

**IMMEDIATE
ATTENTION**

EBD/02/127

August 26, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Notification of Ongoing GAO Review—IMF Reform Efforts to Anticipate Financial Crises**

Attached is a memorandum from the Acting Managing Director notifying Executive Directors of the U.S. General Accounting Office (GAO) ongoing review of the IMF's reform efforts and new proposals to anticipate and prevent sovereign financial crises. This notification is being circulated to Executive Directors to invite their comments prior to the Managing Director's taking a decision to approve the GAO's request for cooperation.

Comments on the notification should be communicated to the Secretary by **noon on Tuesday, September 3, 2002**. With the Managing Director's approval, the review will be carried out in accordance with the procedures established in Decision No. 12424-(01/13). The published report will be circulated to the Executive Board for information.

Questions may be referred to Mr. T. Lane, PDR (ext. 37668).

Att: (1)

Other Distribution:
Department Heads



Office Memorandum

To: The Members of the Executive Board

August 21, 2002

From: The Acting Managing Director *[Signature]*

Subject: **Notification of Ongoing GAO Review—IMF Reform Efforts to Anticipate Financial Crises**

As noted in the attached memorandum from Ms. Lundsager, at the request of the House Financial Services Committee and Joint Economic Committees, the U.S. General Accounting Office (GAO) is conducting a review of the IMF's ongoing reform efforts and new proposals to anticipate and prevent sovereign financial crises. The GAO has asked the Fund to assist in this inquiry. The terms of reference of the review, as provided by the GAO, are attached to Ms. Lundsager's memorandum.

Ms. Lundsager's memorandum indicates that the inquiry will be conducted under the procedures for Cooperation with Investigations by Auditing Institutions of Members (SM/00/97, Revision 1, Supplement 2, 2/2/01). Accordingly, the GAO will give management and staff an opportunity to review the GAO report in draft, provide comments for inclusion with the final report, and ascertain that no confidential information is disclosed and that factual information is accurate. Once the report is published, it will be circulated promptly to the Executive Board, together with an assessment of the staff resources used by the Fund in the inquiry. Staff currently estimates that about 30 hours of staff time will be needed to comply with the GAO's request.

According to the Procedures on Cooperation, the Executive Directors are to be notified of all requests at least two weeks before the commencement of any cooperation with an agency, and should have an opportunity to comment on all aspects of the notification, as they deem suitable. My current intention is to approve the GAO's request for cooperation, but my final decision will, of course, take into account any comments that Executive Directors may have.

Attachment

Cc: The Managing Director (on return)



Office Memorandum

To: The Managing Director

July 11, 2002

From: Meg Lundsager *ML*

Subject: **Notification of GAO Review – Crisis Prevention and Resolution**

At the request of the House Financial Services Committee and the Joint Economic Committees, the U.S. General Accounting Office is conducting a review of the IMF's ongoing reform efforts and new proposals to anticipate and prevent sovereign financial crises. In conjunction with this review, an inquiry has been made to my office for assistance in obtaining documentation, identifying and notifying appropriate IMF officials, and arranging any meetings necessary for the completion of this review.

In accordance with the procedures for Cooperation with Investigations on Fund Activities by Auditing Institutions of Members (SM/00/97, Revision 1, Supplement 2, 2/2/01), attached are the Terms of Reference for the inquiry as provided by GAO. In this context, GAO has confirmed to me that:

- Any document or information provided by Fund management and the staff and designated by the IMF as "confidential" shall be protected. GAO policy and applicable statutory and regulatory requirements obligate the GAO to give the information the same level of confidentiality as the IMF.
- In cases where the GAO receives any document or information provided by Fund management and the staff and designated by the IMF as 'confidential', Fund management and the staff will have two opportunities to review relevant sections of the draft GAO report. At the first stage, Fund management and the staff will check relevant sections of the report for confidential information. At this stage, Fund management and the staff can also identify factual corrections. The GAO will delete any confidential information and undertake to correct factual mistakes before the draft report is circulated for official comment.
- Fund management and the staff will have a second opportunity to review the draft GAO report when it is circulated for official comment. The GAO will reflect the views of IMF management and the staff by, inter alia, including in full the final written official comments of the IMF in the published version of the report.

We understand that if Fund management concludes that the views of the Fund have not been adequately reflected in the published report, Fund management may decide to communicate those views directly to the recipients of the report.

Attachment

GAO REVIEW OF IMF ANTICIPATION OF FINANCIAL CRISES
(IMF Terms of Reference, June 2002)

This document outlines our current approach. Specifics are subject to change in order to meet the needs of congressional requesters and address other issues that may arise. Also, to the extent necessary, we will conduct work and report our observations on IMF and World Bank collaborative efforts.

Congressional requesters

This review was requested by Congressmen, Michael G. Oxley, Chairman, House Financial Services Committee and Jim Saxton, Chairman, House Joint Economic Committee.

Objectives

Provide information on IMF's ongoing reform efforts and new proposals to anticipate and prevent sovereign financial crises. Specifically,

- (1) What is the status of key IMF reforms and have they helped the Fund better anticipate financial crises or be in a position to prevent future crises?
- (2) How does the IMF estimate key economic indicators of member countries and how accurate are its projections for crisis prone countries?
- (3) What new reform proposals are under consideration by the IMF and what is the rationale behind these proposals?

Scope

- (1) We will focus on reforms implemented by the IMF since the Mexican financial crisis of 1994. Specifically, we will examine:
 - the extent that these reforms have been used
 - their impact on anticipating and preventing crises.
- (2) We will examine IMF's methodology for estimating country growth rates. Specifically, we will focus on:
 - key macroeconomic indicators used
 - differences, if any, in growth forecasts methodologies for Standby/External programs and World Economic Outlook (WEO) projections
 - IMF's methodologies in comparison to those of other forecasters

We will also examine the accuracy of IMF's forecasts in predicting country growth rates (and other leading economic indicators) during crisis and non-crisis periods and

how they compare with other official and private forecasts. Additionally, we will examine to what extent could or would the IMF make crises forecast information publicly available.

- (3) We will examine new reform proposals being considered by the IMF, specifically the Sovereign Debt Restructuring Mechanism (SDRM), Collective Action Clauses (CACs), or proposal(s) for a 2003 quota increase. We will examine the rationale behind these proposals, and the potential advantages and challenges of these reforms, and their current status.

Methodology – data gathering

- Obtain and review documents from official U.S., IMF, and World Bank sources.
- Interviews with U.S. government and international financial institution officials from Treasury, the Federal Reserve, IMF and the World Bank.
- Interviews with private sector investors
- Interviews with country government and private sector officials in selected case study countries.
- Obtain views from other experts, creditor countries, international organizations, and nongovernmental organizations.

Support requested from IMF staff

- We will obtain documents provided to the Executive Boards through the USEDs' offices.
- We anticipate an entrance conference, meetings with IMF staff in headquarters, and meetings with country-specific officials. Also, meetings with IMF staff and government officials in selected case study countries. IMF staff will *not* be requested to arrange interviews for us.

Time frames

- Obtain and review documents. Begun in June 2002, to continue through issuance of report in spring 2003.
- Interview officials from those organizations.
- Field work in selected countries, including Argentina and Turkey, fall 2002.
- Testimony/report: spring 2003.

Documents requested from IMF (initial)

- Executive Board documents, including reviews and analytical documents, pertaining to IMF reforms aimed at anticipating and preventing crises since the Mexican financial crisis of 1994.

- Chairman's meeting summaries and accompanying documents related to the above.
- Documents identifying and describing the evolution of IMF reforms, including collaborative World Bank efforts, aimed at anticipating and preventing crises since the Mexican financial crisis of 1994.
- Documents identifying the member countries adopting the above identified reforms.
- Background documents identifying and describing new proposals aimed at anticipating and preventing crises.
- List of countries with ROSC modules completed or in progress since 12/31/01
- List of countries with FSAP missions completed or in progress since 9/30/01
- Documents identifying and explaining IMF methodologies for estimating country growth rates.
- Reports, papers and other analytical documents providing information on the above.
- A schedule of upcoming Board actions on reforms identified.

We do not anticipate requesting documents that have not gone to the Executive Board. However, if a need for such documents were to arise, we will coordinate with the U.S. Executive Director on how to proceed.