1 OVERVIEW

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As FY2010 drew to a close,[1] the global economy appeared to be emerging from the worst recession in over 60 years. The recovery remained uneven, however, with some economies growing very robustly, while others were experiencing more tepid rebounds, and downside risks were increasing—and continued to do so in early FY2011. Policies are needed to address these risks and set the stage for a return to strong and sustained global growth.

During the year, the IMF remained at the center of the international community's efforts to return the global economy to a sustainable growth path. Efforts focused on providing policy advice to members to support recovery, reinforcing the global financial safety net, and fortifying the international financial system. Work advanced on strengthening the Fund, with a focus on reviewing the institution's mandate, modernizing its surveillance work, ensuring that it has adequate financial resources, and reforming its governance structure. In other areas, the restructuring of the income and expenditure sides of the budget continued, human resource policies were modified, transparency increased, and outreach efforts broadened.

EMERGING FROM THE GREAT RECESSION

The global financial crisis that erupted in 2008 took a devastating toll on the world economy. The availability of credit fell, trade collapsed, capital flows dried up, growth slumped, and unemployment rose significantly. While the epicenter of the crisis was a number of advanced economies (and specifically the financial sectors in those countries), the crisis was quickly transmitted to all corners of the globe.

Policymakers responded to the crisis by implementing a set of bold and aggressive monetary, fiscal, and financial sector policy measures that were delivered in an environment of unprecedented cooperation. These concerted policy actions were successful in arresting and then reversing the downward economic spiral. Financial market conditions improved, and the first signs of an emerging recovery became evident in the second half of 2009, with growth gaining steam in early 2010. Nevertheless, the recovery remained moderate and uneven, with advanced country growth relatively weak, but emerging markets and low-income countries generally rebounding strongly.

Although the recovery is proceeding, the outlook is subject to considerable risks. A key task ahead is to reduce sovereign vulnerabilities, which could threaten financial stability and extend the crisis, as public debt levels have increased significantly. The unwinding of monetary accommodation, though necessary and already under way in major emerging markets and some advanced economies, may need to wait in the major advanced economies, in favor of fiscal adjustment and the withdrawal of emergency support to the financial sector. Lingering high unemployment remains a core policy challenge with both macroeconomic and social implications, raising the concern that temporary joblessness will be transformed into structural unemployment. Financial reform must also be high on the policy agenda, and the contours of such reform are clear: higher quantity and quality of capital and better liquidity risk management, a toolkit to address systemic risk in general and too-important-to-fail institutions in particular, and a practical framework to facilitate resolution of cross-border issues. Finally, to restore and sustain robust global growth, demand needs to be rebalanced across countries.

THE IMF'S ROLE IN SUPPORTING A DURABLE RECOVERY

During FY2010, the IMF played a key role in supporting the turnaround in global economic activity. It advocated policy responses that supported the recovery and set the stage for sustained growth, including through a key role in the Group of Twenty (G-20) meetings, and provided support to countries through large programs, including precautionary Flexible Credit Lines (FCLs). It also introduced a number of new measures and advocated policy adaptations in several areas:

- ***Strengthening the global financial safety net.*** The IMF expanded its lending resources during FY2010 and approved and implemented a general allocation of Special Drawing Rights (SDRs) to infuse liquidity into the global economy. It revised and expanded its financing facilities to ensure their continued alignment with member needs through the crisis and its aftermath. Responding to the particularly severe impact of the crisis on many low-income countries, the Fund increased its concessional lending capacity and modified the framework through which it conducts such lending. The Fund's Executive Board approved 14 nonconcessional financing arrangements totaling SDR 72.2 billion during the financial year, with the majority (SDR 52.2 billion) linked to FCLs. Additionally, loan commitments under the Fund's concessional facilities for low-income countries increased sharply, to SDR 2.2 billion.

- ***Maintaining policy stimulus until a sustained recovery in private demand is apparent, while designing, communicating, and beginning to implement credible medium-term fiscal consolidation strategies, depending on countries' specific circumstances.*** The Fund's advice was that fiscal stimulus should be fully implemented, except in countries that faced large increases in risk premiums, where the urgency was greater and consolidation needed to begin. If macroeconomic developments proceed as projected in the IMF's *World Economic Outlook*, most advanced economies should embark on fiscal consolidation in 2011. Consolidation strategies needed to be implemented in a way that was as "growth-friendly" as possible and accompanied by structural reforms that would

Left Workers manufacture petroleum gas canisters at a factory in Cikarang, Indonesia. **Right** IMFC meeting at the October 2009 Annual Meetings, Istanbul Congress Center, Turkey.

boost potential growth. Insofar as inflation expectations remained well anchored, monetary policy could continue being accommodative as fiscal consolidation progressed. Emerging markets would need to lead the tightening cycle, as they were experiencing faster recoveries than advanced economies. Looking forward, the balance of Fund policy advice has shifted toward fiscal consolidation and away from fiscal stimulus.

- ***Reforms to strengthen the global financial system.*** While IMF estimates of the losses suffered by financial systems during the crisis declined during the course of FY2010 as growth restarted and financial markets rebounded, financial institution balance sheets remained stressed in many cases. Fund policy advice deemed repairing balance sheets and revamping financial sector regulation and supervision to be essential for reducing risks and supporting the credit growth needed to underpin a durable recovery.

- ***Policies to rebalance global growth.*** IMF policy advice called for countries that ran excessively high external deficits before the crisis to put in place plans to consolidate their public finances to maintain investor confidence, again in ways that were as growth-friendly as possible. The onus would then fall on those countries that ran excessive current account surpluses to power global demand by shifting from export-propelled growth toward domestic demand. As the currencies of economies with excessive deficits depreciated, then it would follow that those of surplus countries must appreciate. The IMF advised that rebalancing should be supported by financial sector reform and appropriate structural policies in both surplus and deficit countries.

- ***Capacity building.*** The crisis increased the importance of the IMF's technical assistance to build capacity in member countries, both for formulating and for implementing sound macroeconomic policies. The Fund responded urgently to increasing needs in this area, providing technical assistance to a number of countries particularly in dealing with macroeconomic aspects of the crisis.

STRENGTHENING THE FUND TO MEET THE CHALLENGES AHEAD

Significant risks to the recovery remained as FY2010 ended and were expected to persist for some time. An increasing focus was therefore placed during the financial year on strengthening the IMF so it is fully equipped for its evolving role in the global economy. At the October 2009 Annual Meetings in Istanbul, the International Monetary and Financial Committee (IMFC) identified key priorities for the institution going forward:

- Reassess the mandate of the institution to encompass the full range of macroeconomic and financial sector policies that bear on global stability;

- Continue 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;

- Sharpen multilateral surveillance and better integrate it into bilateral surveillance, and undertake further strengthening of cross-country, regional, and multilateral surveillance;

- Reform Fund governance, to increase the Fund's legitimacy and effectiveness.

Reviewing the IMF's mandate

At the October 2009 Annual Meetings, the IMFC called on the IMF to "review its mandate to cover the full range of macroeconomic and financial sector policies that bear on global stability," asking for a report by the 2010 Annual Meetings. Surveillance, financing, and the stability of the international monetary system—broad areas of focus in the Fund's mandate-related work—became a focus of staff papers and Board discussions in the closing months of FY2010 and continuing into the current financial year.

Financing for the twenty-first century

IMF resources

Ensuring that the IMF has adequate resources to meet potential demands was a key focus of the Executive Board in FY2010. In accordance with objectives identified by G-20 leaders in April 2009 and subsequently endorsed by the IMFC, the IMF took rapid and decisive action to assess its available resources and ensure their continuing adequacy for meeting members' needs. Discussions with a number of member countries regarding potential additional bilateral borrowing agreements began in the first half of 2009,[2] and 15 more agreements were signed and took effect in FY2010. Under a framework for issuance of notes to member countries and central banks that was approved by the Board during the year, three bilateral agreements to purchase IMF notes were also signed and became effective. The first use of borrowed resources made available under the various agreements took place in July 2009.

As the bilateral borrowing agreements were put in place as a rapid source of additional resources to meet crisis-driven financing needs, the IMF simultaneously moved to increase its lending resources on a more permanent basis. In November 2009, existing and potential new participants in the IMF's New Arrangements to Borrow (NAB)[3] reached agreement on an expanded and more flexible NAB. The Executive Board subsequently issued a decision expanding the NAB to SDR 367.5 billion (about US$550 billion, at the end-FY2010 exchange rate) and adding 13 new participants, including a number of emerging market countries. In a subsequent discussion of the adequacy and composition of the IMF's lending resources, Executive Directors emphasized that the Fund is, and should remain, a quota-based institution, despite the large increase in available resources under the new NAB, and most 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.

Financing for member countries

In parallel with its efforts to ensure the adequacy of its resources, the IMF also worked extensively during the year on refining its lending toolkit to meet the needs of its member countries in the crisis and thereafter. The Board had approved a major overhaul of the Fund's nonconcessional lending framework at the end of FY2009, and in FY2010 it considered preliminary ideas on further modifications, including (1) refining the FCL by extending its duration, increasing the predictability of qualification, and removing the informal cap on access amounts; (2) establishing a Precautionary Credit Line for countries that do not meet the FCL's qualification requirements but have sound policies; and (3) developing a mechanism through which the IMF could offer liquidity lines to countries with potentially systemic effects. Further work is also planned to strengthen links with regional financing arrangements.

Extending the work it began in FY2009 with its reform of nonconcessional financing, the Executive Board in FY2010 approved reforms to the structure, conditionality, and financial terms of the IMF's concessional financing facilities for low-income countries. A new Poverty Reduction and Growth Trust (PRGT) was established to replace and expand the existing Poverty Reduction and Growth Facility–Exogenous Shocks Facility (PRGF-ESF) Trust, effective January 2010. Along with the new set of lending instruments, the IMF has more than doubled its financial assistance to low-income countries. Its concessional lending capacity is expected to increase to US$17 billion through 2014, including up to US$8 billion in the first two years.

Modernizing IMF surveillance

The global crisis emphasized the need to modernize IMF surveillance to ensure that spillovers from economic developments and policies in one country to others and the central role of the financial sector in affecting economic outcomes are adequately captured in surveillance assessments. The Board considered a number of proposals in this regard, including

- a greater focus on outward spillovers from countries whose policies or circumstances have an impact on the stability of the global system overall, thus helping bridge multilateral and bilateral perspectives;
- initiating new multilateral consultations as needed to foster collaboration and collective action on special topics that do not overlap with existing mechanisms (e.g., in the G-20 mutual assessment process) and to engage more with existing country groups; and
- strengthening financial sector surveillance by mapping interconnectedness across borders and sectors and the transmission channels of macrofinancial instability, filling gaps in financial sector data, and collaborating with key entities involved in financial stability work.

Left A fisherman dries fish on the Cape Maclear Peninsula in Malawi. **Right** IMFC meeting at the April 2010 Spring Meetings, IMF headquarters, Washington, D.C.

The Board also reviewed the Financial Sector Assessment Program (FSAP) during the year and strengthened it in a number of ways. It was agreed that expansion of country coverage and enhancement of the focus and frequency of assessments would increase the program's usefulness.

As part of a broader ongoing effort to increase its coordination with other international organizations, identified as a priority area by the Managing Director, the IMF made increased efforts in FY2010 to collaborate with other international bodies in areas related to its surveillance activities. In September 2009, the IMF was invited to play a role in the G-20 mutual assessment process, which has emphasized that coordinated economic policy has the potential to raise global growth in a sustained and balanced way. The IMF was asked to analyze how the G-20's respective national and regional policy frameworks fit together and examine the policies pursued by individual G-20 countries to assess whether they are collectively consistent with sustainable and balanced paths for the global economy. Together with the Financial Stability Board (FSB), the IMF also developed a semiannual early warning exercise to enhance capabilities for assessing risks to the global economy arising from events that, though unlikely, would have substantial impacts should they occur, and to identify options for mitigating these risks.

The crisis highlighted ways that data collection deficiencies impeded identification and evaluation of vulnerabilities, raising awareness of the importance of both sound data and strong data analysis in surveillance and policy. Working together, the IMF and FSB consulted extensively in FY2010 with official users of economic and financial data in G-20 countries and at other international institutions, then issued recommendations on key information gaps revealed by the crisis. Through the launch of a website providing public access to a database of financial soundness indicators for selected member countries, the IMF took a step toward strengthening the international reporting of these indicators, one of the recommendations issued by the IMF-FSB study.

Reforming IMF governance

As of the end of FY2010, the IMF's most recent quota reform, which was approved by the Board of Governors in April 2008, was still short of the required votes for ratification. The reform is intended, among other things, to advance the goals of increasing the voting share of dynamic emerging markets and enhancing the voice of low-income countries. In its April 2010 communiqué, the IMFC urged members to consent promptly to the reform. Work on additional quota reform began in FY2010 in the context of the Fourteenth General Review of Quotas, which is slated to be completed before January 2011. 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 a basis from which to work, and committed to protecting the voting share of the Fund's poorest members.

Responding to a call by the IMFC for a report on Fund governance, the Executive Board met in July 2009 for an initial discussion of the main issues and reform options from several reports and consultations with civil society. The Executive Board presented its "Report to the IMFC on Reform of Fund Governance" prior to the October 2009 Annual Meetings, where the IMFC stressed the importance of governance reform in regard to Fund legitimacy and effectiveness. Subsequently, the Board discussed considerations on the size of the Fund (in connection with the Fourteenth General Review of Quotas), reforms to the IMFC process, the case for moving to an all-elected Executive Board, and the management selection process.

FINANCES, ORGANIZATION, AND ACCOUNTABILITY

During FY2010, the IMF continued the implementation of a program of internal reforms approved by the Executive Board in 2008 to restructure both the IMF's income and expenditures. On the income side, a key component of the reforms was the sale of a limited quantity of IMF gold, intended to enable the IMF to shift to a new income model and supplement its concessional lending resources. Approved by the Board in September 2009, gold sales were made to three central banks in October–November 2009, and sales on the market began in February 2010. On the expenditure side, significant further progress was made towards achieving permanent reductions in expenditures and staff positions.

In the area of human resources, the 2008 restructuring exercise led to a larger-than-expected number of voluntary separations just as crisis-related work generated a need for temporary additional staff. An initial phase of internal redeployment was followed by a vigorous external recruitment effort that spilled over into FY2010. Recruitment efforts that were focused on underrepresented regions, part of ongoing activities to enhance diversity at the Fund, yielded encouraging, but mixed, results, and the Fund launched a Diversity Scorecard as a transparent way of tracking its progress toward achievement of its diversity objectives. Reforms were also introduced to sustain a positive performance culture and offer mechanisms for rewarding staff for high performance and provide avenues for career enhancement.

Important reforms to the IMF's transparency policy during FY2010 continued a decade-long progression toward greater openness about the Fund's activities. Among a number of changes made, the Board supported a shift to publication of country documents and related policy intention documents on a nonobjection basis and shortened the waiting period for archived documents to be made available to the public.

The IMF's outreach efforts, like many aspects of its work, expanded and intensified as part of the response to the global crisis. Executive Directors and members of the management team stepped up visits to member countries, including a significant number of low-income countries. At the 2009 Annual Meetings in Istanbul, outreach activities aimed at stakeholders in economic policymaking worldwide included a Civil Society Policy Forum that brought together World Bank and Fund staff, civil society representatives, government officials, and others in a series of policy dialogs.