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September 25, 2002

To: Members of the Executive Board

From: The Secretary

Subject: **Revised Report of the Managing Director to the International Monetary and Financial Committee on the IMF in a Process of Change**

The attached revised report of the Managing Director to the International Monetary and Financial Committee on the IMF in a process of change (SM/02/296, 9/16/02) reflects comments made by Executive Directors at Executive Board Meeting 02/99 on September 20, 2002.

It is expected that this report will be posted on the Fund's external website following the IMFC meeting.

Questions may be referred to Mr. M. Allen (ext. 38786) and Mr. M. Walsh (ext. 39350) in PDR.

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INTERNATIONAL MONETARY FUND

Report of the Managing Director to the
International Monetary and Financial Committee
on the IMF in a Process of Change

Prepared by the Policy Development and Review Department

In consultation with other Departments

Approved by Timothy Geithner

September 25, 2002

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I. Introduction

1. Over the past several years, the Fund has been engaged in a process of change and reform, motivated by the increased role of private capital flows in the global economy, and lessons drawn from the financial crises of the 1990s. The reform process is aimed at making the Fund more effective in promoting macroeconomic stability and sustained growth, helping countries to benefit from the opportunities that come with global economic integration, and safeguarding the stability of the international financial system.

2. To enhance the Fund's effectiveness, the changes underway at Fund are focused on five main areas:

- improving transparency, accountability, openness and the learning culture of the Fund;
- enhancing the effectiveness of surveillance and crisis prevention;
- improving the capacity to deal with crises;
- supporting an intensified global effort in the fight against poverty; and
- reinforcing the Fund's role as a cooperative global institution.

3. These initiatives are at varying stages of implementation, and considerable progress is underway in all areas. Nevertheless, the ultimate test of these efforts is in their effective impact on the economic policies and outcomes across the Fund's membership and on the overall conditions of the global economy. Substantial challenges remain and the Fund and its members need to continue to make advances in achieving the reform objectives. This report highlights the efforts underway with a particular focus on progress since the Spring 2002 IMFC meeting, and outlines major elements of the agenda for the period ahead.

II. Improving Transparency, Accountability, and Openness

4. Underlying many of the reform initiatives now underway at the Fund is a fundamental shift in the internal culture of the institution. This has reflected the recognition that the IMF's effectiveness depends in large measure on its ability to be *transparent* and fair in developing and providing policy advice to its members; *accountable* for the advice it has given and lending decisions it has taken; *responsive* to lessons drawn from past experiences, particularly in program design; *open* to input and dialogue from outside; and *cooperative* with other members of the international community in pursing our common objective of promoting broadly shared, sustainable growth.

5. We have made considerable progress on all these interrelated fronts.

- *Enhanced transparency and accountability*: The Fund now publishes most papers on policy issues and an increasing amount of information about its operations and finances. Its members publish virtually all letters of intent, PRSPs, and other country policy intention documents, and the majority also publish staff reports for Article IV consultations and use of Fund resources.

- The Independent Evaluation Office (IEO) is now operational and has produced its first evaluation on the prolonged use of Fund resources. This evaluation was recently discussed by the Board, and follow-up will consider key recommendations that are not already reflected in the Fund's work program. The IEO has two more evaluations underway, on fiscal adjustment in Fund-supported programs and capital account crises, and more will be put in the pipeline in the coming year.

- *Openness*: The Fund is reaching out to civil society through a variety of media and fora, as well as revitalizing its relationships with other international financial institutions, private financial market participants, and other members of the international community more broadly. It has experimented in some cases with a process of making policy papers available for more direct public scrutiny and comment, prior to their consideration by the Executive Board.

- *Learning*: All of these reforms have contributed to the development of a stronger learning culture in the Fund. Lessons learned from past experiences are feeding into our efforts to improve program design. To this end, collaboration with the World Bank and other institutions on country program design and policy advice will be even more important.[1] To help ensure that the overall support for members is appropriate and effective, an enhanced framework for Bank-Fund collaboration has been established by the managements of the two institutions.

- The streamlining and focusing of Fund conditionality represents an example of how this overall change in approach has been translated into concrete action by the Fund. The objective of the new ***Guidelines on Conditionality*** is to enhance the success and effectiveness of economic reforms.[2] The Guidelines reflect input and feedback gathered through an extensive public consultative process. They were designed to recognize that national ownership is a crucial determinant to successful implementation and that conditionality remains a key element of the mutual accountability between the borrowing member and the Fund, but that it must be focused on the critical objectives of each program.

6. Maintaining momentum in each of these areas will be key to helping ensure durable progress by the Fund in its process of change. To that end, the Board and Management will

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[1] See "*The Acting Chairman's Summing up – Strengthen IMF-World Bank Collaboration on Country Programs and Conditionality – Progress Report*" (BUFF/02/156).

[2] See "*Guidelines on Conditionality*" (SM/02/276).

continue to keep progress in each of these areas under review, as highlighted throughout this report.

III. STRENGTHENING SURVEILLANCE AND CRISIS PREVENTION

7. Surveillance lies at the heart of the Fund's work to prevent crises. The aim of our initiatives to strengthen surveillance is to encourage members to adopt policies and institutional reforms that support sustained and balanced global growth, and strengthen the resilience of their economies to adverse external developments and financial stresses, and contribute to the stability of the international financial system. While it would be unrealistic to expect that all crises can be avoided by better surveillance, the Fund can through this instrument help to reduce the risk of future crisis and facilitate their effective resolution. The broad framework of Fund surveillance has several key elements:[3]

- *Multilateral surveillance*, where the World Economic Outlook (WEO) assesses global economic developments and prospects, and serves to provide context to and inform the policy discussions under bilateral surveillance. As a complement to the WEO, the quarterly Global Financial Stability Review (GFSR) has been developed by the International Capital Markets Department (ICM) as part of the Fund's efforts to improve its financial market surveillance.[4] Both the WEO and GFSR are placing increased focus on risks and vulnerabilities that may arise, including on the transmission of shocks from mature to emerging markets.[5]

- *Bilateral surveillance*, anchored in the Article IV consultation process. A number of diagnostic tools such as the Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSCs) have been developed and are being used to help identify vulnerabilities and assist members in addressing them.

- *Enhanced transparency* both on the part of members and the Fund itself so as to help mobilize public support for policy actions, enhance the accountability of the Fund, and facilitate better assessments of risks by borrowers and creditors. Good progress has been made in increasing the availability of information about the Fund and its assessments of

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[3] "*Biennial Review of the Implementation of Surveillance and of the 1977 Surveillance Decision – Overview*" (SM/02/82 and Supplement 1, and Supplement 1. Correction 1 and Supplement 2, and Supplement 2 Correction 1, and Supplement 3.), and "*Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Follow Up*" (SM/02/184 and Supplement 1) and Summing Up (SUR/02/81).

[4] As part of the Fund's effort to strengthen its surveillance of capital markets, the ICM was established in 2001 to deepen the Fund's understanding of capital market operations; improve its capacity for addressing systemic issues related to capital market developments; enhance its capability to provide early warning of potential stress in the financial markets; and strengthen its ability to help member countries gain access to international capital markets.

[5] See "*Concluding Remarks by the Chairman – Global Financial Stability Report*" (BUFF/02/135).

members policies.[6] Maintaining the momentum in this area will be important and in that context the Board intends to revisit the issue next year and consider a possible move to a policy of presumed publication of country reports.

- *Improved data provision,* which is critical for prudent national policy-making and effective crisis prevention.

A. Making Surveillance More Effective

8. The Fund has taken a number of steps to improve the focus and quality of its bilateral surveillance, to enhance the impact of its policy advice, and to strengthen surveillance in program countries.[7]

Focus and quality of surveillance

9. The biennial review of surveillance concluded that the selection of issues for discussions with members should be ***focused*** on macroeconomic relevance and the hierarchy of the Fund's concerns. At the apex of this hierarchy stands external sustainability, vulnerability to balance of payments or currency crises, sustainable growth and the policies to achieve it, and, for systemically important countries, conditions and policies that affect the global or regional outlook.

10. To improve the ***quality*** of the Fund's policy advice, efforts are concentrating on:

- Intensifying the focus on the global or regional impact of the policies of the systemically important economies, including structural issues such as trade policies, and greater attention to developments in the international capital markets and their effects on individual countries.

- Going beyond the conventional macroeconomic analysis, to provide a sharper focus on sources of growth and the institutional requirements for successful economic development.

- Putting in place mechanisms for assessing risks across countries on an almost continuous basis. In this context, much greater attention is being applied to sources of vulnerability and the policies necessary to build in a sufficient cushion of resilience against shocks, with a focus on debt sustainability and the private sector's balance sheet exposure to interest rate, exchange rate, and other macroeconomic shocks, in particular in the banking sector.

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[6] Progress achieved in this area and the key areas for future consideration are covered in the *Managing Director's Statement on Transparency* (SM/02/302).

[7] Findings from the review are summarized in the "*Managing Director's Report to the International Monetary and Financial Committee – Fund Surveillance and Crisis Prevention and Resolution*" (IMFC/Doc/5/02/5).

- Making effective use of the expertise of the World Bank and other appropriate outside institutions, on relevant structural issues outside the Fund's traditional areas of expertise.

Enhancing the impact of the Fund's policy advice

11. Efforts to improve the quality of the Fund's policy advice can only translate into effective surveillance and crisis prevention if this advice informs and affects the policy choices of its members. The Fund's effectiveness depends critically on an open policy dialogue with its members. To enhance dialogue and the impact of its advice the Fund is:

- Taking steps to complement sound advice on economic policy objectives with discussions of alternative ways to achieve these objectives;

- Assessing more carefully the social and political realities that shape economic policy as part of an effort to enhance ownership and improve program design;

- Reaching out more broadly, for instance to the legislative bodies in member countries, and other line ministries beyond the finance ministry and central bank; and

- Ensuring that consultations with members take place at times when the Fund's advice can influence the domestic policy debate.

12. Effectiveness also requires that the Fund's surveillance is evenhanded across the membership; it has to be, and has to be seen to be, at least as ambitious in large advanced countries as in emerging market and developing countries.

13. In parallel, to improve the Fund's ability to assess of the impact of its advice, every Article IV consultation report will now contain a brief assessment of the authorities' response to the key policy challenges identified in the previous consultation and include the views of the authorities on their actions and the Fund's policy advice.

Surveillance in program countries

14. Surveillance has a critical role to play in countries with Fund-supported programs, where a periodic reassessment of the economic challenges facing the member and alternative strategies to address those challenges can help to improve program design and outcomes. The Fund is taking the following steps to ensure that surveillance does fulfill this objective, by:

- *Strengthening surveillance in program countries,* by ensuring comprehensive and candid analysis and discussion of risks and vulnerabilities in Article IV consultations, even if this calls into question the original program framework;

- *Bringing a fresh perspective to Article IV consultations in program countries*, recognizing the necessity to step back from the program framework to take stock of the policy strategy to date. For this purpose, introducing a fresh pair of eyes in Article IV missions may be useful in certain circumstances.

- *Ensuring well-timed Article IV consultations in program countries.* A comprehensive assessment of economic developments, prospects, and policies is likely to be most useful before a program is negotiated, when a program has moved off-track, when a major change in the program strategy is envisaged, or between programs.[8] Thorough surveillance exercises, coupled with frequent contacts under the program, should strengthen surveillance in program countries.

15. The Board will return in 2003 to consider how best to take forward assessments of the effectiveness of Fund surveillance and will consider the need for further work on surveillance in program countries, taking into account experience with the implementation of the above measures.[9]

B. Strengthening Institutional Capacity

16. The Fund has been working, in conjunction with other members of the international community, on a range of initiatives that complement the Fund's surveillance framework. These initiatives are designed to improve the institutional capacity of countries to support strong macroeconomic policy frameworks and more resilient financial systems. They are also targeted at the objective of improving risk assessment by the participants in financial markets.

Strengthening financial sectors

17. The Fund has intensified its financial sector assessment efforts. Evaluation of member countries' financial sector vulnerabilities has been strengthened through the joint Bank-Fund Financial Sector Assessment Program (FSAP) and the Fund's Offshore Financial Center (OFC) assessment initiative.

Financial Sector Assessment Program

18. The FSAP helps countries to foster growth and enhance their resilience to crises and cross-border contagion, by promoting the development of sound financial systems. It has become the Fund's principal platform for identifying vulnerabilities and institutional and regulatory

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[8] "*Summing Up by the Chairman – Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Follow Up*" (SUR/02/81). Details of the conditions are set out in "*Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Follow Up*" (SM/02/184, Supplement 1). To enhance the scheduling of Article IV consultations in program countries, these countries will be moved to a 24-month consultation cycle, subject to certain conditions designed to ensure reasonable continuity of surveillance.

[9] "*Summing Up by the Chairman – Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Follow Up*" (SUR/02/81). The new draft Guidelines were issued to the Board in "*Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Follow Up*" (SM/02/184, Supplement 1).

weaknesses in member countries' financial systems. The FSAP has significantly increased the depth and breadth of coverage of financial sector issues in Fund surveillance.[10]

- In addition to standards assessments and the resulting Reports on Observance of Standards and Codes (ROSCs), FSAP missions use various analytical tools, including stress tests and financial soundness indicators to assess the implications of the macroeconomic environment and policies for the health of the financial sector and to assess possible systemic risks. In particular most FSAPs make use of the Guidelines for Public Debt Management,[11] issued in 2001 by the Fund and the Bank, to assist policy makers in considering their country's vulnerability to international shocks.[12]

- By end-August 2002, nearly half of the Fund's members had participated in the FSAP or volunteered to do so in the near future.

19. The forthcoming review of the FSAP will allow the Board to draw lessons from the program; consider further the prioritization of assessments both in terms of country coverage and scope, review modalities for assessments, reassessments, and updates; assess the various analytical tools used in the FSAP; and to draw together the framework for financial sector surveillance that is emerging from the program.

Offshore Financial Center Assessments

20. Many of the tools developed for the FSAP are also used in the Fund's work on offshore financial activity, another part of its efforts to safeguard the stability and integrity of the international financial system.[13]

- As of end-August 2002 OFC assessments had been completed for 17 jurisdictions, and five of these have been published. Five OFC assessments are currently underway and a further 10 are scheduled before the end of the year.

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[10] The *"Biennial Review of the Implementation of Fund's Surveillance and of the 1977 Surveillance Decisions – Overview"* (SM/02/82) noted that the FSAP participation seems to have been the most important factor accounting for differences in coverage of financial sector issues in Article IV consultations.

[11] See "*Guidelines for Public Debt Management*" (SM/01/27).

[12] The "*Accompanying Document to the Guidelines for Public Debt Management*" is being prepared and will be presented to Directors in Spring 2003.

[13] The Fund's work involves voluntary assessments of OFCs, at three possible levels. Module 1 is an assisted self-assessment with technical assistance from experts, as needed, to help OFCs assess their compliance with particular standards. Module 2 is a stand-alone Fund-led assessment of standards, and Module 3 is a comprehensive assessment of risks and vulnerabilities, institutional preconditions, and standards observance prepared by the Fund, within the framework of the FSAP.

- Three FSAPs to countries with international financial centers have been completed, one is underway and four are scheduled.

Standards and Codes

21. The development, dissemination, and adoption of internationally accepted standards and codes of good practice are an important part of the Fund's efforts to strengthen institutional capacity in member countries. Assessments of members' observance of standards and codes have now progressed from an experimental basis to an established initiative that informs Fund surveillance, serves as a framework for countries to focus their policy and institutional decisions and prioritize technical assistance needs, and promotes better risk assessment by market participants.

- As of end-August 2002, 293 ROSCs have been produced by the Fund and Bank (including 164 under the FSAP) for 83 economies, of which 217 reports for 66 economies have been published (Table 1). Most of the ROSCs produced to date have been conducted in the areas within the Fund's direct operational focus, which are data dissemination, fiscal, monetary and financial transparency, and banking supervision.

- Participation in this voluntary initiative is growing, with nearly 60 percent of members having completed or committed to complete a ROSC (Table 2), although only a few members are close to completing the full range of ROSCs.

22. While the initiative will take time to reach full potential, the initial reactions seem favorable in terms of positive impact on the international financial system. Many countries are taking action to correct weaknesses raised by ROSCs, some under Fund- and Bank-supported programs and some with the support of technical assistance. Standards are now also used as one of the filters for prioritizing technical assistance requests.[14] There are also indications that market participants are increasingly using ROSCs and standards to inform their investment decisions and risk assessments.

23. The forthcoming review of the standards initiative will elaborate on these findings and raise a number of forward-looking issues. These include:

- Review of existing standards by standard-setting bodies, with the view to identifying areas for modification or to addressing important gaps. As recent events have highlighted, corporate governance, accounting, and auditing are important areas for attention in this regard.

- Prioritization and systematic follow-up to ROSCs.

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[14] In financial year 2001/02 the Fund provided 14 staff years of technical assistance through this filter. Summing Up by the Acting Chairman "*Review of the FY2000 Annual Technical Assistance Report and Discussion of Alignment of Technical Assistance with the IMF's Policy Priorities*" (BUFF/01/2).

- Identification, prioritization, and follow-up of technical assistance needs in light of existing resource constraints, in conjunction with the forthcoming review of the FSAP.

Data provision

24. Comprehensive, timely, and accurate economic data, notably on international reserves and external debt, are critical for prudent national policy-making, risk assessments by market participants and for effective surveillance and crisis prevention. Considerable progress has been achieved, though data deficiencies continue to hamper vulnerability analysis in many cases. The Fund continues to work to help members improve their economic data gathering and provision, in order to allow policy makers, as well as markets, to make better informed decisions.[15]

- *Dissemination of data to the public on international reserves is improving*. The frequent and timely disclosure of reserves data is emerging as a best practice for many countries.[16] 50 countries now subscribe to the Special Data Dissemination Standard subscription, while 43 members are participating in the General Data Dissemination System.

- The recent completion of the *Government Finance Statistics Manual* represents a major advance in the development of an analytical framework for fiscal data.[17]

- A further boost to data provision is expected as countries subscribing to the SDDS have now begun disseminating data on their international investment position following the end of the transition period on December 31, 2001, while in respect of external debt, the transition period ends on March 31, 2003 after which subscribers are required to disseminate quarterly debt statistics within one quarter of the reference period.

Technical assistance

25. Technical assistance is critical to assisting the Fund's members to design and implement sound policies. To improve the effectiveness of technical assistance provision the Fund is:

- Ensuring that the needs of recipients and the considerable capacity constraints faced by many members are taken into account in the allocation and design of technical assistance;

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[15] "*Summing Up by the Acting Chair – Data Provision to the Fund for Surveillance Purposes – Executive Board Meeting*" (SUR/02/54).

[16] To help enhance financial system surveillance, a Financial Soundness Indicators Compilation Guide is under preparation and will be considered by the Executive Board as part of its discussion on financial soundness indicators ahead of the Spring 2003 IMFC meeting.

[17] The speed with which member countries can adopt the practices set out in the new manual, however, will in part be influenced by the ability of the Fund to deliver technical assistance.

- Placing emphasis on the development of human and institutional capacities, with the training offered through the IMF Institute playing an important role;

- Making continuous efforts to improve the prioritization and effectiveness of its technical assistance; and

- Increasing its focus on members' records in implementing technical assistance recommendations.

26. The Fund will continue to mobilize external financing for technical assistance activities. Bilateral contributions now play a substantial role in financing Fund-provided technical assistance, and it is strengthening efforts to increase the leverage of its technical assistance resources. In this context, the Fund has increased cooperation with other technical assistance providers, including the World Bank.

27. Recognizing that limited capacity is a major impediment to PRSP/PRGF implementation, the Fund has also been providing more technical assistance through missions, dedicated short and/or long-term advisors, financial programming and other courses through the IMF Institute on current issues related to Fund operations, particularly financial sector issues, and has significantly expanded its network of regional training institutes, programs and technical assistance centers.

- The Caribbean Regional Technical Assistance Center was opened in November 2001.

- Two regional technical assistance centers (AFRITACs) in Dar es Salaam and Abidjan will be established as part of the Fund's support for the New Partnership for Africa's Development.[18]

28. Based on the experience of these latter two centers, the Fund will consider establishing three additional centers to cover the rest of sub-Saharan Africa.

C. Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)

29. In light of the events of September 2001, the international community launched an intensified and comprehensive effort to address money laundering and the financing of terrorism. The Fund and the Bank were asked to play an important role in this effort. Significant progress has been made in implementing the action plan that was agreed upon last November by the IMFC for the Fund.[19] Specific actions are summarized below.[20]

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[18] In late 2001, the Fund, together with the World Bank and with financial support from DfID launched a project to improve 14 Anglophone African countries' statistical capacity, using the GDDS as a framework.

[19] *"Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund"* April 20, 2002 (PR/02/22 Cor. 1).

30. The Fund and Bank Boards have conditionally agreed to a 12-month pilot program of AML/CFT assessments and accompanying Reports on the Observance of Standards and Codes (ROSCs) that would involve participation of the Fund and the Bank, the Financial Action Task Force (FATF) and the FATF-Style Regional Bodies (FSRBs). In collaboration with the Bank and FATF, the Fund has developed a single comprehensive methodology for AML/CFT assessments. This work is virtually completed and will provide a consistent framework for conducting assessments, whether carried out by Fund/Bank, FATF, or FSRBs.

31. The Board agreed to add the FATF 40+8 Recommendations to the list of Standards and Codes useful to the operational work of the Fund, subject to four conditions.[21] A report from the staff on the completion of the four conditions prior to the commencement of the 12-month pilot program will be presented to the Board following the October FATF Plenary.

32. Prior to the development of a comprehensive assessment methodology, the Fund and Bank had already become deeply involved in assessments of anti-money laundering and combating the financing of terrorism, with AML/CFT assessments now included in all FSAPs and OFC assessments. In 2002, in the context of the Fund and Bank FSAPs and the Fund's program for offshore financial centers, the staffs expect to undertake some 20-30 assessments of AML/CFT regimes.

33. In the period ahead, the Fund and Bank are gearing up to begin comprehensive AML/CFT assessments.[22] National jurisdictions have been contacted to identify experts and resources for Fund/Bank led assessments. The Fund and the Bank are working to be ready to begin the assessments in the context of FSAPs and OFC assessments and on a stand-alone basis as soon as the conditions for the 12-month pilot have been met. To avoid duplication the Fund and Bank are collaborating and coordinating with FATF/FSRBs on a schedule of assessments using the new methodology. FSAP teams will draw upon recent FATF/FSRB assessments, where available.

34. The delivery of technical assistance has been expanded. Since September 2001, the Fund/Bank have completed, initiated, or agreed to provide TA to 39 countries, and TA requests have been received from an additional 14 countries. Moreover, the Fund and the Bank, in

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[20] "*Intensified work on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)—Joint Progress Report on the Work of the IMF and the World Bank*" (SM/02/290 and Supplement 1).

[21] The four conditions agreed by Executive Directors were: (i) the FATF mutual evaluations are to be consistent with ROSC process as set out in the July 2002 Board paper (Section II of SM/02/227); and (ii) that the FATF not undertake a further round of the non-cooperative countries and territories (NCCT) initiative, at least during the period of the pilot project; (iii) that the FATF at its October 2002 Plenary finalize the AML/CFT methodology, and (iv) that the FATF endorse the use of this methodology by the FATF, FSRBs and the Fund and Bank.

[22] While assessments by the Fund/Bank or by FATF/FSRBs would encompass comprehensive treatment of AML/CFT covering all FATF 40+8 Recommendations, Fund staff (and experts under staff supervision) would not be involved in assessing implementation of criminal laws and the activities of those parts of the non-prudentially-regulated financial sector that are not macro-relevant and do not pose a significant risk of money laundering or financing of terrorism.

collaboration with key external partners, have developed a mechanism for the coordination of TA for AML/CFT.

35. Other related initiatives include:

- A voluntary *AML/CFT questionnaire* has been developed and is in use to inform Article IV consultations and to better understand AML/CFT weaknesses worldwide. Through September 24, 52 responses have been received.

- For *research and analysis*, a study on informal fund transfer systems (Hawala) has been prepared.

- The Fund's program of *OFC assessments has been accelerated* and is now targeted for completion by the end of 2003.

36. Given the high priority that the international community has attached to the Fund's AML/CFT efforts, additional resources were assigned to AML/CFT work, and resource costs will be further considered in light of experience with the 12-month pilot program as part of the FY 2003-04 budget preparation process.[23]

IV. Enhancing Crisis Resolution

37. Measures to strengthen surveillance and to enhance members' capacity for designing and implementing effective policy should lessen the number and severity of crises over time. But it would be unrealistic to expect that these measures could prevent crises from occurring altogether. The Fund is in the process of a number of reforms designed to improve our capacity for managing and resolving financial crises, including through a more constructive partnership with the private sector. Our work to strengthen the crisis resolution framework aims to re-enforce incentives for good policies and therefore complements the Fund's crisis prevention efforts.

A. Enhancing the Fund's Capacity to Respond to Crises

38. Since the Prague framework for private sector involvement in crisis resolution was established at the 2000 Annual Meetings, the Fund has concentrated on five areas:

- *Strengthening the assessment of debt sustainability* as a basis for Fund surveillance and for its decisions in a crisis resolution setting;

- *Improving the clarity and predictability of the Fund's policy on access to its resources,* to help improve the incentives for stronger risk management by policy makers and the financial markets;

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[23] *"Summing up by the Acting Chair – Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)—Proposals to Assess a Global Standard and to Prepare ROSCs"* (BUFF/02/122).

- *Refining Fund financial facilities* so they can help prevent crisis as well as better support members' policies during crises;

- *Clarifying the policy on Fund lending into sovereign arrears to private creditors*, so that it enhances the likelihood of both successful implementation of adjustment policies and collaborative agreement with creditors; and

- *Improving the legal framework for sovereign debt restructurings*, to facilitate effective crisis resolution.

Improving sustainability analysis

39. A more systematic framework for judging debt sustainability has been developed and endorsed by the Executive Board. It is now being applied in the work on countries receiving financing from the IMF's general resources as well as to other countries with significant access to financial markets.[24] This new framework is designed to help strengthen the diagnosis of problems confronted by a country and the design of better economic programs in response, and to underpin financing decisions. The new framework provides a reality check on the baseline projections on the basis of which sustainability is assessed, clarifying the underlying assumptions regarding key variables including growth, real interest rates, exchange rates and primary fiscal or external imbalances and highlighting their implications. It introduces a set of standardized parameters for stress testing the program baseline, to identify the extent to which sustainability hinges on a macroeconomic outcome more favorable than those experienced in the past and to help ensure the robustness of the program against reasonable shocks.

40. Assessments of sustainability are necessarily based on judgment, given that they depend upon a complex assessment of the interrelationship among several factors — including macroeconomic developments, political and social constraints on adjustment, and the availability and cost of private and official financing. The new framework helps strengthen the analytical basis for making these judgments. It does not provide a mechanistic approach, given the wide variation in the debt-bearing and adjustment capacities of different economies over time. Rather, it is a framework for informing these judgments and expressing them in a transparent manner. As greater experience is gained, efforts will continue on further refining the framework.

Access policy in capital account crises cases

41. As part of the Fund's response to the challenges arising from the increasing integration of global financial markets, the Executive Board recently has given initial consideration to a strengthened policy framework for exceptional access to the Fund's resources.[25] It was agreed that more clearly defined criteria regarding the appropriate use of exceptional access in capital account

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[24] See "*Concluding Remarks by the Acting Chair – Assessing Sustainability*" (BUFF/02/86).

[25] See "*Summing up by the Acting Chair – Access Policy in Capital Account Crises*" (BUFF/02/159).

crises are needed to help shape the expectations of members and markets, provide a benchmark for difficult decisions regarding program design and access, safeguard Fund's resources, and ensure uniformity of treatment of members. To justify exceptional access for members facing a capital account crisis it was generally considered that, at a minimum, the following criteria will need to be met:

- The member is experiencing exceptional balance-of-payments pressures on its capital account resulting in a need for Fund financing that cannot be met within the normal limits;

- A rigorous and systematic analysis indicates that there is a high probability that debt will remain sustainable;

- The member has good prospects of regaining access to private capital markets within the time Fund resources would be outstanding, so that the Fund's financing would provide a bridge; and

- The policy program of the member country provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

42. The proposed framework needs to reflect the importance of involving the private sector for program success and recognized that the Fund should be prepared to provide access above the normal limits in cases where the member's problems have regional or systemic implications, when the other criteria are met.

43. The Board expressed support for the proposals for strengthening the procedures for decision making on access above the normal access limits to provide additional safeguards and enhance accountability:

- *Increasing the burden of proof required in program documents* – to include a thorough discussion of need and the proposed level of access, a rigorous analysis of debt sustainability, and an assessment of the risks to the Fund arising from the exposure and its effect on liquidity;

- *Formalizing early Board consultation on the status of negotiations in exceptional access cases*; and

- *Requiring ex post evaluation of programs of exceptional access* – within a year of the end of the arrangement.

44. Staff will prepare a follow-up paper before the end of the year on how best to put this new framework in place, including the proposed strengthened decision-making procedures and substantive criteria. This paper will also include further consideration of the appropriate maturity of Fund lending in capital account crises, and of the related issue of the mix between the provision of resources made under the Supplemental Reserve Facility (which has a shorter maturity and higher interest rate) and stand by and extended arrangements.

Improving Fund facilities

45. The completion of the Review of Facilities in late 2000 provided the Fund with a streamlined set of facilities to ensure that Fund resources can meet the needs of members more efficiently. The main challenge remains the Contingent Credit Line (CCL), which aims to reinforce incentives for members implementing sound policies to stay the course.

46. The CCL has yet to live up to its potential as a part of the Fund's crisis prevention toolkit. However, the concept of using IMF financing proactively to recognize good performance and help safeguard a sound policy framework in the face of turbulence in international capital markets remains attractive, and will be pursued further. The forthcoming review of the CCL in November provides an opportunity to reassess the CCL, and will look again at the use and structure of precautionary arrangements.

Lending into arrears

47. When a member is experiencing difficulties in servicing its debt obligations vis-à-vis its external private creditors, discussions on the restructuring of its debt may be a difficult and protracted process, and an agreement may not always be reached prior to the emergence of arrears. The Fund continues to stand ready to provide resources to members that are in arrears to private creditors, when prompt support is essential for the successful implementation of the member's adjustment policies and the member is making a good-faith effort to reach a collaborative agreement with its creditors. In September 2002, the Board reviewed recent experience gained with the restructuring of sovereign bonds and the application of the good-faith criterion under the lending into arrears policy:[26]

- Underscoring the importance of a debtor engaging its creditors in an early and constructive dialogue to help secure a reasonably timely and orderly agreement that would help the country regain external viability;
- Stressing the need for continued flexibility in applying the good faith criterion to accommodate the characteristics of each specific case; and
- Approving a set of principles designed to clarify what members would be expected to do in terms of timely and substantive engagement with their creditors in a dialogue during the restructuring process and in the context of elaborating a restructuring proposal.

B. Strengthen the Legal Framework for Sovereign Debt Restructuring

48. Recent experience has demonstrated that the current framework for dealing with situations in which a sovereign's debt has become unsustainable and warrants restructuring needs to be

[26] See "*The Acting Chair's Summing up – Fund Policy on Lending into Arrears to Private Creditors-Further Consideration*" (BUFF/02/142).

improved. Countries now face an increasingly numerous and diverse set of creditors and issue a complex variety of tradable financial instruments, often in multiple jurisdictions. While this is a positive development, as it expands sources of financing and diversifies risks, it also creates collective action difficulties which complicate the task of achieving broad participation in restructurings that may serve the interests of both the debtor and creditors as a group. As a result, the current process for debt restructuring can be prolonged and unpredictable, and can impose undue costs in terms of economic dislocation for debtors and loss of asset value for creditors. The key challenge is to establish a restructuring mechanism that resolves collective action problems while maintaining appropriate incentives for all participants. Current efforts seek to improve the current legal framework in order to make the process more agile, orderly, and predictable.

49. Since the last IMFC meeting the Fund has continued to advance work along two parallel, but complementary, tracks to improve the framework for sovereign debt restructuring:

- *A contractual approach* – the Fund is pursuing ways to promote the use of collective action clauses (CACs), in bond contracts; and

- *A statutory approach* – the Fund is also examining legal, institutional and procedural proposals that in cases of unsustainable debt would enable a sovereign debtor and a super-majority of its creditors to reach an orderly agreement binding all creditors – the Sovereign Debt Restructuring Mechanism (SDRM).

Collective Action Clauses

50. The Fund is pursuing ways to strengthen incentives for the use of CACs, and is working with the G10 and the private sector to develop model clauses that could gain wider acceptance in key bond-issuing jurisdictions. During a preliminary discussion of the issues by the Executive Board in June of this year, it was agreed that:[27]

- The use of contractual provisions could facilitate collective action by creditors holding individual debt instruments, and could play a useful role in the orderly resolution of crises and improve the debt restructuring process;

- The most useful CACs are majority restructuring and enforcement provisions, such as those now existing in many international sovereign bonds;

- The Fund will make efforts to persuade its members to issue debt containing such clauses through its bilateral and multilateral surveillance, but little role was seen for conditionality to support the objective of wider usage of CACs. Several Directors also considered that greater use of CACs in debt contracts could effectively be promoted by regulatory action in

[27] See the "*Summing Up by the Acting Chair – Design and Effectiveness of Collective Action Clauses, and Encouraging Greater Use of Collective Action Clauses in Sovereign Bond Contracts*" (BUFF/02/99).

major financial centers where CACs are not yet the market standard, though the difficulties in this approach were generally recognized.

51. The Fund is continuing its work in this area, and will monitor the use of such clauses both in new bond issuances and in the outstanding debt stock.

Sovereign Debt Restructuring Mechanism (SDRM)

52. The Fund's recent proposals for a sovereign debt restructuring mechanism (SDRM) aim to create the legal foundation for a more rapid, orderly and predictable restructuring process. It seeks to improve the debt restructuring process by creating a stronger legal basis for collective action among the sovereign's external creditors. The proposed statutory framework would allow the debtor and a super-majority of its external creditors to make a restructuring agreement binding on holders of all debt instruments that are subject to the mechanism. It would also allow a super-majority of creditors to vote to provide a temporary stay of the enforcement of creditor claims so as to protect the debtor from litigation during negotiation on the restructuring agreement as well as to provide new priority financing.

53. The proposed SDRM's basic features are modeled on the provisions found in existing sovereign debt contracts governed by English law that allow for collective action among creditors. As with English law bonds, key decisions would be made by the debtor and a super-majority of its creditors, not by a third party. Similarly, the sovereign would propose a restructuring agreement, but only the consent of a super-majority of creditors would make that agreement binding on a minority of holdout creditors.

54. The statutory approach differs from the contractual approach in two keys ways. First, the statutory approach would provide the debtor and a super-majority of creditors with the ability to override contractual provisions in debt contracts that require unanimity to restructure the debts' financial terms. This would immediately create a legal framework that allows for collective action. Second, the votes of creditors holding participating debt instruments would be aggregated, allowing a single vote to restructure the multiple debt instruments. This would make reaching agreement on a restructuring agreement much easier, while still ensuring that any agreement had the support of the vast majority of the sovereign's creditors. It is recognized that given the diversity of the legal, economic and financial interests of creditors, there would need to be a system that allows for the classification of creditors for voting purposes.

55. There is broad support in the Executive Board for a statutory debt restructuring mechanism to improve the international financial architecture.[28] Directors have emphasized that the design of the SDRM should be kept as simple as possible, and that as many decisions as are possible during the restructuring process should be made by the debtor and its creditors. The Board has also

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[28] See the "*Concluding Remarks by the Chairman – Sovereign Debt restructuring Mechanism – Further Considerations*" (BUFF/02/140).

discussed and offered its preliminary views on some of the more detailed features that would need to be worked out to develop an operational design:

- *The scope of debt to be included under the SDRM* should include all claims where the SDRM provides the needed legal tools to overcome collective action difficulties. In particular, the SDRM should include claims held by private creditors that are either governed by foreign law or subject to the jurisdiction of foreign courts. The preliminary view of the Board was that claims governed by domestic law should be excluded from the SDRM. The Board also took the preliminary view that official bilateral claims should be excluded from the SDRM. Close coordination would be needed between the Paris Club restructuring and the restructurings of private external debt through the SDRM.

- *The coverage of individual restructurings* would need to be decided by debtors in light, inter alia, of the willingness of the Fund to support a program based upon such a restructuring and the ability to reach agreement with creditors. It should be sufficiently broad so as to ensure an adequate reduction in the debt and debt service burden, while also providing sufficient inter-creditor equity to garner broad support. In some cases, debt not covered by the SDRM would also need to be restructured.

- *The design of the SDRM* should retain flexibility given the potential complexity and diversity of instruments and creditors involved in individual restructurings.

    - It would be difficult to aggregate all claims on the sovereign for voting purposes into a single vote, as creditors may have different types of claims on a sovereign and may not be similarly situated. In particularly, it would be important to protect the seniority of claims.

    - The establishment of a classification system whereby claims are aggregated within – but not across – classes for voting purposes would allow for the aggregated voting needed to facilitate restructurings, while still protecting the specific interests of a set of creditors holding a certain types of claims. Classification allows the debtor to offer different terms to different classes of creditors, terms which would reflect the different nature of the claims held by the class in question as well as their particular preferences. Approval of the overall restructuring would require the approval of a super-majority of each creditor class.

- *The features of a dispute resolution forum* would provide for legal uniformity in all jurisdictions and ensure uniform interpretation. The Board stressed that the Sovereign Debt Dispute Resolution Forum (SDDRF) should not only be independent, but be seen to be independent. Its role should be limited to the administration of claims and the resolution of disputes.

56. The staff will conduct further outreach, engaging the private sector, emerging market sovereign borrowers, and the public, in order to develop a more concrete set of recommendations and to build consensus on the design of the SDRM. Drawing on these discussions, the Fund staff

will further refine its analysis and outline the elements of a fully defined SDRM for consideration by the Board.

V. STRENGTHENING THE FUND'S SUPPORT TO LOW INCOME COUNTRIES

57. There is currently unprecedented agreement among the international community on the urgent need for a concerted and coordinated effort in the battle against poverty so that globalization is made more inclusive with a better balance of the benefits and risks. Nevertheless, substantial challenges remain to achieve this common aim. While the World Bank has the lead institutional role in poverty reduction, the Fund is actively playing its part within its mandate in the fight against world poverty.

58. The Monterrey consensus creates an architecture of mutual responsibility, based on a two-pillar approach, for reaching the UN Millennium Development Goals (MDGs):

- Low-income countries take primary responsibility for implementing policies to accelerate growth and reduce poverty, recognizing that good governance is crucial for this.

- The international community takes responsibility for buttressing these efforts with more timely, stronger, better harmonized, and more comprehensive support.

59. The Political Declaration and Implementation Plan of the recent World Summit on Sustainable Development in Johannesburg have a broader focus, but in areas where the Fund has a role to play, we are pleased to see that the Johannesburg objectives reaffirm those of both the Monterrey Consensus, and the Doha Ministerial Declaration. Consistent with the two-pillar approach, much of what is to be achieved will take place at the country level, but enhanced international support will be vital.

60. As part of the second pillar, the Fund is supporting its low-income country members in three main areas.

- Helping these countries to develop and implement economic reform programs aimed at accelerating growth and thus reducing poverty. The Fund's contribution to these programs is targeted to our areas of core expertise, and set within the Poverty Reduction Strategy Paper (PRSP) approach;

- Helping the Heavily Indebted Poor Countries (HIPC) address the burden of unsustainable debt through the enhanced HIPC Initiative; and

- Supporting calls for increased and better targeted support by the international community for low-income countries with sound policies, particularly in the areas of aid volumes and effectiveness, donor coordination, and market access.

A. The PRSP Approach

61. The PRSP review—undertaken jointly with the World Bank earlier this year—indicated that this country-owned and results-based approach to development has been widely accepted by low-income countries and by most major development agencies as the basis for providing assistance.[29]

- Some 50 low-income countries are now pursuing country-led development processes under the PRSP approach, of which nearly 20 have completed their full PRSP.

62. The review of the PRGF, also held earlier this year, revealed that there has been a good start in aligning PRGF-supported programs with the associated PRSP.[30] This finding was reaffirmed by the recent report on progress in implementing the PRSP approach, but more needs to be done. [31] The Fund is acting in particular on three areas in the coming months:

- First, ensuring that macroeconomic frameworks underpinning PRSPs and associated PRGF-supported programs are designed to respond flexibly to inevitable changes in the external environment, in order to address concerns about the realism of projections, how best to accommodate higher aid flows without disrupting macroeconomic stability, and consideration of alternative policy options.

- Second, ensuring progress in strengthening public expenditure management and incorporating more poverty and social impact analysis in the design of policy reform options.

- Third, increased attention to countries' policies and programs to create an enabling environment that can stimulate investment and growth. The World Bank has the main responsibility in this area, but the Fund is contributing, through, for example, analyzing the macroeconomic foundations for growth, incorporating developmental issues into the Financial Sector Assessment Program, and encouraging the creation of local investor councils.

63. The Fund is also undertaking efforts to assist countries in implementing their the national poverty reduction strategies through country consultations, technical assistance, and analytical research.

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[29] See "*Poverty Reduction Strategy Papers—Progress in Implementation*," (SM/02/250;8/06/02).

[30] See "*Review of the Poverty Reduction and Growth Facility: Issues and Options*," (SM/02/51; 2/15/02).

[31] See "*Poverty Reduction Strategy Papers – Progress in Implementation*," (SM/02/250 Revised; 9/06/02).

- Consultations with individual low-income members are more focused on identifying sources of growth, including trade liberalization, and an enabling environment that can stimulate investment and growth.

- As noted earlier, the Fund is establishing two regional technical assistance centers in Africa to help support the PRSP process, and is participating in the Integrated Framework for Trade-Related Technical Assistance, including through preparing studies on trade integration, which could feed into analysis underlying countries' PRSPs and reinforce work on building trade capacity.

- The Fund will be conducting a review of its trade policy advice to developing countries in the coming months, and will undertake analytical work on topics related to poverty reduction and growth, such as sources of growth, the macroeconomic dimension of accommodating large aid flows, over-optimism in projections, and the impact of exogenous shocks on growth prospects.

- As noted at the 2002 Spring Meetings, the Fund is exploring how its operational modalities can best meet the diverse needs of low-income members, including assisting them in dealing with the disruptive effects of exogenous shocks, and the needs of countries emerging from conflict. The Executive Board will be considering work on these issues in the coming months.

64. To address the special needs of the transition CIS-7 economies, the Fund, together with the World Bank, the European Bank for Reconstruction and Development, and the Asian Development Bank, has been working closely with the authorities and bilateral donors to achieve the goals of the CIS-7 Initiative launched at the 2002 Spring Meetings.[32] The Initiative envisages more country ownership of intensified development and reform efforts, with additional international support available to countries following strong reform policies. The Fund has maintained a close policy dialogue with these countries in an effort to strengthen reforms and ensure progress towards debt sustainability.

B. The HIPC Initiative

65. The IMF and World Bank Executive Boards recently reviewed progress in implementing the enhanced HIPC Initiative. They encouraged continued progress in addressing the challenges that remain in enabling all HIPC countries to achieve durable debt sustainability.[33]

- Twenty six, or about two-thirds, of the countries expected to require HIPC relief have already reached their decision points, and will receive debt relief totaling US$25 billion

[32] The CIS-7 are Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.

[33] See "Heavily Indebted Poor Countries Initiative - Status of Implementation" (SM/02/264).

(net present value terms), including six countries which have reached their completion points.

- The Fund has committed HIPC relief of about US$2 billion, of which over US$1.1 billion has already been disbursed.

- Together with associated debt forgiveness, total assistance to these countries represents a reduction in the outstanding debt stock of about two-thirds, or US$40 billion in NPV terms. This will reduce annual debt-service payments for most HIPCs substantially, to less than 10 percent of exports.

- The debt relief provided to date has helped these countries increase annual social expenditures from around 6 percent of GDP on average in 1999 to a projected 9 percent in 2002 – more than three times the amount of debt service.

66. Further progress in bringing new countries to decisions points is, as expected, proving to be slower, as most remaining HIPCs are facing difficult situations, including recent emergence from armed conflict. Wherever possible, the Fund is actively engaged with these countries to develop strategies for moving ahead.

- For the 20 HIPCs in the interim period, progress in reaching completion points will likely take longer, due to the time needed to prepare broad-based, participatory PRSPs, or because of significant problems in implementing their economic reform programs. Most of these countries are benefiting from interim debt relief, which lowers their near-term debt-service costs substantially.

- Directors encouraged these HIPCs to stay on track with economic adjustment and reform programs in order to reach their completion point without delay.

67. HIPCs' debt sustainability outlook remains broadly unchanged from the Spring, and the joint progress report still anticipates that some eight to ten HIPCs may exceed a debt stock to export ratio of 150 percent at their completion point.

- Debt indicators in 15 of 24 HIPCs under review worsened in 2001 relative to decision point projections, largely as a result of the global economic downturn and depressed commodity prices.

- The Initiative has the flexibility to provide additional debt relief at the completion point, if a careful case-by-case review reveals that a country has suffered a fundamental change in economic circumstances due to exceptional exogenous shocks. Over the longer term—beyond HIPC debt relief—debt sustainability will require sound economic policies, good governance and prudent debt management policies by HIPCs, as well as new external financing on sufficiently concessional terms.

68. A key issue for successful implementation of the HIPC Initiative remains increasing the participation of multilateral and non-Paris Club official bilateral and commercial creditors. Recent

pledges by donors to help close the financing gap of the IDA-administered HIPC Trust Fund are welcomed, as these will help participation of some multilateral institutions. The Fund is stepping up efforts to help improve participation of non-Paris Club bilateral and commercial creditors.

69. The IMF has thus far mobilized financing projected to be sufficient to support its participation in the HIPC Initiative as currently costed and continuation of PRGF operations during 2002-05, excluding the resources that would be required to address the external debt problems of Sudan, Liberia and Somalia and the resolution of their arrears to the Fund. The available financial resources could also accommodate the relatively small topping up assistance under the HIPC Initiative that might be needed at completion points, as indicated in the recent HIPC progress report. The adequacy of financial resources will need to be monitored carefully, in light of the actual use of these resources and developments in market interest rates, which could affect both financing needs and availability. Adequate resources have also been secured from a number of countries to subsidize the likely call on Fund's post-conflict emergency assistance through 2004.[34]

C. Advocating Aid and Trade and Monitoring Progress

70. Achieving progress on the Fund's efforts to assist low-income countries hinges importantly upon key policies of the international community: donor countries providing more aid, allocated and disbursed in ways that maximize the impact on poverty reduction, and all countries improving market access for developing country exports. In the area of aid, the Fund continues to call for industrial countries to fulfill their commitments to provide ODA in an amount equivalent to the UN target of 0.7 percent of GNP and to allocate and disburse aid flows to maximize their impact on poverty reduction.

71. Trade and investment are key elements for an economic environment conductive to growth. The Fund therefore continues to support trade liberalization that will benefit developing country exports, and has refocused its Article IV surveillance to provide more detailed and critical analysis of the trade policies in industrial and large developing countries, with a view to highlighting the impact of barriers to developing country exports. In discussing a joint Fund and World Bank paper on market access for developing country exports, the Executive Board has recently reemphasized that protectionism in agricultural and textiles trade, in particular, must be overcome for the multilateral trading system to be more supportive of development.[35] At present, the annual cost of subsidies and price supports for agricultural products in the OECD countries is more than six times as large as their aid budgets. In line with other research on the subject, it also noted, however, that the largest efficiency and dynamic benefits would derive from more open trade regimes in the

[34] In addition, in order to provide an opportunity for all eligible HIPCs to establish a policy track record that would allow them to benefit from HIPC relief the Board recently supported an extension of the sunset clause of the HIPC Initiative to end-2004, see "*The Acting Chair's Summing Up – HIPC Initiative – Status of Implementation; and Update of PRGF and HIPC operations and Subsidization of Post-Conflict Emergency Assistance*" (BUFF/02/147).

[35] See "*Market Access for Developing Country Exports – Selected Issues*" (SM/02/280 and Sup. 1).

developing countries themselves. If trade is to develop its full potential action is required by both industrial and developing countries.

72. In addition to its direct contributions, the Fund is working with other institutions to advance the Monterrey consensus by helping to monitor progress in achieving the MDGs. Fund staff were part of the major international agency effort to develop indicators for monitoring the MDGs. The Fund will contribute to ongoing monitoring of MDGs in the areas of growth, external debt and trade, and through its participation in the UNDP-sponsored inter-agency MDG project.

73. The Fund is also working with the World Bank, the European Union, and bilateral donors in seeking ways to align the reporting, monitoring, and performance assessment requirements of program assistance with national PRSP and budget processes, as well as alleviating transactions costs for recipient countries while maintaining a strong focus on performance.

VI. Safeguarding the Cooperative Nature of the Fund

74. The IMF's cooperative nature is reflected in its resource base--derived overwhelmingly from quota subscriptions by its 184 member countries--and the principles of mutual respect, trust, and consensus-building that inform all of its operations. If the Fund is to perform its crisis prevention and resolution objectives effectively, it is essential that it have adequate resources and that the cooperative nature of the institution is reinforced.[36] In that regard, it is important that the Fund quota shares are appropriately representative, that the role and effectiveness of the Executive Board is kept under review, and that the membership continue its consideration of fair and transparent processes for selecting the Managing Director.

75. Considerable progress has been made in clarifying the issues that need to be resolved in reaching a judgment regarding the adequacy of the Fund's resource base and the possible need for a quota increase.[37] At this stage the necessary broad support for a decision to increase quotas does not exist and the differences that remain may only be reconciled in the context of decisions on related issues concerning access to Fund resources and the role of the private sector in crisis resolution. The Executive Board intends to continue its discussion on the size and distribution of quotas and quota formulas, which is viewed as integral to the broader consideration of the role of the Fund in an integrated world economy, with a view to preparing a report to the Board of Governors by January 2003, and to achieving continued progress on these issues in the period ahead.

[36] The Fund is also undertaking administrative reforms. Annual administrative budgets are now set within a medium-term framework that aims to keep the institution at broadly its present size. Other budget reforms are underway to put more emphasis on the Fund's main outputs and activities, and their dollar costs.

[37] "*Concluding Remarks by the Chairman – Twelfth General Review of Quotas – Further Considerations*" (BUFF/02/143).

A. The Adequacy of Fund Resources

76. The Articles of Agreement provide for general reviews of quotas at regular intervals not exceeding five years; general quota reviews allow the IMF to assess the adequacy of quotas and to permit adjustments of members' quotas to reflect changes in their relative positions in the world economy. The last general review was completed in 1998 and under the Fund's rules the current review is to be concluded by January 30, 2003. For this purpose, the Executive Board appointed a Committee of the Whole on December 27, 2001.

77. The current Twelfth General Review of Quotas is taking place in an environment marked by continued economic uncertainty, large volatile capital flows and vulnerability of member countries to financial crises. The impact of global integration and the Fund's response to members' balance of payments financing needs continues to be subject to considerable uncertainty and debate.

78. There is broad support for the fundamental principle that the Fund must have sufficient resources to fulfill its central role in the international monetary system. But at this stage in the quota review, differences of view remain on the current and prospective adequacy of the Fund's resource base, and the possible need for a quota increase. Discussions of the conceptual issues involved in reaching a judgment regarding the adequacy of the Fund's resource base found broad recognition that continued globalization and financial integration has resulted in greater reliance on private sources of capital for many members, which has contributed to increased vulnerability and potential for financial contagion.

79. Several quantitative approaches for assessing the adequacy of Fund resources have been considered, including:

- The size of the Fund relative to various measures of the world economy;
- The magnitude of members' gross financing needs and the volatility of capital flows; and
- Illustrative scenarios of possible demand for Fund resources.

80. Views, though, still differ on the appropriate size of the Fund.

- Many Directors were concerned that a further decline in the relative size of the Fund would send the wrong signals about the Fund's ability to continue to fulfill its important responsibilities at a time when members' balance of payments financing needs are increasing due to the volatility of capital flows and the potential for large reversals in capital flows arising from sudden shifts in market sentiment.
- Many other Directors suggested that alternative measures did not point to a decline in the relative size of the Fund, and that maintaining or increasing the relative size of the Fund would be inconsistent with the catalytic role of the institution, and was not needed to preserve the Fund's central role in the system.

81. In considering possible illustrative scenarios of future demand for Fund financing, the Board agreed that it was very difficult to foresee either the size or timing of future crises, but judgments differed regarding the implications of the illustrative scenarios presented by the staff for assessments of the adequacy of the Fund's resources. A range of views was expressed on the plausibility of the scenarios.

- Some considered the scenarios plausible or even too optimistic with regard to possible future demands on Fund resources.
    - Recent developments were consistent with the pessimistic scenario described by staff, with current Fund credit outstanding at an historic high and the arrangement for Brazil representing the largest single commitment of Fund resources.
    - As a result, Fund liquidity had fallen sharply at a time when bilateral official financing had diminished, which pointed to the need for an early quota increase.
- Others considered the scenarios overly pessimistic.
    - They were based on unrealistic assumptions regarding likely demand for contingent financing and a level of credit outstanding that was unusually high.
    - Even the most pessimistic scenario did not indicate a clear need for a quota increase, as uncommitted usable resources would remain substantial, the estimates of forward lending capacity were based on conservative assumptions regarding a required prudential minimum that had not yet been agreed, and the Fund's borrowing arrangements remained fully available.

B. Quota Shares and Representation

82. The Executive Board has continued to examine possible revisions in the formulas used to calculate members' quotas that would help achieve a quota distribution that better reflects the relative economic positions of member countries and recent developments in the world economy.[38]

- Progress has been made in developing a formula that would be simpler and more transparent than the current formulas and based on an updating of the traditional variables in the formulas.
- Differences remain regarding possible additional variables to be included in quota formulas and the number and form of formulas that could be used in making quota calculations that could result in a distribution of quotas that would command wide support.

[38] For further information see "*The Acting Chair's Summing Up – Alternative Quota Formulas – Further Considerations*" (BUFF/02/77).

83. There is increased recognition that possible changes in quota distribution cannot be achieved effectively and efficiently solely through revised formulas that reflect economic variables relating primarily to the financial functions of quotas. Other means may be required to achieve a distribution that would better reflect the relative economic position of members, particularly those members that have quotas significantly out of line with their role in the world economy, and to improve the governance structure of the Fund.

- A number of countries have actual quota shares that are considerably lower than calculated quota shares, almost regardless of the specific formulas used. According to additional indicators, an even larger group of countries might be seriously out-of-line. Many Directors supported consideration be given to adjustments for countries in this category, either in the context of a general quota review or as a separate ad hoc increase. Some Directors cautioned, however, that decisions on ad hoc increases should carefully consider how the resulting declines in quota share for other countries would be apportioned.

- An increase in the number of basic votes as a means of enhancing the representation of developing countries, especially the poorer members, in the Fund's decision making has been considered, although some have cautioned that care should be exercised to ensure voting power is sufficiently linked to member countries' relative economic and financial importance. The broad support required for an amendment of the Articles of Agreement needed to increase basic votes does not presently exist.

C. Effectiveness of the Executive Board and Selection of the Managing Director

84. The Fund's Executive Board, which operates on a principle of mutual respect, trust, and (as far as possible) consensus, is the key to the institution's effectiveness. The role and procedures of the Board are being kept under continuous review, in light of changes in the Fund policies, the activities of the IMFC and its Deputies, and the Fund's cooperation with other institutions. Based on the report released in April 2001, the Fund's membership is also continuing its consideration of possibilities for a more open and transparent process for selecting its Managing Director.

VII. Conclusion

85. The process of reform initiated at the Fund is still underway, and the broad global debate that accompanied it has not yet ended. But the steps that have already been taken appear to have increased the resilience of the global economy to the shocks it has faced over the past two years. The slowing of global growth, the bursting of the equity price bubble in the advanced economies, the aftermath of terrorist attacks on the United States, and increased risk aversion in international capital markets have posed difficulties for the Fund's members, particularly the emerging markets and developing countries among them. At the same time, developments over the past two years have shown that architecture reforms and good policies pay off. Countries with sound policies and institutions have done best in weathering the storm and, while contagion has not disappeared, markets are increasingly differentiating among countries in their assessments of risk. Nevertheless, the current world economic outlook reminds us of the significant challenges that remain and there is no room for complacency.

86. Discussions at the IMFC and Annual Meetings are a crucial opportunity to take stock of the initiatives that are underway and point the direction for further reform. The Managing Director will come back to the Executive Board after the Annual Meetings to outline the ways in which these discussions will be reflected in the Fund's work program in the period ahead.

Table 1. ROSC Modules Published
(As of August 31, 2002) 1/

Economies	Data	Fiscal	Monetary*	Banking*	Insurance*	Securities*	Payments*	Corporate Governance+	Accounting & Auditing+	Insolvency+	Total Published
Albania	P										1
Algeria				P							1
Argentina	P	P	P	P							4
Armenia	P	P									2
Australia	P	P	P	P							4
Azerbaijan		P									1
Botswana	P										1
Brazil		P									1
Bulgaria	P	P	P, P	P, P	P, P	P	P				10
Burkina Faso		P									1
Cameroon 2/	P	P	P	P	P		P				6
Canada		P	P	P	P	P	P				6
Chile	P										1
Costa Rica	P										1
Croatia			P	P	P	P	P	P	P		7
Czech Republic	P	P	P, P	P, P	P	P, P	P	P, P			12
Egypt, Arab Rep. of								P			1
Estonia	P	P	P	P	P	P	P				7
Euro Area			P				P				2
Finland			P	P	P	P	P				5
France		P	P								2
Gabon			P	P	P						3
Georgia			P	P	P		P	P			5
Greece		P									1
Honduras		P									1
Hong Kong SAR of China	P	P	P	P							4
Hungary	P	P	P, P	P, P	P, P	P, P	P, P				12
Iceland			P	P	P	P	P				5
India		P						P			2
Ireland			P	P	P	P	P				5
Israel			P	P	P	P	P				5
Japan		P									1
Kenya									P		1
Korea, Rep. Of		P									1
Kyrgyz Republic		P									1
Latvia		P	P	P	P	P	P	P			7
Lithuania			P	P	P		P	P	P		6
Luxembourg 3/			P	P	P	P	P				5
Malaysia								P			1
Malawi		P									1
Mali		P									1
Mauritius	P										1
Mexico			P	P	P	P	P				5
Mongolia	P	P									2
Mozambique		P									1
Nicaragua		P									1
Pakistan		P									1
Papua New Guinea		P									1
Philippines								P	P		2
Poland		P	P	P	P	P	P	P	P		8
Romania	P										1
Senegal 2/ 4/			P	P	P	P					4
Slovak Republic		P							P		2
Slovenia		P		P	P	P	P				5
South Africa	P										1
Sri Lanka	P										1
Sweden	P	P	P	P	P	P	P				7
Switzerland			P	P	P	P	P				5
Tanzania		P									1
Tunisia	P	P	P, P	P, P	P	P	P				9
Turkey	P	P						P			3
Uganda	P	P	P	P							4
Ukraine		P									1
United Kingdom	P	P	P	P							4
Uruguay	P	P									2
Zimbabwe								P			1
Total Completed	27	45	49	51	30	26	35	19	7	4	293
Total Published	24	39	33	33	25	21	23	13	6	0	217

Source: Fund staff estimates.

* ROSCs in these areas are usually assessed as part of the FSAP. The exceptions are for the following: Algeria-Banking; Argentina-Monetary, Banking; Australia-Monetary, Banking; Bulgaria-Monetary, Banking, Insurance; Czech Republic-Monetary, Banking, Securities; Euro Area-Monetary, Payments; France-Monetary; Hong Kong-Monetary, Banking; Tunisia-Monetary, Banking; Uganda-Monetary, Banking; United Kingdom-Monetary, Banking. Second-round assessments as part of FSSA-Updates include: Hungary-Monetary, Banking, Insurance, Securities, Payments.

\+ The following ROSCs were assessed as part of The Financial Sector Assessment Program: Corporate Governance-Czech Republic, Georgia, and Latvia; Insolvency-Croatia.

1/ ROSC modules not contained in an FSSA are considered complete once they have been circulated to Directors, and in the case of Bank-led modules, sent in their final form to the authorities. ROSC modules derived from an FSAP are complete only after the FSSA has been discussed by the Executive Board.

2/ In the case of Cameroon and Senegal's Insurance ROSC, an assessment was conducted for the regional insurance supervision council CRCA (Commission Régionale de Contrôle d'Assurance).

3/ As Luxembourg is a member of a monetary union, the module does not include an assessment of the monetary component of the standard.

4/ For Senegal's Banking ROSC, on an exceptional basis, a preliminary assessment was included in the FSSA. A full ROSC is expected to be completed shortly.

Table 2. Comparative Participation in Transparency and Standards and Codes Initiatives 1/ 2/

(As of August 31, 2002)

		(1) Africa	(2) Developing Asia	(3) Central and Eastern Europe	(4) CIS and Mongolia	(5) Western Hemisphere	(6) Middle East, Malta, and Turkey	(7) Advanced Economies	(8) Total IMF Members
Number of Members		**51**	**29**	**15**	**13**	**32**	**16**	**28**	**184**
Initiatives:									
SDDS Subscriber	3/								
Number of members		2	5	9	0	8	1	23	48
GDDS Participant	4/								
Number of members		13	6	3	5	11	5	0	43
PIN Published									
Number of members		48	24	15	11	31	10	28	167
Percentage		94%	83%	100%	85%	97%	63%	100%	91%
Article IV Staff Report Published									
Number of members	5/	29	10	15	9	22	3	26	114
Percentage		57%	34%	100%	69%	69%	19%	93%	62%
FSAPs, Completed So Far									
Number of members		6	1	7	3	5	4	7	33
Percentage		12%	3%	47%	23%	16%	25%	25%	18%
FSAPs, Completed and Committed									
Number of members		16	6	10	6	23	9	16	86
Percentage		31%	21%	67%	46%	72%	56%	57%	47%
ROSC Modules, Completed So Far									
Number of members	5/	20	7	12	8	13	7	14	81
Percentage		39%	24%	80%	62%	41%	44%	50%	44%
ROSC Modules, Completed and Committed									
Number of members	5/	27	8	13	9	20	11	22	110
Percentage		53%	28%	87%	69%	63%	69%	79%	60%
ROSC Modules, Completed So Far									
Number of modules	6/	51	13	76	23	34	16	57	270
Percentage of total modules		19%	5%	28%	9%	13%	6%	21%	
ROSC Modules, Completed and Committed									
Number of modules	7/	100	40	93	48	98	42	103	524
Percentage of total modules		19%	8%	18%	9%	19%	8%	20%	

Source: Fund staff estimates.

1/ This table does not reflect if a member has had more than one full assessment for the same standard. This table does not include territories, special administered regions (SARs), and monetary unions.

2/ The regional groupings are based on the composition of World Economic Outlook (WEO) groups.

3/ The SDDS was established in 1996 to guide countries that have, or might seek, access to international capital markets in the dissemination of economic and financial data to the public. Table includes counts subscribers in full observance only.

4/ The GDDS was established in 1997 to encourage members to improve data quality, provide a framework for evaluating needs for data improvement and setting priorities in this respect, and guide members in the dissemination to the public of comprehensive, timely, accessible, and reliable economic, financial, and socio-demographic statistics.

5/ The number of members for which at least one ROSC module has been completed.

6/ On an exceptional basis, this includes one preliminary assessment ROSC module to be completed shortly included in a Financial System Stability Assessment. One ROSC module performed for a country on a regional basis is also included.

7/ Unless the actual number of modules committed is known, it is assumed that for each country, an FSAP would produce, on average, four ROSC modules, as an approximation.