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Statement by H. E. Ms. Felisa Miceli
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On Behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

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Speaking on behalf of the Southern Cone Countries of Latin America
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1. The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

The world economy continues to show strong growth along with ever increasing external imbalances. Notwithstanding the sustained high price of oil and the continued tightening of the U.S. monetary policy, which is now well within the neutral territory, the world economy remains strong while consumer price inflation expectations remain subdued. The prospects for the world economy are favorable in the short-run given the continued strength of the U.S. and China and the dynamism of domestic demand in Japan and in Europe. The Middle East, Russia and several countries in Latin America are posed, in turn, to achieve continued high growth. In the case of Latin America, it is worth stressing that the presently supportive external environment has been accompanied by a substantial strengthening of the financial and macroeconomic fronts along with public sector debt declines and fiscal consolidation. This has contributed, in turn, to make the region more attractive as an investment destination, including for domestic residents. The world's short-term bonanza could turn, however, into a crisis of global proportions if these favorable times are not used to introduce the necessary adjustment of policies aimed at reversing global imbalances.

While external imbalances represent a serious threat to growth in the medium-term, which is why they are a matter of concern, in the short-run external imbalances allow the world economy to continue growing at unprecedented rates. Of course, there are other underlying factors that are supporting growth, in particular the widespread globalization of the goods and services markets, the impressive pace of technological progress, and equally important, the expansive monetary policies of major central banks which have ensured abundant liquidity that has helped not only to support growth in the domestic economies but also, in the context of unbridled financial markets, to move easily from country to country and from currency to currency. **The foremost critical challenge for all of us is how to contribute to a sustainable growth for the world economy and how to better distribute its fruits to ensure that our fellow citizens remain supportive of the process**. It is clear to us that to achieve sustainable growth, we should aim not just at keeping inflation subdued but, perhaps more importantly, at achieving a kind of growth that is both equitably distributed amongst and within countries and also respectful of the environment.

We all agree that persistent high imbalances represent a major vulnerability. They generate an exponentially growing holding of U.S. dollar-denominated financial assets and if the time comes when investors consider that enough is enough, this would unleash a chain reaction that will certainly plunge the world economy into a major recession. This is not unlikely to happen; it is critical, therefore, to reduce global imbalances in the less disruptive way possible, while trying to avoid adverse effects on growth and employment.

The IMF has been forthright in providing members with adequate analysis of the ever-growing imbalances and a bit less forthright in presenting them a policy package that could unwind them. It has become clear that such a policy package would require coordinated domestic policies aimed at reducing domestic demand in deficit countries, notably the U.S., and at increasing domestic demand in surplus countries, notably China, Japan and other Asian emerging markets. Consequently, **a multilateral understanding by which the biggest economies would undertake a gradual phase-in of economic domestic policies is essential. The IMF has a decisive role in brokering such an understanding.**

The IMF is in the best position to do so. It has a global membership and its main purpose is promoting global monetary cooperation among its members as a way to maintain high levels of employment and real income in the world. It is, also, entitled with a surveillance authority on all of its members. Thus, there is not better organization in which progress in the coordination of policies among countries, particularly systematically important ones, could be achieved.

As regards the content of the policy package that we should undertake, allow me to make one comment. We all know that exchange rates should be part of the package but we would mislead ourselves if we come to believe that all will be solved by a depreciation of the U.S. dollar. Of course the policy package that the Fund has been hinting at is more comprehensive than this as it also calls for collective actions from all members to avoid the type of beggar-thy-neighbor policies that the Fund must prevent. Collective action is critical to achieve the desired exchange rate movements but it does not, and it should not, stop there. Fiscal adjustment in the U.S., measures supporting domestic consumption in China, more investment and domestic consumption in other Asian countries and growth-promoting structural reforms in Europe and Japan should all be part of a coordinated multilateral agreement aimed at an orderly reduction of external imbalances.

Notwithstanding the importance to address external imbalances sooner rather than later, the fact is that in the short run they do not appear to raise an immediate concern. In the short run the threats to global growth are represented, instead, by a continued high price of oil, the likelihood of a bird flu epidemic and most importantly by the potential impact of the tightening cycle of the monetary policies in major economies. Particularly significant at this stage is the impact on the real estate market which has been a main supporter of consumption and growth through the wealth effect in several countries, especially in the US.

As I have stated at the beginning, expansive monetary policies have contributed to global growth directly by energizing domestic economies and indirectly by providing a pool of financial assets that moved from country to country, notably to the U.S, allowing the persistence of global imbalances. To reverse the policy of monetary expansion is certainly necessary, but the key question is how deep and lasting will be the monetary tightening that has been initiated. In this regard, I welcome the moderated pace followed by the FED and hope the tightening cycle at the US may be approaching an end. This would confirm my impression that if the central banks of major economies deserve some praise for the present favourable juncture of the world economy it is for having been able to counteract the existing deflationary pressures rather than for having maintained consumer price inflation subdue.

Low consumer price inflation has not been primarily a merit of central banks as the WEO argues, linking it to the inflation-fighting credentials of central banks. It was due, rather, to the success of globalization that opened global markets to low-cost producers in emerging markets. Another factor has been the favorable supply shock represented by the impressive pace of technological progress that has taken place. These factors, along with **the worrisome fact that wages appear to have been disconnected from increases in productivity**, have set deep world-wide deflationary pressures that, as I have mentioned before, central banks proved, so far, able to counteract. Of course, the building-up of unprecedented external imbalances also represents a major potential cost of those expansive monetary policies, the magnitude of which will be directly related to the ability of the international community to redress those imbalances in an orderly manner.

It is very important to have a correct perspective in relation to the role played by central banks in this process. In this regard, we believe that **we should avoid creating the perception that central banks per-se are able to deliver growth and low inflation on a sustainable basis.** If this view gets entrenched, there is a risk that protectionists' interests may have their day in the misleading hope that central banks will be able to continue delivering growth and low inflation.

Protectionist pressures, both in terms of keeping the old barriers and of raising new ones, have indeed grown as of late. If a disorderly reversal of external imbalances would take place, this would give further strength to the protectionists/nationalistic sentiment that we perceive in some capitals, compounding the likely recessionary shock. **This highlights the need for a successful completion of the Doha Round of trade negotiations. However, such an outcome would only be possible if we can agree to eliminate trade-distorting subsidies and to lower trade barriers, starting by those that, as tariff escalation, are a drag to the capacity of developing countries to add value to their exports.** This would not only enhance growth but would also help reduce poverty in countries with a significant pent-up demand, hence, playing a positive role in the redressing the global imbalances.

As I have mentioned above, **one of the factors underlying the present deflationary pressures is the disconnection of wages from productivity gains, as adequately noted in the WEO. This is worrisome for several reasons**. First, because decoupling salaries from gains in productivity is unfair and seems to be at odds with the need to revamp demand in countries other than the U.S. Second, because it would be very difficult to fight against the revival of the protectionist sentiment if people continue to perceive that globalization brings a race to the bottom in the remuneration of labor. Finally, **by giving policy advice requesting more labor flexibility without first considering whether internationally recognized core labor standards are being complied with, and whether the black economy is already providing too much "flexibility" to the labor market, the Fund may have made things worse.**

Rather than being part of the problem, I would like to see the Fund as part of the solution. We should keep in mind that the real goal is to maintain high levels of income and employment; consequently, both the Fund and the Bank should promote those labor market policies that maximize employment creation while respecting the right of workers to receive a level of income consistent with the level of productivity and effective social protection to cope with the temporary spell of unemployment. It goes without saying that the persistent fall in the share of labor in GDP must be stopped in order to ensure sustainable growth of the world economy. The WEO analysis on the abundance of savings in the corporate sector, due in part to the fact just mentioned, states that these savings could be channeled to increased investment, thus contributing to support growth. However, **if the share of labor in GDP is not improved, it is difficult to expect that corporations find enough effective demand to justify increased investment plans**.

It is also important that **the Fund and the Bank request the opinion of the International Labor Organization (ILO) before giving policy advice on labor matters**. This would help to promote coherence between the IFIs' policy advice and policies that the specialized agency of the United Nations are pursuing. In sum, we believe that the strengthening of labor's share in income should be part of an eventual coordinated agreement to address external imbalances in an orderly manner.

2. Implementation of the IMF's Medium-Term Strategy

I welcome the decision to start as soon as possible with the implementation phase of the Medium-Term Strategy. **I attach particular importance to the streamlining of the work of the Executive Board, management and staff so as to be able to concentrate on multilateral surveillance**. The IMFC, in turn, should become more effective in channeling the conclusions of the Fund's work in the form of internationally agreed-upon policies into concrete implementation by the members. Supplemental consultations to take up issues with a subset of systemically or regionally important members could add effectiveness to the task of multilateral surveillance.

I would like the Fund's focus not to be reduced to just financial and capital markets issues. It is critical not to underplay trade related matters once again in the agenda of the institution with the pretense of streamlining work. Fair trade liberalization is critical for the financial stability of developing countries and for the stability of the global economy at large. The Fund should maintain its presence in this critical debate which has also direct implications to the issue of aid for low-income countries, which could be better served by an open trade system than by the rather ineffective mechanism of donors' handouts.

On the issue of the equilibrium exchange rates, **I welcome the intention to expand the scope of the present assessment to emerging markets, but I would have strong reservations to the idea of publishing the information which will likely be of doubtful reliability but would, nonetheless, be very market sensitive**. I also welcome the proposal to design a new facility that may offer reassurances to emerging markets that Fund assistance will be there at time of need and, most importantly, without intrusive conditionality.

The debt restructuring and lending into arrears section of the Medium-Term Strategy calls for the Fund to specify a medium-term fiscal envelope. In this regard I would like to state that, in so doing, **the rights of claim-holders and economic stakeholders other than financial creditors (e.g. pensioners, the poor and the unemployed), should be preserved, as well as the need of buttressing infrastructure conducive to maintaining strong growth**. A balanced fiscal envelope should also be one which does not overestimate the ability of a debtor to access financial markets or to rely on exceptional financing from the Fund. On the good faith criterion, I would like to restate that **promising beyond what is politically feasible and socially responsible should be characterized as bad faith**.

On the issue of Quotas and Representation at the IMF, there is an overall agreement that a change is needed to better reflect the relative importance of developing countries in the world economy. This would certainly contribute to enhance the Fund's credibility and legitimacy. However, **we are doubtful that any meaningful reform could be done without revising the current quota calculation formula**.

The two-stage approach by which a selected group of members will be granted token ad-hoc increases in a first stage, on the basis of the present quota formula, leaving to a second and diffuse stage the revision of the current formula as well as the redressing of the erosion of the basic votes, would represent only some window-dressing to repackage status quo as part of the on going Strategic Review. Thus, a comprehensive approach is needed to address this important matter so that the measures to be taken may become a lasting solution to the representativity and legitimacy of the institution. A thorough revision of the present quota formula is warranted since it incorporates outdated criteria and therefore GDP should be given more weight in a new formula and, more importantly, that it should be measured on a purchasing power parity basis. Also of critical importance is that the intra-Euro trade should be considered as domestic trade in measuring openness.

3. Outlook for countries in our constituency

The **Argentine** economy is in its **16th quarter of firm growth, which averaged 9 percent a year during the 2003-2005 period**. Growth has been widespread among all sectors with industry showing a 50 percent increase from its minimum during the crisis.

The support given to the small and medium-sized enterprises and to the regional economies helped to make the Argentine growth experience labor intensive. This in turn helped to lower the unemployment rate from 23.3 percent at its peak in May 2002 to 10.1 percent in the fourth quarter of 2005. Increased employment along with the gradual recuperation of real wages supported the domestic market which along with strong exports, in the wake of productivity gains and a competitive exchange rate, unleashed the current virtuous cycle of steadily increasing employment and growth. This has had a positive impact in reducing poverty which came down from 57 percent at the peak of the crisis to 34 percent at present. The latter is still a very high level for Argentina's standards and represents the main challenge for the government. We are committed to bring poverty substantially down through the continued implementation of a socially inclusive development model. The implementation of prudent and equitable income policies has allowed us to increase the minimum wage and the minimum retirement benefits up to 40 percent since the crisis.

The backbone of this process has been a sharp departure from the past, particularly regarding the performance of the **fiscal and external accounts which have consistently rendered surpluses as from 2003**. The consolidated primary fiscal surplus was close to five percent as an average during 2004 and 2005 while the trade and current account surpluses were 6.2 percent and 2.5 percent of GDP respectively during 2005. These are truly unprecedented figures both in their own merit and because they were achieved, as mentioned above, while the economy was growing also at unprecedented rates.

A persistent control of monetary aggregates allowed for a prudent monetary policy and a steady accumulation of foreign exchange reserves, within a context of a strong sterilization policy. The financial system reduced its exposure to the public sector with measured government support in order to recover from the 2001-2002 shock and to improve the quality of its loan portfolio. As a result, in 2005 the banking system started posting earnings equivalent to around 7 percent of equity.

A milestone in the Argentina's process of sustained growth has been **the debt restructuring that took place in 2005 which substantially improved Argentina's solvency indicators**. Interest payments fell from 8 percent of GDP before the crisis to 2 percent at present and the currency composition of the debt has improved with the share of peso denominated debt jumping from 3 percent to 47 percent of the total. Most remarkable is the fact that **despite the crisis, Argentina continued making substantive net repayments to the IFIs and cancelled in an early-repayment all its outstanding debt to the IMF.** Just to illustrate the magnitude of this effort let me recall that with the total repayment of its debt to the IMF, Argentina has made **net** payments to the IFIs in the staggering amount of US$ 25 billion since January 2002 to January 2006.

The rise in inflation starting in 2004 is mainly related to the delayed pass-through of the large devaluation of early 2002 into the relative prices of tradables vis-à-vis nontradables goods and services, which had been initially very limited. The sharp increase in the international price of some tradables, i.e. energy and food has also led to inflationary pressures. The government is fully aware that too high inflation rates can hinder growth and it is therefore determined to maintain inflation under control. With that in mind the government is using a multidimensional strategy consisting in the first place of disciplined fiscal and monetary policies. Indeed, monetary aggregates have remained constrained through a substantial sterilization of the liquidity generated by acquisitions of foreign currency to rebuild international reserves. At the same time, the taxing of staple food and energy exports undergoing sharp price increases in international markets has helped to subdue inflation. On the supply side, a favorable investment climate has been created leading to **investment ratios higher than the ones observed during the 1990s, amounting to 24 percent of GDP during the last quarter of 2005**. The government has also stepped up infrastructure projects. In turn, support for building up human capital and technology has been strengthened and the government has the goal of investing 6 percent of GDP in education (up from the 4.7 percent at present). Finally **the government beyond delivering impressive fiscal surpluses is also promoting price and wage agreements so as to keep inflationary expectations of market participants within reasonable boundaries. Despite the misunderstanding of this policy by some analysts, consensus building is particularly important in Argentina where some goods' and services' markets are not yet very competitive and where past memories of economic instability are still fresh.**

Bolivia has a new democratically-elected government. The new President, Evo Morales, won the general elections at the end of December 2005 with 54 percent of votes and took office in January 2006. One of the challenges of the new administration is to carry out the constitutional assembly and a referendum on regional autonomy in mid 2006, and the authorities are working on a national plan of development which will be presented in the coming weeks. **In 2005, macroeconomic stability was maintained and overall performance was positive despite the political changes**. The economy grew by 4 percent, inflation was less than 5 percent, fiscal deficit fell to 2 percent of GDP, and the external current account registered a surplus of 2 percent of GDP. **The economic outlook for 2006 is encouraging. Real growth is envisaged at 4½ percent, inflation is projected below last year, and the overall fiscal deficit is projected at 3 percent of GDP**. The growth objective will be underpinned by large ongoing mining investments, higher capacity utilization in the hydrocarbon sector, and export growth. **Lower inflation will be supported mainly by a prudent fiscal policy as well as a tight monetary policy.** The fiscal stance and competitive exchange rate, together with strong prices for hydrocarbon products and mining exports would facilitate maintaining the external current account and overall balance of payments surpluses. The Stand-By Arrangement ended in March 2006 and a new program with the Fund is not needed given the current performance and the outlook of the Bolivian economy.

Following solid expansion in 2004, above- trend growth continued in **Chile** through 2005, supported by a remarkably favorable external environment and a still supportive monetary policy stance. Whilst **in the year 2005 real GDP grew at 6.3 percent amid strong domestic demand growth, particularly in fixed investment, the unemployment rate continued to decline** and is currently at its lowest level since 1997.

Headline inflation has increased in recent quarters mainly due to oil price rises, but core inflation measures and expected inflation remain well-contained. Moreover, **the current account has stayed close to equilibrium**. Against this backdrop, monetary policy has continued the gradual tightening cycle initiated in September 2004 from a starting point of very low policy rates. Given that the slack in the economy is gradually vanishing, the Central Bank is expected to continue withdrawing the remaining monetary policy stimulus in the next few quarters in order to ensure inflation reverts to the middle of 2-4 percent target range in the appropriate time-frame. The current policy framework —a fiscal rule anchored around a structural surplus objective, a floating exchange rate regime and inflation targeting— together with a well developed and healthy domestic capital market, suggests that the economy is well prepared to face risks. Nonetheless, the economy may encounter head winds in the form of further increases in oil prices due to potential supply disruptions and shocks and/or international interest rate movements stemming from either inflationary pressures or an abrupt resolution of global imbalances. It may also continue to face the challenge of managing extraordinarily high terms of trade, which are proving to be more long-lasting than previously expected.

Due to the significant increase in fiscal revenues —resulting from the closing of the output gap and unusually high copper prices— **the central government ran a surplus of 4.8 percent of GDP in 2005, which has been used both to prepay public debt and to invest in financial assets**. **The new administration that took office in March 2006 for a four-year term has ensured policy continuity** by adhering to the structurally balanced fiscal rule while supporting the overall macroeconomic framework. For 2006, the Budget Law has expenditures increasing by 6 percent in real terms, and provides the new government with US$300 million in unassigned funding to be spent on policy priorities. Over the next four years, the new government's fiscal package implies an increase in government expenditure of about US$ 500 million per year. This program will be financed by keeping the value added tax at its current rate (19 percent), in addition to the new resources generated by economic growth, and the strengthening of efforts to curtail tax evasion.

Turning to structural reforms, the Fiscal Responsibility Law, which obliges the government to provide information on the underlying or structural fiscal balance as part of the drafting of the annual Budget, is expected to be passed by Congress soon. In addition, the new administration has committed to improving the social security system, with a special focus on pensions. Although the present private pension fund system has served Chile well, coverage is low —almost 50 percent of the adult population in retirement age will not have participated in the private pension system by the year 2020— and competition is limited. Projections indicate that under current conditions, the number of retirees will rise to 2.5 million in 2020 from 1.6 million at present, and only a third of these will have saved enough for a minimum pension of around $250 dollars a month. To draft a strategy to deal with these issues, the government has set up a 15-member independent committee which will submit a report detailing proposals to reform the pension fund administration by June 30th. The government will then design the reform bill on which Congress will vote during the second half of the year.

Paraguay's economic performance under the Fund-supported program was broadly satisfactory and we expect that the next program arrangement will also be helpful. Although adverse weather conditions reduced agricultural output, GDP grew 3 percent in 2005, and inflation remained in the single digits. The macroeconomic framework for 2006 includes a growth objective of 3½ percent and a significant reduction in the inflation rate. A conservative credit policy led to record high international reserves albeit less favorable external conditions, supported by increasing short-term interest rates, which created room for the reserves accumulation. Despite a reduction in the rate of advances on corporate income tax, the authorities have managed to achieve a small surplus in 2005, and are introducing appropriate policies to reach the fiscal balance objective for the consolidated public sector in 2006. Structural reforms agenda for 2006, include strengthening of the institutional framework for tax collection, the National Development Bank (BNF), the functioning of the financial system, the financial position of the Central Bank to improve its effectiveness, the efficiency and the quality of public enterprises, and finally the design of a master plan to improve investment climate in the economy and facilitate higher sustainable growth.

The **strong performance of the Peruvian economy in 2005** reflects the continued implementation of the authorities' economic program. GDP, which grew at a solid 6.7 percent in 2005, has been broad-based, driven by **surging exports and private investment and a greater dynamism in consumption**. Inflation was 1.5 percent by year-end, within the central bank’s target band. Notably, successful inflation performance has resulted in a **continuing reduction in bank credit dollarization**, from 80 percent at end-2001 to 70 percent at end-2005. The **trade surplus for 2005 is estimated at 6.6 percent of GDP** and net official international reserves have reached comfortable levels. The authorities are committed to passing on to the government that will take over in July a strengthened legal fiscal framework with the aim of preserving fiscal discipline in the medium term. Crucially, they are confident that the continuation of key reforms in the areas of privatization, financial supervision and regulation, and poverty reduction, as well as of the ambitious public infrastructure program launched in the last years, will pave the way to high and sustainable output growth over the long run.

Uruguay’s economy has been performing strongly. The country’s economic activity has increased robustly, with a significant boost in investment and exports, in a context of subdued inflation, which has been in line with the Central Bank’s target range. Meanwhile, the **primary fiscal surplus has exceeded the program’s target, leading to a substantial decrease of debt-to-GDP ratio**. The government’s priority in social spending has started to reap fruits, showing a **reduction in poverty rates in 2005**. Likewise, the financial system presents substantial progress. This performance is clearly the result of the authorities’ prudent macroeconomic policies and strong commitment to strictly follow the rule of law, together with a number of structural reforms that have been implemented in the fiscal, monetary, and financial areas, or that are in process of being approved. Credibility pays off and the financial market’s response has been eloquent in this regard. In sum, Uruguay’s government has progressed substantially in meeting its objective of achieving a higher, sustainable, and more equitable growth.