IMF Publication

INTERNATIONAL MONETARY FUND

IMF Survey

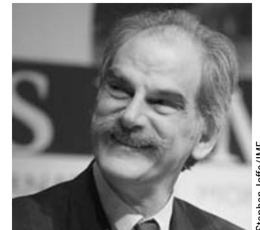
OCTOBER 16, 2006 VOL. 35, NO. 19

www.imf.org/imfsurvey

IMF newly energized after Singapore, says Lipsky

page 296

John Lipsky, the IMF's new number two, believes the recent mandate from Singapore for the organization to rethink its operations will help bring the Fund "back to its roots." In a wide-ranging interview, he defends the IMF's relevance in a world characterized by a global financial and trading system and large cross-border private sector capital flows and elaborates on what the major players will need to do to resolve the growing global imbalances.


Stephen Jaffe/IMF

Ukraine: higher growth hinges on institutional reform

page 300

Following the 2004 "Orange Revolution," Ukrainian President Viktor Yushchenko focused on accelerating the country's institutional transition toward a modern market economy. But political and personal divisions within the government have hampered the implementation of pro-market reforms. A recent IMF study examines the role of institutional deficiencies in Ukraine's performance and the likely payoff of market-friendly reforms. Lasting improvements in living standards will depend on increased efficiency.

Gleb Garanich/Reuters

Falling oil revenues push Syria to adjust fiscal policies

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Syria relies on oil revenues for 25 percent of public spending. But it is running out of oil and faces unsustainable budget deficits by 2015 if it does not adjust its fiscal policies. Two studies for the IMF's recent assessment of Syria's economy explore fiscal strategies that could help Syria adjust. They propose adoption of a transparent fiscal policy framework that puts the government's budget constraint in clear perspective and the phasing out of petroleum price subsidies and introduction of a value-added tax.

Index Stock Imagery

Controversial prophet of doom sees signs of hard landing

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In recent months, New York University's Nouriel Roubini has cheerfully given himself the moniker "Dr. Doom" for his pessimism about the U.S. and global economic outlooks. Why so glum? Roubini spelled out his reasons in a talk at the IMF last month, with a predicted housing bust topping his list of concerns. He warned that U.S. "consumer burnout" is imminent, prompted by elevated oil prices and rising interest rates.

Eugene Salazar/IMF

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Roubini: "Dr. Doom"

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What's on

October

18–20 Asian Regional Forum on Aid Effectiveness, Asian Development Bank headquarters, Manila, Philippines

23–27 IMF High-Level Seminar on Current Issues in Monetary and Financial Law, Washington, D.C., United States

November

6–7 IMF Symposium on Integrity Supervision of Financial Sector Firms, Washington, D.C., United States

6–7 Organization for Economic Cooperation and Development (OECD) Policy Dialogue with Nonmembers on Aid for Trade: From Policy to Practice, Doha, Qatar

9–10 Jacques Polak 7th Annual Research Conference, IMF, Washington, D.C., United States

11–15 Energy Future in an Interdependent World, 20th World Energy Congress, World Energy Council, Rome, Italy

13–14 2nd International Conference on Migrant Remittances: Remittances and Access to Finance, World Bank and U.K. Department for International Development. See *www.financelearning.org/remittances2006*

17–18 Rio 6: World Climate and Energy Event, Rio de Janeiro, Brazil

18–19 14th Asia-Pacific Economic Cooperation Economic Leaders' Meeting, Hanoi, Vietnam

23–24 World Economic Forum, "Connecting Regions—Creating New Opportunities," Istanbul, Turkey

26–28 World Economic Forum, "India: Meeting New Expectations," New Delhi, India

December

7–8 1st Meeting of the OECD Forum on African Public Debt Management, Amsterdam, Netherlands

14 143rd (Extraordinary) Meeting of the OECD Conference, Abuja, Nigeria

January 2007

5–7 Annual Meeting, American Economic Association, Chicago, Illinois, United States

24–28 World Economic Forum Annual Meeting, Davos, Switzerland

IMF Executive Board

For an up-to-date listing of IMF Executive Board meetings, see *www.imf.org.external/np/sec/bc/eng/index.asp*.

New Perspectives on Financial Globalization Call for Papers IMF, Washington, D.C., April 26–27, 2007

The conference, sponsored by the IMF's Research Department and Cornell University, aims to provide a forum to present recent theoretical and empirical research on the macroeconomic implications of financial globalization.

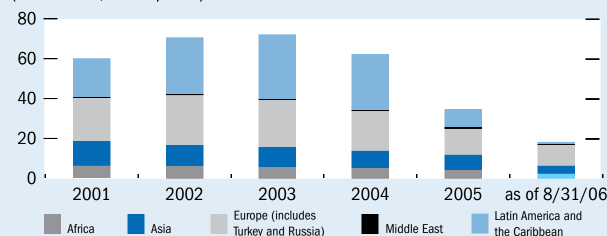
Interested authors should submit either a draft of the paper or a detailed abstract by December 1, 2006, to *globconf@imf.org*.

For details, see *www.imf.org.external/np/seminars/eng/2007/finglo/042607.htm*.

IMF financial data

Total IMF credit and loans outstanding, by region

(billion SDRs, end of period)



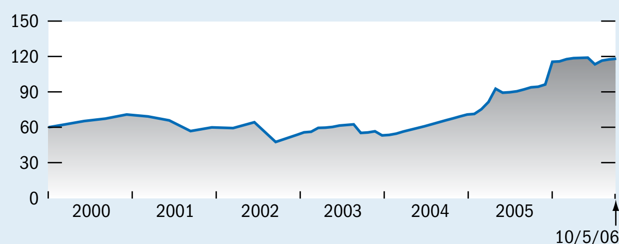
Largest outstanding loans

(billion SDRs, as of 8/31/06)

Nonconcessional		Concessional	
Turkey	7.82	Pakistan	0.96
Indonesia	2.32	Congo, Dem. Rep. of	0.55
Uruguay	0.73	Bangladesh	0.28
Ukraine	0.68	Yemen, Republic of	0.16
Serbia, Republic of	0.49	Georgia	0.15

Available IMF resources

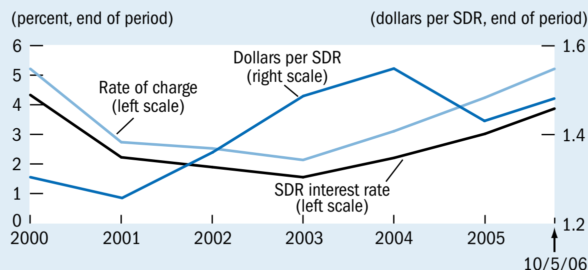
(one-year forward commitment capacity, billion SDRs)



Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR

(percent, end of period) (dollars per SDR, end of period)



Note: Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

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IMF takes steps to rehabilitate Liberia

In a move providing a positive signal to Liberia's development partners and encouraging further reform efforts by the Liberian authorities, the IMF's Executive Board decided, on October 2, to lift its 1990 declaration of noncooperation imposed on Liberia. The Executive Board also initiated the deescalation of remedial measures applied by the Fund against the West African nation because of arrears in payments. The Board said it could consider lifting the suspension of Liberia's voting and related rights following satisfactory performance regarding economic policies and payments to the IMF during an evaluation of approximately 12 months from the Board decision. Liberia is recovering after a prolonged civil war and held elections last year.

"Liberia has established an encouraging track record of policy cooperation and payments under the staff-monitored program that began in February 2006," said John Lipsky, First Deputy Managing Director of the IMF. "The authorities have committed to further strengthening cooperation with the IMF in terms of both policy and continued payments. This would allow the IMF to give consideration to further deescalating the remedial measures and, with adequate financing assurances, a possible rights accumulation program aimed at clearing Liberia's arrears to the IMF. These actions could pave the way for Liberia to benefit from debt relief under the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative," Lipsky added.

Liberia has made considerable progress in implementing its economic program. The IMF said that GDP growth is expected to continue to recover to about 8 percent, and inflation is projected to be in the single digits in 2006. Financial management has been significantly strengthened under the new government, with strict adherence to a commitment control system designed to ensure that expenditures do not exceed available revenues. The central bank's financial position also has improved, and a cash-based balanced budget for fiscal year 2006/07 was approved in late August. Liberia also has made token monthly payments to the IMF.

Chris Hondros/Getty Imagery

Liberian President Ellen Johnson Sirleaf greets voters in Monrovia.

The deescalation process is designed to encourage members with protracted arrears to establish a solid record of policy performance and payments to the IMF, with the ultimate objective of full clearance of arrears and regaining access to IMF financial resources. Substantial financial support from the international community for clearance of arrears and debt relief will be needed by Liberia. ■

Oil prices underpin strong growth in the Mideast and Central Asia

Economic performance in the Middle East and Central Asia region remains strong, despite security problems in some countries and recent asset price reversals, the IMF said in its regional outlook published in October. Growth in the region continues to outpace global growth and should average 6–7 percent in 2006 and 2007—similar to the rates of the past three years, said Mohsin Khan, Director of the IMF's Middle East and Central Asia Department.

Strong external inflows resulting from high oil and non-oil commodity prices, foreign investments, and remittances are fueling credit growth, and inflation continues to edge up, though it remains moderate in most countries, estimated at an average of 7.1 percent in 2006.

The region's fiscal and external surpluses are still rising, but at a slower pace than in recent years. Progress in reducing debt and building official reserves has put the region in a better position to absorb shocks and address development needs.

Policies are on the right track. "With the growing realization that the increase in oil prices—and hence in oil revenue—will endure, many oil-exporting countries have started to pick up the pace of spending and are putting in place major programs to upgrade their social and physical infrastructure," said Khan. As a case in point, the Gulf Cooperation Council countries' investment plans for 2006–10 amount to over $700 billion, covering investments in the oil and gas sector, infrastructure, and real estate.

Large external inflows are creating difficult challenges for monetary policy. Real exchange rate appreciation will eventually be needed in response to permanently higher inflows. For countries with flexible exchange rate regimes, a combination of monetary tightening and nominal appreciation would be the best way to limit inflationary pressures, Khan said. For countries with pegged exchange rates, open trade regimes and flexible labor markets will help to constrain increases in consumer prices. ■

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Bringing the IMF back to its roots

On September 1, John Lipsky, a U.S. national, took over as IMF First Deputy Managing Director—the first person to hold the number two spot who has also worked in the rank and file (1974–84) and held a private sector job in the financial sector. Indeed, prior to rejoining the IMF, he was Vice Chairman of the JP Morgan Investment Bank and Chief Economist of both Chase Manhattan Bank and Salomon Brothers. He spoke with Laura Wallace of the IMF Survey *about the role the IMF should play in a world characterized by a truly global financial and trading system and large cross-border private sector capital flows.*

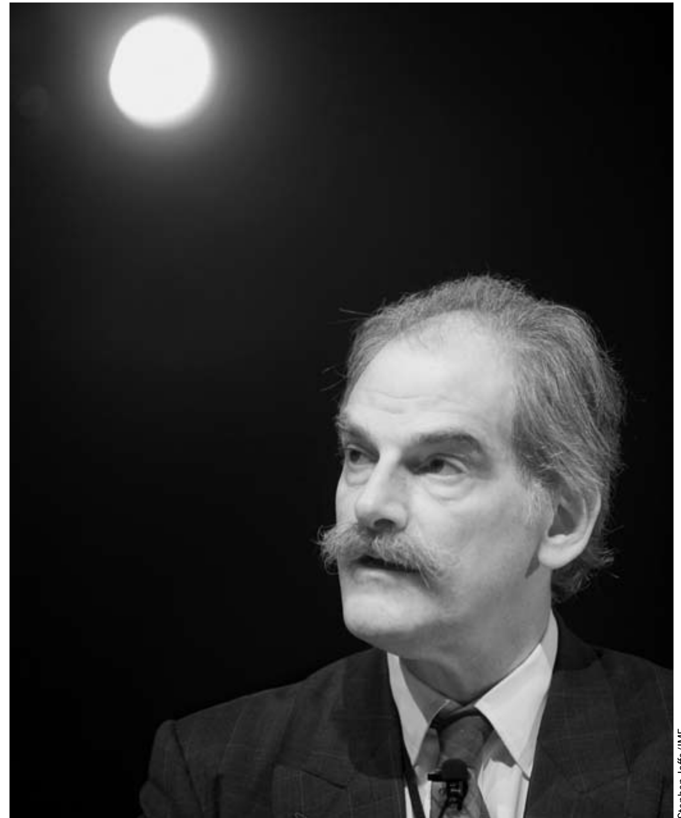
IMF Survey: With private capital flows growing by leaps and bounds, and the IMF's available capital declining relative to those flows, is the IMF losing relevance?

Lipsky: Absolutely not! The IMF was established to provide the foundation for an international monetary and financial system that is nondiscriminatory, multilateral, and based on the rule of law. That role remains unique and highly relevant. There have, of course, been dramatic changes in the global economy over the past 15 years, and the Fund needs to adapt itself in a decisive way in order to fulfill its role comprehensively.

IMF Survey: How about the buildup of international reserves by emerging markets, especially in Asia? Is that further diluting the IMF's traditional role?

Lipsky: The buildup of reserves suggests that many countries have decided, as a matter of policy, to try to self-insure against external volatility. If you thought that was the Fund's traditional role, then the answer to your question might well be yes. The underlying reality is more complex, however. In particular, it appears that the buildup of reserves also in part reflects the sluggishness in investment growth after 1997–98 in many emerging market countries, as well as a deliberate policy choice. That said, I do think the reserve buildup is a symptom of uncertainty about the future stability of the international system and the efficacy of the existing instruments of crisis prevention and resolution. On balance, the reserve growth is more a sign of issues that need to be addressed than a dilution of the Fund's role.

IMF Survey: The recent IMF–World Bank Annual Meetings gave the Fund the go-ahead to explore a new financial facility for emerging markets that might run into crisis—in effect, replacing the Contingent Credit Line (CCL), which was never used. In light of the large stockpiling of reserves, why would a new facility even be needed?



Stephen Jaffe/IMF

John Lipsky: "No one should expect miracles, but it's not clear that miracles are needed to resolve the global imbalances, either."

Lipsky: To begin with, it's worth exploring why the CCL was never utilized, because it was a concept that seemed to find support. We should ask if there are aspects of the CCL that can be usefully modified in a new facility. And if we can develop a useful new tool, it's possible that its existence would reduce countries' perceptions about the desirability of large international reserves. Perhaps more to the point, I view the proposed new tool as a kind of placeholder while the IMF and its members undertake a much broader review of how they should adapt crisis prevention and resolution responsibilities to a world of large-scale, cross-border private sector capital flows. After all, it's exactly the sharp growth in these flows that rendered the IMF's traditional methods of crisis prevention and resolution dysfunctional to a certain degree.

IMF Survey: Does that mean the IMF could be dangerously ill equipped in the event of a major crisis?

Lipsky: Today, the Fund enjoys record liquidity, so there is no risk that the institution wouldn't be able to respond to a new challenge. Nonetheless, it makes sense to take advantage of

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the favorable environment to rethink our approach to crisis prevention and resolution in a comprehensive fashion. You're rarely seriously harmed by the dangers you've worried about. The biggest risks are the things you've taken for granted.

IMF Survey: You've said that the IMF needs to become a center of excellence in understanding the role of financial markets and their impact on the global economy. What specifically should it be doing?

Lipsky: We're already taking action. We've created the Monetary and Capital Markets Department, merging the Fund's work on international and domestic financial markets. The underlying message is that it's no longer appropriate to view internal and external markets as separate. This new department will bolster the Fund's direct knowledge of market developments. In addition, the Research Department will develop new insights regarding the critical interconnections between international trade flows and international finance while also addressing broad systemic stability issues. It's probably not recognized to the degree that it deserves, but the IMF already has made substantial contributions to helping the international system adapt to the growth in private capital flows. This includes developing the data dissemination standards, the Financial Sector Assessment Programs, and Reports on the Observance of Standards and Codes. We need to ensure that the IMF's knowledge about financial issues is incorporated adequately in the reviews of each member country's economy through the Article IV consultations. To this end, we're developing a financial template that will expand and standardize the basic information provided in regular country reviews.

"Both the United States and its trading partners are going to have to shift their sources of growth."

—John Lipsky

IMF Survey: Given the growing importance of relatively unregulated financial institutions, such as hedge funds, how can the prospects of global financial stability be improved?

Lipsky: With the rapid changes in the magnitude and types of cross-border private sector financial transactions, it's both natural and responsible for regulatory and supervisory authorities to make sure that their knowledge and practices are up to the task. Of course, a comprehensive and systemic approach is needed. The basic goal is to have as much oversight as necessary, but no more.

In the case of hedge funds, their capital in principle is provided by sophisticated investors who can bear losses, while most of their leverage derives from regulated institutions such as banks. Thus, it may be that the lessons learned in the wake of the Long-Term Capital Management (LTCM) failure in 1998 already have resulted in measures and practices sufficient to mitigate systemic risks. For example, the popular image is that the institutions that provided LTCM with credit simply weren't able to understand the complexity of that firm's position taking. It's my impression that, in response to that painful and potentially dangerous incident, lenders are unlikely to finance anything close to the leverage that LTCM was able to obtain. It's impressive that the recent spectacular losses by a few hedge funds have left underlying markets little affected. The principle of regulation isn't to prevent individuals or firms from making losses, but rather to protect investors from fraud and to avoid systemic risks. Nonetheless, as markets change and evolve, regulators need to perform their own due diligence to make sure that they're fulfilling their roles.

IMF Survey: In recent months, the IMF has initiated its first multilateral consultations—with China, the euro area, Japan, Saudi Arabia, and the United States—to try to resolve the hefty global imbalances. Is there a reason for the financial markets to believe that a way to unwind these current account imbalances in an orderly fashion can be found through such a mechanism?

Lipsky: Well, I'm hopeful that this initiative will be helpful. The base case scenario of the IMF's *World Economic Outlook* is a benign one, and, in broad terms, financial markets seem to agree. Equity markets are nearing record heights, long-term interest rates are low, and exchange markets have been relatively stable. Moreover, the imbalances grew during a period that was far more positive than almost anyone had anticipated, with the fastest global growth and the lowest inflation in decades, and low volatility.

But there are good reasons to imagine that the coming few years will contain challenges and growing uncertainties—take, for example, the recent slowdown of U.S. economic growth. So it's exactly the right time for the key economic players involved in the global imbalances issue to discuss whether there is something that can be agreed collectively to sustain private markets' confidence that macroeconomic issues are going to be managed responsibly and successfully. What's surprising is that the multilateral consultations represent the first time the key players have had a forum for that purpose. No one should expect miracles, but it's not clear that miracles are needed to resolve the global imbalances, either.

IMF Survey: How much of the adjustment do you believe will need to come from U.S. fiscal policy and how much from a Chinese exchange rate adjustment?

Lipsky: It's true that public discussion about global imbalances often seems to devolve into questions about U.S. fiscal policy and China's exchange rate policy. This strikes me as far from

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Eugene Salazar/IMF

Lipsky, with IMF Deputy Managing Directors Takatoshi Kato (left) and Agustín Carstens, and Managing Director Rodrigo de Rato.

adequate. The underlying cause of the increase of the global imbalances in recent years has been a sustained divergence in the pace of domestic demand growth among major economies. The U.S. federal budget deficit is less than 2 percent of GDP. This isn't at all unusual by historic standards. What's out of line with historical norms is the record-low U.S. household saving rate. Nonetheless, I'm confident that the long-term trend of a declining saving rate is at a turning point and that this rate will tend to "normalize" in the coming years, with or without policy action. The principal cause of the sustained drop in the U.S. household saving rate over the past decade has been the unexpectedly rapid increase in household net worth. Since the early 1990s, U.S. families as a whole have become wealthier faster than they expected, so they've concluded that they can save less out of current income. But the pace of asset price appreciation is likely to slow, with inflation no longer declining and productivity no longer accelerating.

For global growth to remain strong, even if U.S. domestic demand growth is likely to be somewhat slower than in the past few years, both the United States and its trading partners are going to have to shift their sources of growth. In particular, the United States will need to rely relatively more on net exports and business investment, while its trading partners will have to rely more on their domestic demand growth and less on net exports. In China, the authorities' goal of strengthening domestic demand, including consumption, will depend on many more factors than simply adjusting the exchange rate. In Japan and the euro area, shifts in the sectoral sources of growth away from exports are also needed. And the current surpluses of the energy- and commodity-producing economies are assuming new importance.

IMF Survey: How do you think the IMF has changed since 1984, and where do you see it headed after this year's Annual Meetings?

Lipsky: Certainly, the institution is much bigger. After all, its membership is truly global now, and the staff has consequently expanded. It's also become much more transparent, partly because there's more interest in the IMF's work and partly because the IMF itself decided that it's more effective if it tells people what it's doing.

As for the future, there's broad agreement that we need to take a leading role in adapting the international system to the new realities. The medium-term strategy (MTS) is the Fund's specific response to this recognition. Encouragingly, the Annual Meetings provided an endorsement of all of the principal elements of the MTS. First, the Board's proposal for quotas and voice reforms was endorsed. If this effort succeeds—and there's a lot of hard work ahead—the Fund's governance will become more representative of the current and future state of the global economy. Second, the Fund's innovative multilateral consultation initiative was endorsed. This new tool potentially creates an appropriate and effective venue to address the key issues facing the Fund's membership collectively—not to mention putting the IMF back in the center of debate, even among the largest economies. Third, the Fund got the go-ahead to review the basis for its mandated bilateral consultations with individual Fund members—including its approach to exchange rate issues—and, as we discussed, to explore a new financing instrument to better deal with crisis prevention and resolution. Finally, we are strengthening our engagement with our low-income members.

Thus, we have important challenges ahead, but we could hardly have hoped for a more positive result from Singapore—indeed, we've been offered the prospect of a newly energized role in the international system. Now we have to show that we deserve the role and that we can deliver. I'm enthused by all this, in part because it's bringing the Fund back to its roots, and to its unique role.

IMF Survey: In what sense?

Lipsky: Today, the Fund has a mandate to rethink its operations in a fundamental way. The Fund's Articles of Agreement were developed without any real precedent. They created the foundation for a multilateral, nondiscriminatory, international payments system based on the rule of law. The Fund staff and the Executive Board then constructed the new financial system virtually out of whole cloth, without a blueprint. That system represented a remarkable contribution to economic development, because it supported the hoped-for increase in international trade. It's not by chance that the past 60 years have witnessed the greatest period of economic progress in human history. But there have been important recent developments that haven't been fully incorporated into the system in any formal or coherent fashion. We have a mandate and a responsibility to make that happen and to set the stage for new progress. ■

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Copper windfall brightens Chile's outlook but must be managed prudently

For the past 15 years, structural reforms and prudent policies have helped anchor Chile's successful economic performance. In recent years, a fiscal policy rule, inflation targeting, trade liberalization, and an open capital account have yielded strong economic growth and low inflation.

Under the fiscal rule, the central government aims to maintain a structural surplus of 1 percent of GDP after adjusting for cyclical developments and changes in copper prices. High copper prices enabled the central government to register surpluses averaging 3½ percent of GDP in 2004–05, and a surplus of 6 percent of GDP is projected for 2006. The ratio of Chile's net public sector debt fell from 13 percent of GDP in 2003 to 7½ percent in 2005.

The central bank is managing monetary policy prudently. Since September 2004, it has gradually raised its policy rate in response to the economic recovery and the closing of the output gap. Inflation expectations have remained well anchored near the middle of the central bank's 2–4 percent inflation target range.

According to the IMF's latest economic review, Chile's outlook is positive, reflecting strong prospects for copper and robust domestic demand. Sustained growth has encouraged more workers to return to the labor market, and unemployment has gradually edged down.

IMF Executive Directors commended the authorities for their implementation of sound macroeconomic policies, which have yielded substantial benefits, including low inflation, sustained economic growth, a significant reduction in poverty, and strengthened resilience to external shocks. They welcomed the authorities' adherence to the fiscal rule and commended them for keeping spending growth in check. Directors also highlighted the success of Chile's inflation targeting framework.

Chile	2003	2004	2005	Proj. 2006
		(percent change)		
Real GDP	3.9	6.2	6.3	5–5.5
Consumer prices (end-period)	1.1	2.5	3.7	3.4
Unemployment rate (annual average)	8.5	8.8	8.0	7.7
Total domestic demand	4.9	8.1	11.4	7.1
Copper exports				
Billion dollars	7.8	14.5	18.3	28.1
Percent of total exports	36.1	45.0	45.1	53.8

Data: Central Bank of Chile and Ministry of Finance; Haver Analytics; and IMF staff estimates.

Directors supported the medium-term emphasis on promoting sustained growth and reducing income inequality. They welcomed reforms to improve school coverage, increase funding for education, and promote research and development. Directors encouraged the authorities to improve labor market flexibility, to help increase employment opportunities and address the still-high unemployment rate, especially among the young. Progress in these areas should help enhance productivity and support further economic diversification. ■

Iceland: fiscal, monetary tightening required to reverse economy overheating

Iceland is experiencing an economic boom—driven by an expansion of the aluminum sector—that is generating large imbalances, the IMF said in its recent economic review. Strong domestic demand, reflecting rapidly growing investment and private consumption, is causing the economy to overheat and leading to high inflation and record-high current account deficits. Financial market volatility in Iceland has also increased in response to international investors' concern about the risks associated with macroeconomic imbalances and potential financial sector vulnerabilities.

IMF Executive Directors noted that, although medium-term prospects are favorable, large and growing imbalances pose risks to real growth and financial stability in the near term. They welcomed measures taken to curb demand pressures but called for further decisive policy actions to stabilize confidence, help ensure an orderly adjustment, and maintain financial stability.

Iceland	2003	2004	2005	Proj. 2006
Real GDP (percent change)	3.0	8.2	5.5	4.0
Consumer price index (percent change)	2.1	3.2	4.0	6.1
Gross domestic investment (percent of GDP)	19.7	23.4	28.6	26.3
Central bank policy rate (period average, percent)	5.4	6.1	9.4	...
Current account balance (percent of GDP)	–5.0	–10.1	–16.5	–12.5

Data: Statistics Iceland, Central Bank of Iceland, Ministry of Finance, and IMF staff estimates.

Despite low and declining public debt, further fiscal restraint is essential for reducing imbalances and averting their associated risks. The authorities could achieve the required fiscal tightening, Directors emphasized, by postponing additional public investment projects and reducing growth in public consumption expenditure. To lessen economic volatility, they called for a further strengthening of the medium-term fiscal framework and agreed that additional increases in the monetary policy rate would likely be required to anchor expectations and return inflation to target.

Directors also noted that despite the strong balance sheets of financial institutions, rapid expansion has increased banks' risk profile. While welcoming the steps banks have taken to make these risks more manageable, they stressed that the process needs to continue, with the encouragement of and close monitoring by supervisory authorities.

Directors also recommended an immediate reform of the Housing Finance Fund. Increased competition in the mortgage market between banks and the state-owned Housing Finance Fund had undermined the effectiveness of monetary policy, exacerbated excess demand, and increased the risks to financial stability. They encouraged the authorities to consider establishing a privately held wholesale funding institution that would retain the positive features of the current system while allowing for healthy competition in the mortgage market. ■

For more information, please refer to IMF Public Information Notices Nos. 06/97 (Chile) and 06/92 (Iceland) on the IMF's website (*www.imf.org*).

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Country focus

Institutional improvement in Ukraine could lead to growth boom

Following the dramatic events of Ukraine's 2004 "Orange Revolution," in which more than a million people gathered in Kiev's harsh winter weather to overturn a manipulated presidential election, the incoming administration of President Viktor Yushchenko moved quickly to articulate a new policy vision. That vision focused on accelerating Ukraine's institutional transition toward a modern market economy, with much of the new agenda anchored in a strategy of greater integration with the European Union (EU) and the World Trade Organization.

Gleb Garanich/Reuters

After his 2004 election, President Yushchenko focused on pro-market reforms.

Implementing that agenda, however, has proved difficult. The orange coalition government was riven by personal and political divisions and suffered a major setback following the March 2006 parliamentary elections. Yushchenko is still president, but there are fears that the new government, led by Yushchenko's old rival Viktor Yanukovich, will be less than fully committed to pro-market reforms. A recent IMF Working Paper places these developments in context and asks two questions: to what extent have institutional deficiencies hampered Ukraine's past performance? And what would be the likely payoff if the authorities succeeded in strengthening market-friendly reforms?

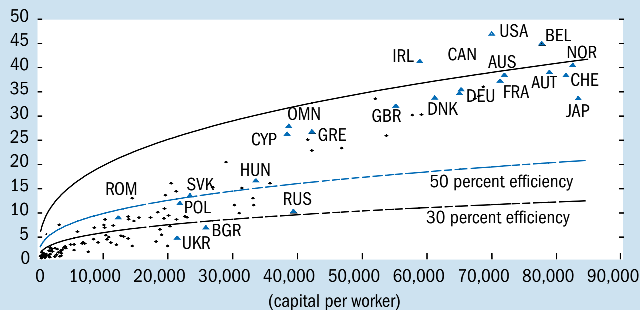
These questions, of course, raise some fairly deep economic issues: What do we know about the role of institutions in driving economic growth and income convergence? International variations in income have been found to result mainly from differences in *productivity* rather than in *factor accumulation*. The obvious follow-up question, then, is how to account for differences in productivity. As a start, productivity can be broken down into *technology*, representing the sum of available knowledge as to how resources can best be combined; and *efficiency*, representing how effectively that knowledge is put into practice.

Chart 1

Coming up short

Ukraine is significantly less efficient than both the world's industrial countries and other former centrally planned economies.

(output per worker in 2000; thousands of dollars[1])



Note: AUS=Australia, AUT=Austria, BEL=Belgium, BGR=Bulgaria, CAN=Canada, CHE=Switzerland, CYP=Cyprus, DNK=Denmark, DEU=Germany, FRA=France, GBR=Great Britain, GRE=Greece, HUN=Hungary, IRL=Ireland, JAP=Japan, NOR=Norway, OMN=Oman, POL=Poland, ROM=Romania, RUS=Russia, SVK=Slovakia, UKR=Ukraine, USA=United States.

[1]1985 prices, purchasing power parity exchange rates.

Data: "How Important Are Capital and Total Factor Productivity for Economic Growth?" Scott L. Baier, Gerald P. Dwyer, Jr., and Robert Tamura, Working Paper 2004-02 (Atlanta: Federal Reserve Bank of Atlanta, 2004); and author's calculations.

Estimates of the relative importance of these two components across a range of developing and emerging market countries all highlight the same message: unless lags in technology are implausibly large, most of the gap between rich and poor countries reflects differences in efficiency rather than in technology. Much of the recent literature on convergence has thus focused on the determinants of efficiency.

The concept of "technology" here is distinct from the techniques that are observed in the workplace. Even with equal access to the same knowledge, different countries may adopt different technologies. Sometimes, this reflects resource differences or comparative advantage. Often, however, it reflects underlying institutional impediments that discourage the implementation of best-practice techniques and prevent new technologies from being used profitably. In this framework, therefore, the presence of suboptimal technologies may not reflect the unavailability of knowledge, but may instead be a symptom of poor efficiency.

Institutions and efficiency

Inefficiency can arise from various sources: unproductive activities (such as stealing, smuggling, rent-seeking behavior, or activity aimed at preventing theft or expropriation), idle resources, and the misallocation of factors across sectors. All of these sources have played a significant role in transition countries, where they are often a legacy of central planning. The study examines the extent to which an absence of market-friendly institutions is responsible for low efficiency in Ukraine and other countries. Although definitions

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can vary, a market-friendly institutional base is typically characterized by, for example, the rule of law, secure property rights, enforceable contracts, and an evenhanded and transparent government.

To quantify efficiency, the study uses a global panel to estimate a *best-practice frontier*—that is, what a country *could* have produced if it had used all its resources optimally, employing world-class, best-practice techniques. Ukraine's actual output is then measured against this hypothetical benchmark as a guide to its overall efficiency. Conducting the same exercise for other countries permits an investigation of the relationship between efficiency and domestic institutions. The study's results suggest that Ukraine is operating significantly within the global frontier and that the economy's low efficiency is associated with its weak institutional base (see Charts 1 and 2).

Impact of reform

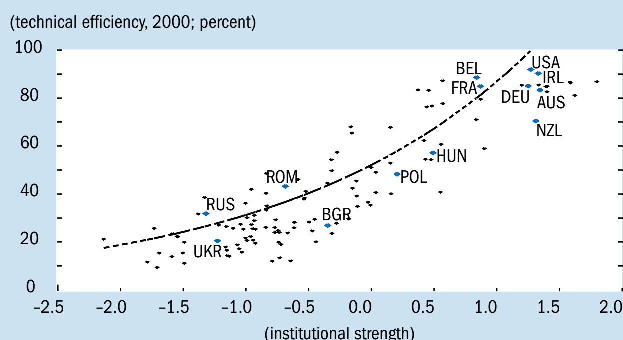
Efficiency in Ukraine deteriorated significantly during the 1990s, partly because of changes in the best-practice frontier. Before 1990, when Cold War considerations hampered the ability of Eastern bloc countries to acquire technology, Ukraine's frontier was more limited than that of Western countries. Over the 1990s, however, Eastern bloc countries were deluged with new ideas and techniques, represented by a rapid outward shift of the frontier. For the most part, the countries of the former Soviet Union failed to capitalize on this influx of new technology. Indeed, they experienced a sustained contraction in output—the result of the dismantling of the Soviet state's central planning apparatus and the fact that, in contrast to more successful countries in Eastern Europe, old institutions were not replaced with a viable alternative. So, rather than move to a more market-oriented system, the countries of the former Soviet Union faced an institutional vacuum, characterized by mounting uncertainty and pervasive rent-seeking behavior.

Since 2000, output in Ukraine has grown rapidly, owing more to improved efficiency than to higher investment. The recovery reflects a complex combination of factors, including a rebound in neighboring Russia. But Ukraine's turnaround also reflects the impact of first-generation institutional reforms introduced in 1999–2000. The reforms focused initially on the energy sector and were key in reducing the prevalence of barter payments and arrears. This improvement, in turn, helped foster a more efficient allocation of resources and the beginnings of a working financial system.

Chart 2

The institutional difference

A country's efficiency can be attributed to the strength of its institutions.



Note: Institutional strength is measured by an index ranging from –2.5 to 2.5; the smaller the number, the weaker a country's institutions. See Chart 1 for country acronyms; NZL=New Zealand.

Data: World Bank and author's calculations.

Capitalizing on efficiency

What does all this mean for future policy? The results suggest that lasting improvements in living standards will depend more on increased efficiency than on higher investment rates, which will require, in turn, that Ukraine commit to improving its market-oriented institutions. The IMF's September 2005 *World Economic Outlook* highlighted the importance of institutions for growth and noted that external anchors have often helped foster institutional change. For transition countries, the prospect of EU accession is a classic example of a successful anchor.

In this light, Yushchenko's early reform agenda was both timely and appropriate. The agenda was anchored principally in the Ukraine-EU Action Plan and, by harmonizing Ukrainian standards with those of the EU, it aimed to accelerate Ukraine's progress toward a regionally integrated market-based economy. Although Ukraine's membership in the EU is somewhat distant and far from guaranteed, the study suggests that the benefits of greater harmonization with EU standards can be substantial and are likely to accrue well before accession.

The study also makes it possible to estimate the impact of these reforms on efficiency (and on growth) based on the experiences of other EU candidate countries. The IMF staff's baseline forecast for Ukraine is consistent with a mild institutional improvement and effectively assumes that, by 2015, Ukraine will have the institutional quality enjoyed by Romania, a current EU candidate. More optimistically, full implementation of an EU-centered agenda might boost Ukraine's efficiency to that of recently successful accession countries, such as Poland and Hungary. In this case, average annual growth could increase to around 8.5 percent over the coming decade. This would be a remarkable achievement and would place Ukraine alongside recent "growth miracle" countries. ■

Andrew Tiffin

IMF European Department

This article is based on IMF Working Paper No. 06/167, "Ukraine: The Cost of Weak Institutions," by Andrew Tiffin. Copies are available for $15.00 each from IMF Publication Services; see page 308 for ordering information. The full text is also available on the IMF's website *(www.imf.org)*.

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With oil revenues declining, Syria faces a daunting fiscal challenge

Syria, which relies on oil revenues for 25 percent of public spending, is running out of crude, raising the specter of unsustainable budget deficits by 2015 if it does not adjust its fiscal policies. Not surprisingly, therefore, the risk of doing too little too late has been at the center of the IMF's policy dialogue with the Syrian authorities in the past two years. In two background studies for the IMF's recent assessment of the economy, staff explored fiscal strategies that could help Syria weather the looming challenge.

Index Stock Imagery

Syria could become a net oil importer by 2010.

After peaking at more than 600,000 barrels a day in 1996, oil production has been declining. If not for the increase in international oil prices that began in mid-1999, maintaining financial stability would have been much more challenging. Syria now needs to accelerate structural reforms and fiscal consolidation to generate new sources of growth and income before its oil reserves are exhausted. Without some action, Syria could become locked in a cycle of financial volatility, fiscal deterioration, low growth, and rising unemployment (see chart, top panel).

What can be done? A recent IMF study suggests that Syria adopt a transparent fiscal policy framework that puts the government's budget constraint in clear perspective over the years to come. The framework should be anchored by a fiscal rule that targets a steady improvement in the non-oil budget balance. To achieve this consolidation, a second study proposes a strategy centered on the phasing out of petroleum price subsidies and the introduction of a value-added tax (VAT).

Putting a straitjacket on the budget

There is an inherent tendency for fiscal policy to generate budget *deficits* rather than *balances*. The bias is usually rooted in procyclical fiscal policies that allow discretionary public spending to rise when revenues increase but not fall when revenues decline. To address the problems created by the deficit bias, many countries have adopted forward-looking fiscal policy frameworks designed to contain public spending and promote fiscal discipline. Successful frameworks combine two types of safeguards: transparency, which allows the public to scrutinize policymakers and thus hold them accountable, and fiscal rules, which address specific issues in a country's fiscal outlook.

Choosing an appropriate fiscal rule boils down to deciding on a medium-term macroeconomic objective for fiscal policy that is always ultimately related to some concept of sustainability. It could, for example, be a fiscal stance consistent with the government's budget constraint as its oil revenues decline. In Syria, as in other oil-producing countries, the oil endowment poses a specific challenge to fiscal sustainability and raises the question of intergenerational equity. With its remaining oil reserves too low to aim for intergenerational equity in the use of the oil wealth, Syria should smooth the adjustment toward a sustainable long-run fiscal position once oil reserves are exhausted.

The IMF study proposes to use the year-on-year change of the non-oil budget balance to approximate the cost of adjustment; this, in turn, is a good proxy for the adjustment's contractionary impact on the economy in any particular year. On this basis, Syria can minimize the cost of adjustment by aiming for a steady improvement in the non-oil budget balance, and the study proposes this as the fiscal rule that should anchor Syria's fiscal policy framework. Such an improvement would reduce the risk of painful, abrupt adjustment, which would likely take a toll on much-needed public investment in infrastructure and social areas or require that revenues be raised through highly distortionary taxes, given a weak tax administration.

Although the proposed fiscal rule would deliver the same performance as the traditional balanced budget rule if oil revenues were to decline smoothly, it would be superior if oil revenues were to level off before declining. Given the inherent uncertainty about the prospective path of oil revenues, the rule targeting a steady improvement in the non-oil budget balance would be better in all cases. The optimal pace of adjustment of the non-oil budget deficit must be reassessed continuously in light of updated information on the net present discounted value of the oil wealth, and the adjustment each year also has to take into account the economy's cyclical position.

Game over for oil subsidies; time for a VAT

The second study argues that, for Syria to secure macroeconomic stability and keep its debt at a sustainable level as its oil

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production declines over the next decade, it must reduce the non-oil budget deficit by some 11 percentage points of GDP, or about 1 percentage point a year, on average. This would bring the non-oil deficit down from the current 13 percent of GDP to 2 percent in 2015 and would contain the rise in public debt to about 40 percent of GDP by 2015, leaving the government room to accommodate possible shocks and other contingent liabilities. To achieve the adjustment, a credible, pro-growth strategy would need to rely principally on phasing out petroleum price subsidies and on introducing a broad-based VAT (see chart, bottom panel).

Most expenditure items are at fairly moderate levels, and some (such as education and health care) are underfunded. For that reason, phasing out subsidies—which, at 14½ percent of GDP, are costly and inequitable—would be a judicious measure. Their elimination would yield large fiscal savings, create significant efficiency gains, and improve equity. Moreover, because higher petroleum prices disproportionately reduce the demand for petroleum products, they generate a greater oil export surplus and contribute to the balance of payments adjustment. By protecting spending on education, health care, and infrastructure, higher petroleum prices also contribute to higher long-term growth.

Because Syria lacks efficient mechanisms for targeting the poor, providing a flat cash compensation for each person was proposed as a second-best solution. The reform of petroleum price subsidies therefore involves two interrelated, critical choices: the speed of price adjustment and the amount of compensation to offer households. The main trade-offs have to do with the risk of destabilizing inflation expectations if petroleum prices increase sharply versus adjustment fatigue from a drawn-out process, and lower fiscal savings versus greater political palatability.

Given the prevailing international oil prices, the study proposes a calibrated combination of the two choices that would yield a net fiscal saving equivalent to 4½ percent of GDP and make a majority of the population better off. It calls for maximum flexibility in the design of the reform. In particular, lower international prices would call for smaller cash transfers to households because government savings from the price adjustment would be smaller, but the welfare losses to consumers would also be smaller.

Actually, because lower prices will make the country better off once Syria turns into a net oil importer around the year 2010, a smaller cash compensation could achieve the same fiscal savings for the government and, at the same time, entail a smaller net welfare loss for consumers. Mitigating the impact of phasing out subsidies by increasing civil service wages could turn out to be very costly and is not advisable.

To make the case for a VAT, the study argues that Syria's tax-to-GDP ratio of 10½ percent of GDP in 2005 is low by regional standards and could be increased without unduly burdening the economy or severely distorting people's incentives to work, save, and invest. The country's lack of a broad-based tax on consumption is notable and explains the observed low ratio of indirect taxes to total taxes. Some features that would optimize the VAT's benefits are a single rate (with an option to impose excises on luxury items), broad coverage (with exemptions limited to hard-to-tax sectors such as financial services), and an initially high taxable threshold for cost-effectiveness. Under these design features, a 15 percent VAT rate could yield about 5 percent of GDP. ■

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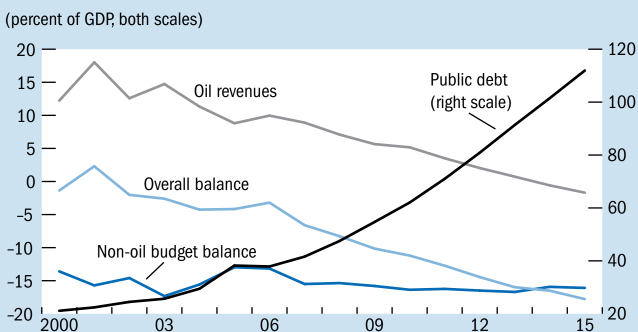
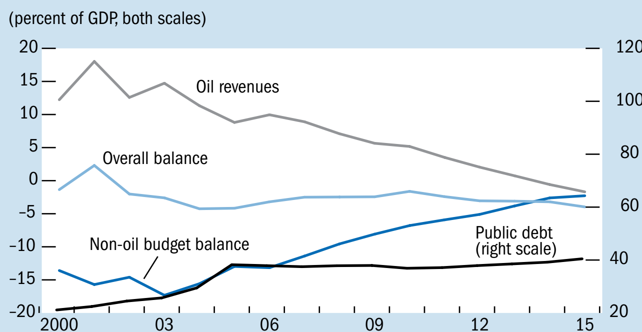
This article is based on IMF Country Report No. 06/295, *Syrian Arab Republic: Selected Issues*. Copies are available for $15.00 each from IMF Publication Services. See page 308 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

Cost of inaction versus action

If Syria does not address the impending loss of oil revenues, its public debt could reach unsustainable levels within 10 years.



By taking steps to steadily improve its non-oil budget balance, Syria could weather the looming fiscal challenges.



Data: National authorities and IMF staff estimates.

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Innovative approach can help countries spot balance sheet risks

Economies have become more reliant on private capital flows and have thus also become more vulnerable to *capital account crises*, when large and sudden withdrawals of capital cause sharp adjustments in the exchange rate. In many cases, capital outflows have been triggered by balance sheet imbalances, as was the case in the late 1990s in Korea and Thailand. In these instances, rising debt levels in corporate and banking sector balance sheets—without compensating increases in the value of assets—undermined investor confidence. A recent IMF Working Paper offers an innovative approach that can be used to measure the balance sheet risk of the sovereign, the financial sector, and the nonfinancial corporate sector.

Illustration Works

This new approach can be particularly useful because it complements traditional flow analysis, which focuses on the gradual buildup of unsustainable fiscal and current account positions—but may no longer be adequate to fully explain the dynamics underlying modern-day capital account crises.

Until recently, the *contingent claims approach* has been widely applied by financial market participants, most notably by leading credit rating agencies to assess credit risk in individual firms. The IMF authors have extended this approach more broadly to measure *aggregated* balance sheet risk in a multisector framework and to analyze credit risk in individual sectors.

Applying the contingent claims methodology to a multisector framework allows policymakers to examine linkages between the corporate, financial, and public sectors, particularly where potentially important feedback effects between sectors can be estimated and valued.

Benefits of a new approach

To put it simply, the Fund's contingent claims approach takes balance sheet information and combines it with current financial market prices to construct various risk indicators. Such an approach has several advantages. First, by using balance sheet information, the Fund is able to identify stock imbalances that, if left unattended, could leave a country vulnerable to shocks. This provides a useful—and essential—complement to flow analysis, which is the mainstay of Fund surveillance.

Second, since market prices represent the collective views and forecasts of many investors, the approach is forward looking, unlike an analysis based only on a review of past financial statements. Third, when estimating credit risk, the approach takes into account market volatility. Volatility is crucial in capturing changes in risk, especially during times of stress, when small shocks can quickly gain momentum and trigger systemic repercussions. And, finally, the approach distills the vulnerability assessment into a single statistic that is easy to interpret, so that the approach will be able to indicate at any time whether the balance sheet is improving or deteriorating.

Pinpointing vulnerabilities

How can this be used to assess vulnerabilities at the country or sovereign level? Using standard option pricing techniques, a measure called the *distance to distress* is derived. As its name implies, this indicator measures the "distance" in terms of standard deviations that sovereign assets are away from a critical debt threshold. If assets fall below the threshold, the sovereign is considered to have entered into a state of distress, which, if left unaddressed, may eventually lead to a default. The more volatile the sovereign assets or the closer the asset value is to the debt threshold, the higher the probability that the threshold could be breached and the higher the probability of default.

To test the approach, the authors applied it to the balance sheet risk of 12 emerging market economies at the sovereign level. The risk indicators are found to be robust and highly correlated with market spreads. Given its multisector setting, the approach was also able to put a value on the risk transfer across interrelated balance sheets of the corporate, financial, and public sectors. In sum, the results show that the approach holds promise as a tool to estimate and manage risk in key sectors of an economy. ■

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This article is based on IMF Working Paper No. 05/155, "Measuring and Analyzing Sovereign Risk with Contingent Claims," by Michael T. Gapen, Dale F. Gray, Cheng Hoon Lim, and Yingbin Xiao. Copies are available for $15.00 each from IMF Publication Services; see page 308 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

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The Maastricht inflation criterion: lessons to learn

As part of the process toward monetary union in Europe, countries were required to fulfill three criteria, set out in the Treaty of Maastricht. One of them required countries to achieve an inflation rate for one year of no more than 1½ percent above the average of the three European Union (EU) member states with the most stable prices. The purpose of this criterion was to bring high-inflation EU countries in line with low-inflation countries before the euro was introduced. According to a new IMF Working Paper, the criterion has achieved its aim of narrowing the inflation gap between EU countries. But it has also encouraged countries to adopt short-run, fiat measures to reduce inflation rather than structural reforms with longer-term economic benefits. The study examines what implications this may have for the 10 new EU member countries, all of which are hoping to join the monetary union in the near future.

From a purely numerical perspective, the Maastricht inflation criterion was a great success: the inflation differential between low- and high-inflation countries, which was in the double digits from the mid-1970s to the early 1980s, started to narrow in the early 1990s, declining to 2–3 percentage points by 1997. But from a policy perspective, it had some unintended consequences. To meet the criterion, EU member countries were faced with two choices: adopt credible monetary policy and market-oriented reforms that reduced inflation on a more permanent basis or opt for short-term measures, such as changes in regulated prices and indirect taxes, and other measures that reduced demand and forced wage moderation.

Which of these two disinflation strategies works best? For rapid entry into the euro zone with maximum political support, the best choice proved to be the short-term strategy. Trying to achieve low inflation through structural reforms can be a protracted process and it might have delayed membership in the monetary union. But countries opting for the longer-term strategy would have entered with a healthier economy.

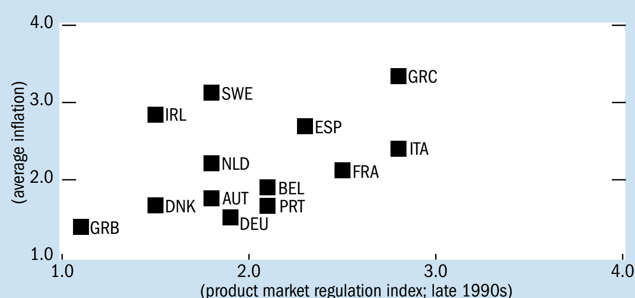
In the late 1990s, in their rush to adopt the euro, all EU members relied at least partly on short-term measures, leaving their goods and factor markets unreformed. Once the effect of these measures faded, however, inflation accelerated again in highly regulated countries (see chart). While the strategy of "low inflation now, reforms later" may have modest short-term costs, the long-term costs are high. The monetary policy transmission mechanism is likely to be less efficient, and economic agents continue to base their decisions on expectations of higher inflation. This makes future disinflation more costly. In contrast, countries that implemented more long-term structural reforms now benefit from flexible markets and expectations of low inflation going forward.

What does the experience of the old EU member countries imply for the new members (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, and Slovakia)? The authors' simulation shows that countries with unreformed economies are likely to face much steeper costs when they try to bring down inflation in the future. This result holds for both the current euro zone members and new member countries. The latter would benefit from an inflation criterion that makes the choice of a short-term disinflation strategy less appealing. At present, the short, 12-month testing period of the Maastricht inflation criterion may encourage use of the fiat strategy. A longer testing period, perhaps covering the full business cycle, might be preferable. The tightness of the inflation criterion also provides a further incentive for one-off measures. These incentives could be alleviated by excluding countries with negative output gaps from the calculation of the criterion. ■

Aleš Bulíř (IMF Institute)
and Jaromír Hurník (Czech National Bank)

Cost of regulation

European Union countries with more regulated markets have higher inflation.



Note: AUT=Austria, BEL=Belgium, DEU=Germany, DNK=Denmark, ESP=Spain, FRA=France, GBR=United Kingdom, GRC=Greece, IRL=Ireland, ITA=Italy, NLD=Netherlands, PRT=Portugal, SWE=Sweden. The index captures competitiveness in countries' product markets; the lower the number, the more competitive the market.

Data: IMF, *World Economic Outlook;* Paul Conway, Véronique Janod, and Giuseppe Nicoletti, "Product Market Regulation in OECD Countries: 1998 to 2003," OECD Economics Department Working Paper WKP(2005)6 (Paris: Organization for Economic Cooperation and Development, 2005); and authors' calculations.

This article is based on IMF Working Paper No. 06/154, "The Maastricht Inflation Criterion: How Unpleasant Is Purgatory?" Copies are available for $15.00 each from IMF Publication Services. See page 308 for ordering details. The full text is also available on the IMF's website (*www.imf.org*).

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Is one financial sector watchdog better than three?

The banking, securities, and insurance industries were traditionally supervised by separate agencies. Over the past two decades, however, the number of integrated agencies keeping watch over the entire financial sector has grown considerably. Are these watchdogs providing higher-quality and more cost-effective supervision? A new IMF Working Paper examines the issues empirically.

The number of integrated supervisory agencies has grown rapidly over the past 20 years, partly in response to increased consolidation in the financial sector. By the end of 2004, there were 29 fully integrated supervisory agencies, defined in this study as agencies that are, at a minimum, in charge of microprudential supervision of banking, insurance, and securities markets.

Impetus to integrate

The most important arguments for integrated supervision are efficiency gains and a greater ability to deal with the issues stemming from the creation of financial conglomerates. Merging multiple supervisory agencies should increase efficiency, if only by eliminating duplicated support functions. There can, of course, be broader synergies as well. With the blurring of lines between traditional components of the financial sector and the creation of conglomerates in many industrial countries, there is an added incentive to integrate supervision to ensure uniform coverage that would minimize the opportunities for regulatory arbitrage.

The integrated supervisor model is not without its downsides, however. First, if the objectives are not clearly specified, an integrated supervisor may be less effective than sectoral supervisors. Second, the economies of scope may be difficult to achieve as long as the regulations across banking, insurance, and securities sectors remain unharmonized. Third, there may even be some diseconomies of scale if the integrated agency becomes too large to be managed effectively. And fourth, an integrated supervisor may extend moral hazard problems across the whole financial sector if financial market participants start to believe that all creditors of all institutions supervised by an integrated supervisor will receive the same protection.

Weighing the benefits

Does integration translate into higher-quality supervision? To measure quality, the paper evaluates the degree to which agencies comply with internationally accepted standards in banking, insurance, and securities regulation. These are the regulations developed, respectively, by the Basel Committee on Banking Supervision (Basel Core Principles for Effective Banking Supervision), the International Association of Insurance Supervisors (IAIS Insurance Core Principles), and the International Organization of Security Commissions (IOSCO Objectives and Principles of Securities Regulation).

A simple comparison of compliance in countries with integrated supervision and in those without it could be misleading. Integrated supervisors tend to be found in more developed economies that also have a better general regulatory environment, which is, in turn, positively correlated with the level of implementation of financial sector standards. However, integrated supervisors tend to have a higher degree of compliance with supervisory standards in banking supervision even after taking the general regulatory environment into account—the Working Paper shows this is the case for three out of every four supervisors.

Integrated supervisors tend to have a higher degree of compliance with supervisory standards in banking, insurance, and securities supervision.

The paper asks whether integrated supervisors generally have a higher degree of compliance with financial sector standards even after adjusting for the general regulatory environment. To address this issue formally, the paper turns to regression analysis. The regression models include a constant, a measure of development of the economy, the general level of regulatory environment, and an indicator of integration of a given regulator. The results suggest that the integrated supervisory agencies tend to have a higher quality of banking and insurance supervision, as well as of securities regulation. A statistical analysis of the variation of performance across the three sectors and across different components of supervision also suggests that integrated supervisory agencies tend to provide a more consistent quality of supervision across the sectors they supervise.

Based on available data, however, it is less clear that integration reduces costs. The Working Paper did not have access to the costs of supervision incurred by the supervised institutions. However, the paper examined the number of supervisory staff in integrated and other supervisory agencies. It found that the number of supervisors depends on the country's population and level of development. However, whether the country has or does not have an integrated supervisory agency does not have a significant effect on the supervisory staff. ■

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Based on IMF Working Paper No. 06/57, "Is One Watchdog Better Than Three? International Experience with Integrated Financial Sector Supervision," by Martin Čihák and Richard Podpiera. Copies are available for $15.00 each.

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IMF bookstore goes partially online

Readers can now order some of the IMF's most recent titles online. The IMF launched a quarterly e-newsletter for subscribers in October, with a link for ordering online: *www.imfbookstore.org/srcpromo.asp?src=NL2006&mlc.*

Cathy Willis, an External Relations Officer in the IMF's Editorial and Publications Division, notes that the newsletter marks the Fund's first Web-enabled e-mail promotion. "The Fund continually publishes new content, but it has always been up to the customer to find it," Willis said. "With this initiative, we are helping existing customers stay up to date on our new and current publications, and we are reaching out to new customers as well."

Here are some of the titles highlighted in the current newsletter:

China and India Learning from Each Other: Reforms and Policies for Sustained Growth

$35.00

The two fastest-growing emerging markets and two of the three largest economies in Asia are increasingly influencing the global economy. This book draws together analysis and insight from high-level policymakers and advisors from both countries and offers concrete suggestions for how each can achieve long-term sustainable development.

India Goes Global: Its Expanding Role in the World Economy

$22.00

India has emerged as a global economic power, the leading outsourcing destination, and a favorite of global investors. Is it entering into a golden age or experiencing a period of rapid but ultimately unsustainable growth? This book examines what lies behind India's economic rise and considers the steps needed to build on this success over the medium term.

2006 Annual Report on Exchange Arrangements and Exchange Restrictions

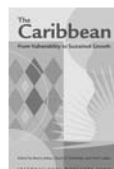
$149.00

The IMF is the only international financial institution officially responsible for reporting the foreign exchange arrangements, exchange and trade restrictions, and relevant prudential measures of each of its 184 members. This volume, published since 1950 and updated annually, is based on a database maintained by the IMF that tracks the monetary exchange arrangements of its members, including historical information.

Pacific Island Economies

$25.00

The Pacific island region has considerable potential for development, especially in tourism, fisheries, forestry, mining, and agriculture. But these countries face such development challenges as small size, distance from major markets, and vulnerability to natural disasters. This book assesses the regional issues and the factors affecting each country.



The Caribbean: From Vulnerability to Sustained Growth

$28.00

Although the countries of the Eastern Caribbean Currency Union have enjoyed a sustained period of price and exchange rate stability, they have recently been buffeted by adverse shocks. To strengthen their growth performance, these countries must integrate with the global economy, develop the tourism industry, and preserve macroeconomic stability. This volume examines the issues that are part of that process.

Central America: Structural Foundations for Regional Financial Integration

$28.00

Intraregional financial activity in Central America has grown substantially in the past decade, contributing to economic development. At the same time, the expansion of activities by regional conglomerates has increased the challenges to supervisory authorities in mitigating the challenges of contagion. This book addresses the common policy challenges facing the countries in financial sector reform.

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Meet Dr. Doom

In recent months, New York University's Nouriel Roubini has cheerfully given himself the moniker "Dr. Doom" for his pessimism about the U.S. and global economic outlooks. Why so glum? Roubini spelled out his reasons in a talk at the IMF last month, with a predicted housing bust topping his list of concerns. Fellow panelist Anirvan Banerji of the Economic Cycle Research Institute remained unconvinced, however.

Moderating the event, IMF Research Department Deputy Director Charles Collyns said that Roubini's "website and his blog are probably the most widely read economics websites among the Fund's staff." Collyns also quipped that the "impressively large crowd" at Roubini's seminar—about 300 staff members attended—perhaps reflected not just great professional interest but also considerable personal interest, "since many of us at least have a substantial part of our personal portfolios exposed to risk in the Washington real estate market."

If the United States sneezes . . .

In Roubini's view, a slowdown in the U.S. housing market would be a key factor in precipitating a recession in the United States next year and a "global hard landing." The "U.S. housing bust," he said, is the most significant of three "bearish factors" in the U.S. economy, with elevated oil prices and rising interest rates being the others. Over the past several years, U.S. consumers have gone on a spending binge, spurred by low oil prices and interest rates, with many consumers using their home equity as an "ATM machine." Now, he warned, "consumer burnout" is imminent.

Roubini drew a parallel between the present situation and early 2001, when the U.S. economy last slid into a recession: "What is happening today is that, instead of a glut of tech goods, we have a glut of housing stock and also a glut of consumer durables." Even if the U.S. Federal Reserve Board lowers interest rates later this year, he said, it will not stave off a recession "for the same reason that Fed easing did not work in 2001." If you have a glut, Roubini reasoned, "you have to work it out, and interest rates effectively do not matter."

Eugene Salazar/IMF

Roubini sees three bearish factors pushing the U.S. toward recession.

Some maintain that, "even if the United States goes into a slowdown or a recession, the rest of the world could decouple" from it because there is enough momentum in domestic demand in Asia and Europe. Roubini questioned this view, noting that dependence on exporting to the United States is still strong enough that "when the United States sneezes, the rest of the world gets a cold." And many countries, he added, have only a limited ability to ease macroeconomic policies in the event of a slowdown, given inflationary pressures or fiscal constraints, and some have to cope with housing sector slowdowns of their own.

Choosing the right analogy

Banerji offered a more measured assessment of U.S. prospects. While he applauded Roubini's "signal role in questioning a complacent consensus," he was nevertheless quite critical of what he termed "forecasting by analogy." Banerji saw "a wide variation in the combination of factors that has helped trigger each recession" in the United States over the past several decades.

He was not persuaded that Roubini's comparison of the present situation with early 2001 was preferable to those forecasters who "see the soft landing of the mid-1990s as the better comparison." Forecasting by analogy is tempting, Banerji observed, "but it is hard to choose the right analogy." ■

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