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Joint Statement by
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and **Mr. Vittorio Corbo,** Governor of the Central Bank of Chile
On behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

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Joint Statement by Mr. Nicolás Eyzaguirre, Minister of Finance of Chile, and Mr. Vittorio Corbo, Governor of the Central Bank of Chile, representing the countries of the Southern Cone (Argentina, Bolivia, Chile, Paraguay, Peru and Uruguay).

I. The Global Economy and Financial Markets – Outlook, Risks and Policy Responses

Global growth prospects for 2005 and 2006 are positive, in line with April's estimates.
For 2006, the United States and China are expected to continue functioning as the drivers of global growth—resulting in benign real and financial market conditions, particularly for emerging economies. Indeed, supported by the sustained expansion in China, commodity prices will continue at high levels. At the same time, the surpluses of commodity exporters and the financial savings of the Asian economies will help to maintain abundant international liquidity.

In the short run, we do not foresee a significant change in the composition of global growth. In this context, it is very likely that long-run interest rates will continue at low levels while commodity prices will remain high. Consequently, emerging economies, particularly in Latin America, will continue benefiting from a supportive external environment.

As a result, the main risk facing the global economy in the near future is related to the potential negative effects of high and volatile oil prices. Due to market concerns/tensions and the relative rigidity of oil output, the oil market is extremely vulnerable to supply shocks. For this reason, terrorist incidents and/or weather-related disasters that affect oil production facilities are potentially very destabilizing. A significant and sustained increase in oil prices, due to supply problems, would have a clear and negative effect on world output, not only because of the damaging effect on personal income and consumption, but also because increases in production costs could augment the probability of more accelerated adjustments in world interest rates. In this context, both the price level of assets in industrial countries and emerging market financing conditions could deteriorate significantly.

In the medium term, concerns related to deep imbalances in the expansion of the global economy will continue, in particular, regarding the large current account deficit in the United States and the surpluses in other regions.

The process of addressing global imbalances must be shared by all regions/countries to avoid increasing the costs of an adjustment, which could lead to a global recession and trigger instability in the foreign exchange market. To this end, the United States must systematically implement its recently announced medium-term fiscal adjustment program. At same time, the euro area should manage its monetary policy stance with caution and advance its structural reforms to boost trend output growth. Asian economies, for their part,

should continue to foster greater exchange-rate flexibility and facilitate consumption growth. In any case, the adoption of erratic policies or delays in the implementation of structural reforms could jeopardize the stability of the international financial system, thus undermining the progress that emerging economies have achieved in recent years.

At the same time, the process of addressing global imbalances should also include emerging economies and low-income-countries (LICs). The high price of commodities, the favorable financial market conditions, and easier access to export markets will allow these countries to increase their contribution to global output. However, favorable conditions to attract private investment will be needed to sustain this process. For this reason, it is imperative that the authorities use the recent rise in fiscal revenues—from buoyant commodity prices and/or higher economic growth—to consolidate their fiscal stance while crowding-in consumption and private investment.

II. Strengthening IMF Support for Low-Income Countries – Instruments, Financing, and Debt Relief

We reiterate our commitment to help low-income countries (LICs) reach the Millennium Development Goals (MDGs). In this context, we fully support the strategy for LICs, as outlined in the report of the Managing Director (MD) on the Fund's medium–term strategy. We also welcome the G8 proposal for 100 percent HIPC debt relief and progress made by the Technical Group on Innovative Financing Mechanisms, as part of the Action against Hunger and Poverty Initiative (led by Algeria, Brazil, Chile, France, Germany, and Spain) and supported by a large number of countries during and after the recent UN Summit.

The Fund has a critical role to play in supporting LICs. Its policy advice and capacity building are essential for helping these countries achieve macroeconomic stability, spur growth, and reduce poverty. When needed, financial assistance should be available to protect these economies from external shocks. Otherwise, the gains achieved during cyclical upturns could be lost. As expressed in the MD's report, Fund facilities need to be better tailored to the LICs' needs. In particular, we agree with the proposal for creating a "shock facility" within the PRGF, which will help ensure that temporary terms of trade shocks do not impose excessive costs on these countries. We also agree with proposals to emphasize the achievement of the MDGs, to focus on the macroeconomics of development (building sound monetary, fiscal, and financial frameworks), and to improve the allocation of staff time.

With respect to the G8 proposal for 100 percent HIPC debt cancellation, we welcome, in principle, the commitment of IMF members on this issue—expressed at the Executive Board meeting last month. It is imperative, however, that the proposal be designed and implemented carefully, to make sure that the financing capacity of the Fund, and of the Bank, is preserved. Therefore, we welcome work underway assessing the implementation of the G8 proposal, such as addressing issues relating to the uniformity of treatment of members, burden sharing, and conditionality, as well as institutional implications for both organizations.

We are pleased to mention that the Technical Group on Innovative Financing Mechanisms has made significant progress in its work. At the Group's request, Professor John Williamson

recently prepared an assessment on the proposal of taxing a limited subset of international currency transactions. He concluded that it is technically feasible and, if applied at low rates, it is unlikely to have adverse effects on international financial markets. The Group is well advanced in developing a pilot project to levy a solidarity contribution on international air fares that will be implemented soon in some countries. President Lagos, at the recent UN Summit, confirmed Chile's participation in this project and we are working to introduce it as of January 1, 2006.

We call on all countries and the IMFC to support the Initiative and the work of the Technical Group to advance towards the implementation of the measures proposed. One of them, approval of the Fourth Amendment to the Fund's Articles of Agreement, is lacking only one vote. Other measures to raise the necessary resources for financing the MDGs need further work, but the technical difficulties are surmountable if we have the political will. This is also true for the UK's proposal for an International Financing Facility (IFF), which we also support.

III. IMF Objectives and Medium-Term Strategy

Globalization as an Organizing principle

We welcome the effort undertaken by the Fund to give greater focus to its work by setting globalization as the organizing principle of its Medium-Term Strategy agenda. However, as stated in the MD's report, the concept of globalization could be too broad in scope. In our opinion, the Fund should concentrate its work on the macroeconomic and financial aspects of globalization.

Advanced Economies

Although the document recognizes the global and regional implications of the advanced economies' long-term policies and trends, we would also like to see the IMF put greater emphasis on assessing and highlighting the responsibility of these economies for the occurrence, management, and reduction of large imbalances in the world economy. On this matter, the Fund needs to go far beyond doing just analysis, and must find ways to stimulate collaborative efforts among major countries to contribute to orderly adjustment, thus reducing the burden of disorderly adjustments on the global economy. The IMFC could serve as a useful forum for such purpose.

Surveillance

We recognize the value of deepening the analysis of long-term aspects of globalization, regardless of the means chosen to present and publish it. We also welcome the emphasis on a better understanding of capital flows in the context of increasingly complex financial instruments and of the international capital market (supply and demand factors), and its implications for local financial market surveillance. We also support a more systematic focus of Fund surveillance on regional developments through detecting regional trends and fostering dialogue with regional institutions. Along these lines, analogous to other excellent

regional reports, we would greatly appreciate the Fund's staff preparing a regional report on Latin America in the near term.

We fully share the view that the Article IV consultations should focus more on the core macroeconomic issues in the context of the challenges posed by globalization. In addition, we are in favor of making more explicit the reasons why the Fund's policy recommendations are rendered ineffective. However, this should not be interpreted as, nor convey the message that, the Fund's recommendations are always correct or that there are always defensive attitudes from the countries' authorities. We also welcome, as part of a continuous transparency effort, the proposal to redefine the communications strategy taking it beyond the publication of reports, and making it an integral part of the public debate on reforms. Considering the importance of communications, we feel this initiative must be given greater weight in the MD's Medium-Term Strategy.

Regarding crisis prevention, we value the broader perspective of obtaining early warnings by including both the analysis of underlying vulnerabilities in emerging market countries as well as the supply-side disturbances arising from advanced countries' financial markets.

Funding and Lending Facilities

We consider that the issue of Fund's lending to its members should be at the top of the Fund's agenda. This is—in our opinion—only weakly developed in the Managing Director's report. In this regard, we consider it essential to add "the reassessment of funding and lending facilities" to the list of key tasks that the Fund will review. In particular, since a considerable share of the Fund's lending is concentrated in a few countries, this reassessment should focus on the large lending facilities. In addition, we urge the Fund to make progress in closing the gaps between the current instruments and mechanisms and the magnitude and characteristics of financial crises. In this direction, we welcome the call to begin a second round of debates on CCLs and precautionary arrangements.

Private Sector Involvement in Crisis Prevention

But not only the Fund's facilities should be explored. We strongly request the Fund to make a significant contribution to developing an international financial architecture with more emphasis on the development of private instruments that could contribute to crisis prevention. In particular, we suggest that the Fund engage more actively with private financial markets around the world to create new financial instruments that deal more effectively with idiosyncratic risks and provide liquidity support at times of stress. Thus, the Fund could contribute to alleviating the international public externality problem surrounding the creation of common knowledge relating to, for instance, the design of new instruments, valuation methodologies, benchmarks and indices, and in general, to nurse new markets. We also support the proposal of increased Fund involvement in the development of local financial markets and instruments to enhance countries' ability to manage their own risks.

Division of Labor and Specialization

Originally, the Fund was conceived to help ensure the stability of the international monetary system and the temporary financing of balance of payment difficulties. Undoubtedly, the Fund has expanded into areas well beyond its original mandate. We believe that the Fund could take steps toward focusing more on its core functions by transferring certain activities (such as anti-money laundering and anti-terrorist financing) towards more specialized international institutions.

Understanding Capital Account Liberalization

We acknowledge the need to deepen the understanding of the issues surrounding capital account liberalization and its administration. We encourage the Fund to exhaustively analyze international experience on these issues, focusing on the pre-requisites, the timing, and the appropriate institutions and macroeconomic policies that contribute to a more successful implementation. Based on our experience with capital account liberalization, we recommend explicitly analyzing the contribution of the macroeconomic policy framework, and the development, surveillance, and regulation of the domestic financial system in the process of financial integration. We also recommend that FSAPs be used to improve the understanding of the capital account liberalization process. This would certainly lead to an improved tailoring of Fund's recommendations to countries' various degrees of development and abilities to initiate the process.

Building institutions and capacity

We agree on empowering the Departments to set the priorities of technical assistance in the context of Article IV surveillance and Fund-supported programs. Nevertheless, we note there is still a need for identifying key areas of technical assistance among the membership in addition to enhancing its relevance in general. As a guiding principle on this issue, we propose that the Fund focus on strengthening the economic and financial resilience of its membership. This involves designing macroeconomic policies and institutions that reduce the probability of financial crises developing in emerging economies, contain their costs, and allow a quick recovery once a crisis has hit.

Governance

We welcome the MD's proposal to undertake the double challenge of addressing the issue of voice and fair quotas on the one hand, and the Fund's governance and ownership imbalances on the other. This should be a significant contribution to improving the Fund's legitimacy and effectiveness as a universal institution. In our opinion, the discussion should focus on increasing quotas for emerging economies on the basis of their increased relevance for global trade and capital flows. If emerging country quotas are increased, we should expect a more active membership involvement and commitment of emerging economies regarding the Fund's decisions, as well as greater availability of resources for the implementation of the Fund's Medium-Term Strategy.

In addition, it would be appropriate to consider the separation of the IMF's lending and surveillance activities, in correspondence with the best practices in order to overcome the agency problem and conflict of interests between these two areas.

Trade

Free trade is crucial for countries to fully benefit from financial integration and the liberalization of their capital accounts. We welcome the Fund's recognition of the difficulties associated with making further progress in the integration of goods and services markets. However, we encourage the Fund to be even more explicit regarding the defense and promotion of free trade as a complement to international capital mobility.

IV. The Countries of the Southern Cone[1]

In May of this year, **Argentina** successfully completed the largest and most complex sovereign debt restructuring in history. This has represented a very significant stride towards the consolidation of the economic model in place since mid-2002, which has allowed, after 12 consecutive quarters of positive real GDP growth and a 28 percent accumulated increase, reaching, and already overtaking, the highest GDP level before the crisis. The consequences of the 1990's experiment leading to the 2001-2002 crisis have been so serious, however, that many more years of sustained, non-inflationary growth accompanied by prudent income policies will be needed to bring poverty and income distribution indicators to the more equitable levels typical of Argentina in the past.

It is worth highlighting that both the sustained growth of the economy achieved so far and the successful debt restructuring were attained without net financial support from the international financial institutions (IFIs). In fact, since January 1, 2002 Argentina has made net payments to the IFIs in the amount of US$13.5 billion equivalent to more than 8 percent of its actual GDP and 53 percent of the present level of international reserves. In turn, Argentina's financial obligations to the Fund were reduced by more than 30 percent during that period. The Argentine government aspires to attain Fund financial support for its economic program and expects to formulate a forward-looking strategy to address the issue of the hold-outs within the context of a Fund program.

Strong fiscal and monetary policies supported by a competitive exchange rate have been the pillars of the Argentine economic model. The different views often heard on what the proper level of the primary surplus should be downplays what is indeed the fundamental fact: that Argentina is now in its fourth consecutive year of unprecedented fiscal surplus, larger than those projected in the Fund program, and accomplished, *inter alia*, through disciplined expenditure policies and full-fledged structural reforms in the area of tax evasion. On the monetary front, notwithstanding the substantial interventions in the foreign exchange market, the monetary aggregates have been kept close to those of the monetary program due to the extensive sterilization policy followed by the Central Bank. Strong fiscal performance and prudent monetary policy have allowed for an inflation rate, that

[1] The following paragraphs have been prepared by the respective countries.

despite some upsurge in the first half of the year, is within the range contemplated in the 2005 budget. The continued sound macroeconomic performance is, and will be, the best anchor to control inflationary expectations. It will also be the best guarantor for creating a favorable investment climate. In this respect, a Business Advisory Council has recently been formed with the participation of leading foreign investors so as to boost investment in general and Foreign Direct Investment in particular.

Bolivia has experienced significant political developments, including a congressional approval enabling general elections in December 2005 and a political agreement to hold a constitutional assembly and a referendum on regional autonomy in July 2006. Despite the social and regional complexity, macroeconomic stability has been maintained. The overall performance in 2005 has been positive. Sustained by the hydrocarbon sector, economic growth remained strong during the first half of the year and is projected to be about 4 percent for 2005. The public sector recorded an overall surplus of 0.4 percent of GDP during the first seven months, reflecting higher hydrocarbon revenues, improvements in tax administration, and lower spending. The external current account has registered a surplus due to a rise in exports as a result of high energy and metal prices, and the capital account has recorded a surplus that is associated, in part, with an increased demand for domestic currency and foreign direct investment in the mining sector. Overall, these trends have resulted in an important increase of net international reserves. For 2006, the Bolivian authorities envisage a real GDP growth in the range of 4-4½ percent, lower inflation, and a decrease in the fiscal deficit. The fiscal stance and competitive exchange rate, together with strong prices for hydrocarbon products and metals will help maintain external current account and overall balance of payments surpluses.

In 2005, **Chile** has benefited from a strong external environment and a supportive monetary policy. Economic activity, fixed investment, and employment indicators, among others, are all expanding robustly. However, compared to previous economic rebounds, the countercyclical fiscal and monetary frameworks and the flexible exchange rate regime have resulted in a smoothing of the economic cycle, improving the sustainability of the economic expansion in the absence of inflationary pressures and latent external imbalances.

Supported by strong domestic demand, real GDP grew by 6.3% in the first semester of 2005, an achievement that contrasts with developments during the same period of last year. Also worthy of note is the 26 percent annual growth increase in physical capital accumulation in the first half of the year. Moreover, employment is recovering and grew above 4% y-o-y during the same period.

Fiscal policy has been guided by continued adherence to the structural budget surplus of 1 percent of GDP—which has allowed for running countercyclical fiscal policies while supporting the monetary effort. Due to the significant rise in fiscal revenues—resulting from a compression of the output gap and higher than normal copper prices—the central government accumulated a surplus equivalent to 2.9 percent of annual GDP in the first six months of 2005. A surplus equivalent to 3.4 percent is expected for the entire year. It is important to note that the better than expected performance in tax revenues is due not only to cyclical factors, but also to structural components. For this reason, and in line with the structural budget surplus rule, it is estimated that public expenditures will increase by 6.5

percent this year—above the 5.5 percent forecast in the Budget Law for 2005. Part of the resulting fiscal surplus has been directed to prepaying public debt and investing in financial assets. It is estimated that gross central government debt will decline to 8.5 percent of GDP at year's end. For 2006, again in line with the structural budget rule, the Budget Law recently sent to Congress forecasts a surplus equivalent to 2.3 percent of GDP and expenditures increasing by 6 percent in real terms. Since the 2006 Budget will be implemented by a new administration, this means that the next President will have US$300 million available to use according to his or her priorities.

In spite of a sustained cyclical recovery, some slack still remains and inflation has increased only gradually—it is now at 3 percent—, with the most recent pickup due to oil prices. In this environment, the monetary policy stimulus has been gradually withdrawn since the last quarter of last year, increasing the monetary policy rate from 1.75 percent to 4 percent, a process that has been broadly consistent with private expectations. After several quarters of stability, the exchange rate showed a rapid appreciation in the last few months, probably reflecting perceptions that the improvement in the terms of trade will be more persistent and that the cyclical recovery in domestic demand has been somewhat stronger than anticipated. GDP growth is expected to be between 6-6.5 percent in 2005, with some deceleration in 2006 to a range 5.25-6.25 percent. Meanwhile, annual inflation should continue to increase in the short term, then decrease during 2006 towards the center of the inflation target range of 2 to 4 percent. The market expects the normalization of monetary policy to continue in the next quarters.

There are, however, some risks for the economic outlook. The current policy framework and improvements in the domestic capital market suggest that internal risks will not be significant in the coming year. Therefore, the greater risk the Chilean economy faces in the short to medium term is the same at that threatening the global economy: a further increase in oil prices due to potential supply disruptions/shocks. In this scenario, Chile's growth and economic prospects may deteriorate. Of course, maintaining Chile's commitment with sound policies will help to cope with the challenge.

In 2005, Chile also advanced with structural reforms. The government implemented Electricity Law II, which eliminated long-run price uncertainty, providing correct incentives to investment in this sector. The Royalty Law was also approved, which will allow payments from the extraction of non-renewable mineral resources to be used for the financing of technological innovation, a crucial ingredient for sustaining the country's growth rate over the medium- and long-term. In the capital markets, there are projects to improve the regulation of both private and state owned companies, and to design incentives for the development of the venture capital industry. Congressional discussion of the Fiscal Responsibility Law is expected soon, which aims at providing information on the underlying or structural fiscal balance, as part of the annual Budget Exercise. This will help provide adequate information about the sustainability of fiscal policy.

Paraguay's economic performance under the Fund-supported program continues to be broadly satisfactory. Prudent economic policies, and the implementation of reforms have been important in reinstating macroeconomic stability and obtaining remarkable results

during the past year. Real GDP in 2004 reached 4.1 percent, one of the highest growth rates in recent history, the inflation rate has dropped below 3 percent, the lowest level in 30 years, the guarani has stabilized, a fiscal surplus was achieved for the first time in a decade, public sector external arrears were eliminated, confidence in the financial system has been restored, and the international reserves increased to record levels. Even while the macroeconomic environment has become less favorable in 2005, the authorities are introducing appropriate policies to offset the negative impact of external and domestic shocks to ensure the program objectives for this year are achieved. They are committed in keeping fiscal and monetary discipline to ensure macroeconomic stability, and in implementing measures and reforms aimed at attaining higher and sustained growth over the medium term.

Peru's economic performance has continued to be strong in 2005 under the Stand-By Arrangement approved in June 2004. Growth is solid, led by exports and investment in a context of global recovery; inflation remains low; buffers are in place to limit vulnerabilities associated with public debt and financial dollarization; and investor confidence continues to improve. The authorities are committed to strengthening the fiscal framework to ensure efficient and transparent use of resources for public investment and social needs, in a way consistent with the fiscal target. They also continue to make progress in increasing the resilience and efficiency of the financial sector. After the important reform of the preferential pension system, the authorities' focus is now to ensure sustained growth through greater private sector participation in infrastructure projects and other policies aimed at improving the business environment.

Just a few months after the new administration was positioned, **Uruguay** reached a strong IMF-supported program. At the same time, Uruguay's economic performance during 2005 has been very satisfactory. The economic activity is growing robustly, inflation rates remain subdued, fiscal performance is in line with the program's targets, and improved market conditions reflect positive developments in terms of confidence. Furthermore, critical progress has been made in the banking area, which will result in a strengthened system. While macroeconomic stability is a necessary condition to achieve the Uruguayan authorities' objectives, investment is key in spurring Uruguay's growth, and, in this regard, the authorities are implementing many critical reforms aimed at further improving the investment climate.