

After recovery takes hold

Implications of aging population will pose crucial policy issues for Japanese authorities

In conjunction with its annual Article IV consultation with Japan, IMF staff prepared a background paper (Japan—Selected Issues) on a number of key topics. Two chapters of that paper dealt with the macroeconomic and fiscal implications of Japan's aging population. The authors—Hamid Faruqee, an Economist in the Research Department, and Martin Mühleisen, an Economist in the Asia and Pacific Department—speak with the IMF Survey about their findings.

IMF SURVEY: Over the past decade, industrial countries have grown more aware of the significant macroeconomic implications of aging populations, but Japan's circumstances seem particularly urgent.

FARUQEE: Population aging is a characteristic of most industrial countries. Societies that achieve higher living standards customarily see their mortality and fertility rates fall—something that is referred to as a demographic transition.

Where Japan differs from other industrial countries is in degree. The rate of increase of Japan's elderly dependents is much higher than elsewhere. Ten years ago, Japan had the lowest share of elderly dependents among industrial countries; now it has the (Continued on page 343)



A sharp demographic shift in Japan will have macroeconomic implications for the young and the old.

Per Jacobsson address

Tošovský reviews lessons learned from transition, indicates process is still incomplete

On September 24 at the Annual Meetings in Prague, Josef Tošovský, Governor of the Czech National Bank, delivered the 2000 Per Jacobsson address, "Ten Years On: Some Lessons from the Transition." His remarks are summarized here; the full text is available on www.perjacobsson.org.

Beginning with the premise that the transition process is still incomplete, Tošovský said that most of the failures and continuing difficulties that transition economies have encountered are rooted in the past—the legacy left by 40 years of central planning.

Ten years ago, Tošovský said, the transition economies of central and eastern Europe were mostly or completely nationalized. As a result of this near-total



Josef Tošovský

nationalization, a mass privatization program was needed to move quickly to a market economy. At the same time, these transitional economies needed to create an adequate institutional framework to support the newly emerging private sector. This second task, Tošovský noted, turned out to be far more demanding.

Distortions in the real economy

Among the legacies of the old regime were the "deformations and distortions" in the real economy, including the exclusive geographic orientation toward eastern markets, aggravated by a policy of economic self-sufficiency.

The true extent of the distortions inherent in centrally planned economies, as (Please turn to the following page)

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(Continued from front page) well as the true magnitude of implicit, hidden indebtedness, came to light only with the political changes that took place in 1989. According to Tošovský, the growth of internal debt was a major problem. To avoid social unrest, ruling communist parties sought to provide an acceptable living standard. But since the productive capacities of the communist economies were eroded by inherent inefficiencies, the only way to achieve a decent living standard was to mortgage the future—that is, by living on hidden debt. The consequences of this long-standing allocation of resources based on political priorities rather than profitability continued to haunt reformers during the 1990s, as massive amounts of bad loans began to surface.

Human factors also accounted for many of the transition problems, Tošovský suggested. For one thing, the structure of education and the mix of skills in a command economy do not match the needs of a market economy. In addition, living under socialism shaped people's qualities, mentality, and morals into patterns inconsistent with the requirements of a market economy.

Finally, the newly democratic economies emerged into an environment of a rapidly moving globalization involving the widespread liberalization of goods and capital markets—in a word, competition.

Although all developing countries had to accept and adapt to these changes, the transition economies were at a particular disadvantage; their “delayed start” gave them much less time to adjust, and they were forced to proceed with integration into the global economy and international financial system quickly, regardless of the risks associated with such rapid integration.

Importance of market-friendly institutions

Many analysts agree, Tošovský said, that the current difficulties of some transition economies whose economies have unexpectedly lagged behind other stronger performers stem from their initial misunderstanding of the importance of institutions in a market economy.

One widespread and very damaging mistake, Tošovský observed, was the misconception that systemic measures—price and trade liberalization, a realistic exchange rate, and creation of market institutions—could be implemented “overnight” in the absence of the necessary supporting structural and institutional reforms. Such underestimation was common, for example, during privatization efforts that failed to establish the regulatory framework needed for a privatized economy to function smoothly.

Central bank independence. In general, transition economies formally embraced most of the elements of the European legal framework defining the position of central banks. But the principle of an independent central bank has not yet been fully accepted by the public, and especially by politicians, Tošovský noted. Central banks have often had the unpopular task of announcing

bad news about mounting macroeconomic imbalances. In addition, they end up getting the brunt of the blame for slow growth, increasing unemployment, and social unrest when they attempt to tighten monetary policy to address the imbalances. This political pressure, Tošovský said, has been “a fact of life” for central banks in most of the transition economies in the region, but he had hopes that this “symptom of immaturity” would soon disappear as these countries became members of the European Union (EU).

Financial sector reform. Because it is the financial sector that undergoes the greatest changes in the course of an economic transition, the financial crises that hit virtually all transition economies were probably unavoidable, Tošovský observed. The transformation of a centrally planned financial sector to a market economy calls for a systemic overhaul requiring the development of a totally new infrastructure. The financial sectors of postcommunist countries still come in for a lot of criticism, he said, but it should not be forgotten that the task of creating from scratch a strong, efficient, globally competitive financial sector operating in an appropriate legal environment is a lot to expect in only 10 years.

Results and conclusions

Despite the highly unfavorable starting conditions, combined with several mistakes along the way, Tošovský said he considered the transformation of the Czech Republic and other countries at a similar stage of transition as successful, even if the traditional indicators, such as GDP, did not appear to support his conclusion. Radical economic transformation is precisely the kind of situation where calculated GDP is not necessarily the ideal indicator of a country's social well-being and quality of life, he stressed. A lot of mistakes were made, but in his view the countries of central and eastern Europe that have made the most progress in adapting themselves to the conditions of a free market economy are incomparably better off than the countries that have postponed these reforms.

In the past 10 years, Tošovský observed, the pitiful economic conditions that prevailed in the closing days of socialism have become a distant memory, and the most advanced transition economies are serious candidates for EU membership. Their maturity is attested to by the extent to which they satisfy the Copenhagen criteria that—in addition to the political requirement that “the candidate state has achieved stability of institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities”—emphasize the existence of “a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union.” ■

Development, monetary and financial issues are focus of wide-ranging discussions

A program of seminars addressing issues on the general theme of making the global economy work for everyone was held in Prague in conjunction with the Annual Meetings. The seminars, organized by the IMF and the World Bank, served as a forum for private sector leaders, government officials, and officials of the international financial institutions to discuss issues related to sustainable development and international monetary and financial relations.

Challenges and opportunities

The opening “keystone roundtable” addressed both the opportunities of globalization and the challenges involved in making the global economy work for everyone. Erna Witoelar, Minister for Housing and Regional Infrastructure of Indonesia, cited the impact of the Asian crisis on economic disparities in her country and said these disparities should be eliminated at every level. She called for renewed efforts to develop the productive capacity of poorer countries.

Stanley Fischer, First Deputy Managing Director of the IMF, observed that globalization was not a new phenomenon and that more people had benefited from globalization today than in any previous period of history. This, he said, was because of recent technological advances, especially in communications technology; the popular taste for more goods and more travel; and public policy initiatives. However, he noted that the recent intensification of globalization has also been associated with negative aspects, including income inequalities and environmental degradation, and stressed the necessity of acting to counter these problems.

Globalization has led to an unprecedented community of values in human rights, equality of women, environmental protection, and an unprecedented generation of wealth, according to Olara Otunnu, the UN Secretary General’s Special Representative for Children and Armed Conflict. The remaining challenges center on those who have been left out of the process, he said, citing persistent income gaps within countries and between regions and ethnic groups.

Currency areas

Opening a seminar on currency areas, Alexander Swoboda of the IMF Research Department noted that, together with financial integration extending to an ever larger number of countries, the birth of the euro represented a fundamental change in the organization of the international monetary system.

Robert Mundell, Nobel Prize winner and professor of economics at Columbia University, said that the intro-

duction of the euro created the prospect for a change from a dollar-denominated currency system to one in which power is shared by the dollar, euro, and yen areas. He made the case for a world currency in the longer run. Hans Tietmeyer, former President of the Deutsche Bundesbank, argued that in a world of free capital movements, there was no effective instrument for controlling exchange rate movements. He also felt that creating a world currency was neither feasible nor desirable in anything but the very long run.

Yung Chul Park, professor at Korea University, stated that interest in monetary and financial cooperation in east Asia had increased strongly in recent months, fueled by frustration with being excluded from decisions on reform of the international financial architecture. The east Asian economies, which hold a substantial fraction of the world’s international reserves, are particularly vulnerable to swings in capital flows and in exchange rates among the world’s three major currencies, he said.

Dollarization and euro-ization

In this seminar, moderated by Zanny Minto-Beddoes of *The Economist*, Jacek Rostowski, Professor of Economics at the Central European University, Hungary, outlined the policy elements that the central European applicants for membership in the European Union should follow. These are to maintain a rapid rate of economic growth, to be committed to free capital movements, to recognize that the prices of nontradable goods will tend to rise as growth proceeded, and to satisfy the Maastricht criteria.

Drawing parallels between the central European and Latin American experiences, Paulo Leme of Goldman Sachs saw a steady movement among groups of countries toward single-currency systems. He emphasized that high quality in the underlying policies, particularly open trade policies, is essential.

Eduardo Borensztein of the IMF’s Research Department said he was not persuaded that every country should either dollarize or set up a currency board. He saw costs as well as benefits from dollarization, saying that countries could lose a degree of policy freedom by tying their hands to gain credibility.

Rudiger Dornbusch of the Massachusetts Institute of Technology essentially recommended that every emerging market economy either adopt a currency board or directly use a strong currency like the U.S.



Bono (left) with IMF Managing Director Horst Köhler.

dollar, thus “outsourcing” monetary policy and gaining credibility and stability automatically.

Challenges for EU accession countries

This seminar, moderated by Pedro Solbes, European Community Commissioner for Economic and Financial Affairs, focused on key policy issues faced by accession countries on their road to European Union (EU) membership.

Charles Wyplosz of the Graduate Institute of International Studies in Geneva argued that removing capital controls too rapidly would entail unnecessary risks and potentially lower long-term growth prospects. György Surányi, Governor of the National Bank of Hungary, discussed the likelihood that strong capital inflows would at times push interest rates in the candidate countries to levels lower than desirable for domestic monetary management.

Marek Belka, economic advisor to the President of Poland, stressed the key role that EU accession prospects had played in crystallizing domestic coalitions for economic reform. Josef Kreuter of the Czech Ministry of Foreign Affairs also stressed the need for the accession candidates to establish the right reform priorities—including in labor market reform.

Financial system stability

Speaking at a workshop on improving financial system stability, Andrew Crockett, General Manager of the Bank for International Settlements, noted that weaknesses in domestic financial systems and in financial markets are most effectively addressed by strengthening best practices and ensuring that markets are transparent, open, and efficient. It would be important to avoid undue complexity, he said, by prioritizing the large number of standards for the benefit of those countries that intended to use them. The chair of the workshop, Bimal Jalan, Governor of the Reserve Bank of India, recommended that the connection between standards and codes and financial stability be clarified.

At a complementary workshop on the development and assessment of international standards and codes, Carl Adams of Merrill Lynch observed that standards serve as the bricks and mortar to hold the global community together and that it is essential to provide details of the work done in this area to the private sector. The moderator, Alastair Clark, Executive Director of the Bank of England, called for a more determined effort to raise general awareness of the standards and codes process.

East Timor

The pressing problems facing the people of East Timor were the focus of a special workshop organized by the IMF and the World Bank on the collaboration between the Bretton Woods institutions in postconflict countries. Opening the discussion, IMF Deputy Managing

Director Shigemitsu Sugisaki cited the emergence of a strong leadership in East Timor, the establishment of a basic macroeconomic framework and a credible judicial system, and progress in foreign relations. He stressed, however, that the remaining tasks are monumental, particularly in the sound allocation of domestic resources, building up indigenous managerial capacity, and the efficient use of international aid.

José Ramos Horta, Nobel Peace Prize winner and representative of the East Timorese leadership, paid tribute to what he said were “exceptionally positive” relations with the IMF and the World Bank and the institutions’ contribution to peace and stability in East Timor.

Focusing on the lessons learned in East Timor, Luis Valdivieso of the IMF emphasized the need to closely coordinate international relief operations and reconstruction efforts, and develop key institutions with adequate resources and staffs.

Time-series data management

Addressing a seminar on economic and financial time-series data management, Warren Minami, Frank Maranto, and Sam Ouliaris of the IMF presented recommendations for collecting, managing, and reporting on large volumes of economic and financial statistical data. The main attraction of their approach is a dynamic link between the database and spreadsheets, which would shift the work of analysts from time-consuming data entry, management, and reporting to the more valuable manipulation and analysis of data, thus “unlocking the hidden value of data in spreadsheets.”

Capstone roundtable

The seminar program was summed up at a roundtable at which the opening speaker was the musician Bono, who said he represented a constituency of those who had lost confidence in institutions such as the IMF and the World Bank. The only reasonable course, he asserted, was to completely cancel the debts of poor countries. Lauren Lenfest of Oracle Corporation saw the challenge of the coming years as making the global economy and technological advances work for everyone.

Elizabeth Tang of the Hong Kong Confederation of Trade Unions said that while workers and unions view globalization as inevitable, they are concerned about losing their jobs. Trade unions, she said, are being weakened by liberalized trade and privatization policies.

Boney Katumbo of the Ugandan National Chamber of Commerce said that developing countries were poised to benefit from the digital revolution. He recommended that international negotiations focus on debt relief or cancellation, free movement of labor, enhanced economic cooperation, and strengthened private sector institutions. ■

Ian S. McDonald
Editor-in-Chief
IMF Survey

Poverty seen as greatest challenge of new century despite improved global environment

Conditions in the global economy are encouraging, and prospects for continued economic growth are generally favorable. Nonetheless, poverty remains the single greatest challenge of the century. Speaking at the plenary sessions of the 2000 Annual Meetings of the IMF and the World Bank, held on September 26–28 in Prague, Czech Republic, the governors representing the IMF's 182 members acknowledged that, although globalization has brought opportunities for growth and development to both rich and poor countries, not everyone has been able to take advantage of the opportunities. The task facing the international community, the governors agreed, is to build a successful, truly global economy that works well for all people and addresses the widespread poverty that remains "the unacceptable face of the global economic situation," according to Yannis Papantoniou, Minister of National Economy and Finance of Greece.

In addition to poverty reduction—a dominant message of the 2000 meetings—governors addressed a number of interrelated topics. These included the current high price of oil—and the implications for, in particular, developing countries that depend on imported oil; support for the goal of bringing debt relief to 20 heavily indebted poor countries by the end of the year; the need for a further strengthening of the international financial architecture; and various issues related to reforms of the Bretton Woods institutions and the division of labor between the IMF and the World Bank.

Growth of the world economy

At the 1999 Annual Meetings, the general opinion among governors was that the worst of the international financial crisis was already over. "We were correct then," said Rodrigo de Rato Figaredo, Second Vice President and Minister of Economy of Spain, "but we were far from realizing that we would now find ourselves in a global economic boom." This boom is expected to carry over to 2001 in all geographical regions of the world. Robust growth in the United States is contributing to this performance, he noted, as is growth in Europe and much of Asia. After recovering from their recent financial crisis, the Latin American economies are expected to join in that growth.

CHEA Chan To, Governor of the National Bank of Cambodia, and KEAT Chhon, Cambodia's Senior Minister of Economy and Finance, noted that the underlying fundamentals of the world economy have strengthened and a more sustainable pattern of growth has been created. They applauded the countries for their successful performances and praised the international community for helping countries imple-

ment the necessary reforms in their financial, corporate, and government sectors.

Several governors, however, cautioned that the task ahead would be to make this growth more sustainable and to spread its benefits more widely. For example, if oil prices were to continue to rise, said de Rato Figaredo, the rosy outlook for world growth could be jeopardized. Didier Reynders, Minister of Finance of Belgium, agreed. "It is in our collective interests," he said, "including those of the oil producing countries, to prevent a slump in world growth; it is therefore essential to ensure that the market is supplied in a manner more in line with economic circumstances." A number of governors, supporting this position, called on the oil producing countries to increase oil production to bring prices down. However, Mohsen Nourbakhsh, Governor of the Central Bank of the Islamic Republic of Iran, characterized the present attempts to shift responsibility to oil producers as "patently unfair." When the price of oil collapses, he said, producers are asked to adjust their economic policies to offset lower prices. When prices recover, the industrial countries do not adjust their economic policies, but attempt to push producers to adjust oil production.

Paraguay's Minister of Finance, Federico Zayas Chirife, also spoke of the risks of globalization, which he said poses an increasingly serious challenge to the ingenuity and creativity of IMF and World Bank members. He hoped that the industrial countries would help to "achieve global economic growth that is truly beneficial to all nations of the world" by opening their markets, providing more aid, and providing debt relief to the poorest countries.

Rod Kemp, Assistant Treasurer of the Commonwealth of Australia, noted that sustained growth required sound domestic policies and institutions, better lending and investment assessments, and better performance from the international institutions. He, too, argued that the industrial countries could boost the prospects of the poorest economies by lowering trade barriers.

DAI Xianglong, Governor of the People's Bank of China, called for "a win-win globalization characterized by equality." He said it was therefore necessary to create a fair and reasonable world economic order involving all countries—to the extent possible and on an equal basis—in international economic decision making and rule setting, and establishing a new and fair international financial and trading system.



DAI Xianglong called for "a win-win globalization characterized by equality."

Strengthening the monetary system

Governors generally welcomed the IMF's recent efforts to strengthen the international financial system, including the formulation of standards and codes, measures to improve surveillance, and efforts to increase transparency. Bangladeshi Minister of Finance Shah A.M.S. Kibria emphasized, however, that to be sustainable, the new financial architecture had to be based on equity, "where both developing and industrial countries have equal opportunity for participation." Dato' Shafie Mohd. Salleh, Malaysia's Deputy Minister of Finance, suggested that IMF surveillance had to be more evenhanded. Surveillance would be more effective, he explained, if the IMF focused more attention on developments in the major industrial countries, which have systemic implications for the rest of the world. Pavel Mertlik, Deputy Prime Minister and Minister of Finance of the Czech Republic, characterized the need for transparency as particularly important in transition economies. "The lack of transparency," he said, "increases the costs of transition and slows down economic growth."

Support for HIPC

Poverty can more easily be addressed during times of strong economic performance, according to Papanтониou, who emphasized that the international community should take advantage of the present favorable conditions. Along with the majority of governors who spoke, he expressed support for the Poverty Reduction and Growth Facility and the Heavily Indebted Poor Countries (HIPC) Initiative. "The developed world," he said, "should intensify its efforts to combat poverty through the systematic application of relief and assistance policies."

Kemp welcomed the progress made in bringing 10 heavily indebted countries to their "decision points," but warned against complacency. He urged the IMF and the World Bank to maintain their current efforts and continue to collaborate closely "to get a further 10 countries to this point by the end of the year." The heavily indebted poor countries themselves, he said, must address circumstances that prevent an early delivery of relief, including armed conflicts in some countries. Prijadi Praptosuhardjo, Minister of Finance of Indonesia, was also encouraged by the progress achieved in implementing the HIPC Initiative but expressed concern that its financing remained unresolved. He urged all bilateral and multilateral donors to "provide the necessary financial supports to avoid setbacks in providing debt relief to poor countries."

Bretton Woods institutions

Cooperation emerged as a catchword of this year's meetings, arising, notably, in discussions of the roles of the IMF and the World Bank. Several governors

exhorted the two institutions to reinforce their partnership with each other as well as to coordinate their activities with regional financial institutions, such as the Chiang Mai Initiative, which several Asian governors described as a further step toward economic cooperation in the Asian region.

Igor Mityukov, Ukraine's Minister of Finance, urged the IMF and the World Bank not to "sideline their core responsibilities in promoting sound development policies, strengthening the international monetary and financial system, and helping to sustain momentum for the acceleration of international trade." He stressed the importance of preserving the cooperative nature of the international financial institutions at the turn of the century of the information revolution.

Another issue that attracted a considerable amount of attention from governors was the IMF's quota formula and revisions that would reflect the changing circumstances of the global economy. Several governors for developing countries—including Kinikinilau Tutoatasi Fakafanua, Tongan Minister of Finance; Dato Haji Selamat Haji Munap, Deputy Minister of Finance of Brunei Darussalam; and Tantely R.G. Andrianarivo, Prime Minister and Minister of Finance and Economy of Madagascar on behalf of the Joint African Group—said they felt that their countries should have a greater say in defining development priorities, especially in light of the new emphasis on country ownership of programs. Nyum Jin, Minister of Finance and Economy of Korea, agreed that the IMF's quota and representation systems needed to be adjusted. In his view, "the IMF's current policy does not properly weigh the economic influence of Asian emerging economies," including that of Korea. Kemp concurred but said he would not want to see the representation of smaller developing countries reduced. Australia, he said, supports a simplification of the current quota formula system, "which lacks both logic and transparency." ■

Selected IMF rates

Week beginning	SDR interest rate	Rate of remuneration	Rate of charge
October 9	4.76	4.76	5.52
October 16	4.73	4.73	5.48

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 (as of May 1, 1999, the U.S. dollar was weighted 41.3 percent; euro (Germany), 19 percent; euro (France), 10.3 percent; Japanese yen, 17 percent; and U.K. pound, 12.4 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (115.9 percent) 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/sdr.pl).

Data: IMF Treasurer's Department

Japan has options in addressing large deficit

(Continued from front page) highest. Some studies have suggested that a relative lack of child care facilities has exacerbated the impact on family size of rising female participation rates in the labor force. Whatever the cause, the decline in fertility rates has been much more dramatic in Japan. The country expects to see a comparatively faster rate of aging and a greater increase in elderly dependents. The country can also expect an overall decline in its population—something that sets Japan apart. Among the industrial countries, only Italy comes close to Japan's experience.

IMF SURVEY: Why is the IMF looking at the macro-economic implications of aging in Japan now, and what concerns were your studies designed to address?

MÜHLEISEN: Japan has long been known for its strong fiscal position. Like its people, the Japanese government has been fiscally conservative and traditionally has had little debt and relatively low expenditures. But the fiscal situation, like the demographic situation, has seen a marked reversal over the past decade. Japan has had to run very high deficits—including several large stimulus programs—to keep its economy afloat after the bubble period in the late 1980s. Within a few years, Japan recorded virtually the highest level of gross debt within the Organization for Economic Cooperation and Development.

Japan still has formidable assets, especially in its social security system, but it cannot continue indefinitely without raising concerns about the sustainability and financing of these deficits. The economy is still fragile, so this is not yet the time for fiscal consolidation. But a thinking process must begin; it is hoped this will lead to a strategy for addressing the fiscal problem before the aging problem really kicks in. A public debate is going on now, and the government has said that it wants to return to a more sustainable fiscal path as soon as the economy allows. Our papers are meant to contribute to this thinking process and help lay the basis for a strategy to address these issues.

FARUQEE: The broader macroeconomic study, which I prepared, sought to quantify the impact of population aging on key macroeconomic variables. We asked ourselves what might happen to Japanese saving and investment rates and growth over the next half-century. We wanted some sense of how large the economic impact of aging would be and then use that information to help frame pertinent policy questions and strategies.

MÜHLEISEN: My paper looked more specifically at the fiscal side. Besides the question of how Japan could move away from its huge deficits in the coming years, we asked ourselves how Japan could address its long-term aging problem. Japan's pension and health care systems are to a large extent publicly financed, with expenditures slated

to rise considerably as the population ages. While the largest pension system for private employees is partly funded, it will run out of funds if Japan doesn't do something in the next couple of years. So the question is what the Japanese authorities can do with the least harmful consequences for growth.

IMF SURVEY: What methodology did you use?

FARUQEE: We extended the IMF's own multicountry macrosimulation model—MULTIMOD—to bring in the impact of population aging and introduced a pension system with revenues generated from different avenues, including wage and consumption taxes. Conceptually, we tried to quantify the impact by looking at how various age groups differed, notably in wage earning. In Japan, as in most countries, you see young workers with rising income, middle-aged workers at an earnings peak, and senior workers and retirees with declining or little labor income. The age-earnings profile helped us characterize labor supply and productivity differences between age groups. And that feature helped us to quantify the impact of the changing composition of the population. The model then used this information to determine demand- and supply-side implications of population aging.

IMF SURVEY: What did the data tell you about the broader implications of Japan's aging population?

FARUQEE: On the supply side, Japan will have a shrinking workforce, with implications for investment. An aging population needs to shed capital as the size of the workforce declines. On the demand side, we found that saving levels also tend to decline with the overall size of the economy, but per capita saving rates tend to stay fairly stable. The fact that we did not find large declines in saving rates is a little different from the findings of previous studies on aging populations. In Japan, the aging comes from a fall in fertility rates and an increase in longevity. The elderly tend to save less than other age groups, but increasing longevity tends to raise saving rates across age groups, because the planning horizon is lengthened. Also, Japan's sharp decline in fertility rates has led to a decline in youth dependency rates, which helps lessen the negative impact on saving rates.

The other main finding was that given a contracting workforce and a contracting population—and barring some change in productivity growth—Japan's overall GDP growth could decline by about $\frac{1}{2}$ of 1 percentage point over the next several decades, compared to a scenario with a stable population and workforce. In per capita terms, this is not necessarily a large decline, because income is declining in line with the number of



Faruqee: "We wanted some sense of how large the economic impact of aging would be and then use that information to help frame pertinent policy questions and strategies."

people. But because the workforce becomes more elderly, you might also expect some decline in per capita incomes compared to a case where no aging took place.

IMF SURVEY: The second study looked at the fiscal situation in greater detail.

MÜHLEISEN: The most important question for the near term is whether Japan's fiscal position is sustainable. The simulations tell us that the problem is manageable but will require serious consolidation in the next few years and a tight fiscal policy over the next couple of decades when the aging process kicks in.

But having said that, there is still some concern over the immediate future, since debt levels are going to rise even if Japan takes steps to turn its fiscal deficit of 8–9 percent of GDP into a primary surplus. On the basis of a realistic policy scenario that incorporates already approved social security reforms, we figure that net debt (excluding the social security system) is not going to stabilize until it reaches 120 percent of GDP by the end of the decade.

The options come in when we talk about the composition of adjustment measures. Japan has one of the largest public investment ratios among the Group of Seven countries, so there is some room to cut public investment. Moreover, while there is comparatively little room to cut current expenditure, Japan's tax revenue ratio is rather small, and the authorities would need to either broaden the income tax base or raise the consumption tax rate.

Our policy analysis looked at the growth and wealth effects of these policy options. For example, cutting public investment a strong positive effect on growth over the longer term but would have sharply negative effects over the short term, since it reduces demand directly. It is not something we would recommend doing on a big scale right away, because Japan's recovery remains weak.

The other two options for stabilizing debt—a consumption tax increase or a broadening of the tax base—tend to have somewhat lower long-term positive effect on growth but create fewer macro problems in the short term. Realistically, however, these measures would also need to be phased in gradually to avoid strong taxpayer resistance. So the policy response will need to be a balanced mixture.

IMF SURVEY: Once the fiscal situation has stabilized, what are the fiscal implications of the aging process?

MÜHLEISEN: In our simulations, we looked first at the finances of the social security system. The Japanese Ministry of Health and Welfare projects that under its currently envisaged pension reform plan, contributions to the major pension system would need to increase from a current level of 17¹/₂ percent on wages to 25 percent over 25 years. We found, using our own macroeconomic assumptions, that this would not be enough. We projected

contribution rates of 30 percent, which would serve as an even larger disincentive for labor force participation.

We also looked at the fiscal implications of rising government transfers on the pension and health insurance systems. We found that once expenditure cuts and measures to broaden the tax base are implemented, additional adjustments will still be required on the consumption tax side. This is a politically sensitive issue, but in the end it is the main tool the authorities have to adjust the fiscal side. Right now, Japan has a relatively low tax rate of 5 percent. Under our baseline projections, the consumption tax rate would have to rise to 25 percent by the year 2050, when the age dependency rate is the highest. This estimate is not very precise, of course, since different assumptions on, say, the fertility rate or total factor productivity growth could lead to considerable variations in the end point for the consumption tax rates. Our estimates are in the range of 18 to 30 percent.

The main long-term question for Japan is really how it should finance the growing pension and health care burden. There are basically three options: maintain benefit levels roughly where they are, but raise contribution levels; keep the current level of benefits, but finance the gap through government transfers instead of contributions; or cut both benefits and contributions. These options have different growth and welfare effects. The baseline option of keeping benefits at current levels and raising contribution levels produces the worst results, because it discourages workforce participation. It is also proves to be the least equitable option, because pension costs would be entirely financed by the young, who are a shrinking proportion of the population.

Cutting both benefit levels and contributions produces the most positive effects. It offers an incentive for higher saving through private pension arrangements, has the least distortionary effects in terms of payroll taxes, and is the most equitable. The third option—higher benefit levels funded by consumption taxes paid by the elderly as well as the rest of the population—offers higher growth than the baseline scenario over the long term, but the welfare effects measured by real consumption and real private wealth tend to disappear over time. The main reason is that the model incorporates welfare losses caused by higher consumption taxes, owing to the wedge between consumer and producer prices. Our simulations conclusively indicate that cutting benefits and raising contributions is the preferred option, albeit a politically difficult one.

IMF SURVEY: What are the key issues, then, for Japan in the near term?

MÜHLEISEN: Let me emphasize that the first priority is ensuring a solid recovery. Debt reduction should be pursued in ways that least endanger the recovery. Our findings underscore the detrimental effects on growth that would initially result from severe public investment cuts.



Mühleisen: "The most important question for the near term is whether Japan's fiscal position is sustainable."

FARUQEE: Certainly, Japan's current macroeconomic climate and persistent cyclical weakness argue that its short-term priorities lie elsewhere, but the prospects for population aging are well in place and thus pose serious policy challenges. Acting early, rather than later, gives the authorities the greatest degree of flexibility in the options they can consider. Acting only after the aging hits with full force would probably also

necessitate a larger, more difficult adjustment. This paper hopes to encourage early action as soon as the strength of the recovery makes that feasible. ■

Copies of *Japan—Selected Issues* will be available shortly for \$10.00 each from IMF Publication Services (see page 350 for ordering details). The two chapters discussed in this article are also being revised and will be released as an IMF Working Paper.

Stand-By, EFF, and PRGF Arrangements as of September 30

Member	Date of arrangement	Expiration date	Amount approved	Undrawn balance
(million SDRs)				
Stand-By Arrangements				
Argentina	March 10, 2000	March 9, 2003	5,398.61	5,398.61
Bosnia and Herzegovina	May 29, 1998	March 31, 2001	94.42	30.15
Brazil ¹	December 2, 1998	December 1, 2001	10,419.84	2,550.69
Ecuador	April 19, 2000	April 18, 2001	226.73	113.38
Estonia	March 1, 2000	August 31, 2001	29.34	29.34
Korea ¹	December 4, 1997	December 3, 2000	15,500.00	1,087.50
Latvia	December 10, 1999	April 9, 2001	33.00	33.00
Lithuania	March 8, 2000	June 7, 2001	61.80	61.80
Mexico	July 7, 1999	November 30, 2000	3,103.00	1,163.50
Nigeria	August 4, 2000	August 3, 2001	788.94	788.94
Panama	June 30, 2000	March 29, 2002	64.00	64.00
Papua New Guinea	March 29, 2000	May 28, 2001	85.54	75.54
Philippines	April 1, 1998	December 31, 2000	1,020.79	237.56
Romania	August 5, 1999	February 28, 2001	400.00	260.25
Russian Federation	July 28, 1999	December 27, 2000	3,300.00	2,828.57
Turkey	December 22, 1999	December 21, 2002	2,892.00	2,226.84
Uruguay	May 31, 2000	March 31, 2002	150.00	150.00
Zimbabwe	August 2, 1999	October 1, 2000	141.36	116.62
Total			43,709.37	17,216.29
EFF Arrangements				
Bulgaria	September 25, 1998	September 24, 2001	627.62	156.92
Colombia	December 20, 1999	December 19, 2002	1,957.00	1,957.00
Indonesia	February 4, 2000	December 31, 2002	3,638.00	2,786.85
Jordan	April 15, 1999	April 14, 2002	127.88	91.34
Kazakhstan	December 13, 1999	December 12, 2002	329.10	329.10
Pakistan	October 20, 1997	October 19, 2000	454.92	341.18
Peru	June 24, 1999	May 31, 2002	383.00	383.00
Ukraine	September 4, 1998	September 3, 2001	1,919.95	1,207.80
Yemen	October 29, 1997	March 1, 2001	105.90	65.90
Total			9,543.37	7,319.09
PRGF Arrangements				
Albania	May 13, 1998	May 12, 2001	45.04	9.41
Benin	July 17, 2000	July 16, 2003	27.00	20.20
Bolivia	September 18, 1998	September 17, 2001	100.96	56.10
Burkina Faso	September 10, 1999	September 9, 2002	39.12	27.94
Cambodia	October 22, 1999	October 21, 2002	58.50	41.79
Central African Rep.	July 20, 1998	July 19, 2001	49.44	32.96
Chad	January 7, 2000	January 7, 2003	36.40	26.00
Côte d'Ivoire	March 17, 1998	March 16, 2001	285.84	161.98
Djibouti	October 18, 1999	October 17, 2002	19.08	13.63
Gambia, The	June 29, 1998	June 28, 2001	20.61	10.31
Ghana	May 3, 1999	May 2, 2002	191.90	120.85
Guinea	January 13, 1997	January 12, 2001	70.80	15.73
Guyana	July 15, 1998	July 14, 2001	53.76	35.84
Honduras	March 26, 1999	March 25, 2002	156.75	64.60
Kenya	August 4, 2000	August 3, 2003	150.00	136.40
Kyrgyz Republic	June 26, 1998	June 25, 2001	73.38	28.69
Madagascar	November 27, 1996	November 30, 2000	81.36	9.48
Mali	August 6, 1999	August 5, 2002	46.65	33.15
Mauritania	July 21, 1999	July 20, 2002	42.49	30.35
Mozambique	June 28, 1999	June 27, 2002	87.20	42.00
Nicaragua	March 18, 1998	March 17, 2001	148.96	53.82
Pakistan	October 20, 1997	October 19, 2000	682.38	417.01
Rwanda	June 24, 1998	June 23, 2001	71.40	28.56
São Tomé and Príncipe	April 28, 2000	April 28, 2003	6.66	5.71
Senegal	April 20, 1998	April 19, 2001	107.01	42.80
Tajikistan	June 24, 1998	June 23, 2001	100.30	40.02
Tanzania	March 31, 2000	March 30, 2003	135.00	95.00
Uganda	November 10, 1997	March 31, 2001	100.43	8.93
Yemen	October 29, 1997	October 28, 2000	264.75	114.75
Zambia	March 25, 1999	March 28, 2003	254.45	234.45
Total			3,507.62	1,958.46
Grand total			56,760.36	26,493.84

¹Includes amounts under Supplemental Reserve Facility.
EFF = Extended Fund Facility.
PRGF = Poverty Reduction and Growth Facility.
Figures may not add to totals owing to rounding.
Data: IMF Treasurer's Department.

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

Cecchetti argues asset price considerations should play role in shaping monetary policy

Should central banks take asset prices into account when they formulate monetary policy? The question often comes to the fore during financial market turbulence or marked changes in asset market valuations. Not surprisingly, it is again topical against the background of the extended fallout from the housing and equity bubbles of the late 1980s in Japan, the crises in southeast Asia in 1997–98, and the run-up in U.S. equity valuations. Addressing this subject at an IMF Institute seminar on September 11, Professor Stephen Cecchetti of Ohio State University argued for a more systematic incorporation of asset prices into monetary policy decisions. His presentation was based on a recent study that he coauthored, *2000, Asset Prices and Central Bank Policy* (Geneva Report on the World Economy, No. 2).

Central bankers keep a keen eye on asset price developments and sometimes act in response to these developments. But Cecchetti noted that the predominant view among central bankers and academics is that central banks should set interest rates in response to actual or forecast inflation, and possibly also in response to the output gap, but should not react systematically to asset price developments. This view holds that asset prices are too volatile to be used in policy formation, that asset price misalignments are

difficult to identify, and that reacting to such misalignments may be destabilizing.

Cecchetti took issue with these views. He argued that central banks are likely to achieve superior performance by explicitly taking account of asset prices in setting monetary policy. He also made the case for giving some asset prices, notably housing prices, a larger weight in inflation measures.

Case for including asset prices

According to Cecchetti, asset price changes influence aggregate demand through wealth effects on consumption; through the impact on firms' balance sheets, which in turn affect firms' ability to borrow; and through the second-round effects of changes in aggregate demand on asset prices. Where asset price changes reflect underlying productivity growth in the economy, demand-side effects may be broadly matched on the supply side, with little need for a reaction from monetary policy. However, when price changes originate in asset markets, the central bank may need to take action to counter the effects on inflation. This could arise, for example, with a change in the equity risk premium, which is the difference between the return that investors require on equities relative to bonds.

Available on the web (www.imf.org)

Press Releases

00/55: IMF Completes Review of SDR Valuation, October 12

00/56: Cameroon to Receive Around \$2 Billion in Debt-Service Relief, October 16

News Briefs

00/92: IMF Completes Third Review of Cameroon and Approves \$23.26 Million Credit, October 11

00/93: IMF Announces Working Group to Review Fund's Financial Sector Work, October 5

00/94: IMF Completes First Review of Papua New Guinea Program and Approves \$24 Million Credit, October 16

00/95: IMF Augments Kenya Access to Resources Under PRGF Program, October 18

Public Information Notices (PINs)

00/84: Argentina, October 3

00/85: Mali, October 5

00/86: Cambodia, October 13

00/87: Kyrgyz Republic, October 13

Press Briefings

Transcript of a radio interview on international debt relief, with Tony Boote, IMF Policy Development and Review Department; John Ruthrauff, Oxfam America; and

Whitney Debevoise, international finance attorney, Diane Rehm Show, October 10

Thomas Dawson, Director, External Relations Department, October 12

Speeches

IMF First Deputy Managing Director Stanley Fischer, "Latin America 2000," LACEA 2000 Conference, Rio de Janeiro, October 12

IMF Deputy Managing Director Eduardo Aninat, "Adjusting to a Globalized Economy," Second Annual Americas' Forum, La Jolla, California, October 13

Concluding Remarks for Article IV Consultations (date posted)

Liberia, October 6

Other

IMF Financial Activities, September 29

IMF Financial Activities, October 6

Schedule of Public Speaking Engagements of IMF Management, October 6

Data Template on International Reserves and Foreign Currency Liquidity, October 13

IMF Financial Activities, October 13

IMF Financial Resources and Liquidity Position, October 16

Cecchetti focused on misalignments in asset prices. These occur when prices diverge from what is warranted by underlying productivity and by sustainable values of the equity risk premium. When misalignments are reversed—when bubbles burst—there can be significant economic damage. He suggested that central banks could improve economic performance (measured as the variability of inflation and output around goals) by leaning against emerging asset price misalignments, even if this caused a short-term deviation from the inflation goal. Such a deviation is warranted to the extent that the benefits of avoiding the future consequences of a large asset price misalignment outweigh the short-term costs of deviating from the inflation goal.

A policy rule that explicitly includes asset prices would limit moral hazard problems by underlining that monetary policy would react symmetrically to asset price movements. At present, Cecchetti said, it is widely believed that the monetary authorities are more concerned about abrupt price declines than about sudden price increases. This impression may, however, have more to do with skewed data (abrupt changes tend to occur more frequently on the downside) than with any bias in central bank policy.

Concerns about including asset prices

Cecchetti discounted concerns that his approach would cause instability. He was not, he said, recommending pricking bubbles but leaning against the wind at an earlier stage to inhibit the emergence of bubbles. Moreover, if central bank action to rein in asset prices led to excessively sharp corrections, the same systematic rule would, at an early stage, prompt a countervailing response. The focus should be on the relevance of asset prices to the overall monetary policy strategy, he stressed.

The argument is frequently made, Cecchetti asserted, that central bankers have no expertise in asset pricing, and market expectations are unobservable. Estimating asset price misalignments is indeed difficult, but no more difficult, he said, than other calculations that central bankers make on a regular basis, such as estimating the level of potential output and its growth rate, the natural rate of unemployment, and the neutral real interest rate. Indeed, the productivity growth rate—a key input for estimates of asset price misalignments—is also essential in estimating the growth rate of potential output.

Implications for U.S. monetary policy

If the United States had adopted this strategy in the recent past, Cecchetti explained, it would have had to set higher short-term interest rates. The equity risk premium has been at the lower end of its historical range, but surveys indicated that equity holders expected

annual returns of 10–12 percent—significantly higher than implied by the equity risk premium. This suggested above-average risk to holding U.S. equities.

He illustrated the implications for U.S. monetary policy with a “Taylor Rule”—a frequently used means of relating short-term interest rates to inflation and the output gap. According to this rule, a federal funds rate of 6½ percent would have been appropriate for the last quarter of 1999. If this rule is augmented to include a link between interest rates and asset price misalignments, a rate closer to 7½ percent would have been indicated for that quarter. In actuality, the rate over that period averaged about 5¼ percent.

Cecchetti stressed the illustrative nature of this exercise. Greater modeling efforts would be needed before this approach could be implemented, and such rules are not, in any case, meant to be mechanically applied. He also noted that a central purpose of his proposed approach was to limit the emergence of asset price misalignments. Thus, the implications of adopting the approach are exaggerated at a time when asset prices may already be significantly misaligned.

Improving measures of inflation

Cecchetti then turned to the question of whether including asset prices could improve measures of inflation. The measures used by central bankers typically cover only the prices of goods and services currently produced. In 1973, Armen Alchian and Benjamin Klein argued that the central bank should maintain the stability of the purchasing power of money—a concept that would incorporate the price of future as well as current consumption. With such an approach, asset prices could be used to measure the price of future consumption. Because current consumption was small in relation to future consumption for the typical individual, current consumption would be given a small weight. Cecchetti doubted that an approach to monetary policy that effectively targeted asset prices could be generally accepted. More substantively, asset prices move around considerably in response to factors that have little to do with inflationary trends.

An alternative approach, Cecchetti suggested, could be based on the idea that all prices, including asset prices, have a common core component that represents aggregate inflation. He proposed a statistical method for extracting this core component from equity and housing prices as well as prices for consumer goods and services. Using data for a range of industrial countries, he concluded that equity prices are generally too noisy to communicate useful information about general inflation, but that housing prices merit a higher weight than they are typically given in consumer price indices. ■

Experience yields practical suggestions for emerging market countries

A new study by three economists in the Monetary Operations Division of the IMF's Monetary and Exchange Affairs Department highlights practical suggestions on inflation targeting that could be particularly useful for emerging market countries. The paper, forthcoming in the IMF Occasional Papers series, taps the years of experience industrial countries have had with inflation targeting, as well as the more recent formulation of inflation targeting frameworks by emerging market countries.

In recent years, emerging market countries have joined industrial countries in adopting formal inflation targeting monetary policy frameworks. (See related stories, *IMF Survey*, February 7, page 37, and April 3, page 103.) Brazil, Chile, the Czech Republic, Israel, Poland, and South Africa have adopted inflation targeting, while other countries, such as Mexico and Thailand, are in the process of doing so.

The experiences of the countries examined suggest that the foundation for successful, full-fledged inflation targeting consists of a strong fiscal position and entrenched macroeconomic stability; a well-developed financial system; central bank instrument independence and a mandate to achieve price stability; a reasonably well-understood transmission mechanism between monetary policy actions and their effects on inflation; a sound methodology for constructing inflation forecasts; and transparency of monetary policy to build accountability and credibility. Many of these elements, especially a strong fiscal position, are needed for sound monetary policy, regardless of the policy objective. In addition, these elements do not need to be in place before a country begins the transition toward full-fledged inflation targeting.

Framework

Under inflation targeting, the legal framework for central banks defines the objectives of monetary policy and provides the central bank with the scope to meet them. Countries usually modify their legal frameworks before adopting inflation targeting. All inflation targeting central banks have effective instrument independence—that is, they are free to choose how they will set their instruments, such as interest rates, to achieve their goal. All countries that adopt inflation targeting specify price or currency stability as a central bank objective—most, but not all, adopt it as the principal objective—reflecting the trade-off between the credibility gains from more formal legislative safeguards versus the effort required to obtain the political support needed to change the governing legislation.

All emerging market countries limit central bank financing of the government.

Typically, the government alone, or jointly with its central bank, announces the inflation targets. In countries where price stability is the primary legal objective of monetary policy, central banks tend to announce the inflation targets unilaterally. The length of the target horizon has, in practice, reflected whether inflation is at or above the long-run objective. When inflation is above its long-run objective, targets are set annually to reduce uncertainty and provide flexibility; annual targets permit policymakers to take advantage of unexpected opportunities to disinflate. Long—in some cases, indefinite—target horizons are the norm when inflation is at the desired long-run level, because extended horizons are better able to accommodate lags in the transmission of policy and short-run output stabilization objectives.

The inflation target price index covers all or a large subset of consumer goods (consumer price index (CPI)). Industrial countries generally use a measure of core CPI inflation because it is influenced less by the most volatile prices and interest rates than total CPI inflation, which emerging market countries typically use because it is widely understood and therefore more credible.

In setting the target, most countries opt for a range, or band, rather than a specific point. An inflation target band provides the central bank with flexibility in responding to shocks. Some countries, however, prefer a point target, again because it is more widely understood. Transparent monetary policy and clear accountability mechanisms are indispensable to the inflation targeting framework. Strong accountability is essential because instrument independence gives central banks significant discretion in conducting policy, but at the same time lags in the transmission of monetary policy make it difficult for the public to monitor policy on an ongoing basis. As a result, central banks have increased their accountability by regularly publishing press releases and inflation outlook reports—and, in some cases, inflation forecasting models—and by communicating with the private sector and the media.

Transition issues

Whether emerging market countries have shifted gradually or rapidly to full-fledged inflation targeting has

Photo Credits: Denio Zara and Padraic Hughes for the IMF, pages 337, 339, 341, 343, and 344; Eriko Sugita, Reuters, page 337; and United Nations, page 352.

depended largely on the degree of nominal rigidities built into the economy, such as price indexation resulting from histories of high inflation. At the beginning of the transition, the authorities announce either the intention to adopt inflation targeting or the inflation target itself. Most countries adopted inflation targeting when inflation was on the decline. In all countries, inflation had fallen below 10 percent at the time they adopted a full-fledged inflation targeting framework (see chart, this page).

The emerging market countries that began the transition with higher inflation and crawling exchange rate bands took the slow-track approach to full inflation targeting to minimize disruptions to employment and output. They gradually widened the exchange rate band and placed increasing weight on the inflation objective, owing to widespread indexation of prices and wages.

Emerging market countries often introduce full-fledged inflation targeting only after attaining a strong fiscal position, stabilizing their financial system—which is especially important for emerging market countries—and reducing their vulnerability to currency crashes. These conditions help limit the risk that the framework might be confronted by multiple objectives in its early days when credibility is fragile.

Operational issues

The operation of monetary policy under inflation targeting is similar for emerging market countries and industrial countries. All inflation targeters need to use good judgment in deciding how to act on the information they have. However, the emerging market countries that have adopted inflation targeting tend to rely less on statistical models for operating monetary policy than their industrial country counterparts. There are also important structural differences between emerging market countries that use inflation targeting and other emerging market countries: the inflation targeters rank in the top 20 percent of developing countries by total GDP and per capita GDP, and they have more developed domestic financial systems.

In emerging market countries that target inflation, policy transmission channels are rapid, weighted toward the exchange rate, and subject to considerable uncertainties. In countries with higher inflation, the channels seem to be characterized by downward price stickiness and rapid pass-through from the exchange rate to inflation until the inflation targeting framework becomes credible. Policy channels can be rendered less effective by corporate and bank balance sheet problems.

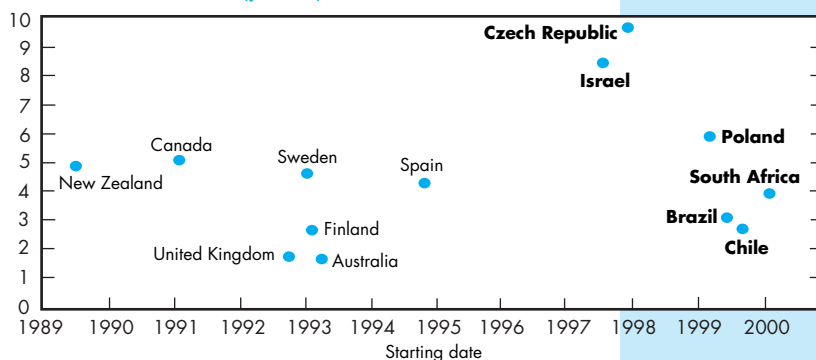
Monetary policy in all inflation targeting countries relies on market-based instruments and short-term interest rates. In emerging market countries that target inflation, the use of market-based instruments reflects their relatively well-developed financial markets. In industrial and emerging market countries alike, the setting of official

interest rates generally reflects deviations of inflation from the target, the output gap, and other variables.

How a country responds to breaches of inflation targets largely depends on whether inflation is at or above the long-run target. When the inflation target is at the long-run rate, policy responses to breaches of the floor and the ceiling of the target range tend to be symmetric in order to limit output variability. Countries that are trying to reduce inflation, in contrast, have accepted inflation that is below the target and have taken advan-

Inflation at time of full-fledged inflation targeting

annual CPI inflation rate (percent)



Note: Emerging market countries are in bold

tage of such unexpected disinflationary outcomes to announce lower targets. Transparency and preemptive policy responses seem to have limited the damage to credibility from breaches of the target ceiling.

Inflation targeting central banks strive to limit the effects of large exchange rate movements on inflation expectations and on the domestic financial system. The generally successful responses of inflation targeting central banks to the Asian crisis in 1997 and the Russian crisis in 1998 ranged from doing nothing to combining foreign exchange intervention and higher official interest rates, depending on whether the shocks were perceived to raise inflation expectations or potentially destabilize the domestic financial system. It is a difficult challenge for countries to reverse, in timely fashion, actions they took in response to financial disturbances. The experiences of several countries in the wake of the Asian and Russian crises suggest that inflation may undershoot if the policy response is not reversed promptly. ■

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The background papers for the high-level seminar “Implementing Inflation Targets,” held in Washington in March 2000, are available on the IMF website: www.imf.org/external/pubs/ft/seminar/2000/targets/index.htm.

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- 00/130: *Evidence on the Fiscal and Macroeconomic Impact of Privatization*, Steven Barnett
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- 00/107: Côte d'Ivoire: Selected Issues and Statistical Appendix
- 00/108: Comoros: Statistical Annex
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World leaders meet in New York to confront twenty-first century issues on a global scale

On September 6–8, the United Nations played host to the Millennium Summit, a truly international effort aimed at addressing a host of current and ongoing issues, including globalization, poverty eradication, and UN peacekeeping operations. The summit, whose official theme was “The United Nations in the Twenty-First Century,” was the scene of the largest-ever gathering of world leaders—100 heads of state and 47 heads of government. Some 8,000 delegates and 5,000 journalists also attended the event. In addition to the main summit, a series of side events were convened, including various forums for nongovernmental organizations (NGOs); the Millennium World Peace Summit of Religious and Spiritual Leaders; the UN Millennium Women’s Summit attended by women presidents and prime ministers; and the State of the World Forum, a global network of leaders from business, government, and civil society, convened by Mikhail Gorbachev.

The idea of a summit was first proposed by UN Secretary-General Kofi Annan in 1997 in his report *Renewing the United Nations: A Program for Reform*. In preparation for the summit, in early April, Annan presented a major statement on his vision for the world body in a report, *We the Peoples: The Role of the United Nations in the Twenty-First Century*. The report sets out a practical vision for the UN in a globalized world that has changed dramatically in the 55 years since the organization was founded. Among its key messages is the need to make globalization more inclusive, to create more opportunities for all, and not leave billions of people in a state of poverty and exclusion.

The summit consisted of three main pillars: a plenary of formal speeches; four interactive roundtables of 50 leaders; and a meeting of the Security Council at the level of heads of state. These various forums gave

Declaration renews commitment to UN ideals

Following are edited excerpts from the United Nations Millennium Declaration, issued by heads of state and government at the Millennium Summit on September 8. The full text and other related information are available on the United Nations’ millennium website (www.un.org/millennium).

Values and principles

The central challenge we face today is to ensure that globalization becomes a positive force for all the world’s people. Its benefits are unevenly shared, while its costs are unevenly distributed.

Responsibility for managing worldwide economic and social development, as well as threats to international peace and security, must be shared among the nations of the world and should be exercised multilaterally. As the most universal and most representative organization in the world, the United Nations must play the central role.

Development and poverty eradication

We are committed to making the right to development a reality for everyone and to freeing the entire human race from want.

Success in meeting these objectives is contingent on, among other things, good governance both within countries and at the international level, including with respect to transparency in the financial, monetary, and trading systems.

We are concerned about the obstacles developing countries face in mobilizing resources and will therefore make every effort to ensure the success of the High-Level Intergovernmental Event on Financing for Development to be held in 2001.

We welcome the Third United Nations Conference on the Least Developed Countries in May 2001 and call on the industrialized countries to

- adopt, preferably by the time of that conference, a policy of duty- and quota-free access for essentially all exports from the least developed countries;
- implement the enhanced program of debt relief for the heavily indebted poor countries without further delay and agree to cancel all official bilateral debts of those countries in return for their making demonstrable commitments to poverty reduction; and
- grant more generous development assistance, especially to countries that are genuinely making an effort to apply their resources to poverty reduction.

We further resolve to halve by 2015 the proportion of the world’s people who earn less than one dollar a day, who suffer from hunger, and who lack access to safe drinking water.

Meeting the special needs of Africa

We support the consolidation of democracy in Africa and will assist Africans in their struggle for lasting peace, poverty eradication, and sustainable development.

Strengthening the United Nations

The heads of state reaffirm the central position of the General Assembly as the chief deliberative, policymaking, and representative organ of the United Nations.

Members’ use of IMF credit

(million SDRs)

	During September 2000	January–September 2000	January–September 1999
General Resources Account	372.32	2,842.27	8,534.31
Stand-By Arrangements	10.37	1,819.00	6,067.57
SRF	0	0	3,636.09
EFF	361.95	1,023.27	1,786.34
CFF	0	0	680.40
PRGF	60.33	335.36	629.09
Total IMF Credit	432.65	3,177.63	9,163.40

SRF = Supplemental Reserve Facility

EFF = Extended Fund Facility

CFF = Compensatory Financing Facility

PRGF = Poverty Reduction and Growth Facility

Figures may not add to totals shown owing to rounding.

Data: IMF Treasurer’s Department



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October 23, 2000

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Heads of state and government from all around the world gathered together to participate in the United Nations Millennium Summit in New York.

heads of state a unique opportunity to engage in spontaneous, substantive dialogues on sensitive political, economic, and humanitarian issues. Many participating heads of state and government also spoke on other occasions and participated actively throughout the three-day event.

At the end of the summit, Annan directed closing thoughts to the leaders of the world: "You have sketched out a clear direction for adapting this organization to its role in the new century. But ultimately,

World leaders pledge to end conflicts, restore peace

Following are edited excerpts from UN Security Council Resolution No. 1318 (2000), issued on September 8 at the UN Millennium Summit.

The heads of state and government pledged to enhance the effectiveness of the United Nations in addressing conflict at all stages, from prevention to settlement to postconflict peacebuilding.

Leaders also pledged to give equal priority to the maintenance of international peace and security in every region of the world and, in view of the particular needs of Africa, to give special attention to the promotion of durable peace and sustainable development in Africa and to the specific characteristics of African conflicts.

Leaders stressed the importance of continued cooperation and effective coordination between the United Nations and the Organization of African Unity and African subregional organizations in addressing conflict in Africa and of enhanced support for the Organization of African Unity Mechanism for Conflict Prevention, Management, and Resolution.

World leaders strongly encouraged the development within the UN system and more widely of comprehensive and integrated strategies to address the root causes of conflicts, including their economic and social dimensions.

you are yourselves the United Nations. It lies in your power, and therefore it is your responsibility, to reach the goals that you have defined. Only you can determine whether the United Nations rises to the challenge."

The outcome of the summit is embodied in the UN Millennium Declaration and Security Council Resolution 1318 (see boxes, pages 351 and 352).

United Nations Millennium Declaration

The Millennium Declaration represents a renewed commitment to the ideals of the United Nations. Specifically, it highlights values and principles of the organization: achieving peace, security, and disarmament; making progress in development and poverty eradication, the environment, human rights, democracy, and good governance; protecting the vulnerable; meeting the special needs of Africa; and strengthening the organization.

Security Council Resolution

While Security Council resolutions are usually not of direct interest to the IMF, this resolution deserves attention. First, the context of the discussion and the renewed commitment to the maintenance of international peace and security are noteworthy, particularly with respect to Africa; second, the resolution seeks to address the root causes of conflicts, including their economic and social dimensions; and, third, the resolution commits heads of state and government to making peacekeeping more effective. ■

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