November 3, 2010

The Acting Chair's Summing Up
Fiscal Monitor—Fiscal Exit: From Strategy to Implementation
November 1, 2010

Executive Directors welcomed the opportunity to discuss the *Fiscal Monitor*, which they considered a valuable addition to the Fund's toolkit for multilateral surveillance. They broadly agreed with its main messages and policy recommendations.

Directors noted that, while the coordinated fiscal expansion undertaken in response to the global financial crisis had prevented a more severe deterioration in global conditions, the resultant increases in fiscal deficits and public debt levels, particularly in advanced economies, are a source of vulnerability for the period ahead. Directors agreed that the key challenge for policymakers now is to provide confidence that fiscal fundamentals will improve in the medium term without undermining the economic recovery.

Directors considered that, globally, the planned adjustment for 2011 strikes an appropriate balance between strengthening fiscal positions and avoiding an undue policy withdrawal. They underscored that policy flexibility remains warranted, and that individual countries need to calibrate fiscal adjustment according to their circumstances. If economic growth falls significantly short of the central projections in the latest *World Economic Outlook*, countries with fiscal space should let automatic stabilizers operate freely. If needed for the recovery to continue, some of the adjustment planned for 2011 may also have to be postponed. Countries with limited room for maneuver or under acute market pressures, on the other hand, should avoid delaying consolidation to prevent a further weakening of confidence.

Directors noted that fiscal fundamentals in most emerging market and low-income economies are generally more robust than in advanced economies, reflecting a less severe impact of the global crisis as well as earlier fiscal prudence. For a few of those facing fiscal challenges, early adjustment will be necessary. In the case of some low-income countries, rebuilding fiscal buffers while protecting social and investment spending could be challenging without additional donor support.

Directors observed that elevated public debt-to-GDP ratios and large financing needs in major advanced economies have so far been associated with low interest rates. They cautioned that as the economic recovery strengthens there may be upward pressures on interest rates. They noted that while the maturity structure of public debt has stabilized for many countries, the share of debt held by non-residents appears to have declined, reflecting greater uncertainties for cross-border investment. In this regard, Directors expressed concern about yields increasing in some euro area countries despite their improving fiscal outlooks, and highlighted the possible implications of a more polarized market sentiment for cross-country spillovers of financial market stress.

Directors welcomed the medium-term fiscal adjustment plans in the G-20 and some advanced economies, and the fact that they are primarily expenditure-based. An explicit commitment to longer-term, country-specific debt targets and a timeline for achieving them could further enhance their credibility. A better articulation of the envisaged measures is also needed in many cases, in particular, steps to deal with looming pressures from health and pension spending, and to reform other social spending while protecting the most vulnerable groups. Where adjustment needs are greatest, the envisaged measures could be based on a review of all expenditure areas. Directors took note of the staff simulations illustrating the positive impact on potential growth of raising the retirement age, which could lead to a significant decline of the fiscal burden in the longer term.

Directors also underscored the need to further strengthen budgetary institutions and policy frameworks, including by adopting, where appropriate, fiscal rules tailored to country-specific circumstances or by establishing independent fiscal agencies.

Noting significant downside risks to the fiscal outlook, Directors highlighted the importance of restoring the public debt ratio to more prudent levels gradually over time. They cautioned that stabilizing the debt ratio at elevated post-crisis levels could lead to a period of slow growth and high interest rates, and a reversal of the relatively benign debt dynamics in the staff's baseline projections.

Directors welcomed the *Fiscal Monitor*'s analysis of a number of issues that could affect the underlying fiscal position of many countries, including steps to increase revenues from value-added taxes, the use of the tax system to reduce systemic financial sector risk, and questions related to efficient carbon pricing. A number of Directors encouraged further analysis in these areas.