4 STRENGTHENING THE FUND FOR THE CHALLENGES AHEAD

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At the October 2009 Annual Meetings, the IMFC endorsed the following broad priorities for the IMF for the period ahead: (1) reassessing the institution's mandate to encompass the full range of macroeconomic and financial sector policies that bear on global stability; (2) continuing to strengthen its financing capacity, to help members cope with balance of payments problems, including financial volatility, and reduce the perceived need for excessive reserve accumulation; (3) sharpening multilateral surveillance and better integrating it into bilateral surveillance, and undertaking further strengthening of cross-country, regional, and multilateral surveillance; and (4) reforming Fund governance, to increase the institution's legitimacy and effectiveness.

REASSESSING THE IMF'S MANDATE

The Fund's work on its mandate responds to a call by the IMFC, at the October 2009 Annual Meetings, for the Fund to "review its mandate to cover the full range of macroeconomic and financial sector policies that bear on global stability, and to report back to the Committee by the time of the next Annual Meetings."[49] The mandate work covers three broad areas: surveillance, financing, and the stability of the international monetary system. Following its initial reflections on the mandate in FY2010, the Board undertook additional work in specific areas for completion of a report to be presented to the IMFC at the October 2010 Annual Meetings. The report was also informed by extensive outreach with country authorities, academics, and civil society.

Initial Executive Board discussion

The Executive Board's initial discussion on how to strengthen the Fund's mandate took place in February 2010.[50] Executive Directors underscored that progress in updating the Fund's mandate should move in parallel with broader governance reform, particularly on the size and realignment of quotas.

In the area of surveillance, most Executive Directors supported, or were open to, exploring a formal Board decision on multilateral surveillance, including modalities for discussing reports that focus on the broader systemic effects of individual country policies. Most also saw scope for further strengthening the Fund's bilateral surveillance, including through thematic Article IV consultations. In regard to financial sector issues, Executive Directors stressed the need for close collaboration with other international bodies and standard setters, as well as greater availability of financial data.

Executive Directors emphasized that any new initiatives in the area of financing require a thorough analysis of the underlying assumptions, need to be anchored in the Fund's core mandate, and must be grounded in a careful assessment of the Fund's recently reformed lending instruments, including those for concessional lending (see "Concessional Financing" later in this chapter). Most were interested in considering innovative means of strengthening the global financial safety net, including exploring the merits of multicountry credit lines and support to regional liquidity pools.

While considering that the Fund could achieve meaningful reforms of its mandate under the existing legal framework, most Executive Directors were open to amending the Articles of Agreement where it proves necessary. Some favored a two-stage approach, involving first reforms possible under the Articles, followed if needed by reforms requiring amendment of the Articles, and some cautioned against introducing new obligations that could infringe upon national sovereignty, noting risks of overstretching the Articles.

Subsequent work

A number of other mandate-related discussions in March and April 2010 followed up on this initial February Board meeting, considering various aspects of the mandate more specifically. Executive Directors took a preliminary look at the Fund's resources for providing financing to its members, in the context of the Fourteenth General Review of Quotas. They also considered a number of initial proposals in relation to the Fund's financing role. Ways to modernize IMF surveillance and strengthen financial sector surveillance as well were the topic of another mandate-related meeting. These discussions are covered in detail in subsequent sections of this chapter on Fund financing, surveillance, and governance, respectively.

Next steps

The Board's consideration of the Fund's mandate extended into the early months of FY2011, with an informal briefing on next steps in the Fund's future financing role, a discussion of further considerations on realigning quota shares, in the context of the Fourteenth General Review of Quotas, and a further discussion of governance reform.

FINANCING FOR THE TWENTY-FIRST CENTURY

In mid-April 2010, shortly after the Board's approval of the expansion of the NAB (see "Proposed Expansion of the New Arrangements to Borrow" later in this chapter), Executive Directors made an initial assessment of the adequacy and composition of Fund resources in the context both of the mandate and of the Fourteenth General Review of Quotas. They emphasized that the Fund is, and should remain, a quota-based institution, despite the large increase in available resources under the new NAB.

The Board's discussion noted that the size of Fund quotas relative to global GDP, trade, and capital flows had shrunk sharply since the last general quota increase in 1998. Most Executive Directors saw a strong case for a substantial increase in the Fund's quotas, to ensure adequate quota resources to meet members' needs in most circumstances.

Ensuring adequate resources for the IMF's work

In line with the IMFC's endorsement of objectives laid out by G-20 leaders in April 2009 (see "Financial Support to Foster Recovery" in Chapter 3), the IMF moved swiftly on several fronts to ensure that resources available to it would remain sufficient to meet those needs.

Bilateral borrowing frameworks and arrangements

Although the quota subscriptions of its member countries are its main source of resources for providing financing to its members[51]—and the Executive Board has emphasized that this is and should remain the case—the IMF can temporarily supplement its quota resources, if needed, through borrowing (see Box 4.1 on the role of borrowed and quota-based resources in Fund financing). Two standing multilateral borrowing agreements, the General Arrangements to Borrow and the New Arrangements to Borrow, have been in place for a number of years to assist the Fund with supplementary resources (see Web Box 4.1).

As the potential size of the demand for Fund financing arising from the global crisis became apparent, however, to ensure that it had adequate resources to meet members' needs even in extreme scenarios, the Fund entered into discussions with a number of member countries regarding potential bilateral borrowing agreements. These discussions focused attention on the operational issues involved in Fund borrowing, and in June 2009, the Executive Board discussed and agreed on an operational framework for the Fund's use of borrowed resources.[52] The framework has four key features: (1) an initial limit of SDR 15 billion per borrowing agreement on the encashability of claims under loan or note purchase agreements in case of balance of payments need; (2) a prudential balance ratio of 20 percent to be applied on the amounts made available under borrowing; (3) an initial one-to-one ratio of borrowed to quota resources to be used in disbursements; and (4) equitable burden sharing among lenders. The Board chose not to establish a limit on borrowing by the Fund but emphasized that if warranted, such a limit could be established at any time.

The first of the IMF's bilateral loan agreements following the outbreak of the crisis, with Japan, was signed and became effective during FY2009. Fifteen additional agreements, for a total amount equivalent to SDR 61 billion, became effective in FY2010. These 15 agreements were signed with Canada, Norges

Box 4.1

Role of borrowed and quota-based resources in IMF financing

Quota subscriptions are the basic source of the Fund's financing, although on a temporary basis borrowing by the Fund can provide an important supplement to its resources. Under the Articles of Agreement, the Fund is authorized to borrow to replenish its holdings of currencies in the General Resources Account that are needed in connection with its financing transactions (Article VII, Section 1(i)).

Though they currently have virtually identical costs, quota-based and borrowed resources have some other distinct advantages and disadvantages that reflect their different roles in Fund financing:

- The primary advantage of relying on quota resources lies in their compatibility with the quota-based nature of the Fund, their permanent availability, and the ease with which they can be drawn upon. Once the Fund has selected members with sufficiently strong external positions to participate in financing its operations, those members are obligated to meet these calls up to the limit of their quotas. The permanent availability of these resources ensures the Fund's ability to respond quickly to members' needs. A key disadvantage of quota resources is that they are fixed into the medium term. Securing the broad consensus required for an increase in quotas can take several years.
- The principal advantage of Fund borrowing stems from the flexibility it offers. Borrowing arrangements with a limited number of official lenders are easy to put in place relative to quota increases involving all members, and as such they provide a convenient temporary supplement to quota-based resources. Moreover, the Fund's standing multilateral borrowing arrangements provide an important source of supplementary resources to the Fund (see Web Box 4.1). However, an overreliance on borrowed resources has the potential of jeopardizing the cooperative and monetary character of the Fund. Also, unlike quota-based resources, resources under the standing arrangements become available only after the arrangements have been activated, whereas bilateral borrowing agreements may specify certain limits to amounts that can be drawn over shorter periods of time (e.g., initial one- to two-year terms, extendable by agreement to up to five-year terms, with weekly and/or monthly limits).

The "Guidelines for Borrowing by the Fund" established by the Executive Board outline some of the key elements of the Fund's framework for borrowing. Moreover, the operational modalities for the use of borrowed resources are subject to continuous review, including in the context of the Fund's quarterly Financial Transactions Plans and semiannual Liquidity Reviews.

Table 4.1

Bilateral loan and note purchase agreements in effect as of April 30, 2010 (in billions)

	Effective date	Currency and amount		U.S.-dollar equivalent[1]
Loan agreements				**200.3**
Japan	February 13, 2009	USD	100.00	100.0
Norges Bank	July 14, 2009	SDR	3.00	4.6
Canada	July 6, 2009	USD	10.00	10.0
EU of which:				85.7
United Kingdom	September 1, 2009	SDR	9.92	15.5
Deutsche Bundesbank	September 22, 2009	EUR	15.00	22.2
De Nederlandsche Bank NV	October 5, 2009	EUR	5.31	7.8
Danmarks Nationalbank	November 4, 2009	EUR	1.95	2.9
Banco do Portugal	November 30, 2009	EUR	1.06	1.6
France	December 2, 2009	EUR	11.06	16.7
National Bank of Belgium	February 12, 2010	EUR	4.74	6.4
Central Bank of Malta	February 12, 2010	EUR	0.12	0.2
Slovak Republic	February 12, 2010	EUR	0.44	0.6
Czech National Bank	March 31, 2010	EUR	1.03	1.4
Swedish Riksbank	April 9, 2010	EUR	2.47	3.3
Bank of Finland	April 26, 2010	EUR	1.30	1.7
Spain	April 26, 2010	EUR	4.14	5.5
Note purchase agreements				**69.9**
People's Bank of China	September 2, 2009	SDR	32.00	49.9
Brazil	January 22, 2010	USD	10.00	10.0
Reserve Bank of India	March 8, 2010	USD	10.00	10.0
Total loan and note purchase agreements				**270.3**

Source: IMF Finance Department.
1 Converted at prevailing exchange rate on the effective date of the agreement.

Bank, the United Kingdom, the Deutsche Bundesbank, De Nederlandsche Bank, Danmarks Nationalbank, France, Banco do Portugal, the National Bank of Belgium, the Central Bank of Malta, the Slovak Republic, the Czech National Bank, the Swedish Riksbank, the Bank of Finland, and Spain (see Table 4.1).

In addition to bilateral loans, the IMF can also issue notes to member countries and their central banks under note purchase agreements. In July 2009, the Executive Board approved a framework for the issuance of such notes.[53] Note purchase agreements were concluded in FY2010 with the People's Bank of China, Brazil, and the Reserve Bank of India (see Table 4.1).

As of the end of FY2010, total resources made available to the IMF under bilateral loan and note purchase agreements stood at about SDR 174 billion (US$270.3 billion), and work continued toward making additional supplementary resources available for use under bilateral agreements in FY2011 (see Table 4.1). Even with the record level of outstanding credit and undrawn commitments, the expanded borrowing capacity made available under the bilateral agreements has boosted the Fund's forward commitment capacity (FCC) to a record level of SDR 161.9 billion (US$239.4 billion), as of end-June 2010 (see Figure 4.1).

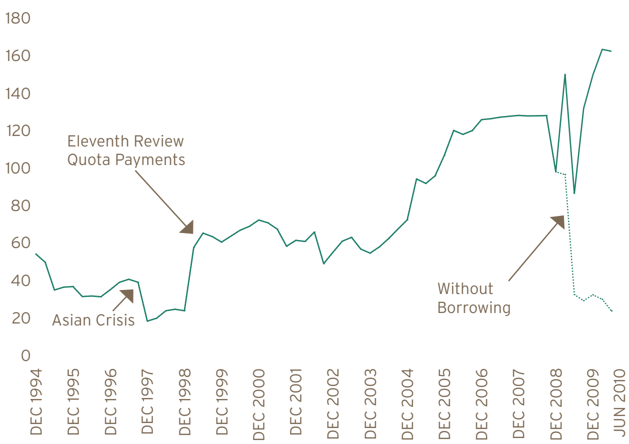
The Fund started drawing on the borrowed resources available to it under the various agreements in July 2009.[54] During FY2010, total borrowing by the Fund under bilateral loan and note purchase agreements amounted to SDR 6.4 billion.

Proposed expansion of the New Arrangements to Borrow

In November 2009, the 26 participants in the IMF's New Arrangements to Borrow, along with potential new participants, reached agreement on an expanded and more flexible NAB of up to US$600 billion.[55] Subsequently, in April 2010, the Executive Board adopted a formal decision that would expand the NAB to SDR 367.5 billion (about US$550 billion) and add 13 new participants, including a number of emerging market countries as significant contributors to the expansion.[56] To make the expanded NAB a more effective tool of crisis prevention and management, the current loan-by-loan activation would be replaced by the establishment of general activation periods of up to six months, subject to a maximum level of commitments specified in each activation proposal, to fund any GRA financing needs approved during the activation period. For the expanded NAB to become operational, current

Figure 4.1

One-year forward commitment capacity, December 1994–June 2010 (In billions of SDRs)



Source: IMF Finance Department.

NAB participants will need to consent to the proposed amendments to the NAB decision and increases in credit arrangements, and new participants will need to notify the Fund of their adherence to the NAB. For many current and future participants, this will involve domestic approval procedures, including legislative approval. According to the decision, by the time of the next NAB renewal decision (in late 2011), the Fund and the participants will review, among other factors, the impact of the Fourteenth General Review of Quotas on the overall size of quotas and consult on possible modifications.

Enhancing IMF financing

The acute volatility and fierce contagion in the global crisis focused attention on the need to enhance the IMF's role in preventing crises and dampening contagion effects from shocks. The Board's work on reforming the mandate included an initial discussion of the IMF's future financing role in April 2010.[57] A number of preliminary ideas were considered:

- refinements of the FCL—which would remain dedicated to countries with very strong fundamentals and policies—principally by doubling the duration of purchase rights under the FCL, increasing the predictability of qualification, and removing the implicit cap on access amounts.
- establishment of a Precautionary Credit Line (PCL) targeted at countries with good policies that do not qualify for the FCL. The PCL would have streamlined ex post conditionality focused on addressing any residual vulnerabilities.
- development of a mechanism to enable the IMF to offer liquidity lines to a limited set of countries that are assessed to be systemic in that their stability would help preserve confidence in the core of the global financial system. This mechanism would complement the role played by central banks and other institutions by helping contain contagion stemming from a systemic shock.

Executive Directors were generally supportive of improving the design of the FCL, including doubling the duration of purchase rights to one year. Although there was sympathy for increasing predictability of qualification, most Executive Directors did not support maintaining a running list of countries qualifying for the FCL and preferred the flexibility embedded in the current approach of making assessments when arrangements are requested. Executive Directors also asked for further work on exit strategies.

Executive Directors were open to considering ways to strengthen the attractiveness of precautionary instruments available to members that do not meet the FCL's qualification bar. They saw considerable scope for further strengthening the Fund's engagement with regional financial arrangements and requested proposals by staff on the operational aspects of lending options.

Staff were asked to give further consideration to the issues raised in the discussion and provide the Board with specific proposals on FCL refinements and the design of the PCL before the 2010 Annual Meetings. Further discussion of the IMF's financing toolkit took place in FY2011.

Nonconcessional (General Resources Account) financing

To enable the IMF to better meet members' needs in the context of the crisis and strengthen its capacity to prevent and resolve crises, the Executive Board approved a major overhaul of the Fund's nonconcessional financing framework at the end of FY2009.[58] (A review and reform of concessional lending instruments for low-income members, pursued as a complementary step, was completed in FY2010; see the next section, "Concessional Financing.") All aspects of the IMF's nonconcessional lending instruments and policies were assessed in the overhaul: the existing GRA facilities, the conditionality framework, access levels, maturities, charges, surcharges, and fees. The reforms approved included modernizing IMF conditionality for all borrowers, introducing the Flexible Credit Line, enhancing the flexibility of the Fund's traditional Stand-By Arrangement, doubling normal access limits for nonconcessional resources, simplifying cost and maturity structures, and eliminating certain seldom-used facilities. As a result of the reforms, IMF-supported programs are now tailored to individual country circumstances and focus on the most immediate issues for resolving the crisis that prompted the need for the program. Structural performance criteria have been discontinued (for all IMF financing, including that from the PRGT in support of programs for low-income countries) and replaced by more flexible monitoring of macro-critical structural reforms seen as essential to a country's recovery.

In the context of the overhaul, the Executive Board asked staff to prepare a report addressing the problem of "blackout periods" under GRA arrangements,[59] which have important

Left Passengers disembark from buses in Bogotá, Colombia. **Right** Workers repair the underground deep drainage tunnel system in Mexico City.

implications particularly in regard to precautionary arrangements, given that the crisis prevention and confidence-enhancing role of these arrangements depends on strong assurances that resources under the arrangements will be available if needed.

The Board approved an "Extended Rights to Purchase" framework in October 2009 aimed at addressing the problems created by blackout periods.[60] The framework provides members with continued access under an arrangement for up to 45 days after a test date, without necessarily having to demonstrate observance of periodic performance criteria specified for that test date. The member must meet a number of conditions to qualify, including having met (or obtained a waiver for) all periodic performance criteria as of the preceding test date and being current on all other requirements under the arrangement.

Concessional financing

Modifications to concessional financing facilities

In 2008 and the first half of 2009, low-income countries were hit first by sharp increases in the prices of food and fuel, and then by the global financial crisis. The IMF responded to the growing international consensus, reflected in calls from its low-income country members and from the G-20 heads of state, for swift policy action to meet the needs of the developing world. In the first half of 2009 it increased substantially its assistance to low-income countries, while making the conditionality attached to these loans more flexible and streamlined.

Building on these measures, in July 2009, the Executive Board approved wide-ranging modifications to upgrade the IMF's concessional financing facilities for low-income countries, fundamentally reforming the structure and financial terms of these facilities (see Box 4.2).[61] The decision adopted by the Executive Board established a Poverty Reduction and Growth Trust, replacing and expanding the existing Poverty Reduction and Growth Facility—Exogenous Shocks Facility Trust. The changes to the Trust's facilities took effect in January 2010, once all lenders to the Loan Account and contributors to the Subsidy Accounts of the PRGF-ESF Trust had consented to them.

Executive Directors underscored that all three of the new facilities created under the reform—the Extended Credit Facility, the Standby Credit Facility, and the Rapid Credit Facility—aim to assist low-income countries in achieving stable and sustainable macroeconomic positions consistent with strong and durable poverty reduction and growth and stressed the centrality of countries' own poverty reduction and growth strategies in Fund-supported programs. They welcomed the increased grant element of Fund lending to low-income countries, including temporary interest relief to help them cope with the global crisis, and supported periodic reviews of the applicable interest rates to limit fluctuations in concessionality and subsidy costs when world interest rates change.

Box 4.2

Key aspects of the 2009 concessional lending reform

- ***Scaled-up concessional financial assistance to low-income countries,*** up to US$4 billion per year in each of 2009 and 2010, compared with US$1.2 billion in 2008. A total of up to US$17 billion could be provided over the period through 2014.

- ***Doubling access to Fund financing,*** with access rules that are consistent across facilities. Together with a new policy that facilitates the use of arrangements that blend concessional and GRA resources, the reforms reduce low-income countries' need to resort to purely nonconcessional financing.

- ***A more effective structure of facilities for low-income countries,*** within the Fund's newly created PRGT, that makes the Fund's concessional lending instruments more flexible and tailored to low-income countries' increasing diversity. The new structure consists of

  - the Extended Credit Facility (ECF), successor to the PRGF, which allows the Fund to provide sustained program engagement and financing for countries facing protracted balance of payments difficulties;

  - the Standby Credit Facility (SCF), similar to the Stand-By Arrangement widely used by emerging markets, which provides financial assistance and policy support to low-income countries with shorter-term or episodic financing needs emanating from a range of sources and also allows for precautionary use; and

  - the Rapid Credit Facility (RCF), which quickly provides a limited amount of financing in response to urgent needs, including for Emergency (Natural Disaster and Post-Conflict) Assistance, with reduced conditionality particularly appropriate to the transitory nature of the financing need or to instances in which policy implementation capacity is constrained.

- ***More-streamlined conditionality,*** with more flexibility in defining structural reform objectives.

- ***Regular reviews of interest rates on concessional facilities,*** to limit fluctuations in concessionality and subsidy costs when world interest rates change. In response to the particularly serious economic dislocations resulting from the global crisis, low-income countries also received exceptional relief of all interest payments on outstanding concessional loans due to the IMF through the end of 2011—effectively, an interest rate of zero on these loans for this period.

- ***Additional resources for concessional financing,*** with additional loan resources of SDR 9 billion (plus up to a further SDR 2 billion in loan resources raised as a prudential balance to cover PRGT lenders' encashment rights) mobilized from bilateral contributions as under the previous framework, and new subsidy resources of SDR 1.5 billion in end-2008 net present value terms mobilized from the IMF's internal resources, including resources linked to gold sales, and through bilateral contributions.

Executive Directors stressed the need to mobilize additional loan resources promptly and called on existing and potential lenders to be forthcoming with additional contributions. They agreed that, to accommodate the additional loan resources, the existing borrowing limit of the PRGT of SDR 20 billion should be raised to SDR 30 billion, and that the loan commitment and drawdown periods should be extended to end-2015 and end-2018, respectively. Most Executive Directors supported a proposed financing package to secure additional subsidy resources of SDR 1.5 billion (in end-2008 net present value terms). Most also agreed that the strategy for subsidy financing would involve the use of windfall profits arising from gold sales;[62] to the extent that the realized windfall profits fell short of the required contribution, the difference would be generated through investment income from the gold endowment. Executive Directors noted that the agreed-upon strategy regarding the use of gold-sales-linked resources for financing subsidy needs would guide future Board decisions to be taken after the completion of the gold sales. They emphasized that the feasibility of the reform of the Fund's facilities for low-income countries and associated financing framework was dependent on the implementation of the above-described strategy for the use of resources linked to gold sales.

In February and March 2010, the IMF signed borrowing agreements through which the Bank of Spain, the Danmarks Nationalbank, and the government of Canada will each provide resources to the PRGT, expanding the Fund's resources for concessional lending to low-income countries.[63] Additional commitments to provide resources for the PRGT were made by the governments of China and Norway as well during FY2010, with the formal agreements signed, or expected to be signed, in the early months of FY2011. Efforts to secure additional PRGT resources are ongoing.

In March 2010, Executive Directors endorsed reforms to facilitate the mobilization of loan resources for concessional lending, particularly from those creditors that desire to provide loan resources in SDRs (which had previously not been permitted). The reforms, when they become effective, will allow for the issuance of notes by the PRGT and the establishment of an encashment regime for concessional lending.

Review of the Debt Sustainability Framework

In the wake of the wide-ranging reform of the IMF's financial facilities for low-income countries in July, and as part of IMF efforts to ensure that its policies and instruments remain adapted to the needs of its members, particularly low-income countries, the Executive Board reviewed selected aspects of the joint IMF–World Bank debt sustainability framework (DSF) for low-income countries in August 2010.[64] The DSF, introduced in 2005 and last reviewed in 2006, has several objectives: (1) guiding low-income countries' borrowing decisions and creditors' lending decisions, consistently with progress towards the countries' development goals and long-term debt sustainability; (2) improving IMF and World Bank assessments and policy advice on debt issues; and (3) helping detect potential difficulties early so that preventive action can be taken. The August review, initiated the previous March in the Board's discussion of changing patterns in low-income country financing,[65] focused on options to enhance the framework's flexibility, seeking to address concerns that it had unduly constrained the ability of low-income countries to borrow and, in light of the global crisis, that it might be too procyclical. (See Box 4.3 for highlights of the revised framework.)[66]

The Executive Board approved revised guidelines with regard to external debt performance criteria in Fund arrangements, based on a menu of options and strengthened analytical underpinnings.[67] The revised guidelines take into account members' debt vulnerabilities and their macroeconomic and public financial management capacities, assessed in accordance with the methodology set forth in the guidelines. No member is subjected to more stringent requirements than under the previous guidelines, and greater flexibility is applied in all cases except when debt sustainability is a serious concern and the member's macroeconomic and public financial management capacity is limited. Executive Directors urged staff to remain vigilant to the risk of less-concessional finance displacing more-concessional finance. Several suggestions were made for staff on the policy's operational modalities, including with regard to capacity assessment, transparency in program documents, and public communication of the changes, which were appropriately reflected in a guidance note to Bank and Fund staff.[68]

Revised framework for concessional finance eligibility

In January 2010, the Board approved a new framework for determining which member countries are eligible to use the IMF's concessional financial resources under the PRGT (see Box 4.4), completing the IMF's overhaul of its concessional financing facilities for low-income countries. The new framework preserves access to the IMF's concessional financing for members most in need, while ensuring uniformity of treatment of members by establishing transparent criteria for entry and graduation.[69] Six countries—Albania, Angola, Azerbaijan, India, Pakistan, and Sri Lanka—graduated from PRGT eligibility under the new framework, which became effective in April 2010.

Executive Directors expressed a range of views on the thresholds proposed for entry into and graduation from PRGT eligibility; at the same time, they recognized the trade-offs involved and the need to strike the appropriate balance. On the one hand, less stringent graduation criteria would allow members to graduate earlier from relying on scarce concessional resources. On the other hand, premature graduation could pose undue risks to the member's financial sustainability. Noting the judgmental element inherent in the framework's market access criterion and vulnerability assessments, Executive Directors underscored the importance of applying the framework consistently and objectively, though recognizing that some degree of flexibility is appropriate. They welcomed the fact that the determination of eligibility would remain closely aligned with International Development Association (IDA) practices, and the large majority of IDA-eligible countries would remain PRGT-eligible. Executive Directors also supported the extension to all small countries of the existing exceptional treatment of small islands in determining PRGT eligibility, to ensure uniformity of treatment for all members with similar vulnerabilities, as well as the proposed modification to the rules for blending concessional and GRA financing.

Review of the Policy Support Instrument

The Policy Support Instrument (PSI), created in October 2005, enables the IMF to support low-income countries that do not need Fund financial assistance.[70] Since 2005, seven PSIs have been approved for six member countries, all in Africa (see Web Table 4.1).

The Executive Board concluded a review of the IMF's experience with the PSI—the first since its inception—in July 2009.[71] Executive Directors broadly shared the staff's judgment that the PSI has generally met its goals and expectations.[72] They noted the staff's assessment that economic performance of PSI users had generally been at least as good as, or better than, that of other comparator groups of low-income countries. They were reassured by survey results that member countries found the PSI to be a useful instrument in circumstances where there is no immediate need for Fund financing. They observed that surveyed views on the PSI's signaling role were less positive than those on other aspects of the PSI. On balance, the Board considered that there was no pressing need to modify the PSI.

Box 4.3

Highlights of the revised Debt Sustainability Framework

- ***Greater recognition of the impact of public investment on growth.*** Executive Directors agreed that analyzing the investment-growth nexus requires a country-specific approach, using a broad range of indicators, supplemented with model-based approaches, where appropriate.

- ***More explicit consideration of workers' remittances in debt sustainability analyses.*** Noting the increased significance of remittances as a source of external financing in low-income countries in recent years, Executive Directors agreed that greater flexibility should be applied in taking account of the size of remittances when assigning risk ratings.

- ***More flexible treatment of external debt of state-owned enterprises.*** Most Executive Directors supported excluding from debt sustainability analyses (DSAs) the debt of state-owned enterprises that pose a limited fiscal risk for the government and can borrow without a government guarantee.

- ***Streamlined DSAs.*** Most Executive Directors supported a streamlining of DSA requirements: full DSAs every three years, with streamlined annual updates in the interim, barring a major change in the debt outlook and program-related requirements.

Box 4.4

Revised eligibility criteria for concessional finance use

The framework ratified by the Executive Board establishes differentiated sets of criteria for entry onto and graduation from the list of countries that are eligible to use the IMF's concessional resources. Countries become eligible for concessional financing if their annual per capita income is below a certain threshold (the same one used by the World Bank Group to determine eligibility for IDA resources) and they have not had substantial access to international financial markets for an extended period of time. Countries are expected to graduate from the PRGT eligibility list if they

> (a) have either a persistently high level of income, exceeding twice the IDA per capita income threshold, or capacity to access international financial markets on a durable and substantial basis; and
>
> (b) do not face serious near-term risks of a sharp decline in per capita income, loss of market access, and/or debt vulnerabilities.

Graduation from PRGT eligibility becomes effective three months after the adoption of the pertinent Executive Board decision and does not affect existing concessional Fund support or ongoing discussions on new financing requests. Moreover, countries that have arrangements in place remain PRGT-eligible for the full duration of the arrangement, and their graduation upon completion of the Fund-supported program does not affect the terms of outstanding concessional or subsidized credit. Countries' PRGT eligibility is reviewed every two years.

To ensure uniformity of treatment for members with similar vulnerabilities, the new framework also extends to all small countries (those with populations of less than one million) the existing exceptional treatment of small islands in determining PRGT eligibility, which involves less stringent criteria regarding per capita income. The policy for blending concessional and GRA financing has also been revised to ensure consistency with the new eligibility framework.

SHARPENING IMF SURVEILLANCE

In April 2010, the Board considered how to modernize the mandate and modalities of IMF surveillance as well as how to strengthen financial sector surveillance.[73]

In regard to multilateral surveillance, most Executive Directors supported, or could support on a trial basis, producing reports on outward spillovers for countries whose policies or circumstances might significantly affect the stability of the system, complementing the Fund's Article IV consultation reports (see "Bilateral Surveillance" in Chapter 3). Many noted, however, that such analysis, as well as other cross-country issues, could, where appropriate, be integrated into existing products—for example, Article IV consultation reports, *Regional Economic Outlooks*, or restructured, shorter *World Economic Outlooks* and *Global Financial Stability Reports*—or into a new, shorter, consolidated report that would bring together existing work and the new initiative on spillovers. Many Executive Directors supported, or were open to, the idea of multilateral consultations, on an as-needed basis, on specific topics that have systemic implications, to foster collaboration and collective action. Many also saw merit in a multilateral surveillance decision to clarify the Fund's role and provide a framework for engaging policymakers.

In the area of bilateral surveillance, many Executive Directors considered thematic multicountry reports a useful vehicle for promoting a better understanding of cross-country linkages. Executive Directors underscored the importance of ensuring that surveillance takes place within a reasonable time frame.

On the subject of improving risk assessment through financial sector surveillance, most Executive Directors supported plans to obtain, through global financial networks, data necessary for the Fund to assess spillovers and their implications for macrofinancial stability. Most also agreed that the Fund should seek more regular access to data on individual financial institutions, building on the modalities already in place for FSAP assessments, and deepen its engagement with key global financial institutions.

Turning their attention to improving the traction of financial sector surveillance, most Executive Directors supported, or could go along with, the staff's proposal to make the FSAP stability module a mandatory part of surveillance for members with systemically important financial systems. Executive Directors stressed the importance of the Fund's engaging with other international bodies, in particular the FSB, based on a clearer delineation of responsibilities. They were generally open to exploring ways to enhance collaboration between the Fund and financial sector standard-setting bodies, based on the Fund's role in assessing implementation of standards and the importance of these standards for macrofinancial stability.

Given concerns about a potential expansion of resource needs flowing from the various proposals, it was observed that some ideas could be pursued on a trial basis, which, as experience was gained, would help better gauge resource implications. Executive Directors cautioned that new initiatives should not be implemented at the expense of bilateral surveillance.

Review of the Financial Sector Assessment Program

Assessments under the FSAP provide valuable input for the IMF's Article IV consultations,[74] and the crisis demonstrated the need for an even more seamless integration of these two strands of the Fund's work. In a September 2009 review of the IMF's experience with the FSAP over the preceding 10 years, the Executive Board agreed to steps to strengthen the FSAP further and to enhance the integration of financial sector analysis into surveillance, taking account of the lessons learned over the decade of experience with the FSAP and during the global crisis (see Box 4.5).[75] Executive Directors agreed that the FSAP's usefulness could be enhanced by expanding country coverage and improving the focus and frequency of assessments, particularly assessments of financial stability, and they broadly endorsed proposed reforms to enhance the flexibility, responsiveness, and analytical rigor of assessments.

Executive Directors also agreed that modular assessments, as well as enhanced off-site monitoring, would introduce much-needed flexibility into FSAPs and help better align assessments with country needs and priorities. They supported conducting partial risk-based updates to Reports on Observance of Standards and Codes (ROSCs), following an initial comprehensive assessment. They also supported introducing into FSAP assessments a standardized risk assessment matrix, which would identify threats to financial sector stability and assess their likelihood and implications for macrofinancial stability. They emphasized the importance of broadening the coverage of cross-border issues and supported further work to develop an integrated analytical framework for capturing macrofinancial linkages and assessing risks. With regard to financial sector coverage in low-income countries, it was felt that closer attention should be paid to the impact of underdeveloped financial markets on the effectiveness of macroeconomic policies and the economy's ability to absorb shocks.

Work with other international organizations and initiatives

Though the IMF has a long-standing history of working closely with other organizations, such as the World Bank, the regional development banks, the World Trade Organization, and UN agencies,[76] its crisis work has brought it into collaborative relationships with a variety of other organizations and bodies, most notably, the G-20 and FSB, and has prompted its participation in broad-based initiatives such as the European Bank Coordination Initiative.

Box 4.5

Revisions to the Financial Sector Assessment Program

In light of strengths and weaknesses revealed by the crisis, in September 2009, the IMF and World Bank revamped the FSAP. Though key elements of the program remain unchanged (participation remains voluntary, and the IMF still collaborates with the World Bank on assessments involving low-income and emerging market countries), a number of new features were introduced:

- ***More candid and transparent assessments,*** through the introduction of a risk assessment matrix;
- ***An improved analytical toolkit,*** enabling better identification of linkages between the broader economy and the financial sector and coverage of a greater variety of sources of risk;
- ***More flexible modular assessments,*** tailored to country needs;
- ***Better cross-country perspectives;*** and
- ***Better targeting of standards assessments.***

These new features will help in integration of FSAP findings into the Fund's bilateral surveillance, by giving greater scope for higher-frequency, more-focused assessments and by encouraging greater cross-country comparability. The design of the FSAP is also being reconsidered in the context of the broader discussion of the Fund's mandate.

From the beginning of the crisis, G-20 leaders have called upon the IMF, both on its own and in collaboration with other organizations, to undertake a number of tasks to ensure that the path out of the crisis is smooth, steady, and most of all, the correct one. Early in the crisis, the G-20 tasked the IMF, in collaboration with the FSB, with developing an early warning exercise (see, in Chapter 3, "IMF Surveillance and Policy Priorities in Response to the Crisis" and Box 3.3). More recently, it solicited the IMF's advice on the most effective ways to ensure that the financial sector contributes to the costs of ensuring its viability (see "Work on Financial Sector Levy" in Chapter 3). And of course, the IMF is a key player in the G-20 mutual assessment process (see, again, "IMF Surveillance and Policy Priorities in Response to the Crisis").

Crisis work has also brought the IMF into more extensive cooperation with the FSB. As just noted, the Fund has partnered with the FSB in developing and executing the early warning exercise, which evolved, in part, from the Fund's existing vulnerability exercise. Additionally, the IMF is collaborating with the FSB and the Basel Committee on Banking Supervision in assessing the macroeconomic implications of implementing the Basel Committee's proposals to strengthen global capital and liquidity regulations. In FY2010, the IMF worked jointly with the FSB and Bank for International Settlements on a report for the G-20 on guidelines for assessing the systemic importance of financial institutions, markets, and instruments, and on identifying and addressing gaps in data and information revealed by the crisis.

The Fund has also participated in a number of groups or initiatives that have either arisen out of the crisis or seen the importance of their work increase significantly because of it. Chapter 3 highlighted the IMF's work as chair of the Inter-Agency Group on Economic and Financial Statistics, specifically in connection with the Principal Global Indicators website, which provides economic and financial data for G-20 countries. A particularly important instance of the IMF's group collaboration is its participation in the European Bank Coordination Initiative (informally, the "Vienna Initiative").[77] Responding to a lack of a framework for coordinated response in the face of a potential crisis-driven outflow of capital from emerging Europe, the IMF, along with a number of other international financial institutions (most notably, the European Bank for Reconstruction and Development and European Commission), initiated a series of meetings, the first in January 2009. In those meetings international financial institutions and policymakers from home and host countries met with commercial banks active in emerging Europe to discuss what measures might be needed to reaffirm their presence in the region in general, and more specifically in countries that were receiving balance of payments support from the international financial institutions. The initiative played a substantial role in stabilizing the situation and settling market expectations and created a dialogue between the private and public sectors. Equally important, it provided a platform for dialogue, thereby creating a degree of certainty in private markets that has been beneficial for the economic policies of the countries in question.

Through its Offices in Europe, the IMF works actively with European-based institutions, including the OECD and the European Union, with which the Fund has collaborated on a number of programs in Central and Eastern Europe, and more recently in the case of Greece.

REFORMING IMF GOVERNANCE

Management and organization

Report to the IMFC

Responding to a call by the IMFC in April 2009 for a report on Fund governance, the Executive Board met the following July for an initial discussion on the main issues and reform options based on several reports, including from the Committee of Eminent Persons headed by Trevor Manuel and the Independent Evaluation Office, and consultations with civil society (see Box 4.6).[78] The Board met again in September to consider a draft of the report to the IMFC, based on the broad guidance provided in the initial discussion, that put forward specific proposals for immediate action and identified areas for further work. The Executive Board presented its "Report to the IMFC on Reform of Fund Governance" immediately prior to the October 2009 Annual Meetings in Istanbul, where the IMFC stressed the importance of governance reform in regard to the Fund's legitimacy and effectiveness (see Web Box 4.2).[79]

In the Board's preliminary discussion, Executive Directors considered five core issues: realigning quota shares; high-level engagement; effective decision making and representation at the Executive Board; open selection of Fund management (and more broadly, enhanced staff diversity); and an updating of the Fund's mandate. The October report to the IMFC assessed and made recommendations in these same five areas. Executive Directors agreed that the report to the IMFC should outline concrete steps to achieve high-level engagement by ministers and governors of the kind evident in the global crisis—for example, by moving from formalistic IMFC meeting formats to more fluid and interactive ones, adopting a more inclusive leadership model like the G-20's troika system, improving the communiqué drafting process, and incorporating mechanisms for accountability.

Expressing their agreement with the Managing Director's view that a strong Executive Board is vital to the institution, Executive Directors stressed the importance of strengthening the

Box 4.6

The Fourth Pillar: Engaging civil society in IMF governance reform

In September 2008, the Managing Director proposed to broaden inputs into the IMF's governance reform, in response to calls from civil society organizations (CSOs) for a voice in the process.[1] Engaging civil society as a "fourth pillar" of the governance reform process was intended to complement the work undertaken by the other three "pillars": the IMF's Independent Evaluation Office, the IMF Executive Board Working Group on IMF Corporate Governance, and the Committee of Eminent Persons on IMF Governance Reform.

The Fourth Pillar consultation included a number of activities over a five-month period involving nearly 200 CSO representatives, think tank analysts, and academics from about 50 countries. A Washington, D.C.–based CSO—the New Rules for Global Finance Coalition—coordinated the consultation, and an external website was set up to enable CSOs to exchange ideas and provide their inputs.[2] Additionally, six videoconferences were organized in 11 countries[3] with participants from academia, CSOs, and the private sector. CSOs also met in July 2009 with Fund staff who drafted the Board papers on governance reform.

In September 2009, CSO representatives met with Executive Directors in an informal seminar at Fund headquarters to present their recommendations on governance reform. These recommendations were incorporated into the final Fourth Pillar Report,[4] which was formally presented to the Managing Director in a meeting with CSOs at the 2009 Annual Meetings.[5]

The Fourth Pillar consultation with CSOs has been a key component of the Fund's ongoing engagement with nonofficial stakeholders, whose informal contribution has been helpful in framing the Fund's policy discussion.

1 For additional information on the Fourth Pillar process, see "Engaging Civil Society in the Reform of IMF Governance," *The IMF and Civil Society*, September 23, 2009 (www.imf.org/external/np/exr/cs/news/2009/CSO91.htm).
2 "The Fourth Pillar: IMF Consultations with CSOs on Governance Reform" (http://thefourthpillar.ning.com/).
3 These countries were Argentina, Ghana, India, Indonesia, Kazakhstan, Kenya, the Kyrgyz Republic, Mexico, Peru, South Africa, and Uruguay.
4 The "Report on the Civil Society (Fourth Pillar) Consultations with the International Monetary Fund on Reform of IMF Governance" is available on the New Rules for Global Finance website (www.new-rules.org/fourth_pillar.htm). French and Spanish versions are also available at the same URL.
5 See "IMF Governance Reform: Update from Istanbul," The IMF and Civil Society, October 14, 2009 (www.imf.org/external/np/exr/cs/news/2009/CSO100.htm).

Board's role, with greater attention to strategic issues, facilitated by modernizing work practices. Among other things, this might include better use of Board committees, and lapse of time procedures and similar recommendations of the Executive Board Working Group report on governance reform, as well as consideration of alternative procedures for the Board's conduct of surveillance. They strongly disagreed, however, with proposals to redraw lines of responsibility—for example, devolving to management the function of surveillance, where strong peer review was felt to be critical. In regard to voting rules, Executive Directors stressed that the practice of deciding by consensus whenever possible has served the Fund well.

The Executive Board intends to finalize a revised process for the selection of management. The Board recognizes that the extent to which such a revised framework succeeds in actually creating an open, merit-based, and transparent process, as called for by the IMFC, will depend on whether the Fund's membership is willing to take full advantage of it. While acknowledging the challenge of reaching consensus on so large an issue, many Executive Directors favored more work on updating of the Fund's mandate, which has a bearing on governance insofar as it frames and shapes the issues and approaches put to the membership in the exercise of their voice and vote.

Follow-up work on governance

Since the delivery of its report to the IMFC, the Executive Board has had a number of follow-up discussions on governance issues. An initial meeting kicking off the Fourteenth General Review of Quotas was held in March 2010, followed by a Board discussion in April of considerations surrounding the size of the Fund in connection with the Fourteenth General Review (see "Reassessing the IMF's Mandate" earlier in the chapter). The Board also held a discussion in March on two issues: reforms to the IMFC process to facilitate more effective deliberations, and the case for moving to an all-elected Executive Board. It took up the issue of instituting an open process for management selection at a restricted executive session in April and considered a concise progress report to the IMFC on governance reform at another April meeting. That report, "Executive Board Progress Report to the IMFC: The Reform of Fund Governance," was presented to the IMFC at the Spring Meetings.[80]

Quota and voice

Quota subscriptions (see Web Box 4.3) are the primary source of the IMF's financial resources. The IMF's Board of Governors conducts general quota reviews at regular intervals (at least every five years), allowing the IMF to assess the adequacy of quotas in terms of members' financing needs and its own ability to help meet those needs, and to modify members' quotas to reflect changes in their relative positions in the world economy, thus ensuring that the decision-making mechanism of the international financial system evolves with the changing structure of the global economy. The most recent of these reviews, the Thirteenth General Review, was concluded in January 2008, with no proposal by the Board of Governors to increase quotas; discussions in relation to the Fourteenth General Review, which is expected to be completed on an accelerated schedule before January 2011 (see "Fourteenth General Review of Quotas" later in this chapter), have already begun.

Status of the April 2008 ad hoc quota reform

The most recent quota reform, approved by the Board of Governors in April 2008, aims to increase the voting share of dynamic emerging markets and provide greater voice to low-income countries. Under the ad hoc reform, 54 members would receive quota increases, and the Articles of Agreement would be amended to triple basic votes and put in place a mechanism to preserve the share of basic votes in total votes. As of April 30, 2010, 35 of the eligible 54 members had consented to the ad hoc quota increases included in the reform. Additionally, 70 members of the required 112, representing 72.9 percent, compared to the required 85 percent, of the total voting power, had accepted the proposed amendment to the Articles of Agreement. In its April 2010 communiqué, the IMFC urged members to consent promptly to the still-pending 2008 quota and voice reform.[81]

Fourteenth General Review of Quotas

Work on additional quota reform is ongoing in the context of the Fourteenth General Review of Quotas, which is scheduled to be completed before January 2011, two years ahead of the original schedule. In its October 2009 communiqué, the IMFC expressed its support for a shift in quota share to dynamic emerging market and developing countries of at least 5 percent from overrepresented countries to underrepresented countries, using the current quota formula as the basis from which to work. It also committed to protecting the voting share of the poorest members.[82]

Executive Directors met in March 2010 to discuss initial considerations on the realignment of quota shares in connection with the Fourteenth General Review. There were also initial discussions in April on the issue of the size of the Fund (see "Financing for the Twenty-First Century" earlier in this chapter), which has a bearing on the question of realignment of quota.

Membership

The Republic of Kosovo accepted the IMF's offer of membership and became the Fund's 186th member in June 2009.[83] The Board of Governors also adopted in FY2010 a resolution on membership for Tuvalu, in response to an application for membership submitted in FY2009. (Tuvalu subsequently became the Fund's 187th member in June 2010.)