

IMF EXECUTIVE BOARD

Work Program to Accelerate IMF Reform

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In discussing the proposed work program with the Board, Managing Director Dominique Strauss-Kahn said that "enhancing the Fund's relevance and legitimacy and ensuring the Fund's financial soundness are our two critical priorities in the period ahead." He added that "addressing these challenges concurrently will provide an opportunity to reestablish the Fund as a focused, lean, and responsive organization."

The Board welcomed the proposed work program, underscoring the importance of making progress on reforming country representation (quota and voice reform), and appreciated the openness

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Dominique Strauss-Kahn: Enhancing IMF's relevance and legitimacy and ensuring its financial soundness are two critical goals.

Helping Build Local Bond Markets

In a world of large-scale capital flows, the development of a local bond market has become a priority for many emerging market countries. Well-functioning local bond markets make a vital contribution to the efficiency and stability of financial intermediation and to economic growth.



Deeper local capital markets can help contain instability caused by asset price bubbles.

Many emerging market countries have liberalized their capital accounts, improved their macroeconomic environment, and made advances in financial innovation—steps that have increased capital inflows to these countries. The IMF and the World Bank are stepping up their active engagement in these countries to help them develop local bond markets.

At the same time, demographic changes, second-pillar pension reforms (a fully funded system of privately managed savings accounts), and changes in accounting and regulatory frameworks have led to a rapid growth of assets under management of institutional investors in both mature and emerging market countries.

In some emerging market countries, the increase in demand for investable domestic financial assets has outpaced

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Lipsky Sees Slower Growth

John Lipsky, the IMF's First Deputy Managing Director, sees world growth slowing because of a combination of higher world oil prices, recent financial market turbulence, and a U.S. slowdown. He says in an interview that it is more urgent than ever that key economies take action to reduce global imbalances (see page 6).

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IMF photo

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Work Program

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of the ongoing discussions on the budget and on refocusing the IMF.

Strauss-Kahn, who took over as Managing Director in November 2007, also said that the IMF had a key role to play in helping members limit the impact of the recent credit crunch. The IMF would help draw lessons from the crisis, which has slowed world growth and exposed weaknesses in the global financial infrastructure. The IMF will announce an update to its forecast for global growth on January 29.

Four-month agenda

In his statement to the Board, Strauss-Kahn outlined an interim work program until the meetings of the Fund's policy guidance body, the International Monetary and Financial Committee (IMFC), in April, when he expects to get endorsement for key areas related to the ongoing reforms.

Economic and financial market surveillance. A key objective is to make surveillance more effective at the country, regional, and global levels. This will be within reach, provided the recently updated surveillance framework is implemented in a consistent and evenhanded manner and that issues are framed in a global context to make better use of the Fund's universal reach and macrofinancial expertise. The Board will also begin work in early 2008 on the regular evaluation of the effectiveness of surveillance (the Triennial Surveillance Review).

Regarding the analysis of the financial turbulence around the subprime meltdown in the United States, the IMF—working with other institutions—is addressing such issues as the transparency, valuation, and methods of accounting of off-balance-sheet instruments used by large banks; risk management practices and incentive structures; and the principles for prudential oversight for regulated financial entities. In addition, the Fund will be looking at issues for investors and recipients related to sovereign wealth funds, including a dialogue on identifying best practices.

IMF income and expenditure. Reform of IMF expenditure and income will be tackled simultaneously. Strauss-Kahn has launched a program to come up with expenditure cuts totaling about \$100 million on an annual basis, including by reducing the number of staff—currently above 2,600—by 300 to 400. The Fund is also looking at ways to find sustainable sources of income, and a final set of proposals could be discussed by the Board in the first part of 2008. The IMFC has requested specific proposals on a new income model and expenditure framework by the time of the April meetings.

IMF governance reform. The IMF is in the middle of a two-year program to reform the system of quota shares to reflect members' evolving weight in the global economy. The program, launched in Singapore in 2006 to enhance the IMF's legitimacy, began with an ad hoc increase for the four most underrepresented countries: China, Korea, Mexico, and Turkey.

IMFC Chairman Tommaso Padoa-Schioppa recently noted that, in his view, enough progress had been made over the past year to give hope that the essential elements of a reform package could be worked out by the next IMFC meeting, which will be held in Washington on April 12, 2008. The objective is to finalize the reform at the Annual Meetings in October 2008.

Low-income countries. In January, the Board will discuss the Fund's assistance to postconflict countries and fragile states. It also plans to comprehensively assess the Fund's role in low-income countries later in the year, after publishing a series of papers during 2007 clarifying its role in these countries.

Capacity building. The Board will discuss ways to implement a new medium-term strategy for technical assistance in early 2008. It will also consider the Fund's training program for member country officials and assess strategic options for the future. ■

IMF Urges Action Soon on Global Warming

Climate change is likely to have an adverse impact on economic growth over the long run and will set back efforts to help the poorest countries unless the international community takes decisive action, IMF Deputy Managing Director Takatoshi Kato told the UN Conference on Climate Change in Bali, Indonesia.

“Climate change is perhaps the largest collective action problem that the world faces,” Kato said on December 14. “Early and sustained action is needed to avoid future harm.”

Kato joined high-level officials from more than 180 countries who were in Bali to create a road map for an international climate change agreement after the Kyoto Protocol expires in 2012. For the first time at UN-organized climate change talks, finance ministers held a forum alongside the main conference, reflecting a growing acknowledgment of the economic policy implications of climate change.

Main challenges

Speaking at the conference’s high-level segment, Kato said that economic challenges posed by climate change are “many and complex.”

Many countries will experience direct negative effects on output and productivity. Countries may also see a deterioration of their fiscal position resulting from a weakening of traditional tax bases

and increased expenditure on efforts to mitigate the effects of climate change. Some countries could experience balance of payments problems owing to a reduction in exports of goods and services, such as agricultural products, fish, and tourism. And private economic costs are also likely to arise from mitigation efforts, Kato said.

The IMF’s membership includes most developed, emerging market, and low-income countries, which gives the IMF an advantage in studying the economic effects of climate change. “On the basis of a very universal membership, we can provide bilateral and multilateral analysis and monitoring,” Kato observed, adding that the IMF has been active in designing relevant tax mechanisms and other fiscal measures.

In addition to the challenges of climate change, Kato noted that efficient carbon pricing schemes could also present potential revenue opportunities for some countries. Precisely how countries use these revenues would have to be decided on a case-by-case basis, but Charles Collyns of the IMF’s Research Department, speaking to the press in Washington ahead of the Bali meeting, cautioned that it was important to ensure that these revenues were directed to efficient local spending or saved.

Need for carbon pricing framework

Despite the long-term nature of the problem, countries are already beginning to prepare for the effects of climate change. “But the response so far is relatively muted because we have not yet had an efficient and credible framework for carbon pricing,” Collyns noted, adding that investors will not fully respond to the incentives of the carbon trade until a credible carbon price path is established.

Collyns was referring to the system of trading in carbon credits developed since the signing of the Kyoto Protocol, giving firms and governments a financial incentive to reduce their carbon footprint. As it currently stands, however, trading in carbon credits is too low to provide for a meaningful reduction in emissions.

Although in some respects, climate change work represents a new area for the institution, many of the issues are ones that the IMF has perennially analyzed. “One large aspect of the problem is proper energy pricing, and that, of course, has been a key Fund concern for many years,” said Michael Keen of the IMF’s Fiscal Affairs Department. “So I think this is far from being a new area for us. It’s an additional part of the context.”

The IMF published an analysis of the implications of climate change in its October 2007 *World Economic Outlook* and is preparing a more in-depth study for the *WEO*’s April 2008 edition. Kato also noted that the IMF’s Executive Board will discuss, possibly in early 2008, the fiscal implications of climate change. ■



Reuters

Carbon pricing provides “strong and credible incentives” for reducing emissions and developing alternative technologies, IMF says.

Developing Local Bond Markets

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availability, leading to sharp increases in asset prices, rapid credit growth, and currency appreciation.

Deeper, well-functioning local capital markets can help countries cope better with volatile capital flows, provide institutional investors with instruments that satisfy their demand for fixed-income assets, and help contain financial instability associated with asset price bubbles. The substitution of domestic for external sources of finance also helps emerging markets protect themselves from being shut out of international capital markets.

Meeting the challenge

The challenge for many of these countries is to develop sound markets and instruments that will enable market participants to share and transfer risks to those most able and willing to bear them. The IMF and the World Bank have been helping countries pursue that goal, in line with a Group of Eight (G-8) action plan for developing local bond markets in emerging market economies and developing countries. The plan was issued last year at the G-8 meeting in Potsdam, Germany, followed by an implementation report issued after the IMF–World Bank Annual Meetings in October 2007.

Among the areas in which the two institutions' commitment has been evident are the Financial Sector Assessment Program (FSAP), technical assistance, and a joint work program.

The FSAP: A joint IMF–World Bank initiative introduced in May 1999, the FSAP aims to increase the effectiveness of efforts to promote sound financial systems in member countries. Supported by experts from a range of national agencies and standard-setting bodies, work under the program seeks to identify the strengths and vulnerabilities of a country's financial system; determine how key sources of risk are being managed; ascer-



Construction in Dakar, Senegal: IMF–World Bank debt issuance plan includes focus on bond financing for African infrastructure.

Djibril Sy/Panapress

tain the sector's developmental and technical assistance needs; and help prioritize policy responses.

Technical assistance: Both the IMF and the Bank have provided significant technical assistance in response to country requests. Traditionally, IMF financial sector technical assistance focused on central banking and bank regulation.

However, as countries have moved toward second-generation reforms, the focus of the IMF's Monetary and Capital Markets (MCM) Department has been broadened to cover issues related to capital markets and asset-liability management. The Bank is also promoting a local currency bond fund (GEMLOC) that represents an important new channel for focusing technical assistance work.

IMF–World Bank collaboration: The International Finance Corporation/World Bank Capital Markets Advisory Group and the IMF's MCM Department have been coordinating closely on issues related to local capital market development. The

teams hold regular monthly meetings to coordinate in the following areas:

- **Regulatory and supervisory frameworks and trading, settlement, custody, and delivery mechanisms.** Through the International Organization of Securities Commissions assessments carried out under the FSAP, and as part of individual country and regional advisory programs, the IMF and the Bank have identified reform priorities in various countries and stand ready to offer technical assistance, in coordination with other international financial institutions, to address weaknesses in these areas.

- **Public debt management and market development.** Ongoing country assistance activities in debt management and debt market development include the recent formulation of an augmented work program for monitoring and improving frameworks for public debt management, and a sharper focus on helping countries develop effective debt management strategies.

• **Securitization.** Asset-backed securities markets can help improve access to long-term funding for housing and infrastructure investment while also providing pension funds and insurance companies with the long-term instruments they need to match their liabilities.

Although the recent subprime crisis demonstrates that risk dispersion can amplify volatility, securitization has fostered the development of financial markets, and its merits cannot be discounted.

However, it will be critical to ensure that financial innovations are carried out with adequate safeguards and risk management capacities. The IMF has initiated a major project in this area, and the Bank has extensive operations to support individual securitization transactions and is also helping countries build domestic securitization markets through technical assistance on legal and operating frameworks.

A properly sequenced, designed, and implemented debt strategy will help provide the market with a choice of instruments and other primary market-related incentives needed for the development of the local public bond market.

• **The investor base.** Domestic pension and mutual funds, as well as foreign investors, are key to developing broader, more liquid bond markets. MCM, as part of the Capital Markets Consultative Group, is exploring the drivers of change in investor behavior in emerging markets, key impediments to the development of emerging capital markets and local and foreign institutional investors therein, and remedial measures.

The IMF is also exploring best practices for developing the domestic institutional investor base (including enabling reforms, such as pension fund reforms) and for improving regulation and consistency of treatment of institutional, foreign, and other investors.

The Bank, whose technical assistance and investment operations promote pension funds and insurance companies, plans to increase efforts to develop bond prod-

ucts that attract more institutional investment. In addition, the GEMLOC project is expected to help diversify the investor base in emerging market countries.

• **Emerging repo and derivative markets.** These markets are essential for improving liquidity and the ability of market participants to hedge risks across markets. MCM has been working with several emerging market countries in this area, including on a major project on derivatives markets.

The Fund, in collaboration with the Bank, will also be hosting regional workshops with participation from regulators and policymakers. The Bank offers derivatives to clients as part of its risk management services and is outlining a strategy to help countries develop these markets.

• **Bond markets in less developed countries.** A joint IMF-Bank initiative has recently been launched to help low-income countries, including in sub-Saharan Africa,

develop and implement their Medium-Term Debt Strategy for debt issuance and debt management. A properly sequenced, designed, and implemented debt strategy will help provide the market with a choice of instruments and other primary market-related incentives needed for the development of the local public bond market.

The Bank's Efficient Securities Markets Institutional Development (ESMID) program, funded by the Swedish International Development Cooperation Agency, will also help build bond markets in selected African countries, with an initial focus on improving bond financing for housing and infrastructure development.

• **Data quality and availability.** The lack of high-quality and internationally comparable bond market data hinders market development in emerging market countries. The staffs of the IMF and the Bank are working with other international

financial institutions, such as the Bank for International Settlements and the European Central Bank, on this front.

At a September 27–28, 2007, meeting in Washington, D.C., the Working Group on Securities Databases agreed on a sequence of goals to improve data on securities, including the development of a handbook on bond securities. In addition, the Bank is investigating the possibility of creating a bond market indicator and is developing an investability index for emerging bond markets related to the GEMLOC initiative.

• **Regionalization.** The IMF and the Bank are scaling up their efforts to identify how regionalization should be designed and implemented to bring greater efficiency, scale, and market access to small capital markets. The Bank is studying examples of successful regionalization to draw lessons for future efforts. A study is being launched under ESMID on the regionalization of East African securities.

• **Exchange of knowledge and experience.** The IMF and the Bank plan to continue to work on this front in the context of workshops and seminars (such as the Bank's Sovereign Debt Conference, the Organization for Economic Cooperation and Development/World Bank/IMF Global Bond Forum, and the IMF's Debt Managers' Forum) involving debt managers, regulators, investors, and other market participants. ■

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Global Economy Likely to Slow More

Rising oil prices, financial market turmoil, and a sliding dollar have grabbed the headlines in recent months. Underlying these developments, however, is the emergence of record-high external payments imbalances and the associated capital flows.

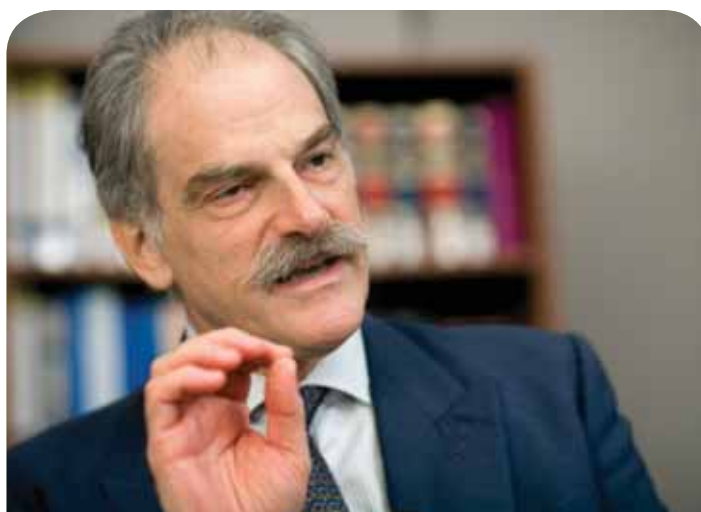
The persistence of these imbalances undermines confidence that the global growth expansion can be sustained, says IMF First Deputy Managing Director John Lipsky. Speaking with the *IMF Survey Magazine*, he argues that it is more urgent than ever that the major players—China, the euro area, Japan, Saudi Arabia, and the United States—follow through on promised policy plans that were announced last April as part of the IMF’s Multilateral Consultation on Global Imbalances.

IMF Survey Magazine: Financial conditions remain unsettled and oil prices have continued to rise. How do you assess the global economic outlook and the risks to it?

Lipsky: Ongoing turbulence in financial markets and a new rise in oil prices have dampened the global outlook since the October update of our *World Economic Outlook*—which forecast growth of 4.8 percent in 2008, down from 5.2 percent in 2007. In particular, the U.S. growth outlook, which we had perceived already as likely to be sub par in 2008, has become subject to somewhat greater risks. The heightened risks reflect both the depth of the housing sector’s difficulties and the financial market strains that now appear to be more widespread and of longer potential duration than had been anticipated previously.

In Europe and Japan, growth appears to be decelerating after solid advances

in the third quarter, and their outlooks would be affected if risks to U.S. growth were to materialize. Emerging markets have been the engine of global growth in 2007, and so far, they remain largely unaffected by the financial market turmoil. But the combination of higher energy prices and weaker growth prospects in advanced economies could dampen the outlook also for emerging markets. Nonetheless, despite these risks, the most likely outcome is a continued global expansion.



John Lipsky: “Despite the risks, the most likely outcome is continued global expansion.”

IMF Survey Magazine: U.S. polls indicate that a growing number of people think that the recession is around the corner. What do you think?

Lipsky: Never say never, but the latest indicators do not justify such a conclusion. Keep in mind that consumer spending is the largest single component of any economy, and the principal determinant of consumer spending is household income. Over the past year or so, employment growth and wage increases have decelerated, but they both continue to grow. As long as U.S.

household income continues to expand, it’s reasonable to expect consumption expenditures to increase.

As for corporate profits, they’ve come under some pressure in the past few quarters, but they’re at all-time highs—in terms of both profit margins and absolute amounts. Moreover, the U.S. corporate sector in general isn’t heavily leveraged. Nonetheless, the increased risks warrant paying close attention to new data as they appear.

IMF Survey Magazine: What’s the bottom line?

Lipsky: I’m cautiously optimistic. As long as corporate profits remain solid, businesses will continue to expand, jobs will continue to grow, income will grow, and the economy should remain in positive territory. This outcome cannot be taken for granted, however, and monetary policy flexibility is required.

IMF Survey Magazine: How do the hefty global current account imbalances fit into this picture [see chart]?

Lipsky: The easiest way to understand the concerns

with global imbalances is that the global expansion from 2002 until 2007 was much stronger and better balanced than had been anticipated. The surprise, however, was that it was also associated with a continued widening of the U.S. balance of payments deficit—which hit record highs in 2005–06. An explanation is that U.S. domestic spending was growing at a much faster pace than in many of the United States’ principal trading partners. In other words, growth in the rest of the world was depending to an unusual extent on the strength of U.S. demand.

It was clear to everyone that this wasn't a healthy situation, and there was a need for better balance in domestic demand growth around the world if the expansion were to be sustained. Indeed, that was the goal of the Multilateral Consultation on Global Imbalances that the IMF initiated in mid-2006—involving China, the euro area, Japan, Saudi Arabia, and the United States. The resulting policy plans that the five principal players announced in April 2007 were agreed by the participants to be in their own interests and at the same time supportive of the general goal of sustaining growth while reducing imbalances. Implicitly, these plans recognize that U.S. growth over the next few years will depend, to an unusual extent, on the growth of domestic demand in its trading partners.

IMF Survey Magazine: Do the new risks to the global outlook alter what each of these parties needs to do, or make the implementation of the policy plans more urgent?

Lipsky: The new risks add urgency. The rise in energy prices has created new strains and increased imbalances, further boosting the payments surplus of energy exporters. At the same time, the financial turbulence has particularly affected the United States, but surprising interlinkages also have appeared with markets and economies abroad.

One of the uncertainties of the moment is the exact magnitude of the impact the financial difficulties will have on real economic performance. That's why it's best to say that the turbulence in financial markets so far has heightened the risk to the outlook—the effect that it will have on economies is not yet clear. Nonetheless, it is important that the key economies are seen to be following appropriate policies.

IMF Survey Magazine: How are the parties doing on implementation?

Lipsky: All of them agreed that the policy plans were medium term—that is, aimed

at sustaining growth over the next few years—but they also agreed that they needed to get started directly on their implementation. That's why it's not too early to say that there have been some positive developments. For example, the U.S. dollar's decline has been consistent with global adjustment in that it has helped boost U.S. exports and reduce the non-oil deficit in the U.S. balance of payments. The dampening of U.S. domestic demand growth has also been consistent with a better balance in the global economy.

That said, there's still much to be done. Efforts to strengthen domestic demand outside the United States have been uneven and had uncertain effects. In addition, the most recent currency moves seem to have worked against the adjustment process in

a real effective basis, by definition there must be currencies that are becoming stronger than is consistent with medium-term equilibrium. Most recently, we find that the euro is by now somewhat on the strong side with regard to our views of medium-term equilibrium.

It was the expectation of the participants in the Multilateral Consultation that the full implementation of the set of policy plans would support a sustainable adjustment process and therefore would tend to produce currency movements that were both orderly and at the same time supportive of the adjustment process. But in a world of floating exchange rates, the influence of large-scale, cross-border capital flows can move currencies

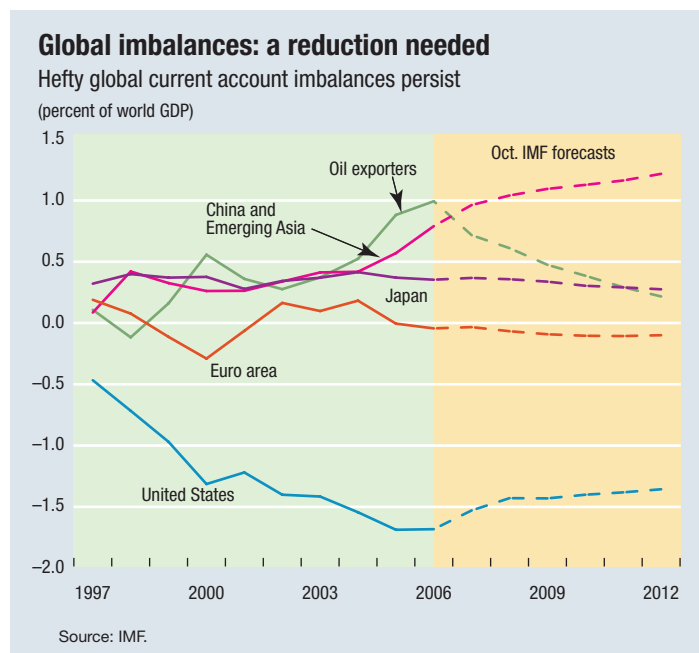
in the short run in ways that aren't necessarily consistent with either policy intentions or long-term logic.

IMF Survey Magazine: So the answer would be greater flexibility for those fixing their currencies and, for some, unpegging from the dollar?

Lipsky: In the case of China, for example, the authorities indicated their intent to increase exchange rate flexibility with reference to a basket of currencies. But the primary focus of the Multilateral Consultation policy plans was not on currency policy.

Remember, those major economies with floating exchange rates have no direct control over rate movements. So the most powerful approach to attaining the dual goals is the implementation of the full set of policies—including structural reforms—that will promote orderly and sustained adjustment. And that, in turn, should encourage financial markets, and currency markets in particular, to move in directions consistent with long-term fundamentals. ■

Laura Wallace
IMF External Relations Department



that the real effective exchange rates—that is, trade weighted and inflation adjusted—of many important economies, especially those with pegged exchange rates (such as some oil exporters and emerging markets) have depreciated even though their balance of payments is in large surplus.

IMF Survey Magazine: The burden of adjustment has fallen on certain currencies, such as the euro. Why has the adjustment process been so skewed?

Lipsky: If some currencies are undervalued and they're becoming increasingly so on

G-7 Preparing for a Jump in Age-Related Spending

Increased longevity, falling fertility rates, and the retirement of the baby-boom generation mean that governments in advanced economies will have to boost spending on the elderly in coming decades and should prepare by strengthening their fiscal positions in the near term.

By 2050, the populations of the seven major industrial countries—Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States (known as the Group of 7, or G-7, countries)—will be smaller and considerably older, with ratios of elderly people to the working-age population (the old-age dependency ratio) projected to double. These trends will put great added pressure on national fiscal balances.

General government age-related spending in these countries is expected to climb by an average of 4 percentage points of GDP over the next 45 years, although with substantial variation across countries.

Life expectancy

UN projections show that the old-age population in these seven countries will increase by an average of 80 percent between 2005 and 2050 (see Chart 1). According to Eurostat projections, life expectancy in the European Union countries will rise by about six years over the next five decades. Given the age structure of European populations, the old-age dependency ratio is expected to double to about 50 percent from 25 percent because of a small decline in the working-age population and a sharp rise in the elderly population.

Such developments imply a steep increase in the countries' age-related government spending by an average of 4 percentage points of GDP over the next 45 years. Estimates vary substantially across countries, with Canada at the high end (with growth estimated at

Key points

The issue: How much of a toll will increasing longevity, falling fertility, and the retirement of baby boomers take on G-7 countries' fiscal accounts in coming years, and how much fiscal discipline will be needed to prepare?

The evidence: These countries are expected to see age-related spending rise by an average of 4 percentage points of GDP over the next 45 years. To prepare for these spending needs, G-7 governments will have to improve their primary fiscal balances by 4–4½ percentage points of GDP relative to their 2005 positions to ensure long-run fiscal sustainability.

Policy considerations: To prepare for the projected large rise in age-related spending, the G-7 countries will need to strengthen their fiscal positions, mainly through fiscal consolidation. Early adjustment will be less costly for long-run growth than delayed adjustment.

9 percentage points of GDP), and Italy and Japan at the low end (with growth rising by about 2 percentage points). The bulk of the spending increase is expected to cover additional health care costs, with long-term care and pension spending accounting for the rest.

Assessing the impact of these demographic changes on the sustainability of public finances is complicated by uncertainties about long-term technological, demographic, labor supply, and productivity growth forecasts—especially the strength of the link between aging and health care costs. Also, a comparison of age-related spending across countries is complicated by differences in methodology across age-related spending projections.

Nonetheless, the relationship between projected old-age population growth rates and age-related spending is fairly close. Still, the uncertainty surrounding long-term spending projections suggests that fiscal policy should recognize the upside risks to the projections and give more attention to worst-case scenarios.

Fiscal adjustment

Two measures were used to assess the evolution of fiscal sustainability for each of the countries and evaluate the impact of policy. (For details on the methodology and robustness testing, see IMF Working Paper No. 07/187.)

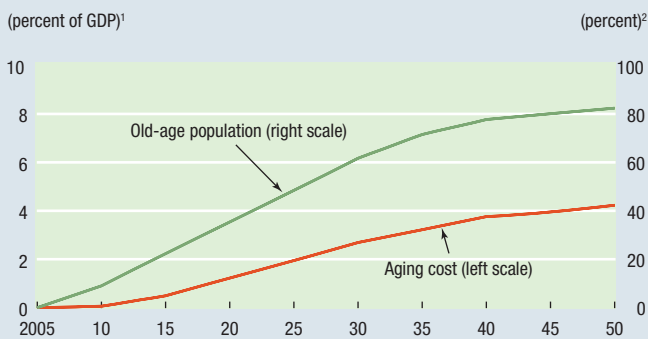
Under either measure, the estimated fiscal adjustment needed to ensure long-run fiscal sustainability (that is, stabilizing fiscal debt at a permanently sustainable level) is large for all of the countries—requiring an average improvement of 4–4½ percentage points of GDP in the primary fiscal balance (that is, revenues less noninterest spending) relative to 2005 positions.

Nearly two-thirds of the fiscal adjustment reflects the expected rise in age-related spending, and the remaining one-third is from the interest on public debt. The largest primary gaps are shown for Japan, which had the largest primary deficit and a high debt level in 2005, and the United States, owing to a combination of a

Chart 1

Greying generation

Increasing longevity and retirement of the baby-boom generation are set to boost G-7 countries' old-age population and raise age-related spending.



Sources: United Nations; Economic Policy Committee of the European Union; Organization for Economic Cooperation and Development.

¹Increase in age-related spending relative to 2005.

²Projected cumulative growth in old-age population.

high primary deficit and large projected increases in age-related spending. The smallest primary gap was shown for Canada, whose primary surplus of 5.5 percent of GDP helps offset the projected impact of the very large expected gain in age-related spending.

Recent improvement

The trends during the years leading up to 2005 were disturbing. Indeed, the fiscal positions of all the countries but Japan worsened during 2001–05 by some 2.7 percentage points of GDP. Even in Japan, whose fiscal sustainability improved over the five-year period, the end-2005 fiscal position was unsustainable.

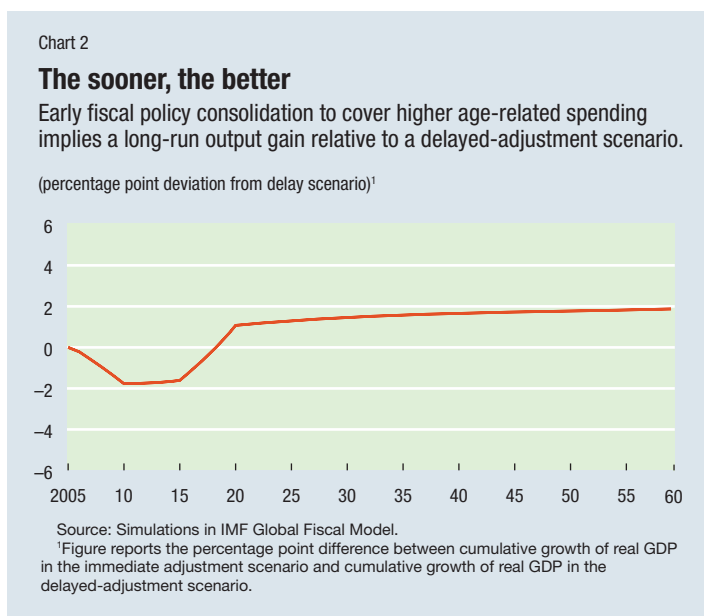
The main cause of the deterioration in fiscal sustainability in the G-7 countries was a worsening primary fiscal balance, which deteriorated by 2.8 percentage points of GDP. The countries showing the sharpest deterioration were the United Kingdom and the United States, whose fiscal balances worsened by 5½ percentage points of GDP.

The public debt component also contributed to widening the primary gaps during 2001–05, but by far less than the fiscal balance. Since 2005, however, fiscal positions have improved substantially, although uncertainties surrounding structural fiscal balances imply that it remains to be seen to what extent this improvement can be sustained.

Most of the seven countries have recently adopted substantial reforms to contain the growth of age-related public spending, making more progress on pensions than on health care. Over the past five years, for example, France, Germany, Italy, and Japan have passed pension reforms that should bring about sizable savings. But additional structural reforms or fiscal consolidation in other areas will be needed. New reforms are also planned, notably health care reforms in Germany and Japan.

Delaying fiscal adjustment is costly

The sooner these countries begin to adjust their fiscal positions the better, both for their own fiscal sustainability and for long-run growth (see Chart 2). We consider two scenarios:



Zuma press

Neuroradiology in Ontario, where the bulk of the age-related spending increase is expected to be extra health care costs.

Immediate adjustment. If the countries adjust their fiscal policy within the next five years, the cost to economic activity will be substantially lower, and the countries will experience gains in long-run output—with their economies growing faster by an average of 0.3 percentage point a year over the next 10 years.

Delayed adjustment. If these countries delay adjustment for 10 years, their public debt levels will increase substantially. The exception is Canada, whose large initial primary surplus permits a steady reduction in debt even if it delays fiscal consolidation. Moreover, delaying adjustment and allowing public debt to increase also implies the need to run permanently larger primary surpluses to service the higher interest costs on the debt.

On average, the primary balance required to stabilize public debt on a sustainable basis is 1.1 percentage points of GDP higher in the long run than in the immediate adjustment scenario. Finally, delayed adjustment entails lower economic growth over the next 10 years because of increasing crowding-out effects and a large rise in payroll taxes.

Over the long run, the faster growth in the early adjustment scenario implies a GDP level about 2 percent higher than in the delayed-adjustment scenario. The long-run output gain is attributable to higher labor supply owing to lower payroll taxes and to higher investment as a result of lower debt and smaller crowding-out effects.

In sum, early fiscal adjustment can be expected to deliver a permanent economic output gain averaging about 2 percent of GDP. Postponing adjustment increases the size of the fiscal adjustment ultimately required to restore sustainability. Given the upside risk to fiscal spending pressures, early fiscal adjustment would also allow greater fiscal scope to absorb any higher-than-expected age-related spending needs. ■

David Haumer, Daniel Leigh, and Michael Skaarup
 IMF Fiscal Affairs Department

Korea Adapts to Changing Landscape

Korea's economic strength testifies to its success in adapting to the changing global economic landscape by pursuing forward-looking and prudent policies. While near-term economic prospects are generally favorable, risks are mainly to the downside.

Since the 1998 Asian crisis, Korea's economy has expanded by nearly 6 percent a year, led by strong exports. Growth reached 5 percent in 2006 and is expected to slow marginally to 4¾ percent in 2007 (see table).

After staying below the central bank's target band of 2½–3½ percent over much of the past year, inflation has recently risen beyond the midpoint of the range, reflecting recent gains in oil and food prices as well as technical factors (see Chart 1). Meanwhile, unemployment has fallen to a four-year low of 3.1 percent.

Oil import bill

The external current account is expected to remain in broad balance (neither in deficit nor in surplus), with strong exports offset by a higher oil import bill and a further widening of the services deficit. The financial sector is in good health, and the Korean currency, the won, appears to be “broadly appropriately valued,” according to the IMF in its annual Article IV consultation with Korea.

Although the impact of the global financial turmoil on Korea's financial sector appears limited, a sharper-than-expected U.S. slowdown could have significant effects. In addition, the recovery in consumption is vulnerable to a downturn in asset markets and further oil price hikes. At the same time, long-term challenges are daunting: the rapid aging of the population risks threatening Korea's fiscal and external positions, while the erosion of its low-skilled manufacturing base and low productivity in the services sector could undermine external competitiveness and growth prospects.

Macro policies: steady as you go

After two consecutive rate hikes in July and August 2007 in response to the growth of monetary aggregates and asset prices,

Export-led growth

Korea's economic growth reached a four-year high in 2006, supported by a strong export sector.

(annual percent change)

	2006	2007	2008
Real GDP	5.0	4.8	5.0
Total consumption	4.5	4.1	3.7
Investment	3.2	5.5	3.7
Construction	-0.4	1.7	1.4
Net exports (contribution)	1.6	0.7	1.3

Sources: CEIC Data Company, Ltd; and IMF staff projections.



Steel factory in Seoul, Korea: The IMF encourages the government to ensure that manufacturing continues to move up the value chain.

monetary policy tightening has paused, with growth and inflation risks appearing balanced. The monetary stance appears appropriate. If downside risks materialize, and provided inflationary pressures remain subdued, there may be scope for loosening monetary policy.

The current, broadly neutral fiscal stance is about right, according to the IMF assessment. There is only limited scope for more expansive fiscal policy, in light of Korea's medium-term fiscal challenges.

Financial risks are manageable

Korea has done a lot in recent years to strengthen its financial sector. The payoff has been increased asset quality, profitability, and capital adequacy (that is, banks' capital is adequate to protect depositors and counterparties from balance sheet risks). At the same time, risk assessment practices and credit information have improved.

Financial vulnerability is low and the sector looks well placed to deal with shocks. Still, pockets of domestic risks bear watching. A fall in housing prices could weaken consumption, especially because a sizable—albeit declining—share of households still hold short-term “bullet-type” mortgage loans (also called balloon loans, with principal paid in one large “balloon” payment at the end of the loan term).

Despite improvements in banks' risk-management practices, rapid growth in lending to small and medium-sized enterprises could lead to an increase in nonperforming loans, especially if the economy slows. Korean financial institutions' direct exposure to the U.S. subprime mortgage market is small.

External competitiveness

While some additional exposures may emerge over time, these are unlikely to have a major impact on financial sector balance sheets. However, prolonged global financial volatility could also dampen confidence and equity prices, trigger capital outflows, or lead to a tightening of credit conditions.

Korea's market-determined exchange rate has served it well. The won has appreciated against all major currencies (especially the yen) since 2003, but Korea's external competitiveness has stayed strong. The 60 percent real appreciation against the yen has, however, taken its toll on some sectors (such as electronics and autos). The currency now seems to be appropriately valued, with no signs of misalignment (see Chart 2).

Long-term challenges

Korea's medium-term prospects are good, but its long-term challenges are considerable. Like many industrial countries, Korea will confront the burden of an aging society in coming decades.

Faced with the added fiscal pressure—compounded by a very low fertility rate and increasing life expectancy—Korea will need to adopt timely reforms on a number of fronts. These include raising tax revenues by broadening the tax base and improving tax administration, additional pension reforms, and reorienting public spending toward such high-priority areas as the social safety net. The IMF assessment commends Korea's efforts to address these challenges and to keep the public informed about long-term fiscal pressures.

Korea's manufacturing sector is likely to face increasingly intense competition from lower-wage countries, while the productivity of the services sector remains weak. To maintain competitiveness in global markets and sustain high growth rates over the long term, the IMF encourages the government to see that

Chart 1

Pressures return

After staying below the central bank's target band over much of the past year, inflation has recently risen beyond the midpoint of the range.

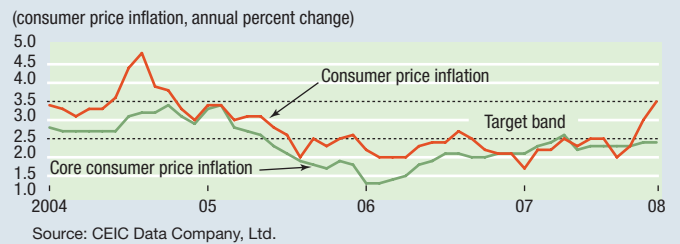
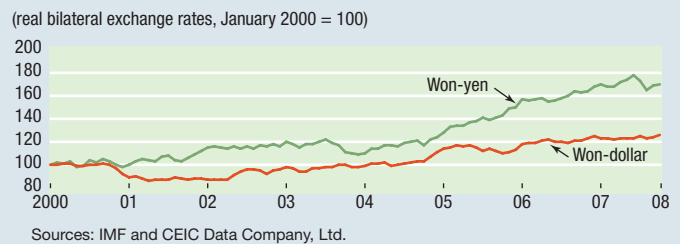


Chart 2

Steady appreciation

The strengthening won is hurting Korea's competitiveness in some sectors but is broadly in line with fundamentals.



its manufacturing continues to move up the value chain and to continue opening and deregulating the services sector to enhance its productivity.

The IMF also recommends that Korea improve the flexibility of its labor markets and the investment climate—especially for foreign direct investment. Without such reforms, Korea's potential growth may decline steadily in coming decades. ■

Guinea Gets \$75 Million Loan

The IMF's Executive Board has approved a \$75 million three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for the West African country of Guinea in support of the government's economic program. The Board also approved the disbursement of \$7.6 million in interim assistance under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative.

The PRGF is the IMF's concessional facility for low-income countries. Loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Policy shift

"The Guinean government has implemented, since March 2007, an impressive policy shift toward macroeconomic stabilization, reversing the deterioration in economic performance and governance that occurred in 2006. This shift has already contributed to rapid disinflation and the appreciation of the Guinean franc. Continued solid policy performance will promote economic growth and help improve Guinea's external situation," said IMF Deputy Managing Director Murilo Portugal.

"The authorities' program of economic and financial policies aims to further stabilize the economy and strengthen Guinea's external position. This will entail the

maintenance of tight fiscal and monetary policies, including no new central bank financing of the budget. Achieving these results and meeting the associated ambitious targets set for nonmining revenues will depend on improved revenue collection and a broadening of the tax base. Normal budgetary procedures will be restored, in order to better manage public spending," Portugal said following the Board meeting.

"The authorities have set governance as a key priority. This and other reforms to improve the business environment are crucial to unlock Guinea's growth potential and reach the ambitious poverty reduction goals that have been set," he added. ■

Indonesia's Push for Treasury Transparency

Indonesia is pursuing public financial management reforms with the support of IMF technical assistance and other donors. The measures aim to bring greater transparency to treasury operations and allow the ministry of finance (MOF) to exercise fuller control over central government operations.

At the time of the Asian financial crisis in the late 1990s, treasury management in Indonesia was particularly lax. Within the ministry of finance, there was no treasury directorate general (DG): all treasury operations were subsumed under the budget DG.

During this period, diagnostic studies by the IMF recommended the establishment of a fully functional treasury DG, as well as the modernization of the legal framework for fiscal management (see Box 1), which had not been updated since

Dutch colonial times. However, the government was preoccupied with the country's financial, banking, and exchange rate crises, and, as a consequence, institutional reforms in public financial management barely advanced.

Fiscal transparency report

In 2006, the authorities published and disseminated a report on fiscal transparency. It was used to identify areas of public financial management in which development partners, including the IMF's Fiscal Affairs Department, could provide technical assistance to help the authorities improve fiscal transparency and accountability.

The government acted to improve the transparency of government financial operations, taking steps, for example, to consolidate government bank accounts. This was partly in response to the external auditor's

report, which called for greater clarity in the government's financial accounts.

Prior to the Asian financial crisis, thousands of bank accounts had been opened in the name of the government. These are now seen to represent nontransparency in central government financial operations. To address the issue, new government regulations were adopted in July 2007 that allow the finance minister to bring all government bank accounts under treasury control.

New legal framework

During 2003–05, the minister of finance oversaw the establishment of a treasury DG. The internal restructuring of the MOF was modeled in line with what was advocated during 1998–2001.

By 2005, new laws relating to the budget, national planning, the treasury, and external audit were adopted by parliament. The Treasury Law provided a legal basis for the rationalization of government bank accounts, many of which had been established by spending ministries and were outside the control of a treasury DG.

The Treasury Law envisages only one main operational account for government transactions, held at Bank Indonesia, the central bank. The objective is to transmit all government revenues into this account by the end of each business day and to use the account for making all government payments, without holding non-interest-bearing deposits in other government accounts.

This had not been the practice previously: powerful ministries, such as defense, obtained financing from substantial resources off budget. Smaller ministries, including even the ministry of religious affairs, as well as directorates of the MOF, also held accounts in commercial banks, outside the main operational account at Bank Indonesia.

Box 1

Improving Treasury Management, 1998–2007

Asian crisis phase: 1998–2001

Achievements: Completion of diagnostic studies of the complex government banking arrangements. Formulation of a reform strategy. Proposals to overhaul the inherited legal framework. Blueprint for MOF reorganization, including creating a treasury DG.

Challenges: Cope with the fallout of the financial crisis. Little action on proposals.

Institutional reforms: 2002–05

Achievements: Reform-minded minister of finance reestablished a public financial management reform committee. New MOF structure, including a strong treasury DG, established. New laws—for budget management, planning, and treasury operations—adopted by parliament.

Main challenge: Implement the new laws.

Early implementation phase: 2005–06

Achievements (in the area of government accounting and treasury management): New government accounting framework adopted. Testing of zero-balance arrangements for treasury-controlled bank accounts. Discussion on remuneration of treasury accounts held at Bank Indonesia.

Challenges: Complete the analysis of all government bank accounts. Close unjustified accounts. Establish full treasury authority over all accounts. Further improve quality of annual accounts. Reach final agreement on remuneration and placement of idle government cash balances.

(See Box 2 for 2007 reforms.)

Results beginning to show

Although the legal and institutional environment improved, it was not easy to make the necessary changes at the transaction level. Many vested interests were at stake. An earlier attempt to conduct a census of all government bank accounts had been met by strong resistance, so it was a bold decision to relaunch an inquiry. However, times had changed: both parliament and the external audit office had become more active in critically examining government performance.

With hands-on leadership from the minister of finance, implementation of reforms leaped ahead in 2007 (see Box 2). By early 2008, it is expected that the bank account consolidation reforms will be nearly completed and that differing views concerning the rate of remuneration of government deposits held at Bank Indonesia will be resolved. Further efforts will be necessary to improve short-term cash planning in the treasury DG and to integrate cash and debt management.

Other improvements

Besides specific treasury reforms, the government is beginning to implement other budget management reforms, including

- taking steps toward introducing a performance-based budget system;



Bank Indonesia offices: 2007 reforms include agreeing on principle of remunerating excess government funds at the central bank.

- introducing medium-term budget and expenditure frameworks (in the 2008 annual budget, aggregate revenues, expenditures and fiscal targets for 2008–10 were presented for the first time); and

- identifying the main fiscal risks (a first-ever statement of fiscal risks accompanied the 2008 annual budget).

In these and other areas, the IMF, the World Bank, and Australia are providing technical assistance to the Indonesian gov-

ernment in its reform efforts. The World Bank is also providing financing for the eventual computerization of budget and treasury operations, for which the IMF provided advice on functional design.

Key lessons

Key lessons arising from a decade of reform efforts center on realistic assessments of the time required to draft and implement meaningful measures and on the need for political support to maintain legislative momentum.

- It can take considerable time to move from completion of initial diagnostic studies to concrete actions on the ground.

- Strong and competent political leadership and commitment to reform—especially at the ministerial level—are needed to promote reforms and ensure implementation of government decisions.

- New laws and regulations, while necessary, are insufficient. If not implemented, a new legal framework can be a misleading indicator of reform progress.

Strong domestic ownership, combined with technical assistance, can be beneficial for helping governments undertake reforms, especially when international experiences are adapted to the specific institutional, legal, and cultural arrangements. ■

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Box 2

Selected Treasury Reform Actions in 2007

- Signing, by the president of Indonesia, of new government cash management regulations in July 2007. These provide strong authority for the minister of finance to rationalize government bank accounts and close bank accounts that are no longer justified.
- Conducting a census of all government bank accounts by end-2007. In its annual report covering the 2005 annual accounts of government, the external audit office (BKP) found more than 6,000 undisclosed accounts. In response, the minister of finance is taking actions to identify government accounts in commercial banks and to ascertain who opened the accounts, when, for what purpose, and whether the accounts should remain open.
- Securing agreement by the ministry of finance and Bank Indonesia on the principle of remunerating excess government funds at Bank Indonesia. An important objective for the central bank is to avoid the transfer of government deposits to commercial banks, which would increase bank liquidity and make monetary management more difficult.
- Accelerating the deposit of government revenues into the main treasury account and reducing lags for making transfers from the main treasury account in Bank Indonesia to the treasury DG's commercial bank accounts in its regional offices (KPPNs) (these accounts are used to pay suppliers of goods and services to government).
- Replicating “showcase” KPPNs, based on the Banda Aceh model established in 2005 for safely transiting tsunami-related donor funds through the central government's treasury system.

Chile Has Scope to Address Social Priorities

Over the past 15 years, Chile's economic reforms and prudent macroeconomic policies have delivered strong growth and low inflation. Per capita income has tripled in U.S. dollar terms, and poverty has been cut by two-thirds to 13 percent. Growth has slowed in recent years from its breakneck pace in the mid-1990s but continues on a 5 percent trend.

In the staff report discussed by the IMF's Executive Board in July 2007, the economy was expected to grow by almost 6 percent in 2007, following a broad-based upswing in the first half of the year. Since then, the outlook has weakened as global food and energy price shocks have pushed inflation above 6 percent, eroding real incomes. However, the medium-term inflation outlook remains anchored around the central bank's 3 percent target, and risk premiums in the interbank market and sovereign spreads have risen only moderately in recent months.

With Chile's open economy and liberal trade regime, the country's macroeconomic policy framework—a floating exchange rate, inflation targeting, and a commitment to running a fiscal surplus—is aimed at mitigating volatility from economic shocks. It has also helped maintain the economy's competitiveness despite

the high price volatility of copper, Chile's main export product, and has provided added scope to address social priorities.

Surplus rule anchors fiscal policy

Fiscal revenues have continued to benefit from strong copper prices, but susceptibility to commodity price fluctuations remains a concern. Public spending increases are in line with revenues under the country's "fiscal surplus rule," which targets the structural surplus (that is, the fiscal surplus adjusted for deviations of output and copper prices from their long-term equilibriums). Chile adopted this rule in 2000 to insulate the economy from the effects of volatility in the price of copper. This has helped the country's floating exchange rate to remain both stable and broadly in line with fundamentals.

Chile's nominal fiscal surplus is expected to be well above 7 percent of GDP in 2007, thanks to strong corporate tax receipts and a rebound in value-added tax revenue. Invested government financial assets exceed 10 percent of GDP, and the central government has become a net creditor. Reflecting its stronger financial position, Chile has reduced its fiscal surplus target to ½ of 1 percent of GDP from 1 percent, beginning in 2008.

The key fiscal challenge, according to the IMF assessment, is for Chile to ensure high-quality public spending. This means carefully weighing the costs and benefits of new projects and improving both the efficiency and transparency of government spending.

Chile's financial markets have been resilient in the face of global financial turbulence, owing to its healthy banking system and strong corporate balance sheets. The financial strength reflects major improvements in banking regulation and supervision after a financial crisis in the 1980s, but capital market reforms in recent years have also helped raise domestic saving, improve market liquidity and depth, promote access to capital markets for emerging companies, and stimulate competition in the local market. More recently, one focus has been on integrating the financial sector more closely with global capital markets, including in a package of measures passed into law in May 2007.

Structural reforms are broad based

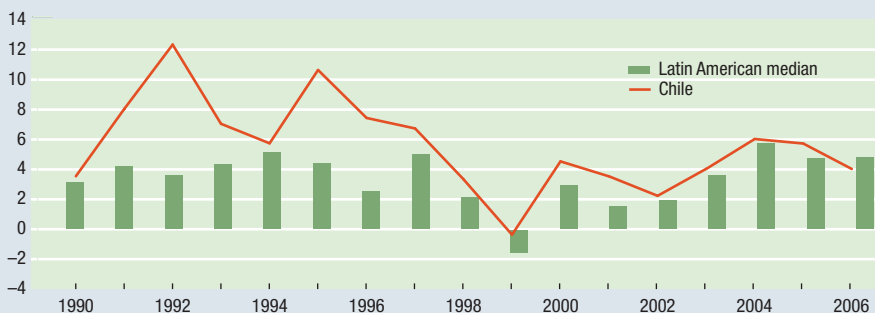
The authorities have a broad structural reform agenda. In addition to capital market reforms, they have proposed a major pension reform to raise benefits, widen coverage, increase returns to saving, and encourage participation in the formal labor market. The proposed reform includes a universal public pension pillar and aims to boost participation by low-income groups and the self-employed. To address social concerns, a key priority is to improve education and build job-specific human capital.

At a September 26, 2007, press conference, two senior IMF officials did not see the recent changes in global economic conditions greatly affecting Chile's strong economic position. "The risks to the outlook," they said, however, "are now more on the downside, given uncertainties about the global financial system, the U.S. outlook, and investors' risk appetite, including for emerging markets." ■

Outperformer

Chile has grown faster than many Latin American countries.

Real GDP growth (in percent)



Source: IMF.

Watchdog Evaluates IMF Loan Conditions

In a study of structural conditionality in IMF-supported programs, the Fund's Independent Evaluation Office (IEO) noted that conditions attached to loans have become more focused, but found that there were still too many of them and that some conditions may not have been tied to the main goals of the program.

In commenting on the report, IMF Managing Director Dominique Strauss-Kahn stated that “while we have been making progress in recent years in streamlining conditionality and focusing it on our core areas of expertise, we will need to ensure parsimony in the selection of conditions in the future, limiting them to measures that are critical to achieve the objectives of the programs we support.”

Tom Bernes, head of the IEO, said that “progress has been made in better aligning IMF conditionality to its core areas of responsibility and expertise. The report also provides evidence of higher compliance with conditionality in the IMF's core areas. However, approximately one-third of the conditions remain outside core areas and compliance overall—at about one-half—remains weak.

“We will need to ensure parsimony in the selection of conditions in the future, limiting them to measures that are critical to achieve the objectives of the programs we support.”

—Strauss-Kahn

This analysis underscores that achieving the objectives of parsimony and criticality remains an important challenge for the Fund and further progress is necessary.”

Following criticism during the Asian crisis in the late 1990s for including too many conditions on its loans, the IMF has been trying to ensure that conditions are linked to key goals in a country's recovery program. This initiative resulted in a comprehensive revision of the Conditionality Guidelines in 2002.

Key IEO findings

The IEO report, which covers Fund-supported programs approved in 1995–2004, arrives at the following conclusions:

- After the streamlining initiative was launched, the composition of structural conditions shifted significantly toward IMF core areas.
- Compliance and effectiveness were higher in the areas of IMF core competency, such as public expenditure management and tax-related issues, and lower in areas such as privatization and reform of the public sector.
- The number of structural conditions in Fund programs remained stable at about 17 per program/year, contrary to expectations when

the streamlining initiative was launched. This was so, in part, because of a strong demand by donors and others to include these conditions as a monitoring tool for their own programs and initiatives,

- Many conditions had limited structural depth—that is, the degree of structural change that they would bring about if implemented. For example, a number of conditions called for preparing plans or drafting legislation.
- Only about half of the conditions were complied with on time and there was a weak link between compliance and subsequent reforms.

IMF response

In their response to the report, IMF staff noted the limitations of counting the number of conditions as a metric to evaluate the success of reforms. The staff noted that the measure of success should not be to look at reforms beyond the program but rather at whether the program goals are achieved and sustained. They also noted that the report did not provide specific evidence to substantiate the conclusion that some conditions may not have been critical enough. Lastly, the staff reaffirmed that the Fund should have the option to adopt conditions in areas outside their expertise (assuming appropriate external expert advice is available) if such conditions are critical to achieving the program goals and are not part of another institution's supported program (such as the World Bank).

At the conclusion of the meeting on the IEO report on December 12, 2007, the Fund's Executive Board broadly agreed with its findings and noted that the assessment gives impetus to the ongoing efforts to make the Fund more focused and relevant. Based on the report and the discussion, the Board endorsed the following recommendations:

- The objective should be to have parsimony of conditions in Fund-supported programs. To this end, IMF staff should have candid exchanges with country authorities to identify critical structural reforms that are linked to program goals and likely to have a significant and sustainable impact. Several Directors at the Board also advised caution on setting conditions in noncritical areas at the request of donors.
- Fund documents should justify the criticality of the proposed conditions (especially those outside the areas of IMF competence) and their relation to the program goals.
- The IMF should continue including conditionality on all measures critical to programs while drawing on the expertise of other institutions in noncore areas. A recently agreed action plan on Bank-Fund collaboration will help coordinate the coverage of conditions by the two institutions.
- The IMF should strengthen its monitoring and evaluation framework to link conditions to program goals and enhance accountability. ■

Conferences Cover Both Sides of Sovereign Balance Sheet

Two IMF conferences aimed to promote the exchange of ideas and experience on both sides of the sovereign balance sheet among officials from emerging and mature market countries and private-sector representatives.

Participants at a November 5–7, 2007, forum for public debt managers heard that there would be a modest growth slowdown in mature markets in response to recent market turbulence, but that there would be continued strong growth in emerging markets. However, participants recognized that the market turmoil might not yet be fully played out and may affect debt issuance and financing plans.

A November 15–16, 2007, roundtable for sovereign asset and reserve managers attracted delegates representing about \$5 trillion of sovereign external assets, including most of the largest sovereign wealth funds (SWFs) and officials from central banks and finance ministries. Discussions covered trends in reserve accumulation and their implications for central bank balance sheets. The event also advanced a call by the International Monetary and Financial Committee, which sets IMF policy priorities, for a dialogue on best practices for SWFs.



Norberto Duarte/AFP

Paraguay Growth “Vigorous”

Economic performance in Paraguay has been favorable, and the South American country has made significant progress on most of the structural measures included in the Stand-By Arrangement approved by the IMF Executive Board in May 2006, according to a review of the arrangement conducted from November 28 to December 12.

“Favorable recent developments suggest that the broad macroeconomic objectives of the authorities’ 2007 program will be achieved,” according to a statement issued in Asunción on December 12 by the IMF mission to the country. “Economic growth has been vigorous and is likely to reach at least 6 percent, exceeding the program objective of 4 percent for 2007. Although inflation has been volatile because of fluctuating food prices, core inflation will end up within target.”

IMF Approves New Iraq Arrangement

The IMF Executive Board on December 20 approved a successor Stand-By Arrangement for Iraq of about \$744 million to support the country’s economic program through March 2009. Iraqi authorities plan to treat the arrangement as precautionary, the IMF said.

The new arrangement follows Iraq’s cancellation of an earlier Stand-By Arrangement and repayment of the \$470.5 million borrowed in 2004 under the Emergency Post-Conflict Assistance policy. The final payment of that obligation was not due until 2009.

Following the December 20 Board action, Takatoshi Kato, Deputy Managing Director, said that “Iraqi authorities have succeeded in keeping their economic program on track in 2006–07, despite the difficult security and political situation.” He cited, among other things, strong anti-inflation policies, elimination of most direct subsidies, new legislation that has made the pension system fiscally sustainable, and a modernized payments system.



Ali al-Saadi/AFP

Record Pledges

Donor countries have pledged a record \$25 billion for the World Bank through the International Development Association (IDA) to help overcome poverty in the world’s poorest countries. In total, the IDA15 replenishment will provide \$41.6 billion, an increase of \$9.5 billion over the previous replenishment (IDA14).

Strauss-Kahn Meets Latin American Leaders

IMF Managing Director Dominique Strauss-Kahn, in a statement following the December 10 inauguration of Argentine President Cristina Fernández de Kirchner, said that after the “strong recovery of recent years” in Argentina, “the challenge now is to continue to improve, in a lasting way, the living standards of all the Argentine people.”

Strauss-Kahn said he met with a number of Latin American heads of state who also were in Buenos Aires for the inauguration of the first elected female president in Argentine history. He said he had a “useful exchange of views on global and regional economic issues, as well as on the ongoing reform of the Fund.” He said that Latin America “is weathering the current global environment well, with the current economic expansion now in its sixth year, also a testimony to improved fundamentals in many countries.”

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