INTERNATIONAL MONETARY FUND

The Managing Director's Report on Implementing the Fund's Medium-Term Strategy

April 5, 2006

I. Introduction

1. ***Background***. Last September, the Fund published its Medium-Term Strategy, which considered the future direction of the Fund in light of the economic transformation wrought by 21st century globalization. The strategy concluded that the emergence of new economic powers, integrated financial markets, unprecedented capital flows, and new ideas to promote economic development required an updated interpretation of the Fund's mandate as the steward of international financial cooperation and stability. Without new focus and carefully chosen priorities, the institution risked being pulled in too many directions and losing its relevance to large parts of the membership.

2. ***Recent debate***. The strategy paper has sparked a lively public discussion about the appropriate role of the institution and the changes needed to discharge that role effectively. The debate has spanned a wide set of issues—from global surveillance to crisis financing to internal governance. It has encouraged frank exchanges about the Fund's effectiveness in coming to grips with the challenges facing the world. And it has produced proposals that range from the evolutionary to the revolutionary. But whatever the line of argumentation, some themes recur—the imperative to stay relevant in a changing world, the importance of tough and independent policy advice, and the need for fresh thinking on financial markets and crisis prevention. Consistently, the bottom line has been a call for a stronger and multilaterally-engaged institution. This is a call that the Fund—with its unique mandate, universal membership, and high-caliber staff—has answered before, and must do so again.

3. ***Goal***. The aim here is to use the intensified debate to bring more precision to the ideas set out in the strategy paper for helping the full spectrum of the membership take advantage of globalization and manage its risks. This requires specific proposals covering issues as sweeping as cooperation for resolving global imbalances, as country-specific as building institutional capacity, and as difficult as preventing financial crises. Moreover, these proposals must be made to fit in the institution's limited budget—which must now also cope with a sharp fall in income from lending operations.

4. ***Priorities***. The proposals put forward here cover the following issues:

- ***New directions in surveillance***. The difficulties in tackling unprecedented global imbalances, and the challenges facing individual countries, underscore the need for stronger exercise of surveillance by the Fund. At the global level, this means doing more to identify—and promote effective responses to—risks to economic stability, including from payments imbalances, currency misalignments, and financial market disturbances. At the country level, this means choosing focus and effectiveness over comprehensiveness, with deeper analysis of financial systems, a multilateral perspective to surveillance, and more regional context and outreach.

- ***The changing role of the Fund in emerging market countries***. In the many countries that have already emerged to become major global players, the main priority must be to augment candid and focused macroeconomic analysis with enhanced surveillance over financial and capital markets. At the same time, the Fund can do more by way of crisis prevention and response.
- ***More effective engagement in low-income countries***. The challenge ahead will be to marshal the expected rise in aid flows, including from debt relief, to achieve higher growth and the millennium development goals. Helping countries do so requires a deeper but more focused engagement by the Fund, including new understandings with the World Bank and other agencies on the division of labor.
- ***Governance***. Fair voice and quota are central to the legitimacy and effectiveness of the Fund. With the requisite political support for a two-stage approach, the goal of making concrete progress by the time of the Singapore Annual Meetings is within reach. The Fund must also address other aspects of governance, including transparent selection of management and better definition of the role of the Board.
- ***Capacity building***. Targeted efforts in this area are key to helping members implement reforms. Capacity building also needs to be part of the strategy to address vulnerabilities identified in surveillance. The Fund's efforts to build macroeconomic institutions can be strengthened with better prioritization and country ownership.
- ***Streamlining***. Action is needed to control procedure and documentation, lest the work, messages, and governance of the institution are lost in a sea of paper. Many specific proposals are made here to enable management and the Executive Board to shift attention from routine and detail to broader, strategic issues.
- ***Medium-term budget***. The overall approach set out here can and must be reconciled within a medium-term budget that deals with the projected fall in the Fund's income. But even with declining real spending, it is clear that a new business model is needed to finance Fund activity in the future, with less reliance on margins from lending and more on steady, long-term sources of income.

5. ***Acknowledgements***. The ideas set forth here, and summarized in Tables 1-6, draw on outreach with the membership and the broader public, discussions with Executive Directors, and the reports of staff groups following up on the strategic review. The latter will be circulated as background, although the proposals contained here differ in some aspects from those put forward by the groups.

II. Surveillance

6. ***Issues***. There is widespread agreement that surveillance needs to be made more effective. The concern is that surveillance has become procedural and diffuse, adapting over

the years to new challenges by expanding its coverage from the original emphasis on exchange rates and macroeconomic policies to structural reforms, standards and codes, banking stability, social issues, and anti-money laundering. However, the complexity of globalization cannot be answered by ever longer and more complicated analysis. Rather, what is needed is focus on the essential, the framing of issues in a global context, and better use of the Fund's comparative advantage—its universal reach and macroeconomic expertise—to achieve progress on key issues. Doing so will require the Fund to remain at the forefront of economic and policy analysis, to vigorously guard its independence, and to demonstrate greater candor in staff and management outreach.

A. A More Global Perspective

7. ***Multilateral consultations***. *To promote debate on issues of systemic importance, it is proposed that a new supplemental consultation procedure be introduced in a multilateral format*. A widespread view brought out by deliberations on the Fund's future is that there is not enough substantive debate to resolve global macroeconomic problems. As a universal institution, the Fund is better placed than any other forum to be a catalyst for multilateral debate and action. However, the Fund's own special procedure for bringing pressing problems to the fore outside the Article IV cycle, the supplemental consultation with a member, is rarely used, partly for the stigma of being singled out. Against this background, it is proposed to complement existing arrangements with a *multilateral* consultation procedure, allowing the Fund to take up issues collectively with systemically important members and even with entities, such as regional groupings, that are not members. A procedure that views problems as the joint outcome of many actors should enable more tangible progress in addressing issues. Operational modalities still need to be worked out on how best to engage the main parties involved. But broadly speaking, the idea would be for the staff to discuss issues of multilateral surveillance with the key parties, both individually and jointly, with a view to preparing a report to be discussed by the Executive Board and, ultimately, by the International Monetary and Financial Committee.

8. ***Exchange rate surveillance***. *More emphasis must be given to the original goal of surveillance—i.e., assessing the consistency of exchange rate and macroeconomic policies with national and international stability*. A challenge for Fund surveillance from financial globalization is the potential for larger and longer-lasting departures from equilibrium exchange rates, which in turn risk crises and disruption when reversals occur. While judgments about equilibrium values are intellectually difficult and politically and market sensitive, the thinking of policy-makers must be informed by an analysis based on a consistent multilateral framework. The work of the Consultative Group on Exchange Rates will thus be expanded from industrial countries to cover all major emerging-market currencies. As analytical methods are refined and experience is gained, consideration could be given to publishing these assessments in the World Economic Outlook. The analysis should also become a point of reference for Article IV surveillance discussions with members. A review of the 1977 decision on exchange rate surveillance would also update guidance on the treatment of exchange rate regimes, the notion of disequilibrium in a world of capital mobility and floating exchange rates, and the procedures for monitoring by the Fund.

9. ***Integrating macroeconomic and financial market analyses***. *The Fund's two flagship publications, the World Economic Outlook and the Global Financial Stability Report, must strengthen the analysis of macroeconomic and financial risks and interactions.* As the locus for the staff's overall views on the global economy, the *World Economic Outlook* performs well. Nevertheless, it could go further in quantifying risks, including by developing risk-based scenario analysis, and exploring the macroeconomic implications of financial sector issues taken up in the *Global Financial Stability Report*. The latter needs to complement its monitoring and analysis of financial developments and vulnerabilities with increased attention to managing prudential risks, including by analyzing and reporting on the Fund's experience—a task that will be facilitated by the merger of the International Capital Markets and Monetary and Financial Systems Departments. It is also proposed to strengthen the analysis of the macroeconomics of globalization, with *Occasional WEO Studies on Globalization* that would highlight cross-cutting issues such as capital flows, income convergence, and the economics of aging. This work, undertaken from time to time as part of the WEO exercise, would bring together research and the experience of operational staff, policy makers, and academics.

10. ***Regional perspectives***. *New modalities are needed to enhance regional surveillance*. The ability of surveillance to bring about change is greater when it draws on shared experience and highlights common risks. It is proposed that area departments formulate regional work plans, focusing on the main policy issues facing the region, the intra-regional linkages, and the implications of the broader risks and trends identified in the *World Economic Outlook* and the *Global Financial Stability Report*.

B. Effective Country Surveillance

11. ***Content and procedure***. *The structure of Article IV surveillance requires changes*.

- ***Financial sector***. The coverage of financial sector issues in Article IVs needs to be elevated to a higher level that builds on the achievements of the Financial Sector Assessment Program and work on capital markets. The analysis of financial sector and balance sheet vulnerabilities must be integrated into reports, drawing the implications for macroeconomic aggregates and capital flows, and scope for domestic and external spillovers. This is part of the rationale for the merger of the International Capital Markets and Monetary and Financial Systems Departments, which will regularly participate in area department missions at least to all systemically important and emerging-market countries, as well as to selected low-income countries. The aim is to give financial issues coverage that is at least on par with, say, the traditional fiscal policy analysis found in Article IV reports. A taskforce has been established to develop an analytical framework aimed at ensuring that the Fund is at the forefront of incorporating financial sector analysis in macroeconomic analysis.

- ***Focus***. The comprehensiveness of surveillance has become counterproductive, covering too much too thinly, at the expense of the core issues that enable staff to engage successfully and be helpful to country authorities. It is therefore proposed that, at the end of each Article IV cycle, staff will develop focused surveillance agendas setting out the staff's surveillance priorities for the next few years. These priorities would dovetail with the streamlined reports discussed in paragraph 44.

- ***Streamlined procedures***. Strong engagement with country authorities need not translate into procedures that imply repetitive, pro forma reporting to the Board. It is possible to carry out Article IV surveillance for a number of countries with lighter procedures—smaller teams, shorter missions, and brief reports cast around the final statement—every other year. The selection of countries can be flexible: non-systemic and stable cases are an obvious choice, but it may also be that there is little to add to the previous year's report for countries that do not fit this description. An ambitious goal should be set for streamlined procedures, say, 35-50 countries (which would work out to 18-25 streamlined consultations in any given year).
- ***Multilateral perspective***. Article IV consultations need to do a better job of bringing to bear both the implications and spillovers of a country's policies for its partners and the lessons drawn from the experiences of other countries in addressing the policy choices facing a member. The Fund is uniquely placed to provide this function.

C. Communications

12. ***Outreach***. *Building consensus around Fund policy advice requires more active outreach*. The potential of surveillance cannot be realized until it is recognized that an Article IV consultation is more than just a mission, a staff report, a summing up, and a press release. The Fund has made great strides in increased transparency and communications in recent years, recognizing that bringing about policy change requires active engagement not only with country authorities, but also with the broader public. The Fund must take these efforts further, including by management, which is well placed to take up issues in public and at the highest political level. In addition to on-going efforts to reach various constituencies, the following is proposed:

- *Article IVs*. Press conferences should become routine, after either the mission or the Board meeting.
- *Management and senior staff*. Their role in engaging the media should be enhanced, through the development of country-specific communication strategies. The External Relations Department will work with area departments to develop a work program.
- *Regional outreach*. This would entail more regional seminars and media events, highlighting cross-country work and drawing the implications of global surveillance.

III. The Fund's Evolving Role in Emerging Markets

13. ***Issues***. Among emerging market countries, doubts persist on whether the Fund has moved far and fast enough to meet the needs of one of the most dynamic and globalized segments of the membership. The effectiveness of surveillance and quota share are part of the story, but so are the gaps in the understanding of financial and capital markets. In addition, important issues need to be addressed regarding the Fund's capacity to lend

adequate amounts, provide contingent financing to prevent crises, and deal with the complications of rare but important cases of sovereign debt restructuring and arrears.

A. The Centrality of Financial Market Issues

14. ***New emphasis***. *The Fund's culture needs to change to put financial and capital market issues at the heart of its macroeconomic analysis in emerging markets*. A key motivation for the recent decision to merge the International Capital Markets and the Monetary and Financial Systems Departments was to create a center of excellence for all financial, capital market, and monetary policy work. This is of particular importance in emerging market countries, which have grown to become systemically important but also vulnerable in integrated global markets. The new department will play a key role in advising emerging economies on debt and capital account issues. This emphasis should be supported by priority in the Financial Sector Assessment Program and the Fund's work on standards and codes, which will likely require technical assistance.

B. Adequate Financing

15. ***Predictability***. *The framework for exceptional access does not provide clear guidance for access outside a capital account crisis*. The criteria under which large-scale access is granted were developed for capital account crises. However, in practice, the Fund has provided exceptional financing even when needs did not relate to an on-going capital account crisis, most recently in Turkey and Uruguay. While the guidelines permit such pragmatism, the fact that the criteria manifestly do not apply has led to perceptions that decisions are ad-hoc and unpredictable. Thus, the guidelines need to be reviewed and modified.

16. ***Duration***. *Flexibility is needed in the duration of large-scale financing*. Experience has revealed the difficulties in predicting how long it takes to recover from capital account crises. In some cases recovery has been slow, requiring successor arrangements and a shift from the short-maturity Supplemental Reserve Facility to access under credit tranches. In other cases the unwinding of outstanding obligations has occurred more quickly. Program design and credibility would be enhanced by upfront recognition of the uncertainty associated with recovery from crises and the need for possible successor arrangements.

17. ***Repayments***. *The incentives for early repayment should be price-based (surcharges), not administrative (repurchase expectations)*. The revolving nature of the Fund's resources makes it important to support prompt repayment once pressures on a member's balance of payments subside. However, the policy on repurchase expectations, with a potentially faster repayment profile, has been difficult to implement and has contributed to erroneous perceptions that the Fund is rescheduling some operations. It is proposed to eliminate the notion of expectations and replace it with unified surcharges.

C. Contingent Financing for Crisis Prevention

18. ***New financing vehicle***. *High access contingent financing could be provided through a new type of arrangement*. Precautionary arrangements provide a simple and well-

understood framework for contingent financing, but many members may perceive the standard conditionality to be burdensome and would prefer a different modality. Thus, a new type of arrangement is needed. The new instrument outlined below would be available to members with strong macroeconomic policies, sustainable debt, transparent reporting, but which still face balance-sheet weaknesses and vulnerabilities:

- *Access would normally be up to 300 percent of quota, automatically available in a single up-front purchase, and augmentable upon subsequent review*. This strikes a balance between providing some assurance of financing and limiting exposure before the size and policy response to a crisis are known. Financing beyond the initial drawing would take into account the emerging needs and policy requirements.
- *Conditionality would target policies to maintain macroeconomic stability and reduce vulnerabilities*. Conditionality would focus on addressing underlying vulnerabilities, and performance criteria set to broadly indicate when policies go off-track, not to capture minor deviations from projections.

19. ***Supporting the pooling of reserves***. *The Fund should be open to supporting regional and other arrangements for pooling reserves, including by signaling sound policies*. The foreign currency reserves of emerging market countries are sufficient to meet the potential needs of most members of this class—unless the largest ones are simultaneously struck by financial difficulties. Some groups, e.g., in Asia under the Chiang Mai Initiative and in the Andean region under the Fund for Latin American Reserves, have already set up funds for contingent financing. While it would be up to these groups to determine the terms for access, the scope for expanding such safety nets would rise with a group's confidence in the economic policies of its members. The Fund can play a role here, focusing on regular and intensive surveillance. It should explore modalities for further engagement in this area.

D. Debt Restructuring and Lending into Arrears

20. ***Basic principle***. *The insistence on progress toward resolution of external payments arrears as a condition for Fund lending remains appropriate*. While the Fund must be neutral between sovereign debtors and private creditors when debt restructuring becomes necessary, its function at the center of the global financial system requires that it promote the resolution of arrears, which damage confidence in the debtor and in the system as a whole. The requirement that arrears be regularized remains appropriate and in the interest of both creditor and debtor, but recent experience raises some practical questions. Should the Fund express views on the macroeconomic parameters that determine settlements? What constitutes a good faith effort to resolve sovereign arrears?

21. ***Specifying a resource envelope***. *Financing in a debt restructuring case should depend on an agreed medium-term fiscal envelope and macroeconomic framework on which the Fund expresses a clear view*. This understanding already exists, but has not been uniformly applied, e.g., in the case of Argentina. A failure to do so is problematic insofar as disputes over the range of reasonable offers hampers early progress and high participation rates in debt exchange offers. Indeed, the Fund's surveillance responsibilities imply that it

should assess the appropriate medium-term fiscal envelope and the macroeconomic framework even in the absence of a program engagement.

22. ***Good faith criterion***. *Recent experience calls for a reconsideration of this policy on efforts to resolve sovereign debt arrears*. The policy aims to promote a collaborative and predictable process for debt restructuring negotiations. However, the ideal process was based on the structured negotiating framework of the 1980s (creditor committees, offers, and counter offers), whereas the recent experience has consisted of consultations via financial advisors, consideration of secondary market prices, and debt exchange offers. There is also the complication of how to define good faith efforts on residual arrears after an initial debt exchange. These are difficult issues without clear-cut answers. However, if future negotiations are to proceed in a timely fashion, some reconsideration of the policy will be needed; a staff paper will be forthcoming.

IV. The Fund's Role in Low-Income Countries

23. ***Issue***. In recent years, great strides have been made in contributing to economic development and enhancing country ownership through poverty reduction strategies and the Poverty Reduction and Growth Facility. More flexible instruments of Fund engagement such as the Policy Support Instrument and the shocks facility have also recently been introduced. However, new challenges lie ahead. The expected increase in aid flows, including via official debt relief, will have major consequences for the Fund's work in terms of monitoring debt sustainability and the use of resources freed up by debt relief. At the same time, the Millennium Development Goals are receiving increasing attention, with the Fund and the Bank called on to monitor and report on the progress. This is a difficult and resource-intensive effort that requires a more focused and flexible engagement by the Fund.

A. Aid and the Millennium Development Goals

24. ***Consistency check***. *The Fund should assess if projected aid flows are consistent with macroeconomic stability and the estimated costs of achieving countries' development goals*. Fund staff will need to be involved in monitoring, advising and reporting on the aggregate resource use of low-income countries, including their macroeconomic absorptive capacity. Estimating the costs of meeting the goals requires knowledge, e.g., of health and education, that Fund staff lack. It will thus have to seek the views of multilateral development banks and others on the cost estimates of achieving the development goals. Based on this analysis, the Fund should give its view as to whether these estimates are consistent with aid commitments, and if macroeconomic policies can be made consistent with expected aid flows.

25. ***Candor***. *The Fund should inform donors when there is scope for more aid to be absorbed and, conversely, when it judges that expected aid flows put macroeconomic stability at risk*. The Fund would work closely with the authorities to propose appropriate macroeconomic policies and strengthened governance. Coordination with the donor community and the Bank will be needed to ascertain the macroeconomic impact of changes in the use, composition, or timing of aid. If macroeconomic instability jeopardizes the effectiveness of aid, staff will need to convey that judgment clearly and candidly.

26. ***Resources***. *Work on low-income countries is resource intensive*. The Fund's work on the millennium development goals and involvement with donors to ascertain aid flows will necessitate additional resources. However, given budgetary realities, the scope for this is strictly limited. The only feasible way forward is to focus staff efforts (see further below), engage local—not headquarters-based—staff in countries, and explore the scope for additional external resources to pay for capacity building and involvement with donors.

B. Successful Debt Relief

27. ***Debt sustainability***. *Strong efforts will be needed to ensure that the beneficiaries of debt relief do not again accumulate excessive debt*. Fund-supported programs will need to include a framework to assist low-income countries to design and adopt medium-term debt strategies. They should provide guidance on the consistency of new borrowing with debt sustainability. In non-program countries, the Fund should advise the authorities if debt accumulation is on an undesirable trajectory. The staff must inform the Board and the international community of any related concerns, and not shy away from identifying borrowing that risks future debt problems.

28. ***Public spending***. *Strengthening public expenditure management systems is key, but the Fund must be aware of its limited role*. The international community expects that low-income countries will use the resources released by debt relief to reduce poverty and achieve the millennium development goals within a framework of enhanced governance and transparency. A key role for the Fund would be to provide technical assistance on public expenditure management. Staff can also assess if sectoral allocations fit in a consistent macroeconomic framework and report on the pattern of poverty-reducing expenditures, while leaving it to the World Bank and others to advise on sectoral allocations.

C. Focus and Flexibility

29. ***Macroeconomic relevance***. *The Fund's role in developing countries needs to be better defined and less thinly spread*. Broadly speaking, work must be geared to supporting policies and economic institutions conducive to sustained private-sector led growth, trade, and a reduction in poverty. The Fund's policy advice, capacity building, and financial assistance should focus on macro-critical issues, including institutions relevant to financial stability and economic growth. It is true that macroeconomic policies and institutions are only part of the story, and that these do not necessarily translate into growth and poverty reduction unless a more multi-disciplinary view of development is taken. But, equally, a relatively small international institution such as the Fund cannot be engaged in too many areas without compromising effectiveness—including in its core macroeconomic mandate. Thus, clear understandings with other development partners will be crucial.

30. ***Country-level division of labor***. *The implementation of the above approach will need to be tailored to individual country circumstances*. It is proposed that, for each country, Fund and Bank staff, together with the country authorities and development partners, identify the main growth-critical issues—i.e., the constraints that inhibit private investment and productivity in the context of the country's Poverty Reduction Strategy. They should also

specify areas in which the authorities need assistance, and the nature of that assistance: financial, technical, or policy advice. In this process, each party would agree on the areas that they are prepared to take the lead on. Fund staff should take responsibility for advising the authorities only on those areas that fall within its macroeconomic expertise. These country-level agreements should be endorsed at the level of the Bank's regional vice presidents and the Fund's area department directors.

31. ***Broader Fund-Bank division of labor***. *It is time to review the modalities for inter-agency coordination and division of labor set out in the 1989 Concordat*. Given the complexity of the multi-disciplinary work in low-income countries, it is essential to have clear divisions of responsibility and accountability. It is thus proposed that a joint Bank-Fund task force, led by an eminent panel of outsiders, make recommendations to update the Concordat in light of new mandates and overlaps in areas such as financial sector work.

32. ***Flexibility***. *New initiatives such as the Policy Support Instrument and the shocks facility allow some flexibility in low-income country work, but more needs to be done*.

- ***Conditionality***. Most arrangements use a standard of upper credit tranche conditionality. While this is appropriate in most circumstances, in some cases such as post-conflict countries, such a standard may be unreasonable. For these countries, a facility with a more flexible standard and a larger capacity-building component—beyond that available through Emergency Post-Conflict Assistance—could be considered. Similarly, for countries with strong track records, there should be more ready acceptance of the authorities' reform agenda and parsimony in conditionality.
- ***Joint Staff Assessment Notes***. To free resources for higher priorities, e.g., more careful debt sustainability analyses, it is proposed to eliminate this note, and have staff reports summarize relevant aspects of the poverty reduction strategy.

V. GOVERNANCE

33. ***Issues***. The roles of ownership and governance for economic prosperity have been important themes of Fund discourse in recent years. These prescriptions, however, apply as much to the Fund, where important deficits have emerged in members' sense of ownership and participation in the organization. Among other things, this has raised questions about the independence and objectivity of Fund analysis.

34. ***Quota and voice***. *It will be crucial to make concrete progress on this issue by the time of the next Annual Meeting in Singapore*. The question of a fair distribution of quotas, reflecting the important changes in the weight and role of countries in the world economy, has been neglected too long on grounds of intractability. Fortunately, there are signs that the membership is realizing that if fair weight and voice cannot be exercised in institutions like the Fund, members will seek to exercise these in other forums, in time diminishing the voice of the Fund itself. Particularly as agreement on a general quota increase seems unlikely in the near future, early progress may require a two-stage approach. Such a strategy could involve ad hoc quota increases for the most underrepresented members in the near term, followed by

further steps at a later stage. Agreement on an increase in basic votes, key for strengthening the voice of the smallest members, could be part of either the first or second phase.

35. ***Management***. *A transparent procedure for the selection of the Managing Director should be formally approved*. Management plays a critical role in maintaining the integrity, credibility, and independence of the institution, and serves as the external face of the Fund. Against this background, the membership needs to respond to the calls for a transparent process by adopting and publishing guidelines on the selection of the Managing Director.

36. ***Executive Board***. *A better balance must be struck between broad oversight and involvement in details*. Some observers have gone so far as to suggest that political influence and involvement in details can hinder the objectivity and independence of the institution. Since the Board is central to the legitimacy of the institution, it must tackle such perceptions head on, and reconsider its role to see if a better balance can be struck.

VI. Capacity Building

37. ***Issues***. Recent Board and internal evaluation reviews have provided many useful insights and recommendations to strengthen capacity-building efforts. A key aim has to be to better align capacity-building efforts with the needs of member countries and evolving Fund priorities, especially the macroeconomic and financial sector vulnerabilities identified in surveillance. Ultimately, however, the success of these efforts depends on the strength of country ownership. Given the growing pressures on Fund finances, as well as the need to allocate resources efficiently, the scope for charging and mobilizing additional outside resources for capacity building must be explored.

A. An Integrated Approach

38. ***Organization***. *To set priorities effectively, it is necessary to combine the institutional objectives of country authorities, the technical expertise of functional departments, and the policy perspective of area departments*. Area departments will take the lead in producing, and posting on the internal web, technical assistance country strategy notes in the context of Article IV consultations. The notes would be discussed with the authorities and form the basis of resource allocation plans by functional departments. It is also proposed to integrate the production of regional allocation plans and the training program of the IMF Institute with the budget process, to better align these elements.

39. ***Priorities***. *Technical assistance priorities should be identified from a strategic perspective and resources allocated accordingly*. Key priorities lie in the financial sector, especially follow up to weaknesses diagnosed in financial sector assessments, in revenue administration and public expenditure management, and in improving statistical information.

B. Harnessing New Resources

40. ***Outside financing***. *Donors and recipients are increasingly sharing the cost of providing technical assistance and training*. This is evident by the funding modalities for the

third Africa Regional Technical Assistance Center and the India Training Center. Still, given the resource pressures, it is important to explore the scope for mobilizing additional external resources. Such financing, however, should be predictable and should not distort priorities for Fund technical assistance—e.g., through excessive geographic or functional earmarking.

41. ***Charging***. *Levying user charges for technical assistance would promote efficient use of scarce resources*. However, unless charges were related to countries' ability to pay, this could impact disproportionately on the ability of low-income countries to receive needed technical assistance. Since some 85 percent of assistance is provided to low-income countries, a schedule of fees that charged low rates for low per capita-income countries would not raise significant revenue. Thus, it is proposed to explore the creation of a trust fund to subsidize user charges for technical assistance and training to low-income countries before deciding on a schedule of charges.

C. Targeted Reports on Standards and Codes

42. ***Prioritization***. *The resources devoted to Reports on Standards and Codes must be better targeted*. For new reports, priority should be given to systemic and regionally-important countries, emerging-market economies, resource-rich countries, and program countries where important institutional weaknesses are addressed. For updates, there is a need for greater differentiation in frequency and focus. Reports should also be integrated in Article IV consultations and with technical assistance, partly by substituting some update reports with mission participation by specialists from functional departments.

VII. Streamlining

43. ***Issues***. With 82,000 pages of paper flowing to the Board each year, the volume of information is at a level that risks drowning the work, messages, and governance of the institution. The causes of excessive documentation and procedure—beyond what can be explained by a widening mandate—are as old and familiar as bureaucracy itself: a larger Board too ready to demand detail, a larger staff too ready to supply it, and an overall culture of risk aversion that makes comprehensiveness safer than a call on what is important. If any headway is to be made in culling work practices, action will be needed on many fronts.

A. Focused Staff Papers

44. *The following steps are proposed to reduce the burden of excess paper*:

- ***Explicit focus and word limits***. All reports would state up front the main questions and indicate issues left for future work. To force more issues-based writing, the length of documents should be cut 10-30 percent, while striking a balance between brevity and adequate treatment of issues and allowing for necessary differentiation.

- ***Fewer papers***. The main recommendations relate to:

(i.) ***Policy reviews***. *Reviews of policies should be on a standard five-year cycle, except the review of surveillance, which could be every three years*. Too frequent reviews add little insight and are resource-intensive. Flexibility can be retained with an understanding that reviews may be brought forward if needed. For early savings and a smooth pipeline, some reviews can be rescheduled and some progress reports consolidated (see *Report on Streamlining*, Table 3).

(ii.) ***Ex-Post assessments***. *There is need for greater flexibility and tailoring of these assessments to individual country circumstances*. While ex-post assessments provide valuable lessons and should continue to be produced, it should be left to the area department to decide which cases require stand-alone assessments and which could be presented in reports for Article IV consultations and program reviews. Further, in many cases, including in low-income countries and when a member is not drawing on Fund resources, a re-examination of policy strategy may not be needed as frequently as the guidelines require. These issues are taken up in a recent policy paper, which the Executive Board will discuss shortly.

(iii.) ***Other papers***. *Greater selectivity and focus should reduce the number of Selected Economic Issues papers and Statistical Appendices.* In both cases, the production decision should be geared to their centrality to the Article IV staff report.

- ***Move to the web***. *It is proposed to replace paper circulation of certain documents with web-posting.* This may not substantially save resources, but it does eliminate clutter and target information. The relevant papers are summarized in Table 6.

B. Efficient Board Procedure

45. To speed up work and consideration of routine matters, it is proposed:

- ***Streamlined surveillance***. Specifically:

(i.) *For some cases, Article IV consultations can be concluded within 30 days, using short reports centered on the mission's concluding statement.* The modalities for streamlined consultations in alternate years were outlined in paragraph 11.

(ii.) *The lag between Article IV missions and Board consideration should be lowered to at most 60 days (except PRGF countries), with 14-day Board circulation.* Staff reports are often out of date by the time they are considered by the Board, and more so by the time of publication. This is an anachronism. Given the nature of low-income country work, the 90-day rule could be retained for PRGF countries.

- ***Streamlined program reviews***. Lapse of time procedures could be used routinely for on-track program/post-program monitoring reviews. "On track" means there are no major problems and all performance criteria are met (or waivers relate to minor and corrected deviations). Normal procedures would apply to exceptional access cases.

- ***Misreporting***. *The Board should consider options to eliminate rigidities in this policy.* In recent years, one of six misreporting cases relates to trivial amounts or issues. However, the resource costs of such cases, and the aggravation to the member, can be enormous. An upcoming staff report will present options for addressing such cases.

- ***Directors' statements and summings up***. Shorter written statements, and modalities for collating Board reactions, could improve the quality of discussions. The long and formulaic style of summings up could also be replaced with a shorter, modern format.

C. Stronger Management Oversight

46. *The key to timely consideration of strategic issues and control of excess paper is a strengthening of the work program:*

- ***Work program***. In practice, this document has tended to be no more than an aggregation of departmental plans for Board papers. The aim, rather, should be for management to use it as a tool for prioritization and scrutiny of staff and Board requests for new papers, ensuring that these fit tightly with medium-term goals.

- ***Delegation***. This would free up management time to devote to the work program. Initially, delegation could begin with routine and technical papers, such as safeguards assessments and donor presentations. Eventually, however, the ground should be prepared for devolving basic quality control and paper clearance to staff, together with new mechanisms of staff accountability.

VIII. Medium-Term Budget

47. ***Issue***. Although the strategy paper had flagged a decline in income from lending as an important issue for the medium term, the future has arrived sooner than anticipated. The SDR 150-250 million fall in annual income in the coming years may be small relative to the Fund's reserves of SDR 6 billion, but it is still equivalent to a third of the current level of annual spending, and it raises important questions about the long-term sustainability of Fund finances. Indeed, even with declining real spending (which, as discussed further below, is consistent with the implementation of the recommendations in this report) and measures to broaden the income base in the near term (such as investment of reserves), there remain financing gaps over the medium term. While the precise adjustment path must await the medium-term budget, it is already clear that the path must eventually lead to a steady, long-term source of income. The current business financing model, of paying for surveillance and capacity building with margins on adjustment lending, is no longer tenable.

Projected Income Shortfall: FY06–09
(millions of SDRs)

	FY06 Est.	Medium-term projections FY07	FY08	FY09
Sources (w/establishment of investment account)[1]	754	616	548	502
Administrative and Capital Expenses	646	673	690	708
real change, admin budget (in percent)		0.0	-1.0	-1.0
Shortfall	-107	57	142	206

Source: Office of Budget and Planning; Finance Department.
[1] Projected income sources also include surcharges.

48. ***Expenditure***. *The priorities outlined in the previous section can be embedded in a real budget envelope that declines moderately over the medium term*. Given the projected

budgetary situation, the proposals in this report have been made budget neutral, allowing the proposals to fit in a declining real spending path. Table 7 is illustrative but shows a scenario in which the additional costs of new initiatives—e.g., to enhance work on surveillance and certain aspects of low-income country work—are offset by initiatives that save resources (e.g., from streamlining) and anticipated staff savings from fewer Fund supported programs in emerging markets. However, budgetary realities call for an even stronger effort and, pending the presentation of a medium-term budget, the *working assumption* here is that real spending, using an external deflator, is frozen in FY 2007 and set to decline by 1 percent in each of the next two years. This stance, which may be contrasted with an average positive real growth of 1 percent in the past three years, will be achieved principally by offshoring, outsourcing and consolidation of the support services that account for a significant part of the Fund's budget. A larger reduction cannot be ruled out, but would entail a sharp curtailment of the institution's mandate—which, to date, is not a demand of the membership.

49. ***Income***. *To place the institution on a sound financial footing over the long term, a new business model, based on a stable source of long-term income, is needed*. Although it is true that the current level of reserves could finance budgetary gaps well into the next decade, and it is possible, if by no means certain, that income will pick up with lending, it is incumbent on an institution devoted to financial prudence to aim for a more credible and durable solution. However, developing a political consensus around any particular measure—be it conversion of gold into earning assets or an annual fee linked to quota or anything else—will take time. It is therefore proposed to catalyze this process by establishing an external committee, headed by an eminent personality, to make recommendations.

IX. Concluding Remarks

50. ***Moving to the implementation phase***. The process for reflecting on a medium-term strategy for the Fund has been a long one. However, it has also been one rich in debate—not just within the Fund, but more importantly, outside of it. The proposals set forth here aim to capture the flavor of that debate while bringing concreteness to the ideas that have emerged. The priority now, after nearly two years of deliberation, should be to move on to the implementation phase of the strategic review.

51. ***Next steps***. Some of the proposals, for example, relating to internal management, can be implemented quickly. Others require Board decisions and, as and when a consensus emerges on specific items, formal decisions will be circulated. And still others require more work by the staff, management, and the Board. Following Board discussion, this paper will be revised in light of comments made by Executive Directors and circulated to members of the IMFC. After the Spring Meeting of the IMFC, a detailed timeline of staff papers and decisions will be circulated to the Board as part of the work program discussion.

TABLE 1. NEW DIRECTIONS IN SURVEILLANCE	
A. A MORE GLOBAL PERSPECTIVE	
➢ Multilateral consultations	• Introduce a new multilateral consultation to promote debate on issues of systemic importance with discussions at the Board and the International Monetary and Financial Committee.
➢ Exchange rate surveillance	• Broaden the Consultative Group on Exchange Rates process to all major emerging market currencies. • As experience is gained, give consideration to publishing CGER analysis in the World Economic Outlook. • Update the 1977 Surveillance decision on exchange rates.
➢ Integrating macroeconomic and financial market analyses	• Strengthen analysis in the WEO and Global Financial Stability Report of macroeconomic risks and their interactions. In the WEO, include risk-based scenario analysis and exploration of the macroeconomic implications of financial sector analysis. In the GSFR, increase attention to managing prudential risks. • Produce Occassional WEO studies on the macroeconomics of globalization.
➢ Regional perspectives	• Formulate regional work plans, focused on key policy issues, intraregional linkages, and the implications of global surveillance.
B. EFFECTIVE COUNTRY SURVEILLANCE	
➢ Financial sector	• Elevate coverage of financial sector issues in Article IVs, with increased focus on financial sector and balance sheet vulnerabilities. • Establish the merged International Capital Markets and Monetary and Financial departments as a center of excellence, with these staff participating in Article IV missions at least to all systemically important and emerging market countries, as well as selected low-income countries. • Through an internal task force, develop an analytical framework for coverage of financial sector issues in Article IVs, aiming to put the Fund at the forefront of financial sector coverage in macroeconomic analysis.
➢ Focus	• Institute rolling multi-year surveillance agendas, identifying staff's priority objectives at the end of each Article IV cycle.
➢ Procedures	• Streamline Article IV reports in alternate years for selected countries. The frequency of the dialogue with the authorities would be unaffected; key changes would be to mission size and length, as well as the volume of papers reporting to the Board.
➢ Multilateral perspective	• Increase the multilateral dimension of Article IV surveillance through an strengthened focus on spillovers and cross-country experience.
C. COMMUNICATIONS	
➢ Outreach	• Make Article IV press conferences routine after missions or Board meetings. • Enhance senior staff and management's engagement with the media through country-specific communications strategies. • Strengthen regional outreach through regional seminars and media events focused on cross-country issues and the implications of global surveillance.

TABLE 2. THE CHANGING ROLE OF THE FUND IN EMERGING MARKET COUNTRIES	
A. THE CENTRALITY OF FINANCIAL MARKET ISSUES	
➢ New emphasis	• Strengthen emphasis on financial and capital market issues. • Give priority to these countries in the FSAP program and the Fund's work on standards and codes.
B. ACCESS TO ADEQUATE FINANCING	
➢ Predictability	• Modify the framework for high-access financing to provide a clear guide to practice outside capital account crises.
➢ Duration	• Recognize upfront the uncertainty associated with recovery from crises and the need for possible successor arrangements.
➢ Repayments	• Eliminate the policy on repurchase expectation and unify surcharges on all exceptional access.
C. CONTINGENT FINANCING FOR CRISIS PREVENTION	
➢ New financing vehicle	• Allow for high-access contingent financing through a new instrument:
• Eligibility	• Provide for eligibility based on strong ownership of good policies, sustainable debt, transparency and a proven track record in dealing with balance sheet weaknesses and vulnerabilities.
• Access and condition for drawing	• Make access of 300 percent of quota available immediately if a capital account crisis emerges and the program is on track. Allow for augmentation with further review. Update exceptional access framework to cover this financing.
• Conditionality	• Focus conditionality on steps needed to address key vulnerabilities and maintain strong macroeconomic stance.
➢ Supporting the pooling of reserves	• Stand ready to support regional and other reserve pooling arrangements, including by signaling sound policies.
D. DEBT RESTRUCTURING	
➢ Lending into arrears	• Fund financing should depend on an agreed medium-term fiscal envelope and macroeconomic framework on which the Fund expresses a clear view. • Review good faith criterion and related aspects of the LIA policy.

Table 3. More Effective Engagement in Low-Income Countries	
A. Aid and the Millennium Development Goals	
➢ Consistency check	• The Fund should assess if projected aid flows are consistent with macroeconomic stability and the estimated costs of achieving countries' development goals.
➢ Candor	• The Fund should inform donors when there is scope for more aid to be absorbed and, conversely, when it judges that expected aid flows put macroeconomic stability at risk.
➢ Resources	• With scope for additional resources strictly limited, seek additional external funding for field-based collaboration with donors and capacity building.
B. Successful Debt Relief	
➢ Sustainability	• Integrate in PRGFs a framework for the design and adoption of a medium-term debt strategy, consistent with sustainability. • Advocate such strategies in non-program LICs and advise the authorities, the Board, and the international community when the staff judges debt accumulation to be on an undesirable trajectory.
➢ Public spending	• Assess if sectoral allocations fit in a consistent macroeconomic framework and report on patterns of poverty-reducing expenditures, while deferring to the World Bank and others to advise on sectoral allocations. • Provide TA for public expenditure management.
C. Focus and Flexibility	
➢ Focus	• Focus the Fund's policy advice, capacity building and financial assistance on macro-critical issues and institutions relevant to financial stability and economic growth. • Work with country authorities, MDBs and other development partners to specify (a) growth-critical issues in the context of the Poverty Reduction Strategy, (b) those issues with which the country needs assistance, and (c) the nature of that assistance (financial, technical or policy advice). Agree with Bank country teams on the roles of the two institutions, with approval at the vice president/department director level. • A task force on Bank-Fund collaboration, led by an eminent outside panel, to provide recommendations for updating the 1989 Concordat on the division of responsibilities at the institutional level.
➢ Flexibility	• Consider a facility with a more flexible conditionality standard and large capacity building component for post-conflict cases. • In countries that have achieved macroeconomic stability and maintained strong growth with progress on poverty issues, rely more on the authorities' own reform agenda in establishing structural conditionality. • Eliminate JSANs; summarize relevant aspects of the PRSP in staff reports.

Table 4. Governance	
A. Quota and Voice	
➢ Fair weight and voice	• Make concrete progress on this issue by the time of the Annual Meetings in Singapore. • Follow a two-stage approach, with an ad hoc increase for the most underrepresented members in the near term, and further steps later. • An increase in basic votes, to strengthen the voice of the smallest members, can be considered in either the first or second phase.
B. Management	
➢ Selection	• Respond to calls for a transparent procedure for the selection of the Managing Director by adopting and publishing guidelines.
C. Executive Board	
➢ Balanced role	• Recognizing the Board's centrality to the legitimacy of the institution, reconsider its role to see if a better balance can be struck between broad oversight and involvement in details.

Table 5. Capacity Building	
A. An Integrated Approach	
➢ Organization and priorities	• To set priorities effectively, area departments to take the lead in producing technical assistance notes in the context of Article IV consultations. • Use these notes as the basis for strategic allocation of resources by functional departments. • Integrate allocation plans and the training program of the Institute with the budget process.
B. Harnessing New Resources	
➢ Outside resources	• Explore scope to mobilize additional outside resources for TA and training. • Develop a reliable data base on costs for external training activities.
➢ Charging	• Explore scope to combine full charging for direct cost of TA and training with a trust fund to subsidize these for low-income countries.
C. Targeting Reports on Standards and Codes	
➢ Prioritization	• For new ROSCs, prioritize systemic and regionally important countries, emerging markets, resource-rich countries, and program countries with weaknesses in areas covered by ROSCs. • Differentiate more in the frequency and focus of ROSC updates. • Integrate ROSCs with Article IV consultations and technical assistance, substituting some updates with participation of specialists in missions.

TABLE 6. STREAMLINING	
A. FOCUSED STAFF PAPERS	
➢ Explicit focus and word limits	• Two steps are proposed: ◦ Require reports to state key issues up front. ◦ Reduce word limits to force more issue-based writing.
➢ Fewer papers	• Three steps are proposed: ◦ Lengthen most policy review cycles to five years and consolidate four of the progress reports (*Report on Streamlining,* Table 3). ◦ Increase flexibility and tailoring to country circumstances of ex post assessments. ◦ Apply greater selectivity in production of selected economic issues papers and statistical appendices.
➢ Move to the web	• Replace paper circulation with web-posting and associated email alerts for routine informational annexes; PRSPs and all ROSCs; working papers; Board and management travel; and various administrative notices.
B. EFFICIENT BOARD PROCEDURE	
➢ Streamlined surveillance	• Two steps are proposed: ◦ Conclude some Article IV consultations within 30-days using short reports centered on concluding statement (see also Table 1). ◦ Reduce the maximum lag between mission and Board discussion from 90 to 60 days (except PRGF countries), with 14-day Board circulation.
➢ Streamlined program reviews	• Use LOT procedures routinely for on-track programs and post-program monitoring reviews.
➢ Misreporting	• Eliminate rigidities in the policy.
➢ Directors' statements and summings up	• Shorten grays and improve modalities for collating Board views. • Shorten summings up to one page for Article IV's and three pages for policy items, unify internal and external summings up for joint Article IV and reviews to two pages.
C. STRONGER MANAGEMENT OVERSIGHT	
➢ Work program	• Reshape process as a near-term implementation plan for the medium-term strategy, with stronger management oversight.
➢ Delegation	• Shorten briefing papers and leave clearance of routine and technical papers to department heads; put in place review and accountability systems that would permit more delegation over time.

Table 7: A Scenario Illustrating the Possible Effects of Proposed Actions on Resource Requirements

	Total Steady-State Staff Positions (including departmental overheads)			Dollar
	Increases	Savings	Net	Equivalent (millions)
TOTAL	**64**	**-69**	**-6**	**0.0**
New Directions in Surveillance	53	-30	22	4.2
of which:				
Financial Sector	32	-17	15	2.9
Resource parity for the financial and fiscal sectors	32	0	32	6.1
Merger of ICM and MFD	0	-7	-7	-1.3
Streamlined FSAPs and GFSR savings	0	-10	-10	-1.9
Occasional WEO Studies on Globalization	10	0	10	1.9
Streamlined Article IV consultations	0	-14	-14	-2.6
Other (outreach, exchange rate work, etc)	11	0	11	2.0
Fewer UFRs in Emerging Markets	0	-7	-7	-1.3
More Effective Engagement in Low Income Countries	10	0	10	1.9
Fewer ROSCs, More Focused Training, and More Targeted TA	0	-8	-8	-1.5
Streamlining	1	-24	-23	-4.3
of which:				
Reduced frequency of policy reviews	0	-9	-9	-1.7
More selectivity in preparation of Selected Issues Papers	0	-6	-6	-1.2
Limit frequency and increase targeting of EPAs	0	-6	-6	-1.1
Other	1	-3	-2	-0.3
Additional dollar costs (including additional travel, consultants)				1.0