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Statement by Ms. Felisa Miceli
Minister of Economy and Production Argentina
On behalf of Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

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Minister of Economy and Production of Argentina
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 looks resilient. The slow-down in the U.S. economy has been moderate so far and the short term prospects remain favorable as the EU, Japan, China and Latin America are keeping the aggregate demand at healthy levels. However, there is no room for complacency. On one hand, the downturn in the U.S. housing market and the recent problems in its sub-prime mortgage market could spill-over a debt-laden economy. On the other hand, we do not see much increase yet in the domestic demand of countries where the current account has been in persistent large and persistent surplus territory. In short, the main risk we see is not inflation but sustainable growth. Some argue that the world economy is posed to a "soft-landing"; perhaps, but we would rather keep it flying, high and nice, although not as dependant on the U.S. demand.

This brings us to the "global imbalances" and the interest that we all share in preventing that they unwind and cause disruption in the world economy that would be particularly felt in developing countries that need to borrow from the international capital markets. The implausible accumulation of liabilities on the U.S. side and reserves on the surplus countries field continues. We see a risk that the financing required to sustain the U.S. current-account deficit may mismatch with the willingness of the world's central banks to continue to build up dollar reserves.

Whereas the American current account has somehow improved in the last trimester of 2006, it still remains close to 6 percent of its GDP and much of the improvement is due to a fall in oil prices. Admittedly, U.S. exports have increased but we still need to see meaningful changes in domestic demand in the surplus countries. **We doubt that the external imbalances could be narrowed by simply allowing a realignment of real exchange rates.**

A depreciated U.S. dollar may make U.S. exports cheaper but this will not necessarily mean that the surplus economies will be raising their effective demand. Exchange rate changes will only do the trick if they are accompanied by domestic policies of the key players in global imbalances. **If the adjustments were to occur mainly through exchange rate alignments, they would have to be significant and would bring undesired ramifications for global financial stability and growth**.

Not that we think that countries with large and persistent current account surpluses need not let their currency reflect their net creditor position, but owing to the particular role that the dollar plays in the world economy, the income and wealth effects that a strong devaluation of the dollar could generate may run counter to desirable relative price effects. Thus, **changes in relative prices of exchange rates, in the absence of structural reforms to boost house-**

hold consumption in emerging markets could increase, rather than reduce, the saving rates of these regions.

Obviously the United States needs to increase its saving rates but fiscal consolidation will only be systemically beneficial if it comes hand-in-hand with structural reforms in surplus countries, aimed at boosting their domestic consumption. This will be even more necessary if the ongoing problems in the sub-prime mortgage sector permeate into other segments of the U.S. housing industry and bring a slow-down in the U.S. domestic demand. **Despite the Fund's lack of familiarity with recommending better income distribution policies; this is precisely the policy advice that should be present in Article IV assessments if we want to articulate our bilateral surveillance with multilateral needs.** We need to unleash repressed demand in surplus countries (China and others), reducing their marginal propensity to save by giving households confidence in a prosperous future.

Consequently, rather than focusing on exchange rate adjustments, we should insist on simultaneous action on two fronts: a) further consolidation of the U.S. fiscal deficit, particularly in those expenditures that have a lesser multiplicative impact on the economy; and b) surplus countries should adopt more expansionary policies to stimulate their aggregate demand.

In fact, we stress that what is really needed to alleviate external imbalances is a domestic consumption-led growth in surplus countries. However, it is self-defeating to expect balanced growth of the world economy if an increasing number of people are kept unable to reach acceptable standards of living. **To many in both the developed and developing world, globalization has not brought the promised economic benefits and this is breeding a nasty protectionist sentiment**.

This comes as no surprise. Globalization and technological changes have increased production of goods and services but at the cost of pockets of unemployment in many parts of the globe and, perhaps more disturbing, along with an increasing deterioration in income distribution. This is very apparent **in the wealthy economies, where labor's share of GDP is at historic lows while profits are soaring. This is both economically and politically unsustainable.**

What is the Fund doing about this? Well, very little or perhaps even more harm than good. The Fund has consistently opposed setting minimum wages and advocated for additional labor flexibility without asking for compliance with internationally recognized core labor standards or, at least, for enforcement of national labor legislation. We have made this point before. Fund needs to consult with the International Labor Organization before giving policy advice on labor policy. Once more, we bring this to the attention of the IMFC members. **Ministers need to be mindful of the political consequences of having the Fund advocating for policy changes that breed protectionism and radical political opposition.**

These are growing signs of distress, which together with the mounting geopolitical challenges and the recent volatility in financial markets indicate that **multilateralism is under stress**. The consequences are already apparent. **The Doha Round is still not**

showing progress, whereas more and more countries see bilateral trade agreements as a substitute; regional reserve pooling arrangements are mushrooming and Central Banks in emerging countries find that there is nothing as reliable as self-insurance policies. If the world moves into bilateralism and regionalism, the present massive rate of reserve accumulation and the cheap financing for the U.S. deficit could not continue.

If globalization has not succeeded in bringing a better income distribution, neither has it succeeded in ensuring stability. Undoubtedly, the global financial system has undergone a profound transformation over the past decades, providing the possibility for greater diversification and transfer of risk across different segments of the financial system. However, this comes at the price of facilitating the spread of financial contagion and the Fund should be ready to help countries cope with this risk.

This brings us to the Fund's Medium-Term Strategy and particularly to the request made during the last IMFC meeting for a concrete proposal on a new liquidity instrument aimed at preventing crisis.

2. **The IMF's Medium-Term Strategy**

The capacity of the Fund to deliver effective policy advice and to "give confidence to members"[1] by assisting them financially is seriously put into question. On one hand, global imbalances indicate that the Fund has not been capable of persuading large members to follow its policy advice; whereas on the other hand, **self-insurance practices and the mushrooming of regional pooling of reserves indicate that potential borrowers do not find reliable financial support in the Fund**.

This is, in short, what we could categorize as the "effectiveness deficit" of the Fund, which is in turn compounded and interlinked with a second deficit, one that has to do with failures in its governance structure, a "legitimacy deficit". Overcoming these two deficits is what the reform should aim at.

Making the Fund more Effective in Lending: The RAL

We are strong supporters of an instrument that would provide meaningful, reliable and non-expensive financial support to countries facing volatility incidents. Nevertheless, let us not fool ourselves; **such an instrument would be successful only if it makes self-insurance policies look unnecessary and costly.** Moreover, it should make regional reserve pooling arrangements look as second or third best options. Unfortunately, **the proposed Reserve Augmentation Line (RAL) recently put forward by the IMF staff falls short of this benchmark.**

[1] Article 1 of the Articles of Agreement.

We think that it is wrong to try to fit the RAL into the mould of the existing Supplemental Reserve Facility (SRF). Admittedly, this has a tactical advantage; dressing the new line so as to fit within this existing facility would make its approval more likely as it would only require a simple majority at the Board. However, the disadvantages are numerous. The SRF is not meant to prevent crisis but to mop-up the consequences of crisis. It is indeed for "members experiencing exceptional balance of payment difficulties". The RAL should rather be an insurance available to prevent "exceptional BoP difficulties". If the RAL was within the SRF, the implication would be that those that apply for it are "experiencing exceptional balance of payment difficulties". Which country would want to admit this?

Moreover, the SRF is very costly, perhaps because it is a line provided in such extreme circumstances. The RAL should come at a lower cost which could possibly be set using the logic of a normal insurance. Indeed, rather than being too selective with the candidates, the Fund should open it to all members, setting the charges according to objective criteria on the macro-economic fundamentals of candidates.

Another major defect of the proposed RAL is that despite some lip-service for objective criteria, at the end of the day, potential users will have to deal with subjective qualifications made by the staff. Not less disturbing is that the supposed automaticity of access is subject to an overburdened monitoring structure of semi-annual reviews on which the green light will depend on the assessment of all the aforementioned subjective qualifications.

We have other concerns with the proposal but these are certainly the most serious. As it stands, we do not see the proposal as very appealing. **It would be quite unfortunate to create a new facility that would require embarrassing marketing efforts from the Fund to get volunteers.**

Making the Fund more Effective in its Policy Advice: The 1977 Decision

The Fund is required to "exercise firm surveillance over the exchange rate policies of members"[2]. Has the Fund been effective in complying with its mandate?

The sheer volume of persistent and growing trade imbalances and the resulting accumulation of increasing amounts of reserves and debt, speak poorly about the Fund's capacity to persuade systemic countries to implement exchange rate policies consistent with international monetary and financial stability. Unfortunately, this poor performance is not unrelated to the protectionist sentiment that has so far prevented progress in the Doha Development Round.

However, a different matter is to conclude that this lack of effectiveness of the Fund in complying with its mandate is due to deficiencies in the drafting of the 1977 Decision. Rather, it seems to us that **if the Fund has not been more effective in the surveillance of systemically important countries, it is mostly because these countries do not need to**

[2] Article IV, 3, b of the Articles of Agreement.

listen to the Fund's exhortations, either because they print currencies of international reserve (and borrow in their own currencies) or because they have accumulated massive reserves so as to feel insulated from the Fund's criticism. On top of that, **systemically important countries have systemically big stakes in the Fund's decision making process so as to be able to tame its criticism if it ever gets too candid.** Will this reality change by modifying the text of the Decision? Obviously not.

We are, nevertheless, open to consider improvements in the drafting of the aforementioned Decision, but a possible revised decision should not create new obligations for members. Curiously, this seems to be a "mantra" repeated by every country; however, it is not as uncontroversial as the uniform repetition may suggest. Some members seem to believe that the 1977 Decision should cover domestic policies that could have a bearing on exchange rates, as fiscal, monetary and financial policies. We disagree. Domestic policies other than exchange rate policies are not currently covered by the 1977 Decision and this should remain so. The revision should not be used to smuggle obligations on fiscal, monetary and financial domestic policies; obligations spelled-out in the 1977 Decision should remain strictly limited to exchange rate policies.

Not less important will be to focus surveillance on exchange rates on spill-over effects and to take into account "circumstances of members" and be respectful of their policy choices, as required by Article IV 3, b.[3].

In sum, our understanding is that **to get the Fund to add focus on systemically relevant exchange rate policies, rather than changes in the 1977 Decision, requires making changes in the Fund's governance structure.**

Making the Fund More Legitimate: Quotas and Voice

In fact, the Fund's possibility to overcome its "effectiveness deficit" is undermined by its current governance structure which, beyond considerations of fairness, is dysfunctional to its purposes. Without a doubt, considerable dissatisfaction has risen concerning the current allocation of decision making in the Fund, determined largely by the distribution of member's quotas, in which advanced economies (i.e., those with no need to borrow from the Fund and whose domestic policies have systemic implications) have more access to its resources than potential borrowers and can virtually run the institution on their own; whereas potential borrowers have little influence in the Fund's policy and relatively low (and expensive) access to the Fund's resources.

This makes very little sense. Moreover, it makes self-insurance policies and regional pooling of reserves look more reliable than the Fund. We should recognize that **if the reform does**

[3] "[Principles for guidance of all members with respect to exchange rate policies, i.e., the 1977 Decision] shall respect the domestic social and political policies of members, and in applying [it] the Fund shall pay due regard to the circumstances of members".

not increase quotas for potential borrowers, then the reform will fall short of increasing the Fund's effectiveness and would possibly reinforce the case for self-insurance and regional reserve pooling. Multilateralism would be further weakened, the Fund would be pushed into irrelevance and bilateralism and regionalism will look more and more appealing. This is the real choice that we face.

On the other hand, **if surveillance, rather than lending, will turn to be the most prominent role of the Fund, then its governance structure should respond more to the logic of its regulatory role and less to that of a club of creditors**.

We have the impression that the Board is missing the point of the reform process. It is tinkering with the current variables and preparing itself to horse-trade on the weight of "openness" and on whether GDP should be calculated at market exchange rates or at PPP. While this happens, in the real world, countries, rather than relying on the Fund, are increasingly resorting to self-insurance policies and building up regional reserve pooling arrangements.

Sadly, **we seem to be heading for a cosmetic change** that could be eventually be marketed as a milestone of improvement in the Fund's "legitimacy". To us, this looks like a futile process as, at the end of the day, **it will imply giving some more votes to a few emerging economies that seem to be "graduating" from potential use of Fund support, at the expense of other developing countries that remain to be potential borrowers**. This is self-defeating for the Fund.

Shouldn't we rather be considering what would be the changes to the Fund's governance structure that could underpin its effectiveness, both in its lending and regulatory rolls? If we care about multilateralism, shouldn't we identify changes to the current quota allocation that would help making self-insurance policies and regional reserve pooling arrangements look unnecessary? What changes to the Fund's governance would improve the credibility of its policy advice by giving governments more sense of ownership? **Rather than pitching for the variable that would better accommodate our narrow interest, our suggestion would be to reflect first on what changes in governance would reinforce the Fund's lending and regulatory roles.**

Other international organizations (e.g., the EU Council, the Council of the Global Environment Facility, the International Seabed Authority, the African Development Bank) are also confronted with the need to combine a regulatory capacity, that calls for an even distribution of votes, with the fact that their members have unequal economic weight. These organizations have resolved the problem by establishing a double majority system in which an economically weighted majority is complemented by a one-country one-vote majority. This combines the recognition for differences in relative economic weight with equality of rights and obligations. It seems to us that it is worth exploring whether such a change would not improve members sense of ownership for the Fund's policy advice, as **the logic of giving**

more votes to those that have more quotas is only appropriate for a credit union but does not bode well with the Fund's surveillance and regulatory function.

An alternative way to go would be focusing exclusively on the lending role of the Fund and, within the logic of a credit union, explore what governance structure would increase its reliability as a multilateral credit union. Would it be better to grant potential borrowers the right to increase their quotas or could their access be increased by de-linking it from their actual quotas? We find this to be a valid question. **It is clear that the current situation, in which potential borrowers have meager quotas and routinely have to resort to exceptional access, is dysfunctional to the Fund's purpose of "give[ing] confidence to members" that face a Balance of Payment problem.**

It should come as no surprise to us that more and more members are turning their back on the Fund and embarking in costly self-insurance policies or finding that regional reserve pooling arrangements offer a reliable alternative to the Fund. We are, of course, not against pooling reserves with neighbors, but **we are wary of a world that resorts to bilateralism or regionalism as an alternative to inefficient multilateral institutions**.

In sum, we have to discuss the kind of Fund that we want and then adjust its governance structure accordingly. It seems very unlikely that we could achieve this by tinkering with the variables used in the current quota formulas.

The Board has not yet decided on which variables will be included in a new formula, let alone their weight. This means that we are still on time to initiate a discussion on what are the adjustments to the Fund's governance structure that would underpin its effectiveness as a truly multilateral institution. Such an exercise would inform our decisions on a new quota formula. After all, **what is the use of defining the weight of quota variables if we are not clear on whether they would increase the effectiveness of the institution?**

<u>Making the Fund Live Up to its Policy Advice: Income and Expenditures</u>

We find that the report presented by Mr. Andrew Crockett puts forward sensible proposals, but before making a few comments on those that appear to us as the most important, we would like to underscore that, as it happens when any of our countries face a drop in income, **the solution has to include adjustments on the expenditure side**.

The Fund has to be consistent with the policy advice it gives. Its credibility (or what is left of it) would be seriously hindered if, to its budgetary problems the solution comes from selling gold and investing members' quotas. This is how public opinion will read it and we have to be mindful of the consequences.

Consequently, it is our view that **proposals to increase income should be considered together with proposals to reduce current expenditures**. We do not want to get into the micromanagement of the institution, which is up to Management and the Board, but we feel embarrassed when, in the context of a sharp drop in income we are asked to approve salary increases for Management and the Board. We voted against the last salary increases and will continue to oppose them in the future. We believe that **IMFC should urge Management and the Board to reduce, or at least, freeze their wages as a contribution to the budgetary problem**. Admittedly, this will not solve the income problem that we are facing, but at least **it will be visible and bring more credibility to the Fund** that has been preaching for adjustment to members in distress.

We now turn to the actual proposals put forward in the Crockett report.

First and foremost, we believe that it is sensible to **stop the practice of setting the rate of charge as a function of the cost of running the Fund**. It is both absurd and unfair that the cost of surveillance and technical assistance and all the other activities of the Fund be shouldered by countries indebted to the Fund. **The rate of charge should be set a low level, compatible with the very low risk that comes together with the Fund's preferred creditor status.**

We can support broadening the investment mandate of the Fund, but we **remain unconvinced of selling gold to feed the Fund's investment account**. We are not squarely saying no, but we have to analyze this further, see if it is coming together with meaningful savings on the expenditure side, and be sure that it is not going to affect the price of gold on the international market.

As regards **using the "*reserve tranche*" of our reserves for investment purposes, we should also reflect on this before taking a position.** To begin with, we understand that this part of a member's contribution to the Fund is accounted as part of its foreign reserves. Correctly so, as they can currently be drawn almost immediately and at anytime. **Would the investment proposed affect their availability and, therefore, affect our foreign reserves?**

Finally, we would like to state that we are **unconvinced of the need to charge for technical assistance (TA)**. The report itself concedes that as a source of income this would be almost irrelevant. The merit of charging for TA would rather be to bring "discipline" to the demand side. Fair enough, but it seems to us that additional discipline should also be ensured on the supply side, as we are aware that TA is sometimes marketed by the staff to our capitals without real demand for it. Beyond this, we consider that the discussion on income is not the appropriate setting to take decisions on the possible improvement of TA.

3. **Outlook for Countries in our Constituency**

Countries in our constituency will continue to grow strongly. Admittedly, global financial conditions are benign and commodity prices remain relatively high. However, regional growth cannot be explained by a positive external environment; much of the credit is for the substantial strengthening of the macroeconomic policy frameworks and the continued improvements on the social front, along with declines in public sector debt and fiscal consolidation.

Argentina's economy is currently undergoing its twentieth quarter of uninterrupted growth, which averaged 8.8 percent per year during the 2003-2006 period. Since the trough of the crisis in 2002, Argentina's GDP grew by 46.8 percent and in 2006 GDP percapita was already 8% percent above its previous peak of 1998. This makes the current phase the most successful period of continued growth since the early 1900s.

Economic growth has been lead by domestic absorption, especially investment spending, which has consistently outpaced GDP growth between 2003 and 2006. In 2006 investment growth (18.7 percent y-o-y) more than doubled GDP growth (8.5 percent y-o-y). The investment rate thus reached 23.5 percent of GDP in 2006, a very high mark for Argentina's own record, supported by an unprecedented high level of domestic savings, which amounted to 26.5 percent of GDP that same year.

Such a remarkable recovery is based on a consistent macroeconomic framework, which combines the maintenance of a competitive exchange rate with balance of payments and fiscal surpluses. The persistence of a competitive real exchange rate favors production, employment and investment in the tradable sector of the economy, what in turn contributes to current account surpluses.

Indeed, the foreign front has remained solid in the face of an exceptionally dynamic growth environment. This is an unprecedented feature for Argentina's economic record: Previous experiences of high GDP growth (exceeding 7 percent y-o-y) were associated with low or negative trade balances due to the combined effect of low export performance and booming imports; whereas high trade surpluses have been typically associated with low imports due to low levels of economic activity. Currently, the trade surplus has reached a historical high, above USD 13 billion (close to 6% of GDP), associated with thriving exports, which are expected to reach a record high of USD 50 billion this year. The current account has also stabilized in positive territory at approximately 3.5 percent of GDP.

For the fourth consecutive year, the fiscal front has performed exceptionally well also. In 2006, the fiscal primary surplus for the federal government amounted to 3.5 percent of GDP, while the overall surplus reached 1.8 percent of GDP, outperforming 2006 budgetary targets. On the revenue side, such a strong fiscal performance stems from improved tax collection efficiency (tax revenues have consistently grown faster than nominal GDP during the past four years), as well as from increased formalization of workers in the labor market, what increases the base for the collection of social security revenues. On the spending side, Argentina has concentrated on the recovery of social and productive infrastructure: While primary expenses rose by 27.6 percent in 2006, investment in public infrastructure grew 64.5%. Public investment currently represents 2.5 percent of GDP, compared to 1.2 percent of GDP during the 90s.

Since 2003, Argentina has faced lasting current account and fiscal surpluses for the first time in four decades. Twin surpluses have enabled the reduction in foreign private and public sector debt and improved Argentina's macroeconomic outlook, thus allowing the Republic to successfully regain access to foreign financial markets.

Most significantly, growth has embraced all sectors of the economy, including the manufacturing industry (which has grown by 70 percent since the trough of the crisis) and has had a positive impact across all regions of the country, with extraordinary results pertaining the labor market. Indeed, the unemployment rate fell from 23.6 percent at its peak in May 2002 to 8.7 percent in the fourth quarter of 2006, in spite of a significant increase in the participation rate, whereas the underemployment rate fell from 17.5 percent to 10.8 percent in the same period. The creation of 2.75 million new full-time jobs between 2003 and 2006, along with the gradual recovery of real wages, brought about a striking improvement in social indicators: Poverty fell from 54 percent at the peak of the crisis to 26.9 percent at present, while extreme poverty decreased from 27.7 percent to 8.7 percent in the same period. The increase in employment opportunities has also resulted in improvements in income distribution, as shown by the Gini coefficient, which fell from 0,537 in 2003 to 0,485 on the last quarter of 2006.

Inflation has also improved, declining from 12.3 percent in 2005 to 9.8 percent in 2006, as income policies, including price agreements have proved to be effective to appease inflationary expectations. Administrative measures have been accompanied by a strict control of the growth of monetary aggregates by the Central Bank (BCRA), ensuring that sustained growth in foreign reserves (amounting today to almost $37 billion) does not translate into monetary overhang. In fact, aided by public sector surpluses, since 2005 the BCRA has pursued a consistent sterilization policy, which has absorbed excess money supply without weakening the Central Bank's balance sheet, as reflected in quasi-fiscal surpluses of over US$0.6 billion both in 2005 and in 2006.

The Central Bank is currently benefiting from the favorable international financial situation to rebuild its stock of foreign reserves. After the repayment in full and in advance the country's debt to the Fund (January 2006), reserves were increased in almost $20 billion. (It should be noted that Argentina's net payments to IFIs amounted to $25.5 billion between January 2002 and December 2006.)

In summary, the current set of macroeconomic policies has enabled Argentina to reverse the macroeconomic and social imbalances built up during the 1990s and aggravated by the collapse of the economy towards the end of 2001. Argentina is currently consolidating the foundations of a process of sustainable growth, as evidenced by the remarkable recovery in gross fixed investment; increase in domestic savings; strengthening of the financial sector; growing exports; steady fiscal surpluses; and, above all, considerable improvement in labor market and social indicators.

A number of indicators show that **Bolivia**'s economy showed a satisfactory performance in 2006. In fact, the GDP growth rate was 4.5 percent, which is the highest it has been since 1998, when the GDP growth rate was 5 percent due to an outstanding flow of foreign investment. In addition, in 2006, inflation (4.8 percent) and unemployment (7.6 percent) were lower than in 2005. The balance of payments reached positive results because exports reached $4.1 billion and the trade surplus was $1.3 billion. Therefore, accumulated international reserves were the highest in recent years ($3 billion). This was a result of the positive international environment reflected in higher prices for Bolivian exports, improved trade terms, and increased foreign remittances. Due to the debt reduction programs that favored Bolivia, the external debt balance decreased to $3.2 billion, which was the lowest since 1984.

Furthermore, in the fiscal sector, Bolivia's economy had the highest surplus in 66 years (5.9 GDP percentage points) due mainly to hydrocarbon revenue, as a result of the 2005 Hydrocarbon Law. In 2006, the Bolivian government negotiated new contracts with foreign oil companies which could increase the government intake and expand expenses for health, education, and infrastructure. Regarding the financial sector, it presented a robust stance as a result of positive growth rates in banking deposits after 2000.

The overall performance of Bolivia's economy should not be considered as result of the positive 2006 international environment, but also as a consequence of macroeconomic policies and changes in the relationship with foreign companies operating in Bolivia. In fact, monetary and fiscal policies were sound and adequately managed in order to keep inflation under control. The change in the government's relationship with foreign oil companies led to higher fiscal revenue and a considerable fiscal surplus. Because of the improved fiscal stance, it was possible to implement new programs to address the need for helping the poor, for example, one initiative was to create subsidies to encourage school attendance in low-income class students and more jobs for teachers. In addition, the government announced negotiations with Brazil on a new price for gas exports following the agreed price with Argentina.

In May 2006, the Government launched the National Development Plan, which covers the period 2006-2011, aimed to implement changes in policies for increasing productivity and competitiveness, as well as improving living conditions and reducing poverty. These changes include political and cultural policies in order to strengthen democracy through promoting social inclusion. In 2006, Congress modified the Land Law to implement a redistribution of unproductive or illegally obtained land, to improve its use and increase employment in rural areas. This new Land Law is somewhat linked to the National Development Plan.

The Bolivian authorities highlight the need to increase GDP growth rates through developing key sectors in the Bolivian economy underpinned by cautious macroeconomic policies – they also think it is necessary to attain greater equity, transparency, and accountability. They are assigning a greater state role in mining and hydrocarbons sectors in order to use the generated fiscal revenue to get better education, health, and sanitation. Getting better results in these three areas will help reduce poverty and inequality, as well as strength infrastructure for enhancing competitiveness. The authorities are aware that private investment is important for growth and job creation, so they emphasize that public investment will be complementary to private investment. Moreover, the Bolivian government attaches great importance to diversification of the economy for gradually reducing ─in the near future─ the high dependence on the hydrocarbon and mining sectors and, consequently, lessening the economy's vulnerability to external shocks.

On the political side, the Constitutional Assembly was installed on August 2006 to reform the current Constitution Law to introduce social inclusion and important changes in order to attain political stability. The agenda of the Constitutional Assembly is broad; it includes, among other issues, the autonomy of the administrative regions. The new Constitution Law is expected to be ready to approval by mid August 2007.

In **Chile**, output grew 4 percent in 2006, less than previously expected. This result reflected, on one hand, the favorable external environment and supportive monetary policy, and, on the other hand, one-off adverse events in natural resource sectors, higher energy prices, some switching effects from domestic to external production in particular sectors, and a marked cycle in fixed capital investment. Domestic demand grew 6 percent in 2006, with consumption expanding briskly and compensating the lower investment momentum. Strong consumption growth has been favored by credit and a firmer labor market. It should also be noted that Chile updated the base year for its national accounts from 1996 to 2003, which resulted in a slightly lower figure for 2006.Going forward, output growth is expected to be between 5 and 6 percent in 2007, underpinned by the continuation of a favorable external environment, a more expansionary fiscal policy, constructive financial conditions, the operation of new plants in natural resource sectors, and a recovery in investment, as supported by the available data for the first months of this year. The risks to this central outlook remain broadly balanced. The main downside risks are the possibility of faster deceleration in some sectors in the U.S. economy, uncertainty in commodity prices, particularly oil, a large correction in the price of copper, and lower domestic demand if investment intentions do not materialize in due time. Higher growth cannot be ruled out if consumption continues to expand at the pace it exhibited during the past few months.

Throughout most of 2006, CPI inflation was on the upper limit of the 3 ± 1 percent target, due mainly to the incidence of higher fuel prices, while core inflation measures and other inflation trend indicators have been around 3 percent. In the last quarter of 2006, the pace of price increases moderated, and both CPI and core inflation measures are now slightly below the 3 percent level. Inflation expectations have remained well anchored around 3 percent while cost pressures are well contained. CPI inflation is expected to remain around 2 percent for the rest of 2007, and gradually move up toward the mid-point of the target range of 3 percent within the monetary policy horizon of around two years. After six months of stability, and in order to ensure inflation convergence to 3 percent, the Central Bank cut the monetary policy interest rate down by 25bp to 5 percent in January 2007. Further changes will depend on incoming information and its implications for the inflation forecast.

In line with the structural budget surplus rule of 1 percent of GDP, and due to high copper prices, in 2006 the central government posted an overall surplus of 7.9 percent of GDP, the result of a 23.1 percent real increase in revenues and a 6.9 percent real increase in public expenditure. The strength of public finances ensures solvency and flexibility were the external environment to deteriorate. In order to manage copper windfall revenues prudently, the Government passed the Fiscal Responsibility Law, which created two funds for the management of the government surpluses. The Central Bank is currently tasked with the management of these funds. The first of these funds - the Economic and Social Stabilization Fund - was constituted with an initial deposit of USD 6 billion, and the second fund – the Pension Reserve Fund – was formed with a USD 600 million deposit. The law also allows the government to use its surplus to recapitalize the Central Bank by up to 0.5 percent of GDP for 5 years, and the first payment of USD 600 million was made in 2006. Government authorities are fully committed to the fiscal structural surplus rule despite high copper prices, and in keeping with the rule the 2007 Budget Law is expected to generate a surplus of 4.4 percent of GDP. Again in line with the fiscal policy framework, the budget provides for expenditure growth of 8.9 percent in real terms, prioritizing social spending in health, education and social housing.

Moving to structural reforms, Congress recently approved the Capital Market II Reform bill, which among measures designed to deepen local financial markets includes a series of initiatives designed to foster the growth of the venture capital industry, potentially increasing available resources by up to approximately USD 1.5 billion. The government recently announced the Chile Invests Plan: a package of measures aiming to boost investment, facilitate entrepreneurship, globalize the domestic financial markets, further enhance trade integration, improve government effectiveness, foster innovation and human capital, and address the country's expanding energy needs. Regarding investment, the plan includes: a new accelerated depreciation tax benefit, operative between March 2007 and December 2008, as an incentive to bring forward investment; the identification and elimination of bottlenecks in the investment process; and increased focus on the execution and quality of public investment. To facilitate entrepreneurship, the government will provide long-term financing for small- and medium-sized enterprises, create a fund to guarantee the investment of small- and medium-sized enterprises, and will create a standardized balance sheet reporting system for this sector based on tax information. In order to globalize the domestic financial markets, a derivatives law setting out a comprehensive tax framework for derivative operations will be sent to Congress; to facilitate the use of the Chilean peso as an international currency the government will facilitate connections to global settlement and custody systems and will reduce the administrative burdens on foreign investors in domestic markets. A third reform bill, the Capital Market III Reform bill will also be sent to Congress later this year. This plan complements the 15-measure Chile Competes Plan announced in 2006, which aimed to promote competitiveness, productivity and job creation by facilitating access to technology and financing, and fostering competition and a stable investment environment.

Within the framework of a Stand-By Arrangement with the Fund, which will be in force until 2008, **Paraguay** has regained its dynamic position during the last few years, following several periods marked by recession. After three consecutive years of economic growth, in 2006, Paraguay's GDP increased by 4.1 percent, this being the highest figure recorded in more than a decade. The forecast for 2007 foresees another year of economic vigor, as GDP is expected to reach 5 percent, thereby allowing the economy of Paraguay to complete a five-year period of sustained growth.

This pronounced recuperation of the Paraguayan economy has taken place along with the strengthening of the country's macroeconomic policies, which have consolidated a balanced fiscal position since 2004. In addition, the monetary policies maintained the stability of prices in such scenarios as that of 2006, which was a year characterized by the high inflow of private capital investments and by the growth of the export sector. These factors introduced significant pressures as regards the real appreciation of domestic currency.

During 2006, the country's international reserves continued to grow, reaching the historically high level of 19 percent of GDP, thereby broadly complying with the goals set in the Stand-By Arrangement. This accumulation of reserves made it possible to forestall a more accentuated appreciation of the Guarani, which in turn contributed to the continued dynamism of the economy. The rate of underlying inflation was reduced in 2006, dropping from 10.3 percent at the beginning of the year to 7 percent towards the end of the year. The inflation target for 2007 is 5 percent and at the present the inflation rate is converging towards that goal.

The Government of Paraguay has planned an ambitious agenda of reforms to be carried out in 2007, while at the same time continuing to proceed with the prudential macroeconomic administration that has been employed during the last few years.

Peru experiences its longest economic expansion on record. Sound policies implemented over the past several years and a favorable international environment have resulted in high growth (8 percent in 2006), low inflation, and a solid external position. The economic program under the precautionary Stand-By Arrangement approved in January aims at securing the macroeconomic gains achieved so far, reducing the country's high poverty level, pressing forward with growth-enhancing reforms, and underpinning financial resilience. Following a significant surplus in 2006, the authorities will seek to address pressing social and infrastructure needs in a way consistent with the deficit ceiling established in the fiscal responsibility law and with a declining path for the public-debt-to-GDP ratio. In this context, they will improve the quality and focus of public spending and strengthen the effectiveness of the tax system. Concerning the latter, recently introduced legislation will expedite the process of phasing out tax exemptions. Regarding monetary policy, in February the central bank reinforced its commitment to price stability under the inflation targeting regime by reducing the inflation target from 2.5 to 2 percent, keeping a plus/minus one percent tolerance margin. Lowering the inflation target will induce further de-dollarization, thus enhancing long-run confidence in the domestic currency and improving the effectiveness of monetary policy. Other reforms include strengthening the financial regulatory framework, improving the business environment, providing a legal framework for public-private partnerships, and deepening trade liberalization. Crucially, the authorities will seek to increase the effectiveness of social programs within a comprehensive anti-poverty strategy.

Following a GDP increase of 7 percent in 2006, it is expected that **Uruguay** continues to grow robustly this year. Consistently, poverty rates have been decreasing, and unemployment is now at one-digit figures, which had not been seen for many years. Even more important than the current situation is Uruguay's economic outlook, considering that the authorities are forging the appropriate environment to continue attracting direct investment, which is essential to achieve higher and sustainable growth rates and the government's envisaged social objectives. The policies' outcomes, in this regard, are very eloquent. For instance, exports show record levels and high diversification, which is a deserved reward of Uruguay's constant search for its further insertion in the global economy; as result of a prudent monetary policy, inflation rates are within the target-range established by the Central Bank; the financial system has critically strengthened, having shown a significant improvement in banks´ liquidity positions, as well as in the system's capital adequacy ratios, leading to a sustained credit growth (especially in local currency); and the significant fiscal primary surplus (expected to be 4 percent of GDP in 2007) will allow the country to leave behind in a couple of years of overall fiscal deficits. Likewise, these policies and results allowed Uruguay to enjoy market confidence, which has been critical in reducing the costs of the country's public debt, significantly lengthening its average maturity (from 7 years in 2003 to approximately 13 years at present), and beginning to undertake a strategy to decrease its dollarization. As part of this successful debt management, as a virtuous cycle, at the end of 2006, the authorities proceeded to repay Uruguay's outstanding debt to the IMF, underscoring that the new situation does not weaken in any way the excellent level of relations that Uruguay has maintained with the Fund.