IMF in Focus

A SUPPLEMENT OF THE IMF SURVEY

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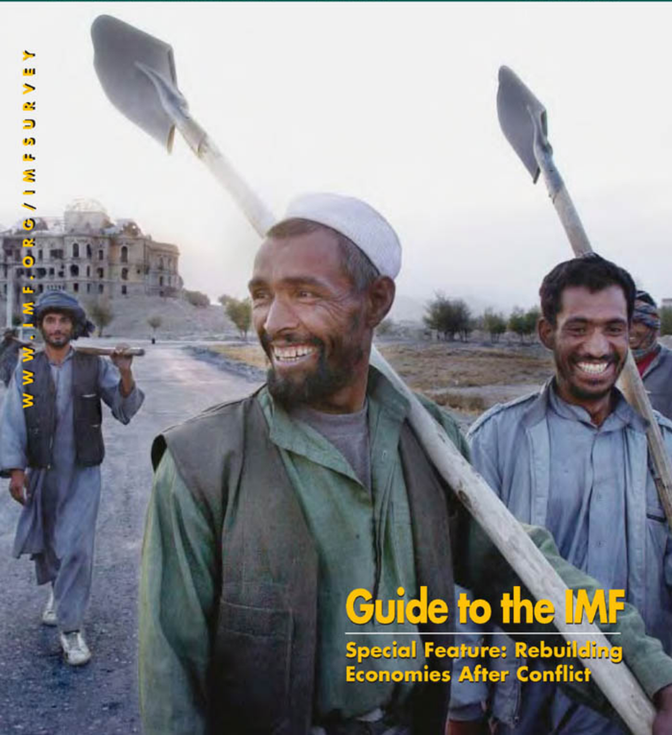

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Guide to the IMF

Special Feature: Rebuilding Economies After Conflict

A QUICK GUIDE TO SOME KEY TERMS

LEARNING THE LINGO

Economists and the IMF use a specialized language. Here's a quick reference to some of the terms used in this publication and the page on which you will find them.

Conditionality: The policy conditions that countries have to meet in most cases when borrowing money from the IMF (see page 22).

Contagion: Refers to the spread of a financial crisis from one country to another (see page 16).

Facilities: Types of IMF loans available to members (see page 25).

Governance: Encompasses all aspects of the way a country or institution is run, including its regulatory framework and its accountability (see page 16).

IMF surveillance: Literally, oversight: under its Articles of Agreement, the IMF is responsible for overseeing the international monetary system and for exercising firm surveillance over the exchange rate policies of members. Surveillance is one of the core activities of the IMF—tracking economic developments, both globally and in individual countries, and letting policymakers know if things are going off course or if policies need to be corrected (see page 15).

Macroeconomics: Macro comes from the Greek word meaning large. Thus, macroeconomics is concerned with the functioning of an economy as a whole and with such variables as total wealth, money, income, unemployment, inflation, and exchange rates (the value of currencies vis-à-vis other currencies). In contrast, microeconomics is concerned with the behavior of individual economic units, such as households and firms, and the determination of relative prices (see page 15).

Sustainability: The IMF promotes policies designed to lead to sustainable economic growth—that is, lasting growth that is not interrupted by, for example, "booms and busts." A country's debt is sustainable if it can be serviced and repaid without jeopardizing the health of the economy (see page 18).

Transparency: Refers to how open an institution is with the public. The more transparent an institution, the more it keeps the public informed about its activities and methods of operation (see page 18).

For further information, see the IMF's glossary of financial terms on its website, *www.imf.org*.

Cover shows Afghan construction workers on a road in Kabul. After the ouster of the Taliban regime, Afghanistan's economy needed extensive rebuilding (see page 2). (Scott Nelson/Getty Images)

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IN THIS ISSUE

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THE IMF'S WORK IN POSTCONFLICT COUNTRIES

Kick-Starting Economies After the Dust Has Settled

When the guns fall silent, the rebuilding begins. From the Great Lakes of Africa to the mountains of Afghanistan and the coffee plantations of Timor-Leste, the IMF is helping revive economies devastated by bloodshed. As part of international efforts to restore stable political and economic structures, the IMF moves in swiftly to help set up the foundations for a functioning economy. Countries emerging from conflict need the capacity to provide essential public services and implement sound economic policies so that people regain confidence that recovery is within reach.

The IMF's role in postconflict countries is part of its broader responsibility to provide policy advice and technical assistance in its core areas (see page 26) and, where appropriate, financing for member countries. The work requires a high degree of flexibility and ingenuity. While some conflicts result in the emergence of new countries, others bring about the complete overhaul of old rules and structures.

The IMF has long been working with countries transitioning to different political and economic systems. In the 1960s and 1970s, the IMF helped many newly independent developing countries set up their monetary and fiscal systems. In the 1980s, it stepped up its assistance for structural reform in low-income countries; and in the 1990s, it assisted the countries of the former Soviet Union, and in Central and Eastern Europe in their transition from centrally planned to market economies. The IMF has built on these experiences in its postconflict work, which has intensified since the international community formally requested the IMF's help in the reconstruction of Bosnia and Herzegovina under the 1995 Dayton Peace Agreement.

"Committed individuals can make a big contribution in postconflict work, but the foundation is a major team effort within the IMF and among the international community," says Scott Brown, who was IMF mission chief for Bosnia and Herzegovina during 1995–98 and subsequently worked in Kosovo and Iraq. The IMF usually plays a major role in advising on the overall economic policy framework and the rebuilding of postwar monetary, financial, and fiscal institutions, which involves the respective IMF area department and the Fiscal Affairs, Finance, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments. Other organizations establish and maintain security—typically under United Nations, NATO, or other multilateral auspices—and major donors coordinate political assistance and mobilize aid.

Local women take goods to the market. The Democratic Republic of the Congo's economy needed rebuilding after the war of 1998–2001.

Starting out and building trust

The IMF's work begins—often while the conflict is still going on—with thorough planning and strategy sessions at headquarters and consultations with potential development partners. Internal working groups coordinated by top IMF management draw on accumulated experience. As soon as it is reasonably safe, IMF staff usually enter a postconflict country as part of a team representing several international organizations.

In Bosnia, a small team comprised of staff from the World Bank, the European Union, the European Bank for Reconstruction and Development, and the IMF visited Sarajevo and Mostar as soon as the cease fire took hold in October 1995. The authorities were ready to get to work, and within a matter of days the IMF began organizing follow-up missions. In less than two months, the teams produced damage assessments and technical assistance diagnostics, prepared Bosnia and Herzegovina for membership in the IMF, and set the stage for the country to become the first user of the IMF's new policy on postconflict emergency assistance—one week after the ratification of the Dayton Treaty.

"Conditions were difficult," remembers Brown. "Staff traveled with soldiers and equipment in military cargo planes or helicopters in the dead of winter. Many key facilities were in ruins. Travel between cities required skirting minefields and passing through the lines of formerly warring armies." Nevertheless, spirits were high. "Our counterparts were resourceful and good-humored," Brown says, "and what we were accomplishing led to a high level of esprit de corps. The relationships we built during that time with the staff from the other agencies became part of our tool kit for future cases."

Close interaction of all parties involved in a postconflict situation is a key element of the staff's work on the ground. Open communication, the exchange of ideas, and the participation of different groups build trust and forge ownership of the reforms. Following the bloody war in the Democratic Republic of the Congo (1998–2001), mission chief Jean A.P. Clément and his team reached out early to a broad spectrum of groups, including civil society, churches, reformers, and the press. "We were very open throughout the process," Clément recalls. "We established trust with the reformers and the authorities." But the IMF team was careful to maintain a balance with all factions to avoid distrust and hostilities from re-emerging. "People need to see that they are benefiting from the peace dividend," Clément says. "They have to realize that the cost of going back to war is higher than keeping the peace."

IMF resident advisors and representatives continue this trust building. An example is Zia Ebrahim-zadeh, the IMF's Resident Representative in postwar Uganda in the 1980s. Faced with government skepticism about the IMF's advice, Ebrahim-zadeh and his team spent long hours with the authorities in both formal and informal settings to draw out their specific concerns and explain the IMF's policy advice. When Uganda's government rejected a proposed currency devaluation for fear that an increase in import prices might harm farmers, especially coffee growers, the IMF team went through the numbers in detail to show that the devaluation's favorable impact on revenue would far exceed the cost. "The close interaction and thorough discussions turned the tide in our relations with the authorities," Ebrahim-zadeh remembers.

Reforming the old, starting the new

In the early stages, IMF missions examine how much of the previous financial and fiscal structures, laws, and institutions have survived, what needs to be restored and reformed, and what needs complete reconstruction. For example, when Timor-Leste broke away from Indonesia, everything had to be created anew. By contrast, Bosnia, Croatia, and Serbia still had many institutional elements of the former Yugoslavia, but they needed major reform. In Afghanistan, the assumption was that after more than 20 years of conflict under Soviet occupation and later the Taliban regime, the system would need to be rebuilt completely, but that proved premature.

During one of his first visits to Afghanistan, Steven Symansky, the IMF's mission chief, met an elderly official who had been working in some capacity or other for the Ministry of Finance since before communism. "He knew how the institutions worked from way back," Symansky says. "He explained the procedures they have had for taxes and expenditures, and those had been quite consistent with good practices. The point was that we could build on his knowledge." They salvaged the budget law for a year or two and used the tax code for a few years until they could improve and adjust them. "You often have to build on what's already there," Symansky adds.

To help ensure that the international community's assistance—usually urgent humanitarian aid—reaches the people in need, IMF technical assistance focuses on getting the payment systems to work. "We would like money to be able to flow into the country and then be allocated according to the priorities at hand," says Åke Lönnberg of the Monetary and Financial Systems Department. Especially after protracted civil wars, different currencies are often in use, banknotes are of substandard quality, and counterfeits may be in wide circulation; and because of dysfunctional payment systems, civil servants and government officials are not getting paid.

Lönnberg saw a vivid example during his first visit to southern Sudan shortly after the Sudanese government and the Sudan People's Liberation Movement (SPLM) formally agreed to end 21 years of civil war in early 2005. Although several currencies circulate in southern Sudan, which had been held by the SPLM, officials there told Lönnberg that they didn't pay their civil staff and military. When Lönnberg asked how the system worked—since they had managed to collect taxes and money was around—they replied that they "assumed the staff would have goats and some cows and that their relatives would support them." When he asked whether they would like this to continue, the officials vehemently objected, saying "We want to pay them, because we haven't paid them for 26 years."

In Afghanistan and Iraq, currency conversions were successfully carried out in less than one year. In Kosovo, a region in Serbia and Montenegro that was granted autonomy under a temporary UN administration in 1999, the Deutschmark—and later the euro—became legal tender, while in Bosnia and Herzegovina—after years of negotiations between the ethnic groups—a national currency was introduced with distinctive designs for the different areas of the country.

The logistics of circulating and collecting money in countries lacking infrastructure and security are challenging to say the least. Timor-Leste, which adopted the U.S. dollar during the UN transitional administration, needed small denominations—in other words, lots of coins. But the logistics did not always work seamlessly. Once, a money shipment was left unguarded at an airfield overnight, but luckily it was still there the next day. Three containers filled with one-cent coins totaling $144,000 were left standing in the courtyard of the Banking and Payments Authority (BPA) for almost two years, because there was little demand for these coins. "The BPA had to ship them back unopened," remembers Lönnberg. "But nothing was stolen. I reckon the reward was too small for what would have been a very heavy loot."

Creating capacity

On the fiscal side, legal and regulatory frameworks must be created and institutions and capacity built up so that fundamental functions such as tax collection and public spending can be carried out. Institutions need professional staff to do the work, which many postconflict countries lack. In severe cases, international experts head these institutions for a period of time until local professionals are trained to take over.

Thomas Story, one of the expert advisors the IMF taps for technical assistance, was the first Revenue Commissioner in Timor-Leste. When he arrived in April 2000, he started in a shared office, with a borrowed table and chair, and an IMF laptop. The objective was to create a fair and transparent tax system that would be simple to administer. Story recruited a few international advisors to operate a rudimentary tax system while at the same time building capacity to run the administration in an environment with no working infrastructure. "Transitional administrations don't have much time, and you must address multiple needs concurrently," he says. "The time required to build capacity is easily underestimated." Selection processes on the basis of merit were completely unknown and caused much consternation and confusion. After a meticulous interviewing

IMF staff

Åke Lönnberg of the IMF shows samples of U.S. dollars and coins to officials in Timor-Leste after the dollar was declared legal tender.

process, Story's office hired 60 people, almost all fresh out of university. Over a six-month period, while the recruits underwent extensive training, Story and his aides identified team leaders, directors, and a deputy commissioner.

A rising star among the staff was a former commander of the Falintil resistance movement. He had called at Story's house one day and introduced himself in the customary way by carefully unfolding and presenting a worn handwritten piece of paper. The paper was his "laissez-passer"—his right to shelter and protection as a proclaimed member of the resistance. Before independence, carrying that paper would have meant certain death if discovered by the security police. The former commander asked Story for a job. Sensing leadership potential, Story encouraged him to apply. Within a few years, the commander rose to the position of Tax Commissioner.

Over the years, the IMF has learned that donor assistance needs to be coordinated to avoid duplicating efforts, delaying progress, and needlessly prolonging aid, and that governments need to be fully committed to the reforms. Indeed, the authorities should take the lead in coordinating technical assistance among external donors, agencies, and national governments. However, if a government requests help in coordinating assistance, the IMF should seek to provide it, as it did in the case of Mozambique.

Although 16 years of civil war ended with a peace agreement signed in 1992, the Mozambican government continued having difficulties in managing public expenditures throughout the 1990s, largely because different donors were involved in accounting, the budget office, and the treasury. "As a result, there was no centralized vision," says Helio Tollini of the Fiscal Affairs Department. "Each donor was trying to accomplish a specific priority for a particular directorate. As the years went by, they realized that not much had been done." In 2001, the government and donors asked the IMF to coordinate efforts to improve public expenditure management. Since then, the IMF and its hired resident consultants have helped the authorities set up a financial management system tailored to Mozambique's needs. "Despite some delays in implementation, a lot has been achieved," says Tollini.

Unique experience

When trying to revive the economy of a country ravaged by death and destruction, the crews on the ground have to keep their wits about them. Working and living conditions are chaotic. Communication is cumbersome and moving around has to be well organized and guarded. Members of the first missions to Afghanistan stayed in the pockmarked building of the central bank, and in Timor-Leste, the mission teams initially slept in small tents set up inside a building guarded by soldiers. Several IMF mission teams to Liberia had to be urgently evacuated in December 2003 when conditions deteriorated rapidly. In Iraq, two missions experienced shootings at close range, and team members were injured in the August 2003 bombing of the UN office in Baghdad.

But IMF staff say that even with the hardship and peril, and at times the disarray and frustration, the experience of helping a country rebuild the foundations of an economic system is unique, because the impact of their work is tangible and immediate. "You can really make a difference," Story says. "Despite the despair and the setbacks, people really want it to succeed." ■

Conny Lotze
IMF External Relations Department

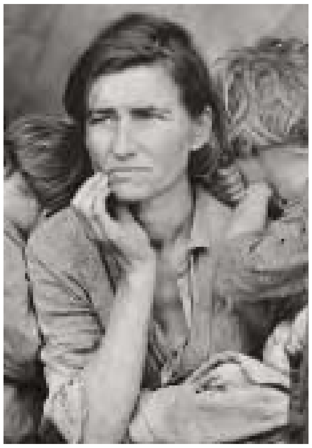
For more information, please refer to the IMF website *(www.imf.org)* for the book *Postconflict Economics in Sub-Saharan Africa: Lessons from the Democratic Republic of the Congo,* edited by Jean A.P. Clément; the Fiscal Affairs Department paper "Rebuilding Fiscal Institutions in Post-Conflict Countries" and the Monetary and Financial Systems Department paper "Restoring and Transforming Banking and Payments Systems in Post-Conflict Economies."

A HISTORICAL OVERVIEW

10 Events That Shaped the IMF

By James Boughton


Bettman/Corbis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The International Monetary Fund was created toward the end of World War II as part of an attempt to build a new, more stable international economic system and avoid the costly mistakes of the previous decades. Over the past 60 years, it has continued to change and adapt. But since its inception, it has been shaped by history and molded by the economic and political ideas of the time.

When delegations from 44 countries met at Bretton Woods, New Hampshire, in July 1944 to establish institutions to govern international economic relations in the aftermath of World War II, avoiding a repeat of the failings of the Paris Peace Conference that had ended World War I was very much on their minds. Creation of an International Bank for Reconstruction and Development would help restore economic activity, while creation of an International Monetary Fund would help restore currency convertibility and multilateral trade. For both John Maynard Keynes, the economist who headed the British delegation, and Harry Dexter White, the chief drafter of the IMF charter for the U.S. delegation, the motivating principle for creating the IMF was to engender postwar economic growth by establishing an institution that would prevent a relapse into autarky and protectionism, not just to avoid a recurrence of the Great Depression.

This article looks at some of the key 20th-century events that had the greatest influence on the IMF and draws some general conclusions about the force of history on the international monetary system that now prevails.

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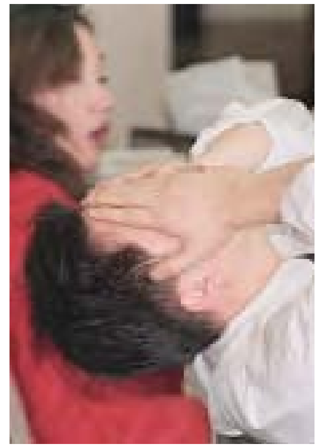
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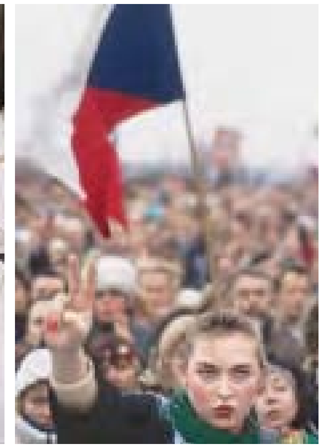

Jacques Langevin/Corbis

1. The Paris Peace Conference

The Paris Peace Conference of 1918 did consider a blueprint for restoring prosperity and world peace, in the form of U.S. President Woodrow Wilson's 14 Points. But six months later, when delegates agreed on the terms of what became known as the Treaty of Versailles, key parts of the blueprint had been cast aside. Within a decade, prosperity was lost. In another decade, peace was gone as well. The most famous failure was Wilson's inability to convince the U.S. Senate to confirm the country's membership in the League of Nations. Arguably the most disastrous, however, was the failure to lay the groundwork for economic cooperation among the world's great trading nations.

2. The Great Depression

The Great Depression that began in 1929 amplified the negative consequences of Versailles, as an implosion of international trade interacted with domestic policy errors to deflate both output and prices around the world. It severely tested the confidence of analysts and voters in the efficacy of free markets and strengthened belief in an activist role for the public sector in economic life. It thus became easier and more natural to start discussions on a post–World War II framework from the assumption that an intergovernmental agency with substantive powers would be beneficial and even essential for the international financial system.

3. World War II

The Second World War provided both the impetus and the context for reforming the international system. When the United States entered the war in response to the bombing of Pearl Harbor in December 1941, Treasury Secretary Henry Morgenthau, Jr., put White in charge of international economic and financial policy and asked him to come up with a plan for remaking the system once the war was over. As it happened, White had already sketched out a rough plan for an international stabilization fund, and he was able to produce a first draft within a couple of months. On the other side of the Atlantic, Keynes was developing a plan for an international clearing union to be run jointly by Britain and the United States as "founder states." Though less overtly multilateral than White's scheme, and based on the British overdraft system rather than on White's rather complicated proposal for currency swaps, Keynes's scheme was similar in its essence to White's. Over the next two years of discussion and negotiation, the two plans would meld into a draft for the IMF charter.

One major consequence of the war was that it left the United States in virtual control of the world economy. The financial structure of the IMF would thus be based on the U.S. dollar rather than on an international currency of its own making. Its lending power would be limited, and the Fund would lack most of the powers of a central bank. Its headquarters would be neither in London nor even in New York, but in Washington, where the U.S. Treasury could exert a strong gravitational pull. For the next three decades, the IMF would be essentially a dollar-centric institution, with the United States providing most of its loanable resources and effectively controlling most of its lending decisions.

4. The Cold War

Harry Dexter White had worked hard in 1944 to persuade the Soviet Union to join the IMF, in the belief that economic cooperation between the Soviet Union and the United States would be the key to postwar peace and prosperity. The Soviet delegation to Bretton Woods did sign the Articles ad referendum, but Joseph Stalin eventually refused to ratify the agreement, apparently because he feared (not without justification) that Fund policies would be largely controlled by the West.

When that tension segued into the Cold War, White's vision of universal membership was dashed. Poland withdrew from membership in 1950. Four years later, Czechoslovakia was forced to withdraw. Shortly after taking power in 1959, Fidel Castro pulled Cuba out. For more than three decades after Mao Zedong took control of China, the U.S. government blocked efforts by the People's Republic to be seated as China's representative on the IMF Executive Board. Most other countries in the Soviet or Chinese spheres of influence simply did not join. Not until the 1980s would the trend be reversed, with the seating of China and renewed membership for Poland.

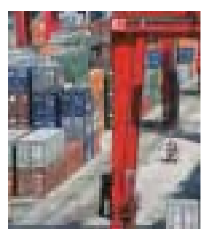
The obvious effect of the Cold War on the IMF was this limitation on membership. In the terminology of the period, the IMF included the first world and much of the third, but the second was absent from the table. The IMF became largely a capitalist club that helped stabilize market-oriented economies.

5. African independence

Only 3 of the IMF's 40 original members were in Africa: Egypt, Ethiopia, and South Africa. Of those, one was more closely affined to the Middle East, and one was minority controlled and more culturally linked to Europe. Most of the continent was still under colonial rule. That situation began to evolve in 1957, when the newly independent countries of Ghana and Sudan became IMF members. Applications then flooded in, and by 1969, 44 of the IMF's 115 members were in Africa. By 1990, all of Africa's 53 countries were in the IMF. They comprised nearly one-third of the member countries, though their average small size and mostly low incomes meant that they controlled less than 9 percent of the voting power and held only 3 of the 22 seats on the Executive Board.

The emergence of Africa as a continent of independent nations had a major effect on the size and diversity of the IMF, and it required a substantial intensification of the Fund's involvement with and oversight of its borrowers. Most of these countries, especially in sub-Saharan Africa, had very low per capita incomes and were among the least economically developed countries in the world—a picture that still holds. Their economic problems tend to be structural even more than macroeconomic; rooted in the need for improvements in education, health care, infrastructure, and governance rather than finance; and more deeply ingrained and persistent than in other regions. Solving these problems requires lending on concessional terms and a wide range of technical expertise. Consequently, the IMF's role has expanded beyond its original boundaries, and close collaboration with the World Bank and other development agencies has become imperative.

6. Rise of multiple economic centers



As the world economy—and world trade—began to recover after the Second World War, U.S. economic hegemony gradually eroded. The first to rise from the ashes was Western Europe. Through a combination of national drive, international support—from the U.S. Marshall Plan, the World Bank, and, eventually, the IMF—and a homegrown multilateralism in the form of the Common Market and the European Payments Union, much of Europe was growing rapidly and was increasingly open to multilateral trade and currency exchange by the late 1950s. The Federal Republic of Germany joined the IMF in 1952 and quickly became one of the world's leading economies. Next came Asia. Japan also joined the Fund in 1952 and, by the 1960s, it was on its way to joining the United States and Germany on the top rung of the economic ladder. Then the 1970s saw the rise of economic power in Saudi Arabia and other oil-exporting countries of the Middle East. In 30 years, the U.S. share of world exports fell from 22 percent to 12 percent, while its share of official international reserves dropped even more dramatically, from 54 percent in 1948 to 12 percent in 1978.

As the balance of economic and financial power became more widely dispersed, more and more currencies became fully convertible for current account and even capital transactions. Trading partners grew at different rates and with different mixes of financial policies. Pressures on fixed exchange rates and on the limited supply of gold and U.S. dollars became increasingly frequent and more severe. The IMF responded in 1969 by amending its Articles and creating Special Drawing Rights (SDRs) to supplement existing reserve assets, but that action was too limited to deal with the underlying problem of differential pressures. As a result, even before the first oil shock in 1973, the original Bretton Woods system of fixed but adjustable exchange rates was no longer viable.

7. The Vietnam War

The intensification of U.S. involvement in the Vietnam War in the 1960s and early 1970s would not by itself have had substantial effects on the IMF, other than the direct effect on Vietnam's membership. When the government of South Vietnam was about to fall in April 1975, its officials tried desperately to borrow as much as they could from the IMF. The IMF refused to go along, and, within a few months, it recognized the Socialist Republic of Viet Nam as the successor government.

The larger effect, however, was on the U.S. economy and its external payments position. In combination with a sizable increase in domestic spending on President Lyndon Johnson's Great Society programs, the rise in external military spending gradually worsened the overvaluation of the U.S. dollar under the Bretton Woods system of fixed exchange rates. In a series of spasms, the system dissolved between 1968 and 1973. With the dollar no longer convertible into gold, the precious metal could no longer serve a central or even a useful function in the international monetary system. The Vietnam War was by no means the sole culprit in this decline, but its catalytic role was certainly substantial.

8. Globalization of financial markets

Private sector financial flows were of limited scope and importance when the IMF was founded. Trade flows were financed largely by trade credits, and most economists considered cross-border portfolio flows to be as much a potential destabilizing nuisance as a potential source of investment capital.

The range and importance of capital flows began to increase in the 1950s as European countries gradually reestablished convertibility. The first big increase, however, came in the 1970s, with the emergence of the Eurodollar and other offshore financial markets. It was driven further by the accumulation of "petrodollars" by oil-exporting countries in the 1970s and the recycling of those assets to oil-importing sovereign borrowers through large international banks. By the 1990s, cross-border flows had become an essential source of finance for both industrial and emerging market economies around the world, and the structure of international financial markets had become so complex that their size could no longer be measured, much less controlled.

One effect of financial globalization was that IMF financing became quantitatively marginalized for many potential borrowers. In the early days of the IMF, countries facing a financing gap in their balance of payments could often close it solely by borrowing from the Fund. By the 1980s, their object was more often to "catalyze" other capital inflows by borrowing relatively small amounts from the Fund to support an agreed package of policy reforms and thereby hoping to convince other creditors that the country was a good prospect. What mattered was not so much the quantity of money as the quality of the reforms. Globalization thus fundamentally altered the relationship between the IMF and its borrowing members and between the IMF and other official and private creditors.

Another effect was to weaken the "credit union" character of the IMF as a membership institution because, by the 1980s, the more advanced economies were able to finance their external payments with private flows and did not need to borrow from the IMF. Much of the membership of the IMF became divided into persistent creditor and debtor groups.

A third effect of financial globalization was that countries with emerging financial markets became reliant on private capital inflows that turned out to be volatile and unreliable when economic conditions weakened, either globally or regionally. When those inflows suddenly went into reverse in the second half of the 1990s, several middle-income countries—Mexico in 1995; Thailand, Indonesia, and Korea in 1997; Russia in 1998; Brazil in 1999—turned to the IMF for financial assistance on a scale that was much larger than what the Fund had provided in earlier cases.

9. International debt crisis

In August 1982, a gradual two-year worsening of conditions in international debt markets suddenly accelerated and precipitated a major economic and financial crisis. A scattering of countries, including Hungary, Morocco, Poland, and Yugoslavia, had already seen their bank creditors turn their backs in 1981 and the first half of 1982. When the banks suddenly pulled out of Mexico, the crisis took on systemic proportions. Within a few months, Argentina, Brazil, and Chile were also in trouble, and the crisis was continuing to spread. Not until 1990, when world interest rates were settling down and the bank debts of the most heavily indebted developing countries were being replaced by Brady Bonds, would it be possible to declare the crisis over. The debt crisis transformed the IMF, catapulting it into the role of international crisis manager. When a series of financial crises broke out in the 1990s, as mentioned above, the IMF was able to draw on this earlier experience, though it also had to try to find new solutions to what turned out to be ever more complex country circumstances and more rapid and widespread contagion as crises spread around the world.

10. Collapse of communism

The fall of the Berlin Wall in 1989 and the dissolution of the Soviet Union in 1991 enabled the IMF at last to become a nearly universal institution. In three years, membership increased from 152 countries to 172, the most rapid increase since the influx of African members in the 1960s. (The IMF now has 184 members.) Many of the new members needed to borrow from the Fund, and almost all of them needed technical assistance and regular consultations. Consequently, the size of the IMF staff increased by nearly 30 percent in six years. The Executive Board expanded from 22 seats to 24 to accommodate Directors from Russia and Switzerland, and some existing Directors saw their constituencies expand by several countries.

Conclusions

The world economy and the IMF have changed greatly in the six decades since Bretton Woods. Much of the volume of IMF lending has become crisis-driven, and the Fund's involvement in crisis prevention and resolution has correspondingly intensified. Because more than half of the membership is now in a persistent creditor or debtor position with little prospect of switching sides, many states tend to view themselves as members of such a group more than as part of the global community. The membership also has become much larger, more diverse, and nearly universal, and the IMF's responsibilities in global economic governance have correspondingly increased. The breadth of its involvement in policymaking in member countries, especially borrowing countries, has vastly expanded.

The evolution of the IMF has been driven by—and necessitated by—these shifts in world economic and political conditions. If the events chronicled here had not affected the IMF along these lines, the institution would have become marginalized and even irrelevant. The challenge for the IMF has always been to hold onto its vital center (the original narrow mandate to promote orderly payments adjustment and global financial stability) while adapting its activities to new circumstances and new ideas. The 60th anniversary of Bretton Woods in 2004 provided the impetus for the IMF to respond to this challenge by launching a strategic review aimed at positioning the institution to respond flexibly to the further changes that the world economy will go through in the decades to come.

Keynes and White created the IMF because they believed that the world needed an official institution to promote multilateral cooperation in place of autarkic economic policies and to compensate for the inherent limitations of private markets. As much as the world and the institution have changed, those goals remain at the core of the rationale for the role of the IMF. ■

James Boughton is an Assistant Director in the IMF's Policy Development and Review Department and the official historian of the Fund.

Taking the Global Pulse

Over the past year, against the background of a relatively benign global economic environment, the IMF continued to strengthen the effectiveness of its operations and better define its priorities to meet the evolving needs of its members. As part of these efforts, IMF Managing Director Rodrigo de Rato launched a review of the Fund's strategic direction to explore a variety of issues and their implications for the work of the Fund, including global financial flows, regional integration, poverty reduction efforts, and the IMF's own governance.

After global economic growth rose to slightly above 5 percent in 2004—its highest rate in three decades—it has moderated in 2005 toward its trend rate of around 4¼ percent. Generally, inflation has remained subdued, and there has been a marked absence of serious financial crises. Yet the going was not entirely smooth over the past year: oil prices rose sharply and substantially, geopolitical uncertainties continued, global payments imbalances widened further, and many of the IMF's member countries continued to grapple with significant social and economic problems.

Surveillance. In its review of member countries' economic policies, the IMF continued to strengthen its surveillance operations. Following up on recommendations of a 2004 biennial review, the IMF aimed to sharpen the focus of its analysis and advice, including by deepening coverage of exchange rate and financial sector issues, and better integrating analysis of debt sustainability, balance sheet vulnerabilities, and regional and global spillovers. It also sought to improve the policy dialogue with member countries, communicate more effectively with the public, and assess more systematically the effectiveness of surveillance.

Lending. In a review of the conditions the IMF attaches to its financial support for member countries' policy programs, the organization took a thorough look at program design and the application of the 2002 Guidelines on Conditionality. The review found that work on program design needs to continue in five broad areas: capital flows and capital account crises, including the role of the financial sector; low-income country

Prakash Singh/AFP

IMF Managing Director Rodrigo de Rato (left) listens to a local worker at an HIV-care center during a visit to India.

issues; growth and structural reforms; fiscal issues; and precautionary arrangements.

To ensure a flexible response to the needs of low-income countries, the IMF continued to enhance the design of programs supported by its Poverty Reduction and Growth Facility, contribute to the refinement of the Poverty Reduction Strategy process, and strengthen IMF instruments for engaging with low-income members. It is in the process of establishing a monitoring arrangement for low-income countries that desire a close policy dialogue with the IMF but do not want or need its financial assistance. The Fund is also continuing efforts to provide low-income member countries with debt relief and help them maintain debt sustainability, and is following through on the Group of Eight proposal to cancel all outstanding debt owed by Heavily Indebted Poor Countries to the IMF, the World Bank, and the African Development Bank.

Technical assistance. Technical assistance remains a vital complement to IMF policy advice, facilitating the implementation of better policies and governance practices, including through help with institution building. Efforts have focused on introducing a more medium-term perspective for technical assistance strategies and priorities, strengthening the evaluation of results and enhancing country ownership, and making regional assistance centers more effective. ■

For further information, see the *IMF Annual Report 2005*, published in September 2005, and also on the IMF's website, *www.imf.org*.

Running the IMF

Although the IMF is a specialized agency of the United Nations and participates in the Economic and Social Council of the UN, it operates independently and has its own charter, governing structure, rules, and finances.

The IMF currently has 184 member countries, seven fewer than the United Nations. The difference is accounted for by Cuba, the Democratic People's Republic of Korea, and five very small countries: Andorra, Liechtenstein, and Monaco in Europe, and the island countries of Nauru and Tuvalu in the Pacific Ocean. Cuba was an original member of the IMF but withdrew in 1964; none of the other six countries has applied for membership. To become a member, a country must apply and then be accepted by a majority of the existing members.

Political oversight of the IMF is primarily the responsibility of the International Monetary and Financial Committee (IMFC), whose 24 members are finance ministers or central bank governors from the same countries and constituencies that are represented on the Executive Board (see organization chart, page 33). The IMFC meets twice a year and advises the Fund on the broad direction of policies.

Most IMFC members are also members of the Board of Governors, on which every member country has a Governor. The Board of Governors meets once a year and votes on major institutional decisions such as whether to increase the Fund's financial resources or admit new members. The Development Committee, which, like the IMFC, also has 24 members of ministerial rank, advises the Boards of Governors of the IMF and the World Bank about issues facing developing countries. It meets twice a year.

The chief executive of the IMF is the Managing Director, who is selected by the Executive Board (which he chairs) to serve a five-year term. The Managing Director has always been European. The Executive Board, which sets policies and is responsible for most decisions, consists of 24 Executive Directors. The five countries with the largest quotas in the Fund—the United States, Japan, Germany, France, and the United Kingdom—appoint Directors. Three other countries—China, Russia, and Saudi Arabia—have large enough quotas to elect their own Executive Directors. The other 176 countries are organized into 16 constituencies, each of which elects an Executive Director. Constituencies are formed by countries with similar interests and usually from the same region, such as French-speaking countries in Africa (see table on page 14).

The IMF has around 2,700 staff from more than 140 countries, most of whom work at the IMF's headquarters in Washington, DC. A small number of staff work at regional or local offices around the globe. The IMF staff is organized mainly into departments with regional (or area), functional, information and liaison, and support responsibilities (see organization chart, page 33). These departments are headed by directors who report to the Managing Director. The staff track economic developments around the world and in individual countries and conduct the analysis of economic developments and policies that forms a basis for the IMF's operational work of policy advice and lending.

Where does the IMF get its money?

The IMF is a financial cooperative, in some ways like a credit union. On joining, each member country pays in a subscription, called its "quota." A country's quota is broadly determined by its economic position relative to other members and takes into account the size of members' GDP, current account transactions, and official reserves. Quotas determine members' capital subscriptions to the IMF and the limits on how much they can borrow. Quotas also help determine members' voting power.

The combined capital subscriptions of the IMF's members form a pool of resources, which the IMF uses to provide temporary help to countries experiencing financial difficulties. These resources allow the IMF to provide balance of payments financing to support members implementing economic adjustment and reform programs.

At regular intervals of not more than five years, the IMF's Executive Board reviews members' quotas and decides—in light of developments in the global economy and changes in members' economic positions relative to other members—whether to propose an adjustment of their quotas to the Board of Governors. The IMF is currently in the period of the Thirteenth General Review of Quotas, which must be concluded by January 2008.

Countries pay 25 percent of their quota subscriptions in reserve assets, defined as Special Drawing Rights (SDRs, the IMF's unit of account, see page 33), or the major currencies (U.S. dollars, euros, Japanese yen, or pounds sterling); the IMF can call on the remainder, payable in the member's own currency, to be made available for lending as needed. Quotas determine not only a country's subscription payments, but also the amount of financing that it can receive from the IMF and its share in SDR allocations. The IMF's total quotas are equivalent to SDR 213.5 billion (about $310 billion). Each country's voting power is the sum of its "basic votes" and its quota-based votes. Each IMF member has 250 basic votes (which were set in the Articles of Agreement as equal for all countries) plus one additional vote for each SDR 100,000 of quota.

If necessary, the IMF may borrow to supplement the resources available from its quotas. The IMF has two sets of standing arrangements to borrow from member countries, if necessary, to cope with any threat to the international monetary system. Under the two arrangements combined, the IMF has up to SDR 34 billion (about $49 billion) available to borrow.

Concessional loans and debt relief for low-income countries come from trust funds administered by the IMF.

The IMF and the World Bank—what's the difference?

The IMF and the World Bank were conceived at the Bretton Woods conference in July 1944 as institutions to strengthen international economic cooperation and to help create a more stable and prosperous global economy. While these goals have remained central to both institutions, their mandates and functions differ, and in both cases their work has evolved in response to new economic developments and challenges.

The IMF promotes international monetary cooperation and provides member countries with policy advice, temporary loans, and technical assistance so they can establish and maintain financial stability and external viability, and build and maintain strong economies. The Fund's loans are provided in support of policy programs designed to solve balance of payments problems—that is, situations where a country cannot obtain sufficient financing on affordable terms to meet net international payments. Some IMF loans are relatively short term (for periods of about a year, repayable in 3–5 years) and funded by the pool of quota contributions provided by its members. Other IMF loans are for longer periods (up to 3 years, repayable in 7–10 years), including concessional loans provided to low-income members on the basis of subsidies financed by past IMF gold sales and members' contributions. In its work in low-income countries, the IMF's main focus is on how macroeconomic and financial policies can contribute to the central goal of poverty reduction. Most IMF professional staff are economists.

The World Bank promotes long-term economic development and poverty reduction by providing technical and financial support, including to help countries reform particular sectors or implement specific projects—for example, building schools and health centers, providing water and electricity, fighting disease, and protecting the environment. World Bank assistance is generally long term and is funded both by member country contributions and through bond issuance. World Bank staff have qualifications that embrace a broader range of disciplines than those of IMF staff.

The IMF and the World Bank collaborate in a variety of areas, particularly in reducing poverty in low-income countries, providing debt relief for the poorest countries, coordinating programs to help meet the Millennium Development Goals (see page 28), and assessing the financial sectors of countries. The two institutions hold joint meetings twice a year.

Paying for the IMF

The IMF's annual expenses are financed largely by the difference between annual interest receipts and annual interest payments. In the financial year 2005, interest and charges received from borrowing countries and other incomes totaled $3.4 billion, while interest payments on the portion of members' quota subscriptions used in IMF operations and other operating expenses amounted to $1.5 billion. Administrative expenditures (including staff salaries and pensions, travel, and supplies) totaled $1 billion. The remainder was added to the IMF's general funds available for lending to member countries. ■

Country representation and votes on IMF Executive Board (as of July 15, 2005)[1]

The Executive Board comprises 24 Directors who represent individual countries or groups of countries. Each Director's name appears in boldface, and the Alternate Director's name appears in italics. The voting power of each country is shown in parentheses. For each constituency, total votes and voting power appear below the list of countries. Totals may not add because of rounding.

Nancy P. Jacklin
Meg Lundsager
United States
371,743 votes **(17.08%)**

Shigeo Kashiwagi
Michio Kitahara
Japan
133,378 votes **(6.13%)**

Karlheinz Bischofberger
Gert Meissner
Germany
130,332 votes **(5.99%)**

Pierre Duquesne
Olivier Cuny
France
107,635 votes **(4.95%)**

Tom Scholar
Andrew Hauser
United Kingdom
107,635 votes **(4.95%)**

Willy Kiekens (Belgium)
Johann Prader (Austria)
Austria (0.87%)
Belarus (0.19%)
Belgium (2.13%)
Czech Republic (0.39%)
Hungary (0.49%)
Kazakhstan (0.18%)
Luxembourg (0.14%)
Slovak Republic (0.18%)
Slovenia (0.12%)
Turkey (0.45%)
111,696 votes **(5.13%)**

Jeroen Kremers (Netherlands)
Yuriy G. Yashuka (Ukraine)
Armenia (0.05%)
Bosnia and Herzegovina (0.09%)
Bulgaria (0.31%)
Croatia (0.18%)
Cyprus (0.08%)
Georgia (0.08%)
Israel (0.44%)
Macedonia, FYR of (0.04%)
Moldova (0.07%)
Netherlands (2.38%)
Romania (0.48%)
Ukraine (0.64%)
105,412 votes **(4.84%)**

Moisés J. Schwartz (Mexico)
Mary Dager (Venezuela)
Costa Rica (0.09%)
El Salvador (0.09%)
Guatemala (0.11%)
Honduras (0.07%)
Mexico (1.20%)
Nicaragua (0.07%)
Spain (1.41%)
Venezuela, República Bolivariana de (1.23%)
92,989 votes **(4.27%)**

Pier Carlo Padoan (Italy)
Miranda Xafa (Greece)
Albania (0.03%)
Greece (0.39%)
Italy (3.25%)
Malta (0.06%)
Portugal (0.41%)
San Marino (0.02%)
Timor-Leste (0.02%)
90,968 votes **(4.18%)**

Kevin G. Lynch (Canada)
Peter Charleton (Ireland)
Antigua and Barbuda (0.02%)
Bahamas, The (0.07%)
Barbados (0.04%)
Belize (0.02%)
Canada (2.94%)
Dominica (0.02%)
Grenada (0.02%)
Ireland (0.40%)
Jamaica (0.14%)
St. Kitts and Nevis (0.02%)
St. Lucia (0.02%)
St. Vincent and the Grenadines (0.02%)
80,636 votes **(3.71%)**

Jon A. Solheim (Norway)
David Farelius (Sweden)
Denmark (0.77%)
Estonia (0.04%)
Finland (0.59%)
Iceland (0.07%)
Latvia (0.07%)
Lithuania (0.08%)
Norway (0.78%)
Sweden (1.11%)
76,276 votes **(3.51%)**

Jong Nam Oh (Korea)
Richard Murray (Australia)
Australia (1.50%)
Kiribati (0.01%)
Korea (0.76%)
Marshall Islands (0.01%)
Micronesia, Federated States of (0.01%)
Mongolia (0.03%)
New Zealand (0.42%)
Palau (0.01%)
Papua New Guinea (0.07%)
Philippines (0.42%)
Samoa (0.02%)
Seychelles (0.02%)
Solomon Islands (0.02%)
Vanuatu (0.02%)
72,423 votes **(3.33%)**

A. Shakour Shaalan (Egypt)
Oussama T. Kanaan (Jordan)
Bahrain (0.07%)
Egypt (0.45%)
Iraq (0.56%)
Jordan (0.09%)
Kuwait (0.65%)
Lebanon (0.10%)
Libya Arab Jamahiriya (0.53%)
Maldives (0.02%)
Oman (0.10%)
Qatar (0.13%)
Syrian Arab Republic (0.15%)
United Arab Emirates (0.29%)
Yemen, Republic of (0.12%)
70,852 votes **(3.26%)**

Sulaiman M. Al-Turki
Abdallah S. Alazzaz
Saudi Arabia
70,105 votes **(3.22%)**

Hooi Eng Phang (Malaysia)
Made Sukada (Indonesia)
Brunei Darussalam (0.11%)
Cambodia (0.05%)
Fiji (0.04%)
Indonesia (0.97%)
Lao People's Democratic Republic (0.04%)
Malaysia (0.69%)
Myanmar (0.13%)
Nepal (0.04%)
Singapore (0.41%)
Thailand (0.51%)
Tonga (0.01%)
Vietnam (0.16%)
69,019 votes **(3.17%)**

Peter J. Ngumbullu (Tanzania)
Peter Gakunu (Kenya)
Angola (0.14%)
Botswana (0.04%)
Burundi (0.05%)
Eritrea (0.02%)
Ethiopia (0.07%)
Gambia, The (0.03%)
Kenya (0.14%)
Lesotho (0.03%)
Malawi (0.04%)
Mozambique (0.06%)
Namibia (0.07%)
Nigeria (0.82%)
Sierra Leone (0.06%)
South Africa (0.87%)
Sudan (0.09%)
Swaziland (0.03%)
Tanzania (0.10%)
Uganda (0.09%)
Zambia (0.24%)
65,221 votes **(3.00%)**

Wang Xiaoyi
GE Huayong
China
63,942 votes **(2.94%)**

Fritz Zurbrügg (Switzerland)
Andrzej Raczko (Poland)
Azerbaijan (0.09%)
Kyrgyz Republic (0.05%)
Poland (0.64%)
Serbia and Montenegro (0.23%)
Switzerland (1.60%)
Tajikistan (0.05%)
Turkmenistan (0.05%)
Uzbekistan (0.14%)
61,827 votes **(2.84%)**

Aleksei V. Mozhin
Andrei Lushin
Russian Federation
59,704 votes **(2.74%)**

Abbas Mirakhor (Islamic Republic of Iran)
Mohammed Daïri (Morocco)
Afghanistan, Islamic Republic of (0.09%)
Algeria (0.59%)
Ghana (0.18%)
Iran, Islamic Republic of (0.70%)
Morocco (0.28%)
Pakistan (0.49%)
Tunisia (0.14%)
53,662 votes **(2.47%)**

Eduardo Lyo (Brazil)
Roberto Steiner (Colombia)
Brazil (1.41%)
Colombia (0.37%)
Dominican Republic (0.11%)
Ecuador (0.15%)
Guyana (0.05%)
Haiti (0.05%)
Panama (0.11%)
Suriname (0.05%)
Trinidad and Tobago (0.17%)
53,634 votes **(2.46%)**

B.P. Misra (India)
Amal Uthum Herat (Sri Lanka)
Bangladesh (0.26%)
Bhutan (0.01%)
India (1.92%)
Sri Lanka (0.20%)
52,112 votes **(2.39%)**

Héctor R. Torres (Argentina)
Javier Silva-Ruete (Peru)
Argentina (0.98%)
Bolivia (0.09%)
Chile (0.40%)
Paraguay (0.06%)
Peru (0.30%)
Uruguay (0.15%)
43,395 votes **(1.99%)**

Damian Ondo Mañe (Equatorial Guinea)
Laurean W. Rutayisire (Rwanda)
Benin (0.04%)
Burkina Faso (0.04%)
Cameroon (0.10%)
Cape Verde (0.02%)
Central African Republic (0.04%)
Chad (0.04%)
Comoros (0.02%)
Congo, Democratic Republic of the (0.26%)
Congo, Republic of (0.05%)
Côte d'Ivoire (0.16%)
Djibouti (0.02%)
Equatorial Guinea (0.03%)
Gabon (0.08%)
Guinea (0.06%)
Guinea-Bissau (0.02%)
Madagascar (0.07%)
Mali (0.05%)
Mauritania (0.04%)
Mauritius (0.06%)
Niger (0.04%)
Rwanda (0.05%)
São Tomé and Príncipe (0.01%)
Senegal (0.09%)
Togo (0.05%)
30,749 votes **(1.41%)**

[1]Does not include the votes of Liberia, Somalia, and Zimbabwe; their representation has been suspended because of protracted arrears to the IMF.

Sherwin Crasto/Reuters

Promoting Healthy Economies

The main job of the IMF is to promote international monetary cooperation, and economic and financial stability in member countries and at the global level, as a basis for sustained economic growth, which is essential for raising living standards and reducing poverty. Promoting macroeconomic and financial stability is partly a matter of avoiding economic and financial crisis, which can destroy jobs, slash incomes, and cause great human suffering. But it is also a matter of avoiding large swings in economic activity, high inflation, and excessive volatility in exchange rates and financial markets. Any of these types of instability can increase uncertainty and discourage investment, impede economic growth, and hurt living standards.

A call center in India's southern city of Bangalore.

A dynamic market economy necessarily involves some degree of instability, as well as gradual structural change. The challenge for policymakers is to minimize instability without hampering the ability of the economic system to raise living standards through the higher productivity, efficiency, and employment that it generates.

Experience has shown that the countries with the strongest growth and employment rates and the least economic instability are those that

- follow sound macroeconomic (fiscal, monetary, and exchange rate) policies;
- allow markets to function, with appropriate regulatory, structural, and social safety net policies;
- are open to international trade;
- build strong economic policymaking and regulatory institutions;
- foster the development of strong financial systems;
- collect, monitor, and disseminate high-quality data; and
- embrace good governance.

The IMF promotes the stability of the international financial system through its three primary functions:

Surveillance. The IMF is responsible for overseeing the international monetary system and the compliance of each member country with its obligations to help ensure orderly exchange arrangements and a stable system of exchange rates. The Fund exercises this responsibility by tracking economic and financial conditions around the world and examining whether policies in member countries are appropriate from the international as well as the national point of view. It alerts member countries to impending dangers, enabling governments to take preventive action if necessary.

Lending. The IMF lends to countries with balance of payments difficulties. The primary objectives of its lending to low-income countries are economic growth and poverty reduction.

Technical assistance and training. The IMF helps member governments develop strong policymaking institutions and economic policy instruments.

Surveillance in action

With its nearly universal membership, the IMF serves as an international forum where members can monitor and discuss developments in their respective economies and also global economic developments. In recent decades, the major challenge to financial stability has come from the growth in the size and sophistication of international capital markets. A large number of countries have gained access to these markets. In many ways, financial globalization is a welcome development. It provides opportunities to channel private capital flows to finance investment and growth in these countries where the capital can be used most productively. Capital market integration also, in principle, enables countries to adjust to external shocks without having to rely on official funds.

But capital flows are also a potential source of volatility, as the past decade has shown, especially in many emerging market countries. A new breed of crisis—arising from sudden capital account outflows—has emerged and has proved harder to manage than the current account imbalances with which the IMF traditionally dealt in its lending activities. Arresting an outflow of capital requires measures that restore investor confidence, including, in some cases, financial help from international institutions.

Financial globalization has also increased the risk of contagion by introducing new channels—in addition to the traditional trade links—through which one country's vulnerabilities can affect others and even spread through the global economic system.

Current trends imply that financial globalization will intensify. Emerging markets are likely to represent a growing share of the world economy in the coming decades. The nascent emerging market giants, India and China, may pose particular systemic challenges. And the aging of industrial country populations, by shifting saving-investment balances internationally, may also imply larger cross-border capital flows.

To keep a close watch on these developments, the IMF is continuing to strengthen its analysis and advice through more tightly focused surveillance, deeper scrutiny of exchange rate issues, and better analysis of financial sectors, debt sustainability, and regional and global spillovers. The 2004 biennial surveillance review endorsed these steps and stressed that surveillance should evolve and adapt continuously to meet the needs of the IMF's membership.

Types of surveillance

Country. The IMF holds consultations, normally once a year, with each member country about its economic policies.

(These are referred to as "Article IV consultations" because they are required by Article IV of the IMF's Articles of Agreement.) The consultations focus on the member's exchange rate, fiscal, and monetary policies; developments in its balance of payments and external debt; the influence of the country's policies on its external accounts; the international and regional implications of its policies; and the identification of potential vulnerabilities.

As financial markets around the world have become more integrated, IMF surveillance has become increasingly focused on capital account, financial, and banking sector issues. Institutional issues, such as central bank independence, financial sector regulation, corporate governance, and policy transparency and accountability, have also become increasingly important to IMF surveillance in the wake of financial crises in emerging market countries and in the context of member countries making the transition from planned to market economies.

Regional. To supplement country consultations, the IMF also examines policies pursued under regional arrangements, such as in the euro area, the West African Economic and Monetary Union, and the Eastern Caribbean Currency Union. In addition to stepping up its surveillance of currency unions, the Fund is paying more attention to issues of common interest to countries in given regions (for example, in Central America, sub-Saharan Africa, or Pacific Island countries). The discussions of staff reports on these topics allow not only consideration of policies decided at the regional level but also comparative analysis of developments and policies across a region, and analysis of the regional transmission of shocks.

Global. In addition to country and regional surveillance, the IMF monitors global economic conditions, countries' economic policies in their global context, and developments in international capital markets. In this global surveillance work, the IMF also assesses the global effects of major economic and financial developments, including in such areas as oil markets and trade. Its main findings on global surveillance are published twice a year in the *World Economic Outlook* and the *Global Financial Stability Report*, which serve as documentation for the discussions of the IMFC. The September 2004 and April 2005 *World Economic Outlook* reports both found near-term global growth prospects to be quite healthy, but risks posed by global current account imbalances, an upturn in global interest rates, and further increases in oil prices. The *Global Financial Stability Report,* meanwhile, cited the increased resilience of the global financial system, but also noted that the risks of market corrections had increased, owing to overabundant liquidity and lower risk premiums. In addition, the Executive Board holds frequent discussions of world economic developments. IMF management and senior staff also take part in discussions on the economic outlook and policies among finance ministers, central bank governors, their deputies, and other officials in a variety of groups and forums, such as the Group of Seven (G7) major industrial countries, the Group of 24 (G24) developing countries, and the Financial Stability Forum.

How is surveillance conducted?

To conduct country surveillance in accordance with Article IV, an IMF staff team visits a member country, normally once a year, to meet government and central bank officials and collect and analyze economic and financial information. The analysis covers recent economic developments, as well as the exchange rate, monetary, fiscal, and relevant structural policies the country is pursuing. The Executive Director for the country usually participates in the mission's high-level meetings as an observer. The team also generally meets with other groups—such as trade unions, business associations, academics, financial market participants, and sometimes members of legislative bodies. The IMF staff team normally prepares a concluding statement, or memorandum, summarizing its findings and policy advice. The national authorities have the option of publishing the statement.

On returning to headquarters, IMF staff members prepare a report that describes the economic situation in the country and their policy discussions with the national authorities and evaluates the country's policies. The Executive Board then discusses the report. The views of the country's authorities are conveyed to the Board by the country's Executive Director, and a written summary of the Board's discussion is produced and sent to the country's authorities. Subject to the approval of the country concerned, the documents related to the consultation are posted on the IMF's website *(www.imf.org)*.

Taking early action

Early warning of an impending crisis is not enough to prevent the crisis; prompt preventive action is also necessary. Moreover, with increasing financial integration, surveillance must focus not just on crisis-prone countries but also on the system as a whole. Even if a country is not itself at risk, it may be contributing to global imbalances and placing the rest of the world at risk. The IMF, as the impartial voice of the international community, has a particularly important role to play here in highlighting major economic challenges that the world has to tackle. This is why, for example, the IMF has, during 2003–05, called on the United States, Europe, and Japan to contribute in particular ways to more balanced and sustained global growth. It has asked the United States to take steps to reduce its fiscal and external current account deficits, and the European Union and Japan to promote more vigorous growth through structural reforms. Surveillance of the major industrial countries is critical, and global surveillance, including of capital markets, needs to be constantly strengthened.

Lessons from the Mexican crisis of 1994–95 and the Asian crisis of 1997–98 prompted significant efforts to sharpen the focus of surveillance on crisis prevention. The IMF now monitors economic and financial developments more closely at the regional and global levels and advises its members to incorporate more "shock absorbers" into their policies—such as fiscal policies that leave room for larger deficits in difficult times, adequate reserve levels, efficient and diversified financial systems, exchange rate flexibility in many cases, and more effective social safety nets. And it has introduced several specific initiatives that seek to make countries less vulnerable to crisis:

- In 1999, partly in response to the Asian crisis, the IMF and the World Bank introduced the Financial Sector Assessment Program (FSAP), through which they assess countries' financial sectors in depth. FSAP reports help countries identify the strengths, risks, and vulnerabilities of their financial systems and formulate appropriate policy responses. The IMF also assesses offshore financial centers, which account for a sizable portion of the world's financial flows and thus are potentially important for global financial stability. In addition, the IMF is involved in international efforts to combat money laundering and the financing of terrorism.
- The IMF has developed and actively promotes standards and codes of good practice in economic policymaking. In the area of data standards, it has designed initiatives to enhance public availability of reliable, timely, and comprehensive statistics on member countries, helping market participants to make well-informed investment decisions and reducing the likelihood of shocks that can precipitate crises.
- The IMF has introduced several types of assessments to enhance its ability to identify countries' vulnerabilities to crisis, (for example, the balance sheet approach, liquidity management, and financial soundness indicators). These frameworks aim to strengthen the IMF's policy advice to member countries on how to make their economies more resilient to shocks.
- The IMF has also improved its debt sustainability analysis to help countries judge whether they can service their external and public debts over time without an unrealistically large correction to the balance of income and expenditure.
- The IMF has been increasing efforts to promote good governance, which is essential for strong economic performance. Particular areas of emphasis include improving the efficiency and accountability of public sectors and financial systems.
- The IMF has stepped up its attention to trade-related vulnerabilities, which remain a pressing issue for the poorest countries with IMF-supported programs. To help developing countries address the short-term effects on their balance of payments of multilateral trade liberalization, the IMF's new Trade Integration Mechanism makes resources more predictably available to qualifying member countries under existing IMF facilities.
- Also under consideration is a request by some member countries and donors for new policy monitoring and signaling arrangements that do not involve IMF financing. Such arrangements would allow members to demonstrate their commitment to sound policies either for domestic purposes or as a signal to international creditors and donors.

Transparency at the IMF

The IMF has also focused on improving its own accountability by establishing in 2001 the Independent Evaluation Office (see page 32) and by increasing over the past decade the transparency of its operations and decision making. The IMF has become a more open and accountable institution and a major source of information for the general public and capital market participants, while preserving its role as confidential advisor to its member countries.

The IMF now publishes most policy papers written for the Executive Board, posts financial and operational information on its website, and makes available more information about its surveillance. Although member countries need to consent to the publication of documents related to their countries, in most cases, publication is presumed, and the large majority of staff reports are in fact published. ■

Helping When Things Go Wrong

However good the IMF's surveillance process and the economic policies governments implement, it is unrealistic to expect that crises will never occur. Indeed, a dynamic market economy will tend to face occasional crises—and the IMF's role is then to help mitigate their impact and shorten their duration through its policy advice and financial support. The IMF also tries to prevent the crisis from spreading to other countries. This has sometimes required the commitment of substantial resources by the IMF. In most cases, this investment has paid off. For example, the IMF's loan of $21 billion to the Republic of Korea in December 1997 was very large by any standards. But it helped restore financial stability by early 1998 and strong growth the following year. And Korea repaid the IMF ahead of schedule. That was a case where large-scale support was appropriate and successful. The IMF played a similar role in Brazil in 1998 and Turkey in 2001.

Brazilian futures market traders in São Paulo.

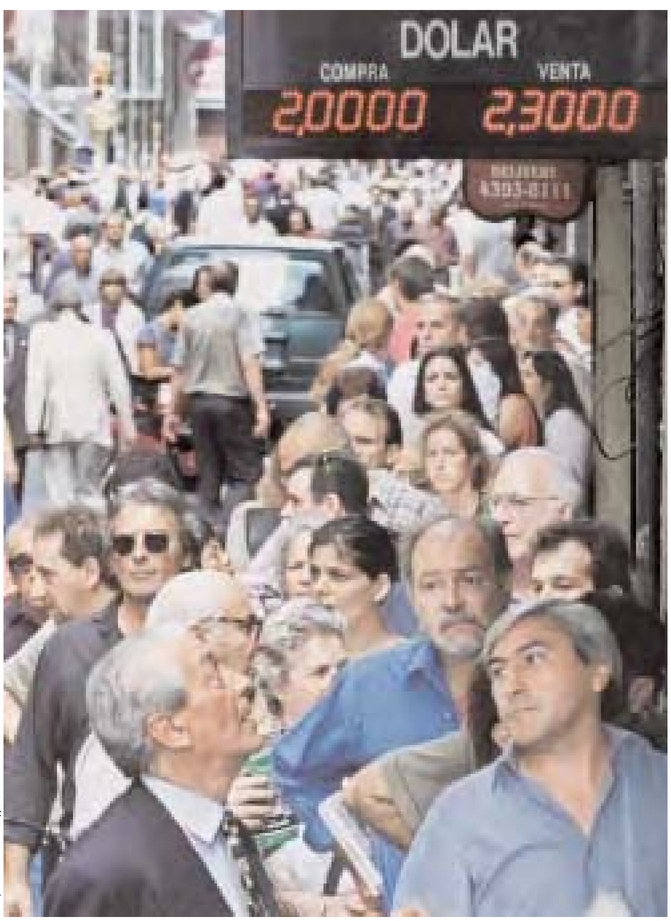
Mauricio Lima/AFP

Why do economic crises occur?

Bad luck, bad policies, or a combination of the two may create balance of payments difficulties in a country—that is, a situation when the country cannot obtain sufficient financing on affordable terms to meet net international payments. In the worst case, the difficulties can build into a crisis. The country's currency may depreciate at a rate that destroys confidence in its value, with disruptive and destructive consequences for the domestic economy, and the problems may spread to other countries.

The causes of such difficulties are often varied and complex. But key factors have included weak domestic financial systems, large and persistent fiscal deficits, high levels of external debt, exchange rates fixed at inappropriate levels, natural disasters, and armed conflicts.

Some of these factors can directly affect a country's trade account—reducing exports or increasing imports. Others may reduce the financing available for international transactions—for example, by causing investors to lose confidence in their investments in a country, leading to massive asset sales and a sudden departure of capital overseas, or "capital flight."



Adalejandro Kaminetsky/Reuters

Buenos Aires residents wait to buy U.S. dollars in early 2002 as the Argentine peso plummets.

How IMF lending helps

IMF lending seeks to give countries breathing room while they implement policies of adjustment and reform aimed at resolving their balance of payments problems and restoring conditions for strong economic growth. These policies will vary depending on the country's circumstances, especially the root causes of the problems. For instance, a country facing a sudden drop in the price of a key export may simply need financial assistance to tide it over until prices recover and to help ease the pain of an otherwise sudden and sharp adjustment. A country suffering from capital flight needs to address whatever problems led to the loss of investor confidence: perhaps interest rates that are too low, an overvalued exchange rate, a large government budget deficit, a debt stock that appears to be growing too fast, or an inefficient and poorly regulated domestic banking system.

Before a member country can receive a loan, the country's authorities and the IMF must agree on an appropriate program of economic policies (see Lending and Conditionality, page 22).

In the absence of IMF financing, the adjustment process would be more difficult. For example, if investors do not want to buy any more of a country's government bonds, its government has no choice but to reduce the amount of financing it uses—by cutting its spending or increasing its revenues—or to finance its deficit by printing money. The "belt tightening" involved in the first case would be greater without an IMF loan. And, in the second case, the result would be inflation, which hurts the poor most of all. IMF financing can facilitate a more gradual and carefully considered adjustment.

In regard to countries that have had IMF-supported programs over the long term, the IMF recently introduced a systematic evaluation process through Ex Post Assessments. These provide a more comprehensive analysis of the problems facing the country, a critical and frank review of the progress achieved during the period of IMF-supported programs, and a forward-looking assessment that takes into account lessons learned and presents a strategy for future IMF engagement.

Tarik Tinazay/AFP

Checking exchange rates in Turkey during the 2001 financial crisis.

In recent years, the largest number of loans has been made through the Poverty Reduction and Growth Facility (PRGF), which provides low-income countries with loans at below-market interest rates and over relatively long time horizons (repayable over 5½–10 years). However, the largest amount of funds is provided through Stand-By Arrangements, which charge market-based interest rates on loans (usually for 12–18 months, repayable over 3¼–5 years) to assist with short-term balance of payments problems (see page 25).

The IMF provides other types of loans as well, including emergency assistance to countries that have experienced a natural disaster or are emerging from armed conflict.

Resolving external debt crises

Some balance of payments difficulties arise because countries amass debts that are not sustainable—that is, they cannot be serviced under any feasible set of policies. In these circumstances, a way must be found for a country and its creditors to restructure the debt. This may involve some easing of the repayment terms, like an extension of maturities and/or an agreed reduction in the face value of the debt.

Together with the World Bank, the IMF has been working to reduce to sustainable levels the debt burdens of heavily indebted poor countries under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative, introduced in 1996 and enhanced in 1999. So far, 27 countries have been approved for debt service relief provided by the Fund and the Bank, other multilateral institutions, and other (mostly official) creditors.

The IMF has continued to promote mechanisms aimed at the orderly resolution of debt crises between countries and their private creditors. It has taken an active role in encouraging sovereign issuers and private market participants to include collective action clauses (CACs)—which prevent small minorities of creditors from blocking restructuring deals to which large majorities agree—in international bond issues in all markets. Partly as a result, the use of CACs has become the market standard in international sovereign bonds issued under New York law. Subsequently, the share of issues with CACs from emerging market countries has grown considerably since early 2004.

The IMF is also encouraging a broadening of the consensus on the Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets, which outline standards of engagement and responsibilities for sovereign debtors and their private creditors in the prevention and resolution of financial crises. ■

Getting Back on Track

The IMF provides financial assistance to members with balance of payments problems to support policies of adjustment and reform, including concessional assistance to low-income countries. The financing is for general balance of payments support, rather than for specific purposes or projects, like the financing provided by development banks. All financial assistance by the IMF is approved by its Executive Board.

The volume of IMF lending has fluctuated significantly. The oil shocks of the 1970s and the debt crisis of the 1980s were both followed by sharp increases in IMF financing. In the 1990s, the transition process in Central and Eastern Europe and the former Soviet Union, as well as crises in emerging market economies, led to another surge in the demand for IMF financing.

Sena Vidanagama/AFP

Tsunami destruction in Sri Lanka.

Over the years, the IMF has developed a number of loan instruments, or "facilities," that are tailored to address the specific circumstances of its diverse membership. Nonconcessional loans are provided through four main facilities: Stand-By Arrangements, the Extended Fund Facility, the Supplemental Reserve Facility, and the Compensatory Financing Facility (see table on page 25). Low-income countries may borrow at a concessional interest rate through the Poverty Reduction and Growth Facility (PRGF). Member countries recovering from natural disasters and armed conflicts can also request emergency assistance from the IMF—in the case of low-income countries, at concessional rates.

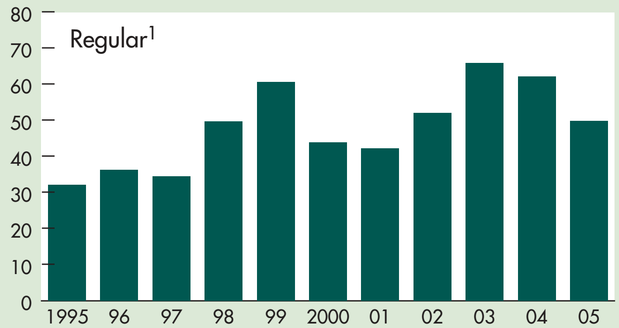
Nonconcessional facilities are subject to the IMF's market-related interest rate, known as the "rate of charge," and some carry an interest rate premium or "surcharge." The rate of charge is based on the SDR interest rate, which is revised weekly to take account of changes in short-term interest rates in the major international money markets. Large loans carry a surcharge.

The amount that a country can borrow varies with the type of loan and is expressed as a multiple of the country's IMF quota. To finance an exceptional balance of payments need, the IMF may also lend beyond the access limits. The IMF encourages early repayment of loans. Although it has a standard repayment obligations schedule, members are expected to repay according to a faster schedule when possible.

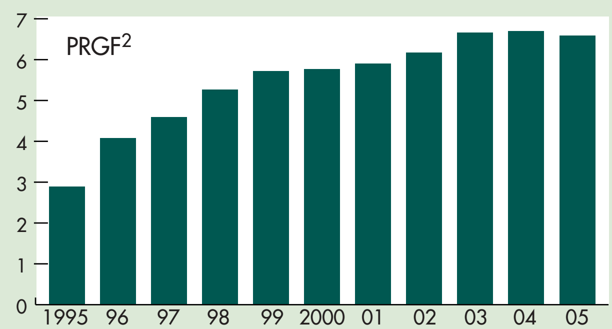
Diverging trends in credit outstanding

Outstanding credit from regular IMF loans has declined . . .

(billions of SDRs)



while it has increased for low-income countries in recent years.



[1]All IMF nonconcessional lending.
[2]Poverty Reduction and Growth Facility.
Note: Data as of the end of the financial year (April 30).
Data: IMF Finance Department.

Conditionality in IMF lending

When a country borrows from the IMF, its government makes commitments to strengthen its economic and financial policies—a requirement known as conditionality. Conditionality provides assurance to the IMF that its loan will be used to resolve the borrower's economic difficulties and that the country will be able to repay promptly, so that the funds become available to other members in need.

In recent years, the IMF has worked to streamline the conditions attached to its financing. The IMF's Board adopted revised guidelines in September 2002 emphasizing the need to focus conditionality on the key macroeconomic objectives and policy instruments and to promote stronger national ownership of policy programs. A recent review suggested that conditionality has indeed become more focused and that fewer programs now stop prematurely.

The policies to be adopted are designed not just to resolve the immediate balance of payments problem but also to lay the basis for sustainability and economic growth over the longer term by achieving broader economic stability—for example, measures to contain inflation, reduce public debt, or strengthen financial systems. Policies may also address structural impediments to healthy growth—like price and trade liberalization or improvements in governance.

Together, these policies constitute a member country's "policy program," which is described in a letter of intent or a memorandum of economic and financial policies that accompanies the country's request for IMF financing. The specific objectives of a program and the policies adopted depend on the country's

Dylan Martinez/Reuters

Unloading banknotes in Jakarta, Indonesia.

circumstances. However, the overarching goal in all cases is to restore or maintain balance of payments viability and macroeconomic stability, while setting the stage for sustained, high-quality growth.

How is compliance assessed?

Most IMF loans feature phased disbursements. This allows the IMF to verify that a country is continuing to adhere to its commitments before disbursing successive installments. Program monitoring relies on several different tools:

- **Prior actions** are measures that a country agrees to take *before* the Fund's Executive Board approves a loan or completes a review. Such measures ensure that the program has the necessary foundation to succeed or is back on track following deviations from the agreed policies. Prior actions could include, for example, adjustment of the exchange rate to a sustainable level, elimination of price controls, or formal approval of a government budget consistent with the program's fiscal framework.
- **Performance criteria** are specific conditions that have to be met for the agreed amount of credit to be disbursed. There are two types of performance criteria: quantitative and structural. ***Quantitative criteria*** typically refer to macroeconomic policy variables such as international reserves, monetary and credit aggregates, fiscal balances, or external borrowing. For example, a program might include a minimum level of net international reserves, a maximum level of central bank net domestic assets, or a maximum level of government borrowing. ***Structural criteria*** are used for structural measures that are critical to the success of the economic program. These vary widely across programs but could, for example, include specific measures to improve financial sector operations, reform social security systems, or restructure key sectors such as energy.
- Quantitative criteria may be supplemented with **indicative targets**. These are often set for the later months of a program and are then turned into performance criteria, with appropriate modifications, as economic trends firm up.
- **Structural benchmarks** are used for measures that cannot be monitored objectively enough to be performance criteria, or for small steps in a critical reform process that would not individually warrant an interruption of Fund financing.
- Another important monitoring tool is the **program review**, which serves as an opportunity for a broad-based assessment by the Executive Board of progress toward the program's objectives. Reviews are used to discuss policies and introduce changes to the program that may be necessary in light of new developments. In some cases, a country might request a waiver for a breached performance criterion—for example, when its authorities have already taken measures to correct the deviation. ■

How the IMF Lends: Terms and Conditions of Financial Facilities

Stand-By Arrangement and Extended Fund Facility

- Stand-By Arrangement (introduced in 1952):
  Designed to address short-term balance of payments difficulties; length is typically 12–18 months with a legal maximum of 3 years.

  Normal access limits: Annual: 100 percent of quota; cumulative: 300 percent of quota for all use of Fund resources in the General Resources Account.

  Maturities (expected repayment)/(obligatory repayment): 2¼–4 years/ 3¼–5 years.

  Charges: Basic rate of charge + level-based surcharges of 100 basis points on amounts above 200 percent of quota and 200 basis points on 300 percent of quota.

  Conditions: Member adopts policies that provide confidence that its balance of payments difficulties will be resolved within a reasonable period.

  Cumulative access: Above 25 percent of quota is subject to stricter conditions (known as upper credit tranche conditionality).

  Phasing and monitoring: Quarterly disbursements contingent on observance of performance criteria and other conditions.

- Extended Fund Facility (1974):
  Provides longer-term assistance in support of structural reforms that address longer-term balance of payments difficulties.

  Normal access limits: 100 percent of quota; cumulative: 300 percent of quota for all use of Fund resources in the General Resources Account.

  Maturities (expected repayment)/(obligatory repayment): 4½–7 years/4½–10 years.

  Charges: Basic rate of charge + level-based surcharges of 100 basis points on amounts above 200 percent of quota and 200 basis points above 300 percent of quota.

  Conditions: Member adopts 3-year program, with structural agenda and provides annual detailed statement of policies for the next 12 months.

  Phasing and monitoring: Quarterly or semiannual disbursements contingent on observance of performance criteria and other conditions.

Special loans

- Supplemental Reserve Facility (1997):
  Provides short-term assistance to members with balance of payments difficulties related to a sudden and disruptive loss of market confidence. Available only as a supplement to a regular arrangement.

  Access limits: None; this facility is available only when access under associated regular arrangement would otherwise exceed either annual or cumulative limit.

  Maturities (expected repayment)/(obligatory repayment): 2–2½ years/2½–3 years.

  Charges: Basic rate of charge + 300 basis points rising to a maximum of 500 basis points after 2½ years.

  Conditions: Program under associated arrangement, with strengthened policies to address a loss of market confidence.

  Phasing and monitoring: Facility available for one year; front-loaded access with two or more disbursements.

- Compensatory Financing Facility (1963):
  Covers a shortfall in a member's export earnings and services receipts or an excess in cereal import costs that is temporary and arises from events beyond the member's control.

  Access limits: Maximum 45 percent of quota for each element—export shortfall and excess cereal import costs—and a combined limit of 55 percent of quota.

  Maturities (expected repayment)/(obligatory repayment): 2¼–4 years/3¼–5 years.

  Charges: Basic rate of charge; not subject to surcharges.

  Conditions: Usually available only when a member already has a Stand-By Arrangement or when its balance of payments position, apart from export shortfall or import excess, is otherwise satisfactory.

  Phasing and monitoring: Typically disbursed over a minimum of six months and in accordance with the phasing provisions of the arrangement.

- Emergency Assistance
  1. Natural disasters (1962): Provides quick, medium-term assistance to members with balance of payments difficulties related to natural disasters.
  2. Postconflict (1995): Provides quick, medium-term assistance for balance of payments difficulties related to the aftermath of civil unrest or international armed conflict.

  Access limits: 25 percent of quota, although larger amounts can be made available in exceptional cases.

  Maturities (expected repayment)/(obligatory repayment): No early repayment expectation/ 3¼–5 years.

  Charges: Basic rate of charge; not subject to surcharges; possibility of interest subsidy for low-income countries if resources are available.

  Conditions: Reasonable efforts to overcome balance of payments difficulties and focus on institutional and administrative capacity building to pave the way toward an upper credit tranche arrangement or an arrangement under the Poverty Reduction and Growth Facility. For emergency postconflict assistance, IMF support would also be part of a concerted international effort to address the aftermath of the conflict.

  Phasing and monitoring: Typically none.

Loans for low-income members

- Poverty Reduction and Growth Facility (1999):
  (Replaced the Enhanced Structural Adjustment Facility, created in 1987.) Provides longer-term assistance for deep-seated structural balance of payments difficulties; aims at sustained, poverty-reducing growth.

  Access limits: 140 percent of quota; exceptional maximum, 185 percent.

  Maturities (expected repayment)/(obligatory repayment): No early repayment expectation/5½–10 years.

  Charges: Concessional interest rate: ½ of 1 percent a year; not subject to surcharges.

  Conditions: Based on a Poverty Reduction Strategy Paper prepared by the country in a participatory process, and integrating macroeconomic, structural, and poverty reduction policies.

  Phasing and monitoring: Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and completion of reviews.

Passing on Know-How

The IMF provides technical advice and training to help strengthen the design and implementation of macroeconomic and financial sector policies in member countries and boost the institutional capacity of their governments. Sound economic policymaking and implementation require know-how and effective government institutions. Many developing countries, in particular, need help to build up expertise in economic management and advice about what policies, reforms, and institutional arrangements are appropriate and have worked well elsewhere. The IMF gives priority to providing assistance where it complements and enhances its other key activities—surveillance and lending.

Through staff missions sent from headquarters, the provision of specialists on a short-term basis, resident advisors, regional technical assistance centers, and training in the field, at its regional training institutes, or at its headquarters, the IMF offers technical assistance in the core areas of its expertise (see chart). These include macroeconomic policy formulation and management; monetary policy; central banking; the financial system; foreign exchange markets and policy; public finances and fiscal management; and macroeconomic, external, fiscal, and financial statistics. Such assistance is a benefit of IMF membership and is free except for countries that can afford to reimburse the IMF. About one-third of the IMF's total technical assistance is financed externally.

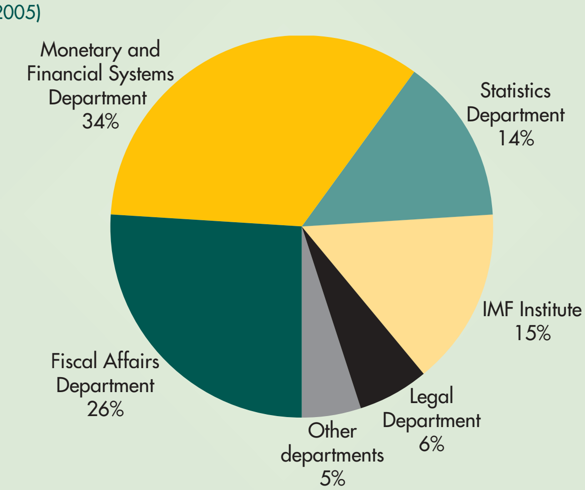
In the early to mid-1990s, as the IMF's membership expanded to include a number of countries in transition from centrally planned to market-based economies, the Fund's technical assistance grew rapidly. More recently, the IMF's efforts to strengthen the global financial system so as to reduce the risk of crises and improve the management and resolution of those that do occur have generated new demands for technical assistance from countries seeking to adopt international standards and codes for financial, fiscal, and statistical management. Most of this technical assistance is based on recommendations resulting from Financial Sector Assessment Programs and Reports on the Observance of Standards and Codes. The IMF's recent work regarding offshore financial centers and the fight against money laundering and terrorism financing also required additional technical assistance.

In addition, the IMF has mounted significant efforts, in coordination with other bilateral and multilateral technical assistance providers, to give prompt policy advice and operational assistance to countries emerging from armed conflict (see page 2). At the same time, there is a continuing demand from low-income countries for help with debt sustainability analysis and the management of debt-reduction programs, and with designing and implementing programs to enhance growth and

Sharing technical expertise

Different departments in the IMF provide assistance in a variety of economic specializations.

(FY2005)



Note: As a percent of total resources, in effective person-years.

accelerate poverty reduction. Increasingly, the IMF has been organizing its technical assistance and training at a regional level. It operates, together with donors, five regional technical assistance centers, two in Africa and one each in the Caribbean, the Middle East, and the Pacific.

In reviewing a recent report by the Independent Evaluation Office on the IMF's technical assistance program, the Executive Board highlighted the increasingly important role that IMF technical assistance plays in responding to the diverse needs of member countries, particularly in policy design and implementation, and capacity building. The Executive Board found that key factors in the effective provision of technical assistance are the ability to respond quickly, tailor advice to members' circumstances, and produce high-quality analysis. Following the report's recommendations, the IMF is working to improve the prioritization of technical assistance, ensure active engagement of the authorities in the design and follow-up stages, and better monitor the results.

Training

The IMF places high importance on building expertise in member countries through training. The IMF Institute is responsible for most of the training provided by the IMF. It trains officials from member countries through courses and seminars in the core areas of macroeconomic policy management, and financial sector, fiscal, and external sector policies. Training is offered by staff from the Institute and other IMF departments, and occasionally assisted by outside academics and experts. Applications from developing and transition country officials are given preference.

In addition to training offered at headquarters, the IMF offers courses and seminars through regional institutes and programs. There are currently four regional training centers: the Joint Regional Training Center for Latin America in Brazil, the Joint Africa Institute in Tunisia, the IMF-Singapore Regional Training Institute, and the Joint Vienna Institute. The IMF has furthermore set up training programs in collaboration with China and the Arab Monetary Fund.

In FY2005, the IMF Institute, with the assistance of other IMF departments, delivered 125 courses for almost 4,000 participating officials. Much of the training was provided at the regional training institutes. Training at headquarters in Washington, DC, including long-term courses, continued to play an important role, accounting for about one-third of participant-weeks. The remainder of the training was at overseas locations outside of the IMF regional network, largely as part of collaboration between the IMF Institute and national or regional training programs, but also in the form of distance learning. ■

Stephen Jaffe/IMF

Training at the IMF Institute.

Effective public spending in Ghana helps to reduce poverty

The IMF has provided considerable technical assistance to improve Ghana's expenditure controls and fiscal reporting and establish a tracking system for public spending aimed at reducing poverty. After a slow start, the reform process has made significant progress over the past few years. A comprehensive system to record aid inflows under the Heavily Indebted Poor Countries (HIPC) Initiative and track poverty-reducing expenditure has been developed. Improved cash management and a system to control expenditure commitments have been introduced. Banking and fiscal data have been reconciled and a large number of bank accounts have been closed, which further improved fiscal control.

Ghana's reform of financial management systems, which has benefited from close cooperation between the IMF and other donor agencies, helped the country to reduce its overall fiscal deficit to 3.6 percent of GDP in 2004 from 9 percent of GDP in 2001, while over the same period increasing public spending aimed at poverty reduction to 7.7 percent of GDP from 4.5 percent.

Striving for a Better Life

The world economy has grown steadily since World War II, bringing widespread prosperity and lifting many millions out of poverty, especially in Asia. Nevertheless, daunting challenges remain. In Africa, in particular, progress in poverty reduction has been limited in recent decades and some countries have fallen back. Looking ahead, in the next 25 years, the world's population is projected to grow by about 2 billion, mostly in developing economies. Many of these people will be doomed to poverty without concerted efforts both by the low-income countries themselves and by the international community.

To tackle these issues, the heads of 189 countries signed the Millennium Declaration in September 2000, adopting the Millennium Development Goals (MDGs), a set of eight objectives incorporating specific targets for reducing income poverty, tackling other sources of human deprivation, and promoting sustainable development by 2015 (see box opposite page). A follow-up meeting of world leaders in Monterrey, Mexico, in March 2002 established a shared understanding of the broad strategy needed to achieve the MDGs.

The Monterrey Consensus ushered in a new compact between developing and developed countries that stressed their mutual responsibilities in the quest to meet the devel-

Refugees from Sudan's Darfur region in Chad.

Stephen Jaffe/IMF

opment goals. It called on developing countries to improve their policies and governance and on developed countries to step up their support, especially by providing more and better aid and more open access to their markets.

Taking stock

The year 2005 represents an important milestone on the way to the MDGs. The *United Nations Millennium Project Report*, published in January 2005, marked the opening of a period of stocktaking on the progress made toward the MDGs and how to accelerate it, to be followed by discussions at the UN Summit Conference on Implementing the Millennium Declaration in September 2005.

The IMF and the World Bank, in the annual *Global Monitoring Report,* track the progress made toward the achievement of the MDGs and the obstacles remaining. The second report, published in 2005, focused on key areas of the policy agenda and paid special attention to Africa—the region most at risk of failing to achieve the MDGs. The report found that meeting the MDGs would require substantial increases in the amount of official development assistance reaching the poorest countries. Although aid volumes had risen since the Monterrey Conference, two-thirds of the increase was debt relief and technical cooperation. Given the reforms under way in many countries in the region, the poorest countries could effectively use a doubling of aid over the next five years, the report said.

Coordinating development assistance

The central goal of the IMF's work in low-income countries is to help them promote economic stability and growth, and thereby achieve deep and lasting poverty reduction. In low-income countries, the IMF works closely with the World Bank, the lead international agency on poverty reduction. Together, they are helping these countries make progress toward the MDGs and contributing to the approach embodied in the Monterrey Consensus through technical assistance, lending, debt relief, and support for trade liberalization.

The IMF also offers low-income countries advice on how to manage the economic impact of aid inflows, which is crucial given the international effort to mobilize more aid for the MDGs. On the donor side, the IMF is working with multilateral development partnerships to enhance the predictability of aid flows and achieve greater policy and administrative coherence on the part of development partners.

Since 1999, two initiatives have been instrumental in boosting the support of the IMF and the World Bank to low-income countries:

- The Poverty Reduction Strategy Papers (PRSPs), written by each borrowing country and setting out its homegrown policy strategy to provide the basis for the IMF's and the World Bank's concessional lending; and
- An enhancement of the debt reduction program—the Heavily Indebted Poor Countries (HIPC) Initiative, introduced in 1996.

The PRSP is a comprehensive country-based strategy for poverty reduction. It aims to provide the crucial links between low-income countries, their donor partners, and the development policies needed to meet the MDGs. The PRSPs provide the operational basis for IMF and World Bank concessional lending and for debt relief under the HIPC Initiative. In the case of the IMF, loans are provided through its Poverty Reduction and Growth Facility (PRGF).

Low-income countries prepare their strategies with the participation of domestic stakeholders and external development partners. Updated periodically (at least once every five years) and with annual progress reports, PRSPs describe the macroeconomic, structural, and social policies that countries plan to pursue and how they will finance them. Once a country has developed a PRSP, it becomes eligible for loans from the PRGF trust and for HIPC debt relief.

The Millennium Development Goals

The MDGs seek, by 2015, to

(1) halve extreme poverty and hunger relative to 1990;
(2) achieve universal primary education;
(3) promote gender equality;
(4) reduce child mortality;
(5) improve maternal health;
(6) combat HIV/AIDS, malaria, and other diseases;
(7) ensure environmental sustainability; and
(8) establish a global partnership for development.

Further steps

While improvements in macroeconomic performance have been especially marked in countries that have, or have had, PRGF arrangements, most low-income countries are far from attaining the sustained high growth necessary for achieving the MDGs by 2015.

What are the problems? Both the IMF staff and the IMF's Independent Evaluation Office (see page 32) have identified a number of difficulties. The IEO concluded in a 2004 report that while PRSPs have significant potential and have had some success in improving country ownership of policy programs, enhancing participation, and providing better-quality strategies, achievements to date have fallen short of expectations. As for PRGF-supported programs, there have been changes in the right direction, but more effort is needed to ensure that the programs provide a sound basis for the sustainable long-term growth needed to meet the MDGs.

Partly in response to evaluations of the PRS process, the IMF and the World Bank have made several changes in the PRS architecture. These amendments—particularly the elimination of the requirement of Board endorsements of the PRS as the basis for IMF–World Bank concessional lending—aim at strengthening country ownership of the PRS process.

The IMF is considering further steps to refine its role in low-income countries. Under consideration are measures to meet the need for a new form of IMF engagement in low-income countries that would not involve IMF lending but that would support countries in their reform efforts while also providing the IMF's assessment of countries' policies and performance. Such assessments are often used by low-income countries and donors to demonstrate and assess the appropriateness and quality of economic policies, and they may affect the flow of external assistance, including debt relief and other aid. Also under discussion is a modification of the PRGF Trust that would enable the IMF to provide concessional financial assistance other than through the PRGF to low-income countries facing exogenous shocks.

For low-income countries that face balance of payments difficulties as a result of natural disasters or trade changes, the IMF has activated mechanisms that provide support—the subsidized Emergency Natural Disaster Assistance (ENDA), and the Trade Integration Mechanism (TIM)—on concessional terms.

Reducing debt burdens

The enhanced HIPC Initiative was introduced in 1999 to provide faster, deeper, and broader debt relief to low-income countries and to strengthen the links between debt relief and poverty reduction, particularly through social policies. Countries' continued efforts toward macroeconomic adjustment and structural and social policy reforms—including increased spending on such social sector programs as basic health care and education—are central to the enhanced HIPC Initiative. In late 2004, the Initiative was extended to end-2006 to provide the opportunity for the remaining eligible countries to establish track records that would allow their consideration for HIPC relief (see table below). Many of the coun-

Status of countries in the HIPC Initiative (as of August 2005)

Countries entitled to full debt relief, having met all criteria (18)		Countries that have begun to receive aid, but must meet additional criteria for full debt relief (10)		Countries still to be considered (10)	
Benin	Mauritania	Burundi	Guinea	Central African Republic	Liberia
Bolivia	Mozambique	Cameroon	Guinea-Bissau	Comoros	Myanmar
Burkina Faso	Nicaragua	Chad	Malawi	Congo, Rep. of	Somalia
Ethiopia	Niger	Congo, Dem. Rep. of	São Tomé and Príncipe	Côte d'Ivoire	Sudan
Ghana	Rwanda	Gambia, The	Sierra Leone	Lao P.D.R.	Togo
Guyana	Senegal				
Honduras	Tanzania				
Madagascar	Uganda				
Mali	Zambia				

tries that would benefit from this extension have been affected by conflict, such as Liberia, Somalia, and Sudan.

Debt relief is essential to enable low-income countries to free up resources for the social and infrastructure spending that they will need to make progress toward achieving the MDGs. Before the Initiative, eligible countries were, on average, spending slightly more on debt service than on health care and education combined. This is no longer the case in the 28 countries receiving HIPC relief. Under recent programs supported by the IMF and the World Bank, these countries have increased their expenditures on health care, education, and other social services to almost four times the amount of debt service payments, on average.

To realize the potential benefits of debt relief, it will be critical to help countries avoid excessive borrowing in the future. To that end, the IMF and the World Bank have introduced a new framework for debt sustainability for low-income countries, including such key elements as standardized forward-looking debt analysis and a consistent financing strategy.

How a better investment climate helps reduce poverty

One crucial element in the strategies to promote growth and reduce poverty are reforms to improve the environment for businesses in low-income countries. Experience has shown that persistence, rather than perfection, is the key in translating investment climate reforms into increased private investment, stronger growth, and faster poverty reduction. Significant progress can be achieved by addressing the most important obstacles in a way that gives businesses confidence to invest and assures them that improvements will continue.

A case in point is Uganda, which initiated reforms in the early 1990s in many areas that affected the investment climate: expropriations by a previous government were reversed, trade barriers were reduced, tax and court systems were strengthened, and the economy was stabilized. The persistent reform efforts boosted the government's credibility, which in turn gave businesses the confidence to invest. As a result, private investment as a share of GDP more than doubled, from just over 6 percent in 1990 to 15 percent in 2002. This strengthened per capita income growth (which averaged 4 percent a year in 1993–2002—eight times the average in sub-Saharan Africa) and reduced poverty from 56 percent in 1992 to 35 percent in 2000.

Trade issues and the Doha Round

Trade is potentially much more important than aid in helping developing countries prosper. The IMF is continuing to press for the successful conclusion of the Doha Development Round of multilateral trade talks (begun in 2001) and, together with the World Bank, has urged participants from both developed and developing nations to make this a priority. The IMF and the World Bank have jointly emphasized the need for the liberalization of trade in agricultural products, for all countries to take on substantive obligations to liberalize trade, and for flexibility in areas that may result in heavy regulatory burdens on poor countries.

The IMF has been doing its part to support an open international trading system. In FY2005, the IMF activated the TIM to help countries cope with balance of payments shortfalls resulting from the implementation of World Trade Organization (WTO) agreements or nondiscriminatory trade liberalization by other countries. The TIM allows IMF members to request financial assistance under the IMF's existing facilities to meet temporary trade-related balance of payments needs.

When the WTO's Agreement on Textiles and Clothing expired at the end of 2004, for example, the Dominican Republic obtained support under the TIM, making it the second country to do so, following Bangladesh in 2004. Discussions with other member countries are under way. The availability of assistance under the TIM should help assuage concerns of some developing countries that an ambitious outcome to the Doha Round could place undue adjustment pressures on them.

To help ensure that member countries can take full advantage of the opportunities of multilateral trade liberalization, the IMF has

- provided technical assistance in such areas as customs reform, tax and tariff reform, and data improvements;
- helped countries incorporate trade reforms in their Poverty Reduction Strategies;
- identified potential risks and helped countries understand the benefits of international integration; and
- assessed how they are affected by trade reforms, such as the implications of reduced agricultural subsidies, preference erosion, and the phaseout of textile quotas. ■

Identifying Changes Needed at the IMF

To get objective and substantive feedback on the IMF's performance, the Executive Board established the Independent Evaluation Office (IEO) in July 2001. The IEO has produced a series of detailed reports on aspects of the IMF's work. The reports are used to evaluate how the IMF does its job and to help formulate desirable changes in policies and practices. The IEO reports to the IMF's Executive Board. It works at arm's length from the Board and independently of management and staff. The IEO comprises a director and 12 other staff, the majority of them recruited from outside the IMF. On June 6, 2005, Thomas A. Bernes became the second director of the IEO, succeeding Montek Ahluwalia.

The IEO's website *(www.imf.org/ieo)* gives detailed information on its terms of reference, work to date, status of ongoing projects, evaluation reports, and seminars and outreach activities. The website also provides opportunities for interested stakeholders (country authorities, academia, nongovernment organizations, and other members of civil society) to interact with the IEO in defining its work program, determining the terms of reference of individual studies, and submitting substantive inputs to these studies.

The IEO develops its work programs on the basis of internal discussions and broad-based consultations. Draft issues papers for all evaluations are posted on the IEO website for public comments. Studies completed during 2002–05 include evaluations of prolonged use of IMF resources; the IMF's role in recent capital account crises in the Republic of Korea, Indonesia, and Brazil; fiscal adjustment in IMF-supported programs; the IMF's role in Argentina during 1991–2001; the effectiveness of the Poverty Reduction Strategy Paper (PRSP) process and the Poverty Reduction and Growth Facility (PRGF); IMF technical assistance; and the IMF's approach to capital account liberalization. Under its current work program, the IEO is conducting evaluations of the Financial Sector Assessment Program (FSAP), IMF assistance to Jordan, IMF structural conditionality, and global surveillance. Under the upcoming work program, the IEO has announced it will undertake evaluations of the IMF's advice on exchange rate policy; the IMF's role in selected African countries with respect to the external resource envelope, aid predictability, and debt sustainability; and of bilateral surveillance, including issues related to surveillance of large industrial countries. ■

Common themes in IEO evaluations

The IEO's reports have contained several common themes:

Surveillance

- Surveillance should take a longer-term view and help inform program design. Based on its surveillance activities, the IMF should provide the authorities with a frank assessment of critical weaknesses and encourage the authorities to develop a policy plan for critical areas where adjustment and reforms have lagged.
- Greater candor is key to making surveillance more effective.
- Systematic stocktaking allows for greater learning from experience, especially in countries with IMF-supported programs.

Program design and uncertainty

- Risks should be explicitly taken into account in program design, and excessively optimistic assumptions about growth and the speed of response of private sector demand should be avoided. Explicit contingency planning would help make programs more flexible. Greater transparency about the critical assumptions and rationale of program design would permit more rapid redesign in the event contingencies actually occur.
- Domestic commitment to core policy adjustments is of utmost importance to the success of programs.

Conditionality and ownership

- Domestic political commitment to core policy adjustments is more important than specific conditions.
- The IMF should consider "second-best" adjustment and reform programs that meet minimum criteria, and should also be prepared to hold back financing when country ownership of programs is insufficient or programs do not meet minimum criteria.
- Ownership of a technical assistance (TA) program—particularly institution building—is critical for its success. The IMF should examine more systematically the reasons behind failures to implement TA recommendations.

IMF effectiveness and decision making

- The IMF needs to be more specific about the intermediate objectives of particular initiatives to measure its effectiveness better. A clearer stance on the scope of the IMF's role in some key areas (e.g., in low-income countries and with respect to TA provision and capital account liberalization issues) is needed for effective priority setting. In recent initiatives, the IMF began to identify more specific performance indicators to monitor its effectiveness. The IMFC has endorsed such efforts and called for the development of a methodology for better assessing the effectiveness of surveillance.
- Political considerations, which are inevitably present in decisions on financing, should be taken into account in a transparent manner, with decisions and accountability clearly at the level of the Executive Board and on the basis of candid technical assessments by the staff.

At a Glance

Key IMF indicators (as of July 31, 2005, unless indicated)

Membership	184 countries
Headquarters	Washington DC
Executive Board	24 members
Total staff	2,700
Total quotas	$310 billion (SDR 213.5 billion)
Quotas	
Largest	United States (17.5% of total)
Smallest	Palau (0.001% of total)
Lending resources	
Available resources[1]	$169 billion (SDR 116.2 billion)
One-year forward commitment capacity[2]	$133 billion (SDR 91.8 billion)
Credit lines[3]	
Credit available under borrowing arrangements	$49 billion (SDR 34 billion)
Reserves	
Precautionary balances[4]	$11 billion (SDR 7.4 billion)
Other assets	
Gold holdings	103.4 million fine ounces
Value on IMF books	$8 billion (SDR 5.9 billion)
Market value	$44 billion (at $429/oz.)

Credit outstanding	
Total credit[5]	$73 billion (SDR 49.8 billion)
To low-income countries on special terms	$10 billion (SDR 6.6 billion)
To other member countries	$63 billion (SDR 43.2 billion)
Current lending arrangements	
Stand-By Arrangements	11
Extended Fund Facility	2
Poverty Reduction and Growth Facility	27
Biggest borrowers	
Turkey	$17 billion (SDR 12 billion)
Brazil	$16 billion (SDR 10.8 billion)
Argentina	$11 billion (SDR 7.6 billion)
Indonesia	$8 billion (SDR 5.9 billion)
Uruguay	$2 billion (SDR 1.7 billion)
Debt relief for Heavily Indebted Poor Countries (HIPCs)	
Full debt relief, having met all criteria	18 countries
Some debt relief, but must meet additional criteria for full debt relief	10 countries
Still to be considered	10 countries
Total debt relief for HIPC[6]	$58 billion at end–2004
Cost to IMF[6]	$5 billion at end–2004

Notes:

[1]The gross amount of money the IMF has available for lending minus money that has been committed, but not yet paid out, under existing loan programs with member countries.

[2]The primary measure of IMF liquidity. It is calculated by adding loan repayments scheduled in the coming year to available resources and then subtracting a prudential balance set at $52 billion (SDR 34.0 billion) for fiscal year 2005.

[3]The IMF has two credit lines it can access if it needs additional liquidity. These are known as the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). The last time these credit lines were activated was in 1998.

[4]The IMF accumulates reserves to protect itself and its creditor members from losses in the event of nonpayment of loans. This figure does not include the IMF's gold holdings.

[5]Details may not add as a result of rounding.

[6]Net present value.

Data: IMF Finance Department.

SDRs explained

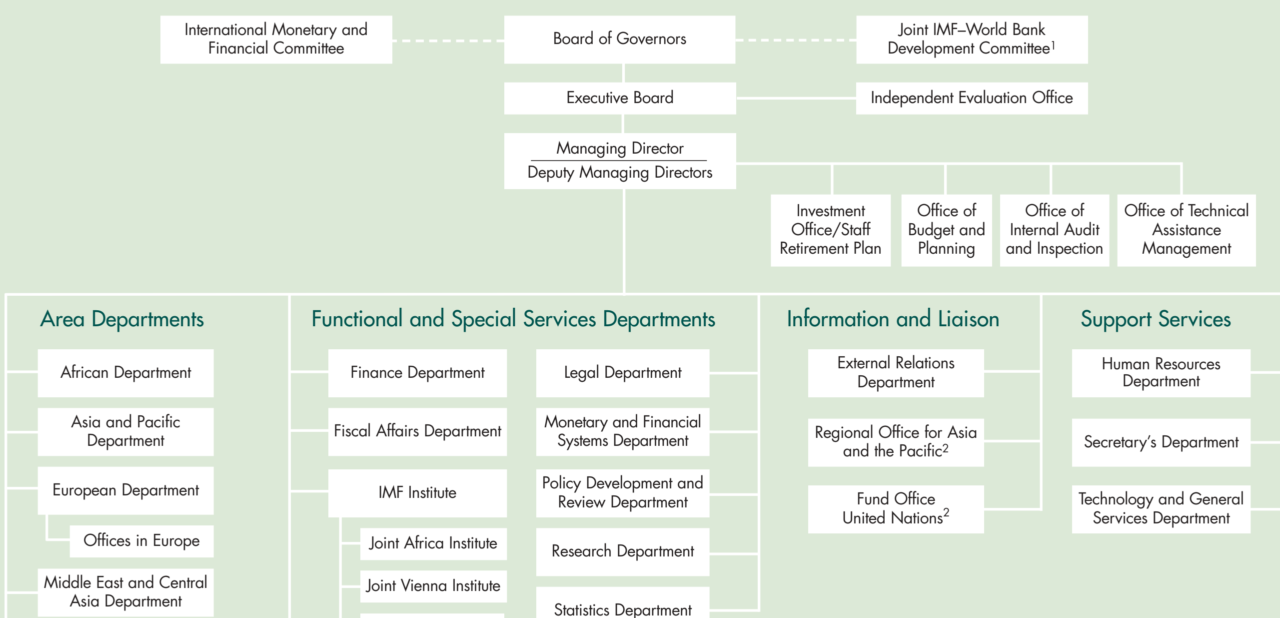
Special Drawing Rights or SDRs are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their quotas. The SDR also serves as the unit of account of the IMF. Its value is based on a basket of key international currencies. U.S. dollar amounts are calculated at the rate of SDR 1 = $1.45186 (July 31, 2005) and are rounded.

Finding out more . . .

The best way to find out more about the IMF is to look at its website *(www.imf.org)*. The biweekly ***IMF Survey*** and the quarterly ***Finance & Development*** are also good sources of information about policies and research.

Critical assessments of IMF policies and procedures can be found on the website of the Independent Evaluation Office *(www.imf.org/external/np/ieo/index.htm)*.

How the IMF Is Organized



[1]Known formally as the Joint Ministerial Committee of the Boards of Governors of the World Bank and the IMF on the Transfer of Real Resources to Developing Countries.

[2]Attached to the Office of the Managing Director.