Stability
Growth
Poverty Reduction

The UK and the IMF 2002

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March 2003

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FOREWORD BY THE CHANCELLOR OF THE EXCHEQUER

These are testing times for us all. Testing, because in a world economy buffeted by stock market volatility and uncertainty in the Middle East, economic policy must be shown to work for the benefit of all, in the bad times as well as the good. Testing also, because in a world where over a billion people live on less than $1 a day, there is a real risk we will miss our target of halving poverty by 2015.

Addressing world poverty and sustaining world growth are inextricably linked. Reducing poverty requires a strong world economy, but if the global economy is to sustain high rates of growth in the years to come, growth can and must come from bringing developing countries into the development process. At the same time, the world economy must advance in a stable and sustainable manner if all countries are to benefit from greater integration. As we saw in East Asia and more recently in Argentina, financial crises can drive millions of people into poverty.

The IMF - as the custodian of the international financial system – can play a decisive role in advancing a globalisation that works for all, but all member countries must also play their part. Only through continued international cooperation and partnership can we deliver stability, growth and poverty reduction on a global scale.

We made much progress in 2002, but there are many challenges that still face us. Foremost among these: economic uncertainty and extreme poverty. So this report also sets out our key priorities for reform at the IMF:

- encouraging member countries to adopt credible, transparent and sound domestic policy frameworks that facilitate integration into the international system while limiting vulnerability to crises;

- strengthening the Fund's crisis prevention and resolution capacity, particularly through greater independence for Fund surveillance, more widespread adoption of internationally agreed codes and standards and a more effective framework for the orderly resolution of financial crises;

- a stronger voice for developing countries in the IMF combined with greater transparency and accountability in its operations; and

- achieving the Millennium Development Goals through the primacy of Poverty Reduction Strategies that are fully country driven, with the requisite increase in resources to back them. To this end, the UK has proposed an International Finance Facility that will provide an additional $50 billion in aid flows each year up to 2015.

As we make progress across these areas, we must move from a situation where crises happen and then we deal with them, to a situation where we can reduce the likelihood of crises and provide more orderly responses when crises have to be resolved. Additionally we can move beyond providing temporary relief to the poorest countries; instead providing predictable, long-term support for their economic and social development.

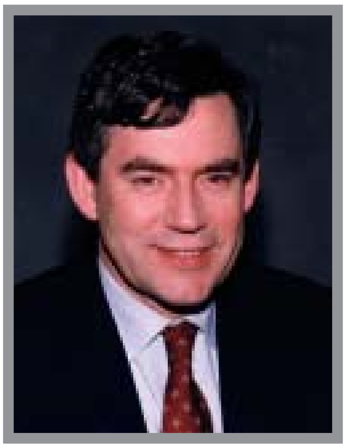
To that end, I am pleased to be able to present this fourth annual report to Parliament and to the public on the UK and the IMF. It demonstrates our continued commitment to transparency and accountability in our dealings with the IMF.

REPRESENTING THE UK IN THE IMF

The Board of Governors of the IMF, on which all member countries are represented, is the highest authority governing the IMF. The Chancellor of the Exchequer is the UK's Governor. He is also Chairman of the International Monetary and Financial Committee (IMFC), the main committee of the Board of Governors, and the main forum for discussing IMF policies at the Ministerial level. The Governor of the Bank of England is the UK's Alternate Governor of the IMF and represents the UK at the IMFC.

The day-to-day work of the IMF is conducted by the Executive Board of the IMF. This comprises 24 Executive Directors representing all 184 members of the IMF. The UK, as one of the five largest contributors to the IMF, has its own Executive Director – currently Tom Scholar.

The Treasury coordinates UK policy advice on IMF issues and the UK's operational interests at the Fund, working closely with the Bank of England, the Department for International Development, the Foreign and Commonwealth Office, the Financial Services Authority and other government departments and agencies. Within the Treasury, the Macroeconomic Policy and International Finance Directorate is specifically responsible for preparing advice on the policy issues and specific country programmes that are brought before the Executive Board.



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1 An IMF For The 21st Century

Since the creation of the IMF in 1944, the global economy has become increasingly interdependent. Events in one country, whether it be financial crisis or widespread poverty, can now have huge ramifications elsewhere. The IMF has a central role to play in managing this interdependence and correspondingly, has grown in membership and mandate. UK priorities for IMF reform are focused on ensuring that it effectively covers this mandate and has the capacity to respond to new challenges.

THE IMF IN A PROCESS OF CHANGE

1.1 Since its creation in 1944, the IMF has continually adapted itself to meet the changing nature of the global economy and the international environment. This constant evolution has been reflected in changes to the function, policies and institutional structure of the IMF, and it is a process that continues today.

1.2 When the IMF was established, together with the World Bank, its core function was to maintain the Bretton Woods system of fixed exchange rates, but when the major industrial countries abandoned this system in the 1970s, this function of the IMF was no longer relevant. However, the Fund has continued to play an important role in the international financial system by changing its operations in response to new economic realities. This has been particularly true since the early 1990s, with the increasing international integration of markets and economies.

1.3 Today's global economy is very different to that of 1944. Globalisation has brought the benefits of higher investment, faster growth and more effective poverty reduction to those countries that have become more integrated into the global economy, but globalisation has also brought new risks and challenges. Events in one country, whether it be financial crisis or widespread poverty, can have implications in many other economies. Globalisation also creates change, which labour markets, tax and social security systems, and fiscal and monetary policy must respond to, and there is a danger that the poorest countries, which have yet to fully benefit from globalisation, will fall further behind as living standards elsewhere rise.

1.4 So at the start of the 21st Century, the IMF must once again adapt to address a new, much larger challenge – how to ensure that the benefits of globalisation are sustained and shared.

Globalisation that works for all

I.5 Delivering a globalisation that works for all will once again require exceptional international cooperation, and the IMF has a central role to play in facilitating this cooperation. The core function of the IMF is "To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems"[1]. In fulfilling this function, the IMF provides a mechanism for member countries to cooperate with others to promote both their own domestic economic prosperity and that of the entire membership.

I.6 The UK believes that this cooperation should focus on three core areas:

- strengthening the international financial system;
- meeting the Millennium Development Goals; and
- enhancing the IMF's institutional framework.

I.7 In each of these areas, the UK has a number of specific priorities for reform that are aimed at ensuring the IMF's policies and processes are geared to addressing the challenges of globalisation. Going forward, we will continue to advance these priorities at the IMF and otherrelevant fora. This chapter outlines those priorities. Subsequent chapters provide additional background and review the relevant discussions that took place at the IMF over the course of 2002, including summaries of the UK position.

STRENGTHENING THE INTERNATIONAL FINANCIAL SYSTEM

I.8 A credible domestic policy framework is essential in ensuring a country can fully benefit from globalisation. The IMF has an important role to play in helping its members establish these frameworks, and more broadly, in addressing the weaknesses of the international financial system. In particular, there are three areas where the UK believes the international financial system needs strengthening: crisis prevention, crisis resolution and combating money laundering and the financing of terrorism.

CRISIS PREVENTION

I.9 The IMF fulfils a vital role in preventing financial crises – through its promotion of codes and standards and its surveillance process. Central to this approach is encouraging members to adopt policies and reforms that support growth and strengthen the resilience of their economies to adverse external developments, thus contributing to the stability of the international financial system.

[1] Article 1, section (i) of the IMF's Articles of Agreement

Macroeonomic Frameworks

1.10 The UK government believes these policies and reforms should be set within a credible, rules-based macroeconomic framework. This framework should constrain macroeconomic policy to achieve clear long-term goals, while providing the short-term flexibility to respond to temporary shocks. The underlying principles for such a framework are:

- clear and sound long term policy objectives;
- pre-commitment through strong institutional arrangements and procedural rules; and
- transparency and clear accountability.

1.11 Sound macroeconomic frameworks must be accompanied by structural reforms to create a more dynamic, efficient and innovative economy. For example, effective corporate governance and financial sector regulatory regimes, as well as labour market reforms to promote flexibility and minimum standards.

Codes and Standards

1.12 The internationally agreed codes and standards framework provides clear benchmarks for good policy across the range of official, financial and corporate sectors. These codes embody the frameworks outlined above, so their adoption will strengthen national economies and promote stability. However, while considerable effort has gone into developing and promoting these codes, with over 80 countries participating, we need to do more to encourage all countries to adopt them.

1.13 The UK will seek to promote more widespread adoption of codes and standards. Where capacity constraints hinder take-up, we will also encourage countries to draw on technical assistance from the Financial Sector Reform and Strengthening (FIRST) initiative – supported by DFID.

Surveillance

1.14 IMF surveillance is an essential tool for strengthening crisis prevention. The Fund is uniquely placed – with its responsibility for overseeing the international monetary system and the economies of its 184 member countries - to assess national and global economic prospects, detect vulnerabilities at an early stage, and provide preventative policy advice to avert crises. Yet economic crises over the last decade have raised questions about the effectiveness and influence of Fund surveillance. Steps have been taken in recent years to strengthen surveillance. However, the UK believes further reforms are necessary. The challenge, as the Chancellor of the Exchequer has said, is to make the IMF as credible and independent from political influence in its surveillance of economies as an independent central bank should be in the operation of domestic monetary policy.

1.15 A key UK priority is therefore to strengthen IMF surveillance to make it more independent, authoritative, transparent and accountable.

Contingent Credit Line

I.16 The IMF's Contingent Credit Line (CCL) was introduced in 1999 to strengthen the IMF's focus on crisis prevention. It is available to countries that are pursuing strong policies but are nevertheless threatened by contagion from financial crises elsewhere. By linking support to strong policy performance, it aims to provide an incentive for countries to implement strong policies and to send a positive signal to markets. While other facilities aim to resolve crises, the CCL is designed to prevent crises. Yet the CCL has so far failed to attract any applicants.

I.17 The UK believes that the objectives of the CCL – to encourage good policies and protect 'innocent bystanders' in financial crises – remain important. However, given the lack of applicants to date, the UK and others called on the IMF to review the CCL to address concerns about its design and consider whether it can be modified to encourage greater use. The Fund has consulted widely with officials from a range of countries (including potential CCL applicants) and private sector participants and is considering the best way forward to achieve the CCL's objectives. We support this approach.

Advancing this Agenda

I.18 We will continue to press for a strengthening of the Fund's crisis prevention tools, both through the Executive Board and through the International Monetary and Financial Committee (IMFC).

I.19 In parallel, we will also work within the EU, G7 and other relevant fora to build support for UK priorities in this area.

CRISIS RESOLUTION

I.20 Even our best attempts to prevent crises are unlikely to be completely successful. The UK therefore strongly supports the IMF's efforts to complement its crisis prevention tools with stronger mechanisms for resolving financial crises once they have occurred.

I.21 The rapid growth in international capital flows has resulted in private sector debt dominating the capital accounts of many emerging markets. At the same time, official sector resources are limited. So once a financial crisis has occurred, it is essential that the private sector play its part in resolving it.

The Crisis Resolution Framework

I.22 The UK is keen to see progress in the following areas:

- development of a more orderly and transparent framework for facilitating a restructuring of sovereign debt;
- clear and consistent application of the policy on access to Fund resources to strengthen the market's understanding of how the official sector will respond to a crisis and hence, the role they will need to play.

I.23 We will continue to actively engage in Fund discussions on these issues, including their application to specific country cases. We will also work within the EU, G7 and G20 and through dialogue with the private sector to ensure the IMF's crisis resolution machinery is developed in an effective and consultative manner.

TACKLING ABUSE OF THE INTERNATIONAL FINANCIAL SYSTEM

I.24 Financial crises are one of the risks associated with the increased integration of financial markets. Another is the potential for the system to be abused through money laundering and the financing of terrorism.

I.25 The UK strongly supported an expansion of the IMF's work in combating these abuses, in particular the development of a new codes and standards module on anti-money laundering and combating the financing of terrorism (AMC/CFT), based on the Financial Action Task Force (FATF) recommendations, as the recognised international standard. The UK is keen to ensure that the pilot phase of this module is successful, with subsequent widespread uptake. In addtion we will work with the FATF, the UN and the Egmont Group to deliver this. We will also continue to support the provision of technical assistance to address weaknesses in members' AML/CFT systems.

MEETING THE MILLENNIUM DEVELOPMENT GOALS

I.26 The international community is committed to meeting the Millennium Development Goals (MDGs), including halving the proportion of people living in poverty by 2015. As part of this wider effort, the IMF has an important role to play in supporting the efforts of low-income countries as they undertake and finance the reforms necessary to benefit from globalisation.

I.27 IMF support to low-income countries is increasingly focused on supporting the development and implementation of Poverty Reduction Strategy Papers (PRSPs) that are consistent with achieving the MDGs at the country level. The IMF provides support for PRSPs through its concessional facility: the Poverty Reduction and Growth Facility (PRGF); and through debt relief: the enhanced Heavily Indebted Poor Countries (HIPC) initiative.

The Poverty Reduction and Growth Facility

I.28 The PRGF should be fully aligned behind the PRSP, supporting country-ownership through streamlined conditionality. The UK will continue to push this with Fund staff and wider stakeholders.

I.29 If other development agencies are to also align their support behind PRSPs, they must be confident that the resources they provide in budgetary support are used effectively. This in turn requires effective public financial management and accountability (PFMA) systems. The IMF and World Bank currently have numerous tools for assessing the various components of these systems but this can lead to duplication and inefficiency. The UK is therefore encouraging the two institutions to place greater emphasis on streamlining their tools for assessing country performance, and on achieving concrete progress at the country level in improving PFMA systems.

The Heavily Indebted Poor Countries Initiative

1.30 Much progress has been made on the HIPC initiative. However, additional work is required. The UK will use international meetings to press for more flexible provision of topping-up at completion point, with additional voluntary bilateral debt relief excluded from the calculation, to ensure fair burden sharing among creditors and greater benefits to HIPCs. The government will also seek to ensure that all creditors play their part in financing and delivering the initiative and that technical assistance is made available to HIPCs being sued by creditors. The UK government will also continue to encourage those HIPCs affected by conflict to work towards peace and put in place the conditions necessary to ensure that debt relief is used for poverty reduction.

Resources for Development

1.31 The international community must also recognise that without additional support, even the best efforts of developing countries will not be enough to meet the MDGs. The IMF has an important international role to play in helping to mobilise these resources via increased aid and trade.

- Aid: No country genuinely pursuing stability and reform should be denied the possibility of help to finance education, health and anti-poverty policies. To this end, a major priority for the UK will be to build support for an International Finance Facility (IFF) that will leverage finance from international capital markets to provide an additional $50 billion per year in aid to 2015. The UK will promote the IFF through all relevant national and international fora.
- Trade: Cutting developed countries' protection of their own agriculture, industrial goods and services sectors by 50 per cent could increase the world's income by as much as an estimated $400 billion per year, with significant benefits for the poorest countries. The UK will continue to work with our European partners to ensure that the EU is able to take a strong, pro-development, position in all areas of negotiation at the WTO Ministerial meeting in Cancún, Mexico, in September 2003.

ENHANCING THE IMF'S INSTITUTIONAL FRAMEWORK

1.32 In addition to requiring changes to the IMF's policies, globalisation is also creating pressures for change in the IMF's institutional procedures and external relationships. Key UK priorities will be to increase transparency, strengthen developing country voice in the IMF's decision-making processes and encourage greater IMF/World Bank collaboration.

Transparency

1.33 Increasing the transparency of the IMF is a critical element of our efforts to strengthen crisis prevention and promote stability. The IMF has made much progress in its transparency in recent years. However, the UK believes that further progress is both possible and useful. In particular, we will continue to push strongly for:

- presumption in favour of publishing the IMF's surveillance reports and assessments of adherence to the codes and standards framework;
- compulsory publication of reports on Fund lending programmes (Use of Fund Resources – UFR – reports);
- further measures to enhance the transparency of the Executive Board, including through accelerated access to the minutes of Board Meetings; and
- greater dialogue by the Fund with non-governmental sectors within its membership, and in particular with Parliaments and civil society.

Representative Decision-Making

I.34 Developing countries constitute the majority of IMF membership and are often profoundly affected by its decisions, yet their ability to influence these decisions is limited. In part this is due to capacity commitments and the mismatch between resources and work volumes. Addressing this through measures to increase developing country voice in the Fund will improve the effectiveness of the IMF and strengthen these countries' sense of ownership of the institution and its policies.

I.35 We are considering a number of proposals to strengthen developing country voice. In the short-term, these include more staff and resources for their delegation offices, better training opportunities and improved communication links to capitals. A package of such measures will help to tackle the immediate voice problems facing the sub-Saharan African constituencies. In particular, that of high workload relative to capacity. We also believe that the proposal to increase the basic vote merits serious consideration. A joint World Bank/IMF paper on strengthening voice will be discussed by the Development Committee at the Spring Meetings in April 2003. Ahead of that, we are seeking to build support for a package of proposals on strengthening voice.

Collaboration with the World Bank

I.36 These reforms should strengthen the IMF's effectiveness and credibility in the wider international institutional system.

I.37 In parallel the government supports strengthened IMF/World Bank collaboration, consistent with their respective mandates. A particular priority is the use of Poverty and Social Impact Analysis (PSIA) in the policy design process. PSIA is an important tool in opening up the debate on alternative policy options and can help strengthen ownership of key reforms, but it has yet to be employed in a systematic manner. Through improved collaboration, the government believes the IMF and World Bank can address this and that PSIA can become an important tool for both institutions.

THE WAY AHEAD

I.38 Global problems increasingly require global solutions. This is placing renewed emphasis on the effectiveness of the international institutional system. The IMF is a key player in this system. Through strengthening the international financial architecture, contributing to the achievement of the Millennium Development Goals and promoting sound economic policies in its members, it has a vital role to play in delivering global growth, stability and poverty reduction. The UK government will continue to push for IMF policies that serve these objectives.

2 IMF Surveillance and the World Economy in 2002

The IMF has an important role to play in monitoring economic and financial developments, both in its member countries and globally. In 2002, these surveillance discussions focused on the fragile recovery in the world economy and the potential impact of shocks on this recovery. The adverse effects of the slowdown on emerging markets and developing countries were a particular concern.

IMF SURVEILLANCE

2.1 Under Article IV of its Articles of Agreement, the IMF is mandated to "oversee the international monetary system in order to ensure its effective operation". It does this through "firm surveillance over the exchange rate policies of members"[3]. However, the coverage of surveillance has evolved to include a wider range of macroeconomic and structural policies and in today's global economy, where economic developments in one country can rapidly spread to another, this surveillance role of the IMF is more important than ever.

2.2 This chapter outlines the IMF surveillance process, then summarises the conclusions of the key surveillance discussions and lending programmes that took place in 2002[4].

2.3 The IMF conducts surveillance at three levels:

- Global: the world economy at the aggregate level. This is done through the IMF World Economic Outlook and the Global Financial Stability Report;
- Regional: key regional economic areas, such as the Euro-Area;
- Country: the IMF holds "Article IV" consultations with each member country about its economic policies.

[3]Article IV, Sections 3(a) and 3(6) of the Articles of Agreement of the International Monetary Fund
[4]Chapter 3 considers the UK priorities for reformof the surveillance process

ARTICLE IV COUNTRY SURVEILLANCE

Article IV consultations between the IMF and individual member countries are normally held once a year. The consultations focus on major aspects of macroeconomic and financial sector policies, in particular exchange rate, fiscal and monetary policies and the balance of payments position, including the policy stance and framework. They also cover other policies that affect macroeconomic performance, including where relevant, labour, productivity, enterprise and environmental policies and economic governance.

An Article IV consultation is conducted by a visiting IMF staff team. The team will collect economic and financial information and discuss economic developments and policies with the national authorities. At the end of the mission, the staff prepare a concluding statement. On their return to Washington, they write the Article IV report that summarises much of the detail obtained from the mission and reflects the analysis underlying their views (as expressed in the Concluding Statement). The report is subsequently discussed by the Executive Board. The views of the Executive Board are summarised in Public Information Notices (PINs) attached to the staff report.

In August 2000, following a successful pilot project, the Executive Board adopted a policy of voluntary publication of Article IV staff reports. The UK participated in this pilot project by authorising the publication of the UK's 1999 Article IV report. Since then, the government has continued to publish the UK Article IV reports.

GLOBAL SURVEILLANCE

Overview of the World Economy

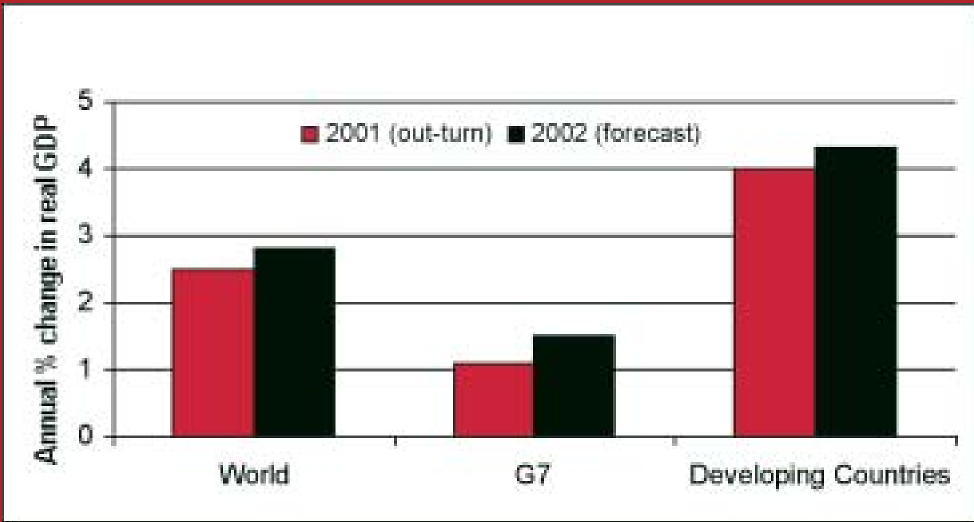
2.4 In 2002, the world economy began to recover from the first synchronised slowdown across the world's major economies in almost three decades. During the first half of 2002, increases in trade and industrial production provided clear evidence that the global recovery was underway. However towards the end of 2002, the outlook weakened again as corporate accounting failures, further declines in equity markets, developments in the Middle East and rising oil prices exacerbated existing uncertainties. As G7 Finance Ministers noted in September 2002, "Economic growth in our countries is continuing, though at a more moderate pace than earlier this year. We recognize that risks remain"[5].

2.5 Continued volatility in global equity markets and the possibility of renewed rises in oil prices pose a clear risk to the global economic outlook. Heightened investor uncertainty, as a result of any more high profile corporate failures or continued uncertainty in the Middle East, could also delay the global investment recovery.

[5]Statement of G7 Finance Ministers and Central Bank Governors, 27 September 2002. Available at http://www.fin.gc.ca/activity/G7/g7270902e.html

2.6 Supportive fiscal and monetary policy should, however, help the global recovery. For example, low interest rates in several countries could stimulate faster than expected household consumption growth.

CHART 2.1 IMF World Economic Outlook



source: World Economic Outlook, Trade and Finance (September 2002)

Global Financial Stability

2.7 The Global Financial Stability Report provides timely and comprehensive coverage of financial markets, with a view to identifying potential weaknesses that could lead to crises. In 2002, its reports analysed the deterioration in global financial market conditions.

2.8 A sharp erosion in investor confidence reflected uncertainty, then concern over the strength and durability of the global recovery and geopolitical conditions. Despite this, the international financial system remained resilient; the markets, while unusually volatile, were still orderly and the financial system functioned smoothly.

2.9 With completion of the first annual cycle of GFSR reports, the Board also expressed its satisfaction at the speed with which the GFSR had become a useful tool in monitoring financial market developments and risks.

REGIONAL AND COUNTRY SURVEILLANCE

2.10 The US, Japan, the euro-area and the UK account for nearly 70 per cent of global economic output[6]. Consequently, the IMF's analysis of these economies and its policy advice are of particular relevance in assessing global growth prospects. This section considers the conclusions of these surveillance discussions.

[6] source: World Development Indicators 2001

US Article IV

2.11 After the slowdown in 2001, there was a return to growth in the US economy in 2002.

2.12 The US Article IV Board discussion in July focused on the prospects and policies required for a renewed and durable expansion. While it was felt that activity was rebounding, uncertainties remained regarding both the underlying strength of final domestic demand and the extent to which the rapid productivity growth achieved during the latter half of the 1990s could be sustained. Staff were particularly concerned by the large current account deficit, and the related broader imbalance of global growth. There was also concern that the US fiscal outlook had weakened considerably over the preceding year and that a key step towards addressing these pressures would be to establish a framework that set the clear goal of balancing the budget excluding social security, over the business cycle.

CORPORATE GOVERNANCE

The crises at Enron, WorldCom and elsewhere triggered a renewed focus on corporate governance issues in 2002. The scandals and resulting loss of investor confidence across world markets continue to contribute to international financial uncertainty, and have played a major role in global stock market declines.

Significant doubts have been cast over the effectiveness of existing corporate governance, accounting and auditing arrangements. In addition, the roles and practices of financial analysts and credit rating agencies are being seriously questioned, while the appropriateness of senior executive remuneration packages – in both style and content – have been brought into sharp focus.

National responses in Europe and the US have been rapid and wide-ranging. Initially draft legislation in the US focused primarily on investor protection, but after WorldCom this was strengthened significantly. The Sarbanes-Oxley Act was passed by Congress in July 2002, almost unanimously. It covers the regulation of accounting and auditing, as well as corporate governance and the practices of financial analysts, while commissioning further studies into credit rating agencies. There are also sections covering the punishment for corporate and criminal fraud.

In Europe, the High Level Group of Company Law Experts led by Jaap Winter has produced a report looking into company law broadly but with specific recommendations for corporate governance, from which an action plan is anticipated. Individual nations also have work under way. In the UK, the Treasury and the DTI set-up the Co-ordinating Group on Audit and Accounting Issues with representatives from industry, regulators and government to ensure that there is a co-ordinated and comprehensive work programme to review the UK's regulatory arrangements. The government also set up an independent review of nonexecutive directors' remuneration chaired by Derek Higgs. Both reported in early 2003 and government and industry are considering their recommendations. The Financial Services Authority is also looking into the role and practices of financial analysts.

The principal concern for the UK has been to ensure that these issues are addressed through considered and well-targeted measures that are developed in full consultation with stakeholders. The problems exposed by the Enron collapse have global implications. The UK is therefore pushing for global solutions that will not hinder the integration of international capital markets, such as the work being done in the Financial Stability Forum and the moves towards recognised international principles, for example the growing adoption of International Accounting Standards.

Japan's Article IV

2.13 The Japanese economy began to recover in 2002 on the back of stronger external demand (and a weaker yen), but the recovery lost momentum towards the end of the year. Deep-seated structural problems in the banking and corporate sectors remain a drag on growth. The government reaffirmed its commitment to press ahead with structural reforms, so the priority now is implementation.

2.14 Japan's Article IV in July considered some of these implementation issues. Directors stressed that macroeconomic policy needs to remain supportive, to offset the short-term effects of structural reform. Fiscal policy needs to remain broadly neutral in the near term, and further measures taken to improve the composition and hence effectiveness of fiscal spending, but it was also felt that a clear medium-term strategy was needed to tackle the high and rising public debt ratio. Monetary policy must be geared to securing an early end to deflation.

Euro-Area Article IV

2.15 Economic activity in the euro-area continued to disappoint during 2002 as consumer spending and investment remained weak. For the year as a whole growth of just 0.75 per cent is expected. A gradual pick-up in activity is forecast for 2003 in-line with global developments, although at a slower pace than previously expected.

2.16 The Euro Area Article IV in October 2002 noted that there remained plenty of scope to raise the area's potential and reduce vulnerability to shocks through further reforms. Directors stressed the need for reforms to support the reabsorption of labour and further product market integration, particularly in services trade. In this context, new impetus to speeding up financial sector integration through the implementation of the Financial Services Action Plan was welcomed.

SURVEILLANCE OF THE UK ECONOMY

The IMF mission for the UK's 2002 Article IV consultation was conducted from November to December 2002. During the mission, Fund staff met with the Chancellor of the Exchequer, the Governor of the Bank of England, the chairman of the Financial Services Authority, senior officials of the government and the Bank of England and representatives of financial institutions, independent research institutes, business and trade unions.

In February 2003, the Board discussed the UK's Article IV Report, alongside the Financial Sector Assessment Programme (see Chapter 3). Executive Directors noted that the UK had performed well since the previous Article IV consultation. They commended the UK government for "the pursuit of prudent and credible economic policies in the context of a sound medium-term policy framework" and "the strong performance of the UK economy" based on low inflation and sustained output and employment growth. The Directors also noted that while growth decelerated in 2002, the economy has so far weathered the global slowdown relatively well, in part because of the timely easing of monetary and fiscal policies in the context of a well-functioning inflation-targeting framework and a low public debt to GDP ratio.

Looking ahead, the Board noted the prospects for a continued economic recovery, but they also saw risks to this outlook stemming from both external and domestic uncertainties.

Both the Concluding Statement of the IMF Mission and the full UK Article IV Report are available on the HM Treasury and IMF websites respectively.

EMERGING MARKETS OVERVIEW

2.17 The picture for emerging markets during 2002 was mixed. The external environment for the first half of the year was favourable reflecting the recovery in the global economy. Many emerging markets took advantage of the resulting improved credit conditions by front-loading their financing for the year. However, uncertainty increased in the second half of 2002 reflecting fears of the faltering US recovery, greater stock market volatility, growing tensions in the Middle East and increased security concerns over the potential for global terrorism.

2.18 In 2002, access to capital was sharply divided along regional lines. Events in Argentina impacted on Latin America and raised borrowing costs for many countries, but the increased political and economic uncertainty did not lead to more broad-based contagion. In fact, Asia and emerging Europe (particularly investment grade borrowers) continued to attract capital despite worsening conditions in Latin America.

2.19 Table 2.1 below shows the continued decline in total flows of private capital to emerging markets since 2000. This is being driven largely by shrinking FDI flows, but bond issuances are also low compared to their 2000 level. Emerging markets continue to depend on private flows rather than official flows for external financing.

TABLE 2.1 Emerging Markets External Financing (US$bn)

	Total Private Flows	Equity Investment		Private Creditors		
		FDI	Portfolio Investment	Commercial Banks	Non-banks	Official Flows
1999	153.2	148.9	19.4	-51.5	36.4	12.6
2000	187.6	135.3	14.4	-0.3	38.2	-4.0
2001	126.0	134.6	11.1	-26.4	6.7	14.0
2002	122.9	113.2	10.5	-10.7	9.9	16.6
2003*	150.8	116.4	15.1	-1.0	20.3	19.0

* Institute for International Finance Forecast
source: Institute for International Finance

IMF Lending to Emerging Markets

2.20 Although the overall picture for emerging markets was mixed in 2002, a number of economies experienced particular difficulties and required IMF assistance. This was particularly true of Turkey, Brazil, Argentina and Uruguay. Between them, these four economies currently account for 85 per cent of committed Fund resources[7].

Turkey: Stand-by Arrangement

2.21 A new Stand-By Arrangement (SBA), amounting to SDR12.8 billion ($17.3 billion) was agreed in February 2002 in support of Turkey's economic programme. This involved further resources to tackle 2002 financing needs and initially had a large, positive impact on market confidence. After the break-up of the ruling coalition in late summer 2002, parliamentary elections were held on 3 November 2002, with the Justice and Development Party (AKP) gaining a majority. The new government remains committed to the IMF programme. Turkey is working to complete the fourth review of its SBA.

Brazil: Stand-by Arrangement

2.22 Despite good economic performance and a sound policy framework, the weakening external environment, the persistence of economic difficulties in Argentina, and uncertainties about the continuity of macroeconomic policy following the presidential elections put substantial pressure on Brazilian financial variables during the summer of 2002. With the *Real* depreciating and bond spreads widening, Brazil's public sector net debt burden increased, making it more and more difficult for Brazil to service its obligations.

[7] source:IMF Survey, January 2003

2.23 In this context, the SBA agreed for Brazil in September 2001 was cancelled. A new $30 billion SBA was arranged in August 2002, and approved by the IMF Executive board in September. The IMF programme provided a bridge across the election period, helped to preserve macroeconomic stability and contributed towards ensuring the maintenance of sound economic policies. The loan will be disbursed in six credit tranches, subject to satisfactory completion of reviews and observance of relevant performance criteria. Directors noted that there were risks to the success of the programme, and stressed that firm implementation of the authorities' economic plan was essential to ensure debt remained sustainable.

Argentina: Stand-by Arrangement

2.24 Towards the end of 2001, Argentina defaulted on its sovereign debt. The subsequent floating of the exchange rate (which depreciated rapidly) and emergency policy measures were aimed at restoring stability. The economy, however, contracted by an estimated 12 per cent in 2002, accompanied by a sharp deterioration in poverty indicators.

2.25 The IMF and the Argentine authorities remained engaged in negotiations for a new programme throughout the year. In early 2003 they reached agreement on a transitional economic programme. The aim of this programme is to maintain macroeconomic stability through the election period and lay the foundations for a comprehensive medium-term programme needed to re-establish investor confidence and capital inflows, achieve fiscal and external viability and establish sustainable growth in Argentina.

2.26 The programme provides the funds needed for Argentina to meet payments due to the IMF from January to August 2003 inclusive. Performance criteria relating to fiscal and monetary policy are specified to keep the economy on a stable path and to ensure the next government inherits a stable policy framework. In addition, the IMF will provide technical assistance in a number of areas to help the authorities start preparatory work on a number of structural reforms – including on fiscal co-ordination between federal and provincial governments, broadening the tax base, and banking sector restructuring. The IMF hopes to agree a comprehensive programme with the incoming government after the election in May 2003.

Uruguay: Stand-by Arrangement

2.27 During 2002, economic conditions in Uruguay deteriorated due to contagion from the Argentine crisis. Consequently, in June the IMF agreed to supplement the country's $750 million SBA with an additional $1.5 billion.

2.28 After a temporary suspension of banking activity on 31 July, the IMF announced a further augmentation of around $500 million in August and re-phased the schedule of disbursements to allow the government of Uruguay to draw around $800 million immediately. This support was intended to address short-term liquidity needs, and assist the authorities' comprehensive and determined effort to restore confidence in the banking sector.

DEVELOPING COUNTRIES OVERVIEW

2.29 Growth prospects for developing countries in 2002 depended heavily on the extent of the recovery in the industrialised countries, commodity and oil price movements, and sound policy frameworks.

2.30 Nevertheless, the IMF estimates that in 2002, GDP growth in developing countries will be 4.3 per cent, only slightly more than the 4 per cent growth in 2001[8]. On average, developing countries' growth is expected to recover strongly in 2003 and 2004, in the absence of additional adverse shocks to the world economy. However, the rebound in 2003 will be less pronounced in many of the poorer, commodity-dependent economies due to continued weakness in commodity prices. On current trends, these countries will fall short of the growth rates needed to meet the Millennium Development Goal of reducing by half the proportion of people living in extreme poverty by 2015.

2.31 Against the background of this uncertain environment, a combination of policy adjustment in developing countries and additional financing from the international financial institutions, particularly for countries pursuing good policies, helped provide an important safety cushion.

2.32 During 2002, the Executive Board approved ten new Poverty Reduction and Growth Facility (PRGF) arrangements (Albania, Cape Verde, Democratic Republic of Congo, Cote d'Ivoire, The Gambia, Guyana, Nicaragua, Rwanda, Tajikistan, and Uganda). The UK supported all of these programmes. As of January 2003, the Fund had PRGF arrangements with a total of 38 countries[9]. The UK's approach to the role of the IMF in poor countries is set out in Chapter 4. The points made by the UK in relation to Board discussions on the PRGF are summarised in Annex I.

[8] IMF World Economic Outlook, September 2002

[9] Albania, Armenia, Azerbaijan, Benin, Cambodia, Cameroon, Cape Verde, Chad, Democratic Rep. Of Congo, Cote d'Ivoire, Djibouti, Ethiopia, The Gambia, Georgia, Guinea, Guinea-Bissau, Guyana, Kenya, Kyrgyz Republic, Lao People's Dem Rep, Lesotho, Madagascar, Malawi, Mali, Moldova, Mongolia, Mozambique, Nicaragua, Niger, Pakistan, Rwanda, Sao Tome and Principe, Sierra Leone, Tajikistan, Tanzania, Uganda, Vietnam, Zambia

3 STRENGTHENING THE INTERNATIONAL FINANCIAL SYSTEM

The development of the international financial system has brought the benefits of faster growth and poverty reduction to many countries, and, despite recent shocks, the system has remained resilient. However the continuing incidence of financial crises and abuse of the system highlight the need for further strengthening. The IMF has a central role to play in this effort.

PROMOTING GLOBAL STABILITY AND GROWTH

3.1 The rapid growth in international capital flows in recent decades has created unprecedented new opportunities for investment, growth and poverty reduction, but it has also presented the international community with new challenges. The east Asian crisis of 1997-98 and, more recently, events in Argentina, have demonstrated the potential for financial crises to cause widespread social and political turmoil, and in the aftermath of 11 September, attention has focused on combating money laundering and the financing of terrorism.

3.2 With it's responsibility for overseeing the international monetary system, the IMF has a central role to play in sustaining the benefits of the system, while also addressing these weaknesses. The latter requires action on two fronts: preventing and resolving financial crises and tackling abuse of the international financial system.

3.3 **Crisis Prevention**. The IMF has a number of tools at its disposal to help prevent financial crises from happening. UK priorities in this area focus on:

- strengthening IMF surveillance so that it is better able to provide early warning of potential problems and advice on actions to address them; and
- enhancing the effectiveness of the codes and standards framework to ensure a sound basis for policy, provide better information to markets and strengthen countries' defences against destabilising capital flows.

3.4 **Crisis Resolution**. These improvements to the IMF's crisis prevention tools are unlikely to completely eliminate the risk of financial crises. The international community must therefore continue to develop a framework for crisis resolution and facilitate greater private sector involvement in the resolution of financial crises. Progress towards this is being made on a number of fronts:

- improving debt sustainability assessments to ensure creditors have an accurate picture of a country's debt servicing capability under different scenarios;
- developing a clear policy on access to Fund resources - exceptional access should be truly exceptional;
- clarification of the Fund's policy on lending into arrears; and
- where necessary, establishing and enhancing methods of facilitating sovereign debt restructuring.

3.5 **Tackling abuse of the international financial system**. In the aftermath of 11 September, the IMF has expanded its work on anti-money laundering and combating the financing of terrorism (AML/CFT). UK priorities in this area focus on:

- the successful development of an IMF codes and standards module designed to assess systems for anti-money laundering and combating the financing of terrorism; and
- provision of technical assistance to address weaknesses in these mechanisms.

CRISIS PREVENTION

Early Warning - Strengthening Surveillance

3.6 Earlier chapters outlined the uncertainty and risks currently facing the global economy, including the synchronised slowdown, financial turbulence in Latin America, volatility in international equity markets and examples of corporate accounting failures. Against this background the IMF's role in bilateral, regional and global surveillance is more important than ever.

3.7 International economic surveillance is an essential tool for strengthening crisis prevention and promoting global stability and growth. It provides a unique means to assess national and global economic prospects, to detect vulnerabilities at an early stage, to provide policy advice, and more broadly to promote international economic cooperation. If surveillance is to be effective, it needs to be:

- authoritative: it must command international respect, be a source of international expertise and best practice, and provide sound and credible policy advice;
- comprehensive: it must cover all the issues that are relevant to economic stability;
- focused: it needs to be well focused, highlighting the most important risks and vulnerabilities, to ensure problems are detected at an early stage;

- influential: its recommendations need to be reflected in the policies of member countries if problems are to be addressed at an early stage, crises averted, and uncooperative practices avoided; and
- accountable: to retain the necessary influence and legitimacy, it must provide a sound basis for its findings and recommendations, be prepared to justify and defend them, and respond to criticisms and suggestions for change.

3.8 The IMF is uniquely placed to undertake surveillance, with its responsibility for overseeing the international monetary system and the economies of 184 member countries. Yet recent developments in the global economy, and in particular the capital account crises since the mid 1990s, have led to concerns about the authority, comprehensiveness, focus, influence and accountability of the Fund's surveillance.

Independent Surveillance

3.9 The Fund is taking steps to strengthen its surveillance. The Biennial Surveillance Review in April 2002 and the IMFC meetings last year outlined a number of specific areas for progress, including: more candid assessments of exchange arrangements and exchange rates; strengthening the coverage of financial sector issues; and more rigorous assessment of vulnerabilities, including debt sustainability and private sector balance sheet exposure to interest and exchange rate shocks. These are welcome changes, and it will be important to implement them effectively over coming months.

3.10 However, as Ed Balls - the Chief Economic Adviser to the Treasury said, the UK believes there is a need to go further. In particular by bringing greater independence and objectivity to the surveillance process[10]. Recent work by the Independent Evaluation office and the Fund itself suggests there is a need to strengthen surveillance, particularly in countries with active Fund programmes. The Biennial Surveillance Review concluded that surveillance of programme countries should bring a "fresh perspective" to the Fund's assessment of the country's policies and prospects, and that this requires a stepping back from the programme framework. Yet there is wide acceptance that Article IV consultation discussions have sometimes failed to do this. The Independent Evaluation Office also found that "by and large, surveillance failed to play a major independent role in prolonged user cases."

3.11 More broadly, there is currently no formal mechanism for assessing whether the Fund is providing objective, rigorous and consistent standards of surveillance across all member countries – programme and non-programme countries. The Executive Board discussions of Article IV reports should, in principle, provide this perspective through peer review. However Executive Directors, while responsible for ensuring the effectiveness of the Fund's activities, also have responsibilities to their authorities.

[10] Speech by Ed Balls to the Institute for International Economics, 6 March 2003

The External Evaluation of IMF surveillance (1999) noted that Fund staff observed that Executive Directors tended to be defensive about the countries they represent, and that other Directors deferred to this, partly because they expected the same deference in return in due course. Peer pressure could, in short, become peer protection.

3.12 So the UK government believe there is a strong case for institutional reform. The government's objectives must be:

- first to ensure that surveillance is, and is seen to be, independent of decisions about programme lending and the use of IMF resources. The full range of options should be considered; and
- second, to establish the IMF as independent from political influence in its surveillance of economies as an independent central bank is in the operation of monetary policy.

3.13 Enhanced transparency, both of procedures and substance, is essential to boosting credibility. So there is a case for publishing staff reports at the same time they go to the Board. However transparency must be matched with clearer procedures and a clear separation between surveillance and programme lending. So we need to re-examine and clarify the objectives, procedures and responsibilities of the Executive Board and IMF Management.

3.14 The UK has called for a wide ranging discussion of the best ways to achieve these objectives. The IMF Board paper on surveillance last year canvassed opinion on various options to achieve greater independence of surveillance in programme countries, from clearer guidance by the Board on the role of surveillance to an "institutional firewall" within the IMF - separating programme and surveillance activities, including consultation missions headed by a mission chief from a different department to the relevant area department. On the broader question of how to deepen accountability, one way forward would be for the IMF Board or even the IMFC to have a formal responsibility to set an annual surveillance remit, with IMF staff and management reporting back regularly on their performance against that remit. For the longterm we also need to consider more radical institutional reforms to achieve our goal – a surveillance framework that would deliver the independence, accountability, authority and legitimacy on which effective surveillance and international economic cooperation depends.

THE BIENNIAL SURVEILLANCE REVIEW

The Executive Board reviews the principles and practice of IMF Surveillance approximately every two years. The last such review took place in April 2002. The Board acknowledged that the coverage of surveillance had expanded beyond monetary, fiscal and exchange rate policies to include vulnerability assessments, debt sustainability analyses, financial sector issues and structural/institutional policies. Directors noted that this expanded coverage had been achieved without a loss of focus but identified a number of areas where further improvements could be made to ensure that surveillance is authoritative:

- greater coverage of financial sector issues in countries that have not participated in the Financial Sector Assessment Programme (FSAP);
- improved debt sustainability analyses, with greater attention paid to the private sector's exposure to interest and exchange rate fluctuations and general economic shocks;
- strengthened coverage of institutional issues, such as corporate governance, particularly through use of Reports on the Observance of Standards and Codes (ROSCs);
- effective coordination with other institutions, such as the World Bank, on structural issues that impact on macroeconomic performance;
- improved coverage of trade policies, particularly in countries whose trade policies have global or regional impacts.

The Board stressed that in many instances, the IMF could complement advice on policy objectives with discussions on alternative ways of meeting these objectives. Social, political and institutional factors could be considered in these discussions to enhance the national ownership of these recommendations and improve the likelihood of implementation.

Promoting Stability - Codes and Standards

3.15 The UK believes that the widespread adoption of internationally agreed codes and standards can reduce the likelihood of financial crises. The codes and standards framework provides clear and transparent benchmarks of good practice in a range of policy areas. By assessing countries against these benchmarks, the framework will help to improve the functioning of markets by allowing objective comparisons to be drawn. The adoption of codes and standards is also designed to improve transparency and good governance, and increase the credibility and accountability of policy.

The Codes and Standards Framework

3.16 The codes and standards framework comprises three core areas: the government, the financial sector and the corporate sector. Within these groups, the IMF and World Bank have identified twelve 'modules': data dissemination; monetary and financial policy transparency; fiscal transparency; banking supervision; securities regulation; insurance; payments systems; corporate governance; accounting; auditing; insolvency and creditor rights; and the FATF 40 recommendations on money laundering and eight special recommendations on terrorist financing, as requiring assessment.

3.17 The Fund also collaborates with a number of other bodies to revise and develop standards. Among others, the IMF has worked closely with the Financial Action Task Force (FATF) and the World Bank to develop global standards for combating the financing of terrorism and countering money laundering and with the Basel Committee on the new Basel Capital Accord, the internationally recognised standard for banking supervision.

Assessing the observance of Codes and Standards

3.18 A country's observance of the various codes and standards modules is examined by IMF and World Bank staff and summarised in Reports on the Observance of Standards and Codes (ROSCs). Over time, the ROSC modules build up a comprehensive picture of a country's progress in implementing the range of codes and standards, while allowing prioritisation according to the specific needs and circumstances of individual countries. By end-September 2002, 310 ROSC modules for 84 economies had been completed and 227 had been published.

3.19 Financial sector ROSCs are usually prepared within the framework of the Financial Sector Assessment Programme (FSAP), which is specifically designed to assess the strengths and weaknesses of financial sectors. By April 2002, 27 countries had completed an FSAP. An additional 50 countries had committed to participate in the programme. All Article IV consultations now routinely provide an overview of members' performance against ROSCs and the FSAP.

3.20 If the codes and standards framework is to be effective in preventing financial crises, it needs to be widely adopted with routine publication of ROSCs. However, at the moment, participation in ROSC modules has been led by Central and Eastern Europe, the advanced economies and Africa. The UK is keen for more countries to participate in the framework, and we will lead by example. With completion of the recent FSAP the UK has been assessed against eight of the ROSC modules. In September 2002, the Chancellor announced that the UK was willing to undertake assessments against the remaining four ROSCs on Corporate Governance, Accounting, Auditing and Insolvency and Creditor Rights. Once these are complete, the UK will be one of the first countries to have been assessed against all 12 codes and standards modules. The UK government has also consistently argued that countries should aim to fully disclose their record on implementing codes and standards.

Technical Assistance

3.21 Countries must have the freedom to implement codes and standards in a manner, and at a pace that reflects their capacity and domestic reform priorities. The implementation of codes and standards is the responsibility of individual countries, but the Fund and other international bodies can help by providing technical assistance in order to ensure that developing countries are more effectively involved in both the design and implementation of codes and standards.

3.22 In April 2002, a multi-donor technical assistance initiative specifically aimed at fulfilling this mandate was launched. The Financial Sector Reform and Strengthening (FIRST) Initiative aims to strengthen national financial sectors through highly targeted projects suggested by developing countries themselves. It will provide technical assistance grants to low and middle-income countries for short and medium-term capacity building and policy development. For example, countries that wish to improve their financial supervision or accounting standards with a view to assessment against the relevant ROSC or implementing the recommendations that flow from a ROSC could seek FIRST assistance. The UK provided an initial contribution of £20 million to the FIRST initiative.

UK PARTICIPATION IN THE FINANCIAL SECTOR ASSESSMENT PROGRAM

In October 2000, the Chancellor of the Exchequer offered UK participation in the Financial Sector Assessment Program (FSAP). The FSAP, a joint IMF and World Bank initiative, was introduced in May 1999 and aims to promote sound financial systems in member countries by assessing the degree of compliance with international standards.

Beginning in 2001 and through 2002, an IMF-led team reviewed the UK's financial stability policy framework. This included assessment of UK arrangements against several codes and standards and stress-testing of models of the UK financial system. In performing its review, the FSAP team worked with the Treasury, Bank of England and Financial Services Authority, other government departments and the private financial sector.

The results were published in a Financial System Stability Assessment of the UK on 7 March 2003 (available on the IMF website). In this report, the IMF said that "the UK's large and sophisticated financial sector features fundamentally sound and highly developed financial institutions, markets and infrastructure, supported by a financial stability policy framework that has been significantly strengthened in a number of ways in recent years, and that in many respects is at the forefront internationally." The UK is "developing a very advanced, indeed leading edge, approach to financial sector supervision." The IMF also made a number of "technical recommendations" for improvements to UK practice to which the UK financial authorities have responded.

The UK found the FSAP process to be a valuable tool for highlighting areas of good practice and those in which more work needs to be done. The UK encourages other countries to submit their systems to the programme, as a constructive means of assessing and promoting sound financial stability policies

Defending against Contagion – the Contingent Credit Line

3.23 The CCL was introduced in 1999 to strengthen the IMF's focus on crisis prevention. It is designed for countries that are implementing strong economic policies but are nevertheless threatened by contagion from financial crises elsewhere. While other IMF facilities focus on resolving crises, the CCL aims to prevent crises by providing incentives for sound policies and a positive signal to markets.

3.24 Countries must pre-qualify for the CCL by establishing a clear track record of good policy implementation. This pre-qualification principle of the CCL means IMF financing can be used to proactively recognise good performance and help safeguard a strong policy framework in the face of turbulence in international capital markets. This reduces the possibility of contagion creating 'innocent bystanders'.

3.25 However, since its introduction, there have been no applicants for the CCL. There are concerns among some emerging market economies that an application for the CCL would be regarded as a sign of weakness by the markets. In 2000, the IMF Executive Board moved to make the facility more attractive but without success.

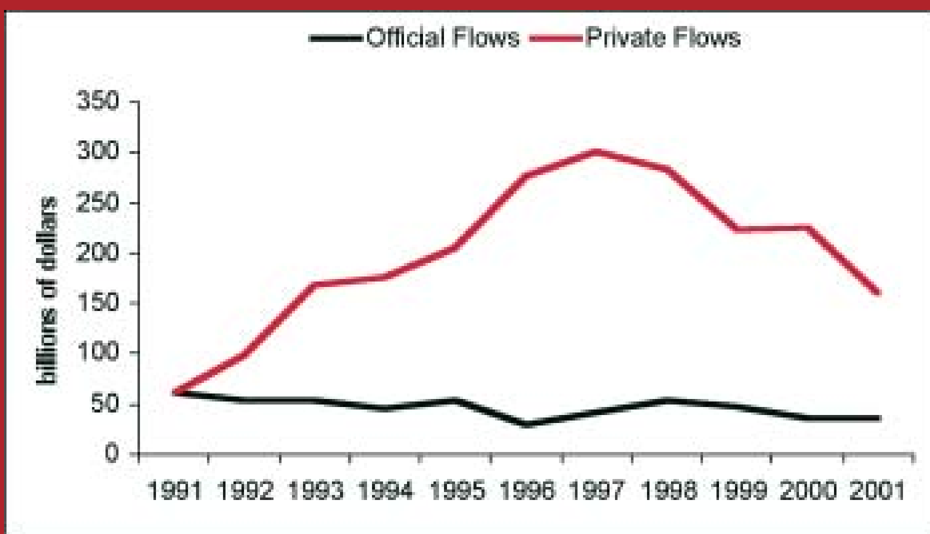
3.26 The UK fully supports the objectives of the CCL, but given that it has not been effective to date, the UK and other members called for a review to address concerns about its design and operation. The IMF is taking forward this review. It has consulted widely with a range of countries (including potential CCL applicants) and private sector participants, and is considering the best way forward. The UK support this approach, and will continue to emphasise the importance of achieving the CCL's objectives – namely to provide incentives for members to pursue strong domestic policies and to support those countries pursuing strong policies but are nevertheless threatened by contagion.

CRISIS RESOLUTION

Developing the Framework for Crisis Resolution

3.27 In a world of globalised financial markets with huge cross-border flows of capital, the official sector does not have sufficient resources to provide automatic and large-scale finance as a standard response to emerging market crises, see chart 3.1. Nor would this provide the right incentives to debtors and creditors. Private investors must bear the consequences of their investment decisions if capital is to be allocated efficiently, and governments must have the right incentives to pursue sound economic policies. The engagement of private investors is therefore essential to resolve payments difficulties and to restore debt sustainability in crisis-hit countries.

CHART 3.1 Net Long-Term Resource Flows to Developing Countries, 1991-2001



source: Global Development Finance, 2002

3.28 At the 2000 Spring and Annual Meetings, the IMFC endorsed a framework of principles to guide and underpin the official approach to crisis resolution. Since then, the UK has been at the forefront of efforts by the international community to develop and strengthen the framework for resolving financial crises. At the Spring Meetings 2002, the IMFC agreed that further work was needed on a range of issues, including:

- improving debt sustainability assessments so as to provide a clear picture of a country's ability to service its debts;
- greater clarification of policy on access to Fund resources to strengthen the markets' understanding of how the official sector will respond to a crisis and hence the role they will need to play;
- greater clarification of the Fund's policy on lending into arrears to protect other creditors in the aftermath of a crisis; and
- strengthening the tools for securing private sector involvement in crisis resolution. In particular, examining a more orderly and transparent framework for addressing the exceptional cases in which a sovereign needs to restructure unsustainable debt, such as through a statutory Sovereign Debt Restructuring Mechanism and through Collective Action Clauses.

Debt Sustainability

3.29 An integral component of effective crisis management lies in the accurate assessment of a country's debt sustainability: its capacity to service its debt without an unrealistically large future correction in the balance of income and expenditure. Debt sustainability assessment forms a key input into programme design and decisions relating to the provision of official finance during crises.

3.30 In order to strengthen the framework for assessing debt sustainability, the Board agreed in 2002 to implement a new methodology for its assessments. A range of information about the sustainability and vulnerability of debtor countries will be provided, in order to improve the quality of projections and the credibility of the overall assessments. Scenario analysis will also be provided, whereby staff projections are stress-tested under differing assumptions about possible future states of the world. This should give a clearer picture of the risks associated with any programme. Debt sustainability assessments will also be conducted on a more regular basis as part of the Article IV process. This should allow for more early warning of potential vulnerabilities.

Access Policy

3.31 In recent years, capital account crises in, for example Argentina, Brazil and Uruguay, have resulted in significant demands on official resources. Normally, access to IMF resources is limited to 300 per cent of the borrowing members' quota, but access beyond these limits has been provided in a number of cases. This has created uncertainty amongst investors about the official sector's response to crises. Greater clarity is needed to condition the expectations of both debtors and creditors. That is why, in 2002 the Executive Board agreed to:

- define more precisely the **circumstances** under which access beyond normal limits will be provided;
- set out the **information** that will be needed to assess whether these circumstances have been met; and
- establish clear **procedures** that must be followed before such access can be granted to strengthen the credibility of access limits.

3.32 Further work to operationalise the new framework is being undertaken, and the IMF will be reporting on progress in implementing the changes at the Spring Meetings 2003. The aim is to increase the clarity and predictability of the official response to crises, thereby creating the right incentives for private sector involvement in crisis resolution at an early stage.

Lending into Arrears

3.33 In the context of a standstill on payments to creditors, the Fund should only be prepared to lend into arrears when the debtor in question is negotiating with its creditors in good faith. This is in order to ensure that these creditors are adequately protected during a standstill.

3.34 The IMF has been developing a clearer definition of the good faith criterion, in order to create greater clarity with regard to its policy on lending into arrears. In September 2002, the Board agreed that the following principles would serve to balance the need for greater clarity with the need for flexibility, to accommodate the individual characteristics of specific cases:

- when a member has reached a judgment that a restructuring of its debt is necessary, it should engage in early dialogue with creditors, which should continue until the restructuring is complete;
- the member should share relevant, non-confidential information with all creditors on a timely basis; and
- the member should provide creditors with an early opportunity to give input on the design of restructuring strategies and the design of individual instruments.

Sovereign debt restructuring

3.35 Recent years have seen growing recognition of the need for better mechanisms to facilitate sovereign debt restructuring when countries are faced with an unsustainable debt burden. Delays in restructuring have caused unnecessarily high economic costs to all involved.

3.36 These delays have a number of sources. In the recent past, instances where minority creditors have been able to successfully litigate against sovereigns in default have introduced uncertainty into the process. The mere threat of disruptive litigation by minority creditors creates uncertainty about the restructuring process and weakens incentives for creditor coordination. It also raises questions as to whether all creditors will be fairly treated resulting in less orderly restructuring negotiations – a trend that has been reinforced by the shift over the last decade away from direct bank lending and towards bond issues held by a large number of dispersed creditors.

3.37 These practical and legal difficulties provide an incentive to governments with unsustainable debt to avoid or delay necessary restructurings. This often results in unnecessarily painful or prolonged domestic adjustment, in addition to a greater loss of value for investors.

3.38 At the 2002 Annual Meetings, the IMFC agreed that two complementary and mutually reinforcing approaches to sovereign debt restructuring should be pursued in parallel. This "twin track approach" comprises:

- the statutory approach (embodied by the IMF's Sovereign Debt Restructuring Mechanism, SDRM – see below) to enable a sovereign debtor and a super-majority of creditors to reach an agreement that is binding on all creditors; and
- the contractual approach to involve incorporation of contractual clauses into sovereign debt instruments which facilitate collective action and majority restructuring.

The Sovereign Debt Restructuring Mechanism

3.39 In November 2001, the IMF proposed the establishment of a new Sovereign Debt Restructuring Mechanism (SDRM), with the following main components:

- to prevent disruptive litigation and creditor co-ordination problems from undermining agreement, debtors that had suspended payments would be given temporary protection from creditor litigation until a fair sustainable resolution had been achieved;
- to prevent this protection being abused by the debtor, it would be necessary to establish a mechanism to facilitate debtor-creditor negotiations and ensure that the debtor acts fairly and in good faith;
- to facilitate the provision of new money, priority would be granted to any new credit extended during the restructuring period; and
- to prevent holdout creditors from deliberately undermining any restructuring agreement reached between the debtor and a requisite majority of creditors, the mechanism would bind minority creditors into the agreement.

3.40 Such a mechanism could play a role in sovereign debt restructuring comparable to that of the national court in corporate bankruptcy (which oversees negotiations, prevents litigation, and mitigates creditor co-ordination problems), for which there is currently no analogous institution in the sovereign context.

3.41 The G7 has pledged its support for further work to develop this proposal and at the Annual Meetings 2002, the IMF was mandated to develop a concrete proposal for an SDRM, in time for the Spring Meetings 2003. There are numerous technical, legal, analytical and policy issues involved in the design of such a mechanism, which the international community is currently addressing, such as:

- the nature of any stay on litigation;
- the proper role of the IMF in such a mechanism;
- the scope of debt to be covered;
- the legal changes required in creditor jurisdictions to give the mechanism sufficient statutory authority; and
- the impact the mechanism would have on developing country access to capital.

3.42 Because of the legal changes required, it may be impossible to establish such a mechanism quickly. Furthermore, the mechanism would constitute only one element of a wider framework for private sector involvement in crisis resolution. The procedure would only be used in extremis, once it had become clear that the country could no longer service its debts. Otherwise the procedure could give rise to serious debtor moral hazard problems, which could raise emerging market borrowing costs considerably.

3.43 However, even if rarely used, the mechanism could considerably improve the overall effectiveness of the official approach to private sector involvement in crisis resolution. By establishing a credible recourse to restructuring, the mechanism should strengthen the credibility of normal access limits and provide the appropriate incentives for creditors and debtors to reach a voluntary solution to sustainability problems, at an earlier stage. This is a phenomenon known as "bargaining in the shadow of the law" in the domestic bankruptcy context.

Collective Action Clauses

3.44 In parallel with ongoing work on the statutory approach, the international community has been developing contractual mechanisms, to facilitate more orderly sovereign debt restructuring through greater use of collective action clauses (CACs) in bonds. These clauses would facilitate creditor-coordination and majority restructuring, and would prevent minority creditors from disrupting restructuring agreements which had been agreed by a majority of creditors.

3.45 Progress in this area will be made by the establishment of CACs as part of the market practice. The private and official sectors have been working together to finalise an agreed set of model clauses which could become the market standard. The UK is one of the few countries which includes CACs in its own foreign currency denominated bond issues, and has been encouraging other developed countries to adopt CACs, in order to lead by example. In September 2002, European Finance Ministers agreed to lead by example, by including CACs in their own international bonds[11].

[11] the EU definition of an international bond is one issued in a foreign jurisdiction

The purpose of this is to overcome some emerging market concerns that the inclusion of CACs could signal an apparent willingness to restructure and raise their borrowing costs. The most important demonstration of confidence in this approach was the announcement by the Mexican government in February 2003 to include CACs in its bonds issued under New York law.

Code of Good Conduct

3.46 Neither CACs nor an SDRM will be able to offer their full advantages immediately. A code of good conduct for debtors and creditors has been suggested as a complement and interim step for each of these approaches. This code would set out a series of principles and procedures to be followed at times of crisis. Some have suggested that the principles could also play a role in crisis prevention by encouraging regular dialogue between creditors and debtors. The principle of such a code is welcome and should be a focus of work amongst all stakeholders: the IFIs, issuing countries and private creditors. This welcome work is at an early stage.

The Paris Club

3.47 When countries experience financial problems, they can restructure their official debt through the Paris Club, an informal group of official creditors whose role is to find coordinated solutions to debt crises. The relationship between the IMF and the Paris Club is mutually dependent. For the IMF, rescheduling by Paris Club creditors helps to fill the financing gaps in Fund country programmes. This involves a postponement and, in the case of concessional treatment, a reduction in debt service obligations (see section 4.25 on debt relief through the HIPC initiative). For the Paris Club, an IMF programme provides evidence of the financing problems a country is experiencing, as well as reassurance that those problems are being addressed in a coherent way. This relationship is long established and during 2002 ten IMF programmes were supported with Paris Club agreements. The UK is a member of the Paris Club and has supported greater co-operation between the Paris Club and the IMF in identifying financing needs and finding sustainable solutions.

3.48 Debt burdens are often a combination of official and private sector debt, and so the principle of comparability is applied to Paris Club restructurings. This principle requires the debtor country to seek restructuring by non-official creditors on terms that are at least comparable to those obtained with the Paris Club. This is to prevent the resources released from the Paris Club restructuring from being used to repay other creditors. In March 2002, the Paris Club met with private sector representatives for an exchange of views and discussion of issues relating to the restructuring of external sovereign debt. There was a general agreement that this exchange of views was useful and that annual discussions should continue in the future. More information on the Paris Club is available at http://www.clubdeparis.org/en/

TACKLING ABUSE OF THE INTERNATIONAL FINANCIAL SYSTEM

3.49 Following rapid and effective international action in the aftermath of 11 September 2001, the IMF has continued to work to ensure that it, along with the World Bank, and in partnership with member countries, is in a leading position in international efforts to combat money laundering and terrorist financing.

3.50 The UK has continued to play a central role in international efforts to combat the financing of terrorism, through the UN Counter Terrorism Committee, the Financial Action Task Force (FATF), the G7, the G20 and the IMF.

ASSESSING ANTI MONEY LAUNDERING / COMBATING THE FINANCING TERRORISM (AML/CFT) SYSTEMS

In September 2002, the IMFC agreed to the adoption of the joint IMF/World Bank anti-money laundering methodology for use in country assessments. The IMF and World Bank have since adopted the methodology as a ROSC (Report on Standards and Codes) for a 12 month pilot period. The methodology is designed to assess countries' compliance with anti money laundering and countering terrorist financing standards. It is based primarily on the FATF 40 Recommendations and the FATF Eight Special Recommendations on Terrorist Financing, but also includes elements from relevant UN Security Council Resolutions, international conventions and from supervisory standards in the financial services sector.

The methodology provides for a detailed and objective assessment of compliance, enabling weaknesses in countries' systems to be identified and comparisons between countries to be made.

At its meeting in October 2002, and with the support of the UK, the FATF approved the use of the IMF/World Bank methodology in its mutual evaluations of member countries for a 12 month pilot period. This complements the use of the methodology by the IMF as part of its FSAP studies, and means that countries will be assessed using consistent criteria by all three international organisations. The IMF, World Bank and FATF will each consider reports on use of the methodology at the end of the 12 month pilot period.

Since February 2002, the IMF has included the examination of countries' AML/CFT mechanisms in its assessments, and has been using the methodology for these assessments (following use of an earlier draft of the methodology since August 2001). Where weaknesses are identified, the IMF and World Bank can often provide technical assistance to address them.

The draft methodology was used to assess the UK's AML/CFT measures, as part of the UK's FSAP, which was conducted in 2002. The Government published the assessment on 3 March 2002. In its assessment, the IMF noted the comprehensive legal, institutional and supervisory regime for anti-money laundering and combating the financing of terrorism. The UK found the assessment and the methodology useful and constructive. The framework provides a helpful, objective and consistent method of assessing a country's measures to counter money laundering and terrorist financing.

3.51 At its September 2002 meeting, the IMFC also:

- welcomed the actions taken by many countries to combat money laundering and the financing of terrorism;
- urged rapid progress on the exchange of information between authorities;
- commended the substantial progress made by the IMF, in close collaboration with the World Bank, in advancing the action plan to intensify work in this area, issued in November 2001; and
- encouraged countries to make available additional experts and resources for the IMF/World Bank pilot programme.

3.52 The IMFC has also called upon all IMF member countries to ratify and implement fully UN instruments to counter terrorism.

Technical Assistance

3.53 The provision of technical assistance to countries which are committed to defeat terrorist financing and comply with international standards but lack the necessary resources to do so, has been identified as an international priority. The IMF and the World Bank are intensifying their work in these areas, with the full support of the UK. In September 2002, the IMF issued a joint progress report with the World Bank on its work on anti-money laundering and combating the financing of terrorism.

3.54 Useful technical assistance is not limited to programmes involving resources. Help with assessments and the provision of guidance is also necessary. The IMF and World Bank have provided technical assistance on issues including the drafting of laws and regulations, establishing financial intelligence units, and strengthening supervision.

3.55 The IMF is working with the World Bank, the UN, FATF and the Egmont Group (a group of Financial Intelligence Units (FIUs) which co-operates in sharing information and good practice) to develop a mechanism for coordinating requests for technical assistance. The UK will contribute expertise by providing legal and law enforcement assistance, and funding through, for example, its contribution to the FIRST initiative.

3.56 It is important that the World Bank and the IMF continue to collaborate closely on this work. The UK will continue to work on the boards of both the Bank and the Fund, and with G7 and other stakeholders, to enhance the coordination and effectiveness of both institutions in tackling money laundering and terrorist financing.

4 Meeting The Millennium Development Goals

In addition to strengthening the international financial system, the IMF has a vital role to play in helping to achieve the Millennium Development Goals. At the country-level it must continue to support the Poverty Reduction Strategy Paper process and the development of realistic and effective policy options in low-income countries. At the global level, it can play an important role in helping to mobilise more resources for development.

THE CHALLENGE OF WORLD POVERTY

4.1 The work of the IMF in strengthening the international financial system is important in encouraging global stability and prosperity. However, there are many low-income countries that are not effectively integrated into the international financial system and so have yet to benefit fully from globalisation. The fight against poverty in these, the poorest countries, is one of the greatest challenges currently facing the international community.

4.2 Over a billion people currently live below the international poverty line, earning less than $1 per day. 110 million children do not receive even the most basic primary education and each day 30,000 people die from avoidable diseases. The moral imperative to tackle these problems is overwhelming. However self-interest also plays a role. Globalisation means that widespread poverty in one country can impact on others, for example through migration flows, and it is only by tackling the cause, that in the long-term we can address the effects.

4.3 If the benefits of globalisation are to be sustained, they must therefore be shared. The IMF has a crucial role to play in this effort, through its support to low-income countries with reform programmes that are aimed at reducing poverty, protecting the vulnerable and increasing growth. At the same time the IMF, in collaboration with the World Bank, must play a central part in ensuring that exceptional shocks do not undermine international efforts to lift the burden of unsustainable debt and channel additional resources into poverty reduction.

The Millennium Development Goals

4.4 The international poverty reduction effort is focused on achieving the Millennium Development Goals (MDGs). At the United Nations Millennium Summit in September 2000, all 189 UN member states reaffirmed their commitment to meeting these goals.

4.5 The MDGs are intended to focus the efforts of both developed and developing countries on achieving significant and quantifiable improvements in people's lives. They establish benchmarks for measuring progress and also help to orientate the development programmes of donor countries and multilateral institutions, such as the IMF and World Bank.

THE MILLENNIUM DEVELOPMENT GOALS

The IMF has joined the international community in stating its commitment to meet the following Millennium Development Goals (MDGs) by 2015:

- curtail extreme poverty and hunger: cut by half the proportion of people living on less than a dollar a day;
- achieve universal primary education: ensure that all boys and girls complete a full course of primary schooling;
- promote gender equality and empower women: eliminate gender disparity in primary and secondary education – preferably by 2005, and at all levels by 2015;
- reduce child mortality: reduce by two-thirds the mortality rate among children under the age of five;
- improve maternal health: reduce by three-quarters the maternal mortality rate
- combat HIV/AIDS, malaria and other diseases: halt and begin to reverse the spread of HIV/AIDS; halt and begin to reverse the incidence of malaria and other major diseases;
- ensure environmental sustainability: integrate the principles of sustainable development into country policies and programmes; reverse the loss of environmental resources; reduce by half the proportion of people without sustainable access to safe drinking water; achieve significant improvement in the lives of at least 100 million slum dwellers by 2020; and
- develop a global partnership for development: develop further an open trading and financial system that is rule-based, predictable and non-discriminatory (includes a commitment to good governance, development and poverty reduction – nationally and internationally).

A New Partnership for Global Prosperity

4.6 In his November 2001 speech to the Federal Reserve Bank in New York, the Chancellor proposed a new approach to development, aimed at delivering the benefits of global prosperity to the world's poor. This new approach would be based on a development compact, with developed and developing countries accepting their mutual responsibilities to deliver the MDGs:

- developing countries accepting primary responsibility for their own development, through good governance and policies that favour growth and investment and meet the basic needs of their people; and
- developed countries recognising that even the best efforts of developing countries will not be enough without international support through open markets and improvements in aid for poverty reduction.

4.7 The Monterrey Consensus, agreed at the UN Conference on Financing for Development in March 2002, marked the international community's first formal recognition of the need for a development compact; a theme that was adopted at subsequent international meeting.

4.8 The remainder of this chapter addresses the role of the IMF in the implementation of this compact. The next section looks at how the IMF is supporting the efforts of developing countries themselves to reach the MDGs. The final section considers the role of the IMF in supporting the international community's efforts to provide more resources for development.

THE MONTERREY CONSENSUS AND JOHANNESBURG PLAN OF ACTION

From the 18-22 March 2002, 51 heads of state/government along with ministers of finance, trade, development and foreign affairs gathered in Monterrey, Mexico for the UN Conference on Finance for Development.

The conference was a successful one. It marked a reversal of the 20 year decline in aid levels, with the EU and US agreeing to provide an additional $12 billion a year in increased aid from 2006. It also agreed the "Monterrey Consensus" – the international community's first formal proclamation of the components that must constitute a development compact, on both the developed and developing country sides.

At the World Summit on Sustainable Development in Johannesburg in Autumn 2002, world leaders reaffirmed their commitment to the principles outlined in the Monterrey Consensus in the Johannesburg Plan of Action.

However, to impact on the lives of the poor the Monterrey Consensus requires effective follow-up. The government therefore made delivery of the Consensus the special theme for the 2002 Commonwealth Finance Ministers Meeting. The UK hosted this meeting in London from 24-26 September, and after consultation with civil society across the Commonwealth, the meeting agreed a Commonwealth Action Plan to take forward the Monterrey Consensus.

Developing countries in the Commonwealth agreed to implement national development and poverty reduction strategies, including by promoting macroeconomic stability, creating the conditions for private investment and strengthening public financial management and acccountability. For their part, developed countries agreed to increase the volume and effectiveness of their aid. All Commonwealth countries agreed to work to enable the benefits of trade liberalisation to be shared by all. A UK initiative, this Action Plan marks an important step forward in the international community's efforts to meet the MDGs.

The Monterrey Consensus is available at www.un.org/esa/ffd/

The Johannesburg Plan of Action is available at www.johannesburgsummit.org/

The Commonwealth Action Plan is available at www.cfmm2002.org

IMF SUPPORT FOR POVERTY REDUCTION

Poverty Reduction Strategy Papers

4.9 At their Annual Meetings in 1999, the IMF and World Bank set out a new approach to development, whereby low-income countries develop a Poverty Reduction Strategy Paper (PRSP) as a framework for concessional support from the International Financial Institutions (IFIs) and other donors. This approach is strongly supported by the UK, and is implemented in practice through the work of the Department for International Development.

4.10 PRSPs are intended to be country-driven: prepared by the developing country itself, in consultation with its civil society. They aim to strengthen national ownership of development plans and ensure that these plans meet development needs across society, with a focus on goals similar to the MDGs and costed, medium term expenditure frameworks. PRSPs also ensure a long-term, strategic view of development, and are an essential tool in ensuring that the many partners involved (the IMF, the World Bank, Regional Development Banks, the UN and bilateral donors) are able to coordinate their activities effectively.

THE PRSP REVIEW

In its' review of the Poverty Reduction Strategy Papers (PRSP) approach in March 2002, the Executive Board received contributions from representatives of low-income countries, international development agencies, and civil society organisations, both in written form and in the context of four regional conferences, and an international conference held in Washington in January 2002.

The review revealed an encouragingly broad-based endorsement of the PRSP approach as the umbrella framework and vehicle for organising domestic and international efforts to achieve poverty reduction in low-income countries.

Poverty Reduction Strategies are becoming the key channel through which development assistance is provided to low-income countries. The Review evaluated and reaffirmed the underlying principles of the PRSP approach: that national poverty reduction strategies should be country-driven, results-orientated, comprehensive, long-term, and foster partnership. In doing so, it allowed a candid discussion of the weaknesses in PRSPs without undermining strong support for the process itself, and highlighted the strong commitment of developing countries to the process.

The Board recognised that progress has been uneven, depending on each country's starting point, capacity, and priorities, and that the design and implementation of country-owned poverty reduction strategies is a complex task that has sometimes taxed countries' limited capacity.

The UK government is encouraged by the progress on the PRSP approach but has pushed for higher quality PRSPs across all countries. Going forward, the main challenges for improving the preparation, content, and implementation of PRSPs are:

- promoting the centrality of the PRSP – ensuring all development agencies align their support fully behind the PRSP process, thus ensuring effective coordination within countries for poverty reduction. This includes donors harmonising and simplifying procedures, further aid untying, and the alignment of assistance with national budget cycles;
- improving the monitoring and evaluation of the effectiveness of PRSPs, including emphasis on the key Millennium Development Goals, and strengthening technical capacity at country-level;
- deepening and broadening the participation of key civil society actors in developing and monitoring PRSPs in a systematic manner; and
- strengthening the content and implementation of PRSPs, particularly by developing pro-poor growth policies, greater specificity of macroeconomic targets and social spending, greater poverty and social impact analysis of key policy reforms, and examination of policy choices and trade-offs.

4.11 Experience suggests that when countries 'own' their policies, they are more likely to implement them. That is why IMF resources are increasingly being used in support of country-led strategies. In low-income countries, the IMF supports the PRSP through the Poverty Reduction and Growth Facility (PRGF) and the Heavily Indebted Poor Countries (HIPC) initiative. It also provides technical assistance to improve the quality of policy-making.

Poverty Reduction and Growth Facility

4.12 The PRGF is the core instrument for Fund support to poverty reduction and growth in low-income countries. In 2001, the IMF committed new PRGF resources of $2.7

billion, a record high. IMF projections indicate that new commitments in 2002 could reach $2 billion[12]. Of the 77 countries that are eligible for the PRGF, 28 have produced interim-PRSPs, another 21 have produced full-PRSPs[13] and 38 have arrangements under the PRGF.

4.13 The PRGF differs from its predecessor – the Enhanced Structural Adjustment Facility (ESAF) - by providing more support for government ownership, a broad approach to poverty reduction and an increased focus on the Fund's areas of expertise. In August 2000, the IMF set out the seven key features that would make the PRGF different from the ESAF, in particular expanding on how the PRGF would focus on poverty reduction and country ownership[14]. That commitment has been strongly welcomed and supported by the UK, and the government is keen to see this approach implemented in low-income countries.

The PRGF Review

4.14 Alongside the PRSP review in March 2002, the Executive Board also reviewed experience with the PRGF. Directors agreed that the basic structure and goals of the facility remain appropriate, and that the 'Key Features of the PRGF' should continue to serve as a summary and guidance document. Since the facility was introduced, more than 40 countries have had new PRGF arrangements or have had arrangements under the ESAF transformed to reflect the new features of the PRGF.

4.15 The UK government was heavily involved in the review process and submitted extensive recommendations related to the seven key features of the PRGF. A number of areas where more progress is needed were highlighted:

- country participation and ownership could be further enhanced by helping to build the capacity of PRGF countries to undertake improved macroeconomic analysis, and to debate policy options;
- Staff reports on the PRGF could do more to show how the PRGF supports the overall poverty reduction strategy;
- more progress is needed on pro-poor budgets to report on levels of primary spending, for instance in health and education;
- the IMF is increasingly more flexible on the fiscal side, but it would help if all PRGFs recorded discussion of choices and compared two or three feasible fiscal scenarios;
- Poverty and Social Impact Assessments (PSIA) of key reforms are a vital part of this, and the UK wishes to see a timetable for all PRGFs to contain such analysis and discussion of options and choices, for 2003; and

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[12] Annual Report 2002, International Monetary Fund, pp46
[13] as at January 2003
[14] Responding to the Challenges of Globalisation, The UK and the IMF 2001, HM Treasury, pp61

- progress has been made in some PRGFs on public expenditure management, which is vital in ensuring that public and donor resources are efficiently and effectively used.

4.16 Around 28 interim–PRSPs have been completed and 21 full–PRSPs. As more full–PRSPs are developed, they will increasingly provide the basis for PRGFs. Progress has also been made in supporting more flexible fiscal targets in PRGF programmes. The UK is now seeking to ensure that the lessons of the PRSP and PRGF reviews feed into IMF policy design and practice, particularly the work on Public Expenditure Management and Poverty and Social Impact Assessments.

Public Financial Mangement and Accountability

4.17 Well-functioning public financial management and accountability (PFMA) systems should ensure that public and donor resources are efficiently and effectively used, properly accounted for, maximise the impact on poverty reduction and contribute to reducing corruption and improving governance.

4.18 Unfortunately current systems of PFMA in many countries are quite weak, even after many years of donor support, as the recent HIPC tracking exercise has shown. The UK government is committed to working with the IMF, the World Bank, and other donors in order to support: annual country-based processes for dialogue, and for monitoring progress on PFMA; a common annual system for regularly measuring and reporting on country performance; better coordinated set of tools for diagnosing and evaluating PFMA systems in countries; and effective technical assistance for long-term capacity building.

4.19 The government believes that improved support should help all low-income countries develop ambitious action plans, within their poverty reduction strategies, to achieve substantially improved public financial management and accountability systems, including target dates to achieve international benchmarks.

Poverty and Social Impact Analysis

4.20 During 2002 an increasing number of PRGFs have started to provide Poverty and Social Impact Analyses (PSIAs) of key reforms, and this has also been better reported by IMF staff in their country PRGF Reports. The UK believes that PSIA is critical to ensuring that poverty-focused dialogue on the policy choices and trade offs associated with key reforms takes place (such as trade liberalisation measures, reforms in key commodity sectors, or utilities privatisation). The government is encouraged by IMF progress in this area, but recognises that approaches are not systematic across all countries, and believes the World Bank must also do more in this area.

4.21 Further work is being undertaken on PSIA, and the UK, through DFID, is directly supporting pilot PSIA work in six countries: Mozambique, Uganda, Rwanda, Armenia, Honduras and Pakistan. The World Bank is also undertaking PSIA in six pilot country studies.

Macroeconomic Frameworks and Growth Strategies

4.22 The review of the PRSP/PRGF in 2002 called for further research and analysis in support of the PRSP approach, with a focus on pro-poor growth; linkages between macro and structural/sectoral policies and poverty outcomes; PSIA; and addressing vulnerability and external shocks.

4.23 The UK believes that many of the analytical macroeconomic issues and knowledge gaps facing developing countries and their development partners require comprehensive research efforts. In developing countries, capacity building in the area of macroeconomics and fiscal issues is an extremely important part of effective programming and increased ownership and participation. For countries to develop and own their programmes, they need to be able to design the programme effectively, and debate policy choices. We welcome Fund efforts to support capacity building. However, the UK believes that better cooperation with the Bank and bilateral donors is needed.

4.24 The UK is working with the IMF and a number of other donor countries to establish joint research priorities for macroeconomic policy in low-income countries. This work will be taken forward at a joint IMF and bilateral government seminar in April 2003, at which government officials from developing countries and academics from both the developed and developing world will participate. The UK will then be taking forward a research programme through financing further research and conferences. This will serve to improve understanding of the appropriate macroeconomic policies for the poorest countries, which face many specific problems. It is also an important step towards opening up IMF policy discussions and enhancing developing country capacity.

Heavily Indebted Poor Countries Initiative

4.25 Support for PRSPs is also provided via the debt relief process – the Heavily Indebted Poor Countries (HIPC) initiative. The UK was instrumental in securing international agreement for both the original (1996) and enhanced (1999) HIPC initiatives, and continues to support the debt relief agenda in all international fora.

4.26 Of the 42 HIPC countries, 38 are potentially eligible for debt relief under HIPC initiative[14]. The process involves two stages. At decision point a country begins to receive relief on its debt repayments, on the basis of an interim poverty reduction strategy. Once that strategy is completed and the government has begun to implement it, a country passes to completion point. At this stage, its debt stock is irrevocably reduced. Table 4.1 shows the status of the various HIPC countries as of December 2002.

[15]the other countries are judged able to achieve debt sustainability through Paris club relief, see Table 4.1

TABLE 4.1 Status of the 4 HIPC Countries (as at end-2002)

Decision Point	Benin; Bolivia*; Burkina Faso*; Cameroon; Chad; Ethiopia; The Gambia; Ghana; Guinea; Guinea-Bissau; Guyana; Honduras; Madagascar; Malawi; Mali; Mauritania*; Mozambique*; Nicaragua; Niger; Rwanda; Sao Tome and Principe; Senegal; Sierra Leone; Tanzania*; Uganda*; Zambia. [**26**] * Also reached completion point [**6**]
Sustainable Debt without HIPC	Angola; Kenya; Vietnam; Yemen. [**4**]
Not yet reached decision point	Burma; Burundi; Central African Republic; Comoros; Cote d'Ivoire; Democratic Republic of Congo; Lao PDR**; Liberia***; Republic of Congo; Somalia***; Sudan; Togo. [**12**] ** Not currently opting for debt relief [**1**] *** No relationship with the IMF [**2**]

Progress so far

4.27 In 2002, two countries reached decision point (Ghana and Sierra Leone) and two reached completion point (Burkina Faso and Mauritania); bringing the totals to 26 and six respectively. The amount of debt to be written off for these 26 countries is $62 billion, a significant step towards the total of $100 billion. Most of the remaining countries are either in, or affected by, conflict. Their progress through the HIPC process has therefore been much slower.

Debt Sustainability

4.28 The Spring Meetings in April 2001 acknowledged the risk of some HIPCs exiting the process with an unsustainable debt burden. For example, a collapse in commodity prices between decision point and completion point could reduce a country's ability to service its debts. The UK agreed with these findings and pressed the Bank, Fund and creditors to find a solution. At the 2001 Annual Meetings, the IMF and World Bank recognised the need to take account of external conditions when assessing debt sustainability at completion point. It was agreed that within existing guidelines and on a case-by-case basis, additional relief (topping-up) could be provided at completion point to ensure that countries exit the process with a sustainable level of debt.

4.29 In his speech to the United Nations General Assembly Special Session (UNGASS) on children in May 2002, the Chancellor called for: the use of more realistic forecasts to calculate debt sustainability between decision and completion point; more generous provision of topping up, including that additional voluntary 100 per cent bilateral debt relief be excluded from the topping up calculation; steps to increase creditor participation; a further $1 billion funding for the initiative to finance its basic funding gap and to pay for these reforms; and technical assistance for HIPCs facing creditor litigation. Following these UK proposals, leaders at the G8 Summit in Kananaskis (June 2002) agreed to: take steps to increase creditor participation, including providing technical assistance to HIPCs being sued by creditors; complete the financing of the initiative; and ask the IMF and World Bank to consider the methodology for topping up at completion point.

4.30 Ahead of the Annual Meetings in Washington in September 2002, the UK took a strong lead on this issue and pledged it's share (up to $120 million including the UK share of any contribution from the European Development Fund) of the funds needed to fill the financing gap. The communiqué of the Development Committee called on other countries to make firm pledges as soon as possible. At an HIPC technical meeting in Paris on 24 October, the UK was joined by many other donors in making pledges that totalled some $850 million. The government hope that other donors who have not yet announced pledges will be able to do so soon.

Countries affected by conflict

4.31 Of the 12 countries that have not yet reached decision point, most are involved in, or affected by, conflict or civil unrest. The UK is encouraging these countries to work towards peace; they can then also start to benefit from debt relief. At the G8 Okinawa Summit in 2000, Heads of Government called on conflict countries to end their involvement in conflict as a necessary first step towards tackling poverty and qualifying for debt relief.

4.32 The IMF and the World Bank, working closely with UN agencies and the international community, are providing technical and financial assistance to assist these countries in establishing economic security and in post conflict reconstruction. The IMF can now provide emergency post-conflict assistance on concessional terms through the Post-Conflict Assistance Account. So far Albania, the Democratic Republic of Congo, Guinea-Bissau, Rwanda, Sierra Leone and Tajikistan have benefited from this facility. The UK pledged £2.5 million to the account and was the first country to make a contribution. The IMF is in dialogue with other potential donors.

4.33 While more work is underway in trying to assist these countries, such as helping to clear the build-up of arrears caused by conflict, the IMF and the World Bank have been actively involved at an early stage in countries that demonstrate a commitment towards peace, such as Burundi. The World Bank has agreed a Transitional Support Strategy and the IMF, a Post-Conflict Assistance facility with Burundi. A multilateral debt trust fund has been established to help Burundi service debt and clear arrears before HIPC decision point. Good progress on economic reform might lead to a PRGF and HIPC decision point in late 2003.

4.34 As a further incentive for HIPCs to work towards decision point, the Chancellor announced on 2 December 2000 that the UK would no longer benefit from debt service payments from poor countries, and that for those countries that were yet to secure debt relief due to civil war, external conflict or the absence of a poverty reduction programme, all debt service payments would be held in trust until those countries can demonstrate that debt relief would go towards poverty reduction. The UK has also brought together its development, political and military efforts on conflict prevention in sub-Saharan Africa, including HIPCs, and funding for conflict prevention has been increased by 42 per cent in real terms.

Impact of debt reduction on social expenditure

4.35 Those countries that have reached Decision Point continue to demonstrate their commitment to poverty reduction by allocating savings from debt relief towards programmes that have an impact on the lives of the poor. The Enhanced HIPC initiative has reduced average debt service costs by 41 per cent, and countries have directed a significant proportion of these savings towards poverty reduction programmes (see Table 4.2). On average, these countries are expected to spend more than three times more on social sectors than on debt service after HIPC.

TABLE 4.2 Increased Social Spending in HIPCs

	1999	2001
Social spending ($ billion)	5.3	6.7
Ratio of social spending to government revenue	37	45
Ratio of social spending to GDP	6	8
Ratio of social spending to external debt service	1.4	2.3

source: HIPC Progress Report, IMF, September 2002

Streamlining Conditionality and Enhancing Ownership

4.36 The release of IMF resources under the PRGF and HIPC, as well as other Fund facilities, is conditional on the borrowing country pursuing certain reforms. The key objective of this conditionality is to ensure that members drawing on IMF resources adopt appropriate policies to resolve their balance of payments problems and promote sustained and balanced growth. At the same time, conditionality is designed to give members confidence that IMF resources will continue to be available to them as long as they implement the policies envisaged under the programme.

4.37 While remaining consistent with these principles, conditionality has evolved over the course of the Fund's history. Specifically, concerns were raised by borrowing countries, donors and non-governmental organisations that excessively detailed conditionality can undermine national ownership of reform programmes in developing countries and strain administrative capacity. The IMF reviewed its 1979 Conditionality Guidelines and in September 2002 produced new guidelines that emphasise streamlining and ownership.

4.38 The UK strongly supports the efforts of the Fund in implementing these guidelines, which are consistent with the PRSP approach. IMF conditionality should be concentrated on measures which are critical to the success of the programme's macroeconomic objectives, are within the Fund's core area of responsibility, and are within the country's capacity to implement in the necessary time.

4.39 All Fund programme reports now contain a box giving details on how conditionality has been streamlined, including identifying those areas of conditionality which are within the World Bank's expertise. The UK will continue to press for uniform and consistent implementation of these guidelines across Fund programmes. A key UK priority is to ensure an effective review of implementation before end-2003, as agreed by the Executive Board in September 2002.

4.40 The UK government strongly believes that Fund conditionality should also be consistent with that of other institutions and integrated into a coherent country-led approach. There are concerns that the streamlining conditionality initiative has not resulted in fewer overall conditions once the programmes of other International Financial Institutions (IFIs) are also considered. The UK is encouraging the World Bank in particular, to undertake an assessment of the net conditionality faced by borrowing members.

SUCCESSFUL OWNERSHIP

Country ownership is essential to sustained poverty reduction in poor countries. It can help to encourage a thorough analysis of the causes of poverty, proper prioritisation of necessary policy actions and allows countries to influence their own development.

It is important that PRSPs are developed in a meaningful, country-led manner. The recent PRSP Review agreed on the importance of country ownership as a guiding principle and it found that there is a growing sense of country ownership among developing countries, but that this is fragile. Some country representatives also felt that though country ownership is important, in practice the ownership can be very superficial; at places confined to only a few Ministries in the country. One aspect of this, emphasised particularly in the Fund board discussions, was the importance of openly discussing alternative policy choices.

In some countries, the PRSP is recognised as being country-led, with the government taking full leadership in formulating the document, and in consultation with civil society. Indeed, the PRSP has launched a process of national policy dialogue in countries where there is little prior tradition of broad-based participation in decision-making. However, successful country-ownership also requires strengthening scrutiny of lending programmes, including the PRGF, to ensure that policies and conditionalities are derived from the PRSP and conditionality is streamlined wherever possible.

The UK believes that the process of Fund dialogue with PRGF-supported countries should better aim to build capacity, enhance ownership and promote transparency in the programme design process as well as accessibility to their content and details. As we take steps to strengthen country ownership, we must also ensure that the quality and objectivity of Fund surveillance and policy advice is maintained. Fund objectivity and credibility are clearly also key factors in determining a programme's success.

In addition, streamlining conditionality is important in the Fund's approach to strengthening country ownership of its programmes. Focusing on those elements critical to the success of the programme leaves room for national decision-making on the broader policy agenda and on the specific ways to achieve national objectives.

Technical Assistance

4.41 In addition to lending in support of the country-owned strategies, the IMF also provides technical assistance to help countries strengthen their policy making process. This assistance is focused on the Fund's areas of expertise, which include fiscal policy, monetary policy and statistics. It is usually provided free of charge with the full involvement of the recipient country, from identification of need to implementation, monitoring and evaluation.

4.42 Since demand for technical assistance exceeds supply, the IMF prioritises its efforts on three main policy areas: crisis prevention, debt relief and poverty reduction. More resources are also being directed to help countries improve their capacity to combat money laundering and the financing of terrorism (see chapter 3).

4.43 IMF provision of technical assistance is concentrated in the low and lower-middle income countries. Reflecting this, in recent years, the Fund has adopted a regional approach to the delivery of technical assistance and training. It already operates two regional technical assistance centres in the Pacific and the Caribbean. In May 2002, the Executive Board endorsed the IMF's Africa Capacity Building Initiative.

4.44 The Initiative will strengthen the capacity of African countries to design and implement their PRSPs as well as improve the coordination of technical assistance. It also aims to increase the volume of capacity building assistance from the IMF to Africa.

AFRITACs

4.45 As part of the Initiative, two African Regional Technical Assistance Centres (AFRITACs) are being established. The first opened in Tanzania in November 2002 and will serve East Africa. The second will serve West Africa. If these are successful three more centres will be established to cover the whole of sub-Saharan Africa.

4.46 The work plans for AFRITACs will be agreed by Steering Groups where both borrowing member countries and donors are represented. It therefore marks an important step forward in strengthening African capacity. The UK fully supported the establishment of AFRITACs.

RESOURCES FOR POVERTY REDUCTION

4.47 Even the best efforts of the poorest countries will not be sufficient to achieve the MDGs without additional support from the international community. Indeed, even in early 2003, we are at risk of not fully meeting many of these targets.

Progress in Meeting the MDGs

4.48 Globally, we are broadly on track to halve the proportion of people living in extreme poverty by 2015. However, despite good progress in East and South Asia, elsewhere we are not on track. Indeed, in sub-Saharan Africa, Latin America and the Caribbean, the Middle East and North Africa, and the transition economies of Europe and Central Asia, the absolute number of people living on less than $1 a day increased by around 100 million people between 1990 and 1999. Sub-Saharan Africa remains the greatest concern and is facing new and terrible burdens, though some reforming countries in Africa are making progress towards these goals.

4.49 Looking at the specific MDGs, one quarter of the world's population live in countries that are not on track to meet the goal of primary education for all by 2015., and the best estimate is that by 2015, on current trends, 100 million children (80 million in Africa alone) will still be denied schooling.

4.50 On current forecasts, 81 countries will not meet our goal of reducing infant mortality by two-thirds. 47 out of 48 sub-Saharan countries will fail to meet our goals of reducing maternal mortality.

4.51 To achieve the MDGs, we need something as bold as a 21st century equivalent of the Marshall Plan. The Marshall Plan was founded on an unprecedented transfer of 1 per cent of national income from the United States to rebuild Europe after the Second World War, financing reform and economic reconstruction. In the same way, the development compact outlined above should be that, in return for reform in developing countries' economies, finance for development is on offer.

4.52 The first building block of such a compact is a new rules-based system for global economic growth and stability under which all countries can prosper. Chapter 3 outlined the role of the IMF in developing this system. The other building blocks are trade, investment and aid.

Trade Liberalisation and Market Access

4.53 Full trade liberalisation globally and trade-related reforms could lift at least 300 million people out of poverty by 2015. Trade subsidies in the developed world total $350 billion each year – seven times greater than the aid provided to developing countries.

4.54 The IMF must continue to promote trade and carefully sequenced market liberalisation that is appropriate to a country's level of development. The Fund continues to press for timely progress in every area of commitments made in the Doha Development Agenda in 2001. The months leading up to the WTO Cancún ministerial in September 2003 will be an important opportunity to ensure that the Doha Development Agenda remains on track. The UK will be looking to the Fund, as well as to other international fora, to continue to provide analytical support to aid all WTO members in reaching an outcome which brings economic benefits to both developed and developing countries.

4.55 In particular, developed countries should improve access to their markets, especially in areas of interest to developing and least developed countries (LDCs) such as agriculture, textiles and clothing. Since the EU's decision to grant duty and quota-free access to all exports, except arms, from LDCs, New Zealand and Australia have taken up similar policies, as has Canada to a large extent. The UK would encourage all developed countries to follow this lead.

4.56 However, there is also much more room for developing country exports to be encouraged by improving access to developed markets in general, and not just for products from least developed countries. In this regard, the UK is working hard for significant reform of the EU's Common Agricultural Policy, in order to reduce its distorting effect on agricultural trade. Simultaneously, we are working with all developed countries which subsidise agriculture and urging them to show leadership by undertaking reform. Timely completion of negotiations under the Doha Development Agenda would have a significant positive impact on market access for developing countries.

4.57 The UK is also keen to ensure that PRSPs give appropriate weight to the role of trade and encourage countries to invest sensibly in trade-enhancing infrastructure, but without imposing additional constraints on national policy-makers. Helping developing countries to make the best use of trade in their economic development is the key goal.

Private Sector Investment

4.58 Private sector investment is an essential complement to trade in achieving the goal of halving the proportion of people living in extreme poverty by 2015. However, levels of private sector investment in many low-income countries are often too low to generate sufficient rates of growth. Developing countries attracted less than 20 per cent of global FDI inflows in 2000. FDI flows to low-income countries are particularly weak: in 2000, 41 per cent of the world's population lived in low-income countries, but they attracted less than 1 per cent of global FDI flows. Limited levels of domestic investment can be further eroded through capital flight.

4.59 Low-income countries can benefit from free movement of capital, including foreign direct investment. FDI in particular can be an important driver of growth and development, through generating higher productivity, employment opportunities and wealth, whilst transferring knowledge, skills and technology.

Creating an enabling environment

4.60 The policies which will help developing countries attract FDI and ensure the benefits from FDI flows are maximised will also create a favourable business environment for domestic investors. Macroeconomic stability is a key determinant of the attractiveness of a country to investors. The adoption of codes and standards to strengthen policy making frameworks and national financial systems can make an important contribution to achieving greater stability, and thus securing higher investment flows. Developing country governments should also be encouraged to put in place effective competition policy to reduce the risk of anti-competitive business practices by multinational corporations, which might adversely affect local consumers and businesses.

Investment Advisory Councils

4.61 The IMF and the World Bank have taken a leading role in promoting these reforms, in particular through fostering increased dialogue between the private sector and developing country governments with a view to removing specific barriers to investment in a particular country. The UK has supported these efforts, and welcomes the establishment of investment advisory councils in countries such as Ghana and Tanzania. These forums are already making recommendations on reforms that will aid investment and economic growth, including regulatory reform, infrastructure development, telecommunications, market size, and regional integration. In addition, PRSPs have correctly focused on creating the right domestic conditions for business investment.

4.62 Reforms to improve the investment climate must be matched by increases in the productivity of the local workforce. The level of education and skills amongst local workers will affect both the amount of investment in a developing country and also the scope for benefit from spillovers. In addition, the health of the workforce will also impact on economic growth.

Corporate Social Responsibility

4.63 Successful economic development which will bring maximum benefit to poor people depends not only on the actions of donors, international institutions and developing country governments, but also on the actions of the private sector itself. The UK government urges businesses to engage as long-term and reliable partners in the economic development process. Alongside constructive engagement with developing country governments to assist policy reform, businesses can make a valuable contribution through improving their communication with stakeholders in developing countries, adhering to proper regulatory frameworks, and upholding appropriate labour and environmental standards, such as those put forward in the OECD's guidelines for multinational enterprises.

Improving Aid Effectiveness

4.64 Putting in place these building blocks for stability, trade and investment, as some developing countries are in the process of doing, will demand radical changes by developing countries and developed countries, but while these are the long-term basis for global prosperity, much of the world's population cannot benefit from them without a fourth building block: a substantial transfer of additional, effective resources from the richest to the poorest countries in the form of investment for development.

4.65 Within the framework of PRSPs, we must strengthen the measures that ensure the effectiveness of current and increased aid flows. In particular, reform and better allocation of poor quality aid could make it 50 per cent more effective in reducing poverty. Reforms should include a refocusing of EU assistance on poorer countries, implementation of the European Commission's proposals on untying aid, and the development of stringent guidelines that permit rigorous scrutiny of the quality of bilateral aid programmes.

4.66 By 2005-06, 90 per cent of the UK's bilateral aid resources will be spent in low-income countries where research shows it can be used best. In 2001, the government untied 100 per cent of its aid, and now provides more aid through direct budget support. The UK is seeking to work more closely with bilateral and multilateral donors to reduce transaction costs in aid for developing countries.

Aid Absorption

4.67 A report prepared by Ernesto Zedillo, former president of Mexico with the help of many others, including Robert Rubin the former US Treasury Secretary, estimates that if we are to succeed in achieving the MDGs, an extra $50 billion in aid flows will be required each year until 2015. This would constitute a doubling of existing aid flows. Improving the effectiveness of aid would ensure that any such increase is used effectively to reduce poverty.

4.68 Many countries have used aid well, including those such as South Korea and Malaysia, which have graduated from being poor to becoming developed countries. Aid can also play a catalytic role for private investment, with every $1 of aid leading to $2 of private investment. Well-designed and well-allocated aid can 'crowd in' private investment, both domestic and foreign.

4.69 Uganda has reduced extreme poverty to 20 per cent since 1992, down from 55 per cent of the population, and has doubled enrolment of primary school children in the space of three years – with aid contributing over 50 per cent of the budget. In Vietnam, economic growth supported by aid has contributed to a halving of poverty in the past 15 years, and a two-thirds reduction in child mortality.

4.70 There is good evidence that poor countries can readily absorb higher levels of aid. The World Bank has estimated that two-thirds of the countries that are unlikely, on current trends, to achieve the MDGs already have in place appropriate policy and institutional environments, and on-going reforms, to allow an additional $40 billion a year to be absorbed. Countries with good policies have a higher capacity to use aid effectively than those with weaker policies. Early evidence shows that countries implementing poverty reduction strategies have increased poverty reduction spending by 20 per cent.

4.71 The OECD estimates that India currently receives only $1 of aid per person, corresponding to 0.3 per cent of GDP. Scaling up India's education system by one-third would bring about universal primary education and cost 1 per cent of GDP. Doubling aid could meet a third of this cost, and be readily absorbed into current systems.

4.72 Aid is also critical for countries emerging from conflict. World Bank research suggests those countries can absorb high flows effectively. With many African countries emerging from conflict, it is critical that substantial resources are made available and sustained over the long-term to avoid a return to instability and conflict.

Aid Volume

4.73 With these conditions in place, it is necessary to ensure that developing countries receive the necessary financing to meet the MDGs. To meet the $50 billion development financing gap, the Zedillo Report stressed the importance of developed countries reaching the UN aid target of 0.7 per cent of GNP. The 2002 Spending Review increased the UK's aid commitments to developing countries from 0.32 per cent of national income in 2002-03 to 0.4 per cent by 2005-06. This represents the largest ever increase in UK aid, and a near doubling in real terms since 1997, underlining the government's commitment to the UN target. It also fulfils the UK's obligation under the EU's commitment to reach an aid ratio of 0.39 per cent by 2006.

4.74 The Zedillo Report also made a number of other proposals for innovative mechanisms to raise development assistance, for example through allocations of Special Drawing Rights (SDRs). Most of these lack sufficient support.

International Finance Facility

4.75 However, the UK proposal for an International Finance Facility (IFF) to raise the finance needed to meet the MDGs has commanded wide interest. The Chancellor outlined the initial IFF concept in his speech to the New York Federal Reserve in November 2001. In early 2003, the UK formally launched the proposal.

4.76 The founding principle of the IFF is long-term, but conditional funding guaranteed to the poorest countries by the richest countries. The Facility would be built on long-term donor commitments to provide regular annual payments to the Facility. On the basis of these, it would leverage up immediate resources by issuing bonds in the international capital markets, thus frontloading aid in the period of urgent need.

4.77 Leveraging funds in this way has long been a part of the financing of development through the World Bank and other development banks, but the IFF is structured to meet the limited and specific task of raising the critical mass of financing needed to meet the MDGs. As a concept it offers a number of advantages:

- it is focused on the financing necessary to help achieve the internationally agreed MDGs;
- it is founded on developed countries' long-term commitments to those countries that are striving towards achieving the goals;

- it bridges the gap by leveraging these long-term commitments, enabling the 0.7 per cent target to be met sooner and allowing a substantial increase in aid when it will have the most impact;
- it will also allow a critical mass of aid to be linked up as a coordinated programme of sustained investment across health, education and other anti-poverty programmes;
- by crystallising long-term commitments from donors it can provide a predictable and stable flow of aid over the medium term to countries that remain committed to achieving the MDGs, thereby helping provide a catalyst for increased private investment;
- its structure encourages donor pooling and coordination, improving the effectiveness of aid. By bringing together donor flows and diversifying risk it is able to secure value for money; and
- it is based on a tried and tested principle for raising finance.

HOW COULD THE IFF WORK?

Donors would make a series of long-term pledges (each of them lasting 15 years) for a flow of annual payments to the IFF. Each pledge would be a binding commitment, subject to high-level financing conditionality. On the back of these pledges the IFF would issue bonds in its own name. It would thus turn the long-term income stream from donors into capital available for more immediate disbursement. The capital raised would be disbursed to the poorest countries with each donor using its chosen mechanism.

The IFF would be a temporary finance facility, not a development bank or aid agency. The disbursement of funds would be in multi-year programmes, providing the predictability essential for effective aid, through existing bilateral and multilateral mechanisms, again in line with donor wishes.

The Facility would be replenished at regular intervals (for example every three years). At each replenishment, donors would make a fresh series of annual long-term funding pledges (each lasting 15 years) to the IFF as the basis for further borrowing.

We envisage that the Facility would be in existence, raising and disbursing funds, for around 15 years. The repayment phase would continue for around a further 15 years after which the Facility would be wound up.

There would be necessary safeguards for donors to ensure that the finance raised by the IFF is used for its intended purpose by countries committed to meeting the development goals.

Donors' pledges to the IFF would be conditional upon the recipient countries meeting one or two common, clearly defined high-level financing conditions to be agreed. These could be, for example, not having prolonged arrears to the IMF or UN sanctions. Donor payments to the IFF in respect of a particular country would be suspended if that country breached these high-level financing conditions.

The multi-year disbursement programmes to poor countries through existing bilateral and multilateral mechanisms would be subject to more detailed conditionality, based on clear development criteria. This would aim to make the most effective use of aid to achieve the MDGs, ensuring that payments were made only to countries implementing agreed PRSPs.

The financial risk of a breach of a fundamental financing condition by a specific recipient country and an ensuing suspension of donor payments would lie with the IFF., but the risk to the IFF as a whole would be small provided:

- there were sufficient cash balances in the Facility to be likely to cover the shortfall arising if some recipient countries did not meet the high-level financing conditions;
- the IFF had commitments from a relatively large number of donors balanced across a range of recipient countries; and
- there were limits to the proportion of funding to any one country.

On this basis, the IFF would be able to leverage a substantial proportion (perhaps up to 80 per cent) of the net present value of the long-term payment stream pledged by donors. Because of the distribution of risk, indications are that the IFF would be able to borrow on very favourable terms reflecting the underlying credit quality of donor commitments.

Discussions with the financial community indicate that the concept is based on sound precedents and that there should be no market barriers to the creation of the IFF. The global market for bonds similar to those the IFF would issue is very deep. For example, the international market for AAA bonds issued by supranational institutions and agencies was worth in excess of $360 billion in 2002. There should not therefore be any material impact on the cost of borrowing.

Health and Education

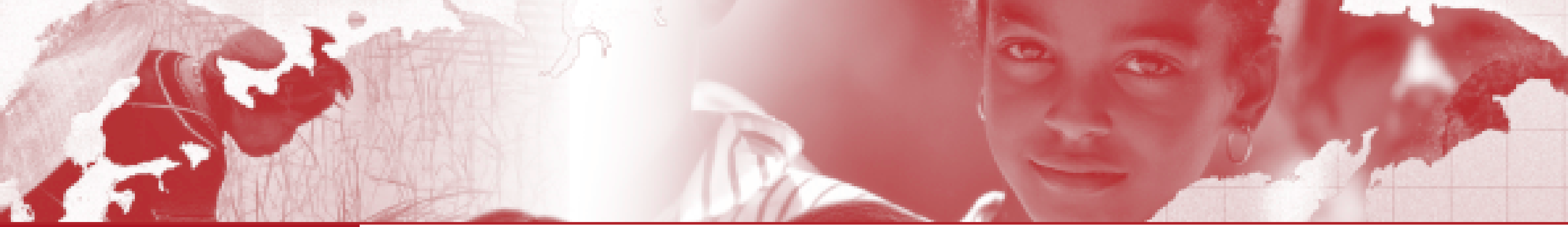
4.78 Since 1997 the UK government through the Department for International Development has committed over £1 billion to strengthen health systems in developing countries. During 2002, progress continued to be made internationally:

- the first disbursements were made from the Global Fund to fight HIV/AIDS, tuberculosis and malaria – which cause 6 million deaths each year. Total commitments to the Global Fund have reached $2.1 billion, of which the UK has pledged $200 million over five years;

- tax incentives were introduced in the UK to encourage new investment in research and development of medicines to fight HIV/AIDS, tuberculosis and malaria in developing countries; and
- the Prime Minister launched the report of the government's High Level Working Group on Access to Medicines in November 2002. The report, which reflects the views of all key stakeholders, outlines proposals to facilitate voluntary differential pricing of essential medicines for the poorest developing countries.

4.79 The government has pledged to expand its support for universal primary education (UPE). Since 1997, the Department of International Development has committed £700 million to basic education. In November 2002 Clare Short announced a further £1.3 billion commitment over the next five years, to enable 20 million more children to go to school by 2006.

4.80 At present about 75 million children within the Commonwealth are unable to go to school. The government has established the Commonwealth Education Fund to build the capacity of civil society to provide strategic support for national UPE plans, and to enhance accountability to parents and children. Under the chairmanship of Sir Edward George, Governor of the Bank of England, and with financial support from business and the government, the Fund is working in 17 countries in Africa and Asia. The Fund is managed jointly by ActionAid, Oxfam and Save the Children Fund, and implemented through local civil society organisations.



5 An Effective Actor in the International Community

The international community as a whole must respond to the challenges of globalisation. The IMF has an essential role to play in this wider effort, but to remain effective it must continue with governance and institutional reforms. This in turn will strengthen its credibility in the international system. UK priorities focus on ensuring the IMF is resourced, representative and responsible; and as an actor in the international community, that the IMF is effective, influential and trusted.

5.1 Over the last 50 years, the international economy has undergone profound and rapid change. In response, the IMF has developed new functions and policies to ensure it remains effective and relevant. Previous chapters outlined UK priorities for strengthening current Fund policies so that it is better placed to respond to the new challenges presented by globalisation.

5.2 However, the changing international environment has also required the IMF to adapt its internal structures and processes. Membership has grown over four-fold since 1944 and with it, the need for more resources on the one hand and greater participation in decision-making on the other. Fund policies are also under more intense scrutiny from a much wider range of stakeholders, including market participants and civil society organisations. This has led to calls for the Fund to be more open and accountable in its operations.

5.3 The IMF also operates within the wider network of the international institutional system. The United Nations, the World Trade Organisation, the World Bank and the Regional Development Banks all have interests which overlap with those of the IMF. Changes to IMF policies will ensure its continued effectiveness within this system. An effective IMF that is representative in its decision-making and responsible in its operations is also important to ensure that the Fund remains an influential and trusted organisation within the international community.

Resourced to Meet its Mandate

5.4 As the international financial system has evolved over the last 50 years, so too have the demands on IMF resources. Private capital flows now dwarf official finance. This raises new questions about whether the IMF has sufficient resources to fulfil its mandate.

5.5 On the one hand, the ongoing efforts to increase private sector involvement in crisis resolution (see chapter 3) may reduce the demand for IMF resources. However, the deteriorating global economic outlook and consequent uncertainty warrant a degree of caution in any assessment of demand.

5.6 On the supply-side, the majority of IMF lending is resourced through the quota system. If necessary, the Fund can also draw on borrowing arrangements with some member countries. Concessional lending to the poorest countries is financed by IMF-administered trust funds which member countries contribute to. The IMF is also one of the largest official holders of gold in the world, although there are strict limitations on the use of this gold.

5.7 Under certain circumstances the IMF can also boost global liquidity through a general allocation of SDRs to its members. In recent years, there have been proposals to use such an allocation as a means of increasing development assistance.

IMF liquidity

5.8 IMF lending continued at a high level during 2002 and remained concentrated in a few large borrowers. New commitments between January and mid-September 2002 amounted to SDR 39.2 billion ($54.1 billion), approximately SDR 8 billion more than the whole of 2001. Most of the new commitments were attributable to Brazil, Turkey and Uruguay (see chapter 2). The SBA that was agreed for Brazil in September 2002 is the largest single Fund programme in the history of the institution.

5.9 The Executive Board considers the adequacy of Fund resources during their discussions on the IMF's liquidity position. These discussions take place twice a year. In 2002 they were held in May and November. An important change this year was in the way IMF liquidity is measured. Directors agreed to use the one-year Forward Commitment Capacity (FCC) instead of the liquidity ratio as the standard measure of Fund liquidity.

5.10 On the liquidity level itself, Directors noted the decline in Fund resources under both measures, and while no Directors thought that the current FCC of nearly SDR 50 billion was too low, there were differences as to whether this was adequate going forward.

MEASURING IMF LIQUIDITY

In 2002, the Executive Board agreed to use a new measure of Fund liquidity: the one year Forward Commitment Capacity (FCC). This measure is intended to provide a clearer indication of the resources available to the IMF for new lending operations and will replace the traditional liquidity ratio as the primary measure of Fund liquidity.

The FCC is calculated by taking the IMF's stock of usable resources (members' quotas, gold holdings etc) less undrawn balances under current lending arrangements (lending that has already been agreed but not disbursed). This gives the level of uncommitted usable resources. Projected repayments (or repurchases) by borrowing countries are then added. Then finally the prudential balance is subtracted.

The prudential balance represents a level of resources that the IMF would not normally draw on to finance lending operations. It is set at 20 per cent of the quotas of member countries whose currencies are currently used in IMF lending and any amounts activated under borrowing arrangements. The prudential balance is determined by judgement and does not constitute a rigid minimum. The IMF's uncommitted resources could, on a strictly temporary basis, fall below this level.

	Billion SDRs (at Nov 2002)
IMF's Stock of Usable Resources	102.2
Less undrawn balances under current lending arrangements	36.5
Equals Uncommitted Usable Resources	65.7
Plus Repurchases one year forward	15.7
Less Prudential Balance	32.6
Equals one year Forward Commitment Capacity	48.7

The Executive Board also agreed that the FCC and the methodology used to calculate it should be available on the IMF website. The FCC itself is now published weekly and monthly. The liquidity ratio also continues to be published for the time being. The use and publication of the FCC marks a further step forward in the Fund's efforts to improve public understanding of its operations.

Quotas & PSI

5.11 This difference of views on the adequacy of Fund resources was reflected in the Twelfth Review of Quotas.

5.12 All 184 members of the Fund have an individual quota which determines their capital subscription to the IMF. Since quotas are the primary source of IMF resources, any discussion on the adequacy of the resource base will have implications for the quota review. For example, if the Executive Board agreed that IMF resources were insufficient to fulfil its mandate, there would be a strong case for a general quota increase and vice versa.

5.13 The adequacy of current Fund resources will partly depend on the success of the current efforts to strengthen private sector involvement (PSI) in crisis resolution. With the increasing importance of private sector finance in global capital flows, it is neither feasible nor desirable for the growth of official resources to keep pace with the rapid growth in international capital flows.

5.14 However, this does not imply that Fund resources should not be increased. More resources and more PSI are not necessarily mutually incompatible. For example, the IMF may need to provide bridging finance before large amounts of private finance come on stream.

5.15 The question is therefore whether, and by how much, Fund resources need to increase. The provision of large-scale financial support from the official sector must not become a standard element of crisis resolution - exceptional access must be truly exceptional. The recently agreed changes to exceptional access criteria and procedures should ensure this happens, so we should not expect demands on resources to continue to grow as fast as they have in recent years. Indeed, if the likely growth in resource requirements is calculated in these terms, there is a risk of undermining the credibility of the newly agreed exceptional access criteria and limits. There needs to be a clear methodology for calculating the necessary increase that does not undermine our PSI objectives.

5.16 Quotas are reviewed every five years. The Twelfth such review concluded on 31 January 2003 with agreement on no increase in quotas but with a clear work programme for the Executive Board to continue discussions on Fund resources, governance and selective quota increases.

The General Arrangements to Borrow

5.17 In addition to quota arrangements, a number of member countries have offered to lend the IMF supplementary funds in the event of an impairment to the international monetary system, or an exceptional situation that threatens the system's stability.

5.18 The first such source of supplementary financing - the General Arrangements to Borrow (GAB) – was established in 1962. Under the GAB, 11 major industrial countries have undertaken to make loans to the IMF of up to SDR 17 billion, with an additional SDR 1.5 billion available under an associated arrangement with Saudi Arabia. The 11 participants are the US, the Deutsche Bundesbank, Japan, France, UK, Italy, Swiss National Bank, Canada, Netherlands, Belgium, and the Swedish National Bank. The UK's credit amount under the GAB is SDR 1.7 billion (about $2.4 billion).

5.19 The GAB was last activated in July 1998 for SDR 6.3 billion (SDR 1.4 billion of which was drawn) in connection with the financing of an extended arrangement for Russia. Following the increase in quotas under the Eleventh General Review and the improvement in the IMF's liquidity position, the outstanding borrowing was repaid by the IMF in March 1999.

The New Arrangements to Borrow

5.20 The second source of supplementary financing – the New Arrangements to Borrow (NAB) – was established in 1998. Under the NAB, 25 countries have undertaken to make loans to the IMF of up to SDR 34 billion. The current participants are all the members of the GAB plus Australia, Hong Kong Monetary Authority, Korea, Thailand, Kuwait, Malaysia, Saudi Arabia, Austria, Singapore, Spain, Denmark, Finland, Luxembourg and Norway. The UK's credit amount under the NAB is SDR 2.6 billion ($3.4 billion).

5.21 The NAB does not replace the GAB, which remains in force. However, the NAB is the first port of call if the IMF needs additional financing. Total borrowing under both the NAB and GAB cannot exceed SDR 34 billion and the UK's maximum exposure under both arrangements is the NAB amount of SDR 2.6 billion.

5.22 Both the GAB and NAB must be renewed at five year intervals with decisions on renewal taken one year prior to expiry. Since the last renewals occurred in 1998, decisions on further renewals fell due in 2002. Following a meeting of the G10 in September, the Executive Board agreed to renew the GAB for a period of five years beginning from 26 December 2003. Chile asked to join the NAB with a contribution of SDR 340 million. NAB participants, including the UK, accepted this application. But there was no increase in the overall size of the NAB. Rather other members' contributions were reduced on a pro-rata basis. The NAB was subsequently renewed for a period of five years beginning from 17 November 2003 and now includes 26 members.

PRGF and HIPC Trust Funds

5.23 The IMF's concessional activities – the Poverty Reduction and Growth Facility (PRGF) and the Heavily Indebted Poor Countries (HIPC) initiative (see chapter 4) – are financed through direct bilateral contributions and the IMF itself. They are separate from the quota subscriptions and are administered under the PRGF and PRGF-HIPC Trusts, for which the IMF acts as Trustee.

5.24 The PRGF Trust was established to provide lending in support of PRGF arrangements and subsidise the market rate of interest to the concessional rate of 0.5 per cent per annum. A number of central banks, governments, and official institutions lend resources to the PRGF Trust, generally at market-related interest rates. These are then lent on PRGF-eligible countries. To finance the difference between the market-related interest rate paid to PRGF Trust lenders and the rate of interest of 0.5 percent per year paid by the borrowing members, contributions are received form bilateral donors and the IMF's own resources. Bilateral contributions total SDR 3496.1 million, of which the UK has pledged SDR 359.1 million.

5.25 The PRGF-HIPC Trust was established to provide debt relief under the HIPC initiative and to subsidise the PRGF during the period 2002-05. The resources in the Trust comprise grants and deposits from 93 bilateral contributors and the IMF. Bilateral contributions total SDR 1559.1 million, of which the UK has pledged SDR 82.2 million[16]. The bulk of the IMF's contribution comes from the investment income on the net-proceeds from off-market gold transactions in gold in FY 2000/01.

Gold Holdings

5.26 The IMF is one of the largest official holders of gold in the world. Valued at market prices, its holdings of gold amount to SDR 24.9 billion ($35 billion). However, the IMF's Articles of Agreement apply strict limitations to the use of this gold. For example, it cannot be used to finance new lending.

[16] figures for the UK pledges to the PRGF and PRGF-HIPC Trust are as at 30 April 2002

ALLOCATION OF SDRS

Special Drawing Rights (SDRs) are an international reserve asset introduced by the IMF in 1969 out of concern amongst members that the current stock and prospective growth of international reserves might not be sufficient to support the expansion of world trade.

Article XV of the IMF's Articles of Agreement allow a general allocation of SDRs – "To meet the need, as and when it arises, for a supplement to existing reserve assets, the Fund is authorised to allocate special drawing rights to members that are participants in the Special Drawing Rights Department."

The IMF allocates SDRs to member countries as a percentage of their quotas. The last such allocation took place in 1981, when there were only 141 member countries. Since 1981, however, the membership has not seen the need for another general allocation of SDRs partly because it has not seen a need to supplement existing reserve assets. The Executive Board last discussed a general allocation of SDRs in December 2001. The UK remains open minded about the possibility of an SDR allocation. A decision on whether this is necessary should be made on the basis of avoiding "economic stagnation and deflation as well as excess demand and inflation in the world" as set out in Article XVIII of the Articles of Agreement.

In September 1997, the Board of Governors adopted a resolution to amend the IMF's Articles of Agreement to allow for a special one-time allocation of SDRs, known as the Fourth Amendment. This proposal would equalise all members' ratios of cumulative SDR allocations to quota at a common benchmark of 29.3 per cent and would result in a doubling of the outstanding stock of SDRs to SDR 42.87 billion. It would enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that more than a fifth of the membership—those countries that have joined the IMF since the general allocation in 1981—have never received an SDR allocation.

The Fourth Amendment will become effective when three-fifths of the IMF membership (110 members), having 85% of the voting power have ratified the proposal. 112 members, including the UK and all of the G7 (except the US) have already done so. The government supports an early implementation of this allocation, as called for in the IMFC communiqué.

REPRESENTATIVE IN ITS DECISION MAKING

5.27 Developing countries constitute the overwhelming majority of IMF membership and are deeply affected by its decisions, yet their ability to influence these decisions is limited, particularly on the cross-cutting policy issues, and as the Fund has become increasingly active in these countries, so the issue of developing country voice has grown more urgent.

5.28 In its White Paper on "Making Globalisation Work for the Poor" the UK government committed to "work with others to build a stronger, more open and accountable international system, in which poor people and countries have a more effective voice[17]" .

5.29 At the UN Conference on Financing for Development in Monterrey in March 2002, it was agreed that the IMF and World Bank should "continue to enhance the participation of all developing countries and countries with economies in transition in their decision-making, and thereby to strengthen the international dialogue and work of those institutions as they address the development needs and concerns of these countries." This need to address developing country voice was echoed in the Johannesburg Plan of Action that emerged from the World Summit on Sustainable Development.

5.30 At the 2002 Annual Meetings of the IMF and World Bank, the Development Committee agreed to take this work forward by calling on the Fund and Bank to prepare a joint paper on developing country voice for the Spring Meetings in 2003. The UK strongly supported this and has advanced a number of specific proposals that it believesmerit serious consideration by the Executive Board.

Strengthening Delegation Offices

5.31 The day-to-day decisions of the IMF are made by the Executive Board, comprising 24 Executive Directors (EDs) representing all 184 member countries. Developing countries tend to be part of the large constituency groupings, so their ED is responsible for representing many countries, several of which have active Fund programmes. This problem is particularly acute in sub-Saharan Africa, where just two EDs represent 44 countries, 24 of which have continuing Fund Programmes (accounting for just under one-half of the total number of countries with programmes).

5.32 Executive Directors (EDs) are served by delegation offices, which are responsible for analysis and briefing on Fund programmes and policies. The capacity of these offices therefore has an important impact on voice.

5.33 Increasing the number of developing country advisors and/or assistants in delegation offices would allow EDs to carry out their duties more effectively. For example, the two sub-Saharan delegation offices currently each consist of eight staff members, more or less comparable with other delegation offices, despite having to deal with a far larger number of active programmes.

5.34 Ensuring delegation staff have access to relevant training opportunities is also important. There are several technical assistance and training initiatives currently in place for delegation staff, including secondments, distance learning, and training at the IMF Institute. Where possible, these should be extended, for example through wider use of internships.

[17]Eliminating World Poverty; Making Globalisation work for the poor (December 2000): pp99

5.35 Good communication links with capitals can also improve participation at the Board. The introduction of the IMF's extranet has helped to strengthen these links, but further measures should be considered, for example use of videoconferencing facilities.

Representation on the Executive Board

5.36 As part of the objectives that guide the Fund in the regular election of Executive Directors, there is agreement that "the size of constituencies will not place undue burdens on Executive Directors and hinder the efficient conduct of business of the Executive Board"[18]. This is a particular issue for sub-Saharan Africa. Its two constituencies are not only the largest, but they also contain a high number of active programmes. This places a relatively heavy burden on the two EDs.

5.37 One option to address this would be to introduce a third African seat, bringing the overall Board size to 25, and allowing these constituencies to regroup themselves, perhaps along regional lines. This proposal would require support from 85 per cent of the Board of Governors and would normally be made in the context of the regular biennial election of Executive Directors. The UK government believes that this option merits serious consideration.

Voting Rights

5.38 Decisions made by the IMF are typically arrived at by consensus, but the distribution of voting rights is important because of the influence it implies. Sub-Saharan countries account for just 4.4 per cent of the total voting power. An increase in the voting shares of low-income countries would serve to increase these countries' influence. A country's voting share in the IMF is dependent on its basic vote and its quota. Changes to quotas will be considered in the Thirteenth General Quota Review.

5.39 All members of the Fund receive 250 basic votes to recognise their rights as members. Until the mid-1970s, basic votes as a percentage of total votes at the IMF remained above 10 per cent; since then however successive general increases in quotas have reduced the share of basic votes to 2 per cent of total votes in 2002. An increase in the proportion of basic votes to 10 per cent would bring it close to its original weighting and strengthen the relative voting power of members with smaller quotas. For example, the voting power of sub-Saharan Africa would rise to 7 per cent. However, a change in the number of basic votes would require an amendment of the Articles of Agreement. The UK believes that an increase in the basic vote warrants serious consideration.

[18] 2002 Regular election of Executive Directors

THE TWELFTH QUOTA REVIEW

The IMF conducts general quota reviews at regular intervals – usually every five years. The last quota review – the Eleventh – occurred in September 1997, when the Board agreed to an overall increase in quotas of 45 per cent. In 2002, the Executive Board discussed the Twelfth General Review of Quotas.

Several different views were expressed during this review. On the one hand, some countries argued that Fund resources are currently adequate to meet potential needs over the coming years and that an increase in quotas would undermine the work on crisis resolution by sending confusing signals to markets about the official sector's readiness to contribute in times of crisis.

However, other countries argued that there may be a case for a quota increase given the uncertainty over the current world economic outlook. Many of the emerging markets also argued that a general increase could be used to bring their quotas more into line with their relative importance in the world economy.

While the UK recognises the importance of not undermining the IMF's work on crisis resolution, we are also supportive of the work on strengthening developing country voice.

In January 2003, the Twelfth Review concluded that there would be no general increase in quotas. However, the Executive Board will continue to monitor the situation closely and will report back to the IMFC in September 2003 on ways of achieving a distribution of quotas that reflects developments in the world economy and on measures to strengthen the governance of the IMF.

RESPONSIBLE IN ITS OPERATIONS

5.40 The activities of the IMF can have a profound impact at both the country and global level. At the country-level its policy advice and lending activities can help restore stability and reduce poverty. Globally, its work on strengthening the financial system and helping to meet the Millennium Development Goals is a public good with the potential to benefit all. With this increased influence has come greater interest in the work of the Fund and a desire to see it learn the lessons of past experience.

Transparency

5.41 Further enhancing the transparency of the IMF is an important element of strengthening crisis prevention. Greater transparency can help strengthen policy frameworks, encourage countries to address vulnerabilities earlier and strengthen the IMF's effectiveness and accountability (there are strong links between these issues and those raised in the biennial review of surveillance, see Chapter 3).

5.42 There are real and significant benefits to increased transparency, both for member countries and for the Fund itself:

- **Stronger accountability for the IMF**: greater transparency regarding the Fund's activities contributes to greater public understanding of the institution and greater public confidence in its policies and operations. By making clear the basis for its policy advice, the IMF can strengthen its authority and address criticisms that might otherwise undermine its influence. By being open to outside critical review, the IMF can ensure it takes account of outside expertise, that any weaknesses in its own approach are addressed, and that its advice is seen as international best practice. All of these elements should help to enhance the IMF's accountability and reputation;

- **More effective Fund surveillance**: while the IMF has in the past sought to exert influence principally through peer pressure "behind closed doors", the succession of crises in the 1980's and 1990's raised questions about the effectiveness of this approach. Making the IMF's surveillance conclusions more transparent to the public and markets, as well as governments, helps strengthen the incentives for members to address and act on its findings;

- **More effective crisis prevention**: transparency helps to identify risks and vulnerabilities at an early stage, encourages governments to make pre-emptive policy adjustments, and enables market participants to make well-informed decisions that differentiate between countries. All of these elements help avoid the build-up of large-scale economic and financial imbalances, and make economies more resilient to economic shocks and financial contagion; and

- **Strong policy frameworks**: at the national level, transparency helps governments strengthen their policy frameworks and command greater credibility and trust – for example, by setting clear long-term objectives, establishing well-understood procedures, and publishing monetary, fiscal and financial data on a regular basis.

5.43 In recent years, the Fund has made real progress in its policy on publication of official documents, for example:

- 114 members published 201 Article IV staff reports between June 1999 (when the Board authorised voluntary publication) and August 2002;

- 54 per cent of stand-alone reports on IMF supported programmes were published between January 2001 (when the Board authorised voluntary publication) and August 2002; and

- during 2001, 21 of 26 papers on policy issues discussed by the Executive Board were published.

5.44 In June 2002, the Executive Board discussed the IMF's Transparency policy. The UK agreed with the staff assessment that, so far, experience with the Fund's policy of increased transparency has been favourable. The Fund is now a more effective, transparent and accountable institution and the significance and impact of these reforms are important. Nevertheless, the UK argued that there would be strong benefits in further increasing transparency.

5.45 In assessing the impact of past reforms and looking at the scope for going further, there is a potential tension between greater transparency and the Fund's role as a provider of candid and frank advice. It is important that the frankness of policy discussions is maintained and that the appropriate balance between transparency and confidentiality is achieved. However, IMF staff found no evidence to suggest that publication of Article IV reports had led to significant disparities in the coverage of sensitive issues between published and unpublished reports.

5.46 The Executive Board considered a number of proposals to increase transparency. The UK supported these proposals but argued that they could go further:

- **More systematic publication of Article IV Reports**. The UK supported moving towards a presumption in favour of publication, and for a strong presumption that IMF missions' concluding statements be published immediately after a surveillance mission has finished (a number of countries including the UK already do this). The UK also argued for a presumption in favour of publication of Reports on the Observance of Standards and Codes (ROSCs). The Board concluded that publication of all these documents should remain voluntary, but agreed to reconsider these issues in June 2003;

- **More systematic publication of Use of Fund Resources (UFR) Reports**. The UK argued for compulsory publication of UFR reports. This would emphasise the importance of full accountability and transparency when Fund's resources are being used. Such an approach should also extend to Letters of Intent (LOI) and Memoranda of Economic and Financial Policies (MEFPs). The government also think there is a strong argument for compulsory publication of post-programme monitoring documents. The Board agreed to move to a presumption in favour of publication of UFR reports, LOIs and MEFPs;

- **Presumed publication of key policy papers and policy Public Information Notices (PINs)**. The UK welcomed this and suggested it be extended to include papers on administrative matters (including the budget). However, while the Board agreed to presumed publication of policy matters it only agreed to consider publication of administrative papers on a case-by-case basis; and

- **Accelerate public access to Board Minutes from 20 to 5 years**. Again the UK supported and hoped access could be further accelerated. In the final event, it was agreed to provide access to Board minutes after 10 years.

5.47 It was agreed that Directors would look again at the Fund's Transparency policy in June 2003. The UK will continue to press for further progress in the areas outlined above.

Accountability

5.48 As an organisation with a mandate to promote global economic stability and whose work can potentially affect millions, it is essential that mechanisms exist that allow the IMF to be held to account for its policy advice and operations. For its part, the Fund must also demonstrate its ability to learn from past experience in the design of future policies. In recent years, much progress has been made on improving the IMF's accountability.

The IMFC

5.49 The International Monetary and Financial Committee (IMFC) is a committee of Governors which meet twice a year to discuss IMF policies. It provides strategic direction to the work programme of the IMF by prioritising areas for further work by the Executive Board and identifying key reforms. Fund management report back to the IMFC on progress with the work programme. This oversight function of the IMFC helps improve the accountability of the Fund to its Governors.

The Independent Evaluation Office

5.50 The UK strongly supported the creation of an effective, Independent Evaluation Office (IEO) for the IMF. In July 2001, the IEO was established to systematically conduct objective and independent evaluations on issues relevant to the mandate of the Fund. This marks a significant step forward in increasing the accountability of the Fund.

5.51 The IEO aims to improve the effectiveness of the IMF by enhancing its learning culture and enabling it to better absorb lessons for improvements in its work. It will also help build the IMF's external credibility by undertaking objective evaluations in a transparent manner.

5.52 The IEO is fully independent from Fund management and staff and operates at arm's length from the Executive Board. This independence is strengthened by a number of safeguards:

- the Director of the IEO is appointed by the Executive Board for a period of four years, renewable for a further three years. He may not be appointed to the IMF Staff at the end of his term. The current Director is Montek Ahluwahlia, a former member of the Indian Planning Commission and Economic Advisory Council of the Prime Minister of India;
- the Director of the IEO is solely responsible for the selection of IEO personnel (including external consultants). A majority of its personnel will come from outside the IMF. In addition, IEO staff report exclusively to the Director of the IEO, not to IMF management; and
- the IEO has sole responsibility for drafting evaluation reports, annual reports, press releases, and other public statements.

5.53 There is a strong presumption that the Executive Board will publish IEO reports promptly after consideration. The first IEO report on the Prolonged Use of Fund Resources has been completed. Two more reports are due before the end of April 2003:

'The Role of the IMF in Capital Account Crises: Korea, Indonesia and Brazil' and 'Fiscal Adjustment in IMF Supported Programmes'.

IEO Work Programme

5.54 The IEO's work programme is established by the Director in light of consultations with interested stakeholders from both inside and outside the IMF. The work programme is presented to the Executive Board for review but it is not subject to the Board's approval. It is also made public. In 2003-04 the IEO will produce reports on:

- the Fund's experience with the PRSP/PRGF approach;
- country case study of the Fund's involvement with Argentina;
- the role of the IMF in providing technical assistance.

5.55 While recognising the need to ensure an appropriate balance between depth of analysis and speed, the UK would also like to see the IEO progressing faster and producing more reports.

IEO REPORT ON THE PROLONGED USE OF FUND RESOURCES

The Executive Board discussed the IEO's first report, on the Prolonged Use of Fund Resources, in September 2002. This paper was candid, comprehensive and well balanced, with a number of recommendations that the UK strongly agrees with, particularly on strengthening surveillance in programme countries.

Some of the key findings of the report were that:

- the IMF has no official definition of prolonged use (the IEO defined it as operating for seven out of 10 years under an IMF arrangement);
- prolonged use predominantly affects low-income countries, but not exclusively; and
- prolonged use has expanded over the last two decades. In 1977, there were 5 five countries that would meet the IEO definition. By 2000 this had risen to 30. The Philippines had spent 25 years since 1971 under Fund programmes, Panama 21 years and Pakistan 20 years.

The IEO attributed prolonged use to a number of factors including changes to IMF policies and expanded expectations of the international community, country-specific characteristics, such as larger initial imbalances or more volatile exports; problems with programme design and implementation, such as poorly designed conditionality and an optimistic bias in growth; systemic and internal IMF governance factors, including the crowding out of effective surveillance by programme work (as the UK has argued).

The report concluded that prolonged use is problematic for both the Fund and member country and advanced a number of recommendations, including:

- that the IMF adopt an operational definition of prolonged use;
- greater operational separation between programme and surveillance missions; and
- greater selectivity by the Fund when extending financial support.

At the Board discussion, Directors commended the IEO for a high quality first report. They also noted that many of the issues raised had relevance beyond the issue of prolonged use and many had already been identified in the context of other elements of the Fund's reform agenda.

The UK welcomed the report and most of its recommendations, particularly those on surveillance. Prolonged use is not necessarily a sign of failure. Rather, a clearer distinction must be made between the causes of prolonged use; is it due to poor programme design, ineffective programme implementation or deep-rooted structural problems? If the latter, there may be instances where prolonged use is appropriate.

At the Board discussion, the IMF agreed to create an internal task force to take forward the recommendations of the IEO report.

THE IMF AND THE INTERNATIONAL COMMUNITY

5.56 The challenge of making globalisation work for all is one that the international community as a whole must address. Within this wider effort the IMF can both influence and be influenced by the process and debate.

5.57 The IMF must work closely with other international organisations, in particular, the World Bank, the UN system and the World Trade Organisation; all have important complementary roles in ensuring world economic growth and stability. At the same time, the IMF's influence with these other organisations depends crucially on its own effectiveness as an institution. The UK, in its capacity as a single member of the IMF, works to strengthen the effectiveness of the IMF according to the priorities outlined earlier and in previous chapters. However, the government also work through the wider international community – the European Union, the G7 and the G20 – to enhance our influence at the IMF.

WORKING WITH OTHER INSTITUTIONS

The IMF and World Bank

5.58 The UK welcomes the steps that the IMF and World Bank have taken to improve their collaboration in recent years. In September 2000, Horst Köhler, Managing Director of the Fund, and Jim Wolfensohn, President of the World Bank, issued a joint statement which promised an enhanced partnership between the institutions. This recognised that the two institutions shared the same broad objective of "helping to improve the quality of life and reduce poverty through sustainable and equitable growth".

5.59 A close partnership through the Joint Implementation Committee has resulted in significant progress in delivering HIPC debt relief and PRSPs. A first-time joint visit to Africa by Köhler and Wolfensohn also signalled the close cooperation between the two institutions. However, there remain significant challenges. In particular, the UK has highlighted public expenditure management, streamlining conditionality and PSIA as areas in need of better collaboration (see chapter 4).

5.60 The Fund and Bank have also sought to strengthen their collaboration in other areas, including: cooperation on financial sector reform through their joint Financial Sector Liaison Committee and the establishment of the Financial Sector Assessment Programme (FSAP), the preparation of ROSCs and an expansion of their work on AML/CFT.

5.61 Consistent with the division of labour between the IMF and the World Bank, each institution concentrates on its primary areas of responsibility and competence. The IMF leads on macroeconomic issues and the Bank on social and structural issues. However, the recognition of the link between macroeconomic stability and structural policies, particularly in a world of open capital markets, has increased the need for the staff and management of the two institutions to consult and work ever more closely together.

5.62 The concept of lead agency in programme design and monitoring has therefore become increasingly important. For each area of policy, on a case-by-case basis, one institution should be identified as the agency to lead the policy dialogue with the country. This process is currently working better for PRGF-supported programmes, i.e. in low-income countries where a division of labour has been established with the World Bank, than under Stand-By Arrangements in middle-income countries, where no formal framework exists. This is another important area where the government wants to ensure improved collaboration between the World Bank and the IMF.

5.63 The UK has a single Executive Director who represents the UK at both the IMF and World Bank Boards. This provides the UK with a unique opportunity to press for close cooperation and greater harmonisation between the two institutions. Through its membership of the Executive Boards of the Fund and Bank, the UK government will continue to work with the G7 and other stakeholders to enhance the coordination and effectiveness of both institutions.

The IMF and the World Trade Organisation

5.64 The IMF and the World Bank have played an important role in developing the 'Integrated Framework' which aims to mainstream trade into developing countries' overall development strategies and to provide for a more coherent approach to trade-related technical assistance between developing countries, developed countries, the International Financial Institutions, the World Trade Organisation (WTO) and other multilateral organisations. The UK played a leading role in this initiative – drafting the original terms of reference – and will continue to support strongly initiatives that encourage improved policy coherence in this area.

The IMF and the UN

5.65 The United Nations system is a fundamental pillar in the promotion of international development, and through its agencies, in particular the United Nations Development Programme, plays a central role in delivering development programmes. The IMF and World Bank work closely with the UN and its agencies, both at country level to coordinate activities and programmes and through the annual meeting of the Economic and Social Council of the UN (ECOSOC) and the Bretton Woods Institutions (BWIs). The UK is working to strengthen the effectiveness of the ECOSOC/BWI dialogue.

5.66 In 2002, the main area of IMF/UN collaboration was in preparing for the UN Conference on Financing for Development in March. Throughout FY 2001/02 the IMF contributed to the work of the preparatory committee providing input for the event and the concluding document – the Monterrey Consensus (see Chapter 4). The institutions are now working together to take forward the Monterrey consensus. This is an important priority for the UK.

THE IMF AND INTERNATIONAL FORA

The European Union and the IMF

5.67 Under the Articles of Agreement, member states of the European Union (EU) are represented individually at the Executive Board. France, Germany and the UK all have their own ED. The remaining EU countries are represented in six constituencies, three of them led by an EU country.

5.68 Despite this individual representation, all EU member states recognise the value of sharing perspectives and, where appropriate, developing an EU consensus on strategic policy issues. This is facilitated through regular meetings of the EU's Economic and Finance Committee, and its Working Group on IMF matters.

5.69 The introduction of the euro has no implications for the representation of EU countries at the IMF; although clearly – on monetary policy issues – the members of the Euro-zone have a common approach. The IMF has, for example, supplemented its country surveillance programme, under Article IV, with a surveillance report on the Euro Area (see section 2.15).

5.70 Once the accession countries join the EU, the number of constituencies in which EU member states are represented will increase from six to seven (under the current constituency structure) in addition to the German, French and UK chairs. However, the increase in the EU voting share would be minimal.

The G7

5.71 G7 countries currently constitute over 45 per cent of IMF quotas. During 2002, G7 Finance Ministers made important progress in their discussions on a broad range of international issues, including crisis prevention, development, debt relief and combating the financing of terrorism.

5.72 On crisis prevention and resolution, the G7 agreed to work together on a far-reaching Action Plan at its April 2002 meeting. This included support for the IMF's work on developing proposals for a Sovereign Debt Restructuring Mechanism and more widespread adoption of Collective Action Clauses in international bond issuances (see chapter 3).

5.73 The G7 also played an important role in the fight against terrorism, acting as a key forum for co-ordinating actions in the freezing of terrorist assets and implementing the Financial Action Task Force's standards against terrorist financing.

5.74 The UK was central in ensuring development issues remained on the G7 agenda. Significant advances were made in financing the HIPC initiative, including a commitment to fill the shortfall in the HIPC Trust Fund. In addition, the G7, along with the IMF expressed their continued support for NEPAD (the New Partnership for Africa's Development).

5.75 The G7 continues to be a valuable forum for the UK, allowing for high-level discussion amongst leading economies, and we will be working closely with the current French Presidency to help ensure that the 2003 Summit is a successful one.

The G20

5.76 In addition to its participation in the G7, the UK remains an active member of the G20. The G20 includes both G7 and key emerging market economies, and provides a useful forum to promote international financial and economic stability.

5.77 The UK believes that the unique mix of countries[18] in the G20 provide a useful complement to other bodies. Through dialogue in the G20, valuable insights and meaningful consensus can be reached outside of the more formal structures of regional and international financial institutions.

5.78 The G20 Ministerial meeting was held in Delhi in November 2002. Ministers and Governors discussed four broad themes: Crisis Prevention and Resolution; Globalisation; Combating Terrorist Financing and Development Aid. India's chairmanship of the group throughout 2002 marked a significant development for the G20. India was the first chairman under a newly agreed model where the chairmanship will rotate annually. Mexico has been appointed chair in 2003, with Germany taking over in 2004.

[18] Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK and the US

A1 IMF DECISION MAKING - UK POSITIONS

VOTES BY THE BOARD OF GOVERNORS

1.1 The IMF's Articles of Agreement and by-laws specify the issues which require a vote by the Board of Governors. These are relatively few and include subjects such as changes to members' quotas, remuneration of Executive Directors, the salary of the Managing Director, decisions on the allocation and cancellation of Special Drawing Rights, amendments to the Articles of Agreement, election and changing the number of Executive Directors, forcing the withdrawal of a Fund member and liquidation of the Fund.

1.2 The resolutions that are passed as a result of Governors' votes are currently published by the IMF, with a two year delay, in the 'Summary Proceeding of the Annual Meeting of the Board of Governors'.

RESOLUTION	VOTING RESULT	EFFECTIVE DATE	UK POSITION
Membership of East Timor	Passed	30 May 2002	Approve
Direct Remuneration of Executive Directors and their Alternates	Passed	7 August 2002	Oppose
Dates and Venues for forthcoming meetings	Passed	16 August 2002	Approve
Procedures for electing Executive Directors	Passed	20 August 2002	Approve
Closure of the Twelfth General Review of Quotas	Passed	30 January 2003	Approve

Explanation of Votes

1.3 In April 2002, East Timor applied for membership of the IMF to take effect after the country's independence on 20 May 2002. The Executive Board discussed the application, which was subsequently put to Governors. The UK supported it.

1.4 The UK has generally taken a tough stance on the remuneration of IMF Executive Directors. The government believes that their remuneration should reflect their primary role as appointed public officials and representatives, rather than being driven by comparability with the private sector.

1.5 Due to security concerns raised by the US – as hosts of the 2002 Annual Meetings – it was agreed to rearrange the dates and timings of the meetings. The UK supported this proposal.

I.6 The procedures for electing and changing the number of Executive Directors are set out in the IMF's Articles of Agreement. Executive Directors are normally elected at the Annual Meetings. However, given the recent problems with the timing of these Meetings, a resolution was put to Governors suggesting that election take place by mail. It also recommended that the next such discussion take place in 2004. The UK supported the resolution on both counts.

I.7 The vote on closure of the Twelfth General Review of Quotas is explained in Chapter 5.

I.8 In addition to these votes by the Governors, there was also a vote on Chile's application to join the New Arrangements to Borrow (NAB), (see section 5.20). In the vote by the 25 participants of the NAB, the UK supported Chile's application.

DECISIONS BY EXECUTIVE DIRECTORS

I.9 Normally, decisions by Executive Directors are taken on the basis of consensus, without recourse to formal voting by the whole Board. This report sets out the key policy, surveillance and programme discussions held by the Board in 2002.

I.10 This annex sets out further details of the key features that the UK expects the IMF to cover in individual surveillance, programme and budget/administrative discussions. These key features have helped the UK to ensure consistency in its approach to individual Board discussions.

Surveillance

I.11 In UK interventions during individual countries' Article IV discussions, the UK emphasises the importance of vulnerability indicators and early warning systems. There are several elements to this:

- Fiscal Policy Frameworks – the Article IV should demonstrate sustainability, with sufficient flexibility to respond to temporary shocks. Specifically, interventions on this point focus on the sustainability of deficit financing, in domestic debt and external debt terms, with an eye on domestic resource mobilisation and aid dependency. Linked to this is an appropriate balance between fiscal and monetary measures for maintaining stability given real interest rates, the tax base and expenditure pressures;
- Vulnerabilities – the Article IV should identify vulnerabilities in the financial sector. We would consider whether the country has undertaken a ROSC, or an FSAP, and if not, whether it would be a suitable candidate;
- Exchange Rate Regime – the Article IV must be sufficiently tough on unsustainable exchange rate regimes.

I.12 In addition, UK interventions also assess factors relating to economic governance, transparency and accountability, resource allocation; the quality of statistics and for many programme countries, the consistency of the conditionality agreed in the Fund programme. In the particular case of HIPC countries, UK interventions would also be based on an assessment of public expenditure management systems, the extent to which pro-poor resource allocation is demonstrated and the availability of data and statistics. In developed country surveillance discussions, we also support IMF work on monitoring trade policies and progress towards the 0.7 per cent ODA/GNI ratio.

I.13 There are also a number of other factors which influence UK interventions at the Board on all Article IV's, including whether the country has been identified by the Financial Action Task Force as a non-cooperative jurisdiction on money laundering, by the Financial Stability Forum as a poorly regulated offshore financial centre, or by the OECD for its harmful tax regime.

EXECUTIVE BOARD SURVEILLANCE DISCUSSIONS

During 2002, the Executive Board held Article IV discussions on the following countries:

Angola; Antigua and Barbuda; Armenia, Republic of*; Australia*; Azerbaijan*; Bahrain; Bangladesh*; Belarus*; Belgium*; Benin*; Bosnia and Herzegovina*; Botswana*; Burundi*; Brazil; Brunei Darussalam; Burkina Faso*; Burma; Cambodia*; Cameroon*; Canada*; Cape Verde*; Chad*; Chile*; China; Comoros*; Congo, Republic of; Croatia*; Czech Republic*; Egypt; El Salvador; Estonia*; France*; Gabon*; Gambia; Germany*; Greece*; Guatemala; Guinea; Guinea-Bissau*; Guyana; Haiti*; Hungary*; Iceland*; India; Indonesia; Iran*; Ireland*; Italy*; Japan*; Jordan; Kazakhstan*; Kenya*; Korea; Kuwait*; Latvia*; Lesotho*; Liberia*; Lithuania*; Macedonia, FYR*; Malawi*; Marshall Islands, Republic of the; Mauritius*; Mexico*; Moldova*; Mongolia*; Mozambique*; Namibia; Nepal*; New Zealand*; Nicaragua; Niger*; Nigeria*; Norway*; Oman; Palau*; Panama; Peru; Philippines; Portugal*; Qatar; Russian Federation*; Rwanda*; St Vincent and the Grenadines*; São Tomé and Príncipe*; Saudi Arabia; Seychelles; Sierra Leone; Singapore; Slovenia*; South Africa*; Spain*; Sri Lanka*; Swaziland; Switzerland*; Tajikistan*; Thailand; Togo; Turkey; Ukraine; United Kingdom*; Uzbekistan; Vanuatu*; Venezuela; Yemen; Yugoslavia, Federal Republic of*; Zambia.

The Board also conducted a number of multilateral surveillance discussions, including World Economic Outlooks, Global Financial Stability Reports, and other regional discussions, including Euro-Area Monetary and Exchange Rate policies.

In these discussions, the UK's interventions were based on the themes and principles set out in the paragraphs above. The Article IV Reports for all those consultations marked with an asterisk* are available at www.imf.org.

Regular Lending Programmes

I.14 In the discussions on regular lending programmes (Stand-By Arrangements and Extended Fund Facilities), the UK assesses programme design on a case-by-case basis, against factors related to the need to promote not only macroeconomic stability, but also sustainable economic growth and poverty reduction. For example, the UK seeks to ensure that assessments of monetary and fiscal policy and financial sectors within the programme are sound, that the programme is sustainable and that there are clear and appropriate assumptions regarding private sector involvement in the programme country. Further information on the UK approach to these issues is highlighted throughout this report.

Discussions of PRGF Programmes

I.15 In the specific cases involving IMF lending to poor countries under the PRGF, the government prepares a view of country progress, based partly on in-country analysis by development experts from the Department for International Development. The government is also monitoring progress on the "Key Features" that IMF programmes are expected to meet in pro-poor countries (see chapter 4), for example through reporting on pro-poor budgets or Poverty and Social Impact Assessments (PSIA).

I.16 PRGF arrangements are typically three years in length, with programmes agreed annually and biannual reviews of progress. As of December 2002, 38 countries had PRGF arrangements of which 24 were in Africa. During discussions of PRGF countries, the UK interventions have focused on questions related to programme design, including:

- does the programme adequately reflect the needs of the country, are required reforms well sequenced and realistic and does the programme support the country-led PRSP?
- performance – have targets been met, if not are waivers justified, and is commitment to ongoing reform and poverty reduction sufficient? and
- generic PRGF issues – how does the PRGF measure up against its objectives? In particular, we have encouraged increasing PSIAs of programme elements, and a focus on improving public expenditure management and fiscal flexibility in the programme.

Budget and Administrative Issues

I.17 There have also been a number of discussions covering the IMF's operational budget and various administrative and management issues, including committees on the budget framework, pension plan and the 2002 Staff Compensation Review.

I.18 In discussions on staff compensation and benefits, the UK takes a rigorous approach, stressing the public service nature of the IMF and the need to consider the financial and budgetary constraints within which member governments are required to operate. In March 2002, the UK voted against an initial proposal for increases to staff compensation. Fund staff subsequently reduced their proposal, and the UK abstained in order to secure this lower increase. In December 2002, the government also abstained in a recommendation by the Pension Committee that staff who were previously recruited on a contract basis, be allowed to apply for full pension credits.

I.19 In discussions on the IMF's general administrative budget, we have consistently supported the efficient use of resources, stressing the need to prioritise activities when faced with new demands. The UK has tended to be sceptical of generalised proposals for increases in resources, but has accepted proposals where needs are more pressing, for example, in financing the African Regional Technical Assistance Centres (AFRITACS, see Chapter 4). Reflecting this, in April 2002 the UK approved the IMF's overall administrative budget, while registering an abstention on the capital budget.

AII IMF DECISION MAKING – UK POSITIONS

II.1 There is no annual subscription for IMF membership. Rather, there are two elements that define the UK's financial relationship with the IMF (which have implications for the composition of UK reserves):

- our quota; and
- our historic SDR allocation from the IMF.

QUOTAS

II.2 The IMF is primarily financed through members' quotas. Each member of the IMF is assigned a quota, which is expressed in Special Drawing Rights (SDRs), the IMF's unit of account. The UK's quota is currently SDR 10,785.5 million (just over £9 billion).

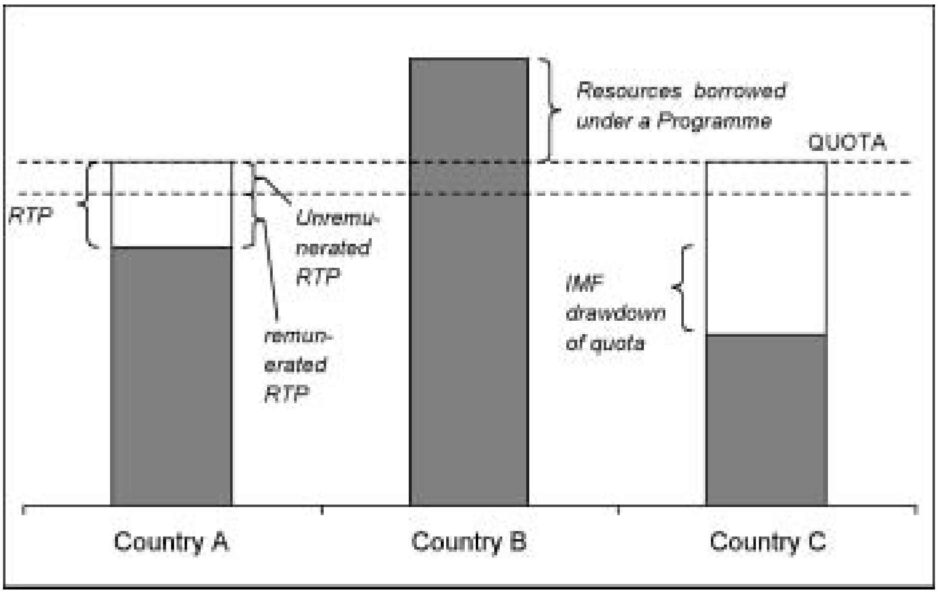
II.3 All members must pay at least 25 per cent of their quota in 'reserve assets' (SDRs or specified, usable currencies such as the dollar, yen, euro or pound). The balance is payable in the member's own currency.

II.4 When the IMF lends to a country, it provides them with reserve assets. So in the first instance, the borrowing country can call back its 25 per cent subscription from the IMF. However, it can also request additional resources. The IMF finances these additional amounts by using the reserve asset subscriptions of other members and/or by calling on financially strong countries to provide reserve assets over and above the required 25 per cent of quota.

II.5 This results in a range of situations. At one end, some borrowing countries have called back their reserve assets from the IMF and requested additional resources. At the other, some creditor countries have provided more than 25 per cent of their quota in reserve assets (see chart II.1).

II.6 The proportion of quota paid in reserve assets is called the Reserve Tranche Position (RTP). This consists of the proportion of our quota originally paid in reserve assets, plus the part of our quota that the IMF has drawn upon. So as the IMF draws on the UK quota, our RTP rises – to a maximum of 100 per cent of quota. As of March 2002, the UK RTP was $4,889 million (approximately 35 per cent of quota). This is financed from the National Loans Fund which is audited by the National Audit Office. The accounts are laid before Parliament.

CHART II.1 Illustration of Financial Positions in the IMF



Country A – Member has paid its quota subscription in full and not drawn on its reserve tranche. Some of this reserve tranche is remunerated at the SDR rate and the remainder is unremunerated.

Country B – The member is using IMF resources, in addition to having drawn its reserve tranche. The level of holdings in excess of the member's quota is subject to charges.

Country C – The IMF has made use of the member's currency and pays the member remuneration on its enlarged Reserve Tranche Position.

The Opportunity Cost of the RTP

II.7 In the event of a balance of payments need, a member country can call back its reserve assets from the IMF. Therefore, the UK's RTP forms part of it's reserves and as such, increases in its size are not regarded as increases in public expenditure. However, there is an opportunity cost to membership

II.8 The IMF remunerates most of our RTP at the SDR interest rate[19]. The remainder of the RTP, approximately one-fifth, is unremunerated. This is because part of the UK's quota was made available to the IMF prior to the 1970's, before the IMF instituted the policy of remunerating members' RTPs. We therefore receive no interest on this portion. In FY 2001-02, the unremunerated portion of the UK's reserve tranche cost £21.87 million[20].

[19] as at 27 January 2002 this was 1.88 per cent
[20] assuming the unremunerated RTP was replaced by 'conventional reserves'

SDR ALLOCATION

II.9 In addition to our quota, in 1969 the UK was also given a one-off SDR allocation of SDR 1.9 billion from the IMF (see Chapter 5). We pay the IMF interest on this allocation at the SDR rate. At the same time, the Fund remunerates any SDR holdings at the SDR rate. Therefore, if we held our full allocation in SDRs, the interest paid on this allocation would cancel out the interest received, resulting in a net interest cost of zero.

II.10 However, members have the option to sell part of their SDR allocation and hold alternative reserve assets. During FY-2001/02, we chose not to retain all of the SDRs we had been allocated. The UK tended to sell SDRs and invest the proceeds in dollar, euro and yen assets for portfolio management reasons[21]. In FY 2001/02, we held on average the sterling equivalent of approximately 0.2 billion in SDRs and 1.4 billion in foreign currency. As a result we paid interest to the IMF on our full allocation of £1.6 billion and received interest from the IMF on our holdings of £0.2 billion. We also received interest on our £1.4 billion in foreign exchange holdings at the foreign exchange interest rate. If this interest rate is higher than the SDR rate we make a net gain on the allocation, and in FY 2001/02, this was the case - the UK made a net gain on its SDR allocation equivalent to £7 million.

NET FINANCIAL COST OF MEMBERSHIP

II.11 The net financial cost to the UK of membership to the IMF is therefore driven by movements in the sterling, SDR and foreign exchange interest rates and to a greater extent by currency fluctuations (dollar, euro, yen and SDR versus pound).

II.12 In FY 2001-02, UK membership of the IMF had a net cost of approximately £7.3 million. For that period, the portfolio of reserves associated with IMF membership cost the UK £65.9 million. However, had we not been a member of the IMF and instead held a portfolio of conventional reserves, the net cost would have been £58.6 million[22]. Being a member of the IMF therefore resulted in a net cost to the UK of £7 million.

II.13 In FY 2000-01 the net cost of membership was £65.6 million, using a similar methodology. The difference is primarily due to a lower return on the 'conventional reserves' portfolio, relative to the sterling cost of funding, in 2001-02 than in the previous year. This is because interest rates fell more slowly in the UK than in other major economies during 2001-02, particularly the United States.

[21] conventional reserves, such as the dollar, euro and yen are more liquid than SDRs and can potentially earn a higher rate of return
[22] assumes conventional reserves comprise a 40:40:20 split between the dollar, euro and yen

AIII IMF LENDING FACILITIES

Regular Lending Facilities

III.1 Stand-By Arrangements (SBA). SBAs form the core of the IMF's lending policies and are designed to deal mainly with short-term balance of payments problems, of a largely cyclical nature. Under an SBA, the member carries out a programme, which it has designed in consultation with the IMF, focusing on key macroeconomic policy measures. To receive financing the member must meet performance criteria marking its successful implementation of the programme. The access limit is 100 per cent of quota annually, and 300% cumulatively, although the Fund may grant access beyond these limits in exceptional circumstances. The country is expected to repay the money it has borrowed over two to four years (with a period of three to five years for obligatory repayment).

III.2 Extended Fund Facility (EFF). Longer-term assistance to address balance of payments problems that stem largely from structural problems and take longer to correct, is provided under an EFF. A member requesting an EFF outlines its goals and policies for the period of the arrangement, usually three years but can be extended to a fourth, and provides a detailed, annual statement of the policies and measures it will implement over the next 12 months. The expected repayment period is four to seven years (with a period of four to ten years for obligatory repayment).

Special Lending Facilities

III.3 Supplemental Reserve Facility (SRF). The SRF was established in December 1997 in response to the unprecedented demand for IMF assistance resulting from the Asian Crisis. It is intended to provide additional short-term financing to member countries experiencing exceptional balance of payments difficulty because of a sudden and disruptive loss of market confidence, reflected in capital outflows. Financing under the SRF is disbursed over one year, in the form of additional resources under a Stand-By or an Extended Arrangement. The expected repayment period is 12-18 months. The Board can extend this by one year, but an interest surcharge is levied to encourage early repayment.

III.4 Contingent Credit Line (CCL). Where countries operate transparent and effective policies, the CCL provides a precautionary line of credit designed to help them strengthen their financial position and guard against contagion. Approval of financing under the CCL would signal the IMF's confidence in a country's economic policies and provide further incentives for the adoption of strong policies and adherence to internationally recognised standards. This is the only facility that operates on the principle of pre-qualification. The surcharge on the use of credit under the CCL is at all times 150 basis points lower than the surcharge that would be applicable under the SRF.

III.5 Further information on CCL is set out in Chapter 3 of this report.

Concessional Lending Facility

III.6 Poverty Reduction and Growth Facility (PRGF). The PRGF is a low-interest facility to help the poorest member countries facing protracted balance of payments problems. A Poverty Reduction Strategy Paper produced by the borrowing country in cooperation with the IMF and the World Bank, describes the authorities' goals, macroeconomic and structural policies for the three year programme. This provides the framework for Bank and Fund concessional lending.

III.7 Further information on the continued development of the PRGF is set out in Chapter 4 of this report.

AIV COMMUNIQUÉ OF THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE OF THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND – 20 APRIL 2002

IV.1 The International Monetary and Financial Committee held its fifth meeting in Washington, D.C. on April 20 2002, under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom. The Committee welcomes the international community's decisive policy actions, especially following the tragic events of September 11, 2001, to maintain financial stability, restore the momentum of world economic growth, and reinvigorate the fight against poverty. We will also sustain our global action to combat money laundering and the financing of terrorism. Our meeting in Ottawa last November emphasised the importance of a collaborative approach for the IMF and its members. Going forward, we will continue to work together for sustained, broad-based growth, creating opportunities for productive employment, reducing vulnerabilities, opening up our economies for trade, and providing resources for durable poverty reduction.

The Global Economy

IV.2 Since the Committee's last meeting, the prospects for the world economy have improved markedly. The challenge now is for governments to help foster the global recovery that is underway. This will require continued vigilance and a further strengthening of medium-term policy frameworks—both to improve prospects for sustainable growth and stability, and to reduce vulnerabilities. The Committee notes the uncertainties associated with the international security issues around the world. The Committee notes also the deteriorating situation in the Middle East. The Committee underscores the importance of stability in oil markets at prices reasonable for consumers and producers.

IV.3 The advanced economies have a responsibility to promote a strong and sustained world economic recovery. While keeping inflation under control, monetary policies should remain broadly supportive of growth. In countries where the recovery is more advanced, consideration may need to be given in the months ahead to reversing earlier policy easing. Reforms should be pursued vigorously, with the aim of improving economic flexibility and resilience, contributing to high and sustainable world growth, and supporting the orderly reduction of persistent imbalances in the global economy. This process will be helped, in Japan, by decisive action to reform the banking and corporate sectors, along with monetary easing to help end deflation; in Europe, by continued progress with wide-ranging reforms to enhance its growth potential; and in the United States, by focusing on the efforts needed over the medium term to preserve fiscal balance.

IV.4 The recovery in industrial countries will contribute to supporting activity in emerging market and developing countries. The Committee is encouraged that many emerging market economies have become more resilient by the adoption of sound economic policies—including more sustainable exchange rate regimes. It will nevertheless remain crucial to further strengthen fiscal positions, and to press ahead with corporate, financial, and institutional reforms to support the emerging recovery and attract foreign direct investment. Improved differentiation and risk assessments by markets have served to limit so far the contagion effects of the Argentine crisis. The Committee acknowledges the steps being taken by Argentina to address its difficult economic situation, and urges the authorities, in cooperation with the Fund, to move quickly to reach agreement on a sustainable economic program that could receive the support of the international financial institutions and provide the basis for the reestablishment of stability and growth.

IV.5 The Committee strongly welcomes the commitment by the international community, at the UN Conference in Monterrey, to improve living standards and reduce poverty through sound policies and higher and more effective aid. It fully supports the New Partnership for Africa's Development and its call for strong domestic ownership, sound policies, strengthened institutions, and improved governance. The Committee welcomes recent announcements of increased and more effective aid, and urges further progress. The Monterrey Consensus will constitute an important input to the World Summit on Sustainable Development in Johannesburg. The Committee also welcomes the new initiative to enhance growth and reduce poverty in low-income CIS countries.

IV.6 The Committee stresses the vital importance of more open trade for a durable economic recovery, and for sustained, broad-based growth in the developing countries in particular. It urges all countries to resist protectionist pressures and to continue to lower trade barriers, concluding the Doha trade round successfully and in a timely manner. Enlarging market access for developing countries and phasing out trade distorting subsidies will benefit both developed and developing countries. The Committee welcomes the commitment, reiterated at Monterrey, to work toward the objective of duty- and quota-free market access to the exports of least-developed countries. It also notes the potential for increased opportunities from lowering trade barriers among developing countries.

Strengthening Crisis Prevention and Resolution

IV.7 Surveillance remains central to the Fund's mandate to promote sound economic growth and financial stability, and to help prevent crises. The Committee is encouraged by the substantial progress in recent years to adapt and broaden the coverage of surveillance in response to a changing global environment, while focusing on issues central to economic and financial stability.

IV.8 The Committee calls on the Fund to spare no effort in enhancing the high quality of its policy advice, and on members to implement this advice. Surveillance will be further enhanced by:

- strengthened assessments of vulnerabilities, with particular attention to debt sustainability and the private sector's balance sheet exposure;
- focusing on the global impact of the policies, including trade policies, of the largest economies;
- more candid and comprehensive assessments of exchange arrangements and exchange rates;
- expansion of substantive financial sector surveillance to the entire membership, including to offshore financial centres;
- strengthened coverage of relevant structural and institutional issues;
- on issues outside the Fund's core expertise, more effective use of the expertise of appropriate outside institutions, in particular the World Bank;
- further integration of multilateral, regional, and country surveillance; and
- deeper coverage of international capital markets.

The Committee notes that the process of surveillance should cover effective and timely reassessments of economic conditions and policies. In program countries, this may require a fresh perspective and appropriate distance from day-to-day program implementation issues.

IV.9 The Committee encourages the Fund to press ahead with the range of recent initiatives designed to enhance the effectiveness of surveillance and crisis prevention. These include the Financial Sector Assessment Program (FSAP) and policies on transparency, including encouraging publication of Article IV and other Fund reports. Further work on standards and codes is a crucial item in the forward agenda to strengthen their relevance and contribution to Fund surveillance, and to ensure that countries have adequate access to technical assistance. The Committee encourages eligible countries to consider applying for the Contingent Credit Line (CCL), and looks forward to a review.

IV.10 The Committee endorses the Fund's work program to strengthen the existing Prague framework for crisis resolution, in particular to provide members and markets with greater clarity and predictability about the decisions the Fund will take in a crisis. This will involve:

- improving debt sustainability assessments;
- clarifying the policy on access to Fund resources for members facing financial crises—with access beyond normal limits requiring more substantial justification, and recognising that some of these members' quotas do not adequately reflect their potential financing needs;
- strengthening the tools for securing private sector involvement; and
- examining a more orderly and transparent framework for addressing the exceptional cases in which a sovereign needs to restructure an unsustainable debt, as well as clarifying the conditions under which the Fund would be prepared to lend into arrears.

The Committee welcomes the consideration of innovative proposals to improve the process of sovereign debt restructuring to help close a gap in the current framework. It encourages the Fund to continue to examine the legal, institutional, and procedural aspects of two approaches, which could be complementary and self-reinforcing: a statutory approach, which would enable a sovereign debtor and a super-majority of its creditors to reach an agreement binding all creditors; and an approach, based on contract, which would incorporate comprehensive restructuring clauses in debt instruments. The Committee looks forward to reviewing progress in this area at its next meeting.

The Fund's Role in Low-Income Countries

IV.11 The Committee fully endorses the Monterrey Consensus, which has reaffirmed that sound economic policies and institutions, together with strong, broad-ranging international support, are the twin pillars on which to build enduring poverty reduction. It encourages the Fund to work closely with the UN, the World Bank, the regional development banks, and bilateral donors in developing a comprehensive and transparent system to monitor progress toward the Millennium Development Goals.

IV.12 The Committee welcomes the outcome of the recent reviews of the Fund's Poverty Reduction and Growth Facility (PRGF) and of the Poverty Reduction Strategy Paper (PRSP) approach. The PRSP process should continue to be nurtured as the suitable framework for fostering the efforts of low-income countries and their international partners to achieve poverty reduction and higher growth. The substantial progress under PRGF-supported programs in implementing the PRSP approach will be further enhanced by better identifying the sources of sustained growth, strengthening public expenditure management, and using poverty and social impact analysis more systematically. The Committee encourages the Fund and the Bank to continue their collaboration on each of these issues and looks forward to reviewing progress at its next meeting. Capacity building will remain a potent vehicle for ensuring ownership and enhancing the implementation of effective poverty reduction strategies, and the Committee looks forward to the review of technical assistance leading to its increased effectiveness. The Committee welcomes, in particular, the African Regional Technical Assistance Centres (AFRITACs), whose establishment will support the New Partnership for Africa's Development, and looks forward to the timely financing of this initiative.

IV.13 The recovery of low-income countries that have been affected by the recent economic slowdown and commodity price shocks will continue to require particular attention. The Committee supports the Fund's continued readiness to respond flexibly and proactively to the financing needs of low-income countries, including by augmenting PRGF financing where necessary. It recognises that there may be a need to consider mobilising new PRGF resources if the high demand for PRGF financing continues. While the Committee is encouraged by the progress with the implementation of the HIPC Initiative, it notes that, in a number of cases, debt sustainability remains an issue and calls on the IMF and World Bank to review the situation. It urges eligible countries to step up their reform efforts to reach their decision and completion points, noting, in this context, the flexibility embedded in the HIPC Initiative framework to accommodate the special circumstances of countries emerging from conflict. The Committee notes the application within the current guidelines of the topping up feature designed to help countries cope with exceptional exogenous shocks. It calls for further efforts to enhance debt management in HIPCs and continued close monitoring of their debt sustainability as they move toward, and beyond, their completion points.

Streamlining Conditionality and Enhancing Ownership

IV.14 The Committee welcomes the initial progress made toward enhancing the effectiveness of Fund-supported programs through streamlined and focused conditionality and strong national ownership of economic reforms. It urges further progress, in cooperation with the Bank, and looks forward to a report on these issues, including on the Fund's consideration of new conditionality guidelines, at its next meeting.

Combating Money Laundering and the Financing of Terrorism

IV.15 The Committee underscores that international efforts to counter abuse of the international financial system to finance terrorism and launder the proceeds of illegal activities remain a priority. It is encouraged by the response by many countries to its call last November for all countries to ratify and implement fully the UN instruments to counter terrorism financing, to freeze terrorist assets, and to establish financial intelligence units and ensure the sharing of information. The Committee urges countries that have not as yet done so to fully implement and comply with these instruments. It also welcomes the substantial progress made by the Fund, in close collaboration with the World Bank, in implementing all elements of its action plan to intensify the work on anti-money laundering and combating the financing of terrorism (AML/CFT). The Committee notes in particular the good start made in assessing gaps in national AML/CFT regimes, and fully supports the provision of technical assistance to help countries identify and address such gaps.

IV.16 While reiterating the responsibility of national authorities for combating money laundering and the financing of terrorism, the Committee stresses that success will critically depend on continued vigilance and timely action at the global level. It calls on the Fund to make further progress on all elements of its work program, consistent with its mandate and expertise. In particular, efforts should now be focused on completing the comprehensive AML/CFT methodology, based on a global standard covering the Financial Action Task Force (FATF) recommendations, and the development of assessment procedures compatible with the uniform, voluntary, and cooperative nature of the ROSC process. Enhancing the delivery of technical assistance on AML/CFT will also be crucial. The Committee urges the Fund, in cooperating with other international organisations and donor countries, to identify and respond to needs for technical assistance. It looks forward to receiving a full report on progress in this area at its next meeting. The Committee calls on members to share information on their own actions in this field.

Other Issues

IV.17 The Committee notes that the Twelfth General Review of IMF Quotas has commenced. Quotas should reflect developments in the international economy. The Committee recommends an early implementation of the Fourth Amendment.

IV.18 The Committee welcomes the progress report on the Independent Evaluation Office, and looks forward to receiving regular updates on its activities.

Next Meeting

IV.19 The next meeting of the IMFC will be held in Washington, D.C. on September 28, 2002.

AV COMMUNIQUÉ OF THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE OF THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND – 28 SEPTEMBER 2002

V.1 The International Monetary and Financial Committee held its sixth meeting in Washington, D.C. on September 28, 2002, under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

The Global Economy and Financial Markets

V.2 The Committee observes that the global economic recovery is proceeding, although at a slower pace than expected earlier this year. Growth is expected to strengthen in the near term, supported by a strong policy response across the international community. However, there remain downside risks and uncertainties, as well as medium-term challenges associated with persistent imbalances, underscoring the need for vigilance. IMF members should continue to be ready to adapt policies as necessary in order to foster broad and sustained growth, to strengthen policy and regulatory frameworks, and to support durable poverty reduction. The Committee underscores the importance of stability in oil markets at prices reasonable for consumers and producers.

V.3 In the advanced economies, growth generally is expected to strengthen. However, monetary policy-makers should remain ready to respond to developments where necessary and to ease policy further if the risk of economic weakness intensifies and inflation prospects remain subdued. In Japan, monetary easing should help end deflation. In many countries, there is scope for automatic stabilizers to operate, but fiscal policy needs to be attentive to the medium term challenge of consolidation in order to ensure sustainable debt levels, improve the scope to respond flexibly to future economic shocks, and help address challenges such as those associated with population aging.

Structural reforms should also be pursued vigorously to further improve growth prospects and strengthen resilience:

- In the United States, the actions underway to strengthen corporate governance, accounting, and auditing are important to underpin confidence;
- In Europe, further reforms, particularly in labour and product markets, are needed;
- In Japan, banking and corporate restructuring should be vigorously pursued, in particular addressing the issue of non-performing loans.

V.4 Performance in emerging markets has been mixed, reflecting both global developments and domestic circumstances. While growth in Asia has picked up strongly, several economies in Latin America in particular are facing a deterioration in conditions due to external developments, country-specific vulnerabilities and policy uncertainties. In countries that have room for manoeuvre, the policy stance should generally remain accommodative, but countries facing external financing difficulties will need to continue to give priority to restoring market confidence. The Committee welcomes Brazil's commitment to sound policies. It acknowledges the positive steps taken in recent months by Argentina to address its difficult economic situation, and urges the authorities, in cooperation with the Fund, to move quickly to reach agreement on a sustainable economic program that could receive the support of the international financial institutions and provide the basis for the reestablishment of stability and growtH.

V.5 Many of the developing countries have also been affected by global developments and adverse movements in commodity prices, as well as domestic circumstances. The Committee reiterates the need for sustained international efforts to fight poverty. The Global Development Compact embodied in the Monterrey Consensus and the Doha Development Agenda based on mutual accountability, country ownership, sound domestic policies and institutions, good governance, increased and more effective international support and commitment to an open multilateral trading system was reaffirmed at the World Summit in Johannesburg. The Committee looks forward to the effective implementation, with international assistance, of the New Partnership for Africa's Development (NEPAD) to strengthen institutional foundations, governance, and infrastructure. Stressing the critical importance of technical assistance to support this effort, the Committee looks forward to the important contribution that the AFRITACs will play. It also calls for urgent international assistance to address the human and economic toll exacted by the drought in southern Africa. It also stresses the positive role of the CIS-7 initiative in improving prospects for enhanced growth and reduced poverty.

V.6 The Committee underscores the vital importance for global growth and effective development of achieving substantial trade liberalisation in the Doha round of multilateral trade negotiations, which will benefit both developed and developing countries. Urgent progress is essential in enlarging market access for developing countries and phasing out trade distorting subsidies in developed countries. Developing countries should also further liberalise their trade regimes to maximise growth and development opportunities. Trade-related technical assistance is also important to support developing countries' capacity building.

Strengthening Crisis Prevention and Resolution

V.7 The Committee welcomes the Managing Director's report on the IMF in a Process of Change, which sets out the reforms underway to make the Fund more effective in promoting greater financial stability and stronger global growth, the progress which is being made, and the agenda for the period ahead.

V.8 The Committee supports the steps taken by the Fund to improve the quality and effectiveness of its policy advice, and to help countries strengthen policy frameworks and prevent crises. These are the key priorities for surveillance. In particular, the Committee:

- stresses that rigorous vulnerability assessments will be key to the Fund's crisis prevention efforts, and, in this regard, welcomes the progress in improving the framework for assessing debt sustainability and looks forward to its application to all members;
- welcomes in this context the increased focus on the interactions between external shocks and domestic vulnerabilities, the strengthened focus on global capital markets in the Fund's multilateral surveillance, and the recent steps to further improve data provision by members to the Fund;
- Emphasises the importance of surveillance of systemically-important countries and their impact on the global economy;
- supports the Fund's ongoing work to ensure that surveillance in program countries reassesses economic developments and strategy from a fresh perspective; and
- underlines the need for high quality and persuasive surveillance of all member countries to help them act promptly to minimise emerging vulnerabilities and avoid policies that might have negative regional or global effects.

The Committee will review, at its next meeting, ways of further enhancing the effectiveness of Fund surveillance. It looks forward to further progress in the voluntary publication of country staff reports, building on the positive role that improved transparency and data dissemination by the Fund and its membership are playing in informing the public and supporting financial market assessments.

V.9 The Committee notes the substantial progress on the Financial Sector Assessment Program and the standards and codes initiative, including their increasing integration into Fund surveillance. It looks forward to the forthcoming reviews of these initiatives, and calls on the Fund to consider ways to build on this progress, together with the World Bank and relevant standard-setting bodies, to address gaps, strengthen technical assistance, and promote broader participation. The Committee notes the importance of enhanced standards and principles on corporate governance, accounting and auditing, and of stronger national practice. It also underscores the role that precautionary access to Fund financing can play in safeguarding sound policy frameworks in the face of uncertainty in international capital markets. The Committee looks forward to the forthcoming review of the Contingent Credit Lines.

V.10 The Committee endorses the Fund's continuing work on private sector involvement and a stronger framework for crisis resolution to provide members and markets with greater clarity and predictability, including about the decisions the Fund will take in crisis management. In particular, the Committee welcomes the work underway to strengthen the policy on exceptional access to Fund resources. This involves more clearly defined criteria to justify exceptional access, and strengthened procedures for early consultation and decision-making. The priority now is to finalise and implement the new framework, and the Committee calls for a progress report by the Spring meetings.

V.11 The Committee strongly welcomes the progress made with the contractual and statutory approaches to restructuring unsustainable sovereign debts. It welcomes the ongoing dialogue on collective action clauses in the G-10 and other fora with private creditors and emerging market sovereign issuers. Going forward, the Committee encourages the official community, the private sector, and sovereign debt issuers to continue working together to develop collective action clauses, and to promote their early inclusion in international sovereign bond issues; in that regard, it welcomes the recent decision by many countries to include collective action clauses. The Committee also calls on the Fund to consider the issues further and to develop, for consideration at its next meeting, a concrete proposal for a statutory sovereign debt restructuring mechanism to be considered by the membership.

The Fund's Role in Low-Income Countries

V.12 The Committee supports the Fund's continuing role in helping poor countries address the challenge of meeting the Millennium Development Goals by supporting economic reforms aimed at accelerating growth and reducing poverty. It welcomes the increased momentum in countries' efforts to develop and implement their PRSPs, and the Fund's and donors' efforts to align their support more closely with PRSPs. It recognises that there may be a need to consider mobilising new PRGF resources if high demand for PRGF financing continues. The Committee stresses the importance of: sound macroeconomic frameworks that can respond flexibly to changes in the external environment; identifying ways to encourage higher and sustainable growth; good governance; improving public expenditure and financial management systems; and using poverty and social impact analysis more systematically, and building country capacity in this area. The Committee encourages the Fund and Bank to continue their collaboration on these issues and looks forward to reviewing progress. Furthermore, it looks forward to considering the results of the Fund's work to better meet the diverse needs of its low-income members, including those stemming from disruptive exogenous shocks and emergence from conflict.

V.13 The Committee welcomes the progress made on the HIPC Initiative, allowing countries to benefit from lower debt servicing and higher social spending. It recognises that significant challenges remain to ensure that countries achieve a lasting exit from unsustainable debt. The Committee reaffirms the commitment to implement the initiative and finance it fully to help countries overcome the burden of unsustainable debt, and underscores that the HIPC Initiative has the flexibility to provide additional debt relief at the completion point to help countries that have suffered a fundamental change in their economic circumstances due to exceptional exogenous shocks. These elements, together with sustained commitment to sound economic policies—including efforts to improve resilience to external shocks, to manage debt prudently, and to reinforce good governance—and new financing on appropriately concessional terms, should provide a basis for long-term sustainability. The Committee notes that the financing shortfall in the HIPC Trust Fund could be up to $1 billion, and welcomes the recent pledges of support. It calls on other governments to make firm pledges and contributions as a matter of urgency. Furthermore, it urges all official and commercial creditors that have not yet done so to fully participate in the HIPC Initiative. The Committee acknowledges that the issues of HIPC-to-HIPC debt relief and creditor litigation raise serious issues that should be addressed.

Combating Money Laundering and the Financing of Terrorism

V.14 The Committee welcomes the actions taken by many countries to combat money laundering and the financing of terrorism, in response to the action plan agreed in Ottawa last year, and urges countries that have not fully responded to do so urgently. It also urges rapid progress on the exchange of information between authorities. The Committee commends the substantial progress made by the Fund, in close collaboration with the Bank, in advancing the action plan. It endorses the conditional addition of the Financial Action Task Force (FATF) recommendations to the list of standards and codes for which Reports on the Observance of Standards and Codes (ROSCs) are prepared, and looks forward to the final adoption of the methodology and an early start of the 12-month pilot program of assessments and accompanying ROSCs. The Committee encourages countries to make available additional experts and resources for the IMF/World Bank pilot program, welcomes the pledges made so far, and urges the IMF and World Bank to coordinate closely with the strong international and bilateral efforts to provide critically important technical assistance. The Committee looks forward to an interim report at its next meeting and a full report at the conclusion of the pilot program.

Other Issues

V.15 The Committee welcomes the adoption by the Fund's Executive Board of new guidelines on conditionality, thus bringing to a successful conclusion the review of conditionality initiated by the Managing Director two years ago. The consistent implementation of these guidelines will help enhance the effectiveness of Fund-supported programs by fostering national ownership and streamlining conditionality, focusing it on elements critical to the success of members' economic programs. The Committee stresses that strengthened collaboration with the World Bank is an integral part of these efforts to enable both institutions to provide complementary and effective support.

V.16 The Committee stresses the importance of the Fund having adequate resources to fulfil its financial responsibilities. Quotas should reflect developments in the international economy. The Committee notes that the Executive Board is continuing its consideration of the Twelfth General Review of Quotas and will present its report to the Board of Governors by January 2003. It recommends an early implementation of the Fourth Amendment.

V.17 The Committee welcomes the first report of the Independent Evaluation Office on "Prolonged Use of Fund Resources" to the Executive Board. It welcomes the establishment by Fund Management of an internal task force to propose steps to carry forward the report's recommendations, as appropriate.

V.18 The next meeting of the IMFC will be held in Washington, D.C. on April 12, 2003.

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