IMMEDIATE ATTENTION

EB/CAR/08/2

June 3, 2008

To: Members of the Committee on the Annual Report
(Mr. Fried, Chairman; Mr. Gibbs, Mr. Mozhin,
Mr. Brown, Mr. Rice)

From: Patrick Cirillo, Acting Committee Secretary

Subject: **2008 Annual Report—Draft Materials**

On behalf of the Chairman of the Committee, Mr. Fried

The next meeting of the committee will be held at **2:30 p.m. on Tuesday, June 10, 2008**, in the Board Committee Room, 12-120B.

The Agenda for the meeting will be as follows:

- Discussion of the draft chapters of the 2008 Annual Report.

The draft chapters are attached. Written comments and questions from Committee members and other Executive Directors on the drafts are welcome and may be sent ahead of the meeting to Ms. Caminis (ext. 36551), copied to Ms. Liuksila (ext. 38768) and Mr. Donaldson (ext. 37084) in EXR; EXREPAST; and EXR, Review.

Att: (1)

Other Distribution:
Members of the Executive Board
Department Heads

International Monetary Fund

Annual Report 2008

June 03, 2008

Table of Contents

BOXES

TABLES

FIGURES

The IMF's financial year is May 1 through April 30.

The unit of account of the IMF is the SDR; conversions of IMF financial data to U.S. dollars are approximate and provided for convenience. On April 30, 2008, the SDR/U.S. dollar exchange rate was US$1 = SDR [ ], and the U.S. dollar/SDR exchange rate was SDR 1 = US$[ ]. The year-earlier rates (April 30, 2007) were US$1 = SDR 0.65609 and SDR 1 = US$1.52418.

"Billion" means a thousand million; "trillion" means a thousand billion; minor discrepancies between constituent figures and totals are due to rounding.

As used in this *Annual Report*, the term "country" does not in all cases refer to a territorial entity that is a state as understood by international law and practice. As used here, the term also covers some territorial entities that are not states but for which statistical data are maintained on a separate and independent basis.

1. Overview: refocusing the IMF

During much of FY2008, the IMF and its 185 member countries faced a difficult economic environment, with turmoil in financial markets, slowing growth in a number of the advanced economies, and soaring world prices for food and oil.[1] These developments lent even greater urgency to the refocusing of the Fund begun in FY2006 under the leadership of the Executive Board. Guided by the Fund's core mandate,[2] the refocusing is designed to enable the Fund to better meet the evolving needs of its member countries, keep pace with changes in the global economy and financial markets, and adjust to a reduced budgetary envelope. Considerable progress has already been made on a number of fronts.[3]

In FY2008, the Board took steps to further strengthen the Fund's surveillance work, including by adopting a new, more comprehensive framework for bilateral surveillance and placing greater emphasis on the linkages between individual national economies and the global economy, and between financial markets and the real economy. Understanding these linkages is essential to improving responses by governments and international organizations to financial crises. The Board also moved forward with improvements to the Fund's governance structure, agreeing on a significant package of quota and voice reforms designed to realign quota shares with countries' economic weight in the global economy and enhance the participation and voice of low-income countries. The package was adopted by the Board of Governors on April 28, 2008. Another landmark achievement of FY2008 was the Board's agreement on a new income and expenditure framework that will enable the Fund to put its finances in order. On the expenditure side, the Board identified savings that will reach approximately $100 million annually in real terms by FY2011. On the income side, the Board proposed changing the Fund's income model from one that relies primarily on lending to one that generates funds from a range of sources. Under a proposed amendment of the

[1]Chapter 2 describes developments in the global economy and financial markets in FY2008.

[2]As set out in the its Articles of Agreement, the Fund is charged with, among other things, safeguarding the stability of the international monetary system and promoting sustainable economic growth. It does this through its surveillance activities—monitoring its member countries' economic policies as well as developments in the international economy and financial and monetary system, and providing policy advice. (Surveillance is described in detail in Box 3.1.) The Fund can also provide its member countries with financial and technical assistance. The Articles of Agreement can be found on the IMF's Web site, at www.imf.org/external/pubs/ft/aa/index.htm.

[3]See CD-Box 1.1.

Articles of Agreement approved by the Board of Governors on May 5, 2008, the investment authority of the Fund will be expanded, allowing the Fund to generate revenues from an endowment to be created with profits from limited gold sales. These and other activities of the Board are described in greater detail in this chapter and the chapters that follow.

SURVEILLANCE

The IMF's surveillance activities are anchored in bilateral surveillance—the oversight of economic policies in member countries to ensure that members comply with their obligations under the Articles of Agreement and that their policies contribute to the stability of the international monetary and financial system. In early FY2008, after a year-long review of the 1977 Decision on Surveillance over Exchange Rate Policies, the Executive Board adopted a new framework. The 2007 Decision on Bilateral Surveillance introduces the concept of external stability as an organizing principle of surveillance. It encompasses both the current and the capital accounts of the balance of payments and thus covers, among other things, the potential risks posed by exchange rate misalignments and volatility in international financial flows. Executive Directors generally viewed the adoption of the Decision as an important underpinning for the Fund's efforts to discharge its surveillance responsibilities effectively and in an evenhanded manner.[4]

One of the key challenges facing the IMF's member countries today is financial globalization. At the same time, financial globalization offers many opportunities to countries in a position to benefit from it. As an international organization with near-universal membership, the Fund provides a unique forum for multilateral discussion of the issues raised by financial globalization, and there has been growing acknowledgment of the need for the Fund to serve as a center of excellence on financial issues. During FY2008, the Board devoted considerable attention to the turmoil in international financial markets, as reflected in its discussions of the *World Economic Outlook* (WEO) and the *Global Financial Stability Report* (GFSR), the IMF's primary vehicles for multilateral surveillance (see Chapter 3). The impact of the turmoil on global stability and growth was a central topic of the April 2008 WEO, while the April 2008 GFSR analyzed the impact on the international financial system

[4]See "IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies," PIN 07/69, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0769.htm.

and assessed the potential for spillovers, examining real and financial transmission channels and providing advice on short-term measures member countries could take to mitigate it.

In April 2008, Executive Directors discussed an initial assessment of the events in financial markets prepared by IMF staff, broadly supporting its preliminary findings and recommendations. The discussion covered risk-management practices related to structured finance products; the valuation of such products and the role and design of credit ratings for them, as well as accounting and disclosure practices; crisis and emergency liquidity management, including by central banks; and the regulation and prudential oversight of banks and other financial entities.[5] While recognizing that events were still evolving at the time of the discussion, Executive Directors underlined the importance of analyzing the causes of the turmoil and drawing lessons from it for Fund surveillance, and encouraged staff to continue to work closely and proactively with national authorities, international bodies, and market participants.

Dealing with the implications of the activities of sovereign wealth funds (SWFs) for monetary and financial stability also falls within the IMF's mandate for surveillance and ensuring the efficient functioning of the international monetary system. In its discussion of such funds in April 2008, the Board considered that the IMF was well placed to facilitate and coordinate the development of best practices for them, in collaboration with other organizations. The IMF is providing the secretariat for an international working group, composed of representatives of 25 member countries, tasked with developing a common set of voluntary principles for SWFs.

To further strengthen the framework within which the IMF conducts surveillance, the Executive Board began discussing the design of the Triennial Surveillance Review in April 2008, which is expected to lead to the adoption of a Statement of Surveillance Priorities by the time of the 2008 Annual Meetings of the Fund and the World Bank.

---

[5]See "The Recent Financial Turmoil—Initial Assessment, Policy Lessons, and Implications for Fund Surveillance," the paper discussed by the Board, which can be found on the CD-ROM as well as on the IMF's Web site, www.imf.org/external/np/pp/eng/2008/040908.pdf.

PROGRAM SUPPORT AND CAPACITY BUILDING

As the needs of the IMF's members evolve, the Executive Board continues to review and update the instruments at the Fund's disposal. In FY2008, both emerging market and developing countries continued to grow robustly, despite the slowdown in some advanced economies and the turmoil in financial markets.

The *emerging market economies'* demand for IMF lending has declined sharply over the past few years, as they reaped the benefits of improved policies, which have resulted in stronger economic fundamentals, and benign market conditions. However, vulnerabilities remain. The emphasis of the IMF in these countries has thus shifted to financial sector risks, macro-financial linkages, and strengthened debt-management practices. A new methodology for distinguishing between vulnerabilities and crisis risk in emerging market countries has been developed, and the Executive Board is pushing forward in its exploration of the modalities for possible crisis prevention instruments.

The Executive Board is also taking steps to deepen the IMF's engagement with *low-income countries,* which is evolving as countries' economies grow and mature, with greater emphasis on policy responses to capital inflows, commodity price swings (including for food and oil), financial market development, and debt sustainability. In this context, the Fund is focusing on its core areas of expertise—macroeconomic policies and institutions that support the stability necessary for sustained growth and poverty reduction (see Chapter 4)—and strengthening its collaboration with the World Bank in a number of areas through the Joint Management Action Plan (see Chapter 5).

In FY2008, the Executive Board introduced changes to the framework for the Heavily Indebted Poor Countries (HIPC) Initiative to reduce delays in making debt relief available to HIPCs with protracted arrears; Liberia was the first country to benefit from these changes. The Board also considered a new framework for providing more effective capacity-building and financial assistance to so-called fragile states. And as soaring food and oil prices in 2008 complicated policymaking and threatened the low-income countries' poverty reduction efforts and ability to achieve the Millennium Development Goals by 2015, the IMF took immediate steps to help vulnerable members assess the implications of rising prices for their fiscal policy, balance of payments, and income. At a briefing in April 2008, Executive

Directors generally approved the work program of a Fund task force convened to coordinate the Fund's response to the crisis. They supported both the provision of policy advice and financial assistance to countries adversely affected by high food and fuel prices and cooperation with other international organizations working on measures to alleviate supply constraints. Directors noted the need to pay attention to preserving debt sustainability in countries that have benefited from debt relief under the HIPC and the Multilateral Debt Relief Initiatives.

The Executive Board is also taking steps to make delivery of the Fund's *capacity-building assistance*—technical assistance and training—to member countries more effective. It is emphasizing more rigorous prioritization and greater integration of these activities with surveillance and lending, as well as heightened collaboration with other donors and increased external funding to leverage the IMF's own resources. Technical assistance and training provided by the IMF are described in detail in Chapter 4.

GOVERNANCE, FINANCES, AND ORGANIZATION

Following two years of extensive discussion, the Board of Governors approved on April 28, 2008, an important package of reforms of the Fund's governance that will, in particular, increase the voice and representation of emerging market and low-income countries.[6] The package, which delivered more than the Board of Governors committed to in its Resolution of September 18, 2006, includes a simpler and more transparent quota formula; ad hoc quota increases for 54 members to realign quota shares with members' relative weight and role in the global economy; a tripling of basic votes[7] to increase the voice of low-income countries; a mechanism to ensure that the ratio of total basic votes to total voting power remains constant; and a second Alternate Executive Director for Executive Directors elected by a large number of members, which in the current circumstances will benefit the two African chairs on the IMF's Executive Board. The Board of Governors' Resolution represents a major step forward in the modernization and restructuring of the Fund to better reflect the

---

[6]See "IMF Executive Board Recommends Reforms to Overhaul Quota and Voice," Press Release 08/64, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0864.htm. The Report of the Managing Director to the IMFC on IMF Quota and Voice Reform can be found on the CD-ROM as well as on the IMF's Web site: www.imf.org/external/pp/longres.aspx?id=4242.

[7]As set out in the IMF's Articles of Agreement, each member was originally allotted 250 basic votes plus one vote per SDR 100,000 of its quota.

changing realities of the global economy. Some of the changes agreed by the Executive Directors and approved by the Board of Governors in April 2008 were the first such changes in the governance structure of the Fund since it was founded. The proposed amendment on the increase in basic votes and the second Alternate Executive Director will enter into force once three-fifths of the Fund's members having 85 percent of the total voting power have accepted it. The ad hoc quota increases will become effective after the proposed amendment has entered into force and require each relevant member's consent to, and payment of, its quota increase.

The Board also reached agreement on a new income and expenditure framework for the IMF, to put its finances on a sounder footing. On the expenditure side, the Board identified approximately $100 million in savings to be achieved over the next three fiscal years through reductions in both staff and non-staff costs, and set out how a leaner, refocused institution will better serve its membership. On the income side, the Board of Governors approved on May 5, 2008, a proposed amendment to expand the investment authority of the Fund, which, to become effective, requires the acceptance of three-fifths of the Fund's members having 85 percent of the total voting power.[8] As part of the income model, the Executive Board also supported a proposal to create an endowment funded with profits from the sale of a limited part of the Fund's gold. All Executive Directors have indicated either that they are ready to vote in favor of a decision to sell a limited portion of the Fund's gold, or that they will seek legislative approval to vote in favor of such a decision.[9]Moreover, the Executive Board approved resuming annual reimbursements of the General Resources Account in respect of the expenses incurred by the Fund in administering the PRGF-ESF Trust.

In parallel with the changes agreed in principle to the Fund's income and expenditure framework, the Board amended the terms of reference for its Budget Committee, to enable

[8]See " IMF Board of Governors Approves Key Element of IMF's New Income Model," Press Release 08/101, on the CD-ROM or on the Fund's Web site, at www.imf.org/external/np/sec/pr/2008/pr08101.htm.

[9]Approval by the U.S. Congress is needed before the U.S. Executive Director can vote in favor of gold sales. See "IMF Managing Director Strauss-Kahn Applauds Executive Board's Landmark Agreement on Fund's New Income and Expenditure Framework," Press Release 08/74, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0874.htm. The Report of the Managing Director to the IMFC on a New Income and Expenditure Framework for the IMF can be found on the CD-ROM as well as on the IMF's Web site: www.imf.org/external/pp/longres.aspx?id=4245.

the Committee to consider the income and the expenditure sides of the budget together, in an integrated framework.

The IMF's communications strategy was also reviewed by the Executive Board in FY2008. The Board welcomed the efforts being made to better integrate the Fund's operations with its communications in building support for the Board's reform agenda. As part of this strategy, the Fund is increasingly shifting to Web-based and multimedia technologies and tailoring its outreach to key audiences of opinion leaders. It is also broadening its communications reach by systematically producing key materials in languages other than English that are heavily used in the Fund's work, and refocusing its publishing program.

The IMF's institutional transparency continues to be high. In FY2008, the Fund published its third annual update on the implementation of its transparency policy, indicating that, even though publication is voluntary, the overwhelming majority of country documents and policy papers are published.

The Board also continued to strengthen the Fund's risk-management framework during FY2008. It welcomed the Advisory Committee on Risk Management's update at an informal Board briefing in January with a call for greater prioritization in the risk-management framework and more consideration of risks stemming from misreporting by members. Also in January, in a briefing to the Board, the External Audit Committee indicated satisfaction with the Fund's internal and external audit processes and encouraged the Fund to take steps to make its financial statements clearer, implement a whistleblower policy, and adopt a more formalized incident-reporting process.

As part of its efforts to formalize the framework for IMF accountability, in FY2007, the Board called on Fund management to produce implementation plans for Board-endorsed recommendations in the Independent Evaluation Office's (IEO) assessments of Fund activities and, in FY2008, to issue periodic monitoring reports on the state of implementation. Three implementation plans have been produced so far; they cover the Board-endorsed recommendations in the IEO's evaluations of the IMF and aid in sub-Saharan Africa, the Fund's advice on exchange rate policies, and structural conditionality in Fund-supported programs. The first periodic monitoring report, which was issued in FY2008, covered recommendations from IEO evaluations that were discussed by the Board before the new formalized framework was put in place.

Turning its attention to sharpening the focus of its own work, in FY2008 the Board approved the recommendations of a working group of Executive Directors that was convened to examine the structure and mandate of Board committees and amended the terms of reference of a number of these committees accordingly. Notable among the changes approved was the broadening of the Budget Committee's mandate, as mentioned above, and the establishment of a Committee on Liaison with the World Bank and Other International Organizations, which is charged with keeping the Board informed of developments at other institutions whose work also involves promoting economic stability and growth.

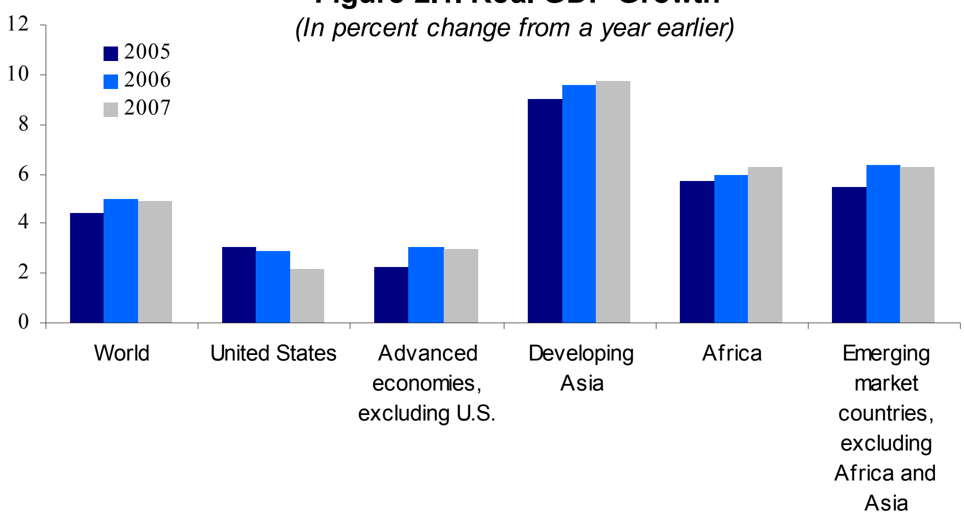
More detail about the Fund's governance, finances, and organization can be found in Chapter 5.

2. Developments in the global economy and financial markets

The course of the global economy in FY2008 was shaped by the interaction of three powerful forces: an escalating financial crisis slowed growth in some of the advanced economies, growth in emerging and developing economies continued at a brisk pace, and inflationary pressures intensified throughout the world, fueled in part by soaring commodity prices.

Overall, global GDP measured at purchasing power parity (PPP) exchange rates increased by 4.9 percent in 2007—well above trend for the fourth consecutive year (Figure 2.1). From the fourth quarter, however, activity decelerated in the advanced economies, particularly in the United States, where the crisis in the subprime mortgage market affected a broad range of financial markets and institutions. Although growth in emerging and developing economies also slowed beginning in the fourth quarter of 2007, it remained robust, by historical standards, across all regions.

Figure 2.1. Real GDP Growth
(In percent change from a year earlier)



Foreign exchange markets were also affected by developments in financial markets. The real effective exchange rate of the U.S. dollar declined sharply from mid-2007, as foreign investment in U.S. securities was dampened by the weakening of U.S. growth prospects and expectations of interest rate cuts. The currencies of a number of countries that have large current account surpluses—notably, China and oil-exporting countries in the Middle East—continued to be tightly managed. The main counterpart of the dollar's depreciation has been an appreciation of the euro, the yen, and other floating currencies, such as the Canadian dollar and some emerging market currencies.

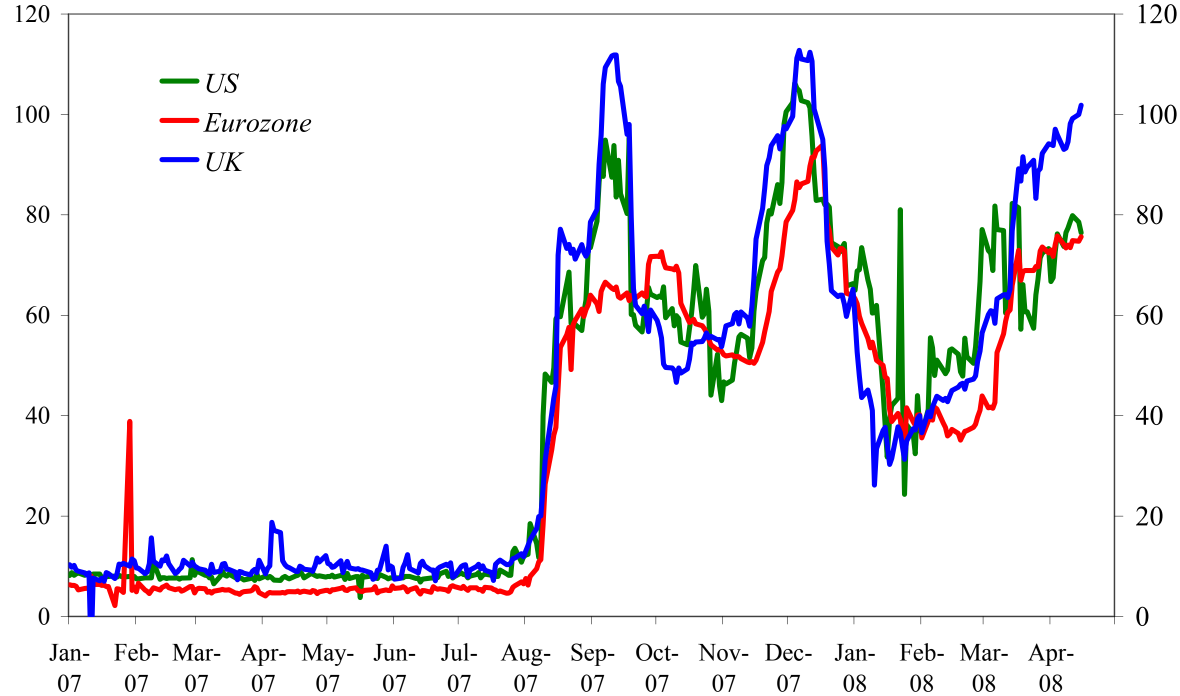
The sharp increase in prices for primary commodities, particularly for food and oil, pushed up headline inflation in virtually all of the Fund's member countries, with spillover effects into core inflation, especially in emerging economies. Surging food prices have compressed real income, especially in countries for which food represents a larger share of consumption baskets. While oil exporters have benefited from record oil prices, some net oil importers have seen their trade balances deteriorate and growth prospects weaken.

ADVANCED ECONOMIES

Spillovers from the credit deterioration in the U.S. subprime mortgage market led to a full-blown liquidity crisis in term-funding interbank markets in August 2007. By October 2007, key central banks had begun taking aggressive policy actions, including providing liquidity to troubled institutions, that helped calm markets temporarily. However, pressures rekindled and intensified toward the end of 2007 as major financial institutions began to report substantial losses, notably from exposures to securities related to subprime mortgages. Market deterioration was compounded by signs that the U.S. economy was slowing. The crisis continued to spread as systemic concerns were exacerbated by a deterioration of asset credit quality, a drop in the valuation of structured credit products, and a lack of market liquidity accompanying a broad deleveraging in the financial system.

While the United States remained the epicenter of the crisis, financial institutions in other advanced economies were also affected because of exposure to structured credits and—to varying degrees—weaknesses in prudential supervision and in the risk-management systems of financial institutions. In response to unfolding events, major central banks in the United States and Europe began to play a pivotal role in containing systemic risk, providing large-scale access to short-term funding through various existing and newly created facilities as private banks retrenched from interbank markets, and becoming key counterparties in term-funding markets as nonbank financial institutions retreated. Sovereign wealth funds also played an important and timely role in containing market strains, contributing substantial amounts of capital to major financial institutions. Nonetheless, financial systems were still experiencing considerable stress as the IMF's financial year came to a close, with continuing strains in interbank markets, wide credit spreads, and leveraged investors selling assets under illiquid market conditions (Figure 2.2).

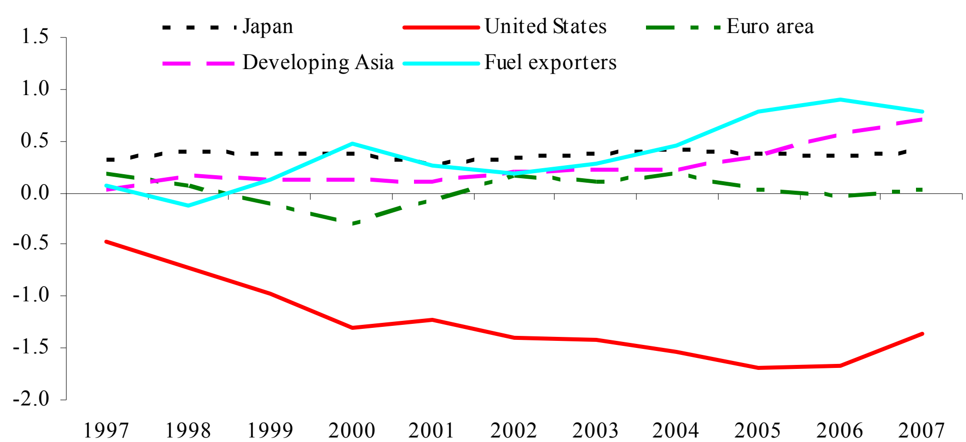
Figure 2.2. 3-Month LIBOR Spreads to OIS
(In basis points)



Note: OIS denotes overnight index swap.

Central banks in the advanced economies found themselves caught—to different degrees—between rising inflation pressures and slower growth prospects, and striking the right balance depended on country or regional circumstances. A number of central banks eased monetary policy, most dramatically in the *United States,* where the U.S. Federal Reserve lowered the federal funds rate by 300 basis points between August 2007 and April 2008. The pace of activity in the United States declined sharply in the fourth quarter of 2007, and consumption and business investment softened markedly as sentiment soured and lending conditions tightened. Growth in 2007 was only 2.2 percent, down from 3 percent in 2006, and fell further, to about 1 percent, in the first quarter of 2008 as the correction in the U.S. housing market led to a contraction of residential investment and household consumption slowed markedly. Rising oil prices contributed to the dampening of consumption while boosting 12-month headline inflation to more than 4 percent in late 2007 and early 2008. The weakening of growth prospects in the United States relative to its trading partners and expectations of interest rate cuts dampened foreign investment in U.S. securities, putting downward pressure on the dollar. The dollar's depreciation vis-à-vis the euro, the yen, and other floating currencies, such as the Canadian dollar and some emerging market currencies, boosted net exports, the one area of strength in the U.S. economy, and the current account deficit of the United States moderated somewhat, to 5.3 percent of GDP in 2007. (Figure 2.3 shows current account balances for different countries and regions as a percentage of world GDP.)

Figure 2.3. Current Account Balance
(In percent of world GDP)



For most of 2007 and in early 2008, activity in the *advanced European economies* continued to expand at a robust pace. Strong domestic demand was fueled by steady employment growth and buoyant investment. The euro area as a whole recorded annual economic growth of 2.6 percent in 2007, close to the rapid pace achieved in 2006, while growth in the United Kingdom registered a strong 3.1 percent increase despite strains in the banking sector. In the first quarter of 2008, euro area growth accelerated to almost 3 percent, notwithstanding deteriorating consumer and business sentiment in response to financial sector dislocation, the impact of rising oil prices on real disposable income, euro appreciation, and a weakening export market. The Bank of England responded to weaker growth prospects by lowering interest rates, but the European Central Bank kept policy rates steady.

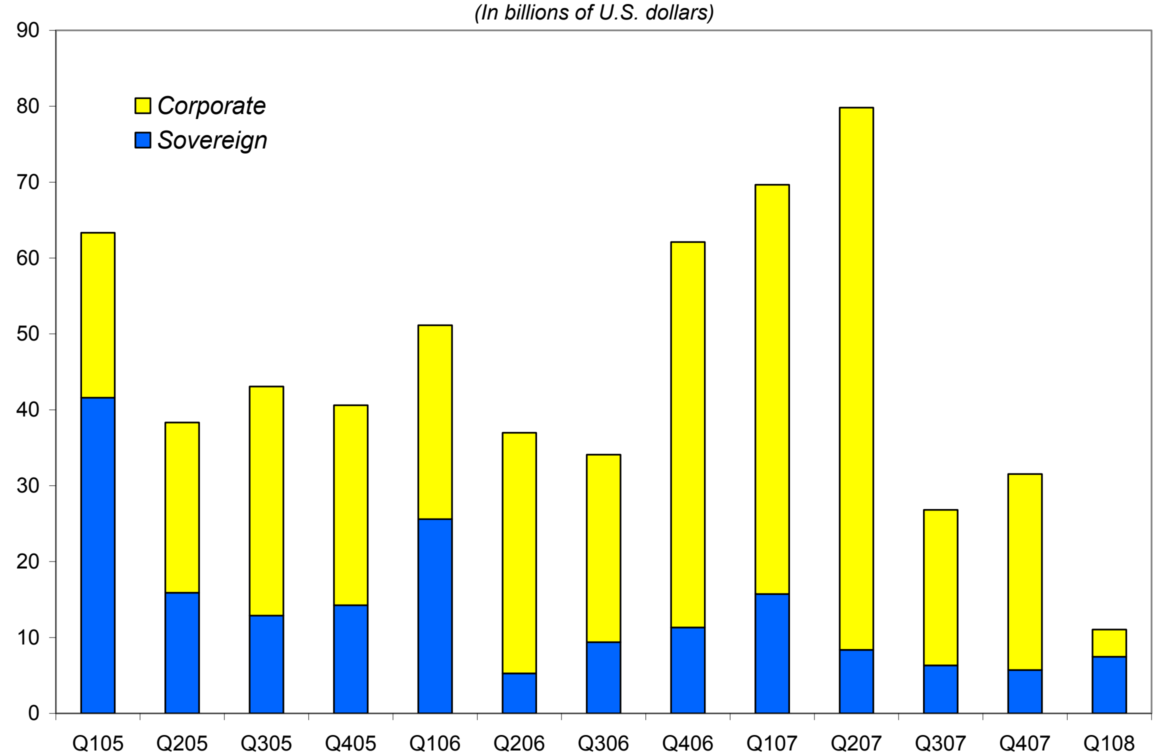
Japan's economy remained largely resilient to the global slowdown through the first quarter of 2008. GDP grew at 2.1 percent in 2007, before accelerating to 3.3 percent in the first quarter of 2008, led by robust net exports and business investment. Japan's external surplus remained large. Business activity appeared to be slowing in the second quarter of 2008, however, and the Bank of Japan kept interest rates steady.

EMERGING AND DEVELOPING ECONOMIES

Throughout FY2008, financial conditions in most emerging market countries continued to benefit from those countries' improved macroeconomic fundamentals and stronger public sector balance sheets. However, some countries—notably those in emerging Europe[10] where domestic credit growth had been fueled by external funding and large current account deficits needed to be financed—came under market pressure. While emerging market sovereigns remained broadly resilient to the financial turbulence in mature economies, and bank lending continued to be strong through the fourth quarter of 2007, emerging market corporate bond issuance slowed sharply in the third quarter of 2007 and remained subdued in early 2008, while the cost of funding rose (Figure 2.4).

[10]As used in Fund publications, this term includes Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, the Slovak Republic, and Turkey.

Figure 2.4. Emerging Market External Bond Issuance
(In billions of U.S. dollars)



Growth in *emerging Europe* moderated by almost a full percentage point, to 5.7 percent, in 2007 but exceeded growth in the advanced European economies for the sixth consecutive year. In most of the emerging European countries, growth continued to be driven by buoyant domestic demand, which again substantially outpaced production in 2007. As a consequence, the region's overall current account deficit widened to 6.7 percent of GDP. Demand continued to be supported by strong credit growth fueled by capital inflows and—in many countries—vigorous wage growth, as labor market conditions tightened further. Inflation pressures increased, especially toward year-end, because of rising food and energy prices and increasing labor costs. Most central banks in emerging economies continued to tighten monetary policy in response to building inflationary pressures.

Real GDP growth was sustained at 8.5 percent in the *Commonwealth of Independent States*[11] in 2007, as high commodity prices, expansionary macroeconomic policies, strong

[11]The group formed in 1991 by 12 of the former Soviet republics: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

capital inflows during most of the year, rapid credit growth, and rising asset prices fueled strong growth in domestic demand.

Growth in *emerging Asia* remained strong throughout 2007, although with some signs of softness, especially in early 2008. External surpluses continued to be large. Growth was led by China, where output expanded by 11.4 percent (year over year) in the second half of 2007, driven by strong investment growth and net exports. The renminbi continued to be tightly managed. Growth in India slowed modestly, to 8.5 percent (year over year) in the second half of 2007 as consumption cooled in response to tighter monetary policy, although investment continued at a brisk pace. The strength of domestic demand in the region, combined with rising food and energy prices, contributed to a buildup of inflation pressures in a number of countries.

Economic activity in *Latin America and the Caribbean* grew by a robust 5.6 percent in 2007, slightly stronger than in 2006. The U.S. slowdown dampened growth in neighboring Mexico, but growth remained high in Central America and in commodity-exporting South American countries while accelerating markedly in Brazil, amid sustained declines in real interest rates and strong employment. Increased domestic demand has been the main driver of growth in the region. Current account surpluses have declined, and inflation has accelerated, driven by high capacity utilization in some countries and by rising food prices.

Building on the largest period of sustained economic growth since independence, the pace of economic activity in *sub-Saharan Africa* accelerated to 6.8 percent in 2007, led by very strong growth in oil-exporting countries and supported by robust expansion in the region's other economies. In non-oil exporting countries, activity was boosted by domestic demand and investment in particular, the payoff from improvements in macroeconomic stability and the reforms undertaken in most countries.

Growth in the *Middle East* also remained strong, reaching 5.8 percent in 2007. Although increases in oil production were limited, high world oil prices supported greater government spending in exporting countries and strong expansion of credit to the private sector. Despite the growth of domestic spending and imports, the large current account surpluses in the oil-exporting countries narrowed only slightly—to about 22.8 percent of GDP—as higher oil prices boosted export revenues; the currencies of these countries continued to be pegged or tightly managed. Growth was even stronger in other countries in the region, spurred by trade, financial spillovers from oil-exporting countries, and domestic reforms. Inflation pressures rose considerably in the Gulf Cooperation Council (GCC)[12] countries because of strong domestic demand, rising food prices, supply constraints in the real estate market leading to higher rents, and interest rate cuts (the latter to match developments in major advanced economies, as required under the GCC countries' pegged exchange rate regimes).

[12]Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

3. Fostering macroeconomic and financial stability and growth through surveillance

Surveillance is at the core of the IMF's mandate. The IMF is responsible, under its Articles of Agreement, for overseeing the international monetary system to identify any vulnerabilities that could undermine its stability. It fulfills this responsibility in part by monitoring the macroeconomic policies of its 185 member countries and providing analysis and policy advice tailored to each member's specific circumstances (referred to as bilateral surveillance) and monitoring economic conditions and developments in international capital markets and assessing the global effects of major economic and financial developments, such as oil market conditions or external imbalances (multilateral surveillance). These activities are supplemented by the Fund's surveillance of regional institutions that conduct monetary and economic policy for groups of countries bound together in formal arrangements, such as currency unions (regional surveillance) (see Box 3.1).

Box 3.1 How the Fund conducts surveillance

Bilateral surveillance. When a country joins the IMF, it makes commitments under Article IV of the IMF's Articles of Agreement[1] to pursue policies conducive to orderly economic growth and price stability and to avoid manipulating exchange rates for unfair competitive advantage. It also commits to providing the IMF with accurate and timely data about its economy. The IMF is mandated by Article IV to oversee members' compliance with these obligations, which it does through ongoing surveillance over members' economic policies. In addition to maintaining contact with the national authorities from its headquarters in Washington, D.C., the IMF sends staff teams to each member country once a year, in most cases. (Informal staff visits often take place between these formal visits, known as Article IV consultations.) During an Article IV consultation, the IMF team analyzes 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, monetary, fiscal, and financial sector policies, and other policies with a direct impact on domestic and external stability.[2] The team may also meet with legislators and nongovernmental parties, such as trade unions, academics, and financial market participants. It 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 team prepares a report describing the economic situation and the talks with the authorities and evaluating the country's policies that is submitted to the Executive Board for review and discussion. The discussion formally concludes an Article IV consultation, and a summary of the Board's views is transmitted to the country's government. Through this kind of peer review, the global community provides policy guidance and advice to each of its members, and the lessons of international experience are brought to bear on national policies. If the member country agrees, the full Article IV consultation report and a Public Information Notice (PIN), which summarizes the Board discussion, are published on the IMF's Web site, in line with the IMF's transparency policy (see Chapter 5).

Through Article IV consultations, the IMF seeks to identify policy strengths and weaknesses, as well as potential vulnerabilities, and advises countries on appropriate corrective actions if needed. Supplementing these systematic and regular Board reviews of individual member countries are frequent informal sessions at which the Board discusses developments in individual countries. On a voluntary basis, countries may also choose to participate in the Financial Sector Assessment Program (FSAP) or to request Reports on the Observance of Standards and Codes (ROSCs) in other areas.[3] Results of these assessments are an important input into surveillance.

Multilateral surveillance. Given the linkages between national economies and financial systems and the international economy and financial markets, the Fund monitors world economic and financial market developments and prospects to help ensure that the international monetary and financial system is functioning smoothly and to identify vulnerabilities that could undermine its stability. Multilateral surveillance is carried out through the Board's reviews of the staff's *World Economic Outlook* (WEO) and *Global Financial Stability Report* (GFSR), which are usually published twice a year. The WEO presents the staff's analysis of global economic prospects and the policies appropriate in different countries, while the GFSR focuses on developments in, and risks confronting, the international financial markets. The Board also holds 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.

Regional surveillance. Bilateral and multilateral surveillance is supplemented by regional surveillance of formal arrangements such as currency unions, whose members have devolved responsibilities over monetary and exchange rate policies to regional institutions, as well as by the preparation of regional economic outlooks that bring together key cross-cutting insights relating to countries with regional ties.

---

[1] The IMF's Articles of Agreement can be found at www.imf.org/external/pubs/ft/aa/index.htm.

[2] The Fund's 2007 Decision on Bilateral Surveillance over Members' Policies includes a principle recommending that members avoid exchange rate policies that result in external instability, regardless of the particular purposes of the policies; implied in this principle is that countries have an overarching commitment to pursue policies consistent with external stability.

[3] See CD-Box 3.1, "ROSCs and Data Standards Initiatives," on the CD-ROM.

As financial markets experienced exceptional turbulence, growth slowed dramatically in some of the advanced economies, and world prices for food and oil soared during FY2008, the IMF's Executive Board intensified its efforts to further strengthen and modernize the Fund's surveillance activities. In June 2007, the Board adopted a new, more comprehensive framework for bilateral surveillance, which replaced the framework that had been in place since 1977. In addition, the Board endorsed efforts aimed at achieving a better understanding of the linkages between national economies and the global economy and between financial markets and the real economy, which is essential to restoring confidence in, and stability to, global financial markets and to improving global economic prospects.[13] New initiatives were also launched, such as coordinating work on developing voluntary principles for sovereign wealth funds (see below).

The Board also sought to deepen the Fund's understanding of fiscal/financial linkages. It held a seminar in February 2008 to examine how fiscal policy can help countries realize the benefits of globalization and financial deepening (Box 3.2).[14]

Box 3.2 Globalization, Financial Markets, and Fiscal Policies

In February 2008, the Executive Board discussed "Globalization, Financial Markets, and Fiscal Policies," a paper prepared by the Fiscal Affairs Department (FAD).[1] The seminar considered how fiscal policy can help countries realize the benefits of globalization and financial deepening.

The impact of globalization on public finances. Executive Directors noted that, despite the general trend toward lower tax rates—for corporate taxes—revenue has been strong until recently. While recognizing that tax competition could be healthy, they pointed out that sustained revenue buoyancy should not be taken for granted and that harmful tax competition could undermine members' revenue. On the expenditure side, globalization could create upward pressure because of demands for more social protection and more investment in human and physical capital. Executive Directors also called for more attention to financial sector contingent liabilities, noting that timely intervention strategies emphasizing preemptive restructuring of at-risk financial institutions could reduce the ultimate fiscal cost, but that such strategies should avoid creating expectations of government bail-outs for financial institutions. On balance, the Board observed that, to the extent that globalization and financial deepening create fiscal pressures, a prepositioning of fiscal policy is warranted. This would not

---

[13] See "The Recent Financial Turmoil—Initial Assessment, Policy Lessons, and Implications for Fund Surveillance," a paper on the crisis written by IMF staff and discussed by the Board, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/pp/longres.aspx?id=4240.

[14] See "IMF Executive Board Holds Seminar on Globalization, Financial Markets, and Fiscal Policies, PIN 08/28, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2008/pn0828.htm.

necessarily mean a tighter fiscal policy, but fiscal policy should be flexible and able to respond to pressures by maintaining room for maneuver in revenue and expenditure policies.

Market access. Greater access to external market financing could either strengthen or loosen fiscal discipline. The effect of market discipline on fiscal policy can be enhanced by increased transparency and a credible political commitment to sound fiscal policies. Globalization and financial deepening could improve the ability of countries with sound policies to borrow abroad in domestic currency, and thus increase debt tolerance.

Fiscal policy with higher capital flows. Globalization and financial deepening have both altered the effectiveness of fiscal policy and led to increased capital flows. The stabilizing role of fiscal policy in response to capital inflows depends on country-specific circumstances. If large capital inflows create aggregate demand pressure, and the scope for using monetary policy is limited, fiscal tightening could be appropriate. In some cases, however, adjustment could occur mainly through the real exchange rate or through temporary capital controls, although in these cases fiscal policy can still be useful. A few Directors, however, noted that fiscal policy may not be the best tool for dealing with significant shifts in capital flows, given the long lags in the implementation of fiscal measures.

Spillovers. Globalization magnifies fiscal policy spillovers. Some Directors agreed that these strengthen the case for enhanced international policy cooperation in certain areas, although some other Directors were reluctant to endorse a new mandate for Fund coordination efforts.

[1]The paper is available on the IMF's Web site, at www.imf.org/external/np/pp/2007/eng/111607a.pdf.

BILATERAL SURVEILLANCE

In FY2008, the Executive Board completed 123 Article IV consultations (see CD-Table 3.1 on the CD-ROM). In line with the new strategic directions endorsed by the Board,[15] more emphasis is being put on strengthening the Fund's global perspective and better integrating the findings of the *World Economic Outlook* (WEO) and the *Global Financial Stability Report* (GFSR), two of the Fund's main instruments for multilateral surveillance (see below) in bilateral surveillance, and improving its analysis of linkages between the real economy and the financial sector and spillovers between national economies and the international economy. The regional dimension is also increasingly informing the Fund's bilateral policy discussions. Selected issues papers and staff reports increasingly focus on regional spillovers

[15]The Statement by the Managing Director on Strategic Directions in the Medium-Term Budget can be found on the CD-ROM and on the IMF's Web site: www.imf.org/external/pp/longres.aspx?id=4243.

and cross-country experiences. As part of the refocusing of the Fund, staff reports on Article IV consultations are being rethought to make the outputs of surveillance timelier, more focused, and more concise, which should enhance their impact.

Exchange rate surveillance is one of the IMF's key responsibilities.[16] Throughout its existence, the Fund has striven to strengthen its framework for assessing exchange rates, adapting it to underlying macroeconomic and financial developments in member countries. The Executive Board updated its surveillance framework, after a year-long review, on June 15, 2007.[17] The 2007 Decision on Bilateral Surveillance Over Members' Policies is much broader and more comprehensive than the 1977 Decision on Surveillance Over Exchange Rate Policies, which it replaces and which was adopted in the wake of the collapse of the Bretton Woods system.[18] By setting clear expectations, the new Decision should help improve the quality, evenhandedness, and effectiveness of IMF surveillance. It also brings greater clarity and specificity to the issues of which exchange rate policies countries should avoid and when these policies may be of concern to the international community. Some of the highlights of the new Decision are described in Box 3.3.

Box 3.3 The 2007 Decision on Bilateral Surveillance

The new Decision expands on the 1977 Decision in a number of important ways, to clarify the framework of surveillance implied by the Articles of Agreement (and thus without creating new obligations for members):

- Introducing, as an organizing principle for bilateral surveillance, the concept of external stability, which encompasses both the current and the capital accounts of the balance of payments.

---

[16]Appendix II, "Financial Operations and Transactions," to this Report contains a brief summary of members' exchange rate regimes in Table II.l3, "De facto classification of exchange rate regimes and monetary policy framework." The Appendix can be found on the CD-ROM and on the IMF's Web site, where the full text and appendixes of the Annual Report are posted.

[17]See "IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies," PIN 07/69, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0769.htm. The Decision can also be found on the CD-ROM and on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0769.htm#decision.

[18]Under the Bretton Woods system, which was established in 1944, central banks of countries other than the United States agreed to maintain fixed exchange rates between their currencies and the dollar, which was convertible into gold at the fixed price of $35 an ounce. The Bretton Woods system collapsed in 1971 when the United States ended the trading of gold at the fixed price.

- Specifying the essential modalities of effective surveillance, including its collaborative nature, the importance of dialogue and persuasion, and the need for candor and evenhandedness, and emphasizing the importance of paying due regard to country circumstances and the need for a multilateral and medium-term perspective.
- Clarifying the concept of exchange rate manipulation in order to gain an unfair competitive advantage over other members, which is prohibited under Article IV of the Fund's Articles of Agreement, and relating such behavior to the concept of fundamental exchange rate misalignment.
- Providing more complete guidance to members for the conduct of their exchange rate policies so as to cover all such policies that may cause external instability, regardless of their particular purpose, as well as to the Fund in its conduct of surveillance.

The Executive Board endorsed the staff's definition of fundamental exchange rate misalignment but underscored the need for appropriate caution in applying it. Executive Directors stressed, in particular, that it should be used with due acknowledgment of the considerable measurement uncertainties involved, and that estimates of misalignment require the exercise of careful judgment. In practice, an exchange rate would be judged to be fundamentally misaligned only if the misalignment were found to be significant, and the benefit of any reasonable doubt would be given to the authorities in establishing whether there is fundamental misalignment. The Board also noted that any judgment on misalignment should be applied in an evenhanded manner regardless of the nature of the exchange rate regime and the size of the economy, and a number of Directors emphasized the potential market sensitivity of estimates of misalignment and the need for care in communicating them.

Key operational aspects in implementing the 2007 Decision are being clarified, including through a [forthcoming] exchange of views among Executive Directors on the concepts and methodologies for assessing external stability, analyzing exchange rates and current account positions, and assessing exchange rate policies, and the Surveillance Guidance Note for staff is expected to be updated in FY2009.[19] In an informal seminar at the

[19]The Surveillance Guidance Note (issued in May 2005) provides guidance to IMF staff on the conduct of bilateral surveillance, in light of its evolution over time and the conclusions of the 2004 Biennial Surveillance Review. The note covers both the content (in particular, the choice of issues to be addressed in an Article IV consultation and the quality of coverage of topics that have received particular attention in Board reviews of surveillance) and the modalities of surveillance. It also provides guidance on the treatment in Article IV consultations of matters related to Article VIII and XIV that concern restrictions on payments and transfers for current international transactions and multiple currency practices. In addition, the note provides guidance on the treatment of other issues that are also not legally part of surveillance under Article IV but, per guidance from

(continued)

end of FY2008, the Board began to review the system and methodology used to classify member countries' de facto exchange rate arrangements to clarify the definitions of the various categories and establish more operational and unambiguous criteria for their application. These discussions will inform this year's *Annual Report on Exchange Arrangements and Exchange Restrictions* (AREAER), which has been published by the Fund since 1950.[20] Prepared in consultation with member country authorities, but reflecting the staff's independent judgment, the AREAER provides a comprehensive description of the exchange rate arrangements, exchange restrictions, controls on capital flows, and other foreign exchange measures of all IMF members.

Complementing the efforts of the Executive Board and the Fund's management and staff to take stock of the effectiveness of surveillance, the IMF's Independent Evaluation Office (IEO) completed an evaluation in FY2007 of the IMF's exchange rate policy advice to member countries. In May 2007, the Executive Board discussed the IEO's recommendations. Based on the recommendations endorsed by the Board, staff and management prepared an implementation plan, which the Board discussed in September 2007 (see Chapter 5).[21] Executive Directors noted that the centerpiece of the implementation plan was, appropriately, the 2007 Decision on Bilateral Surveillance, and that strengthening work related to exchange rate issues would have to be carried out primarily in the context of Article IV consultations. Many Executive Directors agreed that the strengthening of the methodology and expansion of the work of the Consultative Group on Exchange Rate Issues (CGER; see below) would provide important input to the Fund's exchange rate work, although a number cautioned that significant technical limitations would continue to exist in estimating equilibrium exchange rates.

---

the Executive Board, are to be raised in the context of Article IV consultations. Members have no obligation under Article IV surveillance to provide information or to pursue specific policies in these areas.

[20]Appendix II, "Financial operations and transactions," to this Report contains a brief summary of members' exchange rate regimes in Table II.9, "De facto classification of exchange rate regimes and monetary policy framework." The Appendix can be found on the CD-ROM and on the IMF's Web site, at www.imf.org/external/pubs/ft/ar/2008/eng/index.htm.

[21]See "IMF Executive Board Discusses Implementation Plan Following IEO Evaluation of the IMF's Exchange Rate Policy Advice, 1999–2005," PIN 07/119, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn07119.htm.

Since the mid-1990s the CGER has provided exchange rate assessments for a number of advanced economies from a multilateral perspective, with the aim of informing the country-specific analysis of the IMF's Article IV staff reports and fostering multilateral consistency. These assessments are additional tools at the disposal of the IMF staff country desks, which are responsible for formulating exchange rate assessments as part of the Fund's bilateral surveillance. The role of exchange rates in the external adjustment process is increasing as the world economy rapidly becomes more integrated. During the past 15 years, world trade and international financial integration have grown very rapidly, with the ratio of world trade to world GDP increasing by over 40 percent and the ratio of international financial cross-holdings to world GDP more than doubling. Emerging market countries have contributed significantly to these developments, as is evidenced by the increase in their share of world trade—from 27 percent in 1990 to 40 percent in 2006—as well as by their importance in international capital flows. Accordingly, the Fund has extended its CGER methodologies, which can help gauge the consistency of current account balances and real effective exchange rates with their underlying fundamentals, to cover about 20 emerging market countries.[22]

MULTILATERAL SURVEILLANCE

To assist and inform policymakers and the public, the Fund has introduced greater continuity in its multilateral surveillance work, for example, with formal quarterly updates of WEO forecasts and a quarterly financial stability note, to complement its two major vehicles for multilateral surveillance, the WEO and the GFSR, which are published twice a year. It has also deepened its analysis of macro-financial linkages, exchange rates, and spillovers, especially from advanced economies and markets.

[22]In April 2008, the Fund published a paper describing these methodologies, *Exchange Rate Assessments: CGER Methodologies,* as Occasional Paper No. 261. See www.imf.org/external/pubs/cat/longres.cfm?sk=19582.0.

World Economic Outlook

In its September 2007 discussion of the *World Economic Outlook* (WEO),[23] the Executive Board acknowledged that after strong economic growth in the first half of 2007, the global outlook had become exceptionally uncertain and underscored the importance of sound policies and continued vigilance. In its March 2008 discussion, the Executive Board agreed that global growth prospects for 2008 had deteriorated markedly since the January 2008 WEO Update. Executive Directors discussed global economic developments and prospects against the background of exceptional uncertainties about the likely duration and cost of the financial crisis that had spread far beyond the U.S. subprime mortgage market. Growth had slowed in the advanced economies in the face of tightening financial conditions but remained strong in the rapidly globalizing emerging economies. Executive Directors emphasized that the still unfolding events in financial markets posed the greatest risk to the outlook. Many Directors still saw a positive momentum driven by the potential strength of domestic demand in fast-growing emerging economies, while recognizing these economies' exposure to negative external risks through both trade and financial channels. Executive Directors also cautioned that risks related to inflationary pressures and the oil market had increased as commodity prices soared in the context of continued tight supply-demand conditions as well as of growing investor interest in commodities as an asset class and other financial factors. A number of Directors also saw a continued risk of a disorderly unwinding of global imbalances despite the recent depreciation of the U.S. dollar against other flexible currencies and the narrowing of the U.S. current account deficit.

Against this backdrop, Directors underscored that policymakers around the world faced a fast moving set of challenges. The key priorities in the advanced economies were dealing effectively with the financial crisis and countering downside risks to growth while taking account of inflationary pressures and the need to preserve longer-term fiscal sustainability. The challenge for many emerging and developing economies was controlling inflationary pressures while ensuring that strong domestic demand did not lead to a buildup of vulnerabilities. A number of these economies were already facing a fallout from the

[23]The full summings up of the Board's discussions of the October 2007 WEO and the April 2008 WEO can be found on the CD-ROM as well as in the reports themselves, which are available on the IMF's Web site. See www.imf.org/external/ns/cs.aspx?id=29 for links to different issues of the WEO as well as the updates.

slowdown in the advanced economies, and an intensified or prolonged global slowdown would require judicious responses from their policymakers. The Board considered that ensuring the consistency of policy approaches across countries in these difficult global conditions would be important.

More generally, Executive Directors welcomed the ongoing consultations among countries, especially by the monetary authorities of the advanced economies with each other and with international bodies such as the IMF and the Financial Stability Forum (FSF), in dealing with the present financial turmoil. Joint efforts could prove more effective than individual efforts in bolstering confidence and demand. Executive Directors agreed that the Fund was uniquely placed for adding a multilateral perspective to policy responses to the current crisis, providing a forum for discussion and exchanges of views, and promoting consistency of national policies and assessing their spillovers in an increasingly integrated global economy.

Global Financial Stability Report

At their March 2008 discussion of the *Global Financial Stability Report* (GFSR),[24] Executive Directors noted that global financial stability had deteriorated markedly since their discussion of the October 2007 GFSR, which had also focused on financial market turbulence, as the deterioration in the U.S. subprime mortgage market had been followed by severe dislocations in broader credit and funding markets, posing risks to the macroeconomic outlook in the United States and globally. Policymakers' immediate priorities were to reduce uncertainty, mitigate risks to the global financial system, and restore confidence. The Board underscored that, in carrying forward the recommendations in the GFSR, directed at both the public and the private sectors, careful attention should be paid to sequencing and prioritization, to country circumstances, and to coordination among the relevant international and national agencies. It emphasized the role of the Fund in contributing to these efforts, working alongside national and international institutions and bodies.

[24]The full summings up of the Board discussions of the October 2007 and April 2008 GFSR can be found on the CD-ROM as well as on the IMF's Web site. See www.imf.org/external/pubs/ft/GFSR/index.htm.

Executive Directors generally supported the GFSR's finding that markets and investors, the official sector, and monetary authorities had collectively failed to appreciate the extent of leverage taken on by a wide range of financial institutions, and the associated risks of a disorderly unwinding. Private sector risk management, disclosure, financial sector supervision, and regulation all lagged behind rapid financial innovation and shifts in business models, and continuing uncertainty over the size and spread of losses had elevated systemic risks. Potential losses could be sizable, and financial institutions should move quickly to repair their balance sheets by raising equity and medium-term funding.

The resilience demonstrated by emerging markets and developing countries could yet be tested by rising costs, tighter external funding conditions, or a reversal of the recent commodity price boom. A protracted weakening of growth in the advanced economies or a broadening of the problems in financial markets could also have an adverse impact on emerging markets, depending on country circumstances, for example, by increasing the vulnerability to potential capital outflows of those emerging economies that are particularly dependent on advanced economies' direct investments.

It was recognized that a sound understanding of the valuation and accounting of structured finance products was important for comprehending the depth and extent of present financial market instability. The Board noted that there were incentives to rely heavily on short-term wholesale funding to support these longer-term, illiquid structured products. It was also suggested that the rating agencies should review the quality of their methodologies. Executive Directors generally welcomed the prompt and innovative actions of central banks to inject liquidity into the banking system to keep interbank markets functioning smoothly and agreed that the financial turmoil has highlighted the need for central banks to consider more carefully their roles regarding financial stability and monetary policy implementation, noting that these roles were becoming more intertwined. While the authorities in individual countries are moving to stem the effects of disorderly financial market conditions, the Fund should, in coordination with other multilateral bodies such as the FSF as well as with national agencies, play a larger role in international forums to influence policy.

Multilateral consultation

In FY2007, the Fund launched a new vehicle—the multilateral consultation—for the purpose of fostering cooperation among appropriate groups of countries in addressing challenges to the global economy and individual members. The IMF's first multilateral consultation gave its five participants—China, the euro area, Japan, Saudi Arabia, and the United States—a forum for discussing global imbalances and how best to reduce them while sustaining robust global growth. In FY2008, the Board reviewed its experience, concluding that the multilateral consultation discussions have helped deepen agreement on a coherent medium-term approach that identified measures that should gradually reduce imbalances over time while supporting global growth; have been beneficial from a regional and international perspective; and have strong ownership. The participants' individual statements of policy intentions, while not as ambitious as the Fund advised in the context of Article IV consultations and the WEO, still constituted significant steps forward and, once implemented, should contribute substantially toward reducing imbalances over the medium term. Moreover, the publication of these policy intentions has provided a valuable roadmap for the future. Executive Directors recommended that the Fund continue to play an active role in monitoring progress, and this has been done in individual Article IV reports on the relevant members.

Executive Directors considered that the multilateral consultation approach is a useful instrument for enhancing and deepening Fund multilateral surveillance. They noted that the multilateral consultation had two unique aspects: voluntary participation of a limited number of participants that were possible major contributors to a solution to imbalances, and a framework wherein the voice of the entire international community could be heard through the Executive Board and through the International Monetary and Financial Committee (IMFC). These features, together with uncertainty as to what future problems might need to be addressed, warrant retaining flexibility with respect to the operational modalities going forward.[25]

[25]See "IMF Executive Board Discusses Multilateral Consultation on Global Imbalances," PIN 07/97, and "Staff Report on the Multilateral Consultation on Global Imbalances with China, the Euro Area, Japan, Saudi Arabia, and the United States," on the CD-ROM or on the IMF's Web site, at

(continued)

REGIONAL SURVEILLANCE AND OUTREACH

Since members of currency unions have devolved responsibilities over monetary and exchange rate policies—two central areas of Fund surveillance—to regional institutions, the IMF holds formal discussions with representatives of these institutions in addition to its Article IV consultations with the unions' individual members. During FY2008, the IMF's Executive Board discussed developments in the Central African Monetary and Economic Union (CEMAC), the Eastern Caribbean Currency Union (ECCU), and the euro area. It will discuss developments in the West African Economic and Monetary Union (WAEMU) early in FY2009.

Currency unions

CEMAC. Macroeconomic conditions in the CEMAC were highly favorable at the time of the Board discussion, which took place in June 2007,[26] in large part because of sustained high oil prices. Nonetheless, in terms of growth, the region had fallen behind the rest of sub-Saharan Africa, there was little trade and financial integration, dependency on oil revenues had increased, and deep-seated structural impediments to economic diversification remained. These problems need to be addressed urgently if the region is to achieve the Millennium Development Goals (see Chapter 4). The Board thus welcomed the recent reform package adopted by the CEMAC Heads of State, which is intended to strengthen regional institutions and advance the integration process.

ECCU. In its February 2008 discussion, the Executive Board welcomed the ECCU's strong economic performance, characterized by robust growth and generally low inflation. Observing that the region continues to face significant challenges nonetheless, it supported the focus on policies aimed at sustaining growth and building resilience by enhancing competitiveness and economic diversification. The Board also underscored the need to accelerate fiscal consolidation, avoid distortions in tax systems, and control spending. It commended the progress made in enhancing the regulatory framework for the banking

---

www.imf.org/external/np/sec/pn/2007/pn0797.htm. and www.imf.org/external/np/pp/2007/eng/062907.pdf, respectively.

[26]See "IMF Executive Board Concludes 2007 Discussion on Common Policies of Member Countries with CEMAC," PIN 07/81, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0781.htm. The members of CEMAC are Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon.

system and the financial sector more broadly, and recommended continued efforts to strengthen the risk-based supervisory framework. Executive Directors supported the renewed momentum toward economic integration and noted that liberalizing capital and labor flows should play an important role in allowing the region to benefit more fully from globalization. Since data weaknesses remain a key constraint on effective policymaking and surveillance, Executive Directors encouraged the national and regional authorities to bolster statistical practices and data management.[27]

Euro area. In their discussion of euro area policies in July 2007,[28] Executive Directors welcomed the euro economy's move from recovery to upswing. They expected real GDP growth to remain above potential for the near term and employment gains to stay healthy thanks, in part, to reforms of labor markets and welfare systems. However, with rising resource utilization, inflationary pressures could be expected to build gradually and some further monetary policy tightening might be required. They considered the external position of the euro area to be roughly in balance and the real effective exchange rate of the euro to be trading within range of the medium-term equilibrium. Directors welcomed the broad-based structural reforms under way and underscored that their continued implementation, in line with the authorities' commitments under the multilateral consultation (see above), would help strengthen prospects for an orderly resolution of global current account imbalances. Looking forward, population aging was likely to prompt a significant slowing of potential growth; thus, the fundamental challenge in the region is achieving a joint structural acceleration of productivity and labor force participation. Executive Directors emphasized the need for prompt implementation of the Markets in Financial Instruments Directive and welcomed steps to integrate national payments and securities clearing and settlement systems as well as ongoing work to facilitate cross-border bank mergers and acquisitions.

---

[27]The ECCU's members are Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. See "IMF Executive Board Concludes 2007 Discussion on Common Policies of Members of the Eastern Caribbean Currency Union," PIN 08/12, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2008/pn0812.htm.

[28]See "IMF Executive Board Discusses Euro Area Policies," PIN 07/89, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0789.htm.

Other regional surveillance initiatives and outreach

The Fund has also taken other steps in the past few years to expand and strengthen its regional work. Some area departments have created units dedicated to regional issues as well as department-wide working groups on cross-cutting issues. For example, working groups in the African Department are studying such issues as the scaling up of aid, natural resource management, and the development of domestic debt markets; in the European Department, large cross-border capital flows, rapid credit growth, the implications of financial integration for growth and supervision, the use of EU funds by new member states, the competitiveness of the Mediterranean countries, and vulnerabilities in southeastern Europe; and in the Western Hemisphere Department, issues related to the financial sector, monetary and exchange rate policy, pensions, and oil and natural resources. The Fund's Regional Office for Asia and the Pacific, which is located in Tokyo, contributes to research and outreach on regional surveillance.

In addition, the IMF's five area departments now produce *Regional Economic Outlooks* (REOs) twice a year. Publication of the REOs is followed by extensive outreach events—such as seminars for government officials and academics and media briefings and interviews of IMF officials—in several countries in each region. Press releases summarizing REO findings are posted on the IMF's Web site along with the full text of the REOs themselves, as well as transcripts and webcasts of press conferences held upon publication of the REOs.[29]

---

[29]The REOs can be accessed at www.imf.org/external/pubs/ft/reo/reorepts.aspx. Materials related to the REOs can be found on the IMF's Web site. See, for example, the transcript of the press conference following the publication of the April 2008 REO for Asia and the Pacific, at www.imf.org/external/np/tr/2008/tr080411a.htm, and the following press releases: "IMF Regional Economic Outlook for Europe Sees Need for Financial Sector, Fiscal, and Structural Reforms to Tackle Financial Turbulence and Sustain Growth," PR 07/252, www.imf.org/external/np/sec/pr/2007/pr07252.htm; "IMF Regional Economic Outlook for Europe Sees Slower Growth; Explores Challenges Policymakers Face in Seeking to Limit the Impact of Financial Turbulence," PR 08/89, www.imf.org/external/np/sec/pr/2008/pr0889.htm; "IMF Sees Continued Strong Growth, but also Heightened Policy Challenges for Latin America and the Caribbean in 2008," PR 07/249, http://www.imf.org/external/np/sec/pr/2007/pr07249.htm; "IMF Sees Latin America and the Caribbean Region Resilient So Far, But Risks Ahead," PR 08/83, www.imf.org/external/np/sec/pr/2008/pr0883.htm; "IMF's Regional Economic Outlook for the Middle East and Central Asia Sees Continued Positive Near-Term Economic Outlook, but the Region Faces Challenges to Sustain Ongoing Transformation and Reduce Unemployment," PR 07/241, www.imf.org/external/np/sec/pr/2007/pr07241; "Sub-Saharan Africa: Regional Economic Outlook," PR 07/237, www.imf.org/external/np/sec/pr/2007/pr07237.htm; and "Sub-Saharan Africa

(continued)

The IMF also organizes and participates in various regional forums. In June 2007, for example, the IMF participated in the Sixth Annual Regional Conference for Central America, which brought together ministers of finance, central bank governors, and financial sector superintendents from Central America, Panama, and the Dominican Republic to discuss two major regional projects—the consolidation of supervision of regional financial conglomerates and fiscal coordination, including the establishment of a customs union for Central America—as well as the development of equity and private debt markets and fiscal policies to support economic and social stability. In October 2007, IMF staff and the Honduran authorities held a regional workshop on medium-term expenditure frameworks. The workshop was attended by budget officials from Central America, the Dominican Republic, and Panama, and speakers from the IMF, the World Bank, the Inter-American Development Bank, Colombia, and Spain. In November 2007, the IMF's Western Hemisphere Department organized a conference on economic and financial linkages in the Western Hemisphere. A regional seminar on globalization and taxation, involving finance ministers and senior officials from 13 African countries, was held in February 2008 in Nigeria; a high-level seminar on African finance was held in Tunis in March 2008 (see Chapter 4). The IMF also participated in the April and September 2007 meetings of the Trade Policy Coordination Committee of the Central Asia Regional Economic Cooperation program, held in Manila; the annual meeting of the finance ministers and central bank governors of the Gulf Cooperation Council, held in Jeddah in October 2007; and a conference on the role of the private sector in economic development and regional integration in the Maghreb, held in Tunis in November 2007.

In June 2007, the IMF held a policy seminar on financial integration in the Nordic-Baltic region, at which IMF staff and Executive Directors, the European Central Bank representative to the IMF, and academics discussed an IMF study of the arrangements for cross-border oversight and crisis management. The study highlights gaps that may have arisen as a result of growing financial integration in the region. Since financial integration is also increasing in Europe as a whole, and most countries in the Nordic-Baltic region are also

---

Spring 2008 Regional Economic Outlook: Growth Expected to Remain Robust but Global Developments Cloud Prospects," PR 08/86, www.imf.org/external/np/sec/pr/2008/pr0886.htm.

bound by the European regulatory framework, addressing these challenges may need to be considered in this broader European-wide context.[30]

As part of its initiative to hold periodic seminars on economic developments and prospects in the Caribbean, the Board held its first such seminar in September 2007.[31] Executive Directors noted that the historically open nature of the Caribbean economies had served them well, enabling them to achieve relatively high per capita income levels. The macroeconomic performance of the region had been favorable in recent years, and its commitment to social development and equitable growth has contributed to notable progress in health care, education, and poverty eradication. Nonetheless, the region is vulnerable because of its limited economic diversification; persistent, large current account deficits; large public debt; and exposure to natural disasters—hurricanes, in particular. Executive Directors welcomed the initiative to establish the Caribbean Single Market and Economy, increased regional cooperation being key to enabling the Caribbean countries to make the most of globalization, and considered that closer integration of the Caribbean's still largely segmented financial markets could boost growth. They noted that the Caribbean countries' heavy reliance on tax incentives to attract investors was costly in terms of forgone revenues and recognized that the erosion of preferential access to European markets for bananas and sugar would entail significant losses for several countries in the region. Directors also emphasized the importance of timely disbursement of aid and concessional assistance in support of countries' adjustment and restructuring efforts.

FINANCIAL SECTOR SURVEILLANCE

The Fund has been strengthening its financial sector surveillance work at the bilateral, multilateral, and regional levels, on an ongoing basis, working on the development of analytical tools for assessing financial sector stability, both at the institutional level and system-wide, and quantitative analytical methodologies for identifying, measuring, and assessing the impact of financial sector credit and liquidity risks and improving stress testing.

---

[30] The paper, "Financial Integration in the Nordic-Baltic Region: Challenges for Financial Policies," is available on the IMF's Web site, at www.imf.org/external/np/seminars/eng/2007/nordbal/pdf/0607.pdf.

[31] See Public Information Notice 07/124, "IMF Executive Board Discusses Selected Regional Issues in the Caribbean," available on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn07124.htm.

These tools have already been applied in the Fund's work, in particular in the context of financial sector assessment programs (FSAPs). Initiatives in FY2008 included analytical and policy-related work on the impact of the financial crisis that began in mid-2007 on economic activity; more emphasis on macro-financial linkages in the conjunctural sections of the WEO; greater focus on financial sector analysis in Article IV consultations and continued emphasis on FSAPs; internal training on financial sector issues; data collection initiatives that focus on the position of financial institutions vis-à-vis other sectors and the associated risks; and analytical and empirical work on how financial and real sector reforms complement each other. Fund staff continued to collaborate with the FSF and its working groups, as well as to consult with the private sector, regulators and national authorities, standard setters, and other bodies.

Assessment of financial crisis and recommendations

In its October 2007 communiqué, the International Monetary and Financial Committee asked the Fund to reflect on the underlying causes of, and policy lessons from, the turmoil that erupted in financial markets in August 2007. In response, five working groups in the IMF's Monetary and Capital Markets Department, in close cooperation with the relevant FSF working groups and other stakeholders, studied the structural causes of the ongoing crisis and drew up a set of recommendations of a medium-term nature. Their findings were discussed by the Board in April 2008 and are summarized in Box 3.4.[32] The shorter-term policy responses that may be required to help manage and mitigate the crisis are discussed in the *Global Financial Stability Report* (see above).

Box 3.4 Summary of MCM Working Group Policy Recommendations

Findings	**Lessons and recommendations**
Risk-management practices	
Risk management practices in many financial institutions reflected	Risk managers should challenge aggressively the assumptions underlying risk-management and pricing

[32]See "The Recent Financial Turmoil—Initial Assessment, Policy Lessons, and Implications for Fund Surveillance," the paper discussed by the Board, which can be found on the CD-ROM as well as on the IMF's Web site, www.imf.org/external/np/pp/eng/2008/040908.pdf.

shortcomings of both judgment and governance. Institutions relied too heavily on model-based strategies that were based on limited historical data, without due regard for their limitations. Hedging strategies were overly concentrated and, especially in the case of structured financial products, inadequate attention was paid to tail and liquidity risks.	models and scrutinize their firms' risk profile, including hedging strategies, counterparty risk, and possible second-round effects from market shocks. Senior managers need to ensure that internal governance structures are robust and that information and decision-making responsibilities are well defined and appropriate. Supervisors need to take a more active role in monitoring risk management and encourage more rigorous stress testing, especially during good times. Regulators may wish to consider whether the opacity and complexity of structured credit products such as ABS CDOs (collateralized debt obligations consisting of portfolios of bonds of asset-backed securities) undermine market discipline and require prudential or other measures, while guarding against the risk of overregulation.
Valuation, disclosure, and accounting	
The accounting treatment of structured products and shortcomings in valuation models and financial reporting contributed to the depth and duration of the crisis.	Supervisors should ensure that financial institutions develop robust pricing, risk management, and stress-testing models. Consideration should be given to raising prudential norms (for example, capital buffers) for structured financial products. Supervisors should promote better internal processes within regulated entities for managing valuation-modeling risk. Cross-border convergence of accounting and regulatory standards, as well as of bank disclosure requirements, should be sought, especially where global financial institutions are involved. Disclosure of off-balance sheet holdings, SIVs (structured investment vehicles), and conduits should be enhanced.

	Steps could be taken to improve price discovery and liquidity of hard-to-value securitized instruments—for example, greater standardization and development of a centralized registry.
Credit-rating-agency practices	
Credit-rating methodologies failed to capture the risks embodied in structured products. Investors in structured products relied too heavily on ratings and did not appreciate the products' vulnerability to sharp price changes and multiple-notch downgrades.	Credit rating agencies should improve rating methods and practices. At a minimum, they should introduce differentiated ratings for structured products, disseminate information on the susceptibility of the ratings of such products to downgrades, and disclose more information about rating methodologies.
	Approval and licensing procedures could be used to reduce potential conflicts of interest in the credit-rating industry and spur improvements in transparency and the disclosure of rating methodologies.
	National authorities and the major international standard setters should review the use and effectiveness of credit ratings in prudential regulation, especially in light of possible changes to the ratings scales applied to structured products.
Supervision and crisis management	
Consolidated supervision was inadequate, and supervisors did not adequately account for the risks associated with new financial instruments, nor did they address deterioration in underwriting standards. Gaps in crisis-management and bank-resolution frameworks were also exposed.	The Basel II framework will permit a more risk-sensitive approach to supervision, and countries with internationally active banks will need to adopt it quickly. But the transition to Basel II will need to be carefully managed since partial or incomplete implementation would pose risks; the application of capital floors may need to be extended; and particular attention should be paid to the impact analysis from the parallel run period.
	Supervisory practices, such as the frequency of on-site supervision and the use of external auditors, need to be strengthened, and supervisors need to be given adequate resources to perform their duties effectively.

	Consolidated supervision and prudential reporting should be applied to off-balance-sheet entities, with better regard to reputational risks and contingent liabilities.
	Bank-resolution and deposit-insurance frameworks need to be strengthened, and interagency coordination needs to be more effective. Central banks should remain well informed and involved.
	Minimum underwriting and consumer-protection standards should apply to all financial intermediaries to limit excessive risk taking and regulatory arbitrage.
Central bank liquidity	
Shortcomings in existing emergency-liquidity frameworks led to disruptions in interbank markets and exacerbated the turmoil.	Central banks need to be able to lend to a sufficiently broad set of counterparties and accept a sufficiently broad range of collateral while avoiding excessive counterparty/credit risk. Care is needed to avoid unduly stigmatizing the use of central bank liquidity. There would be merit in improving collaboration among central banks, including by establishing a more permanent set of emergency swap lines to address problems of liquidity in foreign currency, and in seeking greater convergence in operational frameworks.

Even though the turmoil in financial markets was still evolving at the close of FY2008, and consensus on the appropriate policy responses was still emerging, the Fund's surveillance has already responded. Recent developments suggest there is scope to sharpen surveillance and policy advice in the following areas:

- In its dialogue with supervisors and regulators, the Fund should seek to ensure that risk-management practices in financial institutions are adequate, especially with regard to complex structured finance products, and that stress testing by both private sector institutions and supervisors is robust.

- Many of these issues are also relevant to the Fund's dialogue with central banks. In countries where central banks do not have supervisory functions, it is particularly important to assess the degree of cooperation with banking supervisors and arrangements for coordinated action and early intervention in the event of financial sector stress.

- The Fund should pay special attention to the authorities' stress-testing and bank-resolution frameworks in emerging market countries, especially those that have either large current account deficits financed by debt-creating flows or financial sectors dominated by banks from mature markets or both. Although emerging market countries have thus far proved resilient to the turmoil in financial markets, the risk of contagion is significant in countries with these characteristics.

Financial Sector Assessment Program (FSAP)

Assessments under the FSAP, a joint initiative of the IMF and the World Bank, are an important input into surveillance, and the Fund continues to carry them out selectively. The FSAP was introduced in 1999 to provide member countries, on a voluntary basis, with a comprehensive evaluation of their financial systems and provides the basis for the IMF's Financial System Stability Assessments (FSSAs)—assessments of risks to macroeconomic stability stemming from the financial sector, including the latter's ability to withstand macroeconomic shocks. Regional FSAPs are also undertaken for currency unions, notably where significant regulatory and supervisory structures are at the regional level. Regional FSAPs have been completed for CEMAC and ECCU, and an FSAP for WAEMU was under way at the end of the Fund's financial year.

With a total of 121 initial assessments now completed or under way, the IMF and the World Bank are increasingly focusing on FSAP updates. The core elements of updates include financial stability analysis, factual updates of the observance of standards and codes included in the initial assessment,[33] and a reassessment of key issues raised in the initial assessment.

In FY2008, 17 FSAPs were completed, of which 12 were updates;[34] another 45 (of which 24 are updates) are either under way or agreed and being planned.

Collaboration with other institutions

The Fund also works closely with other organizations on financial sector issues. It has increased its collaboration with the World Bank in this area in the context of the Joint Bank-Fund Management Action Plan (see Chapter 5). It has also strengthened its analysis of vulnerabilities in advanced economies and collaboration with standard setters (such as the Basel Committee on Banking Supervision), central banks, and finance ministries in conjunction with the FSF and the G-20. It prepared a Global Financial Stability Note for the FSF's March 2008 meeting and has sponsored or cosponsored a number of conferences and seminars on financial sector issues (Box 3.5).

Box 3.5 Collaboration and outreach on financial sector issues

During FY2008, the IMF sponsored or cosponsored a number of conferences and seminars on financial globalization and financial stability.

In December 2007, the IMF Regional Office for Asia and the Pacific (OAP), the 21 COE-Market Quality Project of Keio University, and the Financial Research and Training Center of Japan's Financial Services Agency hosted the conference "Financial Stability and Financial Sector Supervision: Lessons from the Past Decade and Way Forward," in Tokyo. The conference brought together a select group of senior officials from the Asia-Pacific region, international financial institutions, academics, private sector representatives, and other stakeholders to review the progress that had been made in banking reform and financial sector supervision and examination over the last 10 years. Discussions focused on the readiness of financial systems in developing countries in the region to cope with ongoing changes in the global financial landscape, including through an effective implementation of the Basel II standards.

The Fund also cosponsored seminars and conferences with member countries and think tanks. In September 2007, it cohosted with the U.S. Federal Reserve Bank of Chicago the "Tenth Annual

[33] Factual updates describe developments that are relevant to compliance with standards and codes but do not reassess the ratings in the initial FSAP.

[34] These numbers refer to FSSAs discussed by the Board during FY2008.

International Banking Conference: Globalization and Systemic Risk," which provided a forum where policymakers from advanced and emerging market countries and academics could discuss the current landscape of cross-border banking activity; how systemic risk may be enhanced or contained by globalization; the potential sources of systemic risk (particularly banks, insurance companies, pension funds, hedge funds, and other capital market participants); regulatory efforts to address systemic concerns; and policy alternatives that need to be considered. In January 2008, the Fund cohosted a seminar with the Brookings Institution in Washington, D.C., "Global Downturn? The World Economy in 2008."[1] In April 2008, it cosponsored the Conference on International Macro-Finance in Washington, D.C., in collaboration with the World Economy and Finance Research Programme of the U.K. Economic and Social Research Council. Participants included, in addition to IMF staff, representatives from central banks of several member countries and leading academics. The conference served as a forum where participants could present recent theoretical and empirical research narrowing the gap between "open-economy macro" and "finance" approaches to international financial issues.

[1]The transcript of the seminar is available on the CD-ROM and on the IMF's Web site, at www.imf.org/external/np/tr/2008/tr080131.htm.

Vulnerability Exercise

The Vulnerability Exercise established in 2001 provides regular cross-country assessments of vulnerabilities and crisis risks in emerging market economies. The Fund revamped the methodology in FY2008 to distinguish between underlying vulnerabilities and crisis risks, which facilitates the identification of underlying weaknesses in a benign environment when crisis risk is low. It also intends to extend this exercise to mature markets. The Spring 2008 Vulnerability Exercise focused on the impact of global turmoil on emerging market economies, the risk that asset price booms could end in sharp corrections, and the risk that a decline in capital inflows could precipitate a further downward spiral of asset prices, loan quality, and growth prospects.

Sovereign Wealth Funds

Sovereign wealth funds (SWFs) are becoming increasingly important players in the international monetary and financial system, and their assets have increased to an estimated \$1.9–\$2.8 trillion—this is in addition to the dramatic growth of international reserve holdings, which reached \$6 trillion at the end of 2007. SWFs offer various economic and financial benefits—in the home country, they facilitate the intergenerational transfer of wealth, help prevent boom-bust cycles, contribute to fiscal stability, and allow for better portfolio diversification of sovereign assets, while they can have a stabilizing influence in global financial markets and enhance liquidity, as evidenced by SWFs' recent injections of capital into several large banks (see Chapter 2)—but they also pose challenges for policymakers.

At the 2007 Annual Meetings, the Communiqué of the International Monetary and Financial Committee welcomed the work by the IMF to engage in a dialogue with countries on identifying a set of best practices for SWFs.[35] In November 2007, the Fund convened the first annual roundtable of sovereign asset and reserve managers in Washington, D.C., to facilitate the exchange of ideas and experiences in the management of reserves and other sovereign assets. The roundtable was attended by high-level delegations from central banks, finance ministries, and sovereign asset managers from 28 countries. Discussions covered trends in reserve accumulation and their implications for central bank balance sheets.

At the Executive Board's discussion of SWFs in March 2008,[36] most Executive Directors considered that the Fund was well placed to facilitate and coordinate the development of generally agreed principles and practices for SWFs and stressed that this work should go hand in hand with work being undertaken at the Organization for Economic Cooperation and Development (OECD) and elsewhere. Executive Directors supported an inclusive, collaborative approach with SWFs that would involve relevant members and stakeholders, and agreed that these principles and practices would be adopted on a voluntary basis.

In its April 2008 Communiqué,[37] the International Monetary and Financial Committee welcomed the IMF's initiative to work as a facilitator and coordinator with SWFs

[35]The Communiqué can be found on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/cm/2007/102007a.htm.

[36]See "IMF Executive Board Discusses a Work Agenda on Sovereign Wealth Funds," PIN 08/41, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2008/pn0841.htm. The background paper prepared by the staff can also be found on the CD-ROM and on the IMF's Web site, at www.imf.org/external/np/pp/eng/2008/022908.pdf.

[37]The Communiqué is available on the CD-ROM and on the IMF's Web site, at www.imf.org/external/np/cm/2008/041208.htm.

in developing a set of best practices and stated that it looked forward to reviewing the progress made at its next meeting.

On April 30–May 1, 2008, representatives of SWFs met at IMF headquarters in Washington, D.C., with representatives from the countries in which they invest, the Organization for Economic Cooperation and Development, and the European Commission. The SWFs formally established an international working group that is tasked with developing by October 2008 a common set of voluntary principles for SWFs, drawing on the existing body of principles and practices, that properly reflects their investment practices and objectives. The IMF will provide the secretariat for the working group, which is composed of representatives from 25 IMF member countries. The working group is cochaired by a senior representative of the Abu Dhabi Investment Authority and the Director of the IMF's Monetary and Capital Markets Department, who were selected by the participating SWFs.

AML/CFT

The Fund's work on anti–money laundering and combating the financing of terrorism (AML/CFT) is focusing on the assessment of countries that are systemically important or that present acute risk, including emerging and middle-income countries whose financial systems have outpaced their AML/CFT capacity. In accordance with its efforts to become a more cost-effective and efficient institution, the Fund is seeking to mobilize external financing for its AML/CFT work.

Financial soundness indicators

Financial soundness indicators are a relatively new body of economic statistics that are used, along with other economic and financial indicators, to assess the financial strength and vulnerabilities of a country's financial sector. The IMF worked closely with national agencies and regional and international institutions to develop a set of core and encouraged FSIs. The Executive Board endorsed the FSIs in 2001 and a work program in 2003 aimed at increasing the capacity of member countries to compile FSIs and expanding reporting and analysis of FSIs in the work of the Fund. As part of this work program, the IMF produced the *Financial Soundness Indicators Compilation Guide* and launched a voluntary Coordinated Compilation Exercise (CCE) in 2004. The 62 participants undertook to compile the 12 core FSIs and as many of the 28 encouraged FSIs as possible and to provide them, the underlying data series, and related metadata to the IMF for dissemination. FSIs are routinely monitored by the IMF as part of the its enhanced surveillance of financial systems and are frequently reported in staff reports and FSAP reports.

In November 2007, the Executive Board reviewed the experience with the work program and discussed proposals for taking the work on FSIs forward.[38] Executive Directors were of the view that FSIs represented an important starting point for analysis of financial stability and a key element of the IMF's financial soundness assessment toolkit. They urged that FSIs continue to be a standard part of surveillance, FSAP reports, and the IMF's Vulnerability Exercise, and welcomed the increasing reporting of such indicators in staff reports. Noting that FSIs need to be interpreted with caution, given the diversity of the accounting, regulatory, and legal systems that underpin them, the Board called for further progress on improving cross-country comparability and encouraged continued efforts by the IMF and other international agencies to harmonize data compilation methodologies and reporting. Directors saw clear value in the regular collection and dissemination of FSIs by the IMF, with the creation of a centralized public FSI database that would be available to member countries, international institutions, and markets. Directors agreed that countries should be encouraged—but not required—to report FSIs to the IMF.

FRAMEWORK OF DATA PROVISION FOR SURVEILLANCE AND OTHER DATA INITIATIVES

Data provision to the Fund for surveillance purposes

A review by IMF staff of the policy framework for data provision for surveillance, submitted to the Executive Board at the end of FY2008 and discussed in early FY2009, considered that the overall framework remained appropriate, but suggested efforts to clarify staff's assessments of data adequacy, strengthen data reporting for assessments of external stability, improve country participation and coverage for financial sector data initiatives, and take appropriate action in cases where members, despite adequate capacity, fail to provide data.

[38]See "IMF Executive Board Concludes Financial Soundness Indicators—Experience with the Coordinated Compilation Exercise and Next Steps," PIN 07/135, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/07135.pdf.

Fiscal and data transparency

The need for monetary and financial statistics that are accurate, comprehensive, comparable across countries, and widely available on a timely basis has been underscored by modern episodes of instability in financial markets, including the recent stresses in the loan and securities markets. During FY2008, the Fund undertook several initiatives to enhance the transparency and quality of financial sector data in its member countries (Box 3.6). It reconvened the Working Group on Securities Databases and hosted a workshop organized by the Irving Fisher Committee on Central Bank Statistics. It published *Monetary and Financial Statistics: A Compilation Guide,* a companion to the *Monetary and Financial Statistics Manual.* The new Guide is intended to help countries compile high-quality data in accordance with current best practices. During FY2008, the number of economies reporting international investment position data for the Fund's statistical publications continued to increase, reaching 113 at end-2007.

Box 3.6 Initiatives on financial sector data

Well-functioning local-currency bond markets can contribute to strong and sustainable economic growth and financial stability in emerging market and developing countries, but internationally comparable data on bond markets are limited. Information about these markets is typically spread across different organizations that use different classifications and data exchange formats. In 2007, the finance ministers of the Group of Eight (G-8) countries called on the IMF and other international organizations to improve the quality, comparability, and consistency of these data.

In response, the IMF reconvened the Working Group on Securities Databases, which it chairs, to discuss the development of a global securities database. The other members of the Working Group when it was established by the IMF in 1999 were the Bank for International Settlements (BIS) and the European Central Bank (ECB). Its work was put on hold in 2001 until the ECB's development of a Centralized Securities Database was more advanced. In September 2007, representatives from the BIS, the ECB, the World Bank, the Deutsche Bundesbank, the Bank of Mexico, and the U.S. Federal Reserve met at IMF headquarters in Washington, D.C., to take stock of the available data on local debt markets in emerging market and developing countries and to identify any gaps. Participants established that the BIS and the ECB both had databases on domestic and international debt securities that could be developed to meet the requirements of users of statistics. Following up on this meeting, in March 2008 the IMF hosted a workshop organized by the Irving Fisher Committee on Central Bank Statistics. Participants in the workshop, who included representatives from international and regional organizations as well as from central banks and statistical offices in a wide range of countries, came together to discuss the challenges of compiling securities statistics as well as specific methodological issues. They agreed on the need for a guide on compiling securities statistics, since there is as yet no international standard in this area. The guide will focus initially on statistics on debt securities but will eventually be expanded to cover other securities and securities holdings.

In addition, in April 2008, the IMF published the Monetary and Financial Statistics: Compilation Guide, which is aimed at providing direct assistance to data compilers at the national level who are responsible for implementing the methodological and statistical frameworks contained in the IMF's Monetary and Financial Statistics Manual, which was published in 2000. By including the compilation of flow data, the Guide and the Manual represent a major advance in the guidance the IMF has been providing to countries since 1948 on monetary statistics; the focus had previously been on the compilation and reporting of balance-sheet data (end-of-month stocks) for the central bank and other depository corporations. The Guide focuses on the cross-country harmonization of source data and methodology for the compilation and presentation of the statistics. It also describes the unified framework for countries' reporting of monetary data to the IMF. In 2004, the Fund introduced the Standardized Report Forms (SRF) for countries' reporting of balance-sheet data for depository corporations, insurance corporations, pension funds, and other institutional types of financial corporations. Thus far, more than 100 countries/territories have established monthly reporting of SRF data, and time series from these data are published in the IMF's quarterly International Financial Statistics: Supplement on Monetary and Financial Statistics. The Guide also introduces illustrative supplementary data, disaggregated by maturity, currency denomination, and type of interest rate, of sectoral balance-sheet accounts of central banks, other depository corporations, and other financial corporations. The supplementary data include subcategories—by type of contract—for financial derivatives. The financial statistics described in the Guide, which record the distribution and redistribution of financial assets and liabilities among the sectors of an economy on a quarterly basis, are an important input to the IMF's balance-sheet approach to analyzing a country's vulnerability to external or internal shocks.

Finally, in FY2009, the Fund will also initiate regular collection and dissemination of financial soundness indicators (FSIs) and will create a publicly available database. Countries will be encouraged—but not required—to report FSIs to the Fund.

The Executive Board approved in May 2007 the Fund's revised *Code of Good Practices on Fiscal Transparency,* a central element in IMF actions to promote transparency and good governance. The revisions reflected a broad consultative process, in which country authorities, civil society organizations, international institutions, academia, and the private sector took part. Revised versions of the *Manual on Fiscal Transparency* and the *Guide on Resource Revenue Transparency* were also published. Assessments of practices under the

Code of Good Practices on Fiscal Transparency have so far been published for 86 countries as part of the voluntary Standards and Codes Initiative, which was launched in 1999.[39] Fiscal transparency is one of 12 topics covered by the Initiative, under which the IMF and the World Bank respond to member countries' requests for summaries of their observance of good practice standards in three broad areas—transparent government operations and policymaking, financial sector standards, and market integrity standards for the corporate sector. The assessments are designed to help countries strengthen their economic institutions, to inform the work of the IMF and the Bank, and to inform market participants (see CD-Box 3.1).[40]

In February 2008, the IMF and the World Bank released new, enhanced versions of the Quarterly External Debt Statistics (QEDS) database and the Joint External Debt Hub (JEDH). The QEDS database, which was initially launched in 2004, brings together external debt statistics that are normally published individually by countries that subscribe to the IMF's Special Data Dissemination Standard (SDDS). To further enhance the availability of external debt data, the World Bank and the IMF invited a group of low-income countries that participate in the IMF's General Data Dissemination System (GDDS) to report a simplified quarterly set of data focusing on the external debt of the public sector. Fourteen countries have accepted the invitation, and 12 of them have already started providing the requested data. The intention is to expand the number of reporting countries over time.[41] The JEDH is a joint undertaking of the Bank for International Settlements (BIS), the IMF, the OECD, and

[39]Further information on the Standards and Codes Initiative and copies of country assessments can be found on the IMF's Web site, at www.imf.org/external/np/rosc/rosc.asp.

[40]See "IMF Launches Revised Fiscal Transparency Code and Manual," PR 07/95, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2007/pr0795.htm. The *Code* and the *Manual* are also available on the IMF's Web site, at www.imf.org/external/pp/longres.aspx?id=4175 and www.imf.org/external/pp/longres.aspx?id=4177, respectively.

[41]The SDDS was established in 1996 to guide countries that have or seek access to international capital markets and that already meet high standards for the quality of their statistical data. The GDDS was established in 1997 to help countries improve their statistical systems and is open to all IMF members. Both are voluntary, but once a country subscribes to the SDDS, observance of the standard is mandatory. See CD-Box 3.1 and *The IMF's Data Dissemination Initiative After 10 Years,* at www.imf.org/external/pubs/ft/books/2008/datadiss/dissemination.pdf.

the World Bank. It represents a further step by the institutions involved to facilitate and encourage worldwide dissemination of external debt data by as many countries as possible.[42]

Coordinated Direct Investment Survey

In 2007, the IMF decided to undertake a Coordinated Direct Investment Survey in collaboration with its Inter-Agency Task Force partners, including the OECD, the Statistical Office of the European Communities, the ECB, and the United Nations Conference on Trade and Development. All Fund member countries and a few non-members were invited to participate. As of April 2008, 135 countries had indicated a willingness to participate in the survey. The survey will collect information on outstanding direct investment positions, broken down by equity and debt, and then by debt assets and liabilities, by counterpart country as of the end of 2009. The survey will also capture world totals and the geographic distribution of positions and therefore contribute to improved understanding of globalization. The first results are expected to be available by the end of 2010 or early in 2011 and to be published by the IMF. A task force was formed in 2007 to assist the IMF in preparing a guide for countries responding to the survey.[43] The survey is the first such undertaking by the IMF in a coordinated manner on direct investment data. It is, to a large extent, modeled on the very successful Coordinated Portfolio Investment Survey (CPIS), which has been conducted under the auspices of the IMF on an annual basis since 2001.[44]

The Data Standards Initiatives

Data standards continue to play an important role for strengthening Fund surveillance. Implementation of the Fund's Data Standards Initiatives is progressing, with 64 SDDS subscribers and 92 GDDS participants, together representing about 85 percent of the Fund's membership. In February 2008, in an informal seminar, the Executive Board discussed a paper reviewing 10 years of experience with the GDDS, which points to possible future directions and emphasizes data dissemination and plans for improvement that focus on the periodicity and timeliness of data. An outreach program with member countries is in progress

---

[42]See "IMF and World Bank Expand Databases on External Debt Statistics," PR 08/37, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0837.htm.

[43]The Guide can be found at www.imf.org/external/np/sta/cdis/index.htm.

[44]The data on the CPIS can be found at www.imf.org/external/np/sta/pi/cpis.htm.

(two consultations were held in April 2008, one in South Africa and the other in Thailand). A Seventh Review of the Fund's Data Standards Initiatives will be discussed by the Executive Board in the fall of 2008.

THE TRIENNIAL SURVEILLANCE REVIEW

Over the past 30 years, the Executive Board has reviewed the IMF's surveillance work at regular intervals.[45] At a Board briefing in April 2008 based on an Issues Note prepared by staff, Executive Directors began discussing the design of the Triennial Surveillance Review, which will provide them with an opportunity to discuss strategic issues related to refocusing the Fund's surveillance, including focus, quality of analysis in key areas—macro-financial linkages and a multilateral perspective in bilateral surveillance—candor and consistency in assessing external stability, and effectiveness of surveillance communication. It is envisaged that the Review will lead to the adoption, by the time of the 2008 Annual Meetings of the IMF and the World Bank, of a Statement of Surveillance Priorities that will help focus surveillance across the Fund, underpin policy dialogue with members, and enhance accountability.

[45]Under the 1977 Surveillance Decision, reviews of the surveillance procedures and the implementation of surveillance were conducted biennially from 1988 to 2004. In accordance with the Medium-Term Strategy's call for streamlining IMF procedures, the new 2007 Decision provides for triennial reviews.

4. Program support and capacity building

The IMF provides support to its member countries through a variety of instruments, depending on their needs. It has a number of different lending facilities (Table 4.1) as well as mechanisms for providing policy support without financing, and also provides, at the request of members, technical assistance (TA) and training that are consistent with the purposes of the Fund. The IMF's Executive Board regularly reviews these instruments to ensure that they continue to meet the evolving needs of member countries.

Consideration and approval of members' requests for financial assistance and program support are core responsibilities of the Board, alongside surveillance. Under its lending facilities, the IMF makes temporary financing available to member countries to give them time to adjust their policies so as to overcome short-term balance of payments problems, such as insufficient foreign exchange to purchase needed imports or make payments on external obligations; stabilize their economies; and avoid similar problems in the future. IMF financing is provided in support of economic reform programs developed by member countries themselves in collaboration with the IMF, and is expected to have a catalytic effect, enabling a country to restore confidence in its policies and attract additional financing from other sources. The Executive Board regularly evaluates members' performance under their programs, and, in most cases, funds are disbursed as program targets are met.

TA and training help member countries fulfill the commitments they make when they join the IMF—to pursue policies that foster financial and macroeconomic stability, sustainable economic growth, and orderly exchange rate arrangements, and to provide the IMF with timely, accurate, and high-quality data about their economies. TA and training are also vehicles for helping member countries implement the recommendations that come out of the IMF's Article IV consultations (see Chapter 3). Hence, aligning and integrating capacity building with surveillance and program work have become key objectives of the IMF's Executive Board. The IMF offers TA and training mainly in its core areas of expertise, including macroeconomic policy, tax and revenue administration, public expenditure management, monetary policy, exchange systems, financial sector reforms, debt management, and macroeconomic and financial statistics. In recent years, member countries have increasingly requested assistance in addressing issues related to globalization and investment, such as preventing money laundering and the financing of terrorism; strengthening public investment, public-private partnerships, and management of fiscal risks; adopting international standards and codes for data and financial and fiscal management; correcting weaknesses identified under the joint IMF–World Bank Financial Sector Assessment Program; and carrying out debt sustainability analyses.

FINANCIAL ASSISTANCE AND POLICY ADVICE

Financing under the IMF's main credit facilities is subject to charges (interest) and in some cases may be subject to surcharges, depending on the type and duration of financing and the amount of IMF credit outstanding. The bulk of such financing is provided through Stand-By Arrangements, which address short-term balance of payments difficulties, and Extended Arrangements, which focus on external payments difficulties caused by longer-term structural problems. In FY2008, the Fund's Executive Board approved SDR 934.2 million in the use of Fund resources under these facilities (Table 4.2), which included three precautionary Stand-By Arrangements—for Gabon (36 months, SDR 77.2 million), Honduras (12 months, SDR 38.9 million), and Iraq (15 months, SDR 475.4 million)—and a 36-month Extended Arrangement for Liberia (SDR 342.8 million), extended as a blend with concessional financing under the PRGF. In addition, the Board approved a decrease in the amount of SDR 35 million of an existing Stand-By Arrangement for Paraguay.

Table 4.2. Arrangements Under Main Facilities Approved in FY2008
(In millions of SDRs)

Member	Type of Arrangement	Effective Date	Amount Approved
Gabon	36-month Stand-By	May 7, 2007	77.2
Honduras	12-month Stand-By	April 7, 2008	38.9
Iraq	15-month Stand-By	December 19, 2007	475.4
Liberia	36-month Extended Fund Facility	March 14, 2008	342.8
Subtotal			**934.2**
Paraguay (decrease)[1]	27-month Stand-By	October 15, 2007	(35.0)
Total			**899.2**

Source: IMF Finance Department.
[1]Only the amount of the decrease is shown.

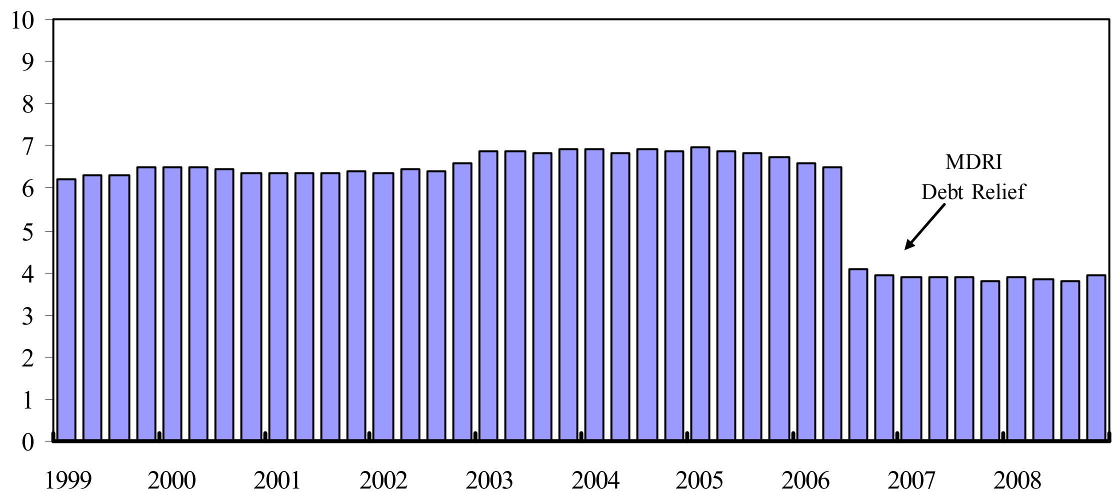
The IMF also provides subsidized loans through its Poverty Reduction and Growth Facility (PRGF) and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). The PRGF, the principal instrument for providing IMF financial support to low-income countries, focuses on poverty reduction in the context of a growth-oriented economic strategy. A low-income country seeking a PRGF arrangement or debt relief must prepare a Poverty Reduction Strategy Paper (PRSP) in a participatory process involving domestic stakeholders, including civil society, based on the strategy developed and owned by the country; the PRSP is issued to the Boards of the IMF and the World Bank. During FY2008, the Executive Board approved four new PRGF arrangements (for Guinea, Liberia, Nicaragua, and Togo), with commitments totaling SDR 424.8 million (Table 4.3). In addition, it approved the augmentation, in the amount of SDR 9.0 million, of an existing PRGF arrangement for Burkina Faso. As of April 30, 2008, the reform programs of 25 member countries were supported by PRGF arrangements, with commitments totaling SDR 1.1 billion and undrawn balances of SDR 0.5 billion. Total concessional loans outstanding amounted to SDR 3.9 billion at April 30, 2008 (Figure 4.1).

Table 4.3. PRGF Arrangements Approved in FY2008
(In millions of SDRs)

Member	Effective Date	Amount Approved
New Arrangements		
Guinea	December 21, 2007	48.2
Liberia	March 14, 2008	239.0
Nicaragua	October 5, 2007	71.5
Togo	April 21, 2008	……………66.1
Subtotal		**424.8**
Augmentation[1]		
Burkina Faso	January 9, 2008	9.0
Subtotal		**9.0**
Total		**433.8**

Source: IMF Finance Department.
[1]For augmentation only the amount of the increase is shown.

Figure 4.1 Concessional Loans Outstanding, FY1998–FY2008
(In billions of SDRs)



Source: IMF Finance Department.

The IMF provides emergency financial assistance to member countries recovering from conflicts (Emergency Post-Conflict Assistance, or EPCA) or natural disasters (Emergency Natural Disaster Assistance, or ENDA). Countries that are eligible for concessional lending under the PRGF can make use of financing under the Exogenous Shocks Facility (ESF) and are also eligible for emergency assistance at subsidized interest rates.[46] During FY2008, the Executive Board approved emergency assistance totaling SDR 218.5 million. Of this amount, two requests were approved under ENDA (SDR 133.3 million for Bangladesh and SDR 2.1 million for Dominica), and three under EPCA (two requests, each in the amount of SDR 40.7 million, were approved for Côte d'Ivoire, and one of SDR 1.8 million for Guinea-Bissau). As of April 30, 2008, three countries—Côte d'Ivoire, Guinea-Bissau, and Lebanon—had outstanding EPCA credit, which amounted to

[46]Since 2001, bilateral contributions have allowed the IMF to provide EPCA to low-income countries at a reduced rate of 0.5 percent per year, from which 16 low-income countries have benefited to date. In early 2005, when subsidization was extended to cover ENDA, the Executive Board set an initial goal of raising additional contributions of SDR 45–65 million to cover the estimated needs for the five-year period through 2009. Since 2005, 17 countries have committed SDR 29 million, prompting the IMF to intensify its resource mobilization efforts. The aim now is to secure SDR 100 million in contributions to cover projected subsidization costs through 2014.

SDR 133.8 million, and five—Bangladesh, Dominica, Grenada, Maldives, and Sri Lanka—had outstanding ENDA credit, for a total of SDR 245.4 million.

In recent years, a number of countries have chosen to repay their outstanding credit to the Fund ahead of schedule. For example, in FY2008, Bolivia, Iraq, and the former Yugoslav Republic of Macedonia completed advance repayment of their outstanding obligations to the IMF, for a total of SDR 330.9 million.

More generally, a number of Fund members have transitioned from a financial and surveillance relationship with the Fund to one that is principally a surveillance relationship, thanks to their improved macroeconomic conditions and ready access to private capital following five years of exceptional broad-based global growth and buoyant financial market conditions. The need for Fund financing has been especially modest over the past few years for middle-income member countries, which traditionally have been the major users of Fund resources in the credit tranches, and approvals of Stand-By and Extended Arrangements have declined. Many low-income countries have also benefited from improved macroeconomic policies, the favorable global environment, and strong demand for commodities. Although demand for financing under the PRGF remains strong, fewer PRGF arrangements were approved in FY2008 than in previous years, reflecting, in part, a shift to use of the Fund's Policy Support Instrument (PSI; see below).

Emerging market economies

In recent years, emerging market economies as a group have become a source of strength for the global economy, and their demand for traditional Fund financial support has decreased. Many have built sizable reserves for self-insurance purposes and have shown resilience in the face of recent financial market turbulence. More flexible exchange rates and increased reliance on local currency–denominated debt have reduced two sources of vulnerability. The Board has underscored the importance of strengthening debt management in these economies, and several major emerging markets, with the Fund's engagement, have implemented policies to strengthen economic fundamentals. However, continued market turbulence could increase risks for those dependent on short-term capital inflows to finance large current account deficits and rapid domestic credit growth.

Policy challenges

In the April 2008 *World Economic Outlook* (WEO), the Fund advocated the use of a variety of tools by governments to combat the spreading effects of market turmoil and limit the impact of the economic slowdown in the advanced economies. The WEO outlined three lines of defense: a combination of monetary policy easing, fiscal stimulus, and public funds, as appropriate, can play a complementary role in helping economies address the current turmoil by supporting demand and limiting the negative interaction between financial markets and the real economy.

In addition, the Fund addressed the challenges posed by large capital inflows. Although private capital inflows can result in long-term benefits if put to good use, they may pose significant risks to macroeconomic stability. The October 2007 WEO addressed, in part, the appropriate policy response to large capital inflows, which depends on country-specific circumstances and the nature of the inflows.[47] A comprehensive cross-country analysis of policy responses over the past two decades provides guidance. The most robust lesson to emerge from the analysis is that keeping government spending on a steady path—rather than engaging in excessive spending during periods of heavy capital inflows—can help mitigate the adverse effects of large inflows.

New instruments for emerging market economies

In the context of decreasing demand for traditional Fund support, the Fund continues to explore whether its financial instruments meet the needs of emerging market economies. There has been some encouraging support for a proposed rapid access line (RAL).[48] Members continue to have mixed views, however, about some elements of the design, and a consensus on the type of instrument that would be most useful to member countries has not been reached. Nevertheless, in view of recent global financial turbulence, the Fund is pushing forward its work on the modalities of a new liquidity instrument and is also considering suggestions made by some Executive Directors for a financial stability line for countries integrating into global capital markets and pursuing financial sector reforms.

---

[47]The WEO is available on the IMF's Web site, at www.imf.org/external/pubs/ft/weo/2007/02/index.htm.

[48]The proposed instrument's name has been changed from a "reserve augmentation line" to a "rapid access line" to better reflect its purpose.

Low-income countries

The Fund remains closely engaged with low-income countries, while refocusing its role by concentrating on its core areas of expertise—macroeconomic policies and institutions that support the stability necessary for sustained growth and poverty reduction—and doing less on noncore structural issues. While the policy advice, financing, and capacity-building assistance (see below) it provides are tailored to each country's needs, it also draws on its cross-country experience and perspective. To improve the focus and increase the coherence of the Fund's policy work on low-income countries, and to promote the exchange of information and the Fund's engagement with donors, the Fund's interdepartmental Low-Income Committee is being revamped. As some low-income countries grow and mature, the Fund is likely to place additional emphasis on issues such as the policy response to capital inflows, commodity price booms and busts, and financial market development, while growth, poverty reduction, and debt sustainability will remain top priorities. The Board is scheduled to examine in depth the Fund's role in low-income countries early in FY2009.

Clarifying the Fund's role in low-income countries

To clarify the Fund's role in, and reinforce its engagement with, low-income countries, the IMF's Managing Director traveled to Burkina Faso, Nigeria, Senegal, and Tanzania in February 2008 for discussions with African leaders and representatives of the private sector and civil society about the challenges facing sub-Saharan Africa and the IMF's role in the region, as well as to hear first-hand how the IMF can best support its members' efforts to enhance growth and reduce poverty. The IMF's Executive Directors also visited a number of African countries in February, meeting with heads of state and high-ranking officials as well as a wide range of stakeholders, including representatives of the public and private sectors, civil society, and development partners.

In June 2007, the Executive Board also discussed the implementation plan for Board-endorsed recommendations in the Independent Evaluation Office's report on the IMF and aid to sub-Saharan Africa (see Chapter 5). While confirming the improvement in the region's macroeconomic performance during 1999–2005, which it attributed in part to the advice and actions of the IMF, the Board identified areas where further improvements were needed, including the IMF's role in poverty reduction efforts, the mobilization of aid, the preparation of alternative scenarios for reaching the MDGs, and the application of poverty and social impact analysis.[49]

The Fund's financial support for low-income countries continues to be important in itself as well as in catalyzing support from other donors. In October 2007, the Executive Board discussed the IMF's role in the poverty reduction strategy (PRS) process and its collaboration with donors, reiterating that the primary focus of the IMF's work in low-income countries in the context of the PRS process should be to provide policy advice on, and technical support for, the design of appropriate macroeconomic frameworks and macroeconomically critical structural reforms.[50] Noting that PRSPs have become the accepted operational framework for countries' poverty reduction efforts and for the coordination of external support for their efforts to achieve the Millennium Development Goals (MDGs), Executive Directors concurred that the IMF's principal contribution to the MDG effort lies in helping countries maintain macroeconomic stability, debt sustainability, and appropriate fiscal frameworks, observing that the Fund should also continue to press for more predictable and more effective aid.

Executive Directors agreed that close collaboration with other development partners is essential for effective IMF engagement with its low-income members and a successful refocusing of the Fund's role and called for a deepening of this collaboration, with greater emphasis on delineating areas of competence and the division of labor. At the same time, Executive Directors stressed that country ownership of the aid process is essential to successful donor coordination, emphasizing the country-level understandings between the authorities, the IMF, the World Bank, and other development partners as a critical element of the collaboration with donors. In FY2008, the Fund strengthened its collaboration with the World Bank with the implementation of the Joint Management Action Plan and pilot projects in the areas of public financial management, the financial sector, and natural resource management in a number of African countries (see Chapter 5).

[49] See *IMF Annual Report 2007*, pages 42–43, and the Web site of the Independent Evaluation Office for more information: www.ieo-imf.org.

[50] The summing up of the Board discussion can be found on the CD-ROM and on the IMF's Web site: PIN 07/130, "IMF Executive Board Discusses the Fund's Role in the Poverty Reduction Strategy Process and Its Collaboration with Donors," www.imf.org/external/np/sec/pn/2007/pn07130.htm.

Debt relief and debt management

Additional countries benefited from debt relief under the HIPC Initiative and MDRI in FY2008, and changes were introduced into the HIPC framework to add Staff-Monitored Programs (SMPs) that meet certain standards to the instruments that HIPCs may use in building a track record to reach the decision point under the HIPC Initiative (see below). Liberia, one of three HIPC-eligible countries with protracted arrears to the Fund, was the first to benefit from the change, reaching its decision point in March (see Box 4.1).[51]

Box 4.1 Liberia: Clearance of IMF Arrears

After having been in continuous arrears to the IMF since 1984, on March 14, 2008, Liberia regularized its relations with the Fund through the clearance of SDR 543 million of arrears. Improved cooperation with the Fund, including satisfactory performance under a Staff-Monitored Program, paved the way for Liberia's arrears clearance. The clearance of Liberia's arrears and subsequent quota increase under the Eleventh General Review was facilitated by intraday bridge loans provided by the United States. In addition, a large number of IMF member countries contributed to the financing package required to provide debt relief to Liberia.[1] These bilateral contributions were facilitated by the partial distribution of the balance in the Fund's first Special Contingency Account (SCA-1), accumulated as reserves to guard against possible credit losses, and the proceeds of deferred-charges-adjustments that had been used to offset the impact on Fund income from Liberia's arrears (see Chapter 5).

Following clearance of Liberia's arrears, the Executive Board restored the country's voting and related rights and its eligibility to use the general resources of the Fund and lifted the suspension of its rights to use SDRs. On this basis, and in light of the existence of satisfactory assurances as to the availability of resources to finance the Fund's debt relief for Liberia, in FY2008 the Board approved Liberia's request for arrangements totaling SDR 582 million under the PRGF and EFF, decided that Liberia had reached the decision point under the enhanced HIPC Initiative, and approved Liberia's request for interim HIPC assistance.

[1] Liberia cleared its arrears to the Fund in April 2008, following its clearance of arrears to the World Bank and the African Development Bank in December 2007. Further steps are being taken to regularize relations with other creditors, including Paris Club members.

---

[51] See Press Release 08/52, "IMF Executive Board Fully Restores Liberia's IMF Status, Approves Financial Support Amounting to US$952 Million and HIPC Decision Point Designation," on the CD-ROM or on the IMF's Web site, www.imf.org/external/np/sec/pr/2008/pr0852.htm.

As of April 30, 2008, 33 countries had reached the decision point under the enhanced HIPC Initiative; of these, 23 had reached their completion points. In total, the IMF has committed SDR 2.3 billion under the HIPC Initiative and disbursed SDR 1.7 billion. During FY2008, three member countries (Afghanistan, the Central African Republic, and Liberia) reached their decision points, and one additional country (The Gambia) reached its completion point. In addition, the Executive Board approved disbursement of HIPC topping-up assistance to São Tomé and Príncipe.

The MDRI was launched in early 2006 to further reduce the debts of qualifying low-income countries and free up resources that they could use to meet the MDGs. Under the established financing framework for the MDRI, qualifying members can receive 100 percent debt relief on the full stock of debt owed to the IMF at end-December 2004 that remains outstanding at the time the member qualifies for such debt relief and is not covered by assistance under the HIPC Initiative.[52] (See CD-Tables 4.[] and 4.[] on the CD-ROM.)

In September 2007, the Executive Board considered the status of implementation of the HIPC Initiative and the MDRI and discussed the financing of the Fund's concessional assistance and debt relief to low-income member countries.[53] Executive Directors expressed concern that, in spite of the delivery of debt relief under the HIPC Initiative and the MDRI and the resulting declines in debt ratios, long-term debt sustainability remains a key challenge for most HIPCs. They emphasized that HIPCs need to increase domestic revenue mobilization, diversify their production and export bases, and strengthen their public institutions to address their underlying vulnerabilities and ensure long-term debt sustainability. They also strongly underscored the importance of strengthening public debt

[52]When the MDRI was established, the cost to the IMF of providing MDRI debt relief was estimated at SDR 2.6 billion.

[53]The summing up of this Board discussion can be found on the CD-ROM and on the IMF's Web site: PIN 07/122, "IMF Executive Board Discusses Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation and the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries," www.imf.org/external/np/sec/pn/2007/pn07122.htm. The Board's discussion was based on a joint IMF–World Bank paper, "Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation," which is available on the Fund's Web site, www.imf.org/external/np/pp/2007/eng/082807.pdf, along with a joint IMF–International Development Association paper, "Enhanced Heavily Indebted Poor Countries (HIPC) Initiative—Status of Non–Paris Club Official Bilateral Creditor Participation," www.imf.org/external/np/pp/2007/eng/091007.pdf, which served as a background to the Board's discussion.

management and encouraged HIPCs to follow responsible financing strategies based on their debt sustainability analyses. In addition, they emphasized that staff should continue to provide TA to HIPCs to improve their debt management capabilities and help them develop medium-term debt strategies. They called on all creditors to ensure that lending to HIPCs does not result in a rapid reaccumulation of debt and is provided in a transparent manner.

In January 2008, the Executive Board amended the PRGF-HIPC Trust Instrument to add Staff-Monitored Programs (SMPs) meeting policy standards associated with programs supported by arrangements in the upper credit tranches or under the PRGF to the instruments HIPCs may use to build a track record toward reaching the decision point under the HIPC Initiative.[54] The amendment is aimed at giving these countries credit, in appropriate circumstances, for their record in implementing strong programs of macroeconomic stabilization and structural reform during the period when the Fund and other international institutions are securing the financing assurances needed for the clearance of arrears and provision of debt relief.

A project aimed at enhancing low-income countries' debt management capabilities has been initiated with the World Bank, and training is being provided to country officials to enable them to use the Debt Sustainability Framework as a policy tool. In FY2008, Fund staff worked closely with the export credit group in the Organization for Economic Cooperation and Development (OECD) to define the sustainable lending principles agreed in January 2008. The principles commit OECD export credit agencies to observe IMF and World Bank concessionality requirements in low-income countries where they exist and to take into account the results of debt sustainability analyses for other low-income countries. The Fund and the World Bank have also established dedicated Web pages to make information on country-specific debt sustainability analyses and concessionality issues more accessible to donors and creditors.[55]

---

[54]The summing up of this Board discussion can be found on the CD-ROM and on the IMF Web site: PIN 08/03, "IMF Executive Board Modifies HIPC Initiative," www.imf.org/external/np/sec/pn/2008/pn0803.htm.

[55]See *The Debt Sustainability Framework for Low-Income Countries,* which is available on the IMF's Web site, at www.imf.org/external/pubs/ft/dsa/lic.htm.

Nonfinancial support

The Fund provides nonfinancial program support to low-income countries through Policy Support Instruments (PSIs). Two PSIs were approved in FY2008 (for Mozambique and Senegal), bringing to six the number of countries for which PSIs have been approved to date. (PSIs were approved for Nigeria in FY2006 and for Cape Verde, Tanzania, and Uganda in FY2007.) The Executive Board established the framework for PSIs in FY2006 to address the needs of low-income countries that no longer need or want IMF financial assistance but that still seek IMF advice on, and monitoring and endorsement of, their economic policies. PSIs also perform a “signaling” function—that is, they indirectly provide information about countries’ economic performance and prospects that can be used to inform the decisions of outsiders (for example, private creditors, donors, and the general public). PSIs mirror the design of and achieve many of the same purposes as PRGF arrangements and, like PRGF arrangements and debt relief, are based on development of a poverty reduction strategy. In the event of an exogenous shock, on-track PSIs can provide the basis for rapid access to ESF resources.

Scaling up of aid

The international community has committed to scaling up aid and improving aid delivery to low-income countries to help them meet the MDGs (Box 4.2). Through its policy advice, financial support (including debt relief), and TA, the IMF has worked to help countries establish a macroeconomic environment that will enable them to use aid effectively. In July 2007, the Executive Board discussed the implications of the planned scaling up of aid to low-income countries for the role of the Fund and the design of Fund-supported policy programs—in particular, design of fiscal, monetary, and exchange rate policies (Box 4.3). [56]

---

[56]The discussion took place in the context of a review of two staff papers and several other background papers synthesizing recent IMF work on accommodating scaled-up aid flows. These papers are available on the IMF’s Web site: “Aid Inflows—The Role of the Fund and Operational Issues for Program Design,” www.imf.org/external/np/pp/2007/eng/061407.pdf, along with a background paper, www.imf.org/external/np/pp/2007/eng/061407a.pdf; and “Fiscal Policy Response to Scaled-Up Aid,” www.imf.org/external/np/pp/2007/eng/060507.pdf, along with two background papers, “Macro-Fiscal and Expenditure Policy Challenges,” www.imf.org/external/np/pp/2007/eng/060507a.pdf, and “Strengthening Public Financial Management,” www.imf.org/external/np/pp/2007/eng/060507b.pdf. The summing up of the Board’s discussion can be found on the CD-ROM and on the IMF’s Web site, “IMF Executive Board Discusses Operational Implications of Aid Inflows for IMF Advice and Program Design in Low-Income Countries,” PIN 07/83, www.imf.org/external/np/sec/pn/2007/pn0783.htm.

Box 4.2 Global Monitoring Report Finds Progress Toward MDGs Off Track

The IMF and the World Bank track the progress made by low-income countries toward the achievement of the Millennium Development Goals (MDGs), jointly publishing their findings annually in the *Global Monitoring Report* (GMR). The fifth GMR, issued in April 2008 and titled *Global Monitoring Report: MDGs and the Environment—Agenda for Inclusive and Sustainable Development,* found that although much of the world is set to cut extreme poverty in half by 2015, poor countries are unlikely to achieve the goals of reducing child and maternal mortality. Serious shortfalls are also likely with respect to primary school completion, nutrition, and sanitation goals.

The report stressed the link between environment and development and called for urgent action on climate change, warning that developing countries stand to suffer the most from climate change and the degradation of natural resources. To build on hard-won gains, developing countries need support to address the links between growth, development, and environmental sustainability.

Progress toward the MDGs differs dramatically across countries, regions, and income groups. Sub-Saharan Africa lags on all counts, including the goal for poverty reduction, although many countries in the region are now experiencing improved growth performance. However, with stronger efforts by both the countries themselves and their development partners, most MDGs remain achievable for most countries. The report lays out an integrated six-point agenda, with strong, inclusive growth at the top, and calls for more effective aid; a successful outcome to the Doha Round of trade talks; more emphasis on strengthening programs in health care, education, and nutrition; and financing and technology transfers to support climate change mitigation and adaptation.

---

[1]The report can be found on the IMF's Web site, at www.imf.org/external/pubs/ft/gmr/2008/eng/gmr.pdf.

Box 4.3 Scaled-Up Aid to Low Income Countries: Operational Implications

In July 2007, the Executive Board discussed the operational implications of scaled-up aid for IMF advice and program design. Noting that scaling up of aid had not yet been widely observed, Executive Directors reiterated that IMF engagement in low-income countries should continue to be focused on the Fund's core areas. They welcomed the finding that Fund-supported programs had become more accommodating of the use of aid and more supportive of pro-poor spending.

Executive Directors supported a focus on identifying best practices for the design of macroeconomic policies in IMF-supported programs in the context of scaled-up but volatile and uncertain aid flows, stressing that, in an environment of scaled-up aid, macroeconomic policy formulation should be based on a longer-term view of spending plans and potential resource availability, with medium-term frameworks the appropriate policy tools for this purpose. Observing that aid disbursements are often volatile, they saw merit in smoothing expenditures over time so that programs are adequately funded, and underscored the need for careful monitoring of spending to ensure debt sustainability, noting that inefficient spending would simply add to debt burdens without improving economic and social outcomes.

Executive Directors underscored the importance of coordinating fiscal, monetary, and exchange rate policies in managing aid inflows, and many noted that scaling up strengthened the case for exchange rate flexibility, while a regime of managed floating could pose difficult challenges for policy and program design. They saw a continuing critical role for the Fund in advising member countries on exchange rate policies and recommended that monetary programs should seek to reconcile the absorption of aid with price stability and reserve adequacy, while avoiding the crowding out of private investment.

Executive Directors considered that measures for eventually reducing reliance on aid should be an integral component of macroeconomic policy for managing scaled-up aid. They emphasized that strengthening fiscal institutions and public financial management (PFM) systems is critical for effective use of scaled-up aid and called upon low-income countries to prepare appropriately sequenced and prioritized action plans for strengthening their PFM systems, based on a diagnostic assessment of existing systems. These plans should prioritize reform measures consistent with local capacity to undertake such reforms. With the growing trend toward decentralization, Executive Directors emphasized the need for effective PFM systems at subnational levels, where much social spending takes place. Executive Directors stressed the need for continued donor support, including TA, to low-income countries for developing and implementing PFM action plans.

Food and fuel prices

In FY2008, the Fund set up an interdepartmental task force on food and fuel prices. The work of the task force is proceeding on three fronts: diagnosing the problem; collaborating with other institutions to ensure that the Fund’s contribution (including financial support) is coordinated with international efforts to address the difficulties posed by price increases; and providing policy advice to the most vulnerable countries, while ensuring that the policies put in place are sustainable over the medium and long terms. For example, the Fund provided a comprehensive note on policy options as background for deliberations of the finance ministers of the West African Economic and Monetary Union’s member countries. A number of countries, mostly in Africa, have asked for extra financial support (through their PRGF arrangements) to cover higher food import costs.

In April 2008, the African Consultative Group met at IMF headquarters in Washington, D.C.,[57] to discuss the impact of high world food and fuel prices and the challenges they present for policymakers in sub-Saharan Africa and globally. The Group agreed that policies should aim at helping those least able to cope with high prices, while not jeopardizing hard-won gains on economic stabilization, and observed that although temporary, targeted subsidies can help protect the most vulnerable from the effect of shocks, it is necessary to ensure that subsidies do not become permanent. Although countries should aim to put in place an efficient social safety net, the Group noted that this is not always easy, and some second-best solutions may be appropriate.

The Group agreed that countries that have a comparative advantage in food production should remove impediments to domestic agricultural production (noting that several were already doing so) and that countries should avoid distortionary policies such as untargeted subsidies. The Managing Director reiterated the IMF's readiness to support countries in designing macroeconomic policies to deal with shocks, including the creation of fiscal space for safety nets. The Group supported the call for bilateral and multilateral donors to substantially increase food aid.

Aid for trade

In September 2007, the Executive Board discussed a joint IMF–World Bank paper on efforts by the multilateral community to support the integration of developing countries into the global economy. Executive Directors welcomed initiatives by the World Trade Organization (WTO) and other institutions to enhance aid for trade and improve its coordination and delivery. While regretting that trade in products of interest to the poorest countries continues to be subject to many obstacles in both developed and developing economies, Executive Directors pointed out that many existing trade opportunities remain unexploited because of infrastructural and other domestic supply constraints as well as policy weaknesses and governance issues, and that aid for trade could help low-income countries take greater advantage of existing and new trade opportunities. They also noted that benefits from aid for

[57]This was the third meeting of the Group, which was formed one year ago to enhance the IMF's policy dialogue with the African Caucus. It comprises members of the African Caucus and the IMF's Managing Director.

trade could be magnified if accompanied by strengthened policy frameworks, including further trade reforms.

Executive Directors agreed that individual countries' priorities for trade-related reforms and for strengthening competitiveness need to be properly identified with support from trade diagnostic studies under the Enhanced Integrated Framework (EIF) and integrated in national development and poverty reduction strategies. Executive Directors also stressed the importance of securing increased financing for the EIF and urged donors to fulfill their pledges on all trade-related aid.

Program design

In FY2008, the Executive Board reviewed the Fund's access policy in the credit tranches and under the EFF, its exceptional access policy, discussed an IEO report on structural conditionality in IMF-supported programs (see Chapter 5), and considered a new approach for fragile states under a two-phase Economic Recovery Assistance Program (ERAP).

Access policy

The Executive Board periodically reviews the Fund's access policy—that is, the limits and guidelines that govern the amount of financing the Fund makes available to its members in support of their economic programs. Reviews include consideration of the normal limits applying to the use of resources in the credit tranches (normally under Stand-By Arrangements) and under the EFF, as well as the framework for exceptional access, which guides decisions on financing beyond the normal limits. Reviews also consider the policies for lending under the PRGF. At the conclusion in February 2008 of the Board's latest review, most Executive Directors agreed that the guidelines and limits underlying the Fund's access policy remain appropriate and supported maintaining the current limits, although some Executive Directors saw a need for increasing access limits, as the resources available to some dynamic members have not kept pace with trade and capital flows. Executive Directors also reaffirmed that access decisions should continue to be guided by a member's need for financing, its capacity to repay its obligations to the Fund, including the strength of its adjustment program, and the amount of its outstanding financial obligations to the Fund. Most Executive Directors also considered that the exceptional access framework and the current access limits and norms for lending under PRGF remain broadly appropriate and that no changes are needed at this time.

Fragile states

In March 2008, the Executive Board considered a new approach—a two-phase Economic Recovery Assistance Program (ERAP)—for helping fragile states.[58] Under the first phase of the proposed ERAP, the IMF would provide TA but no financing. The second phase would allow for financing with limited but well-focused conditionality with a view to further strengthening economic performance and policy implementation so as to enable recipients to meet the standards of upper-credit-tranche financing as quickly as possible.

Executive Directors generally agreed that there was scope to improve the Fund's capacity to assist low-income fragile states, with many seeing merit in a graduated, flexible, medium-term programmatic approach. They stressed that the Fund should focus on helping fragile states rebuild their institutional capacity to implement macroeconomic policy advice and basic economic reforms. There was agreement that the Fund's engagement could help catalyze international financial support for the country and lay the groundwork for debt relief. Many Executive Directors also saw merit in the proposed approach, while a number of others considered that the necessary improvements in the Fund's engagement with low-income fragile states could be achieved in the context of the Fund's existing toolkit of TA, surveillance, assessment letters, Staff-Monitored Programs, and EPCA. Management will return to the Board with operational proposals that reflect the Board's views; the results of outreach to member countries conducted during the IMF–World Bank spring meetings, in April 2008; and further planned outreach to donors and other stakeholders.

BUILDING INSTITUTIONS AND CAPACITY

The Fund's TA and training are critical instruments in helping member countries design and implement good policies and also contribute to the stability of the global economy. In some

[58]The summing up of the Board discussion can be found on the CD-ROM and on the IMF's Web site: PIN 08/43, "IMF Executive Board Discusses the Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience," www.imf.org/external/np/sec/pn/2008/pn0843.htm. The Board's discussion was broadly based on a staff paper, "The Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience—Issues and Options," which can also be found on the IMF's Web site, www.imf.org/external/np/pp/eng/2008/030308.pdf.

areas, such as the development of sound fiscal and monetary institutions, the Fund may be the best—or the only—source of advice and training for members. However, in an environment of resource constraints, the Fund needs to prioritize and to adopt a more strategic approach, and therefore reforms have been undertaken as part of the refocusing of the Fund's work to enhance the impact of its capacity-building activities.

Strengthening the effectiveness and efficiency of TA

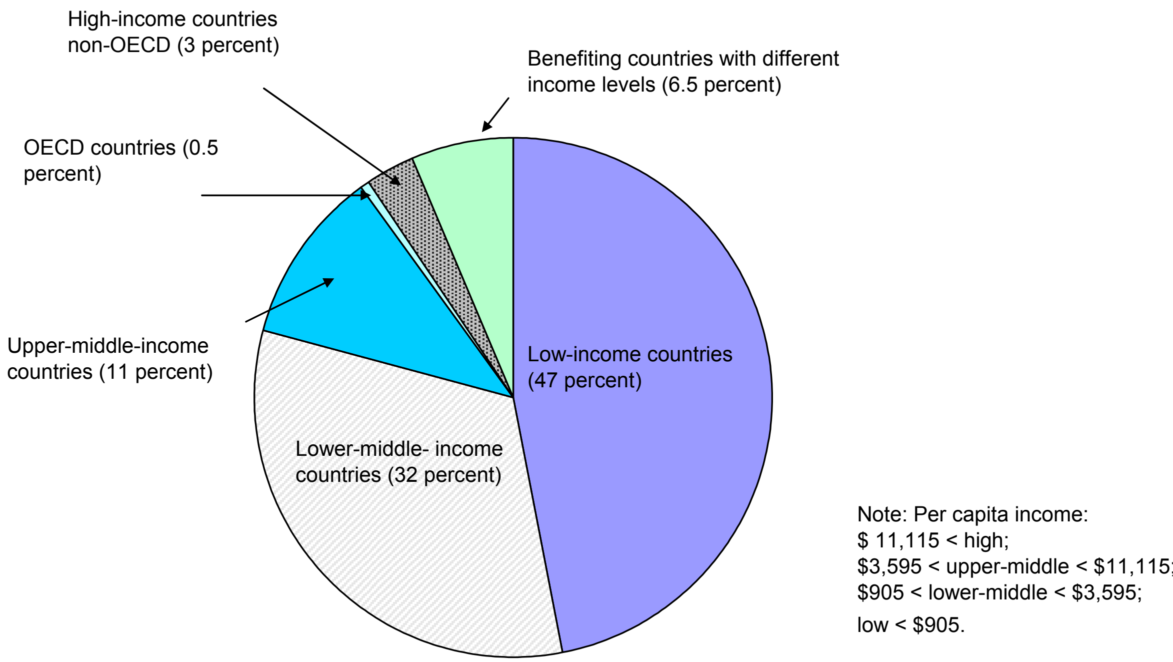
The IMF provides TA in its core areas of expertise—namely, macroeconomic, monetary, exchange rate, and tax policy; revenue administration; expenditure management; financial sector stability; legislative frameworks; and macroeconomic and financial statistics. About 80 percent of the Fund's TA is provided to low- and lower-middle-income countries (Figure 4.2). The substantial changes being made to Fund TA have a number of objectives, including[59]

- enhancing the integration of TA with Fund surveillance and lending;
- improving prioritization of TA by better aligning it with the strategic objectives of recipient countries and the Fund;
- better integrating TA into the Fund's medium-term budget to make it easier to set priorities and to allow TA to be more responsive to changes in priorities;
- widening the dissemination of TA findings to increase sharing of lessons learned and facilitate coordination with donors and other TA providers;
- making TA evaluations more systematic through the introduction of performance indicators; and
- enhancing budgeting, costing, and financing of TA.

---

[59]A paper on TA reforms was prepared by the Fund's Office of Technical Assistance Management, in collaboration with other departments, and submitted to the Executive Board in FY2008. At a meeting in early FY2009, the Board broadly supported the reforms put forward by the staff. See "IMF Executive Board Discusses Reforms to Enhance the Impact of Fund Technical Assistance," PIN 08/58, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2008/pn0858.htm.

Figure 4.2 Fund TA Is Focused on Low Income and Lower Middle Income Countries[1]
(TA Field Delivery In Person-Years; average over FY2003 – 08)



[1]Excludes the Caribbean Regional Technical Assistance Center.

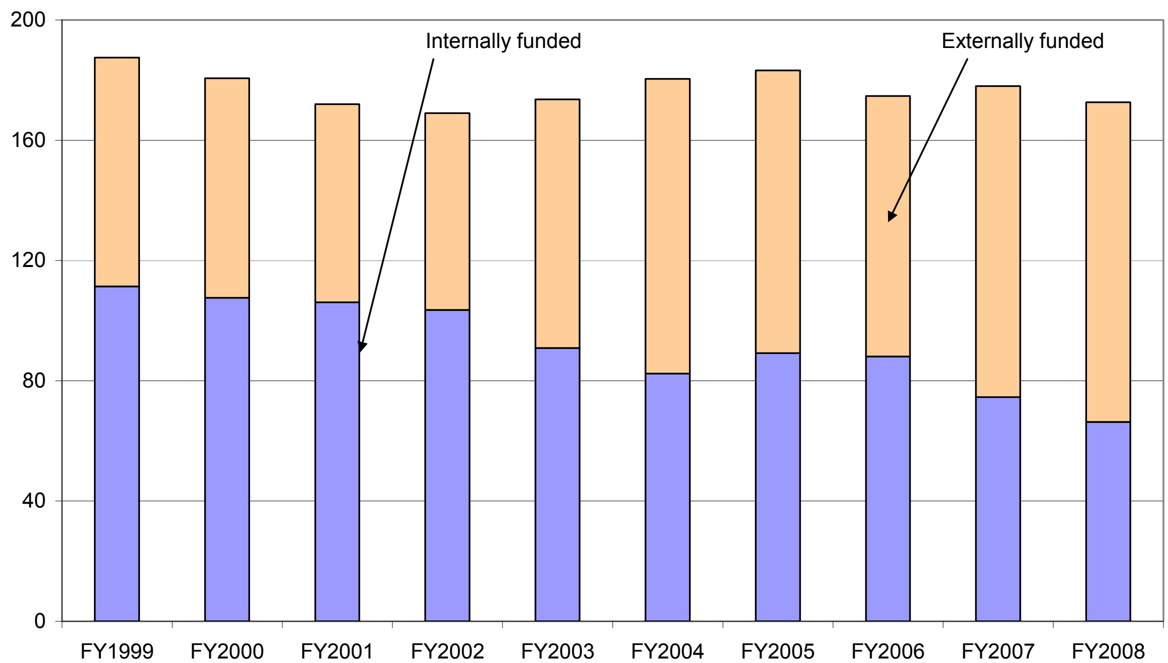
As the primary link between the institution and member countries, Fund area departments have assumed lead responsibility for setting TA strategies in coordination with country authorities. Presented in Regional Strategy Notes (RSNs), TA plans articulate the priorities shared by the Fund and country authorities. They are portrayed in a medium-term setting to ensure appropriate balance between short-term policy needs and medium-term capacity-building requirements. The medium-term approach also facilitates full integration of TA plans with the Fund's operating budget and donor timing. Experience with RSNs as a new initiative will be reviewed in FY2009, and refinements made as necessary.

Measuring the performance of Fund TA is a critical aspect of institutional accountability and governance. Plans to strengthen TA governance and performance measurement include (1) introducing quantitative performance indicators Fund-wide to help make the assessment of TA delivery more transparent and accountable; (2) clearly specifying objectives and deliverables against which results can be measured; (3) evaluating TA more systematically; (4) costing TA more accurately and transparently; and (5) considering a broader charging scheme for TA, which could further improve efficiency and accountability in resource use by subjecting TA to a "value-for-money" market test.

Pressures on Fund finances will continue to dictate that resource use be even better planned and more transparently managed than before, and the Fund is exploring ways to harness new external resources for TA and increasing its engagement with donor partners (Figure 4.3). At the same time, however, financing options need to take into account the unique nature of Fund TA, which not only contains elements of a public good benefiting the international economy, but also enhances the effectiveness of aid flows generally.

Figure 4.3 External Funds Have Increasingly Financed TA Field Delivery

(person-years)



The Fund's six regional TA centers (RTACs)—in the Pacific; the Caribbean; East, West, and Central Africa; and the Middle East—provide a particularly vivid illustration of successful Fund-donor collaboration. The RTACs receive the bulk of their funding from donor countries, international agencies, and regional development banks, many of which have singled out the RTACs' governance structure for special praise. Under this framework, strategic guidance for each center's work program is provided by a steering committee comprising representatives from beneficiary countries, donors, and the Fund, an arrangement that has ensured strong ownership of each center's activities by all stakeholders. In light of the positive experience with RTACs, plans are being pursued to establish new centers, including in Central America, [Central Asia,]West Africa, and Southern Africa. Because RTACs have a more hands-on approach, they complement topical trust funds, which could support more specialized TA on specific issues. Donor interest and participation in both initiatives are expected to be strong.

Selected TA activities in FY2008

TA is provided by a number of Fund departments; the largest providers include Fiscal Affairs (FAD), Monetary and Capital Markets (MCM), and Statistics (STA).

FAD helps IMF member countries to improve fiscal policies and institutions, including by strengthening their macro-fiscal frameworks, reforming tax and expenditure policies, and modernizing public financial management (PFM) and revenue administration. In FY2008, demand was particularly strong for TA in PFM, expenditure policy, natural resource taxation, and VAT implementation. In addition to providing advice on a range of matters related to the budgetary process, the department launched a blog on PFM on the IMF's Web site to share its experience and expertise with practitioners and the public, and organized two seminars on performance budgeting. It also provided TA related to the financial oversight of public-private partnerships, and advised countries on how to address the distributional implications of such macro-critical reforms as subsidy, domestic-pricing-mechanism, and tariff and tax reforms. TA related to tax policy and revenue administration covered such areas as fiscal regimes for natural resource–rich countries; design, reform, and implementation of VAT systems; regional tax coordination; and customs modernization. Regional courses and workshops are an important component of TA on tax policy. In post-conflict countries, FAD provided TA on performance budgeting, PFM, and the rebuilding of revenue administration capacity. FAD also arranged the International Tax Dialogue Conference, Taxation of Small and Medium-Size Enterprises in September 2007, jointly with the World Bank, the OECD, the Inter-American Development Bank, and CIAT.

MCM focuses on the development and integration of capital and financial markets as well as on monetary policy and operations. It has been working to help Central American countries harmonize their capital markets, providing diagnostic and strategic TA to seven countries; publishing studies on public debt, equity, and private debt markets in the region; and organizing regional seminars and participating in other forums organized by regional organizations. It has also organized, with the support of regional and host-country authorities, a series of regional workshops in emerging Asia, emerging Europe, and Latin America on the development of derivatives markets. In connection with the deepening of domestic bond markets in emerging market economies, MCM staff have organized, in collaboration with the World Bank and the Group of 8 (G-8), conferences and dialogues for policymakers, market participants, and foreign investors. MCM also collaborated with the World Bank and the OECD on the organization of a global conference on pension funds and participated in similar regional outreach events organized by Asia-Pacific Economic Cooperation (APEC), OECD, and global and regional pension fund associations.

STA's TA is focused on helping member countries meet internationally accepted data standards. STA works to develop new data series and improve the accuracy and reliability of existing data series in such areas as national accounts and price statistics, government finance, monetary and financial statistics, financial soundness indicators, and balance of payments, international investment positions, and external debt statistics. During FY2008, STA undertook 383 short-term TA missions, 160 of them to sub-Saharan Africa, and placed 14 long-term statistics advisors, 6 of them in the RTACs. (See Chapter 3 for more information about the Fund's work on data and statistics.) It also conducted 40 training courses in macroeconomic statistics through the IMF Institute and the IMF Regional Training Centers (see below) in collaboration with various organizations.

Additionally, the Fund has launched new initiatives to build capacity for public debt and fiscal risk management. A joint World Bank–Fund technical working group is developing a methodological framework for medium-term strategies for the management of public debt in low-income countries, building on the Debt Sustainability Framework. The Bank and Fund are also cooperating on improving debt management systems in middle-income countries in the context of a broader asset-liability management framework.

Training by the IMF Institute

The IMF Institute (INS), in collaboration with other IMF departments, trains officials from member countries in four core areas—macroeconomic management, financial sector policies, government budgeting, and the balance of payments—including how to strengthen the statistical, legal, and administrative frameworks in these areas. About three-fourths of the training provided by the Institute benefits low- and lower-middle-income countries, and the Institute's training program accounts for about three-fourths of all IMF training for officials, including training at the regional technical assistance centers (RTACs).

In FY2008, the IMF Institute delivered 303 course-weeks, producing over 9,800 participant-weeks of training (see CD-Table 4.[] on the CD-ROM), an increase of about 16 percent since FY2004. The seven IMF regional training centers (RTCs; see CD-Table 4.[] on the CD-ROM) account for most of this increase. With substantial cofinancing from local cosponsors and other donors, the RTCs have provided a very cost-effective way of expanding training and now account for over half of all Institute training. Training at the RTCs has other advantages: courses can be better attuned to regional needs and foster collaboration within regions. The Institute's distance learning program, which has also benefited from an infusion of donor funds, accounts for much of the remainder of the increase in training. Training at IMF headquarters, which accounts for about one-third of participant-weeks in FY2008, focuses mainly on longer courses, which are less amenable to regional delivery because of the number of IMF staff involved. The remainder of the training in FY2008 took place at overseas locations outside the regional network, largely as part of ongoing collaboration between the IMF Institute and regional institutions. In the tight IMF budget environment, the expansion of training has been greatly facilitated by increased donor funding.

Considerable efforts are being made to deepen the coverage and broaden the content of the INS curriculum, with a view to addressing the needs of member countries and supporting IMF strategic priorities, in a changing global environment. These efforts—which have been guided by extensive input from member countries, discussion with IMF management and other IMF departments, and reviews within INS—have resulted in several new or significantly upgraded courses in recent years. In FY2008, the Institute offered an overhauled version of the headquarters course on financial programming and policies, which provides much more extensive treatment of balance sheet vulnerabilities and capital account crises; another new variant of this course, placing the design of macroeconomic policy more specifically in the context of a formal or informal inflation targeting regime; and a two-week version for delivery outside of Washington of the four-week course at headquarters on macroeconomic diagnostics.

The Institute also continues to deliver a small number of short seminars for high-level officials, including ministers and central bank governors, with a view to generating a constructive dialogue on policy issues of global or regional importance between member country officials and experts in the international financial institutions, academia, and financial markets. Seminars in FY2008 included the Market and Policy Implications of the Crisis in Asset-Backed Commercial Paper, African Finance for the 21st Century, and Intergovernmental Fiscal Relations in Latin American Countries.

Table 4.1 IMF lending facilities

Credit facility (year established)	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 above 300% of quota).[5]	$3\frac{1}{4}$–5	$2\frac{1}{4}$–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% of quota).	$4\frac{1}{2}$–10	$4\frac{1}{2}$–7	Semiannual

Table 4.1 *(continued)*

Credit facility (year established)	Purpose	Conditions	Phasing and monitoring[1]	Access limits[1]	Charges[2]	Repurchase (repayment) terms[3]		
						Obligation schedule *(Years)*	Expectation schedule *(Years)*	Installments
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).	2 1/2–3	2–2 1/2	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.	3 1/4–5	2 1/4–4	Quarterly

Table 4.1 ***(continued)***

Credit facility (year established)	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 the following:		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.	$3\frac{1}{4}$–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.						

Table 4.1 ***(continued)***

Credit facility (year established)	Purpose	Conditions	Phasing and monitoring[1]	Access limits[1]	Charges[2]	Repurchase (repayment) terms[3]		
						Obligation schedule *(Years)*	Expectation schedule *(Years)*	Installments
Facilities for low-income members								
Poverty Reduction and Growth Facility (1999)	Longer-term assistance for protracted balance of payments problems of structural nature; aims at sustained poverty-reducing growth.	Adopt 3-year PRGF arrangements. PRGF- supported programs are based on a Poverty Reduction Strategy 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%	$5\frac{1}{2}$–10	Not applicable	Semiannual
Exogenous Shocks Facility (2006)	Short-term assistance to address a temporary balance of payments need that is due to a sudden exogenous shock.	Adopt a 1–2 year program involving macroeconomic adjustments allowing the member to adjust to the shock and structural reform considered important for adjustment to the shock, or for mitigating the impact of future shocks.	Semiannual or quarterly disbursements on observance of performance criteria and, in most cases, completion of a review.	Annual: 25% of quota (norm for annual access); cumulative: 50% of quota except in exceptional circumstances.	0.5%	$5\frac{1}{2}$–10	Not applicable	Semiannual

Table 4.1 ***(concluded)***

[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 (see XXX)—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 XXX 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. 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 percent 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.

5. Governance, organization, and finances

The Executive Board's efforts over the past few years to enhance the IMF's governance achieved significant success in FY2008 with the approval by the Board of Governors of a dynamic package of quota and voice reforms. The Executive Board also made considerable progress in placing the Fund's finances on a sound footing, by agreeing to revamp the Fund's income model and approving a new medium-term budget that will achieve substantial savings in administrative expenditures. Other reforms aimed at ensuring that the Fund is run as efficiently as possible so that it can continue to assist its members in line with its mandate despite tightened budget constraints include increased collaboration with the World Bank and other organizations; a more focused and effective communications strategy; and mechanisms for improving accountability and risk management.

QUOTA AND VOICE REFORM

On April 28, 2008, the Board of Governors approved by a large margin a Resolution overhauling the Fund's governance structure, based on a March 28, 2008, recommendation by the Executive Board.[60] The reform is forward-looking and dynamic, fully meeting and, in some respects, going beyond the commitments made by the Board of Governors in its September 2006 "Resolution on Quota and Voice Reform in the IMF"[61] at the time of the 2006 Annual Meetings of the IMF and the World Bank in Singapore (Box 5.1).

Box 5.1. Program for quota and voice reform approved in Singapore

On September 18, 2006, at the IMF–World Bank Annual Meetings in Singapore, the Fund's Board of Governors adopted Resolution 61-5, calling for a comprehensive program of quota and voice

---

[60]See "IMF Executive Board Recommends Reforms to Overhaul Quota and Voice," PR 08/64, and "IMF Board of Governors Adopts Quota and Voice Reforms by Large Margin," PR 08/93, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0864.htm and www.imf.org/external/np/sec/pr/2008/pr0893.htm, respectively. See also "Reform of Quota and Voice in the International Monetary Fund—Report of the Executive Board to the Board of Governors," on the IMF's Web site, at www.imf.org/external/np/pp/eng/2008/032108.pdf.

[61]See "IMF Board of Governors Approves Quota and Related Governance Reforms," Press Release No. 06/205, which can be found on the CD-ROM or on the IMF Web site at www.imf.org/external/np/sec/pr/2006/pr06205.htm. See also "Report of the Executive Board to the Board of Governors: Quota and Voice Reform in the International Monetary Fund," on the IMF Web site at www.imf.org/external/np/pp/eng/2006/083106.pdf.

reforms to be completed within two years. The Resolution provided for an initial round of ad hoc quota increases for four countries—China, Korea, Mexico, and Turkey—that were clearly underrepresented, and requested that the Executive Board reach agreement on a set of more fundamental reforms, including

- a simple and transparent new quota formula;
- a second round of ad hoc quota increases based on the new formula, with a view to achieving a significant further alignment of members' quotas with their relative positions in the world economy;
- in general reviews of quotas conducted after the completion of these reforms, consideration of the possibility of distributing any increases in quotas with a view to achieving a better alignment of members' quotas with their relative positions in the world economy, while ensuring that the Fund has adequate liquidity to achieve its purposes;
- an amendment to the Articles of Agreement to provide for at least a doubling of basic votes to, at a minimum, protect the existing voting share of low-income countries as a group, together with adoption of a measure to keep the proportion of basic votes in total voting power constant in the future; and
- measures to increase the staffing resources of the chairs with the largest constituencies, including consideration of the merits of an amendment to the Articles of Agreement enabling these chairs to appoint more than one Alternative Executive Director.

The quota and voice reform package approved by the Board of Governors (Resolution 63-2) addresses two key objectives set out in Singapore in 2006: (1) to make significant progress in realigning quota shares[62] with members' relative weight and role in the global economy and to make quota and voting shares more responsive to changes in global economic realities in the future, and (2) equally important, to enhance the participation and voice of low-income countries, in which the Fund plays an important advisory and financing role. The reform package adopted by Resolution 63-2 includes a

[62]In general, quotas are based broadly on the relative size and key economic characteristics of members and play a central role in determining members' financial contributions to the Fund, access to Fund resources, and voting power. They are reviewed periodically and can be increased when deemed necessary by the Board of Governors.

simpler and more transparent quota formula and a second round of ad hoc quota increases[63] to enhance the representation of dynamic economies. Resolution 63-2 also approved an amendment to the Articles of Agreement that will increase the voice of low-income countries through (1) a tripling of basic votes—the first such increase since the Fund's inception in 1944; and (2) establishment of a mechanism to preserve, going forward, the share of basic votes in total votes. In addition, the proposed amendment will allow Executive Directors elected by a large number of members to appoint an additional Alternate Executive Director, which, in the current circumstances, will benefit the two African constituencies on the IMF's Executive Board. Recognizing that representation will need to adjust to changes in the global economy and to make further progress in closing the gap between actual quota shares and those calculated under the quota formula, the reform package also calls for the Executive Board to recommend further realignments that will raise the shares of underrepresented members in future general quota reviews, which are conducted at least once every five years.

Under the reform, 135 countries will see increases in their voting power, with an aggregate shift of 5.4 percentage points. A total of 54 countries are eligible for ad hoc quota increases. For individual members, the proposed increases range from 11.7 to 106.1 percent (taking into account the first round of ad hoc increases following the Singapore Annual Meetings). The aggregate shift in quota shares for these members will be 4.9 percentage points. Consistent with the objectives of the reform, some of the largest increases will go to dynamic emerging market countries.

The new quota formula is based on four variables—GDP, openness, variability, and reserves—with weights of 50 percent, 30 percent, 15 percent, and 5 percent, respectively. The GDP variable is a blend of 60 percent of GDP at market exchange rates and 40 percent of GDP at purchasing power parity (PPP) exchange rates. The new formula also includes a compression factor of 0.95, which reduces the dispersion of calculated quota shares.

[63]In the first round of ad hoc quota increases, approved by the Board of Governors on September 18, 2006, four members with significant underrepresentation (China, Korea, Mexico, and Turkey) received quota increases.

As noted previously, the reform package provides for a second round of ad hoc quota increases of approximately 9.55 percent (with an overall increase under the reform of 11.5 percent). All members that are underrepresented under the new quota formula were eligible for increases based primarily on achieving a uniform proportional reduction in the gap between their actual quota shares prior to the reform and their quota shares calculated under the new formula. To further support the objectives of the reform, the package also includes three one-time elements:

- An agreement by a number of advanced countries that are underrepresented—Germany, Ireland, Italy, Japan, Luxembourg, and the United States—to forgo part of the quota increases for which they are eligible.
- A minimum nominal quota increase of 40 percent under the reform for four underrepresented emerging market and developing economies whose shares in global PPP-based GDP are more than 75 percent greater than their actual quota shares prior to the reform.
- A minimum nominal second-round increase of 15 percent for the four members—China, Korea, Mexico, and Turkey—that received quota increases in the first round of ad hoc increases at the Singapore Annual Meetings in 2006 but still remained substantially underrepresented.

The proposed amendment of the Fund's Articles of Agreement on basic votes and Alternate Executive Directors will enter into force when the Fund certifies, by a formal communication to all members, that three-fifths of IMF members representing 85 percent of the total voting power have accepted it. Increases in quotas will not become effective until the proposed amendment enters into force. In addition, to become effective, these increases will require consent and payment on the part of eligible member countries. Consents for the proposed quota increases are to be received by October 31, 2008; the Executive Board may extend this period, taking into account, in particular, the need of members to obtain domestic legislative approval. Payment is to be received within 30 days of the later of (1) notification of consent or (2) entry into force of the amendment to the Articles on basic votes and Alternate Executive Directors.

ADEQUACY OF FUND RESOURCES

The IMF conducts general reviews of members' quotas at least once 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 approved on December 28, 2007, a report to the Board of Governors recommending that the Thirteenth General Review of Quotas be concluded without an increase or any adjustments to quotas, noting in its report to the Board of Governors that while the size of the Fund has declined against a range of economic and financial indicators, the IMF's current liquidity position is at an all-time high. The Board also noted its intention to monitor closely and assess the adequacy of IMF resources during the Fourteenth General Review, which began upon completion of the Thirteenth Review. The Board of Governors adopted a Resolution concluding the Thirteenth General Review effective January 28, 2008.[64] Total quotas stood at SDR 217.4 billion on April 30, 2008.

INCOME, CHARGES, REMUNERATION, AND BURDEN SHARING

Since its inception, the IMF has operated based on an income model heavily reliant on income from its lending activities, which may fluctuate widely, depending on members' financing needs. In this model, the IMF earns income from interest charges and fees levied on its lending and uses that income to meet funding costs and administrative expenses and to build up precautionary balances. On April 7, 2008, the Executive Board agreed on a substantial reform of the Fund's income model; the reform will allow the IMF to establish other steady and reliable long-term sources of income in the coming years (see below).

The basic rate of charge (the interest rate) on regular lending under the current income model is determined at the beginning of each financial year as a margin in basis points above the SDR interest rate (see Box 5.2). For FY2008, the Board agreed to keep the margin for the rate of charge unchanged from FY2007, at 108 basis points above the SDR interest rate. For FY2009, the Board decided to lower the margin to 100 basis points, guided

[64]See "IMF Executive Board Recommends to Governors Conclusion of Thirteenth General Quota Review," PR 08/02, and "IMF Board of Governors Approves Conclusion of Quota Review," PR 08/13, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0802.htm and www.imf.org/external/np/sec/pr/2008/pr0813.htm, respectively.

by the principles that the margin should cover the Fund's intermediation costs and the buildup of reserves, and that it should be broadly aligned with long-term credit market conditions. This new approach to setting the margin is expected to make the rate of charge more stable and predictable, fulfilling one of the goals of adopting a new income model.

Box 5.2. Special Drawing Rights

The SDR is a reserve asset created by the IMF in 1969 in response to the threat of a shortage of international liquidity. SDRs are "allocated"—distributed—to members in proportion to their IMF quotas. Since the SDR's creation, 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 1979–81.Today, the SDR has only limited use as a reserve asset. Its main function is to serve as the unit of account of the IMF and some other international organizations and a means of payment for members in settling their IMF financial obligations. The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external positions in exchange for freely usable currencies.

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. The method of valuation is reviewed every five years. The latest review was completed in November 2005, and the IMF Executive Board decided on changes in the valuation basket effective January 1, 2006. The SDR interest rate is calculated weekly and provides the basis for determining the interest charges on regular IMF financing and the interest rate paid to members that are creditors of the IMF.

Surcharges (level-based) are levied on large use of credit in the credit tranches and under Extended Arrangements. The IMF also levies surcharges on shorter-term financing under the Supplemental Reserve Facility (SRF) that vary according to the length of time credit is outstanding (see Table 4.1).

In addition to charges and surcharges, the IMF receives income from borrowers in the form of service charges, commitment fees, and special charges. A service charge of 0.5 percent is levied on each credit disbursement from the General Resources Account

(GRA). A refundable commitment fee on Stand-By and Extended Arrangements is charged on the amounts that may be drawn during each 12-month period under an arrangement. The fee—0.25 percent on amounts committed up to 100 percent of quota (and 0.10 percent thereafter)—is refunded as credit is used in proportion to the drawings made. The IMF also levies special charges on overdue principal and on charges that are overdue by less than six months.

On the expenditure side, the IMF pays interest (remuneration) to member countries based on their creditor positions with the Fund (known as reserve tranche positions). The basic rate of remuneration is currently set at the SDR interest rate. The Articles of Agreement permit the basic rate of remuneration, less any burden-sharing adjustments, to be set no lower than 80 percent of the SDR interest rate.

The rates of charge and remuneration are adjusted under a burden-sharing mechanism established in the mid-1980s that distributes the cost of overdue financial obligations to the Fund equally between creditor and debtor members. Loss on income from interest charges that are overdue (unpaid) 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. In FY2008, the average adjustments for unpaid interest charges resulted in an increase to the basic rate of charge and a reduction in the rate of remuneration of 19 and 17 basis points, respectively. The adjusted rates of charge and remuneration averaged 4.90 percent and 3.47 percent, respectively, in FY2008.

The burden-sharing mechanism also contemplates adjusting the basic rates of charge and remuneration to generate resources to protect the IMF against the risk of loss resulting from arrears; those resources are kept in the Special Contingent Account (SCA-1). Effective November 2006, however, the Board decided to suspend additional contributions to the SCA-1. On March 14, 2008, a partial distribution of SDR 525 million from the SCA-1 was made following arrears clearance by Liberia and as part of a financing package to fund IMF debt relief for Liberia through bilateral contributions (see Chapter 4).

Income in FY2008 was SDR 55 million short of expenditures. The continued low level of IMF credit outstanding negatively affected the income situation. The lower lending income was partly offset by the strong performance of the Investment Account (IA), which was established in April 2006 and funded in June 2006. The IA earned a cumulative return of 5.31 percent, net of fees, outperforming the three-month SDR interest rate by 161 basis points. Overall, the IA benefited from movements in government bond yields, reflecting policy interest rate cuts in the United States and the United Kingdom and a flight to quality spurred by recent turmoil in financial markets.

THE IMF'S NEW INCOME MODEL

The Executive Board reached a landmark agreement in April 2008 to revamp the IMF's income model, which, together with a new medium-term budget (see below), is expected to put the institution's finances on a sound footing. Support from the membership was broad, with the IMFC endorsing the new income-expenditure framework in its Communiqué of April 2008. In May 2008, the Board of Governors overwhelmingly approved the related proposed amendment of the IMF's Articles of Agreement to expand its investment authority.

The IMF's new income model is based on the principles set out in the January 2007 report of the Committee of Eminent Persons.[65] The Committee found that the income model under which the IMF had operated since its inception was not sustainable. Instead, the Committee recommended a set of measures that would provide the IMF with additional broad-based and predictable income sources more suitable for financing the wide range of its functions and responsibilities, which include public goods such as surveillance of members' economic policies.

Building on the Committee's recommendations, in late FY2008 the Executive Board agreed on the following measures:[66]

- **Proposing an amendment of the Articles of Agreement to expand the Fund's investment authority,** which would allow the Fund to broaden its investments and enable it to adapt its investment strategy as best practices evolve. It is expected that this measure will increase average returns and also diversify the sources of these returns. Given the public nature of the funds to be invested, the

[65]The report can be found at www.imf.org/external/np/oth/2007/013107.pdf.

[66]See "IMF Managing Director Strauss-Kahn Applauds Executive Board's Landmark Agreement on Fund's New Income and Expenditure Framework," Press Release 08/74, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2008/pr0874.htm.

investment policies adopted by the Executive Board under the new authority would take into account, among other things, a careful assessment of acceptable levels of risk. For the foreseeable future, it is intended that these policies will rely on a passive investment approach that closely tracks widely used benchmark indices.

- **Establishing an endowment** to be funded by the profits from the sale of some of the IMF's gold holdings. The sale would be strictly limited to the 403 metric tons acquired after the date of the Second Amendment of the Articles of Agreement, which accounts for one-eighth of the IMF's gold holdings. The endowment would be invested, with the objective of generating income while preserving the long-term real value of its resources. A decision authorizing the sale of gold has not yet been taken, but all Executive Directors have indicated either that they are ready to vote in favor of such a decision, or that they will seek approval from their domestic legislatures to enable them to vote in favor of such a decision. Gold sales would be conducted under strong safeguards to ensure that they do not add to the announced volume of official sales to avoid causing disruptions that would adversely affect gold holders and gold producers, as well as the functioning of the gold market.

- **Resuming annual reimbursements of the General Resources Account.** The long-standing practice of recovering the expenses incurred by the Fund in administering the PRGF-ESF Trust will be restored starting from the financial year in which the Executive Board adopts a decision authorizing the sale of the current stock of post–Second Amendment gold. The Trust's capacity for concessional lending will be protected, including by temporarily suspending reimbursement if its resources are likely to be insufficient to support anticipated demand for concessional assistance.

The Committee had also recommended that the IMF invest an equal proportion of the quota resources subscribed by all members as a further source of income that could be varied over the medium term. This proposal, which would also require an amendment of the IMF's Articles, was discussed extensively by the Executive Board. While it received strong support from many Executive Directors, some could not back this option. Accordingly, the investment of quota resources did not have sufficient acceptance from the membership to make it a component of the new income model.

The adoption of all the elements of the new income model may take some time. The proposed amendment of the Articles of Agreement to expand the IMF's investment authority will come into effect when it has been accepted by three-fifths of the members having 85 percent of the total voting power, and this acceptance will require legislative action in most member countries. Gold sales can begin once they are authorized by the Executive Board with an 85 percent majority of the total voting power—with U.S. Congressional approval needed before the U.S. Executive Director can vote in favor of gold sales—and sales on the market would also be phased over time. Hence, net income shortfalls may continue for a few years until the full benefits of the new income measures and expenditure reductions are realized; the IMF's accumulated reserves will continue to be used to cover these shortfalls.

Borrowing arrangements

In November 2007, the Executive Board approved a five-year renewal of standing credit arrangements—the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB)—between the IMF and a group of members and official institutions whereby they can provide supplementary resources of up to SDR 34 billion (about $54 billion) to the IMF to forestall or cope with an impairment of the international monetary system or to deal with an exceptional situation that poses a threat to the stability of that system. The NAB became effective in November 1998, the GAB in 1962.

Arrears to the IMF

Liberia cleared its arrears to the Fund in March 2008 (see Chapter 4). As a result, overdue financial obligations to the IMF (including as Trustee) fell substantially, from SDR 1.89 billion at April 30, 2007, to SDR 1.34 billion at end-April 2008 (Table 5.1). Sudan accounted for about 76 percent of remaining arrears, and Somalia and Zimbabwe for 18 and 6 percent, respectively. At end-April 2008, all arrears to the IMF were protracted (outstanding for more than six months); one-third consisted of overdue principal, the remaining two-thirds of overdue charges and interest. More than four-fifths represented arrears to the General Resources Account (GRA), and the remainder to the SDR Department, the Trust Fund, and the PRGF-ESF Trust. Zimbabwe is the only country with protracted arrears to the PRGF-ESF Trust.

Table 5.1. Arrears to the IMF of countries with obligations overdue by six months or more, by type
(In millions of SDRs; as of April 30, 2008)

		By Type			
	Total	General Department (incl. SAF)[1]	SDR Department	Trust Fund	PRGF-ESF
Somalia	238.7	217.1	13.5	8.1	0.0
Sudan	1,015.7	935.6	0.0	80.0	0.0
Zimbabwe	87.0	0.0	0.0	0.0	87.0
Total	**1,341.3**	**1,152.8**	**13.5**	**88.1**	**87.0**

Source: IMF Finance Department.
[1]Structural Adjustment Facility.

Under the IMF's strengthened cooperative strategy on arrears, remedial measures have been applied to address protracted arrears. As of the end of the financial year, Somalia, Sudan, and Zimbabwe remained ineligible to use GRA resources. Zimbabwe continued to be excluded from the list of PRGF-eligible countries, and a declaration of noncooperation, suspension of technical assistance, and suspension of voting and related rights remain in place.

Management and organization

After learning in June 2007 of Rodrigo de Rato's intention of stepping down as Managing Director after the IMF–World Bank Annual Meetings, the Executive Board, which appoints the Managing Director of the Fund (see Box 5.3), put a new selection process in place. In accordance with this process, Dominique Strauss-Kahn was appointed in September 2007, and he assumed the position on November 1, 2007.[67]

[67]See "IMF Executive Board Moves Ahead with Process of Selecting the Fund's Next Managing Director," PR 07/159, and "IMF Executive Board Selects Dominique Strauss-Kahn as IMF Managing Director," PR 07/211, on the CD-ROM or on the IMF's Web site, at

(continued)

Box 5.3 How the IMF is run

The highest decision-making body of the IMF is the Board of Governors. The Board of Governors consists of one Governor and one Alternate appointed by each member in such manner as it may determine. The Governor is usually the member's minister of finance or central bank governor. The Board of Governors normally meets once a year. The Executive Board is responsible for conducting the business of the Fund, and for this purpose exercises all the powers delegated to it by the Board of Governors. The Executive Board is currently composed of 24 Executive Directors appointed or elected by member countries.[1] The Managing Director of the IMF is appointed by the Executive Board and serves as its Chair.

There are two committees of Governors that represent the whole membership. The *International Monetary and Financial Committee* (IMFC) is an advisory body currently composed of 24 IMF Governors (or their alternates), who are ministers or other officials of comparable rank, and who represent the same countries or constituencies (groups of countries) as the 24 Executive Directors. The IMFC advises, and reports to, the Board of Governors on matters relating to the latter's functions in supervising the management and adaptation of the international monetary and financial system and, in this connection, reviewing developments in global liquidity and the transfer of resources to developing countries; considering proposals by the Executive Board to amend the Articles of Agreement; and dealing with disturbances that might threaten the system. It has no decision-making powers. The IMFC normally meets twice a year, in March or April and in September or October, at the time of the Spring and Annual Meetings. 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; it advises the IMF and World Bank Boards of Governors on critical development issues and on the financial resources required to promote economic development in developing countries. Like the IMFC, it also normally meets twice a year.

[1]The Executive Board's calendar for FY2008 and a description of its main activities can be found on the CD-ROM. General information on the governance of the IMF can also be found on the CD-ROM, in the *IMF Handbook.*

www.imf.org/external/np/sec/pr/2007/pr07159.htm and www.imf.org/external/np/sec/pr/2007/pr07211.htm, respectively. The terms of Mr. Strauss-Kahn's appointment can be found in PR 07/245, at www.imf.org/external/np/sec/pr/2007/pr07245.htm.

The financial year was marked by other major changes as well, as the Executive Board continued to look for ways to curb the Fund's administrative expenditures, approving a budget that would result in significant savings, and sought to enhance the Fund's cost-effectiveness through a variety of measures, including improved collaboration with other international and regional bodies (Box 5.4) and a restructuring of the staff.

Box 5.4 Liaison with intergovernmental, international, and regional organizations

The IMF has a long history of collaboration with numerous international and regional organizations. The IMF's collaboration with the World Bank is especially close. Areas in which the IMF and the World Bank collaborate include the Financial Sector Assessment Program, development of standards and codes, the Poverty Reduction Strategy Paper process, the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative, and debt sustainability analyses. In March 2006, the IMF's Managing Director and the World Bank's President created the External Review Committee on Bank-Fund Collaboration. The Committee solicited views from member countries on the nature and practice of Bank-Fund collaboration, which has been guided since 1989 by a formal Concordat. The Committee released its report in February 2007. Following up on this report, known as the Malan Report, the Fund and the Bank developed the Joint Bank-Fund Management Action Plan, which builds on the existing division of labor between the two institutions and identifies a series of specific measures designed to improve coordination on country issues; enhance communication through new electronic platforms between the staff of the two institutions on common issues; and improve incentives and central support for collaboration on policies, reviews, and other institutional issues (see Chapter 4).[1]

The IMF also collaborates with the regional multilateral banks—the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, and the European Bank for Reconstruction and Development—including in country mission work and the provision of technical assistance, and attends meetings of the heads of the multilateral development banks. The Inter-American Development Bank and the African Development Fund participate in the Multilateral Debt Relief Initiative.

The IMF is a member of the Financial Stability Forum, which brings together government officials responsible for financial stability in the major international financial centers, international regulatory and supervisory bodies, and committees of central bank experts. It also works with standard-setting bodies such as the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors. In 2000, Horst Köhler, then IMF Managing Director, established the Capital Markets Consultative Group to provide a forum for informal dialogue between participants in international capital markets and the IMF; the Group is chaired by the IMF's Managing Director.

Through its Special Representative to the United Nations, the IMF communicates and cooperates with the United Nations and a number of UN agencies. The Fund's offices in Europe liaise with the Organization for Economic Cooperation and Development (OECD), the World Trade Organization (WTO), the Bank for International Settlements, the International Labor Organization, and the institutions of the European Union. Collaboration between the IMF and the WTO takes place formally as well as informally, as outlined in their Cooperation Agreement of 1996. IMF staff participate in the Integrated Framework for Trade-Related Technical Assistance and the Aid for Trade Task Force. IMF staff also liaise with the Asia-Pacific Economic Cooperation (APEC) and several regional groups in Asia, including the Association of South East Asian Nations (ASEAN).

The IMF is an active participant in the meetings and activities of the major intergovernmental groups, including the Group of Seven (G-7), Group of Eight (G-8), Group of Ten (G-10), Group of Twenty (G-20), and Group of Twenty-Four (G-24). The G-10 countries participate in the IMF's General Arrangements to Borrow, an arrangement established in 1962 that can be invoked when supplementary resources are needed to forestall or cope with an impairment of the international monetary system.

---

[1] See "Enhancing Bank-Fund Collaboration: Joint Management Action Plan," PR 07/235, as well as the Plan itself, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pr/2007/pr07235.htm and www.imf.org/external/np/pp/2007/eng/092007.pdf, respectively.

Administrative and capital budgets

On April 7, 2008, the Executive Board authorized total net administrative expenditures of \$868.3 million for FY2009; a limit on gross administrative expenditures of \$966.9 million; a one-time multiyear appropriation for the costs of institutional restructuring;[68] and an appropriation of \$48.3 million for capital projects in FY2009, as part of a \$138 million capital plan for FY2009–11. The Executive Board also took note of the indicative budget envelopes of \$880 million and \$895 million for FY2010 and FY2011, respectively, that constitute the medium-term administrative budget (MTB).

The strategic considerations underpinning the budget are set out in the Statement by the Managing Director on Strategic Directions in the Medium-Term Budget, which was

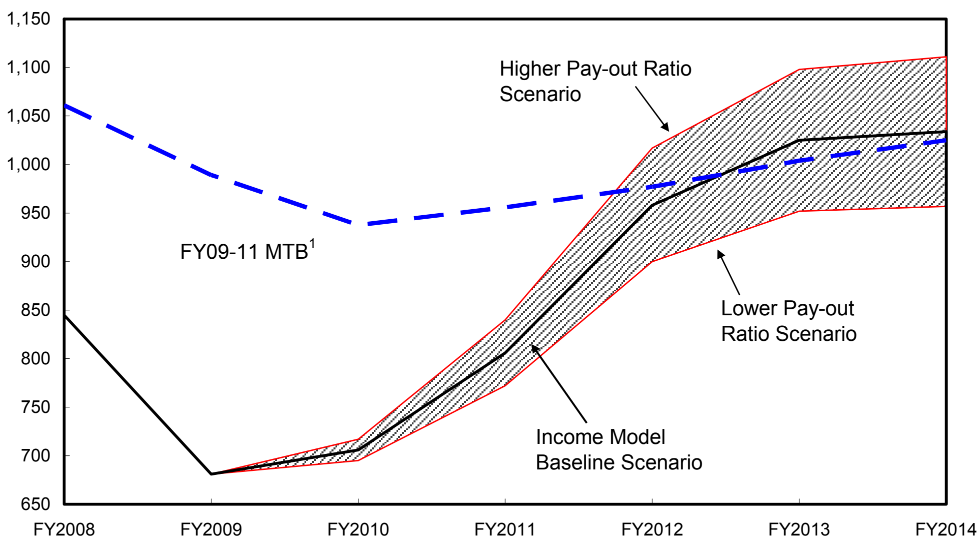
---

[68] The restructuring budget is a one-time, multiyear appropriation to meet the costs of refocusing the Fund.

submitted to the IMFC at the time of the Spring Meetings.[69] The central goal is to reshape the institution so that it delivers more focused outputs cost-effectively in line with its comparative advantage. The MTB will, among other things, contribute in an important way to bridging the medium-term income gap. It delivers an unprecedented 13½ percent real reduction in spending. Nonetheless, it allows for real increases in resources for such priority activities as multilateral and regional surveillance through reallocations from other areas.

A central priority is to put in place a sustainable budgetary framework as a basis for eliminating the income-expenditure gap in FY2013. As Figure 5.1 illustrates, together with the new income model the MTB delivers a balance between income and expenditure in FY2013.

Figure 5.1. Income Model and Medium-Term Budget
(In millions of U.S. dollars)



[1]Includes restructuring expenses, capital budget items expensed, and depreciation.

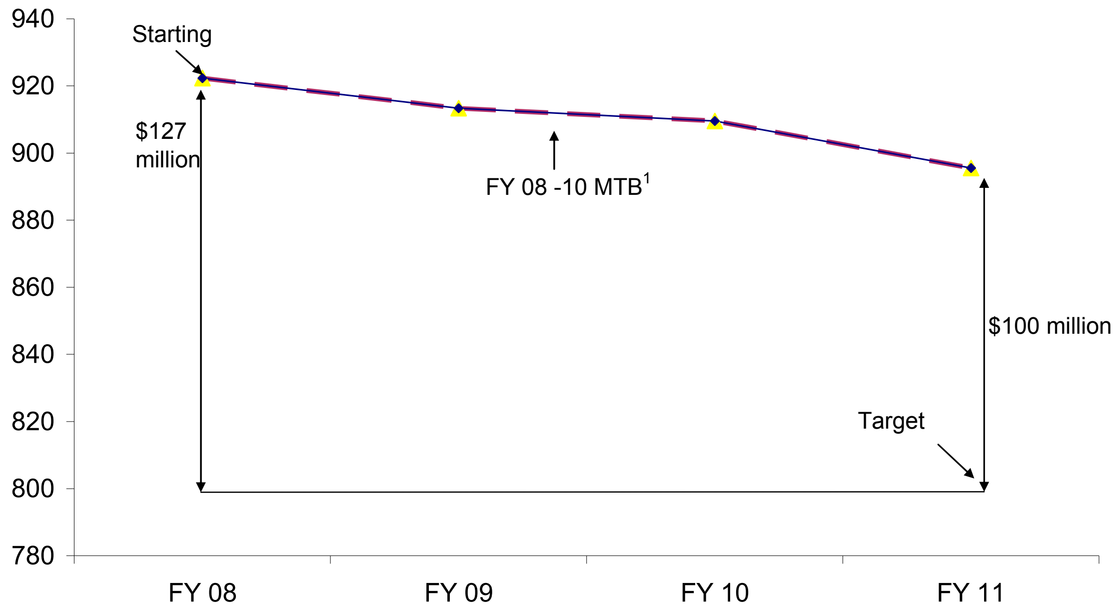
About $100 million of this gap is met through expenditure reductions and the rest through income measures. The FY2008–10 MTB envisaged a real reduction of $27 million dollars, or a cumulative 3 percent reduction in real terms. The FY 2009–11 MTB goes much further, incorporating an additional real reduction of $100 million, or over 10½ percent.

---

[69]The Statement by the Managing Director on Strategic Directions in the Medium-Term Budget, April 9, 2008, can be found on the CD-ROM and on the IMF's Web site at www.imf.org/external/pp/longres.aspx?id=4243.

Thus, measured from the FY2008 budget, total savings amount to $127 million, or over 13½ percent (Figure 5.2).

Figure 5.2. The FY 08–10 MTB Rolled Forward
(In millions of FY 08 dollars)



[1]FY11 figure is calculated assuming the policy stance of a one percent real reduction is continued.

The institution, therefore, has to meet its refocusing needs in the context of a shrinking budgetary envelope. The refocusing has five components:

- Strengthening multilateral surveillance through deeper analyses of macro–financial linkages, exchange rates, and spillovers originating from systemically important countries.
- Sharpening bilateral surveillance by applying cross-country perspectives to policy issues facing individual countries.
- Refocusing work in low-income countries to emphasize macro-stability, growth, and integration with the global economy.
- Streamlining capacity building by focusing on macro-critical activities and making technical assistance more demand-driven and externally funded.

- Modernizing the Fund by updating business practices and seeking efficiency gains.

The budgetary strategy incorporates four key considerations: providing a framework to help refocus the institution; putting in place a budget framework that will help close the income-expenditure gap in FY2013; maximizing reductions in nonpersonnel expenditure to better exploit technology and enhance organizational efficiency; and reducing personnel-related expenditures fairly, while preserving business continuity.

For the three-year period FY2009–11, there are $33 million in nonpersonnel savings (FY2008 dollars). The remaining $67 million in savings are personnel-related (Table 5.2).

Table 5.2. Composition of Savings
(In millions of FY 08 dollars)

Personnel savings	**67**
Efficiency gains	27
Fewer programs, less review, fewer layers	16
Fewer resident representatives/overseas staff	7
Streamline systems and administrative processes	7
Refocus capacity building	5
Refocus low-income country work	2
Refocus surveillance	2
Eliminate policy overlaps	1
Nonpersonnel savings	**33**
Travel related expenses	10
Lower resident representative/overseas office costs	9
Increased leasing of headquarters-2 building	5
Funding investment office through SRP	2
Annual meetings' savings	2
IT services	2
Elimination of subsidies	2
More revenues	1
Total	**100**

The shift of administrative resources across outputs and activities supports the refocusing of the Fund. It moves resources from noncore activities to the core business of the institution, and it reallocates resources within core activities toward priority areas. The MTB provides not only a larger share but also greater absolute levels of expenditure for certain key areas. The real budgetary allocations to (1) multilateral surveillance, (2) surveillance of systemically important countries, and (3) regional surveillance increase

(Table 5.3), while resource allocations to Fund-financed technical assistance and to country programs and support decline. If the Fund succeeds in raising more external financing for TA, the output loss in this area can be mitigated.

Table 5.3. Real Expenditure Allocation, FY08–11[1]

	Millions of FY 08 Dollars		Real percent change
	FY 08	FY 11	
Surveillance			
Multilateral	28	31	9
Bilateral surveillance	158	137	–13
Of which : Systemic countries	44	53	20
Regional	18	22	18
Country programs	122	103	–15
Fund-financed capacity building	106	86	–19
Support	313	272	–13

[1]Allocations are measured by the gross dollar inputs spent on each output area. Support and governance expenditures have not been allocated across outputs.
Note: Columns do not sum to the Fund total because of omitted categories

The reduction in staffing is the principal reason for the sizable decline in expenditures since personnel outlays account for nearly three-fourths of the budget. Staff numbers decline by 380 by FY2011, and most of the reductions are planned for FY2009. As Table 5.4 shows, personnel expenditures fall by 7½ percent in real terms in FY2009, even though average compensation costs are expected to rise 4½ percent. In the outer years, personnel expenditures are budgeted to decline modestly in real terms. Other noteworthy expenditure changes include the following:

- A 6 percent real reduction in travel for FY2009 resulting from a policy decision to reduce travel volumes, the introduction of a new travel policy, and more favorable airline pricing.

- Building and other expenditures fall 6 percent in real terms by FY2011, despite a small nominal rise, because of some necessary IT replacements and building refurbishments.
- As the Fund moves toward more external financing of TA and increased leasing of its properties, receipts are expected to rise over the MTB period, although these estimates are subject to uncertainty.

Table 5.4. Administrative budget by major expenditure category, FY2008–11
(In millions of U.S. dollars, unless otherwise indicated)

	FY2008	FY2009	FY2010	FY2011	FY2011 less FY2008
			(Nominal)		
Personnel	723	697	702	717	–6
Travel	100	98	99	99	–1
Building and other expenditures	161	163	165	170	10
Annual Meetings	0	0	5	0	. . .
Reserves	10	9	13	18	. . .
Gross Expenditures	994	967	985	1004	10
Receipts	–71	–99	–105	–109	–38
Net Administrative Budget	922	868	880	895	–27
			(In FY2008 dollars)		
Personnel	723	670	649	637	–86
Travel	100	94	91	88	–12
Building and other expenditures	161	157	153	151	–9
Annual Meetings	0	0	5	0	. . .
Reserves	10	8	12	16	. . .
Gross Expenditures	994	930	910	893	–101
Receipts	–71	–95	–97	-97	26
Net Administrative Budget	922	835	813	796	–127

Source: Office of Budget and Planning
Note: Figures may not add to totals because of rounding.

Looking at Key Output Areas (Table 5.5), outputs that are expected to absorb greater shares of resources over the MTB are multilateral surveillance, regional surveillance, standards and codes and financial sector assessments, and technical assistance; smaller shares are expected for oversight of the international monetary system, generally available facilities, and facilities specific to low-income countries.

Table 5.5. Estimated Gross Administrative Budgeted Expenditure Shares by Key Output Area and Constituent Output, FY08–11[1]
(In percent share of total gross expenditures, excluding reserves)

	FY08	FY09	FY10	FY11
Global Monitoring	17.4	17.7	17.9	18.2
Oversight of the international monetary system	5.2	4.6	4.7	4.7
Multilateral surveillance	4.5	5.1	5.3	5.5
Cross-country statistical info. & methodologies	3.0	3.2	3.2	3.2
General research	0.4	0.3	0.3	0.3
General outreach	4.3	4.5	4.5	4.5
Country specific and regional monitoring	35.2	36.6	36.5	36.7
Bilateral surveillance	28.3	28.3	28.2	28.4
Regional surveillance	3.1	3.6	3.7	3.8
Standards and codes and financial sector assessments	3.8	4.6	4.6	4.5
Country programs and financial support	23.2	21.1	20.9	20.4
Generally available facilities	10.0	8.1	8.0	7.8
Facilities specific to low-income countries	13.2	13.1	12.9	12.6
Capacity Building	24.2	24.6	24.7	24.7
Technical assistance	17.0	17.5	17.7	17.8
External training	7.2	7.1	6.9	6.9
Total, excluding reserves	100.0	100.0	100.0	100.0
Memorandum items				
Support	31.8	30.5	30.7	31.0
Governance	9.3	9.3	9.4	9.1

Source: Office of Budget and Planning.
Note: Figures may not add to totals due to rounding.
[1]Support and Governance expenditures are allocated across outputs.

The Executive Board approved an appropriation of $48.3 million for capital projects beginning in FY2009 and took note of the capital budget envelope of $138 million for the following two years. The appropriation for FY2009 provides for expenditures over the next three years: over one-third is for building facility projects, and the remainder for information technology projects. In real terms, the capital budget reflects a significant downward adjustment. Over the last decade, real capital expenditures have varied because of, among other things, security enhancements for building facilities and IT expenditures, which are now complete. About one-half of the budget for FY2009 is for projects that preserve the integrity of the Fund's asset base, while most of the remainder includes new and revised projects that will help facilitate the institutional restructuring and refocusing.

Human resources policies

As part of the reforms undertaken by the IMF in order to refocus its activities, modernize operations, and improve cost-effectiveness and efficiency, a framework to restructure the staff was put in place in early 2008. The restructuring exercise had two main objectives: a reduction of approximately 380 positions, and a change in the staffing structure, with more reductions at the managerial and administrative support levels. Fund management was committed to meeting these objectives through a transparent and fair process centering on voluntary separations to the extent possible, recognizing that some mandatory separations would be needed in specific areas. With these objectives in mind, the restructuring framework comprised a voluntary phase and a subsequent mandatory phase, a range of financial and other incentives to encourage voluntary separations, and an independent panel of former senior IMF officials to make recommendations to management on individual separation decisions.

The voluntary phase of the restructuring was successful in meeting both objectives. In implementing the restructuring exercise, measures were put in place to retain (to the extent possible) high-performing staff, and to ensure no undue impact on staff diversity. Outplacement assistance was provided to staff contemplating separation from the IMF, and significant efforts were made to identify employment opportunities in government agencies in member countries, other international financial institutions, and private sector organizations.

The IMF's staff is appointed by the Managing Director, and its sole responsibility is to the IMF. At April 30, 2008, the IMF had 1,950 professional and managerial staff and 636 staff at other levels. The framework for human resource management in the Fund reflects evolving best practices that are consistent with the mission of the institution and the objective of maintaining the quality and diversity of its staff. The Articles of Agreement state that the efficiency and technical competence of Fund staff are expected to be of the "highest standards." In addition, all staff members are expected to 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.

Recognizing 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 185 member countries, and in accordance with the requirement under the Articles of Agreement to pay due regard to the importance of recruiting personnel on a wide geographic basis, the Fund makes every effort to ensure that staff diversity reflects the institution's membership, actively seeking candidates from all over the world. It has established a Diversity Council to further its diversity agenda, building on the creation in 1995 of the position of Diversity Advisor. Progress is monitored and problems are reported in a transparent manner in various formats—including the *Diversity Annual Report*—on the IMF Web site.

Of the IMF's 185 member countries, 145 were represented on the staff at the end of April 2008. The IMF's organization chart and the list of the IMF's senior officers are on pages [00] and [00], respectively, of this Report. The organization of the IMF and the functions of its different departments are described in the *IMF Handbook,* which can be found on the CD-ROM. Also on the CD-ROM are tables showing the distribution of the IMF's staff by nationality, gender, and developing and industrial countries, and the staff salary structure.

Communication and transparency

Through its communication strategy and transparency policy, the IMF seeks to increase its accountability to stakeholders and build understanding of sound economic policies. With the guidance and support of the Executive Board, which regularly reviews the IMF's communication strategy and transparency policy, the IMF's efforts in these areas have increased significantly since the mid-1990s.

Communication

Communication strategy

In June 2007, the Executive Board discussed the IMF's communication strategy, its fifth discussion on this subject since 1998.[70] It noted the progress made since its last review, in 2005, in integrating communication activities with IMF operations and in increasing the IMF's openness and publication of information. Executive Directors broadly endorsed the overall direction of the communication strategy, which aims at building understanding and support for the role of the IMF and its reform agenda; further integrating communications with operations; raising the impact of communication materials; and rebalancing outreach efforts. They agreed on the growing importance of communication—tailored to specific audiences, circumstances, and products—as a tool in strengthening the effectiveness of the Fund in promoting international economic and financial stability and helping countries address economic shocks and the challenges of globalization. They also underscored the importance of two-way communication between the Fund and its members and other stakeholders, so that the staff and the institution can benefit from, and respond appropriately to, external feedback.

With respect to the implementation of the strategy, the Board welcomed plans to harness new technologies and modern communication practices—such as more emphasis on Web-based technologies, better alignment of publications with institutional priorities—and to enhance the effectiveness of communication in languages other than English in a cost-effective manner. It also commended efforts to strengthen internal communication, which plays a valuable role in channeling external views, fostering dialogue, and facilitating understanding of the key issues faced by the Fund. The IMF's efforts to better disseminate surveillance products such as the *World Economic Outlook* and the *Regional Economic Outlooks* were acknowledged by the Board, and many Directors noted the valuable role played by press releases, press conferences, and other channels in supporting country surveillance activities.

---

[70]See "IMF Executive Board Discusses the IMF's Communication Strategy," PIN 07/74, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0774.htm.

Initiatives during FY2008

In line with the strategy endorsed by the Executive Board, and the refocusing agenda, the IMF continued to enhance its communications and outreach during the financial year. Strengthening Web-based communications and expanding communications in languages other than English continued to be priorities. The Fund's recently revamped Web site was made more user-friendly and the search engine was upgraded. The site featured new items, such as landing pages on key policy issues, and Web sites for civil society organizations[71] and legislators.[72] Blogs were launched during the year by the Fund's Chief Economist and by its Fiscal Affairs Department, with the latter focusing on public financial management. Web sites in languages other than English that are heavily used in the Fund's work were revamped or added, and material (such as summaries of, and press releases about, the *World Economic Outlook* and the *Global Financial Stability Report*) for which demand is high were translated and posted on these sites. The Fund's *2007 Annual Report* was translated into Arabic, Chinese, French, German, Japanese, Russian, and Spanish, three more languages (Arabic, Japanese, and Russian) than in the past.

The Fund also sharpened the focus of its outreach, undertaking a number of outreach activities in FY2008 with parliamentarians and civil society organizations (CSOs). For example, in sub-Saharan Africa, it organized seminars for the Tanzanian Parliament's Finance and Economic Affairs Committee and CSOs in Dar es Salaam; for CSOs in Malawi (www.imf.org/external/np/exr/cs/news/2008/022008.htm); and for parliamentarians, nongovernmental organizations, and trade unions in Liberia. Engagement with the media has deepened, as operational staff have increased their contacts, and multimedia technologies permit the IMF to reach a broader media audience. For example, a biweekly media briefing initially intended for media based in Washington, D.C., has since developed into a webcast for journalists around the world. The Online Media Briefing Center, a password-protected multimedia site, allows journalists to access documents under embargo, participate in press briefings, and receive information and data tailored to their needs.[73]

---

[71] www.imf.org/civilsociety.

[72] www.imf.org/external/np/legislators/index.htm.

[73] See "Disseminating information: the IMF's publishing operations and Web site" on the CD-ROM.

Transparency policy

The IMF's transparency has increased dramatically in the past decade.[74] The current policy stems from an Executive Board decision in January 2001 to encourage the voluntary publication of country documents and more systematic publication of policy papers and associated Public Information Notices (PINs) that provide a summary of the Executive Board's assessment. The decision followed steps that had been taken since 1994 to enhance the transparency of the IMF and to increase the availability of information about its members' policies, while including safeguards to maintain the frankness of the IMF's policy discussions with members by striking the right balance between transparency and confidentiality. Members may request deletion of information not yet in the public domain that constitutes either highly market-sensitive material or premature disclosure of policy intentions.

Following their discussion in FY2006 of an IMF staff review of the transparency policy, Executive Directors called on the staff to produce annual updates on the policy's implementation for posting on the IMF's Web site. The third annual report on the implementation of the transparency policy, published in February 2008, presents information on documents considered by the Board between November 1, 2006, and October 31, 2007, and published by December 31, 2007, including publication rates for each type of document, lags between Executive Board discussions of documents and publication, deletion of material from documents, and the publication behavior of member countries.[75] Publication rates for country staff reports remained high, at 83 percent.

ACCOUNTABILITY

The Independent Evaluation Office

The Independent Evaluation Office (IEO) was established in 2001 to conduct independent and objective evaluations of IMF policies and activities with a view to increasing the IMF's

[74] The increased transparency of the IMF is widely recognized. In its *2006 Global Accountability Report,* One World Trust ranked the IMF third out of 10 intergovernmental organizations and fourth out of 30 intergovernmental and private transnational companies in terms of transparency. The report can be read at www.oneworldtrust.org/?display=index_2006.

[75] The report, "Key Trends in the Implementation of the Transparency Policy," can be found on the IMF's Web site, at www.imf.org/external/np/pp/eng/2008/013108.pdf.

transparency and accountability and strengthening its learning culture. Under its terms of reference, the IEO is fully independent of IMF management and operates at arm's length from the IMF's Executive Board, to which it reports its findings.

After an external evaluation of the IEO in FY2006, the Executive Board established a framework in January 2007 to ensure more systematic follow-up and monitoring of the implementation of Board-endorsed recommendations in IEO reports. The framework calls for a forward-looking implementation plan to be presented to the Board soon after its discussion of an IEO evaluation, and for the state of implementation of actions set out in the plan to be monitored periodically. In FY2008, the Board discussed the first two implementation plans, which were developed for two IEO evaluations completed in FY2007: "The IMF and Aid to Sub-Saharan Africa," which was also discussed by the Board in FY2007, and "The IMF's Advice on Exchange Rate Policy," which was discussed early in FY2008 (see below and Chapter 3). Since not enough time had elapsed since these two implementation plans had been developed, the first periodic monitoring report, which was discussed by the Board in January 2008, covered earlier IEO recommendations that had been endorsed by the Board before the establishment of implementation plans. Executive Directors agreed that IEO recommendations have had a substantial impact on how the Fund operates, and that lessons have generally been absorbed and recommendations substantially implemented. They considered that, in the future, monitoring would benefit from greater specificity and clarity about the follow-up actions required and that periodic monitoring reports should not be produced until sufficient time—say, six months—had elapsed following Board discussion of management's implementation plan. The Board reiterated that it was the responsibility of management and staff to prepare future monitoring reports, with periodic Board review, and reaffirmed that policy development, review, and implementation, including of Board-endorsed IEO recommendations, remained the responsibility of the Executive Board and management.[76]

---

[76]See "Implementation Plan Following IEO Evaluation of the IMF and Aid to Sub-Saharan Africa," PIN 07/93; "IMF Discusses Implementation Plan Following IEO Evaluation of the IMF's Exchange Rate Policy Advice, 1999–2005," PIN 07/119; and "First Periodic Monitoring Report on the Status of Board-Endorsed Recommendations of the Independent Evaluation Office," PIN 08/25, on the CD-ROM or on the IMF's Web site, at www.imf.org/external/np/sec/pn/2007/pn0793.htm,

(continued)

In May 2007, the Board discussed "An IEO Evaluation of IMF Exchange Rate Policy Advice, 1999–2005," based on an IEO evaluation conducted in FY2007 of strengths and weaknesses in the Fund's exchange rate policy advice. Executive Directors broadly endorsed the IEO's conclusion that during the period studied, the Fund had not been as effective as it needs to be in some important aspects of the Fund's exchange rate policy advice, and that the Fund should aim at enhancing the effectiveness of its analysis, advice, and dialogue with member countries, as well as address any perception of asymmetry in its exchange rate surveillance. They noted that, since the end of the evaluation period, the Fund's Medium-Term Strategy had identified further strengthening of exchange rate surveillance as a priority and pointed to initiatives under way to enhance the effectiveness of the Fund's work in this area.

Most Executive Directors concurred with the IEO's finding that the rules of the game for exchange rate surveillance remain unclear in some important areas. Accordingly, most agreed with the IEO's recommendation that a revalidation of the fundamental purpose of surveillance is an important goal, although views differed on the best vehicle through which this revalidation could occur. Taking note of the IEO's call to develop clear practical policy guidance on certain key analytical issues, Executive Directors had diverse views regarding the need for such guidance and on the feasibility of developing it. They discussed extensively the IEO's recommendation that management should give much greater attention to ensuring effective dialogue with country authorities, noting that although the IEO survey showed that national authorities across all country groups were generally satisfied with the policy dialogue with the Fund, many countries seek still greater value added from this.

Executive Directors concurred with the IEO that, over the review period, there had been problems in implementing various aspects of existing policy guidance, with most agreeing that there remains scope for improvement in several areas, including the quality of analysis of exchange rate levels and incorporation of the analysis of policy spillovers into regional and bilateral surveillance. They agreed with the IEO recommendation that Fund

---

www.imf.org/external/np/sec/pn/2007/pn07119.htm, and www.imf.org/external/np/sec/pn/2008/pn0825.htm, respectively. The periodic monitoring report itself, which was produced in December 2007, is available on the IMF's Web site, at www.imf.org/external/np/pp/2007/eng/120307.pdf.

management should ensure that exchange rate work across the Fund is organized and managed effectively, in tandem with ongoing work to integrate financial sector issues into Fund surveillance, and they encouraged further strengthening of the existing coordinating mechanisms (including the Surveillance Committee and the Consultative Group on Exchange Rate Issues), as envisaged by the Medium-Term Strategy.

Most Executive Directors emphasized that the Fund's management is responsible for providing the Executive Board with all the information that it needs to conduct surveillance and is accountable to the Executive Board for how it combines this duty with the need for the Fund to serve as a confidential advisor to members. As noted above, the Board considered the IEO's follow-up implementation plan later in the financial year.

During FY2008, the IEO completed an evaluation of structural conditionality in IMF-supported programs, which the Executive Board discussed in December 2007. Executive Directors broadly agreed with the IEO's findings and noted that the IEO assessment gives useful impetus to efforts to make the Fund more focused and relevant. It commended the shift the IEO found in the composition of structural conditionality toward the Fund's core areas, but most Executive Directors expressed concern regarding the IEO finding that the number of structural conditions had not declined significantly, and that some structural conditionality might have covered areas not critical to program goals. They broadly supported strengthened efforts to streamline conditionality, with parsimony as the guiding principle and a focus on measures critical to achieving program objectives. Another area of concern was the IEO's finding that compliance rates on structural conditionality had been low in many cases, and that, often, structural conditionality had not spurred further reforms. To enhance broad national ownership of reforms, the Board called for greater reliance on the authorities' views in setting conditions. The Executive Board considered management's implementation plan for Board-endorsed recommendations in early FY2009.

Also in FY2008, the IEO completed its evaluation of IMF corporate governance, including the role of the Executive Board,[77] and a draft issues paper on the IMF's approach to trade policy issues was posted on the IEO's Web site for public comment. In FY2009, the

[77]The Board discussed the evaluation in early FY2009.

IEO continues to work on an evaluation of the IMF's interactions with member countries and will begin an evaluation of the IMF's research agenda. More information on the activities and reports of the IEO can be found on its Web site, at www.ieo-imf.org.

Risk management

Since 2006, the IMF has had in place a comprehensive risk-management framework, which is overseen by the Executive Board. The Advisory Committee on Risk Management (ACRM)—which is chaired by one of the Fund's Deputy Managing Directors and composed of six senior IMF staff members—supports the risk-management framework, meets regularly to discuss risk-management issues, and briefs management and the Executive Board on its work. The centerpiece of the ACRM's work is the Annual Risk Management Report, which synthesizes the results of a comprehensive risk-assessment exercise covering strategic, core mission, financial, and operational risks.[78] During FY2008 further steps were taken to strengthen the modalities of the risk-assessment framework used. The ACRM also played an important role in monitoring risks associated with the IMF's refocusing efforts.

IMF audit mechanisms

The IMF's audit mechanisms consist of an external audit firm, an internal audit function, and an independent External Audit Committee (EAC) that oversees the work of both.

The external audit firm, which is selected by the Executive Board in consultation with the EAC and appointed by the Managing Director, is responsible for performing the annual external audit and expressing an opinion on the financial statements of the IMF, accounts administered under Article V, Section 2*(b),* and the Staff Retirement Plan. At the conclusion of the annual audit, the EAC transmits the report issued by the external audit firm, through the Managing Director and the Executive Board, for consideration by the Board of Governors and briefs the Executive Board on the results of the audit. The external audit firm is normally appointed for five years. Deloitte & Touche LLP is the IMF's external audit firm.

---

[78]The IMF's safeguards assessments policy mitigates the risk that loans made to member countries will be misused (see CD-Box 5.[] on the CD-ROM).

The internal audit function is assigned to the Office of Internal Audit and Inspection (OIA), which independently examines the effectiveness of the risk-management, control, and governance processes of the IMF. OIA also serves as the secretariat for the ACRM. OIA conducts about 25 audits and reviews annually, which include financial audits, information technology audits, and operational and effectiveness audits. Financial audits examine the adequacy of controls and procedures to safeguard and administer the assets and financial accounts of the IMF. Information technology audits evaluate the adequacy of information technology management and the effectiveness of information security measures. Operational and effectiveness audits focus on processes and associated controls and the efficiency and effectiveness of operations and their alignment with the overall goals of the IMF. In line with best practices, the OIA reports to IMF management and to the External Audit Committee, thus assuring its independence. In addition, OIA briefs the Executive Board annually on its work program and the major findings and recommendations of its audits and reviews. The quality of OIA's activities was assessed in early 2008 by an independent evaluation team of the Institute of Internal Auditors, which confirmed adherence to all applicable international standards.

The EAC is composed of three members selected by the Executive Board and appointed by the Managing Director, and oversees the IMF's accounting, financial reporting, internal control, and risk-management functions. The members serve for three-year terms on a staggered basis and are independent of the IMF. EAC members are nationals of different IMF member countries and must possess the expertise and qualifications required to carry out the oversight of the annual audit. Typically, candidates for the EAC have significant experience in international public accounting firms, the public sector, or academia.

The EAC selects one of its members as chair, determines its own procedures, and is independent of the IMF's management in overseeing the annual audit. However, any changes to the EAC's terms of reference are subject to Executive Board approval. The EAC typically meets in person in January, in June after the completion of the audit, and in July to report to the Executive Board. IMF staff and the external auditors consult with EAC members throughout the year. The 2008 EAC members are Mr. Satoshi Itoh, former Professor, Chuo University, Japan; Mr. Steve Anderson, Head of Risk Assessment and

Assurance, Reserve Bank of New Zealand; and Mr. Thomas O'Neill, corporate director and former Chairman, PricewaterhouseCoopers Consulting.