IMF Survey

INTERNATIONAL MONETARY FUND

OCTOBER 3, 2005 VOL. 34, NO. 18

www.imf.org/imfsurvey

NEWS: Meetings end in debt deal, call for global action

The annual gathering of the world's finance ministers and central bank governors in Washington, D.C., September 24–25 brought a breakthrough deal on debt cancellation for some of the world's poorest countries. Policymakers called on producers and consumers to help stabilize volatile oil prices and urged all countries to play a role in resolving global payments imbalances. They also endorsed measures to reinforce the IMF's role in low-income countries.

Stephen Jaffe/IMF

283

NEWS: IMF gets green light on strategic direction

The IMF received the go-ahead from top finance officials to make responding to the challenges of globalization the organizing principle of its work. They endorsed a strategy, outlined by IMF Managing Director Rodrigo de Rato, that is aimed at improving the IMF's effectiveness and preparedness for the future. Specific proposals include steps to strengthen surveillance, improve technical assistance, and reform the institution's structure and work practices.

Stephen Jaffe/IMF

288

RESEARCH: World economic outlook steady, but with risks

Despite soaring oil prices (which reached a new nominal high of $65 a barrel in late August) and the devastation wrought by Hurricane Katrina, the IMF's September 2005 *World Economic Outlook* (*WEO*) forecasts global growth in 2005 and 2006 at a healthy 4.3 percent annually. But the *WEO* sees a higher risk of slower growth, because of the oil-market situation—where a further substantial price increase cannot be ruled out—and increased global current account imbalances.

Martin Bureau/AFP

292

COUNTRY FOCUS: China's reforms to define its future

The economic news from China remains upbeat: high growth, low inflation, and movement toward greater exchange rate flexibility. What's ahead? Over the near and medium terms, the IMF's Steven Dunaway sees the country's dynamism inextricably linked with high-quality, speedier, and more wide-ranging reforms. Developing an effective banking system and ensuring a fiscal position able to meet rising demands for pensions, health care, and education top the "to do" list.

Richard A. Brooks/AFP

297

IN THIS ISSUE

282 What's on

282 At a glance

283 In the news
Annual Meetings overview
IMFC communiqué
Strategic review
Debt relief
Low-income countries

292 Research
WEO

294 Regional focus
Sub-Saharan Africa outlook
Latin America outlook

297 Country focus
China

300 Forum
Per Jacobsson lecture

What's on

October

3–6 Meeting of the Task Force on the Harmonization of Public Sector Accounting, IMF, Washington, D.C.

3–6 TELECOM Americas Conference, International Telecommunication Union, Salvador da Bahia, Brazil

5–8 National Council on Economic Education Annual Meeting, San Antonio, Texas

15–16 Meeting of Group of 20 Finance Ministers and Central Bank Governors, Beijing

17–18 World Economic Forum, Russia and the World, Moscow

19 IMF Book Forum, Pietra Rivoli, *Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade*, Washington, D.C.

24 United Nations Day

27–28 "China's and India's Changing Economic Structures: Domestic and Regional Implications," IMF, the China Society for Finance and Banking, and the Stanford Center for International Development, Beijing

November

3 "Monetary Institutions and Economic Development," 23rd Annual Conference, Cato Institute, Washington, D.C.

3–4 IMF Jacques Polak 6th Annual Research Conference, Washington, D.C.

4–5 Summit of the Americas, Mar del Plata, Argentina

8–11 IMF forums on regional economic developments in Guatemala, El Salvador, Nicaragua, and the Dominican Republic

16–18 World Summit on the Information Society, Tunis, Tunisia

18 APEC Joint Ministerial Meeting, Busan, Korea

24 IMF forum on regional economic developments for academics, nongovernmental organizations, and media, San José, Costa Rica

27–29 World Economic Forum, India Economic Summit, New Delhi

December

4–9 International Conference on HIV/AIDS and Sexually Transmitted Infections in Africa, Abuja, Nigeria

10 Meeting of Group of Seven Finance Ministers and Central Bank Governors, London

13–18 The 6th World Trade Organization Ministerial Conference, Hong Kong SAR

January

6–8 American Economic Association Annual Meeting, Boston, Massachusetts

25–29 World Economic Forum Annual Meeting, Davos, Switzerland

IMF Executive Board

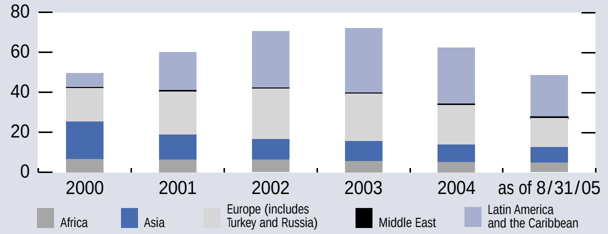
For an up-to-date listing of IMF Executive Board meetings, see *www.imf.org.external/np/sec/bc/eng/index.asp*.

At a glance

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



Major currencies, rates per SDR

(end of period)

	September 28, 2005	Year ago
Euro	1.204	1.190
Japanese yen	163.799	163.219
U.K. pound	0.820	0.810
U.S. dollar	1.449	1.468

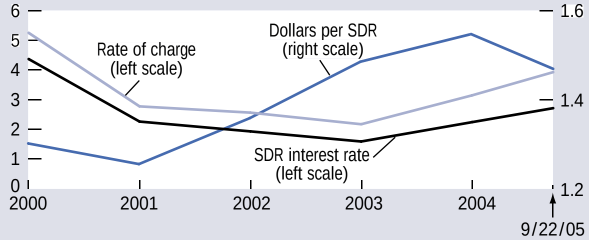
IMF available resources

(one-year forward commitment capacity, billion SDRs)

Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR

(percent, end of period) (dollars per SDR, end of period)



Note on IMF Special Drawing Rights

Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

Stephen Jaffe, Eugene Salazar, and Michael Spilotro/IMF

IMF–World Bank Annual Meetings Overview

Ministers back debt deal, urge action on oil, global imbalances

The world's top finance officials approved a multi-billion-dollar debt cancellation plan for the most heavily indebted poor countries at the IMF–World Bank Annual Meetings on September 24–25. At the same time, they warned that widening global imbalances and high and volatile oil prices posed increased threats to the ongoing global expansion. The finance ministers and central bank governors, meeting in Washington, D.C., also approved new tools for IMF involvement in low-income countries and endorsed a reform strategy for the institution.

Risks to global economy increasing

Although global economic growth is expected to continue in 2006 close to its trend rate seen in 2005, policymakers urged decisive steps to avoid disorderly adjustments in the global economy. "Global imbalances pose serious risks to prosperity," IMF Managing Director Rodrigo de Rato told the IMF's Board of Governors. Despite progress in some areas, he said "many countries need to share the work of reducing global imbalances and sustaining growth." The IMF's latest *World Economic Outlook* is predicting growth of 4.3 percent for 2005 and 2006, down from last year's three-decade high of 5.1 percent. But global payments imbalances, higher oil prices, increased protectionist sentiments, and the possibility of tighter financial market conditions are exacerbating the risk that growth will be weaker than forecast (see page 292).

The International Monetary and Financial Committee (IMFC), the IMF's policy steering committee, called on oil producers, consumers, and companies to work together to stabilize the oil market (see box, page 284). "Consumer and producer countries alike should consider tax reforms and, especially, reductions in subsidies on oil products," de Rato underscored, warning that subsidies cause profound social inequalities and economic distortions, often at great cost to the budget. "What is merely bad fiscal policy when oil costs $25 a barrel becomes ruinous fiscal policy when it costs $65 a barrel," he said.

To tackle global imbalances, the IMFC further urged the United States to increase national savings through fiscal consolidation; emerging Asia to allow greater exchange rate flexibility; and the euro area and Japan to implement further structural reforms. Among the other recommendations are enhancing the investment climate, including in a number of emerging market economies, and, in many countries, strengthening medium-term fiscal positions and measures to make labor and product markets more flexible.

The IMFC stressed that a successful outcome to the Doha Round of trade liberalization is essential for global growth and poverty reduction, and urged action to increase market access, especially for developing countries; reduce trade-distorting domestic support; eliminate all forms of export subsidies in agriculture; and make progress on financial services, in particular, and on issues of intellectual property. "The large economies carry particular responsibility to work for a good agreement, and to head off pressures for protectionism, which would be enormously damaging to the world economy," de Rato said.

In the news

Breakthrough on debt relief

Policymakers also resolved outstanding issues on the Group of Eight (G8) debt relief proposal, paving the way for the cancellation of about $55 billion in debt owed by the heavily indebted poor countries to the IMF, the World Bank, and the African Development Fund (see page 290). IMFC Chair and U.K. Chancellor of the Exchequer Gordon Brown—who spearheaded the G8 effort—said the agreement was a breakthrough in that all the countries of the international community had signed up, leading to "the historic completion of debt relief for these countries." The IMF and World Bank Executive Boards will quickly fine-tune the details of the debt relief deal. World Bank President Paul Wolfowitz told reporters: "Across Africa and around the world, leaders in 38 countries will no longer have to choose between spending to benefit their people and repaying impossible debts, often the legacy of governments past."

Governors agreed that the IMF has a critical role in supporting low-income countries through policy advice, capacity building, and financial assistance, and confirmed that the Poverty Reduction and Growth Facility (PRGF)—the IMF's concessional loan facility—will remain the main instrument for IMF financial support for these countries. The IMFC approved two new instruments to strengthen IMF support for low-income countries. The Policy Support Instrument (PSI) will be available to members that do not want or need IMF financial assistance, but seek IMF assessment and endorsement of their policies. And a new window in the PRGF trust will be available to provide timely financial support to PRGF countries facing exogenous shocks (see page 291).

The IMFC also called on the low-income countries to do their part in the quest to achieve the Millennium Development Goals over the next 10 years. It urged poor countries to strengthen their economic policies through sound frameworks and accountable institutions to help spur private sector growth. In addition, de Rato said "the international community will need to muster additional resources to provide the mix of aid, debt relief, and program assistance needed to reduce poverty and support development."

Charting the IMF's future

The IMFC welcomed a report by de Rato on the IMF's medium-term strategy, agreeing that the IMF needs to deepen its analysis of globalization and continue to develop its strategy for responding to long-term challenges (see page 288). "The Fund needs to be able to advise all our members on dealing effectively with the consequences of increasing integration," de Rato said. The strategy provides a framework for prioritizing the Fund's work and increasing its focus, effectiveness, and preparedness to face the future. It proposes specific action to strengthen surveillance, improve technical assistance, and reform the Fund's organization, structure, and work procedures.

De Rato emphasized the question of whether members' voting shares and representation are still adequately reflected in the institution. He said the IMF's legitimacy was at stake if it did not adequately represent countries of growing economic importance, such as emerging-market economies in Asia. He also suggested greater representational power for the IMF's members in Africa, where the Fund is actively engaged. De Rato, who in paraphrasing Mark Twain had quipped earlier that "reports of the IMF's death have been greatly exaggerated," urged the Board of Governors to deal with these imbalances during the current quota review, which needs to be completed by January 2008.

The Development Committee said that it "considers the issue of enhancing the voice of developing and transition countries in our institutions to be of vital importance." It said it would continue its discussions with a view to building the necessary political consensus, "taking into account progress in the context of the IMF quota review."

Possible loan for Iraq

During the meetings, de Rato announced that he had discussed with the Iraqi finance minister and the central bank governor the possibility of an IMF loan after the end of the current post-conflict program. He said Iraq needs to make further progress in the quality of its data, central bank transparency, and lower oil subsidies to enable him to ask the Executive Board to approve a loan, hopefully by year's end. ■

Conny Lotze
Christine Ebrahim-zadeh
IMF Survey

Ministers stress oil investment needs

The IMFC welcomed the action of members of the International Energy Agency and oil-producing countries to continue increasing oil supplies to the market. At the same time, it called for more investment throughout the supply chain, particularly in refining capacity, and urged countries to improve the climate for such investment. The IMFC also stressed the importance of policies to promote energy conservation, efficiency, and sustainability, and encouraged closer dialogue between oil producers and consumers. It urged further efforts to increase market efficiency by improving oil market data and transparency. Finally, it called on the IMF to stand ready to assist poor member countries in particular in dealing with oil price shocks.

IMFC communiqué

Ministers call for united effort to help stabilize oil market

Following is the full text of the communiqué issued by the International Monetary and Financial Committee (IMFC) after its meeting in Washington, D.C., on September 24. The meeting was chaired by Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

Stephen Jaffe/IMF

IMF Managing Director Rodrigo de Rato (left) and IMFC Chair Gordon Brown brief the press.

The Committee welcomes the ongoing global economic expansion, although it notes that growth divergences between countries remain wide. Global growth is expected to continue, although downside risks to the outlook have increased, especially high and volatile oil prices, recently exacerbated by the effects of Hurricane Katrina, the widening of global imbalances, increasing protectionist sentiment, and the possibility of tighter financial market conditions. While core inflation generally is contained and inflation expectations remain well anchored, higher oil prices remain a risk to price stability. The Committee notes that these areas should be a particular focus of IMF surveillance and policy advice in the coming months.

The Committee emphasizes that oil producers, oil consumers, and oil companies will all have their part to play in working together to promote greater stability in the oil market. First, the Committee welcomes the action by members of the International Energy Agency and oil-producing countries to continue to increase supplies to the market. Second, the Committee calls for further investment both now and in the long term throughout the supply chain, particularly in refining capacity including of heavy oil, and for efforts to create a favorable investment climate. Third, the Committee also stresses the importance of policies to promote energy conservation, efficiency, and sustainability, including through new technologies, alternative sources of energy, and reducing subsidies on oil products. Fourth, the Committee encourages closer dialogue between oil producers and consumers, and further efforts to improve oil market data and transparency to improve market efficiency. Fifth, the IMF should stand ready to provide assistance to help members, especially poor countries, deal with oil price shocks.

The Committee welcomes recent progress in implementing the agreed policies to address global imbalances and foster growth, but urges further action to promote orderly adjustment in view of the heightened risks to the outlook. This includes fiscal consolidation to increase national savings in the United States, greater exchange rate flexibility in emerging Asia, further structural reforms to boost potential growth in the euro area, and further structural reforms, including fiscal consolidation, in Japan, where the economy is regaining momentum. Measures to promote a more investor-friendly environment, including in a number of emerging market economies, would also contribute to reducing imbalances. Oil-exporting countries will also need to play their part, including through efficient absorption of higher oil revenues in countries with strong macroeconomic policies.

Steps to strengthen medium-term fiscal positions remain crucial for supporting global growth and stability. Fiscal deficits in many industrial countries need to be lowered further, and reforms to address pressures from aging populations and ensure the sustainability of pension and health care systems need to be accelerated. Improvements in the fiscal positions and debt structures of many emerging market countries are welcome, but in countries with high public debt levels continued fiscal consolidation efforts are needed. The Committee also calls for more ambitious efforts to address rigidities in labor and product markets in many countries. Regulatory and supervisory authorities should remain alert to risks stemming from ample global liquidity and associated risk taking and leverage.

The Committee emphasizes that a successful outcome to the Doha Round by the end of 2006 remains of critical importance for global growth and poverty reduction. Serious challenges remain in reaching agreement at the World Trade Organization [WTO] ministerial meeting in Hong Kong SAR in December. As finance ministers and central bank governors of WTO member countries, we have a vital interest in successful multilateral trade liberalization. Benefiting from a useful exchange of views with Pascal Lamy, the Director-General of the WTO, the Committee calls on all countries to ensure progress on ambitious trade liberalization with the urgency that the timetable now demands. Key areas for action are increasing market access, especially for developing countries; significantly reducing trade-distorting domestic support; eliminating all forms of export subsidies in agriculture; and making significant progress on services, including financial services, and on issues of intellectual property. The Committee welcomes the joint IMF–World Bank staff report on proposals to enable low-income countries to benefit fully from trade liberalization, and urges the Executive Board to consider these proposals expeditiously.

The Committee welcomes the enhanced growth performance and prospects of many of the world's poorest countries, reflecting improvements in their underlying policies. With 10 years remaining to meet the Millennium Development Goals (MDGs), those countries should move rapidly to strengthen policies needed for sustainable growth and poverty reduction, including through sound macroeconomic frameworks and building the sound, accountable, and transparent institutions that are essential for fostering growth and supporting vibrant private sector growth. Also, the international community must follow through expeditiously on its renewed commitments to provide additional resources, including at the Gleneagles Summit and the Millennium Review Summit. An ambitious outcome to the Doha Round is also essential for poverty reduction.

IMF objectives and medium-term strategy

The Committee welcomes and supports the broad priorities set forth in the *Managing Director's Report on the Fund's Medium-Term Strategy* to improve the IMF's effectiveness in support of its members. In the coming years the IMF will continue to work to help members meet the economic challenges of globalization within its mandate in the macroeconomic and financial areas. The Committee looks forward to specific proposals and timelines on the main tasks identified in the medium-term strategy in the Executive Board's work program, within the context of the IMF's medium-term budget framework and the staff compensation review.

The broad priorities set out in the Managing Director's report are to:

- Make surveillance more effective;
- Adapt to new challenges and needs in different member countries;
- Help build institutions and capacity;
- Prioritize and reorganize the IMF's work within a prudent medium-term budget; and
- Address the issues of fair quotas and voice.

The Committee agrees that the IMF needs to deepen its analysis of globalization and continue to develop its strategy for responding to the long-term challenges it poses.

U.S. Federal Reserve Board Chair Alan Greenspan (left) and Governor of the Bank of Israel Stanley Fischer, who had previously served as an IMF First Deputy Managing Director.

IMF support for low-income countries

The Committee reiterates that the IMF has a critical role in supporting low-income countries through policy advice, capacity building, and financial assistance. The PRGF remains the main instrument for IMF financial support for low-income country members. The Committee agrees that the IMF's concessional lending should be financed at an appropriate level as assessed by the IMF. The Committee calls for incorporation of the lessons from the recent review of the design of PRGF-supported programs in the future work of the IMF in low-income countries.

The Committee welcomes the progress made on new instruments that will strengthen IMF support for low-income countries. The Policy Support Instrument will be available to members that do not need, or want, IMF financial assistance, but that voluntarily request IMF endorsement and continued assessment of their policies as meeting the standard of upper credit tranche conditionality. The country-owned policy frameworks designed by the authorities would consolidate medium-term macroeconomic and financial stability, and deepen reforms in support of poverty reduction and economic growth. A new window in the PRGF Trust will also be available to complement existing instruments by providing timely concessional support to low-income members without a regular PRGF arrangement and that are facing exogenous shocks, and we look forward to contributions from countries.

The Committee supports the proposal to provide 100 percent cancellation of debts owed by Heavily Indebted Poor Countries (HIPCs) to the IMF, the International Development Association and the African Development Fund. This will provide significant additional resources for countries' efforts to reach the MDGs and reinforce longer-term debt sustainability. The Committee welcomes the approach subsequently discussed in the IMF to ensure that the IMF's resources will be used consistently with the principle of uniformity of treatment. It stresses the importance of ensuring that the IMF's capacity to provide financing to low-income countries is maintained, and therefore welcomes G8 countries' commitments to provide additional resources. It also emphasizes that countries benefiting from irrevocable debt relief should have demonstrated sound policies and high standards of governance. Following this agreement now reached on all the elements, the Managing Director has informed the Committee that he will now call the Executive Board together to complete its approval of the arrangements to deliver debt relief by the end of 2005. The implications of debt cancellation for the new debt sustainability framework should be addressed in the review scheduled for Spring 2006. There should be a regular report on progress at future meetings of the Committee.

The Committee underscores the importance of full creditor participation, including by non-Paris Club creditors and private creditors, in contributing their share to implementing the enhanced HIPC initiative. It takes note of the work on identifying low-income countries with unsustainable debts as of end-2004, with a view to finalization by early 2006 of the list of countries potentially eligible for HIPC assistance.

The year 2005 is the International Year of Microcredit. The Committee notes the IMF's role in improving data availability on microcredit and in addressing microcredit issues in the Financial Sector Assessment Program.

Other issues

The Committee welcomes the rapid progress on the inclusion of collective action clauses in international sovereign bonds, and the efforts by emerging market issuers and private sector creditors to broaden the consensus on the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets." The Committee looks forward to further work on the orderly resolution of financial crises, including the implementation of the IMF's lending into arrears policy.

Michael Spilotro/IMF

Saudi Arabian Monetary Agency Governor Hamad Al-Sayari (left) with German Deputy Finance Minister Caio Koch-Weser, and Saudi Arabian Finance Minister Ibrahim Al-Assaf.

Michael Spilotro/IMF

Brazilian Finance Minister Antonio Palocci (left) with South African Finance Minister Trevor Manuel, who chaired the Development Committee.

The Committee calls for continued actions by all countries to develop strong programs on anti-money laundering and combating the financing of terrorism (AML/CFT). The Committee supports the IMF's efforts to implement its intensified AML/CFT work program, and notes the critical importance of supporting countries' efforts with well-targeted and coordinated technical assistance.

The Committee recommends members' acceptance of the Fourth Amendment of the Articles of Agreement. The Committee reiterates that the IMF's effectiveness and credibility as a cooperative institution must be safeguarded and further enhanced. Adequate voice and participation by all members should be assured, and the distribution of quotas should reflect developments in the world economy. The Thirteenth General Review of Quotas presents an opportunity to address the issue, and we look forward to progress on this issue and a report back at our next meeting.

The Committee looks forward to continued high-quality reports by the Independent Evaluation Office (IEO) under the leadership of its new Director, Thomas Bernes, and to the upcoming external evaluation of the IEO.

The Committee paid tribute to Alan Greenspan, in his last meeting of the IMFC, for his outstanding leadership of the U.S. Federal Reserve and for his unprecedented and much-valued contribution to the Committee's work over the past 18 years.

The next meeting of the IMFC will be held in Washington, D.C., on April 22, 2006. ■

The full text of the IMFC and the Development Committee communiqués, as well as the Annual Meetings speeches and press conference transcripts, are available on the IMF's website (*www.imf.org*).


Michael Spilotro/IMF/File Photo

IMF headquarters. IMF Managing Director Rodrigo de Rato launched a strategic review to allow the organization to better respond to critical challenges.

IMF maps out future strategy

The International Monetary and Financial Committee (IMFC) on September 24 endorsed the broad priorities set out in a report by Managing Director Rodrigo de Rato on the IMF's medium-term strategy. The report calls for a sharper focus in the IMF's work so that it can more effectively help countries reap the benefits and meet the challenges of globalization. In welcoming the IMFC's support, de Rato said that a timeline for detailing and implementing the report's recommendations will be part of his proposals for the IMF's upcoming Work Program.

The report—the result of a year-long strategic review launched by de Rato—was prompted by a desire for critical self-reflection, at the time of the IMF's 60th anniversary and in the face of three important developments. There was a sense that the challenges of the past decade had pulled the Fund in too many new directions from its core responsibilities of guarding international monetary stability and financing temporary balance of payments problems. There was an awareness that additional mandates had made it difficult to allocate resources effectively and to stay ahead of emerging challenges. And there was the question of whether the Fund was prepared to meet current and prospective challenges, such as tackling today's unprecedented global payments imbalances and responding to possible capital account crises.

How reform might look

Given the IMF's macroeconomic mandate, helping countries come to grips with globalization would mean:

Making surveillance more effective. There is a need for deeper analysis of the longer-term aspects of globalization. Among these issues are the benefits, imbalances, and fragilities caused by cross-border movements of goods, people, and capital; and the ways in which institutions and policies can be developed to allow countries, especially low-income ones, to benefit from global flows. Also, country surveillance should focus more sharply on core macroeconomic issues, while identifying globalization challenges and drawing synergies from global and regional surveillance.

Adapting effectively to needs of member countries. In the case of advanced and systemically important economies, particularly, IMF policy advice needs to be better tailored to local circumstances, and country assessments need to be better integrated with global surveillance. Regarding emerging market economies, the report proposes strengthening the IMF's work on crisis prevention and crisis resolution, including deepening its knowledge of the issues surrounding capital account liberalization. On the IMF's involvement with low-income countries, the report recommends a sharper focus on promoting macroeconomic stability, and enabling countries to absorb scaled-up aid and take advantage of globalized trade and finance. It also proposes developing more flexible instruments to serve the different needs of individual low-income countries, facilitating progress on the Millennium Development Goals, and streamlining work procedures to free up resources.

Building institutions and capacity. Globalization has added to the push for strong institutions, and increased the importance of technical assistance and training to helping countries put in place the economic institutions crucial to growth and macroeconomic stability. The report proposes strengthening the alignment of technical assistance with evolving Fund priorities across regions, countries, and functional areas, and continuing to enhance fiscal transparency and governance.

Prioritizing work. With the IMF's interest earnings from its large loans of recent years receding, it must set priorities in the framework of a medium-term budget. The report suggests that this will entail reforms affecting expenditures and income, and thus the organizational structure of the institution, staff compensation, and work procedures.

Addressing the issue of voice and representation. Fair weight and voice in the IMF's decision making for all member countries are crucial to the IMF's legitimacy. The current allocation of voting power puts this at risk (see box below).


Stephen Jaffe/IMF

De Rato: The IMF must intensify its focus on helping countries come to grips with globalization.

The report urges resolving these issues during the Fund's Thirteenth General Review of Quotas, which will be concluded in January 2008. ■

The full text of "The Managing Director's Report on the IMF's Medium-Term Strategy" is available on the IMF's website (*www.imf.org*).

Calls for changes in voting shares grow louder

Voice and representation formed one of the main issues discussed during the Annual Meetings. IMF Managing Director Rodrigo de Rato told the Board of Governors that "the Fund's ability to persuade our members to adopt wise policies depends not only on the quality of our analysis but also on the Fund's perceived legitimacy. And our legitimacy suffers if we do not adequately represent countries of growing economic importance." He said this means increases in voting power for some of the emerging market countries, especially in Asia, and also ensuring that Africa is adequately represented. "It's usually taken as axiomatic that if some countries 'win' from a re-allocation of quotas, other must 'lose.' I don't agree. This is not a zero-sum game." And he urged industrial countries to take the lead on this issue.

The Ministers of the Group of 24 developing countries urged in their communiqué that "a new quota formula is needed to reflect more accurately the relative economic size of developing countries in the world, taking into account purchasing power parity and developing countries' greater vulnerability to commodity price fluctuations, volatile capital flows, and exogenous shocks." Ariel Buira, Director of the G24 Secretariat, told a press briefing that without change countries would start "walking away from the Fund," and pointed to Asia as an example where increased regional cooperation—coupled with the huge accumulation of reserves—was reducing the role of the Fund. "If you want the [Bretton Woods] institutions to remain relevant, you need to reform," Buira said.


Michael Spilotro/IMF /File Photo

Buira: Without change, countries would start "walking away from the Fund."

In a recent Executive Board seminar on the issue, Directors agreed that progress will require broad consensus among member countries. Directors examined the options for change if there is no general quota increase: ad hoc increases for selected countries; voluntary adjustments in quotas among country groups or individual members; and an increase in basic votes (which would require an amendment of the Articles of Agreement). With regard to the quota formula, de Rato told the IMFC that although there was support for a simpler and more transparent formula, directors "held differing views on whether adjustments in actual quotas should be linked to agreement on a new formula."

Ministers reach deal on historic debt cancellation scheme

The International Monetary and Financial Committee and the Development Committee reached agreement on a proposal put forward by the Group of Eight (G8) countries to cancel 100 percent of the debt owed by the world's heavily indebted poor countries (HIPCs) to the IMF, the World Bank, and the African Development Fund (AfDF). After months of debate, IMFC Chair and U.K. Chancellor of the Exchequer Gordon Brown announced during the September 24–25 IMF–World Bank Annual Meetings that "agreement has been reached on all the elements," meaning that "this historic process of completing the debt write-off that started many years ago has ended today."

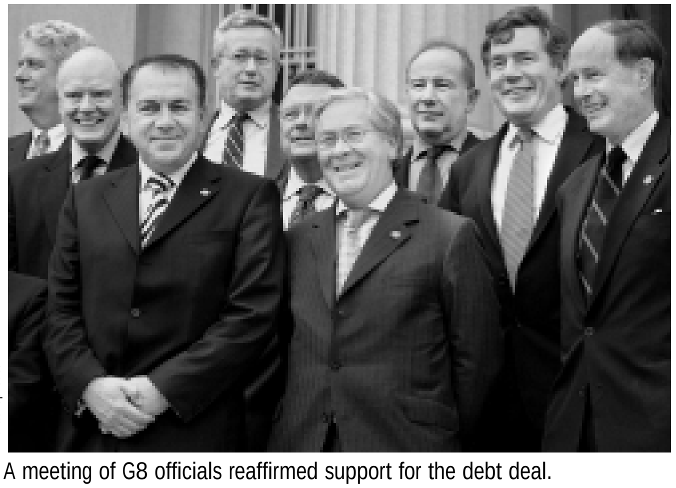
Cancellation of the debt, estimated at around $55 billion will go a long way toward freeing up resources to help these countries accelerate poverty reduction and reach the Millennium Development Goals (MDGs). The 18 HIPCs that could benefit immediately are Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, and Zambia.

Outstanding issues resolved

Agreement by the IMF Governors had hinged on three key issues: additionality, that is, an assurance that the debt relief initiative increase funds available to low-income countries and, in particular, would not reduce the lending capacity of the IMF, the World Bank, and AfDF; uniformity of treatment, which means that eligibility must be based on relevant criteria; and conditionality—conditions that would be placed on recipients of debt relief. "The breakthrough is that we now have a set of proposals that are supported by the whole international community," Brown said. Referring to the debt deal as "the G184 proposal," Trevor Manuel, South Africa's Minister of Finance and Development Committee Chair, said that it sets the stage for faster implementation of the MDGs. Both de Rato and World Bank President Paul Wolfowitz pledged that their respective Executive Boards will now take up approval of the arrangements needed for debt cancellation by the end of 2005.

Stephen Jaffe/IMF

Development Committee Chair Trevor Manuel (center), with World Bank President Paul Wolfowitz (left) and IMF Managing Director Rodrigo de Rato, welcome the debt cancellation for some of the poorest countries.



Michael Spilotro/IMF

A meeting of G8 officials reaffirmed support for the debt deal.

The issue of how to preserve additionality without affecting the finances of the World Bank was resolved when the G8 pledged in a letter to Wolfowitz to "cover the full cost to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled for the duration of the cancelled loans." While the IMF will cover the costs of debt relief with its own resources, the G8 proposal ensures that the IMF has sufficient financial capacity to assist low-income countries. The G8 members also committed themselves to providing contributions to cover additional needs related to the protracted arrears cases (Liberia, Somalia, and Sudan) and other countries that may qualify for assistance under the HIPC initiative.

The issue of uniformity of treatment had come up early in the debate because the G8 proposal had offered debt relief to HIPCs but not poor countries that had been servicing and paying their debt on time. The issue was handled by using per capita income to distinguish how debt relief would be provided by the IMF to the various HIPCs.

Asked by reporters whether debt cancellation could tempt countries to default, Brown said that nobody should draw this conclusion. He said the fact that the conditionality attached to the HIPC process is needed to qualify for debt relief should not be overlooked. The deal "is in no way a signal for people to be profligate." ■

IMF gains new tools in fight against poverty

To bolster the IMF's work in low-income countries, the International Monetary and Financial Committee (IMFC), the IMF's policy steering committee, approved a new set of measures—including assurance of adequate financing for the IMF's main concessional loan facility, a new lending facility, a new tool to support policy programs without financing, and debt cancellation for the heavily indebted poor countries (HIPCs). The hope, the financial officials said, is to strengthen the IMF's role in helping poor countries achieve sustainable growth, reduce poverty, and reach the Millennium Development Goals (MDGs).

"The growing consensus that aid must be increased and debt must be reduced gives us a great opportunity to make a difference to the lives of billions of people," IMF Managing Director Rodrigo de Rato told the IMF's Board of Governors. De Rato added that the IMF's work in low-income countries should tap the organization's core strengths by focusing on macroeconomic policies, including debt sustainability, aid absorption, public expenditure management, and tax policies.


Henrik Gschwindt De Gyor/IMF

Kenya's Finance Minister David Mwiraria (right) welcomed the new Policy Support Instrument, along with other measures aimed at strengthening the IMF's support for low-income countries.

Ensuring financing for the PRGF. The IMFC confirmed that the Poverty Reduction and Growth Facility (PRGF) will remain the IMF's main instrument for financial assistance for poor countries and agreed that concessional lending should be financed at an appropriate level. The IMF will incorporate the lessons of a recent review of PRGF program design and look toward a clearer division of labor with the World Bank.

Policy Support Instrument (PSI). This new tool will allow any PRGF-eligible country that does not need, or want, financial assistance to seek the IMF's advice, monitoring, and endorsement of its policies. Eligible countries should have a poverty reduction strategy in place along with a policy framework for consolidating economic and debt sustainability, and be working on deepening structural reforms in key areas. On-track performance under the PSI, which means that conditionality standards equivalent to those set under an upper credit tranche drawing (over 25 percent of quota) are met, would be a signal that the country has sound economic policies.

Several countries have already expressed interest in the PSI, which will complement, not replace, the PRGF. Nigeria is expected to make the first request shortly after final IMF Executive Board approval of the implementation details of the instrument, as a successful track record under the PSI would pave the way for Paris Club debt reduction.

Shocks facility. This new window in the PRGF Trust will provide concessional financial support to low-income members facing exogenous shocks—such as adverse commodity price swings (including sharp oil price changes), natural disasters, and conflicts and crises in neighboring countries. "We agreed that, because poor countries and poor people should not be left defenseless against oil price shocks, the IMF should stand ready to provide assistance," said Gordon Brown, IMFC Chair and U.K. Chancellor of the Exchequer. This shock-absorbing facility would complement existing instruments such as the Trade Integration Mechanism, which is available to assist countries in dealing with the temporary costs of trade liberalization.

Debt relief. The cancellation of 100 percent of multilateral debt owed by the HIPCs (see page 290) is expected to free up significant resources for countries' efforts to reach the MDGs and reinforce long-term debt sustainability. Stressing that there are only 10 years left to meet the MDGs, Brown said that the international community must now follow through on its commitment to provide additional resources, just as developing countries must implement policies that foster sustainable growth and reduce poverty. ■

For additional information on initiatives to strengthen the IMF's support for low-income countries, see the IMF's website at *www.imf.org/external/np/exr/ib/2005/092015.htm*.

Encouraging *WEO* forecast tempered by increased risks

The IMF's latest *World Economic Outlook (WEO)* sees global growth at a healthy 4.3 percent for both 2005 and 2006 in spite of rising oil prices, but cautions that its new projections are subject to increased downside risks—risks that growth will turn out lower than projected. Briefing the press on September 21, Raghuram Rajan, Economic Counsellor and Director of the IMF's Research Department, pointed to three chief areas of concern: the excessive dependence of global demand on consumption; the elevated level of asset prices, especially for housing; and high and volatile oil prices.

Some have argued that there is a global savings glut, but this is misleading, Rajan said, because the true problem is that in many parts of the world there is too little investment. He saw the current global economic situation as originating in a series of financial crises—in Japan, in emerging markets, and in the information technology (IT) sector—that were triggered by excessive investment. Investment has subsequently fallen off sharply, recovering only tentatively since 2002.

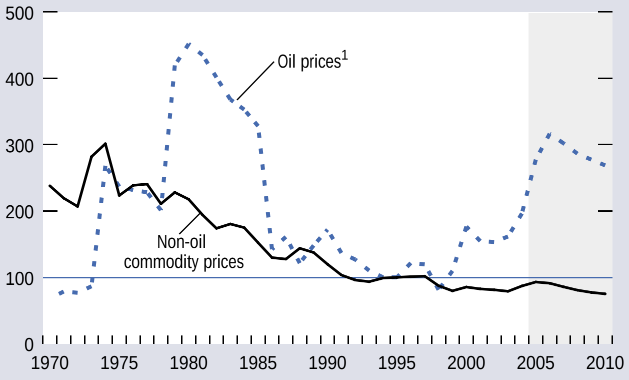
Policy responses have differed considerably across countries. In industrial countries—especially the United States and other Anglo-Saxon countries—low interest rates and expansionary budgets have led to consumption- or credit-fueled growth. Government savings are down, particularly in the United States and Japan, and household savings have fallen in countries experiencing housing booms. By contrast, emerging markets drew lessons from their crises and tightened policies so that they now have fiscal surpluses and have brought inflation down. With corporations cautious about investing and governments similarly prudent about expenditure, growth has become export led, and many emerging markets have been running current account surpluses for the first time. The financing of consumption in rich countries was thus provided by emerging markets.

But this temporary (and effective) response to the crises now needs to be reversed. The world needs two transitions to accomplish this reversal: a transition from consumption to investment, and a reduction of current account imbalances through a shift in demand from deficit countries to surplus countries. Low-income countries, emerging markets (with the notable exception of China), and oil producers need to invest more—high-quality investment that would be promoted by product, labor, and financial market reforms. Strong external demand has allowed a number of these countries to generate growth through exports without the reforms that can create the right incentives to invest, while that demand, originating mainly in a few industrial countries, has been fueled by an increasingly unsustainable fiscal stimulus and inflated housing prices.

Oil prices rising sharply

Increased demand and, more recently, supply contraints are driving oil prices to their highest point since the early 1980s.

(real commodity prices; 1995 = 100)



Note: Shaded areas indicate IMF staff projections.
[1]Simple average of spot prices of U.K. Brent, Dubai Fateh, and West Texas Intermediate crude oil.
Data: IMF *World Economic Outlook*.

Oil prices high and volatile

Rajan termed oil prices—which hit a new high in late August of $65 a barrel (average petroleum spot price) and are now at more than $62 (see chart)—a "clear and present danger." Oil prices have risen by over $20 a barrel since end-2004, and a substantial further increase cannot be ruled out. The rise in oil prices in the past two years has thus far had little effect on growth, partly because it has stemmed more than have earlier oil shocks from strong demand. Lately though, supply shortages and concerns about potential shortfalls have been fueling price increases, which have been weakening confidence and, in economies that are close to capacity, may create stronger inflationary pressures. Rajan stressed that countries need to pass the higher oil cost on to consumers and refrain from subsidies that disguise the real cost. Conservation measures need to be considered. And the oil market should become more transparent so that investors in all links of the supply chain can make informed decisions.

Regional outlooks

Against the background of these concerns, Rajan reviewed the *WEO* projections for the various regions.

U.S. growth slowing. Despite the devastating loss of human life and property, Hurricane Katrina is projected to affect U.S. growth in 2005 by only about 0.1 percent. Until recently, solid growth and booming house prices have allowed consumers to "boldly spend like no one has spent before," quipped Rajan. But now rising inflation is cutting into the spending power of wages, and increasing interest rates are slowing the growth of house prices, so consumer spending is expected to decelerate. The *WEO* projects 3.5 percent U.S. growth for 2005 and 3.3 percent in 2006, slightly below 4.2 percent in 2004.

Euro area continues to disappoint. Weak domestic demand has prompted the *WEO* to lower its projected growth for the euro area to 1.2 percent for 2005 (down from 2.0 percent in 2004 and a drop of 0.4 percentage points from the April projections) and to 1.8 percent for 2006. "Europe's citizens do not seem convinced the bitter medicine of structural reforms will cure the stasis that afflicts much of the continent," Rajan remarked. "Economists can only prescribe, but it takes politicians to persuade. It is a failure of politics that people have not come to see that the more they want to retain the European way of life, the more the way they work will have to change."

Japan looking up. Japan's economy is regaining momentum. Stronger private consumption and business investment mean Japan is becoming less reliant on exports for growth. The first half of 2005 saw very strong growth, and the *WEO* now estimates 2005 growth at 2 percent (up from April estimates of 0.8 percent).

Mixed picture for rest of world. *China* continues to enjoy rapid economic expansion. Growth for 2005 is projected at 9 percent, moderating somewhat to 8.2 percent in 2006. While China has to increase consumption, it also needs to improve the quality of investment. *India* has been growing robustly, Rajan noted, "basking in the glow" of domestic business confidence

Global growth remains strong

Growth has been led by developing countries and emerging markets.

	2003	2004	Proj. 2005	Proj. 2006
		(annual percent change)		
World	4.0	5.1	4.3	4.3
United States	2.7	4.2	3.5	3.3
Euro area	0.7	2.0	1.2	1.8
United Kingdom	2.5	3.2	1.9	2.2
Japan	1.4	2.7	2.0	2.0
Canada	2.0	2.9	2.9	3.2
Other advanced economies	2.5	4.4	3.2	3.9
Newly industrialized Asian economies	3.1	5.6	4.0	4.7
Developing countries and emerging markets	6.5	7.3	6.4	6.1
Africa	4.6	5.3	4.5	5.9
Asia	8.1	8.2	7.8	7.2
CIS	7.9	8.4	6.0	5.7
Middle East	6.5	5.5	5.4	5.0
Western Hemisphere	2.2	5.6	4.1	3.8

Data: IMF *World Economic Outlook.*

Eugene Salazar/IMF

Rajan (right): High and volatile oil prices pose a "clear and present danger."

and increased international interest in its services, including IT. But further reforms and fiscal consolidation are needed if India is to maintain or accelerate the current strong growth. The government needs to build consensus to take the steps that it knows are needed. "As Shakespeare wrote, 'There is a tide which taken at the flood leads on to fortune,'" Rajan quoted, "and India cannot afford to miss the tide again." Growth in *other emerging Asian economies* has moderated because of higher oil prices and the bursting of the information technology sector bubble, but is expected to pick up again in the second half of 2005 if the IT sector rebounds as expected and if oil prices do not take too much of a toll.

After strong showings last year, growth is also slowing down in *emerging Europe* (from 6.5 percent last year to a projected 4.3 percent in 2005) and in *Latin America* (4.1 percent against 5.6 percent in 2004). The decline in Latin America is largely due to an easing of domestic demand growth to a more sustainable pace.

One region for which higher oil prices mean stronger prospects is the *Middle East.* Rising production and prices, and the associated improvements in external accounts and fiscal positions, have combined to fuel growth. But the healthy growth in *Africa* is forecast to moderate to 4.8 percent in 2005, a cut of 0.4 percentage point from the *WEO*'s April projections, partly because of a sharp slowdown in Nigeria as oil production reaches capacity. Exports of non-oil commodities, whose prices have held strong, have helped oil-importing countries weather the higher price of oil. ■

Marina Primorac
IMF External Relations Department

Copies of the September 2005 *World Economic Outlook* are available for $49.00 each ($46.00 academic price) from IMF Publication Services. The full text of the *World Economic Outlook* is available on the IMF's website (*www.imf.org*).

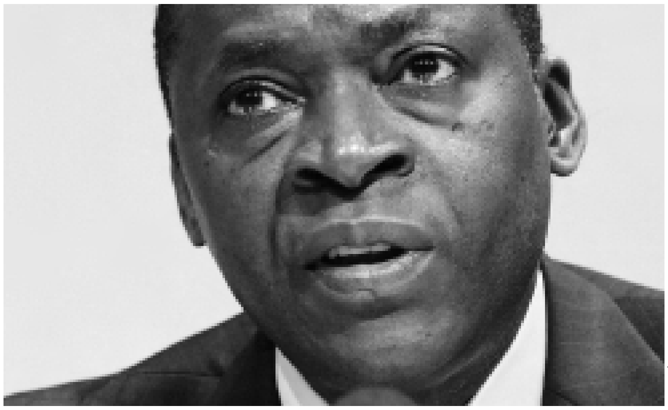
African Regional Economic Outlook

Growth remains robust but MDGs still out of reach

Growth in sub-Saharan Africa remains strong and prospects for next year are very good, but this growth is still insufficient to meet the Millennium Development Goals (MDGs), remarked Abdoulaye Bio-Tchané, IMF African Department Director, at a September 23 press briefing on the region's recent economic developments and prospects. Real GDP growth for the region is expected to slow to 4.6 percent in 2005 from 5.3 percent in 2004, largely because of a deceleration of growth in oil-producing countries and a further worsening of oil importers' terms of trade.

Despite the impact of higher oil prices, real GDP growth in non-oil-producing economies is expected to remain unchanged at 4.5 percent on average in 2005, and to exceed 5 percent in more than one-third of these economies. According to the latest *Regional Economic Outlook: Sub-Saharan Africa Supplement*, continued sound policies have helped many of these economies achieve sustained, robust growth. In some oil-importing countries, higher world prices for cocoa, coffee, tea, and some metals have offset, to some extent, the negative impact on the terms of trade of rising oil prices and declining prices for food and other agricultural exports. However, the U.S. dollar's appreciation vis-à-vis the euro during 2005 has had an additional negative effect on the terms of trade of the CFA franc zone countries in West and Central Africa, which peg their currency to the euro.

CFA franc zone countries are among the 24 countries in sub-Saharan Africa that account for 6 percent of world textile and cotton output. Developments in textile and cotton markets have further worsened the terms of trade for these 24 countries and dampened their growth prospects. Although cotton prices recovered somewhat in the first half of this year, prices remain well below the average of recent years, largely because of oversupply caused partly by continued subsidization of the sector in high- and middle-income countries. Moreover, African textile exporters have not fared well from the ending of the Multifiber Arrangement in January 2005, losing out to competition from China and other Asian countries, especially in the U.S. market. Sub-Saharan African textile and clothing exports to the United States fell by around 5 percent in the first four months of 2005, compared with the same period last year. In contrast, exports from China, Hong Kong SAR, and Macao SAR to the United States rose by more than 36 percent.



Bio-Tchané: Food insecurity remains a serious problem in many countries in Africa.

Strong performance projected for sub-Saharan Africa

Oil producers are forecast to grow at significantly higher rates in 2006.

	2003	2004	Proj. 2005	Proj. 2006
		(percent change)		
Real GDP growth for sub-Saharan Africa	4.1	5.3	4.6	5.3
Oil-producing economies	8.1	8.2	4.7	8.1
Non-oil-producing economies	2.9	4.5	4.5	4.5
		(annual average, percent change)		
Consumer prices for sub-Saharan Africa	13.4	9.4	9.9	8.3
Oil-producing economies	17.0	12.7	11.8	6.2
Non-oil-producing economies	12.4	8.4	9.4	8.9

Note: The oil-producing economies are Angola, Cameroon, Chad, Congo (Republic of), Côte d'Ivoire, Equatorial Guinea, Gabon, Nigeria, and São Tomé and Príncipe. The non-oil-producing economies are Benin, Botswana, Burkina Faso, Burundi, Cape Verde, Central African Republic, Comoros, Congo (Democratic Republic of), Ethiopia, The Gambia, Ghana, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritius, Mozambique, Namibia, Niger, Rwanda, Senegal, Seychelles, Sierra Leone, South Africa, Swaziland, Tanzania, Togo, Uganda, Zambia, and Zimbabwe.
Data: IMF, *Regional Economic Outlook: Sub-Saharan Africa Supplement*, September 2005.

Further increases in oil prices and poor harvests in some countries have put upward pressure on inflation, especially in oil-importing countries. Average inflation in the region is forecast to rise half a percentage point, to 9.9 percent, in 2005, but to fall back to 8.3 percent in 2006, on the basis of continuing prudent monetary policies and subdued world inflation.

Food shortages plague many countries

In the past year, poor harvests in the Sahel region and several countries in eastern and southern Africa have depressed economic performance. Food production shortfalls are expected this year in Burundi, Chad, Malawi, Mozambique, Niger, and Swaziland, and the Food and Agriculture Organization has identified as many as 20 sub-Saharan African countries in need of food assistance. Recurring food shortages reflect the cumulative effects of adverse shocks on fragile environments—made worse, in some cases, by conflict, political turmoil, and the effects of HIV/AIDS on the agricultural labor force.

Many sub-Saharan African countries are finding it increasingly challenging to implement appropriate policies to adjust to external shocks, the report points out. Notably, oil importers' external and domestic balances have been deteriorating. The report urges oil importers to contain emerging fiscal pressures by cutting nonpriority spending, strengthening the revenue base, and, where possible, allowing exchange rate flexibility. Strong policy frameworks should accompany increases in aid or debt relief so that these flows can be more effectively absorbed. Factors that would help mitigate pressures for real exchange rate appreciation include high import content in additional public spending, focusing higher spending on infrastructure improvements to boost productivity and ease supply bottlenecks, and further trade liberalization. For the region's oil producers, accumulating foreign exchange reserves—generally accompanied by a buildup of net government assets with the central bank—can be an appropriate way to ease pressures for real appreciation caused by strong oil revenues.

For oil-producing countries, the average current account surplus, including grants, is projected to increase from 2.3 percent of GDP in 2004 to 7.7 percent this year. Higher revenues have enabled these countries to strengthen their fiscal positions, with the group's overall fiscal surplus projected to rise to 7.9 percent of GDP, from 4.3 percent last year. The report urged oil-producing countries to continue to smooth the fiscal spending response to higher oil prices, take a long-term perspective in implementing fiscal policy, and, especially in view of the scope for "rent seeking" associated with oil windfalls, improve fiscal transparency. At the same time, decisions concerning the extent to which fiscal spending is increased over time need to take into account individual country circumstances.

Political and economic risks cloud prospects

Although the region's economic growth in 2006 is expected to rebound to 5.3 percent, largely on the strength of economic activity in oil-producing countries, the report underscores that the region's prospects remain subject to a number of political and economic risks. If the recent international focus on further reducing debt and stepping up aid bears fruit, economic growth and poverty reduction would advance—assuming recipient countries implement policies that ensure the effective absorption and use of new aid flows.

On the downside, the European Union (EU) proposed sugar reforms—which would dramatically cut the internal EU sugar price and eliminate special quotas beginning in 2006—could lead to severe export revenue losses for several sugar-producing countries such as Mauritius and Swaziland. Other downside risks include the continued vulnerability of much of the region to drought and other natural disasters, the impact of HIV/AIDS, and the still-fragile security situation in the Great Lakes region. Uncertainties in world oil and other commodity markets also pose risks for the region. ■

Jacqueline Irving
IMF Survey

The full text of the *African Regional Economic Outlook: Sub-Saharan Africa Supplement* is available on the IMF website (*www.imf.org*).

African ministers applaud debt deal

African finance ministers attending the IMF–World Bank Annual Meetings welcomed the G8 debt relief proposal to cancel the multilateral debt of the Heavily Indebted Poor Countries (HIPCs) but urged more initiatives to help Africa meet the Millennium Development Goals (MDGs) by 2015.

During a September 24 press briefing, finance ministers from Niger, Kenya, and Zambia heralded the debt cancellation as an opportunity for poor countries to use the freed-up resources in their efforts to reach the MDGs. Finance ministers Ali M. Lamine Zeine and David Mwiraria from Niger and Kenya, respectively, suggested that the G8 proposal be extended to non-HIPCs with similar income and poverty levels. Kenya, for example, is not a HIPC country, but eager to reach the MDGs nonetheless, Mwiraria said. "Therefore, while appreciating what is being done for our HIPC brothers, we think we should be considered for that waiver as well as for increased aid," he added.

The ministers also urged the IMF and World Bank to go further in simplifying and rationalizing its conditionality, and making it easier to apply. Zeine said that although the IMF had already taken encouraging steps to rationalize program conditionality, progress was still below expectations. While Zambia's finance minister Ng'andu Magande echoed this view, he stressed that the conditionality in these programs "must be our own" and cannot be imposed. He described Zambia's experience as one of good cooperation, where IMF staff and Zambian authorities sit down together to discuss and draft a mutually binding agreement. Both Magande and Mwiraria strongly welcomed the potential role of the IMF's new Policy Support Instrument (see page 291), as a nonfinancial mechanism that would give clear signals on a country's policies.

Latin America Regional Outlook

Region builds resilience to shocks, less crisis prone

Latin America is becoming more resilient against economic shocks and less prone to crises as a result of a range of difficult policy measures that have been undertaken in many countries of the region in recent years, Anoop Singh, Director, of the IMF Western Hemisphere Department, told a press conference on September 23. This is good news given Latin America's need to keep growing and to grow faster, in a sustainable way. But risks remain, including from global developments, he said.

Recent developments in Latin America have been encouraging. Over the last year or two, he said, the region has benefited in different ways from commodity price developments, from terms of trade gains, and from diversifying and strong export growth. Financial market conditions have been favorable, and sovereign spreads have reached record lows. Domestic demand growth has remained healthy; inflation is still generally well-contained; unemployment is on a downward trend; and poverty indicators are improving. The IMF projects growth in the region to reach about 4 percent in 2005 and 3.75 percent in 2006, still above historical averages, although below the near-record rate of 5.6 percent in 2004 because many post-crisis countries are returning close to capacity.

Eugene Salazar/IMF/File Photo

Singh: Latin America needs faster and more sustainable growth.

Latin America has built up greater economic resilience through:

Strengthening fiscal policies. Governments have generally maintained tight control over spending and avoided the pro-cyclical tendencies of the past, which have contributed to declining public debts and improved debt profiles. Several countries—most notably Brazil, Chile, Colombia, Mexico, and Peru—have increased their reliance on domestic debt issuance, reducing their vulnerability to exchange rate risk and deepening local-currency markets.

Prefinancing obligations. Many countries have taken advantage of benign financial market conditions to prefinance their external public sector borrowing requirements for this year, with some already covering requirements for 2006.

Improving monetary policies. Better monetary policy frameworks have contributed to a remarkable reduction in inflation over the past decade, anchored in many cases on inflation targeting regimes. Commitments to broad price stability have been illustrated by the willingness of many monetary authorities to tackle inflationary pressures at an early stage, although inflation remains relatively high in some countries.

Strengthening external positions. Much of the region is running trade and current account surpluses, and rising reserves in many countries are providing a larger buffer against external shocks. Most countries have also adopted more flexible exchange rate systems.

Risks ahead

Singh underscored that countries need to take advantage of the currently benign external environment to "strengthen underlying policy positions further and boost the region's long-run growth potential." The region can safeguard against risks, benefit fully from globalization, and sustain and strengthen growth, if governments preserve stable economic policies and press ahead with reforms to remove barriers to private investment and growth.

He said the biggest risk is continued high and volatile oil prices. But so far, the impact of recent oil shocks, including from Hurricane Katrina, "has been surprisingly moderate" both on the global economy and the region. The impact has been larger in Central America and the Caribbean, where countries are net oil importers. For them, it is a major challenge to try to balance the pressure on their fiscal positions and the pass-through into domestic prices of the higher oil prices.

Another risk is a possible abrupt tightening of global financial market conditions—with the emphasis on abrupt, given that some tightening is inevitable as a result of cyclical developments. This is particularly a problem, he said, because of the still relatively high external public debt ratios in many countries of the region.

Finally, there is the risk of continuing competitive pressure from other countries in export markets and a possible rise in protectionist sentiment globally. But, on the plus side, he noted, export growth in the region has been impressive; the Central America Free Trade Agreement should help as countries strengthen their institutions to maximize benefits from the agreement; and the Doha Round holds the promise of gains for the global community—which is why the world at large should apply pressure to conclude the global trade talks successfully. ■

China's reforms hold key to continued dynamism

China's economic powerhouse continues to dazzle: growth is high, inflation remains low, and initial steps have been taken toward a more flexible exchange rate. But to keep growth strong and build a more effective financial sector, China will need to undertake ambitious and intertwined reforms. Top priorities, says Steven Dunaway, Deputy Director in the IMF's Asian and Pacific Department, in an interview with Sheila Meehan of the IMF Survey, *are developing a banking system that operates on a sound commercial basis and ensuring a strong fiscal position and a responsive transfer system that will allow the country to meet rising demands for pensions, health care, and education.*

IMF SURVEY: Isn't China now a key engine of world growth? And if so, doesn't it bear a major responsibility in helping resolve global imbalances?

DUNAWAY: China certainly has become an engine of growth in a regional context. Over the past decade, manufacturing processing has shifted to China, with components coming from such countries as Japan, Korea, Malaysia, and Singapore. But it is harder to make the case that China is an engine of global growth. Ultimately, the key source of demand for China's products remains the industrial countries, with the United States, of course, being the leading export recipient.

As for global imbalances, in our policy advice to China, we've consistently talked about why various changes in policy—in particular, a change in the exchange rate regime—are in China's best interest. At the same time, a change in China's exchange rate could help deal with global imbalances. This is partly through a possible indirect effect—through potential changes in the exchange rate policies of other Asian countries as well. Many of these economies are China's principal competitors, and they have tended to look at China's previously fixed rate to the dollar in keeping fluctuations in their own currencies in narrow ranges.

IMF SURVEY: What do you say to critics who charge that China's massive trade surpluses and rising foreign exchange reserves are evidence of exchange rate manipulation and that the IMF should be doing something about this?

DUNAWAY: It's very difficult to establish manipulation. From the late 1990s into the early 2000s, the U.S. dollar appreciated, and the Chinese renminbi appreciated along with it. Since then, the dollar has depreciated, and the renminbi has come down with it. So China essentially played by the rules for a fixed currency, allowing it to move in both directions against non-dollar currencies.

Dunaway: "The IMF . . . is encouraging the authorities to make full use of the flexibility that the new [exchange rate] regime provides."

But the critical question, and the one that the IMF asked over this period, was whether a fixed exchange rate was really in China's best interest. Increasingly, it became clear that more exchange rate flexibility would be better for China. This was certainly the case over the past two to three years during which China has had a massive increase in reserves and has seen rising speculative pressures. The fixed rate also created problems for domestic monetary policy and constrained efforts to control liquidity in the banking system. The IMF welcomed China's move in late July toward greater exchange rate flexibility and is encouraging the authorities to make full use of the flexibility that the new regime provides.

IMF SURVEY: To what extent has China now supplanted Japan as a convenient "bogeyman" for the West?

DUNAWAY: I guess that there has always been a "bogeyman." In the late 19th and early 20th centuries, it was low-cost U.S. goods that terrified English and other European competitors. In the 1960s and 1970s, there also were fears that the United States, through its foreign investments, would buy up the world. Over the past several decades, Japan and, to a lesser extent, Korea and the Southeast Asian economies have filled this role. Now, China is the chief source of low-cost production and the principal perceived threat.

The reality is that low-cost goods from China have brought the world tremendous benefits—an example of why the IMF pushes for trade liberalization and talks about globalization's benefits. Of course, some people have suffered short-term adverse effects. Change involves adjustment, which entails short-term costs, which can create frictions and problems, and which call for effective and well-targeted social safety nets and other policies to help people adjust.

Much depends upon the overall economic environment. Protectionist pressures were relatively muted in the United States in the mid-1990s, when output and employment were rising faster. Adjustment costs tend to be lower in a rapidly growing economy; people can move between jobs more easily. But with slower output and job growth in the United States and even slower growth and higher unemployment in Europe, these frictions tend to play out in more protectionist pressures.

IMF Survey: China has had some success in slowing down investment growth, but is it truly under control? Aren't there legitimate worries about overinvestment and excess capacity leading to deflationary pressures?

Dunaway: The Chinese authorities ask themselves these questions and one more: Even if investment growth is under control now—and the authorities have managed to slow investment growth—will it stay under control? One encouraging sign is a shift in composition away from sectors where overcapacity was developing (metals, automobile production, and real estate) toward sectors where bottlenecks appeared last year, notably electricity generation and various parts of the transportation network.

But liquidity in the banking system is still high. While banks have limited loan growth this year for a variety of reasons, the means to fuel a resurgence in lending and investment is sitting in the banks. So, we've advised the authorities to do more to drain that liquidity out of the system.

In terms of deflationary pressures, we do see overcapacity in some sectors—particularly automobiles and steel—but we don't see this triggering more generalized deflation. Our chief concern is how overcapacity might adversely affect the profitability of the enterprises in these sectors and their ability to service their bank loans. A lot of government funds have already gone into taking the old nonperforming loans off the books of the major banks. The last thing we'd want is a buildup of new nonperforming loans.

IMF Survey: How critical is it for China to develop a healthy banking sector?

Dunaway: The banking sector plays a fundamental role in any economy, but particularly in China, where national saving is around 50 percent of GDP. In the past, the banking system hasn't done a very good job of taking savings and translating them into profitable investments, as reflected in the large buildup in nonperforming loans, which was, in part, a product of directed lending or lending by fiat.

More recently, however, China has done a lot to restructure bank balance sheets and has begun to restructure bank operations, too. Over the past year and a half, there have been capital injections in three major banks. These capital injections have been linked to restructuring plans that set specific milestones for reducing nonperforming loans, boosting capital, and improving returns on equity and assets. The basic objective is to get China's banks to operate on a sound commercial basis, and an important part of this is strengthening the banks' ability to assess and price risk.

Up to now banks have lent primarily to large-scale, capital-intensive companies, most of which have a significant state presence. But with China's excess labor estimated at 150–200 million people, capital-intensive development isn't what you want. If banks can do a better job of pricing risk, the hope is that more credit will flow to small and medium-sized enterprises, because these play a major role in creating new jobs.

IMF Survey: The authorities have agreed, in principle, to an evaluation under the IMF-World Bank Financial Sector Assessment Program [FSAP]. Would it be better to do this sooner rather than later?

Dunaway: The authorities recognize that an early FSAP can help them formulate plans to restructure and develop the financial sector. The FSAP is not just a stock-taking exercise; it's also a means of measuring where a country's financial sector stands relative to various international standards. And it doesn't cover just the banking system. It involves the whole financial system and can be useful in developing or strengthening stock and bond markets.

IMF Survey: Is China's fiscal position—a deficit under 3 percent of GDP and falling—as good as it looks?

A growing presence in the world economy

China continues to enjoy high growth while containing inflation.

	2001	2002	2003	2004	Proj.[1] 2005
		(percent change)			
Real GDP	7.5	8.3	9.5	9.5	9.0
Consumer prices (period average)	0.7	–0.8	1.2	3.9	3.0
		(billion U.S. dollars)			
Gross official reserves[2]	219	295	412	619	829
		(percent of GDP)			
Current account balance	1.5	2.8	3.2	4.2	6.0
Overall budgetary balance[3]	–3.1	–3.3	–2.8	–1.7	–1.7

Note: Data/projections as of August 29, 2005.
[1]Excludes government-guaranteed debt.
[2]Includes gold, SDR holdings, and reserve position in the IMF.
[3]Central and local governments. The 2005 figures reflect official budget data.
Data: Chinese authorities and IMF staff estimates.

DUNAWAY: It's good, and it's appropriate at this point to have a steadily improving fiscal position. What you are really asking about, however, is the status of the so-called contingent liabilities that the Chinese government has. On the books, official government debt is relatively low, but the recapitalization of the banking system and the writing off of nonperforming loans represent a substantial contingent liability. There are also potentially large contingent liabilities arising from obligations of the pension system. Going forward, there are likely to be large demands for social services as state-owned enterprises unbundle services that they used to provide, particularly health care and education. This unbundling also creates an additional source of tension between the central and local governments, because local governments are responsible for delivering education and health care but may not have the resources to fulfill these functions.

The situation can get even more complicated as you look ahead. China has a very large, underemployed rural population and is likely to experience continued and very large internal movement of population from rural to urban areas, especially migration from the western provinces to the coastal areas. Out-migration will make it difficult for rural governments to raise sufficient resources to fund basic government services, and this may encourage further out-migration. At the same time, in-migration to urban areas will place heavy burdens on local governments to provide needed infrastructure and meet demands for services, particularly education and health care. The central government will be faced with a tremendously complicated balancing act in trying to facilitate this adjustment and ease the burden of the transition. Frankly, there may be little in the experience of other countries that China can draw on. Internal migration on this possible scale hasn't been experienced elsewhere in modern times.

IMF SURVEY: In the ongoing reform of state-owned enterprises, the IMF is urging the authorities to require profitable enterprises to pay dividends to the government. Is this a big issue?

DUNAWAY: It's a very big issue in a couple of senses. First, the government owns these companies, and the benefit from them should accrue to the government, particularly as they're restructured and potentially sold off. Thus far, in the stock issues of state-owned enterprises, the proceeds have been retained by the companies for capital investment.

Second, some companies, particularly resource-based ones, have been tremendously profitable in recent years. They have extensive retained earnings that they've used for investments, some of which haven't been in their core businesses. It's not clear that these investments will provide the government with the highest return on its capital, so you do want the government, as an owner, to have a say in the use of these funds.


Roger Ressmeyer/CORBIS

Broader and more rapid reform can help China keep pace with rising demand for jobs and social services.

IMF SURVEY: Most of these reforms are both complex and intertwined. Should China attempt to tackle all these at once?

DUNAWAY: You do have to make some choices, but these issues are interlinked. China's traditional approach to reform has been to take small steps and use pilot projects. If something succeeds on a small scale, it's then broadened. That worked well in the early days, but with these large, interlinked reforms, it's more difficult to take small, discrete steps. For example, bank reform potentially has consequences for state-owned enterprises. Weaker enterprises that have managed to survive based on their access to credit may have little or no access to credit once banks start making decisions on strictly commercial terms.

Of course, if these enterprises are unable to continue, that has implications for employment and for the government, which will need to take up the services that the enterprises had been providing, as well as possibly fund social safety nets for unemployed workers. And that brings in the question of fiscal reforms and reforms in the transfer system between the central and local governments as well as the mix of taxation.

IMF SURVEY: Is a new paradigm for reform needed?

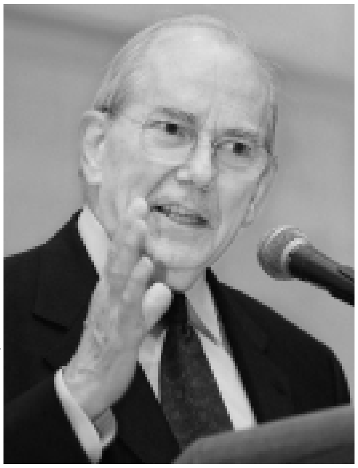
DUNAWAY: Not so much a new paradigm, perhaps, as a pickup in the tempo and scale of China's reforms. In fact, if you look carefully at the recent past, some of this is already happening. ■

For more information, please see Public Information Notice No. 05/122 on the People's Republic of China on the IMF's website (*www.imf.org*).

Camdessus calls for IMF to adapt to changing times

How will the IMF, the World Bank, and other international financial institutions (IFIs) need to change over the next 10–15 years? This was the question asked—with particular focus on the IMF—by Michel Camdessus, IMF Managing Director from 1987 to 2000, in his Per Jacobsson Foundation lecture on September 25 in Washington, D.C.

He said the IFIs should continue to play a vital role in providing a global environment of stable and sustainable growth, helping emerging market countries develop, and helping the poorest countries reduce poverty. At the same time, they must help address a range of challenges including global current account imbalances, worldwide demographic transitions, and the global energy crisis.



Henrik Gschwindt De Gyor/IMF

Camdessus: Reform must take "on board the ethical requirements embraced by today's public opinion."

But to continue performing these roles effectively, he said, the IFIs must adapt their missions, resources, and governance. And they need to do so in ways that take "on board the ethical requirements embraced by today's public opinion"—good governance, public ownership of policies, and partnership between developing and developed countries.

Adapting missions

How might the IFIs' missions adapt? Camdessus outlined three priorities:

Strengthening IMF surveillance. The preliminary conclusions of IMF staff missions for country consultations should be open to public debate. The IMF should also pay more attention to long-term, structural developments; focus more on international spillovers and the systemic impact of countries' policies (such as global payments imbalances); and conduct more precise analysis, with the World Bank, of efforts to meet the Millennium Development Goals (MDGs).

Better equipping the IMF. The IMF must be equipped with "explicit competence and proper instruments" in the areas of capital account liberalization and orderly debt workouts, and for its role as an international lender of last resort. On capital account liberalization, "with the benefit of hindsight" [since the failed moves of 1997 to amend the IMF's Articles of Agreement to give the IMF jurisdiction in this area], "we should now revisit the issue, taking advantage of the lessons learned." As the international lender of last resort, the IMF should be authorized to inject international liquidity temporarily at times of crisis, through the creation and selective allocation of special drawing rights (SDRs).

Adapting financing instruments. All development partners should "concentrate their means and leadership in contributing to the MDGs." The World Bank's role as a long-term lender should be increased, including through greater concentration on infrastructure investment. And the IMF's membership should reaffirm its mission in support of its poorest members "as an essential part of its purposes under the Articles [of Agreement]," provide higher access to its concessional windows, and not relax the discipline of conditionality, which he did not view as being in contradiction with country ownership of programs.

Adapting resources and governance

On IMF human resources, Camdessus called for "strengthening, not downsizing" its staff. On IMF financial resources, he reiterated his view on the need for "significant periodic increases in quotas" and also for periodic allocations of SDRs. And on adapting governance, he called for the introduction of a "Council"—a political decision-making body that would be responsible for the major strategic decisions relating to the IMF—as well as for reforms in the size and composition of the Executive Boards of the IMF and the World Bank and in the procedures for selecting the heads of the two institutions. ■

Archana Kumar
IMF External Relations Department

The full text of Michel Camdessus's lecture, *International Financial Institutions: Dealing with New Global Challenges*—Per Jacobsson lecture 2005—is available on the Per Jacobsson Foundation website, *www.perjacobsson.org*.

The *IMF Survey* (ISSN 0047-083X) is published in English, French, and Spanish by the IMF 22 times a year, plus *IMF in Focus*. Opinions and materials in the *IMF Survey* do not necessarily reflect official views of the IMF. Any maps used are for the convenience of readers, based on *National Geographic's Atlas of the World*, Sixth Edition; the denominations used and the boundaries shown do not imply any judgment by the IMF on the legal status of any territory or any endorsement or acceptance of such boundaries. Text from the *IMF Survey* may be reprinted, with due credit given, but photographs and illustrations cannot be reproduced in any form. Address editorial correspondence to Current Publications Division, Room 7-106, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-8585; or e-mail any comments to imfsurvey@imf.org.

To request an *IMF Survey* subscription ($109.00 annually for private firms and individuals) or IMF publications, please contact IMF Publication Services, Box X2005, IMF, Washington, DC 20431 U.S.A. Tel.: (202) 623-7430; fax: (202) 623- 7201; e-mail: publications@imf.org. The *IMF Survey* is mailed first class in Canada, Mexico, and the United States, and by airspeed elsewhere.