

GROWTH FOR ALL

TOWARDS A STABLE AND FAIRER WORLD

THE UK AND THE IMF 2003



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Growth for All

Towards a Stable and Fairer World:

The UK and the IMF 2003

March 2004

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ISBN: 1-84532-018-2

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FOREWORD BY THE CHANCELLOR OF THE EXCHEQUER

In a year when the international system has faced many challenges, the IMF has remained the institutional embodiment of the multilateral cooperation essential to meeting the challenges of the modern, interdependent world economy.

During 2003 the uncertainties that have dogged the world economy lessened. We now have the prospect of a steady and strengthening recovery, though global growth remains uneven. Every continent must play its part if the recovery is to bring sustained and balanced growth for all. Part of this report is therefore dedicated to recording the efforts the international community has made, through the IMF, to support that goal. It also shows that it is countries with credible fiscal and monetary frameworks, which have made their product and labour markets flexible, and which follow internationally recognised codes and standards that have seen greater stability and stronger growth.

The spirit of international cooperation that animated the founders of the IMF in 1944 remains essential to ensure globalisation works for all, including the very poorest. I am clear that all countries – developed and developing – must work in partnership to ensure that no country genuinely committed to economic development, poverty reduction and good governance standards is denied the chance to achieve the Millennium Development Goals because of lack of investment. Unless the poorest countries share fully in the world growth, supported by a step change in the level of resources available for investment and a successful conclusion to the Doha trade round, rich countries will not be able to maintain the growth rates we have enjoyed in the past. So this report also sets out the UK's priorities for ensuring globalisation works for the very poorest.

The IMF has a central role to play in creating a globalisation that will bring growth for all by creating a stable and fairer world. The last year has seen further reforms, but to play its part fully the UK believes that the IMF must continue this reform process, paying particular attention to:

- stronger and more independent Fund surveillance, with monitoring of the impact and implementation of surveillance, and further institutional reform to ensure surveillance is independent from Fund lending and from political influence;
- further progress in enhancing the Fund's tools for crisis prevention to ensure earlier awareness of potential and developing problems, and more measured and orderly responses when they have to be resolved; and
- assisting the international community as we seek a speedy resumption of the Doha process and enabling developing countries to participate on fair terms in the world economy.

I am pleased to welcome this fifth annual report to Parliament and to the public on the UK and the IMF. It demonstrates our continued commitment to transparency and accountability in our relationship with the IMF.



REPRESENTING THE UK IN THE IMF

The Board of Governors of the IMF, on which all member countries are represented, is the highest authority governing the IMF. The Chancellor of the Exchequer is the UK's Governor. He is also Chairman of the International Monetary and Financial Committee (IMFC), the main committee of the Board of Governors, and the main forum for discussing IMF policies at the Ministerial level. The Governor of the Bank of England is the UK's Alternate Governor of the IMF and represents the UK at the IMFC.



RT. HON. GORDON BROWN,
Chancellor of the Exchequer
UK Governor of the IMF
Chairman of the IMFC



MERVYN KING,
Governor of the Bank
of England. Alternate UK
Governor, UK representative
on the IMFC

The day-to-day work of the IMF is conducted by the Executive Board of the IMF. This comprises 24 Executive Directors representing all 184 members of the IMF. The UK, as one of the five largest contributors to the IMF, has its own Executive Director currently Tom Scholar.

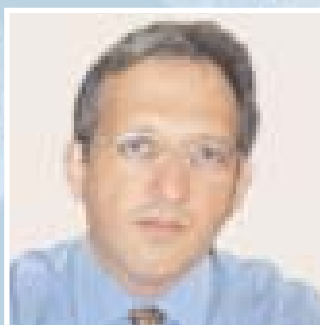
The Treasury coordinates UK policy advice on IMF issues and the UK's operational interests at the Fund, working closely with the Bank of England, the Department for International Development, the Foreign and Commonwealth Office, the Financial Services Authority and other government departments and agencies. Within the Treasury, the Macroeconomic Policy and International Finance Directorate is specifically responsible for preparing advice on the policy issues and specific country programmes that are brought before the Executive Board.



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1

AN IMF TO MEET THE CHALLENGES

The International Monetary Fund, along with the World Bank, was brought into existence at the Bretton Woods conference in 1944. Its aim was to avoid the mistakes of the past and help to ensure a more secure future. Those purposes and the multilateral spirit they embody remain unchanged, even though the world today is radically different from that in 1944. In fact, the IMF is increasingly important in today's globalised economy

The purposes of the Fund¹ allow for an international organisation for monetary cooperation and the facilitation of growth in trade. This provides a mechanism for member countries to cooperate to promote their own prosperity, and that of the whole membership. This report focuses on three challenges for the international community today, and on the UK agenda for the IMF to ensure that it can play its role in meeting these challenges:

- €# maintaining stable economic growth through supporting good policies; avoiding damaging financial crises; and aiding a quick recovery when crises occur;
- €# supporting world trade in a way that benefits all; and
- €# working for a fairer economic system where growth works to reduce poverty.

A STABLE WORLD

1.1 Maintaining sustainable and stable growth in the global economy through multilateral cooperation lay at the heart of the motivation for those at Bretton Woods in 1944. It is at the heart of the Fund's mission still today. The Fund must continue to work to support all its members to attain this sustainable growth. It can do this both by providing policy advice and, in the event a member requires temporary finance, by providing financial support.

1.2 The UK's vision is for a Fund fully equipped both to provide the policy advice which can allow countries to avoid the costs of financial crisis and to respond quickly and effectively when crises do occur.

Crisis Prevention

Surveillance 1.3 The Fund's prime instrument for supporting countries to achieve sustainable growth and avoid financial crisis is through its responsibility to analyse and advise members on their macroeconomic policies - its surveillance function.

¹ Set out in Article 1 of the Fund's Articles of Agreement, at Annex F

1.4 The UK, has consistently argued that the Fund's surveillance function needs to be strengthened. In particular, it should be:

- ⊘ independent;
- ⊘ authoritative;
- ⊘ transparent;
- ⊘ influential; and
- ⊘ accountable

1.5 Discussions on achieving these aims have continued throughout the year. The conclusion of the 2002 Biennial Review of Surveillance, and the work of the IMF's Independent Evaluation Office (IEO) helped ensure that consideration of surveillance remained an important issue for the Fund and its membership in 2003.

1.6 The UK welcomes the progress the Fund has made on bringing a 'fresh perspective' to its surveillance work and the agreement of the Executive Board to new transparency guidelines. Looking forward through 2004, ministers of the International Monetary and Financial Committee (IMFC) used their September meeting in Dubai to identify a number of key issues for Fund surveillance in the coming year: structural reform; medium-term sustainable fiscal frameworks; reducing balance sheet vulnerabilities, including currency mismatches and debt sustainability; and encouraging policy measures to reduce global imbalances.

1.7 The UK will push for continued practical progress on surveillance; will seek clear follow up from the Fund on the issues set out by the IMFC; and will continue to carry out further work on the options and methods for greater independence. The UK's long-term objective remains to make the IMF as independent from political influence in its surveillance of economies, as an independent central bank is in the operation of monetary policy. The UK will work with the Fund, our international partners and others, on building wider support for this agenda.

Credible Policies

1.8 A Fund better equipped to provide policy advice should be able to present credible and persuasive policy options to policy makers that would allow them to reduce the risks of damaging crises. Through this policy advice the Fund promotes sound macroeconomic and microeconomic policies. On the macroeconomic side, history shows that, even in the face of a series of large and destabilising shocks to the global economy, those countries with credible, transparent, flexible and forward-looking macroeconomic frameworks have seen greater stability and stronger growth.

1.9 Stable macroeconomic frameworks need to be supported by sound microeconomic foundations which allow the flexibility for the economy to become resilient to shocks. The sources of this flexibility are well known. In the recent downturn:

- ⊘ In labour markets, more flexible economies have kept unemployment down and employment up;
- ⊘ More flexible product markets have also cushioned the shock;

€# And financial sectors generally, in both developed and emerging markets, have remained robust. Better risk management, through financial innovations - securitised bank loans, credit card receivables, the mortgage market, and financial derivatives - have allowed lenders to diversify, and borrowers have become far less dependent on specific sources of finance.

1.10 The importance of these areas is one reason why the IMFC has stressed the importance of structural reform in routine surveillance. The UK will continue to promote countries adopting the necessary reforms to ensure that they have the best policies in place – a task that will be aided by ensuring IMF surveillance is as effective and transparent as possible.

1.11 A positive step forward on transparency was taken in 2003. The Executive Board agreed to new guidelines that create a presumption to publication of Fund surveillance and programme documents. The UK has consistently pushed for the highest levels of transparency possible and welcomes this progress. The UK will continue to urge countries to meet the spirit of this agreement and to go further where possible, such as with publication of Reports on the Observance of Standards and Codes (ROSCs) and Financial System Stability Assessments (FSSAs).

Appropriate Facilities

1.12 The UK strongly supports the view that IMF finance can and should be used to prevent crises, as well as to resolve them. The twin objectives of incentivising good policies and preventing contagion in those countries pursuing good policies lay behind the introduction of the Contingent Credit Lines (CCL) Facility in 1999.

1.13 The UK continues to support these objectives, seeing them as the natural complement to improvements in surveillance. However, after no country applied for the CCL, it lapsed at the end of November 2003. The UK supports continued work by the IMF in adapting its existing precautionary facilities, and will press for this work to result in effective mechanisms that encourage the adoption of strong macroeconomic policy frameworks.

Crisis Resolution

1.14 Despite efforts to prevent crises, they will still occur from time to time. It is important, therefore, that there is a framework in place for facilitating their efficient and expeditious resolution to minimise the economic costs to all involved.

Creating an effective framework

1.15 The UK is committed to working with the IMF, and in other international fora to create an effective framework for crisis resolution. Work has progressed - to different extents - along several complementary avenues, including contractual, statutory, and voluntary approaches. Recognising that dialogue between stakeholders has enhanced understanding, the UK supports continued consultative efforts to improve the way crises are handled.

TRADE – GROWTH FOR ALL

1.16 The potential of international trade to stimulate growth has long been recognised. It was seen as so important at the time of the creation of the Bretton Woods Institutions that it is set out as the second purpose of the IMF in its Articles of Agreement. It is no less important today.

1.17 The IMF Articles mandate it to “facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.”

1.18 Today, while the WTO is the only place where multilateral trade liberalisation can be agreed, the role of the IMF, along with the World Bank, is of key importance. The Fund and the Bank are ideally positioned to advise and support developing countries in implementing the complementary policies crucial for the benefits of openness to trade to be realised. It is these countries – in the aggregate – that studies show should, with the right perspective, benefit most from multilateral trade liberalisation. However the depth of developing country concerns, and their concerns about taking further steps in WTO negotiations, were illustrated clearly during the collapse of the 5th Ministerial Session in Cancún in September last year.

1.19 The UK welcomes the Fund and Bank’s new initiative to support developing countries in dealing with any short-term adjustment problems brought by trade liberalisation. In addition, it encourages the IMF to extend its research in this area to help support developing countries to adapt to changes to the world trading system. The UK will continue to ensure that the official policy of the IMF on conditionality - that countries themselves must be in the lead on setting economic priorities - is reflected in the approach to interrelated issues in IMF country programmes. Developing countries also need help to build their economic supply-side capacity, so that they can take advantage of new trading opportunities. This means creating a domestic environment in which people and firms can produce goods and services efficiently and get them to international markets, including through investment in physical and human capital and infrastructure. This need must be recognised and supported across IMF activities.

A FAIRER WORLD

1.20 Our aim is for a well run stable global economy, with free trade driving growth, to generate the wealth necessary to tackle development needs around the world and to support poorer countries to ensure that they can share in greater global wealth. The measures against which we will be judged, and judge ourselves, are the Millennium Development Goals (MDGs) agreed to by the world’s leaders – stretching targets on reducing poverty, increasing education and improving health by the year 2015, to ensure that poor people around the world can share in the benefits of global economic growth. This will not be easy, but the UK believes one vital tool in this challenge is an International Finance Facility, as proposed by the Chancellor, to provide the necessary resources to developing countries. These resources must be matched by reform, in low-income countries, driven by those countries and aided by the IMF. The IMF must ensure its support to developing countries is the best it can be, and that those countries have an effective voice within the Fund.

Financing the MDGs

1.21 The UK Government’s aim is to ensure that no country genuinely committed to poverty reduction and good governance should be denied the opportunity to meet the MDGs through lack of resources. The High Level Panel on Financing for International Development, chaired by former Mexican President Ernesto Zedillo, estimated that an extra \$50 billion a year in financial assistance to developing countries is required to reach the MDGs by 2015. At the UN’s International Conference on Financing in Monterrey in 2002, an additional \$16 billion a year was pledged, but this still leaves a large financing gap.

1.22 In addition to providing a robust exit from unsustainable debt, the Heavily Indebted Poor Countries (HIPC) Initiative - which is jointly administered by the IMF and the World Bank - has an important role to play in maximising the resources available for poverty reduction in developing countries. However, all HIPC countries would still need additional aid to meet the MDGs, even if all of their debt from multilateral creditors were to be forgiven. That is why the UK Government has proposed the International Financial Facility (IFF) in order to deliver the additional resources needed to make progress on meeting these targets.

1.23 Since it was proposed, the IFF has received increasing support from developing countries, NGOs, faith communities and business. At the 2003 Annual Meetings in Dubai, the World Bank and IMF were called upon to report back at the Spring and Annual Meetings in 2004 on financing for development issues, such as aid effectiveness, absorptive capacity and financing mechanisms, including the IFF. The UK continues to make the case for the IFF and is working closely with international partners to take this proposal forward.

The Fund in Low-Income Countries

1.24 The aim of the IMF in low-income countries is to promote sustainable long-term growth and poverty reduction and, ultimately, a graduation from Fund financial assistance. Progress has been made in achieving macroeconomic stabilisation in many low-income countries, but there is more to do. Low-income countries face major challenges and so the role of the IMF must be long-term in order to assist these countries in making progress. In 2004, the IMF is planning to undertake a broad review of its programme arrangements for low income countries and its policy advice. This will examine how well the focus and mix of policies in its programmes fit with low-income country circumstances, and respond to specific macroeconomic problems. The UK supports this work and looks forward to meaningful results. The IMF's engagement in low-income countries should be aimed at establishing macroeconomic frameworks that can support high, sustained growth and poverty reduction. If this is to occur, there are tensions to be resolved between short-term stabilisation efforts and long-term growth and poverty reduction mechanisms within programme design. The UK will push to ensure the Fund fully considers the definitions of macroeconomic stability in a low-income country context, and ways of increasing countries' capacity to absorb financial assistance as well as improvements in Government and administrative capacity.

A voice for all in the IFIs

1.25 The spirit of international cooperation with which the IMF was founded is as important today as it was in 1944. But the world has undergone drastic change, with many more countries, with very different needs, in the international system. At Monterrey all governments committed to ensuring that developing and transition countries have an effective voice in international institutions. The UK believes that enhancing the voice of developing and transition countries in the IMF is not only an important step in our partnership with these countries, but can also make a strong contribution to increasing the effectiveness of the IMF in responding to their needs.

1.26 Some welcome progress has been made in the last year on this issue. Significant steps have been taken to increase the capacity of Executive Directors representing developing countries in the IMF Board. The UK has been at the forefront of a multi-donor initiative to establish a financing mechanism to fund the provision of independent research and advice to Executive Directors representing Sub-Saharan Africa, to which we have committed \$500,000. The UK has continued to push for progress on institutional issues such as transparency, staff diversity and decentralisation, all of which contribute to enhancing the voice and participation of developing countries. There have also been detailed discussions – at both the Executive Board and ministerial level – of the more challenging issue of structural reform to the governance structures of the IMF. The UK will continue to work closely with others to generate the necessary political consensus to achieve change at this level.

2

THE FUND IN ACTION

During the course of 2003, the Fund has continued to carry out its core duties in a range of fields. Its surveillance work continues to give us valuable information on the challenges facing economies, at the global, regional and national level – including the vital task of structural reform. It has continued to lend to countries in need, while other countries, like Indonesia that have drawn on programmes, graduated beyond borrowing. The Fund has kept its financial situation under review and continues to develop as a responsive and learning organisation, with the help of its Independent Evaluation Office.

MESSAGES FROM SURVEILLANCE

2.1 Under Article IV of its Articles of Agreement, the IMF is mandated to “oversee the international monetary system in order to ensure its effective operation”. It does this through “firm surveillance over the exchange rate policies of members”. In pursuit of this mandate, the coverage of surveillance has evolved to include a wider range of macroeconomic and structural policies. In today’s global economy, where economic developments in one country can rapidly spread to another, this surveillance role of the IMF is more important than ever.

2.2 This section outlines the IMF surveillance process and summarises some of the key messages emerging from IMF surveillance work in 2003, both in the macro and microeconomic areas. Ministers discussed these messages in Dubai in September, their views are summarised in the Communiqué from the IMFC meeting, which is at annex H. See Chapter 3 for UK priorities for reform of the surveillance process.

2.3 The IMF conducts surveillance at 3 levels:

- €# **Global:** the world economy at the aggregate level. This is done through the IMF World Economic Outlook and the Global Financial Stability Report;
- €# **Regional:** key regional economic areas, such as the Euro-Area;
- €# **Country:** the IMF holds “Article IV” consultations with each member country about its economic policies, see Box 2.1.

Box 2.1 Article IV Country Surveillance

Article IV consultations between the IMF and individual member countries are normally held once a year. The consultations focus on major aspects of macroeconomic and financial sector policies, in particular exchange rate, fiscal and monetary policies and the balance of payments position, including the policy stance and framework. They also cover other policies that affect macroeconomic performance, including, where relevant, labour, productivity, enterprise and environmental policies and economic governance.

An Article IV consultation is conducted by a visiting IMF staff team. The team will collect economic and financial information and discuss economic developments and policies with the national authorities. At the end of the mission, the staff prepare a Concluding Statement. On their return to Washington, they write the Article IV report that summarises much of the detail obtained from the mission and reflects the analysis underlying their views (as expressed in the Concluding Statement). The report is subsequently discussed by the Executive Board. The views of the Executive Board are summarised in Public Information Notices (PINs). These, and those Article IV reports that are published, are available from the IMF.

Global Surveillance

2.4 In 2003, the global economy has continued to recover from the first synchronised slowdown across the world's major economies in almost three decades. This recovery began in 2002, but heightened geopolitical uncertainty compounded existing vulnerabilities, causing global growth to lose momentum in the second half of that year and this continued through the early months of 2003. However, from Spring 2003, as some key uncertainties receded, there were fresh signs of global activity is once again gathering pace. Growth accelerated sharply in several major economies, led by the pick up in the US. Meanwhile, growth also bounced back strongly in South East Asia. More broadly, forward looking indicators – notably confidence measures and stock markets –generally turned up. This improved the prospect of a steady and strengthening global recovery going forward.

Fund Themes

2.5 The Fund focuses on a number of issues in its surveillance work, including key vulnerabilities that threaten the medium term sustainability of the global recovery. In 2003 these themes included:

- €# Global imbalances: Global surveillance has highlighted that growth among the world's largest economies continues to be uneven and that all countries have an interest in seeing more balanced growth. This underscores the importance of close international cooperation and determined action to push ahead with structural reforms that will help ensure the recovery is sustained and broad based over the medium term.
- €# Official reserves: The build up of reserves, especially in Asian emerging market countries, has led to a near doubling of reserves as a proportion of global income. The impact of this on international capital markets and exchange rates has been a key policy debate over the past year. The issue has been closely monitored by the IMF, forming a key part of the September World Economic Outlook. This concluded that the recent acceleration in reserve accumulation could represent a notable shift from expected patterns.
- €# Fiscal consolidation in the major economies: The Article IV reports urged policy makers in the US, Japan and euro area to refocus their attention on medium and longer-term fiscal sustainability issues, especially relating to future pension and health care liabilities.
- €# Debt in the Emerging Market Economies (EMEs): see box 2.2 below

Box 2.2 Debt in emerging markets

The September 2003 World Economic Outlook highlighted the problem of public indebtedness in emerging markets. Public debt has risen sharply in recent years across a broad range of emerging market economies and there have been several sovereign defaults and debt restructurings. There are good reasons for accumulating public debt: financing public investment in infrastructure or social programmes with long-term economic benefits (such as health and education spending) or smoothing out demand during the economic cycle. But excessive public debt can harm growth prospects by raising real interest rates and expectations of future taxation, both of which are disincentives for private investment. Furthermore, at a certain point, it may become politically unfeasible to raise taxation to meet debt repayments at which point public debt becomes unsustainable. Even the suspicion that a sovereign's debts may become unsustainable in the future can trigger a crisis of confidence in financial markets, with devastating consequences.

Emerging markets are also often more vulnerable to changes in market sentiment because:

- €# most of their debt is denominated in foreign currencies - a foreign exchange rate risk ;
- €# much of their debt has short maturity - roll-over risk; and
- €# their debt is often contracted on a variable interest rate basis - an interest rate risk

Avoiding emerging market debt crises is a key objective of the IMF. In particular, the IMF provides financial assistance to members when balance of payments financing gaps emerge and when countries are willing to adopt credible policies to address this situation. Such financing gaps can expand rapidly if private markets become concerned about the sustainability of a country's debt. The provision of short-term financial assistance by the IMF allows the country time to put in place measures to restore financial market confidence. But IMF support in cases when the existing debt position is genuinely unsustainable may be counter-productive because it can delay debt restructuring and needs to be tailored to those circumstances. Therefore, it is important that the IMF has appropriate tools to identify countries with potentially unsustainable debts in sufficient time to encourage them to make policy changes. A high level of debt sustainability is also an important criterion for exceptional access to IMF resources. In the last two years, the IMF has published two papers detailing its approach to assessing debt sustainability.¹

In March 2001, the IMF jointly published with the World Bank "Guidelines on Public Debt Management" which was designed to help countries avoid public debt structures that are vulnerable to adverse shocks. (For more on the crisis prevention role of the Fund see Chapter 3) At the IMFC meeting in Dubai, ministers noted that the improved financial market environment provides a valuable window of opportunity for emerging market economies to continue to improve the composition of their debt.

Microeconomic themes

2.6 In addition to the macroeconomic themes above, the IMF also looks at microeconomic issues. Structural reform is a key challenge for economies around the world, which is highlight here.

¹ IMF: "Assessing Sustainability", 2002; and "Sustainability – Review of Application and Methodological Refinements", 2003.

Box 2.3: Structural reform – A key challenge

Effective Structural Reform is a key driver to promote balanced and sustainable economic growth. The UK government is committed to implementing sound structural reform policies domestically and promoting them internationally, as part of a flexibility and fairness agenda.

At a domestic level, the UK government will continue to build on the structural reform measures it has already taken. As set out in the 2003 Pre-Budget Report, key priorities for 2004 include reforms to promote business and enterprise across the UK, by improving access to finance for small business, reducing bureaucracy and boosting the role of local authorities in encouraging enterprise.

Effective structural reform is a global public good and the promotion of sound policies is a key international objective for the UK. Common challenges face developed, emerging and developing economies – all need to promote dynamic and flexible markets with fairness. In the G7 and G20 the UK has been a proponent of a strong emphasis on structural reform and we will look to build on the “Agenda for Growth” issued at Dubai² and capitalise on the interest expressed by G20 Ministers. We are also committed to continuing progress against the European Union’s Lisbon Goals, and look forward to ongoing discussions with our EU colleagues.

2.7 Structural reform is an important component of each country’s Article IV review. Some of the key structural reform challenges identified in recent Article IV reports follow:

- ⌘ In order to deliver high and stable levels of growth and employment, the **Euro Area** must deliver greater flexibility of labour, product and capital markets, focusing on strengthening competition, increasing levels of Research and Development and promoting innovation and entrepreneurship, restructuring tax and benefit systems, and improving the regulatory environment.
- ⌘ The **US** should strengthen the financial positions of the social security and Medicare systems and further improve the oversight of accounting and corporate governance standards (see Box 2.4).
- ⌘ **Japan** must take decisive action to implement its reform agenda, tackling the weak balance sheet situation in the banking sector and improving the efficiency of the corporate sector.
- ⌘ **Emerging Markets** should implement reforms to ease restrictions on the free flow of goods, services and capital. The speed and sequencing of these reforms are crucial to avoid destabilising financial markets. In some key emerging markets, measures are necessary to ensure medium-term fiscal sustainability (particularly in relation to public-sector pensions and broadening the tax base) and to improve growth prospects (particularly relating to financial and corporate sector reform).

² See *G8 Information Centre*: www.g7.utoronto.ca

€# **Developing Countries**, Developing countries need to work to set up the right policies and institutions to achieve macroeconomic stability, increased growth, improved public financial management and poverty reduction. The IMF provides important support through PRGFs and Article IV Surveillance and is reviewing its support to Low Income Countries (see Chapter 4). The success of such reforms will also rely on Developed Country action, such as implementing the Doha Development Agenda, debt relief and establishing increased, predictable and effective aid flows.

Box 2.4: Corporate governance

The final phases of the strong bull market, particularly in the US, highlighted significant shortfalls in corporate governance and regulatory oversight. The result spilled over into a loss in investor confidence, which had its impact well beyond US borders. Governments responded at both national and international levels. The IMF and the Financial Stability Forum (FSF) have played a significant role in maintaining the momentum for reform and in ensuring that national and international responses have been co-ordinated, coherent and proportionate. Greater transparency, reliable financial information, strong corporate governance and proportionate regulatory oversight are vital for the continued rebuilding of investor confidence and integration of global capital markets.

The UK, in common with other countries, took rapid action to review governance and regulatory arrangements, and moved to enhance auditor independence, strengthen the regulation of financial reporting and the accounting profession, and strengthen the corporate governance code. This approach has been reflected in the European Commission's Company Law and Corporate Governance Action Plan. Implemented effectively, this will contribute to greater co-ordination and integration of corporate governance in EU Member States. Simultaneously, the UK is working with the European Commission to achieve a common approach with the US Securities and Exchange Commission (SEC) on the oversight of auditors. It is hoped that the revised EU 8th Directive on audit and the new SEC oversight board rules on audit supervision will provide complementary guidance and regulations.

It is important that the reforms introduced by different states are co-ordinated and based on the same high-level principles. The work of the IMF and FSF is vital in encouraging moves towards internationally accepted principles of corporate governance and auditing, as is the work of the International Accounting Standards Board (IASB) towards the growing adoption of International Accounting Standards. These will contribute towards enhancing investor confidence in, and continued integration of, global capital markets.

Surveillance of the United Kingdom

2.8 An IMF mission visited the UK in December 2003 to conduct its Article IV consultation. In March 2004 the Executive Board discussed this consultation. Both the concluding statement of the IMF Mission and the full UK Article IV report are available on the IMF website.

2.9 Directors commended “the continued strong performance of the UK economy” and its resilience despite the global slowdown, noting that the economy picked up “well ahead of most other industrial countries”. This robust performance was attributed to “counter cyclical monetary and expansionary fiscal policies within well established and transparent policy frameworks, and to structural factors such as high flexibility of labour, product, and financial markets following decades of reform”. Although concurring that the principal risk to the forecast of the UK economy lies in the risk of a sharp adjustment of house prices, Directors predict growth to remain strong based on improving external conditions and the maintenance of momentum in domestic demand.

IMF LENDING

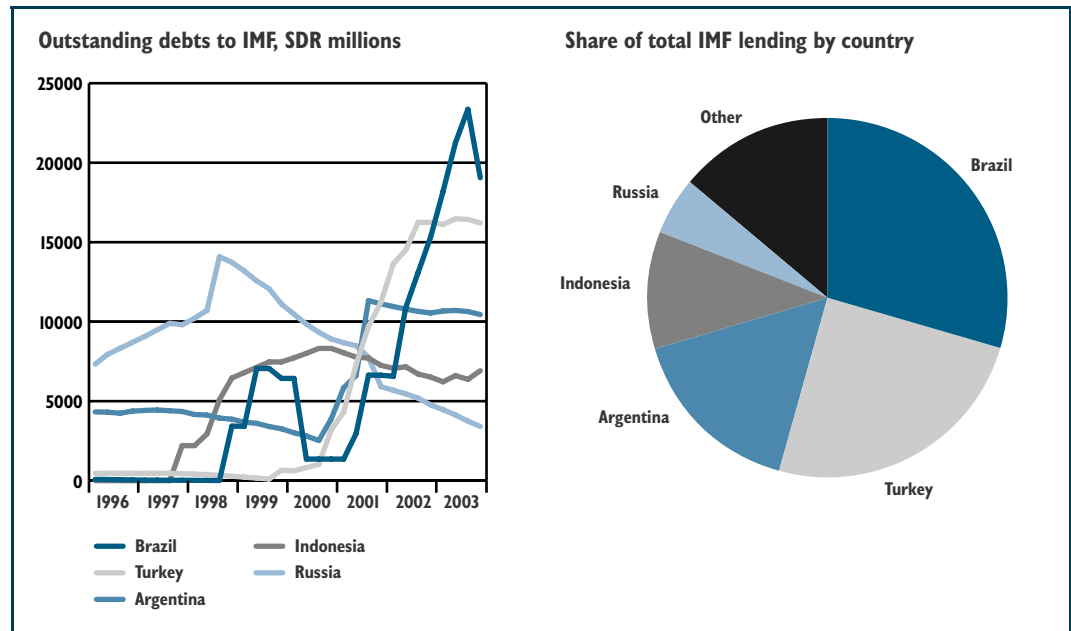
2.10 IMF lending continued its pattern from 2002, with high overall levels concentrated in a few large borrowers, although this level still leaves the Fund with adequate capacity for further lending (see below for Resources). At the end of 2003 the total credit outstanding for the General Resources Account (GRA) of the Fund has increased slightly to SDR³ 65bn compared to SDR 63.6bn at end 2002. Credit outstanding to the Poverty Reduction and Growth Facility (PRGF) Trust Fund has remained constant at SDR 6.9bn. There were a total of fifty-five countries with an IMF programme.

Significant programmes and Fund exposures

2.11 The trend towards concentration is demonstrated by just five countries together accounting for 86 per cent of total GRA exposure at the end of 2003. However, this picture masks considerable change within these figures. While the share of borrowing taken by Brazil, Argentina and Turkey has increased in recent years, the share taken by Russia and Indonesia – the largest borrowers in the late 1990s - has markedly decreased, and both these countries are currently paying back to the Fund without recourse to further programmes. Here economic developments in each of these countries are highlighted and discussed.

³ Special Drawing Rights (SDRs) are an international reserve asset that also serve as the unit of account of the IMF. It's value is used on a basket of key international currencies. At end 2003 there were US\$ 1.49 per SDR

Chart 2.1 Current Five largest debtors to the Fund, by outstanding debts over time and by share of total IMF outstanding credit



Brazil Stand-by Arrangement

Brazil: Stand-by Arrangement

2.12 Brazil has performed well under the Stand-by Arrangement (SBA) agreed in September 2002. Fiscal policy has outperformed relative to targets, the Central Bank has steered inflation back towards target, and important progress has been made on Brazil’s structural reform needs. Markets have responded well to this good performance, with country risk returning to pre-crisis levels and the currency appreciating strongly.

2.13 Despite the success of the SBA though, large financing needs in 2004 mean Brazil remains vulnerable to negative shifts in market sentiment. As such, the authorities requested an extension and augmentation of the current programme. The augmentation provides SDR 4.5bn in precautionary finance, adding to the remaining SDR 5.6bn Brazil is entitled to draw as a result of completion of the fifth review under the 2002/03 SBA, to provide around SDR 10.1bn in precautionary finance for 2004. In addition, to smooth the profile of Brazil’s debt service to the IMF and lower vulnerabilities, SDR 4bn in repayments that had been due in 2004 and 2005 were deferred by a year as part of a shift from the expectations basis to the obligations basis for repurchases. If Brazil does not draw down the precautionary finance, IMF exposure to Brazil will have peaked at SDR23.4bn and had fallen to SDR19.1bn, 29 per cent of total credit outstanding, by end 2003. Should Brazil draw all precautionary finance, exposure would peak at SDR25.4bn in February 2005.

2.14 The programme extension is intended to build on the strong macroeconomic policies that Brazil has pursued over the past few years, and deepens structural reforms in order to enhance the climate for sustained economic growth. The UK supported their augmentation and extension of the programme, based on the authorities’ strong track record, and the commitment to continued economic reform.

Argentina: Stand-by Arrangement 2.15 Following the default and devaluation in late 2001, the government and IMF spent most of 2002 in negotiations on a new economic programme. A “transitional” programme was finally agreed in January 2003. This was designed to strengthen macroeconomic stability through the potentially difficult Presidential election period, and provide a bridge to a longer-term programme, to be agreed with the incoming government later in the year.

2.16 This longer-term programme was agreed in September 2003. Under this three-year programme, Argentina will receive disbursements sufficient to meet principal repayments to the IMF, but will service the interest costs of the debt from its own resources. This will keep exposure roughly constant over the programme at SDR10.5bn, (16 per cent of IMF credit outstanding, at end 2003).

2.17 The programme aims to restore sustainable growth and public finances, thereby tackling the underlying causes of increased poverty in Argentina over the past couple of years.

2.18 In order to achieve this, the programme has three central objectives: first, to set out a credible medium term fiscal framework (to include sovereign debt restructuring), second, to address weaknesses in the bank sector that inhibit a sustained return to growth, and third, to undertake measures to improve the investment climate. Monitoring of progress will be rigorous under the programme, and the plans for addressing these issues will be further elaborated at coming reviews.

2.19 The UK supported the programme for Argentina as on balance it had the potential to build on the authorities’ success in restoring macroeconomic stability, incentivise reform, and pave the way for a return to sustainable growth and poverty reduction. At the time the UK acknowledged the risks to the programme, and pointed out that a successful outcome ultimately rested in the hands of the Argentine government. It also emphasised the key importance of implementation of reforms and close monitoring of programme commitments.

The first review of the program was approved on 28 January 2004. However, the UK abstained, as progress on a number of important structural issues (including debt restructuring, banking sector compensation, and policies related to the business climate) had been weaker than was anticipated in September. Going forward, the UK called for enhanced co-operation between the authorities and the IMF, and noted that progress on a number of structural issues was essential to the program achieving its goals.

Turkey: Stand-by Arrangement 2.20 A stand-by Arrangement, totalling SDR12.8bn was agreed in 2002, in support of Turkey’s economic programme. The sixth review of this programme was approved on 18 December 2003 bringing the total disbursement to SDR11.3bn. The UK supported the continued improvement in Turkey’s macroeconomic performance, but noted that significant risks remain, particularly concerning the size of its debt.

2.21 The programme aimed to achieve economic stability within Turkey and economic conditions have improved over 2003. The economy is on track to meet its main economic targets for 2003, and in some cases to exceed them. In particular, inflation, traditionally a problem for Turkey, has improved considerably since the start of the programme. The programme's objective of reducing public indebtedness has also seen substantial progress reflecting the effects of exchange rate appreciation and the government's achievement of its target 6.5 per cent of GNP primary surplus. However, financial sector reform remains high on the agenda before the IMF programme is completed and Turkey remains vulnerable to shocks. The arrangement is due to expire on December 31 2004. As of end 2003 IMF credit outstanding to Turkey stood at SDR16.2bn, 25 per cent of the fund total. This is due to be repaid by November 2008 at the latest.

Indonesia: Extended Fund Facility **2.22** Indonesia's SDR 3.6bn Extended Arrangement, which was approved in February 2000, expired at the end of 2003. Under this arrangement, Indonesia's macroeconomic performance has improved markedly. Sustained growth has been accompanied by solid progress in reducing inflation and public debt and in strengthening the external position. Against this successful backdrop, the government decided not to seek another funded programme, but rather to engage with the IMF in post-programme monitoring. Credit outstanding at end 2003 stood at SDR6.9bn, 11 per cent of the Fund total.

Russia **2.23** Russia has not had an IMF programme since 1999, when a post-1998 crisis programme went off track within 3 months. Since then, the authorities and the IMF have increasingly agreed on most elements of Russia's economic policy. Since early 2000, Russia has repaid SDR 7.5bn of its past IMF debt (excluding interest and charges paid). Liabilities of SDR3.4bn, (5 per cent of total credit outstanding) remaining at end 2003 are scheduled to be repaid by August 2008.

Box 2.5: Iraq

UNSCR 1483 (United Nations Security Council Resolution 1483) called on the international financial institutions to 'assist the people of Iraq in the reconstruction and development of their economy'. The IMF played an active role in Iraq over the summer, though IMF and Bank staff were withdrawn from the country in light of the security situation. The IMF continues to provide valuable Technical Assistance and advice to Iraqi ministries and the coalition.

At the September annual meeting of the International Monetary and Financial Committee in Dubai, the committee reaffirmed its support for a multilateral effort to reconstruct and redevelop Iraq and welcomed the constructive role the IMF was already playing. The Committee supported the IMF offering financial assistance to Iraq, subject to the IMF's policies.

On 16 October, the United Nations Security Council unanimously passed resolution 1511. The Resolution urged the international financial institutions to take steps to provide financial assistance to Iraq, working with the Iraqi Governing Council and appropriate Iraqi ministries. The IMF contributed to the World Bank and UN needs assessment report on Iraq in October. At the Iraq reconstruction Donors' conference in Madrid, the IMF announced that it stands ready to provide financial assistance in line with its policies and procedures. Total financial assistance to Iraq could range from \$2.5 billion to \$4.25 billion over a four-year period.

The inaugural meeting of the International Advisory and Monitoring Board (IAMB) was held in New York on 5 December 2003. The IMF is one of the four member institutions of the IAMB; the other members are the UN, the World Bank and the Arab Fund for Social and Economic Development. The IAMB will promote the objectives set out in UNSCR 1483 of ensuring that revenues from the Development Fund for Iraq (DFI) are used in a transparent manner, to the benefit of the Iraqi people.

A Technical Assistance sub-account has been established, and will provide a programme of macroeconomic technical assistance to both the Ministry of Finance and the Central Bank of Iraq.

RESOURCES

2.24 A globalised financial system creates a new challenge for the IMF. Over time, private capital flows have come to dwarf official finance. These new pressures require the fund to keep its financial position under frequent review.

2.25 On the supply-side, the majority of IMF lending is resourced through the quota system. Concessional lending to the poorest countries is financed by IMF-administered trust funds to which member countries contribute. If necessary, the Fund can also draw on borrowing arrangements with some member countries. The IMF is also one of the largest official holders of gold in the world, although there are strict limitations on the use of this gold (for details on the borrowing arrangements and gold, see Annex C).

Liquidity

2.26 The liquidity position of the Fund is kept under regular review, with semi-annual discussion by the Executive Board. Fund liquidity is measured by its Forward Commitment Capacity (FCC). A full explanation of the FCC with the most recent liquidity data is available at Annex C. The Board concluded in their discussion that, despite the historically high levels of lending mentioned above, the Fund's FCC is currently adequate, but that the situation should be kept under review.

Quotas

2.27 The quota system provides the first line source of Fund resources. As well as being a country's contribution to the Fund's working resources, a quota dictates a country's access to Fund finance and its voting power within the Fund (see Annex II for the UK's financial relationship with the Fund). The overall level of quotas is reviewed regularly, usually every five years.

2.28 In January 2003, the Board of Governors adopted a resolution closing the 12th General Review of Quotas without an increase in quotas, leaving them unchanged at SDR 212.7 billion. During the period of the 13th General Review, which began with completion of the 12th Review, the Executive Board of the IMF will continue to monitor closely and assess the adequacy of Fund Resources, examine ways to achieve a distribution of quotas that reflects developments in the world economy, and consider measures to strengthen the governance of the Fund (for more on issues concerning the voice of developing countries in the Fund, see Chapter 4).

2.29 The Executive Board has discussed quota issues alongside its discussions on the Fund's liquidity position. In these discussions there was support from most directors for a package of measures, to be undertaken should there be a need for a general increase in resources (which was not judged the case in the last Executive Board review – see Liquidity, above) involving the following:

- ⌘ A general increase with relatively large selective element allocated by a new quota formula
- ⌘ Ad hoc increases to address the clearest out-of-line cases
- ⌘ An increase in the basic vote to correct the erosion of the voting power of the smallest members

2.30 The UK is amongst those who support this position, but the necessary consensus for implementation does not yet exist. Agreement on quotas was judged best achieved in the context of a general quota increase, which would not be appropriate while the liquidity of the Fund is adequate. An increase in the basic vote⁴ on its own attracted support, but would require an amendment to the Articles of Agreement, which would also require a wider consensus than currently exists. The UK will press for an increase in the basic vote if the issue of amending the Articles should arise.

PRGF and HIPC Trust Funds

2.31 The IMF's concessional activities – the Poverty Reduction and Growth Facility (PRGF) and the Heavily Indebted Poor Countries (HIPC) initiative (see Chapter 4) – are financed through direct bilateral contributions and the IMF itself. They are separate from the quota subscriptions and are administered under the PRGF and PRGF-HIPC Trusts, for which the IMF acts as Trustee.

⁴ Basic votes are allocated on an equal basis to all Fund members, regardless of quota. As quotas have been increased over time the significance of the basic vote has declined. Basic votes are established in the Articles of Agreement, and so require an 85% majority in favour of amending the Articles to alter.

2.32 The PRGF Trust was established to provide lending in support of PRGF arrangements and, subsidise the market rate of interest to the concessional rate of 0.5 per cent per annum. A number of central banks, governments, and official institutions lend resources to the PRGF Trust, generally at market-related interest rates. These are then lent on to PRGF-eligible countries. To finance the difference between the market-related interest rate paid to PRGF Trust lenders and the rate of interest of 0.5 percent per year paid by the borrowing members, contributions are received from bilateral donors and the IMF's own resources. Bilateral contributions total SDR 3511.2 million, of which the UK has pledged SDR 370.4 million.

2.33 The PRGF-HIPC Trust was established to provide debt relief under the HIPC initiative and to subsidise the PRGF during the period 2002-05. The resources in the Trust comprise grants and deposits from 93 bilateral contributors and the IMF. Bilateral contributions total SDR 1561.6 million, of which the UK has pledged SDR 82.2 million⁵. The bulk of the IMF's contribution comes from the investment income on the net-proceeds from off-market gold transactions in FY 2000/01.

LEARNING AND RESPONDING

2.34 The IMF is accountable to its members in their role as shareholders who appoint governors of the Fund. The IMFC, chaired by the Chancellor, is one body that ensures the Fund is responsive to its members needs. Complementing the accountability to this source, the IEO is proving a vital tool in providing lessons from the recent past to help identify necessary reforms. The work of the IMF also requires close collaboration and coordination with other institutions. The UK will continue to support a responsive and collaborative Fund, with a strong learning culture.

The IMFC

2.35 The International Monetary and Financial Committee (IMFC) is a committee of Governors which meet twice a year to discuss IMF policies. It provides strategic direction to the work programme of the IMF by prioritising areas for further work by the Executive Board and identifying key reforms. Fund management report back to the IMFC on progress with the work programme. This oversight function of the IMFC helps improve the accountability of the Fund to its Governors.

Working with others

2.36 As with any institution with an international remit, the IMF must work with a great number of other institutions and engage in a number of fora. Key among these is the IMF's sister institution, the World Bank. However, in an increasingly complex world the IMF must work flexibly with all its partners. The UK also seeks to work with its partners in various fora to gain wider agreement for its reform policies.

Working with the World Bank

2.37 The UK welcomes the steps that the IMF and World Bank have taken to improve their collaboration in recent years. In September 2000, Horst Köhler, Managing Director of the Fund, and Jim Wolfensohn, President of the World Bank, issued a joint statement which promised an enhanced partnership between the institutions. This recognised that the two institutions shared the same broad objective of "helping to improve the quality of life and reduce poverty through sustainable and equitable growth".

⁵ Figures are as at end-June 2003

2.38 A close partnership through the Joint Implementation Committee has resulted in significant progress in delivering HIPC debt relief and PRSPs. A first-time joint visit to Africa by Köhler and Wolfensohn also signalled the close cooperation between the two institutions. However, there remain significant challenges. In particular, the UK is keen to see further progress on public expenditure management improvement, following the IMF-World Bank paper⁶ on collaboration in this area; and more work on Poverty and Social Impact Assessments (PSIA) (see Chapter 4).

2.39 The Fund and Bank have also sought to strengthen their collaboration in other areas, including: cooperation on financial sector reform through their joint Financial Sector Liaison Committee and the establishment of the Financial Sector Assessment Programme (FSAP), the preparation of ROSCs and an expansion of their work on Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT).

2.40 Consistent with the division of labour between the IMF and the World Bank, each institution concentrates on its primary areas of responsibility and competence. The IMF leads on macroeconomic issues and the Bank on social and structural issues. However, the recognition of the link between macroeconomic stability and structural policies, particularly in a world of open capital markets, has increased the need for the staff and management of the two institutions to consult and work ever more closely together.

2.41 The concept of lead agency in programme design and monitoring has therefore become increasingly important. For each area of policy, on a case-by-case basis, one institution should be identified as the agency to lead the policy dialogue with the country. This process is currently operating more clearly for PRGF-supported programmes, i.e. in low-income countries where a division of labour has been established with the World Bank, than under Stand-By Arrangements in middle-income countries, where no formal framework exists. This is another important area where the UK wants to ensure improved collaboration between the World Bank and the IMF.

2.42 The UK has a single Executive Director who represents the UK at both the IMF and World Bank Boards. This provides the UK with a unique opportunity to press for close cooperation and greater harmonisation between the two institutions. Through its membership of the Executive Boards of the Fund and Bank, the UK government will continue to work with the G7 and other stakeholders to enhance the coordination and effectiveness of both institutions.

Other Institutions

2.43 The Fund has an important role to play in supporting international trade and, as such, maintains close links with the World Trade Organisation (WTO). This is looked at in detail in The Doha Development Agenda section in Chapter 4.

2.44 The United Nations system is a fundamental pillar in the promotion of international development, and through its agencies, in particular the United Nations Development Programme, plays a central role in delivering development programmes. The IMF and World Bank work closely with the UN and its agencies, both at country level to coordinate activities and programmes and through the annual meeting of the Economic and Social Council of the UN (ECOSOC) and the Bretton Woods Institutions (BWIs). The UK is working to strengthen the effectiveness of the ECOSOC/BWI dialogue.

⁶ Bank/Fund Collaboration on Public Expenditure Issues, February 2003

2.45 Given its unique multi-disciplinary status, the Financial Stability Forum (FSF) provides a valuable resource in efforts to improve international financial stability, by providing a forum to share the results of surveillance and discuss emerging policy issues. The FSF has the potential to be an effective early-warning mechanism for possible international crises, by identifying potential risks and associated gaps in the international regulatory framework and by initiating work programmes to promote risk mitigation. To maximise its effectiveness, the FSF is developing a closer relationship with the IMF, in order to complement the IMF's surveillance of the financial sector.

The IMF and international fora

2.46 Under the Articles of Agreement, member states of the European Union (EU) are represented individually at the Executive Board. France, Germany and the UK all have their own ED. The remaining EU countries are represented in 6 constituencies, 4 of them led by an EU country.

2.47 Despite this individual representation, all EU member states recognise the value of sharing perspectives and, where appropriate, developing an EU consensus on strategic policy issues. This is facilitated through regular meetings of the EU's Economic and Finance Committee, and its Working Group on IMF matters.

2.48 Once the accession countries join the EU, the number of constituencies in which EU member states are represented will increase from 6 to 7 (under the current constituency structure) in addition to the German, French and UK chairs.

2.49 The G7 countries currently constitute over 45 per cent of IMF quotas. It is a valuable forum for the UK, allowing for high-level discussion among leading economies. In autumn 2003 the G7 agreed its Agenda for Growth, setting out priorities for economic reform (see box 2.3) We will be working closely with the US Presidency to pursue coordinated themes through to our presidency in 2005.

2.50 In addition to its participation in the G7, the UK is an active member of the G20. The G20 includes both G7 and key emerging market economies, and provides a useful forum to promote international financial and economic stability.

2.51 The UK believes that the unique mix of countries⁷ in the G20 provide a useful complement to other bodies. Through dialogue in the G20, valuable insights and meaningful consensus can be reached outside of the more formal structures of regional and international financial institutions.

2.52 The G10, as well as constituting the membership of the IMF's General Agreements to Borrow (GAB), offers a further opportunity to make progress on a range of international issues; in addition to the G7 countries, Belgium, Netherlands, Switzerland and Sweden are members. G10 Ministers met in Dubai and the UK will work to ensure the G10 remains a productive forum under US chairmanship in 2004.

⁷ Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK and the US

A learning culture: The IEO

2.53 The UK has been a strong supporter of the Independent Evaluation Office (IEO) for the IMF, established in July 2001. The IEO was established to systematically conduct objective and independent evaluations on issues relevant to the mandate of the Fund. The UK believes it has a useful role in increasing the accountability of the Fund.

2.54 The aim of the IEO is to improve the effectiveness of the IMF by enhancing its learning culture and enabling it to better absorb lessons for improvements in its work. It will also help build the IMF's external credibility by undertaking objective evaluations in a transparent manner. The IEO is fully independent from Fund management and staff and operates at arm's length from the Executive Board. There is a strong presumption that the Executive Board will publish IEO reports promptly after consideration.

2.55 The IEO has now completed three reports: on an 'Evaluation of the Prolonged Use of IMF Resources'; 'The Role of the IMF in Capital Account Crises: Korea, Indonesia and Brazil' and 'Fiscal Adjustment in IMF Supported Programmes'. The lessons from these reports and the Fund's response to them are summarised in Annex E and those on surveillance are dealt with in more detail in Chapter 3.

Ongoing work programme

2.56 The IEO's work programme is established by the Director in light of consultations with interested stakeholders from both inside and outside the IMF. The work programme is presented to the Executive Board for review, but it is not subject to the Board's approval. It is also made public. The IEO is working on three reports to be published in 2004:

- €# The Fund's experience with the PRSP/PRGF approach, which is taking place in parallel with World Bank evaluation of its role;
- €# A case study of the Fund's involvement with Argentina;
- €# The role of the IMF in providing technical assistance.

2.57 After a wide consultation process the IEO should finalise its work programme for 2004/05 in early 2004.

3

AN IMF TO MAINTAIN STABILITY

The key aim of international economic policy must be to ensure continued global economic growth, growth that raises living standards around the world. Crucial to this is stability, but in the new global economy, where private capital flows are increasingly important, maintaining that stability presents a great challenge to the international community. The UK continues to be at the forefront of an agenda to strengthen crisis prevention in the IMF in order, to avoid destructive financial crises. To meet the challenge when crises do occur, the Fund must encourage efforts to increase the role of the private sector in crisis resolution. Finally, the UK believes the Fund has an important role in tackling the challenge of money laundering and the financing of terrorism.

CRISIS PREVENTION

3.1 The UK's main aims for the IMF in the field of crisis prevention have been set out on a number of occasions, most recently in the UK statement to the Annual Meetings of the IMF¹. The course of 2003 has seen progress in some areas, including an agreement to increase transparency - a core requirement of successful crisis prevention. Progress has continued on implementing codes and standards, and new approaches have been offered in the sphere of surveillance. However, key challenges remain in finding ways to incentivise good policies and to make sure IMF surveillance is well founded.

Surveillance

3.2 The case for surveillance reform had been consistently articulated by the UK by the start of 2003. Further supporting evidence for reform came from the lessons on surveillance drawn from the work of the Independent Evaluation Office (IEO), (see box 3.1). This work has helped build momentum for a series of reform initiatives aimed at strengthening the ability of the IMF to carry out the authoritative, comprehensive, focussed, influential and accountable surveillance that the international community requires of it. However the UK has also called for consideration of institutional reform² with the following objectives:

- €# to ensure that surveillance is, and is seen to be, independent of decisions about programme lending and the use of fund resources;
- €# to establish the IMF as independent from political influence in its surveillance of economies.

¹ Available at www.hm-treasury.gov.uk

² Articulated by the Chief Economic Adviser, Ed Balls, in his speech to the Institute for International Economics, 6 March 2003. Available at www.hm-treasury.gov.uk

3.3 Considerable discussion of surveillance issues has continued throughout 2003. The IMFC communiqué at the Spring Meetings laid out the improvements it considered necessary in the Fund's 'toolkit' for surveillance. This was followed up by staff and management in a series of papers³ on both the analytical context of surveillance and the institutional arrangements for assuring that surveillance benefits from a "fresh pair of eyes", particularly in the case of countries with an IMF programme.

3.4 This has led to progress in improving routine surveillance both through:

1. improvements in the analytical 'toolkit' available, including the development and use of a consistent debt sustainability analysis framework and refinements to the vulnerability assessment exercise for emerging markets; and
2. the introduction of a number of practical measures to strengthen surveillance in programme countries. These include new guidelines on timing of Article IV's, to fit with the programme cycle; new guidelines on the substantive content of surveillance; and some experiments with alternative models for the conduct of surveillance, including:
 - ⌘ separate mission chiefs for Article IV surveillance visits and for programme monitoring assessment visits to countries;
 - ⌘ issuing separate reports on surveillance and programme issues;
 - ⌘ separate Board discussions of a country's surveillance and programme issues

3.5 These reforms aim to reduce the potential conflict of interest between the Fund as constructive critic in surveillance and as a partner to member authorities' policy design choices in a programme context.

3.6 In addition to the above, the IMF has continued work to strengthen its internal review process and to increase the candour and transparency of its advice.

3.7 The UK has welcomed this progress. However, the UK will continue to seek reassurance that ongoing improvements in the analytical framework are taking place, to ensure the Fund has the best tools available for its surveillance. While welcoming progress on strengthening surveillance in programme countries the UK seeks clearer procedures to ensure the "fresh perspective" approach is truly embedded, which may require greater institutional reform. Finally, the UK continue to see merit in the second institutional objective set out above, that of true independence from political pressures.

A sharper focus: the Dubai Communiqué

3.8 Building on the IMFC's role, the UK, working with its international partners, has sought to develop a more regular process of priority setting for Fund surveillance. At Dubai, the Committee emphasised the importance of surveillance focussing on identifying potential problems early and providing candid advice on policy reforms and set out priorities for the focus of the Fund's surveillance activities in the coming year. The key areas set out are:

³ Strengthening Surveillance – Further Considerations – July 2003, Sustainability Assessments-Review of Application and methodological refinements – June 2003, Enhancing the Effectiveness of Surveillance-Operational Responses, the Agenda Ahead, and Next Steps – March 2003

- €# Structural reform
- €# Medium-term sustainable fiscal frameworks
- €# Reducing balance sheet vulnerabilities, including currency mismatches and debt sustainability
- €# Encouraging policy measures to reduce global imbalances

3.9 The aim of this approach is to give a sharper focus to IMF surveillance for the coming year, setting out the priorities of its members in a forum that gives strengthened accountability.

Working for a strengthened system

3.10 The UK believes that the above approach provides one way of supporting Fund surveillance work, which could be further developed into an independent remit for surveillance. The 2004 Biennial Surveillance Review is an opportunity to make further progress. The UK will engage with this to push for further work into the long-term aim of exploring greater political independence; to ensure that further progress is made on ensuring the best possible analytical basis for the Fund's work; and to establish the necessary firm procedures to ensure all surveillance in programme countries comes from a truly fresh perspective. The UK will also work with other interested parties to identify possible models for a more independent surveillance system, and on the best way for taking forward this agenda.

Greater transparency

3.11 Greater transparency generates better and more influential surveillance. Publication ensures that Fund staff's recommendations receive public scrutiny. It also provides authorities with incentives to react positively to well justified recommendations. While acknowledging the need to balance the importance of candour in the work of the IMF, the result of greater transparency is both better surveillance and more robust policy.

3.12 The proportion of member countries willing to allow publication of their Staff Reports has increased, with a rise in publication rates from 64 per cent to 69 per cent over the last two years.⁴ However, within this overall pattern there are differences in the rates of publication for different types of report, which give cause for concern. In particular, from an admittedly small sample, there has been a decrease in the publication rates of reports on exceptional access programmes - the use of fund resources beyond normal limits - from an already low 36 per cent to just 21 per cent (4 out of 19). These reports cover those programmes of greatest interest to the public and of greatest importance financially to the Fund. Publication in this area is therefore particularly important. In addition to this, the UK continues to encourage the highest possible levels of publication overall. In this context the UK welcomes the agreement of the Executive Board to new guidelines on transparency as a basis for future progress.

⁴ Comparing Period January 2001 - February 2002, published as of March 2002 with period March 2002 to March 2003, published as of April 2003.

3.13 The main outcomes of the agreement are:

- ⚡ The adoption of presumed publication for Article IV papers, whereby all relevant documents would be expected to be published, unless the member country objects - effective from 1 July 2004
- ⚡ Presumed publication of programme documents, with immediate effect
- ⚡ In the case of programmes that involve exceptional access, the Managing Director will not normally recommend approval of a programme or completion of a review unless authorities publish the documents - applicable to new or enhanced programmes after 1 July 2004.

3.14 While the UK is keen to see the fullest level of transparency possible, this latest step represents progress, creating a presumption in favour of transparency especially in the exceptional access cases of greatest public interest. The UK will carefully monitor progress on publication following this agreement coming in to effect. The UK will urge countries to meet the spirit of this agreement and to go further where possible, such as with publication of Reports on the Observance of Standards and Codes (ROSCs) and Financial System Stability Assessments (FSSAs), publication of which is voluntary, but encouraged.

Box 3.1: lessons on surveillance from the IEO⁵

The role of the Independent Evaluation Office is discussed in Chapter 2. Further detail on the three IEO reports completed in 2003 is at Annex F. All three of these reports brought out lessons on surveillance, which are considered here. The importance of candour to make surveillance more effective is a common message. Instances where surveillance should have been more candid are identified in each report. The IEO recognises that general agreement has been reached in the Fund on the need to improve this, but also that difficulties exist in encouraging greater candour, especially while also increasing transparency. If surveillance is to inform markets and generate peer pressure, increased transparency is essential, and so the IEO concludes "if the broader role of surveillance is indeed to be strengthened, as has been increasingly emphasized in recent years, it is necessary to find ways of raising the standards of both candour and transparency."

All three reports also identify the linkage between surveillance and programme design. Namely:

- ⚡ programmes have tended to crowd out surveillance activities, reducing the potential contribution of surveillance to improving programme design;
- ⚡ surveillance has drawn too few lessons from past failures;

forcing wide-ranging reforms during a crisis, when these have not been adequately discussed earlier in the course of surveillance, can weaken ownership.

And so surveillance can help in future programme design if it provides a frank assessment of critical weaknesses needing to be addressed and encourages authorities to plan to address these weaknesses. This would increase ownership of policy changes that may be included in future programmes.

⁵ Adapted from: IEO annual report 2003: Chapter IV Some Reflections

The difference in time frame of IMF-supported programmes and that required for structural reforms makes it difficult to ensure programme conditionality matches long term objective. For example, reforming the tax system often calls for structural and administrative reforms which take considerable time to implement. It may not be possible to devise appropriate prior actions or performance criteria which would ensure genuine progress towards this longer-term objective within the short time frame of IMF arrangements. In fact, the need to achieve quick fiscal improvements may even generate adverse incentives, focusing attention on actions that are more easily quantified and monitored, but are less important for longer-term sustainability. The fiscal adjustment report provides examples of such actions: raising tax rates rather than broadening the tax base or, on the expenditure side, imposing wage cuts rather than undertaking deeper civil service reform.

This could be overcome if structural and institutional components of IMF-supported programmes were drawn from a country owned and longer-term strategic framework. In principle, the PRSP process provides a mechanism for low-income countries that could provide this. No such mechanism currently exists to serve this purpose for other countries. One evaluation suggests (in the context of protecting critical social programmes) that surveillance could be used to invite the authorities to spell out their reform objectives, with IMF assistance to work out a reform programme if requested. Although this approach could raise apprehensions that it would make surveillance more intrusive. The IEO therefore identifies clear appeal in using the surveillance dialogue to achieve an understanding on the appropriate framework for longer-term structural reforms, but identifies a major challenge in doing it in a manner which keeps the country in the driver's seat to ensure ownership.

Codes and standards

3.15 Internationally agreed codes and standards represent the new 'rules of the game' in the new global economy. The UK believes that the widespread adoption of these codes and standards can reduce the likelihood of financial crises. The codes and standards framework provides clear and transparent benchmarks of good practice in a range of policy areas. By assessing countries against these benchmarks, the framework will help to improve the functioning of markets by allowing objective comparisons to be drawn. The adoption of codes and standards is also designed to improve transparency and good governance, and increase the credibility and accountability of policy.

3.16 A country's observance of the various codes and standards modules is examined by IMF and World Bank staff and summarised in Reports on the Observance of Standards and Codes (ROSCs). Over time, the ROSC modules build up a comprehensive picture of a country's progress in implementing the range of codes and standards, while allowing prioritisation according to the specific needs and circumstances of individual countries. By end 2003, 492 ROSC modules for 101 economies had been completed, 74 per cent of which had been published.

3.17 The importance attached to this by the UK has led HM Treasury to establish the adoption of codes and standards as part of our Public Service Agreement (PSA⁶) targets. Target 4 commits the Treasury to promoting increased global prosperity and social justice; one limb of this is working to increase the number of countries successfully participating in the global economy on the basis of a system of internationally agreed and monitored codes and standards. This is measured by the uptake of ROSCs, which continues to see strong performance. During 2003 17 more countries completed a ROSC for the first time, taking the total to over half the Fund membership. This combines with a 43 per cent increase in the total number of ROSCs completed. As well as providing technical assistance (see below) the UK seeks to lead by example, having undertaken 8 ROSCs and committed to completing the remaining 3 - the first country to commit to all 11 modules.

3.18 Financial sector ROSCs are usually prepared within the framework of the Financial Sector Assessment Programme (FSAP), which is specifically designed to assess the strengths and weaknesses of financial sectors. By end 2003, 59 countries had completed an FSAP. All Article IV consultations now routinely provide an overview of members' performance against ROSCs and the FSAP.

Technical assistance for codes and standards

3.19 The UK is committed to supporting developing countries implement international financial codes and standards and to effectively follow up on weaknesses identified by codes and standards assessments.

3.20 The UK therefore played a leading role by launching the multi-donor Financial Sector Reform and Strengthening (FIRST) initiative, in Spring 2002, which promotes broad, deep and robust financial sectors in low and middle-income countries in order to reduce financial instability and its impact on the poor. FIRST provides technical assistance grants for short and medium-term projects to help address financial system weaknesses highlighted in FSAPs and ROSCs. FIRST also provides grants for projects that look at implementing the international financial standards and codes. Since resources for implementing and following up standards and codes are most scarce in the poorest countries, FIRST commits 60 per cent of its funding to low-income countries.

Backing Sound Policies

3.21 High quality surveillance, made widely available through greater transparency, and meshed with adherence to international standards and codes will encourage and strengthen governments that are undertaking reforms with good policies. However the UK believes that the vital importance of crisis prevention, and the central role that good policies play in this, calls for further action. IMF lending facilities should be available to help prevent crises as well as resolve them. It is for this reason that the UK strongly supported the objectives of the Contingent Credit Lines (CCL) and shall continue to push for a facility that meets these objectives.

The objectives of the CCL

3.22 The UK has long recognised the need to provide an incentive for members to put in place strong policies and robust institutional frameworks, and providing a signal of strength and support to those members with sustainable policy frameworks. While there is some evidence that the risks of global financial contagion have declined, the threat to strong performers from market volatility still remains.

⁶ PSAs are agreed by every UK government department and set out the key objectives and targets that the department is responsible for meeting, in return for the public resources it receives, see www.hm-treasury.gov.uk

3.23 In 1999 the IMF introduced a Contingent Credit Lines (CCL) facility to complement its broader work on strengthening the international financial architecture for crisis prevention. The CCL offered contingent finance to countries with good policies as a defence against the threat of contagion from financial crises elsewhere. However, technical design concerns and the strengthening of the international system more generally, meant that no member applied for the CCL and under the terms of the sunset clause the facility expired on 30 November 2003.

3.24 In September 2003 the IMFC called on the Fund to explore ways of meeting the key objectives of the CCL. The Fund currently provides precautionary support through its existing facilities, however these arrangements are not explicitly designed to meet the objectives of the CCL. An effective precautionary mechanism should be of sufficient size, speed, and certainty to reassure markets and to prevent panic in the event of a crisis. To allow precautionary arrangements to fulfil these purposes the current exceptional access framework (below) may need to be extended. The UK also believes that an instrument of this kind should ensure that official and private sectors receive the right signals about a country's economy and its policy framework. Integrating codes and standards assessments into any system of prequalification for financial support would be an essential part using precautionary arrangements in this way. The Fund will continue its work in this area and the UK will seek an outcome that meets these objectives.

CRISIS RESOLUTION

3.25 However much progress we make on crisis prevention, crises will still occur from time to time. In the event of a crisis, the IMF has a vital role in assisting members to move back to a sustainable growth path. When the need arises, the Fund uses its financial resources to support its members in solving their balance of payments problems and restoring conditions for strong economic growth, backed by appropriate policy advice and conditionality. Improving the framework for managing and resolving crises will be a valuable contribution to the stability of the international economic and financial system, and the UK has been at the forefront of these efforts.

3.26 Since official sector finance is the engagement of private investors is essential to resolve countries' payments problems and restore medium-term debt sustainability. Such engagement is also important to provide the right incentives for debtors and creditors to manage risks effectively.

3.27 The IMF continues to work with the international community on the issues surrounding the framework for private sector involvement in crisis resolution. In the past year this has included:

- €# improving clarity with respect to Fund policy on the limits to access to official finance during crises;
- €# reinforcing incentives for debtors and creditors to reach voluntary solutions to financing problems; and
- €# developing a proposal for a new mechanism for restructuring debt where that is necessary.

3.28 In addition, the UK strongly welcomes reforms to the way in which the Paris Club deals with non-HIPC countries that face debt problems, particularly where such debts are unsustainable.

Sovereign Debt Restructuring

3.29 Sovereign debt crises entail significant economic costs for all parties, as recent cases, such as that of Argentina, demonstrate. Improving the timeliness and clarity of the framework for restructuring unsustainable sovereign debt would help minimise these costs. There has been a compositional shift in the nature of private capital flows to emerging markets over the last two decades, away from direct bank lending towards bond issues. Such bonds are held by a large number of dispersed creditors, which could make creditor coordination during any restructuring process more difficult. The international community has been exploring a range of complementary mechanisms aimed at facilitating the orderly resolution of sovereign debt crises:

- ⌘ a voluntary approach, revolving around a voluntary Code of Good Conduct to guide the actions of debtors and creditors before and during a crisis;
- ⌘ a contractual approach, involving the use of Collective Action Clauses in international sovereign bonds; and
- ⌘ a statutory approach, based on the Fund's proposal for a Sovereign Debt Restructuring Mechanism.

Code of Good Conduct

3.30 A number of private and official sector representatives have been exploring the possibility of establishing a voluntary Code of Good Conduct to guide the actions of debtors, creditors and the official sector before and during crises. This would complement other crisis resolution work streams. It could, if broadly accepted, promote transparency, reduce the uncertainty surrounding debt restructurings, and encourage proactive debt management.

3.31 Progress has been made by a group comprising representatives of Emerging Market countries and the private and official sectors. However, further consensus is required before a Code acceptable to all stakeholders can be developed. This is crucial if a voluntary Code is to be effective, and further work is under way between the principal parties to this end.

3.32 Collective Action Clauses (CACs) in a bond contract allow a qualified majority of bondholders to agree changes to the terms of a bond with the debtor, and ensure that those changes are binding on all bondholders within that issuance. In the event that a country faces debt problems, these clauses could facilitate the agreement of a restructuring deal by preventing minority creditors from disrupting the process through litigation. The use of CACs in sovereign bonds could reduce uncertainty and could further aid timely coordination and information exchange.

Collective Action Clauses

3.33 Significant progress has been made in the development and adoption of CACs. Prior to 2003, their inclusion in sovereign bonds has been standard practice under English and Japanese law, but not New York law. In the past year, the international community has been taking steps to encourage their take-up worldwide:

- ⌘ the G10 has developed a set of model clauses, published in March 2003, to guide the formation of effective CACs;
- ⌘ a number of private sector trade associations have also developed recommended clauses;
- ⌘ the IMF is promoting the adoption of CACs through its surveillance activities;

- €# leading by example, EU Member States announced that, from June 2003 onwards, all their international bond issues would include CACs⁷; and
- €# to signal our support, the UK revised the CACs included in our July 2003 dollar-bond issue to bring these more closely in line with the G10 model.

3.34 Following this work, several Emerging Market countries issued bonds in New York that incorporate CACs, including Mexico, Brazil, South Africa, South Korea and Turkey. Uruguay issued new bonds through a debt exchange that also included CACs, and contained a clause allowing for aggregation of multiple bonds, making it more difficult for any one bondholder to obtain a blocking position.

3.35 Use of CACs has not resulted in any perceptible adverse impact on borrowing costs or investor demand. Rather these developments signal investor confidence in this approach. However, CACs do not affect the existing debt stock, so it could be a long time before the entire stock of Emerging Market bonds includes CACs. This underlines the importance of making progress on other aspects of the crisis resolution framework. Going forward, the UK will work with the IMF, building on the positive developments to date, to promote the inclusion of effective CACs in international sovereign bonds issued by all countries.

Sovereign Debt Restructuring Mechanism

3.36 As the culmination of a two year work programme and in response to a direct request at the Annual Meetings in 2001, a proposal for a Sovereign Debt Restructuring Mechanism (SDRM) was presented at the Spring Meetings of 2003. This was designed to create an overarching statutory framework for the restructuring of unsustainable sovereign debts. The Mechanism would facilitate negotiation and creditor coordination, it would curb the ability and incentives for creditors to litigate against sovereigns in default, and would create a forum for dispute resolution. A framework of this nature would provide greater predictability to the restructuring process and would enable debtors and creditors to agree timely solutions.

3.37 At the 2003 Spring Meetings the International Monetary and Financial Committee concluded that the institutional changes needed to establish an SDRM were considerable and that current work could be more usefully focussed on issues of general relevance to the orderly restructuring of sovereign debt. These include transparency and disclosure of information; the aggregation of creditor claims both within and across instruments; and inter-creditor equity considerations. The UK supports continued work to inform the development of a practical operational framework.

Exceptional Access: providing new clarity

3.38 A key issue in discussions on crisis resolution in recent years has been the role that the Fund and its lending policies play in the development of a capital account crisis. The Fund has examined the way it tackles these events - especially where they involve lending beyond the normal access limits⁸, known as exceptional access cases. Providing a clear framework for official sector lending decisions should help shape the expectations of countries and their private creditors.

⁷ The EU definition of an international bond is one issued in a foreign jurisdiction

⁸ Normally, access to IMF resources is limited to 100 per cent of quota within any 12-month period and a cumulative limit of 300 per cent of quota on the level of Fund Credit outstanding. However, 'exceptional access' beyond these limits has been provided in a number of cases.

3.39 The Executive Board took a number of decisions to improve the procedures in exceptional access cases.⁹ The improvements have three dimensions:

- 1) Providing greater clarity about the situations in which exceptional access may be appropriate, including rigorous debt sustainability analysis and consideration of the prospects for the borrower to repay the IMF. The Board agreed that the case for providing exceptional access should be judged against the following criteria:
 - €# There are exceptional balance of payments pressures on the member's capital account, requiring Fund finance above normal limits;
 - €# Rigorous and systematic analysis indicates high probability that the member's debt will remain stable;
 - €# The member has good prospects of regaining access to private capital markets within the timeframe of the support package so that Fund finance provides a bridge;
 - €# The policy programme of the member has a reasonably strong prospect of success, both in its adjustment plans and capacity to deliver those plans.
- 2) **Involving the Executive Board earlier in the process** and providing the provisional and updated assessments of the above criteria as negotiations progress toward agreement of a Fund programme
- 3) Requiring an **ex post evaluation** within a year of the end of all exceptional access arrangements.

With clear criteria, a good grounding in analysis and an evaluation procedure to ensure these measures are effectively implemented, these procedures should play a strong part in the process of sending clearer signals to markets. This, in turn, should reduce the uncertainty for private investors concerning the official sector lending in crisis situations, and should strengthen incentives for the appropriate pricing of risk. The UK strongly welcomes this. However, as noted above, the framework may need to be extended to provide for the circumstances of precautionary arrangements.

The Paris Club

3.40 The Paris Club is the informal group of major official creditors who meet to negotiate shared solutions with countries experiencing debt problems. There are 19 permanent Paris Club members, including the G8 and many EU countries.

3.41 At the 2003 G8 summit in Evian, Heads of State and Government encouraged the Paris Club to adopt the new "Evian Approach" to facilitate resolving debt problems in non-HIPC countries. The Paris Club adopted the "Evian Approach" in October 2003.

3.42 The "Evian Approach" places debt sustainability at the heart of the Paris Club's approach to resolving countries' debt problems, and thus aims to achieve a viable debt position over the medium-term. It commits the members to systematically examine, with the IMF, the debt sustainability of each country that approaches the Paris Club requesting debt restructuring.

⁹ See The IMF's Public Information Notice (PIN) No. 03/37 of 21 March 2003, available at www.imf.org

3.43 When analysis concludes that a country faces a liquidity problem in meeting its payment obligations, the debtor is to be offered a debt treatment based on terms designed to fill a pre-identified short-term funding gap, usually through a debt rescheduling. However, the Paris Club will make greater use of the flexibility that currently exists in the range of standardised terms to tailor treatments to the debtors needs. In situations where creditors conclude that a non-HIPC country has an unsustainable level of debt, they will construct a tailored debt treatment designed to restore sustainability. That treatment could take many forms including, if justified, debt reduction. We expect these debt treatments to take place in stages and to be closely tied to IMF Programmes.

3.44 The UK strongly supports these developments and expects the "Evian Approach" to lead to a marked improvement in the Paris Club's efficiency and effectiveness as a tool of crisis resolution.¹⁰

TERRORIST FINANCING AND MONEY LAUNDERING: A 21ST CENTURY CHALLENGE FOR THE IMF

3.45 The UK takes a leading role in global efforts to counter money laundering and terrorist financing. We welcome the involvement of the IMF and the World Bank in assessing countries' anti-money laundering capabilities and their systems to combat financing of terrorism (AML/CFT).

The 12-Month Pilot Project

3.46 In 2002, the IMF and World Bank endorsed a pilot project in assessing countries AML/CFT systems, to be run in cooperation with the Financial Action Task Force (FATF) and FATF-style regional bodies. The final report on this 12-month pilot programme will be produced ahead of the 2004 Spring Meetings of the IMF and World Bank. Making such assessments a permanent part of the IMF/WB operations remains a priority for the UK. The IMF, World Bank and FATF are working closely to develop a common methodology for AML/CFT assessments based on revised FATF recommendations on money laundering and terrorist financing.

3.47 A review of the UK's AML/CFT system was discussed by the IMF's Executive Board in February 2003. The review included a Report on the Observance of Standards and Codes (ROSC) undertaken as part of the Financial Stability Assessment Programme. The review concluded that the UK has a strong and comprehensive legal, institutional and supervisory regime for anti-money laundering and complied well with most of the FATF Recommendations.

3.48 The AML/CFT system has been further strengthened in the UK over the last year with the implementation of the Proceeds of Crime Act. In addition, the new Money Laundering Regulations have now been laid before Parliament and will come into force from March 2004.

Technical assistance for AML/CFT

3.49 The transfer of know-how and expertise is essential in helping to strengthen global efforts to combat the financing of terrorism. The IMF and the World Bank continue to provide broad-based technical assistance to countries to help develop and strengthen their AML/CFT infrastructures, with increased emphasis on regional projects including capacity building for FATF-style regional bodies. Staff continue to work with regional and international organisations in the identification, coordination and delivery of technical assistance.

¹⁰ More information on the Paris Club is available at www.clubdeparis.org

3.50 Since March 2003, there has been a marked increase in Bank/Fund technical assistance on AML/CFT with some 40 projects undertaken or planned, benefiting 115 countries. The UK has contributed funding through the Multi-donor Financial Sector Reform and Strengthening Initiative (FIRST). (See Codes and Standards section, above). Through its work on the boards of both the World Bank and the IMF, the UK will help to ensure close coordination between major donors.

4

AN IMF WORKING FOR FAIRNESS

As well as supporting growth, the international community must ensure that growth does not leave anyone behind – this is why the UK is committed to the Millennium Development Goals (MDGs). The Doha Development Agenda is crucial to provide stronger and more equitable growth through greater and fairer world trade, but we must also provide more finance directly to low-income countries to meet the MDGs. The UK sees a role for the Fund in support of this, but its core task must be advice and support to low-income countries that enables them to take full advantage of globalisation. In-country this must be led by the policies of those countries, but developing countries need an effective voice at the global level too.

THE MILLENNIUM DEVELOPMENT GOALS (MDGs)

4.1 The international poverty reduction effort is focused on achieving the MDGs. At the United Nations Millennium Summit in September 2000, all UN member states affirmed their commitment to meeting these goals. The MDGs are intended to focus the efforts of both developed and developing countries on achieving significant and quantifiable improvements in people's lives. They establish benchmarks for measuring progress and also help to orientate the development programmes of donor countries and the multilateral institutions. Achieving these goals will rely primarily on the efforts of developing countries themselves; however, the goals will not be achieved in all countries unless there is more effort from the international community.

Box 4.1 The Millennium Development Goals (MDGs)

The IMF has joined the international community in stating its commitment to meet the MDGs by 2015. These goals include, to:

- €# curtail extreme poverty and hunger: cut by half the proportion of people living on less than a dollar a day;
- €# achieve universal primary education: ensure that all boys and girls complete a full course of primary schooling;
- €# promote gender equality and empower women: eliminate gender disparity in primary and secondary education - preferably by 2005, and at all levels by 2015;
- €# reduce child mortality: reduce by two-thirds the mortality rate among children under the age of five;
- €# improve maternal health: reduce by three-quarters the maternal mortality rate;
- €# combat HIV/AIDS, malaria and other diseases: halt and begin to reverse the spread of HIV/AIDS; halt and begin to reverse the incidence of malaria and other major diseases;
- €# ensure environmental sustainability: integrate the principles of sustainable development into country policies and programmes; reverse the loss of environmental resources; reduce by half the proportion of people without sustainable access to safe drinking water; achieve significant improvement in the lives of at least 100 million slum dwellers by 2020; and

€# create a global partnership for development: develop further an open trading and financial system that is rule-based, predictable and non-discriminatory (includes a commitment to good governance, development and poverty reduction - nationally and internationally).

4.2 Stability, investment and trade are the key long-term drivers of prosperity, economic growth and the attainment of the MDGs. The IMF has a role to play in supporting conditions for increased investment, and must also help to promote trade, consistently urging rich countries to open up their markets to products from the poorest.

THE DOHA DEVELOPMENT AGENDA

4.3 The Doha Development Agenda (DDA) of the World Trade Organisation (WTO) represents a commitment to making the global trading system fairer, and in particular to prioritising the needs of developing countries while pursuing the overall liberalising agenda. This latest set of world trade negotiations was launched at the 4th WTO ministerial in Doha, Qatar in November 2001, in recognition of the importance of trade in promoting growth, and the reality that, if all are to benefit, developed and developing countries must move forward together.

4.4 The potential gains from a successful outcome are substantial. Nagarajan (1999)¹ estimates that the annual welfare gain from a 50 per cent cut in trade protection across all agricultural, industrial and services sectors and a 1 per cent reduction in transaction costs (through improved trade facilitation) would reach nearly \$100 billion in the EU and up to \$400 billion globally. Others, such as the World Bank (2003)² have estimated global welfare gains of over \$500 billion, of which nearly \$350 million would accrue to developing countries. This could lift up to 140 million people out of poverty.

4.5 The breakdown of negotiations at the 5th WTO Ministerial in Cancún in September 2003 was a major setback and a deep disappointment. It is crucial that rapid progress takes place in the coming months to have any chance of meeting the January 2005 deadline for concluding negotiations.

The IMF and the Doha Development Agenda

4.6 While the WTO is the forum for detailed trade negotiations, other multilateral institutions, including the IMF, can and must take actions to support and facilitate the process.

4.7 First Deputy Managing Director Anne Krueger, in her statement at the Cancún ministerial, emphasised the IMF's willingness to do so. She reiterated the IMF's view that openness and economic reform can be combined in a virtuous circle which strengthens economies and promotes growth. At the same time, the IMF recognises the need to provide support for developing countries where necessary to help them deal with transition costs.

¹ Nagarajan, Nigel: The Millennium Round: An economic appraisal, Economic Papers N139, European Commission, 1999

² World Bank: Global Economic Prospects 2004: Realizing the Development Promise of the Doha Agenda, 2003

4.8 IMF management has committed to support members experiencing temporary balance of payments shortfalls as a result of multilateral liberalisation. Such an initiative would complement the existing active programme of financial and policy support and technical assistance to members. It will likely involve a proactive effort on the part of the Fund to discuss with members possible new programmes, or augmentation of existing arrangements, in order to help them accommodate impacts on their balance of payments.

4.9 The World Bank has also been consistent in its support for the Doha Round, and is working on a counterpart initiative to the proposal at the IMF. The two institutions continue to work closely together on trade issues.

4.10 At the meeting of the IMFC in Dubai, one week after Cancún, Ministers agreed in their communiqué on the importance of making progress on trade and development. They urged a speedy resumption of the Doha Round, with a focus on fair access to markets and the reduction of trade-distorting subsidies in all areas, particularly agriculture. They supported the principle of the IMF's new initiative, and asked the heads of the IMF and the World Bank to write jointly to Heads of State and trade ministers of all member countries, emphasising the case for urgent progress.

4.11 This letter was issued by Horst Köhler and James Wolfensohn (President of the World Bank) in November 2003. They took the opportunity to remind members of the important implications for global growth, set out some ideas for moving forward, and stress the willingness of their institutions to provide support.

The wider role of the IMF on trade

a) The IMF has a key role to play in enabling all developing countries to benefit fully from trade liberalisation. It can do so in a number of specific ways.

b) The independent academic research of the Fund is already widely respected as an important source of understanding on economic matters, and in particular on the global benefits of reducing trade barriers. The experience at Cancun highlighted a new range of particular developing country concerns. In order to help address these, the IMF could increase its analytical focus on reasons why liberalisation does not always deliver its potential benefits in individual countries, and develop recommendations for overcoming these obstacles.

c) Trade-related conditionality in IMF programmes has often been the subject of discussion and criticism. The UK believes that for developing countries the IMF and World Bank country-led approach to setting priorities, based on Poverty Reduction Strategy Papers (PRSPs) is the right one. However, some critics assert that trade conditionality continues to go beyond PRSPs. The IMF and World Bank should continue to ensure that any trade conditionality reflects the new country-led approach. In addition, developing countries need help to build their supply-side capacity, so that they can take advantage of new trading opportunities. This means creating a domestic environment in which people and firms can produce goods and services efficiently and get them to international markets, including through investment in physical and human capital and infrastructure. This need must be recognised, supported, and mainstreamed across Fund and World Bank activities. Poverty and Social Impact Assessments (PSIA) could be used effectively ahead of trade liberalisations to help developing countries identify priority areas for action. The UK will continue to promote this approach.

FINANCING THE MDGs

4.12 If the MDGs are to be achieved, the focus must be on building capacity to engage positively in the global economy and address the long-term causes of poverty. There will also need to be a significant increase in the transfer of resources from the richest to the poorest countries in the form of investment for development. The High Level Panel on Financing for Development, chaired by former Mexican President Ernest Zedillo, concluded that if we are to succeed in achieving these goals, an extra \$50 billion in aid will be required each year until 2015.

4.13 Downward trends in official development assistance (ODA) in the 1990s have seen development aid to sub-Saharan Africa fall from \$33 per head to \$20 per head in the last 10 years. Just to bring aid back in per capita terms to the levels of the late 1980s would require an extra \$35 billion of aid. In 2002 at the United Nations' Monterrey Conference on Financing for Development, the international community signed up to the first increase in ODA for 20 years - an additional \$16 billion per year by 2006. Nonetheless, it is estimated that an additional \$10 billion is needed for education, and at least an additional \$15 billion for health.

4.14 This reality imposes a pressing need on the international community to deliver additional finance for development and make further improvements in enhancing the effectiveness of aid. As a result, no country genuinely committed to poverty reduction and to meeting the MDGs is denied the chance of achieving its goals through lack of resources.

Capacity Absorption

4.15 One concern about increasing aid volumes is that higher aid flows will lead to a reduction in returns to aid - that is, if aid flows are increased too much, the countries receiving them will not be able to use them effectively and efficiently. However, analysis of country examples shows that well-managed countries are able to make effective use of aid flows that are large relative to the size of their economies. Even if aid in sub-Saharan Africa were doubled, it would only bring the total amount of aid to 8 per cent of GDP for that area.

4.16 An IMF and World Bank report to the Development Committee at the 2003 Dubai Annual Meetings³ estimated that current additional absorption capacity in low-income countries is between 60 and 100 per cent. Additional flows of at least \$30 billion could, therefore, be effectively absorbed immediately, with significantly more in the medium-term.

Budgetary Constraints in Donor Countries

4.17 The UK Government, along with other donor countries, is committed to reaching the target of 0.7 per cent of GNI being delivered as ODA. On current plans, the UK will see its ODA/GNI ratio rise to 0.4 per cent in 2005-06 (up from a level of 0.26 per cent in 1997, and 0.33 per cent in 2003-04). By 2005-06, UK ODA will be at its highest level proportionally since 1981. Despite international efforts to fulfil this commitment, the world ODA/GNI ratio stands only at 0.2 per cent - a number of donor countries have fiscal constraints that will not allow them to increase aid levels in the short term. However, if we are to meet the MDGs by 2015, a substantial step-change in the level of resources for development is needed in the next four years.

³ IMF and World Bank: Supporting Sound Policies with Adequate and Appropriate Financing, September 2003

4.18 The International Finance Facility (IFF) is a means - in these difficult circumstances - of bridging the current financing gap by leveraging commitments made at Monterrey. This will allow a substantial increase in aid, at a time when it will have the most impact on achieving the MDGs by 2015.

Box 4.2: The International Finance Facility (IFF)

In order to bridge the gap between what has been pledged and what is still required to attain the MDGs, the UK has proposed an International Finance Facility (IFF).

- €# The IFF is designed to provide the resources necessary to meet the MDGs by frontloading aid through the international capital markets. It would deliver long-term predictable aid flows by locking in commitments from donor countries.
- €# Funds would then be leveraged from these commitments and disbursed mainly in the form of grants, though it could also be used for further debt relief.
- €# The Facility would use existing multi- and bi-lateral mechanisms for disbursement.

The IFF has 4 main advantages:

1. it would provide simultaneous and sustainable investment across all sectors, such as health and education;
2. it locks in the political commitment of donors to increased long-term aid and, using these commitments, it can provide a predictable and stable flow of aid over the medium term, allowing for a more effective investment in infrastructure;
3. it encourages donor pooling and coordination, improving the effectiveness of aid; and
4. finally, it would frontload aid to deliver the critical mass of aid needed now to meet the MDGs.

The Case for Frontloading

4.19 There is a moral imperative to act now if we are to meet the MDGs. On current trends, it will take until 2165 to decrease child mortality in sub-Saharan Africa by the two-thirds sought by the MDGs; and we would not meet the MDGs on extreme poverty until 2147, or on primary education until 2129. The IFF would deliver the resources necessary to fulfil our commitments now.

4.20 There is also clear economic justification for frontloading resources where the economic rate of return to programmes is high. Independent project evaluations of World Bank lending confirm high and improving rates of return - projects in 1996-2001 achieved an average rate of return of 23 per cent, compared with 16 per cent for projects in the 1980s. All sectors achieved over the test discount rate of 10 per cent (for example, 13 per cent in agricultural projects, and 23 per cent in water and sanitation projects). World Bank estimates place the rate of return of IBRD financed projects at around 25 per cent. Rates of return on projects financed through the IFF are likely to be similar, and would tend to be particularly high where the focus is on poor countries with sound policies, institutions and governance.

4.21 To drive global growth, investment in economic and social development is needed to ensure the integration of the poorest countries into the global economy. Aid flows raised by the IFF will not remove the need for continued development assistance after the IFF has finished its disbursement programme. However, helping developing countries build their growth capacity will reduce future levels of aid dependency and reduce poverty. Ultimately, this would benefit all countries, rich and poor. The World Bank estimates that to maintain current average growth rates of the world's economy, developing countries need to grow significantly faster and to double their share in global GDP to 40 per cent by 2050.

Taking the IFF Forward

4.22 The IFF has found increasing support, including from within the EU and developing countries. The UK continues to make the case for the IFF more broadly among its international partners in the following ways:

- €# at the 2003 Annual Meetings of the IMF and the World Bank in Dubai, the Bank and Fund were mandated by the IMFC and the Development Committee to do further work into financing for development issues, including on the IFF;
- €# recognising the need to mobilise substantial additional resources in the medium-term, the IMFC called upon the IMF and World Bank to do further work on aid effectiveness, absorptive capacity, and results-based measurement mechanisms. The IMF and World Bank are due to report back at the Spring and Annual Meetings in 2004; and
- €# emerging market and developing countries are being closely consulted. The UK are taking forward this consultation process with its international partners. As part of this process interested parties are being invited to a Ministerial Conference on financing for development in Spring 2004, to be hosted by the French Government.

4.23 The scaling up of aid will make improvements in donor behaviour even more crucial. The UK supports ongoing IMF and World Bank work on considering ways to strengthen coordination, cooperation and collaboration with each other, and with all development partners.

THE ROLE OF THE IMF IN LOW-INCOME COUNTRIES

Creating Macroeconomic Stability through Macroeconomic Frameworks and Growth

4.24 The changing nature of the economic challenges facing low-income countries has implications for the IMF's role in these countries. The compact endorsed by the international community for fighting poverty and achieving the MDGs, the Monterrey Consensus, is based on low-income countries pursuing sound policies and good governance matched by better and stronger international support. Working within its core functions, the IMF plays a major role in low-income countries by supporting macroeconomic policy reforms to achieve stability, growth and poverty reduction. Such reforms include fiscal, monetary, exchange rate policy, and financial system reform. The IMF is also engaged in developing improved support to the management of exogenous economic shocks.

4.25 Policy is most effective at tackling poverty when all parties are fully committed to its implementation and involved in its development. The aim of the IMF in low-income countries is to promote sustainable long-term growth and poverty reduction and ultimately, a graduation from international donor assistance. Progress has been made in achieving macroeconomic stabilisation in many low-income countries, but there is more to do. Low-income countries face major challenges and so the role of the IMF must be long-term in order to assist these countries make progress.

Poverty Reduction Strategy Papers

4.26 The country-driven and participatory Poverty Reduction Strategy Paper (PRSP) approach was formulated in 1999. PRSPs provide a framework for concessional support from the international financial institutions, and increasingly for that of other donors. This approach is strongly supported by the UK. PRSPs are prepared by developing countries in consultation with civil society, and provide a focus for the support of the Fund and the World Bank. They aim to ensure countries are in control of their own development plans, and that these plans balance the development needs across society, with a focus on country-specific development goals, similar in nature to the MDGs and costed medium-term expenditure frameworks. PRSPs also ensure a long-term, strategic view of development, and are an essential tool in ensuring that the many partners involved - the IMF, the World Bank, Regional Development Banks, the United Nations, and bilateral donors - are able to coordinate their activities effectively in support of country plans and priorities.

4.27 IMF support is increasingly provided in the context of country PRSPs. The total number of PRSPs under implementation reached 32⁴ - with 14 completed in the year ended 30 September 2003⁵. Another 3 countries completed interim PRSPs⁶, bringing the total to 21. The World Bank also provides Poverty Reduction Support Credits (PRSC) to support the implementation of a PRSP. As at 30 June 2003, the Executive Directors of the World Bank had approved 7 PRSCs in 7 countries.⁷

Poverty Reduction and Growth Facility (PRGF)

4.28 In support of the PRSP-led approach, the IMF created a new facility, the Poverty Reduction and Growth Facility (PRGF). By the end of 2003 PRGF arrangements supported reform programmes in 37 member countries. The PRGF is intended to be consistent with a broad approach to poverty reduction. The creation of the PRGF reflects the fact that, although the IMF is a monetary institution, it has a vital role to play - alongside development institutions and donors - in supporting poverty reduction in its member countries. This role is both technical and financial as, while macroeconomic stability and sustainable economic growth are vital for reducing poverty, they are not by themselves sufficient. The PRGF provides a framework for policy advice and conditionality, and provision of financial resources to enable macroeconomic adjustment. Progress has also been made in supporting more flexible fiscal targets in PRGF programmes.

⁴ International Monetary Fund: Poverty Reduction Strategy Papers - Detailed Analysis of Progress in Implementation, September 2003

⁵ Azerbaijan, Benin, Cambodia, Cameroon, Chad, Ethiopia, Ghana, Kyrgyz Republic, Mali, Mongolia, Nepal, Senegal, Sri Lanka and Tajikistan.

⁶ Bangladesh, Bosnia and Herzegovina, and Indonesia

⁷ The World Bank Group Annual Report 2003 Volume One - Year in Review p25

4.29 The UK has been encouraging the IMF to work in concert with the World Bank and other donors to maximise the effectiveness of the PRGF and thereby enhance poverty reduction in low-income countries. As part of this process, the IMF proposed - and the UK supported - the following guiding principles for its work in low-income countries⁸:

- €# the IMF should remain constructively engaged over the medium-term in helping low-income countries to achieve macroeconomic stability and high levels of growth;
- €# the IMF should continue to embrace the principles of the PRSP approach, and ensure that the IMF support contributes to efforts to achieve the MDGs;
- €# the IMF should focus on areas within its core competence, while ensuring that efforts to promote macroeconomic stability and good governance complement the work of the World Bank and other development partners;
- €# the IMF should help low-income countries facilitate the transition to a market-based economy, reduce dependence on aid and, over the long-term, move to a point where they can rely predominantly on private sources of financing; and
- €# the IMF should continue to broadly promote policies in other countries - particularly developed countries - that are helpful to low-income countries (for example, trade liberalisation).

Reforming IMF Facilities in Low-Income Countries

4.30 The IMF's current policies and instruments for its engagement in low-income countries are broadly appropriate, although there remain areas where some modifications and improvements are still required. Further work is needed, for example, to ensure that programme design in low-income countries is realistic. In particular, the UK has been calling for:

- €# realistic assumptions on growth, exports, pace of reform and all key variables to form the basis of programme design;
- €# an explicit assessment of how the macroeconomic framework of the programme supports PRSP targets and the MDGs;
- €# an open discussion of alternative macroeconomic frameworks to achieve programme objectives;
- €# more systematic use of Poverty and Social Impact Assessments (PSIAs); and
- €# greater flexibility in accommodating higher aid flows.

⁸ Role of the Fund in Low-Income Member Countries Over the Medium Term - Issues Paper for Discussion July, 2003

4.31 The IMF is making progress in providing advice, technical assistance and short-term financing to low-income countries. The UK supports this process, and believes that the Fund's existing instruments need to evolve in three areas:

- €# supporting post-conflict and other countries with severe institutional weaknesses in developing PRSPs, and implementing PRGF programmes;
- €# assisting those countries with a more durable record of macroeconomic performance to move to a surveillance-based relationship; and
- €# providing policy advice and financial assistance to help countries deal with exogenous shocks.

4.32 Following on from the IMF's review of the PRGF⁹, the Board discussed the need to align the PRGF to the PRSP¹⁰, the proper role of the Fund in low-income countries¹¹, and IMF assistance for countries facing exogenous shocks¹². These documents have helped focus the role of the IMF in low-income countries. Over the coming months, the IMF will produce further papers on Instruments and Financing, and on Programme Design, for Board consideration. The Independent Evaluation Office (IEO) is also undertaking an evaluation of the role of the IMF in low-income countries.¹³ The Government looks forward to this report, and to the discussion of its findings.

4.33 The UK believes that PSIA is critical to ensuring that poverty-focused dialogue on the policy choices and trade-offs associated with key reforms takes place (such as trade liberalisation measures, reforms in key commodity sectors, or utilities privatisation). It is important that the IMF and World Bank collaborate closely on PSIA. The UK notes some progress in this area, but recognises that approaches are not systematic across all countries.

4.34 During the past year - at the request of the IMFC and with strong support from the UK - the IMF and World Bank also produced a joint paper on collaboration in public expenditure management. Improving public expenditure management is important in achieving the MDGs, by ensuring that public resources (including development assistance and debt relief) are used effectively and efficiently, enabling development policies - including those set out in PRSPs - to be turned into effective service delivery. The UK pressed for an improved framework for public expenditure management in low-income countries, based on five key elements:

- €# an annual, country-based process for dialogue and for monitoring progress;
- €# a common system for regularly measuring and reporting on country public expenditure management performance;
- €# a coordinated set of detailed public expenditure management diagnostic tools;
- €# effective technical assistance support for long-term capacity building; and
- €# development and implementation of country-led action plans.

⁹ Review of the Poverty Reduction and Growth Facility - Issues and Options - February, 2002

¹⁰ Aligning the Poverty Reduction and Growth Facility (PRGF) and Poverty Reduction Strategy Paper (PRSP) Approach - Issues and Options - March, 2003

¹¹ Role of the Fund in Low-Income Member Countries Over the Medium Term - Issues Paper for Discussion - July, 2003

¹² Fund Assistance for Countries Facing Exogenous Shocks - August, 2003

¹³ Role of the Fund in Low-Income Member Countries Over the Medium Term - Issues Paper for Discussion - July, 2003

4.35 Since the publication of the report, progress is being made in reforming IMF and World Bank diagnostics and instruments in low-income countries, to support country efforts to improve public financial management and accountability, and to streamline and reduce the burden on governments.

4.36 Exogenous shocks are particularly damaging for low-income countries. The best defence for countries against exogenous shocks are strengthened institutions and policies that are robust to shocks. IMF policy advice in surveillance and programmes has a key role to play in achieving this. In addition, the IMF can provide financial assistance in response to a shock. However, the Fund should concentrate on providing finance to help countries cope with short-term temporary shocks, for example in commodity prices, rather than long-term trends.

IMF Technical assistance

4.37 The IMF also provides technical assistance to help countries strengthen their policy making capacities. Technical assistance is concentrated in low and lower-middle income countries, and focussed on the Fund's areas of expertise, which include fiscal and monetary policy, and statistics. It is usually provided free of charge with the full involvement of the recipient country, from identification of need to implementation, monitoring and evaluation.

4.38 Since demand for technical assistance exceeds supply, the IMF has introduced a set of prioritisation filters and guidelines to enable the IMF's functional departments to more systematically align resource commitments with recipient member needs, consistent with the IMF's core area of specialisation, main programme areas and key policy initiatives.

4.39 In May 2002, the Executive Board endorsed the IMF's Africa Capacity Building Initiative. This Initiative will strengthen the capacity of African countries to design and implement their PRSPs, as well as improve the coordination of technical assistance. It also aims to increase the volume of capacity building assistance from the IMF to Africa, and, by operating out of centres based in Africa, it aims to bring the Fund closer to its clients.

AFRITACs 4.40 As part of the Initiative, two pilot African Regional Technical Assistance Centres (AFRITACs) have been established, modelled on the IMF's technical assistance centres in the Pacific and Caribbean. These Centres are to provide capacity-building support in the areas of macroeconomic and financial management, within the context of the PRSP process. They are intended to complement existing capacity-building efforts by other technical assistance providers in the region.

4.41 The East-AFRITAC opened first in Tanzania in November 2002 and serves six English-speaking countries in East Africa. West-AFRITAC was established in May 2003 in Mali, and serves ten French-speaking countries in West Africa. In each case, the work plans for the Centres are agreed by Steering Committees where borrowing member countries predominate. An external evaluation of the performance of the two AFRITACs is scheduled for September 2004. If it is deemed that they have performed well, consideration will be given to the establishment of three more centres to cover the whole of sub-Saharan Africa.

4.42 The UK fully supported the establishment of the pilot AFRITACs and works in a co-ordinated manner with four other donors (Germany, the Netherlands, Norway and Sweden) who have agreed to a single lead representative for the group on the Steering Committees.

THE HEAVILY INDEBTED POOR COUNTRIES (HIPC) INITIATIVE

4.43 The HIPC Initiative was first launched in 1996 by the international community, with the aim of ensuring that no poor country faces a debt burden it cannot manage. The Initiative entails coordinated action by the international financial community, including multilateral organizations and governments, to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. To be considered for HIPC Initiative assistance, a country must:

- €# face an unsustainable debt burden, beyond traditionally available debt-relief mechanisms;
- €# establish a track record of reform and sound policies through IMF and World Bank supported programs; and
- €# have developed a PRSP or Interim-PRSP through a broad-based participatory process.

4.44 Once these conditions are met, the IMF and World Bank staff carry out a debt sustainability analysis to determine the debt relief needs of the country. If a country's external debt ratio after traditional debt relief mechanisms is above a threshold for the value of debt to exports (or, in special cases, the value of debt to fiscal revenues), it qualifies for assistance under the Initiative. Once a country has made sufficient progress in meeting the criteria for debt relief, the Executive Boards of the IMF and World Bank formally decide on a country's eligibility, and the international community commits to reducing debt to the sustainability threshold. This is called the decision point.

4.45 Once a country reaches its decision point, it may immediately begin receiving interim relief on its debt service falling due. In order to receive the full and irrevocable reduction in debt available under the HIPC Initiative, however, the country must establish a further track record of good performance under IMF- and World Bank-supported programs. The length of this second period depends on (i) the satisfactory implementation of key policy reforms agreed at the decision point, (ii) the maintenance of macroeconomic stability, and (iii) the adoption and implementation for at least one year of the PRSP.

4.46 Once a country has met these criteria, it can reach its completion point, at which time all lenders (the IFIs, Paris Club creditors and other bilateral official creditors) are expected to provide the full and irrevocable debt relief committed at the decision point.

4.47 Most eligible countries, having reached Decision Point by the end of 2000, have benefited from debt relief for the past 3 years. Twenty-seven countries had reached Decision Point at end December 2003, of which nine had reached Completion Point.

4.48 The UK was instrumental in securing international agreement for the joint IMF/World Bank original (1996) and enhanced (1999) HIPC Initiatives, and is continuing to push the debt relief agenda in all international fora. The progress made over the previous two years continued in 2003. The UK has provided commitments of around £2 billion of debt relief to eligible countries, and has pledged an additional £474 million through multilateral institutions to further support the Initiative. The UK has also committed to providing 100 per cent relief for eligible HIPCs when they reach Completion Point.

Table 4.1: Status of the HIPC Initiative as at end 2003

Completion Point	Benin; Bolivia; Burkina Faso, Guyana; Mali; Mauritania; Mozambique; Tanzania; Uganda
Decision Point	Cameroon; Chad; Democratic Republic of Congo; Ethiopia; The Gambia; Ghana; Guinea; Guinea-Bissau; Honduras; Madagascar; Malawi; Nicaragua; Niger; Rwanda; Sao Tome and Principe; Senegal; Sierra Leone; Zambia
Still to be Considered	Burundi; Central African Republic; Comoros; Republic of Congo; Cote d'Ivoire; Lao PDR; Liberia; Myanmar; Somalia; Sudan; Togo
Potentially Sustainable Cases	Angola; Kenya; Vietnam, Republic of Yemen

4.49 Over the past year, attention has been focussed on the need to ensure that the HIPC process leaves countries with a sustainable debt level upon exiting the Initiative. The UK has continued to press major creditors and multilateral institutions to find solutions to this challenge.

Topping up at Completion Point

4.50 'Topping up' can be used to provide additional debt relief at Completion Point to a country that - due to exogenous factors (such as adverse weather conditions; price shocks; or natural disaster) - will otherwise graduate from the HIPC Initiative with a debt-to-export ratio in excess of 150 per cent. At the end of December 2003, only one country, Burkina Faso, had received topping up at Completion Point.

4.51 While there is a general consensus among donors that topping up can be provided to countries that have suffered from an exogenous shock, there remains some disagreement as to how the quantum of additional relief is calculated. When the Enhanced HIPC Initiative was agreed in Cologne in 1999, most Paris Club creditors and all of the G7 went beyond the provision of 90 per cent debt relief (Paris Club terms), and pledged 100 per cent debt relief to eligible HIPCs at Completion Point. This was intended to provide HIPCs with a further cushion against unforeseen events. There has since been much debate as to whether this additional bilateral assistance should be included when calculating the size of any topping up sum.

4.52 The UK has been pushing - both within the G7 and at the Boards of the IMF and World Bank - for this additional assistance to be excluded from the calculation, to ensure that it really is additional to that provided by the HIPC Initiative. A recent World Bank and IMF paper shows that excluding this bilateral assistance from the calculation could provide an additional \$1 billion in debt relief to support increased pro-poor expenditure in HIPCs.¹⁴

Debt Sustainability

4.53 IMF and World Bank analysis suggests that nearly half the countries participating in the HIPC Initiative could exit with debts above the agreed threshold for the debt-to-export ratio (150 per cent).¹⁵ The specific factors behind continued poor debt-to-export ratios are varied, but include:

- ⌘ vulnerability to exogenous shocks, such as adverse terms of trade and bad weather conditions;
- ⌘ waste of resources due to policy deficiencies, poor governance, and weak institutions;
- ⌘ inadequate debt management; and
- ⌘ political factors, including conflict and security issues.

4.54 While topping up at Completion Point can help return these countries' debt position to target levels in the short to medium-term, many HIPCs may remain vulnerable to exogenous shocks going forward. The UK has been vocal in calling for donors, including the IMF and the World Bank, to try to find an acceptable solution, and has argued that no country genuinely committed to good governance, poverty reduction and economic development should be denied the chance to achieve the MDGs through lack of resources.

4.55 In September 2003, the Annual Meetings of the IMF and World Bank in Dubai asked staff to prepare a paper examining debt sustainability in low-income countries for consideration by Ministers in early 2004.

Post-Conflict Countries and the HIPC Initiative

4.56 Most of the 11 countries yet to reach Decision Point (at end 2003) are either involved in, or emerging from, conflict or civil unrest. This makes it very difficult for them to progress towards HIPC debt relief. The IMF and the World Bank, working closely with UN agencies and the international community, are providing technical and financial assistance to help countries progress towards economic security and post-conflict reconstruction.

4.57 The IMF is also refining the instruments available to support post-conflict and other countries with severe institutional weaknesses moving to the point where they can implement PRGF-supported programmes.

¹⁴ World Bank and IMF: Enhanced HIPC Initiative: Considerations Regarding the Calculation of Additional Debt Relief at Completion Point - August 2003 (IDA/SecM2003-0476)

¹⁵ IBID

A FAIR VOICE FOR ALL

4.58 At Monterrey, all governments committed to finding ways of enhancing the voice of developing and transition countries in the International Financial Institutions, including the IMF. The UK believes that enhancing the voice of developing and transition countries in the IMF is not only an important step in our partnership with these countries, but can also make a strong contribution to increasing the effectiveness of the IMF in responding to their needs, and has been a strong supporter of this agenda.

4.59 At the 2002 Annual Meetings, the Development Committee requested a report from IMF and World Bank staff on the issue of 'voice', for discussion at the 2003 Spring Meetings. In the run up to this discussion, HM Treasury and DFID produced a paper to contribute to the debate in the institutions. This paper highlighted the need for increased 'voice' and set out options at three levels: the country level (for example, increased borrowing country ownership of policies through strengthened PRSP processes), the institutional level (for example, increased openness and transparency) and the Executive Board level (for example, an additional seat on the Executive Board for Sub-Saharan African countries or increased capacity for developing country Executive Directors).

4.60 The staff paper prepared for the 2003 Spring Meetings set out the main options for change and went into some detail on what could be done in the short term to help developing country Executive Directors (in both the Fund and the Bank) in Washington represent their constituencies more effectively. Just before the 2003 Spring Meetings, the Boards of both institutions approved three extra staff (in each institution) for each of the two Sub-Saharan African constituency offices. Further capacity-building measures are also now being taken forward. For example, the UK is, with other donors, establishing a trust fund to support independent analysis for the use of the Sub-Saharan African Executive Directors, which will enable them to represent their constituencies more effectively, and has pledged \$500,000 to the fund.

4.61 Progress is also ongoing on the institutional issues highlighted by the UK in 2002 - the Development Committee has urged the World Bank and IMF to step up their efforts to promote greater openness and transparency, decentralisation and staff diversity within the institutions. We will continue to support such reforms, and believe that changes at the institutional level could have a significant impact on the effectiveness of developing country voice.

4.62 It will take time and effort to arrive at the necessary political consensus to achieve structural changes at the Board level, but the UK will continue working with other shareholders to make progress on these issues. At the 2003 Annual Meetings, the UK reiterated its belief that an extra seat for sub-Saharan Africa on the Boards of the IMF and World Bank could be an important means of increasing the effectiveness of developing country representation. The UK will continue to press for an increase in the uniform Basic Vote that is assigned to all fund members and which helps determine their voting shares, as part of any future revision of the Articles of Agreement. We also continue to believe that a package of measures (e.g. special and ad hoc quota increases) to encourage the voice of developing and transition countries, should be considered in the context of any general increase in IMF quotas.

4.63 IMF (and World Bank) Governors and Executive Directors have discussed the voice agenda at both the Spring Meetings and the Annual Meetings in 2003. There will be further discussions in 2004 (both in the Development Committee and the IMFC), ensuring that this issue remains high on the agenda in both the IMF and World Bank. Although some progress has been made, the Government believes that more action is needed. We will continue to work with other shareholders to take the agenda forward, both through immediate actions such as the establishment of the Analytical Trust Fund, and through support for changes in the longer term at the institutional and Board levels.

A

IMF DECISION MAKING - UK POSITIONS

Votes by the Board of Governors

A.1 The IMF's Articles of Agreement and by-laws specify the issues which require a vote by the Board of Governors. These are relatively few and include subjects such as changes to quotas, remuneration of Executive Directors and the Managing Director, decisions on the allocation and cancellation of Special Drawing Rights, amendments to the Articles of Agreement, election and changing the number of Executive Directors, forcing the withdrawal of a Fund member and liquidation of the Fund.

A.2 The resolutions that are passed as a result of Governors' votes are currently published by the IMF, with a two-year delay, in the 'Summary Proceeding of the Annual Meeting of the Board of Governors'. The following decisions were voted on by governors in 2003:

Resolution		Voting Result	Effective Date	UK Position
58-1	Closure of the Twelfth General Review of Quotas	Passed	28 January 2003	Approve
58-2	Direct Remuneration of Executive Directors and their Alternates	Passed	8 August 2003	Oppose
58-3	Financial Statements, Report on Audit, and Administrative Capital Budgets	Passed	24 September 2003	Approve
58-4	Amendments of the Rules and Regulations	Passed	24 September 2003	Approve
58-5	2004 Annual Meetings Change in Date	Passed	24 September 2003	Approve

Explanation of votes **A.3** The vote on the closure of the Twelfth General Review of Quotas is covered in Chapter 2, and was reported on in more detail in last year's edition of this report.

A.4 The UK has generally taken a tough stance on the remuneration of IMF Executive Directors and believes that their remuneration should reflect their primary role as appointed public officials and representatives. The UK opposed the proposed increase in remuneration.

A.5 Decision 58-3 was the Board of Governors' certification that the audited accounts, financial statements and administrative and capital budgets fulfil the requirements of the Articles of agreement and by laws (see below for further details).

A.6 Five elements of the IMF's Rules and Regulations were amended in 2003. These were of minor significance and related primarily to the timing of, and notification for, IMF transactions in members' currencies following the approval of stand-by or extended arrangement by the IMF's Executive Board.

Decisions by Executive Directors

A.7 Normally, decisions by Executive Directors are taken on the basis of consensus, without recourse to formal voting by the whole Board. This report sets out the key policy, surveillance and programme discussions held by the Board in 2003.

A.8 This annex sets out further details of the key features that the UK expects the IMF to cover in individual surveillance, and programme consistency in its approach to individual Board discussions.

Surveillance A.9 In our interventions during individual countries' Article IV discussions, the UK emphasises the importance of vulnerability indicators and early warning systems. There are several elements to this:

- ⌘ Fiscal Policy Frameworks - the Article IV'S should demonstrate debt sustainability, with sufficient flexibility to respond to temporary shocks. Specifically, interventions on this point focus on the sustainability of deficit financing domestic resource mobilisation; and aid dependency. Linked to this is an appropriate balance between fiscal and monetary measures for maintaining stability, given real interest rates, the tax base and expenditure pressures;
- ⌘ Vulnerabilities - the Article IV should identify vulnerabilities in the financial sector. We would consider whether the country has undertaken a ROSC, or an FSAP, and if not, whether it would be a suitable candidate; and
- ⌘ Exchange Rate Regime - Article IV should consider the adequacy and sustainability of member countries' exchange rate regimes.

A.10 In addition, UK interventions also assess factors relating to economic governance; transparency and accountability; resource allocation; the quality of statistics, and for many programme countries, the consistency of the conditionality agreed in the Fund programme. In the particular case of HIPC countries, UK interventions would also be based on an assessment of public expenditure management systems, the extent to which pro-poor resource allocation is demonstrated and the availability of data and statistics. In developed country surveillance discussions, we also support IMF work on monitoring trade policies and progress towards the 0.7 per cent ODA/GNI ratio.

A.11 There are also a number of other factors which influence UK interventions at the Board on all Article IV's, including whether the country has been identified by the Financial Action Task Force as a non-cooperative jurisdiction on money laundering, by the Financial Stability Forum as a poorly regulated offshore financial centre, or by the OECD for its harmful tax regime.

Box I.1 Executive Board Surveillance Discussions

During 2003 the Executive Board held Article IV discussions on the following countries:

Albania; Algeria; Angola; Antigua and Barbuda; Argentina; Aruba; Australia; Azerbaijan; Bahamas; Barbados; Belarus; Belgium; Bhutan; Brazil; Brunei Darussalam; Burkina Faso; Canada; Chile; China; Colombia; Comoros; Congo, Democratic Republic of; Congo, Republic of; Costa Rica; Cyprus; Czech Republic; Democratic Republic of Timor-Leste; Ecuador; El Salvador; Equatorial Guinea; Eritrea; Estonia; Finland; France; Georgia; Germany; Ghana; Greece; Grenada; Guinea; Guinea-Bissau; Haiti; Honduras; Hungary; Iceland; India; Iran; Ireland; Israel; Jamaica; Japan; Jordan; Kazakhstan; Kenya; Kiribati; Korea; Latvia; Lebanon; Lesotho; Liberia; Libya; Lithuania; Macedonia, FYR; Maldives; Mali; Malta; Mauritania; Mauritius; Mexico; Micronesia, Federated States of; Morocco; Mozambique; Namibia; Nepal; Netherlands; Netherlands Antilles; New Zealand; Nicaragua; Norway; Oman; Papua New Guinea; Peoples Republic of China - Hong Kong SAR; Poland; Portugal; Romania; Russian Federation; St Kitts and Nevis; St Lucia; St Vincent and the Grenadines; Samoa; São Tomé and Príncipe; Saudi Arabia; Senegal; Slovak Republic; Slovenia; Solomon Islands; South Africa; Spain; Sudan; Suriname; Sweden; Switzerland; Syrian Arab Republic; Thailand; Tonga; Trinidad and Tobago; Tunisia; Turkmenistan; Uganda; Ukraine; United Arab Emirates; United Kingdom; United States; Uruguay; Uzbekistan; Vietnam; Zimbabwe.

The Board also conducted a number of multilateral surveillance discussions, including World Economic Outlooks, Global Financial Stability Reports, and other regional discussions, including Euro-Area Monetary and Exchange Rate policies.

In these discussions, the UK's interventions were based on the themes and principles set out in the paragraphs above. The Article IV Reports for the majority of these consultations are available at www.imf.org.

Regular lending programmes

A.12 In the discussions on regular lending programmes (Stand-By Arrangements and Extended Fund Facilities), the UK assesses programme design on a case-by-case basis, against factors related to the need to promote not only macroeconomic stability, but also sustainable economic growth and poverty reduction. For example, the UK seeks to ensure that assessments of monetary and fiscal policy and financial sectors within the programme are sound, that the programme is sustainable and that there are clear and appropriate assumptions regarding private sector involvement in the programme country. Further information on the UK approach to these issues is highlighted throughout this report.

Discussions of PRGF programmes

A.13 In the specific cases involving IMF lending to poor countries under the PRGF, the Government prepares a view of country progress, based partly on in-country analysis by development experts from the Department for International Development. The Government is also monitoring progress on the "key features" that PRGF programmes are expected to meet in pro-poor countries (see Chapter 4), for example through reporting on pro-poor budgets or Poverty and Social Impact Assessments (PSIA).

A.14 PRGF arrangements are typically 3 years in length, with programmes agreed annually and biannual reviews of progress. During discussions of PRGF countries, the UK interventions have focussed on questions related to programme design, including:

- ⌘ does the programme support the country-led PRSP, does the programme adequately reflect the needs of the country, and are required reforms well sequenced and realistic?
- ⌘ how does the PRGF measure up against its objectives? In particular the UK encouraged use of PSIA and focused on improving public expenditure management and fiscal flexibility
- ⌘ performance - have targets been met, if not are, waivers justified, and is commitment to ongoing reform and poverty reduction sufficient?

Budget and Administrative Issues

A.15 There have also been a number of discussions covering the IMF's operational budget and various administrative and management issues.

A.16 In discussions on staff compensation and benefits, the UK takes a rigorous approach, stressing the public service nature of the IMF and the need to consider the financial and budgetary constraints within which member Governments are required to operate. Reflecting this position, in March 2003 the UK registered an abstention in the discussions of the proposed increase.

A.17 In discussions on the IMF's general administrative budget, we have consistently supported the efficient use of resources, stressing the need to prioritise activities when faced with new demands. The UK has tended to be sceptical of generalised proposals for increases in resources, but the UK has accepted proposals where needs are more pressing and clearly identified, for example, in financing the African Regional Assistance Centres (AFRITACS, see Chapter 4). Reflecting this, in April 2003 the UK approved the IMF's overall administrative and capital budgets, while registering concerns regarding the need for a hard budget constraint and for rigour in assessing the need for capital expenditures.

B

THE UK'S FINANCIAL RELATIONSHIP WITH THE IMF

B.1 There is no annual subscription for IMF membership. Rather, there are two elements that define the UK's financial relationship with the IMF, namely, the UK's

€# quota; and

€# historic SDR allocation from the IMF.

Both of these have implications for the UK reserves.

Quotas

B.2 The primary source of the IMF's financing is through members' quotas. Each member of the IMF is assigned a quota, which is denominated in Special Drawing Rights (SDRs), the IMF's unit of account. Quotas broadly reflect the member's relative size in the global economy and are assigned to each member on the basis of macro-economic variables including GDP, balance of payments, and the official reserves. It also establishes the member's financial and organisational relationship with the IMF in respect of its financial commitments, voting power and access to IMF financing. The UK's quota as at 31 March 2003, was SDR 10,739 million about £9.2 billion.

B.3 All members of the IMF are required to pay a minimum proportion of their quota (up to 25 per cent) in 'reserve assets' (SDR's or specified, freely usable currencies such as the dollar, pound, euro or yen). The remaining balance is payable in the member countries' own currency, (in the UK's case, sterling) or in the form of non-interest bearing promissory notes.

B.4 When the IMF lends to a country, it provides them with reserve assets. Therefore, in the first instance, the borrowing country can call back the proportion of its quota originally paid in reserve assets from the IMF. However, the borrowing country can also request additional funds. The IMF finances these additional amounts by using the reserve asset subscriptions of other member countries, such as the UK.

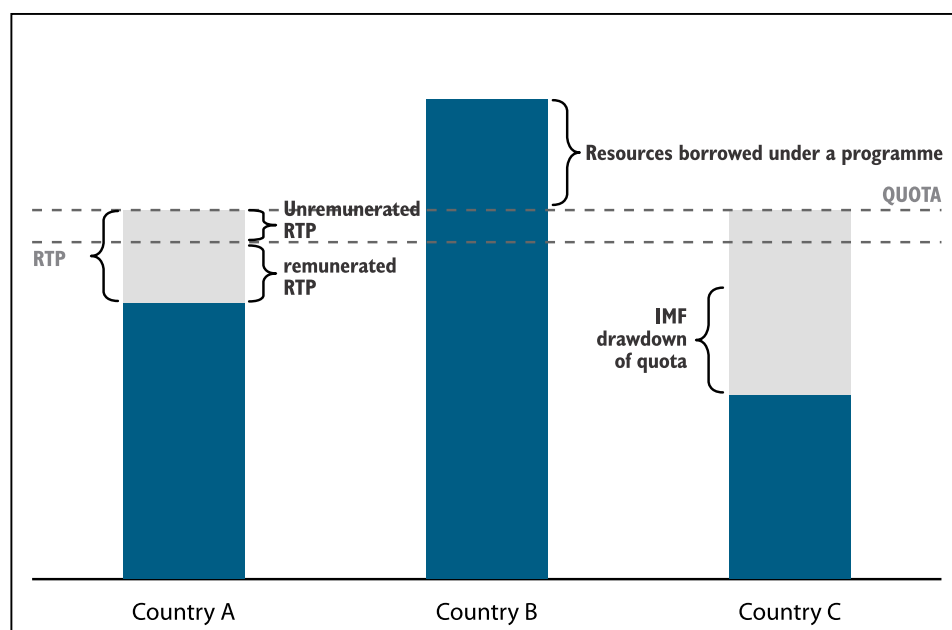
B.5 Such transactions result in a range of situations. On one hand, some borrowing countries have called back their reserve assets from the IMF and requested additional resources. Conversely, some creditor countries have provided more than the minimum proportion of their quota in reserve assets, which is currently the UK's position.

B.6 The amount by which the UK's quota exceeds the Fund's holding of sterling provided is referred to as the Reserve Tranche Position (RTP). This consists of the proportion of the UK's quota, originally paid in reserve assets, plus the part of our quota that the IMF has drawn upon. In the UK, the RTP forms part of the official reserves. As a result, when the IMF draws on the UK quota, our RTP rises, up to a maximum of 100 per cent of quota.

B.7 The UK policy of neutralising changes in the level of the RTP on the official reserves continued during 2002-03. Other things being equal, lending by the IMF in sterling, or an increase in the quota, would lead to a rise in the UK's SDR assets and therefore in the official reserves. To offset this increase in the reserves during 2002-03, the EEA¹ sold other foreign currency assets. Conversely, when countries repay loans to the IMF in sterling and so reducing the UK's RTP, other things being equal, the official reserves would fall. Buying foreign currency with the sterling repayment offsets these trades.

B.8 The UK's RTP as at 31 March 2003 was £3,928 million, approximately 42 per cent of quota, which is funded by the National Loans Fund (NLF). The NLF's accounts are audited by the National Audit Office (NAO) and laid before Parliament annually.

Chart II.1 Illustration of Financial Positions in the IMF



Country A - Member has paid its quota subscription in full and not drawn on its reserve tranche. Some of this reserve tranche is remunerated at the SDR rate and the remainder is unremunerated.

Country B - The member is using IMF resources, in addition to having drawn its reserve tranche. The level of holdings in excess of the member's quota is subject to charges.

Country C - The IMF has made use of the member's currency and pays the member remuneration on its enlarged Reserve Tranche Position, which is the UK's current position in respect of the IMF.

¹ The Exchange Equalisation Account (EEA) is the account that holds the UK's official reserves of foreign exchange, gold and IMF Special Drawing Rights (SDRs). The accounts are audited annually and can be viewed on the HM Treasury website at www.hm-treasury.gov.uk

The Opportunity Cost of the RTP

B.9 A member country can call back its reserves assets (up to the value of its RTP) from the IMF in event of a balance of payments need. With regard to the UK's RTP, this forms part of the national reserves, and as such, any increases in its size are not regarded as increases in public expenditure. SDR's are, however, less liquid than conventional reserves assets (such as dollars, euros, yen) and in some instances can earn a lower rate of return. There is therefore an opportunity cost to membership of the IMF.

B.10 The IMF remunerates most of our RTP at slightly below the level of the SDR interest rate². However, SDR 701 million is unremunerated, reflecting the element of the UK's quota that was made available to the IMF before 1st April 1978 in gold. The UK does not receive interest on this portion.

B.11 For the RTP, the interest cost and capital loss in 2002-03 was £82 million and £40 million respectively. The large interest cost was partly because of the difference between the sterling interest rates used for the liability to the NLF against the SDR rate. In part, it was also because of the unremunerated element of the quota, which would have received £13 million if remunerated³. The net cost for the quota was £122 million.

SDR allocation

B.12 In addition to the quota, the UK has received one-off SDR allocations totalling SDR 1.9 billion, around £1.6 billion from the IMF. The UK pays the IMF interest on this allocation at the SDR rate. At the same time, the Fund remunerates any UK SDR holdings at the SDR rate. Therefore, if the UK held its full allocation in SDRs, the interest paid on this allocation would cancel out the interest received, resulting in a net interest cost of zero.

B.13 However, members have the option to sell part of their SDR allocation and to hold alternative reserve assets instead. The UK has tended to sell SDR's and invest the proceeds in dollars, euros and yen assets for portfolio management reasons. In FY 2002-03, the UK held, on average, £0.2 billion in SDRs and £1.4 billion in foreign currency. As a result, the UK paid interest to the IMF on its full allocation and received interest from the IMF on the holdings of £0.2 billion. The UK also received interest on the £1.4 billion in foreign exchange holdings at the foreign exchange interest rate. If this interest rate is lower than the SDR rate, then there is a net loss on the allocation. This was the case in 2002-03 for the UK when there was a net loss of £4 million. Capital gain on the allocation totalled £32 million for the year, giving a total net gain of £28 million.

Net financial cost of IMF membership

B.14 The estimated net financial cost to the UK of membership to the IMF is therefore driven by movements in the sterling, SDR and foreign interest rate differentials and largely by currency fluctuations (dollar, euro, yen and SDR versus the pound). This analysis does not, however, include the non-financial benefits of IMF membership, such as enhanced voting powers and bigger access to IMF financing.

² The rate of remuneration, which is equivalent to the SDR interest rate, is adjusted downwards for the financial consequences of protracted arrears under the burden sharing mechanism. These adjustments are determined after the end of each financial quarter (July 31, October 31, January 31 and April 30).

³ If the unremunerated RTP were invested in 'conventional reserves', the return would have been £11 million.

B.15 For 2002-03, the portfolio of reserves associated with the IMF membership cost the UK approximately £94 million. However, had the UK not been a member of the IMF and instead held a portfolio of conventional reserves, the net cost would have been approximately £61⁴ million. This figure is calculated by assuming that the amounts of the RTP and allocation are funded in sterling from the NLF and invested in reserve assets. The difference between the UK membership of the IMF and holding conventional reserves was approximately £33 million for 2002-03.

The table below shows the net cost of membership for the last three years.

Table II.1: A summary of the cost of UK membership

Financial Year	Gain/loss from membership (£m)	Gain/loss from non-membership (£m)	Net cost of membership (£m) ⁵
2002-03	-94.27	-61.31	-32.96
2001-02 ⁶	-119.99	-175.94	55.95
2000-01	67.48	133.06	-65.58

⁴ This assumes conventional reserves comprise a 40:40:20 split between the dollar, euro and yen.

⁵ This figure is arrived at by comparing the income/expenditure of the UK's current reserves composition with a scenario where the UK was no longer a member of the IMF, but maintained current level of reserves.

⁶ Figures for 2001-02 have been revised.

C

MEASURING IMF LIQUIDITY

C.1 The one year Forward Commitment Capacity (FCC) was established as the measure of liquidity in the Fund in 2002. This measure is intended to provide a clearer indication of the resources available to the IMF for new lending operations and has replaced the traditional liquidity ratio as the primary measure of Fund liquidity.

C.2 The FCC is calculated by taking the IMF's stock of total resources (Members' quotas, gold and "other assets" - including buildings and receivables) less non-usable resources (including the currencies of countries in a weak external position, the "other assets" and gold holdings and, predominantly, credit outstanding) to give usable resources. Usable resources less undrawn balances under current lending arrangements (lending that has already been agreed, but not disbursed) gives the level of uncommitted usable resources. Projected repayments (or repurchases) by borrowing countries are then added. Finally, the prudential balance is subtracted.

C.3 The prudential balance represents a level of resources that the IMF would not normally draw on to finance lending operations. It is set at 20 per cent of the quotas of member countries whose currencies are currently used in IMF lending, and any amounts activated under borrowing arrangements. The prudential balance is determined by judgement and does not constitute a rigid minimum. The IMF's uncommitted resources could, on a strictly temporary basis, fall below this level. Full details of the IMF's liquidity can be found on the Fund's website www.imf.org.

	Billion SDRs (at end 2003)
IMF's Stock of Total Resources	219.1
<i>Less non-usable Resources</i>	118.4
<i>Equals Usable Resources</i>	100.7
<i>Less undrawn balances under current lending arrangements</i>	22.8
<i>Equals Uncommitted Usable Resources</i>	77.9
<i>Plus Repurchases one year forward</i>	9.2
<i>Less Prudential Balance</i>	32.8
<i>Equals one year Forward Commitment Capacity</i>	54.2

The GAB and the NAB

C.4 In addition to quota arrangements, a number of member countries have offered to lend the IMF supplementary funds in the event of impairment to the international monetary system, or an exceptional situation that threatens the system's stability.

C.5 The first such source of supplementary financing - **the General Arrangements to Borrow (GAB)** - was established in 1962. Under the GAB, 11 major industrial countries have undertaken to make loans to the IMF of up to SDR 17 billion, with an additional SDR 1.5 billion available under an associated arrangement with Saudi Arabia. The 11 participants are the US, the Deutsche Bundesbank, Japan, France, UK, Italy, Swiss National Bank, Canada, Netherlands, Belgium, and the Swedish National Bank. The UK's credit amount under the GAB is SDR 1.7 billion (about \$2.4 billion).

C.6 The GAB was last activated in July 1998 for SDR 6.3 billion (SDR 1.4 billion of which was drawn) in connection with the financing of an extended arrangement for Russia. Following the increase in quotas under the Eleventh General Review and the improvement in the IMF's liquidity position, the IMF repaid the outstanding borrowing in March 1999.

C.7 The second source of supplementary financing - **the New Arrangements to Borrow (NAB)** - was established in 1998. Under the NAB, 26 countries have undertaken to make loans to the IMF of up to SDR 34 billion. The current participants are all the members of the GAB plus Australia, Hong Kong Monetary Authority, Korea, Thailand, Kuwait, Malaysia, Saudi Arabia, Austria, Singapore, Spain, Denmark, Finland, Luxembourg and Norway and the newest member, Chile, which joined in February 2003. The UK's credit amount under the NAB is SDR 2.6 billion (\$3.5 billion).

C.8 The NAB does not replace the GAB, which remains in force. However, the NAB is the first port of call if the IMF needs additional financing. Total borrowing under both the NAB and GAB cannot exceed SDR 34 billion and the UK's maximum exposure under both arrangements is the NAB amount of SDR 2.6 billion.

C.9 Both the GAB and NAB must be renewed at 5 year intervals, with decisions on renewal taken one year prior to expiry. The NAB was renewed for a period of 5 years beginning from 17 November 2003.

Gold C.10 The IMF is one of the largest official holders of gold in the world. Valued at market prices, its holdings of gold amount to \$38.4 billion. However, the IMF's Articles of Agreement apply strict limitations to the use of this gold. For example, it cannot be used to finance new lending.

D

IMF LENDING FACILITIES

Regular Lending Facilities

D.1 Stand-By Arrangements (SBA). SBAs form the core of the IMF's lending policies and are designed to deal mainly with short-term balance of payments problems, of a largely cyclical nature. Under an SBA, the member carries out a programme, which it has designed in consultation with the IMF, focussing on key macroeconomic policy measures. To receive financing, the member must meet performance criteria marking its successful implementation of the programme. The access limit is 100% of quota annually, and 300% cumulatively, although the Fund may grant access beyond these limits in exceptional circumstances. The country is expected to repay the money it has borrowed over 2-4 years (with a period of 3-5 years for obligatory repayment).

D.2 Extended Fund Facility (EFF). Longer-term assistance to address balance of payments difficulties that stem largely from structural problems and take longer to correct, is provided under an EFF. A member requesting an EFF outlines its goals and policies for the period of the arrangement (usually three years, but can be extended to a fourth), and provides a detailed, annual statement of the policies and measures it will implement over the next 12 months. The expected repayment period is 4-7 years (with a period of 4-10 years for obligatory repayment).

SPECIAL LENDING FACILITY¹

D.3 Supplemental Reserve Facility (SRF). The SRF was established in December 1997 in response to the unprecedented demand for IMF assistance, resulting from the Asian Crisis. It is intended to provide additional short-term financing to member countries experiencing exceptional balance of payments difficulty, because of a sudden and disruptive loss of market confidence, reflected in capital outflows. Financing under the SRF is disbursed over one year, in the form of additional resources under a Stand-By or an Extended Arrangement. The expected repayment period is 12-18 months. The Board can extend this by one year, but an interest surcharge is levied to encourage early repayment.

Concessional Lending Facility

D.4 Poverty Reduction and Growth Facility (PRGF). The PRGF is a low-interest facility to help the poorest member countries facing protracted balance of payments problems. A Poverty Reduction Strategy Paper produced by the borrowing country in cooperation with the IMF and the World Bank, describes the authorities' goals, macroeconomic and structural policies for the three-year programme. This provides the framework for Bank and Fund concessional lending.

¹ Until the end of November 2003 a second special lending facility, the Contingent Credit Line (CCL), was available. This was a Fund facility to provide finance for countries with good policies, should they face the threat of crisis due to contagion. This expired under its 'sunset' clause at the end of November, after the Executive Board did not agree to its extension. Further explanation of the UK policy on the CCL is available in Chapter 3

Other Lending Facilities

Emergency Assistance. Countries facing immediate balance of payments needs in the face of natural disasters, or needing to restore macroeconomic stability in post-conflict situations, can apply for Emergency Assistance from the Fund. This must be repaid within 3 1/4 and 5 years and is subject only to the basic rate of charge.

Compensatory Finance Facility (CFF). Members facing temporary difficulties, due to a shortfall in exports or higher cereal import costs, may seek support from the CFF. Purchases are generally part of another programme (SBA, EFF or PRGF) unless the balance of payments situation is otherwise satisfactory. Repayments must be completed within 3 1/4 to 5 years and are expected with 2 1/4 to 4 years. The CFF is subject to the basic rate of charge. A review of this facility will be carried out in 2004.

Summary of recommendations and follow up

E.1 The IEO completed three reports in 2003 on the Prolonged Use of Fund Resources; 'The Role of the IMF in Capital Account Crises: Korea, Indonesia and Brazil'; and 'Fiscal Adjustment in IMF Supported Programmes'. The work of the IEO is discussed in Chapter 2. Lessons on surveillance more generally are dealt with in closer detail in chapter 3. A summary of the key findings of the last three reports and the response of the Fund follows.

E.2 Prolonged use of Fund Resources: The report found 3 sets of factors leading to prolonged use of Fund resources by member countries;

- €# Country-specific factors: applicants for fund support tend to have long term problems, making them likely to request Fund assistance on a recurring basis;
- €# Institutional issues: including unforeseen implications of the expanded IMF mandate, the role of programmes as a "seal of approval" and weakened surveillance in programme environment;
- €# Programme related: including over-optimistic forecasting, badly prioritised and designed conditionality and a lack of appreciation of country ownership and capacity issues.

E.3 The report concluded that prolonged use was often negative for users and for the IMF. It made a series of recommendations including:

- €# That the fund should adopt an explicit definition of prolonged use, should exhibit greater willingness to refrain from lending when programmes have low chance of success and should outline "exit strategies" for prolonged user cases;
- €# There should be a reduction in the "Seal of approval" role of programmes by using other tools, including strengthened surveillance;
- €# The IMF should establish greater country ownership, with policy programmes originating from country authorities;
- €# Programmes should be more selective without excessive conditions attached;
- €# Surveillance should be strengthened and more systematic ex-post assessments in prolonged user cases should be introduced;
- €# There should be greater transparency between technical and political judgements.

E.4 The UK welcomed these recommendations, which include references supporting our objectives on transparency and greater independence for IMF surveillance. This report had been discussed at the 2002 Annual meetings and the IMFC supported the establishment of a task force to look at the implementation of the recommendations. The task force reported ahead of the 2003 Spring meetings. This report did not include many new recommendations, partly because these recommendations are being picked up elsewhere, including in workstreams on surveillance. However, the UK believes, the Fund should present as comprehensive as that possible response to all work of the IEO. Progress has continued from the Fund over the year, including the introduction, automatic ex post assessments in prolonged user cases.

E.5 Capital Account Crises: The report examined the role of the IMF in three crises: Indonesia (1997-98), Korea (1997-98) and Brazil (1998-99). Its main findings included that:

- ⌘ The Fund had weaker surveillance of financial sector weaknesses and a lack of transparency that hampered effect of surveillance on policy;
- ⌘ Macroeconomic outcomes were far from projections;
- ⌘ Fiscal tightening was inappropriate in Indonesia and Korea (although dropped) and failed in Brazil;
- ⌘ Bank restructuring requires comprehensive well-communicated strategy with consistently applied rules;
- ⌘ Indonesia and Korea were subject to heavy conditionality, much of which unnecessary for crisis resolution;
- ⌘ Confidence restoring programmes must communicate a logical strategy to the public and markets; and
- ⌘ Close contacts at multiple layers subjected staff to micromanagement and political pressure.

E.6 The report therefore made the following recommendations to enhance work already underway in response to the IMF's experiences in these crises:

- ⌘ Article IV consultation should take a "stress testing" approach to analysing exposure to capital account crises;
- ⌘ Surveillance should be more candid and accessible to the public to increase its impact;
- ⌘ There should be a comprehensive review of programme design in capital account crises;
- ⌘ Financial package should be sufficient and credible to generate confidence;
- ⌘ The IMF should be proactive in its role as crisis coordinator; and
- ⌘ Country expertise and "centres of expertise" on crises should be promoted within the staff.

E.7 The UK welcomed the report, as it underscores the importance of crisis prevention, and emphasises the recommendations on surveillance and transparency; the UK also highlighted the point that crises should not be used to impose conditionality in other areas. The Fund has now acknowledged the "fresh perspective" agenda and has emphasised its work on financial markets, including FSAPs, greater financial elements in Article IV consultations in non-FSAP countries and the development of Financial Soundness Indicators. (See section on surveillance in Chapter 3).

Fiscal Adjustment in IMF-Supported Programmes: The report found that:

- ⌘ There is not a "one size fits all" approach in fiscal targets;
- ⌘ There may be a contractionary bias in some circumstances;
- ⌘ Documents often do not explain the rationale for the pace and magnitude of the fiscal adjustment;
- ⌘ Internal review does not contribute as much as it could at initial stages;
- ⌘ Fiscal consolidation does not extend beyond year 1 and reform progress unsatisfactory. Article IV is not flagging inaction; and
- ⌘ There is no evidence that IMF programmes are reducing social spending, but maintenance of social spend may be insufficient to protect vulnerable countries in crisis situations.

E.8 On this basis the report made the following recommendations:

- ⌘ Documentation should give clear justification for pace and magnitude of adjustment and its link to growth projections;
- ⌘ Internal review should place more emphasis on early stages; there should be intensive brainstorming for the initial brief;
- ⌘ Formulation and implementation of structural reforms should get more emphasis in programmes;
- ⌘ Surveillance should be used to provide a longer term road map for fiscal reforms and to assess progress (in non PRGF countries); and
- ⌘ IMF should assist middle-income countries in budgetary mechanisms to protect the most vulnerable.

E.9 Fund staff largely accepted these recommendations. The UK supported all the recommendations made, giving particular emphasis to points on greater justification and transparency for decisions, greater use of more candid surveillance and the need to protect the vulnerable. It was acknowledged that the report does not explicitly consider the impact of adjustment on poverty, which could be taken up in evaluation of the PRSP approach and PRGF.

ARTICLES OF AGREEMENT OF THE IMF, ARTICLE 1 - PURPOSES

F.1 The purposes of the International Monetary Fund are:

- (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members, as primary objectives of economic policy.
- (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation;
- (iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members, and in the elimination of foreign exchange restrictions which hamper the growth of world trade;
- (v) To give confidence to members, by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with, opportunity to correct maladjustments in their balance of payments, without resorting to measures destructive of national or international prosperity; and
- (vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.

COMMUNIQUÉ OF THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE OF THE BOARD OF GOVERNORS OF THE IMF - 12 APRIL 2003

G.1 The International Monetary and Financial Committee held its seventh meeting in Washington, D.C. on April 12, 2003, under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

Global Economic Outlook

G.2 Meeting at a time of economic uncertainty, the Committee reaffirms its commitment to close international cooperation to strengthen confidence and support the global recovery. It underscores the importance of continued vigilance. But with readiness to adjust policies as necessary and determined further action on the structural front, the world economy has the prospect of strengthening growth and renewed prosperity. Substantial and concrete progress with multilateral trade liberalization is a key priority for the coming months and has the full political commitment of Ministers.

G.3 In the advanced economies, sound fundamentals and policies should deliver stronger growth in the second half of the year. With inflationary pressures well contained, monetary policies should remain accommodative, and in many countries there is room to ease monetary policy further if needed. On the fiscal side, the automatic stabilizers should be generally allowed to operate, though in many countries action is needed to address medium-term fiscal pressures, including those arising from ageing populations. The advanced economies have a shared responsibility to go further in implementing structural reforms, to enhance prospects for a sustained broad-based world recovery that helps correct global imbalances. In the United States, policies consistent with a sound medium-term fiscal position remain important. In Europe, labour and product market reforms need to be accelerated. In Japan, further steps are needed to strengthen the banking and corporate sectors and end deflation, accompanied by a start toward strengthening the medium-term fiscal position.

G.4 Emerging market countries will need to continue to strengthen their policies for macroeconomic stability and structural reforms and therefore their resilience to adverse global developments. In countries facing external financing constraints, efforts to sustain macroeconomic stability will continue to be key to restoring confidence. For all countries, the continued implementation of reforms to strengthen banking and corporate sectors and underpin growth, remains a priority. The IMF has a key role to play in supporting these efforts.

G.5 Prospects for stronger growth in low-income countries should be supported by improved economic policies, stronger institutions, progress in resolving regional conflicts, and increased donor resources, including through debt relief under the HIPC Initiative. Sustained implementation of sound policies, supported by strong ownership and the Monterrey Consensus, will remain key to reducing poverty and meeting the Millennium Development Goals (MDGs). African countries need to continue to press ahead with the wide-ranging reforms embedded in the New Partnership for Africa's Development (NEPAD) - in particular to improve the quality of their institutions and ensure peace and security. The Committee reiterates the importance of technical assistance, including the contribution of AFRITACs and other regional technical assistance centres. It calls on the international community to urgently mobilise additional assistance to address the serious food shortage in Africa.

G.6 The Committee notes that the present situation in Iraq poses significant challenges, with an urgent need to restore security, relieve human suffering and promote economic growth and poverty reduction. We support a further UN Security Council resolution. We further note that engagement by the international community, including the Bretton Woods institutions would be essential for sustained economic, social, and political development in Iraq, recognising that the Iraqi people have the responsibility to implement the right policies and build their own future. The IMF and the World Bank stand ready to play their normal role in Iraq's re-development at the appropriate time. They will also monitor closely the impact of the conflict on all their members and stand ready to help and support those adversely affected. It is important to address the debt issue, and we look forward to early engagement of the Paris Club.

G.7 The Committee - having greatly benefited from the views of Dr. Supachai Panitchpakdi, Director-General of the World Trade Organisation - underscores the urgency of concrete progress toward multilateral trade liberalisation under the Doha Round, through the continued commitment of the international community. This will be critical in supporting higher economic growth and poverty reduction, and enabling developing countries to participate more fully in the benefits of globalisation. The Committee accordingly calls on industrial, emerging, and developing countries to play their part in renewed efforts to address obstacles to further progress in advance of the ministerial meeting of the World Trade Organisation in Cancún next September. Urgent progress is needed in a number of areas, including agriculture, where better market access and lower trade distorting subsidies are particularly important for developing countries. The IMF, in collaboration with other international institutions, stands ready to support members' closer regional cooperation in the context of deeper integration into world markets.

Strengthening Crisis Prevention

G.8 The Committee reiterates the importance it attaches to strengthening the IMF's crisis prevention capacity and welcomes the steps in many countries to improve economic resilience and financial stability. However, there is still room for further improvement. Going forward, sustained implementation of a strengthened framework of bilateral, regional, and multilateral surveillance will be essential to provide more robust assessments of crisis vulnerabilities, debt sustainability, currency mismatches and other balance sheet and capital account developments, as well as further progress in strengthening data provision to the IMF and data dissemination to the public.

G.9 The Committee welcomes progress with the standards and codes process and the Financial Sector Assessment Programme (FSAP) and the role these play in enhancing IMF surveillance. It calls on the IMF to continue to move forward with these initiatives to strengthen members' institutions, policy frameworks, and financial sectors, including through technical assistance. It stresses the importance of further enhancing the quality and effectiveness of standards and codes assessments, and calls on the IMF to implement quickly agreed measures to strengthen prioritisation, technical assistance, and follow up of FSAP and ROSC assessments. In this context, the Committee looks forward to the further work of the Financial Stability Forum and standard-setting bodies on strengthening the content and coverage of standards in accounting, auditing, and corporate governance, and on improving transparency and financial disclosure.

G.10 The Committee supports the IMF's continued efforts to make surveillance more comprehensive and accountable, including through strengthening the IMF's policy advice on reducing vulnerabilities; greater attention to the spillovers from policies in countries of systemic or regional importance; more effective use of the IMF's cross-country experience; enhanced awareness of political economy factors; and bringing to bear a fresh perspective in surveillance of programme countries. The Committee looks forward to the IMF's further work on surveillance and other crisis prevention issues and a report on progress for this year's Annual Meetings.

G.11 The Committee welcomes the increase in voluntary publication of country staff reports, but notes that the rate of publication across countries and regions remains uneven. It looks forward to further progress through the forthcoming review of the IMF's transparency policy, and stresses that the candour of the IMF's analysis and advice should be preserved.

G.12 The Committee emphasises support for ways to achieve the objectives of the Contingent Credit Lines (CCL) in encouraging policies to reduce vulnerabilities and providing a means of support for members with strong policies in dealing with global financial developments. It looks forward to a report on how best to promote these objectives, following the conclusion of the review of the facility.

Improving the Capacity to Resolve Financial Crises

G.13 Effective crisis resolution mechanisms, by promoting sound policies and better functioning capital markets, contribute to crisis prevention. The Committee welcomes the strengthened framework on access to IMF resources. This includes: the substantive criteria for exceptional access in capital account crises; and strengthened procedures, such as early involvement of the Executive Board in the process, and a separate report evaluating the case for exceptional access. Consistent implementation of the framework will provide members and markets with clarity and predictability about IMF decisions in crises.

G.14 The Committee welcomes the inclusion of collective action clauses (CACs) by several countries, most recently Mexico, in international sovereign bond issues. It also welcomes the announcement that, by June of this year, those EU countries issuing bonds under foreign jurisdictions will include CACs. The Committee welcomes the work of the G10, emerging markets, and the private sector in contributing to the development of CACs. It looks forward to the inclusion of CACs in international bond issues becoming standard market practice, and calls on the IMF to promote the voluntary inclusion of CACs in the context of its surveillance. The Committee welcomes recent initiatives to formulate a voluntary code of conduct for debtors and their creditors, which will improve the restructuring process, and encourages the IMF to contribute to this work.

G.15 The Committee welcomes the work of the IMF in developing a concrete proposal for a statutory sovereign debt restructuring mechanism (SDRM) and expresses its appreciation for the IMF management and staff's efforts. The extensive analysis and consultation undertaken in developing the proposal have served to promote better understanding of the issues to be addressed in bringing about orderly resolution of crises. The Managing Director's report sets out the current position. The Committee, while recognising that it is not feasible now to move forward to establish the SDRM, agrees that work should continue on issues raised in its development that are of general relevance to the orderly resolution of financial crises. These issues include inter-creditor equity considerations, enhancing transparency and disclosure, and aggregation issues. The IMF will report on progress at the Committee's next meeting.

Implementing Initiatives to Support Low-Income Countries

G.16 The Committee recognises the urgent need to address the challenge of meeting the Millennium Development Goals, and reiterates that the IMF continues to have an important role to play in assisting low-income countries' progress toward them. This will require enhanced efforts by developing and developed countries working in partnership. The Committee stresses the importance of sound macroeconomic policies and strong public expenditure and financial management systems. The Committee recognises the urgent need to enhance market access and to increase the level and effectiveness of donor resources for developing countries. Proposals to achieve this, including facilities, are being considered, and the Committee looks forward to progress in the coming months. Building on countries' poverty reduction strategy papers (PRSPs), the Committee encourages the IMF to work with low-income countries to strengthen further the alignment of the PRGF, domestic budgets, and the PRSP approach. This will be facilitated through more realistic economic projections, systematic analysis of the sources of growth, effective Bank-Fund collaboration, and flexibility in programme design, including to accommodate higher aid inflows. The Committee encourages donors to coordinate and harmonise their assistance in line with PRSP priorities, and to provide technical assistance to help members build the needed capacity to design and operationalise PRSP strategies and to improve public expenditure management. It endorses further work on the linkages between growth and poverty reduction, including the role of the private sector. The Committee also looks forward to the review of the role of the IMF in low-income countries over the medium term, and its paper on helping low-income countries to deal with shocks.

G.17 The Committee welcomes the further progress made in implementing the HIPC Initiative, but notes that some countries have experienced delays in reaching the completion point, and that other eligible countries are facing obstacles to participation in the Initiative. It looks forward to a review of these issues at its next meeting. The Committee reaffirms its commitment to the full financing of the Initiative. It urges all creditors to participate fully, and encourages further Bank-Fund efforts to help creditor and debtor countries address HIPC-to-HIPC debt relief and creditor litigation issues. It emphasises the need to ensure lasting debt sustainability, which will require both the full implementation and financing of the Initiative, and continued sound economic policies, good governance, and prudent debt management. In this context, the Committee welcomes the efforts by some countries to provide additional debt relief beyond HIPC terms. The Committee supports joint Bank-Fund work to improve its assessments of longer-term debt sustainability for heavily indebted poor countries, and looks forward to a progress report at the next meeting.

Other Issues

G.18 The Committee welcomes the further actions by members to combat money laundering and the financing of terrorism, and notes with satisfaction the progress with the 12-month pilot programme of AML/CFT assessments. It underscores the importance of continued close cooperation between the IMF, the World Bank, the FATF, and regional bodies to complete the pilot successfully, and of further enhancing the delivery of critically needed technical assistance. The Committee encourages all members to adopt AML/CFT laws and practices consistent with the agreed international standards, and looks forward to a full report at the conclusion of the pilot programme.

G.19 The Committee considers it important that, as pointed out in the Monterrey Consensus, all members should have an adequate voice and representation in the institution. It welcomes recent administrative steps to strengthen the capacity of the African constituencies. The Committee notes that the Twelfth General Review of Quotas has been concluded and that the IMF is well positioned to meet the projected needs of its members. The Committee looks forward to receiving a status report by the 2003 Annual Meetings on the adequacy of IMF resources, the distribution of quotas, and measures to strengthen IMF governance, consistent with the resolution of the Board of Governors, in the context of the Thirteenth General Review of Quotas. The Committee recommends completion of the ratification of the Fourth Amendment.

G.20 The Committee welcomes the thorough follow-up being given to the first report of the Independent Evaluation Office on prolonged use of IMF resources. It looks forward to future IEO reports as a way of enhancing the listening and learning culture within the IMF.

G.21 The Committee expresses its appreciation of the work of Eduardo Aninat as Deputy Managing Director.

G.22 The next meeting of the IMFC will be held in Dubai, on September 21, 2003.

COMMUNIQUÉ OF THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE OF THE BOARD OF GOVERNORS OF THE IMF - 12 SEPTEMBER 2003

H.1 The International Monetary and Financial Committee held its eighth meeting in Dubai on September 21, 2003, under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom. The Committee expresses its gratitude to the Dubai authorities and the government of the United Arab Emirates for the excellent arrangements.

The Global Economy and Financial Markets

H.2 The Committee welcomes the increasing signs that economic activity is strengthening in many economies, and the improved prospects for a steady and strengthening global recovery going forward. The major uncertainties have lessened since we met last April. Nevertheless, risks remain in many countries and it is important that policymakers stand ready to take the necessary policy actions. The Committee underscores the importance of close international cooperation and determined action across the membership to foster a strong, sustainable, and broad-based economic recovery.

H.3 The Committee emphasises that, as the recovery proceeds, all countries have an interest in seeing more balanced growth with orderly adjustment. Sustained and vigorous structural reforms in many areas, and domestic sources of growth, are important in this respect. The Committee agrees on the need for continued focus by the IMF on exchange rate issues across the membership.

H.4 The international community must urgently make progress on trade and development. Ministers reaffirm their full political commitment to a multilateral rules-based approach to trade liberalisation, and to making substantial and concrete progress. Ministers were disappointed at the breakdown of trade negotiations in Cancún. Ministers urge a speedy resumption of the Doha Round, which is vital for strong global growth and our development objectives. This should focus on the issues of importance to all countries of open markets and fair access and the reduction of trade-distorting subsidies in all areas, notably in agriculture. The Committee reiterates the crucial importance of removing the obstacles and moving forward without delay, and calls on all countries to play their part. It stresses the importance of the IMF's initiative to provide assistance to countries to help them address the transitional impact of trade reforms, which will contribute to the Doha Round.

H.5 In the advanced economies, monetary policy should continue to support demand in the context of low inflation, and the automatic fiscal stabilisers should be allowed to operate within credible medium-term frameworks to deliver fiscal consolidation. The vigorous pursuit of structural reforms, and enhanced corporate governance and transparency are key to stronger, globally balanced growth. In the United States, where the fiscal stance has substantially supported activity, fiscal policy will need to focus on strengthening sustainability over the medium term. In Europe, progress in structural reforms should be accelerated and deepened, both to strengthen work incentives, investment, and competition and to address the fiscal pressures of population ageing. In Japan, continued efforts will be necessary to strengthen the banking and corporate sectors and end deflation, and to make a beginning toward fiscal consolidation over the medium term.

H.6 The improved financial market environment provides a valuable window of opportunity for emerging market economies to continue to pursue ambitious institutional and structural reforms which, together with sound macroeconomic policies, will enhance growth prospects and reduce vulnerabilities. While many countries have strengthened policies, key priorities remain to improve fiscal positions, strengthen banking and corporate sectors, reduce balance sheet vulnerabilities, and foster more broadly-based growth. Growth in the Middle East and North Africa has picked up. However, the challenge facing the region will be to accelerate medium-term growth and absorb the rapidly growing labour force.

H.7 The Committee reaffirms its support for a multilateral effort to reconstruct and redevelop Iraq, and welcomes the constructive role being played by the IMF. It looks forward to the donors conference in Madrid next month, based on a comprehensive needs assessment involving the World Bank and the IMF. The Committee supports the IMF providing, subject to its policies, financial and other assistance to Iraq.

H.8 Growth prospects in many low-income countries have strengthened, underpinned by improved macroeconomic policies and domestic reforms. However, significantly faster growth will be needed to reduce poverty and meet the Millennium Development Goals (MDGs) set out in the UN Millennium Declaration. This requires stronger policy frameworks and institutions, better governance, higher and more effective aid flows, and improved market access. African countries should continue to press forward with the region-wide implementation of the New Partnership for Africa's Development (NEPAD), particularly to strengthen the foundations for investment and private sector-led growth.

Strengthening IMF Surveillance and Promoting International Financial Stability

H.9 Strengthened and effective IMF surveillance is essential to enhancing crisis prevention and promoting stability and sustainable global growth. The Committee welcomes the ongoing reforms to strengthen the framework for IMF surveillance, and underlines the importance of enhancing and implementing surveillance consistently and evenhandedly across the membership. The Committee also welcomes the increased focus of surveillance on capital markets, and encourages the IMF and the Financial Stability Forum working together to identify gaps and further strengthen assessments of systemic weaknesses in financial markets.

H.10 The Committee stresses the need for the IMF to continue to improve the quality, effectiveness, and persuasiveness of its surveillance. This will involve: sharpening surveillance, especially in systemically and regionally important countries; working to enhance the impact of IMF policy advice; and continuing efforts to bring fresh perspectives to assessments. The Committee looks forward to discussing progress in these areas, following the Executive Board's 2004 biennial review of surveillance.

H.11 The Committee emphasises that it is particularly important that surveillance focus on identifying potential problems early and provide candid advice on policy reforms. In this respect, Committee members identified a number of key issues for the coming year, including: progress on structural reform and on medium-term sustainable fiscal frameworks; reducing balance sheet vulnerabilities, including currency mismatches, and improving debt sustainability; and encouraging policy measures to reduce global imbalances.

H.12 The Committee underscores the importance of increased transparency and candour of the IMF's advice to members. It notes the Executive Board's recent agreement on a policy of voluntary, but presumed publication of IMF Article IV reports and programme documents, and the enhanced provisions for exceptional access.

H.13 The Committee emphasises its support for ways to achieve some of the objectives of the Contingent Credit Lines (CCL), intended to reduce vulnerabilities and provide precautionary support for members with strong policies in dealing with external financial developments. It looks forward to further work in this area.

H.14 The Committee welcomes the progress in strengthening the framework for crisis resolution, especially the inclusion by an increasing number of countries of collective action clauses (CACs) in their international sovereign bonds, and encourages their use on a voluntary basis by other countries. It also calls on the IMF to promote the voluntary inclusion of CACs. The Committee looks forward to the efforts led by sovereign debtors and private creditors to develop a voluntary Code of Conduct, and encourages the IMF to continue to contribute to this work. It looks forward to the ongoing work on issues of general relevance to the orderly resolution of financial crises, including transparency and disclosure, aggregation and inter-creditor equity. The Committee looks forward to a report on progress at its next meeting.

H.15 Accelerating Poverty Reduction and Strengthening Sustainable Economic Growth in Low-Income Countries

H.16 The Committee stresses that the IMF has an important role to play in helping low-income countries achieve high and sustained growth and poverty reduction, in close cooperation with the World Bank. It agrees that this support should be firmly aligned behind Poverty Reduction Strategy Papers and that the Fund should work in its core areas of competence alongside the Bank in support of the Millennium Development Goals. The IMF needs to remain engaged with low-income countries over the long term through well-targeted technical assistance, capacity-building, surveillance, and, when warranted, temporary financial assistance. The Committee looks forward to reviewing Bank-Fund collaboration in that area at its next meeting.

H.17 The Committee emphasises the importance of initiatives to enhance the IMF's support for low-income countries, including ensuring that macroeconomic policy frameworks support higher and sustained growth and poverty reduction; improving governance and strengthening institutions to support growth and private sector development; reducing vulnerability to shocks; and helping countries move beyond sustained reliance on IMF financial arrangements when ready. The Committee underscores the importance of technical assistance, and looks forward to work on adapting IMF instruments and reviewing PRGF financing. The Committee looks forward to a comprehensive review of progress at its next meeting.

H.18 The Committee emphasises the urgent need to enhance market access and to increase the level and effectiveness of donor resources for low-income countries. In order to help achieve the Millennium Development Goals, the Committee calls upon the IMF to cooperate with the World Bank in work on aid effectiveness, absorptive capacity, and results-based measurement mechanisms, and in examining the merits of various policy options and financing mechanisms, such as an international financing facility, to mobilise the substantial additional resources that are needed over the medium term. Developing and emerging market countries should also be closely involved. The Committee looks forward to a report by the next Annual Meetings.

H.19 The Committee notes the progress in providing debt relief to the world's poorest countries under the enhanced HIPC Initiative. It calls on the IMF, in collaboration with the World Bank, to develop strategies to help countries implement the necessary policies and reforms to reach decision and completion points as quickly as possible, and achieve a lasting exit from unsustainable debt. The Committee urges all creditors that have not yet done so to deliver debt relief in full and invites the IMF to report on the compliance of countries. It recognises the importance of providing topping-up as appropriate, and of the on-going discussions on the topping-up methodology and the financial implications.

Other issues

H.20 The Committee stresses that the IMF's effectiveness as a cooperative institution depends on all members having an appropriate voice and representation. The Committee welcomes the measures being taken to improve the capacity of developing and transition countries to participate more effectively in IMF policy formulation and decision-making. It welcomes the IMF Executive Board's progress report on quotas, representation and voice and asks the IMF to examine these issues further, and will review progress at its next meeting. The Committee recommends completion of the ratification of the Fourth Amendment.

H.21 The Committee welcomes the further actions taken by the international community to combat money laundering and the financing of terrorism, and the progress with the 12-month pilot programme of AML/CFT assessments. The Committee is encouraged by the continued close cooperation among the IMF, the World Bank, the FATF, and FATF-style regional bodies, and increased country involvement, and supports the enhanced delivery of critically needed technical assistance. The Committee encourages all members to adopt AML/CFT laws and practices consistent with the agreed international standards, and looks forward to a full report at the conclusion of the pilot programme.

H.22 The Committee welcomes the work of the Independent Evaluation Office, and its role in enhancing the learning culture, effectiveness, and accountability of the IMF. It emphasises the importance of the IMF taking forward the work on prolonged use, capital account crises, and fiscal adjustment, in the light of the IEO's recommendations.

H.23 The Committee expresses its appreciation of the work of Shigemitsu Sugisaki as Deputy Managing Director and Kenneth Rogoff as Economic Counsellor.

H.24 The next meeting of the IMFC will be held in Washington, D.C. on April 24, 2004.