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To: Members of the Committee on the Annual Report
(Mr. Padoan, Chairman; Mr. Loyo, Mr. Misra,
Mr. Hacche, Ms. van der Willigen)

From: Michael DaCosta, Committee Secretary

Subject: **Annual Report, 2005—Final Draft**

The attached final draft of the *2005 Annual Report* is circulated for the **information** of committee members. It incorporates comments made by the members of the Committee on the Annual Report as well as from the Committee of the Whole.

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Members of the Executive Board

International Monetary Fund

Annual Report 2005

Making the Global Economy Work for All

August 5, 2005

TABLE OF CONTENTS

SELECTED ACTIVITIES BOXES

BOXES

TABLES

FIGURES

Overview

The IMF's 2005 financial year (FY2005), which is the period covered by this Annual Report,[1] marked an important stage in the Fund's development. The 60th anniversary of the July 1944 Bretton Woods Conference, at which the establishment of the IMF and the World Bank was agreed, was a notable landmark for these institutions. Rodrigo de Rato was appointed by the Executive Board to be the Managing Director of the IMF beginning in June 2004, and under his leadership the Fund embarked on a broad strategic review of its activities. In addition, several other, specifically targeted, reviews already under way were concluded.

The IMF's work during the year covered by this report is set out in detail in subsequent chapters. The Fund's work is largely dictated by developments in the world economy and in the economies of its 184 member countries, and by the need to anticipate the challenges that these developments pose. The aim of this introductory chapter is to give a brief overview of the Fund's activities and to set them in the context of global economic developments.

WORLD ECONOMY

The past year saw the most rapid global growth in three decades, with improved economic performance in almost every region of the world, subdued inflation, and a marked absence of serious financial crises. There was thus a very favorable international environment for the IMF's operations. Yet the going was not entirely smooth: oil prices rose sharply and substantially; there were continuing geopolitical uncertainties; global payments imbalances widened further; and many of the Fund's member countries continued to grapple with significant social and economic problems, including poverty.

At the same time, the benign global economic situation and outlook provided an important opportunity to introduce and implement the economic reforms needed to tackle deep-seated problems. It also provided an opportunity for the Fund to embark on a broad

[1] May 1, 2004 –April 30, 2005.

examination of its strategic direction, aimed at assessing its role and activities in the evolving circumstances of the years ahead.

The IMF's 2005 financial year was a period of remarkable expansion for the global economy. At 5.1 percent in calendar 2004, annual growth was the fastest in nearly thirty years. In the first quarter of 2005 (the final calendar quarter of the Fund's financial year), growth remained more buoyant than had been expected. Even more striking, and additionally welcome, was the extent to which this rapid growth was experienced by all regions of the world, including those, such as Latin America, the Middle East, and sub-Saharan Africa, where growth performance had tended to lag well behind.

Among the industrial countries, the United States continued to be the most rapidly growing economy, maintaining its strong recovery from the modest downturn of 2001–02 and continuing to underpin the global expansion. In Japan, the economic recovery that began in 2003 paused in mid- and late 2004 but regained momentum in early 2005. Growth in the euro area continued to be disappointing, with domestic demand remaining weak, especially in Germany.

Most emerging market and developing countries recorded relatively rapid growth. In Asia, growth in the region as a whole was fuelled by continuing strong expansion in China and rapid growth in India. Emerging Asia was the fastest-growing region during the period. But in Latin America there was evidence of strong recovery in most parts of the continent; the Middle East recorded higher growth than expected; and growth in sub-Saharan Africa was more rapid than at any time over the past eight years. And in spite of the sluggish growth performance of their close trading partners in the euro area, the countries of the Commonwealth of Independent States (CIS) continued to experience strong expansion.

World trade grew even faster than output, by 9 percent in 2004, continuing the long-term tendency for trade to expand relative to output, and underlining the contribution that the expansion of trade has consistently made to economic growth. In early 2005, however, there were signs of a slowdown in the growth of trade, possibly related to slower expansion in manufacturing in a number of countries.

Inflation increased slightly in most parts of the world compared with 2003 but generally remained subdued, which also contributed to the strong global expansion. It has become increasingly clear in recent decades that low inflation is essential for sustained and rapid growth, which in turn provides the most reliable route to the lasting reduction of poverty that is an important priority for many of the IMF's members.

The strong global expansion, and especially its widespread nature, owed much to the adoption in many countries of appropriate policies. In recent years, there has been a growing recognition of the importance of establishing a stable macroeconomic framework as a precondition for strong growth that can be sustained over a long period. Sound macroeconomic policies make it easier for countries to withstand the downturns that are an inevitable part of the economic cycle. They also increase an economy's resilience in the face of shocks.

GLOBAL ECONOMIC RISKS

The rapid growth of the world economy in FY2005 brought opportunities and challenges for the IMF's members and the IMF itself. However, two issues threatened to cast a shadow over the world economic outlook: higher oil prices and large global payments imbalances.

Rising oil prices posed risks for oil-importing countries, and were especially painful for low-income countries. The extent of the problems that higher energy prices posed in different countries depended on the energy intensity of production and consumption, the impact on the terms of trade, and economies' flexibility in responding to shocks. The experience of earlier oil price shocks had underlined the risks of higher prices for oil-exporting countries as well. Rising oil revenues have tended to tempt policymakers to relax fiscal discipline more than is desirable. History has shown that dealing with oil revenue windfalls while preserving macroeconomic stability is a difficult challenge for governments in both industrial and developing countries.

Concern about the possibility of a sudden adjustment of global payments imbalances continued to preoccupy the IMF and many policymakers during FY2005. The large and rising U.S. current account deficit, and the corresponding surpluses in Japan, emerging Asia, the oil-producing countries of the Middle East, and other countries, were the focus of these concerns. The IMF made its view clear that resolving these imbalances is a shared responsibility of the international community and endorsed a broad strategy that included medium-term fiscal consolidation in the United States, continued structural reforms to boost growth of demand and output in Europe and Japan, and, in emerging Asia, steps toward greater exchange rate flexibility, supported by continued financial sector reform. There was widespread agreement that implementation of this strategy would help correct these imbalances in an orderly manner and avoid a sudden and painful adjustment.

In the event, concerns that rising oil prices and global imbalances would undermine global growth did not materialize during the period under review; but nor did they dissipate. If high oil prices persist, some countries will remain more vulnerable than they otherwise would be. And without widespread policy adjustments, global imbalances continue to pose risks for future global growth.

At the same time, the expansion of the world economy brought opportunities. The most important of these in the short term was the chance for many countries to take the policy measures necessary to make current growth rates sustainable, and then to go further and raise the sustainable growth rate. These include the adoption of fiscal policies that curb budget deficits and make possible countercyclical policies during downturns. Many industrial and developing countries have budget deficits that are uncomfortably large for the peak of a cycle, which restricts their room for maneuver in the event of a downturn. Improving long-term growth potential also requires removing the structural impediments to more rapid growth—freeing up labor and product markets, and liberalizing trade. Such policy adjustments would benefit both industrial and developing countries.

Strengthening fiscal policy and taking steps to make economies more flexible and thus capable of faster expansion inevitably pose difficult political challenges for policymakers who have to account to their electorates, especially given that reforms take time to deliver tangible benefits in terms of growth. Although history shows that necessary changes are sometimes implemented at times of economic difficulty, when pressure for adjustment is strong, periods of relatively rapid global expansion should offer the best environment in which to pursue economic reforms.

This is equally true of the longer-term reform agenda, where it has become increasingly clear that looming demographic changes pose important challenges for a large number of IMF member countries. The fraction of post-retirement-age dependents in the population is already rising in many industrial economies; and some large emerging market economies, such as China and Korea, will also see their dependency ratios—defined as the number of retirees expressed as a percentage of the workforce—rise sharply in the short to medium term. In other emerging market economies, the full impact of these demographic changes will not be felt for some time, but in many of these countries the public finances are already under strain because of existing pension arrangements that are underfunded. There is increasing evidence that confronting these demographic problems sooner rather than later will mean that the adjustments, whether to pension contributions, benefits, or the retirement age (or a combination of all three), can be much more modest than if remedial action is postponed.

THE WORK OF THE FUND

The IMF's mandate is clearly defined by its Articles of Agreement: to promote macroeconomic and financial stability at the global and national levels, to promote international monetary cooperation in the interests of all its members, to foster a liberal system of trade and payments, and to prevent international crises, as far as possible. The aims are clear, but how they are best achieved inevitably evolves over time. The Fund is, and must remain, a learning institution, seeking to strengthen its work, including by listening to, and learning from, its official and nonofficial interlocutors. It seeks to adapt on the basis of experience. But it also seeks to work pre-emptively, by anticipating challenges and responding to them in a timely manner—an important part of its crisis prevention work.

In FY2005, in the global context described above, an important challenge for the Fund was to continue to be an effective advocate for policies, including reforms, that, at the national level, would foster macroeconomic stability, rapid growth, rising living standards, and poverty reduction, and to argue the case for pre-emptive action in an unusually favorable global economic environment.

The IMF's surveillance work, one of its core activities, remains the principal channel for the advocacy of appropriate policies. As Chapter 1 outlines in more detail, the Fund's surveillance work has three dimensions: global, regional, and national. At the global level, through instruments such as the *World Economic Outlook* and the *Global Financial Stability Report*, the Fund assesses the international outlook and examines and highlights the risks to its central projections. At the regional and national levels, principally through its work on Article IV consultations, the Fund assesses national policies and objectives, and the accompanying risks, and provides advice on appropriate responses.

IMF policy advice, provided by the Executive Board in the context of Article IV consultations, reflected the concerns highlighted earlier about rising oil prices and global imbalances. In preparing Article IV reports on countries where macroeconomic stability had yet to be achieved, Fund staff focused on the need to ensure that policies were directed to implementing appropriate fiscal reforms, lowering inflation, and creating the conditions for sustained and fast-paced growth. In the many other member countries where a stable macroeconomic framework was in place, Fund advice was directed more toward ensuring the implementation of structural reforms aimed at medium-term sustainability and at raising potential output and growth. Attention was also paid to longer-term issues such as demographic changes. IMF staff, and the Executive Board, always seek to be constructive when identifying policy weaknesses and to identify superior alternatives. Staff and the Board also strive to endorse sound macroeconomic policies identified in Article IV consultations.

In addition to its operations with member countries, the IMF in FY2005 reviewed its own activities on several fronts. The core responsibilities of the IMF, as envisaged by its founders more than sixty years ago, remain essential for the effective functioning of the global economic and financial systems. But just as national economies and economic policies must adapt to keep pace with global economic developments, the Fund, too, must be ready constantly to review the ways in which it conducts its business, so that it can best serve its member countries. IMF advice to its members stresses the importance of continuous evolution, and this is a fitting principle for the Fund to apply to its own work and working methods. Transparency, which has become a vital ingredient of the IMF's work over the past decade, has enabled the Fund to conduct large-scale reviews of its activities in an open manner, alert to the needs of all its members while avoiding the impression of undue introspection.

FY2005 saw the conclusion of a number of specific reviews targeting different aspects of the IMF's work. Central among these were the biennial review of the Fund's surveillance work, including an assessment of the increasing importance of financial sector surveillance (described in Chapter 2), and a new review of conditionality, the first since 2000–02 (Chapter 3). Reports from the Independent Evaluation Office provided the opportunity to review, for example, the growing role of IMF technical assistance and the Fund's role in the run-up to the crisis in Argentina in 2001.

More fundamentally, the IMF has taken advantage of the opportunity provided by the relatively favorable global economic environment to embark on a major review of its strategic direction. Such a stocktaking is timely. The global economic and financial system has evolved rapidly in the last decade or two, and the Fund has made considerable changes in response, especially in the past decade, as part of broader reforms of the international financial architecture. With these initiatives maturing, the time has come to step back and review the challenges ahead. The strategic review was started in 2004, and work on the Fund's medium-term strategy—intended as a guide to decision making on the medium-term budgetary framework and work program—is due to be completed in time for the Annual Meetings in September 2005, when the conclusions will be considered by the International Monetary and Financial Committee (IMFC).

The strategic review is anchored in a shared understanding of the IMF's purposes: it became clear at a very early stage in the review process that the Board is generally agreed on the Fund's core mission, as set out in the Articles of Agreement. But the Fund needs to have clear priorities if it is to achieve its principal aims in an effective manner. The focus of the strategic review is on how the IMF can best fulfill its mandate; it aims to develop priorities for the Fund's future activities, and to identify trade-offs and possible organizational changes. Adopting a medium-term budgetary framework is a key component of this effort, which will enable priorities to be determined and kept under review.

Thus surveillance, financial support, and technical assistance will remain the principal components of the Fund's work. But their effectiveness will depend on their continuing evolution to meet the changing global financial environment and the changing needs of member countries. The rapid growth of private capital flows, for example, has had a major impact on the international financial system. Such capital flows can improve both access to investment capital, for industrial and developing countries, and the efficiency of resource allocation. But they can also pose important risks, for individual countries and for the world economy as a whole.

The increasing interdependence of economies has made it more important than ever for the international community to help countries implement policies that will promote domestic and global prosperity. The IMF, with its virtually global membership and mandate to promote international monetary cooperation and sound economic and financial policies, is the natural forum for multilateral cooperation to promote stability and growth in the world economy. It has a responsibility to help countries get their macroeconomic policies and institutions right—a responsibility that shines a spotlight on the quality, persuasiveness, and focus of its policy advice. A special challenge in this regard, particularly given the increased appreciation in recent years of the importance for stability and growth of a broad range of structural and institutional factors, is for the Fund to be focused in its operations on the issues that matter most in each member country, while maintaining evenhandedness of treatment. In a world of increasingly integrated capital markets, it is also important that the Fund continue to develop its understanding of capital flows and their implications. This will strengthen the basis for its advice to members on ways to foster sound domestic financial systems, to gain access to the international capital markets, and to reduce vulnerability to capital account shocks and volatility.

Work on the strategic review has underlined the importance of the IMF's work in low-income countries: how can the Fund do more to support these countries, especially in helping them achieve the Millennium Development Goals? The Poverty Reduction Strategy process is one of the tools that the Fund uses to meet its responsibilities in this area. The improved macroeconomic performance of some low-income countries during the period under review in this report reflected in part the widespread recognition that macroeconomic stability is a prerequisite for raising growth rates to levels that, sustained, can lead to significant and lasting poverty reduction. And macroeconomic reforms in many poor countries have already brought benefits, such as lower inflation and more rapid growth and poverty reduction. In this context, additional transfers from the donor community could help some low-income members build on the progress achieved thus far, provided these are used to buttress policies promoting sustained growth and not substitute for them. A challenge for the Fund remains to identify clearly how its activities—its surveillance, its financing instruments, the design of the programs it supports, its technical assistance, and, potentially, further debt relief—should be shaped to meet the special circumstances of these countries.

The strategic review has also reconfirmed that providing temporary financial assistance to members with short-term balance of payments problems remains a central element of the IMF's work. The Fund is continually working to ensure that its financial resources are used efficiently and in a way that best meets the needs of the membership as a whole. This means that the revolving character of IMF resources must be protected and that countries should "exit" from Fund financial support as and when they are able to do so. The Fund must structure its lending instruments accordingly, and the maturities and charges associated with IMF financial assistance—which are being reviewed in FY2006—are an important element in this respect. More broadly, challenges remain in forging a more solid consensus on the appropriate circumstances and scale of Fund lending, including in cases where countries need a signal of policy soundness rather than financing, and in cases of capital account crises.

The past year was, in some ways, one of intense reflection for the IMF, and this will continue as some of the questions highlighted in the strategic review are explored in more detail. Such reflection is appropriate for an institution that seeks continuously to be ready to serve the needs of its members, and of the international financial system as a whole, in a rapidly changing global economy. To carry out those responsibilities effectively requires a readiness, and an ability, to adapt to changing circumstances—sometimes very quickly. Having a medium-term framework that permits the Fund to establish priorities, and to alter them in a transparent way, could have a profound and positive impact.

1. Surveillance in Action During FY2005

Surveillance is one of the IMF's three main activities, the other two being financial and technical assistance to its member countries. But whereas financial and technical assistance—discussed in Chapters 3 through 6—are provided only to countries that request and need them, the IMF's surveillance applies continuously to the economies of all member countries and to the global economy and financial system. The IMF's responsibilities in this area, set out in Article IV of its Articles of Agreement, are to oversee the international monetary system to ensure its effective operation, and to oversee the compliance of each member country with its obligations to collaborate with the IMF and other members to promote an orderly and stable system of exchange rates, broader financial and economic stability, and sound economic growth. It is mainly through its surveillance operations that the IMF works to help prevent financial and economic crises.

The IMF conducts surveillance by monitoring economic and financial developments and consulting with the authorities of member countries. Surveillance is conducted at the global, country, and regional levels.

In its *global (*or *"multilateral") surveillance,* the IMF monitors economic conditions and developments in international capital markets and assesses the global effects of major economic and financial developments, such as oil market conditions or external imbalances. IMF management and staff also take part in economic policy discussions among finance ministers, central bank governors, and other officials in a variety of groups, such as the Group of Seven (G-7) major industrial countries, the Group of Twenty (G-20) industrial and emerging market countries, and the Group of 24 (G-24) developing countries.

In its *country (*or *"bilateral") surveillance,* the IMF maintains a dialogue with each member country on developments in its economy and on the national and international implications of its economic and financial policies.

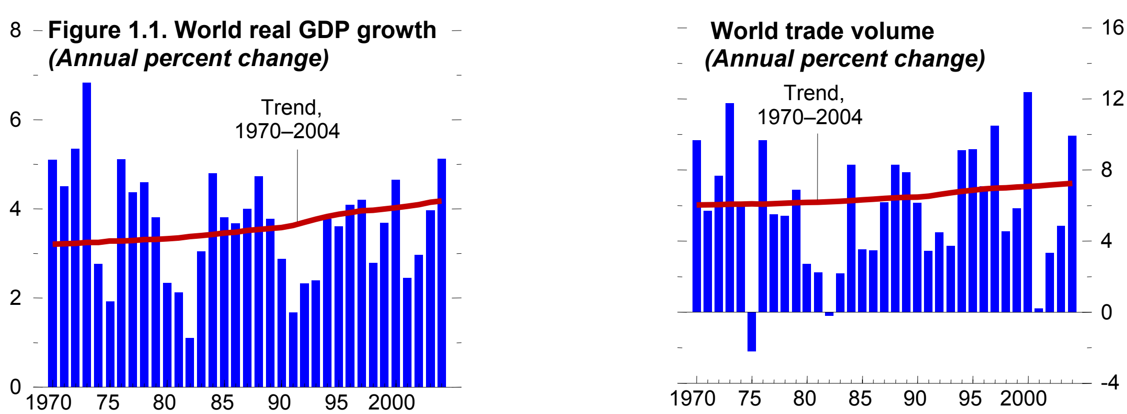
In its *regional surveillance,* the IMF examines the policies pursued under regional arrangements, such as in the euro area, the Eastern Caribbean Currency Union (ECCU), and the West African Economic and Monetary Union (WAEMU), as well as the regional implications of global developments.

Following are some highlights of IMF surveillance in FY2005 (for a summary of key economic and financial developments in FY2005, see Box 1.1):

- The Executive Board's semiannual assessments of the global economy—which appeared in the September 2004 and April 2005 editions of the *World Economic Outlook* publication—focused particularly on policies to address global current account imbalances, the implications of an upturn in global interest rates, and oil market developments. In April 2005, Directors saw solid growth ahead for the rest of the year, but with risks from an increasingly unbalanced expansion, a significant tightening of financial market conditions, and a further sharp rise in oil prices.
- The September 2004 and April 2005 Board reviews of financial market developments, as published in the semiannual *Global Financial Stability Report*, cited the increased resilience of the global financial system but also noted that the risks of market corrections had increased, owing to overabundant liquidity and lower risk premiums.
- At a seminar in March 2005 on oil market conditions, Directors agreed that the market was likely to remain tight for the foreseeable future, given the continued rise in global demand, the peaking of non-OPEC oil output, and the potential for supply disruptions.
- The IMF completed consultations with 128 individual member countries. In a number of cases, these consultations featured a strategic stocktaking, supported by ex post assessments in countries with Fund-supported adjustment programs over longer periods.
- Regional surveillance of currency unions in FY2005 included assessments by the Board of developments in the euro area, the Eastern Caribbean Currency Union, and the West African Economic and Monetary Union.

Box 1.1 Key economic and financial developments, May 2004–April 2005

Global economic growth in 2004, at 5.1 percent, was the strongest in three decades (Figure 1.1). Particularly heartening was the strong performance of many of the poorest countries, including in sub-Saharan Africa, where average growth was the highest in nearly a decade. After exceptionally strong growth in 2004, global growth moderated somewhat in early 2005 but remained solid. The overall picture, however, hides growing divergences across regions, with the United States and China continuing to lead the recovery followed by robust growth in emerging market and developing countries. By contrast, the recovery remained subpar in the euro area and Japan in mid- and late 2004. These developments were associated with widening current account imbalances and U.S. dollar depreciation. The growth of world trade volumes moderated after their early 2004 surge, bringing them back toward trend. Net private capital flows to developing countries increased as net portfolio investment and foreign direct investment (FDI) continued to rise in 2004.



Although the global recovery generally strengthened, growth continued to diverge among key countries. In the *United States*, the soft spot identified in the second quarter of 2004 had largely disappeared by year-end. The first quarter of 2005 saw some moderation, but the annual growth rate remained at 3½ percent. Real GDP growth in *China* remained very strong, with some slowdown in investment offset by increases in net exports and consumption. In *Japan,* the recovery stalled in mid- and late 2004; while it recovered strongly in the first quarter of 2005, temporary factors appear to have been at play. GDP growth in the *euro area* slowed in the course of 2004 but picked up slightly in the first quarter of 2005. High oil prices and the lagged effects of the appreciation of the euro took their toll on net exports, whereas low income growth and lackluster private consumption growth held domestic demand in check.

In FY2005, GDP growth accelerated in nearly all emerging market regions. In many cases, the recoveries became increasingly driven by domestic demand, with less dependence on the external environment.

Growth in *Latin America* continued to exceed expectations, aided by high commodity prices, improved external confidence, progress with structural reforms, and, in some cases, rebounds from earlier crisis-induced slowdowns. Growth picked up in Argentina, Brazil, and several other countries, but political uncertainties continued to undermine growth in others.

Growth in e*merging Asia*, excluding China, moderated somewhat during FY2005, reflecting the moderation in the global expansion, a correction in the semiconductor market, and higher oil prices. Developments in the first quarter of 2005 were dominated by the catastrophic tsunami and the associated devastating loss of human life and property in Indonesia, Sri Lanka, India, Thailand, and several other countries. However, in most cases—except Maldives and, to a lesser extent, Sri Lanka—the impact on GDP growth was small. Regional growth in early 2005 was relatively strong, with the expansion in China remaining robust. India's growth slowed modestly during FY2005, with the impact of uneven monsoons and higher oil prices offset by buoyant industrial activity and strong investment.

During FY2005, as a group, c*entral and eastern Europe* enjoyed the strongest growth since the beginning of transition. Current account deficits widened further as rapid credit growth and expansionary fiscal policies fueled imports. Net FDI inflows continued to represent an important source of funds, but more ambitious fiscal consolidation was needed in several countries, along with continued reform efforts to improve the business climate and encourage domestic saving. Rising oil prices throughout much of FY2005, as well as positive domestic factors, increased growth in the oil-exporting countries of the former Soviet Union. Oil importers in the region also experienced strong GDP growth stemming from robust domestic demand.

In 2004, growth in the *Middle East* benefited from rising oil prices and higher oil production in the face of increasingly thin margins of excess capacity. With oil prices remaining high in early 2005, the outlook remained positive. The situation permitted some of these countries to initiate needed reforms to boost medium-term growth and increase employment for their rapidly growing working-age populations, but more needs to be done.

Growth in *Africa* strengthened during FY2005, supported by improved macroeconomic policies, favorable weather conditions, fewer conflicts, and debt relief under the HIPC (Heavily Indebted Poor Countries) Initiative. Higher prices for oil and, to a lesser extent, nonfuel commodities also helped sustain high growth in a number of commodity-exporting countries.

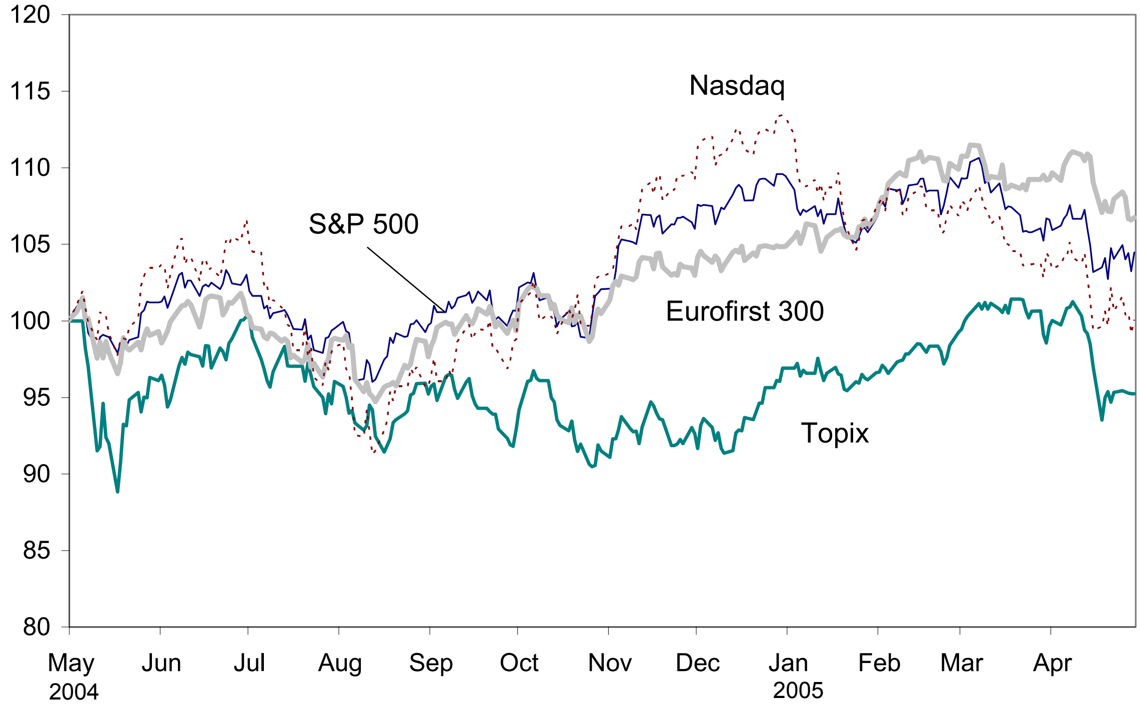
With the firming global economic recovery, demand for commodities continued to put pressure on prices—especially for fuels and most metals. Oil prices rose dramatically, surpassing levels seen the year before, owing to continued supply constraints as well as to higher demand. Consumer price inflation rose modestly in a number of countries, but long-term inflationary expectations remained anchored. The dollar depreciated during the fiscal year on a trade-weighted basis, but most of the movement occurred in the final quarter of 2004 with the dollar trading in a narrow range during early 2005. As before, appreciation of the euro and other industrial country currencies formed most of the counterpart to the dollar's slide. While some emerging market currencies appreciated against the dollar, others remained less flexible.

Monetary policies remained somewhat accommodative in most countries. However, with inflation rising, many countries, most notably the United States, raised interest rates. *Fiscal policies* were varied. Although the fiscal stance in the United States was broadly unchanged, the commitment to halving the deficit over the next four years remains firm. In the euro area, fiscal policies were broadly neutral, delivering almost no consolidation.

In the *major financial markets*, conditions remained benign. Favorable economic fundamentals, including expectations for solid, if slowing, growth, well-anchored inflation expectations, sustained corporate balance sheet strength in the advanced economies, and continued improvements in the credit quality of emerging market borrowers supported financial market stability. Against this backdrop, financial market volatility, government bond yields in mature markets, and global credit spreads remained low.

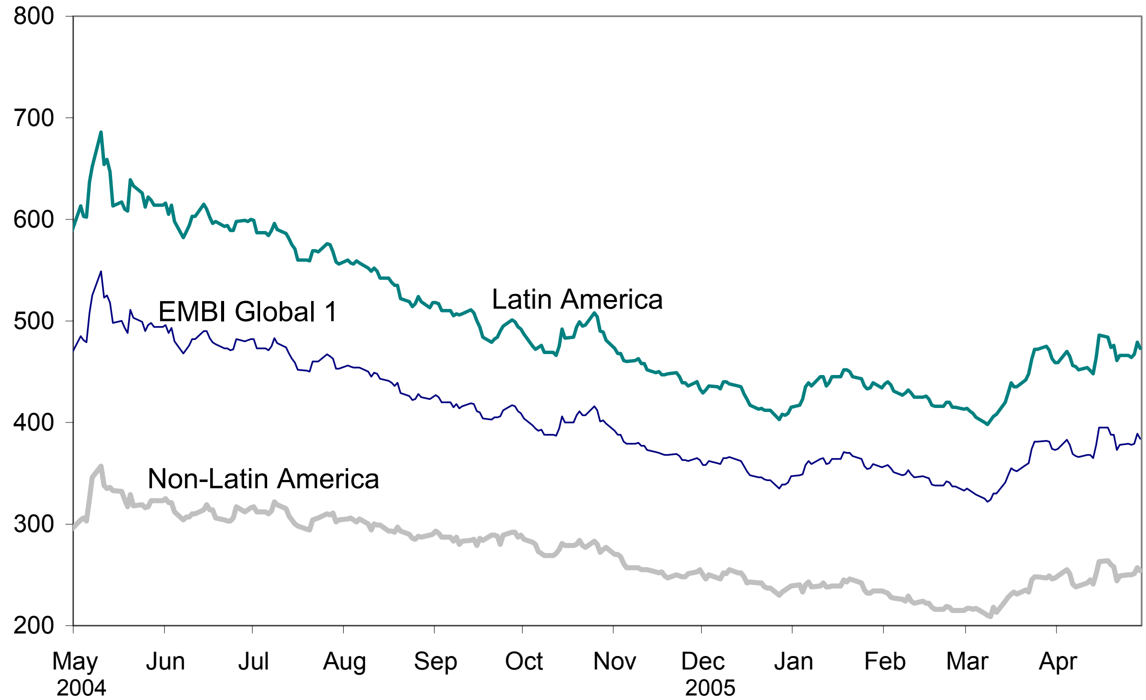
After rallying during FY2004, *global equity markets* remained trendless, trading in narrow ranges throughout the financial year, partly reflecting fears of slower growth because of rising oil prices (Figure 1.2). Actual market volatility and the volatility implied by options on a range of financial assets stayed low. The S&P 500 rose 10.4 percent before retracing most of these gains as interest rate expectations changed near the end of the financial year and high oil prices dampened confidence. European equities followed a similar pattern, rising 17.7 percent from their mid-2004 trough before surrendering part of those gains by the end of the financial year. In Japan, stocks rallied 12.3 percent from their October 2004 trough, as the growth of the Japanese economy strengthened, before falling back to end the year down 6.4 percent.

Figure 1.2. Equity Market Performance
(May 2004 = 100)



After a sell-off in May 2004, *emerging markets* enjoyed an exceptionally favorable economic and financing environment in the remainder of 2004 and early 2005. Interest rates and credit spreads remained low. With liquidity abundant, investor appetite for new issues from emerging market borrowers was quite strong, permitting a high level of issuance at low cost. Driven by improving fundamentals, a benign external environment, and abundant liquidity, the spread on the EMBI Global fell from 549 basis points in May 2004 to a near-record low of 322 basis points in March 2005 (Figure 1.3). Low nominal yields and strong investor demand facilitated increased bond issuance by emerging market borrowers, as many sought to lock in attractive financing costs by prefinancing their future funding requirements. Primary debt market issuance totaled some $49 billion in January–April 2005, covering nearly 80 percent of the financing needs of emerging market countries for the calendar year.

Figure 1.3. Sovereign Spreads
(In basis points)



1 J.P. Morgan Emerging Markets Bond Index Global.

Primary issuance of equities in emerging markets was also strong during the financial year and continued to be dominated by Asia. Importantly, in FY2005, the investor base for emerging market issuers expanded; institutional investors globally found them attractive in view of low interest rates in mature markets and the attractive risk-adjusted returns as their credit ratings were upgraded across a broad spectrum. Another development worth noting was the interest of foreign investors in the domestic currency bonds of emerging market economies.

GLOBAL SURVEILLANCE

The IMF's Executive Board conducts global surveillance through its reviews of world economic and financial market developments and prospects. These reviews are based partly on the staff's *World Economic Outlook* (*WEO*) reports and *Global Financial Stability Reports (GFSRs),* both of which are usually prepared and published twice a year, ahead of the meetings of the International Monetary and Financial Committee, for which they provide documentation. The *WEO* reports provide analysis of global economic prospects and the policies appropriate in different countries, while the *GFSRs* analyze developments and risks in international capital markets. The Board also holds more frequent and informal discussions of world economic and financial market developments, and IMF staff continuously monitor developments in mature and emerging financial markets, as well as economic developments globally.

World Economic Outlook

World Economic Outlook, September 2004

In their September 2004 discussion of the *World Economic Outlook,*[1] Executive Directors noted that the global recovery had remained solid, with economic growth for 2004 projected to reach its highest rate in nearly 30 years. The expansion was underpinned by continued accommodative macroeconomic policies, rising corporate profitability, and wealth effects from rising equity and house prices. Global growth remained driven by the United States, with strong support from Asia, particularly China. Activity in Latin America and some other emerging markets had also picked up strongly, the outlook for Africa had improved, and economic momentum was growing in the euro area. Directors called on policymakers to take advantage of the cyclical expansion to address key medium-term vulnerabilities by taking the following measures:

- Tackling global imbalances. Eliminating these would require medium-term fiscal consolidation in the United States to increase domestic saving; structural reforms to boost growth in Europe, Japan, and elsewhere; and steps toward greater exchange rate flexibility in Asia.
- Quickening the pace of structural reforms to boost economic flexibility and resilience, so that countries are well positioned to exploit the opportunities from globalization and the information technology revolution, while their resistance to future shocks is strengthened. Noting the key role of open markets in promoting competitiveness and efficiency, Directors looked forward to far-reaching trade liberalization under the Doha Round of trade negotiations.

[1]For the summary of the Board's discussion, see *www.imf.org/external/pubs/ft/weo/2004/02/pdf/annex.pdf;* the September 2004 *World Economic Outlook* can be found at *www.imf.org/external/pubs/ft/weo/2004/02/index.htm.*

- Strengthening medium-term fiscal positions in both industrial and developing countries. This would require a combination of fiscal consolidation, while allowing automatic stabilizers to work; structural measures, including tax reform and stronger public expenditure frameworks, to improve debt sustainability; and reform of pension and health care systems.

In discussing the industrial countries in September 2004, Directors welcomed the staff's analysis of the *global boom in house prices* and the impact that rising interest rates in industrial countries might have on housing markets. Directors noted that the analysis, reflecting linkages in economic activity and interest rates, showed a remarkable degree of synchronization of house prices across industrial countries (although they recognized the limitations of the data). Given the importance of house prices for private consumption, through wealth and credit channels, many Directors suggested that policymakers should monitor developments in the housing market closely. A tightening of monetary policy during the transition to a more neutral policy stance could trigger a slowing or reversal of the growth in house prices.

Directors also welcomed the staff's analysis of *demographic change*. To meet the demographic challenges from population aging, industrial countries had to boost labor supply, saving, and productivity. Given the size of prospective demographic changes, this required a combination of reforms to be politically acceptable. Particularly important was the selection of reforms, especially with respect to pension and health care systems: they would have to be resilient to a wide range of possible future demographic changes. For developing countries, the key policy priorities were to increase the flexibility of labor and product markets and ensure that labor resources and savings were effectively utilized. These countries had to move early to lay the groundwork for eventual population aging, including by strengthening pension and health care systems. This was particularly challenging in countries whose medium-term fiscal positions were already strained. Directors agreed that the effectiveness of actions to facilitate movements of goods, capital, and labor smoothly and efficiently across countries would significantly influence the pace, and pattern, of global adjustment to different rates of population aging.

World Economic Outlook, March 2005

At their March 2005 discussion of the *World Economic Outlook*,[2] Executive Directors noted that the global expansion remained broadly on track, underpinned by generally supportive macroeconomic policies and benign financial market conditions. Following a strong performance in 2004, growth was expected to moderate to a more sustainable pace in 2005. At the same time, the expansion had become less balanced—with growth strong in the United States, China, and most emerging market and developing countries but disappointing in Europe and Japan.

Globally, inflationary pressures remained relatively subdued. With monetary tightening under way in most economies in advanced stages of recovery and generally moderate inflation expectations, inflation was expected to remain well contained. Still, Directors felt that inflation risks required careful monitoring, with due regard to rising unit labor costs in many industrial countries as labor markets tighten, and to monetary policy implementation in a number of emerging markets with strong external inflows.

Looking ahead, Directors felt that the more moderate but still solid global growth in 2005 would be underpinned by accommodative macroeconomic policies, improving corporate balance sheets, supportive financial market conditions, a gradual rise in employment, and continued strong growth in China. The key risks to the short-term outlook were

- the increasingly unbalanced nature of the expansion, with global growth significantly dependent on the United States and China;
- a significant tightening of financial market conditions, which could hurt U.S. domestic demand, prompt financial market deleveraging and asset price corrections more broadly, and lead to a deterioration in emerging market financing conditions; and
- a further sharp increase in oil prices (see below under "Oil market developments").

[2]For the summary of the Board's discussion, see *www.imf.org/external/pubs/ft/weo/2005/01/pdf/annex.pdf;* the March 2005 *World Economic Outlook* can be found at *www.imf.org/external/pubs/ft/weo/2005/01/index.htm.*

As to global current account imbalances, Directors were concerned about their further widening over the past year, and a number cautioned that this might increase the risk of abrupt movements in exchange rates. Directors noted that the strategy to support an orderly adjustment in these imbalances had been broadly agreed. Among the key elements were fiscal consolidation in the United States; steps toward greater exchange rate flexibility, supported by continued financial sector reform, in emerging Asia; and continued structural reforms to boost growth and domestic demand in Japan and Europe. Directors reiterated the collective responsibility of the membership to ensure that the strategy was implemented in a timely and effective manner.

A number of key medium-term issues that needed to be addressed were identified.

1. Fiscal positions in many countries remained very difficult, particularly against the backdrop of global population aging, and posed a threat to medium-term macroeconomic stability.

2. Structural reforms had to be advanced to remove rigidities and enable domestic economies to take full advantage of the opportunities provided by globalization.

3. Successful and appropriately ambitious trade liberalization on the part of all countries under the Doha Round—including improved market access for developing countries—was critical for supporting medium-term global growth. Key issues remained to be resolved in agriculture, and faster progress was needed in the area of trade in services.

4. Despite the improved growth performance of recent years, meeting the Millennium Development Goals (MDGs) posed an enormous challenge for most developing countries (see Chapter 4). Directors noted that 2005 was a critical year for the MDGs and called on these countries to press ahead with policy and governance reforms to strengthen their investment environments and private-sector-led growth, and on the advanced economies to support these efforts with substantially higher assistance.

Industrial countries

Among the industrial countries, Directors welcomed the continued strong performance of the *United States* economy, whose expansion was set to continue in 2005. With household saving close to zero, however, a retrenchment in private consumption remained a risk, particularly if house price increases were to slow. Given that inflationary pressures were relatively benign, a measured pace of monetary tightening remained appropriate, although incoming data would have to be monitored carefully in view of possible upside risks to the inflation outlook from labor market pressures or further oil price rises. Directors underscored the need for significant fiscal consolidation, with a view to ensuring medium-term sustainability and facilitating an orderly unwinding of global current account imbalances.

Directors expressed disappointment that the *euro area* economy lost momentum during the second half of 2004, although they expected a strengthening of growth in 2005. Further appreciation of the euro and high and volatile oil prices remained the key risks to the regional outlook. With inflationary pressures well contained, monetary policy should remain firmly on hold until a self-sustaining recovery was in place. As to fiscal policy, Directors saw existing policy as insufficient to deliver the budgetary adjustments required to cope with the fiscal pressures of population aging. Underscoring that a strong fiscal framework was an integral part of monetary union in Europe, Directors noted that reform of the Stability and Growth Pact should be implemented in a way that did not weaken fiscal discipline. Directors also stressed the importance of making further progress in implementing structural reforms, with a greater focus on addressing distortions in labor markets and promoting competition in product markets.

Directors noted that the *Japanese* economy had stalled in the last three quarters of 2004, reflecting weak global demand for information technology (IT) products and falling consumption spending, but recent data were more encouraging. With bank and corporate balance sheets in better shape, Directors believed that growth should regain some momentum in 2005, notwithstanding the downside risks from high oil prices and the possible adverse impact on exports of a sharp appreciation of the yen. While deflationary pressures had eased in recent years, Directors urged the Bank of Japan to maintain a very accommodative monetary policy stance until deflation was decisively beaten. Given Japan’s high public debt and intensifying demographic pressures, fiscal consolidation remained a priority. Directors also stressed the need to continue to strengthen the banking and corporate sectors and to accelerate structural reforms—including measures to increase competition and improve labor market flexibility—to pave the way for sustained medium-term growth.

Emerging markets and developing countries

While the *Asian* emerging countries' performance was strong in 2004, growth had slowed noticeably in most countries except China. In 2005, growth in the region was expected to be slightly weaker, with upside risks from higher-than-anticipated growth in China and downside risks from a more protracted correction in the IT sector or sluggish demand from Japan and Europe. Directors expressed their sympathy at the loss of life and property from the recent catastrophic tsunami (Box 1.2). Although reconstruction costs—and the impact on fiscal and external imbalances—would be very substantial, GDP growth would be only modestly affected in most countries. As to policy challenges facing the region, monetary tightening in most countries—except Korea where domestic demand growth remained weak—was already under way. While budget positions had generally improved, public debt remained high in a number of countries and more fiscal consolidation was needed. In addition, structural reforms were required in several countries to reduce vulnerabilities in the bank and corporate sectors and to boost investment.

Box 1.2 IMF assistance for countries affected by the tsunami of December 2004

The magnitude 9.0 earthquake and associated tidal waves that hit Indian Ocean countries in December 2004 constituted a natural disaster of tragic proportions. The estimated number of dead and missing was nearly 300,000, with roughly 1½ million people displaced. The human cost of this disaster was clearly beyond measurement.

In FY2005, the IMF and the World Bank assisted the governments of the countries affected in coping with the aftermath of the disaster. The World Bank, along with the Asian Development Bank and other international institutions, took the lead role in helping the authorities conduct damage and needs assessments. IMF staff focused on assessing the implications of the disaster for macroeconomic policy, including the effects on growth, as well as fiscal and external positions. Both the IMF and the World Bank have also moved quickly to initiate the provision of emergency financial assistance and longer-term financial aid. (See Chapters 3 and 4 for information on IMF emergency assistance for natural disasters.)[1]

[1]"Preliminary Assessment of the Macroeconomic Impact of the Tsunami Disaster on Affected Countries and of Associated Financing Needs," *www.imf.org/external/np/oth/2005/020405.htm.*

In *Latin America*, Directors noted, growth had exceeded expectations. While the favorable external environment had supported activity, domestic demand was now leading growth. Despite a number of downside risks to the outlook—including unexpected increases in global interest rates or a prolonged slowdown in key export markets—Directors believed that the region would continue to grow robustly in 2005. They were encouraged by the improved fiscal performance in many Latin American economies, although public debt, while declining, generally remained high. They therefore stressed the need for fiscal consolidation and more measures to improve public debt sustainability. Directors agreed that the tightening of monetary policy in a number of countries in response to the recent uptick in inflation had been appropriate; they noted that exchange rate flexibility had played a key role in supporting monetary policy frameworks and improving the region's resilience to shocks.

The *emerging market economies of Europe* were experiencing their strongest growth since the beginning of transition and Directors welcomed the expected moderation in the pace of growth to more sustainable rates. Among the key risks facing these countries were a prolonged slowdown in western Europe and a further appreciation of the euro. Many Directors observed that strong domestic demand had led to a general widening of current account deficits, a key regional vulnerability. The policy requirements to reduce these deficits varied across countries. In the Baltics and southern and southeastern Europe, containing credit growth and improving private saving were key, while in central Europe ambitious fiscal consolidation and structural reforms were needed.

In the *Commonwealth of Independent States*, growth had been buoyant on the back of strong domestic demand and high energy and metals prices. While growth was expected to moderate in 2005, Directors saw the outlook as generally favorable. They cautioned, however, about risks to inflation and growth from capacity constraints and inadequate investment in a number of countries. Given the area's strong capital inflows, Directors were concerned that the pace of disinflation in the region might be slowing; they stressed the need for policymakers to manage prudently the revenue gains from oil and commodity exports while allowing greater flexibility in exchange rates.

In the *Middle East*, growth had been strong in the oil exporters, underpinned by increased export earnings from oil, sound financial policies, and progress with structural reforms. Directors urged policymakers to use the window of opportunity provided by high oil prices to press ahead with the reforms needed to boost medium-term growth and employment prospects and reduce vulnerabilities, including from high public debt levels in some countries. Increased public spending on high-return human capital development and infrastructure outlays, accompanied by an acceleration of structural reforms, could help place these economies on a higher sustained growth path and, by creating jobs, help improve social outcomes. Non-oil-producing countries in the region had also benefited from the positive effects of domestic reforms, as well as from the strong growth in oil-exporting countries in the region.

Sub-Saharan Africa had experienced the highest growth in a decade, underpinned by the strength of the global economy, high prices for oil and some other commodities, improved macroeconomic policies, and progress with structural reforms. Directors viewed the region's prospects for growth as generally favorable but cautioned about a number of downside risks. A less benign global economy and a further sharp depreciation of the U.S. dollar would adversely affect a number of countries. While higher oil prices would be beneficial for some countries, they would not be for others, and many countries would need to adjust to the elimination of world textile trade quotas. To sustain the improved growth performance in the region, Directors urged governments to advance their reform efforts by promoting private sector investment, developing infrastructure, and strengthening institutions (including better transparency, governance, and property rights). They called on the international community to support these policies with increased aid, debt relief, and improved market access.

Global Financial Stability Report

Global Financial Stability Report, August 2004

At the Board's August 2004 discussion of global financial markets,[3] Directors welcomed the strengthening of global financial stability and of key financial intermediaries. The combination of broadening global economic growth and low inflation expectations had created a favorable environment for financial markets. Strong economic growth had boosted corporate and banking sector earnings, facilitated further balance sheet strengthening, and improved credit quality. At the same time, subdued inflationary pressure had contributed to stability and relatively low yields in the major bond markets. This had also benefited emerging markets, boosting their growth prospects and credit quality and facilitating the availability of external financing at relatively low cost.

Nonetheless, Directors cited a number of important risks to the outlook:

- An unanticipated increase in inflation could transform the market's assumptions about the likely pace of tightening and result in market turbulence.
- There was potential for market instability arising from the continued large global external imbalances.
- Emerging market countries could be exposed to future external shocks. These countries should use the favorable financing environment to increase their resilience and press ahead with growth-enhancing structural reforms. Measures to reduce public debt to manageable levels and to improve the structure of public debt remained key priorities for many emerging markets.

The large inflows into *hedge funds* in recent years, particularly from institutional investors, indicated that these funds were an important investor group in global financial markets. Counterparty risk management by large banks and prime brokers with regard to hedge funds had strengthened in recent years, and hedge fund leverage was at relatively moderate levels. Still, most Directors agreed that more information about hedge funds and

[3]For the summary of the Board's discussion, see *www.imf.org/external/pubs/FT/GFSR/2004/02/pdf/annex.pdf;* the *Report* can be found at *www.imf.org/external/pubs/FT/GFSR/2004/02/index.htm.*

their market activities would be helpful in addressing questions about how this investor group could affect market stability.

Discussing the staff's analysis of the *pension fund industry*, Directors noted that the size and projected growth of pension funds highlighted their increasing importance for international capital markets and financial stability and their role as a long-term institutional investor. Directors acknowledged that the roles of state pensions, pension plans in the workplace, and individual saving plans in contributing to retirement pensions varied from country to country. Among workplace pension plans, well-designed defined-benefit, defined-contribution, and hybrid plans could all continue to play a role in encouraging efficient saving for retirement.

While the 2000–02 market downturn had exposed longer-term vulnerabilities at many pension funds, the recent partial recovery in funding ratios provided a window of opportunity for policymakers to introduce measures to encourage better risk-management practices and more stable funding strategies. Directors noted that employers and governments had become more aware of the pension-funding challenges posed by aging populations and the investment risks involved in funded pension plans. They underscored the importance of effective communication of pension challenges and policy priorities to ensure broad-based public understanding and support of pension reform efforts.

The Executive Board discussed the issue of *emerging market countries as net capital exporters*, in light of the conventional wisdom suggesting that capital normally flows from capital-rich mature markets to capital-scarce emerging markets. Directors noted that the shift of emerging markets as net capital exporters during 2002–04 was associated with an unprecedented increase in their net international reserves. This, in turn, was related to their pursuit of export-led growth policies, supported by competitive exchange rates. Directors acknowledged the challenges involved in establishing a general benchmark for what constituted a desirable level of international reserves, as circumstances and vulnerabilities differed from country to country. They considered that policymakers should continue to explore alternative methods to self-insure against sudden reversals in capital flows, including through financial sector reforms and the development of local securities markets, as well as ways to improve the management of international reserves.

Directors called on emerging market countries to establish a track record of consistently strong policies and reforms to enhance their risk-adjusted returns to attract stable inflows. An orderly resolution of global current account imbalances would also contribute to an environment conducive to sustained private capital flows to emerging markets.

Global Financial Stability Report, March 2005

In discussing world financial markets in March 2005,[4] Directors welcomed the further strengthening of the financial system in the previous six months, supported by solid global economic growth and continued improvements in balance sheets of the corporate, financial, and household sectors in many countries. Prospects for continued financial stability were based on the still favorable outlook for the world economy and the growing financial market sophistication that had helped spread risk. Nonetheless, low long-term interest rates and credit spreads could mask underlying vulnerabilities and pose risks of market reversals, especially for less creditworthy sovereigns and corporations. While these risks were generally expected to be manageable given the strength of financial institutions, Directors stressed the need for continued vigilant monitoring and timely policy measures.

Markets had remained orderly through the interest rate tightening cycle in mature markets, facilitated by the increasingly transparent communication strategies of major central banks. Abundant global liquidity and improving credit quality had kept mature market bond yields and financial market volatility low. Also contributing to relatively low long-term bond yields were expectations that inflation would remain under control, low corporate demand for net credit, and growing demand for long-term bonds by pension funds and life insurance companies. More generally, low short-term interest rates had encouraged investors to use leverage and move out along the risk spectrum in their quest for yield, buoying asset valuations and compressing credit spreads.

[4] For the summary of the Board's discussion, see *www.imf.org/External/Pubs/FT/GFSR/2005/01/pdf/annex.pdf;* the *Report* can be found at *www.imf.org/External/Pubs/FT/GFSR/2005/01/index.htm.*

Directors noted that corporate balance sheet improvements in mature markets and the quest for yield had encouraged investors to increase their exposure to credit risk. This had contributed to falling corporate bond spreads and, possibly, to reduced investor discrimination. The growth of credit derivatives markets had facilitated the trading and hedging of credit risks, but many Directors acknowledged that the growth of the derivatives markets might expose some investors to the possibility of leveraged losses, which could be amplified by potential liquidity problems.

As to emerging financial markets, along with improvements in many of these countries' fundamentals, abundant liquidity and quest for yield were driving factors in recent developments. Spreads on emerging market debt had narrowed to near-record lows, and investors' appetite for emerging market financial assets had grown considerably. Directors generally expected financing prospects for emerging markets to remain solid, owing to benign financial market conditions and further improvements in the credit quality of emerging market borrowers.

Turning to risks, Directors noted that the long period of high liquidity and low volatility may have led to a sense of complacency on the part of some investors, and that compression of inflation and risk premiums left little room for error in terms of asset valuations. Against this backdrop, the risk that long-term market rates might rise abruptly required continued vigilance. While no single event may trigger such a rise, most Directors warned of the possibility of a combination or correlation of events. They cited the potential risks of a disorderly adjustment of global imbalances—possibly associated with a diversification of international investors away from U.S. dollar holdings—as well as the possibility of an unanticipated increase in inflation, particularly related to oil and other commodity prices.

To enhance global financial stability and mitigate potential risks, Directors considered a number of steps—in particular, the need for cooperative efforts and credible policy measures to enhance the market's confidence that global imbalances would be reduced in an orderly manner. At a microeconomic level, supervisors and regulators had to be vigilant to the risk profile of financial intermediaries and their exposure to abrupt market price shocks. Emerging market country authorities should continue to adopt prudent macroeconomic policies that reduce financing needs, while taking advantage of the prevailing benign conditions to fulfill their external financing requirements, improve the structure of their debt, and press ahead with efforts to develop local financial markets. In addition, structural reforms to enhance growth prospects remained a critical avenue for reducing debt-to-GDP ratios to more manageable levels.

Directors also considered the implications of the *transfer of risk to the household from the financial sector* and *trends in corporate finance in emerging markets.* Trends in the evolution of household balance sheets in different jurisdictions had benefited households in various ways, including through a significant growth in net worth relative to income, boosted by capital gains. At the same time, the shift away from bank and savings deposits to more market-sensitive assets had also exposed them to greater market risk. Planned reforms of public and private retirement benefits might imply that households would have even more responsibility going forward in managing their financial affairs. Such reforms had brought benefits, such as the portability of defined-contribution or hybrid pension plans, and had reduced some risks, but these reforms had also increased the direct exposure of households to investment and market risks and, possibly more challenging, longevity risk.

Directors generally saw a role for governments in developing communication strategies to inform households about their retirement challenges, and in coordinating with the private sector to provide financial education. They noted the importance of increased efforts to improve the collection, timeliness, and comparability of data on the household sector for assessing the flow of financial risk through the financial system, and in particular the risk profile of households.

Discussing a staff study on *corporate finance in emerging markets*, Directors observed that it was unclear whether the decline in domestic bank lending to corporations (outside China and India) was a result of reduced external financing needs or constraints on the sources of funding. Nevertheless, Directors called for continued efforts by emerging markets to improve their institutional frameworks to facilitate corporates' access to equity finance on appropriate terms. They saw a need to narrow gaps in the implementation and enforcement of widely accepted principles of corporate governance, disclosure, and transparency, while recognizing the need to take into account country-specific legal and institutional circumstances as well as the stage of market development. Assessing corporate sector financial fragilities was significant, given the increased importance of corporates relative to sovereigns in international markets and the potential risks if market conditions became less benign.

Oil Market Developments

In the face of rapidly rising oil prices—which surged more than 30 percent in 2004 and an additional 35 percent between the end of 2004 and mid-March 2005—the Board held a seminar in March 2005 to discuss market developments.[5] Prices were at record levels in nominal terms, although they were significantly below their peaks of the 1970s in real terms. While Directors recognized that the outlook for prices was subject to a large margin of uncertainty, the prevalent view was that some of the recent price increase was likely to be permanent. Directors also broadly agreed that current low levels of spare production capacity, in the context of strong demand growth and potential supply disruptions, increased the risk of greater volatility in prices.

On the issue of investment in new oil production capacity, many Directors felt that the current low levels of spare production capacity and strong demand growth called for increased investment in new productive capacity. Some other Directors, however, pointed to past experiences of overinvestment and very low prices and also noted that other factors besides capacity limitations were contributing to high prices. While Directors considered that a durable increase in prices would stimulate investment, they also cited a number of other factors affecting investment: the high initial costs of investment, the long time horizon for payoffs, uncertainties associated with forecasting long-term prices, and geopolitical risks. Directors agreed that members should strive to remove undue obstacles to investment. They also noted the importance of adequate investment in refining and other downstream activities, where structural rigidities persisted.

[5]The Board's discussion is summarized in Public Information Notice No. 05/48, *www.imf.org/external/np/sec/pn/2005/pn0548.htm.*

Directors broadly agreed that the impact of the recent high oil prices on the global economy had not been too large and that growth prospects continued to be favorable; moreover, oil prices remained well below historical peaks in real terms. They attributed this relatively limited impact in part to the ongoing reduction in oil intensity of consumption and production, especially in advanced economies, as well as to the greater credibility of countries' macroeconomic policy frameworks. Directors were reassured that many oil-importing developing countries were able to respond to price increases without undue hardship through a combination of adjustment, use of reserves, and external financing. However, the impact on some oil-importing developing countries had been significant. Directors thus stressed the need to remain watchful, especially if prices rose further.

Directors recommended that policy responses by oil exporters should take into account their current macroeconomic situation, the size of the oil windfall relative to the economy, the size of oil reserves, the existing liquidity cushion, the external and public debt situation, and the capacity to identify and implement good spending programs. They encouraged oil exporters to react prudently, given the uncertain outlook for oil prices, and attached importance to transparency and accountability in the management of oil revenues (see Chapter 2 for a discussion of the IMF's *Draft Guide on Resource Revenue Transparency*). As to oil importers, their response to higher oil prices would continue to require some combination of increased foreign borrowing, reserve drawdown, and adjustment, including allowing real exchange rate depreciation. Directors agreed that the IMF should continue to stand ready to provide temporary balance of payments financing where it would be a useful complement to countries' own policy adjustments.

Directors noted the desirability, for global prosperity, of stability in oil markets and underscored the importance of closer dialogue between consumers and producers. In that context, they agreed that the timeliness, accuracy, and comprehensiveness of data on oil supply and demand should be improved, including data on inventories. They considered that such improvements could help reduce uncertainty and price volatility as well as improve decision making by producers and consumers. Directors agreed that the Fund should continue to support the efforts of the international bodies responsible for collecting data on the oil market and encouraged Fund representation at meetings of those bodies. Fund support will continue to include technical assistance to members to improve their institutional frameworks, such as statistical legislation and organization. Directors agreed that the Fund should continue to encourage members to accelerate their participation in the Fund's data-related initiatives.

Many Directors also remarked on the important contribution that countries could make to oil market stability through policies to restrain demand for oil products. These actions included policies to improve energy efficiency, promote energy conservation and use of alternative fuels, and facilitate pass-through of international price changes to retail prices. In this context, the prices of petroleum products, including taxes and excises, should reflect not only their market costs but also the social costs that can result from their use. Directors considered that, where necessary, these measures should be accompanied by appropriate social safety nets.

COUNTRY SURVEILLANCE

To conduct surveillance in accordance with Article IV, the IMF regularly sends staff teams to member countries. Formal "Article IV" consultations are usually conducted once a year (less often in some countries), with informal staff visits often taking place between these consultations. The team collects economic and financial data and discusses with government and central bank officials economic developments since the previous consultation, as well as the country's exchange rate and monetary, fiscal, financial sector, and structural policies. The staff team may also meet with such nonofficial groups as legislators, trade unions, academics, and financial market participants to solicit their views on the economic situation. Toward the end of the visit, the team prepares a summary of its findings and policy advice, which it leaves with the national authorities, who have the option of publishing it.

On return to IMF headquarters, the staff team prepares a report describing the economic situation and the talks with the authorities, and evaluating the country's policies. The report is discussed by the Executive Board and a summary of the discussion produced. Through these consultations, the IMF seeks to identify policy strengths and weaknesses, indicate potential vulnerabilities, and advise countries on appropriate corrective actions if needed. If the member country agrees, the full Article IV consultation report, accompanied by a Public Information Notice (PIN), which provides background and a summary of the Board discussion, is published. The member country may elect to release only the PIN. In FY2005, the Board conducted 128 Article IV Consultations with member countries (Table 1.1). (All PINs are posted on the IMF's website, as are Article IV reports approved for release.)

Supplementing these systematic and regular Board reviews of individual member countries are Executive Board assessments of economic developments and policies of member countries borrowing from the IMF, as well as frequent and informal sessions to discuss developments in individual countries. The IMF's country surveillance is also informed by voluntary assessments under the Financial Sector Assessment Program (see Chapter 2).

At its July 2004 biennial review of surveillance, the Board agreed that Article IV consultations with systemically or regionally important member countries would provide fuller treatment of the cross-border impact of their economic conditions and policies. More generally, Directors agreed that consultations would be more explicit in linking economic performance to global economic and financial conditions and would enhance the analysis of country-specific vulnerabilities to global economic and financial risks. (The biennial review is covered in detail in Chapter 2.)

Table 1.1 Article IV consultations completed during FY2005

Country	Board Date	PIN Issued	Staff Report Published
Afghanistan, I.S. of	January 19, 2005	January 27, 2005	February 4, 2005
Albania	February 28, 2005	March 10, 2005	March 10, 2005
Algeria	January 12, 2005	January 28, 2005	February 15, 2005
Angola	March 4, 2005		
Antigua and Barbuda	November 15, 2004	November 22, 2004	November 24, 2004
Armenia	December 1, 2004	December 10, 2004	December 17, 2004
Australia	October 27, 2004	November 8, 2004	November 8, 2004
Austria	August 2, 2004	August 4, 2004	August 5, 2004
Azerbaijan	December 22, 2004	January 21, 2005	January 21, 2005
Bahrain	June 14, 2004	August 24, 2004	
Barbados	May 3, 2004	May 14, 2004	May 26, 2004
Belarus	May 7, 2004	May 19, 2004	May 19, 2004
Belgium	February 18, 2005	March 3, 2005	March 3, 2005
Benin	October 6, 2004	November 12, 2004	November 24, 2004
Brazil	March 21, 2005	March 25, 2005	
Brunei Darussalam	May 21, 2004	September 23, 2004	
Bulgaria	June 14, 2004	June 18, 2004	June 28, 2004
Cambodia	September 13, 2004	September 27, 2004	October 22, 2004
Cameroon	April 22, 2005	April 29, 2005	
Chile	August 4, 2004	August 5, 2004	September 13, 2004
China	July 28, 2004	August 25, 2004	November 5, 2004
Colombia	April 29, 2005	May 9, 2005	May 9, 2005
Congo, Republic of	June 10, 2004	July 22, 2004	August 2, 2004
Costa Rica	July 2, 2004	August 19, 2004	September 20, 2004
Croatia	August 4, 2004	August 12, 2004	August 12, 2004
Cyprus	February 18, 2005	March 22, 2005	March 22, 2005
Czech Republic	August 6, 2004	August 17, 2004	August 17, 2004
Denmark	August 2, 2004	August 6, 2004	August 6, 2004
Ecuador	July 26, 2004	August 12, 2004	
Egypt	May 24, 2004	July 12, 2004	
El Salvador	January 31, 2005	February 14, 2005	
Equatorial Guinea	April 25, 2005	May 6, 2005	May 6, 2005
Eritrea	September 3, 2004	February 9, 2005	
Estonia	November 8, 2004	November 11, 2004	November 11, 2004
Ethiopia	September 13, 2004	January 31, 2005	January 31, 2005
Fiji	August 23, 2004	September 14, 2004	
Finland	January 28, 2005	February 7, 2005	February 7, 2005
France	October 20, 2004	November 3, 2004	November 3, 2004
Gabon	March 28, 2005	April 26, 2005	May 3, 2005
Germany	October 25, 2004	November 2, 2004	November 2, 2004
Greece	February 2, 2005	February 9, 2005	February 9, 2005
Guinea	August 27, 2004	October 3, 2004	December 7, 2004
Guinea-Bissau	November 19, 2004	December 10, 2004	March 11, 2005
Guyana	January 24, 2005	March 11, 2005	
Honduras	March 28, 2005	April 13, 2005	
Hong Kong SAR	February 2, 2005	February 21, 2005	February 21, 2005
Hungary	May 10, 2004	May 24, 2004	May 24, 2004

Table 1.1 ***(continued)***

Country	Board Date	PIN Issued	Staff Report Published
India	January 24, 2005	February 3, 2005	March 10, 2005
Indonesia	May 3, 2004	May 9, 2004	July 2, 2004
Iran, Islamic Republic of	September 10, 2004	September 27, 2004	September 27, 2004
Ireland	October 29, 2004	November 4, 2004	November 4, 2004
Israel	March 21, 2005	March 29, 2005	April 18, 2005
Italy	February 7, 2005	February 9, 2005	February 10, 2005
Jamaica	August 2, 2004	August 16, 2004	August 16, 2004
Japan	July 28, 2004	August 11, 2004	August 11, 2004
Kazakhstan	July 21, 2004	September 20, 2004	October 28, 2004
Kenya	December 20, 2004		
Korea	January 21, 2005	February 4, 2005	February 11, 2005
Kuwait	April 25, 2005	May 13, 2005	
Kyrgyz Republic	November 19, 2004	January 14, 2005	February 10, 2005
Lao P.D.R.	November 29, 2004	January 12, 2005	January 12, 2005
Latvia	August 4, 2004	August 6, 2004	August 16, 2004
Lebanon	May 7, 2004	July 7, 2004	
Liberia	April 20, 2005		
Libya	January 28, 2005	March 8, 2005	March 8, 2005
Lithuania	March 23, 2005	March 31, 2005	March 31, 2005
Malawi	October 29, 2004	November 24, 2004	December 6, 2004
Malaysia	February 7, 2005	March 14, 2005	
Maldives	May 24, 2004	July 23, 2004	
Mauritius	July 21, 2004	August 25, 2004	
Mexico	October 18, 2004	December 23, 2004	December 23, 2004
Micronesia	February 25, 2005	March 22, 2005	March 22, 2005
Moldova	February 7, 2005	February 17, 2005	February 17, 2005
Morocco	May 5, 2004	May 12, 2004	June 9, 2004
Myanmar	March 25, 2005		
Namibia	February 14, 2005	March 9, 2005	March 11, 2005
Netherlands	September 8, 2004	September 17, 2004	September 22, 2004
Niger	June 28, 2004	July 19, 2004	August 24, 2004
Nigeria	July 16, 2004	August 3, 2004	August 6, 2004
Oman	October 8, 2004		
Pakistan	December 1, 2004	December 20, 2004	December 20, 2004
Panama	March 23, 2005	April 12, 2005	
Papua New Guinea	June 2, 2004	November 10, 2004	November 10, 2004
Paraguay	July 30, 2004	September 16, 2004	February 18, 2005
Philippines	March 7, 2005	March 20, 2005	March 21, 2005
Poland	July 12, 2004	July 26, 2004	July 26, 2004
Qatar	March 14, 2005		
Romania	July 7, 2004	July 27, 2004	July 27, 2004
Russian Federation	September 1, 2004	September 30, 2004	September 30, 2004
Rwanda	October 6, 2004	November 16, 2004	December 3, 2004
St. Kitts and Nevis	November 15, 2004		
St. Lucia	May 5, 2004	November 15, 2004	December 8, 2004
St. Vincent and the Grenadines	May 5, 2004	May 19, 2005	
San Marino	July 28, 2004	August 4, 2004	August 13, 2004

Table 1.1 *(concluded)*

Country	Board Date	PIN Issued	Staff Report Published
Saudi Arabia	December 22, 2004	January 12, 2005	
Senegal	March 7, 2005		
Seychelles	January 21, 2005		
Sierra Leone	November 12, 2004	January 19, 2005	January 24, 2005
Singapore	February 7, 2005	April 28, 2005	April 28, 2005
Slovak Republic	February 11, 2005	February 17, 2005	March 2, 2005
Slovenia	May 7, 2004	May 24, 2004	May 24, 2004
Solomon Islands	July 16, 2004	August 12, 2004	August 12, 2004
South Africa	September 3, 2004	December 2, 2004	December 2, 2004
Spain	February 9, 2005	February 17, 2005	February 17, 2005
Suriname	March 25, 2005	April 20, 2005	April 25, 2005
Swaziland	February 18, 2005		
Sweden	August 4, 2004	August 9, 2004	August 9, 2004
Switzerland	June 2, 2004	June 18, 2004	June 18, 2004
Tajikistan	March 18, 2005	March 25, 2005	April 15, 2005
Tanzania	August 6, 2004	September 7, 2004	September 7, 2004
Thailand	September 1, 2004	December 1, 2004	
Timor-Leste	July 16, 2004	October 12, 2004	October 12, 2004
Tonga	June 23, 2004	July 29, 2004	
Trinidad and Tobago	October 22, 2004	December 8, 2004	January 5, 2005
Tunisia	October 27, 2004	November 8, 2004	November 12, 2004
Turkey	July 30, 2004	August 10, 2004	
Turkmenistan	June 4, 2004		
Uganda	February 23, 2005		
Ukraine	October 25, 2004	January 24, 2005	January 24, 2005
United Arab Emirates	May 28, 2004	June 29, 2004	June 29, 2004
United Kingdom	March 2, 2005	March 8, 2005	March 8, 2005
United States	July 23, 2004	July 30, 2004	July 30, 2004
Uzbekistan	June 7, 2004		
Vanuatu	February 25, 2005	March 11, 2005	March 31, 2005
Venezuela	September 13, 2004		
Vietnam	November 22, 2004	January 5, 2005	May 4, 2005
Yemen, Republic of	March 14, 2005	March 24, 2005	March 23, 2005
Zimbabwe	July 7, 2004	September 17, 2004	September 17, 2004

Regional Surveillance

The IMF has been stepping up its regional surveillance by strengthening discussions of regional currency unions and by paying more attention to the regional dimensions of economic developments and policy issues. These discussions are expected to allow, for example, comparative analysis of developments and policies across a region and to shed further light on regional transmission of shocks.

Sub-Saharan Africa

As part of this effort, Fund staff have begun to provide the Board with periodic regional overviews. The first, discussed by the Board at an informal seminar in April 2005, covered sub-Saharan Africa.[6] *Sub-Saharan Africa: Regional Economic Outlook* reported that the most critical challenge the region faces is sustaining and accelerating economic growth. It noted that even recently improved growth rates—which reached an eight-year high of 5 percent in 2004—fall short of the level required to achieve the Millennium Development Goal of halving poverty by 2015 (see Chapter 4).

Eastern Caribbean Currency Union (ECCU)

Faced with a series of setbacks—including natural disasters, the continued erosion of preferential trade agreements in bananas and sugar, declining activity in offshore centers, weaknesses in the global economy, and the lingering effects of September 11—the ECCU countries have followed expansionary fiscal policies to generate growth. These policies, however, have saddled many countries with rapidly rising debt and weak fiscal positions.

The Executive Board, at its May 5, 2004, discussion of the ECCU,[7] urged the regional authorities to strengthen fiscal positions and reduce debt rapidly while undertaking reforms focused on improving the business environment and competitiveness so as to reinvigorate growth.

To reduce the sources of vulnerability in the region, Directors emphasized reducing reliance on traditional agriculture, strengthening underlying fiscal positions, and enhancing the effectiveness of financial supervision. It is also important to strengthen the region's institutional capacity to mitigate the effects of natural disasters. They encouraged the authorities to ensure the consistency of national fiscal policies with the region's currency board arrangement and welcomed efforts under way to develop home-grown stabilization programs.

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[6] For the full report, see *www.imf.org/external/pubs/ft/AFR/REO/2005/eng/01/SSAREO.htm.*
[7] For a summary of the discussion, see Public Information Notice No. 04/101, *www.imf.org/external/np/sec/pn/2004/pn04101.htm.*

Euro Area

The Executive Board discussed economic policies in the euro area in July 2004. Directors acknowledged the brightening of the short-term outlook but observed that longstanding structural challenges had yet to be tackled. Directors cautioned that the transmission of the growth momentum to domestic demand, particularly in some of the larger economies, remained sluggish.

Directors agreed that monetary policy had been appropriate, particularly in view of the persistence of inflation during the cyclical downturn. Looking forward, Directors believed that monetary policy should remain supportive of the recovery in domestic demand as long as the medium-term outlook for price stability was favorable. While risks of second-round effects from higher oil prices, as well as from hikes in indirect taxes and administered prices, had to be watched closely, the slack in labor markets and continued wage moderation underpinned an encouraging outlook for inflation. At the same time, Directors emphasized that renewed appreciation pressures on the euro stemming from global current account imbalances remained a medium-term downside risk to growth.

A genuine consensus on upholding a strong and disciplining fiscal framework had to be restored, Directors emphasized, in particular against the backdrop of the fiscal challenges associated with rapid population aging. Most Directors felt that a failure to build a new consensus on reforming the Stability and Growth Pact (SGP) could have potentially grave consequences for the European Economic and Monetary Union (EMU) and its member countries, many of which rely on the SGP as an external commitment device to maintain fiscal discipline. In this vein, and with the recovery gaining traction, Directors called on member states to accelerate the pace of fiscal consolidation.

Turning to growth prospects, Board members saw the euro area's key structural challenge as raising longer-term growth, in the first instance by strengthening incentives to work. Reversing the long-term decline in labor utilization through reforms of tax-benefit systems and by lengthening working lives would need to be a key plank in the strategy to shore up social protection systems in most member countries. As to the areas for reform, Directors welcomed the measurable progress in deregulating and integrating product and financial markets but urged more efforts to liberalize the service sectors.

The lack of reform momentum was a source of concern for Directors, particularly with respect to labor and pension reforms. The key challenge at the area-wide level was imparting momentum to structural reforms at the national level through more decisive leadership at the European Union level.

Directors welcomed the European Union's new efforts to relaunch the stalled Doha Round of trade negotiations. The European Union's recent offers to phase out all farm export subsidies and further limit negotiations on the four Singapore issues (trade and investment, competition policy, transparency in government procurement, and trade facilitation)—so called because it was at the 1996 Singapore Ministerial Conference that WTO members decided to start work on them—provided a fresh, much-needed impetus for reaching agreement on a negotiating framework, and Directors felt that it would be desirable to complement these efforts with a more ambitious multilateral offer on market access.

West African Economic and Monetary Union (WAEMU)

At the time of the Board's October 2004 discussion, the WAEMU region's economic prospects for 2004 were clouded by the crisis in Côte d'Ivoire, pressures on external competitiveness, higher oil prices, and a locust invasion. While the region's competitiveness had suffered no significant loss, Directors urged the authorities to pursue appropriate macroeconomic policies and structural reforms aimed at enhancing the efficiency of the export sector so as to strengthen external competitiveness and improve prospects for sustainable growth and poverty reduction.

The momentum toward macroeconomic convergence within the WAEMU had slowed and the political commitment to further trade liberalization had softened. Directors stressed that concerted and credible action by all countries to deliver on their regional commitments in all areas was necessary to achieve economic and financial convergence and allow the region to reap the benefits of further trade liberalization.

The WAEMU monetary arrangement had helped keep inflation low and maintain confidence in the currency, Directors observed. They welcomed the move to eliminate central bank financing of the national budgets, which would strengthen financial discipline. To safeguard against the risk of arrears accumulation or excessive external borrowing following this move, WAEMU limits on debt and arrears accumulation had to be strictly observed.

Despite the limited integration of WAEMU financial markets, Directors recommended that the authorities move progressively toward formulating and implementing monetary policy based on regional, rather than country-specific, targets, once constraints imposed by the lack of financial integration were alleviated. To strengthen credit institutions, Directors stressed the need to improve supervisory frameworks through regulatory reform and better enforcement. Finally, Directors welcomed the enhanced collaboration between the WAEMU Commission and the Executive Secretariat of the Economic Community of West African States (ECOWAS) aimed at establishing a single regional market within ECOWAS.

2. Strengthening Surveillance and Crisis Prevention

The IMF continues to strengthen the quality and effectiveness of its surveillance operations. Its efforts in this area, which have been intense since the emerging market crises of the mid- and late 1990s, are aimed at ensuring that the Fund is as effective as possible in helping member countries improve the performance and resilience of their economies, minimizing adverse international spillovers from problems that arise, and identifying and addressing potential vulnerabilities in the international financial system.

During FY2005, the IMF conducted another extensive biennial review of its surveillance and stepped up its consideration of financial sector issues, including through a review of the Financial Sector Assessment Program that it conducts jointly with the World Bank. It also considered members' debt-related vulnerabilities and how these might be related to financial crises, as well as issues relating to central banks' liquidity management. It discussed some members' demand for new policy monitoring and signaling arrangements that do not involve IMF financing, and continued to help members improve their statistical data and comply with international standards and codes.

BIENNIAL REVIEW OF SURVEILLANCE

In its July 2004 discussion of the IMF's biennial review of surveillance,[8] the Executive Board confirmed the need for focused surveillance built on high-quality analysis. The review centered on how to make surveillance more effective for all members, and, in so doing, reinforce the Fund's crisis prevention efforts. It was based on an assessment by Fund staff that sought to take into account views solicited not only from country authorities but also from financial market participants, think tanks and other nongovernmental entities, and the media.

Directors agreed that IMF surveillance should evolve continuously, adapting to changes in the world economy and the needs of member countries. They welcomed the

[8]The Board's discussion is summarized in Public Information Notice No. 04/95, *www.imf.org/external/np/sec/pn/2004/pn0495.htm;* the review can be found at *www.imf.org/external/np/pdr/surv/2004/082404.htm.*

progress in strengthening surveillance since the 2002 biennial review but underscored that challenges remained. Mindful of the International Monetary and Financial Committee's call for proposals to enhance the focus, quality, persuasiveness, impact, and overall effectiveness of surveillance, Directors considered a number of issues.

Focus and Quality of Analysis

Notwithstanding the expanded reach of surveillance, country (Article IV) consultations must remain focused on key issues, Directors reaffirmed. Coverage should be adapted to country circumstances and the selection of topics should be based on macroeconomic relevance. At the apex of the IMF's hierarchy of concerns were 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 economic outlook.

The IMF had generally succeeded in covering a broader range of topics without losing focus, Directors agreed. Still, individual consultations would benefit from more discriminating coverage of issues outside the IMF's traditional areas of expertise, greater use of information from appropriate outside sources, and more selective coverage of trade matters (Box 2.1), with a focus on those that most influence stability and growth prospects. The Board encouraged staff to exchange views with members in defining priority topics but stressed that staff retain ultimate responsibility for selecting them.

Box 2.1 The IMF's role in trade

Trade policy has traditionally been an important part of IMF surveillance and, in a number of cases, IMF-supported programs. Every few years, the IMF reviews aspects of its work on trade. The review undertaken during FY2005 was broader than previous reviews.

At their February 2005 discussion of the IMF's role in trade,[1] Directors endorsed the Fund's trade policy agenda and policy positions. They reaffirmed the importance of successfully concluding the Doha Round of multilateral trade negotiations to promote efficiency and growth, reduce poverty, and support the achievement of the Millennium Development Goals. Developed countries had a critical role to play in addressing remaining impediments to trade, Directors agreed, by removing restrictions to exports from developing countries, reducing tariff escalation, and cutting agricultural and other subsidies. Developing countries, for their part, had to commit to further trade liberalization.

Directors broadly endorsed the Fund's work on trade and favored only a fine tuning. They considered it useful to extend the staff's analysis of the spillover effects of the trade policies of key industrial countries to cover the trade policies of larger middle-income countries, which increasingly affect the export prospects of other countries. Directors also encouraged the staff to increase coverage of trade in services, noting its growing importance.

The Board cited the proliferation of regional trade integration arrangements and the associated pooling of trade policy and administrative decisions. While recognizing that multilateral trade liberalization on a most-favored-nation basis was the preferred way to secure open markets globally, Directors emphasized that regional trade agreements, if appropriately structured, could provide immediate economic benefits and be complementary to and compatible with multilateral liberalization.

The IMF, in collaboration with other international institutions (particularly the World Bank and the World Trade Organization) and donors, should continue to give trade-related policy advice to low-income countries with the aim of integrating trade reforms more systematically into their Poverty Reduction Strategy Papers. Such advice should draw on the work prepared in the context of the Integrated Framework (IF), an interagency initiative to coordinate trade-related technical assistance with development partners and help mainstream trade into national strategies. The IMF should also consider how best to work in a collaborative way with other partners, through the IF, to explore further ways of easing low-income countries' adjustment to more liberal trade regimes.

With regard to the IMF's work in providing financial support for member countries' adjustment and reform programs, Directors welcomed the recent reduction in trade conditionality, which was due to, among other things, the general streamlining of the Fund's structural conditionality and the adoption of more open trade policies by many countries. Directors endorsed the IMF's recent emphasis on trade-related macroeconomic vulnerabilities, which remained a pressing issue for the poorest countries with Fund-supported programs, and welcomed the introduction of the Trade Integration Mechanism (TIM) as a means of dealing with this issue (see Chapter 3).

Directors agreed that the IMF's assessment of trade policy issues remained indispensable in the context of Article IV surveillance and other functions. They acknowledged that the related work of other institutions could provide valuable insights in such assessments from a different perspective but said that it could not replace the Fund's own work.

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[1] "IMF Executive Board Reviews Fund's Work on International Trade," Public Information Notice No. 05/49, *www.imf.org/external/np/sec/pn/2005/pn0549.htm*.

Directors emphasized that IMF surveillance was an ideal vehicle for the analysis of global and regional spillovers. They saw substantial scope for improving the treatment of these issues through greater integration of country, regional, and global surveillance. They also called for fuller treatment of the global impact of the largest member countries' economic conditions and policies and for more pointed treatment, in all consultations, of risks to the short- and medium-term outlook.

Informal Board discussions of issues affecting different regions were valuable complements to the global and country surveillance exercises, Directors agreed. Such discussions provided useful opportunities to undertake comparative analysis of major developments and policies within each region and could shed further light on the regional transmission of shocks.

Clear and candid treatment of *exchange rate issues* remained a challenge. While recognizing the sensitivity of exchange rate issues, Directors stressed that a thorough discussion of them continued to be critical for surveillance. To enhance such discussions, Directors endorsed

- clear identification of the de facto exchange rate regime in staff reports;
- more systematic use of a broad range of indicators and other analytical tools to assess external competitiveness; and
- a thorough and balanced presentation of the policy dialogue between staff and member country authorities on exchange rate issues, particularly when the views of staff and the authorities diverged.

No exchange rate regime was appropriate for all countries or all circumstances, Directors reiterated.

Separately, in a seminar in December 2004, Directors discussed what a country should do to make a successful transition from a fixed to a flexible exchange rate regime (Box 2.2).

Box 2.2 From fixed to floating exchange rates

In recent years, a number of IMF member countries have moved from fixed to flexible exchange rate regimes. Most of these shifts have occurred under disorderly conditions. The Executive Board asked Fund staff to provide more advice to countries making such transitions, given their complexity from both an institutional and an operational perspective.

At a seminar in December 2004,[1] Directors agreed that four ingredients were generally desirable to support a successful, orderly transition to a float:

- a deep and liquid foreign exchange market;
- a coherent intervention policy;
- an appropriate alternative nominal anchor; and
- adequate systems for reviewing and managing public and private sector exchange rate risk.

Directors acknowledged that these four ingredients constituted an ideal framework and that some countries had successfully floated their exchange rates without meeting every condition fully.

In reviewing the key aspects of *developing a deep and liquid foreign exchange market,* Directors highlighted the need to reduce the central bank's market-making role, increase information flows in the market, and improve the market microstructure. They also underscored the need to foster two-way risk in the foreign exchange market to help develop risk-management expertise and minimize destabilizing trading strategies.

Turning to *intervention strategies,* Directors recognized the difficulties in identifying the conditions for, and determining the appropriate timing of, intervention. They noted that identifying and correcting exchange rate misalignments were difficult in practice and that exchange rate movements may provide important market signals. They cautioned that intervention should not be used as a substitute for implementing prudent macroeconomic policies and structural reforms.

Directors agreed that *inflation targeting* could be a useful and transparent nominal anchor to a more flexible exchange rate regime. Many countries, however, lacked the institutional prerequisites to implement inflation targeting quickly and successfully. Furthermore, Directors stressed that other nominal anchors could also be used to promote credible anti-inflationary monetary policies that, combined with sound fiscal policies, could provide a solid environment for flexible exchange rate regimes.

Directors recognized that floating transfers some risks back to the private sector and could bring some vulnerabilities to the fore. They thus encouraged countries to strengthen, at an early stage, *systems to manage foreign exchange risk* in the private sector. They also encouraged the use of such systems for the public sector.

Board members agreed that the pace at which relevant institutions could be built was a main determinant of how early preparations for an exchange rate float could help bolster a country's ability to make the move in an orderly manner.

Most Directors agreed that experience highlighted the risks of opening capital accounts before floating the exchange rate, especially the risk of sudden outflows. In light of experience, they supported moving toward increasing flexibility ahead of, or at the same pace as, liberalizing the capital account, depending on country circumstances.

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[1]"IMF Executive Board Discusses Fixed to Float: Operational Aspects of Moving Toward Exchange Rate Flexibility," Public Information Notice No. 04/141, *www.imf.org/external/np/sec/pn/2004/pn04141.htm*.

While Directors welcomed recent improvements in the coverage of *financial sector issues* in surveillance, they observed that coverage was not yet on a par with that of other main issues. (Further details on how the Fund is enhancing financial sector surveillance are discussed below.) They pressed the staff to make use of all available options to bring necessary expertise to bear on analysis of financial sector issues.

Directors reiterated that vulnerability to balance of payments or currency crises, and external sustainability, were key concerns. The IMF's strategy to improve vulnerability assessments and balance sheet analysis was having a positive impact, and Directors urged the staff to continue refining analytical techniques, while recognizing the data constraints. They called for better integration of the various components of vulnerability assessments to provide a clearer view in staff reports.

Areas outside the IMF's traditional expertise—such as the investment climate, institutional reforms, and social issues—had received substantial attention in Fund surveillance. Directors considered that, in addition to greater selectivity and wider use of appropriate outside sources of information, coverage of the investment climate and institutional reforms would benefit from greater attention to past and current implementation of policy recommendations. Most Board members felt that, in member countries where shocks could have a sizable impact on social conditions, Article IV consultations and other contacts could offer an opportunity to solicit interested member countries' views on protecting social safety nets or other priority expenditures in times of economic stress.

Turning to the IMF's efforts to foster good governance in its member countries, Directors viewed the implementation of the 1997 Guidance Note on Governance[9] as broadly satisfactory. At the same time, coverage of governance issues in Article IV consultations should be refined, Directors agreed, including through the greater use of existing governance indicators. Fund staff should also draw more systematically on Reports on the Observance of Standards and Codes (ROSCs) (see "Standards and codes, and data provision to the Fund," below) and other available material and pay closer attention to policy recommendations and their implementation.

Article IV consultation reports for low-income countries typically contain a broad treatment of growth objectives because, as these countries make progress on macroeconomic stability, the main challenges many of them face are sustaining high growth rates and reducing poverty. In many cases, coverage has been extended to an analysis of the sources and impediments to growth. Most Directors considered that, where relevant, consultations could be used to analyze alternative macroeconomic scenarios under different aid flow assumptions, thereby shedding light on sustainable macroeconomic scenarios. Directors urged the staff to pay greater attention to external shocks that could derail growth in low-income countries and actions that might help improve these countries' resilience. They underscored the importance of close monitoring by the international community of progress toward the achievement of the Millennium Development Goals (see Chapter 4) and suggested that, for this purpose, IMF surveillance in low-income countries should draw as much as possible on World Bank information.

The quality of surveillance in countries with IMF-supported programs had improved since 2002, Directors agreed. They noted that progress on considering the short- and medium-term economic outlook had been more limited, but were hopeful that more systematic use of alternative scenarios would foster advances in this area.

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[9]See *www.imf.org/external/np/sec/nb/1997/nb9715.htm#I2.*

Policy Dialogue with Country Authorities

A close and frank policy dialogue between the IMF and its member countries is essential for effective surveillance. Directors therefore stressed the importance of a close rapport with member country authorities based on trust; they agreed that frequent contacts outside Article IV consultations could help. They also encouraged staff to make greater use of cross-country studies.

In reviewing the modalities of surveillance in currency unions, Directors noted that the formal procedures for surveillance of the euro area had worked well and that the modalities for the other currency unions—the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Eastern Caribbean Currency Union—have also moved toward greater formalization. They favored establishing an appropriate framework for policy discussions with regional institutions in these three currency unions, which would recognize that the discussions should be part of Article IV consultations with concerned members. Such steps would strengthen surveillance over monetary and exchange rate policies, trade policies, and financial sector regulation and supervision.

Communication and Signaling

Effective communication of the IMF's policy messages is essential for enhancing the overall effectiveness of surveillance, Directors agreed. It helps inform economic discussions in member countries and encourages sound decisions by market participants. At the same time, communication, including publication, while crucial for transparency, should not come at the expense of the Fund's role as a confidential advisor to members by reducing the candor of the dialogue with them and in reporting to the Board. To strengthen communication of the IMF's policy messages, Directors encouraged staff to develop outreach programs (see Chapter 8) and enhance contacts with local think tanks and also to disseminate more actively within the Fund best practices and innovations in the modalities of consultations.

Directors also discussed how the IMF could best respond to requests from some members for frequent policy monitoring and for delivering a signal on the strength of a member's policies (see below under "Policy monitoring, precautionary arrangements, and signaling").

Assessing the Effectiveness of Surveillance

Directors underscored the importance of regularly assessing the effectiveness of surveillance, while conceding that it was a daunting task. This was partly because, with the broadening purview of surveillance and its transformation into a more public process, the chain of reactions to IMF policy advice had grown more complex. Directors thus appreciated that the staff's papers for the biennial review were based not only on an in-house assessment but also on outreach to external audiences. In addition, to make further progress, they also encouraged greater discussion of the effectiveness of individual Article IV consultations, including, as needed, the relevance or appropriateness of past IMF policy recommendations and the authorities' responses, as well as clearer delineation and planning of the focus of individual consultations.

Use of Staff Resources

Some Directors thought that the total cost of staff resources devoted to surveillance was already substantial and saw little scope for implementing the review's recommendations fully. A number of others maintained that stronger surveillance could be achieved through more strategic management of resources and better prioritization. Many Directors called for further consideration of resource savings and offsets, such as greater selectivity in the coverage of individual surveillance exercises.

Given resource limitations, Directors saw a need to define priorities among strategic objectives and specific recommendations, while recognizing that the effectiveness of IMF surveillance depended on its evenhanded implementation. They supported assigning immediate priority to sharpening the focus of Article IV consultations and ensuring deeper treatment of exchange rate issues; enhancing financial sector surveillance; and deepening the coverage of regional and global spillovers in country surveillance (Box 2.3). These would serve as the monitorable objectives for the next biennial review. In addition, progress on improving debt sustainability and reducing balance sheet vulnerabilities and further work on surveillance in low-income countries would also be monitored in the next review.

Box 2.3 Better integrating country, regional, and global surveillance

To enhance its analysis of global and regional spillovers, the IMF is working to better integrate country-level, regional, and global surveillance. Its principal means for doing so are through the Executive Board's reviews of the Fund's main global surveillance documents, the *World Economic Outlook* reports and the *Global Financial Stability Reports* (see Chapter 1).

The Fund will also sharpen its focus on global and regional issues in country surveillance. Article IV consultations with systemically or regionally important Fund members will need to provide fuller treatment of the cross-border effects of their economic conditions and policies. To date, such analysis has focused principally on the systemic effects of trade policies. More generally, consultations will be more explicit in linking economic performance to global economic and financial conditions, and will enhance the IMF's analysis of country-specific vulnerabilities to global economic and financial risks.

Regional surveillance and global surveillance complement country surveillance by highlighting spillover effects and regional issues, and need to be better integrated with country surveillance. The Fund has initiated a number of reviews of regional financial sector issues where there are important commonalities and spillovers across countries. For example, the operation of regional financial conglomerates demands the close cooperation of relevant supervisors and an intensified exchange of information. The first such review, covering six countries in Central America, was undertaken in FY2005.

At the same time, the increasing interdependence of economies reinforces the central role that global surveillance must play in the IMF's fulfillment of its responsibilities for overseeing the functioning of the international monetary system, safeguarding global financial stability, and promoting cooperative action to address global imbalances. The IMF's research agenda will give particular attention to evolving priorities for surveillance and program design—including international spillovers—and to how member countries can cope with volatility in global economic conditions.

FINANCIAL SECTOR SURVEILLANCE

A well-regulated and well-supervised financial system is essential for any country to maintain macroeconomic and financial stability and avoid financial crises. In its continuing efforts to help member countries in this important area, the IMF during the financial year

- completed 24 assessments under the joint Fund-Bank Financial Sector Assessment Program, of which 6 were updates (another 36, of which 8 are updates, are under way or agreed), and undertook a strategic review of the FSAP;
- held Board seminars and discussions on issues such as gaps in financial sector regulation and implementation of monetary policy at different stages of market development;
- launched a pilot project in 12 countries to test ways to improve coverage of financial issues in Article IV consultations;
- devoted additional resources to monitoring financial systems, especially using financial soundness indicators (Box 2.4);
- completed the first phase of the assessment of offshore financial sectors; and
- increased participation by financial sector experts in Article IV missions or in separate missions, and enhanced training in financial sector issues for staff working on country surveillance.

Box 2.4 Financial soundness indicators

The financial crises of the mid- to late 1990s in a number of emerging markets underscored the need for new tools to detect vulnerabilities in financial systems. In response, the IMF developed a broad set of indicators and analytical techniques, including indicators designed to evaluate the health of a country's entire financial system, in contrast to bank prudential indicators, which apply only to individual institutions.

Once the set of indicators was agreed upon, the question arose as to how the IMF could help national authorities develop the ability to compile them, ensure that they were comparable across countries, and disseminate them to increase market transparency and strengthen market discipline. The first step was the preparation of a *Compilation Guide on Financial Soundness Indicators,*[1] which reflects the consensus of experts as well as feedback from the public.

After the *Guide* was finalized in July 2004, the IMF Executive Board recommended that staff undertake a coordinated compilation exercise. Statistical coordinators and compilers from about 60 countries participating in the pilot project on a voluntary basis met in Washington in November 2004 to discuss and finalize the specific terms of reference for the exercise. Countries participating in the exercise have made a commitment to compile and submit to the IMF end-2005 data for at least a core set of 12 indicators covering the banking sector. (The *Guide* contains the list of core and encouraged indicators.) The countries are encouraged to follow the *Guide's* recommendations to the extent possible to foster comparability of data across countries, but are permitted to use existing methodologies. To assist data users, countries have also committed to prepare metadata (information about the data), including on deviations of their existing methodologies from the recommendations in the *Guide*.

[1]Available at *www.imf.org/external/np/sta/fsi/eng/2004/guide/index.htm.*

Financial Sector Assessment Program

The Financial Sector Assessment Program (FSAP) was introduced in May 1999 by the IMF and the World Bank to strengthen the monitoring of financial systems. It is designed to help countries prevent or increase their resilience to crises and cross-border contagion and to foster sustainable growth by promoting financial system soundness and financial sector diversity. Assessments of financial systems undertaken under the FSAP

- identify the strengths, risks, and vulnerabilities in the financial system and the two-way linkages between financial sector performance and the macroeconomy;
- ascertain the financial sector's development needs; and
- help country authorities design appropriate policy responses.

The comprehensive nature of financial sector assessments requires a wide range of analytical tools and techniques. These include financial stability analysis, stress testing and scenario analysis, and assessments of countries' observance of relevant international financial sector standards, codes, and good practices. In implementing the FSAP, the IMF and the World Bank draw on feedback received from the Executive Boards of both institutions, from countries that have participated in the program, and from various international groups. They also draw on the knowledge of experts from a range of cooperating central banks, supervisory agencies, standard-setting bodies, and other international institutions, and outside experts augment the expertise in the IMF and the World Bank.

At a March 2005 IMF Board discussion of the Financial Sector Assessment Program,[10] Directors noted that it remained a cornerstone of financial sector work by the IMF and the World Bank in member countries. About 120 countries, two-thirds of the membership, have already participated or requested participation in the FSAP. Directors noted that further proposals may arise from the upcoming reviews of the program by the Independent Evaluation Office (IEO) and the World Bank's Operations Evaluation Department (OED). These studies, together with the Fund's own strategic review, will provide an opportunity to make a more in-depth and critical assessment of the progress so far and the program's overall effectiveness.

Assessments continued to be comprehensive and to highlight a broad range of financial sector vulnerabilities, while heightening member countries' awareness of international financial standards. Expertise developed in the assessment process has also improved the quality of IMF and Bank advice. In addition, especially in assessments of lower-income countries with underdeveloped financial systems, more effort had been devoted to explaining why specific markets were missing and broad access to financial services was limited. Feedback from country authorities underscored the usefulness of the program in diagnosing stability and development needs in financial systems and in charting appropriate policy responses. Directors cited country authorities' suggestions of areas for further improvement as key to strengthening the FSAP.

Joint and voluntary nature. Most Directors agreed that the FSAP's two key features—its joint World Bank–IMF character and its voluntary nature—should remain unchanged. The FSAP exercise was a good example of effective Fund-Bank collaboration. Its joint nature efficiently pools resources from the two institutions, contributes to a broad perspective on financial issues in low- and middle-income countries, and leads to greater

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[10]The discussion is summarized in Public Information Notice No. 05/47 *www.imf.org/external/np/sec/pn/2005/pn0547.htm.* Staff papers on the FSAP are posted at *www.imf.org/external/np/fsap/2005/022205.htm* and *www.imf.org/external/np/fsap/2005/022205a.htm.*

consistency in policy advice. In addition, the FSAP's voluntary participation results in greater country ownership. Directors stressed the importance of maintaining the case-by-case design of FSAP assessments to make the exercise useful to countries, within limits that preserve the program's integrity.

Streamlining. Directors noted that recent FSAP streamlining and improved prioritization had resulted in assessments that are better tailored to country circumstances. This, along with the smaller average size of financial systems undergoing initial assessments in the previous two years, had contributed to lower average costs per FSAP, freeing up IMF resources for other financial surveillance work, such as FSAP updates and participation in Article IV missions, and allowing the World Bank to put more emphasis on issues related to financial sector development. As a result, the balance of resources used in the program had become more equally distributed between the two institutions.

FSAP updates. Directors noted that the number of FSAP updates was rising and would eventually account for the bulk of the program. (Twelve have been undertaken and more are planned.) They agreed that updates would require, at a minimum, an assessment of financial sector developments and progress in implementing earlier FSAP recommendations. Updates should contain a financial stability analysis, reassessments of key development and structural issues raised in the initial assessment, and factual updates of key standards and codes. At the same time, updates could include additional elements if justified by new developments or particular risks. Flexibility would maximize the program's usefulness to country authorities and its contribution to surveillance.

Given the pace of financial sector development and the need to keep the staff's institutional knowledge current enough for effective financial sector work, an average frequency of FSAP updates of about five years seemed reasonable. In any particular country, however, the frequency would depend on financial sector developments; the country's willingness to participate, systemic importance, and track record in implementing recommendations from previous assessments; and resource availability.

Country coverage and follow-up. The Board agreed that the FSAP had achieved broad country coverage, especially of systemically important countries, but that coverage differed widely among regions. Many Directors were concerned that several systemically important countries had yet to request an initial assessment, and they encouraged these countries to do so.

While Directors supported the steps taken by Fund staff to strengthen follow-up monitoring of financial systems, more needed to be done to ensure that issues identified during the FSAP were followed up through IMF surveillance. Directors therefore encouraged more systematic participation in Article IV consultations by financial sector specialists and more technical support from headquarters. They also urged staff to continue making technical assistance follow-up more systematic.

Additional work. Directors favored continued research on developmental and stability issues to better underpin the IMF's policy advice in the financial sector. They saw great potential in regional financial exercises for regions with substantial cross-border links. Directors agreed that countries could gain from deepening such linkages while addressing related vulnerabilities.

Gaps in Financial Sector Regulation

In 2000, the IMF Executive Board endorsed a set of international standards in the area of financial sector regulation to help guide policies and reforms in Fund member countries. The assessment of the observance of these standards by Fund members is carried out mainly in the context of the FSAP. The Financial Stability Forum and the standard-setting bodies have asked the Fund to provide periodic feedback on the assessment process, emerging issues for regulators, and the adequacy of international guidance.

In October 2004, the Board considered a staff paper, *Financial Sector Regulation: Issues and Gaps*.[11] The paper reviews issues in financial regulation across the banking, insurance, and securities sectors, and highlights some of the practical issues in the implementation of good regulation across these three sectors. It examines the implementation of financial sector

[11]Available at *www.imf.org/external/np/mfd/2004/eng/102504.htm*; see also "Financial Sector Regulation: Issues and Gaps—Background Paper," *www.imf.org/external/np/mfd/2004/eng/081704.htm*, and the summary of the Board discussion in Public Information Notice No. 04/131, *www.imf.org/external/np/sec/pn/2004/pn04131.htm.*

regulation in 36 Fund member countries where regulatory systems in all three sectors were assessed under the FSAP during 2000–03. A cross-sectoral approach to the review of regulatory systems was chosen to enable the Fund to identify common regulatory themes.

Directors had a wide-ranging discussion covering, among other things, the role of good-quality regulatory preconditions, some issues regarding the standards themselves, the challenges that financial conglomeration and the internationalization of finance pose for financial sector regulators, and structural factors such as dollarization and state ownership of financial institutions. They considered high-quality financial regulation to be a key element of financial stability and important for Fund surveillance, and agreed that the existence of certain preconditions—including sound macroeconomic policies, adequate legal and accounting frameworks and standards, and the availability of human and financial resources—is crucial for effective financial regulation.

Monetary Policy Implementation at Different Stages of Market Development

Central banks in emerging market and developing economies have been moving toward greater reliance on money market operations for the implementation of monetary policy. The Fund has encouraged the process and provided technical assistance for the transition. So far, the experience of these economies with market-based monetary policy operations has been mixed. Limited competition in financial markets has complicated the use of money market operations, particularly in some smaller countries. While some larger countries have successfully begun market operations, others still cannot fully rely on money market operations for liquidity management, despite lengthy periods of adjustment.

At a seminar in November 2004,[12] the Board discussed the Fund staff's efforts to identify guidelines for developing strong frameworks for monetary policy operations.

Directors saw as useful the development of a menu of options for implementing monetary policy that takes into account potential impediments to market development,

[12]The Board discussion is summarized in Public Information Notice No. 05/15, *www.imf.org/external/np/sec/pn/2005/pn0515.htm*. The paper is posted at *www.imf.org/external/np/mfd/2004/eng/102604.htm.*

including the extent of dollarization, the size of the country, the government's financing needs, structural excess liquidity, central banks' implementation capacity, and the strength of the banking system. They encouraged follow-up work to further refine the IMF's policy advice to countries developing their money markets.

Offshore Financial Centers

During FY2005, the first phase of the assessment of offshore financial centers (OFCs) was completed. These centers account for a sizable portion of global financial flows and thus are important for global financial stability. In recognition of this, in June 2000, the Financial Stability Forum encouraged OFCs to take steps to meet international standards and codes and asked the IMF to undertake initial assessments of them. The IMF's Executive Board, at the November 2003 review of the Offshore Financial Center Assessment Program, commended the significant progress made by the program since it was initiated in 2000 and agreed with its proposed evolution.

Some offshore centers do better than many countries in complying with international standards and codes of good practice. Nevertheless, deficiencies remain, notably in centers' efforts to combat money laundering and the financing of terrorism, cross-border cooperation, and information exchange between jurisdictions and domestic agencies. In its assessments of offshore centers, the IMF evaluates compliance with international standards in banking, insurance, and securities, and with the policies, laws, and methods needed to prevent money laundering and the financing of terrorism.

The evaluation of the first phase of the IMF program—completed in February 2005,[13] in which 41 out of 44 jurisdictions were assessed and their reports published—found that progress had been made in meeting the four priorities set by the Executive Board:

- regular monitoring of developments in financial centers;

[13]"Offshore Financial Centers: The Assessment Program—A Progress Report," *www.imf.org/external/np/pp/eng/2005/022505.htm*.

- improved transparency through an information network developed by Fund staff in consultation with OFCs;
- expanded Fund technical assistance; and
- greater collaboration with standard-setting bodies and onshore and offshore supervisors.

At an informal seminar in March 2005, the Executive Board also considered a staff paper on possible modalities for integrating informal remittance providers into the formal sector through a regulatory framework to avert the risk that informal systems could be misused for money laundering or the financing of terrorism.

BALANCE SHEET APPROACH, DEBT, AND LIQUIDITY

One important contribution to the analysis of an economy's vulnerability to financial crises and to understanding how capital account crises occur is the "balance sheet approach"—that is, the examination of the stocks of assets and liabilities in an economy's main sectors for mismatches in maturities, currencies, and capital structures.[14] During FY2005, such balance sheet analysis was increasingly integrated into the Fund's operations, with a particular focus on the role of public debt. Analyses of balance sheet vulnerabilities are increasingly being incorporated into Article IV consultations and other surveillance exercises.[15]

In their Biennial Review of Surveillance in July 2004, Directors reiterated that vulnerability to balance of payments or currency crises and external sustainability are matters at the apex of the Fund's hierarchy of concerns. They observed that the current strategy to improve vulnerability assessments and balance sheet analysis is having a positive impact and,

[14]See, for example, the note "Integrating the Balance Sheet Approach into Fund Operations," February 23, 2004, *www.imf.org/external/np/pdr/bal/2004/eng/022304.htm.*

[15]Examples include "Bulgaria: Selected Issues and Statistical Appendix," IMF Country Report No. 04/177, June 2004, *www.imf.org/external/pubs/ft/scr/2004/cr04177.pdf*; "Australia: 2004 Article IV Consultation—Staff Report," in IMF Country Report No. 04/353, November 2004, *www.imf.org/external/pubs/ft/scr/2004/cr04353.pdf;* "Republic of Estonia: Selected Issues," IMF Country Report No. 04/357, November 2004, *www.imf.org/external/pubs/ft/scr/2004/cr04357.pdf*; and "Ukraine: Selected Issues," IMF Country Report No. 05/20, January 2005, *www.imf.org/external/pubs/ft/scr/2005/cr0520.pdf.*

while recognizing data constraints, urged staff to continue refining the analytical techniques. A few Directors considered that debt sustainability assessments would be enhanced if they were conducted independently of regular country work. Some other Directors considered that high-quality vulnerability assessments are dependent upon close analysis of country-specific conditions, which require area departments' expertise. All Directors saw a need for better integrating various components of vulnerability assessments to provide a clearer view in staff reports on the extent of vulnerabilities. A number of Directors pointed out that balance sheet analysis is relevant to assessments of vulnerabilities in advanced as well as in emerging market economies.

Directors also held seminars to examine related issues, including innovations aimed at reducing the vulnerabilities that emanate from today's sovereign debt structures (Box 2.5) and liquidity management, and encouraged borrowing countries to have a regular dialogue with their private creditors (Box 2.6).

Box 2.5 Structuring sovereign debt to prevent crises

How should government debt be structured to reduce the likelihood of crises? A paper by Fund staff[1] considers recently developed analytical approaches to improving the structure of sovereign debt using existing debt instruments and cites the pros and cons, and the practical challenges, of a number of innovations.

Three key messages emerge from the analysis:

- The credibility of fiscal and monetary policies has a strong influence on the willingness of investors to hold long-term local currency bonds. Credibility depends on both the quality of a country's institutions and the country's reputation for sound policymaking. Building such a reputation can take many years, but the combination of macroeconomic stabilization and institutional and structural reforms can accelerate the process.

- Finding ways to protect private creditors from the dilution of sovereign debt could reduce the cost of borrowing and increase low-debt countries' market access as well as help prevent overborrowing and risky debt structures. Debt dilution occurs when new debt reduces the claim that existing creditors can hope to recover in the event of a default. Dilution has long been recognized as a problem in the context of corporate debt, where it is addressed through debt covenants and explicit seniority. The Fund staff paper argues for further investigation of analogous innovations in the sovereign context.

- Instruments with equity-like features, which provide for lower payments in the event of adverse shocks and weak economic performance, can help sovereigns improve debt sustainability and international risk-sharing. In particular, GDP-indexed bonds would provide substantial insurance benefits to both advanced and emerging market economies, although they present substantial implementation challenges.

[1]The paper, in revised form, was published in January 2005 as IMF Occasional Paper No. 237, *Sovereign Debt Structure for Crisis Prevention,* Eduardo Borensztein and others (Washington: International Monetary Fund), *www.imf.org/external/pubs/nft/op/237/op237.pdf*.

Box 2.6 Investor relations programs

Having recognized that improved communication between investors and creditors is critical to the prevention and resolution of financial crises, a number of countries and multinational corporations have introduced investor relations programs. The IMF's Executive Board has emphasized the value to countries that borrow from international capital markets of establishing procedures for a regular dialogue with their private creditors and has called on Fund staff to follow up on this matter in Article IV consultation discussions with emerging market countries.

A recent study by IMF staff[1] notes that countries and investors agree that an investor relations program should include several elements, which may differ from country to country:

- dissemination through a website or e-mail of data and information on recent economic performance and policy initiatives;
- establishment of channels (either formal or informal) to answer investors' questions, and to obtain feedback on their concerns;
- contacts of senior policymakers with investors through meetings, teleconferences, and road shows to discuss issues of mutual interest; and
- coordination among government entities in providing information to investors about a country's economic situation and fostering a dialogue between investors and government.

Many countries have made significant strides in all of these areas since 2001.

[1] "Investor Relations Programs—Recent Developments and Issues," October 2004, *www.imf.org/external/np/icm/2004/102604.htm.*

Debt-Related Vulnerabilities

In October 2004, the Board held a seminar to assess the Fund staff's efforts to improve its vulnerability analysis through the balance sheet approach. Discussion focused on the staff paper "Debt-Related Vulnerabilities and Financial Crises—An Application of the Balance Sheet Approach to Emerging Market Countries," which takes a broad look at the evolution of various balance sheet indicators in emerging markets over the past decade, and examines in more detail several recent crises and near-crises.[16] (See "Debt Relief and Sustainability" in Chapter 4.)

Directors noted that an examination of currency and maturity mismatches in sectoral balance sheets had provided a useful complement to the Fund's traditional flow-based analysis. The staff's cross-country analysis and ex post case studies illustrated how the debt structure and balance sheet mismatches could contribute to financial crises. The Fund has also begun work on developing a comprehensive approach to risk analysis based on balance sheets (Box 2.7). Directors generally agreed with the deliberate pace at which the staff had been integrating insights from the balance sheet approach into Fund operations, especially with respect to country surveillance. The need to avoid a mechanistic approach could not be overemphasized, and there was as yet no intention to make the balance sheet approach a standardized element of IMF surveillance. Going forward, the Fund will work with member countries to improve the statistical basis for more meaningful assessments of balance sheet vulnerabilities, with due regard to balancing the costs and the benefits of such an endeavor to member countries.

Box 2.7 Measuring and analyzing balance sheet risk with contingent claims

The contingent claims approach (CCA) is a finance-based economic model used to analyze the vulnerability of the balance sheets of the corporate, financial, and public sectors.

This approach uses balance sheet and financial market data to construct a marked-to-market balance sheet along with a set of credit risk indicators. It is different from other vulnerability analyses in that it

[16]"IMF Executive Board Discusses Balance Sheet Approach to Analysis of Debt-Related Vulnerabilities in Emerging Markets," Public Information Notice No. 05/36, *www.imf.org/external/np/sec/pn/2005/pn0536.htm.*

incorporates volatility to derive current estimates of risk exposures. In so doing, the approach provides a measure of balance sheet risk that is comprehensive and forward looking. The CCA is widely used in the corporate sector to estimate risk and is increasingly being used in the financial sector as well. It is a tool that can help policymakers design and implement strategies to reduce balance sheet risk and rank policy options.

In an informal Board seminar on the contingent claims approach, Executive Directors encouraged Fund staff to continue to develop the model as a means of identifying key vulnerabilities. Fund staff are in the process of building a framework to estimate the credit risk of the corporate, financial, and public sectors.

Although balance sheet analysis should preferably be applied to all countries, because of resource constraints, priority would necessarily be given to countries whose balance sheet weaknesses—particularly currency mismatches—appeared largest and where Fund efforts would most help reduce vulnerabilities. These include emerging market countries and countries of systemic importance. The staff would continue to work with industrial countries to refine balance sheet analysis and to integrate the assessments into Article IV consultations where relevant. Specifically, the staff would continue to apply balance sheet concepts in its study of the potential risks from equity and housing price bubbles in mature countries. Directors observed that developing a balance sheet approach was a work in progress, with much more work needed at both the analytical and the operational levels.

Liquidity Management

In May 2004, the Executive Board held a seminar to discuss the interactions between international reserves, public debt management, and private liability management in limiting a country's liquidity risks. Liquidity management by member countries is important for preventing financial crises, and the IMF's focus on liquidity management complements its other work on debt sustainability analysis and financial sector surveillance.

Directors noted that foreign exchange reserves, along with a country's exchange rate, played a key role in helping countries cope with external shocks by providing them with a temporary buffer to limit immediate disruptions and giving them time to put in place appropriate policy responses. Reserves can also add to market confidence when combined with sound policies, thereby strengthening economic and financial stability. Directors emphasized, however, that international reserves could neither substitute for sound macroeconomic policies and prudent debt management nor make up for fundamental external imbalances.

Reserve indicators are only a guide and a starting point in analyzing the adequacy of reserves, Directors agreed, and they cautioned against a one-size-fits-all approach. Such indicators had to be carefully interpreted, based on a complete analysis of, and careful judgments about, a country's macroeconomic circumstances.

Recent capital account crises have shown that both the structure and the level of public debt can create major vulnerabilities in a country's balance sheets. More broadly, sound liability management by both the public and the private sectors can play a major role in containing exposure to interest rate, currency, and rollover risks embedded in the structure of national balance sheets. Directors thus saw merit in enhancing the IMF's policy advice on public debt management, building on the IMF's and the World Bank's "Guidelines for Public Debt Management."[17] They emphasized the role of short-term, foreign-currency-linked debt in generating vulnerability to crises, and thus the importance of monitoring and addressing the combination of currency and maturity risks in debt structures. Directors noted the need to integrate the analysis of public debt with that of macroeconomic developments and policies such as exchange rate issues and the currency composition of debt.

Directors encouraged IMF staff to undertake further analytical and empirical work on liquidity management issues, to keep developing a diagnostic toolkit, and to continue integrating liquidity management analysis in country work.

POLICY MONITORING, PRECAUTIONARY ARRANGEMENTS, AND SIGNALING

During FY2005 further consideration was given to the instruments for signaling to markets and the public the IMF's assessments of members' policies outside the context of a financial arrangement, and to the current and potential roles of precautionary arrangements both in signaling and in providing protection against the emergence and spread of capital-account-

[17]Available at *www.imf.org/external/pubs/ft/pdm/eng/guide/080403.htm.*

driven crises. Previous Board discussions had not led to a consensus on these issues because of differences of view on whether existing Fund policies are adequate to address members' needs.

Some members continue to look to the IMF for more frequent policy monitoring and delivery of signals on the strength of their economic and financial policies outside the context of a financial arrangement. They seek a mechanism that demonstrates their commitment to sound policies, either for domestic purposes or as a signal to international creditors and donors, but do not need, or prefer not to request, IMF financing. Demand for signaling by the Fund has also come from donors and creditors.

A range of mechanisms can be considered—and indeed have been used or explored in the past—as possible ways of meeting members' demand for signaling. The Board had another exchange of views in September 2004 on the possible design of a proposed signaling instrument, referred to as the Policy Monitoring Arrangement, against the background of a review of the history of signaling by the Fund.[18] Directors generally agreed that any new signaling mechanism, if adopted, should be devised in such a way as to fit appropriately into the Fund's array of instruments ranging from surveillance to Fund-supported programs, noting that precautionary stand-by arrangements and low-access PRGF arrangements have served as useful instruments. Key design issues, should such an instrument be introduced, would include the standard for activation of the mechanism, modalities for reviews, and publication.

Also in September 2004, the Board discussed the possible use of precautionary stand-by arrangements to prevent capital account crises,[19] a subject it has considered on a number of occasions in recent years. Precautionary arrangements are an important instrument for signaling policy discipline and providing contingency financing. The use of these instruments

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[18]For further details, see "Signaling by the Fund—A Historical Review," *www.imf.org/external/np/pdr/signal/2004/071604.htm,* and the summary of the Board discussion, Public Information Notice No. 04/114, *www.imf.org/external/np/sec/pn/2004/pn04114.htm.*

[19]For further details, see "Crisis Prevention and Precautionary Arrangements—Status Report," *www.imf.org/external/np/pdr/cp/eng/2004/090304.htm*; and the summary of the Board discussion, Public Information Notice No. 04/117, *www.imf.org/external/np/sec/pn/2004/pn04117.htm.*

is particularly relevant for countries exiting from sustained use of Fund resources. They also have a role to play in supporting members' efforts to reduce their vulnerabilities to capital account crises. A difficult issue pertaining to this crisis prevention role, however, is the possible use of precautionary arrangements with exceptional access.

In particular, many Directors argued that the expiration of the Contingent Credit Line in late 2003 had left a gap in the Fund's toolkit. A new policy that would provide ex ante assurances of appropriate financial support could help strengthen the Fund's role in crisis prevention. By contrast, many other Directors took the view that regular precautionary arrangements within the normal access limits provided sufficient support for member countries with strong policies and that innovations in Fund surveillance and efforts to increase transparency were already bearing fruit.

As with previous Board discussions on these interrelated issues, no consensus was reached.

Existing policies already allow for frequent consultation with members that do not have a financial arrangement with the Fund, affording a basis for staff assessments of the members' policies. These assessments may be released to the public or to creditors or donors but do not constitute endorsements of the policies or statements that the policies meet a particular standard. Different variants of this approach have recently been used for a number of countries (Box 2.8). At the request of the International Monetary and Financial Committee at its April 2005 meeting, a paper that addresses the issue of signaling for countries eligible for assistance under the Poverty Reduction and Growth Facility will be discussed by the Board in FY2006 (see Chapter 4).

Box 2.8 Signaling under surveillance

The IMF's assessment of members' policies and economic developments provides information or "signals" that may be used by other agents—such as investors and donors—in making decisions. For example, the IMF's assessments of economic trends and policies in publications such as the *World Economic Outlook* and the *Global Financial Stability Report* may inform investment decisions, and its report on a low-income country's policies following an Article IV consultation may influence donors' aid decisions.

Typically, the Fund provides written and oral assessments directly to the donor community in response to specific requests from the latter. On occasion, however, a member country applying to donors and lenders for financial assistance may request that the Fund's assessments be forwarded to them. The assessments are meant to enable the recipients to form a clear view of the strengths and weaknesses of a country's macroeconomic and related structural policies.

To ensure a more regular provision of signals, some member countries have also requested more frequent visits by IMF staff and, in some cases, more frequent reporting to the IMF Board than annual Article IV consultations. Some of these countries want to support an ongoing engagement with the donor community or the World Bank, while others seek the benefits of a more intense dialogue with Fund staff and more frequent independent reports on economic developments. In the cases of Jamaica, Lebanon, and Nigeria, IMF staff prepare two reports a year for the Executive Board. Although the publication of the reports is voluntary, most such reports have recently been published. Despite the lack of formal endorsement of their policies, these countries have found this intensified relationship with the IMF useful.

STANDARDS AND CODES, AND DATA PROVISION TO THE FUND

The IMF and the World Bank assess member countries' policies in 12 areas—data quality, monetary and financial policy transparency, fiscal transparency, banking supervision, securities, insurance, payments systems, anti-money-laundering provisions, corporate governance, accounting, auditing, and insolvency and creditor rights—against international standards and codes that serve as benchmarks of good practice.[20] These assessments are intended not only to help countries identify weaknesses in their policies but also to help market participants make better investment decisions (Box 2.9).

Box 2.9 ROSCs and data standards initiatives

Reports on the Observance of Standards and Codes (ROSCs). A ROSC is an assessment of a country's observance of one of 12 areas and associated standards useful for the operational work of the Fund and the Bank. The reports—about 75 percent of which have subsequently been published—examine three broad areas: (1) transparent government operations and policymaking (data dissemination, fiscal transparency, monetary and financial policy transparency); (2) financial sector standards (banking supervision, payments systems, securities regulation, insurance supervision, and

[20]The Board has not yet endorsed a standard for insolvency and creditor rights, one of the twelve areas.

efforts to combat money laundering and the financing of terrorism (AML/CFT)); and (3) market integrity standards for the corporate sector (corporate governance, accounting, auditing, insolvency, and creditor rights). Participation in the standards and codes initiative continues to grow. As of end-April 2005, 723 ROSC assessments and updates had been completed for 122 countries, or two-thirds of the Fund's membership, and most systemically important countries had volunteered for assessments. More than 300 of the ROSCs were on financial sector standards. Of these, about one-third were related to banking supervision, and the others were fairly evenly distributed across the other standards and codes (except for ROSCs related to AML/CFT, which began to be assessed later).

Special Data Dissemination Standard (SDDS). Created in 1996, the SDDS is a voluntary standard whose subscribers—countries with access to international financial markets or seeking it—commit to meeting internationally accepted norms of data coverage, frequency, and timeliness. Subscribers also agree to issue calendars on data releases and follow good practice with respect to the integrity and quality of the data and access by the public. SDDS subscribers provide information about their data compilation and dissemination practices (metadata) for posting on the IMF's Dissemination Standards Bulletin Board (DSBB).[1] Subscribers are also required to maintain an Internet website, electronically linked to the DSBB, that contains the actual data. SDDS subscribers began disseminating prescribed data on external debt in September 2003. As of April 30, 2005, there were 60 subscribers to the SDDS. Belarus, Egypt, and Russia became subscribers in FY2005.

General Data Dissemination System (GDDS). The GDDS framework was established in 1997 to help Fund member countries improve their statistical systems. Voluntary participation allows countries to set their own pace but provides a detailed framework that promotes the use of internationally accepted methodological principles, the adoption of rigorous compilation practices, and ways in which the professionalism of national statistical agencies can be enhanced. The 79 IMF members participating in the GDDS at end-April 2005 provide metadata describing their data compilation and dissemination practices as well as detailed plans for improvement for posting on the IMF's Dissemination Standards Bulletin Board. Participation in the GDDS has nearly quadrupled since 2001.

In addition, the Fund staff has been developing the Statistical Data and Metadata Exchange (SDMX) standard, in collaboration with other international organizations. The SDMX aims to facilitate efficient electronic exchange and management of statistical information among national and international entities by providing standard practices, coherent protocols, and other infrastructural blueprints for reporting, exchanging, and posting data on websites.

Data Quality Assessment Framework (DQAF). The DQAF is an assessment methodology that was integrated into the structure of the data module of ROSCs following the fourth review of the Data

Standards Initiatives in 2001. The DQAF's broader application in providing guidance for improving data quality has been integrated into the Data Quality Program as well as more prominently into Article IV consultations.

[1]The website address is *dsbb.imf.org/Applications/web/dsbbhome/.*

Draft Guide on Resource Revenue Transparency

In December 2004, the IMF disseminated for public comment a *Draft Guide on Resource Revenue Transparency.* The *Guide* is intended to help countries address the challenges associated with the fiscal management of revenues from extractive industries such as oil, natural gas, and mining. It underscores that institutional strengthening and improved transparency can provide significant benefits to both governments and taxpayers. A higher level of fiscal transparency, in turn, promotes more informed public debate and helps countries achieve sounder fiscal policies.

The *Guide* applies the IMF's Fiscal Transparency Code[21] and supplements the *Manual on Fiscal Transparency,*[22] which was published in 2001 as part of the IMF's work on standards and codes. Fiscal transparency reports, or fiscal Reports on the Observance of Standards and Codes (ROSCs), have been published for about 70 member countries on the IMF's website. These reports assess country practices against those described in the Fiscal Transparency Code. The *Draft Guide on Resource Revenue Transparency* can be used for fiscal transparency assessments by the IMF in natural-resource-rich countries and will also be useful in the IMF's policy dialogue with these countries. The IMF will take into account the public comments received when it finalizes the *Guide*.

[21]Available at *www.imf.org/external/np/fad/trans/code.htm.*
[22]Available at *www.imf.org/external/np/fad/trans/manual/index.htm.*

Data Standards

The IMF's Data Standards Initiatives are designed to enhance the public availability of reliable, timely, and comprehensive statistics on member countries, thereby enabling market participants to make well-informed investment decisions, improving the functioning of financial markets, and reducing the likelihood of crisis-precipitating shocks.

Revision of Guide to GDDS

In October 2004, the IMF issued a revised *Guide to the General Data Dissemination System (GDDS)* to promote the availability of statistical data related to the Millennium Development Goals (see Chapter 4). The *Guide,* developed in collaboration with regional and international organizations, including the World Bank, gives explicit recognition to the MDG indicators and the development of appropriate statistical monitoring systems.

Online External Debt Database

In November 2004, the World Bank and the IMF launched an online database that brings together the external debt statistics of 41 countries that subscribe to the IMF's Special Data Dissemination Standard (SDDS). By end-April 2005, the number of subscribers reporting data had risen to 49. The database provides policymakers and market participants with more timely data in a format that enables cross-country comparison as well as better support for balance sheet analysis and surveillance initiatives. The Quarterly External Debt Database, maintained by the World Bank,[23] represents a concrete step by the two institutions to facilitate and encourage worldwide dissemination of external debt data by as many countries as possible.

The data are supplied by countries in internationally agreed formats. Participation in the database is voluntary, and, while initially it will cover only countries that subscribe to the SDDS, the goal is to extend participation to all countries whose external debt data can be disseminated according to the SDDS requirements.

[23] Available at *www.worldbank.org/data/working/QEDS/sdds_main.html.*

Data and Metadata for Portfolio and Direct Investment

The results of the Coordinated Portfolio Investment Survey (CPIS) for end-December 2003 were released on the Fund's external website in March 2005. The survey, conducted annually since 2001, provides data reported by 70 jurisdictions, including most of the large investing economies. Data are reported on each jurisdiction's cross-border portfolio investment, broken down by equity and long- and short-term debt instruments and by jurisdiction of the issuers of the securities. Holdings of securities that are part of foreign exchange reserve assets as well as holdings of selected international organizations are also reported, broken down the same way.

The data are intended to fill gaps in studies of regional concentration, financial integration, spillover effects between jurisdictions (contagion), and globalization, and to provide partner country data to fill gaps in international investment position statistics for individual jurisdictions. Work is continuing to improve the coverage of offshore financial centers and major oil-exporting countries. Metadata describing the compilation practices of participating jurisdictions are also posted on the Fund's external website.

Metadata describing how countries measure foreign direct investment were posted in March 2005. Information for 56 countries is now available on the Fund's website, based on the results of the 2003 joint IMF/OECD Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI).

For both the CPIS and the SIMSDI, the metadata describe data availability, sources, compilation practices, and methodology used, and indicate whether the practices of each jurisdiction are in accordance with international statistical guidelines. A feasibility study is under way to determine whether a Coordinated Direct Investment Survey could be undertaken along the lines of the CPIS.

Enhanced Data Reporting to the IMF

As part of its overall effort to improve the quality of data the IMF receives from its members for purposes of surveillance, the Board in recent years has acted to expand the categories of information that member countries are required to report (under Article VIII, Section 5, of the IMF's Articles of Agreement) and to establish new procedures and remedial actions to address cases in which members have breached their obligations.

In January 2004, the Board issued a decision expanding the list of minimum data that IMF member countries are required to provide on a continuous basis. The expanded requirement, which took effect on January 1, 2005, brought the Fund's legal framework for data provision more closely in line with contemporary data needs. Reporting of data specifically listed in Article VIII, Section 5, continues to be mandatory and failure to provide the data constitutes a breach of a member's obligation, unless the member lacks the capacity to do so. The Board's decision outlined detailed procedures for how the Fund would handle the nonreporting, or inaccurate reporting, of data required under Article VIII, Section 5.

The Board decision also encouraged members to adopt internationally accepted compilation methodologies. If members do not do so, they must provide data specifications consistent with commonly understood meanings of a particular indicator. The Fund's staff are expected to be familiar with the specific concepts and definitions used for these indicators as well as with the compilation practices and approaches to data revisions. A member is not at risk of being found in breach of its obligations if it provides or revises data in line with the understandings.

3. Strengthening IMF Program Support and Crisis Resolution

The provision of temporary financial support, in the form of loans of foreign exchange, to member countries with balance of payments difficulties is one of the IMF's main responsibilities. Its financial assistance is provided under a variety of policies and lending instruments (Table 3.1). Most forms of IMF financing are made conditional on the adoption by the recipient country of policies of adjustment and reform designed to correct the problems that gave rise to its need for support. Such conditionality is important also to ensure that the IMF's resources are safeguarded for the use of members in future need.

To ensure that IMF financing operations and instruments are well designed, up-to-date, and sufficiently flexible to support country-driven adjustment and reform efforts in a wide range of circumstances, the Fund undertook a broad review of program design and conditionality during the financial year. The review covered the design and effectiveness of programs during 1995–2000, and also the initial experience with programs formulated under new conditionality guidelines adopted in 2002. The review gave the Fund valuable insights that will inform its operations, as well as setting a broad agenda for further work. The adequacy of program design was also examined as part of ex post assessments of programs in 18 member countries during the period.

Besides this wide-ranging reexamination of its policies on conditionality, the Board reviewed its policy on access to the Fund's financial resources. The amount of borrowing to which a country has access is linked both to its quota in the Fund (a reflection of the country's economic size, openness to the global economy, and other factors) and to the terms of the particular lending window. In FY2005 the Board looked at the access policy limits under the credit tranches, the Extended Fund Facility (EFF), and the Poverty Reduction and Growth Facility (PRGF). Also during FY2005, the Trade Integration Mechanism—a way to make new IMF resources more predictably available to qualifying member countries under existing Fund facilities—was activated.

Table 3.1
IMF financial facilities

Credit facility	Purpose	Conditions	Phasing and monitoring[1]	Access limits[1]	Charges[2]	Repurchase (repayment) terms[3]		
						Obligation schedule (Years)	Expectation schedule (Years)	Installments
Credit tranches and Extended Fund Facility[4]								
Stand-By Arrangements (1952)	Medium-term assistance for countries with balance of payments difficulties of a short-term character	Adopt policies that provide confidence that the member's balance of payments difficulties will be resolved within a reasonable period	Quarterly purchases (disbursements) contingent on observance of performance criteria and other conditions	Annual: 100% of quota; cumulative: 300% of quota	Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts of 300%)[5]	3¼–5	2¼–4	Quarterly
Extended Fund Facility (1974) (Extended Arrangements)	Longer-term assistance to support members' structural reforms to address balance of payments difficulties of a long-term character	Adopt 3-year program, with structural agenda, with annual detailed statement of policies for the next 12 months	Quarterly or semiannual purchases (disbursements) contingent on observance of performance criteria and other conditions	Annual: 100% of quota; cumulative: 300% of quota	Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts above 300%)[5]	4½–10	4½–7	Semiannual
Special facilities								
Supplemental Reserve Facility (1997)	Short-term assistance for balance of payments difficulties related to crises of market confidence	Available only in context of Stand-By or Extended Arrangements with associated program and with strengthened policies to address loss of market confidence	Facility available for one year; frontloaded access with two or more purchases (disbursements)	No access limits; access under the facility only when access under associated regular arrangement would otherwise exceed either annual or cumulative limit	Rate of charge plus surcharge (300 basis points, rising by 50 basis points a year after first disbursement and every 6 months thereafter to a maximum of 500 basis points)	2½–3	2–2½	Semiannual
Compensatory Financing Facility (1963)	Medium-term assistance for temporary export shortfalls or cereal import excesses	Available only when the shortfall/excess is largely beyond the control of the authorities and a member has an arrangement with upper credit tranche conditionality, or when its balance of payments position excluding the shortfall/excess is satisfactory	Typically disbursed over a minimum of six months in accordance with the phasing provisions of the arrangement	45% of quota each for export and cereal components; combined limit of 55% of quota for both components	Rate of charge	3¼–5	2¼–4	Quarterly

Table 3.1 ***(concluded)***

Credit facility	Purpose	Conditions	Phasing and monitoring[1]	Access limits[1]	Charges[2]	Repurchase (repayment) terms[3]		
						Obligation schedule (years)	Expectation schedule (years)	Installments
Emergency Assistance	Assistance for balance of payments difficulties related to		None, although post-conflict assistance can be segmented into two or more purchases	Generally limited to 25% of quota, though larger amounts can be made available in exceptional cases	Rate of charge; however, the rate of charge may be subsidized to 0.5 percent a year, subject to resource availability	3¼–5	Not applicable	Quarterly
(1) Natural disasters (1962)	Natural disasters	Reasonable efforts to overcome balance of payments difficulties						
(2) Post-conflict (1995)	The aftermath of civil unrest, political turmoil, or international armed conflict	Focus on institutional and administrative capacity building to pave the way toward an upper credit tranche arrangement or PRGF						
Facility for low-income members								
Poverty Reduction and Growth Facility (1999)	Longer-term assistance for deep-seated balance of payments difficulties of structural nature; aims at sustained poverty-reducing growth	Adopt 3-year PRGF arrangements; PRGF-supported programs are based on a Poverty Reduction Strategy Paper (PRSP) prepared by the country in a participatory process and integrating macroeconomic, structural, and poverty reduction policies	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews	140% of quota; 185% of quota in exceptional circumstances	0.5%	5½–10	Not applicable	Semiannual

[1]Except for PRGF, the IMF's lending is financed from the capital subscribed by member countries; each country is assigned a *quota* that represents its financial commitment. A member provides a portion of its quota in foreign currencies acceptable to the IMF—or SDRs—and the remainder in its own currency. An IMF loan is disbursed or drawn by the borrower *purchasing* foreign currency assets from the IMF with its own currency. Repayment of the loan is achieved by the borrower *repurchasing* its currency from the IMF with foreign currency. See Box 5.1 on the IMF's Financing Mechanism. PRGF lending is financed by a separate PRGF Trust.

[2]The *rate of charge* on funds disbursed from the General Resources Account (GRA) is set at a margin over the weekly interest rate on SDRs (from May 1, 2005, the margin is expressed in basis points over the SDR interest rate; prior to that the margin was expressed as a proportion of the SDR interest rate). The rate of charge is applied to the daily balance of all outstanding GRA drawings during each IMF financial quarter. In addition, a one-time service charge of 0.5 percent is levied on each drawing of IMF resources in the GRA, other than reserve tranche drawings. An up-front commitment fee (25 basis points on committed amounts up to 100% of quota, 10 basis points thereafter) applies to the amount that may be drawn during each (annual) period under a Stand-By or Extended Arrangement; this fee is refunded on a proportionate basis as subsequent drawings are made under the arrangement.

[3]For purchases made after November 28, 2000, members are expected to make repurchases (repayments) in accordance with the schedule of expectation; the IMF may, upon request by a member, amend the schedule of repurchase expectations if the Executive Board agrees that the member's external position has not improved sufficiently for repurchases to be made.

[4]*Credit tranches* refer to the size of purchases (disbursements) in terms of proportions of the member's quota in the IMF; for example, disbursements up to 25 percent of a member's quota are disbursements under the *first* credit tranche and require members to demonstrate reasonable efforts to overcome their balance of payments problems. Requests for disbursements above 25 percent are referred to as *upper* credit tranche drawings; they are made in installments as the borrower meets certain established performance targets. Such disbursements are normally associated with a Stand-By or Extended Arrangement. Access to IMF resources outside an arrangement is rare and expected to remain so.

[5]Surcharge introduced in November 2000.

Finally, during FY2005 the Fund continued to work with other concerned parties to promote mechanisms aimed at the orderly resolution of crises, such as the inclusion of collective action clauses (CACs) in sovereign bonds, the development of the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, and the evolution of the so-called Evian approach adopted by the Paris Club for restructuring the debt of non-HIPC countries.

For more details about developments in IMF financial operations and policies during the financial year, see Chapter 5.

2004–05 Conditionality Review

An IMF-supported program is a package of economic policy measures that, combined with approved financing from the IMF, is intended to accomplish specific economic objectives such as orderly adjustment of the balance of payments, lower inflation, and stronger, sustainable growth and poverty reduction. Conditionality relating to implementation of the agreed policies, usually in a phased way, gives the country confidence that it will continue to receive financing from the IMF through the duration of the program as long as it implements the policies agreed, while also safeguarding the IMF's resources.

During the Fund's previous, 2000–02 Conditionality Review, Executive Directors requested that the next review address broad issues of program design. In response to this request, the 2004–05 Conditionality Review had two parts. The first was a critical review of the design and effectiveness of IMF-supported programs over 1995–2000, and the second considered the Fund's initial experience with new conditionality guidelines introduced in 2002, which replaced previous guidelines adopted in 1979.

Design of IMF-Supported Programs

The first part of the review, conducted by the Board in December 2004, examined key features of IMF-supported programs over 1995–2000.[24]

[24] The Board's discussion is summarized in Public Information Notice No. 05/16, *www.imf.org/external/np/sec/pn/2005/pn0516.htm*; the staff papers include "The Design of Fund-Supported Programs—Overview," *www.imf.org/external/np/pdr/2004/eng/design.htm*; "Fund-Supported Programs—
(continued)

Objectives and Outcomes. Directors agreed that a viable balance of payments and medium-term external debt sustainability remain a core objective of IMF-supported programs.

For programs supported by nonconcessional lending under the General Resources Account (GRA), targeted external adjustment has been broadly in line with this objective, and IMF support seems to have mitigated the short-term negative effect of adjustment on growth. But in a number of cases, especially but not exclusively those of capital account crises, external adjustment has been sharper and larger than needed to stabilize external debt. Directors encouraged the IMF staff to undertake further analysis of the optimal mix between financing and adjustment in situations of capital account pressures as well as of the determinants of private capital flows and of the catalytic effects of IMF-supported programs.

For programs supported by concessional lending under the PRGF, targeted improvements in current account balances have, on average, been smaller than those required to stabilize external debt ratios. In addition, actual improvements have tended to be smaller than targeted. Directors called for further reflection on how to correct this phenomenon. Program outcomes for growth and inflation have been broadly favorable. Directors stressed that the design of programs in low-income countries should be based on full consideration of the implications of policies for poverty reduction.

Analytical Frameworks. No single model or analytical framework is universally applicable to policy formulation in IMF-supported programs. Directors welcomed the fact that, in advising national authorities, IMF country teams normally draw on a variety of models and methods for policy formulation and combine them with economic judgment. The IMF's financial programming framework provides a useful consistency check on policies. This eclectic approach to policy formulation has generally worked well in practice. However, medium-term growth projections have been overly optimistic, which risks undermining the

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Objectives and Outcomes," *www.imf.org/external/np/pdr/2004/eng/object.htm*; and "Macroeconomic and Structural Policies in Fund—Supported Programs: Review of Experience," *www.imf.org/external/np/pdr/2004/eng/macro.htm.*

reliability of debt sustainability assessments and the credibility of programs. More analytical "reality checks" on growth projections, more systematic comparisons with forecasts by other analysts, and greater use of cross-country analysis were recommended.

Exchange Rate Policies. Directors noted that exchange rate regimes are no more likely to be altered at the outset of an IMF-supported program than at other times, and drew from this finding a variety of inferences. Coherence between the exchange rate regime and macroeconomic and structural policies is critical, and Directors emphasized that the IMF should avoid supporting policy mixes that do not sufficiently underpin the exchange rate regime. Disinflation has been achieved equally successfully under fixed or flexible exchange rate strategies, and success has depended instead mainly on whether the targeted fiscal adjustment was achieved. At the same time, countries with more flexible exchange rates have tended to achieve external adjustment with fewer adverse effects on output.

Monetary Policies. Monetary policies have been broadly aligned with program objectives, and there is no evidence that monetary policies have been too tight.

Fiscal Policies. Directors observed that program practice in fiscal policy has been significantly more diverse and has matched overall economic objectives more systematically than is commonly assumed. Fiscal slippages have often occurred, especially in the later years of a program. Directors stressed the need for greater focus on fiscal consolidation in program design, with an emphasis on high-quality fiscal measures that are politically feasible and sustainable. Attention should also be paid to contingent liabilities, including those stemming from financial sector restructuring costs. Fiscal consolidation has generally contributed to improvements in the external current account balance, while generally not being associated with lower output growth, suggesting that confidence effects play a significant role. Directors underscored the importance—in the context of the PRGF—of elements that help to reduce poverty and of analysis of the distributional impact of policies.

Structural Policies. Structural reforms are often necessary to buttress adjustment efforts by enhancing efficiency and eliminating structural distortions that inhibit long-term growth, and to reduce vulnerabilities to financial crises. Broad alignment was found between structural measures and the objectives of IMF-supported programs. Measures intended to underpin demand management seem to have contributed to sustained fiscal adjustment, and measures geared toward enhancing efficiency have been associated with higher growth. While these initial indications were seen as useful, Directors underscored that the linkages between structural reforms and macroeconomic performance remain uncertain, and a more detailed analysis will be required.

Recognizing the changes the Fund made after the Argentine crisis, the Board agreed that the discussion following the assessment by the Independent Evaluation Office (IEO) of the Fund's role in Argentina during 1991–2001 also provided important insights (Box 3.1).

Box 3.1 Independent Evaluation Office's review of the Fund's role in Argentina, 1991–2001

In July 2004, the Executive Board discussed the IEO's review of the IMF's role in Argentina from 1991 to 2001—a period that began with the introduction of the convertibility regime that pegged the Argentine peso at par with the U.S. dollar and ended with the regime's collapse, which was accompanied by a default on Argentina's public debt. The 2001 crisis was one of the most severe in any country in recent years and brought considerable hardship to the Argentine people.

Recognizing the progress that had already been achieved since the Argentine crisis, Directors agreed that the report provided valuable insights for the Fund's financing and surveillance frameworks.

The following are among the key conclusions related to policy recommendations from the Executive Board discussion:

- Where the sustainability of a country's debt or the exchange rate is threatened, the Fund should clearly indicate that its support is conditional upon a meaningful shift in policies. Up-to-date and comprehensive information is critical for the Board to make necessary judgments in such cases. The debt sustainability template and procedures on exceptional access provide important support in this regard.

- Further reflection is needed on the issue of contingency planning in the context of Fund assistance to countries in crisis. There is potential value in such planning from the outset of a crisis, but also a need to establish what can constructively be done in ways that enhance confidence.

- Directors emphasized the importance of, and recent progress in, ensuring that medium-term exchange rate and debt sustainability analysis are the focus of IMF surveillance. While the choice of the exchange rate regime must remain with the member's authorities, the Fund is obliged to exercise firm surveillance to ensure that other policies and constraints are consistent with that choice. Directors saw a need for greater candor in the treatment of exchange rate policy in the context of Article IV discussions, but most also stressed the need to strike an appropriate balance between candor and confidentiality. Analytical work on medium-term debt sustainability has also supported a reassessment, in the Fund and more broadly, of what level of debt is sustainable for emerging market countries, with the concept of "debt intolerance" playing an important role.

- Directors noted the possible risks associated with precautionary Fund arrangements, especially where there are serious political obstacles to needed policies and reforms. Directors reiterated the value of precautionary arrangements as a tool for supporting sound policies. They confirmed the importance of ensuring that program standards and requirements for precautionary arrangements are the same as those for all other arrangements, and most did not think that precautionary arrangements tended to be weaker than other arrangements, noting that, in some cases, precautionary arrangements signaled superior performance.
- The Fund is continuing to reflect on how to strengthen further the role of the Board during a crisis, including through improvements in the provision of full information on all issues relevant to decision making and open exchanges of views between management and the Board on all topics, including the most sensitive ones.
- In all cases of use of Fund resources, particularly those involving exceptional access, close cooperation with the country authorities should be presumed, and the Board kept fully informed of the state of policy discussions.

To ensure that the lessons learned during the review are applied, a number of internal seminars and training initiatives have been planned to raise awareness of the issues within the IMF, including disseminating information on best practices in some specific areas, such as forecasting growth. These internal education efforts will be complemented by significant efforts at external outreach to stimulate a wider debate on some key issues.

Experience with 2002 Conditionality Guidelines

In September 2002, the Board adopted new guidelines to encapsulate ongoing efforts to streamline and focus IMF conditionality. An important objective of the new guidelines was to enhance country ownership and improve the prospects for sustained implementation of Fund-supported programs, most importantly by concentrating the IMF's policy conditions on areas critical to their success.

The second part of the Fund's 2004–05 Conditionality Review examined the initial experience with applying these new guidelines, which had replaced guidelines that dated back to 1979. When Directors met in March 2005,[25] they noted that the new guidelines emphasized national ownership of policies, parsimony in conditions, tailoring of policies to member circumstances, coordination with other multilateral institutions, and clarity in the specification of conditions. Although it was too soon to draw definitive conclusions on experience with the guidelines, the review highlighted a number of preliminary findings focusing on structural conditionality and on processes of program development:

- There is evidence that considerable progress has occurred in streamlining the breadth of coverage (though not the number) of structural conditions and in clearly identifying program-related conditions.
- There are some encouraging signs of stronger program implementation in the form of fewer permanent program interruptions—although there has been little change in the rate at which programs are temporarily interrupted because of failures to meet conditions.
- The shift of conditionality away from growth- and efficiency-related structural reforms is a sign of streamlining, but it will need to be monitored and the implications studied when program outcomes are known. Effective World Bank–IMF collaboration remains crucial in this connection.
- Care should be taken not to specify conditions at a level of detail that could be seen as unwelcome micromanagement—although detailed specification can sometimes be helpful to the authorities.

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[25] The Board's discussion is summarized in Public Information Notice No. 05/52, *www.imf.org/external/np/sec/pn/2005/pn0552.htm*; the staff papers include "Review of the 2002 Conditionality Guidelines," *www.imf.org/external/np/pp/eng/2005/030305.htm*; and "Review of the 2002 Conditionality Guidelines—Selected Issues," *www.imf.org/External/np/pp/eng/2005/030405.htm.*

- Focusing on the linkages between program goals and conditions is critical, Directors emphasized, as are specifying and explaining in staff reports the strategies underlying conditionality and the basis for deeming measures to be critical. Directors considered that improvements in the elaboration and presentation of clear strategies—which tailor conditionality to country circumstances and capacity and clearly link conditions to program goals in the context of the authorities' broader objectives—can enhance program ownership and implementation.
- Directors noted that overly ambitious timetables appear to be a major reason for the high waiver rate—the failure of countries to meet performance criteria—and encouraged realistic, but still appropriately ambitious, implementation timetables.
- In light of the difficulty of gauging program ownership, some Directors saw a role for conditionality, and especially prior actions, as a screening device. However, other Directors observed that higher numbers of prior actions did not bring subsequent program implementation up to the Fund-wide average.

An assessment of structural conditionality in IMF-supported programs by the IEO is scheduled for early 2006. The project is expected to shed further light on these issues. However, Directors agreed that a more comprehensive assessment of the appropriateness of the new guidelines would have to await the availability of data on program outcomes, in both the short and the medium terms, and instructed the staff to return to this issue in 2008. The staff will explore how it can help the Board monitor the application of the guidelines in the interim.

Ex Post Assessments

In addition to the conditionality review, the adequacy of program design was examined in the course of the IMF's "ex post assessments" of experience in countries in which the IMF has been providing program support over a longer term. Ex post assessments have proven to be a useful vehicle for distilling lessons from experience, for both program design and implementation. The first ex post assessments were conducted in 2003 as part of the IMF's response to the IEO assessment of the prolonged use of IMF resources. A total of 27 ex post assessments have been conducted so far, including 18 during FY2005 (for Albania, Armenia, Benin, Bolivia, Bulgaria, Cambodia, Cameroon, Ethiopia, Guinea, Guinea-Bissau, Kazakhstan, the Kyrgyz Republic, Lesotho, Malawi, Niger, the former Yugoslav Republic of Macedonia, Uruguay, and Vietnam). The lessons drawn from ex post assessments are often widely applicable. For example, a key lesson from the ex post assessment of the PRGF arrangements with Vietnam was the importance of allowing sufficient time for the institutional changes that underpin structural reforms. A comprehensive review of experience with ex post assessments will take place later in 2005. A forthcoming IEO evaluation of IMF assistance to Jordan is also expected to yield insights into program design.

Financial Facilities and Policies

Following major changes to its lending policies in recent years, the IMF has continued to review many aspects of its lending facilities to ensure that they meet members' needs, including those related to members' growing financial interdependence.

Access Policy

In April 2005, the Board conducted its biennial review of members' access to financing from IMF resources in various circumstances, including in the credit tranches (see Table 3.1), under the EFF, and under the PRGF. The review included consideration of the limits on lending by the IMF from the GRA (currently 100 percent of a member's quota each year up to a cumulative maximum of 300 percent of quota), as well as the conditions and circumstances that may lead to lending beyond those limits, as set out in the framework for exceptional access. The Board also considered the policies for lending under the PRGF, under which the IMF makes concessional loans to its low-income members.

The Board considered that the criteria for access in individual cases, the access limits in the GRA, and the access limits and norms applying to PRGF resources all remain broadly appropriate. However, a number of Directors felt that member countries' quotas, which provide the basis for determining access, may not always faithfully reflect the size of an economy and, accordingly, should not be viewed as the best metric in all cases.

The review also revisited the policy on exceptional access. Directors recognized that requests for exceptional access can come from members not experiencing capital account crises. Some Directors felt that there would be merit in considering changes to the exceptional access policy to provide greater clarity on the IMF's actions in such cases. However, most Directors believed that, overall, changes to the existing framework of exceptional access were not needed, particularly considering the flexibility to grant access under the exceptional circumstances clause, including in those rare cases where a member could not be expected to meet all criteria. Most Directors agreed that a discussion of exit strategies in program documents would help foster better communication with capital markets and facilitate earlier reaccess, with many Directors calling for a strong presumption that exit strategies would be formulated in the context of a single IMF arrangement.

The Board also conducted a review of maturities and charges in FY2005, which is discussed in Chapter 5.

Activation of Trade Integration Mechanism

The Trade Integration Mechanism (TIM) was established in April 2004 to help developing countries address the short-term effects on their balance of payments of multilateral trade liberalization. The TIM is not a new lending facility but a mechanism making IMF resources more predictably available to qualifying member countries under existing IMF facilities. A major concern in this financial year was the effect that the expiration in January 2005 of the World Trade Organization's Agreement on Textiles and Clothing would have on some developing countries. Bangladesh became the first member country to obtain support in accordance with the TIM, in July 2004, followed by the Dominican Republic in early 2005. At end-April, discussions were under way with a number of other members. The availability of assistance under the TIM should also help assuage concerns of some developing countries that an ambitious outcome to the Doha Round could place undue adjustment pressures on them. (The TIM is also discussed in Chapter 2, Box 2.1.)

CRISIS RESOLUTION

Despite the best efforts of both member countries and the IMF, not all financial crises stemming from debt-servicing difficulties can be prevented. The Fund has therefore continued its work on improving techniques to resolve such crises, particularly those stemming from debt-servicing difficulties (Box 3.2). The Fund's crisis resolution efforts continue to promote the use of collective action clauses in international sovereign bond contracts; encourage a broadening of the consensus on the draft Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets promoted by the Institute for International Finance; and consider other ways to resolve financial crises in an orderly fashion. The Executive Board issued progress reports to the IMFC on crisis resolution in September 2004 and April 2005.[26]

Box 3.2 Debt restructuring in the Caribbean: Dominica, Dominican Republic, and Grenada

In the past year, a number of countries in the Caribbean decided to approach their creditors for restructurings of their sovereign debt. The origins of the problems and the degree of debt restructuring differed across countries. In all cases, the IMF has played a key role in the design and implementation of the macroeconomic adjustment policies, provided financial assistance, and helped ensure that the restructuring process remains orderly and consistent with best practices. This has included providing—at the country authorities' request—assessments to creditors and donors of the countries' economic conditions, adjustment policies, and prospects.

Dominica determined in late 2003 that its public debt, at about 120 percent of GDP, was unsustainable and, based on this assessment, embarked on a strategy to restructure sovereign debt preemptively, with a view to avoiding unilateral default. Substantial progress has been made—as of end-May 2005, creditors (official and private) holding over 70 percent of eligible debt have agreed to the restructuring. In the case of nonparticipating creditors, although payments on original terms have stopped, good faith efforts continue to be made to reach understandings—the authorities are committed to paying into escrow accounts on restructured terms for such creditors. The Fund is providing financial support to Dominica under a three-year PRGF arrangement approved in 2003. Policy implementation under the program has been strong and macroeconomic outcomes have been favorable—after contracting sharply during 2001–02, the economy grew by 3½ percent in 2004.

[26]"Progress Report to the International Monetary and Financial Committee on Crisis Resolution," September 28, 2004, *www.imf.org/external/np/pdr/cr/2004/eng/092804.htm*, and "Progress Report to the International Monetary and Financial Committee on Crisis Resolution," April 12, 2005, *www.imf.org/external/np/pp/eng/2005/041205.htm*.

The *Dominican Republic's* economy experienced a crisis in 2003 that was triggered by problems in the banking sector, among other things. The currency depreciated sharply from 20 to nearly 55 pesos a dollar, and GDP declined by 2 percent during 2003, while inflation accelerated to 29 percent during 2004. Following the country's 2003 Stand-By Arrangement with the Fund, which went off track because of poor policy implementation, the Dominican Republic embarked in 2004 on a robust adjustment program supported by a new Stand-By Arrangement approved in January 2005. Part of the authorities' strategy for addressing macroeconomic imbalances and resolving the country's liquidity problem involves a debt restructuring. Following a period of discussions with creditors, an offer launched in April 2005 to exchange external bonds was well received, with almost 94 percent participation. The Republic has indicated that it will continue to service debt to nonparticipating creditors. It is also engaged in discussions to reschedule debts to external commercial banks and suppliers. Paris Club creditors provided relief during 2004 and could provide additional relief in 2005.

Hurricane Ivan devastated *Grenada* in September 2004, causing destruction amounting to over 200 percent of GDP. Fund emergency financial assistance was provided in the wake of the hurricane. Soon after the hurricane, the authorities publicly announced that they could no longer service their public debt, which had reached almost 130 percent of GDP. Supported by donor-financed legal and financial advisors, they are developing a debt-restructuring strategy and maintaining a dialogue with both official and private creditors. Fund staff are assisting the authorities in the design of an economic adjustment program aimed at restoring medium-term viability and debt sustainability.

Collective Action Clauses

The IMF has taken an active role in promoting the inclusion of CACs—which prevent small minorities of creditors from blocking restructuring deals to which large majorities agree—in international bond issues in all markets, through increased dialogue with sovereign issuers (including during Article IV discussions) and with private market participants. Partly as a result, the use of CACs has become the market standard in international sovereign bonds issued under New York law. In addition, the inclusion of CACs in New York–law bonds has had no observable effect on pricing: no premium seems to have been associated with it. Sovereign issues containing CACs represented over 90 percent of the total value of bonds issued between March 2004 and April 2005. The share of issues with CACs in the total value of the outstanding stock of sovereign bond issues from emerging market countries grew from 39 percent at the beginning of 2004 to 48 percent at the end of April 2005.

Principles for Stable Capital Flows and Fair Debt Restructuring

In November 2004, the Institute for International Finance (IIF) published draft *Principles* aimed at developing a market-based, voluntary, and flexible framework that would outline standards of behavior and responsibilities for sovereign debtors and their private creditors.[27] The draft *Principles*—whose origins can be traced to earlier proposals for a Code of Conduct—are the result of extensive consultations since early 2003 between several emerging market countries and private groups, notably the IIF. The draft *Principles* are based on four pillars: (1) transparency and timely flow of information; (2) close debtor-creditor dialogue and cooperation to avoid restructuring; (3) good faith actions during debt restructuring; and (4) fair treatment of all parties.

The draft *Principles* have received support from a number of emerging market issuers and private creditor associations, although market views are varied. While supporting the drafting of such Principles, the Fund has left their specification to sovereign debtors and their creditors, since the effectiveness of voluntary rules hinges critically on their acceptability to the affected parties.

While the draft *Principles* can be applied in a manner consistent with the Fund's lending into arrears (LIA) policy, in practice, differences arise in a few areas. For example, the draft *Principles* call for a resumption of partial debt service, to the extent feasible, as a sign of good faith to facilitate a restructuring. However, such payments are not a feature of the Fund's good faith criterion under the LIA policy. Despite these differences, the draft *Principles* are, in most respects, consistent with IMF policies. Looking ahead, while there is uncertainty on how the process of further broadening the consensus among issuers and the investor community would evolve, efforts to integrate the draft *Principles* into policies adopted by debtors and creditors would be welcome.

Evian Approach

The Evian approach—a flexible approach adopted by the Paris Club in October 2003, following the agreement reached at the G-8 Summit of June 2003 in Evian, France, for

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[27] For the current version of the *Principles*, see *www.iif.com/data/public/Principles.pdf.*

addressing debt sustainability concerns of non-HIPC countries—continued to evolve in FY2005. Under the Evian approach, Paris Club creditors agreed that they would participate in a comprehensive debt treatment for non-HIPC countries that have debt deemed to be unsustainable by the Paris Club, that are committed to policies that will secure an exit from the Paris Club in the framework of their Fund arrangements, and that will seek comparable treatment from their other external creditors, including the private sector. The Paris Club decision on the appropriate extent of debt relief to be provided will be informed by the Fund's debt sustainability analysis.

In April–July 2004, the Paris Club provided flow reschedulings to the Dominican Republic, Gabon, and Georgia under the Evian approach. In November 2004, Paris Club creditors reached an agreement with Iraq on a comprehensive restructuring of its public external debt. And, in March 2005, the Kyrgyz Republic received a comprehensive debt treatment from the Paris Club.

In another move, Paris Club creditors decided in January 2005 to offer a temporary deferral of debt payments to countries affected by the December 2004 earthquake and tsunami. Creditors emphasized that they expect the resources freed by this deferral to benefit directly the populations affected by the tsunami. Given the exceptional circumstances, traditional Paris Club principles will not apply to the deferral. More specifically, there is no requirement of an accompanying Fund arrangement, nor is there any expectation of comparable treatment from other creditors.

LOOKING FORWARD

The IMF's lending function continues to make an essential contribution to the reestablishment of external viability and economic stability and therefore to sustainable growth in member countries. The institution's traditional role of providing financing to help smooth the adjustment of temporary current account imbalances remains vital for many countries, while for others the IMF's main task is to help prevent or mitigate capital account crises and contagion. Strong ownership and institutional backing remain key for the success of IMF-supported programs, while the IMF, for its part, needs to be selective in supporting only programs that put members firmly on the road to external viability.

In their March 2005 discussion of the Fund's medium-term strategy, Directors looked forward to further reflection on how the needs of members could be met through Fund arrangements, and whether new instruments or revisions to existing facilities were needed. Many felt that further progress needed to be made toward reaching clearer understandings on the appropriate circumstances and scale of IMF lending, and a number of Directors stressed the importance of specifying eventual exit strategies from IMF financial support. Directors also exchanged views on instruments that could meet the needs of members who wished to signal their adherence to sound policies or that could provide a degree of insurance against potential crises. Regarding the appropriate role of the IMF in helping to resolve financial crises, there was recognition of the role of market-based mechanisms as well as interest by a number of Directors in a clearer and more consistent role for the IMF in sovereign debt restructuring and assessment of the adequacy of the instruments available for this purpose. In particular, some Directors called for an early discussion of the Fund's policy on lending into arrears.

4. The IMF's Role in Low-Income Countries

The central goal of the IMF's work with its low-income member countries is to help them promote macroeconomic stability and growth, and thereby achieve deep and lasting poverty reduction. The Fund pursues this goal in close collaboration with other development partners—particularly the World Bank. In doing so, the IMF focuses on its core areas of responsibility and expertise, namely, helping member countries achieve stable macroeconomic conditions by providing them with policy advice supported by financial and technical assistance.

In 1999, the IMF and the World Bank launched the Poverty Reduction Strategy Paper (PRSP) approach and the enhanced Heavily Indebted Poor Countries (HIPC) Initiative (the original HIPC Initiative was launched in 1996). In the same year, the IMF established the Poverty Reduction and Growth Facility (PRGF) to make poverty reduction and growth more central to its lending operations in its poorest member countries. These initiatives stress country ownership of policy programs, including through the broad participation of civil society. Subsequently, at the International Conference on Financing for Development, held in Monterrey, Mexico, in 2002, the international community formally adopted the declaration of intent known as the "Monterrey Consensus." The conference provided a forum at which both industrial and developing countries could examine the internationally agreed development goals, including halving the number of people living in absolute poverty by 2015. The Monterrey Consensus stipulated that, to achieve these goals, low-income countries must implement sound policies, strengthen institutions, and improve governance, while the international community must provide strong support, in the form of greater trade opportunities and increased aid flows, to those countries that carry out sound policies and reforms.

During FY2005, the IMF continued to pursue a range of initiatives to strengthen its ability to respond, within its mandate, to the needs of low-income members, in collaboration with other lenders and donors. Key initiatives included the following:

- working to improve the design of programs supported by the PRGF and the PRSP process;
- strengthening other instruments for supporting low-income members, including the subsidization of Emergency Assistance for Natural Disasters (see Chapter 5), the Trade Integration Mechanism (see Chapter 3), and the possibility of a new shocks window within the PRGF Trust;
- increasing its efforts under the enhanced HIPC Initiative to help low-income member countries achieve debt relief and maintain debt sustainability; and
- mobilizing international support for low-income countries in 2005—a year that represents an important milestone toward the Millennium Development Goals (MDGs).

A priority for the Fund in the short term will be to define more clearly its role in supporting low-income members by unifying its work in program design, signaling, PRSP involvement, and debt relief in a single framework. This work will build on the Board's recommendations following its August 2004 discussion of the IMF's role in low-income countries, which underscored that these countries must take the lead in their own reform efforts and that the Fund should focus on supporting the macroeconomic policy reforms needed to boost growth and reduce poverty over the medium term, through its policy advice and technical and financial assistance.

REVIEW OF THE FUND'S ROLE AND OPERATIONS IN LOW-INCOME COUNTRIES

A committee of senior staff on low-income country work, headed by First Deputy Managing Director Anne O. Krueger, was formed in 2004. One of its first tasks was to craft a succinct preliminary statement on the role of the Fund in low-income member countries, drawing on previous Executive Board documents and a recent study by the IMF's Independent Evaluation Office (IEO) on PRSPs and the PRGF (see Box 4.1). The paper was discussed, along with a number of other issues, by the Executive Board in August 2004.[28]

[28]For the summary of the Board's discussion, see Public Information Notice No. 04/110, at *www.imf.org/external/np/sec/pn/2004/pn04110.htm;* the background paper can be found at *www.imf.org/external/np/pdr/lic/2004/eng/081304.htm.*

Box 4.1 Independent Evaluation Office's review of the IMF's support for low-income countries

In July 2004, the Fund's Independent Evaluation Office published a report[1] on the role of the IMF in the Poverty Reduction Strategy Paper (PRSP) process and on the extent to which programs supported by the Poverty Reduction and Growth Facility (PRGF) were fulfilling the objectives of poverty reduction and economic growth. The IEO report found that, while the PRS approach has resulted in some important changes, its implementation has fallen short of its potential. The report identified, in particular, a need to shift incentives toward improving underlying domestic policymaking processes and institutions and away from the production of documents.

In discussing the evaluation in July 2004, Directors agreed that the PRS approach has yielded benefits but that substantial scope exists for better implementation. They observed that the approach is perceived to be externally driven; participation by concerned domestic groups in the development of the strategy has sometimes been narrow, particularly in the formulation of the macroeconomic framework underlying the PRSP; and PRSPs have often lacked operationally viable strategies. But they also cautioned against drawing premature conclusions about the ultimate success of the PRSP approach based on only five years of experience.

For programs supported under the PRGF, the IEO report found that such programs are increasingly being aligned with country-owned PRSPs, even though such alignment is still somewhat limited. The design of these programs has improved in a number of ways. For example, fiscal targets have become more flexible to accommodate increased expenditures on pro-poor programs, and there is no evidence of an excessive disinflationary bias. But major challenges remain. Directors noted, in particular, the challenge of basing Fund-supported programs on a full understanding of micro-macro linkages—which the IEO emphasized were crucial to understanding sources of growth. Directors also considered that more should be done to integrate the results of poverty and social impact analysis into program design.

The report had a number of constructive recommendations, which will continue to inform the Fund's efforts to strengthen the PRS approach, clarify the Fund's role in this approach, and enhance the Fund's advice and assistance to low-income countries. Individual recommendations include the following:

- introducing greater flexibility in the implementation of the PRS approach;
- shifting the emphasis of the initiative away from the production of documents to the development of sound domestic policy formulation and implementation processes;

- clarifying the purpose of the Fund and the World Bank's Joint Staff Assessment of the PRSP and redefining the vehicle accordingly;
- clarifying what the PRS approach implies for the Fund's own operations and strengthening the implementation of the agreed role;
- strengthening the prioritization and accountability of what the Fund is supposed to deliver within the broader partnership framework, building around the priorities emerging from the PRS process, and ensuring resources match commitments; and
- encouraging a strengthening of the framework for establishing the external resources envelope as part of the PRS approach.

The Fund has responded to many of these recommendations in its joint review with the World Bank of the implementation of the PRS approach and in its work program for 2004-05.

[1]The IEO's Report on the Evaluation of Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility is available at *www.imf.org/external/np/ieo/2004/prspprgf/eng/index.htm.*

In their discussion, Directors welcomed the creation of the committee and agreed that a statement stipulating a framework for Fund engagement in low-income countries would usefully clarify its objectives and responsibilities, as well as guide the IMF's work in these countries in line with its mandate. At the same time, they recognized that the paper was not comprehensive in its coverage of all Fund policies in low-income countries and acknowledged that it was a work in progress involving interrelated components of Fund policies where discussions were still at a preliminary stage and consensus had yet to be reached. The proposed framework would therefore need to be revisited following separate discussions of these specific issues.

Most Directors agreed that it was the responsibility of low-income countries to put in place the policies and institutions needed for their development, while the Fund's support should focus on helping members establish and maintain macroeconomic and financial stability to foster durable growth and poverty reduction. They concurred that the Fund should continue to support the efforts of its low-income member countries through policy advice, capacity building, and financial assistance, including debt relief. They also emphasized international partnerships, which are essential if low-income countries are to make significant progress toward achieving the MDGs over the next decade. Directors underscored the need for the Fund to cooperate closely with other multilateral institutions, especially the World Bank, and bilateral donors under the Monterrey Consensus, as well as with low-income member countries through the PRS process.

STRENGTHENING INSTRUMENTS FOR SUPPORTING LOW-INCOME COUNTRIES

PRSPs: Progress in Implementation

Poverty Reduction Strategy Papers present low-income countries' macroeconomic, structural, and social policies and programs over a two- to five-year horizon that are aimed at promoting broad-based growth and reducing poverty. PRSPs form the crucial link between national public actions, donor support, and development outcomes. The Monterrey Consensus underlined the importance of national ownership of poverty reduction strategies in progress toward the Millennium Development Goals. PRSPs provide the basis for Fund concessional lending and for debt relief under the enhanced HIPC Initiative. They are also being used to help countries develop their statistical systems, which are critical to policy development and monitoring (Box 4.2).

Box 4.2 Using PRSPs to improve statistical data in low-income countries

The availability of high-quality, timely statistics is an important prerequisite for policy development and monitoring. PRGF-eligible and other low-income countries, in particular, face special challenges in compiling such statistics. Data inadequacies and limited data dissemination also hamper stakeholders from participating fully in policy development. The Fund's General Data Dissemination System (GDDS) (see Chapter 2) provides a framework for developing national statistical systems that comprises economic and sociodemographic data, including indicators of progress toward the Millennium Development Goals (MDGs). The GDDS fosters sound statistical methods, professional data compilation, and effective data dissemination practices.

Including statistical development programs in Poverty Reduction Strategy Papers (PRSPs) makes it possible for countries to address their statistical needs more comprehensively. The PRSP process and the GDDS are based on similar premises—country ownership, a medium-term strategy, and an emphasis on monitoring and evaluation. Building the capacity to produce good statistics often requires wide-ranging legal and institutional reform, development of data compilation practices based on international norms, and dissemination in accordance with best practices to support transparency. The GDDS provides a systematic approach for addressing these issues and facilitates coordination among statistics-producing agencies, interactions between data producers and data users, and collaboration with and among potential donors.

Under the PRSP process, development of the statistical system should be addressed in the context of governance issues, together with the overall evaluation and monitoring of PRS implementation. The PRSP for Sierra Leone, for example, includes an "Empowerment with Statistics" section under "Good Governance, Peace, and Security"— the first of the four pillars of the country's poverty reduction strategy. The improvement in Sierra Leone's statistics using the GDDS complements the country's overall poverty reduction strategy, including pursuit of the MDGs. Such an approach is all the more important given that Sierra Leone's capacity for production, management, and analysis of statistics has suffered gravely during the past decade of economic deterioration and civil war.

The core principles underlying the PRS approach are that poverty reduction strategies be (1) country-driven, with broad-based participation by civil society in the adoption and monitoring of the poverty reduction strategy; (2) results-oriented and focused on outcomes that benefit the poor; (3) comprehensive in recognizing the multidimensional nature of poverty; (4) partnership-oriented, aimed at improved coordination among all development partners; and (5) based on a long-term perspective of the challenges of, and need for, commitments to reduce poverty.

The Executive Boards of the IMF and the World Bank have asked the staff of the two institutions to prepare annual reports on progress in implementing the PRS approach. The 2004 report considered by the Boards in September 2004 was the latest in this series.[29]

Fund Directors underscored the importance of the country-driven nature of the PRSP approach and of country ownership as the key to its success. While several countries had

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[29]The IMF Board discussion is summarized in Public Information Notice No. 04/113, *www.imf.org/external/np/sec/pn/2004/pn04113.htm*; "Poverty Reduction Strategy Papers—Progress in Implementation," is available at *www.imf/org/external/np/prspgen/2004/092004.htm.*

made considerable progress in customizing the MDGs to country-specific goals, there was still a need for closer linkages between the PRS process and its integration with country-specific decision-making processes and institutions, particularly the medium-term expenditure framework and the annual budget. Directors emphasized the need for countries to set priorities among the many objectives and goals of their poverty reduction strategies. This would be critical to fully integrating the programs and policies of the PRSP into annual budgets, thus raising the likelihood of their implementation.

On the operational level, Directors broadly supported the staffs' suggested redefinition of the objectives and audience of the joint staff assessment (JSA) and agreed that its primary objective should be to provide detailed feedback to the country authorities on the strengths and weaknesses of their PRSs, including those aspects that require further work. Eliminating the requirement of a standard statement in the JSA that the PRSP is a suitable basis for concessional assistance could contribute to reducing the perception of Washington "sign-off." Directors therefore supported the staffs' proposal to lift the requirement of an explicit endorsement of the PRSP by the Executive Boards in connection with approvals of new PRGF arrangements, reviews of decisions under existing arrangements, and decisions concerning the decision and completion points and interim assistance under the HIPC Initiative. The Board amended the PRGF Trust and PRGF-HIPC Trust Instruments accordingly.[30]

Going forward, 2005 will mark the fifth anniversary of the PRS approach. In this context, a more comprehensive review of progress, challenges, and good practice related to key issues identified by stakeholders, past staff reviews, and the IEO evaluation will be undertaken in advance of the 2005 Annual Meetings. This review will draw lessons from the experience of countries in preparing and implementing poverty reduction strategies and of donors in supporting these efforts. It will focus on five themes: (1) strengthening the

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[30]The proposed decisions were adopted on November 9, 2004, as Decision No. 13373-(04/105) PRGF and No. 13374-(04/105) PRGF. See "Poverty Reduction Strategy Papers—Proposed Amendments to the Poverty Reduction and Growth Facility (PRGF) Trust and the PRGF-HIPC Trust Instruments," November 4, 2004, *www.imf.org/external/np/prsp/2004/110404.htm*.

medium-term orientation of the PRS; (2) using the PRS as a mutual accountability framework between recipient countries and donors; (3) broadening and deepening meaningful participation; (4) enhancing linkages among the PRS, planning documents, medium-term expenditure frameworks and budgets; and (5) tailoring the approach to conflict-affected and fragile states. Other work under way includes a review of the Fund's role in the PRS process.

Access to Financial Support

As part of the implementation of the Board's decision to adopt norms for tapered access to PRGF resources under successive arrangements, operational guidance to staff has been finalized. This guidance clarifies also the policy on blended use of PRGF resources and resources from the General Resources Account, and on the augmentation of PRGF arrangements in response to a shock.[31] More specifically, a shocks window within the PRGF Trust for countries hit by a shock (whether these countries are already using PRGF resources or not) is being considered.

Emergency Assistance for Natural Disasters

The Executive Board agreed in January 2005 to subsidize emergency assistance for natural disasters to PRGF-eligible members, subject to the availability of subsidy resources.[32] Members that have previously received emergency assistance for natural disasters but have not yet fully repaid such assistance (for example, Grenada and Malawi) will be able to benefit from this initiative, as well as members affected by the December 2004 tsunami—notably, Maldives and Sri Lanka, whose requests for emergency assistance were approved in March 2005. To help the latter two members and others affected by the tsunami, the Fund moved quickly to provide an assessment of the macroeconomic impact of the natural disaster (see Chapter 1). These efforts also facilitated the Paris Club creditors' recent decision to provide a one-year moratorium on debt service (see Chapter 3). It is estimated that subsidy

[31]The "Operational Guidance Note on Access under the Poverty Reduction and Growth Facility" can be found at *www.imf.org/external/np/prgf/2004/110904.htm*.

[32]The Board discussion is summarized in Public Information Notice No. 05/8, *www.imf.org/external/np/sec/pn/2005/pn0508.htm*.

needs for natural disaster assistance could amount to about $68 million–$98 million over the next five years, which would need to be met through new contributions from other IMF members.

Post-Program Monitoring

The IMF continues to monitor closely the circumstances and policies of members that have substantial Fund credit outstanding following the expiration of their arrangements. In March 2005, the Board adopted a decision extending post-program monitoring (PPM) to PRGF resources. Most Directors felt that the extension of PPM would enhance the comparability of treatment across members and help safeguard scarce PRGF resources. Specifically, when a member has outstanding PRGF loans or PRGF loans combined with GRA credit in excess of 100 percent of its quota, there would be a presumption that the member would be subject to PPM. The proposed decision provides a consolidated framework for PPM, expanding the presumption of PPM to cover any case in which outstanding credit arising from the combined (or separate uses) of GRA and PRGF resources exceeds 100 percent of quota and the member does not have a program supported by a Fund arrangement or is not implementing a staff-monitored program with reports issued to the Board.

Policy Support and Signaling

The Board will take up in FY2006 the issue of whether and how the IMF's instruments might be adapted to support sound policies in low-income countries, particularly when these do not have a need for, or want to use, Fund resources. The work under way in FY2005 to lay the basis for this discussion drew on extensive consultations with donors and low-income members on their needs for signals and considered whether there is a need to fill information gaps and how this might be done, either within or outside the context of a Fund arrangement (see Chapter 2).

DEBT RELIEF AND SUSTAINABILITY

The IMF continues to work with other official creditors to support low-income countries' efforts to achieve and maintain robust debt sustainability. Through debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative (Box 4.3) and improved tools for analyzing and managing debt, the Fund is playing an important role in supporting low-income member countries' efforts to achieve and monitor debt sustainability even as financing is needed to achieve the MDGs.[33]

Box 4.3 How the HIPC Initiative works

To qualify for HIPC assistance, a country must pursue strong economic policies supported by the IMF and the World Bank. There are three phases. In the first phase, leading up to the decision point, the country needs to establish a track record of good performance (normally, over a three-year period) and develop a Poverty Reduction Strategy Paper (PRSP) or an interim PRSP. Its efforts are complemented by concessional aid from all relevant donors and institutions and traditional debt relief from bilateral creditors, including the Paris Club.

In this phase, the country's external debt situation is analyzed in detail. If its external debt in net present value (NPV) terms, after the full use of traditional debt relief, is above 150 percent of exports (or, for small open economies, above 250 percent of government revenue), the country qualifies for HIPC relief. At the decision point—the second phase—the IMF and the World Bank formally decide on the country's eligibility, and the international community commits itself to reducing the country's debt to a sustainable level.

Once it reaches the decision point, the country must continue its good track record with the support of the international community, satisfactorily implementing key structural policy reforms, maintaining macroeconomic stability, and adopting and implementing a poverty reduction strategy. Paris Club bilateral creditors reschedule obligations coming due, with a 90 percent reduction in NPV terms, and other bilateral and commercial creditors are expected to do the same. The IMF and the World Bank and some other multilateral creditors may provide interim debt relief between the decision and completion points.

A country reaches its *completion point*—the third phase—once it has met the objectives set at the decision point. It then receives the balance of the debt relief committed. This means that all creditors are expected to reduce their claims on the country, measured in NPV terms, to the agreed sustainable level.

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[33] "Enhanced HIPC Initiative—Status of Implementation," *www.imf.org/external/NP/hipc/2004/082004.htm*, and Public Information Notice No. 04/111, *www.imf.org/external/np/sec/pn/2004/pn04111.htm.*

During FY2005 five additional members—Ghana, Honduras, Madagascar, Rwanda, and Zambia—reached their completion points under the enhanced HIPC Initiative. A total of 18 members reached this stage by end-April 2005—two-thirds of the 27 countries that have reached their decision points.

The Fund's disbursement of debt relief at the completion point, together with already disbursed interim relief, accounted for just over 70 percent of the total amount the IMF has committed to the enhanced HIPC Initiative. As of end-April 2005, total disbursements of HIPC Initiative assistance by the Fund amounted to SDR 1.5 billion (see Chapter 5).

Maintaining macroeconomic stability has proved a challenge for many of the nine member countries that are in the interim period between their decision and completion points. The Fund is providing interim relief to three member countries (Chad, the Democratic Republic of the Congo, and Sierra Leone) whose macroeconomic programs are supported by a PRGF arrangement. In another two countries (Malawi and São Tomé and Príncipe), work is under way to put in place macroeconomic adjustments and reform programs that could be supported under the PRGF. Restoring macroeconomic stability in the remaining four members during the interim period (Cameroon, The Gambia, Guinea, and Guinea-Bissau) will require strong efforts to address obstacles in public resource management and structural reforms.

Of the remaining countries that have yet to reach their decision point, two (Burundi and the Republic of Congo) are making considerable progress on that route, while others still face significant challenges. Many of these have been affected by conflict, and several have large arrears to various creditors. Directors urged the staff to continue to work with the authorities in these countries, where possible, to overcome these obstacles. In this context, Directors underscored the urgent need to mobilize financial resources to enable the Fund to provide assistance under the HIPC Initiative to Liberia, Somalia, and Sudan once they become eligible.

In September 2004 the Boards of the Fund and the World Bank extended the HIPC *sunset clause* by another two years, to end-2006, to provide the opportunity for the remaining eligible countries to establish a track record that would allow their consideration for HIPC relief. This extension will apply only to members eligible for support from the World Bank's International Development Association and the Fund's PRGF that have not yet benefited from HIPC debt relief and that are deemed to have public debt in excess of the enhanced HIPC Initiative thresholds after full application of traditional debt relief mechanisms based on end-2004 debt data. Many of the countries that could benefit from the extension of the sunset clause are affected by conflict, and several, in particular Liberia, Somalia, and Sudan, have large and protracted arrears to various creditors.

Further Debt Relief

In response to the IMFC's call at the 2004 Annual Meetings for the international community to provide assistance, including "further debt relief," to enable low-income countries to achieve the Millennium Development Goals (MDGs), the Board discussed issues related to possible further debt relief for low-income countries and possible means of financing such relief at two seminars in March 2005. The Board will also look into the G-8 Finance Ministers' proposal of June 11, 2005, for additional debt relief to low-income countries, which is to be put to the September 2005 Annual Meetings of the Fund and the Bank (see Box 5.5).

Debt Sustainability Framework

To preserve the potential benefits of debt relief, it will be critical to help countries avoid excessive borrowing in the future. This is the purpose of the new debt sustainability framework for low-income countries. The Executive Boards of the Fund and the World Bank discussed the framework in February and September 2004[34] and endorsed its key elements, including a standardized forward-looking analysis of debt and debt-service indicators, an

[34]"Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications," *www.imf.org/external/np/pdr/sustain/2004/020304.pdf;* Public Information Notice No. 04/34, "IMF Discusses Operational Framework for Debt Sustainability in Low-Income Countries," *www.imf.org/external/np/sec/pn/2004/pn0434.htm;* "Operational Framework for Debt Sustainability in Low-Income Countries—Implications for Fund Program Design," *www.imf.org/external/np/pdr/sustain/2004/091304.htm;* "Debt Sustainability in Low-Income Countries—Further Considerations on an Operational Framework and Policy Implications," *www.imf.org/external/np/pdr/sustain/2004/091004.htm;* and Public Information Notice No. 04/119, "IMF Discusses Operational Debt Sustainability Framework for Low-Income Countries, *www.imf.org/external/np/sec/pn/2004/pn04119.htm.*

assessment of sustainability informed by indicative policy-dependent debt-burden thresholds, and a consistent financing strategy. The framework has implications for PRGF program design, since it suggests a more systematic use of indicative targets on the net present value (NPV) of external debt, increased flexibility in the application of limits on nonconcessional debt, and more systematic use of overall fiscal deficit limits. (Examples include the PRGF arrangements for Guyana and the Kyrgyz Republic. Guyana employs overall fiscal deficit limits and indicative targets on the net present value of external debt, while the Kyrgyz Republic's program includes a ceiling on concessional borrowing.)

The Board had a further discussion of the debt sustainability framework for low-income countries in April 2005**.**[35] Directors endorsed indicative thresholds for the ratio of net present value of debt to exports of 100, 150, and 200 percent, depending on the quality of a country's policies and institutions as assessed by the World Bank's CPIA (a formal Country Policy and Institutional Assessment), and corresponding thresholds for the other four debt and debt-service indicators. The thresholds are centered on the operational thresholds of the HIPC Initiative. The new framework will be applied as soon as possible to all low-income member countries, including HIPCs. Specific modalities for collaboration between Fund and World Bank staffs in preparing joint debt sustainability assessments for individual countries have been formulated, taking into account each institution's responsibilities in line with its mandate. Directors asked the staff to report to them on experience with the implementation of the framework after six to twelve months.

MOBILIZING INTERNATIONAL SUPPORT

The international community recognized in the 2002 Monterrey Consensus that decisive progress toward the Millennium Development Goals (MDGs) would require ambitious country-led reform efforts supported by increased aid and its more effective delivery. The Fund offers low-income countries advice on how to manage aid inflows, which is crucial

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[35]"Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations," *www.imf.org/external/np/pp/eng/2005/032805.pdf,* and Public Information Notice No. 05/59, *www.imf.org/external/np/sec/pn/2005/pn0559.htm.*

given the international effort to mobilize more aid for the MDGs. Mobilization and coordination of financing for the MDGs has figured prominently on the international agenda.

The year 2005 represents an important milestone on the way to the Millennium Development Goals for 2015. The United Nations Millennium Project report, published in January 2005, marked the opening of a period of stocktaking on the progress made toward the MDGs and how to accelerate it—discussions that will culminate at the UN Summit Conference on Implementing the Millennium Declaration in September 2005. An important step in this process was the Second High-Level Forum on Aid Effectiveness held in Paris in March 2005. This Forum focused on ways to achieve greater aid effectiveness and better development results in support of efforts to reach the MDGs by harmonizing donor aid delivery procedures and reporting requirements and by aligning donor support programs with recipient countries' priorities. The Fund, although not a donor, supports the principles and commitments in the Paris Declaration on enhancing aid effectiveness and will promote its implementation. In particular, the Fund will work within its mandate with multilateral development partners toward enhancing the predictability of aid flows and achieving greater policy coherence on the part of development partners.

Board Review of Aid Effectiveness

In September 2004, Directors discussed the issue of aid effectiveness and the merits of various options for mobilizing more resources in support of the MDGs, on the basis of a paper prepared jointly by Fund and World Bank staff.[36] Directors emphasized that increased aid is not a panacea and that action is also required in other areas—further improvements in recipient countries' policy environments, better market access for developing countries' exports, better aid management and implementation, and a relaxation of absorptive capacity constraints. Directors generally considered that an increase in official development assistance was the best way to mobilize additional resources in pursuit of the MDGs, and most stressed that donor countries needed to move more forcefully toward meeting the UN target of 0.7 percent of gross national income devoted to aid. Directors' views varied widely,

[36]"Aid Effectiveness and Financing Modalities," is available at *www.worldbank.org*.

however, on alternative financing mechanisms to complement official development assistance, with most Directors calling for further work by the Fund on these issues.

Subsequently, in response to requests by the IMFC and the Development Committee to continue work on innovative sources of development financing, such as the International Finance Facility (IFF) and global taxes, Fund and World Bank staffs produced a joint note outlining progress that has been made in advancing the analysis of these issues. This includes continuing assessment by the Fund of proposed global tax instruments, such as aviation taxes, and a World Bank analysis of progress in putting in place the IFF for Immunization (IFFIm), a fund to support an enhanced vaccination program.

Global Monitoring Report

The second *Global Monitoring Report* was published in April 2005. The annual reports, prepared jointly by the IMF and the World Bank, track the progress made toward the achievement of the MDGs and the obstacles remaining. While the first report, published in June 2004, provided a comprehensive assessment of the policy agenda for achieving the MDGs and related development outcomes, the 2005 report had a more selective focus on key areas of the policy agenda but provided a more in-depth assessment in those areas.[37] It paid special attention to Africa, the region most at risk of failing to achieve the MDGs.

The Fund staff's primary contribution to the 2005 report was on the agenda for growth, which is central to reducing poverty and meeting the MDGs. The broad priorities emphasized are macroeconomic stability and institutions and policies that promote private sector growth. Better expenditure management and policies are critical to improving the expenditure composition and sustaining macroeconomic stability. To invigorate the private sector, countries must remove excessive regulatory and institutional constraints. To underpin these efforts, recent progress on political governance must lead to improvements in economic

[37] "New IMF-World Bank Report Calls for Urgent Action to Cut Global Poverty and Win Better Development Results for Poor Countries", Press Release No. 05/83, April 12, 2005, *www.imf.org/external/np/sec/pr/2005/pr0583.htm.* The *Global Monitoring Report* is available at *www.imf.org/external/pubs/ft/gmr/2005/eng/pdf/gmr.pdf.*

governance. Transparency is a theme of many of the key interventions discussed in the report. Trade liberalization is also a critical domestic policy priority in many cases.

Meeting the MDGs, the report said, would require substantial increases in the amount of official development assistance reaching the poorest countries. While aid volumes had risen since the UN Financing for Development Conference in Monterrey in 2002, when donors pledged to increase assistance to the poorest countries significantly, debt relief and technical cooperation had accounted for a full two-thirds of the increase. Given reforms under way, many countries could effectively use a doubling of aid over the next five years.

5. Financial Operations and Policies

The IMF is a cooperative financial institution that lends to member countries experiencing balance of payments problems. The IMF extends financing to members through three channels:

Regular Financing Activities. The IMF provides loans to countries from a revolving pool of funds consisting of members' capital subscriptions (quotas) on the condition that the borrower undertake economic adjustment and reform policies to address its external financing difficulties. These loans are extended under a variety of policies and facilities designed to address specific balance of payments problems (Table 3.1). Interest is charged on the loans at market-related rates, and repayment periods vary depending on the lending facility.

Concessional Financing Activities. The IMF provides loans to low-income member countries at very low interest rates and with longer maturities than apply to regular Fund credit. The interest rate charged on loans extended under the Poverty Reduction and Growth Facility (PRGF) is 0.5 percent, and the repayment period for such loans is 5½–10 years. These loans support programs to strengthen balance of payments positions and foster durable growth, higher living standards, and a reduction in poverty. The IMF also makes grants available to eligible heavily indebted poor countries (HIPCs) to help them achieve sustainable external debt positions. The principal of concessional loans is funded by bilateral lenders that make resources available to the IMF at market-based rates, with the IMF acting as a trustee. Resources to subsidize the rate charged to borrowers and grants for HIPC debt relief are financed through separate contributions by some member countries and the IMF's own resources.

Special Drawing Rights. The IMF can also create international reserve assets by allocating special drawing rights (SDRs) to members. These SDRs can be used to obtain foreign exchange from other members and to make payments to the IMF.

Among the key financial developments in FY2005 were the following:

- The IMF initiated a review of its finances and financial structure. This ongoing review is focusing on ways in which the existing financial structure can be strengthened. In particular, the review is considering measures to enhance, simplify, and increase the transparency of the IMF's income mechanism and addressing ways to strengthen the IMF's financial position through the diversification of income sources. Measures to modernize the IMF's internal budgetary procedures are also ongoing (see Chapter 7).

- Outstanding IMF credit declined from last year's all-time high, as a favorable external financing environment for emerging market countries contributed to a sharp reduction in the demand for IMF credit.

- The IMF continued its efforts to help its poorest members achieve a higher pace of sustainable economic growth, reduce poverty, and reduce their debt burdens to sustainable levels. In this context, the IMF considered ways to strengthen its ability to provide financial resources to low-income countries over the medium term.

REGULAR FINANCING ACTIVITIES

The IMF's regular lending activity is conducted through the General Resources Account (GRA), in which the members' quota subscriptions are held (Box 5.1). The bulk of IMF financing is provided under Stand-By Arrangements, which address members' short-term balance of payments difficulties, and under the Extended Fund Facility (EFF), which focuses on external payments difficulties arising from longer-term structural problems. Loans under Stand-By and Extended Arrangements can be supplemented with short-term resources from the Supplemental Reserve Facility (SRF) to assist members experiencing sudden and disruptive losses of capital market access. All loans incur interest charges and can be subject to surcharges, depending on the type and duration of the loan and the amount of IMF credit outstanding. Repayment periods also vary by type of loan (Table 3.1).

Box 5.1 The IMF's Financing Mechanism

The IMF's regular lending is financed from the capital (quotas) subscribed by member countries. Each country is assigned a quota—taking into account the country's economic size and external trade—which determines its maximum financial commitment to the IMF. A portion of the quota is provided in the form of reserve assets (foreign currencies acceptable to the IMF or SDRs) and the remainder in the country's own currency. The IMF extends financing by providing reserve assets to borrowers from the reserve asset subscriptions of members or by calling on countries that are considered financially strong to exchange their own currency subscriptions for reserve assets (Box 5.3).

A loan is disbursed by the IMF when a borrower "purchases" the reserve assets from the IMF with its own currency. The loan is considered repaid when the borrower "repurchases" its currency from the IMF in exchange for reserve assets. The IMF levies a basic rate of interest (charge) on loans based on the SDR interest rate (Box 5.7) and imposes surcharges depending on the amount and maturity of the loan and the level of credit outstanding.

A country that provides reserve assets to the IMF as part of its quota subscription or through the use of its currency receives a liquid claim on the IMF (reserve position) that can be encashed on demand to obtain reserve assets to meet a balance of payments financing need. These claims earn interest (remuneration) based on the SDR interest rate and are considered by members as part of their international reserve assets. As IMF loans are repaid (repurchased) by borrowers with reserve assets, these funds are transferred to the creditor countries in exchange for their currencies, and the creditors' claims on the IMF are extinguished.

The "purchase/repurchase" approach to IMF lending affects the composition of the IMF's resources but not their overall size. An increase in loans outstanding will reduce the IMF's holdings of reserve assets and the currencies of members that are financially strong and increase its holdings of the currencies of countries that are borrowing from the IMF. The amounts of the IMF's holdings of reserve assets and the currencies of financially strong countries determine the IMF's lending capacity (liquidity) (Box 5.4).

Detailed information on various aspects of the IMF's financial structure and regular updates of its financial activities are available on the IMF's website at *www.imf.org/external/fin.htm*.

Lending

During FY2005, IMF credit outstanding declined from its all-time high reached in FY2004. At the end of FY2005, credit outstanding stood at SDR 49.9 billion, down from SDR 62.2 billion in April 2004.[38] Disbursements during the fiscal year totaled SDR 1.6 billion; the largest disbursements were made to Turkey and Uruguay under their Stand-By Arrangements. Disbursements totaling SDR 312.9 million were made under Emergency Post-Conflict Assistance to the Central African Republic, Haiti, and Iraq. Disbursements totaling SDR 110.4 million were made under Emergency Assistance for Natural Disasters to Grenada, Maldives, and Sri Lanka. During FY2005, total repayments reached SDR 13.9 billion—reflecting large repayments by Argentina, Brazil, Russia, and Turkey. Both Russia and Lithuania repaid all GRA principal obligations to the Fund; their advance repayments amounted to SDR 2.2 billion in January 2005 and SDR 16 million in February 2005, respectively. Uruguay also made several advance repayments totaling SDR 438.5 million. As a result, IMF credit outstanding at the end of FY2005 was SDR 12.3 billion lower than a year earlier.

During the year, 13 members—Argentina, Bosnia and Herzegovina, Brazil, Bulgaria, Ecuador, Jordan, Pakistan, Papua New Guinea, Romania, Serbia and Montenegro, Sri Lanka, Turkey, and Uruguay—made repayments on the expectation schedule in the amount of SDR 6.1 billion, of which SDR 1.3 billion constituted SRF repayments by Brazil. Six members requested and were granted extensions of repurchase expectations.[39] As of April 30, 2005, IMF outstanding credit amounting to SDR 24.8 billion was subject to time-based repurchase expectations under the policies adopted in November 2000 (Box 5.2).

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[38]As of April 30, 2005, SDR 1 = US$1.51678.

[39]Extensions of repurchase expectations were approved in FY2005 for Argentina, Dominica, the Dominican Republic, Ecuador, Sri Lanka, and Uruguay.

Box 5.2 Expectations Versus Obligations

The IMF's Articles of Agreement (Article V, Section 7(*b*)) specify that members are expected to make "repurchases" (repayments of loans) as their balance of payments and reserve positions improve. To encourage early repayment, the review of Fund facilities carried out in FY2001 introduced *time-based repurchase expectations* on "purchases" (loan disbursements) made after November 28, 2000, in the credit tranches, under the Extended Fund Facility, and under the Compensatory Financing Facility. Purchases under the Supplemental Reserve Facility have been subject to repurchase expectations since that facility's inception; in March 2003, the maturities of SRF expectations and obligations were extended by one year and by six months, respectively. The expectations schedule entails earlier repayments than the original obligations schedule, as shown in the table.[1]

The time-based repurchase expectations can be extended upon request by members.

Credit Facility	**Obligations Schedule** (*Years*)	**Expectations Schedule** (*Years*)
Stand-By Arrangements	3¼–5	2¼–4
Compensatory Financing Facility (CFF)	3¼–5	2¼–4
Extended Fund Facility (EFF)	4½–10	4½–7
Supplemental Reserve Facility (SRF)	2½–3	2–2½

[1] A review of the policy on time-based repurchase expectations is being undertaken in the context of a broader review of the charges and maturities of IMF facilities.

New IMF commitments declined sharply from SDR 14.5 billion in FY2004 to SDR 1.3 billion in FY2005, in part reflecting favorable financing conditions for emerging market sovereign borrowers.

The IMF approved six new Stand-By Arrangements and one augmentation of an existing Stand-By Arrangement involving commitments totaling SDR 1.3 billion (Table 5.1). In addition, as detailed above, the Central African Republic, Haiti, and Iraq made purchases under the policy on Emergency Post-Conflict Assistance (EPCA), and Grenada, Maldives, and Sri Lanka under the policy on Emergency Assistance for Natural Disasters (ENDA). No

Extended Arrangements were approved and no commitments were made under the IMF's Compensatory Financing Facility (CFF) during the year.

Table 5.1 IMF Regular Loans Approved in FY2005

Member	Type of Arrangement	Date of Approval	Amount Approved[1] *(In millions of SDRs)*
Bolivia	Augmentation of Stand-By	June 10, 2004	42.9
	Augmentation of Stand-By	April 8, 2005	42.9
Bulgaria	25-month Stand-By	August 6, 2004	100.0
Croatia	20-month Stand-By	August 4, 2004	97.0
Dominican Republic	28-month Stand-By	January 31, 2005	437.8
Gabon	13-month Stand-By	May 28, 2004	69.4
Peru	26-month Stand-By	June 9, 2004	287.3
Romania	2-year Stand-By	July 7, 2004	250.0
			1,327.3

[1]For augmentations, only the amount of the increase is shown.

New IMF commitments made during FY2005 were small relative to large IMF commitments made during FY2004. The largest commitment made during FY2005, for the Dominican Republic (SDR 437.8 million), was far less than the large commitments made during FY2004 for the Stand-By Arrangement with Argentina (SDR 9.0 billion) and for the augmentation of Brazil's Stand-By Arrangement (SDR 4.6 billion).

Twelve Stand-By and Extended Arrangements were in effect as of the end of FY2005, of which seven are being treated as precautionary, with borrowers having indicated that they do not intend to draw on the funds committed to them by the IMF. Argentina has not drawn under its Stand-By Arrangement since March 2004. At the end of April 2005, undrawn balances under all arrangements still in effect amounted to SDR 7.9 billion.

Resources and Liquidity

The IMF's lending is financed primarily from the fully paid-in capital (quotas) subscribed by member countries in the form of reserve assets and currencies.[40] General reviews of IMF quotas, during which adjustments may be proposed in the overall size and distribution of

[40]Quotas also determine a country's voting power in the IMF, access to IMF financing, and share in SDR allocations.

quotas to reflect developments in the world economy, are conducted at five-year intervals. A member's quota can also be adjusted separately from a general review to take account of major developments. The IMF can borrow to supplement its quota resources and has in place two formal borrowing arrangements with member countries.

Only a portion of the paid-in capital is readily available to finance new lending because of previous commitments made by the IMF and the IMF policy of lending only in the currencies of members that are financially strong. The IMF's base of usable resources increased during FY2005 because Russia was considered sufficiently strong for its currency to be included in the IMF's Financial Transactions Plan (Box 5.3).

The Fund's liquidity, as measured by the Forward Commitment Capacity (FCC; see Box 5.4), rose to SDR 94.3 billion at the end of April 2005 from SDR 58.1 billion at the end of April 2004. This was due primarily to the expiration of Brazil's Stand-By Arrangement; the rise of usable resources as a result of net repurchases by Argentina, Brazil, Turkey, and Russia; and the inclusion of Russia in the Financial Transactions Plan (Figure 5.1).

Box 5.3 Financial Transactions Plan

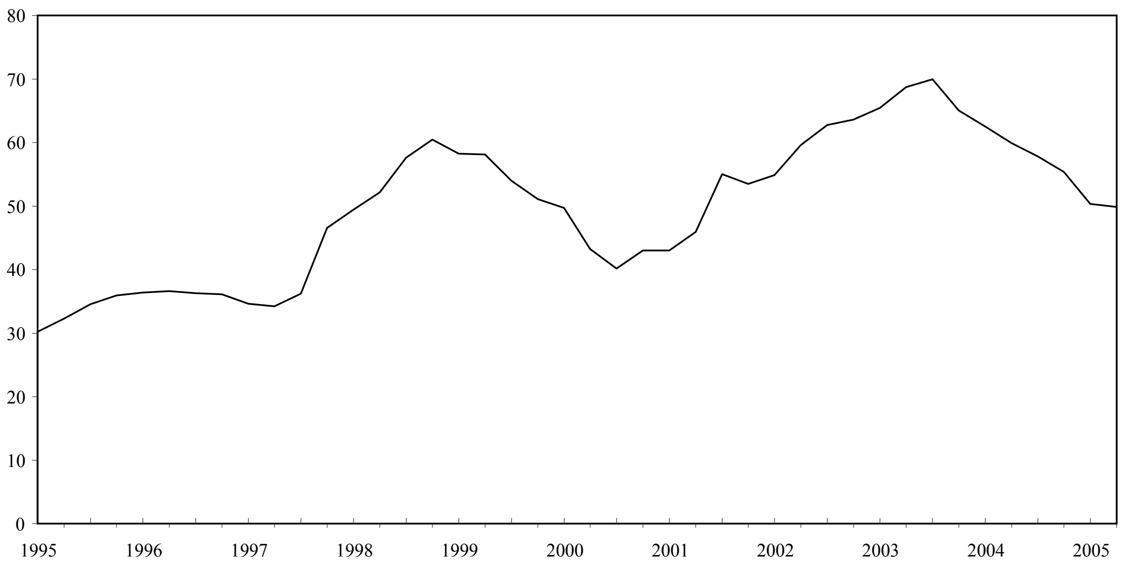
The Financial Transactions Plan, adopted by the Executive Board for each upcoming quarter, specifies the amounts of SDRs and selected member currencies to be used in transfers and receipts expected to be conducted through the General Resources Account during that period. The IMF extends loans by calling on financially strong countries to provide reserve assets to weaker members in balance of payments need. The members that participate in financing IMF transactions in foreign exchange are selected by the Executive Board based on an assessment of each country's financial capacity. These assessments are ultimately a matter of judgment and take into account recent and prospective developments in the balance of payments and reserves, trends in exchange rates, and the size and duration of external debt obligations.

The amounts transferred and received by these members are managed to ensure that their creditor positions in the IMF are broadly equal in relation to quota, the key measure of members' rights and obligations in the IMF. The IMF publishes on its website the outcome of the Financial Transactions Plan for the quarter ending three months prior to publication. As of April 30, 2005, with the addition of Russia in March 2005, there were 46 participants in the Financial Transactions Plan.

Australia	France	Malaysia	Singapore
Austria	Germany	Mauritius	Slovenia
Belgium	Greece	Mexico	Spain
Botswana	Hungary	Netherlands	Sweden
Brunei Darussalam	India	New Zealand	Switzerland
Canada	Ireland	Norway	Thailand
Chile	Israel	Oman	Trinidad and Tobago
China	Italy	Poland	United Arab Emirates
Cyprus	Japan	Portugal	United Kingdom
Czech Republic	Korea, Rep. of	Qatar	United States
Denmark	Kuwait	Russia	
Finland	Luxembourg	Saudi Arabia	

Figure 5.1. Regular Loans Outstanding, 1995–April 30, 2005

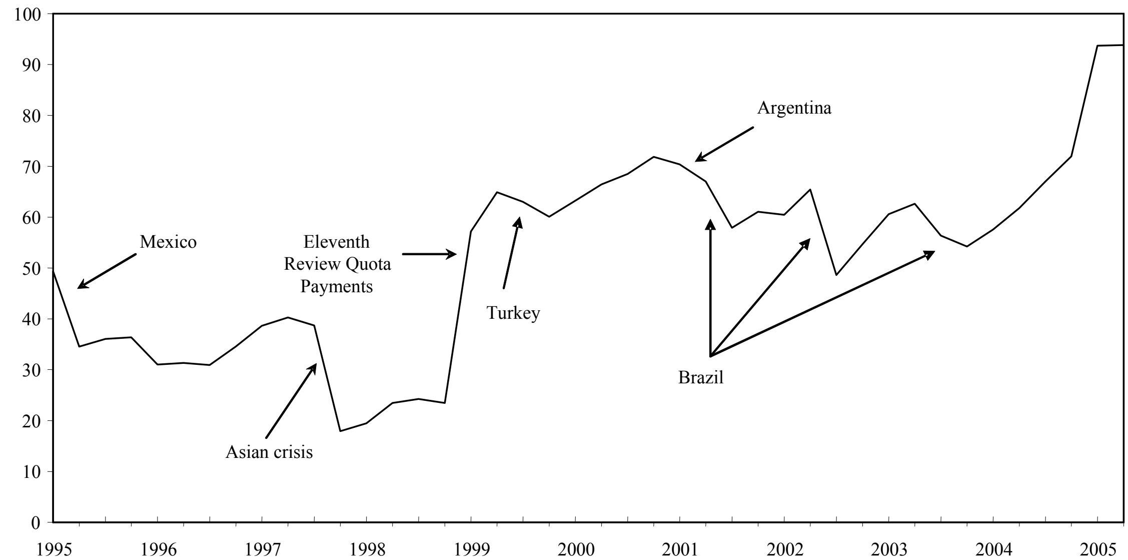
(In billions of SDRs)



Source: IMF Finance Department

Figure 5.2. IMF One-Year Forward Commitment Capacity, 1995–April 2005

(In billions of SDRs)



Source: IMF Finance Department.
Note: The IMF started publishing data on its Forward Commitment Capacity (FCC) in December 2002. For earlier periods, the figure shows estimates of the FCC. The FCC increases when quota payments are made. It also increases when repurchases are made and decreases when the IMF makes new financial commitments. The reference to member countries and the Asian crisis notes selected large financial commitments by the IMF to members and groups of members.

Box 5.4 The IMF's Lending Capacity

The IMF's key measure of liquidity is the Forward Commitment Capacity (FCC), which is designed to be a clear measure of the IMF's capacity to make new loans. The one-year FCC indicates the amount of quota-based resources available for new lending over the next 12 months (Figure 5.2).

The one-year FCC is defined as the IMF's stock of usable resources *less* undrawn balances under current lending arrangements, *plus* projected repayments during the coming 12 months, *less* a prudential balance intended to safeguard the liquidity of creditors' claims and allow for any potential erosion of the IMF's resource base. The IMF's usable resources consist of its holdings of SDRs and the currencies of financially strong members included in the Financial Transactions Plan (Box 5.3). The prudential balance is calculated as 20 percent of the quotas of members included in the Financial Transactions Plan, *plus* any undrawn amounts under activated borrowing arrangements.

Information on the one-year FCC is published weekly (*Financial Activities: Week-at-a-Glance*) and monthly (*Financial Resources and Liquidity*) on the IMF's website at *www.imf.org/external/ fin.htm*.

Concessional Financing Activities

Poverty Reduction and Growth Facility

In 1999, the IMF modified its objectives for concessional lending to include an explicit focus on poverty reduction in the context of a growth-oriented economic strategy. The IMF, along with the World Bank, supports strategies elaborated by the borrowing country in a Poverty Reduction Strategy Paper (PRSP) prepared with the participation of civil society and other development partners. Reflecting the new objectives and procedures, the IMF established the Poverty Reduction and Growth Facility (PRGF) in place of the Enhanced Structural Adjustment Facility (ESAF) to provide financing under arrangements developed in the context of PRSPs. (See Chapter 4 for more information on the assistance the IMF provides to low-income countries.)

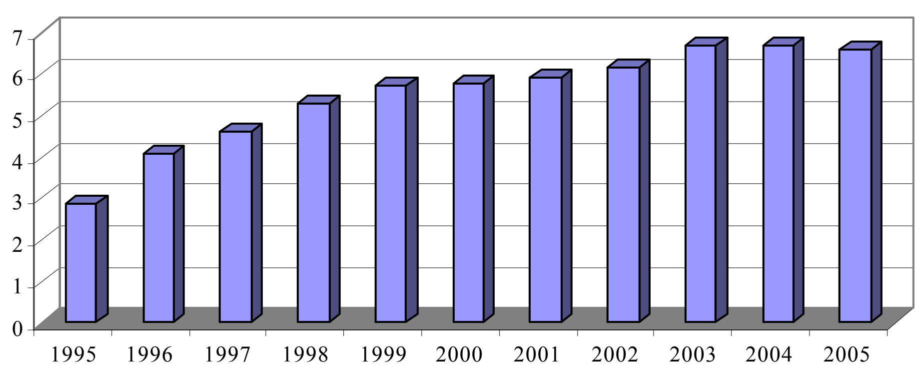
During FY2005, the Executive Board approved eight new PRGF arrangements (for Chad, the Republic of Congo, Georgia, the Kyrgyz Republic, Mali, Mozambique, Niger, and Zambia), with commitments totaling SDR 434.4 million (Table 5.2). In addition, the Board approved augmentations of the existing arrangements for Bangladesh and Kenya in the amounts of SDR 53.3 million and SDR 50 million, respectively; Bangladesh's augmentation was associated with the first approval under the newly created Trade Integration Mechanism, while Kenya's augmentation was in response to drought and the sharp rise in oil prices. The commitment of Azerbaijan's PRGF arrangement was reduced by SDR 12.9 million owing to the cancellation of one review. Mauritania cancelled its PRGF arrangement on November 7, 2004. Total PRGF disbursements amounted to SDR 0.8 billion during FY2005. As of April 30, 2005, 31 member countries' reform programs were supported by PRGF arrangements, with commitments totaling SDR 2.9 billion and undrawn balances of SDR 1.3 billion; total PRGF credit outstanding as of the end of April 2005 stood at SDR 6.6 billion (Figure 5.3).

Table 5.2. PRGF Lending Approved in FY2005

Member	Type of Arrangement	Date of Approval	Amount Approved *(In millions of SDRs)*
Chad	3-year PRGF	February 16, 2005	25.2
Georgia	3-year PRGF	June 4, 2004	98.0
Kyrgyz Republic	3-year PRGF	March 15, 2005	8.9
Mali	3-year PRGF	June 23, 2004	9.3
Mozambique	3-year PRGF	July 6, 2004	11.4
Niger	3-year PRGF	January 31, 2005	6.6
Republic of Congo	3-year PRGF	December 6, 2004	55.0
Zambia	3-year PRGF	June 16, 2004	220.1
Subtotal			**434.4**[1]
Bangladesh	Augmentation	July 28, 2004	53.3
Kenya	Augmentation	December 20, 2004	50.0
Azerbaijan	Reduction	December 22, 2004	(12.9)

Source: IMF Finance Department.
[1]Figures may not add up to subtotal because of rounding.

Figure 5.3. PRGF Credit Outstanding, 1995-2005
(In billions of SDRs; end of financial year)



Source: IMF Finance Department

Financing for the PRGF is provided through trust funds administered by the IMF—the PRGF and PRGF-HIPC Trusts—that are separate from the IMF's quota-based resources.[41] The trusts have been financed from contributions from a broad spectrum of the IMF's membership and the IMF itself. The PRGF Trust was established in 1987 and borrows resources at market or below-market interest rates from loan providers—central banks, governments, and government institutions—and lends them to PRGF-eligible member countries at an annual interest rate of 0.5 percent. The PRGF Trust receives grant contributions to subsidize the rate of interest on PRGF loans and maintains a Reserve Account as security for loans to the trust. The PRGF-HIPC Trust was established in 1997 to subsidize PRGF operations beginning in 2002 and to provide resources for HIPC Initiative assistance.

As of the end of FY2005, the total loan resources that had been made available for PRGF operations amounted to SDR 15.8 billion, of which SDR 13.0 billion had already been committed to borrowing members and SDR 11.7 billion had been disbursed. It is estimated that the remaining uncommitted PRGF loan resources of SDR 2.7 billion will cover the projected demand for PRGF resources through 2006. There is a long-standing plan to move to a self-sustained PRGF once the interim PRGF runs its course. Following the March 2004 Executive Board discussion,[42] the IMF staff updated its estimates of PRGF financing requirements over the medium term under current policies. These updated estimates indicated the need for a PRGF lending capacity of SDR 0.8–1.2 billion a year over 2006–10. Further projections will have to be made to take into account the possible impact of the G-8's June 2005 proposal for additional debt relief to low-income countries.

Enhanced HIPC Initiative

Originally launched by the IMF and the World Bank in 1996, the HIPC Initiative was considerably strengthened in 1999 to provide deeper, faster, and broader debt relief for the world's heavily indebted poor countries. By April 30, 2005, 27 countries had reached their decision points under the enhanced initiative and one (Côte d'Ivoire) under the original

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[41]For a fuller account of the sources of funds for IMF concessional lending operations, see International Monetary Fund, 2001, *Financial Organization and Operations of the IMF*, Pamphlet 45, 6th ed. (Washington), available online at *www.imf.org/external/pubs/ft/pam/pam45/contents.htm*.

[42]Box 7.6 of the IMF's *Annual Report 2004* provides more information on this Board discussion of the financing of PRGF operations over the medium term.

initiative. Of these countries, 18 reached their completion points under the enhanced initiative (see also Chapter 4).

The IMF provides HIPC Initiative assistance in the form of grants that are used to service part of member countries' debt to the institution. As of April 30, 2005, the IMF had committed SDR 1.8 billion in grants to the following countries: Benin, Bolivia, Burkina Faso, Cameroon, Chad, Côte d'Ivoire, the Democratic Republic of the Congo, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia. Five members (Ghana, Honduras, Madagascar, Rwanda, and Zambia) reached their completion points under the enhanced HIPC Initiative during FY2005. As of April 30, 2005, total disbursements of HIPC Initiative assistance by the IMF amounted to SDR 1.5 billion (Table 5.3).

Table 5.3. Status of Commitments of IMF HIPC Assistance

(In millions of SDRs; as of April 30, 2005)

Member	Decision Point	Completion Point	Amount Committed	Amount Disbursed[1]
Under the original HIPC Initiative				
Bolivia	Sep. 1997	Sep. 1998	21.2	21.2
Burkina Faso	Sep. 1997	Jul. 2000	16.3	16.3
Côte d'Ivoire	Mar. 1998	—	16.7[2]	—
Guyana	Dec. 1997	May 1999	25.6	25.6
Mali	Sep. 1998	Sep. 2000	10.8	10.8
Mozambique	Apr. 1998	Jun. 1999	93.2	93.2
Uganda	Apr. 1997	Apr. 1998	51.5	51.5
Total original HIPC			**235.3**	**218.6**
Under the Enhanced HIPC Initiative				
Benin	Jul. 2000	Mar. 2003	18.4	20.1
Bolivia	Feb. 2000	Jun. 2001	41.1	44.2
Burkina Faso	Jul. 2000	Apr. 2002	27.7	29.7
Cameroon	Oct. 2000	Floating	28.5	5.5
Chad	May 2001	Floating	14.3	8.6

Table 5.3 ***(concluded)***

Member	Decision Point	Completion Point	Amount Committed	Amount Disbursed[1]
Congo, Dem. Rep. of	Jul. 2003	Floating	228.3 [3]	2.3
Ethiopia	Nov. 2001	Apr. 2004	45.1	46.3
Gambia, The	Dec. 2000	Floating	1.8	0.1
Ghana	Feb. 2002	Jul. 2004	90.1	94.3
Guinea	Dec. 2000	Floating	24.2	5.2
Guinea-Bissau	Dec. 2000	Floating	9.2	0.5
Guyana	Nov. 2000	Dec. 2003	31.1	34.0
Honduras	Jun. 2000	Apr. 2005	22.7	22.7
Madagascar	Dec. 2000	Oct. 2004	14.7	16.4
Malawi	Dec. 2000	Floating	23.1	6.9
Mali	Sep. 2000	Mar. 2003	34.7	38.5
Mauritania	Feb. 2000	Jun. 2002	34.8	38.4
Mozambique	Apr. 2000	Sep. 2001	13.7	14.8
Nicaragua	Dec. 2000	Jan. 2004	63.5	71.2
Niger	Dec. 2000	Apr. 2004	31.2	33.8
Rwanda	Dec. 2000	Apr. 2005	33.8[4]	33.8
São Tomé and Príncipe	Dec. 2000	Floating	—	—
Senegal	Jun. 2000	Apr. 2004	33.8	38.4
Sierra Leone	Mar. 2002	Floating	98.5	62.0
Tanzania	Apr. 2000	Nov. 2001	89.0	96.4
Uganda	Feb. 2000	May 2000	68.1	70.2
Zambia	Dec. 2000	Apr. 2005	468.8	468.8
Total enhanced HIPC			**1,590.3**	**1,303.0**
Grand total			**1,825.5**	**1,521.6**

Source: IMF Finance Department.
[1] Includes interest on amounts committed under the enhanced HIPC Initiative.
[2] Equivalent to the committed amount of $22.5 million at the decision point exchange rate (March 17, 1998).
[3] Amount committed is equivalent to the remaining balance of the total IMF HIPC assistance of SDR 337.9 million, after deducting SDR 109.6 million representing the concessional element associated with the disbursement of a PRGF loan following the Democratic Republic of the Congo's clearance of arrears to the IMF on June 12, 2002.
[4] Excludes commitment of additional enhanced HIPC assistance of SDR 12.98 million subject to receipt of satisfactory financing assurances from other creditors.

During FY2005, the IMF Executive Board approved additional HIPC assistance amounting to SDR 51.8 million for four members (Burkina Faso, Ethiopia, Niger, and Rwanda).[43]

Under the enhanced HIPC Initiative, a portion of the assistance committed at the decision point can be disbursed before the country reaches its completion point. Such assistance from the IMF may amount to up to 20 percent annually, with a cumulative maximum of 60 percent of the total committed amount of HIPC assistance. In exceptional circumstances, the annual and maximum amounts of assistance can be raised to 25 percent and 75 percent, respectively. During FY2005, SDR 7.0 million of interim assistance was disbursed to three countries. As of April 30, 2005, SDR 624.2 million had been disbursed as interim assistance.

Resources still need to be identified to meet the IMF's share of HIPC Initiative assistance for three protracted arrears cases—Liberia, Somalia, and Sudan. In addition, the potential costs associated with further cases of "topping up" and the extension of the HIPC sunset clause have not yet been identified. Moreover, recent calls to consider further debt relief will also have important financing implications for the IMF. In this regard, the IMF's Executive Board is considering the implications for the IMF's finances and operations of the G-8 proposal for additional debt relief (Box 5.5).

Box 5.5 Further Debt Relief Beyond the HIPC Initiative and Its Financing

At the 2004 Annual Meetings of the IMF and the World Bank, the International Monetary and Financial Committee called on the international community, including the IMF, to consider further debt relief for low-income countries beyond that provided by the HIPC Initiative. In this regard, in March 2005, the IMF's Executive Board discussed two staff papers on the key issues relating to further debt relief and its financing.

[43]This includes SDR 12.98 million in additional HIPC assistance approved for Rwanda subject to the receipt of satisfactory financing assurances from other creditors.

The paper on further debt relief provided an opportunity to discuss how debt relief could play a role in helping low-income countries tackle their problems and make progress toward the Millennium Development Goals (MDGs). Further debt relief holds out the promise of easing concerns about debt sustainability while attracting additional financing to achieve the MDGs, and of providing predictable budget support with relatively low transactions costs for recipients. Drawbacks include the possibility that it could perpetuate moral hazard and raise issues of equity by allocating scarce resources on the basis of past borrowing and that it would not address the broader agenda of reforms needed to accelerate progress toward the MDGs. Directors emphasized that the benefits of further debt relief would depend importantly on the commitment of the donor community to increase the overall aid envelope to ensure additional net resource transfers to these countries and that these benefits must be weighed against other potential uses of scarce resources.

The financing paper emphasized the close interlinkages between the financing of further debt relief and the financing of the IMF's ongoing lending operations with low-income countries. Directors agreed that it would be crucial to ensure that the IMF has adequate financing to meet the future demand for concessional lending.

In June 2005, the finance ministers of the Group of Eight (G-8) countries proposed that the IMF, the World Bank, and the African Development Bank (AfDB) cancel 100 percent of their claims on 18 countries that have reached the completion point under the enhanced HIPC Initiative and the claims on other HIPCs (currently 17 countries) as they reach the completion point.[1] The key elements of the G-8 proposal were as follows:

- Donors would provide additional contributions to the International Development Association (the concessional lending arm of the World Bank) and the AfDB, based on agreed burden sharing, to cover their full cost of debt relief.

- The costs of fully covering the Fund's debt relief would be met by the use of existing Fund resources, without undermining the IMF's financing capacity.

- In situations where other existing and projected debt relief obligations cannot be met by the use of existing IMF resources (for example, Somalia, Liberia, and Sudan), donors would commit to providing the additional resources necessary. The G-8 finance ministers committed to provide, on a fair burden-sharing basis, a minimum of $350 million in resources over the next three years to cover costs to the IMF that are difficult to forecast and that are in excess of existing resources and to cover the costs of countries that may become eligible for HIPC assistance under the sunset clause (see Chapter 4). They also invited voluntary contributions to a new trust fund to support poor countries facing commodity price and other exogenous shocks.

The IMF's Executive Board met for an initial discussion of the G-8 proposal in late June 2005. Directors asked staff to prepare a careful assessment of the proposal and of its legal, financial, and policy implications for the IMF, as well as possible modifications.

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[1]The following 18 countries would be eligible immediately: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia. As the remaining HIPCs reach their completion points, they would also become eligible.

Financing of PRGF Subsidies and the HIPC Initiative

The financing of the subsidy requirements of the PRGF and the IMF's participation in the enhanced HIPC Initiative is administered through the PRGF and the PRGF-HIPC Trusts. Under the current framework, the total cost required for these purposes is projected at SDR 6.3 billion on a cash basis through 2019: PRGF subsidies are projected at SDR 4.1 billion, and the IMF's cost of HIPC assistance is estimated at SDR 2.2 billion. (Further projections will need to be made to account for the possible impact of the G-8 proposal for additional debt relief.) These resource requirements are sensitive to interest rate assumptions. They are expected to be fully met by bilateral contributions from member countries and by the IMF itself.

Bilateral pledges for the PRGF and the PRGF-HIPC Trusts have come from a cross section of the IMF's membership (with 94 countries having pledged support), demonstrating broad support for the PRGF and the HIPC Initiative. Bilateral contributions are estimated at SDR 3.6 billion on a cash basis through 2019. As of the end of April 2005, all pledged bilateral contributions to the PRGF Trust, as well as 98 percent of total contributions to the PRGF-HIPC Trust, had been made effective. Pledged contributions by 10 countries, amounting to about SDR 32 million, remain pending.

The IMF's own contributions amount to SDR 2.6 billion, of which SDR 2.2 billion is for the PRGF-HIPC Trust. The bulk of the contributions would come from the expected investment income on the net proceeds of SDR 2.2 billion generated from off-market gold transactions in 1999–2000 (see *Annual Report*, 2000, page 71). The investment income on the gold proceeds held in the Special Disbursement Account (SDA) may be used, up to a maximum limit of SDR 1.76 billion, to meet the IMF's share of the HIPC Initiative assistance.

The IMF's other contributions include a one-time transfer of SDR 0.4 billion from the SDA to the PRGF Trust in 1994 and forgone reimbursements to the GRA from the PRGF Reserve Account for the administrative expenses related to PRGF operations during financial years 1998–2004, with the equivalent amount being transferred to the PRGF-HIPC Trust. In addition, part of the interest surcharges on financing provided in 1998 and 1999 under the SRF, related to activation of the New Arrangements to Borrow, were transferred to the PRGF-HIPC Trust. Investment income on the balances in the two trusts is also applied toward financing PRGF loan subsidies and HIPC Initiative assistance.

Investments to Support Concessional Financing and HIPC Initiative Assistance

The IMF invests assets supporting the PRGF subsidies and the HIPC Initiative in a diversified portfolio of fixed-income securities issued by governments and international financial institutions. As of April 30, 2005, the value of these assets totaled SDR 9.6 billion.

In March 2000, the IMF's Executive Board endorsed investment objectives and risk-tolerance parameters designed to supplement returns over time while maintaining prudent limits on risk.[44] Under this investment strategy, about half the assets have been invested in bond portfolios, currently managed by the World Bank and two private external managers. The remaining assets have been invested in short-term deposits with the Bank for International Settlements to serve as a liquidity tranche and to conform with the administrative arrangements agreed with certain contributors.

Currency risk is minimized by limiting purchases to securities denominated in the four currencies of the SDR basket (euros, Japanese yen, pound sterling, and U.S. dollars), with regular rebalancing of the portfolio weight of each currency to remain in line with the weights of the SDR basket.

[44] Prior to this shift in investment strategy, these assets had been invested in short-term SDR-denominated deposits with the Bank for International Settlements.

For the year ended April 30, 2005, the annual return on the portfolio was 2.1 percent, up from 1.7 percent a year earlier. In the five years that the investment strategy has been in place, the average annual portfolio return has been 3.5 percent.

Emergency Assistance

The IMF provides emergency assistance to post-conflict countries, as well as to countries struck by natural disasters, in the form of loans subject to the IMF's basic rate of charge. In May 2001, a decision was taken to provide Emergency Post-Conflict Assistance (EPCA) for PRGF-eligible countries at a subsidized rate of 0.5 percent a year, and an administered account was established at that time for contributions by bilateral donors. In January 2005, the IMF's Executive Board decided to extend the subsidization to Emergency Natural Disaster Assistance (ENDA) for PRGF-eligible countries—provided sufficient resources were available—and requested new bilateral contributions from member countries. The existing administered account was split into three subaccounts, allowing for bilateral contributions to be earmarked for either EPCA or ENDA, or to be used flexibly for either kind of emergency assistance.

As of the end of April 2005, 14 member countries have pledged bilateral contributions totaling SDR 35.1 million for the subsidization of emergency assistance (Table 5.4). Of this amount, SDR 23.9 million are new pledges received after the January 2005 decision. SDR 9.7 million of the overall total is available to subsidize EPCA only, SDR 12.5 million to subsidize ENDA only, and SDR 12.9 million to subsidize either.

During FY2005, six countries made purchases under emergency assistance. Three purchases were made under ENDA—SDR 2.9 million for Grenada in November 2004, SDR 4.1 million for Maldives in March 2005, and SDR 103.4 million for Sri Lanka in March 2005. Another three purchases were made under EPCA—SDR 5.6 million for the Central African Republic in July 2004, SDR 297.1 million for Iraq in October 2004, and SDR 10.2 million for Haiti in January 2005. Of these six countries, only Iraq is ineligible for subsidization of emergency assistance, since it is not a PRGF-eligible country.

Table 5.4. Contributions to Subsidize Emergency Assistance

(In millions of SDRs; as of April 30, 2005)

Contributor	Contribution Pledged	Contribution Received	Subsidy Disbursed
Sub-Account 1: EPCA subsidization only			
Belgium	0.6	0.6	0.3
Canada	1.7	1.7	—
Norway	3.0	3.0	—
Sweden	0.8	0.8	0.8
Switzerland	0.8	0.8	—
United Kingdom	2.9	2.9	1.1
Subtotal	**9.7**	**9.7**	**2.2**
Sub-Account 2: ENDA subsidization only			
Austria	0.7	—	—
Canada	2.6	0.5	—
India	1.5	—	—
Japan	1.6		
Luxembourg	1.1	—	—
Russia	1.0	—	—
Saudi Arabia	2.6		
Switzerland	1.3	—	—
Subtotal	**12.5**	**0.5**	**0.0**
Sub-Account 3: Subsidization of EPCA and ENDA			
France	1.3	—	—
Netherlands	2.8	1.5	—
Norway	1.1	1.1	—
Sweden	6.6	6.6	—
United Kingdom	1.2	1.2	0.1
Subtotal	**12.9**	**10.3**	**0.1**
Total	**35.1**	**20.6**	**2.3**

Source: IMF Finance Department.

Thus far, disbursements from the administered account have totaled SDR 2.2 million to subsidize the rate of charge on EPCA for nine countries (Albania, Burundi, the Central African Republic, the Republic of Congo, Guinea-Bissau, Haiti, Rwanda, Sierra Leone, and Tajikistan). Of these, only three countries—the Republic of Congo, the Central African

Republic, and Haiti—still have purchases outstanding under EPCA. A total of SDR 0.1 million has been disbursed so far to subsidize interest on ENDA for two countries (Grenada and Malawi). They became eligible for subsidization following the Executive Board's decision in January 2005. As of April 30, 2005, four countries—Grenada, Malawi, Maldives, and Sri Lanka—have outstanding purchases under ENDA.

INCOME, CHARGES, REMUNERATION, AND BURDEN SHARING

The IMF, like other financial institutions, earns income from interest charges and fees levied on its loans and uses the income to meet funding costs, pay for administrative expenses, and build up precautionary balances. The IMF's reliance on quota subscriptions and internally generated resources provides it with some flexibility in setting the basic rate of charge. However, the IMF also needs to ensure that it provides creditors with a competitive rate of interest on their IMF claims.

The basic rate of charge on regular lending is determined at the beginning of the financial year as a proportion of the SDR interest rate (see "SDR developments," below) to achieve an agreed net income target for the year. This rate is set to cover the cost of funds and administrative expenses as well as add to the IMF's reserves. The specific proportion is based on projections for income and expenses for the year and can be adjusted at midyear in light of actual net income and if income for the year as a whole is expected to deviate significantly from the projections. At the end of the financial year, any income in excess of the target is refunded to the members that paid charges during the year, and shortfalls are made up in the following year.

The IMF imposes level-based surcharges on credit extended after November 28, 2000, to discourage unduly large use of credit in the credit tranches and under Extended Arrangements. The IMF also imposes surcharges on shorter-term loans under the SRF. The surcharges vary according to the length of time credit is outstanding. Income derived from surcharges is placed in the IMF's reserves and is not taken into account in determining the net income target for the year.

The IMF also receives income from borrowers in the form of service charges, commitment fees, and special charges. A one-time service charge of 0.5 percent is levied on each loan disbursement from the GRA. A refundable commitment fee on Stand-By and Extended Arrangements, payable at the beginning of each 12-month period under the arrangement, is charged on the amounts that may be drawn during that period, including amounts available under the SRF. The fee is 0.25 percent on amounts committed up to 100 percent of quota and 0.10 percent for amounts exceeding 100 percent of quota. The commitment fee is refunded when credit is used in proportion to the drawings made. The IMF also levies special charges on overdue principal payments and on charges that are overdue by less than six months.

The IMF pays interest (remuneration) to creditors on their IMF claims (reserve positions) based on the SDR interest rate. The basic rate of remuneration is currently set at 100 percent of the SDR interest rate (the upper limit permitted under the Articles of Agreement), but it may be set as low as 80 percent of that rate (the lower limit).

Since 1986, the rates of charge and remuneration have been adjusted under a burden-sharing mechanism that distributes the cost of overdue financial obligations between creditor and debtor members. Loss of income from unpaid interest charges overdue for six months or more is recovered by increasing the rate of charge and reducing the rate of remuneration. The amounts thus collected are refunded when the overdue charges are settled. Additional adjustments to the basic rates of charge and remuneration are made to generate resources for a Special Contingent Account (SCA-1), which was established specifically to protect the IMF against the risk of loss resulting from arrears. In FY2005, the combined adjustment for unpaid interest charges and the allocation to the SCA-1 resulted in an increase to the basic rate of charge of 10 basis points and a reduction in the rate of remuneration of 11 basis points. The adjusted rates of charge and remuneration averaged 3.10 percent and 1.98 percent, respectively, for the financial year.

In April 2004, the basic rate of charge for FY2005 was initially set at 154.0 percent of the SDR interest rate, but it was later reduced at midyear to 136.0 percent of the SDR interest rate to achieve the agreed net income target of SDR 191 million (excluding income from surcharges). Net income amounted to SDR 244 million, which exceeded the target by SDR 53 million, owing mainly to the rise in the SDR interest rate, which was partly offset by lower-than-expected use of IMF credit and higher GRA administrative expenses (net of reimbursement) in SDR terms. In accordance with decisions taken at the beginning of FY2005, this excess has been refunded to borrowing members by retroactively reducing the rate of charge coefficient applied in the first half of FY2005 from 154.0 to 144.0 percent of the SDR interest rate. Income derived from SRF and level-based surcharges amounted to SDR 636 million in FY2005. Adjusted for expenses associated with administering the PRGF Trust (SDR 54 million)[45] and the cost of pension and other post-retirement provisions (SDR 160 million), total net income for the year amounted to SDR 613 million. This amount was added to the IMF's reserves, of which SDR 582 million (equivalent to the surcharge income *minus* the cost of administering the PRGF Trust) went to the General Reserve and the remainder to the Special Reserve.

In April 2005, the Executive Board decided to calculate the rate of charge by using a fixed margin above the SDR rate instead of a proportion of the SDR rate. This change in calculating the basic rate of charge was aimed at increasing the transparency and stability of the rate of charge. For FY2006, the fixed margin was set at 108 basis points above the SDR interest rate. The Executive Board also decided to continue its ongoing review of the IMF's financing mechanism, which began in the second half of FY2005.

Credit Risk Management in the IMF and the Level of Precautionary Balances

The IMF mitigates credit risk by rigorously implementing the policies governing the use of its resources and carefully managing its liquidity, while accumulating adequate precautionary balances.[46]

Credit Risk Management

The principal credit risks faced by the IMF stem from large arrangements with middle-income countries. As of the end of April 2005, three countries (Argentina, Brazil, and Turkey) accounted for some 73 percent of all General Reserve Account credit outstanding,

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[45]As agreed in April 2004, the GRA is not reimbursed for the expenses of administering the PRGF Trust; instead, these resources remain in the PRGF Trust to meet concessional financing needs.

[46]For more details, see the IMF's website at *www.imf.org/external/np/sec/pn/2004/pn0416.htm*.

and these three plus Indonesia and Uruguay accounted for 89 percent. The IMF's Articles of Agreement charge the IMF with assisting cooperating members—including those in very difficult circumstances. As a result, the size of the IMF's loan portfolio can change dramatically in a short time, as can assessments of its riskiness. Sound risk management requires the IMF to be prepared for the possibility of payments disruptions, which could arise from the increase in, and concentration of, its outstanding credit. However, in view of the cooperative nature of the IMF and the IMF's role in promoting global macroeconomic stability as a public good, diversification of lending is not, and cannot be, one of its objectives.

Although the specific features of the IMF's institutional framework and financing role suggest that high credit concentration is inevitable in an uncertain world, such concentration does not embody the same degree of risk for the IMF as for other financial institutions. An important means of mitigating financial risk is the IMF's preferred creditor status—that is, members giving priority to repayment of their obligations to the IMF over those to other creditors—which is fundamental to the IMF's role in the international financial system and to the IMF's financing mechanism. The IMF's preferred creditor status has allowed it to take the risks necessary to provide financial assistance to members in exceptionally difficult balance of payments situations in support of their efforts to implement strong adjustment policies without resorting to measures destructive of national and international prosperity. The IMF's policies on access to, and the use of, its resources are, along with effective crisis prevention and conditionality in support of strong country-owned programs, the most important elements of the IMF's risk-management framework. An IMF member's commitment to adopt sound economic policies, the IMF's conditionality, and the safeguards in place (including an assessment of the member's ability to repay the IMF) reduce the risks to the IMF of lending and of credit concentration.

The profound changes in the IMF's lending policies in recent years in response to the changing global macroeconomic environment and the growing financial interdependence of members led to the adoption of the framework for exceptional access in 2003 that was reaffirmed by the Executive Board in April 2005 (see Chapter 3). Firm application of the criteria governing exceptional access to IMF resources and rigorous assessments of the risks to the IMF arising from high access and of the member's capacity to repay are crucial for effective risk management. In addition, it is the responsibility of IMF members benefiting from financial assistance to pay the IMF back as soon as their temporary balance of payments problems are resolved. Policies to promote this goal include surcharges, the shorter maturities on use of Fund resources under the SRF, the presumption that exceptional access will be provided on SRF terms, and the policy on repurchase expectations.

Precautionary Balances

To safeguard its financial position, the IMF has a policy of accumulating precautionary financial balances in the GRA. These precautionary balances consist of reserves and a Special Contingent Account (SCA-1, see previous subsection). Reserves provide the IMF with protection against financial risks, including income losses and capital losses. The SCA-1 was established as an additional layer of protection against the adverse financial consequences of protracted arrears.

Existing precautionary balances have been financed through the retention of income and the burden-sharing mechanism (see previous subsection). The net income and the income from surcharges on the Special and General Reserves are added to reserves. Under the Articles of Agreement, the resources in the General Reserve may be distributed by the IMF to members on the basis of their quota shares. The IMF may use the Special Reserve for any purpose for which it may use the General Reserve except distribution. Total reserves increased to SDR 5.7 billion as of April 30, 2005, from SDR 5.1 billion a year earlier. The balance in the SCA-1 amounted to SDR 1.6 billion, compared with overdue principal of SDR 0.7 billion. SCA-1 resources are to be refunded after all arrears have been cleared but can be refunded earlier by a decision of the Executive Board.

The Executive Board has set an eventual target level of precautionary financial balances of SDR 10 billion. The adequacy of precautionary balances and the pace of accumulation, as well as the application of the burden-sharing mechanism, is kept under close review.

QUOTA DEVELOPMENTS

There were only a few noteworthy quota developments in FY2005, reflecting the fact that the Thirteenth General Review of Quotas (Box 5.6) is still at an early stage.[47]

As of April 30, 2005, 180 member countries accounting for more than 99 percent of quotas proposed in 1998 under the Eleventh General Review of Quotas had consented to, and paid for, their proposed quota increases. All member countries eligible to consent had done so by the end of the financial year, and three member countries were ineligible to consent to their proposed increases because they were in arrears to the IMF. On September 20, 2004, the Board of Governors adopted a resolution that established a new period for consent to the Eleventh Review quota increases that would cover 12 months from the date of the resolution. At the close of the financial year, total quotas amounted to SDR 213.5 billion.

Box 5.6 Twelfth and Thirteenth General Reviews of Quotas

The IMF normally conducts general reviews of members' quotas every five years to assess the adequacy of its resource base and to adjust the quotas of individual members to reflect changes in their relative positions in the world economy. The Executive Board completed the Twelfth General Review of Quotas on January 30, 2003, without proposing an increase (or adjustments), which leaves the maximum size of quotas unchanged at SDR 213.7 billion.

During the period of the Thirteenth General Review, which began with the completion of the Twelfth Review, the IMF's Executive Board will monitor closely and assess the adequacy of IMF resources, consider measures to achieve a distribution of quotas that reflects developments in the world economy, and explore measures to strengthen the governance of the IMF. In April 2005, the International Monetary and Financial Committee (IMFC) emphasized that the period of the Thirteenth General Review of Quotas provides an opportunity for the membership to make progress toward a consensus on issues of quotas, voice, and participation.

SDR DEVELOPMENTS

The SDR is a reserve asset created by the IMF in 1969 to supplement other reserve assets. SDRs are allocated to members in proportion to their IMF quotas. A member may use SDRs

[47]For more details, see the IMF's website at *www.imf.org/external/np/sec/pn/2003/pn03106.htm.*

to obtain foreign exchange reserves from other members and to make payments to the IMF. Such use does not constitute a loan; members are allocated SDRs unconditionally and may use them to meet balance of payments financing needs without undertaking economic policy measures or repayment obligations. A member that makes net use of its allocated SDRs pays the SDR interest rate, while a member that acquires SDRs in excess of its allocation receives interest at the SDR rate. A total of SDR 21.4 billion has been allocated to members—SDR 9.3 billion in 1970–72 and SDR 12.1 billion in 1978–81. The value of the SDR is based on the weighted average of the values of a basket of major international currencies, and the SDR interest rate is a weighted average of interest rates on short-term instruments in the markets for the currencies in the valuation basket (Box 5.7). The SDR interest rate provides the basis for calculating the interest charges on regular IMF financing and the interest rate paid to members that are creditors to the IMF. In addition, the SDR serves as the unit of account for the IMF and for a number of other international organizations.

Box 5.7 SDR Valuation and Interest Rate

Valuation

The value of the SDR is based on the weighted average of the values of a basket of major international currencies. The method of valuation is reviewed at five-year intervals. Following completion of the latest review, in FY2001, the Executive Board decided on a number of changes to take account of the introduction of the euro as the common currency for a number of European countries and the growing role of international financial markets. Currencies included in the valuation basket are among the most widely used in international transactions and are widely traded in the principal foreign exchange markets. Currencies selected for inclusion in the SDR basket for 2001–05 are the U.S. dollar, the euro, the Japanese yen, and the pound sterling (see table). A review of the SDR valuation is scheduled to be completed in 2005 and the new basket to be in effect on January 1, 2006.

Interest rate

Since the method for determining the SDR interest rate was reviewed in FY2001, the weekly interest rate has been determined on the basis of a weighted average of interest rates (expressed as equivalent annual bond yields) on short-term instruments in the markets for the currencies included in the SDR valuation basket, namely the three-month Euribor (Euro Interbank Offered Rate), Japanese government 13-week financing bills, three-month U.K. treasury bills, and three-month U.S. treasury bills. During FY2005, the SDR interest rate evolved in line with developments in the major money markets, rising gradually from 1.62 percent at the beginning of May 2004 to peak at 2.49 percent in the last week of April 2005. Over the course of FY2005, the SDR interest rate averaged 2.1 percent (see figure).

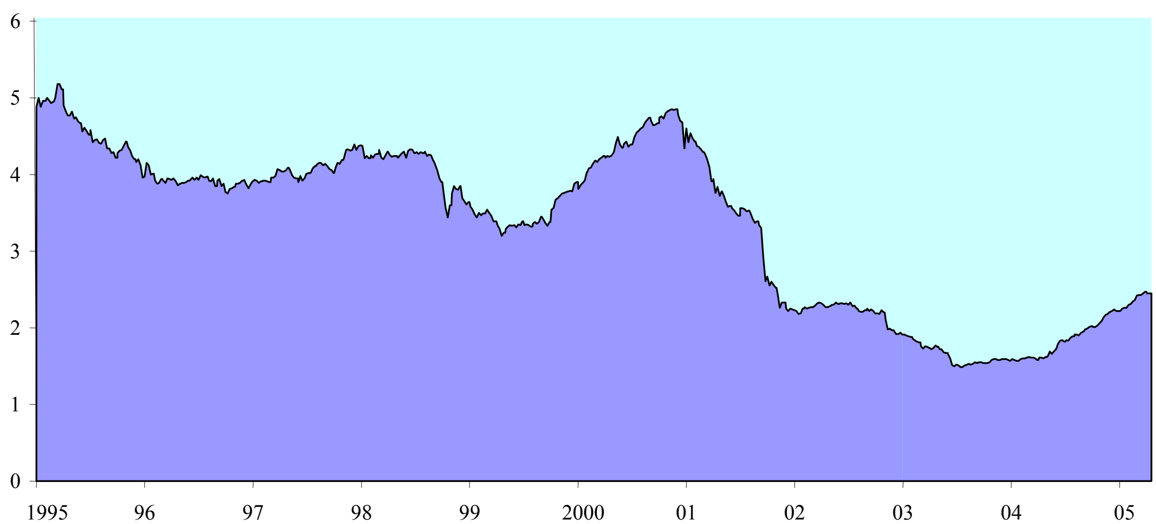
SDR Valuation, as of April 30, 2005

Currency	Amount of Currency	Exchange Rate[1]	U.S. Dollar Equivalent[2]
Euro	0.4260	1.29560	0.551926
Japanese yen	21.0000	105.15000	0.199715
Pound sterling	0.0984	1.91200	0.188141
U.S. dollar	0.5770	1.00000	0.577000
			1.516782
Memorandum:			
SDR 1 = US$1.51678			
US$1 = SDR 0.659291			

[1]Exchange rates in terms of U.S. dollars per currency unit, except for the Japanese yen, which is in currency units per U.S. dollar.
[2] Rounded to six digits.

SDR Interest Rate, 1995–April 2005

(In percent)



There are two types of SDR allocations:

- *General allocations of SDRs.* Decisions on general allocations are made in the context of five-year basic periods and require a finding that an allocation would meet a long-term global need to supplement existing reserve assets. A decision to allocate SDRs requires an 85 percent majority of the total voting power.
- *Special one-time allocation.* In September 1997, the IMF Board of Governors proposed an amendment to the Articles of Agreement to allow a special one-time allocation of SDRs to correct for the fact that more than one-fifth of the IMF membership, having joined the IMF after the last general allocation, have never received an SDR allocation. The special allocation of SDRs would enable all members of the IMF to participate in the SDR system on an equitable basis and would double cumulative SDR allocations to SDR 42.9 billion. The proposal will become effective when three-fifths of the IMF membership (111 members) having 85 percent of the total voting power have accepted the proposal. As of April 30, 2005, 131 members having 77.33 percent of the total voting power had agreed and only acceptance by the United States was required to implement the proposal.

SDR OPERATIONS AND TRANSACTIONS

All SDR transactions are conducted through the SDR Department (which is a financial entity, not an organizational unit). SDRs are held largely by member countries and by official entities prescribed by the IMF. The balance of allocated SDRs is held in the IMF's GRA. Prescribed holders do not receive SDR allocations but can acquire and use SDRs in operations and transactions with IMF members and with other prescribed holders under the same terms and conditions as IMF members. Transactions in SDRs are facilitated by 14 voluntary arrangements under which the parties stand ready to buy or sell SDRs for currencies that are readily usable in international transactions, provided that their own SDR holdings remain within certain limits.[48] These arrangements have helped ensure the liquidity of the SDR system.[49]

Total transfers of SDRs decreased in FY2005 to SDR 10.6 billion, from SDR 13.8 billion in FY2004. The largest transfers of SDRs (49.1 billion) took place in FY1999, when the volume of SDR transactions increased significantly because of members' payments for quota increases.

By end-April 2005, the IMF's own holdings of SDRs, which had risen sharply as a result of payments for quota subscriptions in 1999 and subsequently fallen to a low of SDR 0.5 billion in FY2004, had risen to SDR 0.6 billion. SDRs held by prescribed holders amounted to SDR 0.3 billion. SDR holdings by participants remained unchanged from FY2004 at SDR 20.6 billion. SDR holdings of the industrial and net creditor countries relative to their net cumulative allocations decreased from a year earlier. SDR holdings of nonindustrial members amounted to 96.3 percent of their net cumulative allocations, compared with 76 percent a year earlier.

SAFEGUARDS ASSESSMENTS

Since FY2000, the IMF has conducted safeguards assessments of member countries' central banks in connection with IMF lending operations. These safeguards assessments—which are aimed at providing reasonable assurance to the IMF that a central bank's framework of reporting, audit, and controls is adequate for management of its resources, including IMF disbursements (Box 5.8)—continued to identify vulnerabilities in central banks' safeguards frameworks, including in external audits and financial reporting. In FY2005, 17 safeguards

[48] These include 12 IMF members and 1 prescribed holder that have established two-way arrangements with the IMF and 1 member that has established a one-way (selling only) arrangement with the IMF.

[49] Under the designation mechanism, participants whose balance of payments and reserve positions are deemed sufficiently strong may be obliged, when designated by the IMF, to provide freely usable currencies in exchange for SDRs up to specified amounts. The designation mechanism has not been used since 1987, following the setup of voluntary arrangements starting in 1986.

assessments of member countries' central banks were completed, bringing the total number of finished assessments as of April 30, 2005, to 112.[50]

The findings of safeguards assessments to date have indicated that significant but avoidable risks to IMF resources may have existed in certain cases, although over time identified vulnerabilities have declined in importance and frequency. Experience has shown that the central banks are progressively implementing the measures recommended to mitigate identified vulnerabilities. In FY2005, central banks continued to implement assessment recommendations at a high rate (over 92 percent for the most important measures). The main areas of improvement in central bank operations and controls resulting from the implementation of safeguards measures have included (1) establishing independent external audit policies in accordance with international standards; (2) reconciling the economic data reported to the IMF for program-monitoring purposes with the underlying accounting records of the central bank; (3) improving the transparency and consistency of financial reporting, including publication of the audited financial statements; (4) improving controls over reserves management; and (5) implementing independent, high-quality internal audit functions. Central banks have generally embraced the findings of safeguards assessments, and this policy has enhanced the IMF's reputation and credibility as a prudent lender while helping to improve the operations and accounting procedures of central banks.

In April 2005 the Executive Board completed a second review of the experience of the safeguards assessments policy and confirmed continued broad support for the policy.[51] In concluding its review, the Board (1) recognized that the existing framework for assessing operations of central banks was broadly appropriate; (2) agreed that safeguards assessments had a positive impact on central banks' operations, including their governance and controls frameworks; (3) endorsed, as appropriate, a case-by-case approach for the application of

[50]This total includes 27 abbreviated assessments that were conducted for arrangements in effect prior to June 30, 2000, and that examined only one key element of the safeguards framework, namely, that central banks publish annual financial statements that are independently audited by external auditors in accordance with internationally accepted standards.

[51]The report, together with a report by an independent panel and previous update reports, is available on the IMF website at *www.imf.org/external/fin.htm.*

safeguards assessments to the use of IMF resources provided through EPCA and the modalities for the conduct of three types of assessments in the future; and (4) consented to modify the frequency of the safeguards update papers from semiannual to annual. The next review of the safeguards policy will take place in three years.

As part of the second review, the Executive Board considered the findings in a report issued by an independent panel. This panel, consisting of four deputy central bank governors from different regions, prepared a report on the policy, after surveying 27 central banks. The panel's report concluded that the safeguards policy has been successful but suggested a few improvements to the process.

As in previous years, in FY2005 IMF staff continued to explain the safeguards methodology and the relevance of the framework to central banks by conducting seminars on safeguards assessments. Such seminars were held at the Singapore Training Institute in May 2004 and at the IMF Institute (Washington, D.C.) in December 2004. As of April 30, 2005, more than 170 officials from 92 countries had attended these seminars.

Box 5.8 Safeguards Assessment Policy

The safeguards policy, which was initiated in FY2000 following several instances of misreporting to the IMF and allegations of misuse of IMF resources, aims at supplementing conditionality, technical assistance, and other means that have traditionally ensured the proper use of IMF loans.

Objective of safeguards assessments

- To provide *reasonable* assurance to the IMF that a central bank's control, accounting, reporting, and auditing systems and legal framework in place to manage resources, including IMF disbursements, are adequate to ensure the integrity of financial operations and reporting to the IMF.

Applicability of safeguards assessments

- Central banks with new arrangements for use of IMF resources approved after June 30, 2000; existing arrangements that are augmented; member countries following a Rights Accumulation Program (RAP) under which resources are being committed; member countries receiving EPCA (determined on a case-by-case basis);
- Voluntary for members with staff-monitored programs; and

- Not applicable to first-credit-tranche purchases and stand-alone Compensatory Financing Facility Arrangements.

Scope of policy

Assessments examine five important safeguards areas in central banks. These areas, referred to by the acronym ELRIC, are

- **E**xternal Audit Mechanism;
- **L**egal Structure and Independence;
- Financial **R**eporting Framework;
- **I**nternal Audit Mechanism; and
- Internal **C**ontrols System.

Methodology

- Safeguards assessments follow an established set of procedures to ensure consistency in application. All central banks subject to an assessment provide a standard set of documents to IMF staff, who review the information and communicate as needed with central bank officials and the external auditors. The review may be supplemented by an on-site visit to the central bank to obtain or clarify information necessary to draw conclusions and make recommendations.
- The outcome of a safeguards assessment is a confidential report that identifies vulnerabilities, assigns risk ratings, and makes recommendations to mitigate the identified risks. Country authorities have the opportunity to comment on all safeguards assessment reports. The conclusions and agreed-upon remedial measures are reported in summary form to the IMF Executive Board at the time of arrangement approval or, at the latest, by the first review under the arrangement, but the safeguards report itself is not made available to the Board or the general public.
- The implementation of safeguards recommendations is monitored periodically by IMF staff.

Publication references

- The staff's papers and other background information concerning the safeguards policy are available on the IMF website at *www.imf.org/external/fin.htm.*

ARREARS TO THE IMF

The strengthened cooperative strategy on overdue financial obligations to the IMF consists of three essential elements: prevention, intensified collaboration, and remedial measures.[52]

Total overdue financial obligations to the IMF were SDR 2.0 billion at the end of April 2005, a slight decline from SDR 2.1 billion at the beginning of the financial year (Table 5.5). The main reason for the decline was Iraq's settlement of its protracted arrears to the IMF of SDR 55.3 million on September 22, 2004. Sudan's arrears to the IMF also declined as a result of its regular monthly payments in excess of obligations falling due. At the end of April 2005, most arrears to the IMF were protracted (outstanding for more than six months), 44.9 percent of which represented overdue principal, with the remainder consisting of overdue charges and interest. More than four-fifths of arrears were to the GRA and the remainder to the SDR Department and the PRGF Trust.

Table 5.5. Arrears to the IMF of Countries with Obligations Overdue by Six Months or More and by Type

(In millions of SDRs; as of April 30, 2005)

		By Type			
	Total	General Department (incl. SAF)	SDR Department	Trust Fund	PRGF
Liberia	510.7	455.2	25.1	30.4	—
Somalia	223.1	204.4	10.8	8.0	—
Sudan	1,058.1	978.8	0.1	79.2	—
Zimbabwe	203.7	122.8	—	—	80.9
Total	**1,995.6**	**1,761.2**	**36.0**	**117.5**	**80.9**

[52] See *Annual Report*, 2001, pages 72 and 73, for background on the IMF's strengthened cooperative strategy for dealing with arrears.

The two countries with the largest protracted arrears to the IMF—Sudan and Liberia—account for 78.6 percent of the overdue financial obligations to the IMF; Somalia and Zimbabwe account for the remainder. Under the IMF's strengthened cooperative strategy on arrears, remedial measures have been applied against the countries with protracted arrears.[53] No changes were made in the IMF's strengthened cooperative strategy on arrears during FY2005.

The IMF's Executive Board reviewed the overall arrears strategy in August 2004 and extended the rights approach for one more year.[54] The Board also conducted several reviews of individual member countries' overdue financial obligations to the IMF during FY2005:

- The Board twice reviewed Liberia's overdue financial obligations to the IMF—on October 20, 2004, and April 20, 2005. During the October review, the Board urged the authorities to implement a time-bound action plan to address slippages in fiscal and monetary management. During the April review, the Board noted that Liberia's record on cooperation with the IMF in terms of policies and payments had been mixed since the last review, but agreed that this uneven policy performance reflected, to a large extent, the difficult post-conflict recovery and political circumstances. The Board decided that no further remedial measures would be taken at that time. However, the Board urged the authorities to adopt and implement at an early date a comprehensive economic program that could be monitored by IMF staff and to increase their monthly payments to the IMF in light of fiscal and balance of payments developments.

- On December 15, 2004, the Board reviewed Sudan's overdue financial obligations to the IMF. The Board welcomed the favorable economic policy performance by the Sudanese authorities under the 2004 staff-monitored program, as well as the

[53]For Somalia, the application of remedial measures has been delayed because of the absence of a functioning central government.

[54]Established in 1990, the rights approach permits a member to establish a track record on policies and payments to the IMF under a rights accumulation program and to earn "rights" to obtain IMF resources under successor arrangements following the completion of the program and settlement of the arrears to the IMF.

authorities' commitment to increase payments to the IMF to $30 million for 2004. They urged Sudan to further increase its payments to the IMF in light of balance of payments developments, taking into account the fiscal and foreign exchange requirements of the peace process.

- The Board twice discussed the complaint by the Managing Director regarding Zimbabwe's compulsory withdrawal from the IMF.[55] On July 7, 2004, the Board urged the authorities to adopt and implement a comprehensive adjustment program—including measures on the exchange rate, monetary and fiscal tightening, and structural reforms—as a matter of urgency. The Board noted the resumption of Zimbabwe's quarterly payments of $1.5 million to the IMF. To provide the authorities with a further opportunity to improve cooperation with the IMF, the Board decided to again consider the complaint before January 6, 2005, which was subsequently extended to February 17, 2005. At its meeting on February 16, 2005, the Board noted Zimbabwe's payments of $13.5 million to the IMF since the last review, which, however, fell short of stabilizing Zimbabwe's arrears to the IMF. The Board urged Zimbabwe to make every effort to increase payments and to resolve its overdue financial obligations to the IMF. The Board noted Zimbabwe's initial steps to arrest the economic decline but considered them to be insufficient. The Board again urged the authorities to adopt and implement a comprehensive adjustment program as a matter of urgency. The Board decided to further consider the Managing Director's complaint within six months or at the time it considered the 2005 Article IV consultation with Zimbabwe, whichever is earlier.

As of the end of April 2005, Liberia, Somalia, Sudan, and Zimbabwe were ineligible under Article XXVI, Section 2*(a)* to use the general resources of the IMF. In addition, Zimbabwe had earlier been removed from the list of PRGF-eligible countries. Declarations of noncooperation—a further step under the strengthened cooperative arrears strategy—were in effect for Liberia and Zimbabwe, and their voting and related rights in the IMF were

[55]The procedure on Zimbabwe's compulsory withdrawal from the IMF (under Article XXVI, Section 2(*c*) of the Articles of Agreement) was initiated on February 6, 2004.

suspended. In addition, a complaint with respect to the compulsory withdrawal of Zimbabwe from the IMF remained outstanding.

External Audit Mechanism

The IMF's external audit arrangements consist of an External Audit Committee and an external audit firm. The External Audit Committee has general oversight of the external audit function and internal control processes. It consists of three members selected by the Executive Board and appointed by the Managing Director. The members serve for three years, on a staggered basis, and are independent. Committee members are nationals of different member countries of the IMF at the time of their appointment and must possess the qualifications required to carry out the oversight of the annual audit. The External Audit Committee generally meets twice a year in Washington and is available for consultation throughout the year.

The 2005 External Audit Committee members are Mr. Philippe Adhémar (Chair), Conseiller Maître à la Cour des Comptes, France; Mr. Pentti Hakkarainen, Board Member, Bank of Finland; and Dr. Len Konar, independent consultant, South Africa.

The responsibility for performing the external audit and issuing the opinion rests with the external audit firm. The external audit firm is selected by the Executive Board in consultation with the External Audit Committee and is appointed by the Managing Director. At the conclusion of the annual audit, the External Audit Committee transmits the report issued by the external audit firm, through the Managing Director and the Executive Board, to the Board of Governors. In the process, the External Audit Committee briefs the Executive Board on the results of the audit. The external audit firm is normally appointed for five years. Deloitte and Touche (Washington) is the IMF's present external auditor.

The IMF's financial statements for FY2005 form Appendix VII of this *Annual Report*.

6. Technical Assistance and Training

Besides offering policy advice to member countries in connection with its surveillance of their economies and its lending programs, the IMF provides technical assistance, and training for officials, mostly free of charge to developing countries upon request.

The IMF spends about $80 million annually on technical assistance and training designed to help member countries build knowledge, skills, and stronger institutions in the areas in which the Fund has expertise, such as fiscal, monetary, and foreign exchange policies; central banking; financial regulation and supervision; budgetary management; and economic statistics. Nearly 70 percent of IMF spending on technical assistance goes to countries with annual GDP below $1,000 per capita.

The Fund also cooperates closely with a number of other providers of technical assistance to leverage its own efforts. For example, the FIRST Initiative (Financial Sector Reform and Strengthening), a $53 million multidonor program, has undertaken 23 projects in close partnership with the Fund, to which it has committed over $2.6 million. Most of these projects are aimed at following up on recommendations made under the joint IMF–World Bank Financial Sector Assessment Program (FSAP). In total, the FIRST Initiative has undertaken 46 FSAP-related projects at a cost of nearly $8 million.

IMF technical assistance is offered by different departments in the Fund—the Fiscal Affairs Department and the Monetary and Financial Systems Department are the biggest providers—and is coordinated and monitored by the Office of Technical Assistance Management (OTM) in the Office of the Managing Director. Training is provided by the IMF Institute, in collaboration with other departments, at headquarters, in the field, and through regional training institutes.

Technical assistance is delivered in a variety of ways. IMF staff may be sent to member countries to advise government and central bank officials on specific issues, or the Fund may provide specialists on a short- or a long-term basis. Since 1993, the Fund has provided a small but increasing part of its technical assistance through regional centers.

The regional technical assistance centers are guided by steering committees with representatives from participating countries and supporting donor agencies, as well as observers from regional institutions involved in capacity building. Each country appoints a representative and an alternate to the committee. Center coordinators, who are IMF staff members, have responsibility for the day-to-day management of the centers. With the opening of a new center in the Middle East (METAC) in October 2004, five centers have now been established with the Fund's assistance: two in Africa (West AFRITAC, based in Bamako, Mali, and serving western Africa, and East AFRITAC, based in Dar es Salaam, Tanzania, and serving eastern Africa), and one each in the Caribbean (CARTAC) and the Pacific (PFTAC) regions, based in Barbados and Fiji, respectively. Based in Beirut, Lebanon, METAC serves Afghanistan, Egypt, Iraq, Jordan, Lebanon, Libya, Sudan, Syria, the West Bank and Gaza, and Yemen. It focuses on helping post-conflict countries in the region restore macroeconomic stability and develop basic institutions for policymaking. In October 2004, the IMF decided to extend CARTAC's mandate (which was due to expire in early 2005) through 2007. CARTAC, which was established in 2001, provides technical assistance and training to 20 Caribbean island countries and territories. It is supported by the IMF and eight bilateral and multilateral donors.

During FY2005, the Fund expanded its efforts in priority areas, sought to leverage its resources by cooperating with other providers of technical assistance and by mobilizing external funding, and continued to review the effectiveness of its technical assistance.

TECHNICAL ASSISTANCE DELIVERY IN FY2005

Technical assistance efforts were expanded and strengthened in FY2005 in a number of priority areas, including trade facilitation, reflecting how critical trade liberalization is to low-income countries' efforts to stimulate growth (Box 6.1).

The IMF-World Bank Financial Sector Assessment Program, which is important in informing IMF surveillance, also supports members' efforts to build better institutions in the financial sector (see Chapter 2), in part by providing a timeline and prioritization for technical assistance after an assessment is made. The Fund held a seminar in June 2004 to familiarize country officials with FSAP methodologies and tools.

Following the Executive Board's discussion in July 2004 of the Biennial Review of Surveillance, at which Executive Directors emphasized the need to focus more closely on exchange rate issues, at a seminar in December 2004, the Board discussed a staff paper providing guidance to countries wishing to move from a fixed to a floating exchange rate, drawing on the experience of countries that have successfully made such a transition (see Chapter 2). Follow-up work has begun on developing practical advice in areas highlighted by the Board such as the speed and sequencing of a move toward floating, measures to avoid disorderly exits from a fixed exchange rate regime, factors that make orderly exits durable, and development of an adequate risk-management system.

Fund staff have held several regional meetings to disseminate key findings of the staff paper "Monetary Policy Implementation at Different Stages of Market Development," which was discussed by the Board in November 2004 (see Chapter 2), and seek feedback from member countries. In March 2005, a regional outreach meeting for the Pacific Islands was held at the Reserve Bank of Fiji, in cooperation with the Pacific Financial Technical Assistance Center (PFTAC). A similar event was held in cooperation with the Caribbean Center for Monetary Studies in May 2005. Several other activities are planned for next year, in cooperation with the technical assistance centers in Africa and the Middle East. The events held so far confirmed the key conclusions of the study, while allowing Fund staff to appreciate the specific constraints to monetary policy implementation in countries with shallow markets. They provided useful material for the development of a menu of options for monetary policy implementation in countries at different stages of market development.

The first phase of the assessment of offshore financial sectors, which began in 2000, was virtually complete by the end of FY2005, and Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) assessments were being complemented with expanded delivery of technical assistance for the areas covered under the revised standard—the 40 + 8 Recommendations of the Financial Action Task Force (FATF) endorsed by the IMF's Board in March 2004. Since 2001, the Fund has conducted numerous awareness-raising seminars, as well as training workshops, around the world to sensitize member country authorities to the international standards on AML/CFT and issues directly affecting their countries. The

Fund's work on AML/CFT is undertaken in close collaboration with the FATF, the FATF-style regional bodies, and the United Nations.

In the area of data quality and governance practices, in December 2004, the IMF posted a *Draft Guide on Resource Revenue Transparency* on its website, seeking comments from the general public. The *Guide* is intended to help countries address the governance and transparency issues that arise in managing resource revenues from extractive industries such as oil, gas, and mining (see Chapter 2).

In February 2005, the Executive Board held a seminar on IMF technical assistance to post-conflict countries in the monetary and fiscal areas. Directors noted that the Fund had an important role to play, in collaboration with country authorities and other donors, in rebuilding key institutions to help restore macroeconomic stability and lay the basis for sustainable growth in such countries. (See Chapter 3 for a description of Fund emergency lending in post-conflict countries.)

One way the IMF measures its technical assistance is by tracking the time spent helping countries. In FY2005 the IMF provided the equivalent of almost 381 person-years of technical assistance. This was 4 percent higher than in FY2004 and over 80 person-years higher than a decade ago (300.5 person-years in FY1995).

Reflecting new needs within program areas, technical assistance in FY2005 increased for policy reform and capacity building, including efforts by countries aiming to meet international standards and codes and to achieve financial sector improvements. Technical assistance for the Heavily Indebted Poor Countries (HIPC) Initiative declined, reflecting the maturing of the program (see Table 6.1).

Table 6.1 Technical Assistance Program Areas, FY2003–05

(Field delivery in person-years)[1]

	FY2003	FY2004	FY2005
Main Program Areas			
Crisis prevention	34.9	34.8	27.7
Poverty reduction	60.8	57.0	58.5
Crisis resolution and management	26.3	25.2	23.6
Postconflict/isolation	30.4	27.2	28.1
Regional	41.2	57.0	63.8
Total	**193.6**	**201.1**	**201.6**
Key Policy Initiatives and Concerns			
Assistance on standards and codes, excluding FSAP	18.1	21.7	14.8
FSAP-related	6.0	9.9	15.4
HIPC-associated	16.8	11.5	5.7
Offshore financial centers and AML/CFT	10.4	8.6	11.3
Policy reform/capacity building	142.3	147.4	154.4
Other	**-**	**1.9**	**-**
Total	**193.6**	**201.1**	**201.6**

Source: IMF Office of Technical Assistance Management.
Note: FSAP = Financial Sector Assessment Program; HIPC = Heavily Indebted Poor Countries Initiative; AML/CFT = Anti-Money-Laundering and Combating the Financing of Terrorism.
[1]Excludes headquarters-based activities related to technical assistance. An effective person-year of technical assistance is 260 days.

Of all the regions, sub-Saharan Africa continued to receive the largest, and an increasing, share of IMF technical assistance. Technical assistance also increased, and has remained high, in the Asia-Pacific region, in part because of the assistance provided to post-conflict countries such as Cambodia and Timor-Leste, and support for reforms in China, Indonesia, and Mongolia. Technical assistance to other geographical regions, as well as for interregional projects, remained broadly the same as over the past three years (see Table 6.2 and Figure 6.1).

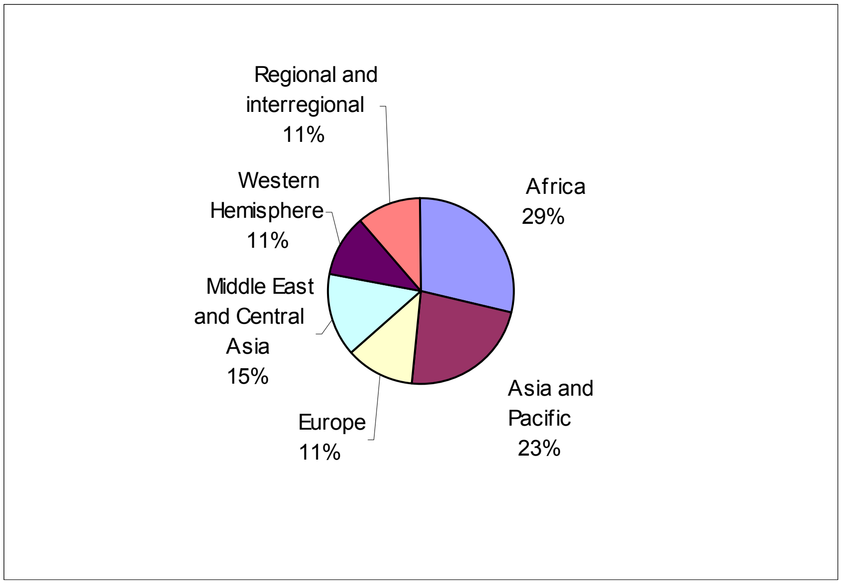
Table 6.2 Technical Assistance Resources and Delivery, FY2001–05
(In effective person-years)[1]

	FY2001	FY2002	FY2003	FY2004	FY2005
IMF technical assistance budget	**265.5**	**268.8**	**262.2**	**262.1**	**283.4**
Staff	171.8	172.2	174.1	186.1	195.6
Headquarters-based consultants	22.7	23.2	20.1	20.6	27.4
Field experts	71.0	73.4	68.0	55.4	60.4
External technical assistance resources	**77.7**	**77.8**	**93.5**	**105.3**	**97.1**
United Nations Development Program	8.4	9.6	9.6	8.1	5.8
Japan	59.5	56.2	61.9	61.6	52.5
Other cofinanciers	9.8	12.0	22.0	35.6	38.9
Total technical assistance resources	***343.3***	***346.6***	***355.7***	***367.4***	***380.6***
Technical assistance regional delivery[2]	**275.8**	**280.0**	**286.5**	**291.1**	**301.4**
Africa	68.2	71.9	72.1	83.8	86.9
Asia and Pacific	57.0	63.1	67.5	69.0	68.2
Europe I	30.2	30.3	27.7	—	. . .
Europe II	40.8	32.6	25.1	—	. . .
Europe	—	—	—	35.5	34.5
Middle East	27.8	22.4	26.5	—	
Middle East and Central Asia	—	—	—	40.1	45.1
Western Hemisphere	23.7	28.0	32.6	26.6	32.7
Regional and interregional	28.0	31.7	35.1	36.0	33.9
Technical assistance nonregional delivery[3]	**67.5**	**66.6**	**69.2**	**76.4**	**79.2**
Total technical assistance delivery	***343.3***	***346.6***	***355.7***	***367.4***	***380.6***
Technical assistance delivery by Fund department					
Fiscal Affairs Department	111.9	97.5	94.3	95.6	99.5
Monetary and Financial Systems Department	101.2	115.5	120.0	122.0	127.0
Statistics Department	48.2	49.2	55.7	59.0	53.1
IMF Institute	54.4	56.0	55.4	53.6	57.0
Legal Department	15.4	15.5	19.6	23.9	23.5
Other[4]	12.2	12.9	10.7	13.3	20.4

Source: IMF Office of Technical Assistance Management.

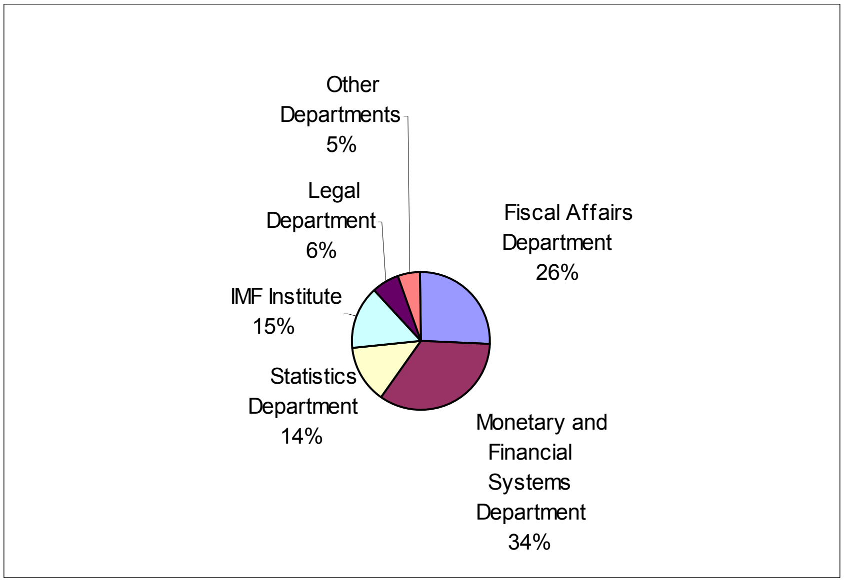
[1]An effective person-year of technical assistance is 260 days. New definition used since 2001; data adjusted retroactively.
[2]In FY2004 the former European II Department was dissolved, and its countries were absorbed by the new European Department and Middle East and Central Asia Department.
[3]Indirect technical assistance, including technical assistance policy, management, evaluation, and other related activities.
[4]Includes the Fund's Policy Development and Review Department, the Technology and General Services Department, and the Office of Technical Assistance Management.

Figure 6.1. Technical Assistance by Region, FY2005



The Monetary and Financial Systems Department remained the largest technical assistance provider among Fund departments, delivering some 127 person-years of assistance, reflecting the Fund's financial sector initiatives. The Fiscal Affairs Department, the IMF's second-largest technical assistance provider, increased its delivery level to 99.5 person-years. While the Statistics Department's technical assistance delivery was a little lower than in the previous year, the Legal Department maintained its level of technical assistance with its continuing involvement in activities to combat money laundering and the financing of terrorism (see Table 6.2 and Figure 6.2). During FY2005, the International Capital Markets Department began to provide technical assistance in the areas of investor relations programs, certain aspects of liability management, and development of local capital markets.

Figure 6.2. Technical Assistance by Department, FY2005



IMF INSTITUTE

The IMF Institute trains officials from member countries through courses and seminars focused on four core areas—macroeconomic management, and financial, fiscal, and external sector policies. Courses and seminars are delivered by Institute staff and by staff from other IMF departments, occasionally assisted by outside academics and experts, at IMF headquarters in Washington, D.C., and at various overseas locations. Some preference in acceptance is given to officials from developing and transition countries.

In FY2005, the IMF Institute, with the assistance of other IMF departments, delivered 124 courses for officials, attended by almost 3,900 participants (see Table 6.3). About two-thirds of this training in terms of the number of courses, and about one-half in terms of participant-weeks, were provided through the IMF's six regional training institutes, which are located in Austria, Brazil, China, Singapore, Tunisia, and the United Arab Emirates (see Table 6.4). Training in Washington, where courses are longer, continued to play an important role, accounting for about a third of participant-weeks. The remainder of the training was at overseas locations outside of the IMF regional network, largely as part of ongoing collaboration between the IMF Institute and national or regional training programs, and in the form of distance-learning courses, the latter including residential segments held in Washington.

Table 6.3 IMF Institute Training Programs for Officials, FY2000–FY2005

Program	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005 estimate
Headquarters training						
Number of courses and seminars	21	21	18	20	18	20
Number of participants	753	760	695	698	614	714
Number of participant-weeks	3,548	3,584	2,718	3,009	2,764	2,907
Regional training institutes and programs[1]						
Number of courses and seminars	52	64	73	73	82	85
Number of participants	1,495	1,998	2,291	2,302	2,607	2,594
Number of participant-weeks	3,064	3,691	4,261	3,969	4,449	4,583
Other overseas training						
Number of courses and seminars	24	19	16	17	18	16
Number of participants	775	569	439	496	551	469
Number of participant-weeks	1,367	1,050	828	899	949	800
Distance learning[2]						
Number of courses	1	1	3	3	2	3
Number of participants	36	40	120	110	72	114
Number of participant-weeks	170	166	551	490	344	611
Total courses and seminars	98	105	110	113	120	124
Total participants	3,059	3,367	3,545	3,606	3,844	3,891
Total participant-weeks	8,149	8,491	8,358	8,367	8,506	8,901

Source: IMF Institute.

[1]Includes Joint Vienna Institute (established in 1992), IMF-Singapore Regional Training Institute (1998), IMF-AMF (Arab Monetary Fund) Regional Training Program in the United Arab Emirates (1999), Joint Africa Institute in Côte d'Ivoire and Tunisia (1999), Joint China-IMF Training Program (2000), and Joint Regional Training Center for Latin America in Brazil (2001). Data do not include courses offered by the African Development Bank and the World Bank at the Joint Africa Institute, or those offered by the Austrian authorities at the Joint Vienna Institute.

[2]To avoid double counting, only the residential segment is counted in the number of courses and seminars and the number of participants. Participant-weeks include both the distance and the residential segments. In FY2005, four distance segments were completed. The residential segment for one of these courses will take place in FY2006.

Table 6.4 IMF Institute Regional Training Programs

Regional Program	Date Established	Location	Cosponsors	Intended Participant Countries
Joint Vienna Institute	1992	Austria	Austrian authorities, European Bank for Reconstruction and Development, Organization for Economic Cooperation and Development, World Bank, and World Trade Organization[1]	Transition countries in Europe and Asia
IMF-Singapore Regional Training Institute	1998	Singapore	Government of Singapore	Developing and transition countries in Asia and the Pacific
IMF-AMF Regional Training Program	1999	United Arab Emirates	Arab Monetary Fund	Member countries of the Arab Monetary Fund
Joint Africa Institute[2]	1999	Tunisia	African Development Bank, World Bank	African countries
Joint China-IMF Training Program	2000	China	People's Bank of China	China
Joint Regional Training Center for Latin America	2001	Brazil	Government of Brazil	Latin American countries

[1]A number of other European countries and the European Union, although not formal sponsors of the Joint Vienna Institute, provide financial support.
[2]In 2003, the Joint Africa Institute shifted its operations temporarily from Côte d'Ivoire to Tunisia, owing to the security situation in Côte d'Ivoire.

The number of training courses and seminars rose by over 3 percent in FY2005 and the number of participant-weeks rose by 5 percent. Almost two-thirds of the increase in participant-weeks of training reflected an expansion of the distance-learning program. Two distance-learning courses were added for African officials, with funding from the French and U.K. governments. Training delivery in FY2005 was also facilitated by a full year of training at the Joint Africa Institute following its move from Côte d'Ivoire to Tunisia in FY2004.

The IMF Institute has continued to pay close attention to developing its curriculum and adapting its program to the needs of member countries. In FY2005, new courses were delivered on such topics as Fiscal Decentralization, and Macroeconomic Management and

Debt Issues. The Institute also delivered its first French-language distance-learning course, on Financial Programming and Policies, and also delivered for the first time an Arabic version of the course on Macroeconomic Management and Financial Sector Issues. There was increased training in the area of anti-money-laundering and combating the financing of terrorism, in support of IMF initiatives in this area. The Institute has also continued to provide, both in Washington and through the regional institutes and programs, short seminars tailored to the needs of high-level officials on key current issues. In FY2005, the seminars covered topics such as Arab Economic Integration, Asset Securitization and Structured Finance, Challenges of Reforming Tax and Customs Administrations, China's Foreign Exchange System, and Foreign Aid and Macroeconomic Management.

Box 6.1 Trade-Related Technical Assistance and Institution Building

The August 2004 World Trade Organization (WTO) agreement setting up the negotiation frameworks and modalities for the Doha Round of trade talks called on the Fund and other international agencies to provide technical assistance for trade facilitation. The Fund and other agencies subsequently set up an information network that enables them to respond efficiently to specific needs for assistance.

The principal source of the Fund's trade-related technical assistance is the Fiscal Affairs Department (FAD), which provides assistance on customs administration modernization and tariff reform. The Fund's technical assistance in customs administration is strategic in nature, aimed at providing the overall framework for reform and continuing oversight, with other donors providing support on specific aspects. In contrast, technical assistance in trade policy usually takes the form of "one-off" missions that often have a wider tax focus than tariffs alone, given that countries lowering tariffs must compensate for reduced trade revenues by strengthening domestic tax collection. Overall, FAD has seen a modest increase in trade-related technical assistance missions in recent years. To varying degrees, the Fund's regional technical assistance centers also provide help in this area.

With other international partners, the Fund has been engaged in a joint effort to promote the mainstreaming of trade in poverty reduction strategies and trade-related technical assistance and capacity building. At the core of this agenda has been the Fund's involvement in the Integrated Framework (IF), a cooperative effort of six agencies (the IMF, the International Trade Center, the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Program (UNDP), the World Bank, and the World Trade Organization, which is the chair), with the participation of bilateral donors and developing countries. The IF coordinates the preparation of

Diagnostic Trade Integration Studies in developing countries, often prepared under the leadership of the World Bank with contributions from the Fund. The studies identify policy and assistance priorities ("action matrix"), which are reviewed in national workshops that include government, the private sector, and civil society, with the objective of integrating them into national development and poverty reduction strategies. The action matrices are presented to donors for funding, as appropriate, but the IF also has a small funding capacity of its own for capacity-building projects that require rapid follow-up. (See Box 2.1 for a discussion of the Fund's role in trade policy.)

EXTERNAL FINANCING

The IMF finances its technical assistance and training mainly from its own resources, but external financing provides an important complement. External financing is provided in the form of grants, mainly under the IMF's Framework Administered Account for Technical Assistance Activities but also through cost-sharing arrangements with the United Nations Development Program (UNDP) and, in a small number of cases, direct reimbursement arrangements. In FY2005, three new subaccounts were established under the umbrella Framework Administered Account, for a total of 19 subaccounts. The three new subaccounts were the Middle East Regional Technical Assistance Center Subaccount, the Technical Assistance Subaccount to Support Macroeconomic and Financial Policy Formulation and Management, and the Spain Technical Assistance Subaccount. These subaccounts now include five multidonor subaccounts to support the PFTAC, the AFRITACs, METAC, technical assistance to Iraq and technical assistance for macroeconomic and financial policy formulation and management.

In FY2005, external financing accounted for 26 percent of total assistance delivered by the IMF. Japan remained the largest single donor, providing some 54 percent of all external finance for technical assistance. Other bilateral donors were Australia, Austria, Brazil, Canada, China, Denmark, Finland, France, Germany, India, Ireland, Italy, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, the Russian Federation, Singapore, Sweden, Switzerland, the United Kingdom, and the United States. Multilateral donors were the African Development Bank, the Arab Monetary Fund, the Asian Development Bank, the European Commission, the Inter-American Development Bank, the United Nations, the UNDP, and the World Bank.

REVIEWING AND ENHANCING EFFECTIVENESS

In FY2005, the IMF's Independent Evaluation Office (IEO) completed a report on the Fund's technical assistance program (see Chapter 7 for a more detailed description of IEO's responsibilities and activities), and OTM commissioned an independent evaluation of the AFRITACs as part of its formal evaluation program, which was launched in April 2003 (see Table 6.5 for other evaluations planned during FY2006–07).

IEO Evaluation of Technical Assistance

In February 2005, the Executive Board reviewed the IEO's report on the Fund's technical assistance (TA) program. Directors highlighted the increasingly important role that Fund technical assistance plays in responding to the diverse needs of member countries, particularly in the areas of policy design and implementation, and capacity building. They concurred that the Fund's key strengths in providing technical assistance were its ability to respond quickly, to tailor advice to members' circumstances, and to produce high-quality analysis based on effective quality control. As for areas for improvement, there was a need to introduce a more medium-term perspective for setting technical assistance strategy and priorities; strengthen the tracking and evaluation of technical assistance implementation and results; enhance country ownership; and revisit the need for prioritization filters.

Table 6.5 Technical Assistance (TA) Evaluation Program—FY2006–07

Subject of Evaluation Report	Financial Year
TA on tax policy in countries facing a loss of revenue as a result of trade and tariff reform	2006
Capacity-building TA in four selected countries in the monetary and financial systems area	
TA in anti-money-laundering and combating the financing of terrorism	2007
Revenue administration—TA to Middle Eastern countries	
Revenue administration—TA to Southeast Asia	
General Data Dissemination System (GDDS)—Regional technical assistance projects	

As recognized in the IEO report, the Fund has been taking steps in these areas, for instance with the introduction of departmental technical assistance strategy notes, a planned pilot to provide technical assistance summaries in selected Article IV reports, the launch of the technical assistance evaluation program in 2003, and the development of the Fund-wide

Technical Assistance Information Management System (TAIMS—see Box 6.2). At the same time, however, improving the effectiveness of technical assistance remains a challenge, and Directors considered how the IEO's six major recommendations could advance this effort:

- Recommendation 1. The IMF should develop a medium-term country policy framework for setting TA priorities, incorporating country-specific strategic directions and linked to more systematic assessments of factors underlying past performance.
- Recommendation 2. The IMF should develop more systematic approaches to track progress on major TA activities and to identify reasons behind major shortfalls.
- Recommendations 3 and 4. Greater involvement by the authorities and counterparts in the design of TA activities and arrangements for follow-up should be emphasized as a signal of ownership and commitment. Stronger efforts should be made by TA experts to identify options and discuss alternatives with local officials prior to drafting TA recommendations.
- Recommendation 5. The program of ex post evaluations of TA should be widened and more systematic procedures of disseminating lessons put in place, thereby strengthening recent trends, including through periodic stocktaking exercises and regular reviews.
- Recommendation 6. The prioritization filters should be discontinued or replaced by ones that would more effectively guide TA allocation.

Box 6.2 Technical Assistance Information Management System (TAIMS)

During FY2005, the IMF launched the first phase of TAIMS, a multiyear information technology project that will bring industry best practices to the Fund in the delivery and management of technical assistance. It will also provide the Fund with the tool it needs for the effective management of resources, projects, and donor relations; medium-term planning; and integrated monitoring and evaluation.

A standard Fund-wide system, TAIMS is being deployed in three phases to provide a consistent, easily accessible, and integrated view of the Fund's technical assistance activities across departments. It will provide the basis for reporting to management and the Executive Board on technical assistance activities and, eventually, outcomes.

TAIMS Phase I deploys a Fund-wide, standard, computer-supported technical assistance information and monitoring system that consolidates information on technical assistance projects from existing databases. Additional information (such as a general definition of projects, their objectives and outputs, activities, and scheduled monitoring events) is also collected during this phase. The system provides both a narrative description of projects and data on resource use and costs.

TAIMS Phase II will focus on improving the medium-term planning of technical assistance to better incorporate policy and management prioritization in the planning process. The goal is to enable the Fund to forecast its future resource needs. Tools will be created to facilitate the Resource Allocation Planning (RAP) process.

TAIMS Phase III, subject to management's approval, will aim at creating tools and supporting work practices to evaluate the effectiveness of the Fund's technical assistance over the medium term. It will build on the monitoring and planning tools created in Phases I and II to improve the effectiveness of the Fund's technical assistance, as well as on the TAIMS database.

Directors agreed with the recommendation that the IMF should develop a medium-term country policy framework for setting technical assistance priorities that incorporates country-specific strategic directions and is linked to the more systematic assessment of factors underlying past performance. In particular, most Directors agreed that the Poverty Reduction Strategy Papers drawn up by low-income countries (see Chapter 4) should serve as a vehicle for identifying medium-term technical assistance needs and improving coordination among various agencies. Directors also saw value in the evolution of annual Resource Allocation Plans (RAPs) toward a multiyear framework, consistent with the IMF's move to a three-year budget framework; in area departments taking a central role in developing country frameworks that would help prioritize technical assistance needs; and in the Fund's resident representatives in member countries also contributing to the identification of technical assistance needs and the monitoring of delivery. Such a framework would allow a comparison of needs for technical assistance across sectors and countries, and enhance the Fund's ability to meet them. It would also provide a means of identifying emerging pressure points that might call for a reallocation of resources across the Fund's departments that provide technical assistance. Prioritization of the uses of resources should flow from a shared vision of the Fund’s overall medium-term objectives, while the Fund should retain the flexibility to respond to members’ urgent needs. Functional departments should remain responsible for ensuring the quality of technical assistance and for devising technical assistance strategies in their sectors, as well as for the choice of the most effective way of delivery. In this context, Directors generally supported the view that country authorities should ultimately be responsible for coordinating technical assistance, although the Fund might need to work more closely with other agencies and donors in cases of weak capacity in member countries.

Directors also supported the recommendation that IMF staff and the authorities agree at the outset of major technical assistance projects on measurable indicators of progress. They noted that TAIMS could become the vehicle through which enhanced, transparent, and standardized monitoring practices are implemented across the institution.

Greater involvement by the authorities and counterparts in the design of technical assistance activities and arrangements for follow-up should be emphasized as a signal of ownership and commitment. Stronger efforts should be made by technical assistance experts to identify options and discuss alternatives with local officials prior to drafting technical assistance recommendations. Directors concurred that greater involvement and ownership by the recipient authorities and discussion of options were crucial to greater technical assistance effectiveness and to enhancement of local capacity.

Directors recommended that the program of ex post evaluations of technical assistance be widened, and more systematic procedures of disseminating lessons put in place, thereby strengthening recent trends at the Fund, including through periodic stocktaking exercises and regular reviews. Directors agreed that external evaluations were a useful tool to enhance accountability and provide a fresh perspective.

It was also stressed that, given the low-income countries’ pressing needs for technical assistance in the context of the Millennium Development Goals, implementation of the report’s recommendations should not involve any reduction in the volume of technical assistance delivered to these members.

Evaluation of the AFRITACs

The IMF's regional technical assistance centers in eastern and western Africa were established in 2002 and 2003, respectively, for the purpose of strengthening the capacity of sub-Saharan countries to design and implement poverty reduction policies and to improve the coordination of capacity-building technical assistance in the PRSP process. The AFRITACs have provided technical assistance and training in a range of subjects, including banking and microfinance supervision, customs administration, debt and financial markets, monetary operations, public expenditure management, revenue administration, statistics, and tax administration. They were evaluated in FY2005, at the behest of OTM, by a three-person team of independent consultants specializing in public economics, financial management, and evaluation techniques.

The evaluation found that the AFRITACs provided an effective delivery vehicle for capacity building. They distinguish themselves from other delivery modes by superiority in responsiveness to client needs, proximity to member countries, quick response time, familiarity with local context and issues, and relevant leadership. For the most part, the two centers, which have a demand-driven approach based on in-depth consultations with member countries, have achieved their objectives. Respondents to a questionnaire noted that the AFRITAC model enhanced country ownership, increased regional solidarity, kept donors better informed about country circumstances and needs, enhanced staff accountability, and increased the use of African experts. The AFRITACs' delivery approach also seems to be relatively cost effective and the centers are well managed. Member governments have supported the centers. The main area for improvement is in monitoring and evaluation, where there is a lack of performance indicators. The AFRITACs have worked closely with such regional organizations as the African Capacity Building Foundation and AFRISTAT (Economic and Statistical Observatory for sub-Saharan Africa), and aim at developing further their relationships with the Macroeconomic and Financial Management Institute for Eastern and Southern Africa and the Joint Africa Institute.

The evaluation made a number of recommendations, including the following: beneficiary countries should adopt comprehensive capacity-building programs as part of their

Poverty Reduction Strategy Papers; beneficiary agencies should prepare plans, with help from the IMF, for developing staff resources and institutional capacity; countries' representation on the Steering Committee should reflect their technical assistance needs; workshop participants should be carefully selected and required to share the knowledge acquired with colleagues from their own and related agencies; the IMF should engage a short-term expert to assist in the elaboration of performance indicators and of a logical framework approach for evaluating AFRITAC outputs yearly, at a minimum; and the AFRITACs should continue to promote African expertise by recruiting resident and short-term experts on the continent, preparing local individuals to provide training, and intensifying their cooperation with regional institutions. In April 2005, the Steering Committees of the two AFRITACs endorsed the independent evaluation report and decided to develop an action plan to implement its major recommendations.

7. Governance and Management of the IMF

The IMF is accountable to the governments of its member countries, which appoint its Board of Governors and appoint or elect its Executive Directors, who sit on the Executive Board.

The *Board of Governors*, the highest decision-making body of the IMF, consists of one governor and one alternate governor from each of the IMF's 184 member countries. The governor is usually the member country's minister of finance or the head of its central bank. All governors meet once a year at the IMF-World Bank Annual Meetings.

There are two committees of governors that represent the whole membership. The *International Monetary and Financial Committee* (IMFC) is an advisory body composed of 24 IMF governors (or their alternates) representing the same countries or constituencies (groups of countries) as the 24 Directors who make up the IMF's Executive Board. The IMFC normally meets twice a year, in March/April and at the time of the Annual Meetings in September/October. Its responsibilities include providing guidance to the Executive Board and advising, and reporting to, the Board of Governors on issues related to the management of the international monetary system. The current Chair of the IMFC is Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom. The *Development Committee* (formally, the Joint Ministerial Committee of the Boards of Governors of the World Bank and the IMF on the Transfer of Real Resources to Developing Countries) is a joint World Bank–IMF body composed of 24 World Bank or IMF governors or their alternates. The Committee serves as a forum that helps build intergovernmental consensus on development issues, including on the financial resources required for promoting economic development in developing countries. It usually meets twice a year, following the IMFC meetings. Both committees generally summarize their meetings in communiqués, which are published on the IMF's website (see Appendix IV).

The day-to-day oversight of the work of the IMF is conducted at its Washington, D.C., headquarters by its *Executive Board;* this work is guided by the IMFC and supported by the IMF's staff. The Managing Director is Chair of the Executive Board and head of the IMF staff; he is assisted by a First Deputy Managing Director and two other Deputy Managing Directors.

The Executive Board, which consists of 24 Directors, has a central role in policy formulation and decision making in the IMF, and exercises all the powers for conducting the institution's business except those that the Articles of Agreement reserve for the Board of Governors or the Managing Director. The Board meets in "continuous session," that is, as often as the business at hand requires, usually for three full days each week. In calendar 2004, total Board meeting time amounted to about 500 hours. The Board held 265 formal meetings (including those in which decisions are made), 9 informal seminars, and 91 other informal meetings, including committee meetings. The Board spent 55 percent of its time on member country matters (mainly Article IV consultations and reviews and approvals of IMF financing arrangements); 22 percent of its time on global and regional surveillance and general policy issues (such as the world economic outlook, global financial stability reports, IMF financial resources, strengthening the international financial system, the debt situation, low-income countries, and issues related to IMF lending facilities and program design); and the remaining time on committees and administrative and other matters.

Each member country's voting power in the Fund is determined by its quota (which broadly reflects each country's relative economic size and also helps to determine the amounts it can borrow) and by the basic votes that are distributed equally among all members (for more information about quotas, see *www.imf.org/external/np/exr/facts/quotas.htm*). Under the IMF's Articles of Agreement, general reviews of quotas are conducted at intervals of not more than five years. The Fund is currently in the period of the Thirteenth General Review of Quotas, which must be concluded by January 2008. In this context, the Executive Board has had a number of discussions on issues relating to the distribution of quotas and members' voice and participation in the Fund (see Box 7.1).

The IMF is committed to meeting the highest standards of internal management and control, and several important initiatives are under way in this regard. Further reforms of the Fund's internal budget process have been launched with the ultimate aim of establishing a medium-term, output-oriented budget system. (See "Administrative and capital budgets" below and the Overview for more details.) In FY2005, the Fund began a comprehensive review of its employment framework, compensation, and benefits, drawing on external expertise. It also undertook a review of the resident representative program.

Box 7.1 Status of IMF Discussions on Quotas, Voice, and Participation

On January 30, 2003, the IMF's Board of Governors adopted a resolution concluding the Twelfth General Review of Quotas without proposing an increase in IMF quotas. The resolution also noted the Executive Board's intention during the Thirteenth General Review "to monitor closely and assess the adequacy of Fund resources, to consider measures to achieve a distribution of quotas that reflects developments in the world economy, and to consider measures to strengthen the governance of the Fund." Under the IMF's Articles of Agreement, general reviews of quotas are to be conducted at intervals of not more than five years; the Thirteenth Review will therefore need to be concluded by January 2008.

On July 31, 2003, the Executive Board considered issues related to the distribution of IMF quotas—including quota formulas—and voting power. Most Directors saw considerable merit in a package approach including elements that would benefit the membership as a whole. Such a package would involve a general quota increase with a relatively large selective element allocated by means of a new quota formula; ad hoc quota increases aimed at addressing the cases of countries whose quotas were most clearly out of line with the relative size of the economies; and an increase in basic votes aimed specifically at correcting the erosion of the voting power of the smallest members.[1] Based on the IMF's liquidity position and regular monitoring of the adequacy of IMF resources, most Directors believed that there was no need for a quota increase. Updated illustrative quota calculations were provided to the Board in August 2004.

The Executive Board has taken a number of actions in recent years to enhance the administrative and technical capacity of the developing and transition countries' Executive Directors to participate fully and effectively in the IMF's decision-making processes. In April 2003, the Executive Board decided to allow the Executive Directors from sub-Saharan Africa, who had the largest constituencies, to add three new staff members to their offices.

The Executive Directors have also advanced their work in several other areas aimed at enhancing capacity in Executive Directors' offices, particularly those of developing and transition countries. These recent and ongoing initiatives include an agreement to make available informal voluntary guidelines on the qualifications and duties of personnel in the offices of the Executive Directors; to provide additional training for new members of Executive Directors' staff on a regular basis; to explore ways in which new technology could facilitate close and effective communication with authorities in capitals; and to strengthen efforts to provide incoming Board members and their staff with timely and comprehensive information on Board procedures and Fund policies.

A status report by the IMF’s Executive Board on Quotas, Voice, and Representation was provided to the IMFC for its October 2, 2004, meeting. In taking note of the report, the IMFC encouraged the Board “to consider further issues of voice, quotas, and participation, noting as the Board agreed, that progress will require broad consensus among the shareholders.” On this issue, the Committee also recommended the completion of the ratification of the Fourth Amendment (see IMFC Communiqué, October 2, 2004).

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[1]An increase in basic votes would require an amendment of the Articles of Agreement.

Administrative and Capital Budgets

The IMF’s administrative budget provides funds for personnel costs, travel, and other recurrent expenses. It covers the period May 1 through April 30 and is approved by the Executive Board on both a gross and a net basis. The gross budget includes expenditures that are funded from receipts—mainly external donor contributions for capacity building (technical assistance and training of member country officials). The net budget covers only those expenditures that are funded from the net income of IMF operations. In addition to limits on gross and net expenditures, the Executive Board sets a ceiling on full-time (both open-ended and limited-term) staff positions.

The Board also approves three-year budget appropriations for capital projects starting in the forthcoming financial year. Capital projects comprise building facilities, including regulatory-mandated and security-related upgrades, and information technology (IT) projects. The reforms to capital budget procedures introduced in FY2003 shifted from a system of annual appropriations for separate stages of capital projects to full appropriation at the beginning of a project, giving authorization to spend up to that amount over the next three fiscal years; funds not spent within this time frame lapse, unless reappropriated by the Board.

The IMF’s net administrative expenses are funded from its operational income, which includes charges on the use of Fund resources. The rate of charge depends mainly on the income outlook—itself determined largely by the level of Fund credit outstanding and the SDR interest rate—but also on the level of expenses. (See Chapter 5, "Financial operations and policies.") At the time of the Board consideration of the FY2006 budget in April 2005, it was estimated that the administrative and capital budgets for FY2006, relative to the FY2005 outturn, would contribute an additional 4 basis points to the rate of charge set for FY2006, all else held constant.

Background

Following an external review in the summer of 2001, the IMF began to modernize its internal budgetary procedures and practices with a view to adopting an output-focused medium-term budget system, along the lines of those that have evolved in the public sectors of many industrial countries. The IMF has now shifted to dollar budgeting, while retaining a limit on the number of staff positions, and has established a top-down dollar limit on the size of the administrative budget. Departmental business plans have been introduced, both for the direct delivery of services to member countries and, in the case of support departments, for the provision of services to other departments.

A principal recommendation of the external review was that the Fund should put in place a medium-term strategy. Work began on developing such a strategy toward the end of 2004. However, pending its completion, and given that two major expenditure reviews[56] are under way, the administrative budget for FY2006 was formulated as a transitional arrangement.

Nonetheless, other budget reforms were introduced during FY2005.

- A new time-reporting system (TRS) was implemented to reduce the number of activity codes and adapt them to better match the IMF's primary outputs.
- A new cost allocation system, complementing the TRS, was put in place to assign staff and nonstaff costs to primary outputs.
- Activity indicators were introduced on a pilot basis for certain IMF activities.

[56]The Employment, Compensation, and Benefits Review and the Review of Information Technology together cover areas of expenditure that account for more than 75 percent of the total administrative budget.

These measures have been supported by an improved computerized management information system. Further development of the information system is planned.

Budgets and Actual Expenditures in FY2005

The IMF's *administrative budget* for the financial year that ended April 30, 2005 (FY2005) authorized total expenditure of $905.1 million ($849.6 million net of receipts). The FY2005 *capital budget* made provision for expenditures of $31.8 million over three years on new projects commencing in FY2005, of which $8.1 million was for building facilities, including security-related upgrades, and $23.7 million for information technology projects.

The outturn on the administrative budget for FY2005 amounted to $892.2 million on a gross basis, $12.9 million (1.4 percent) less than budgeted. This gap reflects underspending of $6.4 million in travel and $5.5 million for other expenditures. Personnel expenditures were $1 million above budget, after taking into account an acceleration of planned payments into the Staff Retirement Plan and a retroactive pay adjustment, which more than outweighed the effect of lower-than-anticipated staffing levels. Receipts were larger than projected, in part because of an unbudgeted one-off refund of $3 million received under the Medical Benefits Plan. In addition, disbursements from donors for the financing of technical assistance and travel rebates were higher than projected. Further information on the actual expenditures of the administrative budgets for FY2003 through FY2005 and budgeted expenditures for FY2006 is provided in Table 7.1.

The available activity indicators, as well as input data on travel, expert assignments, and staff members, suggest a modest increase in activities related to capacity building during FY2005, partly as a result of increased external financing for technical assistance. The data also suggest a small shift of resources from work on the use of Fund resources to surveillance, because there were four fewer Fund-supported financial programs or cases of countries being near such programs than in FY2004. Work on standard setting and policy development, research, and operation of the international monetary system was broadly stable.

As noted earlier, information is also available on the cost of providing the Fund's primary outputs. However, a strict comparison between FY2004 and FY2005 is problematic because of the previously mentioned changeover to the new Time Reporting System. While the new system allowed staff time to be linked more accurately to primary outputs, it also resulted in some discrete shifts in time recorded on those outputs, which reflect data refinement rather than shifts in real resources.

Total *capital spending* in FY2005 was within the relevant approved budgets. Expenditures of $126.0 million were funded in line with new appropriations from the FY2005 budget, as well as appropriations from previous capital budgets. In particular, total spending on the Headquarters 2 building project remained within the $149.3 million multi-year budget approved by the Executive Board. The building was opened to staff in May 2005—eight months ahead of the original schedule (Box 7.2).

Budgets for FY2006

On April 22, 2005, the Executive Board approved a gross administrative budget of $937 million and a net administrative budget of $876.1 million, implying a nominal increase of 3.5 percent in gross terms (3.1 percent in net terms) over the FY2005 approved budget. The Board also approved an unchanged ceiling of 2,802 full-time staff positions for FY2006.[57]

As noted, the administrative budget was formulated as a transitional arrangement. Within a zero-real-growth top-down constraint, priority was given to further enhancing the effectiveness of surveillance, following the recommendations of the July 2004 Biennial Review of Surveillance, and to strengthening the IMF's support for low-income member countries. Accordingly, the FY2006 budget increases resources devoted to surveillance, with emphasis on the financial sector and low-income countries (particularly in Africa), and to work on Fund lending programs. A broadly stable allocation of resources for the delivery of technical assistance and training to member country officials is also planned. The IMF's ability to deliver these capacity-building services is increasingly dependent on the availability of external funding from donors. Figure 7.1 shows the projected share of resources by primary output category under the FY2006 gross administrative budget.

The necessary reallocation of funds within the budget is being wholly accommodated through redeployment of staff positions and dollar resources—mainly from support to primary

[57]The budget document can be accessed electronically at *www.imf.org/external/np/pp/eng/2005/040105.htm.*

activities. Over the past four years, more than 50 full-time staff positions have been redeployed from support to frontline activities, enabling the IMF to raise the delivery of its primary outputs within a broadly unchanged employment ceiling.

In terms of input costs, the FY2006 administrative budget allows for a 3.6 percent structural salary adjustment and provisions for additional expenditures on security, based on recommendations of the U.S. Secret Service (Box 7.3). For the second successive year, it incorporates declines (in real terms) in dollar provisions for the travel and building and other expenses categories. Some elements of individual budget accounts that have not been used in recent years were eliminated.

The medium-term capital plan for FY2006–08, which covers all new capital projects scheduled to start in each of the next three years, is also of a transitional nature, pending completion of the above-mentioned reviews. The FY2006–08 capital plan allows for $148.3 million in capital spending, compared with $122.9 million for the FY2005–07 plan approved in FY2004. The increase is more than accounted for by the cost of security-related projects, totaling about $30 million over the next three years. Part of the cost of these security projects has been accommodated within the plan by rephasing or delaying other facilities projects. For information technology (IT), the highest priority is the creation of back-up facilities to ensure availability of all critical systems in the case of a serious disruption.

Within this medium-term plan, capital spending in FY2006 is budgeted at $52.5 million, of which $28.5 million is for building facilities and $24.0 million for IT projects.

The Medium-Term Budgetary Framework

In addition to approving the administrative and capital budgets for the upcoming financial year, beginning in FY2002 the Executive Board was asked to take note each year of the medium-term expenditure framework (MTEF). The MTEF provided a "top-down" reference for administrative expenditures for the current and each of the following two financial years. It reflected the cost of policies, with the number of staff positions unchanged and allowing for projected price increases in the main inputs—personnel costs, travel, and other expenditures.

As part of the budget reform program, the MTEF will become a more comprehensive medium-term budgetary framework (MTBF). Pending completion of the IMF's medium-term strategy, an initial MTBF for FY2007 and FY2008 has been formulated mainly for illustrative purposes. The application of the assumed price increases for the Fund's main inputs, after allowing for the extra costs of holding the next Annual Meetings in Singapore ($5 million), yields annual increases in gross and net administrative budgets of 4.4 percent and 3.3 percent in FY2007 and FY2008, respectively.

Box 7.2 New Headquarters Building

The construction of a second IMF headquarters building (HQ2), adjacent to the existing headquarters, was nearly complete at the end of FY2005, and occupancy was completed in June 2005. Completion ahead of schedule allowed the Fund to terminate leases at the International Square building seven months earlier than originally planned. With the termination also of the IMF's lease at 1776 G Street in December 2005 and the move of staff to headquarters, the entire Fund staff will be accommodated completely in Fund-owned space and within a single headquarters complex for the first time since 1983. The HQ2 building is a modern, light-filled structure with extensive use of glass to create an open and attractive office environment. At the same time, the building is designed for enhanced security with reinforced concrete, strengthened glass, and air filtration. Other features include a large conference facility and mini-atria on office floors for informal meetings.

The new HQ2 building incorporates the advanced technology known as Internet Protocol Telephony, or IPT, which allows organizations to use existing computer networks for voice communications, thereby lowering costs while facilitating the expansion of the range of services, such as audio and video conferencing. This technology will be made available throughout the Fund by end-2005.

Table 7.1 Administrative Budgets, Financial Years 2003–06[1]

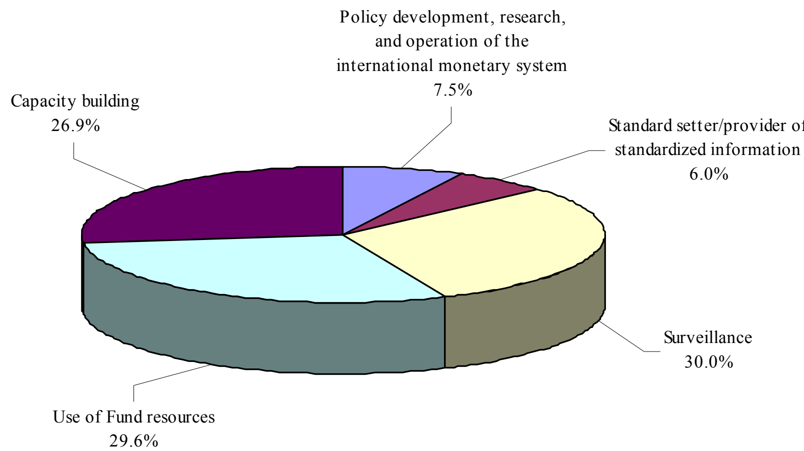
(In millions of U.S. dollars)

	Financial Year Ended April 30, 2003: Actual Expenses	Financial Year Ended April 30, 2004: Actual Expenses	Financial Year Ended April 30, 2005: Budget	Financial Year Ended April 30, 2005: Actual Expenses	Financial Year Ended April 30, 2006: Budget
Administrative Budget					
Personnel expenses					
Salaries	337.1	355.9	373.8	375.2	395.7 [2]
Budgets and other personnel expenses	191.3	200.3	259.9	259.5	263.8
Subtotal	**528.4**	**556.2**	**633.7**	**634.7**	**659.7**
Other Expenses					
Travel	79.9	91.5	97.6	90.2	99.4
Other Expenses	155.7	158.4	173.8	167.3	177.9
Subtotal	**235.6**	**249.9**	**271.4** [3]	**257.5**	**277.3**
Total Administrative Budget (gross)	**764.0**	**806.1**	**905.1**	**892.2**	**937.0**
Receipts	(44.1)	(58.5)	(55.5)	(66.1)	(60.9)
Total Administrative Budget (net)	**719.9**	**747.6**	**849.6**	**826.1**	**876.1**

Note: Figures may not add because of rounding.
[1]Administrative budgets as approved by the Board for the financial years ending April 30, 2005, and April 30, 2006, compared with actual expenses for the financial years ended April 30, 2003; April 30, 2004; and April 30, 2005.
[2] Includes $1 million in contingency reserves for salaries.
[3] Includes $2 million in contingency reserves—$1 million for travel and $1 million for other expenditures.

Figure 7.1. Projected Share of Resources Devoted to Each Primary Output, FY2006

(As a percent of gross Administrative Budget)[1]



Source: Office of Budget and Planning.
[1]Excluding governance—that is, activities that provide services to the departments that deliver primary outputs or service the governance structure of the Fund.

Note: Primary outputs are defined as follows:
Policy development, research, and operation of the international monetary system: Multilateral surveillance (including *World Economic Outlook* and *Global Financial Stability Report*); collaboration with other bodies on international financial issues; operation/reform of the IMFC, Development Committee, and related bodies.
Standard setter/provider of standardized information: Dissemination and research on Fund-developed standards and statistical information; compilation and dissemination of standardized statistics; development of statistical policies and methodologies.
Surveillance: Bilateral and regional surveillance. The Article IV consultation process; related policy advice; strengthened surveillance for monitoring and signaling purposes; analytical work, research, and policy development; Financial Sector Assessment Program, offshore financial centers and anti-money-laundering/combating the financing of terrorism assessments; Reports on the Observance of Standards and Codes.
Use of Fund resources: Operational activities related to the use of General Resources Account resources; the use of Poverty Reduction and Growth Facility and the enhanced Heavily Indebted Poor Countries Initiative; research, assessment (including ex post assessments), and policy development; monitoring/assessment of Fund liquidity and PRGF/HIPC financing; safeguarding Fund resources.
Capacity building: Provision of technical assistance (TA) and external training; collaboration with other providers of TA and sources of financing; monitoring, assessment, and related research.

Box 7.3 Security Matters

On August 1, 2004, citing threats by an international terrorist group against the financial services sector in New York City, northern New Jersey, and Washington, D.C., the U.S. Department of Homeland Security raised the domestic security threat level for these areas, which included IMF headquarters. The IMF immediately put in place enhanced security measures, which law enforcement authorities considered appropriate, and Fund security staff remained in continuous contact with the investigative law enforcement agencies. On November 17, 2004, the U.S. authorities reduced the terrorism threat level for the financial services sector in the three areas, noting the enhanced permanent security measures adopted by the Fund and the other institutions. Further physical security enhancements are planned for FY2006.

HUMAN RESOURCES

The Managing Director appoints a staff whose sole responsibility is to the IMF. The efficiency and technical competence of the IMF staff are expected to be, as stated in the Articles of Agreement, of the "highest standards." Subject to "the paramount importance" of securing such standards, staff diversity should reflect the institution's membership, with "due regard to the importance of recruiting personnel on as wide a geographical basis as possible."

The goals of the IMF require that all who work for the institution observe the highest standards of ethical conduct, consistent with the values of integrity, impartiality, and discretion, as set out in the IMF Code of Conduct and its Rules and Regulations. In accordance with these high standards, the IMF relies on a financial certification and disclosure process for staff and other internal controls to prevent actual or perceived conflicts of interest.

To provide the continuity and institutional memory from which the membership benefits, the IMF has an employment policy designed to recruit and retain a corps of international civil servants interested in spending a career, or a significant part of a career, at the IMF. At the same time, the IMF recognizes the value of shorter-term employment and recruitment of mid-career professionals, given the changing labor market and the benefit of fresh perspectives. In the case of a number of skills and jobs—relating mainly to certain services and highly specialized economic and financial skills—business considerations have called for shorter-term appointments or for outsourcing. A comprehensive review of the IMF's employment framework and compensation and benefits systems is currently under way and is expected to be completed in FY2006. Launched in July 2004 at the initiative of the Managing Director, the review covers the full range of policies for recruiting, retaining, and developing the IMF's staff. The key objective of the review is to ensure that these policies are aligned with the strategic needs of the institution and are cost-effective.

As of December 31, 2004, the IMF employed 1,994 professional and managerial staff (about two-thirds of whom were economists) and 718 staff at the assistant level. In addition, the IMF had 384 contractual employees on its payroll, including technical assistance experts, consultants, and other short-term employees not subject to the staff ceiling. Of the IMF's 184 member countries, 141 were represented on the staff. (See Table 7.2 for the evolution of the nationality distribution of IMF professional staff since 1980.)

Table 7.2 Distribution of Professional and Managerial Staff by Nationality[1]

(In percent)

Region[2]	1980	1990	2004
Africa	**3.8**	**5.8**	**5.8**
Asia	**12.3**	**12.7**	**15.7**
Japan	1.4	1.9	1.8
Other Asia	10.9	10.8	13.9
Europe	**39.5**	**35.1**	**35.0**
France	6.9	5.5	4.6
Germany	3.7	4.3	4.9
Italy	1.7	1.4	2.9
United Kingdom	8.2	8.0	5.3
Transition economies	—	—	5.0
Other Europe	19.0	15.9	12.3
Middle East	**5.4**	**5.5**	**4.3**
Western Hemisphere	**39.1**	**41.0**	**39.2**
Canada	2.6	2.8	3.7
United States	25.9	25.9	23.9
Other Western Hemisphere	10.6	12.3	11.6
Total	**100.0**	**100.0**	**100.0**

[1]Includes staff in Grades A9–B5.

[2]Regions are defined broadly on the basis of the country distribution of the IMF's area departments; beginning in 2004, regions are defined according to the country groupings in the *2004 Diversity Annual Report*. The European region includes the Russian Federation and countries of the former Soviet Union. The Middle East region includes countries in North Africa.

Changes in Management

There have been no changes in the IMF's management team since the appointment of Rodrigo de Rato as Managing Director for a five-year term, which began on June 7, 2004. A national of Spain, Mr. de Rato was Minister of Economy and Vice President for Economic Affairs during 2000–04, prior to which he served as Spain's Minister of Economy and Finance.

Recruitment and Retention

In 2004, 178 people joined the IMF staff, compared with 175 in 2003. The new recruits included 91 economists, 34 professionals in other specialized career streams, and 46 assistants. Fifty-six of the recruits were mid-career economists, and 35 entered the two-year Economist Program, which is designed to familiarize entry-level economists with the work of the IMF. Participants in the program are placed in two different departments, for 12 months each. Those who perform well are offered regular staff appointments.

During 2004, 159 staff members, 115 of whom were in professional and managerial grades, separated from the organization. The separation rate for these staff was 6 percent.

Salary Structure

To recruit and retain the highly qualified staff it needs, the IMF has developed a compensation and benefits system designed to be internationally competitive, to reward performance, and to take account of the special needs of a multinational and largely expatriate staff. In addition to the comprehensive review of the Fund's employment, compensation, and benefits to be completed in FY2006, the IMF's staff salary structure is reviewed annually by the Executive Board and, if warranted, adjusted on the basis of a comparison with salaries paid by selected private financial and industrial firms in the United States, France, and Germany, and in representative public sector agencies, mainly in the United States. After analyses of updated comparator salaries, the salary structure was increased by 5.6 percent for FY2005,[58] and the Board approved an increase of 3.6 percent for FY2006 (Table 7.3).

[58]The Executive Board approved a 3.6 percent structural adjustment but subsequently adjusted this figure by 2 percentage points.

Table 7.3 IMF Staff Salary Structure

(In US dollars, effective May 1, 2005)

Grade[1]	Range Minimum	Range Maximum	Illustrative Position Titles
A1	25,270	37,950	Not applicable (activities at this level have been outsourced)
A2	28,320	42,460	Driver
A3	31,680	47,560	Staff Assistant (clerical)
A4	35,490	53,290	Staff Assistant (beginning secretarial)
A5	39,810	59,710	Staff Assistant (experienced secretarial)
A6	44,480	66,820	Administrative Assistant, other Assistants (for example, Computer Systems, Human Resources, External Relations)
A7	49,890	74,870	Research Assistant, Senior Administrative Assistant, other Senior Assistants (for example, Accounting, Human Resources, External Relations)
A8	55,880	83,880	Senior Administrative Assistant
A9	59,410	89,210	Librarian, Translator, Research Officer, Human Resources Officer, External Relations Officer
A10	68,360	102,560	Accountant, Research Officer, Administrative Officer
A11	75,510	117,810	Economist (Ph.D. entry level), Attorney, Specialist (for example, Accounting, Computer Systems, Human Resources, External Relations)
A12	87,910	131,930	Economist, Attorney, Specialist (for example, Accounting, Computer Systems, Human Resources, External Relations)
A13	98,500	147,740	Economist, Attorney, Specialist (for example, Accounting, Computer Systems, Human Resources, External Relations)
A14	110,310	165,490	Deputy Division Chief, Senior Economist
A15/B1	124,650	187,050	Division Chief, Deputy Division Chief
B2	143,700	208,520	Division Chief, Advisor
B3	170,770	222,210	Assistant Department Director
B4	199,020	248,760	Deputy Department Director, Senior Advisor
B5	234,350	281,330	Department Director

Note: Because IMF staff other than U.S. citizens are usually not required to pay income taxes on their IMF compensation, the salaries are set on a net-of-tax basis, which is generally equivalent to the after-tax take-home pay of the employees of the public and private sector firms from which IMF salaries are derived.

[1]Grades A1–A8 are support staff; grades A9–A15 are professional staff; and grades B1–B5 are managerial staff.

Management Remuneration

Reflecting the responsibilities of each management position and the relationship between the management and staff salary structures, the salary structure for management as of July 1, 2004, is as follows:

Managing Director	$376,380[59]
First Deputy Managing Director	$327,290
Deputy Managing Directors	$311,700

Management remuneration is reviewed periodically by the Executive Board; the Managing Director's salary is approved by the Board of Governors. Annual adjustments are made on the basis of the Washington, D.C., consumer price index.

Executive Board Remuneration

Upon the recommendation of the Board of Governors' Committee on the Remuneration of Executive Directors, the Governors approved increases of 4.1 percent in the remuneration of Executive Directors and their Alternates effective July 1, 2004.[60] The remuneration of Executive Directors is $196,730; the remuneration of Alternate Executive Directors is $170,170.[61]

Diversity

The IMF has continued to emphasize the importance of staff diversity in improving the IMF's effectiveness as an international institution. The diversity of its staff is a source of strength for the institution. The IMF recognizes that the membership must have at its service individuals who understand, through their professional experience and training, a wide range of policymaking challenges that confront country officials and who can offer policy advice appropriate to the circumstances of each of the 184 member countries.

To this end, the IMF has in place a diversity strategy grounded in the principle of inclusion, quantitative and qualitative benchmarks, regular monitoring, and mainstreaming of diversity into the Fund's daily work. The institution places strong emphasis on people management skills in assessing the performance of supervisors and in recruitment and

[59] In addition, a supplemental allowance of $67,380 is paid to cover expenses.

[60] In determining the salary adjustments for Executive Directors, the committee took into consideration such things as the percentage change in the remuneration of the highest-level civil servant in the ministry of finance and central bank of selected member countries, and the change in the selected countries' consumer price index.

[61] These figures do not apply to the U.S. Executive Director and Alternate Executive Director, who are subject to U.S. congressional salary caps.

promotion decisions, which are of particular importance in an institution with a diverse workforce. Since 1995, the Senior Advisor on Diversity, who reports directly to the Managing Director, has advised and assisted management, the Human Resources Department (HRD), and other departments on ways to strengthen, manage, and monitor diversity in the Fund (Tables 7.2, 7.4, and 7.5). In line with the IMF's diversity strategy, HRD continues to focus on integrating diversity into the human resource management policies, procedures, and practices of the institution.

Table 7.4 Distribution of Staff by Gender

	1980		1990		2004[1]	
	Number	Percent	Number	Percent	Number	Percent
All staff	**1,444**	**100.0**	**1,774**	**100.0**	**2,714**	**100.0**
Women	676	46.8	827	46.6	1,246	45.9
Men	768	53.2	947	53.4	1,468	54.1
Total support staff [2]	**613**	**100.0**	**642**	**100.0**	**718**	**100.0**
Women	492	80.3	540	84.1	613	85.4
Men	121	19.7	102	15.9	105	14.6
Total professional staff[3]	**646**	**100.0**	**897**	**100.0**	**1,633**	**100.0**
Women	173	26.8	274	30.5	579	35.5
Men	473	73.2	623	69.5	1,054	64.5
Total economists	***362***	***100.0***	***529***	***100.0***	***1,008***	***100.0***
Women	42	11.6	70	13.2	249	24.7
Men	320	88.4	459	86.8	759	75.3
Total specialized career streams	***284***	***100.0***	***368***	***100.0***	***625***	***100.0***
Women	131	46.1	204	55.4	330	52.8
Men	153	53.9	164	44.6	295	47.2
Total managerial staff [4]	**185**	**100.0**	**235**	**100.0**	**363**	**100.0**
Women	11	5.9	13	5.5	54	14.9
Men	174	94.1	222	94.5	309	85.1
Total economists	***99***	***100.0***	***184***	***100.0***	***293***	***100.0***
Women	4	4.0	9	4.9	31	10.6
Men	95	96.0	175	95.1	262	89.4
Total specialized career streams	***86***	***100.0***	***51***	***100.0***	***70***	***100.0***
Women	7	8.1	4	7.8	23	32.9
Men	79	91.9	47	92.2	47	67.1

[1]Includes only staff on duty; differs from the number of approved positions.
[2]Staff in Grades A1–A8.
[3]Staff in Grades A9–A15.
[4]Staff in Grades B1–B5.

Table 7.5 Distribution of Staff by Developing and Industrial Countries

	1990		2004 [1]	
Staff	**Number**	**Percent**	**Number**	**Percent**
All staff	**1,774**	**100.0**	**2,714**	**100.0**
Developing countries	731	41.2	1,187	43.7
Industrial countries	1,043	58.8	1,527	56.3
Total support staff [2]	**642**	**100.0**	**718**	**100.0**
Developing countries	328	51.1	394	54.9
Industrial countries	314	48.9	324	45.1
Total professional staff [3]	**897**	**100.0**	**1,633**	**100.0**
Developing countries	343	38.2	682	41.8
Industrial countries	554	61.8	951	58.2
Total economists	***529***	***100.0***	***1,008***	***100.0***
Developing countries	220	41.6	442	43.8
Industrial countries	309	58.4	566	56.2
Total specialized career streams	***368***	***100.0***	***625***	***100.0***
Developing countries	123	33.4	240	38.4
Industrial countries	245	66.6	385	61.6
Total managerial staff [4]	235	100.0	363	100.0
Developing countries	60	25.5	111	30.6
Industrial countries	175	74.5	252	69.4
Total economists	***184***	***100.0***	***293***	***100.0***
Developing countries	54	29.3	91	31.1
Industrial countries	130	70.7	202	68.9
Total specialized career streams	***51***	***100.0***	***70***	***100.0***
Developing countries	6	11.8	20	28.6
Industrial countries	45	88.2	50	71.4

[1] Includes only staff on duty; differs from the number of approved positions.
[2] Staff in Grades A1–A8.
[3] Staff in Grades A9–A15.
[4] Staff in Grades B1–B5.

Management receives regular updates on quantitative and qualitative benchmarks for the most underrepresented staff groups, as established in the 2003 Enhanced Diversity Action Plan. To strengthen data monitoring, a process for collecting multiple citizenship data was put in place during 2004. Notable progress has been achieved in the recruitment and promotion of several underrepresented staff groups, but more still has to be done to establish gender and regional balance in all grade groups.

A staff survey launched at the end of 2003 and completed in 2004 gathered opinions and perceptions on various aspects of the workplace environment. The survey identified issues pertaining to career development, discrimination, harassment, and performance management. Following the staff survey, departments developed and implemented plans to address the issues identified in the staff survey. Using staff survey data, the Senior Advisor on Diversity carried out a diversity analysis focusing on racial and ethnic data. In 2004, management also approved a centralized mobility program, which augmented the internal job market system.

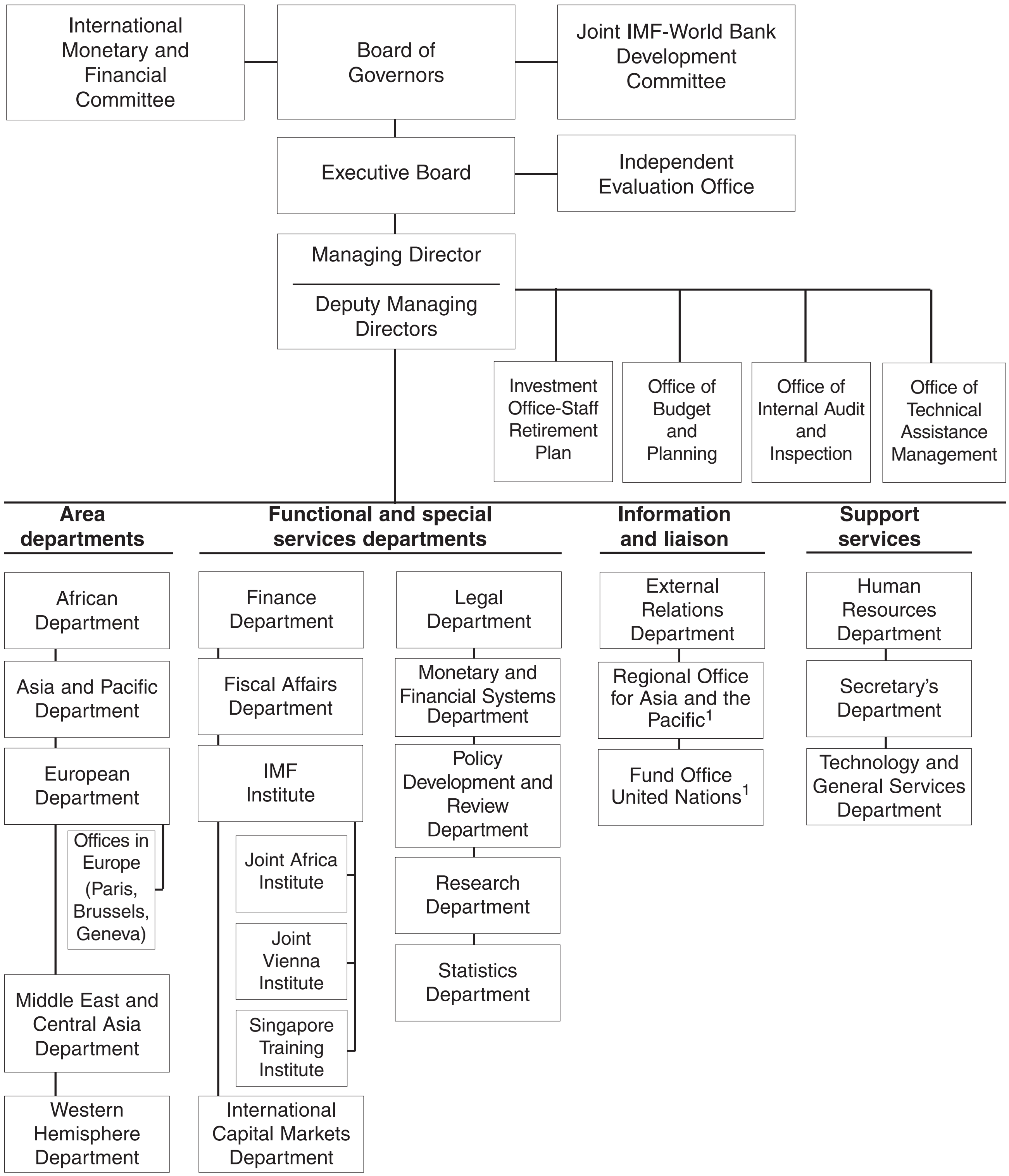
Promoting and sustaining diversity of staff in any institution is a continuing challenge that requires concerted effort. Progress is monitored and problems are reported in a transparent manner in various formats—including the *Diversity Annual Report*—on the IMF website. The Fund's Senior Advisor on Diversity works closely with HRD and other departments to identify needs and opportunities for promoting diversity in each department's annual human resources plan, which provides a business-relevant and systematic framework for the IMF's diversity efforts. Typically, departmental and Fund-wide diversity actions include initiatives in recruitment and career planning, orientation and mentoring for newcomers, and measures to improve performance assessment and management selection and development. The Fund is making special efforts to increase the transparency of human resource policies, procedures, and statistics.

ORGANIZATION

The IMF staff is organized mainly into departments with regional (or area), functional, information and liaison, and support responsibilities (Figure 7.2). These departments are headed by directors who report to the Managing Director.

Figure 7.2 IMF organization chart

As of April 30, 2005



[1] Attached to the Office of the Managing Director.

Area Departments

The five area departments—*African, Asia and Pacific, European, Middle East and Central Asia*, and *Western Hemisphere*—advise management and the Executive Board on economic developments and policies in countries in their regions. Their staffs are also responsible for putting together financial arrangements to support members' economic reform programs and for reviewing performance under these IMF-supported programs. Together with relevant functional departments, they provide member countries with policy advice and technical assistance, and maintain contact with regional organizations and multilateral institutions in their geographic areas. Supplemented by staff in functional departments, area departments carry out much of the IMF's country surveillance work through direct contact with member countries. In addition, 85 area department staff are assigned to members as IMF resident representatives (Box 7.4).

Box 7.4 Resident Representatives

At the end of April 2005, the IMF had 85 resident representative positions covering 90 member countries in Africa, Asia, Europe, the Middle East, and the Western Hemisphere. New offices were opened in Jordan (in support of Iraq) and the Dominican Republic. An office in Paraguay opened in May 2005. These posts—usually filled by one IMF employee supported by local staff—help enhance IMF policy advice and are often set up in conjunction with a reform program. The representatives, who typically have good access to key national policymakers, can bring major benefits to the quality of IMF country work. In particular, through their professional expertise and deeper familiarity with local conditions, resident representatives contribute to the formulation of IMF policy advice, monitor performance—especially under IMF-supported programs—and coordinate technical assistance. They can also alert the IMF and the host country to potential policy slippages, provide on-site program support, and play an active role in IMF outreach in member countries. Since the advent of enhanced initiatives for low-income countries, resident representatives have helped members develop their poverty reduction strategies (see Chapter 4) by taking part in country-led discussions on the strategy and by presenting IMF perspectives. They also support monitoring of program implementation and institution building, working with different branches of government, civil society organizations, donors, and other stakeholders.

Functional and Special Services Departments

The *Finance Department* is responsible for mobilizing, managing, and safeguarding the IMF's financial resources to ensure that they are deployed in a manner consistent with the Fund's mandate. This entails major responsibilities for the institution's financial policies and for the conduct, accounting, and control of all financial transactions. In addition, the department helps safeguard the IMF's financial position by assessing the adequacy of the Fund's capital base (quotas), net income targets, precautionary balances, and the rates of charge and remuneration. Other responsibilities include investing funds in support of assistance to low-income countries and conducting assessments of financial control systems in borrowing members' central banks.

The *Fiscal Affairs Department* is responsible for activities involving public finance in member countries. It participates in area department missions, particularly with respect to the analysis of fiscal issues; reviews the fiscal content of IMF policy advice, including in the context of IMF-supported adjustment programs; helps countries draw up and implement fiscal programs; and provides technical assistance in public finance. It also conducts research and policy studies on fiscal issues, including tax policy and revenue administration, as well as on income distribution and poverty, social safety nets, public expenditure policy issues, and the environment.

The *International Capital Markets Department* assists the Executive Board and management in overseeing the international monetary and financial system and enhances the IMF's crisis prevention and crisis management activities. As part of the Fund's global surveillance, the department prepares the semiannual *Global Financial Stability Report,* which assesses developments and systemic issues in international capital markets. Staff members also liaise with private capital market participants, national authorities responsible for financial system policies, and official forums dealing with the international financial system. In addition, the department plays a leading role in the IMF's analytical work and advice to members on access to international capital markets, as well as on strategies for external debt management.

The *IMF Institute* provides training for officials of member countries—particularly developing countries—in such areas as financial programming and policy, external sector policies, balance of payments methodology, national accounts and government finance statistics, and public finance. The Institute also conducts an active program of courses and seminars in economics, finance, and econometrics for IMF economists (see Chapter 6).

The *Legal Department* advises management, the Executive Board, and the staff on the applicable rules of law. It prepares most of the decisions and other legal instruments necessary for the IMF's activities. The department serves as counsel to the IMF in litigation and arbitration cases, provides technical assistance on legislative reform, assesses the consistency of laws and regulations with selected international standards and codes, responds to inquiries from national authorities and international organizations on the laws of the IMF, and arrives at legal findings regarding IMF jurisdiction on exchange measures and restrictions.

The *Monetary and Financial Systems Department* is engaged in four operational areas—financial system surveillance (including the Financial Sector Assessment Program and Article IV participation), banking supervision and crisis resolution, monetary and exchange rate infrastructure and operations, and technical assistance. It provides analytical, operational, and technical support to member countries and area departments, including development and dissemination of good policies and best practices. An important role is coordinating with collaborating central banks, supervisory agencies, and other international organizations.

The *Policy Development and Review Department* (PDR) plays a central role in the design and implementation of the IMF's policies related to surveillance and the use of the IMF's financial resources. Through its review of country and policy work, PDR seeks to ensure the consistent application of IMF policies throughout the institution. In recent years, the department has spearheaded the IMF's work in strengthening the international financial system, streamlining and focusing conditionality, and developing the Poverty Reduction and Growth Facility (PRGF) and the HIPC Initiative. PDR economists participate in country missions with area department staff, typically covering 80–90 countries a year, and help member countries that are making use of IMF resources mobilize other financial resources.

The *Research Department* conducts policy analysis and research in areas relating to the IMF's work. The department plays a prominent role in global surveillance and in developing IMF policy concerning the international monetary system. It cooperates with other departments in formulating IMF policy advice to member countries. It coordinates the semiannual *World*

Economic Outlook exercise and prepares analysis for the surveillance discussions of the Group of Seven, the Group of Twenty, and such regional groupings as the Asia Pacific Economic Cooperation (APEC) forum, and the Executive Board's discussions of world economic and market developments. The department also maintains contacts with the academic community and with other research organizations.

The *Statistics Department* maintains databases of country, regional, and global economic and financial statistics, and reviews country data in support of the IMF's surveillance role. It is also responsible for developing statistical concepts in balance of payments, government finance, and monetary and financial statistics, as well as for producing methodological manuals. The department provides technical assistance and training to help members develop statistical systems and produces the IMF's statistical publications. In addition, it is responsible for developing and maintaining standards for the dissemination of data by member countries.

Information and Liaison

The *External Relations Department* works to promote public understanding of and support for the IMF and its policies. It aims to make the IMF's policies understandable through many activities aimed at transparency, communication, and engagement with a wide range of stakeholders. It prepares, edits, and distributes most IMF publications and other material, promotes contacts with the press and other external groups, such as civil society organizations and parliamentarians, and manages the IMF's website (see Chapter 8).

The IMF's *Offices in Asia and Europe and at the United Nations* maintain close contacts with other international and regional institutions. The UN Office also makes a substantive contribution to the Financing for Development process, while the offices in Asia and Europe contribute to bilateral and regional surveillance and are a major part of the IMF's outreach effort (see Chapter 8).

Support Services

The *Human Resources Department* helps ensure that the IMF has the right mix of staff skills, experience, and diversity to meet the changing needs of the organization, and that human resources are managed, organized, and deployed in a manner that maximizes their effectiveness, moderates costs, and keeps the workload and stress at acceptable levels. The department develops policies and procedures that help the IMF achieve its work objectives, manages compensation and benefits, recruitment, and career planning programs, and supports organizational effectiveness by assisting departments with their human resources management goals.

The *Secretary's Department* organizes and reports on the activities of the IMF's governing bodies and provides secretariat services to them, as well as to the Group of Twenty-Four. In particular, it assists management in preparing and coordinating the work program of the Executive Board and other official bodies, including by scheduling and helping ensure the effective conduct of Board meetings. In carrying out these tasks, the department helps promote open and efficient channels of communications between the governing bodies, management, and staff. The department, in cooperation with its counterpart office in the World Bank, also organizes the arrangements for the Annual Meetings.

The *Technology and General Services Department* manages and delivers services essential for the IMF's operation. These include information services (information technology, library services, multimedia services, records and archives management, and telecommunications); facilities services (building projects and facilities management); general administrative services (travel management, conference and catering services, and procurement services); language services (translation, interpretation, and preparation of publications in languages other than English); and a broad range of security and business continuity services (covering headquarters security, field security, and information technology security).

The IMF also has *offices* responsible for budget matters, technical assistance, and investments under the staff retirement plan.

Independent Evaluation Office

The Independent Evaluation Office (IEO) was established by the IMF Executive Board in 2001 with a view to increasing transparency and accountability and strengthening the learning culture of the IMF. The IEO is independent of IMF management and staff, and reports regularly to the Executive Board on its findings. Detailed information on the IEO's activities, including its terms of reference, work program, publications, and outreach efforts, is available on its website (*www.imf.org/ieo*). In May 2005, Thomas A. Bernes was appointed to succeed Montek Singh Ahluwalia as Director of the IEO, effective in June 2005. Mr. Ahluwalia, who had served as the IEO's first Director since July 2001, resigned to become Deputy Chair of India's Planning Commission.

During FY2005, the IEO completed evaluations of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility (see Chapter 4); the IMF's role in Argentina (see Chapter 3); and IMF Technical Assistance (see Chapter 6).

In the coming financial year, the IEO will evaluate the IMF's approach to capital account liberalization, IMF assistance to Jordan from 1989 to 2004, and, jointly with the World Bank's Operations Evaluation Department, the joint IMF–World Bank Financial Sector Assessment Program.

Office of Internal Audit and Inspection

The Office of Internal Audit and Inspection (OIA) contributes to the internal governance of the IMF by providing independent examinations of the effectiveness of the risk management, control, and governance processes of the IMF. The OIA conducts about 20 to 25 audits and reviews per year—for example, examining the adequacy of controls and procedures to safeguard and administer Fund assets and financial accounts, assessing the efficiency and effectiveness with which internal resources are being used, evaluating the adequacy of the management of information technology, and ensuring that adequate physical and information security and contingency measures are in place. It also assesses whether departments'activities are aligned with the overall goals of the Fund, whether resources dedicated to low-priority activities can be reallocated, and whether the work is conducted in an efficient and effective fashion. The OIA has a dual reporting line to IMF management and to the External Audit committee, thus assuring its independence.

SENIOR OFFICERS

April 30, 2005

Gerd Häusler, Counsellor

Raghuram G. Rajan, Economic Counsellor

Area Departments

Abdoulaye Bio-Tchané
Director, African Department

David Burton
Director, Asia and Pacific Department

Michael C. Deppler
Director, European Department

Mohsin S. Khan
Director, Middle East and Central Asia Department

Anoop Singh
Director, Western Hemisphere Department

Functional and Special Services Departments

Michael G. Kuhn
Director, Finance Department

Teresa M. Ter-Minassian
Director, Fiscal Affairs Department

Leslie J. Lipschitz
Director, IMF Institute

Gerd Häusler
Director, International Capital Markets Department

Sean Hagan
General Counsel, Legal Department

Stefan Ingves
Director, Monetary and Financial Systems Department

Mark Allen
Director, Policy Development and Review Department

Raghuram G. Rajan
Director, Research Department

Robert Edwards
Director, Statistics Department

Information and Liaison

Thomas C. Dawson II
Director, External Relations Department

Hiroyuki Hino
Director, Regional Office for Asia and the Pacific

Saleh M. Nsouli
Director, Offices in Europe

Reinhard Münzberg
Director and Special Representative to the UN Office at the United Nations

Support Services

Jorge R. Marquez-Ruarte
Director, Human Resources Department

Shailendra J. Anjaria
Secretary, Secretary's Department

Brian C. Stuart
Director, Technology and General Services Department

Offices

Barry H. Potter
Director, Office of Budget and Planning

Alain Coune
Director, Office of Internal Audit and Inspection

Claire Liuksila
Director, Office of Technical Assistance Management

Thomas Bernes
Director, Independent Evaluation Office
Assumed position in June 2005.

Jeanette Morrison, Chief
Editorial and Publications Division

8. Cooperation, Communication, and Outreach

One of the IMF's purposes, stated in its Articles of Agreement, is to "promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems."

The IMF promotes international cooperation first and foremost in the course of its work with its members. But it also collaborates with other international organizations that have different mandates and responsibilities, particularly the World Bank, the World Trade Organization (WTO), the United Nations and its specialized agencies, the Bank for International Settlements (BIS), the Financial Stability Forum, the Organization for Economic Cooperation and Development (OECD), regional development banks, international standard setters, and intergovernmental groups.

International cooperation is even more essential in safeguarding the stability of the international monetary system today than it was when the IMF was founded 60 years ago. It is also essential in working to achieve the goals the international community has set for itself in recent years. These include the work to further the agenda of the Doha Round of Trade Negotiations at the WTO and to help the poorest countries achieve the UN Millennium Development Goals—work that is directly related to the IMF's mandate to facilitate the balanced growth of international trade and to promote the growth of real incomes. The IMF's role in the international monetary system, and its division of labor and collaboration with other organizations, are among the questions being considered in the Fund's current strategic review, discussed in the Overview.

At the same time, the Fund has increasingly recognized the need to communicate effectively with nonofficial groups and the general public to enhance understanding of its work and in recognition of the important role of transparency in ensuring proper accountability. For example, the International Monetary and Financial Committee, in its communiqué of October 2004 (see Appendix IV), called upon the IMF to "strengthen communications to markets and the public of the IMF's policy messages while preserving its role as a candid and confidential advisor." The IMF's External Relations Department coordinates and largely organizes the Fund's efforts to communicate with nonofficial groups and the public, but the Executive Board, the IMF's senior management team—the Managing Director, First Deputy Managing Director, and two other Deputy Managing Directors—and staff from all departments play important roles. Central to the Fund's communications work in recent years has been its transparency policy, under which it makes public the majority of official policy papers and country documents discussed by the Executive Board (see *Annual Report,* 2004, page 65).

COOPERATION WITH OTHER INTERNATIONAL ORGANIZATIONS

Cooperation between the IMF and other international organizations continued to be strengthened in FY2005.

Regional Representation

The IMF's Offices in Europe (in Paris, Brussels, and Geneva) and its Regional Office for Asia and the Pacific (in Tokyo) maintain close ties with other international organizations. Staff in the Paris Office liaise with the Group of Ten (G-10), the OECD, the BIS, and the European Commission. Additionally, they attend, on an ad hoc basis, meetings of organizations such as the Financial Action Task Force (FATF), the European Parliament, and the Council of Europe.

The Office in Geneva reports on the activities of Geneva-based socioeconomic agencies, with particular emphasis on the multilateral trading system and trade-related developments in the European Union, including the WTO, the International Labor Organization, the UN Conference on Trade and Development, the UN High Commissioner for Refugees, the UN Office of the High Commissioner for Human Rights, the World Health Organization, the UN Economic Commission for Europe, and the Inter-Parliamentary Union.

In FY2005, the Offices in Europe contributed to, among other things, the Fund's work on the Doha Round of trade liberalization; the international community's interim assessment of progress toward the Millennium Development Goals; the G-10's work on the financial position of the IMF; and the work in the Office of the UN High Commissioner for Human Rights on the role of human rights in development strategies.

The IMF's Regional Office for Asia and the Pacific is responsible for enhancing surveillance and promoting the IMF's initiatives in Asia, working with regional groups such as the Asia-Pacific Economic Cooperation, the Association of South East Asian Nations, the Asia-Europe Meeting, the Pacific Islands Forum, the South Asian Association for Regional Cooperation, the South East Asian Central Banks, and the Executives' Meeting of East Asia-Pacific Central Banks. In addition, the Office maintains close contact with the Asian Development Bank, the UN Economic and Social Commission for Asia and the Pacific, and the World Bank's Office in Japan.

World Bank

The strong collaborative relationship between the IMF and the World Bank has existed since their founding at the Bretton Woods Conference of 1944. As mandated in their respective Articles of Agreement and in a joint 1989 Concordat, the two institutions play important complementary roles in contributing to global economic stability, growth, and poverty alleviation. Collaboration takes place at all levels, including through regular meetings between the IMF's Managing Director and the Bank's President and joint visits by the two heads to several regions and countries, consultations of senior staff members, joint missions by the staffs, the coordination of policy advice to member countries, and information sharing. High-level coordination of the two institutions also takes place at the Annual Meetings of the Boards of Governors of the IMF and the World Bank and twice yearly ministerial meetings. Governors also convene during the semiannual meetings of the Development Committee, which was established in 1974 to advise the Boards of Governors of the IMF and World Bank on critical development issues—including trade and the environment—and on the financial resources required to promote economic development in low-income countries.

The two institutions continued to pursue joint initiatives in FY2005 centering on the Millennium Development Goals (MDGs), aid and aid effectiveness, debt sustainability and debt relief, trade, financial sector reform, and money laundering and combating the financing of terrorism. They continued to work together toward the common objective of reducing poverty by stimulating economic growth and providing debt relief through the Heavily

Indebted Poor Countries (HIPC) Initiative and the Poverty Reduction Strategy process (see Chapter 4). In April 2005, they published the second Bank-Fund *Global Monitoring Report,* an annual report that assesses progress on policies and actions needed to achieve the MDGs. Bank and Fund staff are also collaborating on enhancing the Fund's General Data Dissemination System (GDDS) to support the compilation of MDG indicators. During the financial year, Fund and Bank staff jointly wrote two papers for the Development Committee on innovative modalities for financing the MDGs and will present a third paper, on international contributions (global taxes), at the September 2005 Annual Meetings.

The IMF and the World Bank have consistently supported the Doha Round of multilateral trade negotiations following the failure of discussions at the last ministerial meeting of the WTO in Cancún, Mexico, in September 2003. They have also cooperated in monitoring financial system stability, especially through the Financial Sector Assessment Program (FSAP; see Chapter 2), introduced in 1999, which aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries.

United Nations

The IMF works closely with the United Nations through the Special Representative of the Fund to the UN and through other extensive institutional contacts. The mandate of the Special Representative, who operates out of the Fund Office at the United Nations in New York, is to foster communications and cooperation between the IMF and the UN. The most prominent functions of the UN Office include making the IMF's views known, providing input for the deliberations at the UN on IMF-related issues, keeping the IMF informed of major developments within the UN system, and facilitating cooperation between the two institutions.

During FY2005, the IMF continued to collaborate with the UN, in particular in the follow-up to the 2002 Monterrey Consensus, and in supporting the efforts of member countries to achieve the Millennium Development Goals. For instance, Deputy Managing Director Agustín Carstens and a number of the Fund's Executive Directors participated in the April 2005 meeting, "Achieving the internationally agreed development goals, including those contained in the Millennium Declaration," of the UN Economic and Social Council (ECOSOC) with the Bretton Woods institutions, the WTO, and the UN Conference on Trade and Development. UN participants were broadly supportive of the Fund's work in low-income countries, and the President of ECOSOC urged continued cooperation among the UN agencies and the international financial institutions in support of developing countries.

World Trade Organization

Collaboration between the IMF and the WTO takes place formally as well as informally, as outlined in their Cooperation Agreement signed in December 1996. Under the Cooperation Agreement, the Fund has observer status at WTO meetings and regularly attends formal meetings of many WTO bodies. Fund staff contribute to the work of the WTO Working Group on Trade, Debt, and Finance, and regularly participate in meetings of the WTO Committee on Balance of Payments Restrictions and in the WTO-led Integrated Framework for Trade-Related Technical Assistance. The Cooperation Agreement has worked well with respect to the sharing of documents and reciprocal observer status, and has facilitated frequent and productive cooperation at the staff level.

International Standard Setters

The Fund's work in assessing standards and codes and producing Reports on Standards and Codes (ROSCs) for its members enables it to collaborate with standard setters, providing them with views from the Fund's global membership. Recent examples of this collaboration include

- following up with the Basel Committee and International Association of Insurance Supervisors (IAIS) on the issues raised in the staff paper "Financial Sector Regulation—Issues and Gaps" (see Chapter 2);
- working with the IAIS to develop methods for assessing the solvency of insurance companies;
- participating in the Basel Committee initiative to update the Basel Core Principles for Effective Banking Supervision (issued in 1997) to reflect subsequent guidance and Basel II developments; and

- collaborating with the Committee on Payments and Settlement Systems in formulating general guidance for the development of payments systems and principles for payments systems for remittances.

International Tax Dialogue

Founded in 2004, the International Tax Dialogue (ITD), a joint initiative of the IMF, the World Bank, and the OECD, is designed to bolster cooperation among tax officials throughout the world. The Fund's involvement reflects its responsibility for promoting sound macroeconomic policies, including in the fiscal area, and the importance of ensuring that tax systems enable revenues to be raised to finance necessary government expenditures in ways that are nondistortive and equitable and that allow untoward deficits to be avoided. The ITD's website (*www.itdweb.org)* provides information on key issues in tax policy and administration and on tax laws and practices around the world.

In March 2005, the ITD organized its first global conference, which took place in Rome, hosted by the Italian Ministry of Economy and Finance. The conference brought together tax officials from more than 100 countries and international organizations for the discussion of issues related to the Value-Added-Tax (VAT), with a particular focus on the need to combat fraud, ease administrative burdens for businesses, and explore means to improve international cooperation.

EXTERNAL COMMUNICATION AND OUTREACH

The IMF's external communication activities are of three broad types:

- Media relations—communicating through the media via articles and letters to the editor as well as briefings, interviews, and other contacts with journalists;
- Publishing—encompassing both electronic and print products (Box 8.1);
- Outreach—communicating and meeting with parliamentarians, civil society organizations (CSOs), the private sector, the general public, and, in some cases, officials of government agencies that are not traditionally interlocutors of the Fund.

Box 8.1 Disseminating information: the IMF's publishing operations and website

The IMF publishes a wide variety of material targeted at a broad range of readerships. Many of the Fund's publications are available both in print and on the IMF's website (*www.imf.org*).

- In recent years, the IMF has released a growing number of reports and other country documents covering economic and financial developments and trends in member countries. Each report, prepared by a staff team after discussions with officials of the country, is published at the option of the member. This series includes Article IV Reports, Reports Related to Use of IMF Resources, Selected Issues papers, Recent Economic Developments, and Statistical Appendixes.
- The IMF's *Annual Report* provides a comprehensive look at the IMF's activities in each financial year and is designed to be used as a reference tool.
- The *Annual Report on Exchange Rate Arrangements* presents information on the exchange and trade systems of the IMF's member countries in a tabular format.
- The *World Economic Outlook* and the *Global Financial Stability Report (GFSR)* are the main vehicles through which the IMF publicizes its global surveillance findings and some of its most significant analytical work.
- The Fund publishes periodical reports on its activities and external developments that influence its activities. In FY2005, it published the 29th edition of *Selected Decisions and Selected Documents of the International Monetary Fund* and Volume III of *Current Developments in Monetary and Financial Law.*
- Staff research on the international monetary system and other topical subjects is published in *IMF Staff Papers*, a quarterly journal; the quarterly newsletter *IMF Research Bulletin;* the IMF Working Papers series; the Occasional Papers series; books; and various other publications.
- The Fund's *Dissemination Standards Bulletin Board* (*http://dsbb.imf.org/Applications/web/dsbbhome/*) provides links to the data and statistical websites of SDDS subscribers and GDDS participants and presents, in a user-friendly format comparable across countries, comprehensive information on the methods and practices behind the compilation and dissemination of such data.
- *International Financial Statistics (IFS)*, produced monthly, provides updated financial information from countries around the world; the IMF's Statistics Department also produces a yearbook containing annual data over 12 years for the countries covered in the monthly publication. The *IFS* database is available online to subscribers. Other statistical publications

include the *Balance of Payments Statistics Yearbook, Government Finance Statistics Yearbook,* and *Direction of Trade Statistics* (quarterly and yearbook issues).

- Guides and manuals published by the Fund cover a variety of subjects, such as balance of payments statistics and compilation, external debt statistics, foreign direct investment trends, and the producer price index.
- The biweekly newsletter *IMF Survey* reports on current IMF policies and activities, and its annual companion, *IMF In Focus,* seeks to offer a clear, concise picture of how IMF policies and operations have evolved.
- Pamphlets such as *What Is the IMF?* and *IMF Technical Assistance* are written for the nonspecialist, as are factsheets and issues briefs posted on the IMF's website, which aim to explain key aspects of IMF operations and policies.
- The quarterly magazine *Finance and Development (F&D)* and the Economic Issues series (pamphlets on broad economic subjects related to the Fund's areas of expertise) are written in nontechnical language and aimed at disseminating information on topical subjects to nonspecialists.
- Op-eds in publications worldwide and speeches published on the external website offer broad overviews of the IMF and its policies.
- An on-line, quarterly *Civil Society Newsletter* (*www.imf.org/external/np/exr/cs/eng/index.asp*) covers IMF activities and issues of particular interest to civil society organizations.
- Videos about the work of the IMF are available to interested media, educational institutions, and social organizations, and are also used in recruitment activities.
- Educational material is available from the IMF Center and at *www.imf.org/econed*. The IMF Center hosts a permanent exhibition on the international monetary system and temporary exhibitions on related subjects and is open to the general public daily, from Monday to Friday.

Outreach to Parliamentarians

Outreach to nonofficial groups is an integral part of IMF country work, and the IMF's dialogue with parliamentarians plays a particularly important role in these efforts, given their roles as decision makers and elected representatives. The IMF has expanded its outreach to parliamentarians in recent years, in accordance with the high priority given to this activity by both management and the Executive Board. The objective has been to familiarize parliamentarians with the work of the Fund, explain the rationale for IMF advice, and learn their views and concerns.

IMF staff teams often meet with key parliamentarians during country visits, and resident representatives also do so from time to time. In addition, the IMF has conducted single-country and regional seminars, including capacity-building seminars; participated in workshops/conferences organized by umbrella parliamentary groups; and hosted delegations of parliamentarians visiting Washington, D.C., where the IMF has its headquarters.

Country seminars. Single-country seminars such as those in Tanzania (October 2004), Cambodia (March 2005), Timor-Leste (March 2005), and Mongolia (April 2005) focus on the specific challenges facing a country. Multicountry regional seminars—for example, Joint Vienna Institute seminars (since 1995) and the seminar with the Central African Economic and Monetary Community—CEMAC (January 2005)—help identify common themes and draw policy lessons across a group of countries. Demand is growing for capacity-building seminars for parliamentarians and their staff on macroeconomic policy issues, especially those involving legislative actions.

Participation in workshops/conferences by umbrella parliamentary groups. The IMF has a well-established relationship with the Parliamentary Network on the World Bank, and its management and staff participate in the annual conference, regional events, and field visits. IMF staff have also attended meetings organized by the Inter-Parliamentary Union, the Global Organization of Parliamentarians Against Corruption, Parliamentarians for Global Action, the Parliamentary Centre, and the Commonwealth Parliamentary Association.

Visiting delegations of parliamentarians. The number of parliamentary delegations visiting the IMF has been increasing. Most visits are by delegations from single countries, but many are multicountry. Typically, the staff and Executive Directors' offices work together to organize meetings and briefings, which sometimes include management. For example, the UK Treasury Select Committee and the UK International Development Committee visit the IMF annually and meet with the Managing Director and senior staff. Also, members of the NATO Parliamentary Assembly visited IMF headquarters in early 2005.

Engaging Civil Society Organizations

The IMF is an important focus of the work of many civil society organizations (CSOs)—nongovernmental organizations (NGOs), labor unions, and faith-based organizations. CSOs have highly diverse interests at both the global and the national levels.

In interactions with CSOs, perennial *global issues* include the social and environmental implications of IMF advice; poverty reduction; the IMF's approach to human rights; governance and transparency; program conditionality; and the voice and the representation of developing countries in the IMF and the World Bank.

Contacts take a wide variety of forms—meetings, seminars, and consultations with IMF management, Executive Directors, and staff at IMF headquarters and worldwide. A series of Civil Society Dialogues, organized in parallel with the Annual and Spring Meetings of the IMF and the World Bank, covers a wide range of topics. CSOs are frequently invited to contribute to reviews of the IMF's policies, by attending seminars or by providing comments on papers posted on the external website.

The IMF maintains a *dialogue with the international labor movement*, represented mainly by the International Confederation of Free Trade Unions (ICFTU) and the World Confederation of Labor (WCL), through workshops, regional seminars, and leadership meetings held in Washington, D.C., often jointly with the World Bank. The IMF and the World Bank agreed with the ICFTU and WCL in 2002 to hold leadership meetings biennially, with staff-level meetings on particular issues to be interspersed between them. The second such leadership meeting, held in October 2004, included about 80 leaders of national and international confederations of unions, representing nearly 200 million workers worldwide.

A highlight of communication with *faith-based organizations* in recent years has been the dialogue with the World Council of Churches (WCC), the main interdenominational organization of Protestant churches. Founded in 1948, it counts among its membership churches with more than 400 million adherents. The dialogue began with an IMF initiative in 2000, in response to critical public statements by the WCC about the IMF and the World Bank, and has continued since then, focusing mainly on poverty reduction and development issues. In October 2004, following management-level meetings at WCC headquarters, the leaders issued a joint statement in which they concluded that the areas of common ground are large and significant, and that, although there remain significant differences, the three institutions should find more effective ways to work together. The dialogue would continue, and would, in the period ahead, focus on country case studies and specific topics.

At the *national level,* IMF country teams, resident representatives, and regional offices in Europe and Asia and the Pacific, increasingly recognize the importance of more systematic engagement as a means of, among other things, understanding CSO views and building consensus and ownership of sound policies. In low-income countries, the participatory nature of the Poverty Reduction Strategy Papers process creates the expectation that governments will consult with civil society, and IMF staff are often invited to participate. According to an internal staff survey in 2002, 69 percent of IMF missions had contacts with labor unions or other labor representatives at least once in the previous two years, for the purposes of hearing the views of labor unions and explaining and discussing IMF policy advice. The IMF, after consultation with CSOs, produced a *Guide for Staff Relations with Civil Society Organizations*, published on the external website to assist staff—and CSOs—to develop a more productive relationship.

In addition, the IMF established a Civic and Community Relations Office in 1994 to strengthen its outreach and assistance to the Washington, D.C., community, where the IMF's headquarters are located, as well as in communities in developing countries, including through charitable donations (Box 8.2).

Box 8.2 The IMF Civic and Community Relations Office

The IMF Civic and Community Relations Office coordinates the IMF's efforts to be a good neighbor and responsible civic entity through *Civic Program* charitable giving, *INVOLVE* employee volunteerism, and *Community Relations* local outreach and partnering.

Activities in both the IMF host city of Washington, D.C., and developing countries give priority to nonprofit programs that address urgent social problems and help the neediest become self-sufficient—echoing IMF work to improve lives in member countries. The budget ($703,734 in FY2005) is for humanitarian purposes only and is separate from the financial assistance the IMF provides to member countries.

The *IMF Civic Program* gives grants and surplus property to charities, guided by an advisory committee of 12 representatives drawn from staff, spouses/partners, retirees, and INVOLVE volunteers. (See guidelines and past recipients at *www.imf.org/external/np/cpac/cpindex.htm*.)

During FY2005, IMF management presented donations to charities in Angola, Burkina Faso, Equatorial Guinea, Gabon, India, Nigeria, Senegal, and Uganda. Staff initiated appeals for victims of the Indian Ocean tsunami, hurricanes in the Caribbean, and other humanitarian emergencies in Paraguay, Russia, and Sudan, raising $360,000. The IMF matches employee donations to appeals, as well as the annual giving campaign, by 50 percent.

INVOLVE, the acronym for **In**ternational **Vol**unteer **Ve**nture, encourages IMF employees, retirees, families, and friends who join to participate in 65 local projects yearly to clothe and mentor poor children, feed the homeless, and repair homes of the elderly, or participate in the annual, citywide "Help the Homeless Walkathon" and the "D.C. Cares Servathon."

Community Relations partners with peer organizations and matches local needs with the IMF's ability to help. In FY2005 it provided facilities for meetings of community groups, such as the D.C. Children and Youth Investment Trust sponsored by the mayor's office. The IMF contributed substantially to local charities, including the D.C. Housing Trust Fund, D.C. Central Kitchen, St. Mary's Court senior citizens home, and adjoining neighborhood beautification programs. Annually, the IMF organizes a popular one-week summer camp for inner-city children.

Integrating Communications and Operations

IMF staff have increasingly reached out to diverse interested groups and to the general public when preparing policy proposals and reviewing policy experience. Some examples of the IMF's communication and outreach activities during FY2005 are

- The 2004 Biennial Surveillance Review (see Chapter 2) made extensive use of interviews, surveys, and workshops not only with country authorities but also with financial market participants, think tanks, other nongovernmental experts and observers, and the media.

- An extensive and systematic program of outreach has been undertaken in support of the IMF's efforts to assess and explain its work in low-income countries. During FY2005, IMF staff participated in a variety of activities, including conferences and seminars where IMF policies or initiatives were the focus of discussion. Examples include two IMF-sponsored conferences in Africa on the review of IMF program design and IMF participation in seminars on debt sustainability in Accra, Berlin, and Paris. A recent innovation was the organization of events for CSOs in Washington, D.C., around the time of the October 2004 Annual Meetings.

Surveillance

Outreach is an integral part of the IMF's country and regional surveillance process. While the focus of Article IV consultation missions (see Chapter 1) is on communication between member country officials and staff mission teams, staff teams' statements at the conclusion of Article IV missions, as well as press conferences, press releases, and Public Information Notices (PINs) issued by the Executive Board after its discussions of Article IV consultations are used—with the country's agreement—to publicize and explain the findings of the surveillance and to inform markets. The IMF's Media Briefing Center is used to disseminate, under embargo, web-streamed press briefings to journalists. The IMF's Offices in Europe and Asia maintain relations with local media. Country teams often place op-eds and letters to the editor in local newspapers to explain country-specific and regional issues. In addition, interaction with parliamentarians, the private sector, and CSOs, including labor unions and faith-based organizations, has become more important for improving the IMF's understanding of specific issues as well as for explaining IMF views.

Financial assistance

Outreach is perhaps most important in countries that are using IMF resources. The 2002 Conditionality Guidelines[62] indicate that staff should encourage national authorities to broaden the base of support for sound policies and thus to enhance the likelihood of successful program implementation. In low-income countries receiving financial assistance under the Poverty Reduction and Growth Facility, the preparation of the Poverty Reduction Strategy Paper provides a mechanism for public consultation by the authorities.

Mission teams and resident representatives increasingly devote time and resources to outreach as programs evolve. These staff members are in a position not only to explain IMF

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[62]See *www.imf.org/external/np/pdr/cond/2003/eng/050803.htm* and *www.imf.org/external/np/pdr/cond/2002/eng/guid/092302.htm*.

views and policy advice but also to listen to the concerns of nonofficials and to help shape program design in a way that strengthens country ownership.

Standards and codes

The IMF has undertaken a number of initiatives to make member countries aware of *international standards and codes* and to encourage compliance with them, including by providing technical assistance when needed. Nearly 75 percent of the summary assessments, known as Reports on the Observance of Standards and Codes (ROSCs), have been published. Documents setting out standards and codes are published on the IMF's external website, and some are also available in print.

The IMF's external website provides a venue for experts outside the institution to contribute to the IMF's work on *statistical issues.* Drafts of statistical manuals are posted for comment, and the IMF hosts discussions on statistical topics such as the treatment of nonperforming loans and pension schemes in macroeconomic statistics. In recent years, the IMF has stepped up publication and distribution of statistical manuals and guides in multiple languages to promote standardized methodologies and policies. It is a member of, or has observer status in, a number of standard-setting bodies. It attends meetings of the Financial Stability Forum and, in October 2004, was invited to become a full member of the International Association of Insurance Supervisors.

The Fund has continued to strengthen its regional outreach effort, which has been integrated with technical assistance, in Data Dissemination Initiatives. Fund staff conducted several regional outreach seminars and workshops in FY2005 to promote subscription to the Special Data Dissemination Standard (SDDS) and participation by countries in the General Data Dissemination System (GDDS).

In 2005, for example, the Fund conducted seminars and workshops on international standards related to anti-money-laundering and combating the financing of terrorism initiatives, as well as on the data template on international reserves.

Conferences on Policies and Research

The IMF also holds workshops and seminars for officials in member countries to disseminate the results of its research and to seek feedback. Its annual research conference, in November 2004, focused on policies, institutions, and instability. In October 2004, it cohosted, with the Bank Negara Malaysia, a high-level conference in Kuala Lumpur on the Fund’s role in supporting financial sector development in Asia, and in December 2004 it cosponsored, with the Central Bank of West African States (BCEAO), a seminar on trade and regional integration in Africa. And in January 2005, it invited representatives from a wide variety of agencies involved in HIV/AIDS work to a workshop, in an effort to raise their awareness that IMF-supported programs do not specify hard budget ceilings on health care spending and to counter misperceptions that its policy advice hinders the disbursement of funds that are becoming available for combating HIV/AIDS.

Role of IMF Management

In early August 2004, at the conclusion of a trip to Africa, Managing Director Rodrigo de Rato affirmed that the IMF was committed to helping the region raise economic growth to attain the UN Millennium Development Goals. During his week-long visit he met with African leaders, parliamentarians, and representatives of civil society to discuss issues ranging from increasing Africa’s voice and representation in the IMF to improving governance in the oil sector. On September 8–9, the Managing Director returned to sub-Saharan Africa to attend the African Union’s Extraordinary Summit on Employment and Poverty Reduction in Africa, held in Ouagadougou, Burkina Faso. In his address to the summit, Mr. de Rato identified three priority areas for the IMF in the region: making IMF financial assistance more flexible and responsive; sharpening the IMF’s role in countries that do not need the institution’s financial assistance, including through policy advice and technical assistance; and reinforcing the IMF’s analysis and assistance in support of Africa’s regional integration initiatives. On the sidelines of the summit, the Managing Director met individually with nine heads of state or government to listen firsthand to the challenges they face and their views on what the IMF can do to combat poverty on the continent.

Also in September 2004, Mr. de Rato traveled to Santiago, Chile, to attend the Eleventh Annual Finance Ministers' Meeting of the Asia–Pacific Economic Cooperation (APEC). Participants, who included senior officials from APEC economies, business leaders, and academics, agreed to promote structural reforms in APEC's 21 member economies and, to this end, to set up a steering committee within APEC to formulate structural reform measures and monitor implementation.

IMF management also worked with governments and other international agencies to assess the financing needs for reconstruction in the areas devastated by the December 2004 tsunami in the Indian Ocean. The IMF offered emergency assistance on the order of $1 billion and sent teams to the region to evaluate financing and support needs in individual countries. The Managing Director toured the worst-hit region of Aceh in northern Sumatra in January 2005. While in Indonesia, Mr. de Rato attended the Special ASEAN Leaders' Meeting on the Aftermath of the Earthquake and Tsunami, and met with regional and international leaders, including UN Secretary General Kofi Annan, World Bank President James Wolfensohn, and Asia Development Bank President Tadao Chino.

The IMF's Deputy Managing Directors also attended many conferences, meetings, and seminars throughout the course of the year. In June 2004, First Deputy Managing Director Anne O. Krueger traveled to Vienna, Austria, to deliver a speech and participate in the conference "60 Years of Bretton Woods: The Governance of the International Financial System—Looking Ahead." She then traveled to Basel, Switzerland, to attend the 74th Annual General Meeting of the Bank for International Settlements. In November 2004, Ms. Krueger delivered a keynote address at the Bankers' Conference 2004 in New Delhi, India, and in December 2004 she addressed the IMF Seminar on Trade and Regional Integration in Africa, held in Dakar, Senegal. Ms. Krueger also visited Sri Lanka and Maldives, two of the countries hard hit by the tsunami, in January 2005.

In October 2004, Deputy Managing Director Agustín Carstens traveled to Kuala Lumpur, Malaysia, to deliver a speech at the High-Level Conference on Financial Sector Issues in Emerging Markets in Asia and the Role of the IMF. He proceeded to Geneva, Switzerland, to participate in the WTO Council Meeting, and then to Madrid, Spain, to attend the Sixth Annual Conference on Latin American Countries Risk.

In October 2004, Deputy Managing Director Takatoshi Kato traveled to Nairobi, Kenya, to participate in a Fund-sponsored seminar, "Growth and Poverty Reduction—Lessons from Africa, China, and India." In November 2004, he delivered opening remarks at the 2004 APEC Finance and Development Forum in Hainan, China.

Executive Board's Evaluation of External Communications

In March 2005, the Executive Board discussed a paper prepared by the External Relations Department (EXR) on "Integrating IMF Communications and Operations."[63] The Board discussion was the fourth on the IMF's communications strategy (the first was in 1998). These four discussions have supplemented and reinforced the separate Board reviews and updates of the IMF's transparency policy, which set the guidelines for the types and extent of information that the Fund may release publicly.[64]

Overall, Executive Directors felt that the IMF continues to pursue a reasonably balanced communications strategy, aimed, first and foremost, at strengthening the global constituency for sound and transparent policies, while enhancing the persuasiveness and thereby the effectiveness of IMF policy advice. The discussion also provided suggestions on various aspects of the IMF's communication strategy, which were to be implemented taking into account the ongoing development of the IMF's medium-term strategy.

Directors agreed that a key medium-term objective of the IMF's communication strategy should be better coordination and integration of communication activities with the IMF's operations, both in country work and in broader policy design and implementation. Directors supported closer collaboration between area departments and EXR in developing and implementing regional and country communication plans. To ensure that such plans are adapted to each country's circumstances and priorities, they should be designed and executed with the support of Directors and national authorities.

[63]The text of the paper is available at *www.imf.org/external/np/exr/docs/2005/020805.htm.*

[64]See Public Information Notice (PIN) No. 03/122, "IMF Reviews the Fund's Transparency Policy—Issues and Next Steps," *www.imf.org/external/np/sec/pn/2003/pn03122.htm*.

Many Directors saw regional offices and resident representative offices as having a crucial supportive role, but stressed the importance for effective communication of close coordination among mission chiefs, department heads, and management. Directors also saw a continuing role for themselves in external communication activities, in their capacity both as officials of the IMF and as country representatives. In this regard, they viewed Directors' group travel as continuing to provide a further vehicle for outreach, both to inform member countries about the IMF and its policies and to listen to the authorities and civil society.

Directors generally agreed that communication planning and activities in the context of IMF-supported country programs remain a particular priority. In this context, communications should continue to focus on the authorities' own efforts, to reinforce country ownership of economic policy programs. Directors recommended that the authorities be consulted closely when planning in-country communications and supported the emphasis on enhancing communication with national parliamentarians whenever judged appropriate by the authorities.

Directors saw considerable scope for the IMF to convey its surveillance findings more widely and effectively. Additional emphasis on communication related to surveillance would, in many cases, need to rely primarily upon area department staff, with support from EXR. A number of Directors pointed to the benefits of making summaries of surveillance analysis and findings, as well as program documentation, available in local languages. They noted the potential benefits and opportunities for wider communication, as well as the additional costs that would be associated with an expansion of non-English materials. In this regard, Directors welcomed the recent formation of a working group of Directors and staff to consider issues related to the publication of material on the IMF's external website in languages in addition to English.

Progress made by the international community toward achieving the Millennium Development Goals (MDGs) will be a subject of special interest in the period ahead. In this context, the IMF's commitment to helping countries make progress toward the MDGs needs to be emphasized, and clear communication will be key to effective signaling in low-income countries, in line with the IMF's own ongoing deliberations on its role in these countries. At the same time, Directors noted that the IMF is only one among several partners in the achievement of MDGs, and its communication strategy should avoid contributing to excessive expectations.

Directors were of the view that, notwithstanding the major advances made in improving public understanding of IMF policies, the mission of the IMF is still not as readily recognizable or understood as that of some other international organizations. Publishing and outreach activities aimed at explaining the work of the IMF to journalists, parliamentarians, civil society, and the general public will therefore remain of considerable importance. A further area identified for strengthening outreach is contacts with the private sector. Directors also noted the important role of the Independent Evaluation Office in the Fund's outreach and communication activities.

SA Box. Emergency Post-Conflict Assistance

The IMF provides emergency assistance (see Table 3.1) to member countries with urgent balance of payments financing needs in the wake of natural disasters and armed conflicts. (For a discussion of emergency natural disaster assistance, see Chapter 4.) Emergency financial assistance is designed to be disbursed rapidly and is supported by policy advice and, in many cases, technical assistance.

Beginning in 1995, emergency assistance was made available to countries emerging from conflict that are unable to develop and carry out a comprehensive economic program because their capacity has been damaged by the conflict but that still have the capacity for planning and policy implementation. IMF assistance is designed to help them expedite their economic recovery by rebuilding and strengthening their administrative and institutional capacity and by catalyzing additional funds from international donors for reconstruction. The rate of charge on loans for low-income countries eligible for assistance under the Fund's Poverty Reduction and Growth Facility is subsidized by grant contributions made by other members (see Chapter 5).

During FY2005, the Board approved emergency post-conflict assistance for three countries: the Central African Republic ($8.2 million), Haiti ($15.6 million), and Iraq ($436 million).[1] In February 2005, the IMF's Board discussed the provision of technical assistance to post-conflict countries (see Chapter 6).

[1]Details are available on the Fund's website: *www.imf.org/external/np/sec/pr/2004/pr04158.htm, www.imf.org/external/np/sec/pr/2005/pr0504.htm,* and *www.imf.org/external/np/sec/pr/2004/pr04206.htm*.

Armenia

During 1996–2004, Armenia completed two IMF-supported programs. These programs supported the authorities' efforts to establish and maintain macroeconomic and financial stability, sustain economic growth, reduce poverty, promote structural reforms, and tackle a banking crisis that forced the closure of one-third of the banking system.

During 2001–04, under Armenia's most recent program supported by the IMF's Poverty Reduction and Growth Facility, real economic growth averaged 12 percent a year, while annual inflation averaged 4 percent. Poverty and inequality indicators have fallen rapidly. The authorities improved fiscal management by clearing all external and domestic expenditure arrears. Moreover, Armenia significantly reduced its debt burden, while building up its foreign exchange reserves. The authorities also introduced major structural reforms that transformed the energy sector and significantly reduced quasi-fiscal deficits. Toward the end of the program, the financial sector began to recover.

In May 2005, the IMF approved the authorities' new three-year program supported under the PRGF. The new program, which aims to build on the achievements of the previous programs, focuses on reforming tax and customs administration as well as on improving the financial sector. Both of these are key to macroeconomic and financial stability.

The IMF has also provided significant technical assistance to Armenia in the financial and fiscal sectors, enabling it to make great strides in strengthening public sector management and to identify important reform objectives for the new program.

Armenia-IMF activities in FY2005

May 2004	Completion of the fifth review of Armenia's performance under the country's PRGF-supported program
December 2004	Completion of Article IV consultation and ex post assessment of Armenia's performance under Fund-supported programs. Completion of the sixth review of Armenia's performance under the PRGF-supported program
April 2005	IMF and World Bank staff prepare a joint advisory note on the authorities' Progress Report on the country's Poverty Reduction Strategy Paper (PRSP)
May 2005	IMF Executive Board approves a new three-year PRGF arrangement for Armenia

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Canada

Since the mid-1990s, Canada has had the fastest growth and strongest budget position of the large industrial countries. Its impressive performance has been supported by a strong macroeconomic framework comprising inflation targeting and the fiscal objective of a "balanced budget or better" and by reforms that include a restructuring of the employment insurance system, tax cuts, and trade liberalization. Canada's Article IV consultation with the Fund, which was completed in February 2005, focused on the challenges stemming from the rapid appreciation of the Canadian dollar and the aging of the Canadian population.

Domestic demand has remained robust, supported by buoyant household spending, employment gains, and increases in net wealth, while business investment has expanded rapidly, boosted by strong corporate earnings, low interest rates, and a decline in the cost of imported capital goods. However, the fast-paced appreciation of the Canadian dollar in the second half of 2004 weighed on net exports. As a result, the Bank of Canada kept monetary policy steady after moves to tighten it in September and October 2004. The year-on-year core inflation rate was a subdued 1¾ percent in April 2005, slightly below the 2 percent mid-point of the Bank of Canada's target range.

The goal of a "balanced budget or better" has continued to drive fiscal policy, which was strengthened in 2004 by the addition of a medium-term debt target. As a result, the ratio of government debt to GDP is projected to continue falling, helping Canada prepare for the fiscal costs of its aging population. However, the budget for Canada's fiscal year 2005 leaves little room for maneuver if unfavorable fiscal developments occur. With the public pension system on a sound financial footing, the country's main long-term fiscal challenge is to curb cost increases in the health care system. In addition, there remains considerable scope for further structural reform, including in the tax system and social programs, to increase economic efficiency and flexibility.

Canada-IMF activities in FY2005

February 2005 Completion of the 2005 Article IV Consultation discussions.

Chile

Chile's economy grew at an annual rate of 6.1percent in calendar 2004, a level not seen since the mid-1990s, thanks to a sharp improvement in Chile's terms of trade and the strong performance of both mineral and nontraditional exports. Private investment picked up significantly, including in the mining sector, and the economic growth outlook for the remainder of 2005 remains favorable.

In 2004/2005, the Chilean authorities continued to pursue prudent macroeconomic policies. Consistent with the country's structural balance rule, which aims at a cyclically adjusted surplus of 1 percent of GDP, the central government registered a surplus of 2¼ percent of GDP in 2004. The central bank has continued to manage monetary policy prudently in the context of its inflation targeting framework and, in April 2005, headline inflation was about 3 percent, the mid-point of the central bank inflation target range.

In August 2004, the IMF and the World Bank jointly completed a Financial System Stability Assessment (FSSA) for Chile that included Reports on the Observance of Standards and Codes (ROSCs) on monetary and financial policy transparency, banking supervision, and securities regulation. The FSSA, which found that Chile's financial system was robust, outlined suggestions for further improvements, including strengthening competition in the provision of financial services, modernizing the securities market infrastructure, and enhancing financial oversight.

Chile-IMF activities in FY2005

August 2004	Completion of the 2004 Article IV Consultation discussions and publication of the FSSA and accompanying ROSCs
September 2004	Visit of Managing Director Rodrigo de Rato
October 2004	Publication of Detailed Assessment of Observance of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies under the Financial Sector Assessment Program
December 2004	Staff visit
March 2005	Publication of ROSC—FATF Recommendations for Anti-Money-Laundering and Combating the Financing of Terrorism

Ghana

In May 2003, the IMF's Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Ghana covering 2003–05. During this period, Ghana has made progress in achieving most of the program objectives and its economic performance has been satisfactory.

Real GDP growth outpaced program projections during 2004, for the second consecutive year, and Ghana built up international reserves as a buffer against external shocks much faster than expected. While the inflation rate remained above the central bank's target, it declined by one-half by the end of 2004. At the same time, the ratio of domestic debt to GDP—the government's fiscal anchor—has declined significantly, helped both by better budgetary discipline and by faster GDP growth.

Satisfactory policy implementation also helped Ghana reach the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in July 2004. Ghana received debt relief equal to $2.2 billion, in net present value terms, and will be able to save about 1.2 percent of GDP in debt-service payments annually during the next 10 years.

Ghana-IMF activities in FY2005

June 2004	Submission of Ghana's Annual PRSP Progress Report
July 2004	Completion of the second review of Ghana's PRGF-supported program
	Ghana becomes the fourteenth country to reach the completion point under the enhanced HIPC Initiative
	Publication of the joint IMF-World Bank assessment of the PRSP progress report
	Publication of the Report on the Observance of Standards and Codes (module on fiscal transparency)

India

The IMF's policy dialogue with the Indian authorities during FY2005 stressed the need for rapid progress on a broad range of reforms to enable India to build on recent successes and realize its ambitious objectives—especially creating jobs and reducing poverty. The Fund urged the authorities to pursue fiscal adjustment, preempt inflationary pressures, accelerate trade liberalization and labor market reform, and further open the financial sector.

The authorities are taking steps to address these issues. They remain committed to meeting the medium-term targets of the fiscal responsibility law. India appropriately tightened monetary policy, lowered tariffs, opened up important sectors to foreign direct investment, and announced a road map for banking reform. For the first time, India agreed this year to the publication of the Fund's staff report on its Article IV consultation.

In addition, India participated in the Fund's pilot study on public investment. The study stressed the need to raise public savings, further improve the management of the public investment program, strengthen capital markets, address regulatory risks that limit private participation, and improve the accounting and reporting of debt-like obligations that arise under off-budget schemes for infrastructure funding.

India also received technical assistance from the Fund's Fiscal Affairs Department in setting up a state fiscal database and debt register, which will be critical in allowing the authorities to fashion a program for fiscal reform at the state level. The Fund stressed the need, in the short term, for India to develop the ability to consolidate states' accounts and, in the medium term, for the country to move to a computerized integrated financial management system.

India-IMF activities in FY2005

December 2004	IMF technical assistance mission on states' fiscal database
January 2005	Completion of India's Article IV consultation by the Fund's Executive Board
March 2005	Visit of Managing Director Rodrigo de Rato
April 2005	Issuance of Board paper on "Public Investment and Fiscal Policy—Lessons from the Country Studies"

Senegal

In April 2003, the IMF's Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Senegal covering 2003–05 to support implementation of the government's Poverty Reduction Strategy Paper (PRSP). The PRGF-supported program emphasizes improving revenue collection, increasing capital and pro-poor spending, strengthening the efficiency and transparency of public expenditure management, and removing impediments to private sector development. Senegal also requested an updated assessment, under the joint IMF-World Bank Financial Sector Assessment Program (FSAP), of the stability and development potential of its financial sector.

In 2003–04, Senegal's economic growth was robust, inflation was low, and the fiscal and external deficits and government indebtedness were maintained at sustainable levels. Structural reforms were implemented, albeit with some delay, and the authorities took steps to correct fiscal slippages. Senegal reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in April 2004, paving the way for debt relief of $0.5 billion, in net present value terms, and a reduction in debt service of about 2 percent of GDP annually during the next 10 years.

Senegal-IMF activities in FY2005

May 2004	Submission of Senegal's Annual PRSP Progress Report
March 2005	Completion of Senegal's 2004 Article IV consultation and of second review of Senegal's PRGF-supported program
	Publication of joint IMF-World Bank advisory note on Senegal's PRSP Progress Report
April 2005	Publication of report on Financial System Stability Assessment update

Slovenia

Against a backdrop of prudent macroeconomic policies, a gradualist approach to structural reform, and political and social cohesiveness, Slovenia has experienced average annual real GDP growth of about 4 percent and macroeconomic stability since 1995. Thanks to a conservative fiscal policy, which has kept the deficit below 1½ percent of GDP, and a high private saving rate, its external position is balanced. Its monetary framework has been unorthodox: interest rates were adjusted in response to inflation dynamics and expectations, while the exchange rate was managed so as to discourage interest-sensitive capital inflows.

Slovenia joined the European Union on May 1, 2004, and entered the ERM2 (exchange rate mechanism), on June 28, 2004. Slovenia is well poised to achieve its goal of adopting the euro in January 2007; it already complies with all of the Maastricht criteria except for the one on inflation. To further reduce inflation, which declined to 3.6 percent in 2004, from 8 percent, the authorities are maintaining a stringent fiscal policy, tight monetary conditions, wage moderation, and restraint in administrative price adjustments.

Slovenia is the only transition country that has not had a Fund-supported program, although it has received technical assistance. Its financial sector has been assessed under the Financial Sector Assessment Program (FSAP) and subsequently updated, and the Fund has also completed a number of Reports on the Observance of Standards and Codes (ROSCs) for Slovenia.

Slovenia-IMF activities during FY2005

April–May 2004	The Fund provides technical assistance on performance information to support better budgeting
May 2004	Completion of 2004 Article IV consultation; publication of Financial Sector Stability Assessment update, with ROSCs on banking and insurance supervision
July 2004	Staff visit
November 2004	Technical assistance on recording transactions in international trade in services
March 2005	Discussions on 2005 Article IV consultation

Turkey

Under Turkey's previous IMF-supported program, the government implemented ambitious macroeconomic and structural policies, laying the basis for continued economic gains in FY2005. Turkey's new three-year program should help consolidate these achievements.

Economic growth reached an impressive 10 percent in 2004. To rein in public debt and the current account deficit, the government overperformed on its budgetary target and secured a primary surplus of 7 percent of GNP in 2004. This reduced Turkey's public debt burden to 63 percent of GNP, almost 30 percentage points lower than after the 2000–01 crises. The central bank's skillful conduct of monetary policy drove the inflation rate down to the single digits, the lowest in a generation. Marking this success, the Central Bank of Turkey announced it would move to formal inflation targeting in 2006. The authorities also introduced a redenominated currency in January 2005—the new Turkish lira—dropping six zeros from the old currency. As part of the new Fund-supported program, the government has also embarked on important reforms of, among other things, tax administration, social security, and banking legislation. These structural reforms will strengthen Turkey's institutional framework and support medium-term growth prospects.

Reflecting these gains and large capital inflows, financial market performance has been impressive. Benchmark bond interest rates have fallen well below 20 percent, from 25 percent at end-April 2004; external bond spreads have narrowed substantially; the stock market is at record levels; and the lira remains strong.

Turkey-IMF activities in FY2005

May 2004	Visit of First Deputy Managing Director Anne O. Krueger
July 2004	Completion of eighth review of Turkey's performance under Stand-By Arrangement and of Article IV consultation by the Fund's Executive Board
April 2005	Visit of Managing Director Rodrigo de Rato to address second Istanbul Investment Advisory Council

Zambia

In April 2005, Zambia became the seventeenth country to reach the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. Full delivery of HIPC assistance by all creditors will reduce Zambia's debt by $2.5 billion, in net present value terms, allowing Zambia to save about 2 percent of GDP in debt-service payments annually over the next 10 years.

Since Zambia reached the HIPC decision point in December 2000, its economy has grown by an average of 4½ percent a year—a marked turnaround from the economic decline of the previous two decades. Inflation has remained high, however, and the government's domestic debt rose substantially, largely because of expenditure overruns. In 2004, initially under a staff-monitored program and then under a new PRGF-supported program, the authorities achieved a substantial fiscal adjustment, which cut the government's net domestic borrowing by 4 percent of GDP, to less than 1 percent of GDP. The fiscal adjustment eased pressure on inflation and interest rates and allowed for a substantial expansion of bank credit to the private sector.

Zambia-IMF activities in FY2005

June 2004	Approval of a new three-year arrangement for Zambia under the PRGF
December 2004	Completion of the first review of Zambia's PRGF-supported program
February 2005	Publication of the Report on Observance of Standards and Codes (module on data transparency)
April 2005	Completion of the second review of Zambia's PRGF-supported program
	Zambia reaches the completion point under the enhanced HIPC Initiative
	Publication of joint IMF-World Bank advisory note on the Poverty Reduction Strategy Paper (PRSP) Progress Report