IMF urges planning to trim deficits

By IAN TALLEY

WASHINGTON—The International Monetary Fund warned Thursday that the world’s largest economies are failing to plan adequately beyond next year in efforts to cut fiscal deficits and maintain market confidence.

While the IMF said next year’s plans to tighten budgets and wind down stimulus to help the economy recover are appropriate, it added that if growth slows more than forecast, advanced economies with fiscal room to spare should delay plans to slash spending.

One of the biggest risks to the global recovery now is a mountain of sovereign debt—estimated at around $4 trillion—that needs to be refinanced in coming years. Debt-rollover problems, or even a full-blown sovereign-debt crisis "could emerge as a result of solvency concerns in the short or medium term," the IMF said in its Fiscal Monitor report, a review of global deficit issues.

Fund staff noted that while spreads have widened on government-bond yields as investors move into safer countries from ones seen as ailing, those differences between yields don't reflect changes in budget strategies.

"Spreads may reflect market considerations that go far beyond a reasonable set of fundamentals and should be interpreted with caution when assessing the impact of fiscal-policy developments on sovereign risk," fund staff advised. Carlo Cottarelli, head of IMF’s Fiscal Affairs Department, argues that markets are currently over-estimating the risk of defaults in several advanced countries.

"They're too pessimistic," Mr. Cottarelli said.

The IMF said another major threat to global growth over the next several years is that debt burdens—compared with countries' gross domestic products—could very likely stabilize at high levels. Higher debt levels can raise interest and mortgage rates and corporate borrowing costs, as well as undercut investment and consumer spending as taxpayers eye higher taxes.

"The risk that these events materialize remains high by historical standards for advanced economies," the IMF said. "Risks arising from macroeconomic uncertainty are generally higher than six months ago, amid concerns that the global recovery may be losing steam," the fund added.

The IMF said that next year, most countries should record smaller deficits as they put the brakes on government-funded stimulus programs. Among the Group of 20 industrialized and developing nations, for example, the fiscal balance as a percent of gross domestic product is expected to contract to -5.6% from -6.8% this year for advanced economies—predominantly the U.S., Western Europe and Japan.

"This pace of adjustment is broadly appropriate, as it strikes the right balance between addressing..."
market concerns about fiscal fundamentals and avoiding an abrupt withdrawal of support to the nascent recovery,” the IMF said.

During the sovereign-debt crisis earlier this year, the IMF urged wealthy countries to cut spending substantially and boost taxes to keep debt levels from exploding and avoid the kind of market reaction that engulfed Greece. Rich-country debt levels are forecast to balloon more than 34 percentage points by 2015 to 108.2 percent of GDP from their pre-crisis levels in 2006. Former IMF official Eswar Prasad estimates total net government debt in the world will more than double to $48 trillion in 2015 from $23 trillion in 2007.

In response, G-20 members at their Toronto meeting in June committed to halving their deficits by 2013 and stabilizing or reducing their debt-to-GDP ratios by 2016.

Still, the IMF said in its latest Fiscal Monitor report that plans fall short of what is required. In particular, detailed adjustment measures haven't been identified. Although some strategies include addressing short-term pressures from health-care costs, none include the comprehensive reforms the IMF says is needed to contain medium- and long-term spending.

As health and pension spending is expected to vastly outweigh the budget costs of the crisis, "this is an important failing." Also, few countries have committed to long-term targets to cut debt levels, or if they have, indicated how they plan to get there.

As an example of the type of structural reforms needed to cut long-term deficits, the IMF waded into a controversy created as France and other countries seeking to ax their bloated budgets: raising the retirement age. The IMF said requiring two extra years of work before retirement would boost GDP by 1 percentage point in the near-term and 4.5 percentage points in the longer term.

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