

Strauss-Kahn Spotlights Inflation Concern

Inflation should be the top concern of policymakers confronted by higher food and fuel prices, IMF Managing Director Dominique Strauss-Kahn stressed to the leaders of the Group of Eight (G8) July 9 at their meeting in Hokkaido, Japan.

“When you worry about high oil and food prices, you should be concerned about growth, but even more concerned about inflation,” Strauss-Kahn said, calling on leaders to act to prevent higher food and fuel prices from turning into generalized inflation.

Hitting global demand

Oil prices are likely to remain high and volatile for some time, because demand and supply react only slowly to higher prices, he said, adding that the 70 percent increase in oil prices since the beginning of the year is reducing purchasing power in importing

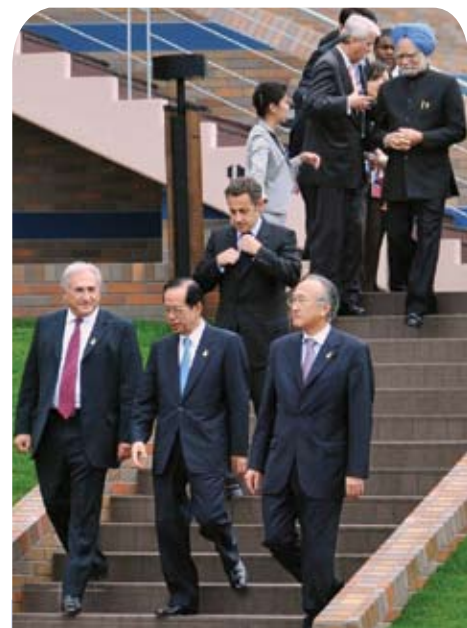
countries and could lower global demand by $\frac{3}{4}$ –1 percentage point.

Many advanced economies have taken appropriate monetary policy remedies to tackle higher-than-expected headline inflation. But in some emerging economies where real interest rates are low or negative, there is a risk that central banks are falling “behind the curve.”

“Headline inflation rates in many emerging economies are up by more than 5 percentage points this year. This is mostly because food and fuel have a high share in consumption baskets. But there are signs that rising food and energy prices are sparking more generalized inflation through second-round effects.”

Strauss-Kahn was speaking after attending the final day of the three-day summit,

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IMF's Dominique Strauss-Kahn (l) confers with Japanese Prime Minister Yasuo Fukuda (c), International Energy Agency Executive Director Nobuo Tanaka (r), with French President Nicolas Sarkozy following, at G8 summit.

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IMF Work Agenda Focuses on Four Priorities

Tackling imminent crises tops the coming work agenda for the International Monetary Fund.

The IMF will focus its activities on key issues of global economic and financial concern, shifting the emphasis away from internal reforms toward the actions the Fund can take to help its members meet the challenges of the 21st century, IMF Managing Director Dominique Strauss-Kahn said in outlining the IMF's Work Program for the period ahead.

“It is time to turn the page. Our work on restructuring the Fund is now well advanced, but our work on refocusing the Fund is only beginning,” Strauss-Kahn told the Executive Board during the discussion on June 18, 2008. “The principle guiding our work will continue to be

responsiveness to our members' needs with a focus on the Fund's comparative advantage.”

The IMF's Board of Governors in May overwhelmingly approved a broadening of the Fund's investment authority, a key element of the proposed new income model for the IMF that will allow the institution to generate revenues from a variety of sources. The previous month, Governors adopted by a wide margin far-reaching reforms of the institution's governance, supporting measures to increase the voting shares of a majority of the 185 member countries.

Strauss-Kahn, who took over as Managing Director last November, said the IMF aimed to make substantial

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Food and Fuel: Some Countries at Tipping Point

The IMF has just released a major analysis of the impact of rising commodity prices, which is available on www.imf.org/external/np/pp/eng/2008/063008.pdf. (See also pages 103–108.)

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Work Program

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progress over the next several months in four areas:

Enable member countries deal with imminent crises and urgent tasks. Issues include:

- *Helping the world economy respond to the challenges posed by rising food and fuel prices.* The Work Program sets out how the Fund can make a contribution in this urgent area through its policy advice, financial support, and analytical work. The IMF released on July 1 a major analysis of the impact of rising commodity prices, particularly on vulnerable states.

- *Drawing lessons from the financial market crisis.* The Work Program emphasizes the importance of drawing lessons from the global financial market turmoil and the need to strengthen further the Fund's financial sector work at the country level.

- *Advancing key surveillance issues.* The Work Program points to how the Fund's core bilateral surveillance work can be strengthened; and how it can advance efforts on multilateral as well as regional surveillance, global spillovers and cross-country issues, and early warning systems.

- **Take a fresh look at the IMF's lending instruments.** The Work Program points to the need for the Fund to adapt some of its lending instruments and related policies, including access rules, so it can continue to provide a good option for countries facing

volatile capital flows and limited access to private capital. A review of Fund lending instruments and related policies, including access, is proposed before the Annual Meetings in October.

Put in place new organizational tools and working practices. This will include ensuring greater cohesiveness in the IMF's approach to low-income country work; more dedicated research and focus on macro-financial linkages; and possible new approaches across a range of the Fund's responsibilities and services, including Article IV annual consultations and capacity building programs.

Further advance the IMF's governance agenda. Building on the recent achievement to strengthen membership representation through quotas and voice improvements, the second stage of governance reform will now proceed. The Work Program indicates that the recent review by the Fund's Independent Evaluation Office of governance arrangements provides a useful starting point for this effort.

Strauss-Kahn emphasized that the IMF's Work Program is focused on "the actions that the Fund will take to help our members meet global challenges. We aim to make substantial progress over the next few months but, in a number of areas, the work will continue beyond the Annual Meetings." ■

Inflation

(continued from page 101)

along with the leaders of G8 countries—Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States. The European Union and 15 developing and emerging market countries also were represented at the talks, which covered diverse topics including climate change, development and Africa, global food security, international institutions, and political issues.

Allowing the price increases in fuel and food products to be translated into a

general increase in inflation would delay the supply and demand responses to high prices, undermine growth by raising inflationary expectations, and hurt the poor because they have the least capacity to hedge against inflation, according to Strauss-Kahn.

Fragile confidence in markets

Strauss-Kahn said financial markets remain under stress, adding, "Market confidence remains extremely fragile."

Investors have been reassured by central bank actions to forestall systemic events, but the continuing need for banks to raise capital suggests that credit conditions could tighten still further.

"We recommend that authorities monitor financial sectors closely and be aware that budget support for troubled institutions or debtors might be needed." ■

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Commodity Price Surge Is Boosting Inflation, Hitting Budgets

The effects of higher food and fuel prices are being felt throughout the global economy: growth is slowing, overall inflation is rising, and some countries are experiencing large swings in terms of trade—all with important balance of payments repercussions.

Net importers of oil and food are being hit very hard by the commodity price shocks, with negative impact on their budgets, according to an IMF analysis, “Food and Fuel Prices—Recent Developments, Macroeconomic Impact, and Policy Responses,” published July 1. If oil and food prices continue to spiral, the result could be unsustainable fiscal positions that could undermine the health of government finances in some countries.

The price hikes have serious effects on poverty, both across and within countries; the implications for government finances and fiscal policy responses are considerable. The report provides a first broad assessment of the impact of the surge in food and fuel prices on a large sample of low- and middle-income countries.

Balance of payments impacts

The IMF study highlights three findings:

- First, the balance of payments (BOP) impacts from food and fuel price increases have already been quite sizable over the past year and a half. In low-income countries (LICs), for example, the study estimates that the gross impact of higher fuel prices during the January 2007–April 2008 period was more than 2 percent of GDP, while higher food price impacts were 0.5 percent.
- Second, possible *further* increases in food and fuel prices in 2008 and 2009 suggest that a large number of countries are likely to encounter significant strains on their balance of payments. Using one metric—that a country should have reserves to cover three months of imports—the paper finds that 37 LICs and 25 middle-income countries will have a less-than-adequate



The rise in oil prices is expected to have a more severe effect on countries' balance of payments than food price increases, according to the IMF's analysis.

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reserves position after a combined food and fuel shock; a similar number of LICs and middle-income countries are also expected to be severely impacted using an alternative metric—in cases where a combined shock is as large as at least half a month of imports.

- Third, the rise in oil prices is expected to have a more severe and widespread impact on countries' balance of payments than are food price increases. This is because fuel imports are, on average, 2½ times larger than food imports for LICs and about twice as large in the cases of middle-income countries.

But there is a wide variance in country-specific impacts. Low-income countries, such as Benin, Eritrea, Liberia, Haiti, Togo, the Central African Republic, and the Kyrgyz Republic, will be quite heavily affected—with shocks (in all these cases) equivalent to at least one month of import cover. At the other extreme, the study projects that some LICs either will face minimal adverse impacts or could actually be net beneficiaries—Côte d'Ivoire, Guyana, and Uganda, for example.

Inflation impact

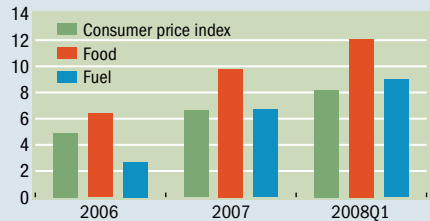
Higher commodity prices have already led to substantial increases in headline inflation, and have been quite widespread and dramatic in both low- and middle-income countries (see chart). Across a sample of 120 nonmember countries of the Organization for Economic Cooperation and Development, headline inflation jumped from a median of near 5 percent in 2006 to above 8 percent in the first quarter of 2008; food inflation doubled in the same period from near 6 to 12 percent.

Some states have fared worse than others. There are 18 countries where inflation, on a 12-month basis, has jumped by more than 5 percentage points since the end of 2007. In some cases, this has been the result of a fast pass-through of food and fuel prices, but high demand pressures have also been at play.

Food prices—rather than fuel prices—have the most dramatic impact on inflation. This reflects a high weight of food in the consumer price index, which, on average, is more than five times that of fuel (37 percent versus 7 percent, respectively).

Price spiral

Food and fuel inflation has doubled since 2006. (median inflation in 120 low- and middle-income countries, year-on-year, percent)



Source: IMF.

Fuel prices can, of course, feed through to other prices through second-round effects, but the immediate impacts on inflation are still dominated by food prices.

Poverty impact

The urban poor are most directly affected by higher costs of food. The share of household income spent on food typically

far exceeds the direct share of oil-related products and services in emerging and developing countries.

In emerging economies, food's share of household spending typically exceeds 25 percent, and in developing countries it is often above 50 percent. In contrast, the amount spent on fuel is typically below 10 percent of the household budget, but this also reflects in part high domestic fuel subsidies in some countries.

However, the direct and indirect impact of fuel price increases is still likely to be large for the urban poor. The share of undernourished could also rise rapidly above the current 40 percent of total population in developing countries. High import dependence, taken together with a high poverty incidence, increases countries' vulnerability to rising food prices.

Fiscal impact

Countries have resorted to a range of fiscal policy measures on both the revenue and

expenditure sides to mitigate the impact of higher prices (see page 108). These policy measures come at a fiscal cost, which, in many cases, can be substantial. For about 29 countries, the fiscal costs already exceed 1 percent of GDP, with the largest increases driven by expansions in universal fuel price subsidies. Of the 79 countries that face higher fiscal costs, 50 are classified as vulnerable to balance of payments pressures.

In the coming months, the challenge for countries will be to refine their policy responses so that they become more efficient and effective. The IMF can help governments in assessing fiscal policy options to manage the costs of policy responses, while at the same time ensuring fiscal sustainability. These options will necessarily be country specific, depending on individual countries' macroeconomic situation and its ability to create the appropriate amount of fiscal space. ■

Commodity Price Spiral Taking Toll on African Economies

Many African countries are among the hardest hit by the world food and fuel price crisis.

High food prices in particular tend to have an outsized impact—food generally represents a very large share of the poor's expenditures—and thus put at risk progress on poverty reduction, social cohesion, and the broader development agenda.

Fuel price increases have a variety of damaging effects, including raising the cost of agricultural production and, in turn, aggravating the food crisis. The two shocks together raise sharply the overall import bill in many countries, threatening to derail macroeconomic stability, growth, and efforts to reach the Millennium Development Goals.

The IMF's African Department has produced an analysis of the implications of the price shocks for the balance of payments of low-income countries in sub-Saharan Africa. The note identifies a list of 18 countries in the region that are especially hard hit and that, consequently, face a pressing need for additional balance of payments and budget support. The list reflects country circumstances and underlying assumptions as of May 2008, and is subject to change; it is not meant to be definitive.

Unavoidable pass-through

High food and fuel prices are likely to persist. Pass-through to higher domestic prices, though not necessarily immediate, is therefore ultimately unavoidable. More broadly, monetary, fiscal, and other policies will have to adjust. In some cases, the exchange rate



Additional budgetary expenditures may be called for to promote development of domestic agriculture, IMF analysis says.

Frank May/Newscom

can play an important role. Additional financing can play two critical roles in this context.

- In the short term, additional external support to meet higher import bills can give countries time to phase in the necessary adjustments, thereby easing their economic impact and reducing social pressures. Such support may also make it feasible for some countries to run temporarily larger fiscal deficits to cover targeted budgetary assistance to the poorest segments of the population.

• Looking to the longer term, additional budgetary expenditures may be called for to promote the development of domestic agriculture and to put in place sustainable social safety nets. Although these expenditures may be met in part through higher domestic revenues or reductions in other spending, additional concessional financing will also have a role to play. The terms of such financing will need to take into account individual countries' debt situations; for most countries, they should be wholly or predominantly grant terms.

Need for additional financing

The IMF analysis seeks to identify countries that may face the most pressing near-term need for additional concessional financing. The balance of payments impact of the food and fuel price shocks is large on average, but their incidence is highly country specific, depending on the patterns of trade as well as initial conditions.

There are a couple of caveats: Although there is merit in focusing attention on the hardest hit, the list is not meant to be definitive. First, there is a degree of arbitrariness in the cutoffs used to place countries on the list. Countries below the cutoffs in many cases have substantial and urgent needs. Second, the list reflects price assumptions and country-specific circumstances in May 2008; as the outlook changes, so too will the impact on individual countries.

The list comprises countries for which the trade balance impact of the 2008 food and fuel price increases exceeds one of two thresholds (see chart):

- 50 percent of initial international reserves: Eritrea, Ethiopia, Guinea, Liberia, Madagascar, Malawi, the Democratic Republic of the Congo, and Zimbabwe;

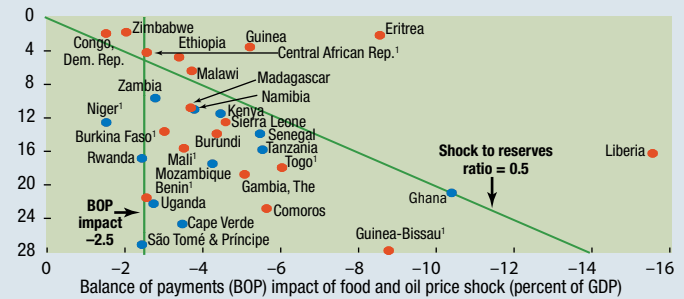
- 2.5 percent of GDP: this threshold is applied to the West African Economic and Monetary Union and the Economic and Monetary Community of Central Africa currency zones (for which the reserves-based indicator is less meaningful): Benin, Burkina Faso, the Central African Republic, Guinea-Bissau, Mali, and Togo; and to states with particularly weak initial institutional frameworks: Burundi, Comoros, the Gambia, and Sierra Leone.

For Madagascar, the cost of reconstruction due to natural disasters (cyclones) is also a factor. The estimates for Zimbabwe are highly uncertain, owing to data problems. The list excludes Senegal, which meets the second criterion, because of other influences on the balance of payments.

Attached to the note are one-page country briefs providing context and background on the situation in each of the 18 included countries. As these briefs suggest, country experiences differ widely.

Shock effect

Many African countries have been badly hit in terms of both the magnitude of the shocks and the impact on international reserves. (international reserves, percent of GDP)



Source: IMF.
¹Countries in the CFA franc zone pool reserves. The group reserve holdings can be more informative than country reserve ratios.

As examples:

- In the Central African Republic, both food and oil price rises weakened the balance of payments. To help address the higher import bill—about 2.5 percent of GDP—the current IMF-supported program was augmented in June.
- In Malawi, the negative impact is mainly due to the oil shock as well as higher fertilizer prices. The magnitude of the shock is about 4 percent of GDP, more than half of international reserves. ■

Andrew Berg and Paulo Drummond
 IMF African Department

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IMF to Investigate Factors Behind Oil Price Surge

The IMF will prepare an analysis of the real and financial factors behind the recent surge in oil and commodity prices, their volatility, and the effects on the global economy, Managing Director Dominique Strauss-Kahn said.

Responding to a call by the Group of Eight (G8) major industrial nations, Strauss-Kahn said that as part of the analysis, the IMF would look into the possible role of financial market speculation in the recent price hikes.

“How important it is and what kind of influence it has on the market and futures is something we have to investigate,” he told reporters in Osaka, Japan after the June 13–14 meeting.

Strauss-Kahn said it was not clear if speculators were a factor, but that some G8 ministers wanted this angle to be probed. Separately he said that he expected the slowdown in the world economy to rein in oil prices that have touched record highs.

Dampening global growth

The impact of high energy and food costs on global growth was the main theme of talks, which Strauss-Kahn also attended, among finance ministers of Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States in Osaka.

The ministers met in June to prepare for the July G8 summit in Hokkaido, Japan (see story on page 101). The meeting was clouded by continued fallout from the U.S. subprime crisis, the impact of high commodity and fuel prices on an already slowing world economy, and the renewed risk of rising inflation in several countries.

Strauss-Kahn said that, despite the better-than-expected first-quarter performance of some industrialized countries, particularly the United States, he still expected a prolonged slowdown in the global economy. “Even if the slowdown is



The G8 urged oil-producing nations to step up output to curb the feverish rise in crude prices.

Karen Bleier/AFP/Newscom

not going to be deep, it is going to be protracted,” the Managing Director said.

Report for Annual Meetings

The G8 communiqué called on the IMF and the International Energy Agency “to work together, with appropriate national authorities, in carrying out further analysis of real and financial factors behind the recent surge in oil and commodity prices, their volatility, and the effects on the global economy, and report back at the next Annual Meetings.”

The IMF and the World Bank hold their annual meetings in Washington this October.

The G8 also urged oil-producing nations to step up output to curb the feverish rise in crude prices, which has stoked protests worldwide over rising fuel costs.

Strauss-Kahn said the IMF now had a role to play in helping to better reveal the interlocking workings of the global economy following the boom in commodities, adding the past consensus on the issue had become “outdated.”

“A lot of analysis has to be done to rebuild an understanding of the economic environment in which we are,” he said.

Other issues in the G8 communiqué relating to the IMF were:

Strengthening the financial system.

The G8 looked forward to concrete progress by the IMF and the Financial Stability Forum on reinforcing early warning capabilities in financial sector work.

- **Promoting oil market transparency.** Ministers called for greater transparency and reliability in market data, including on oil inventories, and urged wider and more timely participation in the Joint Oil Data Initiative, in which the IMF is participating.

- **Sovereign wealth funds.** The G8 encouraged investors to work with the IMF to identify and adopt high standards in areas such as governance, risk management, and transparency.

- **Addressing high food prices.** The G8 welcomed work by the IMF to address the needs of food-importing countries facing balance of payments difficulties, including a review of its Exogenous Shocks Facility.

- **Examining fuel subsidies.** The G8 asked the IMF to conduct work on reform of fossil fuel subsidies, with a report by the Annual Meetings. ■

Jeddah Meeting Calls for Steps to Restore Oil Market Stability

Major oil-producing and oil-consuming countries met in Jeddah, Saudi Arabia, on June 22 to identify the causes of the recent oil price increases and suggest policies to improve oil market stability.

Highlighting the detrimental impact of current oil price levels and volatility on the global economy, the meeting concluded with an urgent call for concerted policy efforts to improve the functioning of the oil market.

Participants agreed that restoring oil market stability requires concerted moves to implement a broad set of policy measures, including increased oil investment, strengthened pass-through of price signals to end-users, and improved oil market data.

The Saudi Arabian government announced at the meeting that the country stood ready to increase oil production beyond the 0.5 million barrels a day (mbd) rise already planned for the remainder of the year. Its oil production capacity will reach 12.5 mbd by end-2009, with ready plans for further expansion to 15 mbd if warranted by demand developments. In addition, Saudi Arabia will provide \$1.5 billion to help the poorest countries cope with higher oil and food prices.

New policy agenda

The broad-based policy agenda developed at the meeting—held at the invitation of the Saudi Arabian government—includes measures to

- boost oil investment;
- improve transparency and regulation of oil financial markets;
- enhance oil market data;
- strengthen cooperation among international and national oil companies and improve access to technology;
- ensure pass-through of price signals to end-users; and
- step up development assistance to poor countries most affected by high prices.

Market expectations

First Deputy Managing Director John Lipsky, representing the IMF at the meeting, welcomed the Saudi Arabian announcement: “There is an urgent need for a strong set of policy actions to anchor oil market expectations and reverse market sentiment,” Lipsky said.

He added that the Saudi Arabian production increases and capacity commitments are important signals in this regard. “I hope that other major producing and consuming countries will follow suit with concrete measures. The priority is to adjust policies that have fostered market rigidities and prevented demand and supply from appropriately responding to the signals from rising prices.”



The Jeddah meeting on oil stressed the importance of data on upstream and downstream capacity, expansion plans, and proven reserves.

There was widespread recognition of the essential role that underlying oil demand and supply fundamentals have played in the recent oil price surge. Slow growth of new capacity and continued strong demand in emerging economies have led to declining spare capacity and tight market conditions.

Financial factors

In contrast, the role of financial commodity investment and financial speculation remained a point of discord at the meeting. In his remarks at the conference, Lipsky said that financial factors played a temporary role in the recent run-up of oil prices, but that it remained difficult so far to establish a lasting impact of financial commodity investment on oil price trends over the past few years.

Lipsky noted that the IMF will be cooperating with the International Energy Agency to study this issue further, as requested recently by the G8 finance ministers meeting in Osaka, Japan.

Besides strengthening the role of price signals in oil markets, improving oil market data was widely recognized as another policy priority. In addition to timely and adequate global data on oil demand, production, and inventories, participants also emphasized the importance of data on upstream and downstream capacity, on expansion plans, and on proven reserves. Only with such data could oil markets assess current and future production trends.

A follow-up conference hosted by the United Kingdom government will assess the progress on the policy agenda before the end of 2008. ■

*Thomas Helbling
IMF Research Department*

Policy Response: How Countries Can Cope

Countries can use a combination of monetary, trade, and fiscal responses to stave off and adjust to the damaging impact of high food and fuel prices, according to a new IMF study.

The threat of hunger has dramatically raised the stakes for low- and middle-income countries that rely on imported food and fuel. These countries must figure out how to feed the hungry and maintain macroeconomic stability in the face of rising inflation and slowing growth.

Every country is different, and exact policy prescriptions will vary considerably. The IMF is helping countries assess the macroeconomic impact of the food and fuel shocks and providing advice on how to create fiscal space for pro-poor spending, contain inflation through monetary and exchange rate policy, and structure trade policy to help balance supply and demand.

The IMF is also providing technical assistance. For instance, it can help countries implement tax and tariff changes or design transfer programs targeted at the poor. It is prepared to disburse funds quickly to countries facing balance of payments gaps, and has already provided additional financing for seven low-income countries through its Poverty Reduction and Growth Facility.

Countries are already using a wide array of policy tools to mitigate the impact of the shocks. From an efficiency standpoint, it makes sense to pass on the full price increases to consumers because this will encourage producers to increase supply and consumers to reduce demand. At the same time, the poor must be protected.

The best approach is to develop a well-targeted social safety net. But many low-income countries have neither the capacity nor the fiscal means to do that. Understandably, most affected countries have therefore had to adopt other policies that could be implemented quickly.

Twenty-nine of the 46 countries with fuel subsidies have increased these subsidies in

response to the surge in oil prices, recently standing at over \$140 a barrel. Subsidies have risen to dramatic levels in some countries: five report spending more than 5 percent of GDP. Besides being costly, universal fuel subsidies encourage overconsumption, exacerbate the upward pressure on international fuel prices, and are hard to reverse.

Eighty-four countries reported that they had lowered food taxes. But reducing consumption tax rates and excise taxes leads to higher consumption. And because higher-income households consume a disproportionate share of almost all goods, they will also receive a disproportionate share of the benefit from a tax reduction.



Export taxes and bans should be removed so that producers and consumers can adjust to higher food prices, a new IMF study says.

Twenty-eight countries reported that they subsidize food directly, some by more than 1 percent of GDP. Twenty-two of these have increased food subsidies since 2006. General subsidies lower prices, but everybody who buys the cheaper goods benefits, including those who could afford to pay in full.

Fifty-six countries have attempted to get around the problems posed by price subsidies and tax preferences by targeting transfers to specific (more vulnerable) groups through school lunches, public works projects, and cash transfers. Thirty-nine countries have increased these subsidies. As noted, targeted transfers can be very effective but are difficult to manage for countries with limited resources.

Another important challenge is to contain inflation. Countries should generally try to accommodate the effects of higher food and fuel prices while using monetary policy to avoid more general price increases. This is particularly important for countries where prices have already been rising because of increased fiscal spending.

To the extent that the shocks are deemed permanent, they will likely call for a real exchange rate depreciation for net food and fuel importers. A tightening of monetary policy will increase the odds that a larger part of the real depreciation is achieved through lower inflation rather than a nominal depreciation.

Many countries have also used trade policy to counter the crisis. Some key food producers have resorted to export restrictions. The urge to secure the national food supply is understandable, but such policies make the global problem worse by discouraging production. Therefore, export taxes and bans should be removed so that producers and consumers can adjust to higher prices. In contrast, tariff reductions can help by reducing inefficient trade distortions and mitigating price increases.

Some countries have implemented universal rather than targeted measures because of the need for a quick response and out of a concern for equity. But such measures carry a high price tag. IMF research shows that about 60 low- and middle-income countries will be at risk of running down their reserves to dangerously low levels if prices stay at the current level—or move higher.

Affected countries should consider whether it makes sense to move to more cost-effective measures targeted directly at the most vulnerable people. But such a shift will not be easy. A multilateral approach is essential, and the global community will have to work together to ensure that food and finance reach the most affected countries as quickly as possible. ■

IMF Boosts Financial Assistance to Haiti

The IMF has provided additional assistance to Haiti, which has been badly affected by the recent sharp rise in commodity prices. In the following interview, IMF economists Andreas Bauer and Laure Redifer talk about how the Fund is helping the government in Port-au-Prince tackle the crisis.

IMF Survey: How is the IMF helping Haiti address soaring prices, increase national food production, and create jobs?

Bauer: As a large net importer of food, Haiti has been particularly affected by the sharp rise in international prices. This shock has also had a significant impact on domestic inflation and caused a widening of the trade deficit. In response, we have modified Haiti's program targets to accommodate crisis spending proposed by the government. Initially, this consisted mainly of a temporary subsidy on the price of rice.

Since then, government programs providing more targeted assistance to the most vulnerable people are being scaled up, including school food programs and public works employment, as are programs to stimulate domestic food production. Monetary policy and targets for the accumulation of official reserves are also being adjusted to limit the inflationary spillover of increased international food and fuel prices to all other prices.

The IMF Executive Board has also just approved a significant increase in our financial support—about \$26.5 million—in additional financial assistance to Haiti under the Poverty Reduction and Growth Facility. The disbursement of additional financial resources will help soften the economic adjustment needed to correct Haiti's external imbalances caused by the much higher cost of food and fuel.

IMF Survey: How is the IMF working with others to increase assistance for Haiti?

Redifer: We are working with other international financial institutions and bilateral

donors to catalyze aid. Our main focus is to figure, together with the Haitian authorities, the financing needed to implement the planned budget and emergency measures, and communicate this to donors so that they can step up support accordingly. For many donors, maintaining macroeconomic stability and its monitoring, which is undertaken by the IMF, are preconditions for their disbursements to Haiti.

IMF Survey: Some critics have said that the IMF's focus on trade liberalization has undermined food security. Has this made things worse in Haiti?

Bauer: We are aware of claims that the IMF "forced" Haiti to reduce tariffs and even to abandon agricultural production, particularly for rice. This is not true, and it is important to get the facts right. The liberalization that brought tariffs on rice down to current levels took place in two steps in the mid-1990s.

In November 1994, the tariff on rice was reduced by the government from 50 percent to 10 percent. A law that proposed a broad tariff reform and reduced the tariff on rice further from 10 to 3 percent was submitted by the authorities to parliament in December 1994, and approved in January and February 1995.

Haiti only signed an agreement with the IMF in March 1995, after these tariff reductions were decided.

IMF Survey: Even if tariff reductions were initiated by Haiti before an IMF program was in place, did the Fund in fact encourage tariff reductions for rice?

Bauer: The IMF was supportive of trade liberalization in general, but not specifically on rice. Our institution's support for general trade liberalization—in both developed and developing countries—reflects the clear evidence that countries open to trade do better and grow faster than countries with restrictive regimes.

In the specific case of rice in Haiti, it was the high cost of living that motivated the authorities to reduce tariffs, even before broader tariff reform was undertaken. At the time, inflation had accelerated to more than 40 percent and was causing considerable hardship. Reducing the tariffs on rice and other foodstuffs provided an avenue for the authorities to address the situation.

IMF Survey: So why has rice production lagged in Haiti?

Redifer: It is not just rice, but many agricultural products that have been in decline, including export crops. This suggests the presence of more fundamental problems that have contributed to a decline in competitiveness, including poor rural infrastructure (irrigation, roads) due to faltering investment, lack of adequate inputs, and, more generally, a poor business environment due to political and social tensions and uncertainty.

IMF Survey: What are Haiti's prospects now?

Redifer: The authorities have made progress in a number of areas. Budget execution, a weak point in the past, has improved considerably. As a consequence, domestically financed investment was up by almost 140 percent in the first half of Haiti's fiscal year. These public investments are key to help overcome bottlenecks for private sector activity, including in the agricultural sector, and to reap the potential benefits that expanded U.S. trade preferences could provide for textile exports.

The recently completed Poverty Reduction Strategy Paper provides a road map for strengthening social services, expanding infrastructure, and cultivating areas for growth and job creation. Its implementation would provide an important boost to Haiti's development prospects. The international community must remain engaged, and stabilization of the political situation will also be essential. ■

Norway's Oil Fund Shows the Way for Wealth Funds

The Norwegian Oil Fund—recently renamed “the Government Pension Fund-Global”—is often cited as an exemplary sovereign wealth fund (SWF). This uniquely positions the fund as a model for, and potentially important contributor to, the new set of voluntary principles being developed for SWFs.

SWFs have been receiving increased scrutiny owing to their growing presence in global financial markets. Their total assets are currently estimated at about \$3 trillion (see table). Experts expect that their assets will increase rapidly to more than \$10 trillion in the next 5–10 years.

The growing importance and active investment strategies of SWFs are expected to affect the structure of international financial markets and asset pricing. On one hand, their long horizons, lack of leverage, and absence of claims for imminent withdrawal of funds could help stabilize international financial markets by enhancing market liquidity and dampening asset price volatility.

On the other hand, their sheer size, rapid growth, and potential to abruptly change investment strategies, coupled with—in some cases—a lack of transparency and uncertainty surrounding the purpose of their investments, could exacerbate market uncertainty and thus increase volatility.

In light of the concerns about SWFs, the IMF has been given a new mandate to facilitate the development of a set of voluntary principles for these funds. These principles would cover issues of public governance, transparency, and accountability. To this end, an international working group of SWFs was formed at end-April 2008 and began work on the set of principles.

The principles should help countries with SWFs both to strengthen their domestic policy frameworks and institutions and to facilitate their macroeconomic and financial interests. The principles will also help ease concerns in countries receiving SWF investments and promote an open global monetary and financial system.

Pumped up

Experts estimate that total sovereign wealth fund assets will increase rapidly to more than \$10 trillion in the next 5–10 years.

(estimated assets of largest international SWFs, end-2007, million dollars)

Country	Fund name	Assets	Inception year	Source of funds
TOTAL		2,926,630		
UAE	Abu Dhabi Investment Authority ¹	875,000	1976	Oil
Norway	Norway Government Pension Fund-Global	373,000	1996	Oil
Singapore	Government of Singapore Investment Corporation	330,000	1981	Other
Saudi Arabia	Saudi Arabian funds of various types	300,000	...	Oil
Kuwait	Reserve Fund for Future Generations	250,000	1953	Oil
China	State FX Investment Corporation and Hueijing Co. ²	200,000	2007	Other
Singapore	Temasek Holdings ¹	159,210	1974	Other
Russia	Stabilization Fund ³	133,000	2003	Oil
Libya	Oil Reserve Fund	50,000	2005	Oil
Algeria	Fonds de régulation des recettes	42,600	2000	Oil
Qatar	Qatar Investment Authority	40,000	...	Oil, gas
United States	Permanent Reserve Fund (Alaska)	38,000	1976	Oil
Brunei	Brunei Investment Authority	30,000	1983	Oil
Malaysia	Khazanah Nasional BHD	25,700	1993	Other
Korea	Korea Investment Corporation	20,000	2006	Other
Chile	New SWF based on the Copper Fund ⁴	17,820	1985	Copper
Kazakhstan	Kazakhstan National Fund	17,600	2000	Oil, gas
Taiwan Province of China	National Stabilization Fund	15,000	...	Other
Canada	Alberta Heritage TF	15,500	1976	Oil
Iran	Oil Stabilization Fund	15,000	1999	Oil
Nigeria	Excess Crude Account	11,000	2003	Oil

Sources: Stephen Jen, 2007, “How Big Could Sovereign Wealth Funds Be by 2015?”; and Morgan Stanley Research.

¹Estimate, September 2007.

²Launched in September 2007.

³Split in February 2008 into Reserve Fund and National Welfare Fund.

⁴The Pension Reserve Fund and the Economic and Social Stabilization Fund.

Note: ... denotes not available.

Lessons from Norway's experience

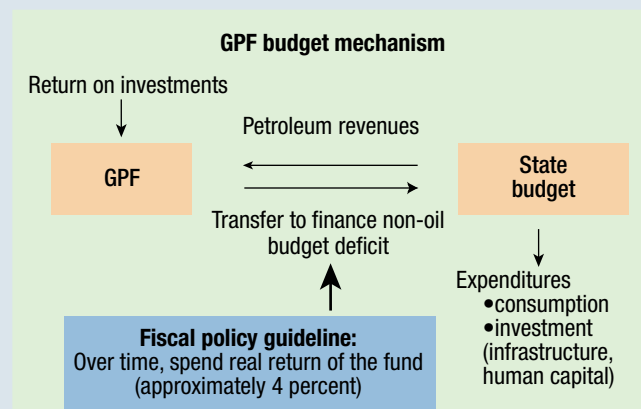
Norway's Government Pension Fund-Global (GPF) has a number of exemplary features that could serve as a model for other SWFs. The GPF is one of the largest and fastest-growing SWFs in the world, with total assets amounting to \$373 billion at end-2007, or close to 100 percent of Norway's GDP. But size aside, the Norwegian GPF is mostly known for its features, which in many ways are considered best practices by international standards:

- The GPF's stated aim is to support government saving and promote an intergenerational transfer of resources. The fund facilitates the long-term management of the government's petroleum revenues.

Chart 1

Policy partners

One of the exemplary features of Norway's GPF sovereign wealth fund is that it is integrated with the country's fiscal policy.





Newsroom

An oil tanker sails into a Norwegian fjord: Norway's sovereign wealth fund is one of the largest and fastest-growing in the world.

Given the expected population aging in Norway, it serves to pre-fund public pension expenditures.

- The GPF functions as a fiscal policy tool, which, together with a fiscal guideline, serves to limit government spending. The fund's capital consists of revenues from petroleum activities. The fund's expenditure is a transfer to the fiscal budget to finance the non-oil budget deficit. The fiscal guideline, introduced in 2001, calls for a limit on the non-oil structural central government deficit of about 4 percent of the assets of the GPF. Because 4 percent is the estimated long-run real rate of return, this rule amounts to saving the real capital of the fund and spending only its return (akin to an endowment fund).

- The fund is fully integrated into the budget (see Chart 1). The net allocation to the fund forms part of an integrated budgetary process. This process makes transparent the actual surplus of the fiscal budget and the state's use of petroleum revenues.

- It pursues a highly transparent investment strategy (see Chart 2). The ministry of finance—the fund's owner—reports regularly on the governance framework, the fund's goals, investment strategy and results, and ethical guidelines. The central bank—the fund's

operational manager—publishes quarterly and annual reports on the management of the fund, including its performance and an annual listing of all investments. Detailed information on the fund's voting in shareholders' meetings is also published.

- Its assets are invested exclusively abroad. This strategy ensures risk diversification and good financial returns. Moreover, it helps to shield the non-oil economy from shocks in the oil sector, which can put pressure on the exchange rate (so-called "Dutch disease" effects). The GPF has small ownership shares in over 7,000 individual companies worldwide (the average ownership stake at end-2007 was 0.6 percent, against a maximum allowed of 5 percent).

- Its high-return, moderate-risk investment strategy has been hitting the mark. Currently, the fund is adjusting its portfolio to its new strategic benchmark of 60 percent of assets in equities and 40 percent in fixed income. There are plans to move gradually into real estate to improve the risk-return trade-off. This strategy has produced a healthy 4.3 percent average annual real return during the past decade.

- Its asset management is governed by a set of ethical guidelines. These guidelines, established by the ministry of finance, are based on internationally accepted principles developed by the United Nations and the Organization for Economic Cooperation and Development. Two policy instruments are used to promote the fund's ethical commitments. First, the fund exercises ownership rights in companies in which it invests with a view to promoting good and responsible conduct and respecting human rights and the environment when this is consistent with the fund's financial interests. Second, the ministry of finance can forbid investments in specific companies whose practices constitute an unacceptable risk that the fund could become complicit in unethical activities.

A role for Norway

The Norwegian GPF brings to the table several elements that could help design a set of successful voluntary principles for SWFs. The fund's role as a fiscal policy tool could guide other countries with nonrenewable resources in managing their policies in a sustainable way over the long run.

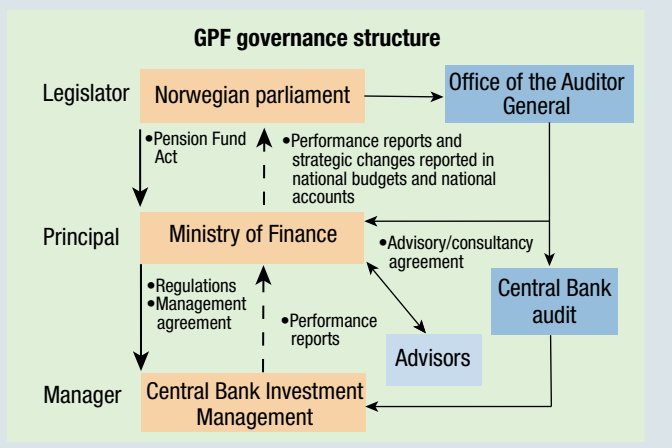
The GPF's highly transparent, yet competitive and successful, asset management strategy—buying in markets whose values are falling to rebalance its portfolios—can serve as an example that open strategies not only produce financial results, but also enhance market liquidity and financial resource allocation and act as a stabilizing influence. Its experience with ethical guidelines provides further proof that commitment to the common good is not necessarily antagonistic to high returns.

The Norwegian authorities have openly supported the IMF's work on SWFs and firmly back equal treatment of investors. They do not think that the investment activities of SWFs need to be more restricted than the activities of other investors—especially because, in contrast to hedge funds, SWFs have yet to be proven to be disruptive to markets. The Norwegians also caution that restricting investments of oil-related SWFs may reduce extraction, which could have a destabilizing effect on oil markets. ■

Delia Velculescu
IMF European Department

Chart 2
Out in the open

The owner and managers of Norway's GPF sovereign wealth fund report regularly as part of a transparent investment strategy.



Mexico: Building on Reforms to Tap Full Potential

Mexico's economy has achieved broad stability and enhanced resilience in recent years, and the country has enjoyed steady—though not stellar—growth. Strong macroeconomic and financial policies have enabled Mexico to deal well with the recent global financial market turbulence and the economic slowdown in the United States, to which Mexico's economy is closely tied.

But Mexico needs to go further to achieve its economic potential and join the league of fast-growing emerging market countries. Important progress has been made in addressing poverty, but poverty and inequality are still high. Productivity growth needs to be accelerated substantially. Underlying these challenges are a host of structural problems, including weak infrastructure and education, insufficient competition in key sectors, and inflexible formal labor markets; still-limited financial intermediation; and weaknesses in the rule of law.

The National Development Plan laid out by the new government in 2007 recognizes these challenges, establishing a wide-ranging policy agenda that includes proposals to boost infrastructure spending and press ahead with structural reforms. The plan emphasizes building a more inclusive society that bridges the gap with fast-growing economies while generating more and better jobs.

At the same time, the Mexican government will confront the risk of a sustained drop in oil production, on which the budget now relies for more than a third of its revenue. Proven reserves of oil are less than 10 years' production, and Mexico could cease to be a net exporter of hydrocarbons within about 5 years.

Strengthened policy framework and financial position

Sound policies in recent years have enhanced economic and financial stability in Mexico. The Mexican authorities have met the annual

targets for the federal government budget balance, which has produced a gradual decline in the public debt ratio. The recent Fiscal Responsibility Law seeks to lock in fiscal discipline by holding the budget balance at zero.

Meanwhile, monetary policy has brought annual inflation down to the low single-digit range, in the context of an inflation targeting framework. Even after a barrage of external commodity price shocks, inflation expectations seem anchored, although slightly above the 3 percent inflation target.

Accompanying the inflation targeting regime, Mexico's policy of allowing full flexibility of the exchange rate has been serving the economy well. This transparent policy has facilitated continuous and smooth adjustment to shocks, thereby contributing to internal and domestic stability. The real effective exchange rate seems broadly in line with Mexico's fundamentals.

The country's overall external position has steadily strengthened, and the same is true for its banking system. The external current account deficit—helped by rising oil export prices—has become quite modest and is more than financed by foreign direct investment. External debt ratios have declined to low levels, while foreign exchange reserves have climbed to a comfortable position, primarily reflecting export earnings of the state-owned oil sector. Moreover, the authorities have greatly bolstered financial regulation and supervision over the years. Banks remained well capitalized, profitable, and liquid.

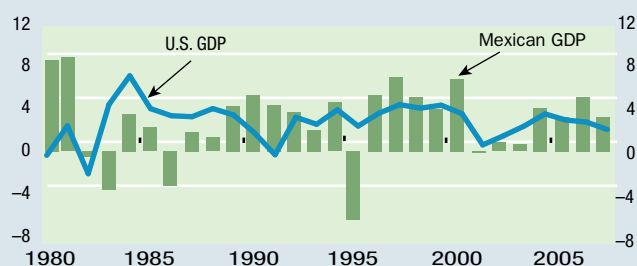
As a result, Mexico has developed greater resilience to external shocks, adjusting smoothly and avoiding disruptive episodes of financial stress and sharp movements in capital flows and the exchange rate. In a "Great Moderation" of the Mexican business cycle, output is much less volatile than in the past, although now more closely linked with the U.S. cycle.

Chart 1

Steadier, but not yet stellar

Mexico's business cycle has become steadier and more synchronized with the U.S. cycle—but reforms are needed to accelerate growth.

(annual percentage change)

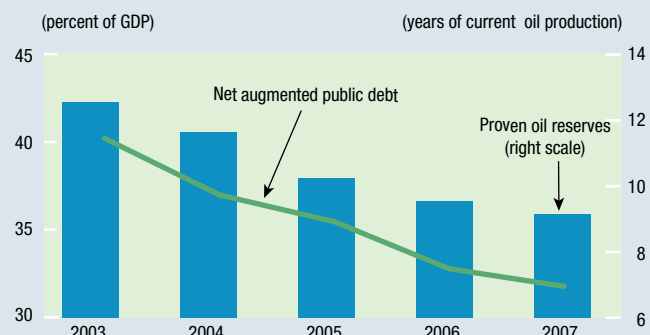


Source: National Statistical Institute of Mexico.

Chart 2

Drop in debt

Public debt is steadily dropping—but so are the country's oil reserves.



Source: Mexican Ministry of Finance and Public Credit, and PEMEX.

Deteriorating external environment

Reflecting Mexico's strong fundamentals, the country has weathered well the international financial market turbulence that began in mid-2007. Financial markets functioned normally throughout this period, without need for policy intervention by the authorities. Modest price drops in Mexico's currency, sovereign bond, and stock markets—associated with a global repricing of assets—were smaller than seen in other emerging market countries, and for the most part have been reversed. Notwithstanding Mexico's many strong links to the United States, its financial institutions were not exposed to problematic U.S. "subprime" assets, and there was no hint of a credit crunch in Mexico. In fact, bank credit growth continued the rapid recovery, albeit from a still-low level, that began several years ago. Amid some deterioration of the consumer loan portfolio, however, banks have increasingly focused on lending more to enterprises.

Mexico's economic expansion continued on a solid footing in 2007, although it was unavoidably dampened by the U.S. economic weakening. With a deceleration of exports—more than 80 percent of which go to the United States—growth for 2007 came out at just over 3 percent, down from an unusually strong performance of almost 5 percent growth in 2006. With some fall in oil output and oil export volume and slower growth of remittances from the United States, the current account deficit widened modestly, to about ¾ percent of GDP in 2007, but was still more than matched by inflows of foreign direct investment.

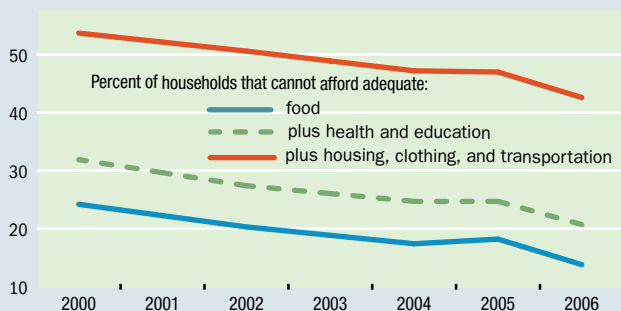
Confronting challenges ahead

Accelerating growth and reducing poverty will require action on many fronts over the coming years, along with major steps to safeguard the public finances, the National Development Plan acknowledges.

Chart 3

Declining poverty

Poverty indicators are improving, but further progress is needed.



Source: National Council for Evaluation of Social Policies, Mexico.



Mexico's National Development Plan includes proposals to boost infrastructure, such as this bridge under construction.

Notimex/Foto/Jorge Arcega

The IMF's latest assessment of Mexico welcomed an impressive start by the new government in addressing these challenges. In 2007, breakthroughs were achieved with several essential, forward-looking reforms, including:

- civil service pensions, which put them on a financially sustainable footing, addressing a longer-term fiscal challenge;
- major tax changes gauged to offset the revenue loss from declining oil production in the coming 5 years;
- a package to enhance efficiency and accountability in public spending, including at the subnational government level; and
- further measures to boost competition in the financial sector and expand the private sector's access to finance.

Critical areas

The IMF assessment also noted the importance of building on these recent reforms in several critical areas:

- Using cautiously the upfront revenue gains from recent tax reform, in light of the prospective decline in oil income. The IMF welcomed the government's focus on capital expenditures, while recommending the targeting of existing subsidies to those most in need;
- Following through with plans to strengthen tax administration and expenditure management;
- Moving quickly to reform the declining state-owned oil sector to raise investment as well as efficiency there and potentially reap large gains in the longer term;
- Supplementing the balanced budget requirement with a focus on steadily reducing the government's large non-oil deficit at a time when the future stream of oil revenue is subject to much uncertainty; and
- Enhancing competition, especially in such key network sectors as telecommunications, to generate positive spillovers throughout the economy and promote equity. ■

Steven Phillips
IMF Western Hemisphere Department

Distinctive Swiss Monetary Framework Shields Real Economy

Switzerland's unique monetary policy framework, which targets an interest rate determined in another country, has helped to shield the nonfinancial sector of the Swiss economy from the recent turbulence in financial markets.

The Swiss National Bank (SNB) implements monetary policy based upon an explicit definition of price stability—an annual CPI inflation rate under 2 percent—as a long-term anchor and uses an inflation forecast as the main indicator for monetary policy decisions.

As an operational objective, the SNB announces a target range for the 3-month London Interbank Offered Rate (Libor) for Swiss francs, a rate fixed daily by a panel of banks in London. The SNB attempts to steer the 3-month Swiss franc Libor to the middle of this target range by buying and selling short-term instruments, in particular, 1-week repurchase agreements (repos) in the domestic market.

Why it picked Libor

The SNB chose the Libor as its reference interest rate because it is the main rate at which Swiss franc credit is priced, it is closely linked to Swiss final domestic demand, most Swiss franc derivatives contracted in international markets are priced off Libor, and it cannot be easily manipulated. Although the Swiss franc Libor is a nonmarket rate based offshore, as the sole provider of Swiss franc liquidity, the SNB has demonstrated it can steer the rate through domestic repo operations.

In contrast, most industrial country central banks conduct their monetary policies by targeting market-based overnight rates determined in domestic markets.

The SNB developed this framework because Switzerland's open economy and the close international ties of its financial center required that the bank have the ability to swiftly adjust to changes in financial markets without having to make



The Swiss National Bank's monetary policy approach has served it well in recent months.

adjustments to the monetary stance (target range). The current system allows this because liquidity conditions can be adjusted up or down while the target range for the 3-month Libor can remain unchanged.

More flexibility

The Swiss approach imparts a degree of flexibility, which has served it well during the turbulence in financial markets. For example, when a sharp repricing of credit risk caused the 3-month Libor to move above the midpoint of the target range before the SNB policy meeting last September, the SNB at first tolerated the increase. That was because the SNB Governing Board was expected to raise the Libor target, given a worsening inflation outlook. At the September meeting the Governing Board did that, raising the target range by 25 basis points to 2.75 percent. But at the same time, to drive the Libor down, it lowered the 1-week repo rate by 25 basis points.

By partly compensating for the increase in banks' funding costs due to higher risk premiums, the move calmed interbank money markets. As risk premiums have ebbed and flowed since then, the SNB has kept the target range constant at 2.75 percent, issued longer-term repos to help banks manage liquidity, and adjusted 1-week repo rates to keep the 3-month rate near the target.

In this manner, the Swiss monetary authorities have largely offset gyrations in the risk premium and changes in interest rate expectations in recent months. This has shielded the real economy as mortgage, prime lending, and other retail interest rates linked to Libor have remained relatively stable.

Potential hurdles

Recent events have demonstrated the framework's flexibility to adjust to changing bank refinancing conditions. Nevertheless, they have also highlighted some issues:

- The risk premium inherent in the Libor has become much more volatile: The difference between the 3-month Libor (an unsecured rate) and the 1-week repo (a secured rate) remained relatively stable as risk aversion declined across markets earlier in the decade. However, it has increased since the start of the subprime crisis and is more volatile.
- Continued lack of liquidity may also affect Libor volatility: Libor is based on banks' perceived unsecured funding costs rather than actual market trades. There is no evidence that the Swiss franc Libor does not reflect true market interest rate conditions. However, not all reporting banks have been equally affected by the turmoil, and the liquidity of Libor-based, money market trading in a crisis is much lower than usual. As a result, the range of reported bank funding costs has been much wider, which can create random fluctuations in Libor.
- Communicating the monetary stance will become more important: Markets appear to understand the SNB framework. Nevertheless, the September decision to tighten the monetary stance—while engineering an effective relaxation—may have been difficult to understand by non-SNB watchers. ■

Kevin Ross
IMF European Department

Mauritius: Laying the Foundations for a Second Growth Miracle

When Mauritius gained independence 40 years ago, many observers, among them Nobel prize-winning economist James Meade, wondered how Mauritius—a multi-ethnic society with few natural resources, a one-crop economy, a small domestic market, and rapid population growth—could ever develop.

Mauritius proved Meade and the others wrong during the “first growth miracle” of the 1970s and 1980s. This miracle was founded on the traditional sugar sector, a new textile sector based in export processing zones, and an emerging tourism sector. Remarkably, Mauritius was able to raise per capita income from \$200 at independence to \$6,300 in 2007/08. Strong democratic institutions, which promoted social cohesion, were key to the country’s success.

But after two decades of remarkable growth, Mauritius suffered at the turn of the millennium as longstanding trade preferences began to be phased out. The end of the Multi-Fiber Agreement (MFA) for textiles in December 2004, large reductions in the European Union’s sugar protocol prices (by 36 percent) over 2006–10, and, more recently, the sharp rise in petroleum and food prices resulted in a cumulative terms of trade shock of nearly 25 percent. Economic growth declined from 5 percent in the 1990s to 3 percent in the early 2000s.

The adjustment and reform challenge

In response to these shocks, the government launched a wide-ranging reform strategy in 2005. Trade was liberalized, some price controls were lifted, business regulations were simplified, a far-reaching tax reform and a fiscal consolidation strategy were initiated, and monetary policy was strengthened. In response, growth has recovered and foreign direct investment is flowing into the country at unprecedented rates. Growth, projected to be above 6 percent this year and next, is broad based but especially strong in tourism, banking, construction, and services.

The authorities introduced reforms to spur business development and employment growth, cutting red tape and introducing business-friendly regulations. Their efforts bore fruit—the World Bank’s *Doing Business 2008* lists Mauritius as the best place to do business in sub-Saharan Africa.

The reforms also focus on fiscal policy consolidation, which is key for preserving domestic and external stability. It will be required to bring public sector debt down from a high of 63 percent of GDP in 2006/07 and to counter the strong aggregate demand from the large foreign investment inflows. Progress has been made in reducing



Mauritius’ growth, projected to be above 6 percent this year, is especially strong in tourism.

the fiscal deficit since 2005/06, built on the positive revenue impact of the tax reform.

The large capital inflows pose challenges for monetary policy. The authorities established the Monetary Policy Committee in 2007, an important step toward increased transparency and effectiveness. The central bank is working to bolster its analytical framework through a better understanding of the monetary transmission mechanism and to strengthen its governance structure.

The reforms also mean adjustment for the sugar and textile industries. The sugar industry, a pillar of development since colonial times, is consolidating and restructuring. The area planted is being reduced, with land converted to tourism and other agricultural uses. Producers are also expanding into

related activities, such as power generation from the sugar cane residues (bagasse) and ethanol production, and are moving up the supply chain into refined sugar.

The textile sector, after years of restructuring and decline, has begun to grow again in 2007/08. With the dismantling of the MFA, many producers closed or moved abroad. The firms that remained, largely locally owned, have survived and, in some cases, prospered through a vertical integration strategy refocusing on higher-quality products.

Mauritius has seen rapid growth in its off-shore financial sector. The sector’s growth is founded on Global Business License firms—entities registered in Mauritius that funnel investments into their targeted country, primarily India. Given Mauritius’ low tax rates (and no capital gains tax), this system has effectively allowed low-tax or tax-free investment channels to India and elsewhere. A high-end real estate development initiative, tied to the tourism sector, is also developing rapidly, drawing in large amounts of foreign direct investment.

A second growth miracle?

Recovering growth and rising foreign investment have lifted the economy and reduced unemployment. But Mauritius faces rising labor, infrastructure, and other bottlenecks—as well as strong headwinds from international commodity prices. Inflation, although declining, remains high.

Mauritius is addressing its macro imbalances and taking steps to secure a second growth miracle. The authorities’ ambition is to see Mauritius transition to a regional banking and services hub. For this goal to be realized, the country’s bold reforms will need to be pursued and deepened, with special attention to managing demand pressures and removing constraints to higher growth. ■

Paul Mathieu and Patrick Imam
IMF African Department

Strauss-Kahn Stresses Multilateral Approach to Global Crises

IMF Managing Director Dominique Strauss-Kahn has urged policymakers around the world to seek a cooperative approach to global challenges stemming from the rise in food and fuel prices and a worldwide economic slowdown.

“Policymakers can respond in two ways: they can take the mercantilist approach, looking only at what is best for their country. Or they can look for multilateral solutions. History has shown us the defects of the first approach but also the difficulties of the second,” Strauss-Kahn said at the International Economic Forum of the Americas in Montreal on June 9.

Speaking later in Cancún, Mexico, about heightened inflationary pressures in Latin America, Strauss-Kahn noted that countries in the region need to act decisively, but he also stressed the importance of multilateralism. “The world needs strong international institutions to deepen understanding of these key global challenges and to provide a forum for finding cooperative approaches to them,” he said.



Marte Reboljar/AFP

Annual Review of IMF's Income Position

The IMF Executive Board has completed its annual review of the IMF's income position for the financial year ended April 30, 2008, and set the lending rate for IMF credit for the coming financial year.

Net operational income for FY 2008 before restructuring and other nonoperational costs was projected at \$3 million, compared with initial projections of a \$234 million shortfall. This improvement stemmed primarily from the strong performance of the Fund's investment portfolio, the one-time income effects associated with Liberia's arrears clearance, and lower expenditures.

IMF Research Conference

The IMF will hold its Jacques Polak Ninth Annual Research Conference on November 13–14 in Washington, D.C. The conference provides a forum for discussing innovative research in economics, by both IMF staff and outside economists, and facilitates the exchange of views among researchers and policymakers. Jean Tirole, Scientific Director of the Institut d'Economie Industrielle in Toulouse, France, will deliver the Mundell-Fleming lecture.

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IMF Names New Department Directors

IMF Managing Director Dominique Strauss-Kahn has announced that he will appoint two new IMF department directors: Marek Belka, European; and Adelheid Burgi-Schmelz, Statistics.

Belka, who will join the IMF in the fall, is currently Under-Secretary-General at the United Nations and Executive Secretary of the UN Economic Commission for Europe. He served as the Prime Minister of Poland from 2004 to 2005 and was Poland's Minister of Finance from 2001 to 2002.

Burgi-Schmelz, who takes up her post on October 31, has served as Director General of the Swiss Federal Statistics Office since 2002.

Working Group on Sovereign Wealth Funds

The International Working Group of Sovereign Wealth Funds (IWG) will conduct its third full working-level meeting in Santiago, Chile, on September 1–2 to discuss a set of best practices. The meeting will take place ahead of the October 11 meeting of the IMF's policy-guiding International Monetary and Financial Committee in Washington, D.C.

The IWG, established in May, also met in July in Singapore to continue deliberations on a set of principles and practices relating to sovereign wealth funds.

Burundi Receives \$75.6 Million

The IMF Executive Board approved a three-year, \$75.6 million arrangement under the Poverty Reduction and Growth Facility (PRGF) for Burundi. The country's new PRGF—the IMF's concessional facility for low-income countries—succeeds an arrangement that expired earlier this year.

Following the Executive Board's July 7 discussion, IMF Deputy Managing Director Murilo Portugal commended the Burundian authorities for their progress in a difficult post-conflict environment. “Though structural reforms have been slow, most monetary and fiscal reforms have progressed well,” he said, noting that Burundi's challenges in meeting the Millennium Development Goals continue to be significant.

“The success of the authorities' PRGF-supported program will depend, in part, on strong and coordinated assistance from the international community,” Portugal said. He added that accelerating structural reforms, notably on governance issues, would be critical.



José Cendon/AFP/Getty Images