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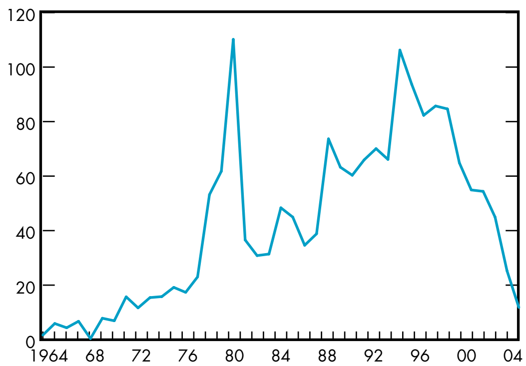
Turkey: From crisis to recovery

For a few months in late 2000 and early 2001, Turkey hovered on the brink of economic collapse. High inflation, a large public debt, a growing current account deficit, and delays in restructuring the economy triggered a loss of confidence among investors and caused a run on the country's banks. To deal with the crisis, the government undertook a sharp fiscal correction, floated the exchange rate, and initiated wide-ranging structural reforms as part of an ambitious package supported by the IMF. Three years later, Turkey is on its way to becoming a new tiger economy. But it has faltered before. Will it manage to stay the course this time? Michael Deppler and Reza Moghadam—respectively Director and Assistant Director in the IMF's European Department—spoke with Camilla Andersen of the IMF Survey *about the country's prospects.*

IMF Survey: Turkey has undergone an amazing recovery since the 2001 crisis. What made this possible?

Deppler: Turkey's growth has averaged 6–7 percent over the past two years, well above the 5 percent forecast under its Stand-By Arrangement with the IMF. Inflation has come down from around 70 percent to single digits (see chart below); *(Please turn to next page)*

Kicking the habit of high inflation
(percent)



Data: IMF, *International Financial Statistics* and *World Economic Outlook*.

Interview with Takatoshi Kato

Top IMF official underscores need for flexible exchange rate management in Asia

Kato: "Manipulation is an emotional term that has been used too widely and too loosely."

In February, Takatoshi Kato of Japan joined the IMF as Deputy Managing Director, replacing Shigemitsu Sugisaki (also of Japan). Previously, he held a series of senior positions at Japan's Ministry of Finance—including Vice-Minister of Finance for International Affairs (1995–97)—advised the president of Tokyo-Mitsubishi Bank, and taught in both Japan (Waseda University) and the United States (Princeton University). He spoke with Laura Wallace of the IMF Survey *about the 1997–98 Asian financial crisis, current trends in Asia, and his IMF security brief.*

IMF Survey: How do you view the tremendous build up of foreign exchange reserves in Asia in recent years? How do you react to charges that all this "one-way intervention" amounts to currency manipulation and to concerns about a lack of exchange rate flexibility in Asia?

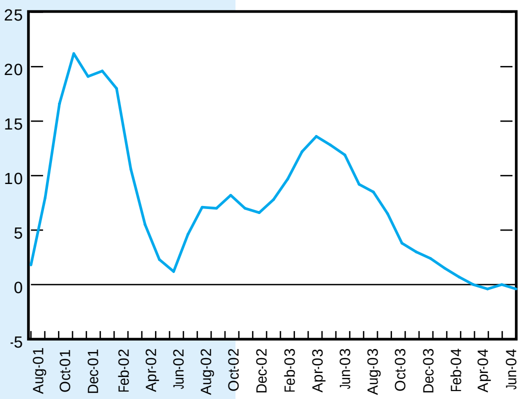
Kato: One of the lessons of the 1997–98 Asian financial crisis is that it makes sense for an emerging market economy to build up its foreign exchange reserve position to enable it to better handle short-term liquidity problems. So I can understand the desire of these countries to accumulate foreign exchange reserves. However, they now have the equivalent of about nine months' worth of imports—which is eight times *(Please turn to page 264)*

For Turkey, fiscal policy remains key

(Continued from front page) reserves are many billions of dollars above what we had programmed; and real interest rates—which are key to confidence—are down from about 30–35 percent to 15 percent. All this has happened because strong policies, together with IMF financing to give the process time, have restored confidence in the economy. People are now investing and spending more. Turkey is, in fact, a classic case of successful stabilization.

Turkey's central bank has restored credibility in fighting inflation

(percent)



Note: Expected annual inflation minus the central bank's announced inflation target.

IMF Survey: What sparked this transformation?

Deppler: The crisis, basically. Economic problems are almost invariably political problems. Societies get themselves into a situation where they accommodate too many rent-seeking activities. When this becomes unsustainable, it results in crisis, which then brings about change. I have seen this in many countries. A case in point is Bulgaria, where a crisis changed the dynamics of what is possible. Turkey is another such case.

IMF Survey: Can you give us a sense of where the Turkish economy has come from and where it is going?

Deppler: Turkey is shifting to a new view of both its place in the world and how it wants to manage its economy and its politics more generally. As part of this, there is much more coherence to the policy package, the policy perspective, and the direction of the economy. That is probably the most significant change to have come out of the crisis, and it gives us reason to hope that Turkey's performance in the future is going to be significantly better than it has been in the past.

IMF Survey: Fiscal policy has always been Turkey's Achilles' heel. What should the government do to put fiscal policy on a sound long-term footing?

Moghadam: The performance of fiscal policy in Turkey has been impressive compared with that in emerging markets around the world. Last year the government ran the highest primary surplus on record in that country—just over 6 percent of GNP.

But if you look more closely at the budget, difficult challenges lie ahead. For example, three-fourths of total spending is nondiscretionary, leaving the government with little flexibility to control expenditures. And because tax rates are already very high, there is little room to increase revenues. International experience shows that sustaining fiscal adjustment depends, to a large extent, on controlling expenditure.

There are other challenges as well. During the crisis, current spending was increased at the expense of capital spending. This must now be reversed to make room for more public investment in infrastructure and social programs. All of this points to the need for structural fiscal reforms to sustain the fiscal performance.

IMF Survey: Paying down Turkey's debt will be difficult to reconcile with the social demands placed on the state by high unemployment, regional inequality, and population growth. How can the government balance these contradictory demands?

Deppler: With the crisis giving way to recovery, there is clearly a shift to paying greater attention to social issues. Unemployment, in particular, has become a greater concern. Needless to say, this is a concern we share.

The real issue is how to address it. As you suggest, many people see increased public spending as the solution. My answer to them is that Turkey's very tough fiscal policies have lowered interest rates dramatically, and this has led to very strong economic performance. Real interest rates are still about 15 percent, which, by any standard, is extremely high. Policies that reduce real interest rates to single digits—which are more the norm in emerging market economies—will pay off much more in terms of reducing unemployment and increasing tax receipts to fund social programs than would token spending policies in favor of particular programs. Do not underestimate the growth that can be achieved from sound fiscal and monetary management in a situation like Turkey's.

IMF Survey: Has Turkey finally kicked the habit of high inflation?

Moghadam: There has definitely been a structural change. For the first time in Turkey's history, the credibility gap—the gap between market expectations and the inflation target—has turned negative (see chart, this page). This means the central bank has managed to restore credibility in terms of dealing with inflation. Now, the challenge will be to move toward European rates of inflation. Fiscal policy has been key in bringing down inflation, and it will continue to be important. Another important change has been the government's decision to grant independence to the central bank.

IMF Survey: Turkey is still very vulnerable because of its debt. What can it do to reduce its exposure?

Moghadam: The government is well aware of the need to reduce the debt. In the new member states of the European Union [EU], gross public debt is typically about 40 percent of GDP. At about 80 percent of GDP, Turkey's gross debt is double that figure. The IMF has done a lot of work in recent years on risks associated with high debt, and the Turkish authorities recognize these risks. So the debt will have to come down, which points to the need for continued large primary surpluses. Structural fiscal reform is therefore essential. As reforms take hold and policy credibility improves, real interest rates will come down, which will help generate a virtuous circle and facilitate further declines in debt.

IMF Survey: Why is there still so little foreign direct investment [FDI] in Turkey?

Moghadam: Historically, FDI has been low in Turkey, for understandable reasons. If you have a lot of policy volatility and macroeconomic instability, then you cannot expect FDI to be high. But Turkey has gotten over the first hurdle—creating a stable macroeconomic environment—and FDI is picking up as a result. The potential of the country—with a population of almost 70 million, a vibrant economy, and a geographical position that has Europe, Asia, and North Africa in close proximity—means prospects are excellent.

The government is aware of the need to increase FDI. In recognition of that, the prime minister recently invited about 20 top business people from around the world to discuss what is holding it back. They pointed to macroeconomic stability as being key, but also said the government must address corruption, improve the judicial system, upgrade its infrastructure, and remove red tape.

IMF Survey: Weak banks contributed to the crisis in 2001. Has banking reform corrected these failures?

Moghadam: Banking reform has been impressive, but it has come at a heavy price. The cost of cleaning up the banking system has been close to $50 billion and is the key reason for the increase in public debt. The banking system is in a far stronger position than it was three years ago, and the government is working on a new banking law that will bring the supervisory regime closer to EU standards. However, asset recovery has been disappointing and needs to be accelerated to recoup some of the costs incurred.

IMF Survey: Turkey is awaiting a decision from the EU in December on whether it will be allowed to start accession talks. How important will this be for Turkey's economic future?

Deppler: We agree with the authorities that, regardless of what happens, the present economic strategy needs to continue. That said, there is no question that joining the EU would be a major boost to Turkey's prospects. The EU has been a beacon for sound policies throughout Eastern Europe over the past 10 to 15 years, and it will serve the same role in Turkey. In terms of economic payoffs, I would have the greatest hopes for improving the business climate—through judicial reform and moving toward greater respect for the law—where clearly there are problems of corruption. These issues are difficult to address, and the prospect of EU accession would help propel change.

IMF Survey: The IMF has tremendous exposure to Turkey. The country owes $23 billion, which accounts for one-fourth of total IMF lending. How does this affect the IMF's relations with Turkey?

Deppler: Needless to say, it focuses the mind and the attention of senior staff, management, and Executive Directors. But if you think about big programs in the IMF, Turkey is not among the more controversial ones. So while there is much attention, it has been relatively benign.

IMF Survey: Many people have criticized the IMF for the way it handles financial crises. But, in stark contrast to what happened in Argentina, Turkey managed to avoid default and has experienced growth since then. What went right in Turkey?

Deppler: To my mind, Turkey is much more the normal case than the IMF is typically given credit for: given a supportive political environment, programs generally succeed. What happened in Turkey is what the IMF always tries to do—and often succeeds in doing. Countries are generally very reluctant to default. In my experience, when countries come to the brink and must decide, they generally resist default. Hungary and Bulgaria in the 1990s come to mind.

IMF Survey: The government announced in August that it would seek a new program with the IMF once the current one expires in February next year. What will the new program seek to achieve?

To my mind, Turkey is much more the normal case than the IMF is typically given credit for: given a supportive political environment, programs generally succeed.
—Michael Deppler

Moghadam: "The cost of cleaning up the banking system has been close to $50 billion and is the key reason for the increase in public debt."

Deppler: There is no question that, although Turkey is doing much better than in the past, it remains quite vulnerable. Its debt is far too high for an emerging economy. It also preempts too much of the national savings needed to finance a growing economy. Turkey must therefore continue its debt reduction strategy at a pronounced pace.

The purpose of the new program, as we understand it from our discussions with the authorities, is to continue reducing the debt, strengthen the economy, and make fiscal policy compatible with both debt reduction and a vibrant private sector. This means tax and other reforms. Together with continuing efforts to strengthen the banking sector, these are the key features of the future program, which would basically extend the existing arrangement.

IMF Survey: You have followed Turkey for many years. Where do you see the country in 20 years?

Deppler: In 1980, Turkey went through a bout of liberalization and reform. At the same time, it initiated 20 years of erratic and cumulatively harmful macroeconomic policies. If Turkey had simply liberalized and continued with sound policy management, it would have enjoyed some of the highest growth rates in the world. Instead, it performed slightly above average. There is a good chance now that Turkey will continue to pursue not only market-oriented policies but also sound macroeconomic policies. Such policies would enable the private sector to respond strongly and allow Turkey to enjoy growth that is well above average over the next 20 years. I think there is a strong prospect of that, and this is encouraging. ■

The IMF's Turkey team is led by Reza Moghadam and comprises Mark Griffiths, Donal McGettigan, and Christian Keller. For more information on the IMF's recent appraisal of the Turkish economy, please refer to the statement "IMF Concludes 2004 Article IV Consultation with Turkey" on the IMF's website (*www.imf.org*).

Kato on Asian monetary cooperation

(Continued from front page)

larger than their short-term debt—so they can feel quite comfortable with current reserve levels. A challenge for the IMF is to persuade some Asian member countries that it is in their own best interest to manage their exchange rates with greater flexibility. Supporting measures need to include developing an active foreign exchange market with instruments to allow participants to cover foreign exchange risks and a more general modernization of economic structures to increase resiliency against shocks.

They now have the equivalent of about nine months' worth of imports—which is eight times larger than their short-term debt—so they can feel quite comfortable with current reserve levels.
—Takatoshi Kato

IMF Survey: What about charges that some of these countries are manipulating their exchange rate to help their exports?

Kato: Manipulation is an emotional term that has been used too widely and too loosely. Some countries accused of manipulation have had long-standing exchange rate pegs; others so accused have seen large swings in their currencies over the period since the onset of the Asian financial crisis. Is it manipulation to "lean against the wind" of swings in currency markets? Or to maintain an exchange rate? Clearly not, as a matter of definition. A much more nuanced assessment is needed to evaluate whether a country's exchange rate management is appropriate—which is exactly what the IMF seeks to provide in its annual Article IV consultation with a country's authorities.

IMF Survey: Some have argued that the failure of IMF quotas to reflect the current economic importance of the Asian emerging market economies will add to the incentive for the region to create an Asian Monetary Fund independent of the IMF. How do you see those arguments? Do you favor stronger Asian monetary cooperation, and what would this mean potentially for the IMF?

Kato: Most countries in Asia recognize the benefits that can accrue from closer regional cooperation and integration, as exemplified by the European experience over several decades. There are differences of view as to how best to realize these benefits—whether through a series of concrete initiatives to foster cooperation in specific areas (such as the Asian Bond Fund) or more ambitious efforts to establish new institutions to promote integration (such as an Asian Monetary Fund). I am among those who favor the former approach. I believe the IMF can play a valuable role in assisting the cooperation process, through analysis and technical assistance.

IMF Survey: Do you foresee Asian countries pegging to the yen the way European countries did to the deutsche mark before European monetary union? If not, do you see monetary union occurring in Asia in some other way?

Kato: Right now, the major objective of Japan's monetary policy orientation is to pull the country out of a recessionary phase and prolonged deflation, whereas most of the Asian emerging market countries—such as China—are focused on controlling "overheating." Given these differences, pegging to the yen wouldn't be practical at this juncture.

Looking down the road, I expect to see gradual movement toward more coordination of monetary policies within the Asian region, as currencies become fully convertible and financial intermediation in key economies becomes fully market-based. Ideally, the basic conditions for closer integration should be put in place, step by step, so that an arrangement similar to the European Exchange Rate Mechanism, which led to a single currency, can eventually be introduced in Asia—although this will be a lengthy process, as indeed it was in Europe.

IMF Survey: The IMF has recently updated its 2004 GDP forecast for Japan to 4.5 percent. Can we breathe a sigh of relief that Japan has finally turned the corner after its lost decade?

Kato: As of end-June, Japan recorded positive growth in the preceding five consecutive quarters, and this positive growth was realized without fiscal stimulus. The engine of growth came from the private sector, which was good news, and the Japanese equity market responded quite positively. But many difficult challenges remain to be tackled. An immediate issue is the sizable fiscal deficit, which has, over time, contributed to the accumulation of an exceptionally large public debt—equivalent to about 170 percent of GDP, by far the highest debt-to-GDP ratio among the Group of Seven major industrial countries. Recovery in the financial system is under way, but the major banks need to boost their profitability, and the financial supervisors will have to remain vigilant and, where warranted, proactive.

IMF Survey: You're responsible for IMF staff safety. In light of the recent al Qaeda security threat, how can the IMF continue to help its member countries when it is explicitly targeted? Are we ready to go back into Iraq, a little more than a year after the bombing of the UN office in Baghdad?

Kato: We were all surprised and shocked to learn that the IMF was one of a small number of key financial institutions to be the subject of detailed reconnaissance efforts by al Qaeda. As a multilateral institution, we see ourselves as being above the fray of international politics, but clearly not all parties see us in this light. We need to handle risks prudently, seeking lower-risk alternative forms of engagement where warranted, while at the same time carrying on the work required of us by our 184 member countries.

As for Iraq, the IMF has been providing technical assistance to Iraqi officials for some time—albeit outside the borders of Iraq—and is now engaged in policy dialogue with the interim Iraqi government, which plans to take part in the early October IMF–World Bank Annual Meetings. We are currently exploring how best to provide financial assistance to the government—which will need broad-based assistance from the international community if Iraq is to achieve a lasting economic recovery.

IMF Survey: In what ways do you think your background helps you in the job of Deputy Managing Director?

Kato: I have been fortunate to have had an interesting and varied career to date. I worked at the Organization for Economic Cooperation and Development Secretariat doing balance of payments forecasting, just prior to the breakdown of the Bretton Woods system in 1971. I was Executive Director at the Asian Development Bank when the Philippines experienced a "people power" regime change from President Marcos to President Aquino in 1986. I was responsible for Japan's foreign exchange rate policy when the yen appreciated to 80 yen to the dollar in April 1995. And I was Japan's Vice-Minister of Finance for International Affairs when the Thai baht was floated in 1997 and an international support package had to be put together to assist Thailand. At the time, I thought that the package of support provided to Thailand would have a favorable demonstration effect on its neighboring countries, but this proved too optimistic an assessment, given the strong contagion that affected the region. Like others, I didn't expect the severity of the macroeconomic damage that came out of a balance sheet crisis.

So I've had the opportunity to observe many dramatic economic events, and later had the chance to step back and reflect on what lessons we could learn. In fact, this is a subject that I taught in both Japanese and U.S. universities. One thing I have learned myself is the need for careful analysis of problems—reexamining one's assumptions to see if they are still relevant and being aware of the political dimension of economic policies—before taking actions. This is certainly a good guideline for the IMF as well. It is what we at the IMF should do and have the capability to do exceptionally well.

IMF Survey: You've also served on the World Health Organization's Commission on Macroeconomics and Health. Does the IMF have a role to play in fighting HIV/AIDS?

Kato: HIV/AIDS is having a catastrophic effect in several countries, cutting life expectancy and the

The IMF needs to help countries that are severely affected by HIV/AIDS to develop viable economic frameworks.
—Takatoshi Kato

working-age population, eroding government revenues and health system capabilities while producing an explosion in demand for HIV-related health services. For a few countries, large inflows of HIV/AIDS assistance, though welcome, are complicating the management of the exchange rate. The IMF needs to help countries that are severely affected by HIV/AIDS to develop viable economic frameworks. We can offer technical assistance, policy advice, and, in some cases, financial assistance—although the loans we can provide are often not the ideal choice for poor countries handling severe long-term supply shocks. Such countries would benefit most from the grant-based assistance bilateral donors can provide. We can help countries explore ways not only to streamline health-related expenditures but also to raise domestic revenues to fund health-related expenses. ■

Available on the web (www.imf.org)

Press Releases

04/179: Press Release: Statement by an IMF Staff Mission in Honduras, August 27
04/180: IMF Completes Fifth Review of Uruguay's Stand-By Arrangement, August 27
04/181: Press Release: IMF Completes Fourth Review Under Cape Verde's PRGF Arrangement and Approves $2 Million Disbursement, August 30
04/182: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of His Visit to Argentina, August 31
04/183: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of His Visit to Uruguay, September 1
04/184: IMF Managing Director Rodrigo de Rato to Visit South Africa and Burkina Faso, September 1
04/185: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of His Visit to Chile, September 2
04/186: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of His Visit to Brazil, September 3
04/187: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of his Visit to South Africa, September 6–7, 2004, September 7
04/188: Mauritania Formally Begins Participation in the IMF's General Data Dissemination System, September 8
04/189: IMF Executive Board Completes Fifth and Sixth Reviews Under Nicaragua's PRGF Arrangement, Approves Disbursement Amounting to $20 Million, September 8
04/190: IMF Managing Director Rodrigo de Rato's Statement at the Conclusion of His Visit to Burkina Faso, September 9
04/191: IMF Completes Sixth and Final Review Under Lesotho's PRGF Arrangement and Approves $5 Million Disbursement, September 10
04/192: IMF Staff Statement on Discussions Beginning September 16 on a New IMF Stand-By Arrangement for Turkey, September 13
04/193: Statement by IMF Managing Director Rodrigo de Rato on Hurricane Damage in the Caribbean, September 13
04/194: IMF Completes Sixth Review Under Ethiopia's PRGF Arrangement, September 13
04/195: Islamic Republic of Iran Accepts IMF's Article VIII Obligations, September 13

Public Information Notices

04/79: IMF Executive Board Discusses Euro Area Policies, August 3
04/80: IMF Concludes 2004 Article IV Consultation with Nigeria, August 3
04/81: IMF Concludes 2004 Article IV Consultation with Austria, August 4
04/82: IMF Concludes 2004 Article IV Consultation with San Marino, August 4
04/83: IMF Concludes 2004 Article IV Consultation with Chile, August 5
04/84: IMF Concludes 2004 Article IV Consultation with Denmark, August 6
04/85: IMF Concludes 2004 Article IV Consultation with the Republic of Latvia, August 6
04/86: IMF Concludes 2004 Article IV Consultation with Sweden, August 9
04/87: IMF Concludes 2004 Article IV Consultation with Turkey, August 10
04/88: IMF Concludes 2004 Article IV Consultation with Japan, August 11
04/89: IMF Concludes 2004 Article IV Consultation with the Solomon Islands, August 12
04/90: IMF Concludes 2004 Article IV Consultation with the Republic of Croatia, August 12
04/91: IMF Concludes 2004 Article IV Consultation with Ecuador, August 12
04/92: IMF Concludes 2004 Article IV Consultation with Jamaica, August 16
04/93: IMF Concludes 2004 Article IV Consultation with the Czech Republic, August 17
04/94: IMF Concludes 2004 Article IV Consultation with Costa Rica, August 19
04/95: IMF Executive Board Reviews the Fund's Surveillance, August 24 (see page 267)
04/96: IMF Concludes 2004 Article IV Consultation with the Kingdom of Bahrain, August 24
04/97: IMF Reviews the Former Yugoslav Republic of Macedonia's Performance Under Past Fund-Supported Programs, August 25
04/98: IMF Concludes 2004 Article IV Consultation with Mauritius, August 25

PRGF = Poverty Reduction and Growth Facility

Making surveillance more effective

Economic policy oversight—in IMF parlance, "surveillance"—is a key responsibility of the institution and of its member countries. The challenge for the IMF, particularly over the past decade, has been to ensure that its surveillance remains effective and in step with the dramatic changes taking place in the world economy. Every two years, the IMF undertakes a review of its surveillance. John Hicklin, a Senior Advisor in the IMF's Policy Development and Review Department, talked with the *IMF Survey* about the results of the most recent biennial review.

"One of the core responsibilities of the IMF and its members," Hicklin says, is "the obligation to discuss and assess the national and international consequences of key economic and financial policies." Assessment of exchange rate policy has long been a vital part of this dialogue, but the IMF's analysis typically encompasses a broad range of policies. And the success of the surveillance process, Hicklin adds, is "critically dependent not only on relevant and insightful analysis, but also on cooperation and mutual trust." It is important, for example, that the IMF be seen to conduct surveillance in an even-handed way across the membership."

Formal surveillance takes place in the context of a regular (typically annual) consultation between the IMF and member country officials that culminates in a staff report on the country's economy and policies. The report is then discussed by the IMF's Executive Board, which provides an opportunity for all member countries to contribute to the assessment.

The surveillance work with individual countries is more continuous than the formal process might suggest and is complemented, Hicklin observes, by multilateral analysis, including the *World Economic Outlook* and the *Global Financial Stability Report*. Surveillance has also become markedly more complex as the IMF has been challenged to devise better ways to assess potential vulnerabilities, including in the wake of the capital account crises of the past decade and the developments in financial markets. As Hicklin stresses, surveillance now benefits from a very broad range of IMF work—notably financial sector and vulnerability assessments and efforts to evaluate countries' observance of a variety of international standards and codes.

Can we do better?

The theme of the most recent biennial review was how to make surveillance more effective across the whole membership. The question drew many recommendations; the challenge now, Hicklin says, "will be to implement them." The review, which concluded in July with an Executive Board discussion, focused on four areas, namely,

• the focus and depth of the IMF's economic analysis and policy advice;

• the nature of the policy dialogue with country authorities;

• communication of the IMF's policy messages, including signaling to creditors and donors in the context of surveillance; and

• assessments of the overall effectiveness of surveillance.

In general, the review found that the choice and treatment of topics have in many cases been fine and that the staff has managed to combine comprehensive coverage with appropriate focus. But the report did highlight a number of areas where improvements were warranted. One was the continuing need for clearer and more candid treatment of exchange rate issues. The report also cited the IMF's financial sector analysis as an element that had improved but "is still not on a par with coverage of other areas." In addition, the report underscored the need for "greater integration of the global and regional issues in individual country reports, particularly when the countries are of systemic importance."

On other aspects of the review, there was, according to Hicklin, widespread appreciation for the quality of the policy dialogue and for the increased transparency of the IMF's analysis and assessments. At the same time, however, there were also vigorous calls for strengthened policy discus-

How to gauge success

One of the most difficult tasks in surveillance, Hicklin acknowledges, is assessing its effectiveness. Should success be gauged solely in terms of changes in policies and outcomes? Or is there, as some have argued, real value in the vigor of the policy discussion itself and in the provision of data to the public?

To better ascertain the value of surveillance to its member countries, the IMF has tried to spell out more clearly the different stages of this process. It has, for example, examined the chain of results that derives from policy dialogues, staff reports, governmental preference for policy changes, and, of course, whether policies changed and whether outcomes improved. In the absence of a single monitorable output, it is important to get an understanding of that chain of events as a first step in measuring the effectiveness of the whole process.

Hicklin: "The success of the [surveillance] process is critically dependent not only on relevant and insightful analysis, but also on cooperation and mutual trust."

sions and improvements in the communication of the IMF's message.

"Of the many proposals," he notes, "I would highlight three: the Executive Board's support for increased use of cross-country studies as a way of adding value to policy discussions; agreement that informal Board discussions of regional issues will be valuable complements to existing meetings and will provide opportunities for comparative analysis of developments and policies, as well as shed light on regional transmission of shocks; and, finally, the focus on strengthening communication of the IMF's policy message through greater outreach, including contacts with local think tanks." Directors also discussed how surveillance can best respond to the increasing demand for high-frequency policy monitoring and for signaling the strength of country policies. This topic will be debated more extensively in the next few months.

Priorities going forward

"If there's one key aspect of this review," Hicklin says, it is that the IMF must prioritize and establish "clearly monitorable goals" for its surveillance. For example, "each individual report could benefit from stating succinctly what the strategic focus of that consultation is, what lessons have been learned from the past, and so on." This would allow the IMF and the country authorities at the next review to measure progress or examine whether the advice had been appropriate.

At the end of its July meeting, the Executive Board set out its broad Fund-wide surveillance priorities for the next two years. These priorities are to

- sharpen the focus of individual consultations and, within this, ensure a deeper treatment of exchange rate issues;
- enhance financial sector surveillance; and
- deepen the coverage of regional and global spillovers in surveillance with individual countries.

These goals will be monitorable objectives for the next surveillance review.

Reflecting concerns expressed by the IMF's policy body—the International Monetary and Financial Committee—issues such as the further progress made in improving debt sustainability and efforts to reduce balance sheet vulnerabilities will also be monitored, as will ways in which the IMF's surveillance in low-income countries can be made more effective. The latter task, Hicklin notes, "will be an important element of the work now under way to define the Fund's role in low-income countries and to respond to the formidable challenge to sustain high growth and reduce poverty in these countries." ■

Lessons from outreach

The recent biennial review of surveillance departed from customary procedures in seeking a wide range of views and in reporting the results of this outreach effort to the IMF's Executive Board. The process, Hicklin says, produced many compliments but also a realization that the surveillance process is not well understood and the IMF's assessments are not widely absorbed in several countries. "We need to take these lessons to heart," he acknowledges.

The outreach effort complemented the traditional in-house review carried out by the Policy Development and Review, Research, and International Capital Markets Departments, with considerable assistance from the IMF's area (regional) departments. One valuable lesson that the outreach effort highlighted is the importance of making sure that the policy dialogue is "well focused, useful to the authorities, and seen as helpful." On communication, the feedback pointed to the usefulness of tailoring the message for different audiences. This, Hicklin observes, may have implications for the IMF's style of writing and the length of its surveillance documents. Respondents in some countries, for example, suggested that summaries of the surveillance findings be no longer than one page if they are to reach a relatively wide audience.

In the course of the outreach efforts, staff had discussions with a wide range of country authorities, market participants, think tanks, and other observers. The IMF also hired a consultant—Dr. Pisit Leeahtam, former Deputy Finance Minister of Thailand—whose experience in the wake of the Asian crisis and contribution, for example, to the work on transparency and accountability for the Group of 22 was most helpful. Leeahtam held confidential discussions with the authorities of more than 20 countries to draw out frank perspectives on the effectiveness of surveillance. What resulted, Hicklin says, are "very valuable insights on the ways in which we'd been successful in surveillance and the ways in which we can do better."

World Economic Outlook

No single "magic bullet" for demographic shifts

The world is undergoing a major demographic transition. In industrial countries, aging populations will strain government finances and reduce growth. In contrast, expanding workforces in many developing countries may translate into higher growth. Both trends are likely to pose significant challenges for global and domestic economies. In the September *World Economic Outlook* (*WEO*), an IMF team analyzes these developments and examines how policymakers should respond. Nikola Spatafora of the IMF's Research Department provides more details below.

The world is currently witnessing a significant demographic change, with potentially profound economic implications. In most advanced economies, populations are aging rapidly, (see chart, this page), and the size of the workforce relative to total population is starting to decline. In many developing countries, in contrast, declining fertility and rising longevity will translate over the next 20–30 years into sharp reductions in
the share of the young in total population and a corresponding increase in the relative size of the working-age population.

There is no dispute about the direction of these trends, but it still is not clear what these shifts will mean for economic growth and for country authorities hoping to either contain the damage done to fiscal positions or seize the opportunity to boost growth. The *WEO* team researched the likely effect of these demographic developments on different countries and regions, focusing on the nature and scale of the required policy response, and on how wide-ranging reforms should be.

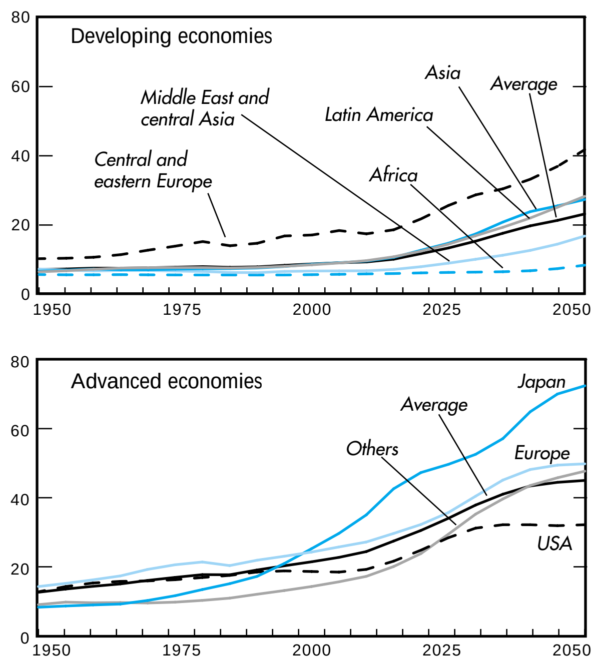
Dramatic shifts in workforces

Demographic projections are inherently uncertain. Most plausible scenarios, however, imply a number of broad trends. Over the next half century, the world's population growth will slow, from the current 1¼ percent a year to perhaps ¼ of 1 percent. The world's population will continue to age, with the share of working-age adults in the total population falling in advanced economies but increasing in many developing countries.

The share of the elderly in the total population is projected to rise especially dramatically in Japan and Europe. Smaller increases are anticipated in the United States, where high immigration and higher fertility will stabilize the share of the working-age population after 2025. Among the developing regions, aging is already under way in Central and Eastern Europe; the process will also begin to accelerate in Asia and Latin America starting around 2015. In contrast, the share of the elderly in Africa and the Middle East will remain relatively small, and their working-age population will continue to rise through 2050.

Elderly dependency ratios are rising

(percent of working-age population)



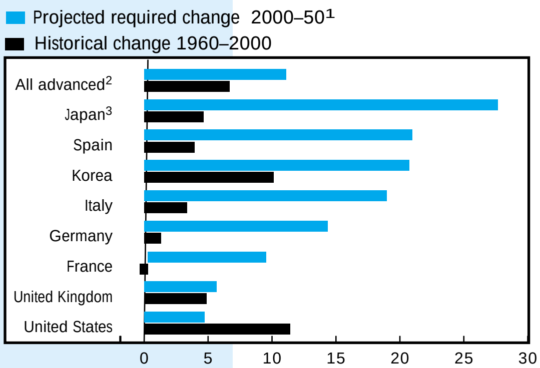
Data: United Nations, *World Population Prospects: The 2002 Revision*

Using both econometric analysis and multicountry macroeconomic models, the *WEO* team found that rapid population aging in advanced economies is likely to strain government finances and reduce growth. In particular, over the next 50 years, demographic changes will likely reduce average output per capita growth rates in most advanced economies by around ½ of 1 percentage point. Developing countries, in contrast, are likely to see an increase in the relative size of their working-age population, which will produce a "demographic dividend" that should result in stronger growth over the next couple of decades.

These demographic changes will also affect saving, investment, and capital flows. For instance, Japan and Europe, which are aging fastest, could see large declines in saving and a deterioration in their current account positions if the elderly run down their assets during retirement.

Much higher labor participation would be needed to stabilize the workforce

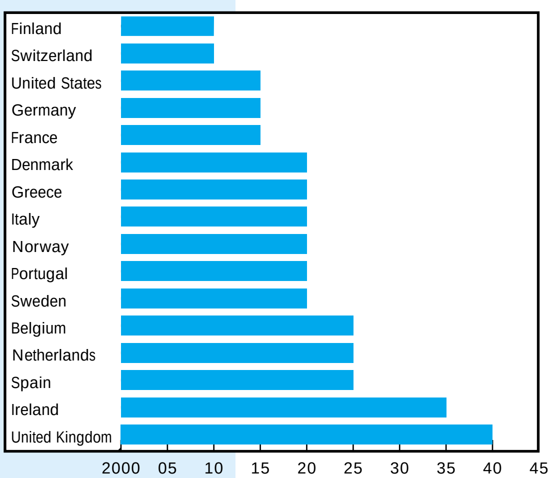
(percentage point change in labor participation rate)



[1]Increase in the labor participation rate necessary to maintain the ratio of labor force to total population in 2050 at its 2000 level.
[2]Average of all advanced economies.
[3]For Japan, even if the; labor population rate increased from its 2000 value of 78.8 percent to 100 percent, the relative size of the labor force would still decline.
Data: United Nations, *World Population Prospects: The 2002 Revision*

The last train for pension reform departs in . . .

Year in which voters aged 50 and older—adjusted for turnout—account for at least 50.1 percent of all voters



Data: Institute for Demographic and Electoral Assistance, *Youth Voter Participation* (1999); United Nations, *World Population Prospects: The 2002 Revision*; and IMF staff calculations

Policymakers must respond

Given the size of the demographic shift and its economic impact, policy changes will be necessary. According to the *WEO* team, the advanced economies will need to focus on minimizing the macroeconomic and fiscal impact of population aging. To do so, it will be crucial to take steps to boost labor supply, saving, and productivity; reduce public debt; and reform pension and health care systems.

In developing countries, the challenge will be to maximize the growth benefits of the demographic dividend while preparing for the kind of population aging that advanced economies are now beginning to experience. Developing economies should therefore implement sound macroeconomic policies, improve governance, strengthen financial institutions, and improve education and training so that their labor force has the skills necessary for employment. Pension and health care systems will have to be carefully crafted and implemented so as to provide a safety net that is both adequate and fiscally sustainable. There are lessons for developing country governments to learn from the experiences of advanced countries. It is important that developing countries not commit themselves to future benefits that will be difficult to finance.

The movement of goods, capital, and labor among countries will be an integral part of the global adjustment to differing rates of population aging, and increased international cooperation will be needed to manage these flows. Policymakers will have to decide how these channels can best be used by weighing the economic and social implications of each. A balanced approach, however, would help reduce the risks that may accompany large capital flows.

Broad-based response needed

Given the scale of these demographic changes, there can be, as the *WEO* study stresses, no single "magic bullet." Politically acceptable reforms in any single area will be insufficient to address the impact of population aging. On their own, unrealistically large increases in the retirement age (seven years), the labor force participation rate (11 percentage points), or immigration (30 percent of total population) would be required for advanced economies to maintain the ratio of workforce to total population at its current level (see top chart, this page). Changes in all three areas, however, would be more manageable and certainly more achievable politically.

The *WEO* analysis also suggests that such reforms will need to be made as resilient as possible, given uncertainties about future population aging (past population projections have, for example, consistently underestimated the degree of population aging in advanced countries). The report recommends considering measures that link increases in the retirement age to gains in life expectancy or tie the pension benefits to life expectancy (as Sweden has done), so as to make pension systems more robust to the uncertainties about future increases in life expectancy.

Finally, policymakers must begin to tackle these issues now. The full impact of demographic change will not be felt in most countries for a number of years, but planning a response will be a lengthy process. These reforms will involve difficult trade-offs, take time to agree on and implement, and need to be phased in to allow people time to adjust their behavior. Pension reforms in advanced countries will also become increasingly difficult to implement as populations age—indeed the "last train" for pension reform will leave in the not too distant future (see bottom chart, this page). All the more reason, the *WEO* team says, for policymakers to take advantage of current strong global growth to advance the reform agenda. ■

The analytical chapters of the *World Economic Outlook* are available on the IMF's website (*www.imf.org*). Copies of the full September 2004 *World Economic Outlook* will be available in late September for $49.00 each ($46.00 academic price) from IMF Publications Services. See page 275 for ordering details. The full text of the *World Economic Outlook* will be available on the IMF's website on September 29.

IMFSURVEY

Global Financial Stability Report

World markets calm as interest rates edge up

Broadening global economic growth and low inflationary expectations have fostered an increasingly favorable environment for financial markets, according to the IMF's September 2004 *Global Financial Stability Report (GFSR)*. In mature markets, strong economic growth has boosted corporate and financial sector earnings, helped strengthen balance sheets, and improved credit quality. Emerging markets have also benefited from stronger growth prospects and credit quality, as well as easier access to external financing at relatively low cost. Still, more must be done to address structural sources of instability and increase resilience to shocks, and the currently favorable environment affords a useful opportunity to do just that.

Throughout much of 2003, stimulative monetary policies and strengthening fundamentals contributed to a strong rally in asset prices and a compression of credit spreads on both mature and emerging market bonds (see chart, this page). But in some cases, the increase in asset prices appears to have been motivated as much by the push of abundant liquidity as by the pull of fundamental valuations. In such an environment, assets could become overvalued if investors boosted leverage to high levels in the expectation that interest rates would remain low indefinitely.

In 2004, changing interest rate expectations have served as the main driver of global financial markets. Early this year, investors, adjusting to the prospect of a tighter U.S. monetary policy, became more cautious. In the process, some investors partly unwound positions encouraged by last year's abundant global liquidity. The resulting adjustments in April and May, though pronounced in some emerging and higher-risk markets, produced fewer disruptions than had been feared, and all markets remained orderly.

Smooth adjustment

A number of factors contributed to this relatively calm transition. First, the U.S. Federal Reserve Board gave abundant warning to investors and financial institutions to prepare themselves for a tightening of monetary policy. As a result, markets widely anticipated, and reacted calmly to, the first U.S. interest rate hikes in June and August. Second, the Federal Reserve's message that the pace of interest rate increases will be measured is consistent with market expectations that inflationary pressure is likely to remain subdued. Finally, higher global economic growth is supporting the credit quality and earnings prospects of corporations in the mature markets and of emerging market borrowers.

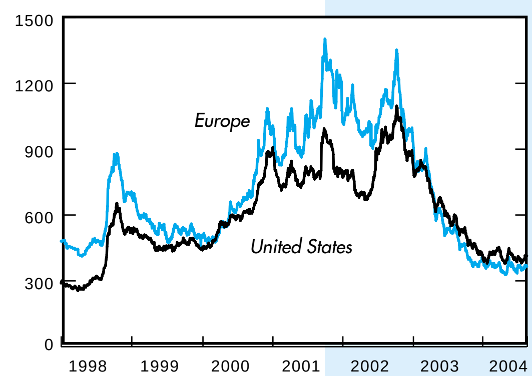
The calm with which financial markets have adjusted to the anticipated gradual increase in interest rates is welcome. It is also encouraging that leveraged positions seem to have declined and that financial institutions appear well positioned to withstand the move to a higher interest rate environment. Moreover, option prices suggest that markets do not expect large changes in asset prices.

Risks remain

Amid widespread optimism, however, a number of potential risks stand out, with geopolitical concerns representing an imponderable one. In recent months, security concerns have affected oil prices, compounding already strong demand, low inventories, and limited capacity to expand production. Persistently high oil prices would dampen economic activity and could weaken the external accounts of oil importers. Geopolitical concerns also have the potential to heighten investors' risk aversion, which could widen credit spreads and lower asset prices.

Extraordinarily low interest rates over the past several years have encouraged a variety of carry trades, involving short-term borrowing to invest in risky assets, and increased interest in alternative investments. These factors have contributed to higher leverage and a proliferation of hedge funds, whose assets under management are estimated to

Credit spreads in mature markets remain narrow
(in basis points)



Data: Merrill Lynch

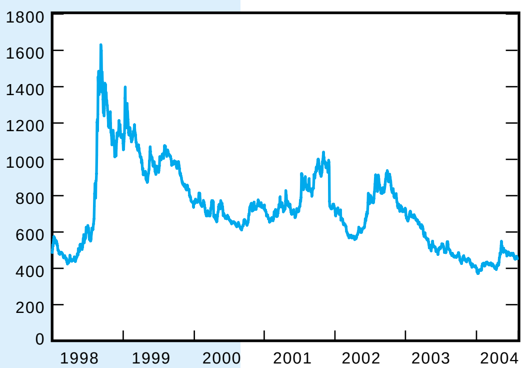
The *Global Financial Stability Report* also examines structural issues that affect financial stability. In recent issues, it has turned its attention to the ongoing transfer of risk in mature markets from banking to nonbanking institutions (see coverage of the insurance sector in *IMF Survey*, April 12, pages 107–8 and August 9, pages 234–36). The September report takes a closer look at the pension industry. A subsequent *IMF Survey* article will review the issues posed by the growing importance of pension funds as long-term institutional investors.

have doubled since 1998 to about $1 trillion.

The potential for investor "herding" has arisen as particular investment strategies gain wide favor across a number of hedge funds and other leveraged investors. A sudden reversal of such positions could reduce market liquidity and spur disproportionate price movements. In addition, achieving an orderly adjustment of global imbalances remains a challenge. Large, persistent imbalances pose a potential source of vulnerability in currency markets that could spill over to other asset classes, including bond markets.

A rise in interest rates in the major financial centers has historically translated into a less hospitable financing environment for emerging markets. Currently, however, strong growth and the modest requirements of some emerging market borrowers will probably mitigate the impact of higher interest rates in mature markets, at least initially. But, as rates continue to rise, emerging markets may find it increasingly difficult to attract the financing they need. In particular, investors may discriminate in favor of those emerging markets that have made progress on their reform agendas or are locked into a broader process that would allow them to converge over time with more mature markets.

Emerging market bond spreads remain at relatively low levels
(in basis points)



Data: J.P. Morgan Chase & Co.

Debt structures and other balance sheet mismatches are also potential sources of risk. Although a number of emerging market countries have taken steps to extend maturities and reduce the share of debt indexed to foreign exchange or short-term interest rates, unstable debt structures and mismatched balance sheet positions still represent potential sources of instability in several key emerging markets.

Prospects are favorable

Despite these risks, the prospects for financial stability in the major financial centers appear favorable. The past year has seen balance sheets of corporations, financial institutions, and households strengthen in most mature markets, although the extent of improvement has varied. Banking systems in the major emerging markets have also continued to recover, with generally improving capital positions, asset quality, and earnings.

Moreover, the combination of broad-based economic growth, limited inflationary pressure, and low interest rates has created a supportive economic and financial environment for emerging market countries. Strong global growth has boosted the demand for their exports and buoyed commodity prices, helping to strengthen the balance of payments position of many of these countries.

At the same time, low interest rates, stability in the major bond markets, and expectations for a gradual tightening of monetary policy have made the external financing environment for emerging markets more favorable (see chart, this page). Many emerging market borrowers have, appropriately, taken advantage of this environment to issue securities at attractive terms. An estimated 80 percent of planned 2004 issuance for emerging market sovereigns was completed in the first half of this year, and a number of countries have begun to tap the market for their needs in 2005.

In addition, some emerging markets have taken steps to strengthen their debt management by reducing balance sheet vulnerabilities or generating savings on debt-servicing costs. Indeed, the current period of market calm provides an opportunity to bolster resilience through steps to strengthen public finances, reduce high debt levels, and push forward growth-enhancing structural reforms. ■

David J. Ordoobadi
IMF International Capital Markets Department

Copies of the September 2004 *Global Financial Stability Report* are available for $49.00 ($46.00 academic price) from IMF Publication Services. See page 275 for ordering details. The full text of the report is also available on the IMF's website (*www.imf.org*).

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
August 23	1.93	1.93	2.91
August 30	1.95	1.95	3.00
September 6	1.98	1.98	3.05
September 13	1.99	1.99	3.06

The SDR interest rate and the rate of remuneration are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket. The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For the latest rates, call (202) 623-7171 or check the IMF website *(www.imf.org/cgi-shl/bur.pl?2004)*.

General information on IMF finances, including rates, may be accessed at *www.imf.org/external/fin.htm*.

Data: IMF Finance Department

Stand-By, EFF, and PRGF Arrangements as of August 31

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
			(million SDRs)	
Stand-By				
Argentina	September 20, 2003	September 19, 2006	8,981.00	4,810.00
Bolivia	April 2, 2003	December 31, 2004	128.64	53.60
Brazil	September 6, 2002	March 31, 2005	27,375.12	10,175.48
Bulgaria	August 6, 2004	September 15, 2006	100.00	100.00
Colombia	January 15, 2003	January 14, 2005	1,548.00	1,548.00
Croatia	August 4, 2004	April 3, 2006	97.00	97.00
Dominican Republic	August 29, 2003	August 28, 2005	437.80	306.46
Gabon	May 28, 2004	June 30, 2005	69.44	55.55
Paraguay	December 15, 2003	March 31, 2005	50.00	50.00
Peru	June 9, 2004	August 16, 2006	287.28	287.28
Romania	July 7, 2004	July 6, 2006	250.00	250.00
Turkey	February 4, 2002	February 3, 2005	12,821.20	907.20
Ukraine	March 29, 2004	March 28, 2005	411.60	411.60
Uruguay	April 1, 2002	March 31, 2005	1,988.50	279.60
Total			**54,545.58**	**19,331.77**
EFF				
Serbia and Montenegro	May 14, 2002	May 13, 2005	650.00	250.00
Sri Lanka	April 18, 2003	April 17, 2006	144.40	123.73
Total			**794.40**	**373.73**
PRGF				
Albania	June 21, 2002	June 20, 2005	28.00	8.00
Armenia	May 23, 2001	December 31, 2004	69.00	9.00
Azerbaijan	July 6, 2001	March 31, 2005	80.45	38.61
Bangladesh	June 20, 2003	June 19, 2006	400.33	251.83
Burkina Faso	June 11, 2003	June 10, 2006	24.08	17.20
Burundi	January 23, 2004	January 22, 2007	69.30	42.90
Cameroon	December 21, 2000	December 20, 2004	111.42	31.83
Cape Verde	April 10, 2002	April 9, 2005	8.64	3.72
Côte d'Ivoire	March 29, 2002	March 28, 2005	292.68	234.14
Congo, Democratic Republic of the	June 12, 2002	June 11, 2005	580.00	53.23
Dominica	December 29, 2003	December 28, 2006	7.69	4.71
Ethiopia	March 22, 2001	October 31, 2004	100.28	10.43
Gambia, The	July 18, 2002	July 17, 2005	20.22	17.33
Georgia	June 4, 2004	June 3, 2007	98.00	84.00
Ghana	May 9, 2003	May 8, 2006	184.50	105.45
Guyana	September 20, 2002	March 19, 2006	54.55	37.06
Honduras	February 27, 2004	February 26, 2007	71.20	61.03
Kenya	November 21, 2003	November 20, 2006	175.00	150.00
Kyrgyz Republic	December 6, 2001	December 5, 2004	73.40	9.56
Lao People's Democratic Republic	April 25, 2001	April 24, 2005	31.70	13.58
Lesotho	March 9, 2001	October 31, 2004	24.50	3.50
Madagascar	March 1, 2001	March 1, 2005	91.65	22.70
Malawi	December 21, 2000	December 20, 2004	45.11	32.23
Mali	June 23, 2004	June 22, 2007	9.33	8.00
Mauritania	July 18, 2003	July 17, 2006	6.44	5.52
Mongolia	September 28, 2001	July 31, 2005	28.49	16.28
Mozambique	July 6, 2004	July 5, 2007	11.36	9.74
Nepal	November 19, 2003	November 18, 2006	49.91	42.78
Nicaragua	December 13, 2002	December 12, 2005	97.50	55.71
Pakistan	December 6, 2001	December 5, 2004	1,033.70	172.28
Rwanda	August 12, 2002	August 11, 2005	4.00	1.71
Senegal	April 28, 2003	April 27, 2006	24.27	17.33
Sierra Leone	September 26, 2001	March 25, 2005	130.84	28.00
Sri Lanka	April 18, 2003	April 17, 2006	269.00	230.61
Tajikistan	December 11, 2002	December 10, 2005	65.00	29.40
Tanzania	August 16, 2003	August 15, 2006	19.60	11.20
Uganda	September 13, 2002	September 12, 2005	13.50	6.00
Zambia	June 16, 2004	June 15, 2007	220.10	137.56
Total			**4,624.73**	**2,014.17**

EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.

Data: IMF Finance Department

Members drawing on the IMF "purchase" other members' currencies, or SDRs, with an equivalent amount of their own currency.

De Rato continues listening tour

The IMF will continue to remind industrial countries of their responsibilities to provide more effective support to developing countries—both through higher, more predictable, and better coordinated aid and through more open trade polices, said IMF Managing Director Rodrigo de Rato on concluding a visit to Burkina Faso on September 9. This is the latest in a series of listening tours to IMF member countries undertaken by the IMF's Managing Director to sound out governments and civil society about their priorities and main concerns. His most recent travel included stops in South America and sub-Saharan Africa.

De Rato (left) at a press conference with Chile's Finance Minister Nicolas Eyzaguirre.

De Rato returned to sub-Saharan Africa for a second visit in a month, at the invitation of Burkina Faso's President Blaise Compaoré to attend the African Union's Extraordinary Summit on Employment and Poverty Reduction in Africa, held in Ouagadougou, Burkina Faso, on September 8–9 and attended by the heads of state of 17 African countries. In his address to the summit, de Rato identified three priority areas for the IMF in the region: making IMF financial assistance more flexible and responsive; sharpening the IMF's role in countries that do not need the institution's financial assistance, including through timely and high-quality policy advice, as well as through technical assistance and capacity building; and reinforcing the IMF's analysis and assistance in support of Africa's regional integration initiatives.

On the sidelines of the summit, de Rato met individually with nine heads of state or government to listen firsthand to the challenges they face and their views on what the IMF can do to combat poverty on the continent. At the end of the visit, he remarked that by meeting nearly one-half of the leaders in Africa during his two visits to the region, he had met the goal he had set for himself of consulting widely in Africa.

Prior to visiting Burkina Faso, de Rato held meetings in South Africa on September 6–7 with President Thabo Mbeki and his economic team, as well as with business leaders and other representatives of civil society. While discussions focused on economic conditions in South Africa, de Rato also explored South African perspectives on various pan-African initiatives, including the New Partnership for Africa's Development and the African Union. He exchanged views with Mbeki and others on the impressive strides South Africa has made in rebuilding its economy since its first democratic elections in 1994, while noting that growth will need to rise to a higher plateau in order to significantly reduce unemployment. "In our discussions, the authorities raised again their desire to see greater voice and representation for African countries in the Bretton Woods institutions," de Rato said.

During the previous week, de Rato had visited South America for the first time as Managing Director. On August 31, he met with Argentine President Néstor Kirchner and other senior officials, remarking that discussions "revealed many common understandings on the economic policy priorities that lie ahead." He said that the main goal of his visit was to offer support to the president for normalizing Argentina's economy and its standing in the financial markets. In this context, de Rato highlighted the importance of completing a comprehensive and sustainable restructuring of Argentina's sovereign debt to private creditors and a supporting medium-term fiscal framework.

De Rato and Kirchner also discussed the steady improvement in Argentina's fiscal position since 2002 and the recovering banking system, agreeing that priority had to be given to safeguarding and building on this recent track record. They also agreed to resume program discussions "at the first possible opportunity," de Rato said, after having had a chance to assess the outcome of debt restructuring and further progress on structural reforms.

Later that day, de Rato met with Uruguay's President Jorge Batlle and his senior economic team, commending them for sound management of the economy, which has recovered strongly in the two years following a long recession and near financial collapse. He also met with the three candidates in next month's presidential election. During his meetings, de Rato emphasized the need to lay the basis for debt sustainability, through fiscal discipline and structural reforms to raise economic growth, and to continue with banking sector reforms to restore a sound financial system.

From Uruguay, de Rato traveled to Santiago, Chile, to attend the Eleventh Annual Finance Ministers' Meeting of the Asia–Pacific Economic Cooperation (APEC) on September 2–3. Participants, who included senior officials from APEC economies, business leaders, and academics, agreed to promote structural reforms in APEC's 21 member economies and, to this end, to set up a steering committee within APEC to formulate structural reform measures and monitor implementation. While attending the meeting, de Rato referred to Chile's experience of gradual deregulation of controls on capital flows and moves to a more flexible exchange regime as a positive example for Asian economies.

During his time in Santiago, de Rato met with Chile's President Ricardo Lagos, his economic team, and other senior government officials. He noted that Chile's inflation-targeting framework and its credible structural balance rule for guiding fiscal policy were two pillars that have been essential for economic stability. And he agreed that steps to increase access to education—particularly for poor children—and measures to enhance labor market flexibility would be central to promoting strong growth and further reducing poverty. De Rato also visited a local community to see how Chile was tackling the problem of poverty and was impressed by people's stories and the efforts to give the poor access to existing government housing and training programs.

Following the APEC meeting, de Rato traveled to Brazil to meet with President Luiz Inácio Lula da Silva, his economic team, and representatives from civil society. De Rato described the government's economic policies as courageous, noting the economy's improved ability to weather external shocks and stating that he shared the president's optimism about Brazil's prospects for further economic growth. He agreed that key reform priorities include reducing bank borrowing costs, improving the climate for private investment, and further strengthening social programs.

President Mbeki (left) greets de Rato at the start of their September 6 meeting in Pretoria, South Africa.

De Rato also underscored the importance of increasing public investment while simultaneously improving project selection and encouraging higher private investment in infrastructure through concessions, public-private partnerships, and a better regulatory environment. IMF staff are working closely on these issues with national authorities in Brazil, Chile, and other countries in the region. ■

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IMFSURVEY

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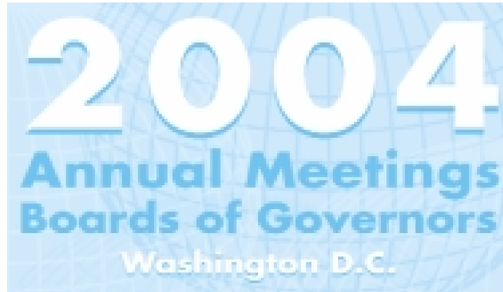
Annual Meetings 2004 preview

Strong recovery provides window of opportunity



A strengthening world economic recovery and the 60th anniversary of the Bretton Woods institutions will provide the backdrops for the IMF–World Bank Group Annual Meetings in Washington, D.C. on October 2–3. The meetings, which once again have been compressed from the customary four days to two days at the U.S. government's request, will bring together the world's finance ministers and central bank governors.

For Rodrigo de Rato, this will be his first Annual Meetings as IMF Managing Director. In introductory remarks on October 2 to the International Monetary and Financial Committee (IMFC)—the IMF's chief advisory body—he is expected to discuss the current state of the world economy and the risks posed by, among other things, a now more volatile energy market.

LIM Hng Kiang, Singapore's Minister for Trade and Industry, will chair the 2004 Annual Meetings in Washington, D.C.

The committee's exchange of views on the global economy will also be informed by the latest projections of the IMF's *World Economic Outlook (WEO)* as well as its special focus on the policy implications of the demographic changes facing the world, notably population aging in the advanced economies. Raghuram Rajan, Economic Counsellor and head of the IMF's Research Department, will also address these topics when he releases the *WEO* in a press conference on September 29.

Also expected to be on the agenda for the IMFC, chaired by Gordon Brown, U.K. Chancellor of the Exchequer, are the recommendations of the Executive Board's biennial review of IMF economic oversight and proposals for making surveillance more effective for all countries. The committee is also likely to examine the IMF's role in enhancing international support for low-income countries and to consider progress reports on crisis resolution initiatives, IMF governance issues (specifically issues related to IMF quotas and voice and representation), and the activities of the Independent Evaluation Office.

Immediately afterward, the Development Committee, chaired by Trevor Manuel, South Africa's Finance Minister, will convene. There, aid effectiveness and proposals to scale up financial assistance to help countries achieve the Millennium Development Goals are likely to top the agenda. The committee is also expected to consider World Bank agendas for strengthening the foundations for growth and private sector development; debt sustainability (and a joint IMF–World Bank progress report on the Heavily Indebted Poor Countries Initiative); and the issue of voice and participation of developing and transition countries in the IMF and World Bank Executive Boards.

The Annual Meetings will be preceded, as is the custom, by a series of meetings, including a gathering of the Group of Seven advanced economies; a meeting of Group of 24 developing countries; and a day-long program of seminars, which will be held on October 1 and is open to the public. On October 3, Lawrence Summers—President of Harvard University and former U.S. Secretary of the Treasury—will deliver the Per Jacobsson Lecture, entitled "The U.S. Current Account Deficit and the Global Economy."

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