

**FOR
AGENDA**

SM/08/310

September 26, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Draft Statement by the Managing Director to the International Monetary and Financial Committee on Surveillance Priorities, the Fund's Lending Role, and Governance Reforms**

Attached for consideration by the Executive Directors is the draft statement by the Managing Director to the IMFC on surveillance priorities, the Fund's lending role, and governance reforms, which will be brought to the Board for discussion on **Wednesday, October 1, 2008** alongside the umbrella paper and IMFC agenda. The statement is intended to help shape the IMFC's discussion by providing a focused, forward-looking perspective on the key items under "IMF Reforms and Policy Agenda". It includes, as an attachment, the draft statement of surveillance priorities (SSP), as issued to the Board in SM/08/287. This attachment will be revised in line with the Board discussion of the draft SSP on Monday, September 29. Similarly, the paragraph on the Fund's lending role will be revised in line with the summing up of the Board discussion on the Fund's financing role.

The staff proposes the publication of this paper, with any needed revisions, on the Fund's external website following its circulation to members of the IMFC.

Questions may be referred to Ms. Mateos y Lago (ext. 37219) and Mr. Marsh (ext. 34489) in SPR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

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INTERNATIONAL MONETARY FUND

Draft Statement by the Managing Director to the IMFC on Surveillance Priorities, the Fund's Lending Role, and Governance Reforms

September 26, 2008

We are meeting in the midst of a financial crisis of historic proportion. Its broader effects on the global economy remain uncertain. But as the ripples are being felt across the world, we are reminded that globalization is not a slogan but a vivid interdependence. Dealing with the fallout of the current crisis is, of course, the immediate priority. We are actively helping members tackle this challenge, while remaining mindful of the needs of our low-income members reeling from the food and fuel price shock. But we should also look ahead and consider what this crisis implies for the Fund's surveillance and collaboration roles, to help steer through the current turmoil and prevent future threats to global financial stability and prosperity. Let me set out for our discussion some undertakings that will help the Fund rise to these challenges.

Surveillance Priorities. An overarching objective must be to provide clear, advance warning of risks in the global economy. We must also help members understand the interdependence of their economies and policy decisions, and promote collaboration or globally consistent actions. Doing so requires being more insightful, courageous, and persuasive. My vision for realizing this goal rests on four priority areas where I believe we can deliver unique value-added to our members if we focus our efforts:

- ***Early warnings are needed to help keep policymakers ahead of events.*** To focus policy, the Fund should provide clear assessments of risks to baselines, including insights from global or regional risk analysis. To help do so, we are extending our periodic vulnerability diagnostics exercise to advanced economies and will strive for innovative ways of assessing and communicating risks, trying to be neither too coded nor too alarmist.
- ***Understanding macro-financial linkages is crucial.*** Recent surveillance has offered examples of high quality macro-financial analysis, and described key vulnerabilities and risks. We are intensifying work to guide everyday macro-financial analysis and update our toolkit for financial stability analysis, so that today's best practice becomes tomorrow's norm.
- ***Multilateral perspectives are integral to Fund surveillance.*** The current crisis is giving strong impetus to more thorough treatment of cross-country financial linkages. Staff will continue efforts to give more prominence to work on cross-country themes, and to better draw out the policy implications of multilateral surveillance findings.

- ***Exchange rates and external stability remain key focus areas.*** Exchange rate assessments have improved lately, but we have further to go in casting these in a broader external stability context encompassing capital account developments and global foreign exchange markets. We are continuing to refine and extend methodologies. Meanwhile, where there are significant concerns about external stability matters, we will have closer engagement with members through *ad hoc* consultations.

These priorities are now encapsulated in the Fund's first *Statement of Surveillance Priorities* recently adopted by the Executive Board (attached). The Statement further identifies three key interlocking challenges once the current turmoil subsides: (i) adjusting to global financial and commodity booms and busts; (ii) reducing global imbalances; and (iii) optimizing the potential of global capital flows. I see this Statement as a key tool to steer our efforts, and I hope you can endorse its thrust, and reiterate in the Communiqué members' willingness to work with the Fund to achieve these objectives.

The IMF's Lending Role. It is particularly critical at this time for the Fund to have a robust lending function that meets our members' needs—whether financing, signaling or insurance. The global financial system and members' needs have changed enormously since the Fund was created, and although the Fund has a record of adapting to change, the truth is that our lending instruments are based on a model that may no longer be suited to the needs of a large part of the membership. We have therefore launched a review of the Fund's lending role to ensure we have a modern set of instruments relevant for all members and subject to adequate safeguards. We had a good first discussion at the Board on broad issues and ideas. Based on this discussion, we have developed a road map to advance work *concurrently* in five broad areas: (i) exploring analytical considerations for Fund lending; (ii) advancing the work on a new liquidity instrument; (iii) re-examining conditionality ; (iv) reviewing our lending role and facilities for low-income members; and (v) reviewing access limits and financing terms for using Fund resources. My plan is to have preliminary discussions with the Board in all these areas by the Spring Meetings and no decisions until then, unless there is a strong consensus in any particular areas (e.g. liquidity instrument). After the Spring Meetings, we will take stock and decide how to pull these building blocks together to set the stage for decisions before the 2009 Annual Meetings

Governance Reforms. The Fund's decision-making framework is a key element of its ability to fulfill its global mandate effectively and achieve meaningful global cooperation in the twenty-first century. To assess its adequacy after the historic steps already agreed on quotas and voice, and advise on any further modifications that might be needed, I have appointed a committee of eminent persons, chaired by Mr. Trevor Manuel. I look forward to hearing your views on the issue. Based on our discussions, the committee's perspective which I hope to receive by next April, and the work of groups and individuals such as the IEO and the Executive Board, I hope to make concrete proposals for reform by next September.

ATTACHMENT

SURVEILLANCE PRIORITIES FOR THE INTERNATIONAL MONETARY FUND, 2008-2011

To foster multilateral collaboration, and provide timely and relevant advice to member countries and the public, IMF surveillance will be guided through 2011 by the following overarching objective and supporting priorities:

Early warnings and rapid response. *Provide clear, advance warning of developments and risks in the global economy, to help members take actions needed to support their economies during a period of global adjustment.*

Economic priorities

*The global economy faces a period of slower growth alongside the challenges of sharp changes in commodity prices, the deflation of financially-driven bubbles, and continuing global imbalances. Policies should aim at achieving sustainable noninflationary growth. In coordination with other International Financial Institutions, the IMF should **promote a common understanding** of the forces and linkages underlying these challenges; **draw key lessons** from different experiences to share across the membership; and **advise on how best to use policy**—in particular monetary, fiscal, exchange rate, and financial sector policies—in support of **three specific, intertwined objectives**:*

- **Adjusting to global financial and commodity booms and busts.** *The challenge will be to achieve noninflationary growth at a time when booms and busts are slowing potential output growth, changing the sources of global demand, and providing a boost to headline inflation that could well reverse abruptly. This will require domestically appropriate and globally consistent policy responses to past and potential future rapid changes in commodity prices, and to financial sector de-leveraging and associated volatility in asset prices;*
- **Reducing global imbalances in an orderly manner while minimizing adverse real and financial repercussions;**
- **Optimizing the potential of global capital flows** *while forestalling disruptive patterns by being attentive to cross-border capital flows, including to LICs, arising from global imbalances, and strengthening the global financial system with emphasis on upgrading regulation and supervision, including across borders.*

Operational priorities

- **Risk assessment.** *Refine the tools necessary to provide clear early warnings to members. Thorough analysis of major risks to baseline projections (including, where appropriate, high-cost tail risks) and their policy implications should become more systematic.*
- **Real-financial linkages.** *Improve financial stability diagnostic tools, deepen understanding of linkages, including between markets and institutions, and ensure adequate discussion in surveillance reports;*
- **Multilateral perspective.** *Bilateral surveillance to be informed systematically by analysis of inward spillovers; outward spillovers (where relevant); and cross-country knowledge (as useful); and,*
- **Exchange rate analysis and external stability risks.** *Clearer and more robust discussions to be provided in all staff reports, underpinned by further progress in refining assessment methodologies.*

The Executive Board has highlighted the above priorities to foster multilateral collaboration and guide IMF management and staff in the conduct of surveillance. These priorities look ahead three years, but may be revised if circumstances warrant. Permanent guidance for surveillance (such as provided in the *2007 Decision on Bilateral Surveillance*), traditional areas of strength, and relevant country-specific issues should not be overlooked.

Management and staff are responsible for delivering on the operational priorities, subject to members' cooperation in line with commitments under the Articles of Agreement. To foster progress toward economic priorities, management and staff are responsible for providing candid high-quality analysis and effective communication. The Managing Director will report: (i) regularly on actions toward priorities and readily visible results; and (ii) at the time of the next Triennial Surveillance Review on progress in attaining these priorities; management's and staff's contributions; and factors that impeded progress.