts in her role as chief bourse enforcer. She predicts the days of blatant insider trading are numbered. "We now have the people in place to pursue the worst offenders," she said. "God knows we have been waiting a long time for this." EM

— Edward Luce

UNPROMISING FIELD WORRYING IN RACE FOR THE PRESIDENCY

BY NIRMAL GHOSH

President Fidel Valdez Ramos has been arguably the least charismatic of all Filipino presidents.

In a country which thrives on personal charisma, that would seem a recipe for disaster. Yet the president has largely succeeded in pushing through major structural reform, keeping rebel groups at bay, presiding over the slow disintegration of the Communist Party of the Philippines, weathering periodic domestic crises and refurbishing the international image of the country.

A legendary film star, Estrada plays the role of vice president and chief crime-buster as if he is acting in one of his movies.

Ramos is a plodder and a survivor. He has military training (which possibly helps — part of it was in psychological warfare). Most agree that he is a true nationalist. And he never misses an opportunity to exhort Filipinos to work hard as a team to become competitive.

"Let us forget about partisan politics," is his battle cry. "The name of the game out there is economic competitiveness."

But Ramos is limited to only one term — unless he changes the constitution and engineers his own return.

Analysts doubt that will happen, because the political price would be too high. Filipinos are extra sensitive to skullduggery that helps presidents stay in power, with one good reason: Ferdinand Marcos and his 20 years of martial law following a self-serving amendment to the constitution.

Ramos' term ends in June 1998. Speculation on who will be his successor is mounting.

The landscape is not promising. Topping the field is the current vice president, Joseph "Erap" Estrada. A legendary film star, Estrada plays the role of vice president and chief crime-buster as if he is acting in one of his movies. "I get lazy if I'm not part of the action," he said recently, after the president clipped his powers to move against criminal elements.

He is holding his cards close to his chest, but most believe he will run for president, and is a likely winner — even if his credibility has suffered recently because of his anti-crime squad's spotty and often brutal record.

Estrada is not considered a statesman by the intelligentsia. If he does become president he would need a good team — and would need to delegate to them — if the country were to remain stable.

Another front-runner is Senator Miriam Defensor Santiago, a maverick given to wild posturing at some expense to her credibility. Yet she remains a darling of the masses, who love an eloquent fighter.

Third place looks better. When Senator Gloria Macapagal Arroyo topped the senate race this year, she became the first woman in the Philippines to do so. The daughter of a former president, Arroyo is a trained economist. She was instrumental in pushing through key economic reforms and persuaded the government to accede to the Gatt. She has taken to answering questions on her political ambitions with a pregnant pause followed by a homily: "My father passed on to me his mode of public service, which is to do what is right and do your best, and God will take care of the rest."

Next come a clutch of possibilities: Subic Bay Metropolitan Authority chairman Richard Gordon, Senator Juan Flavier, Senator Edgardo Angara and Manila mayor Alfredo Lim.

Gordon may be too young, and doesn't have a national image. Senator Flavier lost votes in this year's election because the Catholic Church opposed his pro-birth control policies when he was health secretary. His undoubted popularity, therefore, has its limits.

Another front-runner is Senator Arroyo, a maverick given to wild posturing.

Lim also does not have a national image. Angara, like Ramos, is a quiet and canny plodder. But he was recently ousted from the presidency of the senate by other senators, which has reduced the space available to him for political maneuvering.

The business community is unlikely to greet a presidency of any of the above with a cheer, with the exception of Arroyo.

Economic reforms are unlikely to be endangered by political change, analysts agree. But the social and political environment, currently stable by Philippine standards, is still volatile by global standards.

Crime, corruption and bureaucratic red tape continue to flourish, and policymaking is painfully slow. Political success is a function of personality rather than ideology.

Ramos could end the speculation by visibly anointing a successor. So far, he hasn't. The general has become a canny politician, and is good at keeping even his own inner circle guessing. EM



©LES STONE/SYGMA
Subic Bay: U.S. Navy out, Taiwan in

LITTLE TAIWAN SETS UP SHOP IN SUBIC BAY

Within two years, there may be a tiny Taiwan in the former American naval base of Subic Bay, north of Manila.

The U.S. pulled out of the base in 1992, and it was redesignated a free port by President Fidel Ramos. Subic Bay Metropolitan Authority (SBMA) chairman Richard Gordon quickly targeted Taiwanese investors, citing Subic Bay's excellent working infrastructure and skilled labor pool.

Taiwanese firms have since accounted for about 26 percent of investment committed to Subic Bay, totaling some $250 million.

Seven plants are operational already. Among them are computer giant Acer Computers and Reebok supplier Subic Star, the largest employer on the base.

But most of the investment will flow into a 326 hectare industrial park which is being set up by a joint venture between SMBA and Taiwan's private sector China Development Corporation (CDC). Phase 1 of the park — a 105 hectare area — is seeing the first signs of development.

The joint venture, financed by a $23 million loan from the Taiwanese government, is addressing infrastructure in the form of water, electricity and roads. The first of the investors are due to start building soon, says Raymond Wu of the joint venture, SBDMC. Over the next year, hopes Wu, all the investors will be in place, after pumping in close to $1 billion.

Some investors, however, have been unhappy recently at the slow pace of infrastructure development in the industrial park — and at rising rents prompted by higher than expected development costs.

SBMA chairman Gordon dismisses the objections as part of the game of international business negotiations. "If they pull out" he said recently, "it gives me the opportunity to give it to others. There's a long list of people waiting."

Taiwanese consultant Brian Liu confirms that there is a long waiting list. "The park is three months late in developing, so some investors held back from signing up. But 37 are waiting for Phase 2."

Wu says the profile of investors leans towards high-technology industries rather than labor-intensive manufacturing.

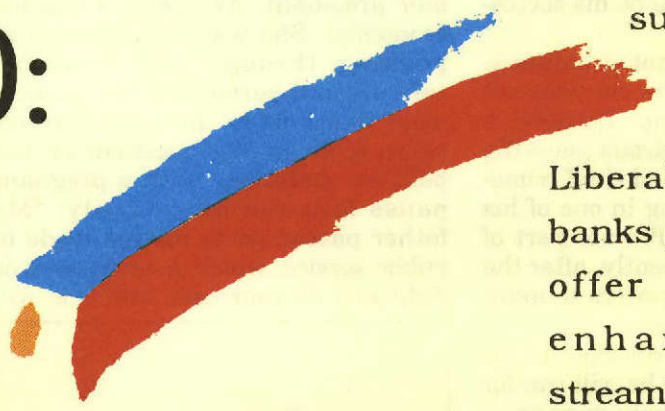
Jimmy Leu of Chung Nan Textiles grumbles that it takes two Filipino workers to do the job of one Taiwanese. Product quality is also slightly inferior to that produced in their Taiwan plants.

But wages are one third those in Taiwan, so it still makes sense to operate out of Subic. Chung Nan has plants in Taiwan as well as China, Vietnam, Laos and Nicaragua.

Liu cautions that investors should not expect the same standards as in Taiwan. Acer, he notes, has met its production targets. EM

— Nirmal Ghosh

TOWARDS PHILIPPINES 2000: THE BEST IS SOON TO COME.



The competitive landscape of the Philippine banking industry is undergoing a dramatic transformation. Reforms in the deregulation of foreign exchange, branching and foreign bank entry — all these heralded the onset of a liberalized financial environment. In this "revolutionized" banking industry, innovation and technological advancements rather than survival were the key strategies.

Liberalization gave local banks greater flexibility to offer state-of-the-art enhancements that streamlined operations and ensured greater customer convenience.

- The Philippine Domestic Dollar System, the fifth to be established worldwide, facilitates the electronic transfer (via on-line real time) of US dollar funds from one Philippine bank to another within the same day. Speedier fund transfers are guaranteed.

- Greater accuracy and operative safeguards are ensured by the automation of certain systems such as the Government Securities Clearing and Funds Transfer System, Interbank Call Loan Settlement System, Data Delivery Facility and the Electronic Delivery of DDA Balances.

- The Philippine Central Depository, Inc. was established to provide settlement and depository services to participants in the equities and debt securities markets in the country. This world-class innovation expedites settlement and reduces market risk arising from the physical delivery of stock certificates.

- Foreign exchange transactions as well as government securities and interbank trading were enhanced with the creation of the Philippine Dealing System Plus.

- The development of the Electronic Clearing System not only translates to longer internal cut-off times for check deposits but offers banks early availments of settlement figures, reports and files as well.

The vision of a thriving and economically robust

Philippines is anchored on the twin objectives of human development and global competitiveness. It is a commitment that the private sector shares with the national government.

• Local banks arranged syndicated term loans to finance the construction of power plants in La Union and Angeles — concrete solutions to supply the country's long-term energy requirements.

• Several government assets — Petron Corporation, Fort Bonifacio, PASAR, PHILPHOS, FTI and Manila Gas — were privatized to improve their efficiency and productivity.

• The Bankers Association of the Philippines (BAP), which is composed of all the country's commercial banks, continues to work with the government and with other sectors of society in bolstering the Philippines' position in the global scenario. It remains committed to addressing the diverse needs of the market while maintaining a premium on its pursuit of national goals.

As a vital engine of growth, the private sector understands the importance of strengthening the Filipino entrepreneur class. To maximize their potential as one of the major pillars of Philippines 2000 not only manifests good business sense but civic duty as well. The Bankers Association of the Philippines has also devoted its attention to the small and medium enterprises (SMEs) Through the banks' tie-ups with the BAP Credit Guaranty Corporation, SMEs were given access to short- or long-term credit facilities.

The Philippines is at the threshold of a promising future. By maximizing its inherent strengths and with the support of world-class Filipino professionals, the Philippines is poised to make its presence felt in the global marketplace. A stronger financial market and significant growth enjoyed by other sectors — these indicate that, in the Philippines, the best is soon to come.

BANKERS ASSOCIATION OF THE PHILIPPINES

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Philippines
The Philippines
SPECIAL REPORT

WORKERS ABROAD KEEP ECONOMY AFLOAT

BY NIRMAL GHOSH

A labor-exporting program started in 1974 by the late President Ferdinand Marcos has kept the country afloat during the worst of its economic crises — but is proving a political hot potato today.

Of a population of about 67 million, close to 5 million work overseas — making the Philippines the largest exporter of labor in the world.

Filipinos abroad send back more than $3 billion each year through the banking system alone, and probably double that if other channels are taken into account. Most of the money flows back to the provinces where they came from, creating upward mobility in towns and the countryside. There is evidence, the government says, that remittances helped blunt the communist insurgency of the 1980s by alleviating the rural poverty that fed it.

In the crisis years, which lasted from 1983 into the current administration, money channeled into the country from Filipinos abroad was the country's biggest single source of foreign exchange. Even now that the peso has been deregulated, exports are growing at close to 20 percent and foreign investment is buoyant, remittances remain the biggest source of foreign currency.

Recent events, including the hanging of a Filipino maid in Singapore for murder earlier this year, the death sentence passed on a maid in the United Arab Emirates and the sentencing of a Filipino worker in Saudi Arabia, have forced the government to look at protecting the rights of Filipino workers abroad, or keeping them from going there in the first place. Concern has mainly centered around women, whose absence additionally leads to family breakup at home.



Some of the 120,000 Filipinas in Hong Kong on a day off

"When women go abroad, the family loses the glue that holds them together," notes Nieves Confesor, former labor secretary and until recently chairperson of the governing board of the International Labor Organization (ILO).

A commission set up by the government earlier this year recommended a phase-out of Filipino workers overseas — and an immediate ban on sending them to some countries. Confesor was against a ban from the outset with the strong belief that it would not work. Evidence to that effect is the current ban on sending domestic helpers to Singapore; dozens of workers slip through every day by going as tourists, finding work and staying on. Confesor favors a policy of encouraging domestic workers to go to destinations where salaries are relatively higher and their rights somewhat protected — such as Hong Kong, Taiwan and South Korea.

Keeping workers at home would also substantially reduce the $3-6 billion they send home annually.

A general ban or phase-out would keep thousands at home, but it would be politically loaded.

Not enough jobs are being created at home. According to political scientist Alex Magno, it would take the government a minimum of 10 years to absorb overseas workers in the domestic job market.

"Even if exports grow at over 20 percent, a lot of it is in non-labor-intensive sectors," he notes, "overseas jobs are proxies for the lack of jobs at home."

President Fidel Ramos wants to create one million jobs a year at home. But currently only 750,000 are being created, and the population is growing at well over 2 percent — the highest growth rate in Southeast Asia. Some analysts believe even one million jobs a year would not be enough — they estimate annual demand at close to 1.4 million.

Increasing the need for domestic employment by keeping workers home would be politically explosive. Labor flows have internal implications, according to research available at the ILO's Manila office. A majority of the overseas workers come from four regions, and workers from other regions take their places in hometown jobs. If the overseas workers were to return or stay home, these workers would be displaced in turn. Keeping workers at home would also substantially reduce the $3-6 billion they send home annually. At this stage, losing the money would hurt. "The country can't afford it," said one economist bluntly.

The Philippines' foreign debt is around $40 billion, and its domestic debt considerably larger. The government turned in a budget surplus in 1994, but only after selling off key state assets.

Last year the current account deficit was 4.8 percent, while the trade deficit was close to 13 percent. Most of the difference is accounted for by officially recording remittances from overseas workers.

Revenue flows are poor because fewer than 3 percent of the population pays taxes. The economy is on a growth curve, and the country needs to invest some $45 billion on infrastructure over the next 10 years to keep up with demand, according to the World Bank. Most of the money will come from the private sector, but at least some will have to be forked out by the government.

Remittances from overseas workers have a significant effect in creating a lower middle class across the country. But returning overseas workers lack in entrepreneurship, complains the government, and they don't invest their savings wisely.

"Overseas workers are one-day millionaires," says Cyrus Aparri, referring to their tendency to splurge on luxuries like televisions and video players.

Many overseas workers are overqualified for the jobs they do. And working at such jobs overseas actually erodes their skills and market value.

Aparri was one of the exceptions: he invested a tiny amount and worked hard after his return from Saudi Arabia, starting a fish farming business which has grown into an empire. Today he exports herbal soaps, a fish by-product, to Japan.

Filipinos are not big savers. The national savings rate is one of the lowest in southeast Asia, and according to the head of Citibank's credit card division in the country, Harpal Duggal, the population may be net debtors. But the hard currency overseas workers save is substantial. Government figures indicate that Filipino workers in Hong Kong send home about 28 percent of their earnings through official channels. If unofficial channels were taken into account, the figure could be about 50 percent.

Although much of the rest is spent on living overseas and buying goods overseas, the money sent home is still a massive infusion of funds by any standards. It crams shopping malls, trickles down to relatives and friends, and provides constant stimulus to sectors such as housing construction. It also finances education for the next generation.

A more likely negative factor is related to unemployment — cited by the government as a major problem.

Many overseas workers are overqualified for the jobs they do. Teachers, for example, earn more as housemaids in Hong Kong than they would teaching at home. And working at such jobs overseas actually erodes their skills and market value in the sector they are qualified in.

At the high end of the labor market is another problem. About 2.8 percent of Filipinos overseas are professionals and managers, whose absence is felt at home — even if there is a trickle of returnees emboldened by the country's new economic success.

"Filipino managers who have worked overseas are head and shoulders above those who haven't," notes the treasury chief of a European bank in Manila. But there are too few of those to go around.

To lure them back, banks and other corporations are being forced to push salaries up to international levels.

But economic volume in terms of remittances — and a political constituency that cannot be ignored — lie in mass overseas labor. Economists worry about hundreds of thousands of previously skilled Filipinos coming home with money but without marketable skills. The government is trying to introduce reintegration programs for returning workers to address this. But the mass returns will almost certainly not begin to take place before the beginning of the next century. EM

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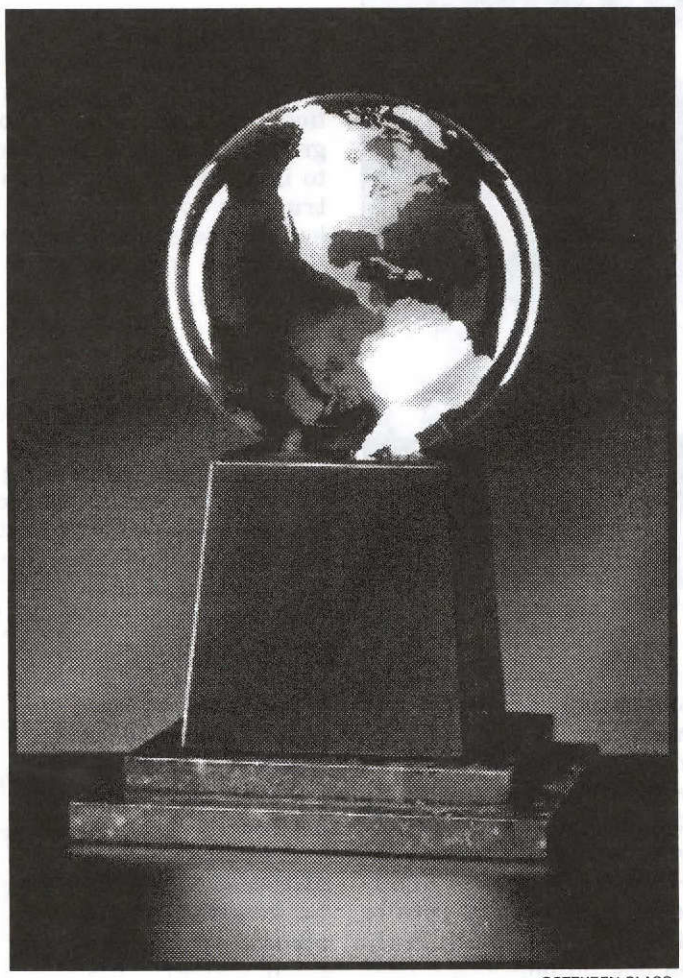
Percy Barnevik
ABB Asea Brown Boveri Ltd.

Percy Barnevik, President and Chief Executive Officer of ABB Asea Brown Boveri Ltd. received the Award for the chief executive of a company headquartered in the developed world, whose expansion into emerging markets has best shown how these markets can contribute significantly to corporate revenues and profitability and has produced benefits for both the countries involved and the corporation in question.

Stan Shih
The Acer Group

Stan Shih, Chairman and Chief Executive Officer of The Acer Group was elected winner of the Award for the chief executive of a corporation headquartered in one of the world's emerging economies whose vision and company performance has best shown the pattern that can be offered as a model to other emerging markets companies around the world.



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Two years ago, International Media Partners, publishers of Emerging Markets and parent company of the CEO Institutes, and ING Bank, the leading financial institution in emerging markets worldwide, joined to establish two important new Awards.

The purpose was to recognize the sea change in developing economies as countries have gone from debt rescheduling and aid support to a new world of liberalization, privatization, trade agreements and stock exchanges. Traditionally, recognition has reflected on the policymakers and planners of these economies. The rational behind these unique Emerging Markets CEO Awards is to reward the true builders of these markets — businesses and business leaders with vision.

Nominations for the Awards were solicited from around the world and the elections were made by an independent Selection Committee comprised of corporate leaders, institutional investors, government officials and multilateral executives. The Committee's decisions were final. The Awards were presented on October 9 during the joint annual meetings of the IMF and World Bank in Washington, D.C.

IMP and ING Bank are delighted to have such worthy recipients of the 1995 Awards and look forward to continuing the tradition in 1996.

Copies of the winners' citations, the list of the Selection Committee members, and details on this and next year's Awards are available by contacting: Richard Burns, President, International Media Partners, The Cable Building, 611 Broadway, Suite 300, New York, NY 10012. Telephone: (212) 995-9595. Telefax: (212) 995-9389.

Features

AMAGENTS:
TROUBLE IN THE TOWNSHIPS

BY MZIMKULU MALUNGA

"I sacrificed my youth and did not go to school for the sake of the struggle, but today I am unemployed, unskilled," a Soweto youth complains bitterly.

Out go the comrades, in come "Amagents." Prior to the non-racial elections of April 27, 1994, South Africa's townships were ruled by the comrades — paramilitary youth groups which were principally aligned with the African National Congress. In the post-apartheid era their influence has largely diminished.

The new rulers of South African townships are Amagents. In a word they are thugs — known for wearing expensive clothes, having beautiful women cling to their arms and driving flashy cars. But they are best known for carrying guns.

Amagents, ironically, means "the gentlemen." It is the name these gangs have given themselves.

They exist beyond Johannesburg as well, but under different names. And, they become more visible every day. For example, in the Vaal townships about 40 kilometers south of Johannesburg, they use the name the Matadiana, the Sesotho word for "the Italians."

The areas in which the two groups operate may be different, but their actions are the same.

As for the former comrades, the mood is one of anger and frustration that they are yet to see the fruits of liberation.

"I sacrificed my youth and did not go to school for the sake of the struggle, but today I am unemployed, unskilled," a Soweto youth complains bitterly.

The lucky few have been absorbed into the army and a handful into the police force as reservists, but the majority are still roaming the streets. Some have even joined the Amagents and Matadiana.

Prior to the elections, in each and every township there used to be ad hoc governing bodies. For instance, there were street committees whose mandate was to look after bread and butter issues of a particular street in a township. They addressed issues ranging from disciplining kids who beat up their parents or parents who abused their children to handling disputes over houses and defending the area from intruders.

Several street committees would come together to form a block committee. When combined together the blocks would form a branch and the branch reported to the region.

These governing bodies were not without their negative sides. Some elements within them had a tendency to take the law into their own hands. They were associated with the infamous "necklace" — where people would be sentenced to death in a makeshift court and set alight with a tire around their neck.

During that time the Amagents were virtually unheard of. Hijacking people's cars or breaking into houses was not as common.

Today, as the crime rate reaches for the sky, the communities are helpless.

Prior to the election, the police, associated with the apartheid era, earned a reputation they have been fighting to escape. A reputation which thwarts their fighting crime. The result is a police force with a morale problem. A force that, after decades of fortifying apartheid, faces a mountain of crime it does not know how to tackle.

The new government has initiated the formation of local police forums to improve the image of the police and bring them closer to the communities. But complicating matters further for communities and the police force is the criminal element among the officers.

The police are weakened by the apparent collusion between some members of the force and criminals — particularly syndicates which steal cars.

Apart from the anger among township residents with what appears to be the new government's failure to address crime and unemployment, there is a mounting indignation over the government's reconciliation campaign.

While township people are not opposed to reconciliation, there is a feeling of frustration that the new government is taking black aspirations for granted while bending backwards to accommodate white interests. Fueling their anger is the apparent arrogance of certain elements of the white community.

In almost every public address to blacks by the new ruling elite, the emphasis is on patience without indicating how long people will have to wait.

"We are aware that the government cannot address our problems overnight, but at least they should start delivering instead of preaching reconciliation only," comments a middle-aged woman.

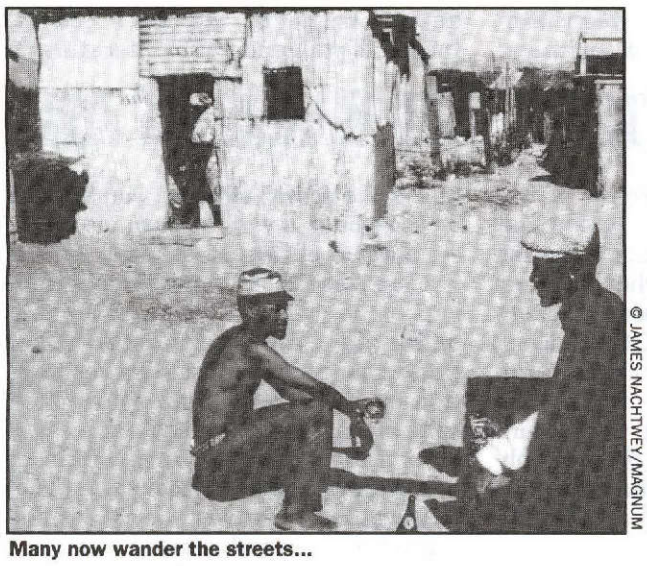
The frustration that the new government is taking its reconciliation campaign too far at the expense of black aspirations is not enough to quell the new sense of pride among black people that they are free from the bondage of the past.

Also, like the rest of the country, South African townships are normalizing. Politics are no longer the overriding issue at hand. People who used to discuss freedom now confront bread and butter issues like crime, culture, love, fashion, the environment and parties.

Although the townships are known for their vibrant parties, these days parties take to the streets quite literally. In the past, partygoers would jam-pack yards, and to some extent overflow into the street. Township yards are quite small. But even when this happened, the street would still be open to traffic.

But these days, this is no longer the case. Some parties turn into road blocks where the partygoers take their chairs and sit in the middle of the road to celebrate. In fact, from the weddings of early spring (September) the parties steadily build to the Christmas-New Year's summer holidays.

Despite the frustrations with the new government and anxiety caused by increased crime, South Africa's townships have become normal and there is a sense of relief that the days of turbulence have passed so that people can carry on with their lives. EM



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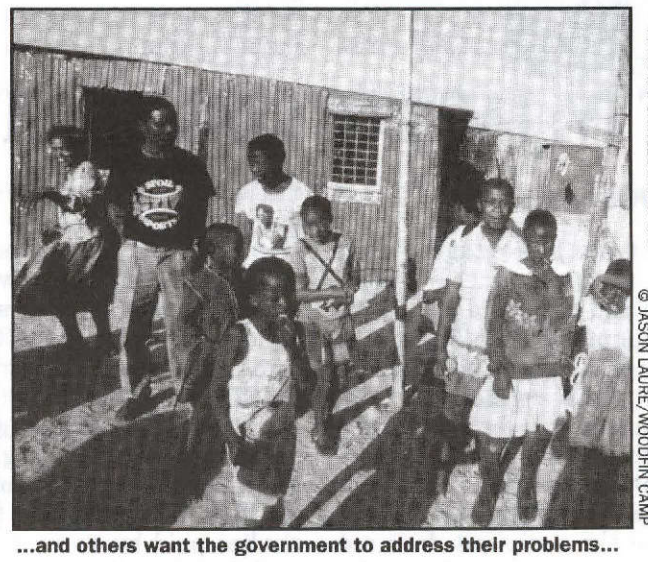
Many now wander the streets...



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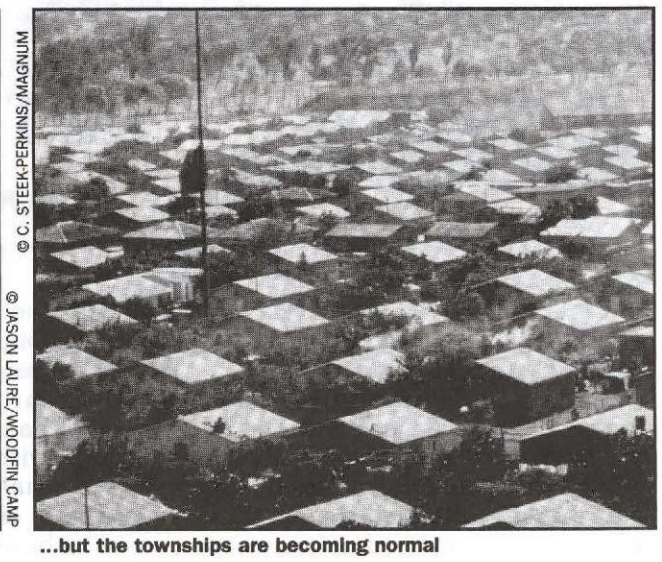
...and others want the government to address their problems...



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...but the townships are becoming normal



At the Grassroots

There is a feeling of frustration that the new government is taking black aspirations for granted while bending backward to accommodate white interests.

Features

DEVELOPMENT ASSISTANCE

PART IV: JAPAN'S CORPORATIONS HIT BACK AT AID

BY KEVIN RAFFERTY

One of the world's biggest aid projects is moving from the drawing board to reality. It is a five kilometer bridge spanning one of the world's biggest and most capricious rivers, the Jamuna or Brahmaputra, which slices Bangladesh in two isolated halves. Ever since its creation in 1971, Bangladesh has dreamed of the multibillion-dollar unifying bridge; and since then Japan has been helping with technological studies and with aid. But today as the engineering work gets under way, the Japanese have lost out on the most lucrative contracts — a fact which is causing soul searching and a review of official aid policy in Tokyo.

Japan several years ago overtook the U.S. as the world's biggest aid donor. Hopes, however, that it might assume an influential leadership role in international aid similar to that which America had a few decades ago are being squeezed from two directions at once: by budgetary constraints and by grumbles from Japanese companies that they are not getting a fair crack at winning projects supported by Japanese taxpayers' money.

Figures from the Paris-based Organization for Economic Cooperation and Development (OECD, the club of rich industrial nations) show that Japan's net disbursements of aid rose to $11.3 billion in dollar terms in 1993 (the last year for which comparative figures are available), with the U.S. trailing in second place with $9.7 billion, followed by France and Germany, respectively providing $7.9 billion and $7 billion.

The annual report of the organization's development assistance committee noted that official aid from all its members fell to $56 billion in 1993 from $61 billion the previous year. Measured as a percentage of gross national product, aid fell to its lowest level for more than 20 years and was an average of 0.3 percent, way below the UN target of 0.7 percent of GDP. The U.S. was the lowest of all the 21 countries in the group, providing only 0.15 percent, while only Denmark, the Netherlands, Norway and Sweden exceeded the UN target figure.

Even in this undistinguished company, Japan's performance fell short of stellar. As a percentage of GDP, Japan provided just 0.26 percent, below the international average. Indeed, Japan's aid in its own currency showed a fall to ¥1.25 trillion from ¥1.41 trillion in 1992. The improvement in the dollar figure was simply because the yen appreciated against the greenback. Hopes that Tokyo would become the new aid leader as part of its aspirations to be a "lifestyle superpower" and international good neighbor were already faltering against the lack of imagination of politicians and growing tightfistedness of bureaucrats.

That was before the aid climate began to become stormy. In the last few months, particularly as the Jamuna bridge contracts were let and Hyundai of South Korea and Dutch engineering companies including Van Oord beat out Japanese firms, Tokyo has been urged to rethink its policies.

Japanese companies, beginning to see their profits hit again by the rising yen, feel sore that aid contracts, which used to be a good source of income, are no longer so. The statistics show that the percentage of contracts won by Japanese companies on aid provided by Tokyo has plummeted from 68 percent 10 years ago to 27 percent last year. One reason for the change is that Japan, in tune with a more open and international policy, has given more of its aid in the form of "untied" loans, where the recipient does not have to hire companies from the country providing the aid. The other reason for the Japanese failure to win contracts was the rising yen.

Keiichi Terada, director general of the Japan Plant Association, complains that "aid fatigue" has set in and now many Japanese companies are not bothering to bid for aid contracts. Unhappiness also seems to have spread to some in government because untied aid is "faceless," as one official puts it. He cites the infamous case of the Indus Highway in Pakistan connecting the port of Karachi with the north of the country, for which Japan provided ¥29.3 billion, or 80 percent of the cost. The prime contractor was Turkish, so the Turkish ambassador got invited to the ground-breaking ceremony in 1992, but not the Japanese ambassador. After a protest, Japan got an invitation, but it came the day of the ceremony. "I couldn't attend the ceremony because the invitation was so late," complained the ambassador, Kunio Muraoka.



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Nishigaki: very modern aid agency

Japan is thus experiencing the pressures that have lately marked U.S. aid policies, with critics asking how much benefit the country gets from aid. But in Tokyo, criticisms have not been driven by politics as much as by business. "We have to consider how our economic cooperation policies will affect the Japanese economy," declares an official of the ministry of international trade and industry.

One possibility being advocated by some foreign ministry officials is to get planning of projects supported by grants instead of loans. In part, this reflects turf-fighting between ministries, since grants and technical assistance are the preserve of the Japan International Cooperation Agency, which comes under the wing of the foreign ministry, whereas loans are provided by the Overseas Economic Cooperation Fund (OECF), which is under finance ministry tutelage. OECD rules that insist on reasons being given for excluding other countries from project bidding do not apply to grants. If Japanese companies can get their foot in the door for feasibility studies paid by grant, as one official explains, it will be "more likely that those companies will become the main contractors even though the bids are open to everyone."

The OECF's annual report however shows that the real competition comes not from other industrialized nations, which took only 16 percent of the contracts financed by Japanese aid, but from developing countries, which won 57 percent of deals backed by OECF money last year. It is proof of the prowess of rapidly developing Asia.

The lion's share of Japan's aid goes to Asia — 90 percent of OECF's ¥882.2 billion commitments last year. It channels more than 40 percent of total Japanese aid and has become the biggest aid agency for Asia and bigger than all four regional development banks combined. Indeed, it is just half the size of the World Bank in terms of loan funds, but with a staff one-nineteenth the size (see table).

The bulk of its money goes to infrastructure — in the past 30 years, 60 percent, or a massive ¥8.33 trillion. Akira Nishigaki, president of OECF, promises that the agency will respond "more flexibly" to the needs of developing countries. It has just revised its guidelines to make sure that right from the planning and design stages of projects there is awareness of environmental considerations. Officials are also widening their horizons to encourage more private sector involvement in infrastructure lending, to support basic needs and to help in the development of women's skills. Indeed, if you read OECF literature or talk to its senior officials, you get the impression of a very modern aid agency, abreast of the latest ideas. OECF is not susceptible, as the foreign ministry is, to overt political pressures in using aid. Foreign Minister Yohei Kono was quick to promise resumption of aid to Myanmar (Burma) in spite of Aung San Suu Kyi's request to wait and get more concessions to democracy. This is another example of corporate pressures, as Japanese industry does not want to get left behind Singapore and other Asian countries in the race to develop Myanmar's considerable natural resources.

Another problem hinders aid: Japanese in general have not developed an international culture where they can feel at home outside their own islands. The numbers of fluent speakers of English and Chinese are growing, but slowly, and the pressures are strong on bright youngsters to join government or Japanese companies with a strong national culture where spending too long abroad can be a hazard to career prospects. That is one reason why OECF's staff is so small.

Lack of international awareness is most apparent at the political and bureaucratic level where aid is being squeezed. The finance ministry is concerned about ballooning government deficits and debts. Aid is one of the easiest areas to cut. For the moment the line is being held at a 7 percent increase this year, but this is a far cry from Japan's dream of being a major aid power, reshaping the economic development not just of neighboring Asia, but of the world. EM

THE WORLD'S MAJOR MULTILATERAL AID DONORS

Aid institution	Staff	Loans disbursed & outstanding ($bn)	Loans per staff member ($m)
OECF	327	81.6	249.54
World Bank	6,338	172.1	27.15
ADB	1,926	27.9	14.49
IDB	1,798	30.7	17.07
AfDB	1,224	15.5	12.66
EBRD	665	1.3	1.95

Source: OECF Annual Report

Next — Part V: USAID Survives Death Threats

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Part IV
Challenge to THE SYSTEM

DEATH ON THE NILE:

Africa's Need For A Regional Strategy

BY MARK HUBAND

Signposts to the "source du Nile" decorate the roadside running the length of Lake Tanganyika in Burundi.

Visions of the same great river flowing through its delta in northern Egypt seem barely connected to the trickle which emerges from Burundi's valleys. But as the power politics influencing the entire length of the Nile emerge from the obscurity of the Cold War into the harsh light of African realpolitik, the two ends of the river have indeed become linked in a web — a web with two centers, one in the Sudanese capital Khartoum, the other in the Ugandan capital Kampala.

More than ever, region-wide strategic issues as well as the influence of interests from beyond Africa's shores are determining the course of events and, more importantly, the prerequisites for peace in a troubled region. In turn this has created a need for a region-wide strategy to confront interlinked problems for which a coordinated regional solution may be the only answer.

In October 1993, Burundi's mountains echoed with the screams of Tutsis being murdered by Hutus avenging the savage killing of the country's first Hutu president, Melchior Ndadayo. In response, the Tutsi-dominated army slaughtered thousands of Hutus as their way of bringing back a semblance of order.

"Between October 1993 and April 1994, there was the appearance in Burundi of the Hutu militia, who had been trained by the government of Juvenal Habyarimana in Rwanda," said Pierre Buyoya, Burundi's reformist former president. "They were trained separately from the Hutu militia which led last year's genocide in Rwanda, but were trained by the Rwandan army."

In the wake of the killings in Burundi, talks between Habyarimana's government and the rebel Tutsi-dominated Rwandan Patriotic Front (RPF) collapsed, opening the door to the government's slaughter of Tutsis and the RPF's subsequent victory.

Key to the strengthening of the Tutsi in Rwanda — where, as in Burundi, they are in the minority — has been the support given them by Uganda's President Yoweri Museveni.

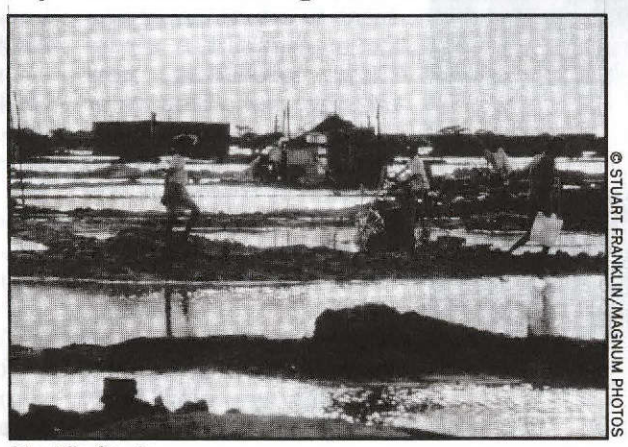
The Hutu's expulsion of Rwandan Tutsis in 1959 created a large Rwandan Tutsi population in Uganda. During the 1980s when Museveni was amassing his National Resistance Army to overthrow Idi Amin, many Rwandans, including Rwanda's current vice-president Paul Kagame, joined him. In return he supplied them with the hardware needed for them to fight and win their civil war.

The victory of Kagame's RPF last year has provided Museveni with his only safe border. In August, Museveni recognized this when he visited Kigali and reaffirmed his support for the RPF-led government despite the almost total absence of senior Hutu representation.

Museveni's backing for Rwanda's Tutsis has intensified the Hutu sense of isolation in both Rwanda and Burundi. The fact that the RPF is led by English speakers who grew up in Uganda has taken Rwanda out of the French-speaking world — which the French themselves are determined to retain intact in Africa.

The influence of France, which leaders like Museveni and Kagame regard as neo-colonial, is also a source of conflict with Zaire on the other side of the Nile. Zairian President Mobutu Sese Seko is barely on speaking terms with Museveni, as the two presidents come from radically opposite ends of the African political spectrum.

Museveni's own security concerns have meanwhile intensified as Sudanese-backed rebels have infiltrated further inside Uganda, determined to overthrow him. Rebel activity inside Uganda has intensified since Sudanese government forces seized the southern Sudanese border town of Kaya in August. This has also hampered Uganda's supply lines to the Sudan People's Liberation Army, which has been fighting for the self-determination of southern Sudan since 1982.



© STUART FRANKLIN/MAGNUM PHOTOS

The Nile floods

The foreign policy and domestic concerns of the Islamic government in Khartoum are as strongly influential on regional affairs as those of Kampala. From Khartoum, Sudan's neighbors in Eritrea and Ethiopia are also being sucked in to the region-wide web. One of RPF leader Kagame's first visits abroad after taking power was to Eritrea, to reassert the unity of "modernizers" in the region.

"Museveni, Meles Zenawi in Eritrea and Isaias Aferwerki in Ethiopia are seen as united black Africans in favor of modernism and nationalism. But they're united against Khartoum for pragmatic reasons, because they are weak countries. Kenya should be with them as part of this string of frontline states, but isn't, even though Moi hates Arabs, despises Islam and is fearful of Khartoum," said one Western diplomat with wide experience of the region.

In a characteristically elliptical attempt to explain why the regional initiative to find a solution to the war in south Sudan had failed, Sudan's religious leader Hassan El-Tourabi said in a recent interview: "To be a moderate you have to stand in the middle, and they don't, and Uganda behaved a little bit abnormally. Museveni himself isn't a Ugandan, and he has problems with Zaire, Sudan and Rwanda. And the United States is very close to the Ugandans, and in opposition to the French, who are close to the Hutus. I have no doubt that the U.S. is very much behind the Ugandans and Eritreans, in order to encircle Sudan, along with the Egyptians."



© AFP

Kagame scratched Museveni's back; Museveni returned the favor

Beyond the physical presence of the Nile itself, the other thread running through the region is French policy, in large part aimed at maintaining the French language in its former colonies — and thus French influence. France has retained close ties with the deposed Rwandan Hutus who led last year's genocide. In Sudan, France has likewise maintained links with the regime, never criticizing it for its alleged links with terrorists.

"The French believe that this regime has influence over Islamic groups. Their modus vivendi with regard to Sudan is that Sudan should stay out of Chad, Central African Republic, Zaire, Djibouti. In return France will remain a friend of Sudan," said one diplomat.

Western division over attitudes towards Sudan, and the radically different interests of the U.S., the U.K. and other countries with regard to Uganda, Rwanda and elsewhere, have contributed much to the failure to find a negotiated solution to the war in southern Sudan.

Also, varying attitudes from within the region have caused discussions to stumble and stall, and ultimately to collapse. One cause of this has been the absence of pressure on Khartoum from the Arab world, notably Egypt, a factor which has allowed Khartoum to condemn initiatives as dominated by Christian Africans hostile to Islam.

"While the other Arab countries aren't interested, for Egypt it's a matter of life and death for them that Sudan should be a united country, because a hostile regime in the south would be anti-Arab and anti-Islamic and more concentrated on eastern Africa," said Haydar Ibrahim Ali, director of the Sudan Study Centre in Cairo.

In November 1994, U.S. President Bill Clinton presented a discussion paper aimed at developing a regional strategy which for the first time linked what he described as the Greater Horn of Africa — specifically all the countries between Burundi and Eritrea.

The paper recognized the extreme interlinkages within the region, and recommended looking at ways to achieve food security there, in the hope that such an achievement would bring with it political and social security, not least for the region's 11.1 million refugees and displaced people. As recent events in eastern Zaire have shown, their presence is a tinderbox waiting to explode, vividly heightening the need for the region to be regarded as one, with interlinked political crises.

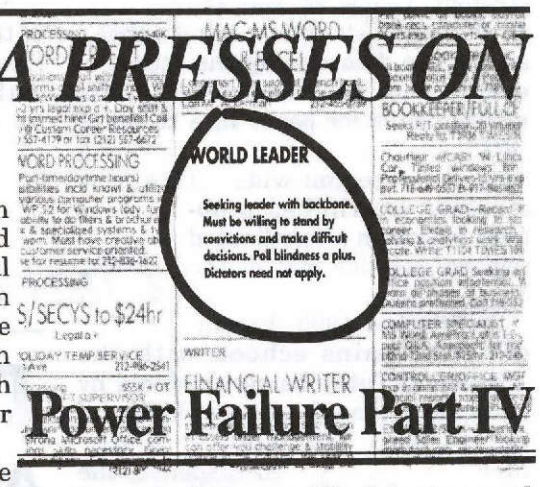
A stable Uganda would assist in resolving the Hutu-Tutsi conflict in Rwanda and Burundi, but cannot do so until its own northern border is secure — heightening its need for its RPF allies in the south. Uganda's security is impossible to imagine unless the war in south Sudan is resolved and the government in Khartoum is forced to moderate its Islamist policies regarding all its neighbors, who are currently united against it.

Only by forcing recognition of the real need of the region's 186 million people will it be possible to draw up the parameters for discussion which could solve a worsening crisis. Failure to do so creates the risk of turning ethnic conflicts within national borders into regional wars as states collapse, as they have effectively done already in southern Sudan, Rwanda and Burundi and further afield in Somalia. EM

Next — Part V: Women Raise a Global Voice

Features

THE U.S. WAFFLES AS CHINA PRESSES ON



BY ROBERT A. MANNING

Why We Must Contain China," admonishes the column in *Time* by a leading pundit. "The Real Chinese Threat," screams *The New York Times* magazine. These headlines, even as Bill Clinton gears up for a summit with Chinese President Jiang Zemin, reflect more than the bitter clash over Taiwan President Lee Teng-hui's unprecedented U.S. visit. They reflect a mood of growing apprehension in the U.S. that, from Taiwan to trade and missiles to human rights, a hornet's nest of contentious issues may add up to China as antagonist. This is matched by a mood in Beijing that behind U.S. actions, from WTO demands to normalization of ties with Vietnam, lies a hostile containment strategy.

It is increasingly understood that the emergence of China as a regional and global power is one of the premier structural challenges to the international system of relations at century's end. With its UN Security Council veto, population of 1.2 billion, nuclear weapons, modernizing military and dynamic economy, Chinese behavior — whether assertive military action, burning coal, importing more grain or absorbing global capital flows — matters hugely. As U.S.-China relations are a key factor shaping Beijing's policies, the stakes are readily apparent.

Beyond these truisms things begin to get fuzzy. It is no state secret that U.S.-China relations have been increasingly volatile since 1989. Deprived of its Cold War strategic rationale and tortured by images of the Tiananmen massacre, this pivotal relationship has degenerated to the point where it is now a collection of disparate irritants whose cumulative weight has fostered a dynamic in which both sides may be backing into an adversarial impasse. This has been evident in the debate over most-favored nation (MFN) status, and more recently in the controversy over Taiwan.

Seeking to quell fears that tensions were spinning out of control after the Taiwan clash, U.S. officials portrayed the recent release of human rights activist Harry Wu and Hillary Clinton's trip to Beijing as reciprocal gestures by both sides to halt the downward slide and avoid renewed confrontation. But contrary to assertions that "we have turned the corner" and proclamations of "engagement," any lull in U.S.-China tensions should not be mistaken for stability. Current diplomacy, however, does represent an effort by two weak governments with large interests at stake to put a floor under the downward slide.

But "engagement" is neither a strategy nor a policy; it is merely a process. From the beginning, the Clinton administration has lacked clarity, constancy and any sense of priorities in its policy toward China; it has been a bazaar of competing interests: business, labor, human rights, non-proliferation, population control, pro-Taiwan, pro-Tibet.

The annual renewal of MFN status required under the Jackson-Vanik law has been the main venue for playing out the China debate. Trying to have it both ways, i.e. trade and human rights, Clinton renewed China's MFN status by executive order in June 1993. Cutting an unnecessary deal with Congress, the order made future MFN renewal contingent on specific human rights improvements.

That strategy effectively boxed in the president, postponing the hard decision for a year. But an indignant China bet on capitalist greed and the pattern of waffling Clinton had already demonstrated in Bosnia, Haiti and Somalia. And after publicly humiliating the U.S. secretary of state in March 1994, Beijing's octogenarians were proven correct in May, as Clinton changed course and renewed MFN unconditionally, announcing a policy of constructive engagement. Unfortunately, the price of Clinton's belated adoption of the right course was U.S. credibility, perhaps the most precious commodity of a great power.



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Wu: bargaining chip

Moreover, the MFN decision was largely a response rather than part of a coherent China strategy. Thus, from proliferation and human rights to trade and Taiwan, a festering laundry list of contentious issues has created a dangerous slippery slope in Sino-American relations. The reality of a fluid leadership succession in Beijing, where no Chinese leader can be viewed as "soft" on the U.S. and the widespread Chinese misperception that the explanation for a large swath of disconnected U.S. policy decisions is that Washington seeks a weak and divided China, makes the situation ripe for missteps on both sides.

Whatever is declared at a Clinton-Jiang summit, there are minefields in all three major baskets of issues: trade/finance, political/security, and human rights. Moreover, as was seen dramatically in the administration's flip-flop over inviting Taiwan's president to the U.S., an assertive Republican Congress shapes much of the agenda and constrains administration initiative.

Apart from enforcing existing agreements on intellectual property and prison labor and concern over the $30 billion bilateral trade deficit, China's desired entry into the WTO is a major item on the Sino-American agenda. The U.S. has pressed China, whose $200 billion annual foreign trade makes it the 12th largest trading nation, for more transparency and market access on a range of issues, most of which overlap with requirements for WTO entry.

In regard to security issues, the context is as important as the issues. China is enjoying the most peaceful security environment around its many borders as at any time over the past two centuries. Yet China's military is rapidly modernizing; its murky defense budget, even absent the Cold War, has at least doubled since 1989. It clearly seeks to attain power-projection capabilities: air in-flight refueling, new missiles, and a blue water navy. At the same time it is asserting territorial claims by force in the South China Sea and refusing multilateral negotiations, and saber-rattling over Taiwan. Against this background many are asking, if China acts this way now, what will it be like in 20 years?

Most of the issues referred to as "proliferation of weapons of mass destruction" revolve around Beijing's sale of missile technology, particularly M-11 missiles to Pakistan and missile and nuclear technology to Iran. The U.S. is the only member of the Missile Technology Control Regime (MTCR) that has legislatively-imposed sanctions for MTCR violations, thus it is largely a bilateral issue. In the case of Iran, however sinister Iran's intent, Beijing's activities thus far appear to be within the framework of the non-proliferation treaty. Unfortunately, the U.S. has tended to raise these issues in a confrontational, legalistic and moralistic fashion, rather than posing the more basic strategic question as to why Beijing is engaged in destabilizing activities in a volatile region.

Similarly, issues such as independence for Tibet have gotten mixed in with human rights matters. Thus, China in many instances dodges legitimate questions about its internal and international behavior by hiding behind the cloak of sovereignty. And after Taiwan has its first direct elections for president next March, that question can be expected to heat up, regardless of how often the administration claims to be following the traditional "One China" policy.

What is urgently required is a new bargain between Washington and Beijing based on reciprocity: broadly, the U.S. must accept China as a dominant regional and major global power; China must adhere to international norms or alter the ones it dislikes through established political processes. For a new understanding to work, no single issue can be allowed to hold the relationship hostage, yet none can be ignored. Areas where there is common ground — trade and investment, stability in Northeast Asia — should come to the fore. It is possible China will prove adversarial in some respects. If this is the case, it should occur after all other possibilities are exhausted, not through the law of unintended consequences.

Perhaps the most explosive issue is Taiwan, which holds the potential to force strategic choices across the region should an armed conflict occur. The essence of a new understanding on Taiwan is one in which all sides must face reality: Taiwan must face the fact that at present, a UN seat is not possible; China must face the fact that Taiwan is a vibrant free market democracy and major economic player in the region.

Both the U.S. and China need to redefine a strategic rationale for their relationship, assess where their respective interests overlap and where they differ, and think through how to manage differences in a manner that permits a modus vivendi. EM

Next — Part V: Russian Pride & Western Prejudice

ARGENTINA

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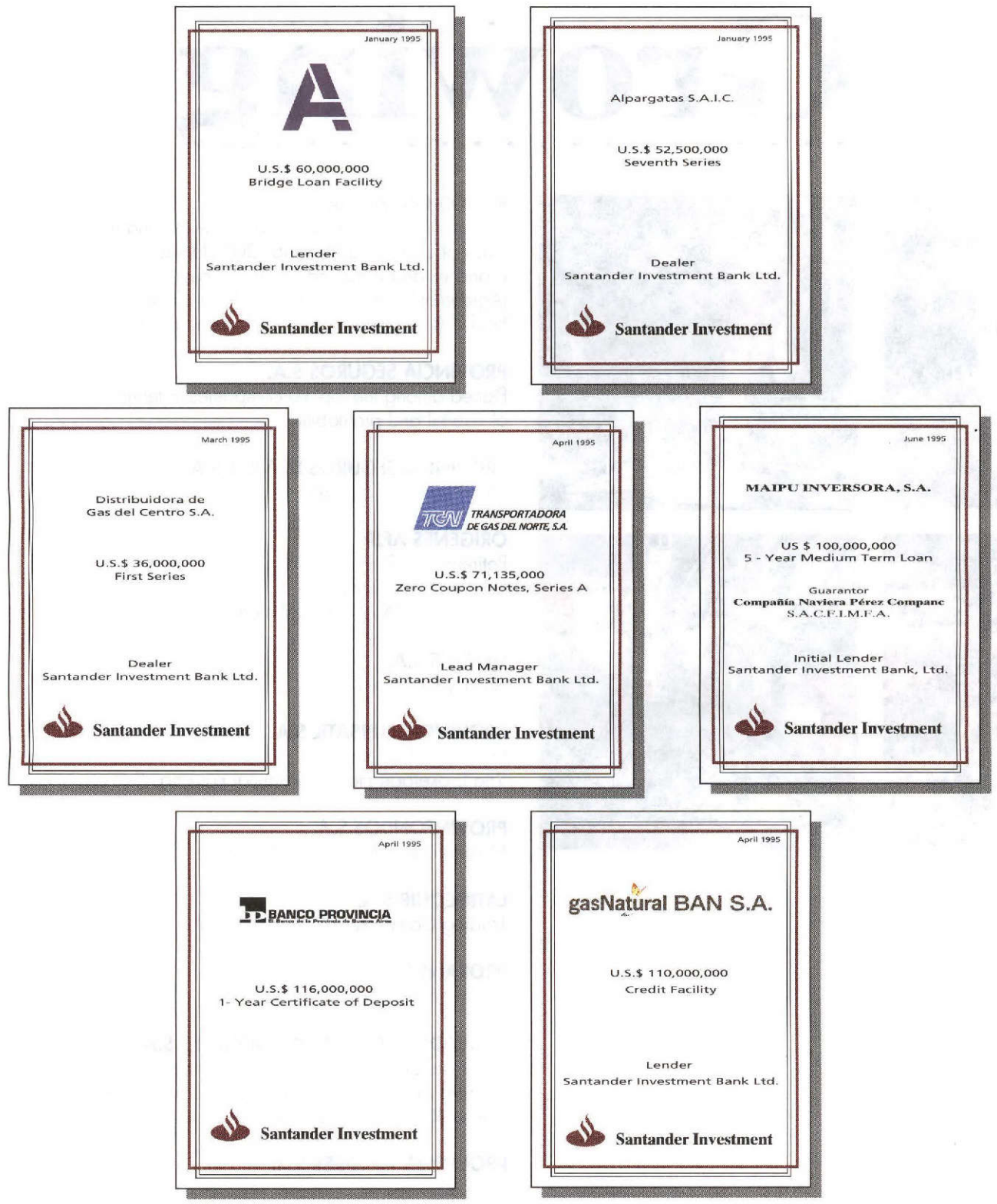

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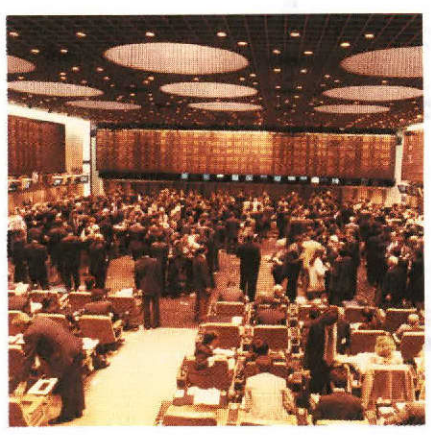



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Profile



HASHIMOTO

Fuji Bank's internationalist boss has key responsibility for smoothing out Japan's domestic banking mess.

BY KEVIN RAFFERTY

The abiding memory of Toru Hashimoto is a toothy grin, so strong and infectious that like that of the Cheshire Cat in *Alice in Wonderland* you are sure it will survive right to the end. Which is just as well since the 60-year-old Hashimoto has two troubled jobs: the president of Fuji Bank, one of Japan's top three banks, is also chairman of the Federation of Japanese Bankers' Associations and thus point man in the struggle to clean up the country's financial mess.

Unlike Yasuo Matsushita, governor of the Bank of Japan, who berated the press last month for persisting in asking about the financial crisis, Hashimoto faces the question, admitting "real concern in the country about financial failure." He refuses to speculate on the total of bad loans, accepting that the ministry of finance (MoF) is the authority with access to all the figures.

The Fuji Bank president speaks English fluently. His interest was sparked as a fifth grader at elementary school in immediate post-war Japan when he dedicated himself to learning the language as a way of getting food to eat — his uncle was a chef on a U.S. military base and sometimes brought back meat, then one of Japan's scarcest commodities. Another incentive came in winning an English-speaking contest at high school in Okayama, where he met the girl who became his wife. After graduating from Tokyo University, he joined Fuji because of its reputation for being international.

For a Japanese banker his international exposure has been substantial, including a Fulbright scholarship to the U.S., six years in London, then sorting out the Walter Heller group of Chicago which Fuji bought. His connections have helped Hashimoto to win many international friends and admirers. Among them are new World Bank president James Wolfensohn (who recommended Hashimoto for interview and profile).

CHECKING FOR BOOBY TRAPS

But Hashimoto is clearly the boss of a Japanese bank at the center of a very Japanese system with an overload of interwoven, complicated restrictions. In his conversation he is not only cautious, but seems to be conservatively feeling his way checking for tripwires or booby traps into which a careless statement of real feeling might cause him to blunder.

On the vexed question of using public money for bailouts, he says: "A distinction should be preserved between the use of government money to rescue a particular institution and the use of government money to save the financial system from disaster." The problem is knowing whether it is the system or the individual institution at stake.

Hashimoto supports helping hapless depositors with money in an institution that fails, arguing that individuals do not have enough information to know whether a particular institution is sound or heading for the rocks. "If any financial institution collapses and depositors are not protected, then it is very possible that this would touch off financial turmoil because everyone knows that the system is full of non-performing assets, and financial turmoil may cause runs on banks whether good or bad. Good banks may encounter runs as well. So at the present time it is not conceivable that the ministry of finance would let any small institution go bankrupt."

He admits that "they can't go on doing this forever." The solution is a five-year grace period, in which better disclosure is put in place, deposit insurance improved, the system liberalized — then banks and depositors will have no one to blame if they make mistakes, lose money and go under. But it may not be so easy; Japan's financial system is a maze of rules and regulations which govern city banks, long term credit banks, trust banks, regional and savings banks, credit unions, housing loan companies, all with their own turf and penalties against trespassing. That is complicated enough. Worse is that the smallest and weakest institutions were heavy speculators and badly caught by the exploding bubble economy.

The Fuji president claims that the banks "are not asking for public money. We should take care of ourselves, and we can take care of ourselves." The question is to what extent MoF officials expect the big banks to mop up problems at smaller troubled financial institutions. In the past the ministry would exercise its paramount power to demand that a strong bank act as a kindly "big brother" and rescue a smaller one in trouble. But the MoF, though given a deference unthinkable in the West, is no longer the absolute ruler.

Hashimoto answers hypothetically: "The decision whether Fuji Bank would buy another financial institution would depend on how we assess it, whether the pluses of the acquisition are bigger than the minuses or the costs. Even if there was pressure from the government authorities, we would say 'No' if the minuses were greater...We have to convince our shareholders [that the deal is a correct one]."

He realizes that nothing in Japan is as simple as the U.S. where a bank can close its doors overnight — as many have, Japanese bankers were proud to point out before the current crisis began — and life would go on. Depositors would pick up deposit insurance, bank staff and executives would hunt around and find new work, some lessons would be learned.

SOLVING THE PUZZLE

Hashimoto looks forward to the eventual removal of the maze of barriers that will allow Japanese banks freedom to create integrated financial services operations, "with a bank holding company with several subsidiaries — banking, securities, insurance, leasing and so on. Our strategy is to be a universal bank offering integrated financial services." He foresees mergers and some existing banks developing specialized niches, but asked to speculate on how many of today's big 21 banks will exist in 10 years (without having to identify which) typically he retreats behind a nervous laugh. "Well, it is very hard to guess, but I would say the number would be smaller."

The impending merger between Bank of Tokyo and Mitsubishi Bank to create the world's biggest bank (with $800 billion in assets against Fuji's $550 billion) will not lead Hashimoto into a catch-up attempt to find a partner. "We are big enough to be responsive to customers' needs and be efficient without a merger. But if there were a merger partner which would add something more than just size, then it would make sense."

His immediate task is to preside over the mopping up of the mess of bad debts and to raise rates of return, "which are particularly poor now because we are generating income to write off assets. We need to go back to lending for cash-flow future growth, which we did during the post-war economic recovery period. In the bubble period we depended so much on [lending against] collateral, real estate, property," Hashimoto laments.

One senses a sensitive man keeping a bravely cheerful face under remorseless pressures. An internal document circulated when he became president said that if Hashimoto could have his life again, he would love to be a painter, an artist. Indeed, to paint on one's own canvas is a luxury the Fuji president does not have. EM

THE ADVENTURES OF BANKERMAN

By William Bramhall



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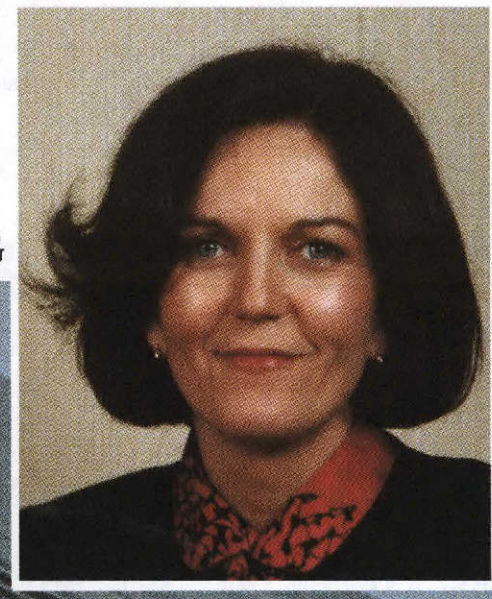

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People



Citibank makes use of its new anti-party-crasher software to keep out uninvited guests



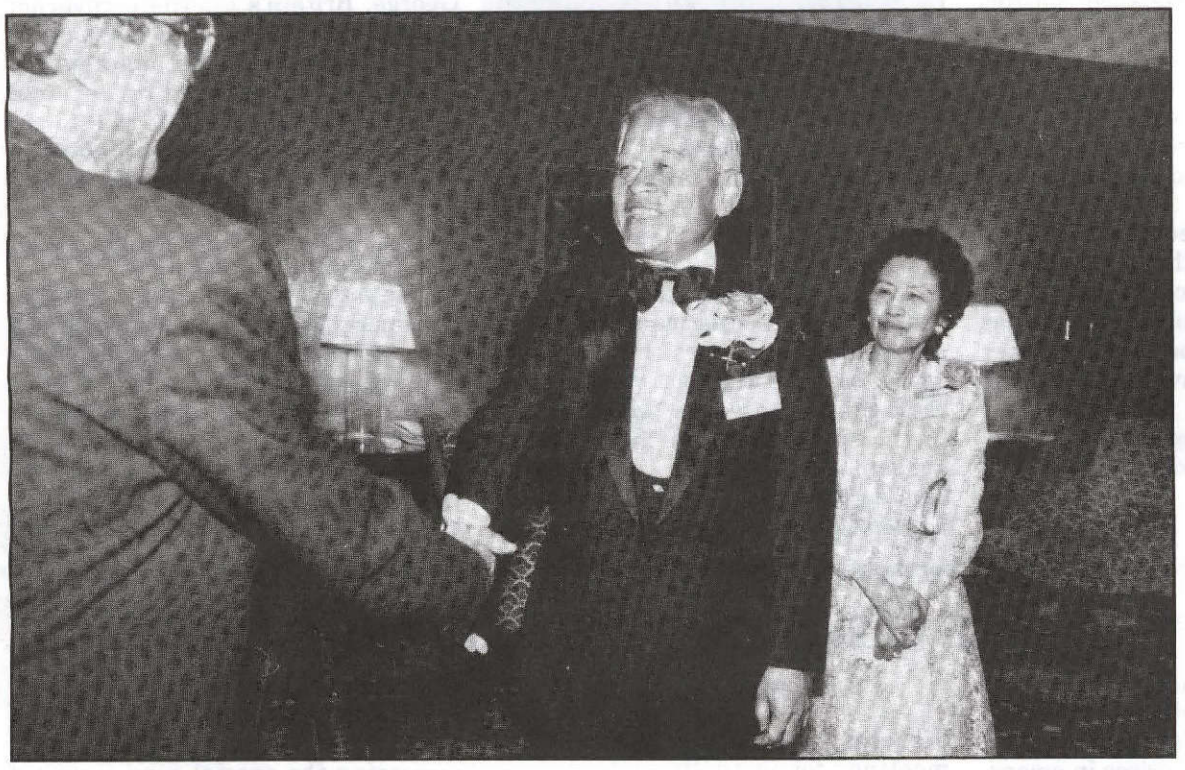
The World Bank's Richard Frank and wife Irma make a quick escape from the Citibank party



ABN-AMRO's Jaap Rost Onnes and his wife could have danced all night at the Brown Brothers Harriman reception



Economists Peter Kenen of Princeton and Richard Cooper of Harvard offer a hand to development at the BoT event



Bank of Tokyo president Tasuku Takagaki greets guests at his reception in a bid to "out-tux" tux-famous BoT chairman Toyoo Gyohten



Daiwa Bank Research's Takeshi Ota answers Princeton's Kent Calder's one billion questions about Japanese banking scandals

Oh, What a Night!

Photos by Donna Dietrich and Lisa Quinones



Helen and Rory Keelan call guests' attention to Walter Brown's rousing rendition of "Wild Irish Rose"



Bright-eyed NLI Research Institutes' chairman, Takashi Hosomi (l), keeps Hiroko and William McCamey entertained at the BoT reception

News

THE KEN AND EDDIE SHOW GOES ON

Japanese finance minister Masayoshi Takemura is not the only one to bail out early from this year's annual meetings. British chancellor of the exchequer Kenneth Clarke took flight on Monday evening for London, leaving governor of the Bank of England Eddie George to deliver his speech to yesterday's plenary sessions. Asked why the minister had gone home so early, a British aide said that Clarke "has the Conservative Party conference coming up." Takemura at least has the Japanese constitutional pretext that no minister should be out of the country while the Japanese national Diet is in session to fall back on.

BENTSEN BOOSTS $1bn LATIN FUND

BY ROB WRIGHT

A year ago, he attended the World Bank/IMF annual meetings as a U.S. governor. Now that he's out of government, Lloyd Bentsen is back in an all-new guise: top adviser to a $1 billion Latin American private investment fund.

Bentsen yesterday unveiled the new AIG-GE Capital Latin American Investment Company, which will make long-term direct investments in private power, telecommunications and transport projects across the region. It is being managed by Emerging Markets Partnership (EMP), the Washington advisory house run by former senior World Bank executives Moeen Qureshi and Donald Roth.

Bentsen will be chairman of the fund's advisory board, which will work closely with the Inter-American Development Bank and may co-invest in some IFC deals as well. American International Group and GE Capital have each pledged $150 million, leaving it up to EMP to raise the rest. EMP raised $1.1 billion for its earlier effort, the AIG Asian Infrastructure Fund.

Broken Promises

(*Continued from page 1*)

perity" to recognize their new global responsibilities that wealth brought. China's finance minister Liu Zhongli also chipped in with demands of satisfactory funding for IDA.

Benin's finance minister Paul Dossau, who is the chairman of the annual meetings, reminded his audience of hundreds of bankers and minister attending the packed opening session that "In a world where economic relations have grown ever more complex...and Internet reigns supreme, still one billion people live in abject poverty, 140 million are unemployed and one billion are underemployed."

Rubin applauded IDA's work. He had recently visited "an IDA-supported watershed project at Udaipur, India. I saw first hand how a carefully designed effort can enhance people's lives by drawing on local planting skills, by teaching low-cost methods to prevent run-off and erosion and by involving women and children."

Michel Camdessus, the IMF's managing director, in his speech emphasized concerns that showed a renewed closer working relationship between the fund and bank. He urged the need for "high-quality growth. In too many countries, the quality of growth suffers from widening distributional inequalities related partly to high unemployment but also to stagnating wages of unskilled workers. And too many countries continue to suffer from poor governance, corruption and increasing crime."

Camdessus Urges Dramatic Boost to Resources

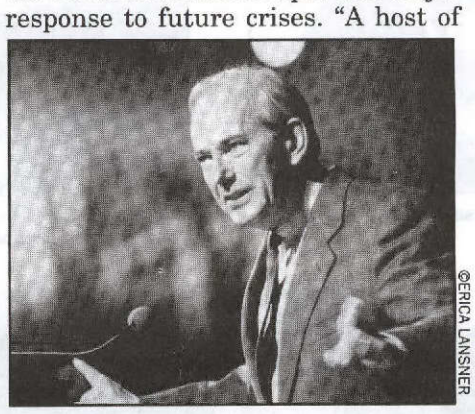
BY ANTHONY ROWLEY

World financial leaders yesterday pledged support for a massive increase in IMF resources in the wake of the Mexico crisis, and promised that all countries involved in the process would have a say in how the money is spent. But they also warned that the provision of a global safety net must not be allowed to lull emerging market authorities and investors into a dangerous sense of false security.

IMF managing director Michel Camdessus revealed to the plenary session of IMF and World Bank governors that Mexico came perilously close to imposing "exchange controls or a debt moratorium" last December, with "potentially devastating effects on global capital flows and confidence." IMF resources must be dramatically boosted to prevent anything like this happening again, said Camdessus.

U.S. treasury secretary Robert Rubin agreed that "the increased size and speed of financial flows mean that resources required to redress future crises may be much greater than anything now available." But he warned that in the future "neither the U.S. nor any other country can be relied upon to function as a lender of last resort."

Rubin lauded the G10 plan, which would bring a group of wealthier emerging economies into the net of contributors to the IMFs general agreement to borrow (GAB), allowing the Fund to mount a rapid and major response to future crises. "A host of countries can now afford to share responsibility for the health of the international and economic system," he declared.



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Camdessus: close to disaster

The treasury secretary sought to respond to widespread concern among these countries that they will get no say in return for their money. They must be given a "greater voice in the stewardship of the financial system," said Rubin. Japan also favors giving new lenders to the GAB a greater say in the G10 decision-making process, Kosuke Nakahira, advisor to Japanese finance minister Masayoshi Takemura told *Emerging Markets* last night.

Rubin meanwhile warned that the proposed doubling of IMF quota and borrowed resources to $500 billion could be a dangerous two-edged sword. Emergency financing proposed by the IMF to help countries in severe balance of payment difficulties must be on highly conditional terms so that no country comes to rely on the safety net as an alternative to policy reform, he said.

Bank of England governor Eddie George, Britain's alternate governor at the IMF, added, "We must never give the world's capital markets the impression that the international financial authorities will ride to the rescue of every sovereign debtor in difficulties over debt service or foreign exchange." This, he said, would create "significant moral hazard for both lenders and borrowers."

Camdessus added a plea yesterday for emerging markets not to "shrink from globalization" as a result of the traumas that erupted globally after Mexico. "Rather, all countries should embrace the opportunities of globalization and rise to its challenges" by putting in place sound domestic policies and financial structures, he said.

Tietmeyer Offers Cautious Support for Reforms

BY PETER KOENIG

Bundesbank president Hans Tietmeyer yesterday cautiously endorsed the IMF's plan for speeded-up responses to financial crises in emerging markets. But he warned developing countries and international investors not to rely on the IMF coming to the rescue the next time there is a Mexican-style financial crisis.

"An emergency in one country is not enough" to trigger the IMF's new rapid-response procedure, Tietmeyer declared. "For the procedure to go into effect, there must first be a risk to the financial system as a whole."

The Bundesbank president characterized the IMF's plan for countering financial disturbances like Mexico's peso crisis last December as a "procedure" not a "mechanism," and asserted that the main effect of the plan should be to force countries and investors to pay the price for poor economic policies and bad investment decisions.

"The greatest risk is that the fund will turn into a lender of last resort and it will be too ready to bail out countries and investors," Tietmeyer said. "One should not underestimate the moral hazard problem," he added. "If rescue packages are put together too easily, investors will not be careful."

The fund's governing interim committee this week approved a new system allowing the IMF managing director to call emergency board meetings for virtually instant decisions on loans in cases of "serious financial crises."

But the Bundesbank president, who is widely regarded as the conscience of financial markets, placed less emphasis on the quick dispensation of loans, and more emphasis on the fact that there is now also at hand a speeded-up procedure for consultation on whether loans should be dispensed in the first place.



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Tietmeyer: don't rely on IMF rescue

After the U.S. and the IMF put together a $37.5 billion bailout for Mexico in February, European officials bitterly protested they had not been adequately consulted. Even as discussions between the U.S., Europe, Japan, and relatively rich newly industrializing countries like Korea and Singapore are proceeding on how to beef up the IMF's resources, Tietmeyer strongly argued that the IMF's "normal" mechanisms for increasing its capital base should take preference.

This week in Washington, IMF staff were working on three proposals for raising new money: increasing the quotas member states should pay; increasing the special fund financed by the Group of Ten (G10) from which the fund can borrow in emergencies; creating a second special fund to be financed by the G10 countries plus newly industrializing countries from which the fund can also borrow.

"The most straightforward way for the fund to increase its resources is for there to be a quota increase," Tietmeyer said.

The Bundesbank president accepted, however, that other countries are placing a heavier emphasis on beefing up the IMF's borrowing lines. He reported that complex negotiations were now under way between G10 members on the one hand, and on the other, the G10 as a whole and the newly industrializing nations being pressured to ante up new funds on the other. "Discussions about quota increases are one thing; they directly involve the IMF," he said. "Discussions between the G10 and the newly industrializing countries are another thing. They do not directly involve the IMF," he concluded.

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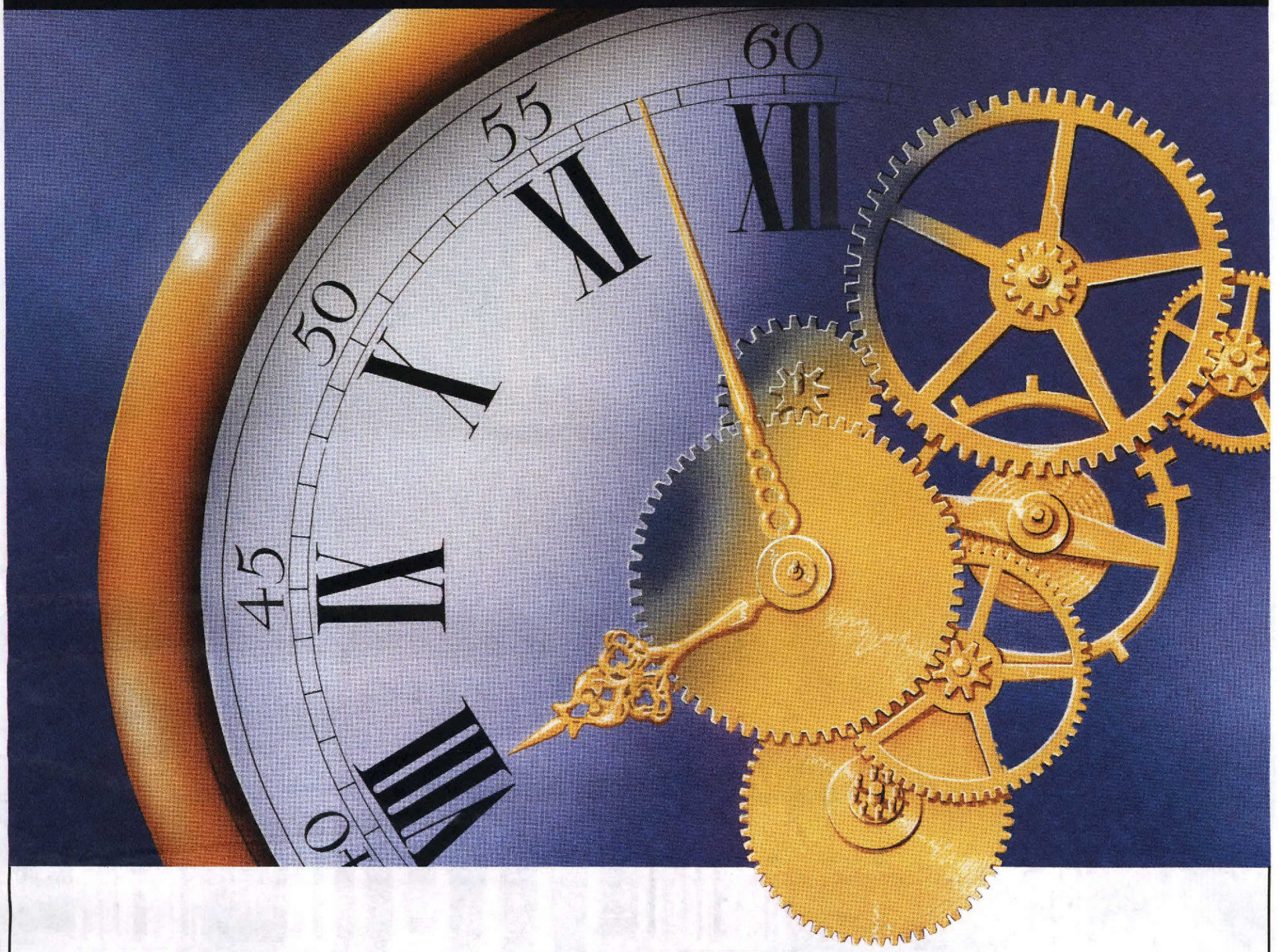

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EMERGING MARKETS

IMF/WORLD BANK DAILY EDITION • WASHINGTON, D.C. • THURSDAY, OCTOBER 12, 1995

Bank in Marriage of Convenience

BY JON MARKS

A growing but uneasy friendship suggested yesterday that it could bloom into a more enduring alliance when mainstream nongovernmental organizations (NGOs) and the World Bank came together to tackle poverty, which James Wolfensohn called "an issue that is above skirmishing."

Both the NGOs and the bank argued that the IDA11 replenishment channeling funds to the poorest nations was essential to ensure world stability. At a rare joint press conference, bank president James Wolfensohn reiterated that the IDA replenishment was jeopardized by opposition in the U.S. Congress.

One group holds the key: the budget-cutting Republican majority in Congress, which this week is considering halving the U.S.'s IDA contribution and cutting an overall 35 percent from the aid budget. "It's no longer a danger of aid fatigue," Oxfam International's Stewart Wallis said. "We are facing potentially terminal sleeping sickness."

According to InterAction president Julia Taft, the average U.S. taxpayer would save no more than $5 a year — "less than the cost of a carry-out pizza" — from Washington shelving its IDA contribution. "Balancing the U.S. budget is not an issue here," she concluded.

However, "development assistance through IDA has been an easy target for cuts as it does not affect the domestic voter in the North," argued Abdou El Mazide N'diaye, president of the Forum of African Voluntary Development Organizations. If Washington does not show leadership, he asserted, "other countries will adjust to what the U.S. does."

Speaking after the meeting, NGO representatives said they would continue lobbying for the bank to secure IDA11 despite continuing differences with the multilateral over other issues, notably structural adjustment. "We are lobbying in the U.K., Germany and other donor countries, but even though we have had meetings in Congress, the U.S. is the hardest," a Washington-based Oxfam lobbyist said.

NGOs are fulsome in their praise for Wolfensohn, but are more concerned at the attitudes of his staff and the IMF. "The World Bank has come a considerable way in its thinking, whereas the IMF has been more hesitant. It would be a shame if too much caution from the fund was to mess up the positive things that are happening," Wallis said.

Whisky winner — p. 11



Bill Clinton appeals to Republicans to abandon isolationism ©LISA QUINONES

IKE LIKED IDA!

BY K. MICHAEL FRASER AND PATRICK SMITH

U.S. President Bill Clinton yesterday spoke out strongly in support of IDA and international cooperation and demanded that Republican opponents abandon isolationism. His address to the joint annual meeting was punctuated by applause and drew warm reactions from officials.

"He has said it all before, but this is the most important forum for international economics and finance. There were several thousand bankers here who will possibly carry the message back to the people they back so strongly in the Republican Party," Canadian secretary of state Doug Peters told *Emerging Markets*.

Clinton praised the IMF and World Bank for reacting quickly to support Mexico when its currency collapsed last December. He said their "swift and decisive support played a vital role" in containing the crisis.

In reaction, Argentine economy minister Domingo Cavallo said, "I completely agree with his interpretation of the importance of the way the transformation of the Mexican crisis into an international crisis was prevented."

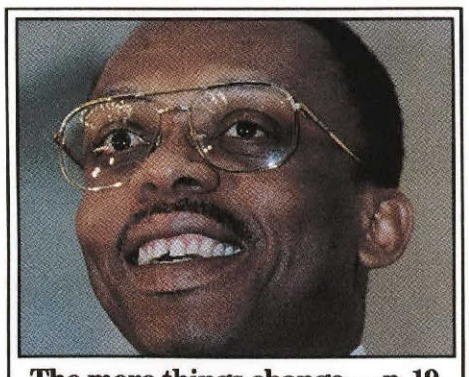
Clinton said that rapid changes, especially in communications and the development of global markets, "have made all our societies more vulnerable to disturbances that once may have seemed distant."

But, he said, "we are hearing again the voices of retreat here in our own country. There are those who say that America should simply erect a wall and live within its own borders...but, my fellow citizens of our shared planet, economic interdependence is a fact of life. The goal must be to have it benefit all people."

Thailand's minister of finance, Surakiart Sathirathai, welcomed Clinton's strong support for American involvement in international affairs: "I am very pleased that he announced to the world that free trade is not enough, and that close international cooperation and consultation on global economic stability are important to the United States."

Clinton berated his Republican opponents who want to drastically cut the U.S. contribution to the

(Continued on page 54)



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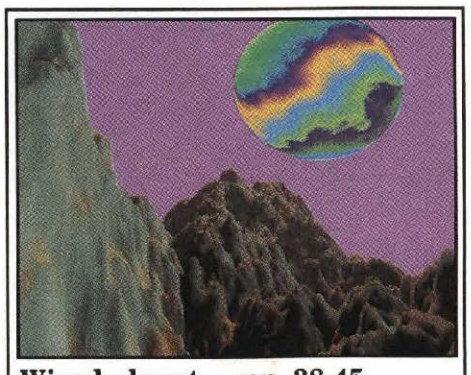

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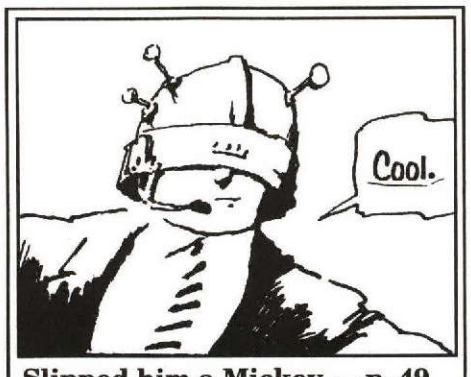

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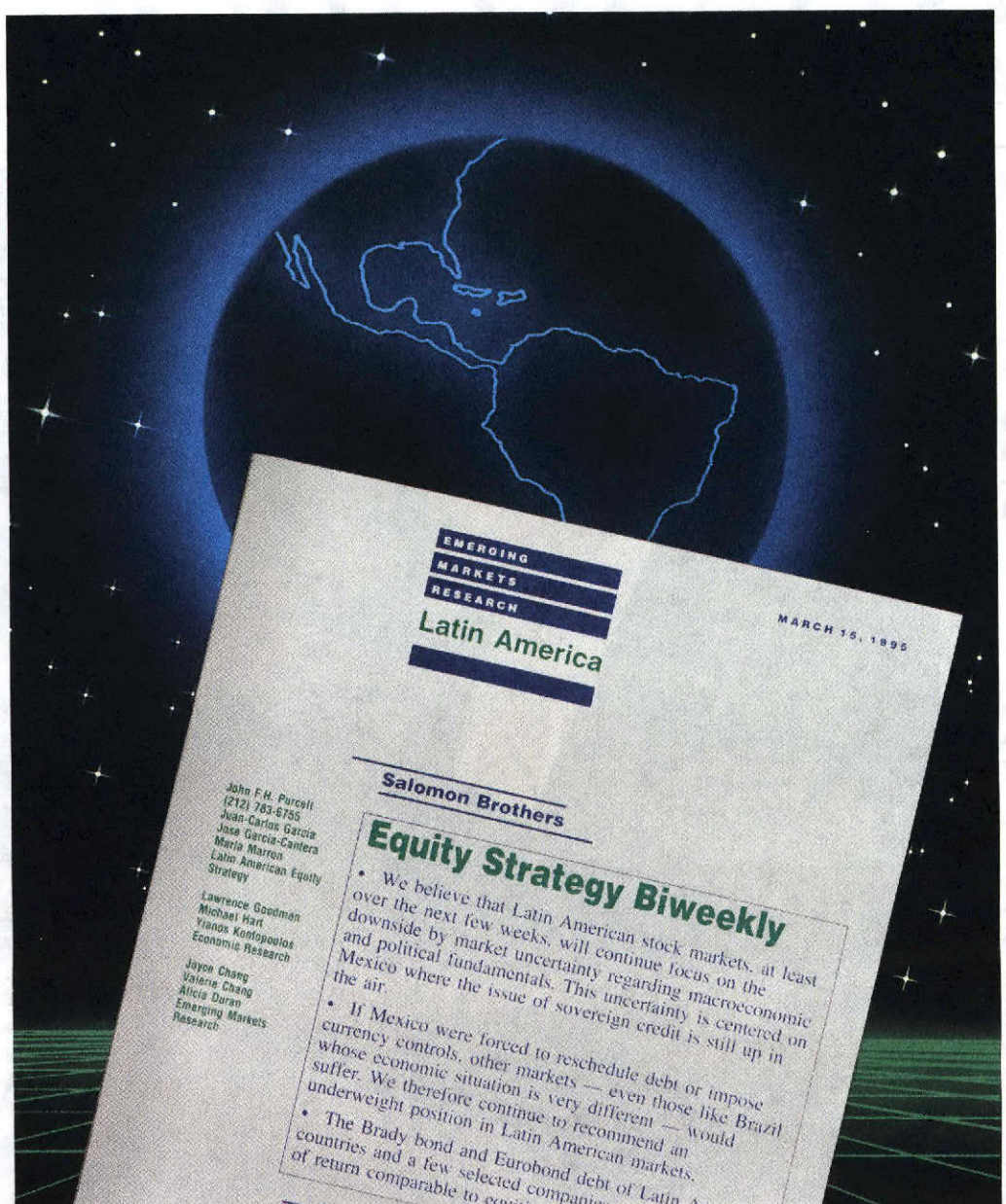

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"The African crisis is a crisis of leadership. We must accept that we have failed."

— Ronald Penza, minister of finance, Zambia



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The Good, the Bad and the Ugly

The 1995 annual meetings are virtually over, bar the final press conferences and the tidying up of the debris left over by up to 10,000 bankers, ministers and journalists. New ground was broken with the series of seminars held before the meeting proper began. They were a useful — and highly productive, according to the participants — counterpoint to the waffling of the G7 on Saturday and the all-day waffle-in of the interim committee the next day.

Equally important, bank president James Wolfensohn's initiatives to get together with the NGOs have clearly paid dividends. Abdou El Mazide N'Diaye, the president of the Forum of African Voluntary Development Organizations, succinctly summed up the relationship. Before, "we did not speak the same language and were always fighting; now we hear each other," he said. Both he and Wolfensohn made it plain that the bank and NGOs would not always see eye to eye. That's natural enough, and it would be a disaster if the bank surrendered its leadership to the NGOs — which Wolfensohn clearly has no intention of doing. But at least the bank and the bigger, responsible NGOs are in dialogue and listening and learning from each other. The bank has enormous knowledge and expertise and hundreds of skilled professionals; the NGOs are part of "civic society" and can often show the way to the grassroots that politicians and bank staff don't know enough about.

The big question is still IDA and whether it can get its essential funding to reach the poorest people in the world, who are a third of the people on this fragile planet. Wolfensohn is no doubt hoping that his new-found NGO friends will find their voice to persuade their congress members and MPs that these people should have priority over aid for arms sales, should have priority over almost everything else since the fate of the humblest and weakest and most hungry of our fellow citizens of this planet affects us all.

You would not have thought so Tuesday night in the Republic National Bank of New York reception at the National Gallery of Art. The wine and whisky flowed like the proverbial water. Many in the Third World wish they had such a gush of water. There were endless varieties of meats and sweetmeats. Even 30 minutes before the doors were due to close at midnight, the tables were still groaning with goodies, the galleries crowded with fragrant women and wealthy men parading their wit and wisdom. It was an odd contrast to the pictures on the walls displaying the treasured art of centuries, drawing attention to the importance of ideas and imagination over puffed-up pride. Many of the paintings were of the tiny Christ child who could not have identified himself with most of those present. Interestingly too, bouncers pounced on members of the press who dared to try to enter. "No press," declared one of the guards catching a glimpse of a yellow badge and pushing the poor riffraff journalist away.

One of the dangers is that the IMF/World Bank meetings are becoming split — between the ministers of the G7 and the rest, between the bankers and the rest — with little contact between opposite sides. It is becoming a disgrace that the G7 sit in their closed session, pontificate and then clear off home, as Masayoshi Takemura, Kenneth Clarke and Anatoly Chubais all did. More must be done to bring the big bankers, Japanese, British, German and American, onto the center stage at the seminar presentations, which should surely be a regular event — but sharpened up and allowed more time to get dialogue flowing. It would be an excellent idea if trade and economy ministers could be encouraged to participate, at the seminars if not at the main event, because growth in world trade has to be expanded if economies are to prosper.

A word about the IMF. Michel Camdessus has been overshadowed at this meeting by his colleague Wolfensohn, but he deserves praise for the spirit of cooperation between the two institutions in trying to tackle common problems. The question is whether his staff can be persuaded to go along with him.

Which brings me to a final point. An experienced professional reporter, but a relative newcomer to these meetings, was shaking with anger yesterday when he was turfed out of a planned meeting with one of the delegations. It was at their request. He got out of the elevator at the required floor at the appointed time, but was stopped by the security guards, who told him he could go no further without an escort. The telephones on the floor were not working to talk to the delegation. The guard refused to go to get them. So he was told to go away. "This is a badge of dishonor," the reporter said, pointing to his press badge.

It is. And it is a reflection on the IMF and World Bank. Almost anyone can wander almost anywhere in the meeting halls except the press. Even the NGOs have their own special passes that are not painted the dreaded yellow. Please remember, M. Camdessus and Mr. Wolfensohn, that the press are here as representatives of the public, to find out what is going on and to report it fairly and accurately. We are the public's eyes and ears. If you want your pleas for IDA to be heard, you need us. The World Bank staff have tried to be as helpful as possible within the draconian constraints imposed by the joint secretariat. The IMF staff guard their secrets like some hangover Soviet apparatchiks. One of them even described himself, jokingly we hope, as "the enemy." When will the spirit of democracy and liberalization come home to the IMF?

Kevin Rafferty, Editor

News

Salomon Takes 49% of MBA

BY ROB WRIGHT

Salomon Brothers has just expanded its play in the Buenos Aires capital market, buying a 49 percent equity stake in the firm that has been its local partner since 1987, Merchant Bankers Asociados (MBA).

The investment, the terms of which were not disclosed, provides new capital to boost MBA's bond and equity trading and corporate finance advisory work. MBA currently ranks fourth, after Santander and two local institutions, in equity volumes on the Buenos Aires bolsa, and is increasing its market position in bond trading.

Salomon's stake comes four years after the IFC picked up 20 percent of MBA, which has since been active in the privatization and subsequent financing of oil company YPF, phone company Telefonica and others.

"Clearly, the strategy Salomon is developing is one of associating with local firms that have a leadership position in their market, rather than opening new ones — which in some other parts of the world has been shown not to be the way to go," said MDB managing director Juan Schilling.

Guide to India's Fallen Angels

When free and open markets have become the new gospel of economic development, it is well to be aware that freedom also provides plenty of opportunities for the unscrupulous.

R.C. Murthy, Bombay correspondent for the *Financial Times*, has offered a useful reminder to the unwary that developing markets can be dangerous places for strangers to venture. His just published *The Fall of Angels** is a guide to the dirty deeds that caused the Rs40 billion scam on the Bombay stock market in the early 1990s.

The "angels" in question are the foreign banks Citi, Standard Chartered, ANZ Grindlays, Bank of America, Hongkong and Shanghai, and Deutsche Bank, plus the State Bank of India. They might be flattered to be called angels, but they will not want to be reminded of how they blundered and bungled in the strange world of banker's receipts, ready-forward and double-ready-forward deals and *badla* finance that corrupt but sharp Indian dealers used to steal their money.

Murthy has not told the whole story but has written a useful book for anyone venturing into the world of Indian high and low finance.

*Published by Harper Collins, India; available through S.C. Ravalur, 117 S. Pickens Street, Columbia SC. for $22 plus $6 postage and handling.

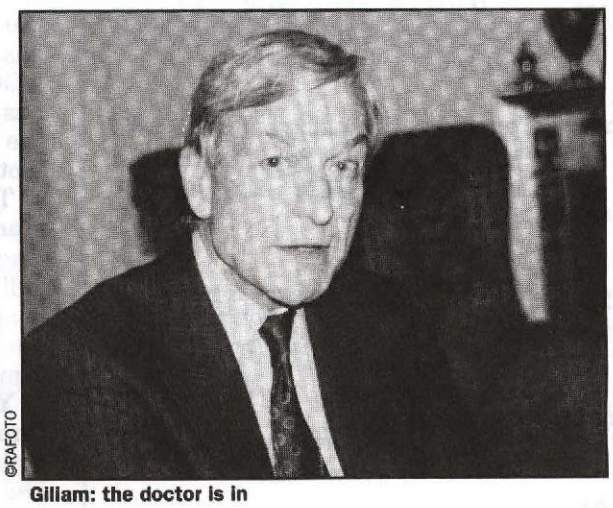
"THE EMERGING MARKETS BANKERS' BANK"

BY KEVIN RAFFERTY

While the London market tumbled this week in reaction to a fall in New York stocks, two leading British bankers were sitting in Washington feeling pretty pleased. Stock in Patrick Gillam and John McFarlane's bank, Standard Chartered, bucked the trend and actually rose by 20 pence to a new high of 486 pence a share while most others were plummeting.

Stanchart, as it has become commonly known, benefited from news of merger talks between Lloyds and TSB. But there were also rumors that Stanchart itself might be a plum ripe for picking.

Chairman Gillam denies any wish to be a big bank or a big player in the mature markets of London or New York. "We are a medium-sized institution with a unique franchise in the world, and it is a franchise that increasingly larger banks feel they must have access to." Colleague and group executive director McFarlane adds, "We are the emerging markets bankers' bank."



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Gillam: the doctor is in

The chairman continues: "We are quite unique as an international bank that concentrates totally on the developing world and the emerging markets. We have only two branches in our headquarters in the U.K., apart from our finance company. And we only operate in the U.K., Europe, and North America as a means of connecting our clients there to the developing world and connecting people in the developing world into the developed countries, which are, of course, an immense source of trade and investment finance."

Stanchart deals overwhelmingly with Asia, including the Indian subcontinent, which provides 70 percent of its assets and of its bottom line, and with Africa, which provides 10 percent. Gilliam states, "We have no ambition whatever to become an ordinary banker in the developed world where the margins are low, the competition is exceedingly fierce, and it's not what history is about and not what we are good at." He sees history developing in the emerging markets, where economies are growing by between 5 to 8 percent a year and where his bank offers special expertise.

The earnings — as well as the share price — say that Gillam is doing the right thing. "We have steadily reduced the baggage of the past in the U.S. and U.K.," he said. "We are highly successful. We made £510 million($800.7 million) pretax last year, £319 million pretax in the first six months of this year when our return on equity was 27 percent and our tier one capital was just under 7.5 percent. Market analysts say we will make £630-650 million this year.

"If we can do that in economies that are growing by 5 to 8 percent a year, why shouldn't we go on growing the business very substantially? We don't need capital. We are not basically a very large lender to long-term projects. We deliberately resticted our exposure to commercial property, so that we have a very good business out of which we can make a very good return for our shareholders. At the time of publication of the 1994 results, the share price was about 250; now it is 480-490. It means that our market cap has gone from £2.5 billion to nearly £5 billion."

McFarlane chips in that "our costs are flat and our productivity has been improving." The two men sit comfortably in a room in the Jefferson Hotel, "like a doctor's waiting room, some people say," observes Gillam, "though you wouldn't find so much hooch there." Almost all the bottles are untouched and unopened.

Stanchart does not host a large or splashy cocktail party for the world, but hosts two breakfasts each annual meeting for its banker friends and clients. Business is done there. Clients get to meet each other, and there is follow up in the doctor's waiting room later.

The bank is now concentrating on developing its own business in Asia, especially in the "three giants" of China, India and Indonesia, as well as in Africa, and in building its correspondent relationships in Latin America. "Don't write off Africa," urges Gillam, praising the good effects of economic reforms, especially in Zimbabwe, where Stanchart is the largest bank, as well as Zambia, Botswana and Kenya.

HORMATS THROWS WEIGHT BEHIND MDBS

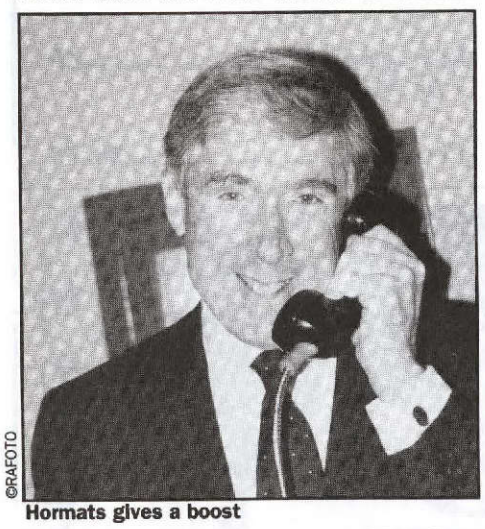
BY ANTHONY ROWLEY

Prominent Wall Street investment banker and former U.S. state department official Robert Hormats yesterday threw his weight behind the need to beef up the resources of both the IMF and the World Bank so that they can cope with unprecedented challenges to the international financial system and to development.

A one-time undersecretary in the Carter administration and now vice chairman of Goldman, Sachs in New York, Hormats told *Emerging Markets*, "We have to come out of these meetings with a strong political commitment [to these goals]."

"There is a democratic gap between what is needed to make the international financial system work better, and popular support for those measures," said Hormats, who strongly favors a boost for IMF quotas and borrowing facilities as well as a strengthening of the World Bank's International Development Association (IDA).

There is almost universal agreement that the IMF needs to double



©RAFOTO

Hormats gives a boost

both its quota resources and its General Agreement to Borrow (GAB) if it is to provide a safety net against future Mexico-type crises, noted Hormats. "But every country except Japan is in a fiscal contraction mode at present."

The emergency financing mechanism, currently being put in place by the IMF under a mandate it was given at this year's G7 summit, can function only if it is given the resources to do the job, said Hormats. And IDA cannot achieve its critical task of bringing poorer and transition economies into the global market economy without sufficient funds. "These are the central issues," said Hormats.

The respected economic guru also put his support behind the call from a group of more advanced developing countries for a larger say in the affairs of the G10 group, which administers the GAB, in return for their agreement to contribute resources. "There should be appropriate arrangements for them to participate" in G10 decision-making, he said.



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News

THE WORLD BANK ON A BUSINESS CARD

World Bank chief spokesman Tim Cullen's dedication to his job knows no bounds. People handed his business card not only get his office direct line, his fax number and e-mail address (tcullen@worldbank.org), but they get his home telephone number and a quick digest of the bank's aims and ambitions for the IBRD itself, IDA and the IFC. It's slightly out of date since the 178 members are now 179 with Brunei's entry. For progressive congressmen and NGOs, Cullen crams in the information that the bank's loans for human resource development rose to 15 percent from 5 a decade ago. "If people can put the Lord's Prayer on a postage stamp, I thought I could put the World Bank on my name card," says spokesman Cullen, who designed the card himself on his Apple Macintosh.

AFRICA FACES "CRISIS OF LEADERSHIP"

BY PATRICK SMITH

"The African situation is a crisis of leadership," boomed Zambia's finance minister, Ronald Penza, "we must accept that we have failed...we have been meeting and talking for too long, we must be more results-oriented."

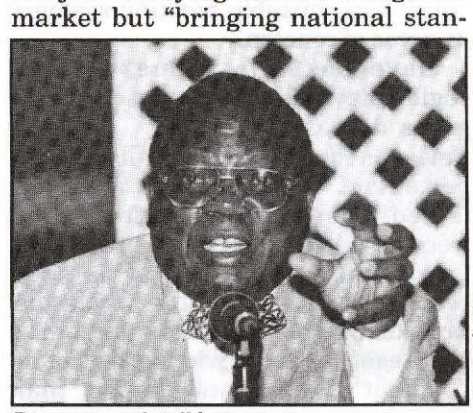
Speaking at an *Emerging Markets* annual forum in Washington yesterday, Penza challenged government and business leaders to open up Southern Africa: "I would like to see a redirection of policy, a clear sequencing and a timetable for economic liberalization."

This is, said South African minister of finance Chris Liebenberg, "music to my ears." Businesses, he said, want to know where a country or region is going. In terms of "policy milestones," such as fiscal and monetary targets and liberalization measures, Liebenberg said his government had clear projections where it wanted to be in 1999, and that was "confidence-building" for investors.

But he cautioned there would be political, even psychological constraints: "We in South Africa are very mindful that we do not want to be the economic bully in the region." Regional cooperation must be seen as a means of promoting growth and investment in the 12-member Southern African Development Community (SADC). For L.B. Monyake, SADC deputy executive secretary, the issue was a more emotive one: "Culturally, historically and geographically, there is a bond." Similarly, for Mozambique's finance minister, Tomaz Salamao, the new Southern Africa was a challenge: "After 30 years of war in the region we have a chance to show the world that we can move on."

For Liebenberg the market was the motive: "We have 40 million potential consumers in South Africa...that's not a big enough market to establish world competitiveness...we need SADC's 128 million consumers."

But Zimbabwe's Reserve Bank governor, Leonard Tsumba, cautioned that the region's economic strategy must be "export-led," and that meant not just worrying about the regional market but "bringing national standards of competitiveness to world levels."



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Penza: enough talking

Liebenberg was more cautious on the pace of the economy opening up: "Trade liberalization is a very sensitive issue...we are coming from an era where our economy was based on import substitution."

Penza had little time for such qualifications: "I want South Africa to open its market to us." Countries in the region would have to accept the consequences of opening up, Penza said. There may be some casualties, but for Penza, "liberalized trade and exchange policies and openness" are the most effective ways to support regional integration. And time was running out, he added: "The past three decades there has been no growth in Southern Africa."

Zimbabwe's power authority chairman, S. Tawengwa, objected to Penza's steamroller approach, saying that the region can match the achievements of other emerging markets: "But we object to being viewed as a satellite of South Africa's." Penza had no such scruples: "I don't mind whether we are satellites or not as long as we are redirecting our economic policies." Zambia, Penza said, was forcing the pace on economic liberalization and what was needed was faster change — and that included "our major partner [South Africa]."

The problem of South Africa's economic "giantism" was being overstated, according to former African Development Bank president Babacar Ndiaye. Ndiaye said the region must face the fact that more than 75 percent of its GDP is generated by South Africa.

"What shocks me is that South Africa is wary about playing a leading role while other countries in the region are afraid that South Africa may be too successful!" The success of the south would not just be for the 128 million people in the region, Ndiaye said, but for the 600 million on the continent. "I want to translate Cecil Rhodes' dream of Cape to Cairo with an African dream of Cairo to Cape."

Uganda Questions if Camdessus Can Deliver

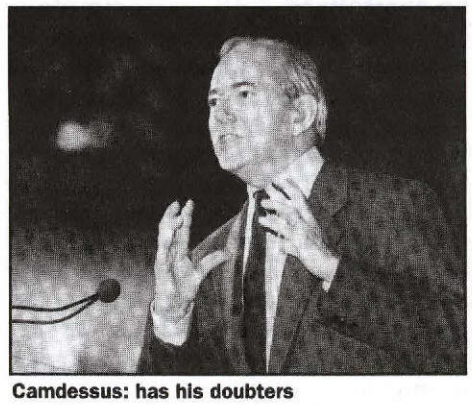
BY PATRICK SMITH

Debtor countries are increasingly concerned that the World Bank and IMF's determination to tackle poor countries' multilateral debt problems may be diluted by some members of their staffs. "We are convinced that James Wolfensohn and Michel Camdessus want action but we're worried about whether Monsieur Camdessus will carry his staff with him," said Uganda's finance ministry permanent secretary, Emmanuel Mutebile.

He was speaking after the development committee's statement on multilateral debt, which referred to a "small group of countries" requiring assistance. Mutebile's fear is that opinion is tilting to the fund view that only four countries have substantial multilateral debt problems — World Bank officials reckon 24 countries — and that the IMF will hold the line against any groundbreaking or systematic approach to the issue. The bank/fund taskforce on multilateral debt is due to report at next year's spring meetings.

After visiting Uganda in June, World Bank president James Wolfensohn says he was struck by the country's efforts to follow tough economic reforms: "I came back an Africa bull."

But he was told repeatedly these efforts were hampered by the debt burden. Of Uganda's $3.2 billion debt, $2.5 billion is owed to multilateral creditors. It is not just the service payments on the multilateral debt — though running at 30 percent of projected export earnings they are substantial — there is also a problem with the so-called "debt overhang." That is the country's accumulated stock of debt — only part of which may be eligible for relief measures. The bank's chief economist for Africa, Ravi Kanbur, warns that this overhang can deter foreign investors who see governments saddled with apparently unsustainable commitments.



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Camdessus: has his doubters

Kanbur also points out that Uganda has been able to win substantial reduction of its bilateral debt because of the restrictive rules of the "Naples terms," which on paper allow debt-distressed countries to write off as much as 66 percent of their government-to-government debt. But the rules state that only debt which has not been rescheduled before is eligible for the Naples terms — this means only 15 percent of Uganda's bilateral debt is eligible for write off.

Uganda's debt condundrum is all the more frustrating, bank officials say, because on all the other indices it is one of the best performing African economies. Growth has averaged over 5 percent for the past decade and private investment is beginning to flow in — more than $2 billion of new business projects are planned, of which just over half are up and running.

President Yoweri Museveni, while determined to plough his own political furrow, has followed the bank and fund's economic lore determinedly. Tax collection has shot up to $50 million a month this year from $11 million in 1990. And the civil service has been slashed from 320,000 in 1992 to 150,000 this year.

Tokyo Touts Japanese Way

BY ANTONY ROWLEY

Tokyo plans new initiatives to prove to the world that there is a Japanese way in economic development — one that emphasises the uniqueness of each region. The first step will be to promote so-called intellectual exchanges between Japan and two countries, India and the Philippines.

Tatsuo Watanabe, director of the Japan finance ministry's development policy division, disclosed to *Emerging Markets* yesterday that the next consultative group meetings for these countries will take place in Tokyo rather than Paris and will be sponsored by Japan instead of being under the aegis of the World Bank as usual.

The need to promote a "better exchange of ideas and experience between industrial and and developing countries," as well as with development finance institutions, was stressed by Japan's alternate governor Yasuo Matsushita at the IMF/World Bank plenary sessions. He disclosed that, "Japan will offer further opportunites for the exchange of ideas and experience in which experts from the private sector, as well as from academia, can participate."

Tokyo will kick off this process by cementing its development relationships with India, a country where Japanese influence has traditionally been weak. By hosting the consultative group meeting (of aid donors) with India in Tokyo early next year, Tokyo hopes to extend its sphere of economic influence into the sub-Continent.

In the case of the Philippines, where Japan's economic presence has also been weak relative to that in other parts of South East Asia, the December meeting of the consultative group will give Tokyo a chance to demonstrate its commitment to the country, said an official.

Japan is emphasising not only the need for a new kind of development dialogue, but also for a new approach that respects what Matsushita called the "uniqueness and diversity" of different countries and regions. Development assistance strategies "must be equally diverse because a static, unified approach will not work," he said.

"Development banks in each regon have long tailored their missions, policies and methods of doing business to the uniqueness and diversity of the particular regon. The World Bank and development banks in each region should further develop strategies focusing on the uniqueness of each region through the active exchange of experience and ideas," Matsushita added.

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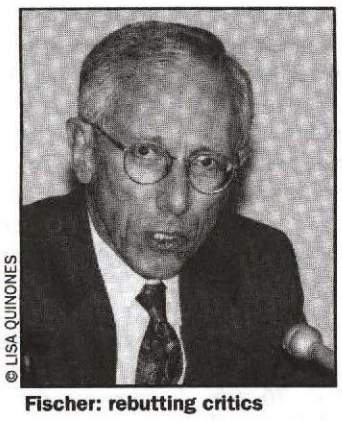
IMF Defends Programs in East Europe

BY PETER KOENIG

Defending the strong medicine the IMF has prescribed for East Europe and the former Soviet Union, first deputy managing director Stanley Fischer yesterday asserted that "stabilization seems to be an inextricable part of getting growth going," and reported that currently, "growth is taking place in more than half the region's 26 countries. The situation has turned."

Since 1989, the countries of the former communist region have followed a common pattern of political disintegration, dwindling economic output, and hyperinflation, the IMF economist said. They suffered harsh crunches when IMF-style programs cutting spending and raising interest rates and taxes were imposed as an antidote, he added. But within three years they reversed course and moved decisively toward sustainable economic growth.



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Fischer: rebutting critics

Analyzing the performance of 26 economies moving from communist to free market systems over the past six years, Fischer highlighted initial growth rate declines of 30 percent annually, inflation rates topping 3,000 percent, and distributed data showing when each economy had subscribed to a stabilization program, what kind of exchange rate regime it employed, and what kind of reversal had occurred as a result of new measures.

He concluded that the experiences of East European and Balkan countries sharply contrasted with those of the former Soviet Union. "In general, East Europe is three years ahead of the former Soviet Union," he said. Most countries in the former Soviet Union are just beginning their stabilization programs now.

He argued that "growth increases as inflation comes down." Rebutting critics who have held that IMF stabilization programs are depressive, he declared that his data show that "it is not born out that tight credit destroys growth."

Speaking at the same symposium, Maximo Russo and John Odling-Smee, the two IMF department heads for East Europe and the former Soviet Union, highlighted the difficulties of imposing tough fiscal, monetary, and exchange rate policies in the region.

"One problem is that when these policies work the result is often large capital inflows," Russo noted. Foreign capital makes domestic macroeconomic management more complicated.

Russo also worried about the collapse of social security systems in the region. "To sustain them is proving very, very difficult," he said. He added that "the experience in East Germany shows that you need massive transfers, and we don't see where the transfers will come from."

Focusing on the difficulties of stabilization programs in the former Soviet Union, Odling-Smee identified dramatic drops in government revenues and unstable banking systems as areas of concern.

Government revenues in the region have fallen even more than gross domestic products, Odling-Smee noted, because typically a large percentage of Soviet taxes were collected from those industries that were unable to survive the transition from communist to free market economies. He noted that wholesale tax exemptions to farmers and other privileged sectors, widespread nonpayment of taxes, and the fact that the new entrepreneurs had yet to be captured by tax administrators contributed to the problem. "Taxpayer identification numbers might be a good thing," he said.

Banks in the former Soviet Union often were weak, Odling-Smee concluded, because they were loaded with bad loans, were frequently forced to subsidize uncompetitive enterprises, and suffered from "a significant amount of fraud and criminal activity."

IFC PLANNING NEW SUPPORT FOR LOCAL DEBT MARKETS

BY K. MICHAEL FRASER

As part of its growing effort to develop local debt markets, the International Finance Corporation's (IFC) new products manager, Syed Aftab Ahmed, said yesterday he expects the corporation to launch an innovative venture early next year to nurture emerging market corporate bonds.

After playing a crucial role in establishing equity markets in many emerging countries, the IFC is now turning to local currency debt markets as a source of capital to promote development.

Aftab Ahmed told *Emerging Markets* he hopes the IFC's board will approve an investment in a financial guarantee insurance company that will guarantee securitized bonds issued by companies throughout the developing world.

"The new company will be part of a broad strategy to develop local bond markets," Rashad Kaldany, the IFC's capital markets manager for Asia, said in an interview.

The IFC is investing in local merchant banks that deal in debt and in asset management companies that invest in it. This weekend, the IFC unveiled another wrinkle in its strategy when it unveiled the Inter-Arab Rating Company, which it is sponsoring to provide debt-rating services in the Middle East.

To bring liquidity to local debt markets, the corporation is considering investing in market-makers. And just as it helped create the first emerging market equity investment funds in the late 1980s, it is now working on debt funds. In 1994, it helped structure, and then invested in, SG Warburg's $50 million Latin American corporate debt fund. Now it is working on a global emerging market corporate debt fund.

The IFC's new "blended" guarantee instrument (which means the IFC guarantees the issue, but brings in other investors) will ensure that payments are made on local-currency bonds. A major part of the strategy is advising governments on deregulating existing debt markets and creating new ones. For instance, Kaldany said, the IFC is now working with the Thai government to develop the legal framework needed to support securitization.

"We want to establish companies whose bread and butter is to find deals, structure them, provide guarantees to enhance credit if necessary, and sell the bonds," says Aftab Ahmed.

The first venture under this program was Citimas Capital, which the IFC helped organize in 1994 to structure deals in Indonesia. The IFC now plans to extend the program, likely to India or Thailand.

The company Aftab Ahmed hopes to have operating early next year will be capitalized with approximately $150 million to qualify for a AA international rating, and will be a joint venture with a U.S. financial guarantee company. Most of the guarantees will be used to enhance the creditworthiness of securitized bonds.

The guarantees will cover the risk that the cash flow collateralizing a bond issue will fall below expectations and be insufficient to pay the bonds' principal and interest. The new company will not, however, give long-term guarantees for sovereign risk — i.e. the risk that servicing the bonds will be impossible because of social turmoil or a government action, such as nationalization or refusal to honor a contract.

"Issuers will have to find some other way to mitigate political risk," said Kaldany. "That's something the World Bank and its affiliate, Miga, or Opic, or the Asian Development Bank might do."

ICICI Goes to Market for $200m

BY R. C. MURTHY

The Industrial Credit and Investment Corporation of India (ICICI), India's largest private sector development bank, plans to make a foray into the international pension funds market to float long-term bonds for $200 million.

ICICI was established jointly by the Indian government, private sector, the World Bank and KFW of Germany more than 30 years ago. It is in the forefront of industrial financing, providing long-term loans, and has now spawned subsidiaries for banking, merchant banking and share broking, as well as a specialized institution for financing ship acquisition.

India is for the first time tapping global insurance funds, paving the way for entry into the pension fund market. B.V. Bhargava says the 10-year bond issue will help match its long-term lending profile.

Among others, Merrill Lynch, J.P. Morgan and Salomon Brothers are in a race for a mandate to manage the bond issue.

ICICI has strong capital adequacy, well above the BIS 8 percent requirement, and is tightening up lending procedures further to improve this number.

Framlington in $30m Central Asia Fund

BY ROB WRIGHT

London-based Framlington is close to reaching agreement with the IFC and EBRD on a new $30 million private investment fund for Central Asia. The vehicle is being touted as the first of its kind dedicated to Kazakhstan, Uzbekistan, Kyrgyzstan and Tadjikistan.

Framlington CEO Michel Haski had been expected to meet with the IFC this week, but postponed his visit. The plan is for a venture capital-oriented vehicle for unlisted equities, with the the EBRD investing up to $7 million, the IFC adding $3 million, and the rest coming from daredevil international investors intrigued by the region's potential for high returns in agribusiness, manufacturing and other industries.

The fund is to be managed by an Almaty-based advisory company whose owners will be Framlington, IFC, EBRD and Kazommertsbank of Kazakhstan. IFC experts say that an abundance of informal stock markets and an avid commercial culture may also make Kazakhstan and Uzbekistan appeal to emerging markets investors once a track record has been built through the new fund.

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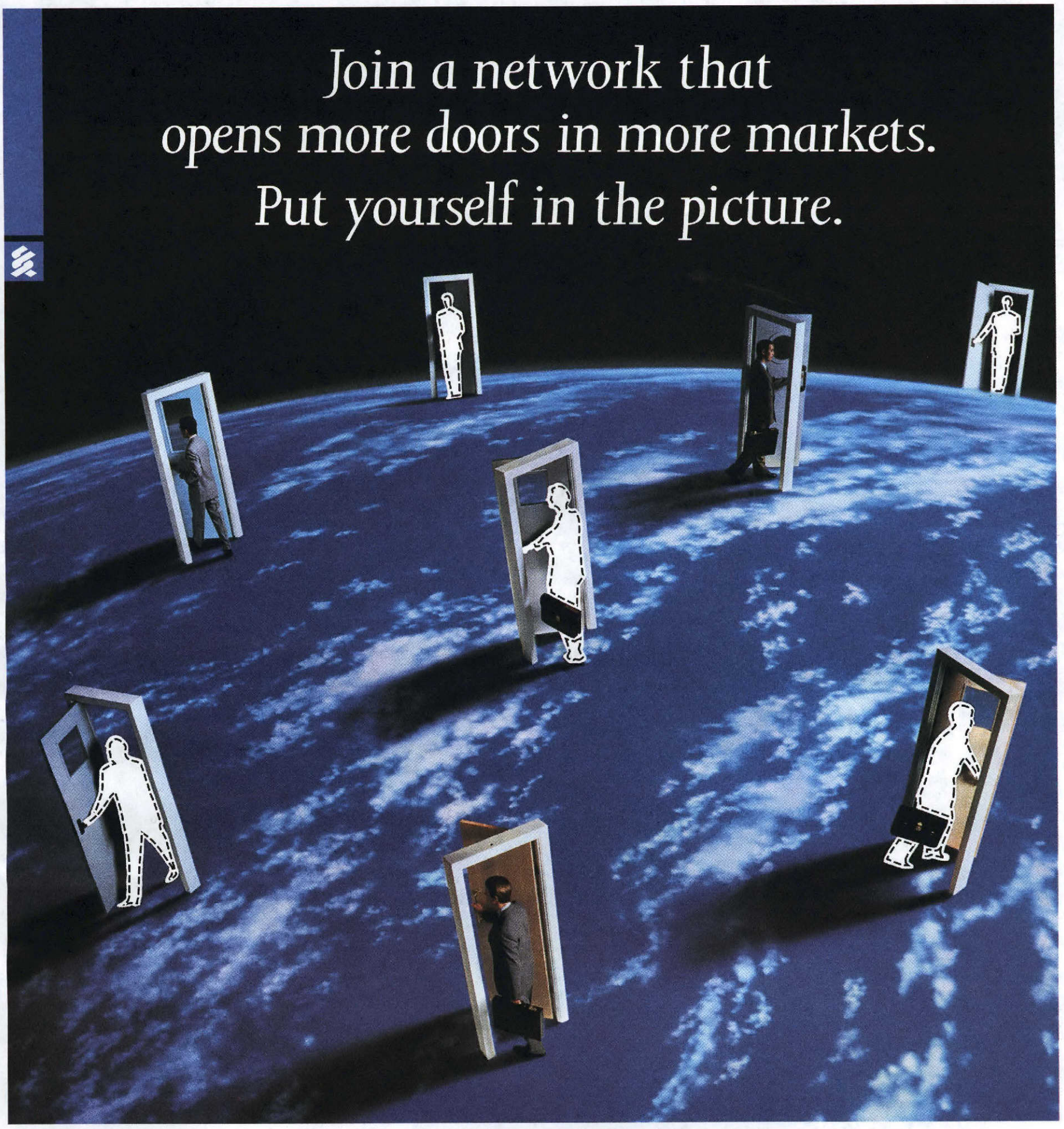

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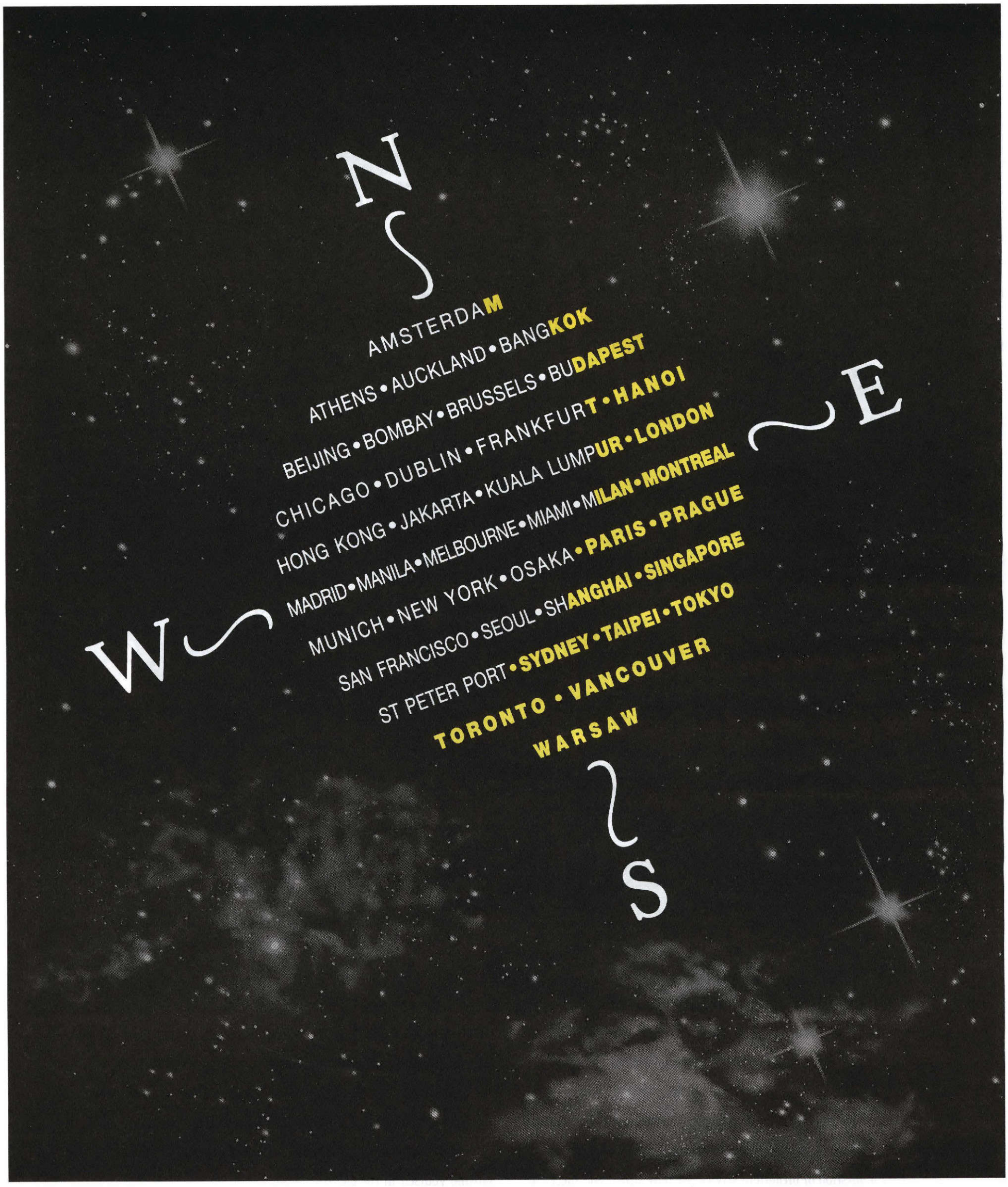

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News

EUROPESOMIST TAKES WHISKY BACK TO U.K.

Thousands of bankers in town for the annual meetings could not put together a single decent suggestion for the name of the new united European currency; the best ideas came from non-bankers. The judges were puzzled by *cashino* and *vistür* (supposedly meaning a vision of the future). In the end, the winning entry came from across the Atlantic in Kent, England, from Dave Stagg, who suggested the *europesomist* and even suggested that 1,000,000 *euroskeptics* equal one europesomist. He adds: "A parallel economy will be operated by London taxi drivers, French waiters and Italians at every level, who will be happy to change dollars into europesomists at highly advantageous rates. This form of exchange will be known as the Black Mark." Mr. Stagg wins The Macallan.

Shochat Puts Faith in Peace and Election Win

BY JON MARKS

Many Israelis' discomfort at peace with the Palestinians and the prospect of handing Golan back to Syria is heightened with every bomb that explodes in Jerusalem. But Israeli finance minister Avroham Shochat believes the Rabin government can consolidate Middle East peace, bring rigor to the budget — and still win elections in 1996.

"The economy is growing by 6 percent. We've brought the budget deficit down from 6.2 percent [of GDP] in 1994 to 2.75 percent this year, which shows we've made good results," Shochat argued. "I think, and there are independent polls that prove it, that people in 1996 will feel good about the economy and understand our policies."

A worrying budget deficit will come down to 2.5 percent of GDP in 1996 despite major costs, including financing the redeployment of Israeli forces. Shochat's budget for 1996 was passed in the government by 17 votes for, one against and two abstentions. "This was a very good result by Israeli cabinet standards, but it will be tougher in the Knesset [the parliament]." The budget goes to the Knesset on October 29 and, after committees, should be in place by January 1.



© TODD FRANCE

Shochat: budget cuts and election victory

The first phase of redeployment — the pullback from Gaza and Jericho — cost over $250 million. The next stage will cost more, Shochat told *Emerging Markets*. "We don't know the final figure for the full withdrawal, but it is around $1 billion," he said.

Israel is now transferring some $350 million a year in taxes and other revenues to the Palestine National Authority.

Shochat does not envision military spending coming down in the short term. "The cost of peace has not yet been offset by cutting the cost of military spending. To create a situation where the Israeli people think they won't risk anything by opting for peace, we have to keep a strong army. In future years, this will be different."

Strong growth in the economy has helped control the "still very high" military budget, which has fallen to 8-9 percent of gross domestic product from 18 percent, Shochat commented.

Following peace agreements with the Palestinians, Egypt and Jordan, Israel is now looking to conclude a peace settlement with Syria, which Lebanon would then follow. "I don't see why we can't do it — there is bargaining now over what should be on the table," Shochat said. "Diplomatic relations between Syria and Israel are in the interest of both sides — and the Syrian economy has problems: the people have low living standards which could be raised within the Middle East peace framework."

Arab officials question whether Syrian President Hafez al-Asad is disposed to do a deal which would undermine the ideological base of his regime and could lead Syrians outside the regime structures to demand accelerated change. "When you look at Syria, I don't think Asad is ready yet," one official said.

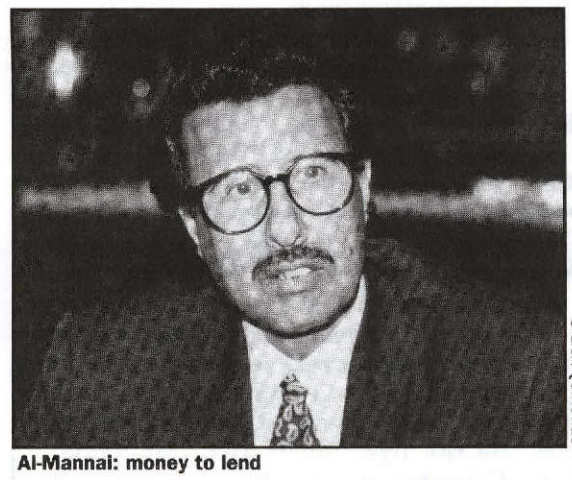
ARAB FUND WEATHERS ARREARS CRISIS

With a steady flow of loans resuming after a financial crisis, arrears under control and partnership with the International Finance Corporation and others adding to its business development portfolio, the Arab Monetary Fund (AMF) is in more confident mood than for years.

Director-general and chairman Jassim Al-Mannai expects the AMF to make a similar number of structural adjustment loans in 1995 as it did in 1994, when after a period of slump four support facilities were approved: for Algeria, Morocco, Yemen and Jordan. These totaled $285 million: small by multilateral standards but "a huge improvement on the previous year," when less than $10 million was loaned.

"We have got the money to lend, provided the countries fulfill their commitment," Al-Mannai, one of the Gulf's most respected younger generation technocrats, told *Emerging Markets*.

Among the countries in talks is Lebanon, where the AMF is also working on capital markets development. In Washington this week, the AMF, IFC and European agency IBCA signed an agreement to create a new Arab ratings company IBCA.



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Al-Mannai: money to lend

The Palestine National Authority is an AMF member, but is not eligible for loans, as it has not paid up its share of capital. "They are interested to pay their share of $9-10 million, and know that, once paid, they could borrow 250 percent of this amount," Al-Mannai observed prior to meeting PNA finance minister Muhammad Nashashibi.

Export development is also a major priority, through an AMF affiliate, the Arab Trade Financing Program, which Al-Mannai chairs.

Arrears remain substantial but manageable, Al-Mannai said. They now total about $500 million, owed by three countries: Iraq, Somalia and Sudan. Outstanding principal and interest is substantially less than the total, which has been inflated by penalties.

Iraq, which owes under $150 million, has said it will pay when sanctions permit. "In Somalia there is a major problem: there is no government," Al-Mannai observed.

Al-Mannai met Sudan's central bank governor and finance minister on Tuesday. He believes there is a chance for a solution, "but finding an agreement involves a question of principle. Every country must pay, and Sudan, to be fair, has shown interest in doing this." The sum involved is believed to be over $100 million.

"We want to see Sudan borrowing again, but rescheduling is not allowed. What we are trying to do is to find formulas in which Sudan can repay over time, but we will not accept that they get priority over others."

Accommodation between Khartoum and the AMF will be separate from any IMF agreement. Although many of the same principles apply to both organizations, the Arab fund chief believes "they have a bigger problem with the IMF."

— Jon Marks

MidEast Bank Doubts Remain

The proposed Middle East Development Bank remains in doubt as officials hold informal meetings in Washington to shape a compromise. The MEDB's supporters wanted a $5 billion bank, with $1.25 billion capital paid up, but this is unlikely for now. Announcement of the new regional multilateral is supposed to be the centerpiece of the October 29-30 Middle East/North Africa economic summit in Amman.

But Europeans remain opposed to creating an MEDB which, officials privately argue, would do little to add to the European Union's own increasingly proactive policy in the region. Brussels' compromise is a Middle East and North Africa Financial Intermediary Organization (Menafio) to support cooperation and project preparation, but without borrowing capacity for at least two years.

"The Europeans are pushing ahead with the Menafio, which the U.S. says will kill the idea. To work, the bank needs to raise capital with a triple-A rating," comments Gideon Schurr, the Israeli official handling the project. "It's still not sure we'll have an agreement in time for Amman."

Meanwhile, the World Bank is lobbying the Gulf Cooperation Council states and Israel to join IDA11. They are not yet members.

— Jon Marks

Moroccan Projects Power Ahead

Work is to start soon on Morocco's first private power and water projects, officials say. This signals a new phase in the kingdom's liberalizing strategy, with schemes intended to create growth in the face of tough budget cuts.

ABB Asea Brown Boveri's concession to build a first 300 megawatt independent power plant at Jorf Lasfar will go ahead soon, state power company chief Driss Benhima said. Final negotiations have hinged on pricing — also an issue for France's Lyonnaise des Eaux, which is gearing up to take over Casablanca's water and sewerage system.

Austerity policies and government inactivity in several sectors have provoked criticism at home, but the privatization program has so far been spared from heavy flack.

"Conceding a public service to the private sector seems to be the most interesting method of economic development, which guarantees both the strategic interests of the state and its citizens, and the legitimate aspirations of the private sector," Benhima said. Risk guarantees are being discussed with four export credit agencies and the Multilateral Investment Guarantee Agency for the Jorf Lasfar scheme.

— J.M.

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Emerging Markets IMF/World Bank Daily
is a publication of International Media Partners, L.P., The Cable Building, 611 Broadway, Suite 300, New York, NY 10012 **Telephone** (212) 995-9595 **Facsimile** (212) 995-9389

Printing: Smith Lithographic Corp., 1029 E. Gude Drive, Rockville, MD. James Brown, Account Executive Phone: (301) 424-1400/1 (800) 622-2577

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Bank's $18bn Quarterback Bows Out

BY CRAIG MELLOW

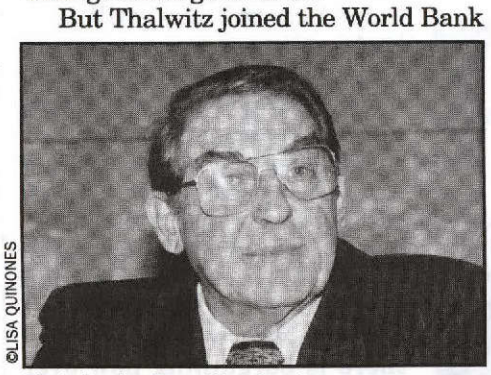
We all have moments in our life that we cherish. One of Wilfried Thalwitz's came when a Latvian taxi driver refused to take Deutsche marks from him for a fare. Thanks all the same, the cabbie said, but he would rather be paid in his own lat.

For a man who spent 32 years living a faith in "the immutable truth of the primacy of financial stabilization," this experience was rewarding indeed.

Thalwitz, who after the annual meetings will retire from his position as World Bank vice-president for Europe and Central Asia, has spent the last six years reaping rewards he never anticipated. Born in Bavaria in the inauspicious year of 1932, he watched the Berlin Wall go up first-hand in 1961. "When my wife called me and told me it was being torn down, I was ready to declare her insane," he told *Emerging Markets*.

By 1991, Thalwitz had become quarterback of a bank campaign which has so far poured $18 billion into the liberated Soviet bloc. "I think the world can sleep a lot more easily about this region than two or three years ago," he reflected. "Even in Russia, there are structural changes which no government that would ever emerge could go back on."

But Thalwitz joined the World Bank in 1963 because he wanted to help the world, not just his native region. His first resident's posting was in Indonesia, and he spent most of the 1970s and 1980s specializing in West Africa.



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Thalwitz: banker with a heart

The institution he came to work at, Thalwitz recalls, was a very simple place, about one-tenth of its current size. Yet the biggest change has been philosophical, not physical. "There was a consensus then about the leading role of the state," he said. "When we went into Peru in the early 1960s, even the White House sent a message asking whether they had a five year plan."

Having seen a great many world leaders at work, Thalwitz has come to admire receptivity to change above all political attributes. An outstanding example, he said, is Indian Finance Minister Monmohan Singh, who has evolved from central planner to uncompromising reformer. Among post-communist leaders, Thalwitz's unsung hero is Albanian President Sali Berisha. "This man is from a small country," he enthused. "But he is a giant."

Thalwitz worries now about the rich countries' increasing tendency to "leave behind" Africa and other developing regions. "The new isolationism is only partly masked by the NGO explosion, which gives the appearance that society still has a heart," he observed.

Thalwitz could not say what was the most exciting part of his career. "The most exciting thing," he said, "is always what you are working on right now."

BIG RUSH AS PERU OPENS MINING TO FOREIGNERS

BY K. MICHAEL FRASER

Mining companies are rushing to metal- and mineral-rich Peru, which is open for prospecting for the first time in almost three decades.

"Peru is crawling with geologists. You can't walk up a hill without running into three or four of them. And right behind them are the financial advisors," says Chuck Preble, president of the board of the Southern Peru Copper Corporation.

"Every important mining company and many unimportant ones are there."

Britain's Rio Tinto Zinc, South Africa's Anglo American, Switzerland's Glencore International (formerly Marc Rich), Newmont and American Barrick from the United States, and Canada's Cominco are among the major prospectors.

Preble, who has spent 30 years digging copper in Peru, guesses companies have budgeted $25 million to $40 million to look for gold, silver, copper, zinc, lead and a host of other metals and minerals.

"They are exploring in areas the government never allowed before and in areas that were closed because of terrorists," says Preble. "Besides getting out and beating the rocks, companies are using new technology to look at areas that haven't been explored for 25 or 30 years. The whole country is being satellite scanned. It's a major rush."

At least $9 billion in private sector investment in Peru's mining and smelting sector is expected over the next eight years.

Peru's highly successful privatization program has created some of the interest. Companies that bought government-owned mines and smelters have been successful and have plans to expand. Cominco, which, with Japan's Marubeni, bought the Cajamarquilla zinc refinery last November, now is planning to bid for the enormous Cerro de Pasco zinc mine.

Carlos Montoya, head of Peru's privatization program, said the sale of the state-owned holding company, Centromin, which includes the Cerro de Pasco mine, will be one of next year's most important sales.

Colombia Spending Draws Top New York Bankers

BY ROB WRIGHT

Using $300 million in funding provided by the World Bank, Colombia plans to create a private sector infrastructure finance facility in 1996. Top New York advisors, including Salomon Brothers, Booz-Allen and Hamilton, CS First Boston and Merrill Lynch, are competing for the prestigious mandate Bogota expects to award in the coming weeks. The deal will use the $300 million offered by the World Bank to Colombia's export credit agency, Bancoldex, to support a new generation of private sector toll roads and power plants.

The project is emerging as a showcase for the bank's new policy of flexibility in instruments to support private infrastructure financing. One strong possibility is a backstop facility that Colombian sponsors could access to refinance their projects in the capital markets in cases of unforeseen disruptions in market conditions. Clemente del Valle, an aide to finance minister Guillermo Perry, said yesterday that the mandated investment bank will also determine if market conditions require that the money support guarantees on a case-by-case basis, or be supplemented with more funding from multilateral or bilateral institutions.

"It's up to the investment bankers to recommend the definition and scale of the project," del Valle said. "That's what we're bringing them in for."

In a related initiative, the World Bank is also proposing a guarantee for up to $80 million of the $200 million Puerto Salgar-Tobia Grande road project that Colombia wants to put out to international tender under a 20-year concession early next year. The road would improve connections between Bogota and Medellin. It is to be the first major road for which Colombia has sought private capital in international markets. It is seen as a pilot project, and if successful, the government hopes to use its investment grade status as a springboard to attracting additional private capital into the sector. It is already doing the same in power generation, where UBS has just closed financing for Asea Brown Boveri's Termo Barranquila power plant. Chase is hoping to close another deal in the next few months for the Termovalle plant sponsored by U.S.-based independent power producer KMR.

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Preview

THURSDAY, OCTOBER 12, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 15

Greed is Good For Something After All

BY HENRY COPELAND

Sitting in the Sheraton's ballroo.m yesterday waiting for Bill Clinton, it was hard not to look up at the weird array of silvery mirrored pyramids and rows of hanging strands of lights. The ceiling would have fit in well in any London disco built to hook petrodollars in the 1970s.

The setting is a fitting one for the 51st annual meetings of the World Bank and IMF, institutions that have become as unfashionable in recent years as the Sheraton's ballroom ceiling.

Among other things, visitors to the meetings discovered this week that the World Bank has recently spent money on a study to determine that African countries could make money selling crafts and goods to African-Americans. Any entrepreneur in Washington's trendy Adams Morgan could have told the bank staff the same thing for the cost of a cup of coffee.

Outside of the hall, a giant Mitsubishi television set offered another example of the bank's attempt to be user-friendly: "...so miners are only responding to markets. In the United States it is estimated that every person consumes directly or indirectly 10 tons of metal products each year. Developing countries consume much less on a per capita basis, but consumption is rising more rapidly than in mature economies. Roadways, for instance, require sand and gravel, bitumen, cement and iron for reinforcement. In a building, the window frames are made of steel, the floor tiles of clay, the wall brick of cement. The roof of aluminum or corrugated iron sheets, the plumbing of copper tubing. Minerals are widely dispersed in the earth's crust...."

Useful stuff for an eight-year-old, but the 24-minute video from the industry and mining division of the industry and energy department left casual viewers wondering just which government they were trying to reach.

If anyone is responsible for forcing this elderly spinster of an institution suddenly to don lycra and awkwardly attempt to rollerblade into the future, it is bank president James Wolfensohn. His speech to the delegates was replete with the most up to date jargon: "relevant," "clients and results," "the power of partnership," "center of excellence," and "getting closer to our clients."

The new spirit was summed up by an anecdote, related by a proud bank staffer to *The Washington Post*, that had Wolfensohn walking through an African village holding hands with a chief. The spirit of Wolfensohn's hand-holding notwithstanding, all but a few of the visitors to the annual meetings avoided rubbing shoulders with Washington's citizens on the five-minute, $1.10 metro ride and walk from bank headquarters to the Sheraton. They chose instead to sit for up to 45 minutes in $60-an-hour limousines. The adventuresome took $5 cab rides.

As the World Bank learns to hip hop, Michel Camdessus is seeking to reinvent the IMF as the big brother to every angry little country that picks a fight with the world's financiers. The bank tried on the role after Mexico, and liked it. Bank of England governor Eddie George may bluster against the idea that the fund will bail out speculators, but a trend is in place. With an "emergency financing mechanism" in the wings, can an accompanying bureaucracy and a bankruptcy court be far behind?

Speculators around the world relish the idea that they can invest in places like Mexico with relative impunity. It won't take them long to figure out that the riskier the position, the better the chance of being stopped out of losses by the IMF. The IMF should remember something park rangers learned long ago: that rushing to extinguish brush fires only leaves more kindling for a final all-encompassing inferno.

The unwillingness to allow the markets to reap their just rewards and losses is ironic. Greed may not be morally good, but it is good at taking care of itself. Or at least that is the theory we've all been pretending to subscribe to since the trade ruble went the way of Czar Nicholas II.

October 12, 1995 AGENDA

THURSDAY, OCTOBER 12

7:00 A.M.
Press breakfast hosted by the World Bank Group. Cotillion Rooms, Sheraton Washington Hotel.

8:00 A.M.
Press conference with World Bank president James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.

9:30 A.M.
Annual discussions. Plenary Hall, Sheraton Washington Hotel.

11:00 A.M.
Closing ceremonies. Plenary Hall, Sheraton Washington Hotel.

12:00 P.M.
Institute of International Bankers hosts a reception and luncheon with guest speaker Alexandre Lamfalussy, president of the European Monetary Institute in Frankfurt. Grand Ballroom, Plaza Hotel. By invitation.

12:00 P.M.
Press conference with IMF managing director Michel Camdessus. Cotillion Rooms, Sheraton Washington Hotel.

1:00 P.M.
Press luncheon hosted by Michel Camdessus and James Wolfensohn. Cotillion Rooms, Sheraton Washington Hotel.



$1bn Is Band-Aid for Angola's Deep Wounds

BY VICTORIA BRITTAIN

The international community made its most serious commitment yet to Angola's peace by promising nearly $1 billion at a donors' meeting in Brussels last month which brought President Eduardo Dos Santos and Unita rebel leader Jonas Savimbi together under the auspices of the EU and the U.S.

However, behind the public facade of ambitious plans for economic revival in a country whose oil and diamonds place it among Africa's potentially richest, lie deep social crisis and the key unresolved question of Savimbi's political future.

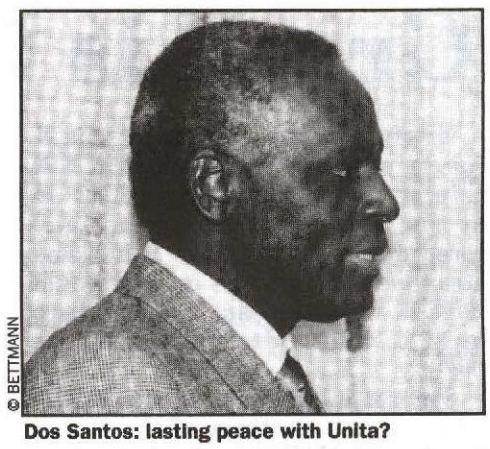
A year after the Lusaka accords were signed, though not by Savimbi himself, the country's economic situation is so bad that for urban dwellers of every class the constant preoccupation is with having enough to eat. Inflation has rocketed daily ever since the war was started again by Savimbi after the 1992 election, and is estimated to have reached 1,700 percent per year. The fighting cut off most of the country from commerce, slashed agricultural production as three million or more people fled off the land to the cities, and then virtually destroyed the entire industrial production base through Unita's attacks on the towns in 1993.

Strikes have hit almost every sector of the economy, including hospitals and schools in some provinces. In many places civil servants have not been paid for months. But even when they are paid, their wages are utterly unrealistic after a series of huge devaluations, and everyone who works in the public sector must either have a second job or rely on the family network to survive. A university professor, for instance, earns $25 a month, a civil servant $3, a nurse $1.

As a result the intellectual capital of the country is being lost as cadres desert the state sector for low level jobs in the aid industry where payment is dollar-linked and they can realistically expect to earn at least 100 times more. In a serious portent for the future, Luanda University is only functioning at minimal level with four out of six faculties closed or nearly so. A generation of intellectuals is being lost to the country and the next generation is not being formed.

The liberalization of the economy introduced by the World Bank and the IMF in the late 1980s, combined with the war and remarkable government incompetence have contributed to a wild capitalism in which no formal rules apply. The provinces of Lunda in the northeast on the Zaire border, for instance, are anarchic as the country's diamonds are mined in industrial quantities by business interests from France, the U.K. and South Africa protected by shady military alliances which appear to have produced a tacit division of the spoils between Unita and some elements (whether former or current it is impossible to know) of the government army. In Luanda the corruption of the political class and military officers (mostly no longer serving) is ostentatious.

New restaurants and mushrooming construction in the capital contrast dramatically with the wild children in rags, amputees in old army uniforms and naked beggers with open sores who roam the streets. The crime wave in the capital is dramatic, and corruption of the police is endemic as they are paid paltry salaries on which they cannot live. Luanda is swollen with half a million refugees living in utter misery and growing impoverishment. Across the nation in what were their home towns and villages the health service has collapsed and epidemics of tuberculosis, malaria and sleeping sickness are rampant, according to the international non-governmental organizations which now carry out almost the entire responsibility for health in the country. Provincial hospitals are graveyards with no medicines, no functioning water or electricity supplies. With extraordinary devotion a handful of Angolan doctors struggle on in the provinces, but with the blank eyes of trauma victims and a deep bitterness.



Dos Santos: lasting peace with Unita?

Twenty years of building national capacity have been destroyed by the government's inability to solve the problem of unrealistic salaries for professionals such as these as the cost of living has soared. The crisis of cadres and the loss of social morality are the two most urgent questions facing civil society. Despite the international community's new confidence displayed in Brussels, few Angolans believe in their leaders' capacity to solve them. EM



FISH WAR ROILS MOROCCAN EU BID

BY MARK HUBAND

The best accord would be if there was no accord." Morocco's Prime Minister Abdellatif Filiali enjoys the infamy his attitude towards a new fish pact with the European Union has brought him.

His statement, hardly likely to bring Morocco closer to the European orbit the Maghreb kingdom is yearning to join, peppers all local discussions concerning its most potent foreign economic issue — an issue widely portrayed as having the sovereignty of Morocco and its territorial waters at its heart.

"All concessions, for whatever reason, with regard to a new fishing agreement with the EU, will represent an infringement on our national sovereignty," the Shipowners Association in the Atlantic port towns of Agadir, Safi and Mehdia said in a statement.

Spanish fishermen have violently blocked Moroccan goods landing at Spanish ports.

In September, talks aimed at renewing with revisions a pact allowing EU trawlers into Moroccan waters collapsed after less than one week. A week later EU fisheries commissioner Emma Bonino discussed the growing crisis with Morocco's King Hassan himself, to no avail.

The prospect of an EU fish war with Morocco first surfaced in April, when a four-year pact signed in 1992 allowing Spanish and Portuguese trawlers into Moroccan waters was scrapped a year early at Moroccan insistence. Then, 730 EU trawlers were banned from Moroccan waters, many of them having remained tied-up in south Iberian ports ever since.

It had become the EU's most important external fisheries agreement, providing a livelihood for 28,000 people in southern Spain, the Canary Islands and Portugal. Under the accord EU fisherman could catch 50,600 tons of squid, shrimp, sardines, octopus and hake in Moroccan waters. In return, the EU paid Morocco $135 million a year.

The 1992 agreement, the sixth of its kind, worked very much in the EU's favor, but was drawn up before the recent rapid development of the Moroccan fishing industry.

Morocco now lands over 500,000 tons of fish per year, including the world's largest sardine catch. It wants to see a 30 percent reduction in the EU sardine catch in its waters. It has also demanded a 65 percent cut in catches of octopus and squid and a 50 percent cut in shrimp and hake trawling over three years.

EU officials acknowledge that if existing fishing controls were properly enforced it would help to solve the problem over quotas. However, the EU argues that for EU fishermen to meet Moroccan demands that EU vessels unload more fish in Moroccan ports and impose closer monitoring of catches, the infrastructure of the Moroccan fishing industry has to be improved.

In protest at Moroccan demands for a bigger share of what they say already belongs to them, Spanish fishermen have violently blocked Moroccan goods landing at Spanish ports. Meanwhile Moroccan ship owners, political commentators, newspapers and the fishing communities have turned the dispute into an issue of national pride.

At the heart of the issue from the Spanish side is the fact that Spain has so far failed to restructure its fishing industry. Its ships are overmanned and its ports inefficient.

Spanish officials admit this, and acknowledge that Morocco is looking for an agreement which will necessitate the kind of restructuring Spain should anyway have instigated years ago. Meanwhile Morocco is being portrayed as the villain and Spain is using the issue to threaten Morocco's wish to draw up a treaty of association with the EU.

"An agreement of association between the European Union and Morocco will not be possible without a fishing agreement. Spain will block the accord, and relations with Morocco will fall into an impasse," Spain's agriculture and fisheries minister said after the collapse of the talks in September. EM



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HAITIANS STRUGGLE IN LIMBO WHILE INVESTORS WAIT

BY CANUTE JAMES

Haiti's hopes for rapid economic change to accompany the political rehabilitation of the country have been disappointed. When President Jean-Bertrand Aristide returned from three years in exile a year ago, there were indications that the weakest economy in the Americas would receive a desperately needed jump-start from foreign donors and investors. But little has happened.

In limbo, Haitians continue to struggle with a per capita income of $220 and unemployment of 70 percent. There has been only marginal improvement in the economy.

The country had expected just under $1 billion from foreign donors and international financial institutions. Government officials also spoke confidently of a return to Haiti of foreign companies, many involved in the light manufacturing and assembly industry. Few have come back.

Agreements between the government and the donors had committed the Aristide administration to a series of economic reforms. There was an encouraging start when the government cleared $83 million in arrears on its foreign debt, satisfying the first criterion for access to the funds it needed.

In a letter of intent sent to the IMF, the government set out its economic program. It started to reform tariffs, with lower duties on a range of imports, and eliminated import licensing. It also promised to cut the fiscal deficit and curb inflation, and to remove interest rate controls.

Central to the economic program is privatization of several state-owned enterprises, including the cement and flour plants, telephone and electricity companies, and airports and seaports. There has been persistent opposition to the privatization program, not only from opposition parties, but also from nationalist elements close to Aristide.

The differences within the administration emerged soon after a government invitation to investors to bid for 78 percent of the cement factory, and for a contract to lease the flour mill with an option to purchase. Government officials report that Aristide was not consulted before the invitations were issued. Privatization means selling the country's patrimony, argued those opposed to the program, in messages conveyed through graffiti frequently seen in Port-au-Prince. The sale of the companies would enrich only the elite which dominates the country, ran the argument.



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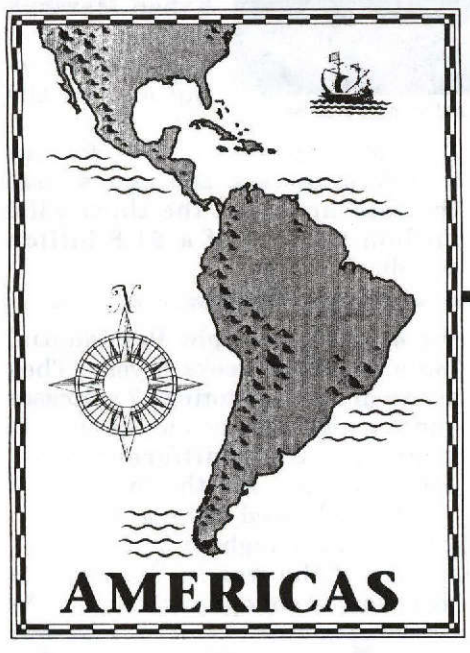
Economic change has not come with democracy

The privatization program could lead to unrest, said Smarck Michel, Haiti's prime minister, who visited Washington seeking changes to the program. So virulent were the arguments that finance minister Marie-Michele Rey threatened to resign after she was publicly criticized as the person behind the program.

The delay in disbursement of aid funds has prevented the administration from tackling Haiti's poor infrastructure. The country's road network is being improved, but at a rate much slower than government officials say is needed. Telecommunications and electricity need immediate attention, say the officials. The new jobs which the government expected, and which would have conveyed to Haitians that economic change was accompanying the move towards democracy, have not been created.

These failures, combined with political uncertainty, have not encouraged foreign investors. The assembly industry, producing clothing, baseballs and electrical appliances for the U.S. market, was killed by the economic embargo imposed on Haiti's former military rulers. A few companies have reopened, but fewer than Haitian officials expected.

While there were indications that foreign businesses would return to Haiti soon after Aristide's reinstatement, it is now clear that most are awaiting the outcome of the presidential election due in December, and the installation of Aristide's successor in February. EM



Brazil Law Gives Anti-Trust Watchdog Bite

BY MICHAEL KEPP

Though the Brazilian government has, since the early 1990s, opened up its economy through lowered trade barriers and other deregulatory measures to increase competition, regulatory initiatives towards the same end have lagged behind.

But a new anti-trust law and a newly-empowered federal watchdog agency are now aimed at further stimulating local competition — though some fear stifling restructuring attempts in the process.

The law, decreed in June of 1994, states that when one company's acquisition of (or merger with) another results in control of over 20 percent of the market, an independent justice department watchdog agency, the Administrative Council for Economic Defense (Cade), must approve the deal. Though Cade has been around since 1962, it has taken the anti-trust law to give the agency any bite.

Cade's power of approval over market-cornering mergers and acquisitions, combined with its delays in making such decisions, have caused some companies to think twice about such fusions.

In October of 1994, Cade, in its first big anti-trust move, partially blocked Rhodia, a Brazilian subsidiary of France's Rhone Poulenc company, from acquiring polyester-maker Sinasa. The acquisition would have made the new company, Rhodia-ster the only polyester and acrylic fiber producer in Brazil.

The Cade decision forced Rhodia-ster to create a new company, Polifiatex — the acrylic and polyester fiber part of the acquisition — which it has put up for sale. The decision does, however, allow Rhodia-ster to make products — PET resins for plastic bottles and polyester films — which don't monopolize the market.

Later in 1994, Cade refused to allow Brasilit, with 25 percent of the cement-asbestos roofing tiles market, and another roofing tile maker, Eternit, with 20 percent of that market, to merge tile production in each of their two factories in southern Brazil to lower transport costs.

The government, in the early 1990s, however, gave Brasilit and Eternit, two former competitors, permission to merge production operations at their Rio de Janeiro and Sao Paulo factories, an association which Brasilit claims created a greater economy of scale and lowered the price of its tiles to $225 per ton from $250 per ton.

As a result, Cade's decision caused Brasilit to charge that the agency was promoting competition at the consumers' expense.

"Cade's decision to block Brasilit Eternit's restructuring efforts in southern Brazil prohibits us from lowering costs and consequently prices as we've done before because of production mergers elsewhere in Brazil," said Brasilit president Jean-Claude Breffort. "Is this the kind of public service Cade should be performing?"



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Coutinho

Cade president Ruy Coutinho strongly disagrees. "Whenever a company has a monopoly over, or even control over a market, that company has the power to dictate price," he said. "And that's dangerous."

In March 1994, Cade ruled that it would not allow the Gerdau group, a big local steelmaker, to acquire the Pains steel mill, bought as part of Gerdau's purchase of Germany's Korf GmbH company, which owned 68 percent of Pains. Cade blocked the Pains purchase because it boosted Gerdau's share of the long-products steel market from 39 to 46 percent.

But Gerdau took advantage of a new Cade ruling, decreed in July, which allows companies to appeal Cade decisions provided they present new arguments which show their merger or acquisition will have less of an impact on the market than originally anticipated.

Gerdau will argue that it plans to convert 55 percent of Pains production to specialty steel, a non-market-cornering type of steel in Gerdau's case. Gerdau also plans to argue that its acquisition of Pains will result in productivity increases and technology upgrades. Cade is expected to rule on the appeal soon. EM

Eastern Europe

THURSDAY, OCTOBER 12, 1995 EMERGING MARKETS IMF/WORLD BANK DAI

Ukrainian Privatization Shows Signs of Early Life

BY DEAN TEMPLE

Ukraine's privatization program is expected to fall far short of the 8,000 medium and large sized enterprises decreed by President Leonid Kuchma in January. According to the European Bank for Reconstruction and Development's (EBRD) Oleksandr Savchenko, "Only 2,000 of these enterprises will be privatized by the end of the year."

In addition, Savchenko, the EBRD's director for Ukraine, Moldova, Romania, Georgia and Armenia, projects a mere 30 percent of small-scale enterprises (such as shops and restaurants) will be privatized, far short of the original goal of 100 percent.

That is not to say that there haven't been bright spots. One example is the Ukrrichflot shipping company, based in Kiev.

At the end of last month, the Bank of Scotland agreed to lend, in conjunction with the European Bank, $16.5 million to Ukrrichflot, which transports both passengers and freight on the Dneipr River, the entire Black Sea region, the eastern Mediterranean and the Danube. The loan will primarily go toward the purchase of five new vessels, although some will be allotted to reconstruction. The loan is significant, says Savchenko, because it is the first made to a Ukrainian company by an international bank without a government guarantee. Ukrrichflot, a publicly held company listed on the Kiev stock exchange, is valued at approximately $200 million according to Savchenko, although he admits it is difficult to value its assets. "It may be the biggest in that area." Ukrrichflot was privatized in 1993 with the EBRD as key advisor.

Another promising program is a $121 million credit line, opened by the EBRD through Ukraine's central bank, offered to private commercial banks. "This money is made available to Ukraine's best commercial banks as determined by an international auditor. Banks which get international audits are able to lend up to $2.5 million," says Savchenko.

The money from these loans is used for medium-term loans to private businesses. As a result of these loans, Savchenko estimates that 300-400 new private enterprises have started up. So far only one bank, Grdo Bank, has qualified for access to the credit line, but four other banks will start next month. These include: Ukrin Bank, Aval Bank, Privad Bank and the First Ukrainian International Bank.

"This is done with the goal of these banks ultimately going to the international financial markets," says Savchenko.

The bank director attributes delays in the privatization program to the technical problems involved in organizing voucher auctions, but most of all to Ukraine's entrenched bureaucracy. He goes on to say that most of the corruption facing Ukrainian reform is fostered by the state sector.

"Corruption does not need to come from the private sector. From a tax point of view, the situation is very well, comparable to [the U.K.]."

Ukraine has a graduated tax from 0-50 percent, a corporate tax of 30 percent and a capital gains tax of 15 percent.

Savchenko does emphasize that the state needs to step up its efforts on the economy. "Reforms are going in principle, but it is a slow, slow process. The main task is for the government to get the economic program passed through the parliament."



© IMPPHOTO

Savchenko: reforms are a slow, slow process

Ukrainian Prime Minister Evhen Marchuk assured Western donors in Washington at the end of last month that his country would not forsake its reform process. During his visit, the IMF approved the third $350 million tranche of a $1.8 billion standby loan. EM

Slovenia: Tarred with Yugoslav Brush

BY HENRY COPELAND

Looking out through the billboard-sized plate glass window, Marjan Jarc considers his hotel's biggest selling point a front row seat on Slovenia's tranquil Lake Bled.

"One American lady told me this is a million dollar view," says Jarc, who works at the Grand Hotel Toplice, the 120 room crown jewel of Slovenian hotels. Jarc's business card says he is the hotel's sales manager, but after 30 years at the hotel he does everything from recommending scenic walks to giving waiters tips on serving coffee.

Sitting on an elegant couch in the hotel's huge tea room, Jarc gestures to his left. On the lake just below, four ducks paddle in a line. A little further out, a backstroking swimmer's lazy arms break the placid water. Further still, a wooden rowboat crawls toward a small island topped with a 17th century church. The lake nestles in the foothills of the Julian Alps.

"Sarajevo is over 600 kilometers away, much farther from Bled than Munich, but that doesn't matter to tourists."

For the price of a $2 cappuccino, the view is available to anyone. But the hotel's 25 couches and 37 armchairs are empty as Jarc speaks.

In explanation, Jarc, a slight 61-year-old in a crisply pressed blue suit, raises his right arm and points in the opposite direction, back through the hotel and out the front door. "Krajina is 250 kilometers in that direction," he says. Not too long before, the Croation army had flushed the Serbs out of their Croatian stronghold.

"As long as war continues, the image of Slovenia equals zero," he says. Sarajevo is over 600 kilometers away, much farther from Bled than Munich, but that doesn't matter to tourists, Jarc says. "Every night people turn on their televisions, and see terrible scenes, and Slovenia is just a dot on the map right next to that war for them," he says.

"We still get mail addressed, 'Grand hotel Toplice, Bled Yugoslavia.' And we politely answer them, 'thank you for your letter, but we would like to point out that we became Slovenia in June of 1991, and were recognized by the United Nations in January of 1992,'" he says.

Before Slovenia's brief war of independence in June of 1991, the hotel boasted 60,000 "overnights" a year, says Jarc. In 1992 and 1993, that dropped to 20,000. There were 32,000 overnights in 1994, and occupancy should be about the same this year. But even with this slight improvement, the hotel is barely hanging on, says Jarc.

There have been no layoffs. Instead, says Jarc, "the young waiters saw there was no business and got other jobs" and the staff has dropped from 280 to 160. Remaining employees have forgone pay increases, despite inflation that ran 18 percent last year.

The Grand Hotel Toplice was built in 1931, a more civilized age of vacationing, the era of zeppelins and world cruises and leather suitcases. War notwithstanding, one Viennese couple still books the 500 Deutsche marks ($350) a night Presidential Suite for three weeks a year. They arrive in two cars toting 17 suitcases and "enough clothes for the wife to wear something different every day," says Jarc. But the suite, which used to be booked 120 nights a year, is used just 70 nights a year now.

Even if the war in Bosnia ends soon, Jarc is not optimistic about the near future. "In 1912, Bled had 15,000 overnights. Then World War I came, and our visitors fell by half. We did not have the same number of guests until 1926. It took eight years for tourism here to recover from the war." Jarc's voice loses its genial veneer when he tries one more time to explain to a visitor that Slovenia's two million citizens have nothing to do with the mayhem to its east.

"Making us a part of Yugoslavia in 1918 was a mistake. Slovenes belong to Europe — the rest are the Balkans," he says. "I don't want to upset anyone, but we are different. The Turks occupied them for 500 years, their cultures became mixed up. Maybe you've noticed that there have been many agreements made in this war, and all were broken. We are different: what we say, we do." EM

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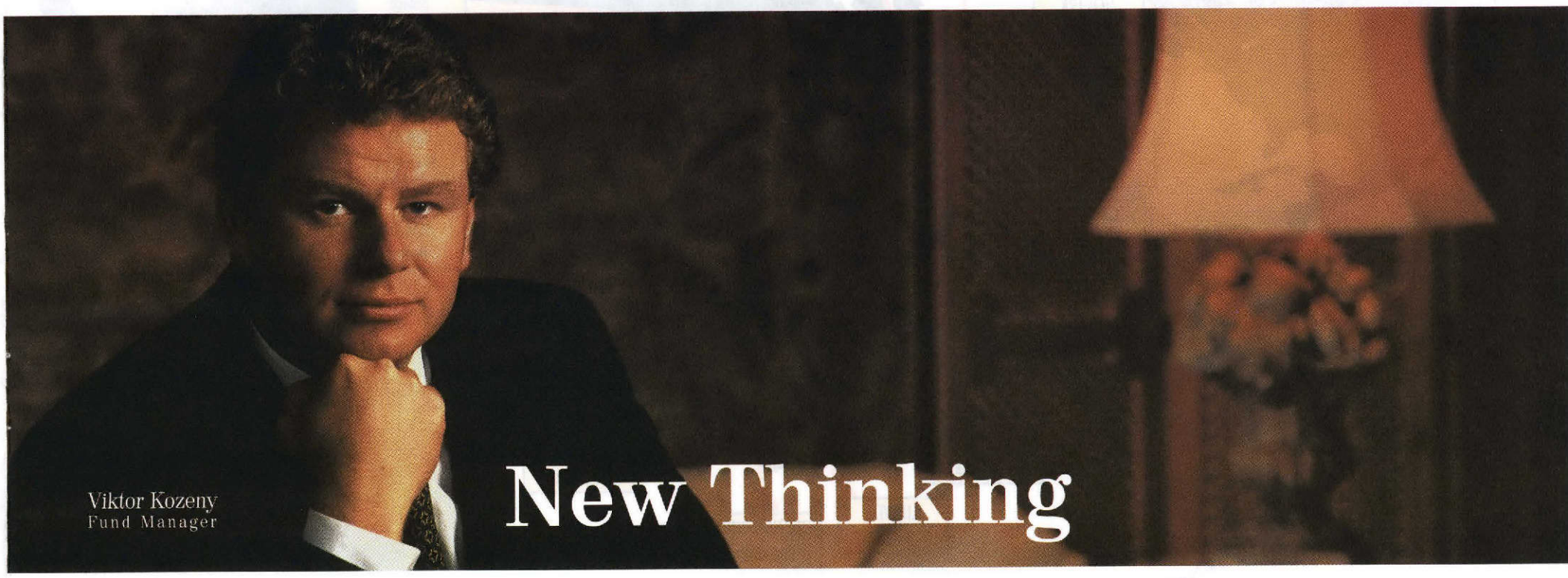

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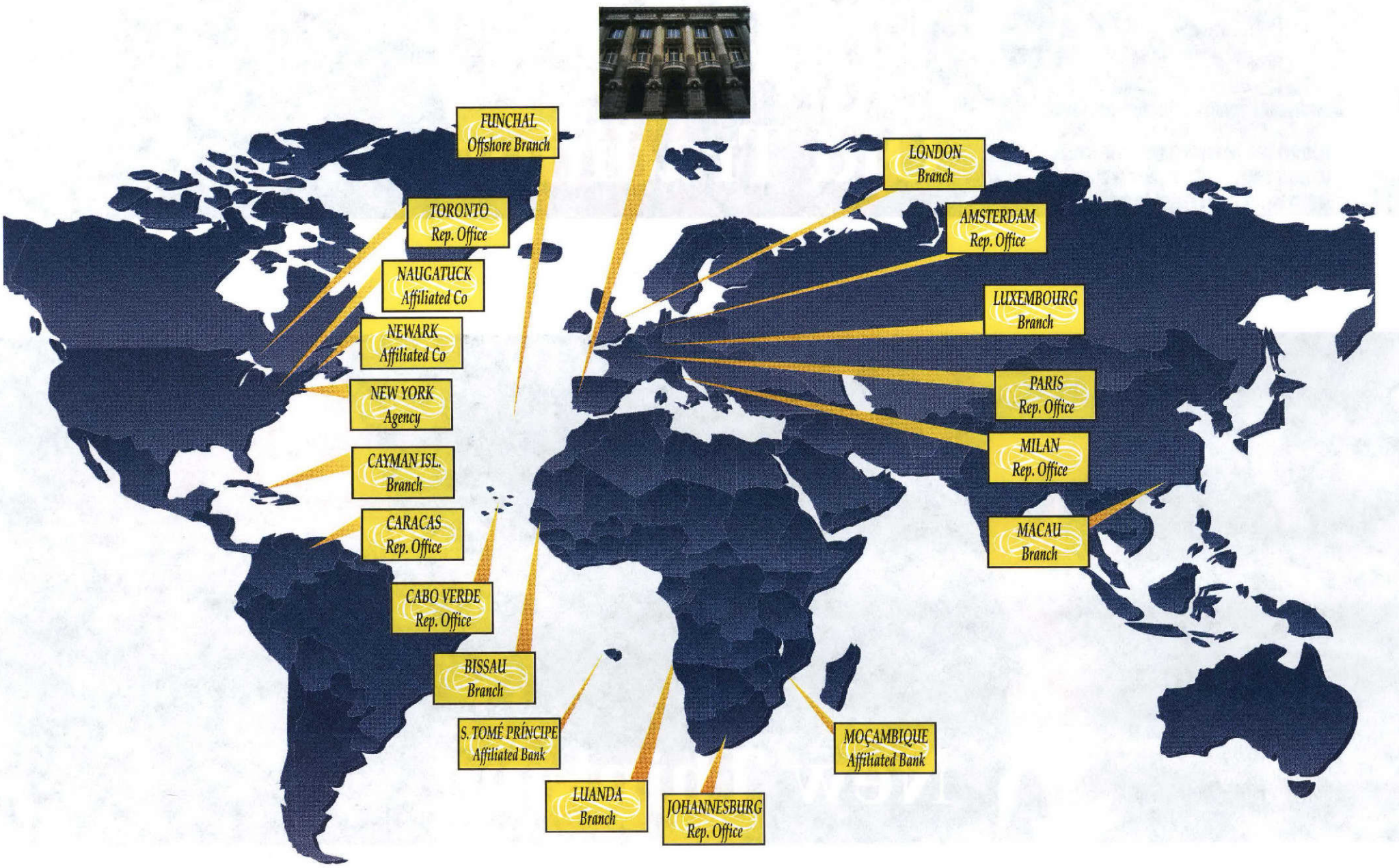

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G7

Tony Blair's "New" Labour Turns Right to Polls

BY ALEX BRUMMER

As U.K. Labour leader Tony Blair continues to push his party farther to the right on a range of issues from education to law and order, it becomes increasingly indistinguishable from the ruling Major administration. Indeed, one senior diplomat in London, sending back a mid-decade political report to his foreign ministry in the Pacific, has dubbed the likely policies of a future government headed by the Labour leader as Blatcherite: Thatcherism with a human face.

Blair, who acceded to the Labour leadership in July 1994 after the sudden death of his dour Scottish predecessor, John Smith, has switched the party to the right with a dogged determination which has surprised both his followers and detractors. He is, however, determined to win the next election — to be held in May 1997 — at all costs by making his "new" Labour Party (as he likes to call it) electable. "The facts are these," Blair states plainly. "It is 25 years since Labour won 40 percent or more of the vote. It is 21 years since we have won an election. By 1996, we will have been out of power for longer than any mainstream left-of-center party in the Western world. The swing required to win at the next election is the largest in any election since 1945," he asserts.

To achieve his goal of leading new Labour to victory Blair has been forced to overhaul the party's architecture and policies. "Transformation has to be at every level: organization, ideology and ideas," Blair says. His goal since taking on the leadership has been to change the reference point for what he calls "radical politics." In Blair's view the objectives of new Labour policy have not changed. They remain much the same as those of other center-left parties. This includes creating what Blair calls "a prosperous and just society." This the Labour leader believes can be achieved by "tackling the evils of unemployment and poverty; coping with massive economic and technological change; [forging] a modern industrial partnership between government and business, and at work between management and workforce; good public services; safer communities; and a political constitution which fits a new age."

Like Newt Gingrich in the U.S., Blair also is very switched into the age of information technology. It is no coincidence that one of the most detailed policy papers that new Labour has issued is focused on how the U.K. can best take advantage of the multimedia changes which are shaping society. "There is a new industrial revolution under way," the vigorous 42-year-old opines. "Information superhighways — the interconnection of computer networks, telephone services and television displays will change the way we work, learn and play...This is not just an issue for techno-freaks or big businessmen, the technology could benefit us all."



Blair: Thatcher with a human face?

©JON JONES/SYGMA

The prime minister-in-waiting, as he is now clearly seen in the U.K., does not plan — like his predecessors — to unpick the Thatcher-Major legacy of privatization and free markets. Instead, he promises to improve and tighten up the regulatory framework for privatized utilities like electricity and water, and to grant new freedoms to U.K. players like British Telecom and Cable & Wireless which have been left at the fringes of the information revolution. Unlike earlier Labour oppositions there are no promises on his agenda to raise taxation — except for perhaps the very richest in society — to pay for welfare programs. Instead, Blair would leave in place the supply-side taxation reforms begun in the Thatcher era and concentrate on microeconomic change.

"I am an unashamed long-termist," Blair argues, when it comes to economic management. "Though the actions of a Labour government will be immediate, they will be aimed at the long term. If this country is to grow in strength in what is an increasingly competitive global market, it must learn the lessons of the past and move beyond its battles." Among the key actions he advocates are raising the standards of education and skills; establishing a new partnership between government and industry and giving more independence of action to the Bank of England so as to rake the inflation issue out of the immediate political spotlight.

Tony Blair's switch of direction, photogenic good looks and willingness to debate new ideas have found tremendous favor with the British public. Most opinion polls show that new Labour would score a Canadian-style victory if the U.K. were to go to the polls today. Some 40 sitting Conservative members of Parliament have voted with their feet by announcing they will leave the House of Commons at the next election. But the Labour leader is taking nothing for granted: "General elections are not won in opinion polls. General elections are won in general elections," he says. EM



Europe Prices Itself Out of Car Market

BY MARK MILNER

Earlier this month, the great and the good of Europe's car industry gathered at Frankfurt's huge trade fair for the biennial motor show. There was the familiar glitter and spectacle, enough indeed to impress the actual visitor. Beneath the surface however, all was not well with the European car industry, not least in Germany.

Volkswagen, Europe's leading carmaker, was facing a series of strikes over management calls for more flexible work rules — designed to boost productivity. Daimler Benz executives talked openly of the need to shift more of the production of its Mercedes cars abroad. BMW announced the appointment of a new chairman at its British subsidiary, Rover — a move which was interpreted as signaling the Munich-based company was planning a more hands-on approach to its management. More generally, there was much hand-wringing over Germany's perceived uncompetitiveness in the face of higher labor costs and the strength of the German mark.

Europe's niche players have survived, but consolidation may yet prove the only option.

Nor will Europe's car makers have enjoyed comments from Chrysler chairman Robert Eaton, that the U.S. is now the cheapest place for vehicle manufacture, with quality levels to match or beat those in Europe and Japan.

Elsewhere, car makers in France and Spain were coming to terms with the scrapping of state-financed incentives which had given the buyers of new cars a handsome trade-in price for their old models.

In the short run, some of the problems appeared less serious than they had been billed. VW reached a settlement with its workforce, trading a 4 percent pay increase for greater flexibility. Figures for August car sales showed it still top of the heap in Europe.

BMW was quick to dismiss speculation that the appointment of the new Rover chairman meant greater control from Munich. Daimler Benz may be having trouble with its aerospace business but in the first half of the year, operating income at the Mercedes car business jumped 45 percent. As for talk about building up the percentage of production outside Germany, Mercedes is far from alone among Europe's carmakers in wanting to see greater foreign output — but as part of a strategy of gaining access to markets like India, China and South America, rather than one of ducking high domestic costs.

Germany's car makers will also have drawn heart from the fact that in August the domestic car market was up 8.8 percent from a year ago, with total sales of 217,000 vehicles — the third monthly increase in a row.

Underlying problems remain, however. Europe's car industry possesses six volume car makers: VW, Ford, General Motors (through its Opel and Vauxhall subsidiaries), Renault, Peugeot-Citroen and Fiat. In addition it has a string of niche players like Sweden's Volvo (recently rumored as a Chrysler bid target), and Saab (where GM has 50 percent and management control), BMW and the Ford-owned Jaguar marque.

So far, despite the competition posed by the Japanese transplants in the U.K., all six have managed to survive. But tougher times are coming. The Koreans are expanding their market share. Towards the end of the decade the "voluntary" agreement over Japanese penetration of EU car markets starts to unwind. Last year Renault saw its merger with Volvo called off at the last moment but consolidation may yet prove the only answer to competition. EM

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Oil Policy

THURSDAY, OCTOBER 12, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 25

Khaddafi Grapples with the Ghosts of Lockerbie

BY JON MARKS

Twenty-six years as a revolutionary leader, almost as long as the West's favorite bogeyman, Libyan leader Muammar Khaddafi has found the formula for holding on to power and making headlines far beyond his scantily populated desert state in North Africa.

His defenders say he is a scapegoat. Critics agree with Ronald Reagan, who called him a "mad dog." Khaddafi argues he has been wronged.

"I know there is a deliberate misinformation campaign designed to distort my image," Khaddafi told a recent visitor to his tent in Tripoli's Bab al-Azizya barracks. "The CIA have been trying to destroy me for years."



©BETTMANN

Khaddafi: mad dog or scapegoat?

Blaming Libya has become something of a reflex. "Libya hasn't had any real power for years — probably not since the early 1970s when Khaddafi's backing for Arab liberation movements, especially Palestinians, was important, and Libyan policy was critical in pushing up the international oil price," says George Joffe of London's School of Oriental and African Studies. "Now it's really just a political football that's convenient to kick."

Khaddafi points to the Oklahoma City bombing, where many in the U.S. immediately blamed Arab terrorists. "The Americans go on about terrorism, yet behind many acts of terrorism both at home and abroad, you'll find the Americans involved — for their own interests," Khaddafi says.

At home, Libya's leader still wields a big stick. Riots in Benghazi, where militant Islamic radicals are said to be leading the opposition, have led some Western analysts to conclude that Khaddafi's days in power could be numbered — once again.

Libyans are not so sure. "In one wave of arrests about 300 or 400 people were arrested," says Mohammed M., a Libyan resident of the eastern city. "Of these, perhaps 30 or 40 were hard-line Islamists; the rest were just students following the trend. Khaddafi has always believed in raising the maximum fears to stop people getting rebellious ideas — that's why so many of us are growing older by being apolitical."

Khaddafi blamed the riots on foreign infiltrators, a common formula in Libya also aimed at winning favor among anti-Islamist neighboring governments, with whom Khaddafi hopes soon to sign a mutual security treaty. Soon after the worst violence, he decided to throw thousands of Palestinians and other Arabs out of the country.

The expulsions were another manifestation of Libya's maverick politics, where support for radical liberation groups and extravagant anti-imperialist statements blend with the ruthless elimination of opponents to create an atmosphere strongly tinged with tragedy and farce, while little concrete information about Khaddafi's *Jamahiriya* (state of the masses) filters through to the outside world.

Most international attention is focused on a question worthy of any political thriller: whether two Libyan intelligence agents were responsible for the bomb on Pan Am flight 103, which exploded over Lockerbie, Scotland in December 1988.

Since the U.S. Federal Bureau of Investigation (FBI) placed two Libyans, Abdel Basset al-Megrahi and Amin Khalifa Fhimah, on its list of "10 most wanted fugitives" — with a reward of up to $4 million for information leading to their arrest — the fortunes of Khaddafi's Jamahiriya and the small Scottish town have seemed inseparable.

"It's difficult to deny that the Lockerbie evidence points to Libya — and if that's so, it is difficult to say that Khaddafi is just a scapegoat," Joffe concludes. Forensic evidence points to Libya, but identification evidence gathered later is less convincing. "There seems to be a clear Libyan connection, but was that Libya acting as a state or two individuals acting on their own account? That is not clear," Joffe argues.

The Libyan state has been targeted over many years, especially since Khaddafi upset Jimmy Carter by giving his support to Iran in the 1979-81 hostage crisis. Joffe believes "What is revealing is how little it has been able to respond."

Khaddafi may be tiring of conflict and isolation. "Bill Clinton has no bad blood with us," he said. "Unfortunately the poor man can't act freely — he's had his hands tied and has been restricted by policies laid out by former presidents who came from the World War II generation with colonialist aspirations."

According to Libyan foreign affairs secretary Omar Mustafa al-Muntasser, "The biggest losers from American sanctions imposed since the Reagan years are American companies. We used to do at least $1 billion worth of business with American companies in the oil sector. We've had to substitute them with other companies."

Khaddafi's solution shows his flare for drama is not on the wane: "I invite Bill and Hillary Clinton to come and live here because Libya is the safest country in the world. I'll send a private plane for them immediately." EM

Eurasia's Future Geopolitics Hang on Pipeline Routes Struggle

BY STEVEN BLANK

Currently, governments and energy executives are deciding the geopolitical and economic fate of post-Soviet states in the Caspian region: Azerbaijan and the Central Asian states Kazakhstan and Turkmenistan. These states possess huge oil and gas reserves that could become the new energy frontier into the next century. But they lack the capital, technology, and infrastructure to explore or produce the energy and, as they are landlocked or far from international waterways, they depend on others to build pipelines to transport it. Because the reserves are so vast and the potential profits so enormous, they could become these states' best chance to attack their terrible economic and ecological crises and become truly economically and politically independent from Russia.

Therefore they have sought to diversify both the exploration and pipeline aspects involved in developing these reserves among many states. This means an orientation to the West and Western consortiums, as well as Iran, Pakistan, China and Japan. It also means that if routes bypassing and excluding Russia are chosen for pipelines and Russia is not part of the consortiums for exploration, it will lose much of its leverage over these states' independence.

For Central Asia and Azerbaijan, diversification and orientation to Western partners offers a chance for growth and independence. For Russia it means the end of empire and Western intervention in its self-proclaimed exclusive sphere of influence. The choice to be made now is of pipeline routes. The routes chosen will then determine much of Eurasia's future geopolitical orientation.

Turkey clearly seeks to displace Russia and become the patron of Central Asia.

There are four options. The first route starts in Central Asia and goes overland through Russia to Novorossisk and from there either to Russian ports in the Black Sea or further overland through Russia and Bulgaria to Greece. The second option is that pipelines connecting Azerbaijani and Central Asian sources would link up to Baku, proceed through Grozny in Chechnya (a major reason for Russia's 1994 invasion of the region), and then go to Novorossisk and Russian ports.

The other two options bypass Russia altogether and enhance the role of Turkey, which seeks to become the middleman, earn handsome transit fees and royalties, and become a major player in the regional status quo. Therefore, Ankara recommends that the pipeline go through the Caspian to Baku, proceed overland through Nagorno-Karabakh as part of a peace settlement there, and go on either to Georgia and the Black Sea or directly to the Mediterranean. Allegedly on ecological grounds, Turkey closed the Bosporous to tankers, forcing Russia to develop the Balkan route. Turkey clearly seeks to displace Russia and become the patron of these states' independence.

Russia has tried everything possible to block those routes. It has fomented coups in Azerbaijan, conducted economic warfare against Kazakhstan and Turkmenistan, interfered in the Nagorno-Karabakh peace process, invaded Chechnya, and, Georgian President Shevarnadze believes, instigated an assassination attempt on him recently. These developments have also led U.S. officials to tell Moscow that Washington will not accept an exclusive sphere of influence in the Caspian and is backing its own peace process in Nagorno-Karabakh.

As the decision approaches, everyone has tried to influence its outcome, and with good reason, as it will be one of the utmost consequence for Eurasia and signifies the return of an intense and durable international rivalry along Russia's peripheries. EM

Capital Markets

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MOROCCO AWAKENS FROM HONEYMOON

BY JON MARKS

The Arab world's most ambitious program, an unprecedented opening to foreign investors, accelerating reforms in the economy and the Casablanca bourse all made Morocco the darling of emerging markets investors in the Middle East-North Africa region. But the honeymoon is over.

Lower than forecast trading volumes this summer in the recently renamed Societe de la Bourse des Valeurs de Casablanca (SBVC) signaled a tired and weakening market.

"Sell and take another look at the end of the year," Blakeney Management, a London-based specialist in Arab-Africa markets, said.

With gross domestic product forecast to decline by around 4 percent in 1995, market fundamentals are looking weaker than for several years. This has been reflected in a steady slice in the value of shares such as the privatized CTM-LN urban transport, the CIOR cement companies and the ONA Group's B shares.

There are fears that a general market slump could develop if drought and other negative factors impact on balance sheets.

Local brokers are talking up the prospects, with forecasts of a further 5 percent growth in the index before year's end. But foreign analysts believe the market needs more regulatory reforms as part of a strategy to build liquidity levels.

"Accelerate the reforms," International Finance Corporation capital markets official Iyad Malas said during a visit to the kingdom. "It is necessary to elaborate on the plans for deregulatory instruments already introduced, but also to modernize the bourse itself."

The privatized bourse is modernizing quickly. The SBVC chose one of the founding partners in the Casablanca Finance Group, Amyn Alami, as its first president. Alami and the group's management, like their colleagues and competitors, including Upline Securities and Maroc Inter Titres, are young and forward-looking.

"The Casablanca bourse has avoided the temptation to keep the old bureaucracy in place — unlike exchanges elsewhere in the region," a London-based analyst says.

To give investors more confidence, a private securities and exchange commission, the Conseil Deontologique des Valeurs Mobilieres, has been established. New accounting standards and settlement procedures have been put in place.

"Sell and take another look at the end of the year."

The launch of 13 mutual funds is intended to give stability to a market whose boom has depended on privatization issues. Thirty-eight offerings — eleven of them in 1995 — have allowed the market to continue its growth, creating a new shareholder community and new managements.

The sale of Banque Marocaine du Commerce Exterieur (BMCE) in June underlined the substantial local and international interest. It prompted an early example of corporate governance when Othmane Benjelloun, an industrialist with substantial financial sector holdings, replaced former finance minister Abedelatif Jouahri as president of BMCE. Benjelloun led the group of local and international investors which purchased a core stake in the foreign trade bank.



© THE KOBAL COLLECTION

Bogey, too, knew it was time to get out of Casablanca

To maintain momentum, privatization minister Abderrahmane Saaidi is pushing through more issues, including the largest industrial sell-offs to date: oil refiners Societe Marocaine de l'Industrie du Raffinage (Samir) and Societe Cherifien des Petroles.

Other companies to be sold include Banque Nationale pour le Developpement Economique (BNDE) and state steelmaker Sonasid.

BNDE has faced problems but Saaidi says he is confident a buyer can be found — and has worked out a solid sales pitch. "True, there are no BMCEs left to sell, but BNDE provides a genuine opportunity — what other vehicle is so well fitted to create a genuine merchant bank in Morocco?" he asks.

Saaidi is working on other instruments to keep the bourse at the center of Morocco's economic take-off. These include convertible government bonds, which would be tradable on the stock exchange. The bonds would be issued at lower rates of interest than other treasury paper, but would give their holders priority in buying privatization shares.

The next few months will be testing, but the SBVC should prove sufficiently robust to withstand the strain, With issues like Samir and mutual funds boosting activity, and the potential for more of Morocco's larger, often family-owned groups to come to the market, the Casablanca bourse will continue to play a crucial role. EM

Tunis Bourse Excites and Disappoints

The bull run on the Tunis stock exchange, the Bourse des Valeurs Mobilieres (BVM), yielded substantial profits for those involved. But analysts say it is over for the time being — just as the market opens wider to foreign investors.

The BVM index moved up by about 25 percent in the first eight months of 1995, fueled by short-term speculation in public share offerings, known locally as OPVs, for companies including Banque de Tunisie & des Emirats d'Investissement (BTEI) and national carrier Tunisair.

"Everyone is discovering the stock market in Tunisia these days," said Khemais Bhejaoui, the bourse's head of trading, as applications flooded in for BTEI stock.

The BTEI issue in August was five times oversubscribed, creating 140,000 shareholders — and meaning that for the first time a local company has a broad investor base.

The sale of 15 percent of Tunisair was another success, with the initial TD23.5 ($25.2) price on July 24 rising to TD38.73 by August 25.

BTEI and Tunisair showed that using the stock market could develop popular capitalism and promote privatization. But the government has reservations about its uses.

"The stock market is one instrument for bringing in investment but for now we are more concentrated on joint ventures."

"The stock market is one instrument for bringing in investment and its time will come, but for now we are more concentrated on encouraging joint ventures than takeovers and our privatization will mostly be achieved by other means," the influential international cooperation and foreign investment minister Mohamed Ghannouchi says.

Tunisian analysts say the creation of a new watchdog agency to control the BVM —headed by Tijani Chelli, a 65-year-old former minister who started work in September — will usher in a period of stability following the BVM's fifth year of sharp gains.

Others question whether plans to create a privatized BVM are moving ahead quickly enough to provide the cutting edge necessary to make the exchange a leading player in Tunisia's market take-off.

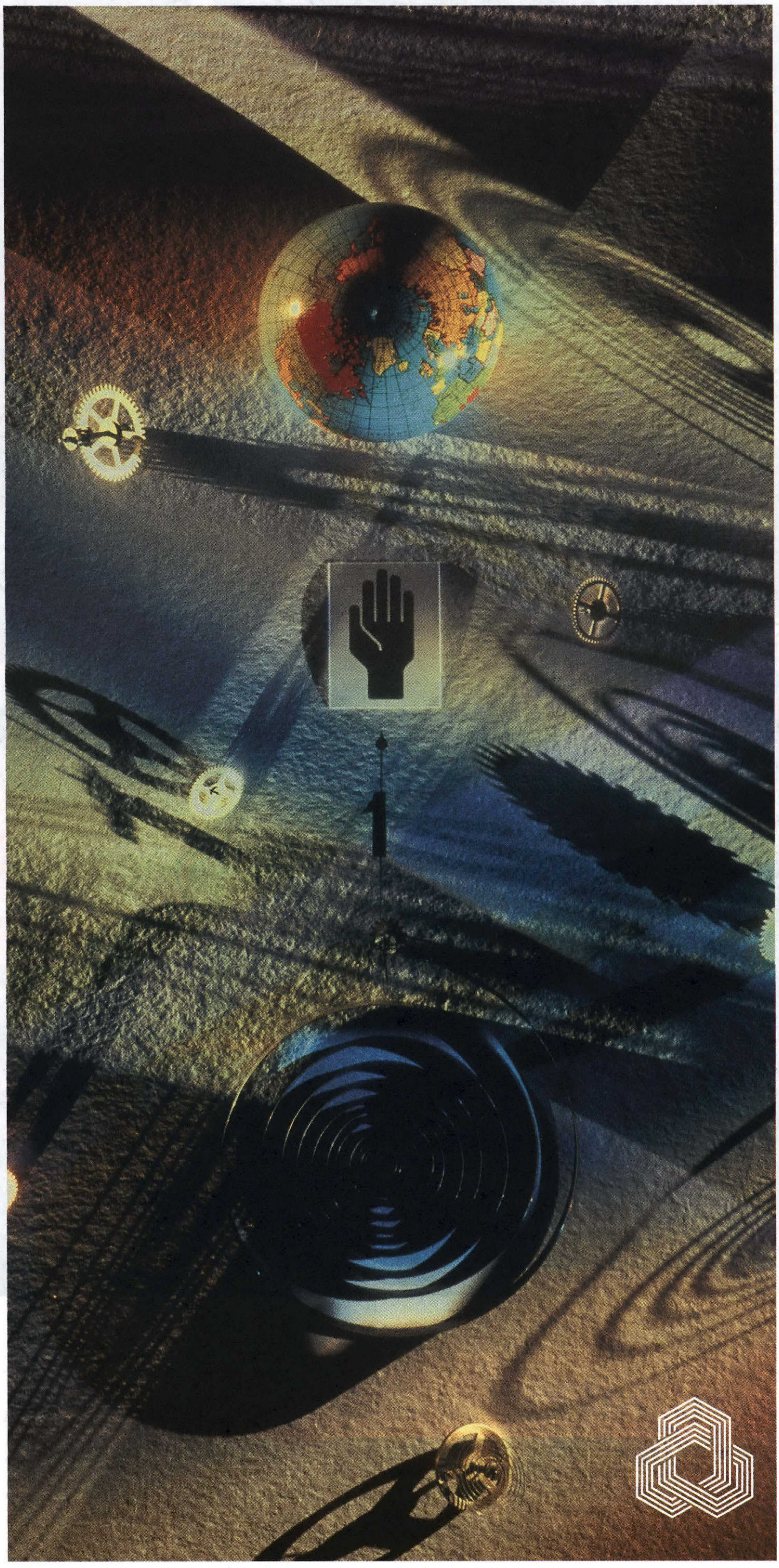
Chelli's reputation is as an effcient administrator. He will work with a new BVM president, still to be appointed, who will replace finance ministry official Ahmed Hadouej, who was blamed by market-makers for recent problems. "Mr Chelli's role is now to cool things down," says one local broker.

One problem is that share values do not often reflect the performance of quoted companies.

An OPV launched by Societe Frigorifique & Brasserie de Tunis (SFBT) brought dizzying gains for investors, but, as the local Compagnie Generale d'Investissement noted, at the same time the bottler's share of the local soft drinks market fell by 10 percent.

By November, a whole package of reforms will be in place, finance minister Nouri Zorgati told *Emerging Markets*."When these are in place, the bourse will follow the laws of the market." EM

— Jon Marks



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IMF Update

THURSDAY, OCTOBER 12, 1995 EMERGING MARKETS IMF/WORLD BANK DAILY PAGE 31

Fund Speaks — But Softly — Against Corruption

BY CHRISTINA KATSOURIS

Some weeks ago, a senior IMF official took the unusual step of drawing public attention to the Kenyan government's failure to conclude a court case over a three-year-old charge of gold export compensation fraud. The case had angered donors and stalled aid flows to a country where many senior officials are renowned for world class corruption.

The move was unusual because the fund, while happy to don boxing gloves in private negotiations, rarely speaks out on specific cases of "economic misgovernance" — its euphemism for corruption.

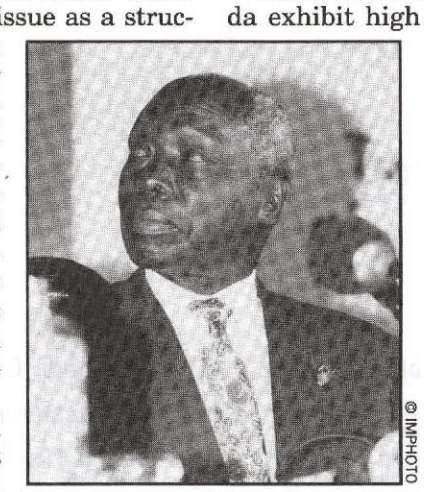
Though couched in IMF-style understatement and prefaced with a list of Kenya's reform achievements, the message was clear. Lack of financial accountability was holding up negotiations for an enhanced structural adjustment facility and other donor funds.

Does this mean that the IMF is strengthening efforts to reduce corruption, and will begin to speak out as a matter of policy? Yes and no, according to IMF insiders.

Its position on corruption has not changed. The IMF says it fosters good governance by promoting transparent mechanisms for resource allocation and public accountability while discouraging price controls, tax exemptions and other interventionist policies that provide opportunities for misgovernance.

However, it appears set to confine public criticism to "appropriate occasions," according to sources at the institution. They would not be drawn on how such occasions are to be defined.

The definition of guidelines for public criticism is a thorny issue which raises many questions of style and substance for donors. Most donors approach the issue as a structural rather than a moral problem. For example, in its euphemistically entitled pamphlet "Unproductive Public Expenditures," the fund states that public sector corruption can be caused by low public sector wages and inadequate wage differentials.



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Kenya's Moi: an IMF scolding

The fund will nudge a government where lack of good governance "weakens the government's capacity to carry out policies and undermines external financing of programs," and its position on Kenya is consistent with this approach. Other donors intervene in similar situations, and where corruption is seen to be causing serious damage to an economy.

However, intervention can only be effective where donors have muscle. In some cases they face complex dilemmas in how to use that leverage. Officials recognize that no government is pure and that it would be dangerously counterproductive to pull funds where benefits from reform momentum outweigh the damage caused by corruption.

Favored reformers such as Uganda exhibit high levels of corruption, yet donor money continues to flow generously. This is partly because the government's reform program, to which it is strongly committed, is removing the structural factors that promote corruption. Moreover, such activities are not destroying the economy — as they have done in Zaire and are doing in Nigeria.

However, donors appear relatively powerless to act in some cases. One example is Ecuador, which currently has sufficient reserves to carry on its own sweet way. Just as important, corruption has so far paralyzed politics rather more than the economy.

Ecuador's vice president faces impeachment charges on corruption grounds, partly because he expressed frustration at having to bribe congressmen to pass legislation. The impeachment is the lawmakers' revenge.

Bank and fund officials believe that their interventions have already done much to reduce corruption, and there is much evidence to support this. In reforming African countries, there are clear signs that the removal of price controls has eliminated parallel markets, where goods were bought by well-connected people at low fixed prices and sold for a profit on the black market.

The removal of import licensing has also reduced rents on trade. Exchange rate liberalization has widened access to hard currency and reduced the parallel market premium on it.

However, at the same time, new economic reforms are delivering fresh corruption opportunities, particularly in privatization, where officials in many countries are using their privileged position as insiders to line up sales for themselves and their partners at bargain basement prices before enterprises go on the market.

This has not gone unnoticed by donors. But for the most part, they don't mind too much, as long as the process is kept under control. "There's a good argument that it is better to rid the state budget of these drains on resources once and for all — and quickly — than to hang on to them in the interests of a fair sale," says one aid official. EM

CHURCH SETTLES $23mn IMF INFRASTRUCTURE DEAL

BY K. MICHAEL FRASER

Negotiating an agreement with the IMF has caused riots, toppled governments and cost a cadre of economy and finance ministers their jobs. But the minister of Washington's Western Presbyterian Church is more than pleased with the deal his congregation made with the fund.

To acquire a site for its new building, the fund bought the church, found a new location for the congregation and built them a brand new church in an arrangement the IMF values at $23 million.

"It was a great deal," pastor John Wimberly has reportedly said.

Avis Hatfield, the pastor's administrative assistant, was also pleased with the results of the negotiations. "If it hadn't been for the IMF, this congregation wouldn't be in existence now," he said. "The church was falling apart. It needed to be rewired and replumbed, and we didn't have the money."

Like many IMF negotiations, this one dragged on. But this arrangement took more than two decades to settle — long even by IMF standards.

When the fund originally acquired land for its headquarters two blocks from the White House, it tried to buy out the church, which owned a quarter of the block at the corner of H and 19th Streets. But the church refused.

In 1972, the fund opened its main building, which covered half the block bounded by G and H Streets between 20th and 19th Streets.

A deal still hadn't been reached by 1982, when the IMF expanded to cover the whole block except for the church's quarter.

But as many countries have learned in hard times, you can't say no to the IMF forever.

According to fund spokesman Graham Newman, in the late 1980s the congregation finally agreed to a deal under which the IMF found a new site for the church, constructed the new building and established a $5 million endowment to finance the church in perpetuity.

Like its former incarnation, the new church seats approximately 450. It opened a year ago at 2401 Virginia Street NW, only a few blocks from its original location.

By the end of 1995, the IMF expects to be laying foundations for the third expansion phase of its headquarters. For now, staffers are housed in leased offices, mostly in the International Building. Construction should be completed by early 1998, and the fund calculates that having staffers in its own building rather than rented space will save it enough to recoup its $118 million outlay, including the $23 million to acquire the site.



© RAFOTO

The fund's own infrastructure

"It will finish off the project we started in the mid 1960s," says Newman. "[The new building] won't be particularly opulent. We're not expecting any Carrera marble." The building will consist almost entirely of offices, although some space has been sacrificed for "a small atrium — but nothing as big as we have now," says Newman.

A few blocks away, the Presbyterians are happy with their new church. "It's a beautiful building," says Hatfield. "The IMF duplicated about what we had. They brought over the same pews, and the sanctuary has been duplicated. The only thing we have more of is room for offices and space for Christian education."

The church also has more money to carry on its work. The congregation, which numbers about 200, is active on social issues. It recently won a fight to open a soup kitchen, over the objections of some of its neighbors. So the church will be able to go on helping the poor, which is more than many countries can say after negotiating an IMF deal. EM

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Percy Barnevik
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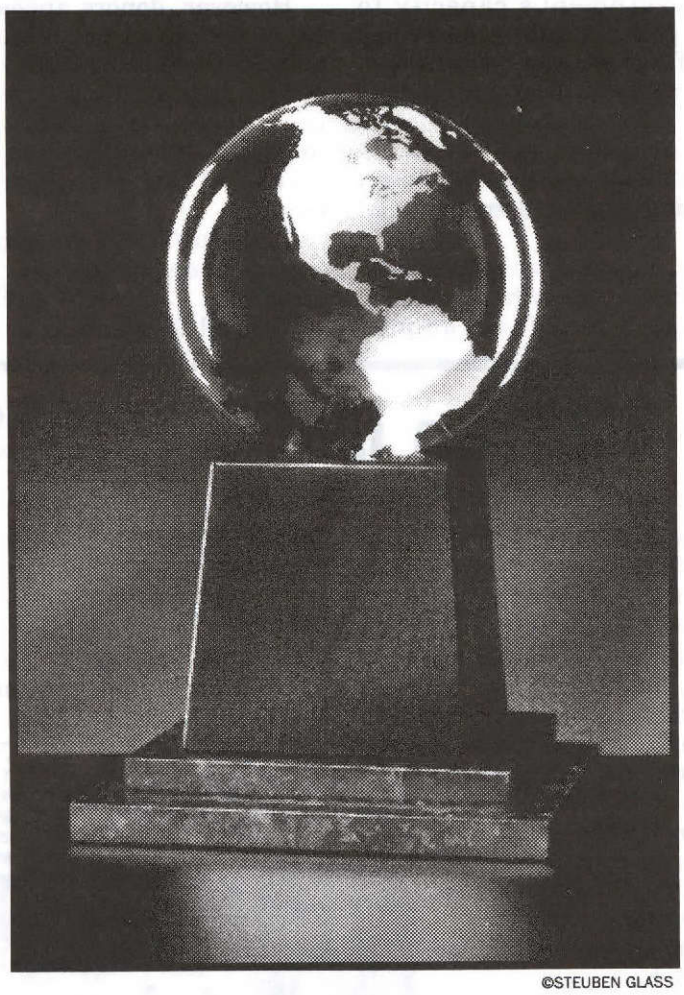
Stan Shih
The Acer Group

Percy Barnevik, President and Chief Executive Officer of ABB Asea Brown Boveri Ltd. received the Award for the chief executive of a company headquartered in the developed world, whose expansion into emerging markets has best shown how these markets can contribute significantly to corporate revenues and profitability and has produced benefits for both the countries involved and the corporation in question.

Stan Shih, Chairman and Chief Executive Officer of The Acer Group was elected winner of the Award for the chief executive of a corporation headquartered in one of the world's emerging economies whose vision and company performance has best shown the pattern that can be offered as a model to other emerging markets companies around the world.



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Two years ago, International Media Partners, publishers of Emerging Markets and parent company of the CEO Institutes, and ING Bank, the leading financial institution in emerging markets worldwide, joined to establish two important new Awards.

The purpose was to recognize the sea change in developing economies as countries have gone from debt rescheduling and aid support to a new world of liberalization, privatization, trade agreements and stock exchanges. Traditionally, recognition has reflected on the policymakers and planners of these economies. The rational behind these unique Emerging Markets CEO Awards is to reward the true builders of these markets — businesses and business leaders with vision.

Nominations for the Awards were solicited from around the world and the elections were made by an independent Selection Committee comprised of corporate leaders, institutional investors, government officials and multilateral executives. The Committee's decisions were final. The Awards were presented on October 9 during the joint annual meetings of the IMF and World Bank in Washington, D.C.

IMP and ING Bank are delighted to have such worthy recipients of the 1995 Awards and look forward to continuing the tradition in 1996.

Copies of the winners' citations, the list of the Selection Committee members, and details on this and next year's Awards are available by contacting: Richard Burns, President, International Media Partners, The Cable Building, 611 Broadway, Suite 300, New York, NY 10012. Telephone: (212) 995-9595. Telefax: (212) 995-9389.

Features

PART V: USAID SURVIVES DEATH THREATS

BY ROB WRIGHT

The hangman's noose was ready. The gallows had been built. The crowd of morbid onlookers was starting to gather. But the U.S. Agency for International Development (AID) has been granted a stay of execution — at least for now.

When the Republicans took over Congress in January, Washington was full of talk that AID faced elimination. Whatever domestic constituency it once had seemed to be long gone, making it highly vulnerable to the budget cutter's ax. The Senate foreign relations committee chairman, arch-conservative senator Jesse Helms, demanded that it be merged into the state department, along with two other agencies, and essentially disappear. The move gathered steam in June, when the House of Representatives passed a bill calling for just that.

But here it is October, and there are no wrecking balls coming down on AID headquarters. Although its long-term survival remains in question, the U.S. bilateral aid agency — if existence alone is the measure of judgment — looks safe at least for the next year. The budget reductions Capitol Hill is imposing, however, threaten progressively to emasculate AID's core programs. If the process keeps going for many more years, there may not be much left worth retaining.

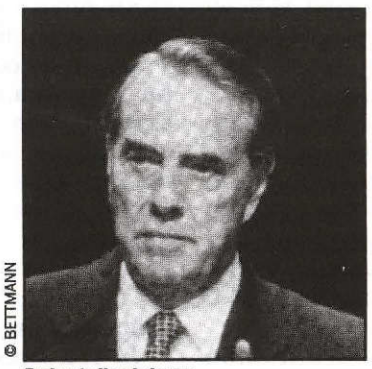
As Washington's fiscal year budget battles ground down in late September, the House had already approved an appropriations bill cutting AID's overall budget back to $11.9 billion from the prior year's $13.5 billion, showing no concern for the Clinton administration's request of $14.7 billion. With senate action unclear, the final figures remained uncertain, but were unlikely to be too far removed from those levels. Actual bilateral aid is likely to fall to $5.8 billion next year from $6.5 billion. Many of the cuts were set to slice long-term development assistance accounts by 20 percent or more, such as Africa programs that could be cut from $800 million a year down to $650 million.

Congressional Republicans argue that 40 years of foreign aid has little to show for itself in Africa and other low-income regions, and no longer deserves priority in a U.S. view of the world marked by harsh federal budget realities. AID chief Brian Atwood has been vociferously arguing just the opposite. He links aid programs to the larger U.S. foreign policy agenda, calling the developing world a "simmering cauldron" full of major national security threats such as terrorism, drug trafficking, and potential nuclear proliferation that aid dollars can fight. He is putting up a good fight, but only meeting with limited success.

"Military preparedness must still be the foundation of our security, but the weapons of the Cold War are no longer sufficient," he said in September. "New weapons are needed: development assistance, a diplomacy of crisis preventions, and deterrence that works not by fear but by example — the example to one struggling country that development in another, once equally-poor country can succeed."

The agency's budget battles are hardly new, but are more intense this year than ever before. For the past two years, Atwood has begun to scale back the agency, closing several missions in Africa and dropping holdover programs that had fallen low on the priority list. He quickly learned this year, though, that he hadn't cut nearly enough to satisfy his new overseers on Capitol Hill.

"Atwood had been trying already, but he must continue to show that he can make even stronger reforms or else he will be reorganized out of existence," warned Rob Buchanan of Oxfam-U.S., a non-profit group that has tried to show support for the agency and its objectives in this year's difficult political climate. His biggest concern: that the current Congress is increasing military sales to poor countries at the same time it is cutting back on aid programs that could address root causes of war like poverty, income inequality, and scarcity of natural resources.



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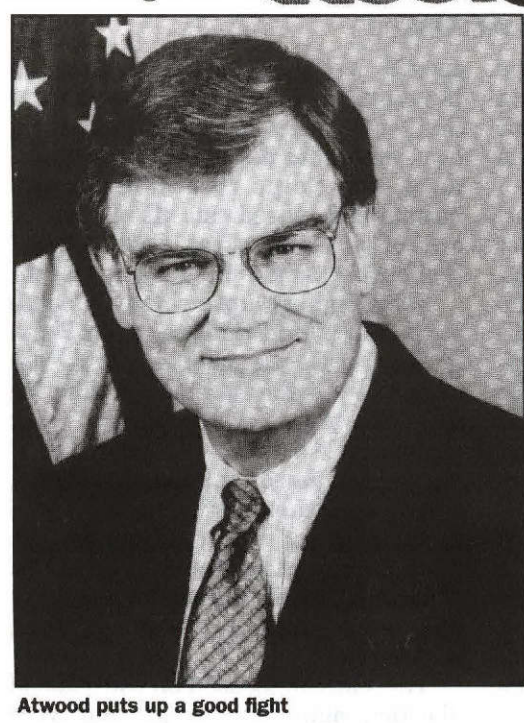
Dole: talked down

"Look at where our money is being cut from, that's what counts," added AID spokesman Russell Porter. "The message that they're sending in Congress is that they're taking an unbalanced approach to foreign policy. It's a very short-term approach and does not face any of the long-term challenges we're facing."

As noble as its poverty-fighting objectives may be, it's no secret that AID is widely held in low regard even in the development community. Charges fly about its bureaucratic nature, lack of financial resources, excessive reliance on consultants, and chronic inability to make decisions. Even with those complaints, groups closest to its work still want it to keep going, fearing that once its agenda disappears in Congress, it will never come back and hundreds of millions of poor worldwide will suffer even more.

DEVELOPMENT ASSISTANCE



Atwood puts up a good fight

"We've not been thrilled with the way AID has performed, but we do think there is a need for a long-term U.S. development assistance program," Buchanan said. "We think AID can be reformed, but what it should be is less political, not more."

The current Congress is increasing military sales to poor countries at the same time it is cutting back on aid programs that could address root causes of war like poverty and scarcity.

The issue of further politicization at what was once the world's largest source of foreign aid money is the one that irks development professionals the most. The bill the House passed favors killing AID as an independent entity and merging what few functions remain of it into the state department, along with the U.S. information agency and the arms control and disarmament agency. Major staff cuts would occur as a result, with the state department's regional bureaus left in charge of the various surviving assistance programs that would then lack a central coordinator.

Like many other drastic proposals, however, this one ran aground in the chaotic atmosphere of the U.S. Senate. Helms had gotten those same terms through his committee, but when it came time in July to take to them to the necessary vote before the full Senate, a blockade emerged in the form of a Democratic filibuster. House rules do not allow such talkathons to hinder floor action. Senate majority leader Robert Dole lacked the necessary two thirds vote to stop the verbal onslaught and eventually decided to give up and pursue more important legislative issues instead. The agency's death threat has not come up since, and few think it will again in the near future.

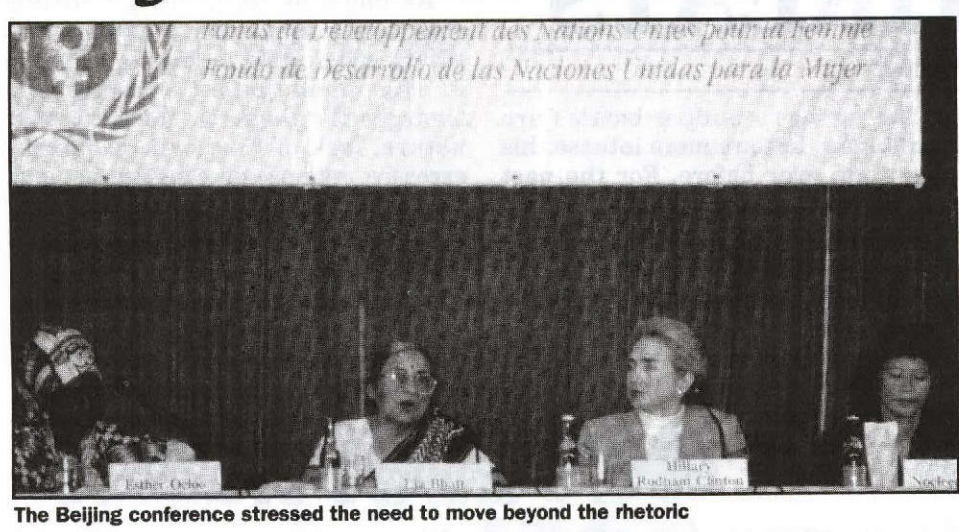
"We're glad that effort failed, because it meant AID would be overseen by people whose interests are and have to be political, not long-term developmental," Buchanan said. "For development to occur you really have to look over the long-term — 10, 15, 20 years — but if you give resources to political people, they are by necessity going to have short-term political objectives: one to two years, or at most the four years of their administration."

So, while it may still exist, AID is now left wondering whether it will have enough of a budget to do its job in a future when it can count few friends in the majority party of Congress. Its ability to retain top caliber staff in such an environment will be thrown into question, as will its ability to build much new support internationally.

"If we are to mount a policy that helps to create a world in which we would want to live 20 years hence, we must allocate the necessary resources now," Atwood insisted. "Our national security — in the broadest sense — depends on it. Sadly the debate that is now coming to a head in Congress has been mainly a budget debate. It has not really addressed national security, nor has it involved the American public." EM

Features

Part V
Challenge to THE SYSTEM



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The Beijing conference stressed the need to move beyond the rhetoric

Women Raise a Global Voice

BY JOANNE OMANG

I need no persuading that women are absolutely central to sustainable development, economic advance and social justice," World Bank President James Wolfensohn told the closing session of the UN Fourth World Conference on Women in Beijing. "All the evidence tells us that not to empower women is a tragically missed opportunity — not only to create a more just, but also a more prosperous society."

The concept of women's human rights now fronts any assault on poverty, including the bank's. But for much of the world, that is still a fairly revolutionary notion. Many nations had reservations about the Beijing conference platform of action, and if the thousands of women there remained dry-eyed at its passage, it is because they have heard sweet rhetoric before.

No UN pact is legally binding upon nations, and the bank must have member backing for its initiatives. Many nations will do nothing, and even the best-intentioned governments must negotiate women's rights packages past their own versions of Senator Jesse Helms, the immovable object in the path of U.S. women's drive toward equal rights.

Wolfensohn, too, is sure to face opposition in any attempt to convert his words to real policy change. He pointed out himself that the bank's chief lending arm to the world's poorest nations, the International Development Association, is the bank unit likeliest to benefit women, yet it is having trouble getting member nations to come up with funds for its latest replenishment.

In many nations, not all of them impoverished, women live in virtual bondage to men. Worldwide, they are routinely beaten or killed; forced into sexual slavery abetted by state authorities; deprived of education, health care, property and civic rights; and barred from voting, holding office or getting loans. These practices are often defended as cultural or religious tradition, but UN and World Bank statistics are stark: an estimated 60 million women are "missing" from the populations of China and India, presumed victims of female infanticide. Because of discriminatory feeding and health care, girls' mortality is globally far higher than boys': 77 percent higher in Bangladesh, for example.

"Much of the work women do is not valued — not by economists, not by historians, not by popular culture, not by government leaders."

Girls' school enrollment rates are far lower than boys' in 68 of 83 developing nations. As a result, women's education, land ownership and income levels are all a fraction of men's; of the world's poorest 1.3 billion, 70 percent are women. At least 85 million women have suffered genital mutilation. One in five American women will suffer a sexual assault.

In retrospect, the economic effects of all this seem obvious. If half a population is crippled by ignorance, injury, ill health, poverty and political repression, any nation will operate at half-speed. One small UN agency, the UN Development Fund for Women (Unifem), had been giving grassroots women's groups direct assistance for nearly 20 years on this theory, but its work was ignored, its share of nations' voluntary UN contributions nearly invisible.

However, in the late 1980s and early 1990s, it was politically incorrect to promote women's rights as good business, rather than for its own sake. Without invoking economics, a coalition of more than 800 women's groups worldwide launched a petition drive to put these findings on the agenda at the 1993 United Nations World Conference on Human Rights in Vienna — for the sake of simple justice.

It worked. Conference delegates not only took up the issue but declared that abuses of women were abuses of human rights. They called for the appointment of a special UN rapporteur to monitor women's human rights worldwide.

That, of course, meant money. Countries prone to resist rights for women argued immediately that they could not afford it. The women's movement needed ammunition against that argument.

In a little-noted 1992 speech in Pakistan, the World Bank's then-chief economist Lawrence Summers had put a startling economic value on women's rights. "Investment in the education of girls may well be the highest-return investment available in the developing world," he said.

Loans to women's small businesses are almost invariably profitable and stimulate instant growth, he said. Increasing women's options in life leads to lower birth rates and infant mortality, better family nutrition and health, higher family income and, simply put, improvement in every desirable social and economic indicator, he said. Bank studies had shown this.

The economic impact of women's situation became Topic A. Further research has backed Summers' report. "A bank study of successful microcredit programs for women in Bangladesh, for example, has shown that with a loan as small as $100 to a poor woman to develop her own business, she helps to double family income and indeed can lift her family out of poverty after five years," Wolfensohn said in his Beijing speech.

Such findings upset many. Debate at the UN World Conference on Population and Development in Cairo last year revolved almost totally around the definition of women's rights and what women's role in the world should be.

Are human rights really universal, several governments wanted to know, in effect asking if some people are more human than others. Why affirm women's human rights when men's rights are routinely abused as well, others asked.

The Vatican focused on the issue of abortion rights, as though that were the only right in question. Major media outlets said the proposed platform of action called for far too radical a change in women's roles for most countries to swallow.

In what must have seemed an unkind cut, many women attacked the World Bank and the IMF, not only for historic inattention to women's business but for structural adjustment "belt-tightening" orders that have too often slashed education and social safety-net spending that affect poor women most.

When the smoke cleared, the Cairo conference admitted the truth of all the studies and declared that improving women's lot is central to slowing population growth and to achieving sustainable economic development. Even the Vatican endorsed the basic finding.

The Women's Conference in Beijing was a celebration of these rhetorical victories and a demand for laws, appropriations and regulations in every nation to put them into effect. Unifem should get a lot more money, the conference agreed.

"We need a new definition of economic development that provides for women's empowerment," said Noeleen Heyzer, Unifem director, in a Beijing interview. "Women must have access and control over the means to make a living on a sustainable and long-term basis. This includes access to credit, job training, technology and equal rights and benefits."

U.S. First Lady Hillary Rodham Clinton agreed. "Much of the work we do is not valued — not by economists, not by historians, not by popular culture, not by government leaders," she told the assembled world delegations, to loud applause.

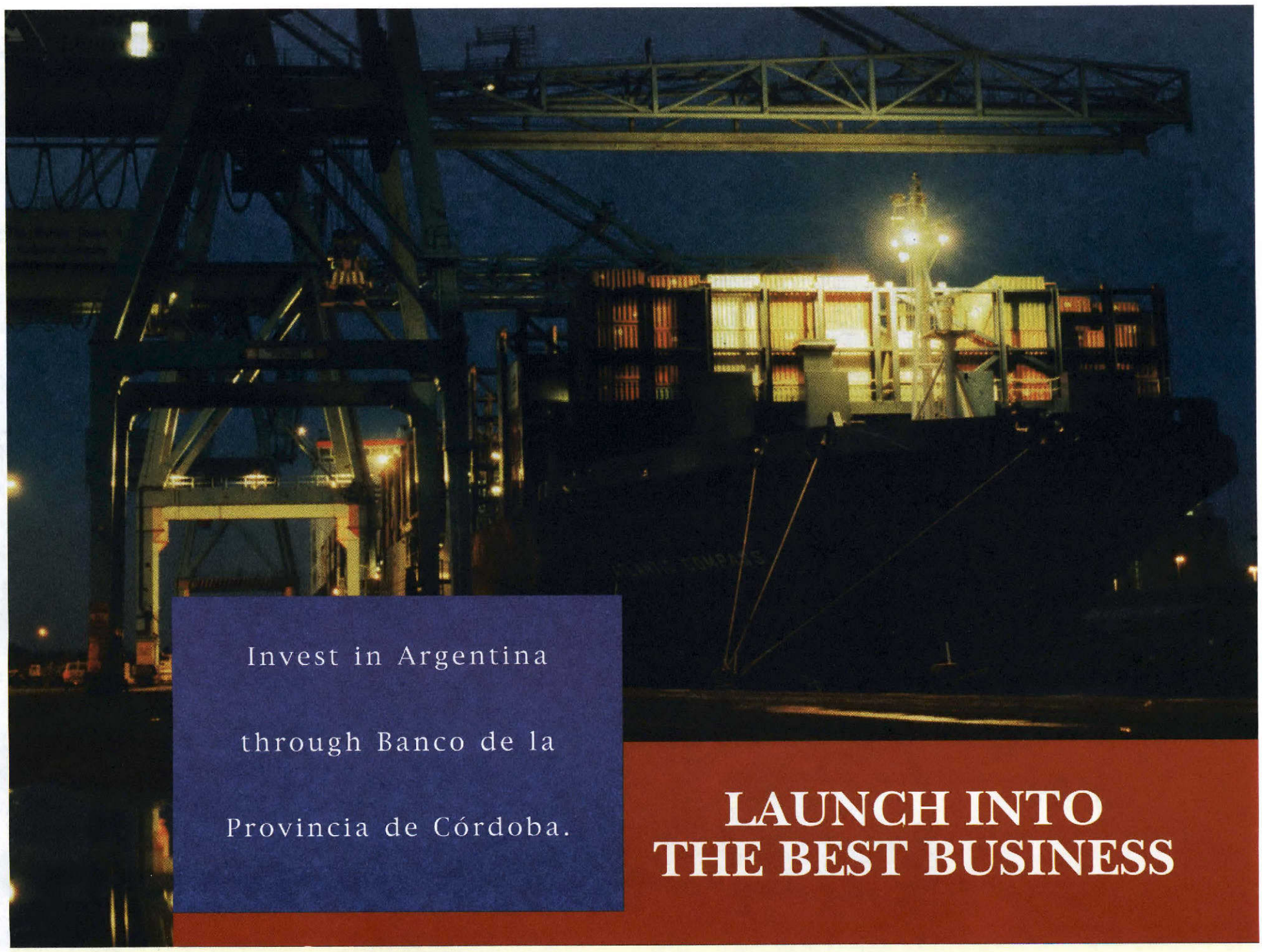
Wolfensohn's speech became part of the chorus. Saying he was "well aware" of women's complaints about the effects of structural adjustment on them, Wolfensohn promised to be "vigilant and more sensitive" on the issue. "You can be certain that my colleagues and I will listen to you when you raise particular issues of concern," he said. "We want no unfeeling nor automatic conditions. We will be specific in our plans and match economic with social considerations in the programs we support....

"The World Bank stands with you. We will commit our finance and our energy as an advocate and a partner in the fight for equity."

The fight will be lengthy. Consider the blithe remarks of Libya's assistant secretary for women, Nura Ramadan, to the Beijing conference:

"Twenty-six years ago this month, Libyans and especially women were liberated from all forms of oppression, coercion and exploitation," she said. "Any distinction between women and men in political, economic and social rights is a blatant injustice. However, the distinction between them in duties preserves the humanity of [Libyan] women and reflects a correct undertaking of their biological constitution."

Such surreal support is common. The fact that women's rights are good business may lift the concept over the doorsill in Libya and other places, but it will be a long walk from there into the legislative record books. EM



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Features



RUSSIAN PRIDE & WESTERN PREJUDICE

BY CRAIG MELLOW

Can the Balkans do it again? Can the narrow, intractable conflicts of the southern Slavs ruin relations between greater powers who otherwise have nothing to fight about?

The answer from Moscow seems mercifully to be, no. Russia's vanity was unquestionably wounded last month when Nato bombed the Bosnian Serbs against its will. Reformers and nationalists united behind a parliamentary demand for the head of pro-Western foreign minister Andrei Kozyrev. President Boris Yeltsin kept Kozyrev, but did a bit of his own foaming at the mouth.

Yet most Russians in or out of the power elite could not care less about the Serbs, who spent the Tito years spitting on their elder Orthodox brothers at every opportunity. No more than a hundred fanatics turned up for a Death-to-America style rally outside the U.S. embassy. Countless millions stayed home and watched Russian television's new smash hit, Dynasty.

Yet the dust-up over the Bosnian bombing was a potent warning that the relationship which might reasonably be considered the linchpin of world peace has been carelessly set adrift, or perhaps sacrificed to lesser ends. Russians do care about the prospect of Nato marching up to their doorstep. They care still more about their 25 million brothers (the relationship is often literal) now resident in sovereign states of the "near abroad."

Both passions could spell the end of friendly relations with the West, if not the return to hostile ones. Where Western and Central Europe see a sovereign right to ally in Nato, Russia sees unprovoked aggression.

Liberal Russians, as well as others in the former Soviet Union, fear the launching of a vicious cycle. The more the West fears aggressive nationalists taking power in Moscow, the more its policy tilts toward neo-containment. The more its policy tilts, the stronger the nationalists' argument becomes.

Some fading of the honeymoon feeling between Russia and the West circa 1990-92 was of course inevitable. The post-reform economic contraction proved much longer than most Russians expected (although it may now have ended). Reformers consequently lost political strength, and the example of their EurAmerican friends lost some of its allure.

Yet many Westernizing Russians complain that G7 policies have accelerated the slide. The first broad irritant was a failure to engage Russia where engagement might have mattered most, by a concerted campaign to make use of its advanced technology. Three years ago Russian scientists waited for a flood of joint projects in space, lasers, nuclear science and other disciplines where their qualifications were unique. The U.S. Pentagon, among others, trumpeted intentions to this effect.

What they got instead was lingering COCOM sanctions, threatened anti-dumping actions on Russian uranium, and a diplomatic fuss whenever Russia did manage to sell an advanced system abroad — whether rockets to India or Mig29s to Malaysia. The consensus reaction in Moscow is expressed by Mikhail Gerasyev of the arch-Westernizing Institute of USA and Canada. "The United States," he says, "has clearly decided it is not in its interest that we develop as a high-technology power."

The Nato issue is far more emotional. Only a few kooks so far see the alliance's new commitment to expansion as code for the Poles and Germans ganging up on Russia. But all but a few Russians see it as a punishment for something they have not done yet: elect a fanatical nationalist leadership. They also note that Nato membership is a much cheaper way to please the Eastern European countries than letting them into the EU. "I understand that this is in the Czechs' interest," comments Yevgeny Bazhanov, vice-rector of the foreign ministry's diplomatic academy. "But I don't think the Czechs should dictate United States policy."


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No fanatic nationalists yet: Yeltsin flanked by defense and prime ministers

The Russian policy elite also perceives Nato expansion as breaking an important bargain. Mikhail Gorbachev himself has said he agreed to the reunification of Germany partly thanks to a pledge from George Bush that the alliance would not come East.

Of course, Russia has substantially contributed to its own disappointments. It grossly overestimated what it had to contribute in advanced technology, and jealously guarded what was truly valuable.

Russia's diplomacy with the former Warsaw Pact countries has also been disastrous. As anybody who has shopped lately in Moscow knows, there is a pretty fine economic fit between Russia's resources and market, and budding Czech, Polish and Hungarian manufactures. But Russia's political elite is too full of foolish pride to sell itself as a more amenable commercial partner than the capricious EU. Wedded to the great power delusion, Moscow has looked straight through its freed colonies to what it considers its equals in the West.

Indeed, this is the heart of the matter. Russia hoped to be treated by the West as what it lately was, the world's number two power. It viewed its economic problems as somewhat akin to the debt Louis XIV left France after his death. The detail of unpaid bills could not essentially diminish the might the country gained racking them up.

The fashion in the West, however, is to assess power economically. By this scale, Russia was one more wreck which if it took its IMF medicine might attract enough investment to make it an important market within a generation or two. Naturally all those missiles persuaded the multilateral mandarins to bend the rules a bit, but Russians wanting to know where they really stand need go no further than any Western embassy to apply for a visa. The bureaucratic subtext is unmistakable: coolie, wetback, threat to our already strained social service infrastructure.

> *Russia hoped to be treated by the West as what it lately was, the world's number two power.*

"This reminds me of our relationship with China in the 1950s," Professor Bazhanov remarks. "China was too proud and ancient a civilization to accept that younger brother role indefinitely. So they turned away."

If Russia does turn away definitively, the spur will almost certainly come from within the former Soviet Union. Sentiment for a reconquista of the USSR is extremely slight, in the Russian armed forces or anywhere else. If Russian and Chechen civilians shared the same mass graves in Grozny, the implications for fighting in eastern Ukraine are unthinkable to almost everybody. Russians struggling to survive economically are also in no mood to redigest neighbors they know are much poorer still.

Yet Russians can hardly be asked to look at the boundaries drawn cavalierly between Soviet republics as just and inviolate under any circumstances. The residents of large swaths of Ukraine and Kazakhstan would almost certainly vote to be back in Russia if they had the chance. Moscow finds itself staving off the Crimeans' perfectly democratic attempt to desert Ukraine, and throwing cold water on reintegration feelers from Belarus.

All the current major CIS governments are arch-pragmatists on national questions. But submerged emotions run strong. One can imagine a range of scenarios where any Russian government would feel obliged to back nationals abroad with pressure which could include military action.

The West looks to be digging itself an inflexible, sovereignty-is-sacred position on this complex range of issues. By this doctrine, any Russian action to defend its own would read as a return to the all-aggressive Moscow of old. While it is tough to imagine Nato peacekeepers running around the Donbass, full-scale diplomatic revulsion would run the U.S. alone a few hundred billion dollars in extra defense spending.

None of these dark developments is inevitable, or even probable. Much of Russians' purported disillusionment with the West has come simply from knowing enough about it to separate the wheat from the chaff. The broad center of the electorate has sufficient self-esteem to be proud of their Russianness while enjoying what the world has brought culturally and materially over the past few years. They will in all likelihood pick a new government which stands on the same reasonable ground. EM

A LITTLE COMMON SENSE DETERS HACKERS AND VIRUSES

BY JOHN KADOR

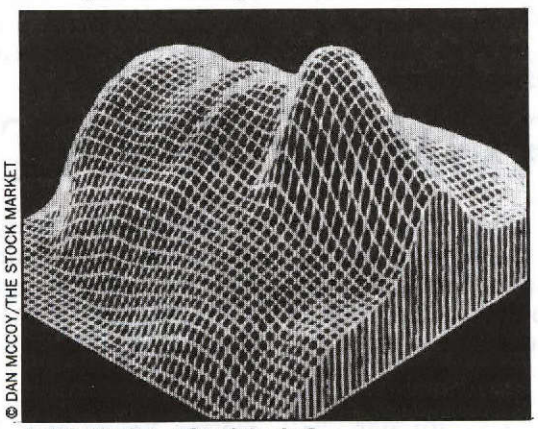
Financial executives are finding that their expanding use of networked personal computers is creating both opportunities and risks. Networking can shorten business processes, improve productivity, and advance cross-functional communications. The risks involve compromises to information security. When an institution's business is information, breaches in this area can spell disaster.

The irony of computing is that while networked personal computers bring the world to their users, the reverse is also true. The communication links that tie individual PCs to the world are two-way streets that expose an individual PC's resources to a growing number of predatory eyes. With the significant potential for an adversary to gain information from computers and networks, organizations are seeking the best way to protect sensitive information.

Protecting computers and networks is not an easy process, nor is it an impossible task. Most of it is far from rocket science and a little common sense goes a long way. Data crooks often go for the most vulnerable component of the computer — the floppy disk. As any security manager knows, inadvertent or overt security violations begin with the individual or the computer user. When he was finally caught, CIA renegade spy Aldrich Ames was caught with a significant number of floppy disks he was preparing to turn over to the Soviets. Ames obtained sensitive information from CIA computers simply by copying classified files to floppy disks and walking out of CIA headquarters.

Avanti Associates Inc. of Valley Forge, Pennsylvania, markets a product called TAG labels to increase security awareness. The TAG labels have two uses. They preclude an individual from leaving a disk in a disk drive inadvertently because a portion of the label hangs out of the disk drive. It also can be used for document control. The TAG can include both eye-readable and bar-code serial numbers for audit control and full accountability. The labels can also be used to keep diskettes from being removed from secured facilities. The labels can have magnetic strips or passive radio frequency (RF) antennas placed on them. With the use of a gateway, the risk of diskettes being removed is significantly reduced.

The primary target for gaining access from outside is the network. The accepted way to protect a network linked to the Internet is through a "firewall." Firewalls represent the first — and perhaps the most critical step — in a systems security plan, particularly one involving a link to the Internet. Simply described, a firewall places a barrier between a computer system and outside or unauthorized access. It buffers or insulates an institution's private network from the outside world. All information that leaves an organization through the network must first go through the firewall, where it is must meet the requirements of the organization's security policies before it is allowed on its way. Conversely, all information that attempts to enter the private network must be examined by the firewall system. This process is designed to eliminate hackers and viruses.



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Is this the face of an intruder?

Two general types of firewall implementations are possible. The first type permits access to everything that is not expressly denied. The second denies everything that is not expressly permitted. The former method is less restrictive, but is easier to manage because security administrators are concerned only with exceptions. The latter method offers greater security but is more difficult to manage. This method serves the same function a receptionist serves, demanding answers to questions such as: Who are you? Who have you come to see? Do you have an appointment?

On a network, a function similar to the reception desk is performed by a firewall which checks every packet of information sent over the network to determine who sent the packet and to whom it is addressed. The system then confirms whether sender and recipient belong to the same user group. If they do, the firewall passes the packet on. If they do not, the firewall does not allow the packet through. This technique is known as a "closed user group" — a list of devices that are authorized to talk to each other.

To ensure that every user who wants access to a server or departmental network has a legitimate reason for that access, network administrators can configure certain PCs for access to confidential information while denying access to others.

The good news is that data encryption can play an important role in securing information. The bad news is that encryption is an expensive security measure because, like a valve on a water pipe, it degrades network performance. Encryption implemented by hardware tends to impact performance the least, although it is the more expensive approach, costing about one-third the average price of a PC. Software encryption is relatively inexpensive, but greatly reduces efficiency and is useful only where network response time is not critical. In addition to the up-front costs of encryption, security administration is a major challenge. Key management (securely distributing encryption keys on a timely basis) is a complex task with hardware encryption. It should be used only where information disclosure presents a very high business risk.

The number one priority of network administrators is to ensure that the network is up and running. But simply protecting network availability is not enough. Now that network devices contain security features that protect the confidentiality and integrity of information on the network, these security features themselves must also be protected. Network management systems can also provide point-of-entry controls against unwanted intruders. No unauthorized person should be allowed to turn off the need-to-know feature and other security mechanisms. EM

Videoconferencing Comes of Age

It took the fax machine 30 years to populate virtually every office in the world as well as a growing number of homes and, in California at least, automobiles. If this evolution holds true for videoconferencing, look for equal saturation of the worldwide commercial sector by the year 2005.

The benefits are enormous. Any company that can avoid routine business travel by using videoconferencing can significantly reduce expenses and avoid the unproductive "dead" time of executives on the road. It enables businesses to be more impromptu, providing valuable immediacy to the exchange of information. More significantly, videoconferencing promotes the efficiencies of the virtual corporation, where the physical location of employees is irrelevant.

Computer systems manage the complexity of compressing rich video signals onto ordinary telephone lines and then decompressing them on the other end. It's not easy. Even the latest systems fall short of the ideal of full motion video with high fidelity sound. Most of today's images are jerky, the sound less than robust.

The business has long been dominated by companies that rent facilities, but some large corporations have built their own dedicated videoconferencing rooms.

There are an estimated 18,000 public video conference rooms available worldwide. These facilities range from inexpensive no-frills closet-size teleconferencing set-ups to upscale lavish boardrooms that seat 30 or so persons.

There are an estimated 18,000 public video conference rooms available worldwide.

Most desktop systems cost up to $6,000 per seat, though some low-end versions can be had for as little as $999. Conference-room systems, by contrast, generally start at $25,000 and rise steeply from there. These prices are reflected in the cost of using rental facilities.

The future of videoconferencing, however, is with desktop video units. A recent market research report from Livingston, New Jersey-based Insight Research estimates that there were just 34,000 desktop units installed worldwide at the end of 1994. But it expects that number to soar to 2 million units by the end of 1998. If it occurs, that proliferation will be due to the sudden advent of a number of relatively low-cost, high-performance desktop systems.

Intel's recent entry into the market also demonstrates the emerging congruence between the desktop computer and videoconferencing markets. Industry observers expect Intel to spend $100 million on videoconferencing research and development over the next 12 months, or more than all other companies combined spent last year. EM

— John Kador

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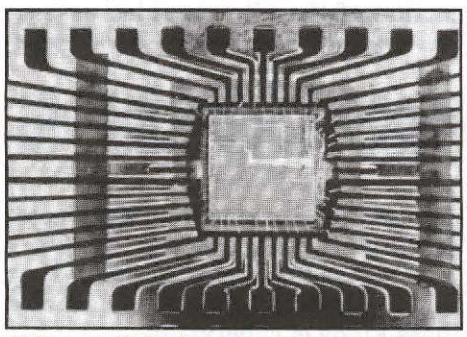
Technology

IT'S JANUARY 1, 2000
Do you know where your data are?

BY JOHN KADOR

Most of the world's computer applications, unless they are fixed, will have a meltdown of monumental proportions on midnight, December 31, 1999. That's because most of the world's mission-critical software was written using shortened date fields of the form YY/MM/DD. Under this shorthand, the date October 30, 1998, is coded 98/10/30. The trouble is, the date October 30, 2001, is coded 01/10/30.

Now, every sixth grader knows that the year 2001 is greater than 1998, but any software using the two-digit year field will be unreliable because 01 is less than 98. All software doing work based on the system date generally subtracts the earlier date from the later date to calculate



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Not so sophisticated as a sixth-grade child

interest, leases, rents, etc. Any system that attempts to make this subtraction using dates after midnight on December 31, 1999, will conclude that the chronologically later date "02" actually refers to 1902, not 2002. When that happens, the system will crash or, worse, generate completely off-the-wall results.

The solution to this problem is not particularly difficult, but it will be time-consuming. Unless individual applications are specifically tested for the end of century contingency, organizations cannot be confident that these often mission-critical applications will operate correctly or even operate at all.

The bright side to the equation is that you're not alone — hundreds of thousands of other businesses worldwide are facing the same challenge. Ad hoc user groups throughout the world are forming to address the problem. A number of software companies are gearing up with tools to automate fixing and testing the date problem.

For companies that do not want to distract already busy system staffs to address this problem, outsourcing is the answer. A number of service companies are available to offload all or part of the year 2000 problem.

Ideally, the year 2000 conversion effort should be completed by January 1, 1999. It is in any company's best interest to have everything in place by then, allowing a full year to complete final testing and provide adequate cushion to handle unforeseen problems or issues.

The problem is pervasive. Virtually every Cobol program written from the 1960s on uses the two-digit date field. A typical large company has thousands of computer programs, of which 82 percent need to be tested for date-related field names, requiring approximately 200-300 staff months. According to industry estimates, the average cost to modify a program is $0.40-0.80 per executable line of code.

Of course, the window of opportunity to fix this progam is closing for other reasons. The population of Cobol programmers is smaller now than it has been at any time since the 1970s. As the century winds down and companies gear up for the reprogramming effort, they will bid the costs of the remaining programmers off the scale. It will be ironic that Cobol programmers will find themselves in great demand to repair the problems they architected in the first place. EM

Help Is Available!

For additional information about the date problem, consider the following resources:

Tick, Tick, Tick...is a quarterly newsletter devoted to the end of the century problem. An annual subscription is $75. A complimentary issue is available on request. Contact Bill Goodwill, Publisher, P.A. Box 020538, Brooklyn, NY 11202-0012. Telephone: 718-643-TICK. E-mail: 71776.3131@compuserve.com.

Online, the Year 2000 Information Center offers Internet users the latest facts and information about the year 2000 computer crisis and provides a forum for discussing solutions. The information center offers free access to information from vendors and service providers that offer consulting and solutions. Contact: The Year 2000 Information Center http://arganet.tenagra.com/year2000/.

An electronic mailing list has been established for discussion of the year 2000 problem. Internet users can join the mailing list by sending an e-mail message to: listmanager@hookup.net with the test SUBSCRIBEYEAR2000 in the body of the message. EM

Teaching Computers How to Learn

Corporate downsizing is raising the stakes for artificial intelligence. Downsizing — the attempt to squeeze fat out of an organization — sometimes eliminates muscle or critical resources. When such "dumbsizing" occurs, organizations can be in real trouble. To avoid such an outcome, organizations employ artificial intelligence to capture the experience of their most valued people and allow networks of personal computers to do the work of displaced workers using that captured expertise.

Before the development of personal computers in the late 1970s, most activity in the area of artificial intelligence was hugely irrelevant to businesses. But since 1990, a number of businesses have enjoyed some success in deploying the two main benefits of artificial intelligence: expert systems and voice recognition.

Expert systems are computer programs able to make or help a worker make a decision. They capture important knowledge, not just data, and take or recommend actions based on that past experience. For example, American Express reengineered its credit approval process by giving employees an expert system that guides them through the most difficult credit granting decisions. The result? The decline rate (decisions not to grant credit) has been reduced by fully one third with no impact on creditworthiness.

Expert systems, which depend on explicit knowledge, excel at logical, cognitive, step-by-step decision making, such as diagnosing medical symptoms or configuring complex machines. Expert systems cannot be considered true artificial intelligence systems without the ability to learn: their knowledge base is bound by their initial programming. However, when expert systems are combined with the power of neural networks, which can apply knowledge gained from experience to new situations, then they can begin to predict results from new inputs.

Voice recognition is the most anticipated application of artificial intelligence and the area where 80 percent of research resources has been focused. If computers can recognize voice commands, every computer application from dictation ("Dear Mr. Stevens...") to inventory ("White wine: 250 cases, red wine: 125 cases...") to reporting ("Give me the November sales figures for Hong Kong") would become universally accessible.

The technology is improving, but it's going to take a few more years for practical applications. Speech-recognition systems available today recognize only isolated words that are clearly spoken with a pause between each word. Understanding natural, continuous speech is the big goal. Systems today must be trained for each speaker, a time-consuming process that, even if it works, is confounded if one day the speaker has a cold.

Understanding natural, continuous speech is the big goal.

Yet there are two reasons to be optimistic. The disabled have been well served by artificial intelligence systems such as machines that enable blind or dyslexic persons to read. There are a growing number of elegant devices that translate the contents of a computer screen into speech for the visually impaired. Synthesized speech applications have made it possible for the vocally impaired to communicate.

Another area of interest is simultaneous language translation. These sophisticated systems take input from one language and in real time output a very serviceable translation in another language. They offer the hope that workers from around the world will be able cooperate with language differences becoming totally transparent.

The most common application area of speech recognition is in generating reports, particularly in health care. Speech recognition systems can circumvent problems such as the time, expense and inaccuracy of preparing medical record by hand, and some insurers offer discounts in medical malpractice premiums to physicians who use voice-reporting systems.

What executives are waiting for is practical, reliable continuous speech recognition. When computers can recognize speech, executives will have palm-held computers into which they can record memos or letters. Voice recognition will then be integrated into virtually every electronic device we have, including automobiles, door locks, refrigerators, telephones and automatic teller machines. EM

— John Kador

Multilateral Cybertours

BY DEAN TEMPLE

Navigating the World Wide Web in these young and tender years is akin to surfing the multiple stations available on cable television on a rainy weekend afternoon. Every once in a while one stumbles upon a classic Cary Grant flick or the Star Wars Trilogy; most often one finds infommercials and a walk in the rain doesn't seem so bad.

Emerging Markets decided to forage through some of the more relevant information on the Web. What follows is a mini-tour and critique of some of the hottest cyber-sites in international development.

Possible grades — Excellent, Very Good, Good, Fair, Poor, Incomplete

INTER-AMERICAN DEVELOPMENT BANK

Address — www.iadb.org

Promises — This site, written in English and Spanish, promises Latin America and the Caribbean in numbers, a public information center, a "what's new" area and links to other sites of regional interest.

Delivers — The most useful information is in the public information center, which contains a complete directory of IDB staff, including Iglesias' extension in the Washington office and the address, phone, fax and telex numbers of IDB country offices. This area also contains information about publications, bank documents and news services.

The site further offers basic socio-economic data from last year back to 1985, including: exchange rates, prices, international liquidity, national accounts, non-financial public sector, monetary survey, external trade, balance of payments and external debt. A good source to find out say, that Argentina's multilateral debt has increased four-fold in that time.

It also contains new project documentation, environmental briefs and reports and project proposal abstracts.

Extras — The IDB is very good at providing hypertext links (underlined words that can be clicked with a mouse to send a cybernaut to a subsequent site) to additional sites, including numerous Latin American country sites and other institutions with data on international affairs.

Grade — *Very Good*

ORGANIZATION OF AMERICAN STATES

Address — www.oas.org

Promises The site, also offered in Spanish, promises current events at OAS, programs and activities, documentation, public information and an area entitled *Toward Free Trade in the Americas.*

Delivers The information provided is predominantly in press release format. *Toward Free Trade in the Americas* is a seven chapter report addressing topics from "Merchandise Trade in the Americas," to "Hemispheric Free Trade and the Less Developed Countries."

Further information is available in programs and activities such as: lists of the rulings of the Inter-American Court of Human Rights, reports on the findings of the Inter-American Telecommunications Commission (although not the findings themselves) and information on exhibits and sponsored cultural activities at the Art Museum of the Americas. Other categories are also included.

Like the IDB, the OAS realizes the importance of communication and provides a directory with the address, phone, fax and telex of permanent missions and general secretariat.

Unlike the IDB, OAS does not provide links to related sites. It does, however, promise to have these links in the future.

Grade — *Very Good*

ASIAN DEVELOPMENT BANK

Address — www.asiandevbank.org

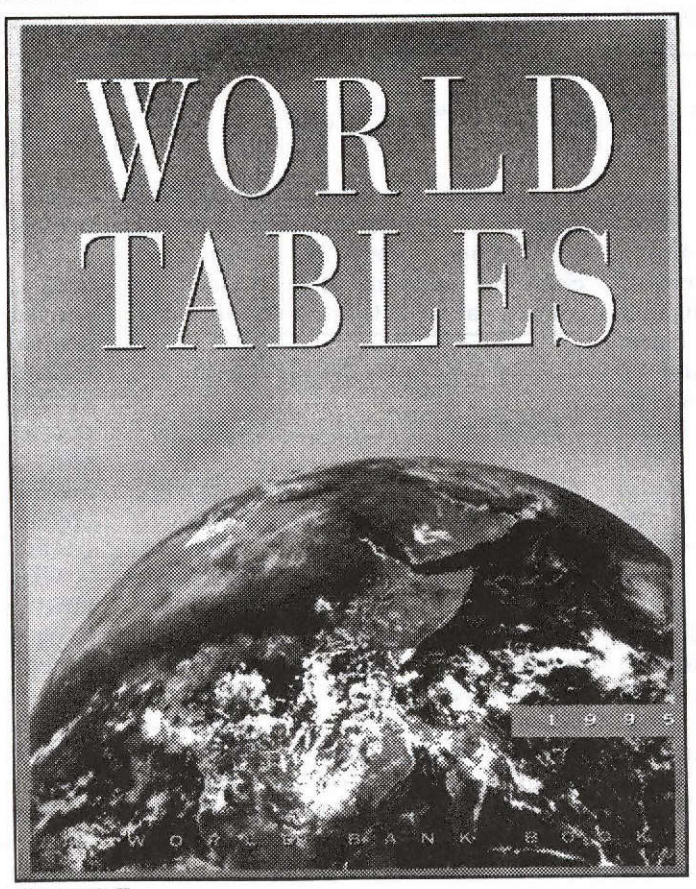
Promises — The site promises business opportunities, environmental impact assessments, news releases, project profiles, publications, law and development as well as links to other relevant sources.

Delivers — The site offers extremely detailed information on bank projects (down to the phone number of the project officer). Project profiles are listed according to country. They vary in the amount of information they actually provide. Some have extensive statistics on projects from financing source (foreign and local cost) to consultancy arrangements to viability assessments, while others contain very little in statistical analysis, often because much of it is "to be determined."

The publications area was a disappointment and provided little more than remedial resources for the uninitiated. If you are, however, looking for ADB definitions of terms like co-financing or lending, this is the place to visit.

A nice new addition to the ADB server is a list of ADB regional and resident missions with contact information that was added at the beginning of September.

Grade — *Good*



Heavy stuff

UNITED NATIONS

Address — www.undcp.org

Promises There are not enough pages in this newspaper to list all of the information this site claims to provide. It offers links to: keyword searches in General Assembly, Ecosoc and Security Council resolutions; information on the 50th anniversary; country offices; and UN organizations, as well as information about activism, conferences, documentation, human rights and women.

Delivers The site contains detailed reports from numerous UN organizations. Some highlights: information from country offices for Unicef including recent reports from Rwanda; half-lives, radioactive decay and nuclear structures data from the International Atomic Energy Agency database; and electronic trade information, as well as a special test for Africa connectivity to the Internet in the Unctad site, to name a very few.

This summer the UNDP website also contained a section called "The Beijing Express" (the train that went to the World Conference on Women in Beijing) which offered information about the train, participants and events, and also included "Train Mail": updates from the train as it was in transit.

Grade — *Excellent*

WORLD BANK

Address — www.worldbank.org

Promises — The site promises general bank information, current events, publications, research, project and country information, inspection panel, and what's new.

Delivers — The site claims to contain speeches, but only held one, delivered by bank president Wolfensohn to the Beijing conference on September 15. The site does contain a nice vehicle for obtaining abstracts on country sector reports, including poverty assessments, private sector assessments and public expenditure reviews. The database can be searched by field, date of report, or full text content. For some reason, only documents concerning the environment seem to be available from the IFC, and only by mail order. The operations evaluation section of the site provides assessments of a few completed projects, some reasonably negative. This website creates the impression that the bank feels only NGOs make these kinds of cybervisits.

One nice thing about the site is it contains full-text copies of some bank publications. Those who lug 50 pound bags back from the annual meetings certainly will appreciate that on the way home.

Grade — *Good*

INTERNATIONAL MONETARY FUND

Address — no web site, IMF gopher

Promises — The gopher promises general information, country reports, press releases, news briefs, SDR exchange rates, and speeches from managing director Camdessus, as well as links to other international organizations.

Delivers — The site does provide daily SDR exchange rates to 46 currencies from one month before (not much help if one needs a current rate). Country reports were not actually available online, but by mail order. News briefs were available, but none within the past three months. It does, however, have an extensive directory of economic, commodity and development organizations, with address, phone, fax and telex numbers.

Grade — *Poor*

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

Address — none

Comments — Anyone who has attended the annual meetings of the EBRD is familiar with the electronic mail system to contact bank staff and other delegates. They have not shown the same zeal for technology in providing information to the general public.

Grade — *Incomplete, failing* EM



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Technology



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Someday soon they may all be on the Web

THE MAN WHO WIRED AFRICA

BY JEFF GREENWALD

Built on a fractal peninsula scratching the Atlantic, Dakar, Senegal is an exciting and often unnerving capital where French manners meet African funk. It's a city where you can have fresh croissants and cafe au lait for breakfast and *yassa thiof* for dinner; a place where Muslims spread their prayer mats out on the sidewalks at noon, and *burro-burros* — traditional "pharmacists" — hawk iguana heads and monkey paws on blue plastic tarps. Blind beggars pace the sidewalks chanting verses from the Koran, while musicians like Youssou N'Dour and Baba Maal keep the nightclubs alive until dawn.

And Dakar is probably the only city in the world where instead of a busy signal, you often get a scratchy Afro-pop recording backed by a colanut voice that apologizes for your call's delay in melodic French.

Yet, despite its hot link to the planet's endocrine system, Africa remains (electronically speaking) out in the cold. This fact is of considerable concern to Babacar Fall — a Senegalese journalist and communications specialist appointed by the UN Educational Scientific and Cultural Organization (Unesco) to revive the Pan African News Agency (Pana). If his efforts are successful, Fall may well go down in history as the Man Who Wired Africa.

Fall met me at Pana headquarters in Faan, a ritzy suburb where all the ambassadors sleep. At 42, he is a tall, intense man with almond eyes and a sparse, wiry beard. Having studied communications in Dakar and Montreal, he received a master's degree in political science at the Sorbonne. He is fluent in at least four languages and obviously well-read; a copy of Howard Rheingold's *The Virtual Community* sat on his office table.

The Pan African News Agency, Fall explained, was launched in 1979. Its mandate was to gather news at the local and continental levels and distribute it among African nations as well as to the rest of the world.

"Pana sent its first dispatch off in '83," he said, "but its success was short-lived. Political interference badly compromised its credibility, and by 1987 the product could not be used." A financial crisis brought the situation to a head. In 1991, Senegal's state telecom system shut Pana down for persistent nonpayment of telephone bills. That same year Fall — working as the head of Unesco's African communications projects office in Paris — was asked to head a team of experts charged with developing the news agency's recovery plan.

Fall's plan, submitted in April 1992, was based on three goals. The first two, editorial independence and privatization, are serious challenges that will determine, in the long run, whether the agency wins any measure of professional credibility. But the third goal — the nitty-gritty problem of bringing Pana online with state-of-the-art local and international telecommunications — has been an even tougher nut to crack.

"Forty-eight out of 52 African nations now belong to Pana," Fall declared (the four that don't are South Africa, Namibia, Morocco and Eritrea). "Most of them are using radio transmitting stations, which are totally dependent on the weather. Tropical storms and sandstorms can totally screw up transmission," he added.

Bad lines are the main problem bedeviling Pana in its attempt to become a credible electronic media source. "It can take three, five, even 10 attempts to reach another African country by phone," Fall said. "It can take an entire day. And even where good telephone lines are available, the price is often prohibitively expensive." Telecommunication in Africa is so bad, in fact, that some stations still have to rely on telegraphs, dinosaur systems that cost $22,000 a year and transmit at the rate of — hold on to your hat — 50 baud (the rate at which information is transferred; Western rates vary from 2,400 up to 57,600).

One of the main reasons for this primitive state of affairs is that the major news networks tend to ignore Africa. Except for stories about South Africa, turmoil and civil wars or natural disasters, it remains something of a blind spot in the Western eye. In this day and age, such media invisibility is the ultimate impediment to progress, perpetuating Africa's long exile on the fringes of the world community.

> *"We can leapfrog. Africa doesn't have to go from drums to telegraphs to telex. We can go right to satellites, electronic media and a computerized newsroom."*

Fall's solution involves dishes and digits. To begin with, the main news agencies in Africa will be linked through a Very Small Aperture satellite terminal (VSAT) system. That process ought to get under way by the end of the year and will immediately cut Pana's telecom costs in half. "But to gather and collect information from all the bureaus," he pointed out, "and to transmit them worldwide, we need a two-way link. We need the Internet."

Fall's dream of a wired Africa was realized partially on February 18, when Orstrom, a Dakar-based research company, provided Pana with a basic Internet link. It's cheap, and it's a start, but the hookup — which comes only five times a day — isn't enough for Fall. "When you have news, it burns your hands. You've got to get it online very, very quickly, because it is news. So we want more than just a link; we want to be an electronic center for all of African media. We want to become an Internet node."

Such ambitions cost money, but Fall reckons the agency's volume of news will soon be able to support the expense. His convictions were echoed by Amadou Mahtar Ba, Pana's marketing assistant, who claims that over 300 black media sources and African-American support organizations in the U.S. and the Caribbean alone are ready and waiting for the Pan African News Agency's input.

Babacar Fall's grandest plans for Pana hinge, of course, on a quantum leap in African telecommunications systems — a reality that he projects (at least for the major cities) within the next few years.

"We can leapfrog," he pointed out. "Africa doesn't have to go from drums to telegraphs to telex. We can go right to satellites, electronic media and a computerized newsroom."

Fall sees Pana's Internet node as the first step in an Africa-wide network that will stretch from Algeria to Zimbabwe — providing a lot more than the latest World Cup scores. Fall's vision of a wired Africa, in fact, has less to do with late-breaking news than with the more complex issue of pan-African development. It's well known that aid projects on the continent have a history of expensive failure; the reason, Fall advanced, is the dismal state of African communications.

"You can't treat people like cattle," he stated imperatively. "You have to convince them — which means you have to communicate with them. For 20 years, the priorities for development in Africa have included agriculture, health and the environment. Yes, but none of these can succeed if there's no communication. You can't develop agriculture if you can't have a dialogue with the farmers in rural areas. You can't improve health if people aren't informed about major epidemics like Aids. You can't protect the environment if you can't communicate with the people who are placing it in danger. The industrial countries have spent billions of dollars trying to develop agriculture, change health conditions and fight problems like pollution and desertification. Nearly all these programs have failed. Finally, we understand why: there is no way to develop a country if the people cannot participate."

Fall peered into his empty teacup as if reading the leaves. Then he made a revolutionary declaration.

"For years," he said, "the main obstacle to real development has been the statement, 'We have to feed the people first.' After all, who can withhold food? But if you want the people to feed themselves, you have to have a different view." He gave me an appraising look. "Say you go to a small village. The people are hungry. Is the priority an electronic mailbox...or 100 kilograms of corn?"

I said nothing. Fall nodded his head.

"What we've learned over the past 20 years is that the mailbox may well be the priority." EM

This piece is reprinted with permission from Wired *magazine. Jeff Greenwald is the author of* The Size of the World, *published by Globe-Pequot Press.*

Profile



YUNUS

The Grameen Bank chief set out to do a task that traditional bankers refused — lend money to the people who need it most.

BY KEVIN RAFFERTY

Muhammad Yunus is the chief executive of a billion-dollar bank with two million customers and 1,000 branches. He is successful enough to be suggested by U.S. President Bill Clinton as a worthy winner of the Nobel Prize, and tipped as a candidate for president of the World Bank. He is in Washington for the annual meetings, but you won't find him challenging Edmond Safra, Toyoo Gyohten or John Reed as host of the splashiest reception or even hobnobbing over cocktails with Toru Hashimoto, Sir William Purves or Walter Shipley.

It would be interesting to ask leading lights of the top 1,000 banks if they know Yunus. Probably not many do, since his bank does not figure in Moody's or Standard & Poors lists, though if it did it would surely deserve the coveted AAA rating since it boasts almost no bad debts and a 98 percent repayment record — so rare these days that you would think that the biggest bankers would be beating a path to his door asking for his secrets.

SUBSTANCE NOT FLASH

Not that Yunus is elusive or difficult to find. You can spot him easily in a crowd. He is the one not wearing the sharp Savile Row suit, silk tie or shiny shoes. He sat next to Hillary Clinton at a Washington dinner recently wearing a hallmark shirt with high neck but no collar or tie.

It is appropriate wear for visiting his borrowers and shareholders who will never be seen at an IMF or World Bank annual meeting. Few of them have seen the inside of a jet aircraft and they don't travel by swanky limo, but by cycle rickshaw or "baby taxi," a three-wheeled scooter. On a world scale they are hardly plutocrats, borrowing an average of $140, but that doesn't worry Yunus, who set out to do a job that traditional bankers refused.

Let him tell his story of how a university economics professor gave up his job to found Grameen Bank in his native Bangladesh: "In 1974, we had a terrible famine. People were dying on the streets. I got very frustrated with what I was teaching, the development economics and all those theories, where everything sounded so good and all problems had fail-proof solutions. But when you walked out of the classroom and faced the real world it looked different." He visited a neighboring village and discovered that the simple sum of $30 could put 42 people on their feet, surely an easy proposition for a local bank manager.

His account of his request to the bank for $30 could be a modern Alice in Wonderland: "The bank manager gave me a big laugh. He thought it was such a funny idea. I said 'Why?' He said, 'This little money is not even worth all the papers they have to fill in, and the bank is not going to do that.' I said 'Why not? To them this is really important.' Then he replied, 'We can't give loans to the poor people. They don't have any collateral.' I said, 'So what? You don't eat collateral, you want your money back.' 'Of course we want our money back, but at the same time we need collateral.' I replied, 'To me it doesn't make sense. If somebody can be sure that the money comes back, why do we need collateral?' He said, 'That's our rule. I can't help you. Why don't you talk to the officials in higher positions?'"

Yunus persisted in pestering the bankers and finally got $300 as guarantor of the loan. He made his first loans, was repaid, made more loans and went back to the bank to demonstrate his success, but the managers were skeptical, saying that he had only worked in a few villages. So he lent his money over a whole district. The traditional bankers were still not satisfied. "So I said to myself, why am I running after the bankers? Why don't I set up my own bank and settle the issue?"

So, in 1983, Grameen Bank was born to lend money to the have-nots of Bangladesh. Since then it has gone from strength to strength. Last year it lent more than $400 million, and this year the total will be about $500 million. It operates in more than half of Bangladesh's 68,000 villages and 94 percent of its customers, who are also its shareholders, are women. The average loan is still small — for chickens, a cow, or a sewing machine for the more ambitious. Under a new leasing program, loans for bigger things like scooter rickshaws, tubewells and computer equipment — maybe up to $3,000 — will be available. One woman used part of her loan to by a mosquito net, not for herself, but for her cow: "My blood has been so badly tainted that it is beyond protecting," she said, "but if I can look after my cow, perhaps she can give me good milk to rebuild my strength and improve my blood."

Yunus explains why his borrowers are virtually all women: "Women have plans, for themselves, for their children, about having children, about the home, the meals. They have a vision," he asserts. "A man wants to enjoy himself." The women who fill nine of 14 Grameen Bank directorships get angry if their credentials are questioned: "I've raised children; I run a house; I know about life and what's going on about me," one firmly told off her questioner.

Not that Grameen gives anything free. Interest is above market rates — currently 18 to 20 percent. Getting a loan involves tough questioning. You don't just go along to the bank and convince a manager to hand over money. "When a person wants to borrow from Grameen Bank, we ask her to form a group of five persons of similar economic situation," says Yunus. The rule is that not all the women in the group can borrow at the same time, and the group is responsible for overseeing repayment. Members must save at least one taka a week.

"Members of the group help each other to overcome individual problems," Yunus adds. "When you are part of a group you try to do things which will make everyone a winner — you want to do something together that your friends outside the group will appreciate." Groups get together to form a center, and only when a project has been formulated and passed by the group and the center will the bank itself approve it. Bank staff don't sit in their offices but are on the move visiting centers. Grameen does not have a soft grace period that the World Bank gives to its country clients, but repayments must start a week after the loan as been taken.

A decade on, Yunus faces criticisms even within his native Bangladesh, for example from one businessman who scoffed "All he is doing is lending to women who want to rear 12 chickens. He'd make us a nation of small chicken farmers." To this Yunus responds: "If they did not have any chickens before that, it is an infinite improvement, and if two million families all have 12 chickens, that would be a very big poultry industry."

BANK OF THE FORMERLY POOR

His modest manner and statement of modest ambitions hide big plans. Yunus says he wants to run "a bank of the formerly poor." Asked to detail success stories, he refuses to point to millionaires, but says "If a family had one meal a day and now has two, that is a big success; if a family lived under the shade of the trees and now has a tin roof, that is success; we have given 325,000 housing loans, so those people all have nice houses; and we have two million savers with us."

Grameen is no longer just a bank, but is Grameen Group, with offshoots for agriculture and for fisheries, for making and marketing textiles and clothing under the "Grameen Check" design. Yunus also has set up Grameen Telecom to bring cellular telephones to the poorest people of the poorest villages, potentially altogether a multi-billion-dollar enterprise.

The challenges that Yunus poses to the established international finance order are enormous. The system is loaded against the poor and the weak, he asserts, and the claimed "trickle down" effect of development aid has failed to trickle down and goes to the rich and the powerful. He puts forward his vision: "A human being is a very creative animal, not just a workhorse. He/she is endowed with the ingenuity and creativity which no other creature can match. Every human being has a tremendous potential which most often remains unexplored because of the system we have built around us. If only we had imagined a world where every human being is a potential entrepreneur." Traditional bankers should not ask whether people are creditworthy, but should ask, are *they* people-worthy? EM

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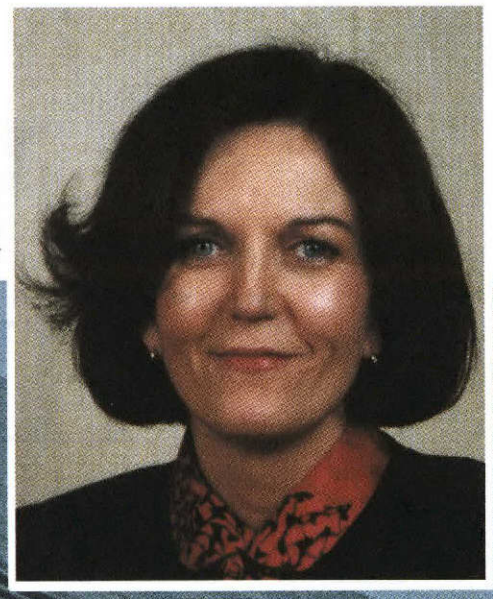

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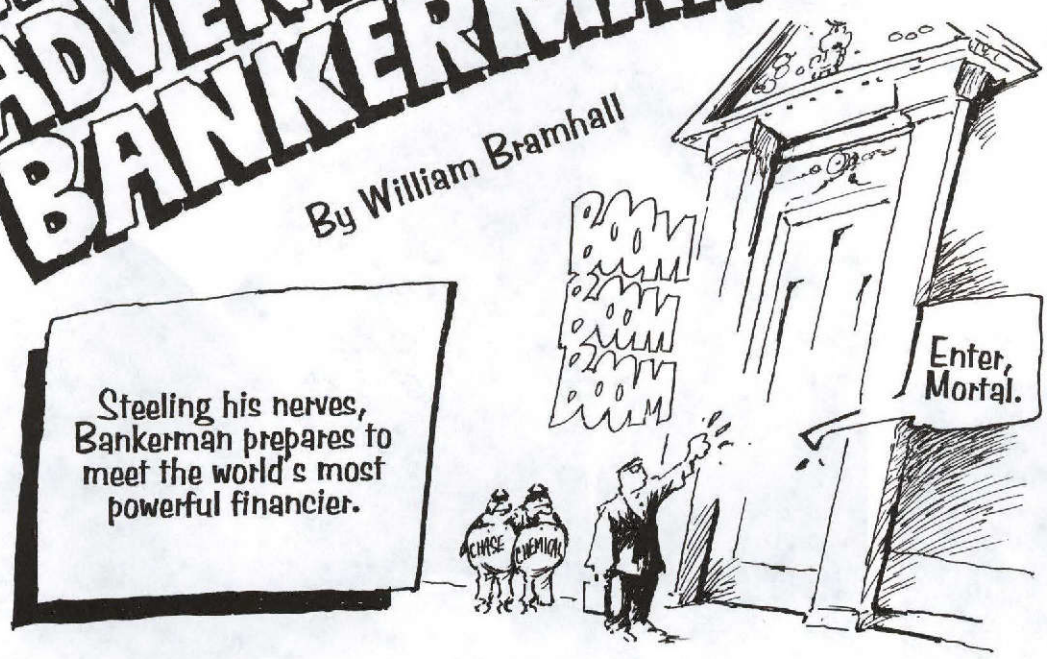
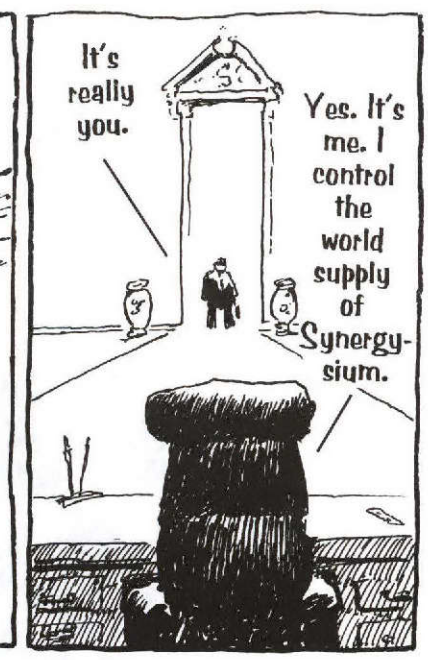
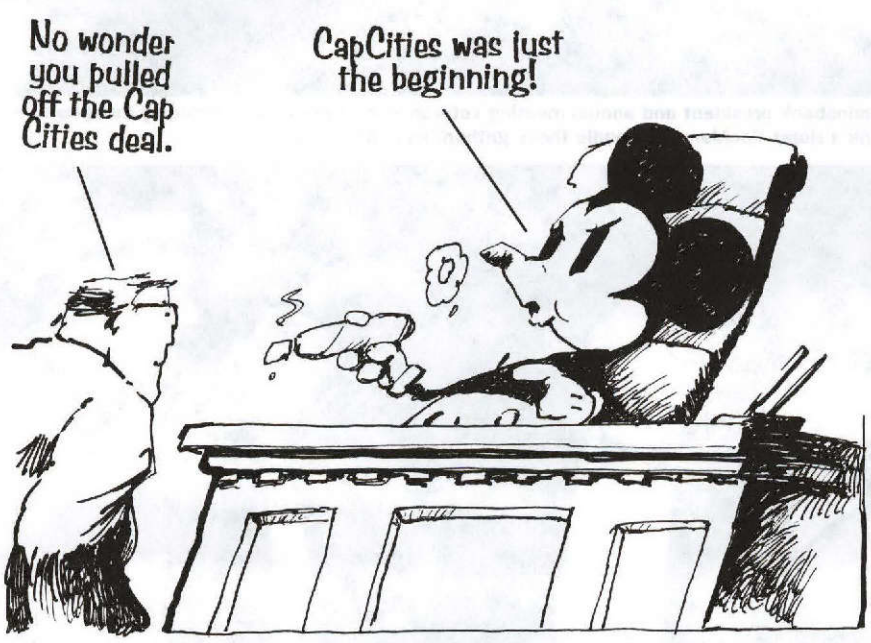
THE ADVENTURES OF BANKERMAN

By William Bramhall

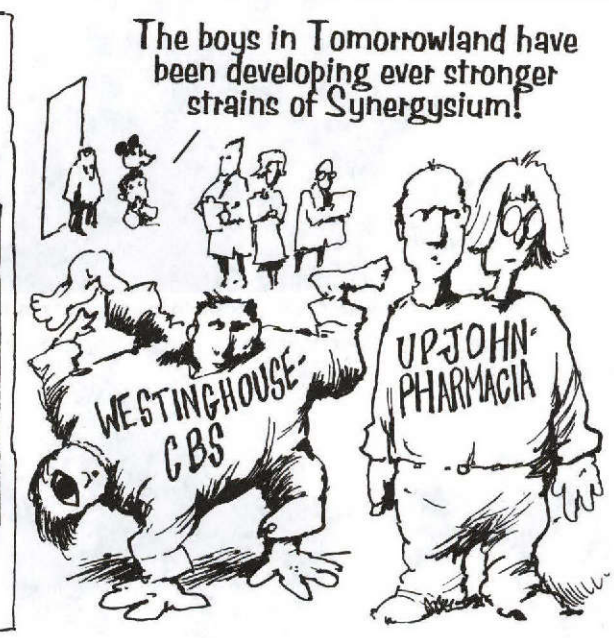


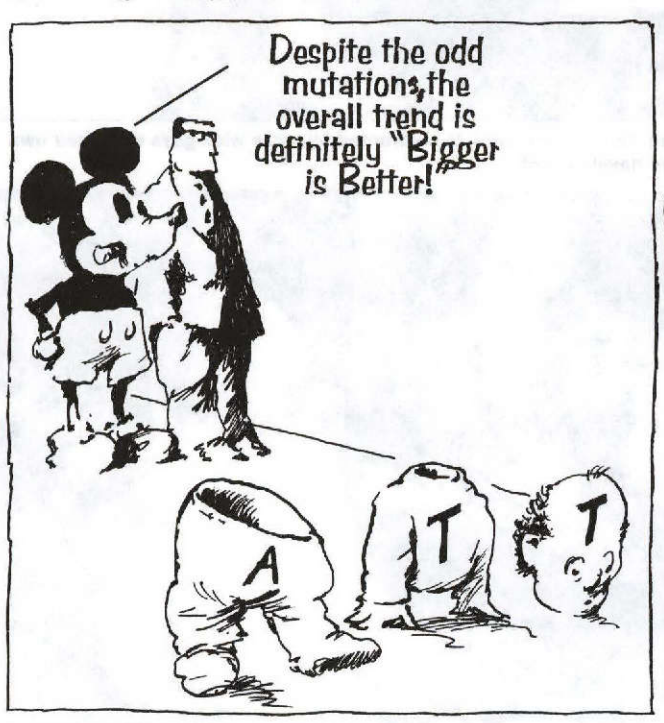


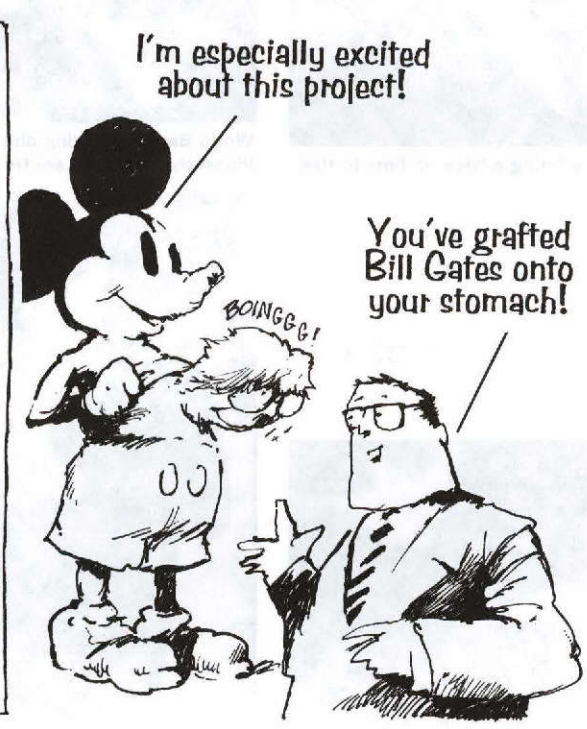


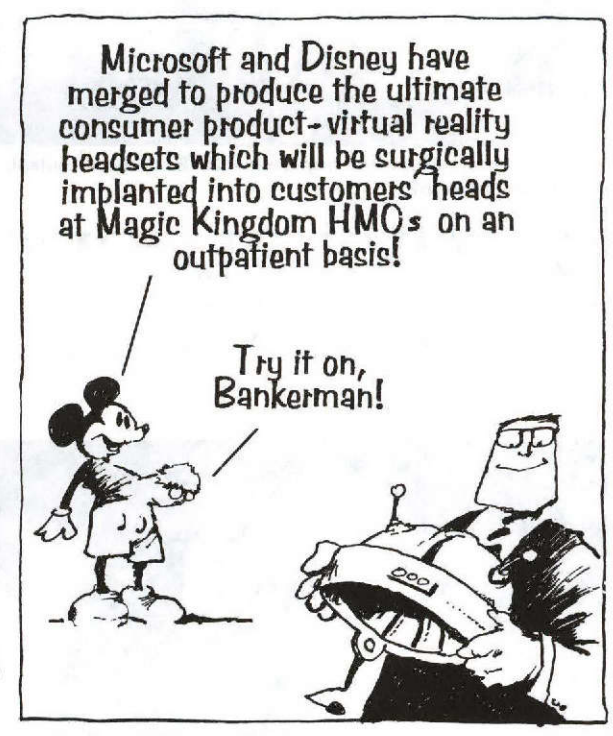


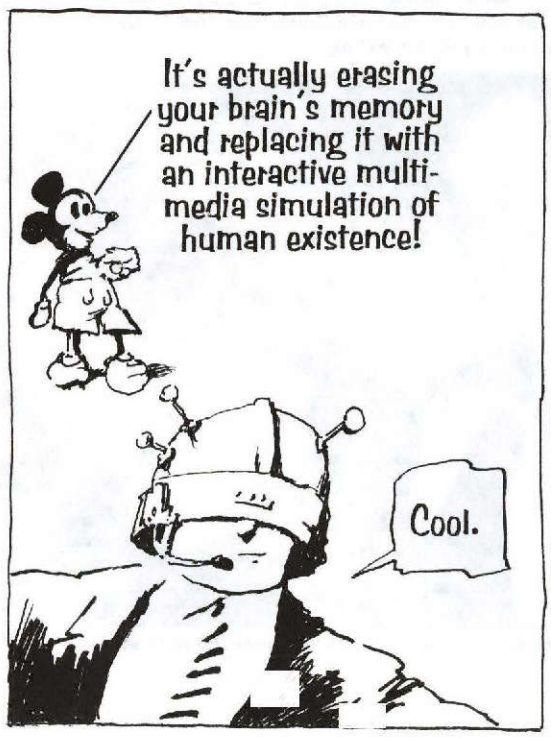


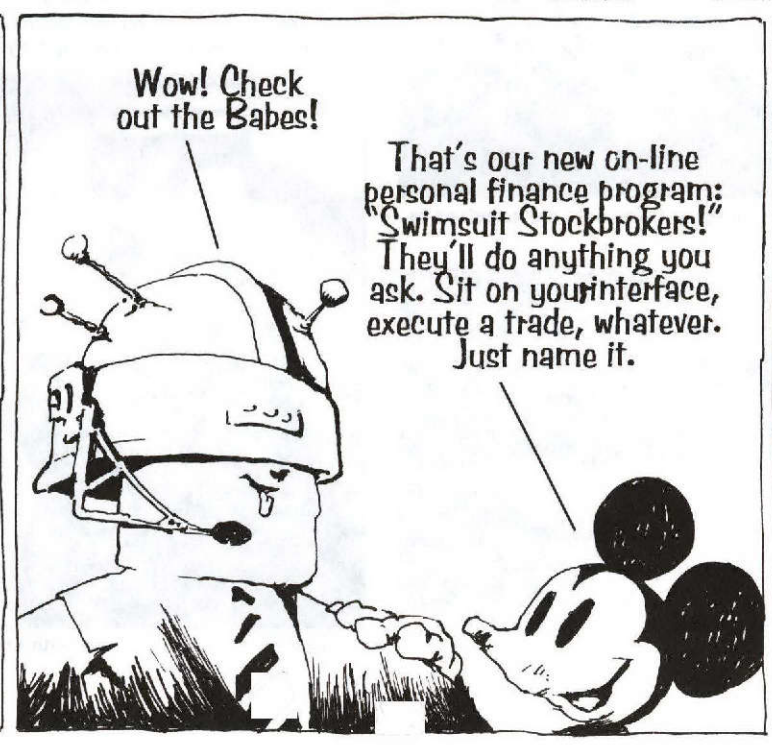


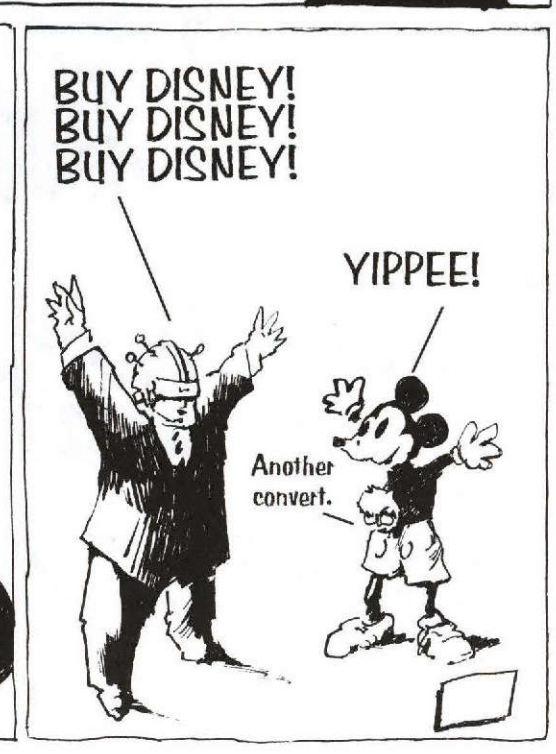












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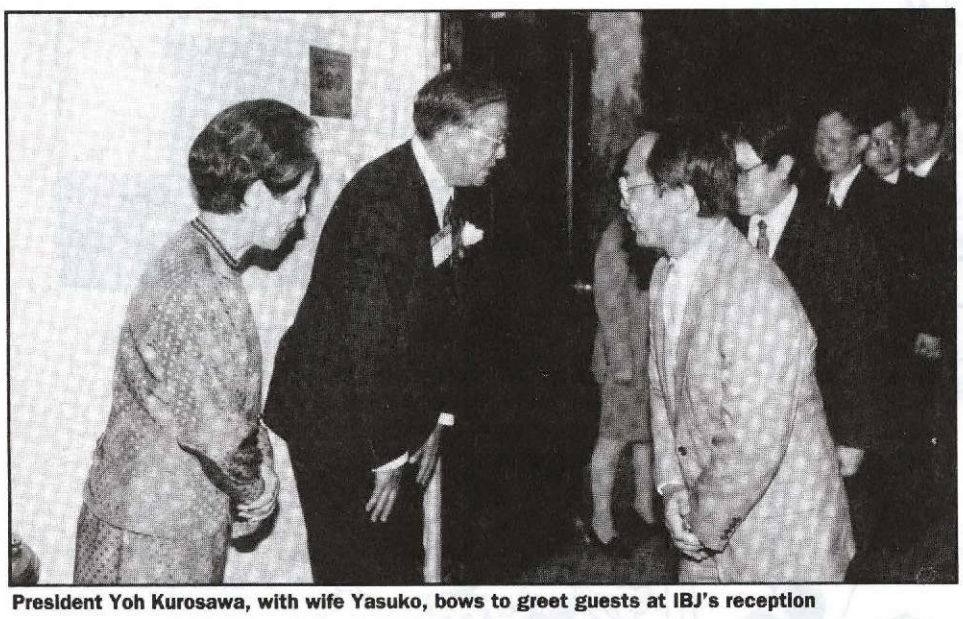


President Yoh Kurosawa, with wife Yasuko, bows to greet guests at IBJ's reception



Banco de Credito president Anthony Heeb with IBJ's Shozo Nurishi: offering advice on how to rise above tensions in Tokyo?



Bundesbank president and annual meeting veteran Hans Tietmeyer, greeted by European Savings Bank's Horst Koehler, can handle these gatherings in his sleep



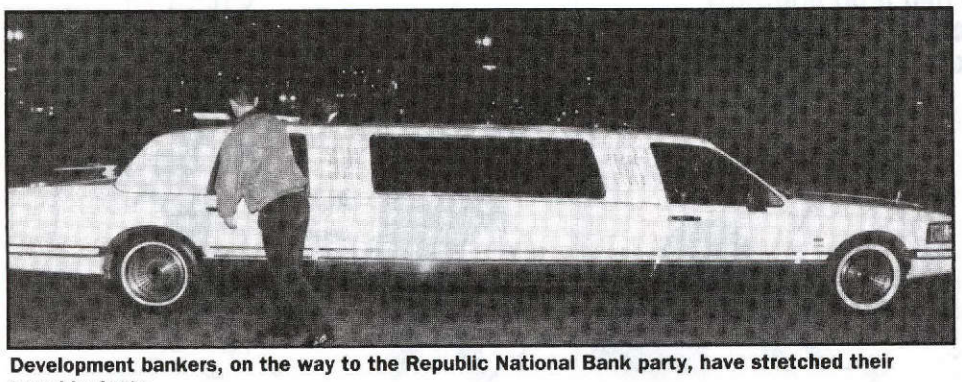
World Bank managing director Richard Frank is confronted by some wise guys with their own ideas about private sector development

POSITIVE RECEPTIONS

Photos by Donna Dietrich, Erica Lansner & Lisa Quinones



At the Merrill Lynch event, Keith Horner, Herb Allison and Marie-Paule Donsimoni are surprised to find out how spaced out some delegates are



Development bankers, on the way to the Republic National Bank party, have stretched their travel budgets



At the Merrill Lynch party, Willem Naves and Onno Vandem Broek learn that NGOs have come from everywhere in the known galaxy to this year's meeting



Armando Lloreno of Corfivalle with Leonor Llorente: It's amazing what the right suit can do

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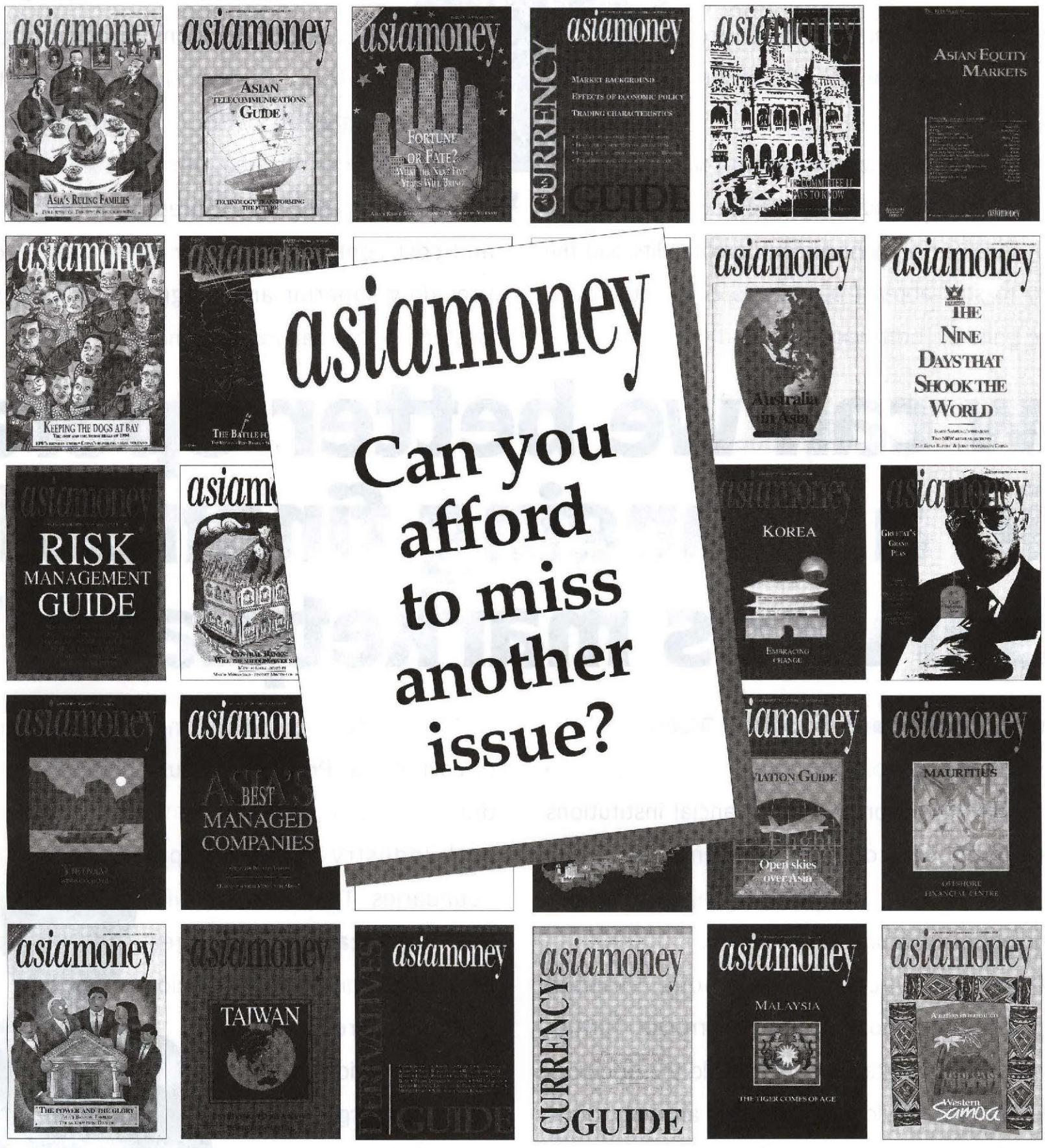

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That's a question we've heard from senior management at some of the largest financial institutions in the world. They realize that the complexity of the capital markets is steadily increasing, that technology is accelerating change in the financial services industry and that globalization cannot be shrugged off.

While there are few prototypes of successful global organizations, the key issues clearly involve risk management, profitability and the ability to stay abreast of tax and corporate governance systems, both nationally and internationally.



How can we better operate in a changing financial services marketplace?

Identify Present and Potential Risks

Price Waterhouse professionals Bill Linnenbringer and Bob Bench have worked with financial institutions to help them overcome the problems associated with the changing geographic, regulatory and technological contours of the industry.

Mergers and acquisitions among financial institutions are almost a daily occurrence. Further consolidation is inevitable, both to build the resources needed to operate globally and as an antidote to the industry's fundamental overcapacity. Technology has made possible the emergence of "one-stop-shopping" institutions and threatened the decline of the single-product firm. And in a number of businesses, increased regulatory oversight has made it crucial to develop state-of-the-art capabilities to assess whether the products and services an institution provides are always suitable for its clients.



Bill Linnenbringer

Determine the Optimum Strategy

Price Waterhouse professionals can help institutions understand and meet the myriad challenges arising from continued industry change. They are dedicated to developing creative solutions to complex problems arising from deregulation, globalization, securitization and technological innovation – as well as increased pressures from competition and cost containment. They have experience in providing superior and pragmatic programs for strategic and organizational change.

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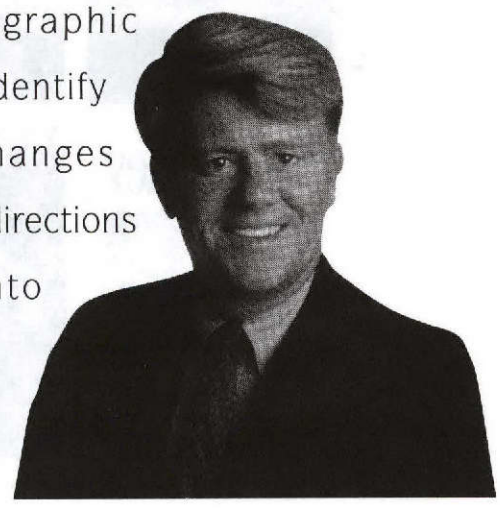

Bob Bench

If your organization needs help in overcoming the complexities of operating in a changing financial services marketplace, contact the professionals at Price Waterhouse.

For more information, call Bill Linnenbringer (212) 596-8575 in New York or Bob Bench (202) 414-4300 in Washington, D.C.

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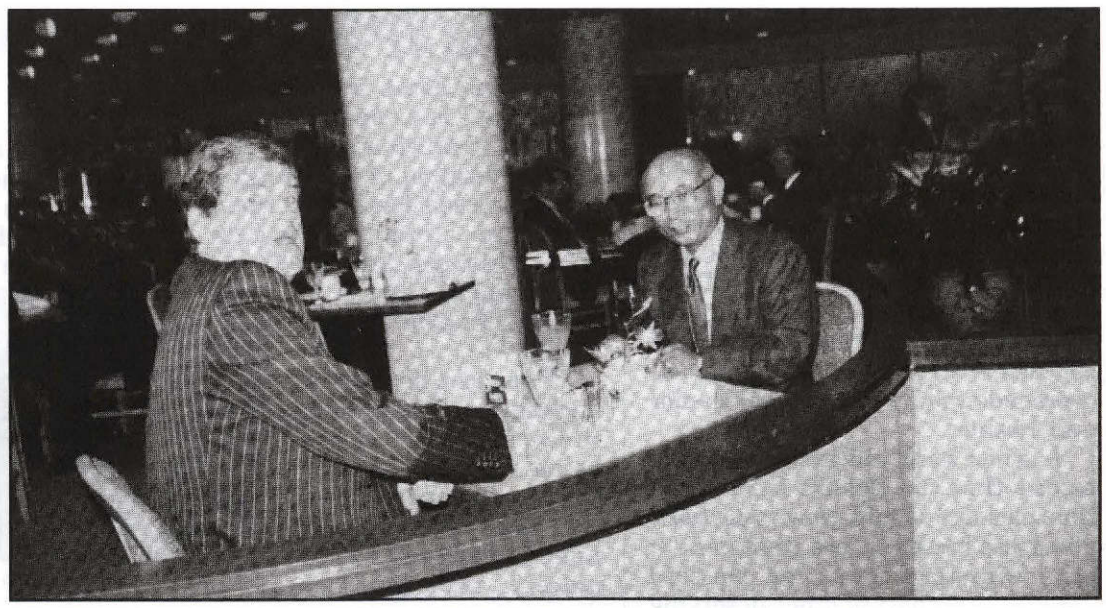
Financial Services Industry Practice

People



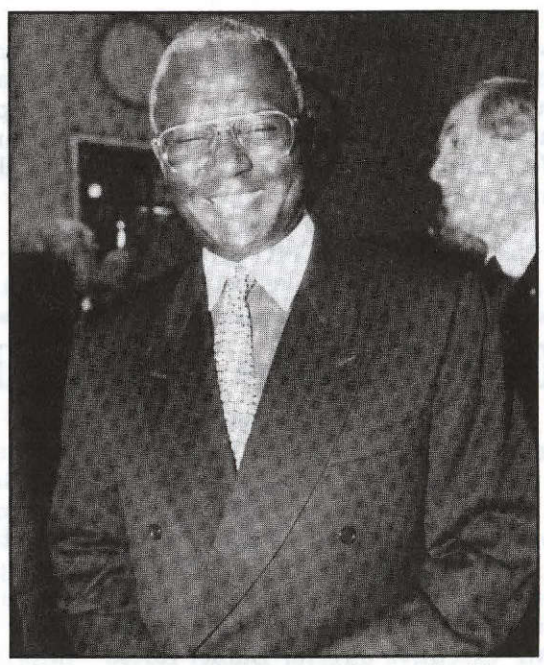
The prospect of a video phone is too good for Goldman, Sachs' Robert Hormats to resist; now if only he could call the future



NatWest's John Howland Jackson (l) and Warburg Tokyo's Shinji Asanuma take a brief caffeine break to push them through the day's proceedings



David Mulford: the de-moustached vice chairman of CS First Boston enjoys being a more passive attendee of the meetings



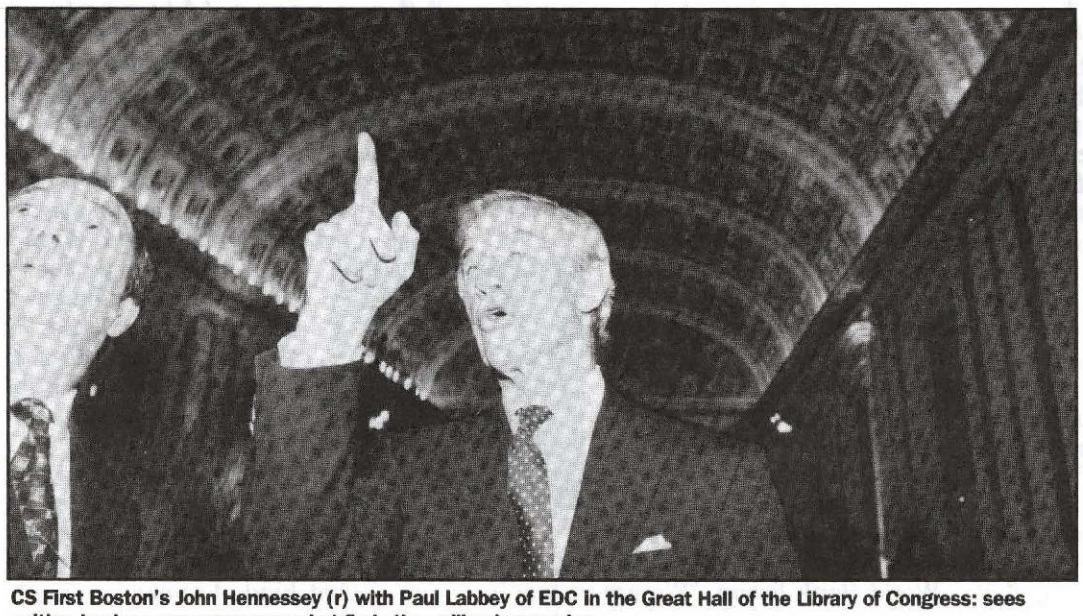
The new private sector Babacar Ndiaye smiles like a man with a load off his back



In former MoF mandarin and ex-BoT chairman Yusuke Kashiwagi's experience, shiny shoes do a good meeting make

Shines, Shaves & Smiles

Photos by Erica Lansner, Lisa Quinones & Rafoto



CS First Boston's John Hennessey (r) with Paul Labbey of EDC in the Great Hall of the Library of Congress: sees neither books nor congressman, but finds the ceiling impressive



IMF managing director Michel Camdessus: his own take on what the U.S. Congress should do with its ideas on aid cuts

News

SIGN OF THE (OCCIDENTAL) TIMES

Stone Johnson runs a shoe-shine stand at the bottom of the hill below the Sheraton. "Free your mind the shine will follow. Then you get up, you won't feel so shallow," he tells passersby. The IMF/World Bank meetings are good for his business, called "Shine of the Times," he said. "I got to tell you one thing," he said. "In the career of Shine of the Times, I have never shined the shoes of an Oriental person. From Korea, Japan, China, wherever. That is one of the things I will work on, even if it takes me until the year 2000. Because if I buy a Mitsubishi, they gonna have to do the switchee and get a shine."

Bosnian Deal Runs into Flack

Negotiations for a post-war reconstruction fund for Bosnia have provoked debate at the annual meetings about a global post-chaos relief program. The calls to offer a "global approach" come from governments in other war-torn countries who are concerned that their needs may be overshadowed by the political clamor over Bosnia.

A senior bank official insisted yesterday that the Bosnia reconstruction package would raise questions about the bank's future treatment of other war-torn countries. He said Africa is not short of other deserving candidates: Liberia, Rwanda and Somali will also be up for consideration. But any attempt to generalize from a Bosnia package would meet fierce resistance from several powerful donors: "A global approach sounds like a terrible idea," a U.S. official said.

Such sentiments do not augur well for the Liberian delegation at the annual meeting led by new finance minister Lasanah Kromah. Representing the new multi-party council of state formed after a peace accord was signed in Monrovia last August, Kromah is trying to negotiate help for his war-torn country — after six years of civil war and more than 60,000 dead. "The economy has effectively collapsed," Kromah said.

— P. Smith and H. Copeland

Ike Liked IDA!

(*Continued from page 1*)

World Bank's International Development Association, which makes subsidized loans to the poorest countries.

Clinton's reminder that a Republican president was behind the creation of the International Development Association won him applause from the audience. "IDA is essential," Clinton said. "A lot of people don't remember this, but the IDA was the brainchild of President [Dwight] Eisenhower."

Clinton went on to quote the former U.S. president, saying that when "'people despair that their labor will ever decently shelter their families or protect them against disease, [then] peace and freedom will be in danger — and the seeds of conflict will be sown."

Officials also warmed to Clinton's demand that governments honor the promise of a better life for the people who paid for free-market reform with unemployment and austerity.

Charles Kikonyogo, governor of the central bank of Uganda, said "Internationalism, integration and interdependence all came across in the speech, as did the need to prepare the [Bretton Woods] institutions for the 21st century."

EUROPEAN CURRENCY OUTLOOK CLOUDY

BY PETER KOENIG

Heading home from Washington yesterday, European officials and bankers breathed a sigh of relief over the stabilization of the French franc, but expressed fears that turmoil in European currency markets will resume between now and the meeting of European heads of state in Madrid December 15.



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Sutherland: EMU a concern

"If you look beyond the fluctuations of last week, there is a great game being played," Graham Bishop, Salomon Brothers' chief economist in London declared. "Ultimately, that game is down to Germany."

The question, according to Bishop, is whether Germany is prepared to sacrifice the absolute integrity of the Deutsche mark for the greater political objectives linked to the merging of European monetary policies. Citing those objectives — tying Germany into West Europe, paving the way for the integration of West and East Europe — Bishop queries, "Is Germany really prepared to let the EMU project collapse? One wouldn't have thought so."

Other analysts, however, are not so sure. These analysts suggest that Europe's political leaders have lost control of events, and that this suits the opponents of European monetary union in Germany's Bundesbank, especially those who hope that a loss of direction will doom the project.

"The period ahead is, relatively, one of the most important since the beginning of the project to integrate Europe in the 1950s," Peter Sutherland, chairman of Goldman, Sachs International declared. "If EMU does not go ahead now, I fear the moment will pass, and the consequences will be extremely serious for Europe."

Analysts agree on why the French franc plunged last Friday: a local scandal threatening the political career of French Prime Minister Alain Juppe catalyzed broader concerns about economic policy.

Spurred by growing labor unrest, French president Jacques Chirac faces a brutal choice. He can continue to support the franc fort policy of his predecessor, and trust that low inflation, a solid government budget picture, and a strong currency will eventually make the economy come right with a the payoff of reduced unemployment.

Alternatively, he can soften the franc fort policy and hope that the markets smile while a relaxation of economic policy reduces unemployment, thus setting in motion a virtuous circle anchored in faster growth.

The markets concluded last week that Chirac had opted for the soft option. "There are grounds for genuine concern about France's 1996 budget," Brendan Brown, chief economist of Mitsubishi Finance in London said.

What analysts do not agree on, however, is Germany's commitment to shoring up the French franc over the medium term in the face of market jitters, in order to guarantee the success of European monetary union.

One source close to the Bundesbank said the Bundesbank would pursue its hard line on implementing the Maastricht treaty until it was overruled by the government in Bonn.

IMF Battle Looms Between New and Old World

The IMF's plan to boost its emergency credit lines so that it can deal with future Mexico-types crises is shaping up into a major battle between old-world and emerging economies. The outcome will affect the balance of power among international financial institutions, Switzerland's IMF executive director Daniel Kaese said last night.

The U.S., Japan, Canada and the U.K. are backing demands from a group of potential new lenders for an equal voice in global decision making. But European members of the group of ten (G10), which currently finances the General Agreement to Borrow (GAB), are reluctant to cede control.

At stake is a say in the GAB (a joint arrangement between the IMF and the G10) and also in the Bank for International Settlements, which is effectively controlled by the G10. Europeans are reluctant to allow Asian and other countries to "buy" their way into the G10. But IMF interim committee chairman Philippine Maystadt insisted yesterday that "all participants must be treated equally."

The conflict threatens to snarl part of the IMF's strategy to double its total resources and put in place an emergency financing mechanism for countries in crisis. This strategy involves a proposed doubling of the GAB as well as of the IMF's main funding source — members' vote-giving quotas, of which the newcomers will also want a larger share.

Australia's governor, Ralph Willis, insisted yesterday that all GAB participants "should have the same rights and responsibilities, and there should be no second-class citizens." Willis also represents various Asian countries including South Korea which are being asked to help finance the GAB enlargement. Others include Singapore, Malaysia and Thailand, in addition to a group of smaller European countries and some from Latin America.

— Anthony Rowley

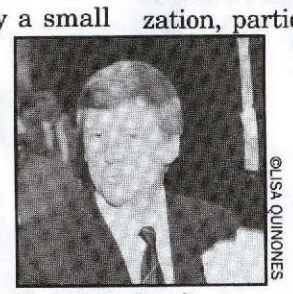
Russians, Ukrainians Go Home to Massive Trouble

BY CRAIG MELLOW

Both Russia and Ukraine basked in unprecedented favor during this year's annual meeting as bank and fund officials gave their fragile financial stabilization programs the benefit of the doubt. But both delegations head home to fresh political battles with their sometimes recalcitrant parliaments. So eager was Russian delegation chief Anatoly Chubais to rejoin the domestic fray that he left Washington without giving his plenary speech.

The Russian economic czar hurried home, sources said, to prepare for the government's introduction of its 1996 budget to the state Duma, which is slated for tomorrow. Debate on the document promises to be bruising as the government tries to keep the deficit tight with a much reduced IMF contribution, and legislators posture in advance of the December elections.

Chubais was joined by finance minister Vladimir Panskov and other senior officials, leaving only a small clutch of junior Russians to herald President Clinton's arrival at the meeting.



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Chubais: early exit

In Ukraine, President Leonid Kuchma yesterday placed an extensive reformist plan of action before a legislature bound to be less than fully receptive. Ukrainian state property fund director Yuri Yekhanurov told a World Bank forum, "We are in highly pressured negotiations with each parliament member and committee."

Yekhanurov pointed to a rapid acceleration of small privatization in Ukraine over the past five months.

He said Ukraine aims to learn from Russia's mistakes on industrial privatization, particularly ceding too large a stake in enterprises to their working collectives. He promised that in Ukraine, 70 percent of all state property would be divested in return for vouchers.

In a less welcome sign for outside investors, the privatization boss also said Ukraine will be more cautious about "what kind of money" comes to buy state property.

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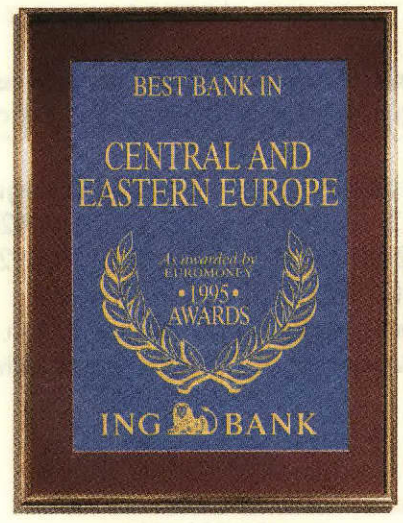









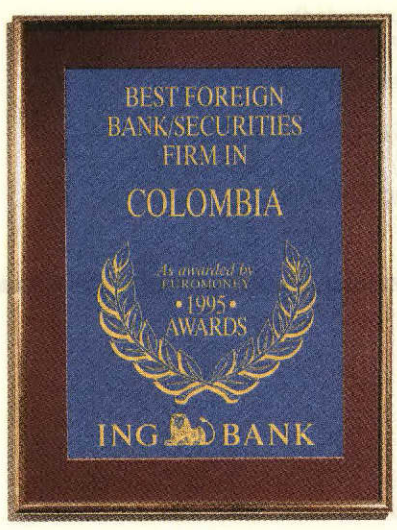

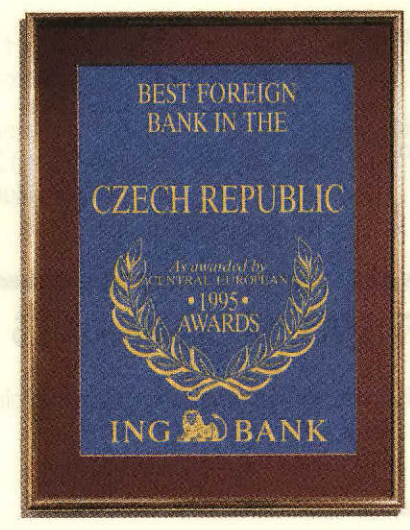

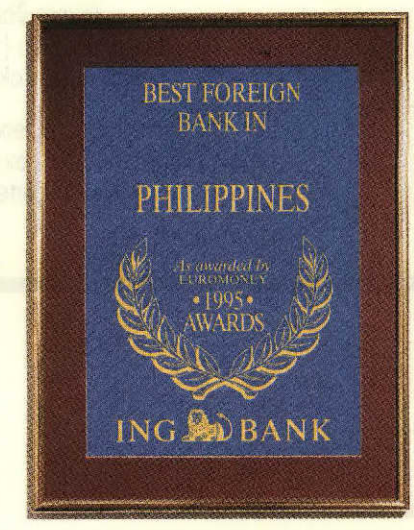

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