

IMF EXECUTIVE BOARD ACTIVITIES



October-December 2019



Office of the Executive Director for Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen.

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Medium-term Revenue Strategy (MTRS) – Taxation and Development



Vitor Gaspar, Director – Fiscal Affairs Department

Delivered at the conference of “Medium Term Revenue Strategy (MTRS)—Building More Effective Tax Systems”, at the Federal Academy of Finance, Sonnwendgasse 13, 1100 Vienna, Austria

October 29, 2019

It is very appropriate for me to speak about how to build tax and state capacity in Vienna. That is because I often start from Schumpeter: *The Crisis of the Tax State*. As many of you may know, his original lecture was presented here in Vienna in 1917. The article was then published in the following year and translated into English much later. Its most important contribution was the idea that taxation constitutes the form of financing that is used by the state and by the state alone. Taxation appears as the financial backbone of state capacity. It is interesting to note that about 100 years ago, Austria had Schumpeter as Minister of Finance of its first republic. He was about to leave the job after only a little over six months.[1]

Today we emphasize that tax capacity is required if the state is to fulfill its role in sustainable and inclusive growth. Taxation is necessary to enable the state. Taxation is thereby at the center of development policies.[2] Development in turn is a concomitant with overall prosperity.

I hope that these brief words and references have persuaded you of the importance of our topic. The question is then: how can countries improve their tax capacity?

For countries committed to improving their tax capacity, in an enduring way, the Platform for Collaboration on Tax (PCT—a partnership of the IMF, OECD, UN, and WBG—put forward the concept of Medium-Term Revenue Strategy (MTRS) to Tax System Reform.[3]

The MTRS – A process and not a static concept

So, what exactly IS an MRTS? The MTRS starts from the formulation of a high-level road map of tax system reform in a country—extending over 4 to 6 years. The MTRS is the sustained process of implementation of this tax system reform over time.

Why an MTRS?

“Why is an MTRS needed? How will it help countries achieve lasting and meaningful tax system reforms?” Many have asked us these questions.

The organizing principle is a vision for the future tax system that the country aims for. Clarity of purpose helps to overcome well-known problems in the political economy of tax system reform. Experience points to the fact that erratic, inconsistent efforts at change frequently result in no change at all—or in quick reversal.


Building a country-specific vision requires a government-led effort and whole-of-government buy-in and support, and a broad social and political commitment to tax system reform. Thus, an MTRS process is a country endeavor leading to a broadly supported, public, transparent, tax system reform. The process is fundamentally political and social. Here we continue to follow Schumpeter who asserts: “The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare—all of this and more is written in its fiscal history, stripped of all phrases.”[4]

I should add that the idea of the MTRS approach is well-rooted in best practice: our medium-term design and sustained implementation are the most successful approaches to tax system reform. Those experiences have led to the MTRS.

MTRS’s four interdependent components

The MTRS has four interdependent components:

The first MTRS component is about determining spending required to support economic and social development. This goal-setting exercise has to be led by the government and, at the same time, be inclusive; involving a broader stakeholder community; and ideally society as a whole. Developing a good understanding across the government, parliament, civil society organizations, and taxpaying community will help navigate the political economy difficulties of tax system reform. This will enable building broad consensus and commitment to a substantial and well-thought-out tax system reform road map—based around suitable and realizable longer-term revenue and other goals. (This links to the third component that I will cover later).



When thinking about tax capacity for inclusive growth, for example, it is crucial to consider spending needs for priority items like public infrastructure—better economic connectivity—and health and education to strengthen human capital. In this way, the MTRS links closely to the Sustainable Development Goals (SDGs), and their financing.

Additional spending required in low-income developing countries—like Rwanda and Benin—is quite considerable at about 20 percent of GDP by 2030.[5] In emerging market economies, the estimates are much lower with, for example, 5.6 percent in the case of Indonesia. For advanced economies, the question is more how to facilitate an inclusive transition to green and digital economies and societies. The example of Indonesia is particularly well documented. The central importance of tax capacity in economic development comes out crystal clear.[6]

The second MTRS component is the tax system reform road map itself—covering tax policy, revenue administration, and the legal framework. Why take this comprehensive view of the tax system? Because policy and administration linkages influence the overall tax system effectiveness. And the legal framework is the enabler to apply and enforce countries' taxation.

Tax system reform must be formulated to mobilize the needed revenues in the medium to long term. At the same time, it should be shaped so as to contribute to economic and social development. The key is to use the positive synergies among tax policy, revenue administration, the legal system and, in general, the functioning of public administration. A common difficulty comes from urgent revenue needs. Those may require prompt actions. But these have to be taken with a view to meeting ultimate reform goals.

Exactly what this tax system reform will look like must, of course, be very country-specific. It depends on existing capacity, and the shape of the current tax system. The idea is to follow a holistic tax system reform plan for ultimate success and sustainability.


In supporting countries to formulate MTRSs, key challenges have been observed in adopting a more comprehensive approach to tax system reform. The siloed approach is predominant in initiatives to improve tax systems, sometimes with piecemeal endeavors that do not exploit the potential synergies in taking a more holistic approach. Quantification of impact (especially on revenues) is another significant issue, which is somehow easier with tax policy options—if, a big if, good statistical data and tax records are available—and much more difficult with the administrative reforms and legal changes.

Here, too, Schumpeter continues to be our guide. Writing about the origins of the tax state he affirms: "Taxes not only helped to create the state. They helped to form it. The tax system was the organ the development of which entailed the other organs." Besley and Persson likewise link up tax capacity, state capacity and legal capacity.

The third MTRS component is about sustained medium-term government commitment to reform. For the formulation and steady implementation of the tax system reform, enduring political support is necessary. And government commitment must be expressed in concrete and visible measures. A whole-of-government approach is crucial to support the tax system reform formulation and implementation across its different fronts. Some of the elements of reform demand support from government entities beyond the revenue agencies and the ministry of finance. For example, policy changes to rationalize sectoral tax expenditures need line ministries to align behind them; modernization of revenue agencies' human resource policies requires civil service agencies to be supportive; enforcement of taxpayers' compliance in certain sectors demands cooperation with other enforcement agencies, just to name some examples. Secured funding support to revenue agencies modernization, notably in their path to digitalization, requires medium-term budgets that are sustained during the span of reform.

A critical enabler (and success factor) in this third MTRS component is the reform governance arrangement at the highest level in government—the leadership of the minister of finance is certainly critical. The political economy of a tax system reform effort of this magnitude requires that it be led by a high-level official resourced and empowered to mobilize the government and engage with the broader society. This will demonstrate the political commitment and priority the government is assigning to the reform. And it has to be sustained and with clear accountabilities of the entities contributing to the tax system reform. Achieving this government stance to the tax system reform will send a clear signal to taxpayers from whom voluntary compliance is expected.

Reform governance has been a major challenge in our capacity development support to countries, when undertaking targeted tax system reforms. In the scenario of an MTRS, this requirement (even pre-requisite) is much more critical given the broad coverage of several entities involved in making the MTRS a success. Revenue agencies are more familiar with the need to organize their reform efforts under well-structured reform management offices; however, finance ministries often are not. Thus, adopting the MTRS approach to tax system reform requires strengthening of reform management capabilities, which is crucial for guiding the MTRS process and its accountability.



The active engagement of economic and social stakeholders is also required. The perception that economic agents and citizens are getting value for money is crucial for quasi-voluntary compliance.

The same can be said about perception of fairness of the budget. Transparency and accountability are important dimensions of lasting understanding with civil society.

Finally, through its fourth component the MTRS approach calls for a coordinated but ‘subordinated’ external support to the government-led tax system reform. Thus, an MTRS identifies the resources needed for the process of reform itself. Those will come from the country concerned, but additional assistance will be required in many cases. So, the MTRS will help align and coordinate external support under the umbrella of the government-led reform effort. Also, it can help development partners plan ahead not only to ensure appropriate resources to help the government deliver on the strategy—but also to overcome situations in which partners provide support on a fragmented basis, not based upon effective sequencing. This, like the political economy of reform within government, frequently arises from the political economy of technical assistance. Outcomes are notoriously hard to measure, let alone show causation for—and each provider of course has to answer to its own leadership. In some countries, too, especially but not only the lowest income, external support will be helpful to assist the government in structuring the tax system reform itself, building on progress already achieved, so that all providers can line up around and behind it.

We have gained experience in this area. Effective coordination has proved to be challenging. It is important to avoid gaps and overlaps. Sequencing of support has not always been aligned. Sometimes it has not been timely. But let me repeat for emphasis: the key principle is government leadership, so each external partner provides its support under the government-led tax system reform agenda.

We at the IMF are enthusiastic—even passionate!—about the MTRS. We believe that it has the potential to help overcome the difficulties that serious, broad tax system reform always faces. So, we greatly look forward to hearing from our panels today and tomorrow, and also to listen to your thoughts during the discussions. We see these two days as an important moment in making the development and application of the MTRS approach a landmark in the support provided to build effective and fair revenue systems so critical for sustained development.

With that, I would like to thank you for your attention and invite you to actively participate in the conference and share your views on how tax systems can be improved. It is central. To repeat Schumpeter’s historical insight: “The

tax system was the organ the development of which entailed the other organs.”

How to Use Debt Wisely



Kristalina Georgieva, IMF Managing Director

20th Annual Research Conference, Washington

November 7, 2019

Introduction

Ladies and Gentlemen—good morning and welcome to the Jacques Polak Annual Research Conference.

It is the 20th anniversary of this conference, and I would like to thank many current and former colleagues for their inspiration and tireless work.

Year after year, outstanding academics and policymakers come together to discuss cutting-edge ideas that can help make a difference—not just intellectually, but in people’s lives.


Over the next two days, we will talk about the importance of debt. This theme is more critical than ever, because debt levels have never been higher. And with low interest rates available to many borrowers, they are taking on more leverage.

Global debt—both public and private—has reached an all-time high of \$188 trillion. This amounts to about 230 percent of world output. [i]

A major driver of this buildup is the private sector, which currently makes up almost two-thirds of the total debt level. But that is only part of the story.

Public debt in advanced economies is at levels not seen since the Second World War. Emerging market public debt is at levels last seen during the 1980s debt crisis. And low-income countries have seen sharp increases in their debt burdens over the past five years.

That is why policymakers are facing tough questions:



When are debt levels too high? How can we reduce debt burdens in a fair and growth-friendly way? And how can we maximize the essential benefits of debt?

I look forward to hearing fresh ideas on how to address these and many other issues.

The bright side of debt

Let us start by focusing on what I would call “the bright side” of debt. Why do we need loans and other forms of credit in the first place?

Simply put, they allow us to do something now and pay for it later, when we have more income.

This is a very old idea. Going back to 3,000 BC, loans were provided for the purchase of seeds, for example. Those seeds would be planted, and the harvest would repay the debt.

Of course, the lender would need to have confidence in the borrower’s ability to repay the loan. The word “credit” itself comes from the Latin word for “trust” —which is the lifeblood of economic and financial systems.

Today, bank loans and credit markets continue to play their essential role in planting the seeds of future prosperity: helping families buy a home, helping businesses invest in new ideas, and helping countries raise extra capital to support growth and employment.

In fact, countries with room in their budgets should use this moment of low, or negative, interest rates to scale up productive public investments.

In places such as Germany, the Netherlands, and South Korea, an increase in spending—especially on infrastructure and R&D—can help boost demand and growth potential.

Where there is fiscal space, borrowing can also help countries scale up spending to meet the Sustainable Development Goals. This, in turn, requires building trust through sound macroeconomic policies and a welcoming business environment.

The goal is to produce an economic harvest that is good for the borrower and good for the lender.

The darker side of debt

And yet, history tells us about the darker side of debt. Think of the devastating effects of unsustainable credit booms, including in the run-up to the global financial crisis.

How can we avoid this reckless risk-taking? Can we tame the private credit cycle? And what is the role of monetary policy and macroprudential tools? Jeremy Stein, who will deliver the Mundell Fleming Lecture, will have more to say on that later this evening.

Addressing these issues is more important than ever, because the current level of record-high debt poses risks to economic and financial stability.

Remember: the buildup of public debt has a lot to do with the policy response to the 2008 financial crisis—when private debt moved to public balance sheets, especially in advanced economies.

Recent IMF staff research [ii] shows that direct public support to financial institutions alone amounted to \$1.6 trillion during the 2008 crisis.

In developing countries, the buildup reflects a broader range of factors—from sharp declines in commodity prices, to natural disasters and civil conflict, to high investment spending on projects that were not productive.

The bottom line is that high debt burdens have left many governments, companies, and households vulnerable to a sudden tightening of financial conditions.

Yes, global financial conditions have remained easy, in part because interest rates are low for longer than expected in advanced economies. But the world is also facing increased uncertainty—driven by trade tensions, Brexit, and geopolitical risks.


If investor sentiment were to shift, the more vulnerable borrowers could face financial tightening and higher interest costs—and it would become more difficult to repay or roll over debt. This, in turn, could amplify market corrections and intensify capital outflows from emerging markets.

Of course, high debt is not just a risk to financial stability; it can also become a drag on growth and development efforts.

In low-income countries, high debt burdens could jeopardize development goals as governments spend more on debt service and less on infrastructure, health, and education. We estimate that 43 percent of low-income countries are either at high risk of falling into debt distress or are already in distress.

Planting the right policy seeds

So how can countries move closer to the bright side of debt? How can they plant the right policy seeds?



Let me highlight three priorities that can help make a difference in developing countries.

First—we need to ensure that borrowing is more sustainable. This means proceeding carefully in taking on new debt—focusing more on attracting equity-based investment, such as foreign direct investment; boosting tax revenues; and stepping up the fight against red tape and corruption.

It means focusing on investment projects with credibly high rates of return. And it means increasing the responsibility of lenders—who need to assess the impact of new loans on the borrower’s debt position before providing new loans.

Debt sustainability is also a key objective of IMF-supported programs. Recent analysis by the Institute of International Finance [iii] shows that the median Fund-supported program achieved substantial debt reduction within five years.

Second—we need to ensure that borrowing and lending practices are more transparent. In many countries, there is room to significantly strengthen the institutions that record, monitor, and report debt.

Here the IMF is working closely with the World Bank to help our member countries strengthen their debt management capacity and governance frameworks.

We are also using our debt sustainability analysis to shine a light on potential risks, helping borrowers to build—or rebuild—trust.

Third—we need to encourage better collaboration between borrower countries and lenders. This means working together to improve the disclosure of debt contracts, which can help reduce risks and increase accountability.

We also need better collaboration to prepare for debt restructuring cases that involve non-traditional lenders, including creditor countries outside the Paris Club. This means establishing new ways in which official creditor coordination can take place.

These issues—from debt sustainability, to transparency, to collaboration—will be critical for the wellbeing of developing countries. That is why we need increased efforts, more dialogue, and fresh ideas.

The same is true for advanced economies, where governments are wondering about the right policy seeds.

The fact is that some countries with high deficits have seen low interest rates and low inflation for an extended period. And some are even wondering whether “low for long” could turn into “low forever.”

It is not surprising, therefore, to see growing debates about the very nature of fiscal policy in the advanced world.

Is it possible that debt levels that were deemed too high in the past are now acceptable? Is population aging a game changer for fiscal policy? Is it time to reassess traditional fiscal rules and assumptions?

Conclusion

I certainly look forward to hearing more on these issues from our world-class participants, including two former IMF chief economists—Olivier Blanchard and Ken Rogoff.

They are not only leaders in their field, but they embody the spirit of intellectual openness and relentless curiosity. That spirit is also at the heart of our Annual Research Conference.

Over the next two days, we can draw inspiration from the musical *Hamilton*, in which Alexander Hamilton ponders a key question. “What is a legacy,” he asks. “It’s planting seeds in a garden you never get to see.”

I am convinced that the legacy of this generation of economists will be closely linked to our policy advice on debt.

Our joint responsibility is to help countries plant the right seeds now—so that future generations can share a more plentiful harvest.

Thank you very much.

Counting Everything That Counts

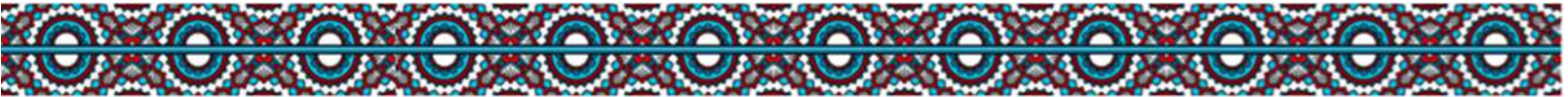


David Lipton, IMF First Deputy Managing Director

Opening Remarks - IMF Seventh Statistical Forum: “Measuring the Informal Economy”, Washington, DC

November 9, 2019

Good morning and welcome to the 7th annual IMF Statistical Forum.



The theme for this year's conference is how to measure the informal economy.

This theme reminds me of a quote, often attributed to Albert Einstein: "Everything that can be counted does not necessarily count; everything that counts cannot necessarily be counted."

So, with this year's conference, one could say we are trying to prove Einstein wrong and find ways to count all the things that count, but are not currently counted!

Why measure informal activity

The last two Statistical Forums were about diagnosing and providing recommendations on the impact of digitalization on the accuracy of macroeconomic and welfare indicators. This year's conference returns to the basics. Needless to say, it is not an easy task. For one, some activities are informal precisely to stay in the shadows, away from tax obligations or laws. But capturing informal activities is not just for tax collection or law enforcement purposes. The informal economy is so much more, and is only growing with the rise of the shared economy. In some low-income countries, for example, the informal sector is estimated to be the same size as the formal one, and perhaps even larger.

If only we knew for sure.

As management guru Peter Drucker said, "if you can't measure it, you can't improve it." It would be an improvement, for example, to assess a country's debt sustainability, or apply a fiscal rule, if we could measure all economic activity.

And to the extent we know, we can understand economic trends better. For example, when I was working on Poland in the early '90s, we documented how informal markets were emerging as substitutes for state sector production. That explained how the seeming decline in food processing was simply a shift to informal production that was not picked up in the official data.

The path forward

Measuring informality is not exactly a new problem. The IMF first established a conceptual framework to measure the informal economy in 1982, with a book called *The Underground Economy in the United States and Abroad*.

Since then we have made big strides, but more is needed.

In some cases, the answer lies in increasing a country's capacity to measure GDP. Our Statistics Department has enormous demand for Technical Assistance to improve GDP measurement. By covering economic activity that

was previously not- or ill-measured, one country in Africa saw its GDP increase by 89 percent!

Another route is to create incentives for formalization. This requires reforms in various areas, for example taxation, labor law, product markets, and improving the business climate. Countries like Egypt, India, and Mexico have achieved important results with that approach.

Our staff is always exploring new methodologies. We formed a task force on the informal economy in 2017 to identify data collection techniques and compilation methods to reflect the informal economy in external sector statistics. We are working with other international agencies on illicit financial flows. One of the cases you will hear about tomorrow argues that tracking illegal activity in the US national accounts would have raised 2017's GDP by 1 percent.

Other international organizations are working in the same direction within their expertise. The World Bank, the International Labor Organization, and the UN have been doing excellent work on measuring informality through the labor market, and we collaborate closely with them.

The power of Big Data

A new and exciting area is about using innovation and technology to help with this major challenge. How can big data and AI help measure the informal sector? What innovative sources of data can be leveraged to provide new insights on economic activity? And ultimately, how can developing economies leap-frog using these new techniques?

Let me give you some examples from the upcoming presentations:

Experts from the Chinese National Bureau of Statistics will talk about how transactions on digital platforms can be used to observe informal activities. Since observing is not the same as measuring, one challenge they have is disentangling what is informal from what is already formal.

Researchers from the Central Bank of Mexico will explain how they use satellite nightlights imagery to estimate that the "non-registered" economy in the country could represent up to 29 percent of GDP. This is a technique that Fund researchers have also used to gauge economic activity in Iran and Venezuela, among others.

You will also hear about how the Fund is using big data to estimate economic activity in countries where official GDP and trade data are either imprecise or too delayed, as in the case of Zimbabwe.

Conclusion

To sum up, this year's conference is essentially a return to core statistical business: measuring economic activity accurately, using all possible means. I hope your discussions will result in practical advice on measuring informality, which is so important and yet so difficult.

I would like to thank you all for coming to our Forum—which, despite all of what I just said, we hope to keep very

For Venezuela's Neighbors, Mass Migration Brings Economic Costs and Benefits

By Emilio Fernandez Corugedo and Jaime Guajardo

November, 2019

The world's newest migration crisis is unfolding in Latin America, where Venezuela's economic collapse and unprecedented humanitarian crisis has sparked a wave of emigration to neighboring countries. While these countries are providing helpful support to migrants in many areas, large migration flows have strained public services and labor markets in these countries.

According to the Response for Venezuelans, which is a joint International Organization for Migration and UNHCR platform, the total number of migrants leaving Venezuela reached about 4.6 million in November 2019—with about 3.8 million settled in Latin America and the Caribbean.

Venezuela's migration can potentially raise GDP growth in receiving countries.

Without a clear end in sight to the crisis and amid rising social tensions across the region, how can Latin American governments best craft a coordinated response that serves the needs of refugees while protecting their citizens and economies? Striking this balance will be critical, but also potentially beneficial.

Our latest research finds that Venezuela's migration can potentially raise GDP growth in receiving countries by 0.1 to 0.3 percentage points during 2017–2030. Policies, including greater support for education and integration into the workforce, could help migrants find better-paying jobs and, ultimately, help raise growth prospects for countries receiving migrants.

Crisis and Exodus

Since the beginning of the crisis, living conditions have severely deteriorated for Venezuela's 31 million inhabitants. Extreme poverty rose from 10 percent of the population in 2014 to 85 percent in 2018. And severe shortages of food and medicines continue to plague the population.

informal. Let me also thank Louis Marc and his team in the Statistics Department for putting together yet again a great conference.

Thank you.

Making matters worse is the sharp drop in economic activity, which has contracted by around 65 percent between 2013 and 2019. This was driven by plummeting oil production, worsening conditions in other sectors, and pervasive electricity blackouts.

Meanwhile, hyperinflation continues unabated with monthly price increases of about 100 percent, rivaling other historic hyperinflation episodes.

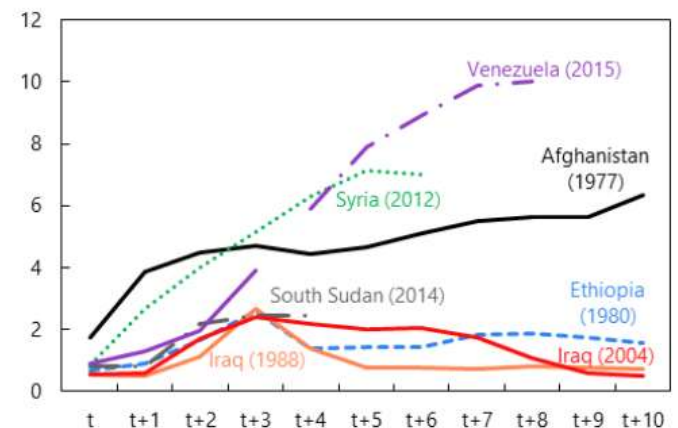
Facing these harsh living and economic conditions, migrants are fleeing Venezuela and settling in neighboring countries.

Colombia has received the largest share, followed by Peru, Ecuador, Chile, and Brazil. Migration flows to some countries in the Caribbean and Central America have been even larger relative to their local populations, though smaller in absolute numbers.

Seeking refuge

Venezuela's humanitarian crisis is driving mass migrations estimated to reach 10 million by 2023.

(millions of people)



Sources: United Nations High Commissioner for Refugees; and IMF staff calculations.

Note: Only countries with at least 2 million refugees are shown. t defined as the first year when refugees exceed 500k.

Based on current trends, our research projects that the total number of migrants could reach 10 million in 2023—although with a wide range of uncertainty around this figure. If realized, Venezuela’s mass migration would overtake past refugee crises—for instance, Syria in the 2010s or Afghanistan in the 1980s.

Regional spillovers

What does an exodus of this scale imply for the region? Spillovers from large migration flows from Venezuela are expected to place immediate pressures on fiscal spending and labor markets in recipient economies, but over time they would also contribute to higher economic growth.

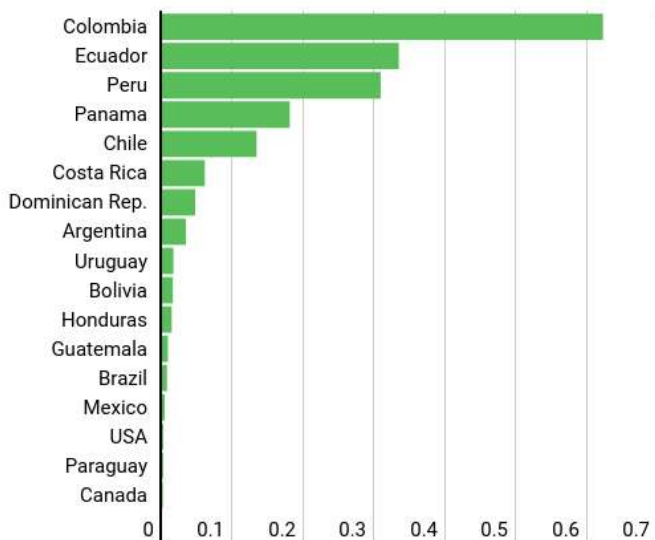
On budgetary pressures, receiving nations are providing helpful support to migrants in the form of humanitarian aid, basic healthcare, education, validation of educational titles, and job search.

Using detailed data for Colombia on each of these categories as a benchmark, estimates suggest that public spending related to growing migrant populations could reach around 0.6 percent of GDP in Colombia by 2023, 0.3 percent in Ecuador and Peru, and 0.1 percent in Chile.

Under pressure

The recent influx of migrants from Venezuela is adding to budgetary pressures in recipient countries.

(percent of GDP; 2023)



Source: IMF staff calculations.

The overall impact on the fiscal deficit would be smaller than what the higher spending would imply, because tax revenue would also increase as the economy expands.

Over time, real GDP growth is expected to increase as the size and skills of the labor force expand, as many

Venezuelan migrants bring relatively high levels of education and skills. Factors such as language and culture may also help migrants from Venezuela integrate more easily into regional economies in Latin America compared to other recent migration episodes. The expansion of the labor force would also lead to higher investment.

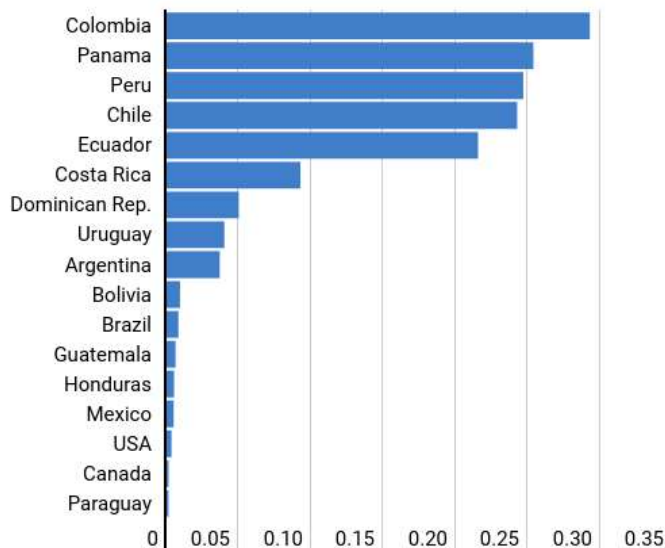
In the near term, however, the influx of migrants—depending on the speed and scale of the inflows—can place pressure on labor markets to absorb them, displace some local workers, and increase informality.

Taking into account the age, size, and skill levels of migrants, as well as the fact that most have taken low-skilled jobs in the informal sector, Venezuela’s migration is estimated to raise GDP growth in recipient countries by 0.1 to 0.3 percentage points during 2017–2030.

Growth potential

Venezuela’s migration is estimated to raise GDP growth in recipient countries by 0.1 to 0.3 percentage points between 2017-2030.

(percent of GDP; average 2017-30)




Source: IMF staff calculations.

The growth impact could be larger and more immediate if migrants can find jobs in line with their educational level—a transition that can be made easier by policies.

Policy Challenges

A key challenge for policymakers in the region is how to manage the transition at a time when their economies have slowed, and many countries need to reduce their fiscal deficits.

In the near term, facilitating the integration of migrants into the domestic labor market and easing the process to validate their professional titles or to set up businesses



would maximize the impact on growth and minimize the need for public support.

Multilaterally, international cooperation to assist the main receptors of Venezuelan migrants with the costs of migrant assistance should be considered. Individual country actions toward migrants, such as border restrictions, can complicate the situation for other partners—pointing to the need for a more regional approach.

Statement by IMF Managing Director Kristalina Georgieva on Meeting with the Prime Minister of Sudan

December 6, 2019

Ms. Kristalina Georgieva, Managing Director of the International Monetary Fund (IMF), issued the following statement today, following her meeting with Mr. Abdalla Hamdok the Prime Minister of Sudan:

“I was pleased to meet Prime Minister Hamdok of Sudan today in Washington. We discussed recent economic developments in Sudan and the region.

“Sudan faces significant challenges, compounded by past sanctions and the legacy of conflict. We discussed the authorities’ economic reforms to restore macroeconomic stability and promote inclusive growth. We also highlighted the need for a significant increase in social transfers to the most vulnerable groups.

Opening Remarks at the 2019 Seminar on Climate Resilience for Small Islands States



Tao Zhang, Deputy Managing Director

2019 Seminar on Climate Resilience for Small Islands States July 16, 2019

December 4, 2019

Good morning ladies and gentlemen. It is my pleasure to welcome you to this important seminar on strengthening climate resilience and the role of public finance. Some of you have come from very far away, and we are pleased to have you here.

Looking further ahead, providing migrants with access to education and healthcare will be key to ensuring they live long and productively to benefit not only themselves but also the economies in which they reside.

“IMF staff is engaged with the authorities on how the Fund can further assist with their reform efforts and to help ensure that Sudan receives adequate external assistance. Donor support is crucial to help the country’s gradual recovery.”

Publication of essential macroeconomic data through the NSDP will provide national policy makers and domestic and international stakeholders, including investors and rating agencies, with easy access to information critical for monitoring economic conditions and policies. Making this information easily accessible in both human and machine-readable formats will allow users to have simultaneous access to timely data and bring greater data transparency.

Louis Marc Ducharme, Chief Statistician and Data Officer, and Director of the IMF’s Statistics Department, welcomed this major milestone in the country’s statistical development: “I congratulate the authorities for the launch of the NSDP, an important step forward in data dissemination. I am confident that Qatar will benefit from using the e-GDDS as a framework for further development of its statistical system.”

Changes in climate pose serious threats, particularly to low-lying island states that are at risk of rising sea levels and extreme weather events. We already see some signs. The last two decades have witnessed 18 of the 19 warmest years in history. Climate-related disasters, including hurricanes, cyclones and droughts, have been increasing in intensity and frequency. These disasters have caused massive humanitarian emergencies and economic damage and are expected to be more severe in the future as global warming continues.

The international community has recognized the threat posed by changes in our climate. Efforts to reduce greenhouse gas emissions through various mitigation measures have been taken, e.g., phasing out fossil fuels in favor of renewable energy or increasing energy efficiency. But the efforts are moving at a very slow pace. It is crucial that countries meet their commitments under the Paris Agreement. But even more efforts will be needed. The longer countries delay taking measures, the greater the cost of stabilizing global temperatures.

More importantly, mitigation policies will not be enough. Actions by countries to adapt and build up resilience are



needed to safeguard people's lives and economies in the face of intensified climate-related disasters.

This is especially true for your countries— island states in the Caribbean, Pacific, and Indian Ocean—which are particularly vulnerable to natural disasters and sea-level rise. Indeed, in the past, some disasters, such as Hurricane Irma in Dominica in 2017, have caused the equivalent of more than 200 percent of countries' annual GDP in damage.

Today, I will focus on two aspect of resilience building, improvements to physical infrastructure and the financial architecture. Strong fiscal policies and effective fiscal institutions can set the foundation such resilience building.

Resilient physical infrastructure is one way to reduce the human and economic losses when countries are hit by disasters and to protect against rising sea levels. Studies have shown that gains from investment in resilient infrastructures, if managed properly, can easily outweigh their short-term costs.

However, in practice, investments in resilient physical infrastructures are lagging.

While the benefits from such investments will accrue over the long term, their upfront costs could be daunting for small island countries. For example, in Fiji, the World Bank has estimated that adapting to climate change and natural disasters requires physical investments of around 100 percent of GDP over the next 10 years. The average annual costs almost equal the current budgeted capital spending. Mobilizing tax revenue and raising financing from the private sector and donors can help meet these costs.

Strengthening resilience also requires improvement to the financial architecture to manage the financial costs of natural disasters. Since the impact of disasters cannot be fully eliminated, countries need to plan for addressing the fiscal and financial costs. A critical part of the plan is to develop a multipronged strategy for managing disaster costs.

This includes things such as:

Building up fiscal buffers;

Insuring critical public and private assets through disaster insurance funds; and

Arranging contingent financing.

But, strengthening climate resilience requires not only good fiscal policies. It needs robust fiscal institutions to effectively implement these policies and ensure that spending on resilient infrastructure is done wisely and efficiently.

Strong public investment management systems play a particular role. Strong institutions in this area can help improve the efficiency and effectiveness of public investment and get the most out of limited resources. They also give donors the assurance that their funds will be well used. This requires strengthening project selection and implementation to ensure effectiveness of resilience investments.

Many small island countries have been reforming their public financial management institutions and have made considerable progress. However, there is room to do more. For example, the climate change policy assessments, which are conducted jointly by the IMF, the World Bank, and their counterparts in small islands economies have found it challenging to link climate change policies to budget allocations—and difficult to track the spending on climate resilience.

Role of International Community and the IMF

Climate change is a global problem, but it is one that affects you—the small island states—disproportionately in potentially severe ways. The international community needs to play a strong role in helping your countries.


As I previously mentioned, the needs of resilient investments are huge and far beyond the small states' own fiscal resources. As estimated by the UN Environment Programme, the costs of climate change adaptation in developing economies are currently estimated to range from \$56 to 73 billion, 2 to 3 times higher than currently available financing. These estimates rise to potentially as much as \$140 to 300 billion by 2030.

We at the IMF are fully engaged in tackling climate change. I will be traveling to Madrid next week to attend the UN Climate Conference (COP25). Together with other development partners, we are continuing to help countries strengthen their resilience. We can support your efforts in multiple areas of resilience building, including policy advice, capacity development, and financial support. Some of our current efforts include:

Advising on macroeconomic policies integrating near-term natural disasters and longer-term climate risks.

Helping countries build capacity and strengthen public financial management and infrastructure governance. Our regional technical assistance centers, such as those for the Caribbean and Pacific, have played a pivotal role in this effort.

Together with the World Bank and other development partners, conducting more climate change policy assessments, or similar assessments, to assess country preparedness and identify needed reforms.



Supporting countries to develop a Disaster Resilience Strategy that covers structure resilience, financial resilience, and social resilience, of emphasizing other pre-and-post disaster efforts.

Assisting countries facing balance of payments needs when implementing their resilience-focused medium-term program, or when hit by natural disasters.

Conclusions

This three-day seminar provides a valuable platform for peer-to-peer learning among senior officials of finance ministries of small states. We are pleased to bring together under one roof Caribbean, Pacific, and Indian Ocean island states. You all face similar challenges, and sharing your experience will be very useful to your peer countries and to all of us.

The staff from various IMF departments, and representatives from other international financial institutions and donors will also provide their insights, experiences, and perspectives on resilience building.

I would like to express our appreciation to all participants for being here today. And of course, I would like to thank the Government of Japan for kindly funding this event under our infrastructure governance partnership.

I wish you all a very productive and successful seminar.

Thank you!

The Power of Text: How News Sentiment Influences Financial Markets

December 16, 2019

How do investors react to news? This question has been at the core of the financial research agenda for several decades. Now, two forces make this question even more pressing.

First, innovations in information technologies have dramatically increased the reach of financial and economic news and the speed at which it travels. Real time newswires, such as Reuters and Bloomberg, generate and disseminate information almost instantaneously to an ever-increasing set of market participants.

Second, a growing number of countries, especially emerging markets, have opened their financial markets to the rest of the world. This makes it possible for foreign news to affect local market conditions much more directly.

For a long time, however, studying the impact of news on investors' behavior and asset prices remained a daunting task. What is news exactly? What does it talk about? And

how can we identify, in a systematic way, good (or bad) news?

Fortunately, the last decade brought major advances in natural language processing—mining and analyzing large amounts of textual information to extract key features, such as topic or tone. Since then, successful examples of text mining in economics and finance—using both traditional news sources and social media content—have flourished.

Building on the most recent technologies, our IMF research project assessed the role of news on international asset prices using more than 4 million articles covering economic, financial, corporate, and political news published by Reuters worldwide between 1991 and 2015. The project assessed whether the tone of each article was bullish or bearish, using text-mining techniques to identify positive terms such as “gains,” “recovery,” or “confidence,” and negative ones such as “crisis,” “losses,” or “decline.” With this data, we constructed a daily news-based sentiment index for both advanced and emerging markets. We then asked whether optimism (or pessimism) in the news today could help predict future changes in asset prices.

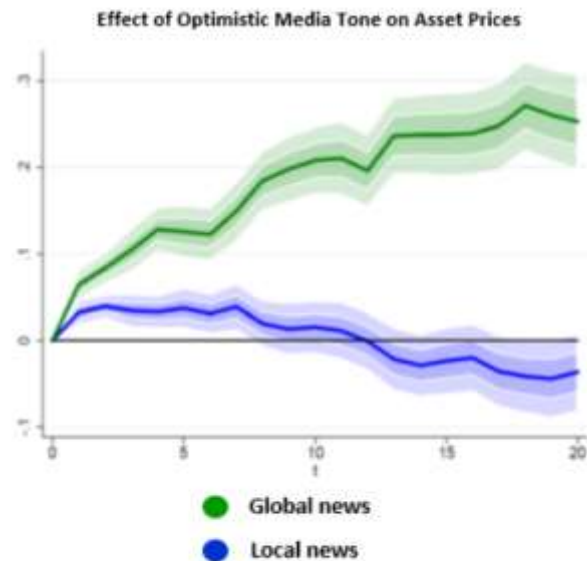
We found that sudden changes in news sentiment had a significant impact on asset prices worldwide, confirming that media tone, in general, is a very good proxy for investor sentiment itself. It also highlights the role of foreign news (and foreign investors) rather than local news (and local investors) in driving local asset prices. (By foreign news, we mean news involving multiple countries and their interrelationships, as opposed to local news involving a single country.)

Although sudden optimism in global news sentiment generates a strong and permanent impact on asset prices around the world, the effect of optimism in local news was more muted and only temporary. From a technical perspective, the study offers another example of the power of text as an input to cutting-edge economic and financial research.

When global news is bullish

Optimistic global news tends to have a stronger and longer-lasting impact in world markets than positive news that affects just one country.

(changes in world equity prices in response to optimism in global news, in green, versus local news, in blue)

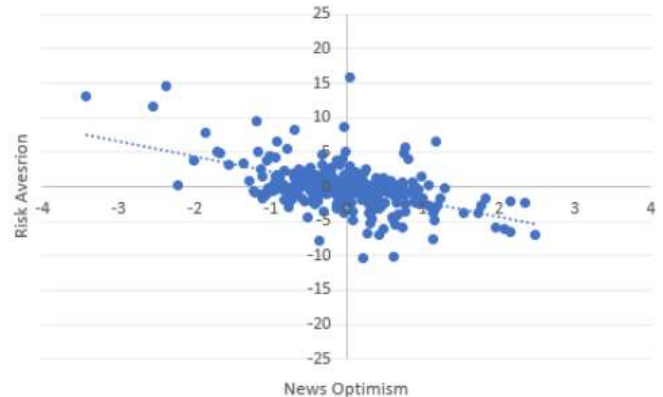


Source: IMF staff calculations.

Mirroring the Fear Index

When global news sentiment becomes less optimistic, expectations of market volatility increase, along with an aversion to risk taking.

(changes in CBOE volatility index vs. changes in news optimism—vertical axis)



Source: IMF staff calculations.

Importantly, the study also illustrates how new technologies—such as big data and text mining—can help institutions in their daily work. For instance, the mood captured in the news published around the world every day—the so-called “global news sentiment index”—mirrors other popular measures of global risk aversion, such as the CBOE Volatility Index, or VIX, which represents market expectations of volatility over the coming 30 days and is often called the “fear index.” However, the news-based index is ultimately a better predictor of future movements in international asset prices than the VIX.

We are still in the process of understanding why news sentiment matters so much, and why it seems to capture much more information about investors’ mood than other market-based indicators that are widely used. But the project already shows that monitoring news tone in real time is a very effective way to capture sudden changes in investor sentiment that would not be captured otherwise; which is key for financial surveillance.

Policy Papers

Safeguards Assessment—2019 Update

Safeguards assessments are a key pillar of the risk management arrangements for IMF lending. Safeguards assessments aim to mitigate the risks of misuse of Fund resources and misreporting of program monetary data under Fund arrangements. Safeguards assessment reports are confidential and therefore the IMF Executive Board is provided with a periodic report on safeguards activities on a biennial basis, in addition to high-level summaries in member country staff reports on key findings and recommendations. This update on safeguards activity covers the period May 2017 to end-April 2019 (the period).

Working Papers

Banks' Holdings of Government Securities and Credit to the Private Sector in Emerging Market and Developing Economies

This paper studies the relationship between banks' holdings of domestic sovereign securities and credit growth to the private sector in emerging market and developing economies. Higher banks' holdings of government debt are associated with a lower credit growth to the private sector and with a higher return on assets of the banking sector. Analysis suggests that the negative relationship between banks' claims on the government and private sector credit growth mainly reflects a portfolio rebalancing of banks towards safer, more liquid public assets in stress times and provides only limited evidence of a crowding-out effect due to financial repression.

The Macroeconomic Effects of Labor and Product Market Reforms in Morocco

This paper studies the macroeconomic effects and sequencing of (LMRs) and product (PMRs) market reforms in Morocco. It finds that introducing LMRs and PMRs simultaneously would add about 2.5 percentage points (pp) of GDP growth and reduce unemployment by about 2.2 pp after five years. If sequencing is required, starting with PMRs would be more effective in boosting output, while starting with LMRs would reduce unemployment faster. Finally, increasing unemployment benefits would be more effective if this reform takes place after the implementation of LMRs and PMRs.

Assessing Oil and Non-Oil GDP Growth from Space: An Application to Yemen 2012-17

This paper uses an untapped source of satellite-recorded nightlights and gas flaring data to characterize the contraction of economic activity in Yemen throughout the ongoing conflict that erupted in 2015. Using estimated nightlights elasticities on a sample of 72 countries for real GDP and 28 countries for oil GDP over 6 years, I derive oil and non-oil GDP growth for Yemen. I show that real GDP contracted by a cumulative 24 percent over 2015-17 against 50 percent according to official figures. I also find that the impact of the conflict has been geographically uneven with economic activity contracting more in some governorates than in others.

Macroeconomic Outcomes in Disaster-Prone Countries

Using a dynamic stochastic general equilibrium model, we study the channels through which natural disaster shocks affect macroeconomic outcomes and welfare in disaster-prone countries. We solve the model using Taylor projection, a solution method that is shown to deal effectively with high-impact weather shocks calibrated in accordance to empirical evidence. We find large and persistent effects of weather shocks that significantly impact the income convergence path of disaster-prone countries. Relative to non-disaster-prone countries, on average, these shocks cause a welfare loss equivalent to a permanent fall in consumption of 1.6 percent. Welfare gains to countries that self-finance investments in resilient public infrastructure are found to be negligible, and international aid has to be sizable to achieve significant welfare gains. In addition, it is more cost-effective for donors to contribute to the financing of resilience before the realization of disasters, rather than disbursing aid after their realization.

Firm-Level Data and Monetary Policy: The Case of a Middle Income Country

We test the existence of the balance sheet channel of monetary policy in a middle-income country. Firm-level data scarcity and quality, in such a context, make the identification of this channel a steep challenge. To circumvent this challenge, we use panel instrumental variables estimation with measurement error to analyze the financial statements of 58 500 Moroccan firms over the period 2010-2016. Our analysis confirms the existence of this channel. It shows that monetary policy has a significant impact on small and medium enterprises' access to banks' financing, and that firm-specific variables are key determinants of firms' financing decisions.



On the Substitution of Private and Public Capital in Production

Most macroeconomic models assume that aggregate output is generated by a specification for the production function with total physical capital as a key input. Implicitly this assumes that private and public capital stocks are perfect substitutes. In this paper we test this assumption by estimating a nested-CES production function whereas the two types of capital are considered separately along with labor as inputs. The estimation is based on our newly developed dataset on public and private capital stocks for 151 countries over a period of 1960-2014 consistent with Penn World Table version 9. We find evidence against perfect substitutability between public and private capital, especially for emerging and LIDCs, with the point estimate of the elasticity of substitution estimated closely around 3.

Long-Term Macroeconomic Effects of Climate Change: A Cross-Country Analysis

We study the long-term impact of climate change on economic activity across countries, using a stochastic growth model where labor productivity is affected by country-specific climate variables—defined as deviations of temperature and precipitation from their historical norms. Using a panel data set of 174 countries over the years 1960 to 2014, we find that per-capita real output growth is adversely affected by persistent changes in the temperature above or below its historical norm, but we do not obtain any statistically significant effects for changes in precipitation. Our counterfactual analysis suggests that a persistent increase in average global temperature by 0.04°C per year, in the absence of mitigation policies, reduces world real GDP per capita by more than 7 percent by 2100. On the other hand, abiding by the Paris Agreement, thereby limiting the temperature increase to 0.01°C per annum, reduces the loss substantially to about 1 percent. These effects vary significantly across countries depending on the pace of temperature increases and variability of climate conditions. We also provide supplementary evidence using data on a sample of 48 U.S. states between 1963 and 2016, and show that climate change has a long-lasting adverse impact on real output in various states and economic sectors, and on labor productivity and employment.

Macroeconomic Effects of Reforms on Three Diverse Oil Exporters: Russia, Saudi Arabia, and the UK

We build and estimate open economy two-bloc DSGE models to study the transmission and impact of shocks in Russia, Saudi Arabia and the United Kingdom. After accounting for country-specific fiscal and monetary sectors,

we estimate their key policy and structural parameters. Our findings suggest that not only has output responded differently to shocks due to differing levels of diversification and structural and policy settings, but also the responses to fiscal consolidation differ: Russia would benefit from a smaller state foot-print, while in Saudi Arabia, unless this is accompanied by structural reforms that remove rigidities, output would fall. We also find that lower oil prices need not be bad news given more oil-intensive production structures. However, lower oil prices have hurt these oil producers as their public finances depend heavily on oil, among other factors. Productivity gains accompanied by ambitious structural reforms, along with fiscal and monetary reforms could support these economies to achieve better outcomes when oil prices fall, including via diversifying exports.

In Search of Lost Time: Examining the Duration of Sudden Stops in Capital Flows

This paper investigates what factors affect the duration of sudden stops in capital flows using quarterly data for a large panel of countries. We find that countries with floating exchange rate regimes tend to experience shorter sudden stop episodes and that fixed exchange rate regimes are associated with longer periods of low output growth following sudden stops. These effects are quantitatively large: having a flexible exchange rate regime increases the probability of exiting the sudden stop state by between 50 to 80 percent. Flexible exchange rate regimes significantly shorten the duration of output decelerations following sudden stops by over 30 percent. Positive variations in terms of trade also abbreviate the duration of sudden stops. In terms of policies, identification is trickier, but the evidence suggests that monetary policy tightening shortens the duration of sudden stops. Changes in capital account restrictions do not seem to matter.

Pricing Sovereign Debt in Resource-Rich Economies

How do oil price movements affect sovereign spreads in an oil-dependent economy? I develop a stochastic general equilibrium model of an economy exposed to co-moving oil price and output processes, with endogenous sovereign default risk. The model explains a large proportion of business cycle fluctuations in interest-rate spreads in oil-exporting emerging market economies, particularly the countercyclicality of interest rate spreads and oil prices. Higher risk-aversion, more impatient governments, larger oil shares and a stronger correlation between domestic output and oil price shocks all lead to stronger co-movements between risk premiums and the oil price.



Designing Central Bank Digital Currencies

We study the optimal design of a central bank digital currency (CBDC) in an environment where agents sort into cash, CBDC and bank deposits according to their preferences over anonymity and security; and where network effects make the convenience of payment instruments dependent on the number of their users. CBDC can be designed with attributes similar to cash or deposits, and can be interest-bearing: a CBDC that closely competes with deposits depresses bank credit and output, while a cash-like CBDC may lead to the disappearance of cash. Then, the optimal CBDC design trades off bank intermediation against the social value of maintaining diverse payment instruments. When network effects matter, an interest-bearing CBDC alleviates the central bank's tradeoff.

The Dynamics of Non-Performing Loans during Banking Crises: A New Database

This paper presents a new dataset on the dynamics of non-performing loans (NPLs) during 88 banking crises since 1990. The data show similarities across crises during NPL build-ups but less so during NPL resolutions. We find a close relationship between NPL problems—elevated and unresolved NPLs—and the severity of post-crisis recessions. A machine learning approach identifies a set of pre-crisis predictors of NPL problems related to weak macroeconomic, institutional, corporate, and banking sector conditions. Our findings suggest that reducing pre-crisis vulnerabilities and promptly addressing NPL problems during a crisis are important for post-crisis output recovery.

How Do Changing U.S. Interest Rates Affect Banks in the Gulf Cooperation Council (GCC) Countries?

Given their pegged exchange rate regimes, Gulf Cooperation Council (GCC) countries usually adjust their policy rates to match shifting U.S. monetary policy. This raises the important question of how changes in U.S.

monetary policy affect banks in the GCC. We use bank-level panel data, exploiting variation across banks within countries, to isolate the impact of changing U.S. interest rates on GCC banks funding costs, asset rates, and profitability. We find stronger pass-through from U.S. monetary policy to liability rates than to asset rates and bank profitability, largely reflecting funding structures. In addition, we explore the role of shifts in the quantity of bank liabilities as policy rates change and the role of large banks with relatively stable funding costs to explain these findings.

U.S. Monetary Policy Spillovers to GCC Countries: Do Oil Prices Matter

This paper provides empirical evidence that the size of the spillovers from U.S. monetary policy to non-oil GDP growth in the GCC countries depends on the level of oil prices. The potential channels through which oil prices could affect the effectiveness of monetary policy are discussed. We find that the level of oil prices tends to dampen or amplify the growth impact of changes in U.S. monetary policy on the non-oil economies in the GCC.

Political Costs of Tax-Based Consolidations

This paper studies the impact of tax-based consolidations on reelection outcomes. Using a granular database of tax-based consolidations for a panel of 10 OECD countries over the last 40 years, we find that tax reforms are politically costly but some reforms are costlier than others. Measures aimed primarily at reducing existing deficits and debt are costlier than tax consolidation policies for improving long-term growth prospects. Electoral costs are particularly high for broad-based indirect tax and corporate tax reforms. Voters tend to penalize governments less if tax consolidations are announced early in the government's term or if the government has a strong political mandate. Favorable economic conditions increase public support for tax-based consolidations. Personal income tax reforms are electorally salient if the reforms are frontloaded, announced during recessions, and in less progressive tax systems.

EXECUTIVE BOARD ACTIVITIES

Policy Items

2019 External Sector Report

Executive Directors generally agreed with the findings of the 2019 External Sector Report and its policy recommendations. They noted that, while global imbalances had declined considerably since the global financial crisis, progress has been more limited in recent years, with increased concentration in advanced economies. Directors also observed that the persistence of current account surpluses and deficits have led to a continued widening of stock imbalances, reaching record levels. Moreover, recent trade measures are weighing on global trade, with negative implications for investment and growth.

Directors shared the view that, in the near term, financial risks from the current configuration of global imbalances are generally contained. Nevertheless, an intensification of trade tensions and a disorderly Brexit, with knock-on effects on global growth and risk aversion, could adversely affect economies highly dependent on foreign demand and external financing. Over the medium term, Directors cautioned that, absent corrective policies, trade tensions could become entrenched, and further divergence of external stock positions could trigger costly disruptive adjustments in key debtor economies that could spill over to the rest of the world.

Directors agreed that carefully-calibrated macroeconomic policies, tailored to country-specific circumstances, would be necessary not only to achieve domestic objectives but also to support external rebalancing. Excess deficit economies should give priority to adopting or continuing with growth-friendly fiscal consolidation, and to deploying macroprudential policies where credit growth or foreign-currency borrowing may be excessive. Excess surplus economies should deploy available fiscal space to boost potential growth, including through public infrastructure investment, while avoiding overreliance on monetary policy, where applicable. Directors highlighted that, even in some economies where external positions are assessed to be broadly in line with fundamentals, policy actions are necessary to address domestic vulnerabilities and prevent a resurgence of external imbalances. Meanwhile, rising external debt liabilities in a number of economies require careful monitoring, especially of maturity and currency mismatches.

Directors underlined the key role of carefully-sequenced and designed structural policies to tackle persistent external imbalances. Reforms that enhance competitiveness and productivity of the tradable sector are central for rebalancing

in excess deficit economies. In excess surplus economies, reforms should aim to encourage investment—including through innovation support and deregulation of certain sectors—and discourage excessive savings by households and corporations. Noting that excess surpluses tend to be associated with rising corporate saving and the resultant wealth inequality, Directors encouraged staff to conduct further analysis on its drivers, including at the country level, to arrive at more concrete policy implications.

Directors agreed that exchange rate flexibility remains key to facilitate external adjustment and welcomed the analysis on how evolving features of international trade, such as dominant currency invoicing and global value chain integration, can affect the external adjustment process. They noted that, while exchange rates may have relatively muted effects in the short term as a result of some of these features, standard exchange rate effects on trade flows remain at play in the medium term. Directors saw the benefits of policies that ease capacity constraints, through improved access to credit and transportation infrastructure, in helping strengthen exchange rate mechanisms. They looked forward to further analysis on the mechanisms of external adjustment, including through balance sheet channels and trade in services, to distill policy lessons in an integrated framework that takes other important country-specific characteristics into account.

Directors stressed the importance of a collective effort by the international community to avoid policies that distort trade, including trade barriers and subsidies. They observed that recent trade barriers had done little thus far to address underlying external imbalances while reducing welfare. They encouraged countries to work toward reviving liberalization efforts, including in areas like e-commerce and services trade, and strengthening the rules-based multilateral trading system.

Directors highlighted the valuable public good aspect of the Fund's multilaterally-consistent external sector assessments. They appreciated ongoing efforts by staff to strengthen the analysis and transparency of the External Sector Report, especially in the use of judgment, while acknowledging inherent uncertainties in the conduct of external assessments. Directors called for continued efforts to improve the External Balance Assessment (EBA) methodologies, including to better understand the risks posed by external stock positions and their composition, as well as strengthen data collection efforts to account for the rising cross-border activities of multinational corporations. Directors reiterated that, given large unexplained residuals,



caution would continue to be needed in interpreting model results and drawing policy recommendations. In this context, they encouraged staff to continue using all EBA models and complementary tools in the conduct of external assessments.

Directors stressed that rigorous and evenhanded analysis of external positions is necessary to promote growth-

friendly policy actions by both surplus and deficit countries to rebalance the global economy in a durable and symmetric way. They looked forward to further integration of external sector assessments into surveillance at both the bilateral and multilateral levels.



Country Matters

Surveillance

Greece: 2019 Article IV Consultation

Executive Board Assessment

Executive Directors recognized the progress that the authorities had made in implementing reforms during the program period, as well as the Greek economy's continued recovery, but noted that important challenges remain. In this context, they took positive note of the new government's commitment to pursue growth-friendly and inclusive policies and welcomed their early policy actions. They stressed, however, that sustained and deeper reform implementation, deploying a full range of policy tools, and strong political resolve to tackle vested interests will be necessary to meaningfully boost investment, growth, and social inclusion.

Directors supported the authorities' plans to cut direct tax rates and urged more ambitious efforts to broaden tax bases and enhance tax payment compliance. They urged a shift of spending priorities toward more investment and targeted social spending, while strengthening fiscal risk management and contingency planning. A number of Directors considered that the authorities should build a consensus with European partners around a lower primary balance target to support the growth objectives. A number of other Directors, however, stressed keeping the target, which they noted was agreed taking into account European fiscal rules and the implications for Greece's debt sustainability.

Directors emphasized the importance of restoring the financial sector's resilience and ability to support growth. In this regard, they welcomed the government's more ambitious nonperforming exposure (NPE) reduction objectives, noting that the proposed state-supported NPE securitization guarantee scheme could provide important backing. However, Directors stressed the importance of taking a more comprehensive, ambitious, and well-coordinated strategy to clean up bank balance sheets, relying on market-based mechanisms (with any public support subject to cost-effectiveness assessments). These efforts should also include further improvements in the legal financial framework, including, in particular, an overhaul of the personal insolvency law to eliminate primary mortgage protection in order to strengthen payment discipline.

Directors underscored that Greece's success within the currency union will require policies to help boost productivity and narrow its competitiveness gap. In this context, they welcomed the government's efforts to unblock privatization, implement business deregulation, and restore elements of the cornerstone program-era labor market reforms. Directors stressed that realization of benefits from labor

market reform would require meaningful parallel progress with other structural reforms, particularly further liberalization of product markets.

Directors noted the importance of continued improvements in public sector efficiency and governance. They welcomed the recent progress in strengthening the AML/CFT regime and anti-corruption institutions but underscored that important remaining shortcomings should be addressed. Specifically, they urged the authorities to strengthen public revenue administration (including strengthening tax enforcement), enhance the efficiency and quality of the judicial system (including enforcement of contracts), and speed up anti-corruption reforms.

India: 2019 Article IV Consultation


Executive Board Assessment

They noted that India's rapid economic expansion in recent years has lifted millions of people out of poverty. However, in the first half of 2019 a combination of factors led to subdued economic growth in India. With risks to the outlook tilted to the downside, Directors called for continued sound macroeconomic management. They saw an opportunity with the strong mandate of the new government to reinvigorate the reform agenda to boost inclusive and sustainable growth.

Directors noted that a credible medium-term fiscal consolidation path driven by subsidy-spending rationalization and tax-base enhancing measures is needed to reduce debt, free up financial resources for private investment, and reduce the interest bill. Some Directors advocated that automatic stabilizers should be allowed to operate in the short run. Directors called for more robust revenue projections and enhanced fiscal transparency and budget coverage.

Directors recommended that near-term policies to address cyclical weakness focus on monetary policy and broad-based macro-structural reforms. In this regard, they welcomed the monetary policy easing undertaken so far this year and recommended that an easing bias be maintained at least until the projected recovery takes hold.

Directors noted that inflation targeting has contributed to macroeconomic stability by better anchoring inflation expectations, thus helping improve the economic well-being of low-income households. Continued action is needed to improve the monetary transmission mechanism to enhance the effectiveness of monetary policy and enable the central bank to achieve the medium-term inflation target on a sustained basis. Directors also welcomed the authorities' commitment to maintain exchange rate flexibility. They noted that foreign exchange intervention should continue to be two-way and limited to disorderly market conditions.



Directors welcomed the steps taken to tackle the twin bank and corporate balance sheet problem but noted the continued challenges of the financial sector. They recommended that the recently announced public sector bank merger plan be accompanied by deep operational restructuring and far-reaching governance reforms in order to improve efficiency, risk management, and credit allocation. Directors welcomed the strengthened monitoring and regulation of non-bank financial companies and recommended enhancing the availability of timely and granular data to help restore confidence in the sector. Directors urged further follow-up on the FSAP recommendations.

Directors commended the authorities' concerted efforts to strengthen the business climate. These efforts need to be complemented by continued labor, product market, land, and other reforms aimed at increasing labor market flexibility, enhancing competition, and reducing the scope for corruption. This will help harness India's demographic dividend by creating more and better jobs for the rapidly-growing labor force and enhancing female labor force participation. Directors also welcomed the important progress that has been made in strengthening the supply side of the economy through large infrastructure investments. They noted that land reform remains essential to raise agriculture sector productivity and achieve the authorities' ambitious infrastructure development targets. Directors also encouraged further trade and investment liberalization.

Turkey: 2019 Article IV Consultation

Executive Board Assessment

Executive Directors noted that stimulus-driven growth in previous years had contributed to large economic imbalances in the Turkish economy. Following the recession in 2018, expansionary fiscal policy, rapid credit provision by state-owned banks, and more favorable external financing conditions led to a resumption of economic growth. Directors emphasized that the current calm remains fragile and that vulnerabilities persist. These include low reserve buffers, large external financing needs, and stressed bank and corporate balance sheets. Against this background, Directors underscored the importance of prudent policies to address weaknesses and highlighted the need for a comprehensive package of reforms to secure stronger and more resilient growth over the medium term.

Directors emphasized that fiscal policy should remain a key policy anchor. While the recent fiscal stimulus has helped the economy recover, the underlying deficit has increased significantly. Directors recommended a broadly neutral fiscal stance in 2020, combined with tight monetary and quasi-fiscal policies, to strike a balance between supporting the nascent recovery while also containing financing needs and enhancing fiscal space. They noted that a modest consolidation is needed over the medium term to ensure that public debt remains low and stable. Directors welcomed

the authorities' efforts to strengthen oversight and management of public-private partnerships. Given still-high inflation expectations, Directors stressed that monetary policy should focus on durably lowering inflation, which would help permanently lower interest rates. In this context, they noted that recent monetary policy easing has gone too far. Directors also called for clearer monetary and intervention policy to bolster transparency and central bank credibility. They recommended rebuilding international reserves as conditions allow.

Directors emphasized that vigilance is needed in view of the rapid credit growth of state-owned banks. They encouraged taking steps to rein in credit growth and clean up bank and corporate balance sheets to support financial stability and stronger, more resilient growth. Directors generally agreed that a third-party asset quality review and new stress tests are needed to better understand underlying bank health. Additional reforms to improve the insolvency regime and out-of-court restructuring would also help release resources and restart productive lending.


Directors called for focused and carefully sequenced structural reforms to enhance medium-term growth and increase resilience to shocks. In particular, steps to improve product market efficiency, labor market flexibility, the quality of human capital, and female labor force participation would facilitate a reallocation of resources to productive sectors. Governance reforms would also help improve the investment climate and economic efficiency. Directors commended Turkey for hosting a large number of refugees.

Islamic Republic of Mauritania: 2017 Article IV Consultation

Executive Board Assessment

Executive Directors commended the Mauritanian authorities for their strong economic policy response to the challenging external environment of low metal prices, but noted that macroeconomic and financial stability as well as the incipient recovery remain fragile. Against this background, they agreed that the main challenge now is to support growth, reduce poverty and unemployment, diversify the economy, and meet infrastructure needs while, at the same time, strengthening macroeconomic stability, the external position, and debt sustainability. To achieve these objectives in the context of limited resources and elevated debt, Directors called for sustained prudent policies and structural reforms.

Directors concurred that structural reforms and infrastructure improvements are critical to address external imbalances and promote economic diversification. At the same time, most Directors called for greater exchange rate flexibility as a priority to help boost competitiveness, improve the external position, absorb shocks, and allow monetary policy to better address tight bank liquidity and support economic growth. A few Directors questioned the



exchange rate's potential to boost competitiveness, given the country's limited production base. Some Directors also noted the authorities' concern that an accommodative monetary policy could jeopardize ongoing efforts to stabilize the still weak external position. More generally, Directors encouraged the authorities to introduce a competitive and transparent foreign exchange auction system, remove regulatory obstacles to the development of an interbank market, and strengthen reserve buffers.

Directors recommended that fiscal policy be focused on consolidating the adjustment achieved so far and on creating fiscal space by accelerating ongoing reforms. This would allow for higher social and infrastructure spending without jeopardizing macroeconomic stability and debt sustainability. Directors encouraged the authorities to continue to modernize tax and customs administration, introduce a corporate income tax, adopt the new organic budget law, and review and phase out tax exemptions. They called for recent measures to strengthen public investment and debt management to be operationalized promptly to help prioritize projects. Directors generally agreed on the need to avoid non-concessional borrowing and, instead, give preference to concessional loans and grants. Regarding Mauritania's ongoing negotiations with bilateral non-Paris Club creditors, a few Directors reiterated the importance of preserving comparability of treatment across official bilateral creditors.

Directors stressed the importance of addressing heightened financial stability risks and boosting credit to the private sector. In this regard, they encouraged the authorities to build on recent progress and accelerate the implementation of the 2014 FSAP recommendations, especially strengthening banking supervision and adopting the new banking law and central bank statute.

Directors welcomed the authorities' draft multi-year development strategy to achieve higher and more inclusive growth, and encouraged its swift finalization and implementation. They recommended expanding social policies, strengthening social safety nets, and continuing efforts to improve the business climate and governance to support private sector growth, job creation, and diversification. Directors emphasized that higher spending on education and health would improve social outcomes and productivity, and help reduce poverty.

People's Republic of China-Hong Kong Special Administrative Region: - 2019 Article IV Consultation

Executive Board Assessment

Executive Directors noted that economic activity in Hong Kong SAR has deteriorated significantly on account of the global growth slowdown, U.S.-China trade tensions, and ongoing social unrest. While the balance of risks is tilted to the downside going forward, Directors agreed that Hong

Kong SAR's robust policy frameworks and ample buffers will help the economy weather the challenges ahead. They welcomed the authorities' readiness to use these buffers as and when necessary.

Amid the growth slowdown and strong headwinds, Directors agreed that countercyclical fiscal support would continue to be essential. They welcomed the recently announced stimulus targeted at the most vulnerable households and small- and medium-sized enterprises. Directors recommended a comprehensive medium-term fiscal package to cope with the cyclical downturn and address longer-term structural challenges associated with housing market imbalances, population aging, and income inequality, while preserving fiscal sustainability. In light of the envisaged spending pressures, Directors encouraged the authorities to consider tax reform over the medium to long term to boost revenues and foster equity. On the expenditure side, they saw scope for improving budget planning and execution, as well as developing a long-term healthcare spending strategy.

Directors supported the authorities' three-pronged approach to contain housing market risks and improve housing affordability, with priority given to increasing land allocation for residential housing. Noting the effectiveness of macroprudential measures, Directors concurred that any adjustment should be based on evolving financial stability risks. They encouraged the authorities to phase out the new residential stamp duty and replace it with alternative nondiscriminatory macroprudential measures once systemic risks from nonresident inflows dissipate.


Directors underscored the importance of safeguarding financial stability amid rising global volatility. They commended the authorities for the progress in implementing the 2014 FSAP recommendations. Continued efforts would be needed to monitor vulnerabilities in the corporate sector, further strengthen the regulatory and supervisory framework, and facilitate innovation while managing risks. Directors noted that further development of green finance and the Greater Bay Area would help maintain Hong Kong SAR's competitiveness.

Directors observed that Hong Kong SAR's external position is broadly in line with medium-term fundamentals and desirable policies. They agreed that the Linked Exchange Rate System remains an appropriate anchor of stability. They stressed that preserving a track record of public communication would be key to the credibility of the currency board arrangement.

Islamic Republic of Afghanistan: 2019 Article IV Consultation

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' commitment to



implement their reform program consistent with Afghanistan's National Peace and Development Framework, aimed at reducing poverty, raising inclusive growth, and boosting job opportunities for the growing labor force. However, insecurity and political uncertainty continue to undermine confidence and hinder investment and sustained growth. Directors stressed that policies should remain focused on preserving macroeconomic and financial stability, strengthening institutions, and accelerating the reform momentum to entrench sustainable private-sector-led growth. Continued financial support by donors will remain critical to help preserve macroeconomic stability, support reforms, and finance security and development needs.

Directors encouraged the authorities to continue to pursue fiscal discipline. They noted that the economic development plans currently under consideration should be grounded in a robust and sustainable macro-fiscal framework reflecting Afghanistan's still limited debt-carrying capacity and high risk of debt distress. The latter calls for continued reliance on grants and highly-concessional borrowing, supplemented by efforts to strengthen capacity in public financial and debt management and the assessment of investment projects and fiscal risks.

Directors agreed that the overall fiscal balance including grants should remain the fiscal anchor that preserves a broadly balanced budget, prudent cash buffer, and low public debt. This policy should be supplemented with a gradual reduction of the operating deficit before grants to prudently use domestic resources, shift expenditure toward pro-growth and pro-poor outlays, rationalize current spending, and create fiscal space to meet the country's considerable development needs. Directors supported the authorities' continued targeting of sustainable revenue collection through an expanding tax base, increased efficiency, and VAT adoption planned by early 2021.

Directors welcomed the authorities' commitment to price stability supported by exchange rate flexibility. They noted that further measures to reduce high dollarization can help improve monetary transmission. They highlighted the importance of safeguarding financial stability and welcomed the continued focus on addressing shortcomings in weak private banks, strengthening the framework for crisis prevention and resolution, and implementing the strategy to reform the state-owned commercial banks. They also took positive note of efforts to formalize the activities of unregulated financial institutions. Directors encouraged fostering financial intermediation through the implementation of the recently adopted National Financial Inclusion Strategy.

Directors were encouraged by the authorities' progress with anti-corruption legislation and institutions, but stressed the need to strengthen implementation by prioritizing anti-corruption efforts in cooperation with donors and guided by the National Strategy for Combatting Corruption. They

urged swift progress in closing gaps in the criminalization of the remaining corruption offenses, and the staffing and operationalization of new anti-corruption institutions. These efforts should go hand-in-hand with improvement of the business environment, the regulatory framework, and the AML/CFT regime. Addressing poverty and gender inequality

Use of Fund Resources

Morocco: Second Review Under the Arrangement Under the Precautionary and Liquidity Line


On December 13, 2019, the Executive Board of the International Monetary Fund (IMF) completed the second review under the Precautionary and Liquidity Line (PLL) Arrangement for Morocco. The two-year arrangement supports the authorities' policies to strengthen the economy's resilience and promote higher and more inclusive growth. The Moroccan authorities have not drawn on the arrangement and continue to treat it as precautionary.

The PLL arrangement for Morocco in the amount equivalent to SDR 2.1508 billion (about US\$3 billion) was approved by the IMF's Executive Board on December 17, 2018 (See Press release No. 18/477). It will expire on December 16, 2020.

Following the Executive Board's discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, said: "Morocco has made significant strides in strengthening the resilience of its economy in recent years. In 2019, economic activity has weakened due to a contraction in agricultural output, while inflation remains low. The external position is expected to improve only modestly, and fiscal consolidation has slowed down due in part to weaker-than-expected tax revenues and increased public wage spending.

"Looking ahead, growth is expected to accelerate gradually over the medium term. However, the outlook remains subject to downside risks, including potential delays in reform implementation and the external environment. In this context, the PLL arrangement continues to provide valuable insurance against external risks and support the authorities' economic policies.

"The authorities are committed to sustaining sound policies. The government's economic program remains in line with key reforms agreed under the PLL arrangement, including to further reduce fiscal and external vulnerabilities, while strengthening the foundations for higher and more inclusive growth.



“In light of the slowdown in fiscal consolidation, stepped up tax reforms and contained wage bill are needed to lower the public debt-to-GDP ratio while securing priority investment and social spending in the medium term. A decisive and comprehensive tax reform should aim to secure adequate revenues while bringing about greater equity and simplicity of the tax system. In addition, further improvements are needed in the efficiency and governance of the public sector, careful implementation of fiscal decentralization, strengthened state-owned enterprise oversight, and better targeting of social spending.

“The transition to greater exchange rate flexibility initiated last year would enhance the economy’s capacity to absorb shocks and preserve its external competitiveness. The current favorable economic environment continues to provide a window of opportunity to conduct this reform in a sequenced and well-communicated manner. Following the adoption of the central bank law, addressing weaknesses in the AML/CFT framework, and continuing to make the supervisory framework more risk-based and forward-looking will help further improve financial sector soundness.

“Building on recent progress in improving the business environment, sustained reforms are needed to raise potential growth and reduce high unemployment, especially among the youth, increase female labor participation, and reduce regional disparities. Reforms of education, governance, and the labor market should also contribute to more private sector-led growth and job creation.”

The Federal Democratic Republic of Ethiopia: 2019 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility and Under the Extended Fund Facility

Executive Directors agreed with the thrust of the staff appraisal. They noted that Ethiopia’s growth model, driven by public investment, had supported rapid growth and remarkably improved living standards over the past decade. At the same time, it has led to a build-up of debt and external vulnerabilities. Directors highlighted the urgency of fundamental reforms to correct macroeconomic imbalances, ease structural bottlenecks, and lay the foundation for sustainable, inclusive growth led by the private sector.

To this end, Directors welcomed the ambitious Homegrown Economic Reform Plan, which is appropriately built around macroeconomic, structural, and sectoral reforms. They considered that the plan, together with the authorities’ strong ownership and commitment, deserves Fund support, which would help catalyze private investment and donor financing. Noting high implementation risks amid external vulnerabilities and political uncertainty, Directors underscored that steadfast determination, strong

communication, and social protection would be key to obtain a broad-based public buy in. They also urged the authorities to seek additional debt reprofiling from external creditors to improve debt dynamics.

Directors supported a comprehensive approach to addressing the exchange rate overvaluation and foreign exchange shortages. They agreed with the priority placed on increasing exchange rate flexibility, reducing inflation, strengthening competitiveness, and rebuilding international reserves. They recommended a reform roadmap to transition to a market clearing exchange rate regime. Directors also supported monetary tightening, complemented by spending restraint by state owned enterprises (SOEs) and the phasing out of central bank financing of the government and the Development Bank of Ethiopia (DBE). Continued efforts are needed to modernize the monetary policy framework and further develop financial markets to deepen inclusion.

Directors stressed the need to reform SOEs to reduce public debt vulnerabilities and improve governance and transparency. In this context, it would be important to reduce SOEs’ borrowing, strengthen their financial positions, and prioritize investment activities. Immediate priorities also include an asset quality review of the Commercial Bank of Ethiopia, and a strategy to address the DBE’s non-performing loans and develop a sustainable financing model.


Directors agreed that reforms are urgently needed to reverse the recent decline in domestic revenue mobilization and to meet Ethiopia’s social and infrastructure needs. They welcomed the planned extension of the value added tax coverage. Directors also emphasized the need to protect high quality social assistance programs, rationalize subsidies, and improve expenditure efficiency more broadly.

Directors called on the authorities to build on progress made in improving the AML/CFT framework, and further strengthen data quality.

Pakistan: First Review Under the Extended Arrangement Under the Extended Fund Facility and Request for Modification of Performance Criteria

The Executive Board of the International Monetary Fund (IMF) on December 19, 2019 completed the first review of Pakistan’s economic performance under the Extended Fund Facility (EFF). The completion of the review will allow the authorities to draw SDR 328 million (about US\$ 452.4 million), bringing total disbursements to SDR 1,044 million (about US\$ 1,440 million).

The Executive Board approved the 39-month, SDR 4,268 million (about \$6 billion at the time of approval of the



arrangement, or 210 percent of quota) EFF for Pakistan on July 3, 2019 (see Press Release No. 19/264).

Following the Executive Board's decision, Mr. David Lipton, First Deputy Managing Director and Acting Chair, issued the following statement:

"Pakistan's program is on track and has started to bear fruit. However, risks remain elevated. Strong ownership and steadfast reform implementation are critical to entrench macroeconomic stability and support robust and balanced growth.

"The authorities are committed to sustaining the progress on fiscal adjustment to place debt on a downward path. The planned reforms include strengthening tax revenue mobilization, including the elimination of tax exemptions and loopholes, and prudent expenditure policies. Preparations for a comprehensive tax policy reform should start early to ensure timely implementation. Enhanced social safety nets will help alleviate social costs and build support for reforms.

"The flexible, market-determined exchange rate remains essential to cushion the economy against external shocks and rebuild reserve buffers. The current monetary stance is appropriately tight and should only be eased once

disinflation is firmly entrenched. Strengthening the State Bank of Pakistan's autonomy and governance will support these efforts.

"Faster progress is needed to improve the AML/CFT framework, supported by technical assistance from the IMF and other capacity development providers. Swift adoption of all the necessary measures is needed to exit the FATF's list of jurisdictions with AML/CFT deficiencies.

"The authorities have adopted a comprehensive plan to address the accumulation of arrears in the power sector. Its full implementation is key to improve collection, reduce losses, and enhance governance. Timely and regular adjustment of energy tariffs will bring the sector in line with cost recovery.

"Efforts are ongoing to further improve the business environment, strengthen governance, and foster private sector investment. Reform of the state-owned enterprise sector will help put Pakistan's public finances on a sustainable path and have positive spillovers by leveling the playing field and improving the provision of services."