3 POLICIES TO SECURE SUSTAINED AND BALANCED GLOBAL GROWTH

3 POLICIES TO SECURE SUSTAINED AND BALANCED GLOBAL GROWTH

As the recovery from the global economic crisis continued at varying speeds and in varying modes across the globe in FY2011, the IMF's efforts were directed toward identifying and promoting the implementation of policies that would secure sustained and balanced growth in the world economy and continuing to offer financial and other support to member countries suffering from the crisis's lingering effects.

Demand for Fund resources remained high, with 30 arrangements (13 nonconcessional, 17 concessional) approved during the year; of the total nonconcessional financing of SDR 142.2 billion, more than half (SDR 82.5 billion) was under FCLs for Colombia, Mexico, and Poland, and another SDR 45.9 billion went to support Greece and Ireland. Support for low-income countries also continued at a high level, with concessional financing during the year totaling SDR 1.1 billion. While attending to countries' immediate financing needs, the IMF

- continued to expand its financing toolkit in forward-looking ways, instituting the PCL, which, like the successful FCL, relies on prequalification but also on ex post conditionality and may be available to a wider group of countries, and by establishing a Post-Catastrophe Debt Relief Trust to enable it to offer additional support to member countries afflicted by the worst disasters.

- enhanced work in its core area of surveillance, focusing on a review of the institution's surveillance mandate, as well as the modalities under which surveillance is conducted, and assigning priority to promoting the functioning and stability of the international monetary system, with Executive Board and staff work regarding capital flows, reserves, and the role of the SDR in enhancing international monetary stability.

- considered a broad spectrum of issues involved in strengthening the global financial architecture, brought to the fore by the crucial role played by the financial sector in the recent crisis.

- focused on issues facing the Fund's low-income members, with Board discussions on macroeconomic challenges and enhancing domestic revenues, along with the introduction of the analytical framework for a Vulnerability Exercise aimed at assessing risks posed to these countries by changes in the global economy.

SECURING BALANCED GROWTH AND A STRONGER, MORE SUSTAINABLE GLOBAL ECONOMY

The multispeed nature of the recovery from the global crisis, along with residual issues in a number of countries (slow employment growth, high indebtedness, financial sector fragilities), presented persistent challenges for the global economy in FY2011. During the year, the IMF supported efforts to build a strong and sustainable recovery, based on a more-balanced pattern of global growth, continued its financial support for member countries, and made additions to the IMF's toolkit for providing such support.

Modernizing the Fund's surveillance

Under its Articles of Agreement (the institution's charter), the IMF is responsible for overseeing the international monetary system and monitoring the economic and financial policies of its 187 member countries, an activity known as surveillance. As part of the process, which takes place at the global level, at the regional level, and in individual countries, the IMF highlights possible risks to domestic and external stability and advises on the necessary policy adjustments.[2] In this way, it helps the international monetary system serve its essential purpose of facilitating the exchange of goods, services, and capital among countries, thereby sustaining sound economic growth.

In September 2010, as a follow-up to several previous discussions, the Executive Board met for a discussion on how best to modernize the mandate and modalities of IMF economic surveillance in the aftermath of the global crisis.[3] Executive Directors agreed that there was scope for strengthening the Fund's multilateral surveillance by increasing the synergies among various products.

Most Executive Directors supported staff proposals to enhance integration of the Fund's multilateral macrofinancial analysis in the *World Economic Outlook* (WEO) and *Global Financial Stability Report* (GFSR), and to prepare a short stand-alone document with the main policy messages from these and related surveillance products, including the *Fiscal Monitor* (FM). Noting that past surveillance reviews had called for better coverage of outward spillovers, Executive Directors agreed that the Fund should strengthen its spillover analysis. Many supported the proposed experimentation with "spillover reports" for systemic economies;[4] in this context, staff were directed to provide further clarification on the expectations, process, and logistics for such reports.

Executive Directors emphasized the importance of enhancing the traction of IMF surveillance, while acknowledging that traction is complex to define and measure. They urged the continuation of efforts to improve traction in both policy action and policy debate. Most supported staff proposals to simplify and improve the flexibility of the rules applicable to Article IV consultation cycles.

In the near and medium terms, three priority areas for IMF surveillance have been identified: (1) pursuing growth consistent with macrofinancial stability and job creation, (2) reforming the international monetary system and rebalancing external demand, and (3) continuing to adapt IMF support to low-income members. These priority areas reflect awareness more broadly of the need to enhance—indeed transform—surveillance of the global economy to help policymakers be ahead of the curve.

Bilateral surveillance

The centerpiece of the IMF's bilateral (or individual-country) surveillance is the Article IV consultation (see Web Box 3.1), normally held every year with each member of the Fund in accordance with Article IV of the Fund's Articles of Agreement. The IMF conducts a thorough assessment of relevant economic and financial developments, prospects, and policies for each of its members, and provides candid policy advice based on its analysis. A total of 127 Article IV consultations were completed during FY2011 (see Web Table 3.1). In the vast majority of cases, the staff report and other analysis accompanying the consultation are also published on the IMF's website.

The IMF's Executive Board reviews the implementation of the Fund's bilateral surveillance every three years. Since the last Triennial Surveillance Review in 2008, the Fund has assisted members in addressing the repercussions of the global financial crisis while also tackling gaps in its surveillance framework that the crisis revealed. In March 2011, the Executive Board held an informal discussion in preparation for the next Triennial Surveillance Review, which was expected to be completed in September 2011.

Multilateral surveillance

The IMF's Articles of Agreement require the Fund to "oversee the international monetary system in order to ensure its effective operation." To carry out this function, known as "multilateral surveillance," the IMF continuously reviews global economic trends. Its key instruments of multilateral surveillance are three semiannual publications, the WEO, the GFSR, and the FM. These publications, along with the five *Regional Economic Outlook* reports (see "Engagement with External Stakeholders" in Chapter 5), constitute the IMF's World Economic and Financial Surveys, and aid the Fund in its examination of economic and financial developments among the membership. Interim updates for the WEO, GFSR, and FM are issued twice a year.

The WEO provides detailed analysis of the state of the world economy and evaluates economic prospects and policy challenges at the global and regional levels. It also offers in-depth analysis of issues of pressing interest. The October 2010 WEO focused on recovery, risk, and rebalancing, and the April 2011 edition examined tensions from the two-speed recovery, particularly in regard to unemployment, commodity prices, and capital flows. The GFSR provides an up-to-date assessment of global financial markets and prospects and addresses emerging market financing issues in a global context. Its purpose is to highlight imbalances and vulnerabilities that could pose risks to financial market stability. The topics covered in FY2011 were sovereign debt, legacy problems in banks, and systemic liquidity (October 2010) and high debt burdens and the path to durable financial stability (April 2011). The FM surveys and analyzes the latest public finance developments, updates reporting on fiscal implications of the global economic situation and medium-term fiscal projections, and assesses policies to put public finances on a sustainable footing. The November 2010 issue of the FM considered fiscal exit, from strategy to implementation, and the April 2011 edition examined ways to tackle challenges on the road to fiscal adjustment.

A survey of the issues covered in the WEO, GFSR, and FM in FY2011 is presented in Chapter 2.

Financial sector surveillance

The global financial crisis highlighted the need for deeper analysis of linkages between the real economy and the financial sector, resulting in greater emphasis on integrating financial sector issues into the IMF's surveillance activities. Financial sector issues are receiving greater coverage in the Fund's bilateral surveillance, building on the Financial Sector Assessment Program.[5] Analytical tools for integrating financial sector and capital markets analysis into macroeconomic assessments are also being developed. In its advice to individual countries, the IMF staff tries to leverage cross-country experiences and policy lessons, drawing on the organization's unique experience as a global financial institution. The IMF's work in the area of financial sector surveillance is highlighted in "Building a More Robust Global Financial System" later in the chapter.

Spillover reports

As mentioned previously, in its follow-up discussion on modernizing the Fund's surveillance mandate and modalities in September 2010, the Executive Board decided that the Fund should strengthen its analysis of spillovers, starting with "spillover reports" for systemic economies. Work was started in FY2011 on such reports for five economies/areas (China, the euro area, Japan, the United Kingdom, and the United States).

Early Warning Exercise

As part of its efforts to strengthen surveillance, especially the analysis of economic, financial, and fiscal risks, as well as cross-sectoral and cross-border spillovers, the IMF conducts semi-annual Early Warning Exercises in cooperation with the Financial Stability Board (FSB). The exercises examine risks with a low probability but a high potential impact that would result in policy recommendations that could differ from those generated under the baseline scenario presented in the WEO, GFSR, and FM. Early Warning Exercises do not attempt to predict crises, but to identify the vulnerabilities and triggers that could precipitate systemic crises, along with risk-mitigating policies, including those that would require international cooperation. Executive Board members were briefed on the results of the fall 2010 exercise at an informal seminar in late September, and the results of the spring 2011 exercise were discussed at an informal Board session in early April.

Emerging market performance during the global crisis

Following an initial evaluation of IMF financing to emerging markets in response to the crisis, in which the Board requested a broader evaluation of how these countries had coped in the crisis, the Board took up that topic in a June 2010 seminar, drawing some preliminary conclusions from emerging markets' experience.[6] Executive Directors emphasized that for both advanced and emerging market economies alike, sound policy frameworks and continued efforts to improve economic fundamentals are the first line of defense against future shocks. They highlighted the need to strengthen vulnerability analyses and the importance of IMF surveillance and policy advice more broadly. Executive Directors acknowledged that recovery across emerging market countries had been helped by, and in turn contributed to, growth in advanced economy trading partners. They saw the risk that fast recoveries might lead to rising capital inflows, closing of output gaps, and rising inflation. Raising interest rates when policy rates in major advanced economies remained near historic lows could prompt excessive capital inflows, which could, in turn, fuel asset price bubbles. Monetary policy decisions might thus be constrained in some emerging market countries.

Revenue and expenditure policies for fiscal consolidation

In a discussion in February 2010, the Board noted that general government debt was on the rise in advanced countries, along with age-related expenditures such as health care and pensions, as well as in emerging economies. The following May, the Board returned to the topic, discussing revenue and expenditure policies for fiscal consolidation in these economies.[7] Most Executive Directors concurred that the strategy for consolidation, particularly in advanced economies, should aim to stabilize age-related spending in relation to GDP, reduce non-age-related expenditure ratios, and increase revenues efficiently. Executive Directors underscored that the appropriate mix of measures is different for each country, though spending cuts would likely need to dominate. They expressed concern about the compliance gaps in tax systems in many countries, and the evidence of pervasive tax abuse through informality, aggressive tax planning, offshore tax abuse, fraud, and increasing tax debt as a result of the crisis and recession. They observed that recent advances in international collaboration in tax information exchange and transparency were an important step forward.

Financial support for IMF member countries

IMF financing in FY2011

Nonconcessional financing

The demand for Fund resources remained high in FY2011, and commitments continued to increase at a rapid pace. The Executive Board approved 13 nonconcessional arrangements during the year, for a gross total of SDR 142.2 billion.[8] The two largest nonprecautionary arrangements approved in FY2011 involved euro area member countries—Greece and Ireland.

Left A worker sorts tobacco leaves to be used for cigars in Danli, Honduras. **Right** A man boils willow in a cauldron as part of the wickerworking process in Iza, Ukraine.

In May 2010, the Executive Board approved an SDR 26.4 billion (about €30 billion) three-year Stand-By Arrangement for Greece in support of the authorities' multiyear economic adjustment and reform program, whose key objectives are to boost competitiveness, strengthen financial sector stability, and secure sustainable public finances, so that growth and jobs can in time be restored. The program is designed so that the burden will be shared across all levels of society and the most vulnerable groups will be protected. The arrangement was part of a cooperative package of financing with euro area member states amounting to €110 billion. The program made SDR 4.8 billion (about €5.5 billion) immediately available to the Greek authorities, and after the third review of Greece's economic performance in March 2011, Fund disbursements under the arrangement amounted to the equivalent of SDR 12.7 billion (about €14.6 billion).

Deteriorating public deficits and debt in the wake of extraordinary official support for the country's banking sector put intense economic and financial pressures on Ireland in 2010. In December 2010 the Board approved an SDR 19.5 billion (about €22.5 billion) three-year Extended Fund Facility arrangement for the country that involved exceptional access. As in the case of Greece, the arrangement was part of a larger financing package in cooperation with the European Union, in this case amounting to €85 billion, including Ireland's own contribution. The main goal of the authorities' economic and financial program, which builds on recent efforts in the country, is to restore confidence and financial stability by restructuring and recapitalizing the banking sector, making it smaller and more resilient, and by implementing fiscal consolidation and reforms aimed at enhancing competitiveness and growth. It steps up the pace and range of measures to address financial and fiscal stability concerns, with a financial system strategy resting on twin pillars: deleveraging and reorganization, and ample capitalization. A substantial share of the total financing package, SDR 5.0 billion (about €5.8 billion), was made available immediately after the arrangement became effective. The combined first and second reviews under the program were completed by the Board in May 2011, and an additional SDR 1.4 billion (€1.6 billion) in Fund resources was made available to the authorities.

More than half of the Fund's gross nonconcessional financing commitments for FY2011 (SDR 82.5 billion) were under the FCL arrangements for Colombia, Mexico, and Poland. In the case of Poland, two FCL arrangements were approved during the period. The first became effective in July 2010 for a period of one year and, at the authorities' request and with Board approval, was replaced in January 2011 by a new two-year FCL arrangement with a higher level of access. The FCL arrangements for Colombia and Mexico were successor arrangements that became effective in May 2010 and January 2011 for periods of one and two years, respectively.

Of the nonconcessional arrangements approved in FY2011, two were on Extended Fund Facility terms (those for Armenia and Ireland),[9] while six were Stand-By Arrangements, three involved exceptional access (those for Greece, Ireland, and Ukraine), and two were precautionary (those for Honduras and Romania).[10] In January 2011, the Executive Board approved a PCL arrangement for the former Yugoslav Republic of Macedonia—the first such arrangement since the PCL was added to the Fund's crisis prevention toolkit. There were no augmentations of previously approved nonconcessional arrangements in FY2011. In total, by end-April 2011, purchases[11] from the General Resources Account (GRA) reached SDR 26.6 billion, with purchases by Greece and Ireland accounting for about two-thirds of the total. Repurchases for the period amounted to SDR 2.1 billion.

Table 3.1 provides general information about the IMF's financing facilities, and Table 3.2 and Figure 3.1 detail the nonconcessional arrangements approved during the year, with Figure 3.2 offering information on nonconcessional resources outstanding over the last 10 years.

Table 3.1

IMF financing facilities

Credit facility (year adopted)	Purpose	Conditions	Phasing and monitoring[1]
CREDIT TRANCHES AND EXTENDED FUND FACILITY[3]			
Stand-By Arrangements (1952)	Medium-term assistance for countries with balance of payments difficulties of a short-term character.	Adopt policies that provide confidence that the member's balance of payments difficulties will be resolved within a reasonable period.	Quarterly purchases (disbursements) contingent on observance of performance criteria and other conditions.
Flexible Credit Line (2009)	Flexible instrument in the credit tranches to address all balance of payments needs, potential or actual.	Very strong ex ante macroeconomic fundamentals, economic policy framework, and policy track record.	Approved access available up front throughout the arrangement period, subject to a midterm review after one year.
Extended Fund Facility (1974) (Extended Arrangements)	Longer-term assistance to support members' structural reforms to address balance of payments difficulties of a long-term character.	Adopt 3-year program, with structural agenda, with annual detailed statement of policies for the next 12 months.	Quarterly or semiannual purchases (disbursements) contingent on observance of performance criteria and other conditions.
Precautionary Credit Line (2010)	Instrument for countries with sound fundamentals and policies.	Strong policy frameworks, external position, and market access, including financial sector soundness.	Large front-loaded access, subject to semiannual reviews.
SPECIAL FACILITIES			
Emergency Assistance	Assistance for balance of payments difficulties related to the following:		None, although post-conflict assistance can be segmented into two or more purchases.
(1) Natural disasters (1962)	Natural disasters.	Reasonable efforts to overcome balance of payments difficulties.	
(2) Post-conflict (1995)	The aftermath of civil unrest, political turmoil, or international armed conflict.	Focus on institutional and administrative capacity building to pave the way toward the upper credit tranche or Poverty Reduction and Growth Trust arrangement.	
FACILITIES FOR LOW-INCOME MEMBERS UNDER THE POVERTY REDUCTION AND GROWTH TRUST			
Extended Credit Facility (ECF) (2010)[5]	Longer-term assistance for deep-seated balance of payments difficulties of structural nature; aims at sustained poverty-reducing growth.	Adopt 3-year ECF arrangements. ECF-supported programs are based on a Poverty Reduction Strategy Paper prepared by the country in a participatory process and integrating macroeconomic, structural, and poverty reduction policies.	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews.
Standby Credit Facility (SCF) (2010)	"Stand-By Arrangement–like" to address short-term balance of payments and precautionary needs.	Adopt 12–24-month SCF arrangements. Replaces a high-access component of the Exogenous Shocks Facility (ESF) and provides support under a wide range of circumstances.	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews (if drawn).
Rapid Credit Facility (RCF) (2010)	Rapid assistance for urgent balance of payments needs arising from an exogenous shock or natural disaster in cases where an upper credit tranche–quality program is not needed or feasible.	No review-based program necessary or ex post conditionality. Replaced the Rapid Access Component (RAC) of the ESF and a subsidized component of Emergency Natural Disaster Assistance/Emergency Post-Conflict Assistance.	Usually in a single disbursement.

1 Except for that which is made available through the Poverty Reduction and Growth Trust, the IMF's lending is financed from the capital subscribed by member countries; each country is assigned a *quota* that represents its financial commitment. A member provides a portion of its quota in foreign currencies acceptable to the IMF—or SDRs—and the remainder in its own currency. An IMF loan is disbursed or drawn by the borrower *purchasing* foreign currency assets from the IMF with its own currency. Repayment of the loan is achieved by the borrower *repurchasing* its currency from the IMF with foreign currency. ECF, RCF, and SCF concessional lending is financed by a separate Poverty Reduction and Growth Trust.

2 The *rate of charge* on funds disbursed from the General Resources Account is set at a margin over the weekly interest rate on SDRs. The rate of charge is applied to the daily balance of all outstanding GRA drawings during each IMF financial quarter. In addition, a one-time service charge of 0.5 percent is levied on each drawing of IMF resources in the GRA, other than reserve tranche drawings. An up-front commitment fee (15 basis points on committed amounts of up to 200 percent of quota; 30 basis points for amounts in excess of 200 percent and up to 1,000 percent of quota; and 60 basis points for amounts in excess of 1,000 percent of quota) applies to the amount that may be drawn during each (annual) period under a Stand-By, Flexible Credit Line, Precautionary Credit Line, or Extended Arrangement; this fee is refunded on a proportionate basis as subsequent drawings are made under the arrangement. A precautionary arrangement under the SCF is subject to an availability fee of 15 basis points per annum on the undrawn portion of amounts available during each six-month period.

Access limits[1]	Charges[2]	Schedule (years)	Installments
Annual: 200% of quota; cumulative: 600% of quota.	Rate of charge plus surcharge (200 basis points on amounts above 300% of quota; additional 100 basis points when outstanding credit remains above 300% of quota for more than 3 years).[4]	3¼–5	Quarterly
No preset limit.	Rate of charge plus surcharge (200 basis points on amounts above 300% of quota; additional 100 basis points when outstanding credit remains above 300% of quota for more than 3 years).[4]	3¼–5	Quarterly
Annual: 200% of quota; cumulative: 600% of quota.	Rate of charge plus surcharge (200 basis points on amounts above 300% of quota; additional 100 basis points when outstanding credit remains above 300 percent of quota for more than 3 years).[4]	4½–10	Semiannual
500% of quota available upon approval of arrangements; total of 1,000% of quota after 12 months of satisfactory progress.	Rate of charge plus surcharge (200 basis points on amounts above 300% of quota; additional 100 basis points when outstanding credit remains above 300 percent of quota for more than 3 years).[4]	3¼–5	Quarterly
Generally limited to 25% of quota, though larger amounts of up to 50% can be made available in exceptional cases.	Rate of charge; however, the rate of charge may be subsidized to 0.25% a year, subject to resource availability.	3¼–5	Quarterly
Annual: 100% of quota; cumulative: 300% of quota.	0% (1/7/2010–end-2011)	5½–10	Semiannual
Annual: 100% of quota; cumulative: 300% of quota.	0% (1/7/2010–end-2011)	4–8	Semiannual
Annual: 25% (up to 50% of quota); cumulative: 75% (up to 100% of quota).	0% (1/7/2010–end-2011)	5½–10	Semiannual

3 *Credit tranches* refer to the size of purchases (disbursements) in terms of proportions of the member's quota in the IMF; for example, disbursements up to 25 percent of a member's quota are disbursements under the *first* credit tranche and require members to demonstrate reasonable efforts to overcome their balance of payments problems. Requests for disbursements above 25 percent are referred to as *upper* credit tranche drawings; they are made in installments as the borrower meets certain established performance targets. Such disbursements are normally associated with a Stand-By or Extended Arrangement. Access to IMF resources outside an arrangement is rare and expected to remain so.

4 Surcharge introduced in November 2000. A new system of surcharges took effect on August 1, 2009, replacing the previous schedule: 100 basis points above the basic rate of charge on amounts above 200 percent of quota, and 200 basis points surcharge on amounts above 300 percent of quota. A member with credit outstanding in the credit tranches or under the Extended Fund Facility on, or with an effective arrangement approved before, August 1, 2009, had the option to elect between the new and the old system of surcharges.

5 The ECF was previously known as the Poverty Reduction and Growth Facility.

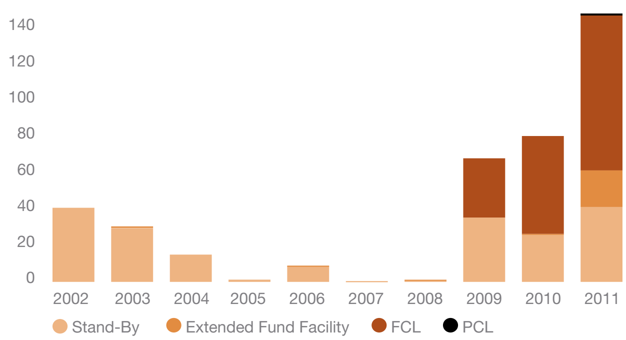
Left Workers make prostheses at a local hospital in Lomé, Togo. **Right** Laborers build a transitional shelter for flood victims at a village in Charsadda, Pakistan.

Emergency assistance. The Fund's Emergency Natural Disaster Assistance (ENDA) is provided to allow members to meet their immediate balance of payments financing needs arising from natural disasters without a serious depletion of their external reserves, such as in cases of shortfalls in export earnings and/or increased imports. Emergency assistance financing (see Web Tables 3.2 and 3.3) is disbursed in the form of outright purchases and does not involve specific economic performance targets. (Additionally, to support its poorest members affected by the most catastrophic of natural disasters, Fund assistance in the form of debt relief is now available through the Post-Catastrophe Debt Relief Trust; see Box 3.1.)

In September 2010, the Executive Board approved a disbursement of SDR 296.98 million (about US$451 million) for Pakistan under ENDA to help the country manage the immediate aftermath of the massive and devastating floods that ravaged the country in July 2010. In January 2011, the Executive Board approved a combined SDR 5.36 million (about US$8.19 million) in emergency assistance for St. Lucia to help the country cope with the economic consequences of Hurricane Tomas, which struck the Caribbean island in late October 2010, causing loss of life and significant damage to the nation's road network, water supply, and agriculture sector. The financial assistance consists of an SDR 3.83 million (about US$5.85 million) disbursement under the IMF's Rapid Credit Facility (RCF) and SDR 1.53 million (about US$2.34 million) under ENDA. A month later, the Executive Board approved a disbursement of an amount equivalent to SDR 2.075 million (about US$3.26 million) under the RCF for St. Vincent and the Grenadines to help the country manage the economic impact of Hurricane Tomas, which inflicted significant damage on agriculture, housing, and infrastructure in that country as well.

Figure 3.1

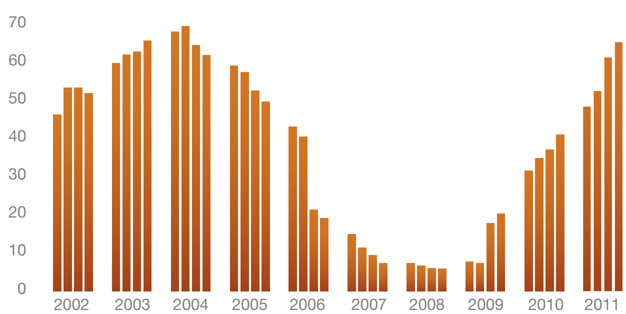
Arrangements approved during financial years ended April 30, 2002–11 (In billions of SDRs)



Source: IMF Finance Department.

Figure 3.2

Regular loans outstanding, FY2002–11
(In billions of SDRs)



Source: IMF Finance Department.

Table 3.2

Arrangements under main facilities approved in FY2011 (In millions of SDRs)

Member	Type of arrangement	Effective date	Amount approved
New Arrangements			
Antigua and Barbuda	36-month Stand-By	June 7, 2010	81.0
Armenia	36-month Extended Fund Facility	June 28, 2010	133.4
Colombia	12-month Flexible Credit Line	May 7, 2010	2,322.0
Greece	36-month Stand-By	May 9, 2010	26,432.9
Honduras	18-month Stand-By	October 1, 2010	64.8
Ireland	36-month Extended Fund Facility	December 16, 2010	19,465.8
Kosovo	18-month Stand-By	July 21, 2010	92.7
Macedonia, former Yugoslav Republic of	24-month Precautionary Credit Line	January 19, 2011	413.4
Mexico	24-month Flexible Credit Line	January 10, 2011	47,292.0
Poland	12-month Flexible Credit Line	July 2, 2010	13,690.0
Poland	24-month Flexible Credit Line	January 21, 2011	19,166.0
Romania	24-month Stand-By	March 31, 2011	3,090.6
Ukraine	29-month Stand-By	July 28, 2010	10,000.0
Total			**142,244.5**

Source: IMF Finance Department.

Support for low-income countries

Concessional financing. In FY2011, the Fund committed loans amounting to SDR 1.1 billion to its low-income member countries under the Poverty Reduction and Growth Trust (PRGT). Total concessional loans outstanding to 64 members amounted to SDR 4.9 billion at April 30, 2011. Detailed information regarding new arrangements and augmentations of access under the Fund's concessional financing facilities is provided in Table 3.3. Figure 3.3 illustrates amounts outstanding on concessional loans over the last decade.

Debt relief. The Fund provides debt relief to eligible countries that qualify for such relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). During FY2011, the Comoros reached its decision point[12] under the HIPC Initiative, and four members (the Democratic Republic of the Congo, Guinea-Bissau, Liberia, and Togo) reached their completion point.[13] As of April 30, 2011, 36 countries had reached their decision point under the HIPC Initiative; of these, 32 countries had reached their completion point. In total, the IMF has provided debt relief of SDR 2.5 billion under the HIPC Initiative and SDR 2.3 billion under the MDRI (see Web Tables 3.4 and 3.5).[14] With the vast majority of eligible countries having reached the completion point and received the debt relief for which they were eligible, the Executive Board met informally in February 2011 to discuss the future of the HIPC Initiative; it was expected to deliberate further on this issue in FY2012.

In July 2010, Haiti became the first recipient of debt relief financed through the newly created PCDR Trust (see Box 3.1), when the Executive Board decided to provide the country with debt relief in the form of a grant of SDR 178 million (around US$268 million), used to cancel its entire outstanding debt to the IMF.[15]

Policy Support Instrument. The IMF's Policy Support Instrument (PSI), introduced in October 2005, enables the Fund to support low-income countries that have made significant progress toward economic stability and no longer require IMF financial assistance, but seek ongoing IMF advice, closer monitoring, and endorsement of their economic policies—what is referred to as policy support and signaling. PSIs are available to all countries eligible for PRGT assistance with a Poverty Reduction Strategy in place. The Executive Board approved PSIs for six countries in FY2011: Cape Verde, Mozambique, Rwanda, Senegal, Tanzania, and Uganda.

Modifications to the financing framework

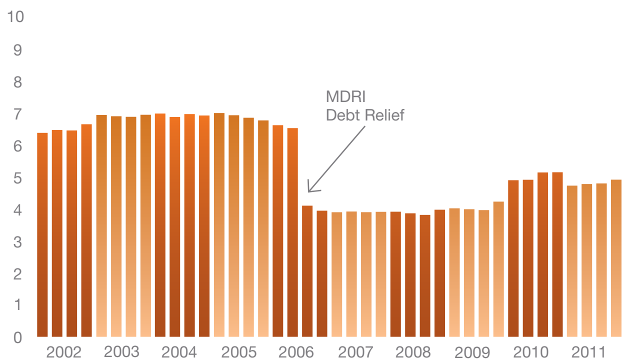
Enhancing the crisis prevention toolkit

In August 2010 the Executive Board decided to increase the duration and credit available under the existing Flexible Credit Line and to establish a new Precautionary Credit Line for members with sound policies that nevertheless may not meet the FCL's high qualification requirements.[16] This strengthening of the Fund's insurance-type instruments was designed to encourage countries to approach the Fund in a more timely fashion to help prevent a crisis, and to help protect them during a systemic crisis.

Figure 3.3

Concessional loans outstanding, FY2002–11

(In billions of SDRs)



Source: IMF Finance Department.

Table 3.3

Arrangements approved and augmented under the Poverty Reduction and Growth Trust in FY2011

(In millions of SDRs)

Member	Effective date	Amount approved
New three-year Extended Credit Facility[1] arrangements		
Armenia	June 28, 2010	133.4
Benin	June 14, 2010	74.3
Burkina Faso	June 14, 2010	46.2
Guinea-Bissau	May 7, 2010	22.4
Haiti	July 21, 2010	41.0
Kenya	January 31, 2011	325.7
Lesotho	June 2, 2010	41.9
Sierra Leone	July 1, 2010	31.1
Yemen	July 30, 2010	243.5
Subtotal		959.3
Augmentations of Extended Credit Facility arrangements[2]		
Tajikistan	June 7, 2010	26.1
Togo	June 25, 2010	11.0
Subtotal		37.1
New Standy-By Credit Facility arrangements		
Honduras	October 1, 2010	64.8
Solomon Islands	June 2, 2010	12.5
Subtotal		77.2
Disbursements under Rapid Credit Facility		
Kyrgyz Republic	September 15, 2010	22.2
Nepal	May 28, 2010	28.5
St. Lucia	January 12, 2011	3.8
St. Vincent and the Grenadines	February 28, 2011	2.1
Subtotal		56.6
Total		**1,130.3**

1 Previously Poverty Reduction and Growth Facility.
2 For augmentations, only the amount of the increase is shown.

The FCL, created in March 2009 as part of a major overhaul of the IMF's lending framework, allows members with very strong fundamentals, policies, and track records of policy implementation, without ex post policy conditions but subject, in the case of two-year arrangements, to an annual review of qualification, to draw on the line upon approval or to treat it as a precautionary instrument. The enhancements approved by the Board include

- doubling the duration of credit line arrangements to one year (from the previous six months) or to two years with an interim review of qualification after one year (from the previous one year with a review after six months);
- removing the implicit cap on access of 1,000 percent of a member's IMF quota,[17] with access decisions based on individual country financing needs; and
- strengthening procedures by requiring early Board involvement in assessing the contemplated level of access and the impact of such access on the IMF's liquidity position.

Qualification for the PCL, available to a wider group of members than those that qualify for the FCL, is assessed in five broad areas: (1) external position and market access, (2) fiscal policy, (3) monetary policy, (4) financial sector soundness and supervision, and (5) data adequacy. Although it requires strong performance in most of these areas, the PCL allows access to precautionary resources to members that may still have moderate vulnerabilities in one or two of them. It has two main features:

- ex post conditionality focused on reducing any economic vulnerabilities identified in the qualification process, with progress monitored through semiannual program reviews.
- access of up to 500 percent of quota made available on approval of the arrangement and up to a total of 1,000 percent of quota after 12 months.

Post-Catastrophe Debt Relief Trust

Following the devastating earthquake in Haiti in January 2010, the IMF explored options for joining international efforts to provide extraordinary debt relief to the country. In June 2010 the Board approved the creation of a Post-Catastrophe Debt Relief Trust (see Box 3.1) to provide debt relief to very poor eligible low-income countries and free up their resources to meet their exceptional balance of payments needs resulting from catastrophic disasters.[18]

In considering the proposal for establishing the Trust, Executive Directors underlined the Fund's role in complementing, not substituting for, other bilateral and multilateral initiatives. They broadly agreed that PCDR support should be limited to the poorest and most vulnerable countries among those eligible for support under the Poverty Reduction and Growth Trust. They also agreed that debt relief should be provided only after the most devastating of natural disasters, those that have an exceptionally large impact on the economy and the population of the affected country.

Most Executive Directors supported the staff's proposal that countries meeting the qualification criteria would automatically receive debt flow relief for two years following the catastrophic event, and most agreed that, after more data on relevant factors become available, the Board could declare the country's debt eligible for full stock relief, which could also cover any emergency liquidity support extended immediately following the disaster. Executive Directors emphasized that debt stock relief would be conditional on concerted debt relief efforts by other official creditors, as well as an assessment of the member's implementation of macroeconomic policies in the period preceding the decision to disburse debt relief.

Regarding financing, most Executive Directors supported, or could go along with, the proposal to transfer the surplus balance of the Multilateral Debt Relief Initiative I (MDRI-I) Trust to fund the PCDR Trust.[19] It would be expected that, over time, members would contribute bilateral resources as might be needed to ensure adequate financing of the PCDR Trust for future potential cases.

Collaboration with other organizations

Group of Twenty Mutual Assessment Process

Leaders of the Group of Twenty industrialized and emerging market economies pledged at their 2009 Pittsburgh Summit to work together to ensure a lasting recovery and strong and sustainable growth over the medium term and thus launched the "Framework for Strong, Sustainable, and Balanced Growth." The backbone of this framework is a multilateral process, the Mutual Assessment Process. At the request of the G-20, the IMF provides the technical analysis used in the MAP to evaluate how the G-20's respective national and regional policy frameworks fit together and whether policies pursued by individual G-20 countries are collectively consistent with the G-20's growth objectives. In October 2010, the Executive Board received an informal briefing on the revised staff assessment of G-20 policies in the context of the MAP.

At the Seoul Summit in November 2010, the G-20 made two key commitments in regard to addressing imbalances that could jeopardize their growth objectives: (1) an enhanced MAP, with indicative guidelines for key imbalances, and (2) commitments by each G-20 member to policy actions to help achieve the growth objectives identified by the leaders. At their February 2011 meeting in Paris, G-20 authorities reached agreement on the key indicators—public debt, fiscal deficits, private saving rate, private debt, and the external balance composed of the trade balance and net investment income flows and transfers—that will form the basis for assessing these imbalances, and at the G-20 ministers' meeting in Washington in April 2011, agreement was reached on the indicative guidelines (i.e., qualitative or quantitative benchmarks) against which the indicators will be assessed. This provides a concrete basis upon which G-20 economies can assess one another's economic policies and suggest policy remedies to address potentially destabilizing imbalances. It sets the stage for the next G-20 summit, in Cannes in November 2011, at which G-20 leaders are expected to reach a detailed agreement on the policies needed to achieve the shared growth objectives.

Box 3.1

Post-Catastrophe Debt Relief Trust

Assistance through the PCDR Trust is available to low-income countries eligible for concessional borrowing through the PRGT whose annual per capita income is below the prevailing income threshold for accessing the World Bank's most concessional lending from the International Development Association (IDA). (For countries with a population of less than one million, annual per capita income must be below twice the IDA cutoff.) PCDR support is limited to the most catastrophic of natural disasters, specifically those that have directly affected at least one-third of a country's population and destroyed more than a quarter of its productive capacity or caused damage deemed to exceed 100 percent of GDP.

Under PCDR Trust assistance, eligible low-income countries receive debt flow relief to cover all payments falling due on such countries' eligible debt to the Fund from the date of the debt flow relief decision to the second anniversary of the disaster. Early repayment, by the Trust, of a country's full stock of eligible debt to the IMF is also possible in cases in which the disaster and the subsequent economic recovery efforts have created substantial and long-lasting balance of payments needs and in which the resources freed up by debt stock relief are critical for meeting these needs. Debt stock relief is conditional on concerted debt relief efforts by the country's official creditors, availability of Trust resources, and specified track record and cooperation requirements.

The Trust was initially financed by SDR 280 million (around US$422 million) of the IMF's own resources and is expected to be replenished through future donor contributions, as necessary.

Financial Stability Board

As of September 2010, when approval was granted by the Executive Board, the IMF became a member of the Financial Stability Board, which brings together government officials responsible for financial stability in the major international financial centers, international regulatory and supervisory bodies, committees of central bank experts, and international financial institutions. The Fund and FSB collaborate on the biannual Early Warning Exercise, launched as part of the IMF's efforts to strengthen surveillance. In March 2011, the IMF and FSB organized a conference on the G-20 data gaps initiative in Washington, D.C.

In approving the Fund's membership in the FSB,[20] Executive Directors noted that Fund staff had already been collaborating informally but closely with the FSB's predecessor, the Financial Stability Forum, on a wide range of financial sector issues. They further noted that the responsibilities of the IMF and the FSB are distinct but closely related and complementary. They stressed that the Fund should continue to take the lead in surveillance of the international monetary system and analysis of macro-financial stability issues in its member countries. At the same time, the Fund should collaborate with the FSB to address financial sector vulnerabilities and to develop and implement strong regulatory, supervisory, and other policies that support financial stability.

Other collaboration

The IMF collaborates with a number of other organizations in the course of carrying out its responsibilities, including the World Bank, the regional development banks, UN agencies, and other international bodies. It also works with standard-setting bodies such as the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors. It has a Special Representative to the United Nations at UN Headquarters in New York who acts as liaison between the IMF and the UN system in areas of mutual interest, such as cooperation between the statistical services of the two organizations, and in new areas such as social protection and labor market policies, and facilitates reciprocal attendance and participation at events.

PROMOTING THE FUNCTIONING AND STABILITY OF THE INTERNATIONAL MONETARY SYSTEM

Although the international monetary system proved resilient to the crisis, tensions in the system—observed in widening global imbalances, volatile capital flows and exchange rate movements, and massive reserve accumulation—remain. Achieving a better-functioning international monetary system requires a combination of analyses—to better understand the factors at play—and strong multilateral policy instruments. Board work during the year in the areas of capital flows (including the Fund's role in regard to these flows), reserve accumulation, and reserve adequacy addressed key areas for effective functioning of the international monetary system, and the Board also considered whether the SDR could have a role in enhancing international monetary stability. Given the breadth and complexity of the agenda, a Board stock-taking session on strengthening the international monetary system in April 2011 evaluated progress to date across the range of work streams involved and identified areas for further work.

Capital flows

The IMF's role regarding cross-border capital flows

In December 2010, the Executive Board discussed the IMF's role regarding cross-border capital flows.[21] Executive Directors observed that, while capital flows have conferred substantial benefits by facilitating efficient resource allocation across countries, volatile capital flows played a key role in the recent crisis, both in increasing vulnerabilities and in transmitting shocks across borders.

Considering the IMF's mandate to oversee international monetary stability, Executive Directors agreed that the Fund's role regarding international capital flows should be strengthened. They saw merit in developing a coherent IMF view on capital flows and the policies that affect them, that could help establish guidelines for IMF surveillance on capital account policies and possibly others affecting capital flows. It was noted that such guidelines should be designed in a way that leaves sufficient room for country-specific circumstances and in particular should acknowledge the difference between countries with open capital accounts and those that have yet to liberalize.

Executive Directors noted that macroeconomic, financial, and capital account policies designed to address domestic concerns can have significant effects on other countries by generating or curtailing capital flows or acting to divert them to third countries. They also recognized the scope for members to take divergent approaches in addressing any tensions created, and that these could also have effects on others. Executive Directors emphasized that the Fund has an important role in drawing attention to these potential spillovers and the possible implications for the international monetary system as a whole. They supported efforts by the Fund to analyze and disseminate lessons from cross-country experiences in dealing with capital flows, and to foster dialogue with both originators and recipients of cross-border capital flows.

Executive Directors expressed a wide range of views regarding possible amendment of the Articles of Agreement to provide a more complete and consistent legal framework for addressing issues related to capital flows. While a number of Executive Directors were open to considering an amendment of the Articles in the future, most felt that it would be premature to initiate a discussion on this step without further analysis and practical experience.

Recent experiences in managing capital inflows

As a follow-up to the December 2010 discussion of cross-border capital flows (see previous subsection), in March 2011 the Executive Board discussed the IMF's work on recent cross-country experiences with capital flows and on developing a policy framework for managing capital inflows.[22] Executive Directors agreed that the recent surge in capital inflows had been driven by a combination of improved fundamentals and growth prospects in capital-receiving economies and accommodative monetary policy in capital-originating economies, among other factors. They emphasized that capital inflows are generally beneficial for recipient countries, promoting investment and growth. At the same time, they recognized that a sudden surge in inflows can pose challenges, including currency appreciation pressures, overheating, the buildup of financial fragilities, and the risk of a sudden reversal of inflows. They observed that policy responses to the surge had varied across countries and that countries had generally supplemented macroeconomic policy with other measures to manage inflows, although there were wide differences in the nature, extent, and effectiveness of these measures.

Most Executive Directors broadly supported the substance of the proposed policy framework for managing capital inflows, which they agreed would apply to all countries with open or partially open capital accounts. Executive Directors emphasized that policy advice on managing inflows should be evenhanded and give due regard to country-specific circumstances and the external setting. They recommended that emphasis be placed on structural measures to increase the capacity of an economy to absorb capital inflows and strengthen the resilience of the domestic financial system in handling them.

Executive Directors noted that when a country is confronted with surging inflows, macroeconomic policies are appropriate tools—namely, rebalancing the monetary and fiscal policy mix consistent with inflation objectives, allowing the currency to strengthen if it is undervalued, and building foreign exchange reserves if these are not more than adequate from a precautionary perspective. They agreed that capital flow management measures could be used to address macroeconomic and financial risks related to inflows, but stressed that they should not be used as a substitute for necessary macroeconomic policy adjustment.

International reserves

Reserve accumulation and international monetary stability

Reserve accumulation has accelerated in the past decade, with total international reserves having reached levels well above traditional benchmarks, particularly in emerging markets. In May 2010, the Board reviewed links between official reserves accumulation and international monetary stability and considered options to make the international monetary system more robust in response to recurrent crises.[23]

Executive Directors observed that although stability of the international monetary system was a long-term issue, it warranted attention in the context of the ongoing review of the Fund's mandate. Most observed that the current system had demonstrated its resilience, although increasing pressures were evident.

The unprecedented buildup of international reserves in recent years, with its concentration in a narrow set of currencies—though partly reflecting policy choices—pointed, it was noted, to systemic imperfections, such as the absence of automatic adjustment to imbalances, asymmetric adjustment to shocks, and uneven availability of international liquidity. First and foremost, sound macroeconomic and financial policies, particularly by reserve issuers and other systemic countries, were felt to remain central to the long-term stability of the system. Enhanced Fund surveillance over members' policies was therefore perceived to be critical to international monetary system stability.

Executive Directors considered a number of options to mitigate the growth in demand for reserves. Many supported further analytical work that could provide guidance on appropriate levels of precautionary reserves tailored to country circumstances. Improved analyses of volatile capital flows were called for, as these flows were perceived as a key motivation for self-insurance. Executive Directors supported further work on the potential Fund role in helping its members reap the benefits from capital flows while sustaining domestic and global stability.

Assessing reserve adequacy

In March 2011, as many countries were grappling with ways to reduce external vulnerabilities and global reserve accumulation had resumed its precrisis pace, the Executive Board discussed approaches to assessing reserve adequacy.[24] Noting that consensus is lacking on what constitutes an adequate level of reserves, Executive Directors generally welcomed new metrics for emerging market and low-income countries proposed by the staff as useful starting points for analyzing adequacy of precautionary reserves. They stressed that there should be no "one approach fits all" to such assessments and supported supplementing the metrics with judgment and country-specific characteristics, including due consideration of macroeconomic and prudential frameworks and policies, as well as alternative forms of contingent financing, country insurance, and overall assets and liabilities, and they also noted the relevance of reserve management practices in consideration of reserve adequacy.

For emerging markets, whose balance of payments is dominated by capital account flows, Executive Directors generally welcomed the proposed new risk-weighted metric as building on the simple and transparent approach of traditional calculations while encompassing broader vulnerabilities. For low-income countries, whose balance of payments vulnerabilities are mostly based in the current account, Executive Directors concurred that the proposed approach for calibrating optimal reserves according to country characteristics provided an effective means of introducing such characteristics into the assessment. They encouraged further analysis and refinement as part of the ongoing work in this area to enable a more comprehensive assessment of reserve adequacy.

Special Drawing Rights

Enhancing international monetary stability: A role for the SDR?

In January 2011, the Executive Board discussed the potential contribution that the IMF's Special Drawing Rights could make

Left A man harvests grapes near the town of Rahovec, Kosovo. **Right** Workers prepare to unload a container ship at a terminal in the port of Aden, Republic of Yemen.

to improving the long-term functioning of the international monetary system.[25] Executive Directors stressed that enhancing the role of the SDR was not a substitute for efforts to strengthen the stability of the international monetary system, particularly greater global policy collaboration, supported by stronger surveillance, and an enhanced systemic financial safety net, along with financial deepening in emerging markets. It was observed that as a complement to these efforts, which should be pursued with urgency, an enhanced role for the SDR could potentially contribute to the long-term stability of the international monetary system, provided appropriate safeguards were put in place and political commitment and private sector interest were mobilized.

Executive Directors emphasized the need for an in-depth analysis of the causes of problems prevailing in the international monetary system, and to formulate a coherent package of reforms to address them. Many remained unconvinced at this stage that there was a key role for the SDR in the process. On the whole, Executive Directors expressed their willingness to consider SDR-related issues with an open mind, with a view to building a broad consensus across the membership.

Executive Directors considered the idea to expand the stock of official SDRs through regular allocations to meet the growing demand for international reserves and help reduce global imbalances. They took note of the staff's finding that, under most scenarios, regular SDR allocations would not be inflationary, and called for further reflection on the respective roles of SDR allocations and traditional conditionality-based IMF financing.

2010 review of SDR valuation

In November 2010, the Executive Board completed its review of SDR valuation, which it normally undertakes every five years, determining that the value of the SDR would continue to be based on a weighted average of the values of a basket of currencies comprising the U.S. dollar, euro, pound sterling, and Japanese yen and approving revised weights for the four currencies.[26] Effective January 1, 2011, the four currencies were assigned the following weights based on their roles in international trade and finance: U.S. dollar, 41.9 percent (compared with 44 percent at the 2005 review); euro, 37.4 percent (previously 34 percent); pound sterling, 11.3 percent (previously 11 percent); and Japanese yen, 9.4 percent (previously 11 percent), with the weights rounded to one decimal place, rather than to the nearest whole percentage point as in past reviews. The decision adopted followed the established methodology for SDR valuation.

The criteria used to select the currencies in the SDR basket remained unchanged from the 2000 and 2005 reviews: the currencies included in the SDR are the four currencies issued by IMF members, or by monetary unions that include IMF members, (1) whose exports of goods and services during the five-year period ending 12 months before the effective date of the revision have had the largest value, and (2) which have been determined by the Fund to be freely usable currencies in accordance with Article XXX(f) of the Fund's Articles of Agreement. The weights assigned to these currencies continue to be based on the value of the exports of goods and services by the member (or by members included in a monetary union) issuing the currency and the amount of reserves denominated in the respective currencies that are held by other members of the IMF.

The Board also reviewed the method for determining the SDR interest rate and decided to continue to set the weekly interest rate on the basis of a weighted average of interest rates on short-term instruments in the markets of the currencies included in the SDR valuation basket. The interest rate on the three-month Treasury bills of the United States, United Kingdom, and Japan and the three-month Eurepo rate will continue to serve as the representative interest rates for the U.S. dollar, pound sterling, Japanese yen, and euro, respectively.

The amounts of each of the four currencies to be included in the new SDR valuation basket were calculated on December 30, 2010, in accordance with the new weights, with the precise amounts of each currency determined in such a way that the value of the new and existing SDR baskets remained the same. Effective January 1, 2011, the value of the SDR is the sum of the values of the following amounts of each currency—U.S. dollar, 0.660; euro, 0.423; pound sterling, 0.111; and Japanese yen, 12.1.

In their discussion in connection with the review of the SDR's valuation,[27] Executive Directors noted that although China had become the third-largest exporter of goods and services on a five-year-average basis and had taken steps to facilitate international use of its currency, the Chinese renminbi did not meet the criteria to be a freely usable currency and would therefore not be included in the SDR basket at this time. They urged that this issue be kept under review in light of future developments.

Executive Directors agreed that the next review of the method of valuation of the SDR should take place by 2015, with some noting that an earlier review should be considered if warranted by developments.

BUILDING A MORE ROBUST GLOBAL FINANCIAL SYSTEM

The financial crisis highlighted the crucial role played by the financial sector in global financial stability, and issues pertaining to that sector occupied a significant place in the IMF's work in FY2011, with a number of Board discussions considering a wide variety of aspects involved in strengthening the global financial system. (The Fund's stepped-up efforts in the area of financial sector surveillance also played a part in this; see "Financial Sector Surveillance" earlier in the chapter.)

Integrating financial stability assessments into Article IV surveillance

The Financial Sector Assessment Program, established in 1999 in the aftermath of the Asian crisis, provides a framework for comprehensive and in-depth assessments of a country's financial sector.[28] The program has been a key tool for analyzing the strengths and weaknesses of the financial systems of IMF member countries. Between its inception and 2010, more than three-quarters of the Fund's members volunteered for financial stability assessments under the program, some more than once.

FSAP assessments are conducted by joint IMF–World Bank teams in developing and emerging market countries and by the Fund alone in advanced economies. All include a financial stability assessment, which is the responsibility of the IMF, and those for developing and emerging market countries also include a financial development assessment, the responsibility of the World Bank.

In September 2010, the Executive Board decided to make financial stability assessments under the FSAP—which up to that point had been conducted on a strictly voluntary basis—mandatory for members with systemically important financial sectors, as part of the surveillance consultations under Article IV of the Fund's Articles of Agreement (see Box 3.2). In its discussion of the staff proposal with specific

Box 3.2

Mandatory financial stability assessments

The mandatory financial stability assessments approved by the Board in September 2010 comprise three elements: (1) an evaluation of the source, probability, and potential impact of the main risks to macrofinancial stability in the near term, based on an analysis of the structure and soundness of the financial system and its interlinkages with the rest of the economy; (2) an assessment of each country's financial stability policy framework, involving an evaluation of the effectiveness of financial sector supervision against international standards; and (3) an assessment of the authorities' capacity to manage and resolve a financial crisis should the risks materialize, looking at the country's liquidity management framework, financial safety nets, crisis preparedness, and crisis resolution frameworks. The mandatory assessments will take place every five years, although countries may undergo more frequent assessments, if appropriate, on a voluntary basis.

A total of 25 jurisdictions were identified as having systemically important financial sectors (see list below), based on a methodology that combines the size and interconnectedness of each country's financial sector. This group of countries covers almost 90 percent of the global financial system and 80 percent of global economic activity. It includes 15 of the G-20 member countries and a majority of members of the FSB, which has been working with the IMF on monitoring compliance with international banking regulations and standards. The methodology and list of jurisdictions will be reviewed periodically to make sure it continues to capture the countries with the most systemically important financial sectors that need to be covered by regular, in-depth, mandatory financial stability assessments.

Economies subject to mandatory financial stability assessments (as of September 2010)

Australia	Korea, Republic of
Austria	Luxembourg
Belgium	Mexico
Brazil	Netherlands
Canada	Russia
China	Singapore
France	Spain
Germany	Sweden
Hong Kong SAR	Switzerland
India	Turkey
Ireland	United Kingdom
Italy	United States
Japan	

modalities for implementing this important change,[29] most Executive Directors saw the mandatory financial stability assessments as an important step toward strengthening the Fund's financial sector surveillance, consistent with the Fund's existing bilateral surveillance mandate, and as a key component of the overall strategy to modernize the Fund's surveillance mandate and modalities. At the same time, Executive Directors called for further steps to integrate financial sector issues more fully into bilateral surveillance for all members.

Most Executive Directors supported or were willing to go along with the former Managing Director's proposal to set the expected frequency for financial stability assessments under Article IV at no more than five years. At the same time, Executive Directors acknowledged that, depending on the circumstances, it may be appropriate for the Managing Director in some cases to encourage members with systemically important financial sectors, on a voluntary basis, to undergo such assessments more frequently, in particular, within a three- to five-year time frame.

Executive Directors noted that making financial stability assessments under the FSAP mandatory for members with systemically important financial sectors should not lead to a diminished availability of FSAP assessments for members without systemically important financial sectors. They emphasized that developmental assessments conducted by the World Bank in developing and emerging market countries should continue to be provided on a voluntary basis and urged continued close cooperation between the Fund and the Bank in this area.

Macroprudential policy: An organizing framework

Results of a 2010 IMF survey of country practices reflected uncertainty among national policymakers in regard to macroprudential policy and its role in preserving financial stability, both at the conceptual level and in practical terms. In April 2011, the Executive Board discussed initial considerations for the elaboration of a macroprudential policy framework.[30] Executive Directors broadly agreed with the staff's proposed definition of macroprudential policy and its objectives,[31] noting that the primary goal of the policy should be to limit the buildup of system-wide financial risk over time and across financial systems and countries. They stressed that macroprudential policy should be viewed as a complement to macroeconomic and microprudential policies and noted that boundaries between macroprudential and other policies, particularly microprudential ones, are not easy to draw in practice.

Executive Directors shared the staff's view that the analytical and operational underpinnings of macroprudential policy are still incompletely understood. They acknowledged that the measurement of systemic risk would be challenging and highlighted the need to expand data availability to strengthen the monitoring of such risk. Executive Directors emphasized that progress will depend on developing robust approaches for measuring systemic risk and on improving the capacity to detect its buildup. They considered that progress in addressing data gaps has been lagging and that efforts need to be intensified, since more-detailed information would help identify emerging imbalances.

Central banking lessons from the crisis

In June 2010, as policymakers were beginning to draw lessons from the crisis for policy frameworks, the Board discussed lessons for central banks from the crisis and important questions on the relationship between monetary policy and macroprudential issues.[32]

Executive Directors concurred with the staff's assessment that financial stability should be primarily addressed using a macroprudential framework that integrates macroeconomic and systemic financial considerations and builds on microprudential supervision. They noted that the effective use of tools, such as capital requirements and buffers, forward-looking loss provisioning, liquidity ratios, and prudent collateral valuation, could reduce systemic risk by mitigating procyclicality and the buildup of structural vulnerabilities.

Executive Directors generally agreed that central banks should play an important role in macroprudential policies, regardless of whether they serve as the main financial regulator. They noted that considerable work remained to operationalize macroprudential frameworks and encouraged further progress in this area.

Executive Directors also broadly agreed that price stability should remain the primary objective of monetary policy and emphasized the importance of preserving central banks' hard-won credibility, which had been critical in anchoring inflation expectations. They noted, however, that increasing efforts should be made to monitor and assess systemic financial developments and risks.

Executive Directors noted that experience to date suggested that some good practices had been acquired for unconventional central bank measures. The effectiveness of these measures, it was observed, is enhanced by an explicit objective, clearly explained transmission, transparency, and protected central bank balance sheets.

Cross-border bank resolution

The complex issue of the resolution of international financial groups holds a high place on the international agenda. In July 2010 the Board discussed a proposed framework for enhanced coordination of cross-border bank resolution that would take a pragmatic approach focusing on enhanced coordination among national authorities.[33]

Executive Directors concurred with staff assessments that strengthened supervision and regulatory regimes would be important in reducing the likelihood of financial firm failure. However, acknowledging that the possibility of failure cannot be eliminated, they recognized the need for robust resolution mechanisms to be employed effectively in cross-border scenarios.

The Board generally agreed that the following elements would be important features of a policy framework: countries would amend their national legislation to remove legal or practical barriers to cross-border cooperation, ensure that their national resolution regimes met core coordination standards and robust standards of supervision, and agree to procedural mechanisms for the coordi-

Left Laborers rebuild a railway outside Monrovia, Liberia. **Right** A worker walks past new excavators at a Lonking factory in Shanghai, China.

nation of cross-border resolution actions. Additionally, Executive Directors observed that it could be useful to establish criteria for ex ante burden-sharing agreements, with the goal of minimizing the need for public funding, although some recognized potential obstacles for reaching consensus in this regard.

Executive Directors agreed that countries sharing specific cross-border banks should enhance cooperation and work to meet these criteria. They noted that such a framework represented a step in the right direction, but emphasized that a number of policy and technical issues remain to be addressed, calling on staff to work closely with the FSB and the standard setters in efforts to do so.

Financial interconnectedness

In October 2010, the Executive Board discussed financial interconnectedness, as part of the ongoing efforts to enhance IMF surveillance.[34] Executive Directors viewed the mapping of the cross-border financial architecture as a valuable first step towards constructing maps of systemic risk and identifying fault lines along which financial shocks could propagate. Such maps, it was observed, would further strengthen the Fund's capacity to assess vulnerabilities, monitor the buildup of systemic risks, and provide early warnings.

Executive Directors called for further work so that analysis of financial interconnectedness could be applied to the Fund's surveillance. The analysis, it was noted, could be used to enhance assessments under the FSAP and strengthen bilateral surveillance by incorporating multilateral perspectives. Executive Directors noted that, in keeping with the Fund's mandate and comparative advantage, the objective of such analysis should be to enhance macrofinancial assessments of risks.

Executive Directors recognized the large data gaps and challenges for both comprehensively mapping the global financial architecture and analyzing the buildup of systemic risk concentrations. They called for close collaboration and efficient division of labor among all relevant parties and viewed the joint IMF-FSB working group on data gaps and systemic linkages[35] as a critically important effort in bridging such gaps. They highlighted the confidentiality concerns and legal constraints that prevent the sharing of information of individual institutions with nonsupervisory entities such as the Fund.

Financial sector contribution to crisis costs

In response to a request by G-20 leaders, the IMF prepared, for the leaders' meeting in Toronto in June 2010, a report on the range of options countries had adopted or were considering as to how the financial sector could make a fair and substantial contribution toward paying for any burden associated with government interventions to repair the banking system. The report followed an interim report on the matter presented to the G-20 finance ministers in April 2010.

After analyzing various options, the report proposed two forms of contribution from the financial sector, serving distinct purposes. The main component would be a "financial stability contribution," linked to a credible and effective resolution mechanism, initially levied at a flat rate (varying by type of financial institution) but refined thereafter to reflect individual institutions' riskiness and contributions to systemic risk—such as those related to size, interconnectedness, and substitutability—and variations in overall risk over time. Further contributions from the financial sector, if desired, could be levied through a "financial activities tax" on the sum of the profits and remuneration of financial institutions and paid to general revenue.

Review of the Standards and Codes Initiative

During the Board's review of the Standards and Codes Initiative in March 2011,[36] Executive Directors acknowledged that compliance with agreed-upon standards represents only one of the building blocks for crisis prevention. It was observed that

Left A salesman hawks a solar-powered LED lamp at a cattle market in Bukeda, Uganda. **Right** A coconut plantation in Guadalcanal produces copra, the main export of the Solomon Islands.

the recent crisis had identified gaps in the architecture of standards and codes and had brought to the fore the need to complement assessments for Reports on the Observance of Standards and Codes (ROSCs) with rigorous follow-up on implementation, strengthened surveillance of financial institutions, and international cooperation on cross-border issues and crisis resolution. It was noted that the impact of the crisis on public balance sheets also called for renewed attention to fiscal transparency, including a possible review of fiscal standards and an update of the framework for assessing data quality.

Executive Directors supported the decision by the FSB to combine the accounting and auditing standards embodied in the initiative into one policy area and to introduce a new policy area on crisis resolution and deposit insurance. Given the demand for assessments of the new standards and the limited resources available, Executive Directors generally considered it necessary to prioritize ROSCs across standards.

Executive Directors saw considerable merit in the use of topical trust funds to finance follow-up technical assistance in high-priority areas. They stressed the need to ensure that the focus on systemically important members does not crowd out low-income and emerging market countries.

Executive Directors generally supported the broader application of targeted ROSCs to enhance efficiency and allow for more frequent updates. Most agreed with recommendations to better integrate ROSC findings into Fund surveillance, including by following up on macro-relevant ROSC recommendations in the context of bilateral surveillance.

Executive Directors welcomed steps to improve the public's access to ROSCs and efforts to encourage countries to publish ROSCs. They were generally open to considering a mechanism to facilitate public reporting on progress in implementing ROSC recommendations, based on clear guidelines to ensure credibility.

Executive Directors agreed that the next review of the Standards and Codes Initiative should be undertaken in five years, with some flexibility to conduct ad hoc reviews as necessary.

SUPPORTING GROWTH AND STABILITY IN LOW-INCOME COUNTRIES

Responding to the needs of its low-income country members has been a particular priority for the IMF in recent years, as these countries suffered the ill effects of the global financial crisis and more recently the renewed surge in food and fuel prices. Board discussions in FY2011 considered macroeconomic challenges facing these countries as they emerge from the crisis and explored ways that developing countries could enhance domestic revenues. The IMF introduced an analytical framework for assessing vulnerabilities and emerging risks in low-income countries arising from changes in the global economy. Demand for the Fund's concessional lending continued, as did efforts to ensure adequate resources for such lending (see "Budget and Income" in Chapter 5).

Though there is still much to be done, the Fund's ongoing efforts to assist its low-income members have met with some success. Initiatives such as the HIPC Initiative and MDRI (see "Support for Low-Income Countries" earlier in the chapter) have begun to realize their goal of lifting more households out of poverty and bringing low-income countries closer to achieving the Millennium Development Goals. Box 3.3 details one "success story" among the Fund's low-income countries: Liberia.

Macroeconomic challenges facing low-income countries

In November 2010, the Executive Board discussed macroeconomic challenges facing low-income countries as they exited from the global crisis.[37] Executive Directors noted that the crisis had triggered the sharpest economic slowdown in four decades, pushing an additional 64 million people into extreme poverty by year-end 2010. Nevertheless, in two-thirds of low-income countries, per capita GDP growth remained positive during the crisis, in contrast to previous crises and to the situation in most advanced economies.

Executive Directors attributed the resilience of low-income countries to generally stronger macroeconomic positions prior to this crisis, including smaller fiscal and current account deficits, lower debt and inflation, and higher levels of international reserves. Most of the countries, in particular those with IMF-supported programs, were able to maintain real primary spending growth throughout the crisis and even improve expenditure in priority sectors such as health, education, and infrastructure.

Executive Directors recognized the IMF's important role in helping low-income countries weather the crisis, through unprecedented financing and policy advice. The reform of the Fund's lending facilities for low-income countries, strengthening of the concessional financing framework, and general allocation of SDRs were instrumental in cushioning the effects of the global crisis, catalyzing donor support, and facilitating an early rebound.

Looking ahead, Executive Directors noted that the pace of economic recovery in low-income countries, though varying across regions, was expected to be faster and more closely aligned with the rest of the world than in previous crises, reflecting greater trade and financial integration and more robust domestic policies. However, they cautioned against complacency, given the downside risks to the global economy as a whole and the reduced policy space in most countries.

Vulnerability Exercise for low-income countries

In March 2011, the IMF introduced an analytical framework for assessing vulnerabilities and emerging risks in low-income countries arising from changes in the global economy.[38] The Vulnerability Exercise for low-income countries is intended to enable Fund staff to spot vulnerabilities and assess member countries' resilience to emerging risks before they materialize, and thus help guide policy responses.

Previous internal IMF Vulnerability Exercises for advanced and emerging market economies have focused on capital account or systemic financial sector crises and growth recessions that have the potential to trigger significant contagion or dislocation on a

Box 3.3

Liberia achieves long-term debt sustainability

After nearly five years of intensive engagement with the Fund, the World Bank, and other official and private creditors, in June 2010, Liberia reached the completion point under the HIPC Initiative, its total external debt having been reduced by over 90 percent. The main factor in the country's progress, though, was the strong macroeconomic program and ambitious reform agenda implemented by the Liberian authorities.

The IMF's involvement began with technical assistance to help rebuild core functions of the Ministry of Finance and the Central Bank of Liberia, along with policy advice, monitoring of economic policy implementation, and periodic reporting to the international community on economic developments. Based on the country's continued progress in macroeconomic management and structural reforms, the IMF provided new financing in 2008 through the Extended Credit Facility (ECF). The Fund provided US$0.9 billion in debt relief, financed through a major collective effort involving 102 IMF member countries, the bulk of which was delivered at the completion point.

In addition to reducing its debt burden, Liberia has expanded its capacity to deliver public services, as indicated by a doubling of tax receipts to GDP over the past five years to close to the average for sub-Saharan Africa. Financial resilience to economic shocks has dramatically improved, with a multifold increase in foreign exchange reserves, in particular resulting from the 2009 allocation of SDRs to combat the global financial crisis. Liberia has balanced its budget for five years. As macroeconomic stability returned, the banking sector expanded, while the level of credit to the private sector—an important component of faster growth—increased to the average for Africa.

Despite this impressive progress over the past five years, Liberia still faces the legacy of conflict. Per capita income has increased by two-thirds, from US$157 to US$261, but remains low, making employment and income generation a top priority for the country. To ensure sustained economic growth, the country must rebuild the transportation infrastructure and utilities, develop its institutional capacity, and strengthen the rule of law, particularly property rights. The IMF will continue to contribute to the ongoing international effort to support Liberia and achieve a lasting reduction in poverty. Policy advice and monitoring under the ECF arrangement, as well as ongoing technical assistance in public financial management, revenue administration, and banking supervision, will help the Liberian authorities achieve their development goals.

regional or global scale. By contrast, the exercise for low-income countries focuses on these countries' vulnerabilities to sharp growth declines arising from external shocks—such as sharp swings in terms of trade and volatile external financing flows. These shocks can spark fiscal and external instability, debt distress, banking system stress, and steep output drops, all of which can generate substantial welfare losses and even social dislocation.

The results of the annual Vulnerability Exercise for low-income countries will bolster IMF surveillance by strengthening risk assessments of individual low-income countries and providing the basis for cross-country comparisons and analyses. Assessments of emerging external risks relative to existing policy buffers will help identify areas where buffers would need to be strengthened, and highlight the scope for preemptive policy action.

The Vulnerability Exercise is part of a broader program of IMF work aimed at helping low-income countries manage volatility and mitigate external shocks. The program also includes forthcoming work on the role of contingent financing instruments in managing volatility in low-income countries, as well as a review of the macroeconomic and policy challenges of low-income countries facing fragilities, including those arising from fragile political environments and weak institutional capacity.

Revenue mobilization in developing countries

In March 2011, the Executive Board discussed revenue mobilization in developing countries.[39] Executive Directors broadly agreed with the main principles and recommendations in the staff's analysis of the topic, stressing that their application should pay due regard to member countries' specific circumstances and the appropriate sequencing of reforms. They underscored the important role of the Fund in continuing to support developing countries' efforts to mobilize domestic revenue to meet their substantial spending needs and expressed strong support for Fund technical assistance in this area.

Executive Directors emphasized that while the primary objective of tax reform is to increase government revenue, its distributional effects, as well as its impact on efficiency and long-term growth, should be taken into consideration. Social protection of the poorest, including through basic public spending, should be an overarching concern.

Executive Directors appreciated the staff's wide-ranging discussion of core tax policy issues for developing countries. They noted that the value-added tax (VAT) has proved to be a relatively efficient source of revenue. Careful explanation and further analysis of the distributional impact of the VAT and of the links between VAT revenue and its use for poverty reduction is needed, given the limited capacity in some countries to implement well-targeted social programs.

Executive Directors observed that tax evasion and avoidance by the wealthiest and most influential has been a cause of concern in some countries, particularly those with persistently low tax-to-GDP ratios. Addressing this problem requires concerted efforts, aimed not only at increasing government revenue, but also at improving the transparency and fairness of the tax system.

Executive Directors welcomed the trend toward reduced reliance on trade tax revenues, but stressed the need to offset the budgetary impact with domestic taxation. Greater international cooperation, including on information exchange and in regional groupings, can help protect and strengthen the revenue bases of developing countries. IMF technical assistance in this area will be useful.