

A Stronger Global Economy

THE UK AND THE
IMF 2004-05



HM TREASURY



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The UK and the IMF 2004-05

July 2005

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FOREWORD BY THE CHANCELLOR OF THE EXCHEQUER

2005 marks five years since the world's leaders made their historic pledge to deliver the Millennium Development Goals (MDGs) by 2015. This year the first of these goals, to achieve gender parity in education, is certain to be missed. On current levels of progress some of the targets will not be met in Sub-Saharan Africa for over 100 years. Although some poor countries have made improvements in recent years, creating sustained growth and reducing global poverty in the long term will require further action.

This year, the UK holds the presidencies of both the G8 and the EU. We are using this opportunity to drive forward a step-change in international development. At Gleneagles, the G8 confirmed commitments that the OECD DAC estimates would lead to an increase of around \$50 billion a year by 2010, compared to 2004 with \$25 billion a year by 2010 going to Africa, more than doubling aid to Africa compared to 2004. We are also furthering work on innovative financing mechanisms such as the International Finance Facility (IFF) to enable some countries to meet their commitments and for others to bring forward timetables for increased aid, as well as an IFF for immunisation to tackle preventable diseases.

The G8 has already agreed a major proposal on 100% multilateral debt relief on debts owed by first 18, then 27, then possibly 38 HIPC countries. On trade, the UK will continue to press for an ambitious outcome to the WTO Doha development round. The G8 leaders have stated their commitment to eliminate all forms of export subsidies by a credible end date and to substantially reduce trade-distorting domestic support. It is also crucial to ensure that developing countries have the appropriate flexibility to decide, plan and sequence reforms in line with their own development programmes. The IMF has a vital role in this effort, helping its poorest members overcome the challenges they face in achieving sustained growth through its advice, and ensuring it supports country lead economic programmes.

In 2004 and into 2005 the global economic recovery has extended into a period of stronger and more widely spread global growth. But increased pressure from rising oil prices and continued global imbalances mean continued effort is required. Preparing for the long-term economic challenges and opportunities will require sustained effort across a range of policy areas. The IMF should continue to support its members in their actions to promote growth and reduce vulnerabilities.

The 60th anniversary of the foundation of the IMF has focussed attention on its evolving role and the strategic direction it should take in future. The UK's priorities for the Fund's continued development are:

- An IMF that has the best tools for preventing crises, including stronger and more independent surveillance;
- An IMF that fully supports its poorest members with appropriate policy advice, financial support, and technical assistance;
- An IMF with the highest standards of modern governance and management practice.

I am pleased to publish this sixth annual report to Parliament and the public on the UK and 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.

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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THE 2005 AGENDA

2005 marks an important year internationally, and for the United Kingdom. As the UK holds the G7 and G8 presidency for the year, as well as the EU presidency from July, there is opportunity to drive progress on the key challenges of poverty reduction, structural reform, trade, and climate change. This chapter sets out the UK agenda for 2005, covering those priorities for the presidencies; the necessary reforms at the International Monetary Fund (IMF) to meet the challenge of a changing global economy; and the action necessary at the Fund and more widely to ensure the benefits of globalisation are truly shared by all.

Chapter 2 of this report sets out the main activities and discussions at the Fund in the course of 2004 and early 2005, and the UK position on these issues. Chapter 3 provides more detail on the UK agenda to strengthen the Fund in supporting stability and growth, and Chapter 4 provides more detail on UK policies to ensure all share in greater prosperity.

THE PRESIDENCIES – A CRUCIAL OPPORTUNITY

1.1 In 2005 the UK holds the presidency of the G8 and G7, and now in the second half of the year the UK also holds the presidency of the EU. This is a crucial opportunity to drive forward UK international priorities.

The Presidencies

The G8 is a forum of the Heads of State of the world's major industrial economies. It is made up of the United States, the United Kingdom, Germany, France, Italy, Canada, Japan, and Russia. The Presidency rotates annually between the members. In 2005, the G8 Summit was held in Gleneagles between 3 and 6 July.

The G7 is a Finance Ministers led process. Russia attends meetings of the G7 to discuss business related to the G8 Summit. The G7 meets four times a year, twice in the country which holds the presidency and at the time of the IMF/World Bank spring and autumn meetings.

HM Treasury manages the UK's participation in the G7 Finance Ministers' process, whereas the Foreign and Commonwealth Office and No.10 Downing Street manage the UK's involvement in the G8 leaders' process.

The Presidency of the EU currently rotates on a 6 monthly basis between all 25 member states. The UK currently has the Presidency for the second half of 2005. As part of this, the UK will chair five meetings of EU Finance Ministers (ECOFIN) including an Informal ECOFIN in the UK in September 2005.

The Presidency Priorities

1.2 The UK Presidencies of the G7/8 and EU in 2005 are set against a backdrop of a radical transformation in the global economy, with far-reaching and fundamental changes in technology and trading patterns. The UK is using its Presidencies to tackle the following key challenges:

- On **international poverty reduction**, to ensure that all regions of the world benefit from, and contribute to, increased global growth and prosperity. Within this, the focus will be on three areas: increasing aid flows - through innovative finance mechanisms; further debt relief; and fair trade for developing countries.
- On **structural economic reform**, to increase flexibility and make developed economies better able to adjust to the ongoing changes to the pattern of global growth.
- On **trade**, to encourage openness to free and fair trade and outward-looking internationalism, recognising that developing countries can carefully design and sequence their own trade reform.
- On **climate change**, the UK Presidencies will support the drive to tackle climate change as a priority for all industrialised nations.

The Commission for Africa

On current trends, Sub Saharan Africa will not meet any of the UN's Millennium Development Goals by 2015. Africa is therefore one of the Government's two priorities for its G8 presidency this year. The Commission for Africa was established in February 2004 to determine what policies have been effective and where more can be done to support Africa's development. The final report was published in March 2005 and set out a comprehensive plan of action for the African continent, demonstrating that, with bold and concerted action, African can be set back on track to meet the Millennium Development Goals.

A CHANGING GLOBAL ECONOMY

1.3 The radical transformation underway in the global economy has led to an increased potential for global growth, but it also raises new challenges and increased vulnerabilities. To inform the UK domestic response, a paper was published alongside the 2004 Pre-Budget Report on "Long-term global economic challenges and opportunities for the UK"¹. However, prospects for the UK also depend on the performance of the global economy. As the global economy continues to strengthen into 2005 it is vital to ensure this growth can be maintained and vulnerabilities tackled. To help achieve this it is important that the IMF has the surveillance tools, facilities, and governance structures to support its members, and to prevent crises before they occur. To address the need for ongoing reform in the Fund in a comprehensive way, work led by the Managing Director is underway to review the strategic direction of the IMF.

¹ 2 December 2004; available from www.hm-treasury.gov.uk

Strategic Direction of the IMF

The IMF has undergone a major transformation over the past decade and faces new challenges including ongoing increases in international trade and financial flows; the rise of emerging market economies and the integration of transition economies into global markets; and the renewed commitment of the international community to support low-income countries.

Rodrigo de Rato, the IMF's new Managing Director, is conducting a review of the Fund's Strategic Direction, which is due to be completed at the time of the 2005 Annual Meetings. This will be a key opportunity for the IMF to consider its response to the changed global environment, and comes after the 60th Anniversary of the Bretton Woods Institutions, and discussion of the Bretton Woods Institutions strategic direction in the G7, G20 and other groups.

The UK welcomes the opportunity presented by this review to consider how best to reinforce the role the IMF plays in the global economy. The UK looks forward to seeing proposals from this work, and will be fully engaged in the discussion of these among IMF members, governors and external stakeholders. The UK's strategic priorities are discussed in detail throughout this report.

Strengthening Surveillance

1.4 The changes taking place in the world economy mean that IMF surveillance is now more important than ever. At the core of the UK vision for the IMF is independent, authoritative, and transparent surveillance, to ensure that members are aware of vulnerabilities facing their economy, and receive credible and influential advice to address risks and to raise growth rates in the long term. The UK believes that strengthening surveillance is the single most important step for the IMF to make in its progress towards being an institution devoted to the prevention of crises.

1.5 In 2004 the Fund undertook a full review of the surveillance function, with a comprehensive assessment of its activities in this area. The International Monetary and Financial Committee (IMFC) endorsed the priorities for follow up set out in the review, namely sharpening the focus of Article IV consultations, including a deepening of the discussion of exchange rate issues; enhancing financial sector surveillance; and better integrating debt sustainability analysis and regional and global spillovers into country surveillance. Following the 2005 Spring meeting, the Board of the IMF committed to building on the conclusions of the review as part of work on the IMF review of its strategic direction. In 2005 the UK will continue to strongly support full, timely and effective implementation of the recommendations of this review.

1.6 In addition to these priorities the UK will place particular emphasis on a number of areas. Firstly, further improving the Fund's communication with markets and the public, building on its strengthened transparency framework. Secondly, the establishment of a clear methodology for assessing the effectiveness of surveillance, that comprehends both its traction on members, and the appropriateness of advice given. Thirdly, continued progress on bringing a fresh perspective to surveillance in programme countries. Fourthly, a strengthening of efforts to ensure the objectivity of surveillance, including through enhanced debt sustainability analysis. The UK also supports greater attention to the Millennium Development Goals in IMF surveillance, and welcomes agreement that further work on surveillance in low income countries will be monitored as part of the next review. The UK also looks forward to further lessons on surveillance from the IMF's Independent Evaluation Office, as it reviews IMF multilateral surveillance in 2005.

1.7 These priorities will help to substantially strengthen surveillance in line with the UK vision. However, to ensure the Fund can meet these objectives, the UK continues to believe that the long term strengthening of surveillance should involve greater independence, both through independence of activities in programme countries, and through enhanced objective and independent processes within the Fund. The UK will continue to make this case.

Appropriate Facilities

1.8 As well as providing appropriate policy advice, the Fund needs to ensure that its facilities remain suitable for the modern economy. The range of facilities at the Fund's disposal should reinforce the introduction of strong policies to aid both crisis prevention and successful crisis resolution. A number of new Fund facilities have recently been proposed and work is continuing to consider the potential for the following:

- Enhanced precautionary arrangements.
- A Policy Support Instrument (PSI).
- A precautionary Poverty Reduction and Growth Facility (PRGF).

1.9 The UK welcomes the work to review the range of Fund facilities, which will ensure that the IMF has the right mix of tools to meet the needs of its member countries. We remain strongly supportive of precautionary arrangements aimed at crisis prevention. We also look forward to consideration of PSIs and precautionary PRGFs for low-income countries. Recent work on the Fund's signalling role has been helpful, and we support future work. It is important that the Fund engages in outreach with countries and other stakeholders to assess what features would usefully complement existing instruments and surveillance.

A Modern Fund

Management and budgeting

1.10 The UK consistently supports an effective framework for managing the IMF and ensuring it delivers on its objectives. It is important that resources are best employed to match these objectives, and these resources must be seen to be used effectively, within an affordable framework. It is essential that the Fund be seen to meet the highest standards of modern practice in management and spending frameworks, and it must make progress to stay abreast of developments in these areas. The UK welcomes the package of reforms launched by the Fund, drawing on experience of many organisations and countries – including the UK. We will support follow up to ensure effective implementation of these measures, including a more strategic work planning and budgeting framework, an outcome focus with performance measurement, and an integrated budget that can make tradeoffs within an effective overall budget constraint.

Voice 1.11 Accountability in the IMF must be combined with ensuring all members have an effective voice. At Monterrey, all Governments committed to ensuring that developing and transition countries have an effective voice in international institutions. The UK has supported progress on issues that strongly affect voice, including country ownership, diversity, and transparency - both at country and institutional level. The UK is also one of the main donors' to the Analytical Trust Fund, a capacity building measure for the offices of the Sub-Saharan African Executive Directors at the IMF and the World Bank. However, the Government would like to see more progress on the crucial structural issues that play a key role in giving countries an effective voice. The Development Committee is taking forward further work on structural issues, and the World Bank is producing a report with more detail on Board reform options, to report to the Board of Governors in 2005. The UK will continue to work to improve the voice of the Fund's poorest members.

SHARING THE BENEFITS FOR ALL

1.12 Building on a well-run and stable global economy, the international community – and the IMF specifically – can play a role in making sure the benefits of stability and growth are shared more equitably. The Millennium Development Goals (MDGs) provide our framework for reducing poverty – with targets on income poverty, improving environmental management and increasing access to basic services like education and health. The actions that developing countries pursue themselves will be important in determining progress – improving governance, and putting in place an environment that encourages private sector development, especially of small and medium sized domestic firms. But the response of the international community will also be key. Rich countries need to open their markets, provide appropriate flexibility to developing countries so that they are able to decide, plan and sequence reforms in line with their own development programmes and step up financial support to those countries committed to poverty reduction. A substantial increase in resources is needed immediately if we are to meet the MDGs by 2015. Innovative financing mechanisms such as the UK's proposal for an International Finance Facility (IFF), will also be crucial to provide developing countries with the resources they need to invest in growth and poverty reduction. As aid increases, IMF programmes in low income countries need to be flexible enough to accommodate the extra investment needed in infrastructure, education and tackling disease.

Finance for growth and poverty reduction

1.13 At their June 2005 meeting in London, G8 Finance Ministers agreed to complete the process of debt relief through 100% debt cancellation of outstanding obligations of HIPC's to the IMF, World Bank and African Development Bank while ensuring that the financing capacity of international financial institutions is not reduced. The Government has been a champion of the cancellation of poor countries' debt. The debt relief agreed in June will benefit up to 38 countries with debt relief worth up to \$55 billion.

1.14 This builds on the success of the Heavily Indebted Poor Countries (HIPC) Initiative which provides over \$70 billion of debt relief, thereby maximising the resources available for poverty reduction in developing countries. In October 2004, creditors agreed to extend the Initiative by another two years to the end of 2006, potentially allowing a further debt write off of \$30 billion for another ten countries. Too many countries are forced to choose between servicing their debts and investing in programmes that will make progress towards the MDGs. The UK has already written off all debts owed to it by the HIPC countries and has led in building a global commitment to further debt relief. To help relieve the burden of their debts to the multilateral institutions, the UK first, in January 2005, paid its share of the debt service owed by the poorest countries to the concessional financing arms of the World Bank and African Development Bank. 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 Finance Facility (IFF) in order to deliver the additional resources needed to make progress on meeting these targets.

1.15 In January 2003, HM Treasury and the Department for International Development (DFID) launched a proposal for the IFF. The IFF is designed to “frontload” aid to help meet the MDGs and has the support of almost eighty developing and emerging market countries – including France, Italy, Sweden, Brazil, China and South Africa – as well as broad support from NGOs and faith groups. At the 2004 Annual Meetings, the IMF and World Bank reported that the IFF was technically feasible and noted that the IFF was the most advanced proposal to frontload aid. In spring 2005, the Development Committee encouraged interested parties to proceed with these proposals. In the UN, the Secretary General’s March 2005 report, “In Larger Freedom”, urged the international community to launch the IFF in 2005. The January 2005 UN Millennium Project Report to the Secretary General confirms that the IFF is “the most advanced proposal for achieving a rapid increase in development assistance”. The March 2005 Report of the Commission for Africa also calls for the immediate launch of the IFF.

1.16 The UK has also been working with partners in the Global Alliance for Vaccines and Immunization (GAVI) and other donors to explore using the IFF principles to fund an IFF for Immunization (IFFIm), to be launched in 2005. This will demonstrate the technical feasibility of the IFF and the significant benefits of frontloading resources. To date, the UK, France and Sweden have committed to participate in the IFFIm and it also has the support of Spain and Italy. Work is ongoing with a number of other potential donors. On 26 January 2005, the UK announced that it proposes to provide funding for one-third of a \$4 billion pilot. Technical details of the IFFIm are being finalised and Eurostat, the European Statistical Agency, is currently considering the appropriate treatment of the IFFIm in Member States’ national accounts.

1.17 The UK continues to consult with governments, international institutions, faith communities, NGOs and business in both developed and developing countries to raise additional support for the IFF.

The Fund in low-income countries

1.18 The aim of the IMF in low-income countries is to provide stable macroeconomic environments in which growth and poverty reduction can take place. Reforms to achieve stability must be coherent with broader plans for investment to meet the MDGs, such as in basic health, education and other infrastructure for growth. The IMF has been reviewing its role in low-income countries over the last 18 months to consider how it can best contribute to growth, development and poverty reduction within the construct of the Poverty Reduction Strategy approach. The Fund's instrument for engagement in low-income countries is the Poverty Reduction and Growth Facility (PRGF).

1.19 The PRGF serves a number of purposes, including building strong macroeconomic frameworks, reducing vulnerability to shocks, and a signalling role. Options to enhance the range of facilities available to meet these objectives include PSIs and precautionary PRGFs. The UK will explore these options, if there is demand from potential users, as part of ongoing discussions about the range of facilities available from the IMF. The UK will also support the strengthening of country ownership as the IMF reviews its conditionality and also seek closer collaboration between the IMF and World Bank, particularly in implementing the new joint debt sustainability framework.

In the course of 2004 and early 2005 the Fund has carried out its wide range of activities, overseen by its Executive Board and Board of Governors. This chapter looks at a range of Fund activities in the areas of surveillance, lending, and management and governance. It considers some key elements from 2004-05 in these areas, and gives information on the discussions in the Executive Board, and the UK position in these discussions. A summary of the UK voting record, and explanation of the UK votes in the Board of Governors, is included in Annex A.

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”. This section covers Fund surveillance activity in practice, and relevant issues and discussions from 2004 and early 2005. Information on the UK policy agenda on the Fund’s surveillance process is set out in Chapter 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; and
- Country: the IMF holds “Article IV” consultations with each member country about its economic policies.

The Global Economy

2.2 World growth in 2004 was around 5 per cent, the strongest rate for three decades and around twice the rate in 2001. The pick-up in world economic growth during 2003 and 2004 was the result of improved economic developments in most advanced economies as well as a number of major emerging economies. Growth in 2004 and going into 2005 has been principally driven by the strength of demand in the US, and export and investment growth in China and wider Asia. Growth in 2005 and 2006 is expected to remain robust, but to moderate from the historically high rates of 2004.

2.3 The strength of world growth, together with increasing regional integration, particularly in Asia, buoyed the rate of world trade growth towards 10 per cent in 2004, significantly stronger than in recent years, but below the 30-year high reached in 2000 of 12.5 %. However, the disparities in growth rates and the source of demand in the key economies has resulted in diverging trade and current account balances, which have set up pressures. To ensure an orderly adjustment of these global imbalances and to help achieve more sustainable external positions and stronger medium-term growth, the UK has supported the IMFC’s call for concrete actions by all to implement the agreed policy response in a timely and effective manner.

¹ For a full explanation of the Article IV and other surveillance processes, see www.imf.org

2.4 Global economic growth has remained resilient despite high and volatile oil prices. This is because oil price rises have largely reflected strong demand for oil, particularly from China and other rapidly expanding emerging economies, rather than the predominantly supply-side influences that have driven previous episodes of high prices. In addition, energy intensity in the advanced economies has been in long-term decline. Nevertheless, the tight market for oil has resulted in prices being more sensitive to perceived supply risks, low stocks and capacity constraints. Prices rose rapidly from early 2004 and peaked in October at new record nominal highs. Prices have fluctuated since then, but recently reached further historical highs in early April 2005.

2.5 Despite declining spare capacity and the rise in commodity prices feeding through to headline rates of inflation in advanced economies, core inflation remained relatively stable, allowing monetary tightening to be gradual, principally in the US, but also in the UK, Canada and some other advanced economies. Consequently, financing conditions continued to be supportive of growth.

The IMFC Remit for Surveillance

The UK, working with its international partners, has sought to build on the IMFC's oversight role to develop a more regular process of priority setting for Fund surveillance. In autumn 2003 the IMFC sought to provide a sharper focus by setting out the following priorities for the focus of Fund surveillance in the coming year: improving debt sustainability; reducing balance sheet vulnerabilities; and making progress on structural reform and sustainable medium-term fiscal frameworks; along with policies to facilitate the adjustment of global imbalances.

This 'remit' has continued to evolve through 2004 and the Fund has provided report back on these issues at each of the semi-annual IMFC meetings. At the 2004 Spring meeting the IMFC also called for due attention to be paid to relevant political risks and to vulnerabilities to exchange rate and interest rate movements. Looking to the coming year and reflecting recent developments, the IMFC at its Annual 2004 and Spring 2005 meetings called for surveillance to focus on: the impact of higher oil prices, especially on the most vulnerable countries; the sustainability of medium-term fiscal positions and debt in many members; and managing the policy response to potential inflationary pressures. The UK welcomes this process, and will encourage the Fund to maintain this focus.

The UK Article IV

2.6 An IMF mission visited the UK in December 2004 to conduct its Article IV consultation. The concluding statement of the IMF mission is available on the HM Treasury website². The Executive Board discussed this consultation in March 2005, and in line with the UK commitment to transparency, the final report was made available by the IMF following the Board discussion. In summing up, the Executive Board “commended the United Kingdom authorities for their skilful macroeconomic management and flexibility in responding to changing economic circumstances, and welcomed the continued robust performance of the economy. Economic growth has been relatively rapid and stable, unemployment has fallen to one of the lowest rates among industrial countries, and inflation has been subdued. Directors noted that underlying this impressive performance have been clear and “state-of-the-art” policy frameworks underpinned by strong institutions, as well as a sizable countercyclical policy stimulus and a sharp increase in house prices. Looking ahead, Directors considered that the key challenge will be to ensure that the strong policy frameworks are sustained and supported by the right policy decisions.”

A key policy challenge: Ageing Populations

In 2004 the IMF used its multilateral surveillance work to review the issue of demographic change. The UK has argued that ageing populations will be one of the most fundamental socio-economic developments over the coming decades in most developed, but also in many less-developed, countries. The global ageing trend and the projected changing population sizes are likely to have profound effects on economic performance on the national and international level. For example, as a result of substantially faster projected growth of its working-age population, the US economy is likely to grow markedly faster than the European and Japanese economies over the coming decades, which are faced with stagnant or even declining workforces.

Given the long time horizon over which the ageing trend will unfold, a range of policy options could be considered to deal with the potential economic impact. The IMF, in its September 2004 World Economic Outlook, argues that policies that help to boost labour supply, saving, and productivity are generally the most appropriate to deal with the economic effects of population change.

Maintaining sustainable long-term public finances in the face of ageing populations is a key policy challenge in most developed countries, where spending on the elderly (particularly in the form of pensions and health care) represents a large share of overall government spending. The UK has published reports since 2002 on long-term public finance, in which the long-term fiscal sustainability of current policies is assessed. The reports, which put the UK at the forefront of analysis of long-term sustainability, show that the UK is in a strong position relative to many other developed countries to face future challenges arising from an ageing population.

² http://www.hm-treasury.gov.uk/documents/uk_economy/imf_reports

Board Discussion on Surveillance

2.7 Surveillance discussions in the Executive Board are used to bring cross-country experience to surveillance reports, and to provide an element of peer review that is part of the founding principle of Fund surveillance work. The box overleaf lists those countries discussed in 2004 and the first quarter of 2005.

Executive Board Surveillance Discussions

During 2004 and the first quarter of 2005 the Executive Board held Article IV discussions on the following countries:

Albania; Algeria; Afghanistan; Antigua and Barbuda; Armenia; Australia; Austria; Azerbaijan; Bahrain; Barbados; Belarus; Belgium; Belize; Benin; Bosnia and Herzegovina; Botswana; Brazil; Brunei Darussalam; Bulgaria; Burundi; Cambodia; Canada; Central African Republic; Chad; Chile; China; Comoros; Congo, Republic of; Costa Rica; Cote d'Ivoire; Croatia; Cyprus; Czech Republic; Denmark; Djibouti; Ecuador; Egypt; El Salvador; Eritrea; Estonia; Ethiopia; Fiji; Finland; France; Gambia, the; Germany; Greece; Guinea; Guinea-Bissau; Guyana; Hong Kong; Hungary; India; Indonesia; Iran, Islamic Republic of; Ireland; Israel; Italy; Jamaica; Japan; Jordan; Kazakhstan; Kenya; Korea; Kuwait; Kyrgyz, Republic; Lao, PDR; Latvia; Lebanon; Lesotho; Lithuania; Luxembourg; Malawi; Malaysia; Maldives; Marshall Islands; Mauritius; Mexico; Micronesia; Moldova; Morocco; Myanmar; Namibia; Netherlands; New Zealand; Niger; Nigeria; Norway; Oman; Pakistan; Palau; Panama; Papua New Guinea; Paraguay; Peru; Philippines; Poland; Portugal; Romania; Russian Federation; Rwanda; San Marino; São Tomé and Príncipe; Saudi Arabia; Seychelles; Sierra Leone; Singapore; Slovakia; Slovenia; Solomon Islands; South Africa; Spain; Sri Lanka; St Kitts and Nevis; St Lucia; St Vincent and the Grenadines; Swaziland; Sweden; Switzerland; Syrian Arab Republic; Tajikistan; Tanzania; Thailand; Timor-Leste; Togo; Tonga; Trinidad and Tobago; Tunisia; Turkey; Turkmenistan; Ukraine; United Arab Emirates; United Kingdom; United States; Uzbekistan; Vanuatu; Venezuela; Vietnam; Zambia; Yemen; 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.

The Article IV Reports for those countries that agree to publication are available at www.imf.org.

UK Positions on Surveillance

2.8 For individual countries' Article IV discussions, whilst the nature of UK interventions vary depending on the countries' individual circumstances and level of economic development, the UK considered the following broad themes and questions when formulating interventions at the Board.

Presentation of outlook and vulnerabilities:

- Is there an explicit discussion of the risks, both faced and posed by the member country, of most significance to both the member country and the world economy?
- Have the various components of vulnerability assessments and the balance sheet analysis been integrated within the main body of the Article IV?

- Does the Article IV demonstrate debt sustainability? Have alternative scenarios been used in the presentation of these risks and vulnerabilities, and has their potential impact been quantified?

Macroeconomic policy frameworks:

- Have alternative macroeconomic policy frameworks been analysed?
- Is the current fiscal framework appropriate? Or could the country benefit from some form of fiscal rule?
- Is the monetary policy framework effective?
- How transparent are the macroeconomic policy frameworks?
- Have necessary structural reforms been implemented fully and effectively?

Exchange rate regime:

- Has the Article IV considered the adequacy and sustainability of the exchange rate regime?
- Is there a clear identification of the de facto exchange rate regime?
- Have staff used a broad range of indicators to assess external competitiveness?
- Has the policy dialogue between staff and the authorities on the exchange rate been presented, and is it balanced?

Financial Sector Issues:

- Does the Article IV consider the key vulnerabilities in the financial sector?
- Is the country suitable for a ROSC/FSAP? If they have undertaken one, how do they plan to implement recommendations? Could they be eligible for FIRST funds? (See Chapter 3, Codes and standards)

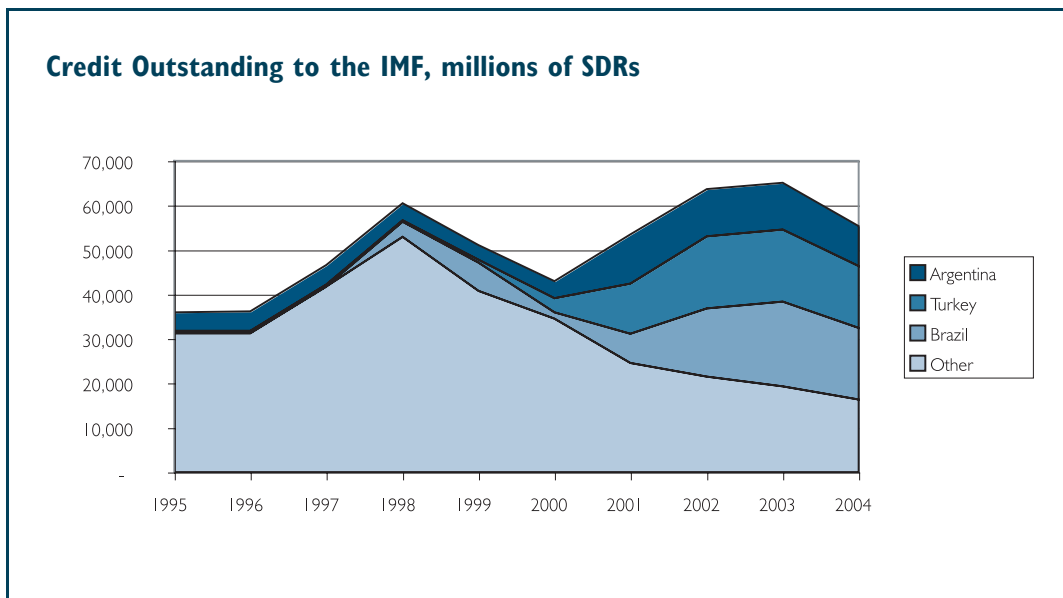
2.9 For low and middle income countries, UK interventions also emphasised the need for the IMF's surveillance work to comprehensively assess progress towards the Millennium Development Goals (MDGs). For low income countries the UK also concentrated on the need for effective public expenditure management, for resources to be allocated towards pro-poor expenditure, the need for improved donor co-ordination and to consider whether the country has an external financing gap and a need for more resources to assist progress towards the MDGs. In developed country surveillance discussions the UK supported IMF work on monitoring trade policies, and encouraged progress towards the 0.7% ODA/GNI ratio. The UK encouraged transparency at the country level, such as through revenue transparency and signing up for the Extractive Industries Transparency Initiative, and through cross-checking the Financial Action Task Force (FATF) list of non-cooperative jurisdictions, or the OECD list of harmful tax regimes. The UK also called for the publication of Article IV reports.

2.10 In addition, UK interventions also concentrated on whether the Article IV includes a rigorous treatment of those issues identified during the 2004 Biennial Surveillance Review, including whether a strategic focus was defined for the consultation, whether there is an assessment of the effectiveness of previous Fund surveillance (either in the staff papers or the countries' Executive Directors statement), and whether there is an adequate coverage of global and regional spillovers.

LENDING

2.11 The IMF's lending operations are conducted through a number of facilities, the core facility being the Stand-by Arrangement (SBA). To help the poorest member countries facing protracted balance of payments problems, the Fund provides concessional lending through the Poverty Reduction and Growth Facility (PRGF). A full description of the Fund's facilities is available on the IMF website, and information about work on the Fund's range of facilities is at Chapter 3.

2.12 The majority of IMF lending is financed through the General Resource Account (GRA) of the IMF, while concessional lending is paid for through trust Fund arrangements (see Fund Finances, below, for more information). At the end of January 2005 the total credit outstanding to the GRA stood at SDR³ 52.7bn, a steady decline from the end 2003 level of SDR 65bn. Credit outstanding to the PRGF Trust Fund stood at around SDR 6.8bn. At end 2004 there were a total of 48 countries with an IMF programme in operation. More detail on the three countries with the largest outstanding debt to the Fund is provided below, as well as information on Fund relations with Iraq, Mozambique, and Nigeria.



Argentina 2.13 Following the election of a new president in September 2003, the Argentine government and IMF agreed a new three-year Stand-by Arrangement to replace the “transitional” programme that had been in place since the devaluation and default in late-2001. This programme was designed to re-establish a sustainable path for Argentina's public finances and build upon the macroeconomic stability established under the transitional programme.

³ Special Drawing Rights (SDRs) are an international reserve asset that also serves as the unit of account of the IMF. Its value is based on a basket of key international currencies. At end 2004 there were US\$ 1.55 per SDR

2.14 Argentina's economic program has three fundamental elements, designed to combat the economic problems and destabilizing factors that underlie the increased poverty and inequality that have arisen in recent years. Firstly, to set out a medium-term fiscal framework promoting growth, employment, and social equity, and including a restructuring of the defaulted sovereign debt that would normalise relations with creditors and ensure debt sustainability. Secondly, to attend to the flaws in the banking system that were hindering financial intermediation. And thirdly, institutional reforms designed to improve the investment climate, particularly in key areas such as utilities.

2.15 Under the arrangement, about SDR 9.0bn would be disbursed over 3 years; enough to cover Argentina's scheduled repayments to the IMF over the period and keep the IMF's net exposure roughly constant at around SDR 10.5bn.

2.16 The first review was approved in January 2004. The UK abstained from this decision 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. 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. The second review was approved during March 2004 on the basis that quantitative criteria were met and that there had been some progress on areas of structural reform. The UK supported this decision, noting the Argentine authorities' commitment to make progress on their debt restructuring deal and to negotiate this in good faith with their creditors.

2.17 However, the third review scheduled for June 2004 has not been completed, and, at the request of the Argentine authorities, the programme was put on hold whilst arrangements for the restructuring of their defaulted sovereign debt were finalised. Argentina has since carried out a debt swap on its defaulted debt which concluded in March 2005 with a participation rate of 76 percent. The authorities are now looking to negotiate a new programme with the IMF with the aim of exiting permanently from IMF assistance. Credit outstanding to the Fund stood at SDR 9.1bn at end 2004, around 16.5% of total IMF credit outstanding. Going forward, the UK would wish to see enhanced cooperation between the Argentine authorities and the IMF, respect for the IMF's preferred creditor status maintained, and those measures necessary to restore Argentina to sustainable growth and alleviate poverty undertaken.

Brazil 2.18 In March 2005, Brazil ended its Stand-by Arrangement with the Fund. The decision reflected the success of Brazil's macroeconomic stabilisation and reform policies that supported the Stand-by Arrangement. Underpinned by these policies and a favourable external environment, economic activity rebounded strongly in 2004 bringing GDP growth to over 5%, its highest level since 1994. During the 10th review, the Brazilian authorities reiterated their commitment to continuing with their reform agenda, and moves were announced to strengthen public finances and reform the social security system. The authorities also pledged to maintain a primary surplus target of 4.25% of GDP. The UK commended the Brazilian authorities for their able economic stewardship and successful cooperation with the IMF, and welcomed their recent decision to continue these strong policies without an additional IMF program.

2.19 Credit outstanding to the Fund stands at SDR 16.1bn at end 2004, around 29% of total IMF credit outstanding. The Brazilian authorities had been treating the arrangement with the Fund as precautionary (with SDR 10.2bn available to draw, at end 2004), and on this basis credit outstanding to the IMF was approximately SDR 15.4bn at end-March 2005.

Turkey 2.20 Turkey has achieved a strong performance under its Stand-by-Arrangement, agreed in 2002. The programme was designed to address the economic problems that Turkey suffered previously: high public debt, volatile growth, high inflation as well as banking sector difficulties. The macro-environment has now substantially improved, with inflation in single digits and robust GDP growth. In addition, Turkey made good progress on the fiscal target in 2004 and achieved a primary surplus target of 6.9% of GDP, above the target set under the program.

2.21 Exposure to the Fund remains high at SDR 13.8bn (at end 2004), around 25% of total IMF credit outstanding. A new precautionary Stand-by Arrangement was agreed in May 2005, with overall access of an amount equivalent to US \$10bn.

2.22 The new economic programme will aim to help Turkey create the conditions for sustained growth and employment creation, reduce inflation toward European levels, and enhance the economy's resilience, in part through further decline in debt. It should also allow Turkey to exit from further IMF financial support. Continued fiscal discipline will remain central to achieving these goals. Therefore a strong fiscal component, including a primary surplus of 6.5% will remain central to the new programme. To support the program's fiscal objectives, the government plans to undertake reforms of public expenditure, tax administration, and tax policy.

The Exceptional Access Framework

The amount a country can borrow from the IMF is based on access limits. 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 in cases such as those highlighted above, Fund lending exceeds these limits, and are known as exceptional access cases. In 2003 the IMF Executive Board agreed a framework for handling such cases. The improved procedures in this framework require earlier and fuller information to the Board as a negotiations towards a programme continue; an evaluation within a year of the end of all exceptional access arrangements; and that the following criteria should be used to judge each case to provide greater clarity to members and other creditors about when exceptional access should be provided:

- 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.

This framework provides necessary protection of the Fund's limited resources, and ensures these resources provide the right incentives to all actors. The UK continues to strongly support this framework and its rigorous application. The original decision noted that there may be special circumstances when exceptional access is appropriate but not all the criteria are met. Handling these special cases is a matter of ongoing debate. The UK has supported exploring ways in which IMF facilities – including those offering exceptional access – can be used to support stronger policy frameworks (see chapter 3, Appropriate Facilities).

Exceptional access procedures were further strengthened in 2004, with the coming into effect of the enhanced transparency guidelines. Since July 2004 the Managing Director is not expected to recommend approval of a programme or completion of a review for programmes involving exceptional access unless authorities agree to publish all documents related to new or enhanced programmes.

Iraq 2.23 During the first half of 2004, the IMF assisted the Coalition Provisional Authority (CPA) in Iraq, providing technical assistance and commenting on important draft legislation, including the Central Bank Law, and the Financial Management Law, which set out rules for the preparation and execution of budgets.

2.24 In June 2004, United Nations Security Council Resolution 1546 was passed, endorsing the transfer of authority to an Iraqi Interim Government. The Resolution called for the international financial institutions to engage fully in assisting Iraq's reconstruction and development. The IMF assisted the Iraqi Interim Government through its continuing programme of valuable technical assistance, through seminars held outside Iraq.

2.25 On 29 September 2004, the IMF Board approved an Emergency Post Conflict Assistance (EPCA) package worth \$436 million for Iraq, as a sign of support for Iraq's economic reconstruction efforts through 2005 and to help catalyse additional international support, including Paris Club debt relief.

2.26 The International Advisory and Monitoring Board (IAMB), of which the IMF is a member, produced two reports during 2004 on CPA management of oil revenues, ensuring transparent auditing of revenues from the Development Fund for Iraq.

2.27 IMF staff worked closely with the Paris Club of official creditors to produce the necessary analysis underpinning the deal agreed on 21 November 2004 that saw the Paris Club restore Iraq's debt sustainability by writing-off 80% of Iraq's debt in three stages over the next three years. Once non-Paris Club creditors deliver terms comparable to those of the Paris Club, Iraq's debt is expected to be reduced by some \$100 billion. The UK welcomes the timely work of the Fund in establishing the EPCA package for Iraq, paving the way for the debt relief agreement that is a vital precondition in building a stable Iraqi economy.

The PRGF: Mozambique

2.28 Mozambique became a member of the IMF in 1984. Its outstanding use of Fund resources stood at SDR 127 million at end 2004. In 2004, the Executive Board, with UK support, approved the fourth consecutive three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) for Mozambique. Under the arrangement the IMF will provide SDR 11.36 million to support the government's economic program into 2006. The economic program for 2004-06 seeks to consolidate macroeconomic stability and address an important agenda of pending structural reforms, in order to sustain growth, promote employment, and further reduce poverty.

2.29 In financial terms, Mozambique's latest PRGF arrangement is significantly smaller than previous arrangements. However, it is seen to play a catalytic role in securing financing from donors and other multilateral and regional institutions. In addition, both donors and the Mozambican authorities are of the view that the arrangement helps the government garner support for politically difficult reforms.

2.30 Mozambique economic performance was broadly satisfactory throughout the programme periods with strong GDP growth and significant progress toward meeting the government's poverty reduction objectives. The population living below the poverty line declined from almost 70 percent in 1996 to 54 percent in 2002.

2.31 The IMF also provided, often in close collaboration with the UK's Department For International Development, significant technical assistance in the areas of tax policy and administration, public expenditure management, statistics, monetary and exchange rate management, and banking supervision and restructuring.

Nigeria 2.32 2004 saw Nigeria begin implementation of their National Economic Empowerment and Development Strategy (NEEDS), a home-grown medium-term economic strategy aimed at addressing Nigeria's deep-rooted macroeconomic and structural problems and reducing poverty. The development of NEEDS signals a clear break with the past and its commitments are broadly consistent with the recommendations of the 2002 Article IV consultations. G8 Finance Ministers agreed in June to provide a fair and sustainable solution to Nigeria's debt problems, through the Paris Club of major official bilateral creditors. The Paris Club reached an agreement in principle on the key parameters of a deal and issued a press release on 29 June 2005. The formal negotiation is expected in the autumn. A permanent exit from unsustainable debt will enable Nigeria to confront successfully the daunting economic and social challenges that lie ahead.

2.33 In July 2004 the IMF welcomed the recent improvements in prospects for sustained adjustment and economic reform in Nigeria, and fully agreed with its overall policy thrust and direction for tackling economic development and unleashing Nigeria's growth potential. Although there is no IMF programme for Nigeria, the IMF welcomed Nigeria's request for monitoring of the implementation of the NEEDS program as part of intensified surveillance efforts, and committed to providing policy advice and helping build institutional capacity in Nigeria. This was strongly supported by the UK and we will encourage Nigeria to continue reform. Fund staff will undertake quarterly visits to Nigeria and deliver semi-annual information reports to the Executive Board.

Board Discussions on Programmes

2.34 As with surveillance discussions, the Executive Board usually acts on the principle of consensus in its lending decisions. However, the use of members' assets as the basis for Fund lending (see Annex B for the UK financial relationship with the Fund) gives Executive Directors a fiduciary responsibility to their taxpayers, alongside the desire to ensure the success of any programme for the benefit of the citizens of the programme country. As discussed earlier, in 2004 the UK made a rare departure from consensus in this area to register an abstention in the discussion of the first review of Argentina's programme.

UK positions on lending discussions 2.35 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.

2.36 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 also monitors progress on the key features that PRGF programmes are expected to meet in pro-poor countries, for example through reporting on pro-poor budgets and Poverty and Social Impact Assessments (PSIA).

2.37 PRGF arrangements are typically 3 years in length, with programmes agreed annually and biannual reviews of progress brought to the Board. 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, 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 encourages use of PSIA and a focus on improving public expenditure management and fiscal flexibility.
- for HIPC countries, where is the country in the HIPC initiative? For example, is it moving towards completion point?
- on performance, have targets been met? If not, are waivers justified and is commitment to ongoing reform and poverty reduction sufficient?
- on aid, has there been effective donor co-ordination? Are proposed conditions essential to achieve the objectives of the programme, well-timed and appropriately sequenced?

MANAGEMENT AND GOVERNANCE

2.38 To ensure the Fund remains effective and is seen as legitimate in its operations it is essential that it abides by the highest standards of management and governance. This section considers the Fund's finances; the governance of the Fund including ensuring the voice of all members is heard; the role of the Independent Evaluation Office in 2004; and decisions on the budget and management processes at the Fund.

Fund Finances

Liquidity 2.39 Maintaining the liquidity of the Fund's finance is crucial for the performance of its lending activities. This liquidity is kept under regular review, with semi-annual discussions by the Executive Board. Fund liquidity is measured by its Forward Commitment Capacity (FCC). The FCC derives from a number of calculations to identify the amount of resources freely available for lending by the IMF, allowing for retention of a prudential balance. At end 2004 the Fund's FCC stood at SDR 71.9bn. In its most recent discussion of the IMF's liquidity the Board concluded that the FCC was currently adequate to meet likely demand.

Quotas, the NAB, and the GAB

2.40 Quotas provide the main source of IMF resources. Information on the UK's provision of quota to the IMF, and its financial relationship with the Fund in general is contained in Annex B. Quotas also determine a member's basic access to Fund resources (see exceptional access, above) and the bulk of a member's voting power (see Voice, below). Quota levels are kept under review, usually every five years, with the 12th General Review of Quotas closing in January 2003, with quota levels left unchanged at SDR 212.7 billion.

2.41 Quota issues remain under discussion as part of the Board's work on Fund liquidity. The Board is committed to examining ways to achieve a distribution of quotas that reflects developments in the world economy and to consider measures to strengthen the governance of the Fund. Should a quota increase become necessary, due to a need for greater liquidity, most directors – including the UK – would support a package of measures to achieve these aims, through:

- A general increase with a 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.

2.42 However, more work is necessary to achieve the required consensus for such a package. The section on Voice below contains more information on this and related issues.

2.43 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. The first such source of supplementary financing - the General Arrangements to Borrow (GAB) - was established in 1962. 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 a total of SDR 34 billion. The NAB is now 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 SDR 2.6 billion. 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.

Financial position of the PRGF

2.44 The IMF's concessional activities – the Poverty Reduction and Growth Facility (PRGF) and the Heavily Indebted Poor Countries (HIPC) initiative – 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.

2.45 The PRGF Trust was established to provide lending in support of PRGF arrangements and to 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. The difference between the market-related interest rate paid to the PRGF Trust's creditors and the charges of 0.5 percent per year paid by PRGF borrowers is subsidised using contributions from bilateral donors and the IMF's own resources. Bilateral contributions to the PRGF trust total around SDR 3.5 billion, of which the UK has pledged around SDR 370 million.

2.46 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 around SDR 1.5 billion, of which the UK has pledged around SDR 80 million. 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.

2.47 From end 2006, the PRGF is scheduled to become self-sustaining, ceasing to draw down capital and subsidy from donors and financing future lending using its' existing capital and reserves. This will allow lending of SDR 660 million each year. However, demand for PRGF resources may exceed this level, leaving a shortfall in the availability of PRGF finance. The UK has argued, and the IMFC has agreed, that the PRGF must "maintain adequate capacity to meet future needs". The level of future demand for PRGF finance is not clear, and the IMF is currently revising its' estimates. If there is a shortfall, the PRGF may require additional credits from donor governments to supplement its loan capital.

Voice and Governance

Voice 2.48 At the March 2002 International Conference on Financing for Development, in Monterrey, Mexico, 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. The UK has supported progress on a number of ways of achieving this, but progress on structural issues is proving to be slow, and the UK will continue to push for prompt agreement of a successful package of measures in this area.

2.49 Institutional and country level measures have a significant impact on the effectiveness of developing country voice. At the country level, issues include the follow-up work to the Poverty Reduction Strategy review, and the forthcoming conditionality review (see Chapter 4). The UK also believes that transparency, on both country and institutional level, can play a key part in increasing the effectiveness of developing countries' voice, including for civil society in those countries. The UK has consistently supported increased transparency at the IMF (see Chapter 3). Increasing staff diversity at the IMF will also widen its experience base. Another key voice matter concerns capacity building. The UK has, with other donors, established a trust fund to support independent analysis for the use of the Sub-Saharan African Executive Directors at both the IMF and the World Bank, enabling them to represent their constituencies more effectively.

2.50 However, to meet the Monterrey commitment we still need to make progress on the institutional side. It is taking time and effort to arrive at the necessary political consensus to achieve changes at the Board level, but the UK will continue working with other shareholders to make progress on these issues. The World Bank agreed at the 2004 Annual meetings to produce a fuller report on the options most likely to garner political consensus, to lead up to a full, informed political discussion in the 2005 Development Committee. The UK strongly supports the work by the World Bank to bring forward options to a stage where they will require action, and looks forward to a decision focused discussion in the Development Committee to make meaningful progress.

2.51 The UK will continue to press for an increase in the Basic Vote⁴ as part of any future revision of the Articles of Agreement. As noted above, the UK continues to believe that a package of measures that enhance the voice of developing and transition countries should be advanced as part of any general increase in IMF quotas.

Accountability and the IMFC

2.52 The IMF achieves its legitimacy through being - and being seen to be - accountable. The formal embodiment of the Fund's accountability to its members is through their role as shareholders, who appoint governors of the Fund. This accountability is supported through bringing greater transparency, ensuring all members have adequate voice and representation, and through the Independent Evaluation Office (see below).

2.53 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.

2.54 In addition to their representation through the IMFC, the full Board of Governors assembles at the Annual Meetings every autumn, and governors vote directly on a limited number of specific decisions, rather than delegating to the Executive Board as usual. A list of such votes taken in 2004 is included in Annex A, with an explanation of the UK position.

The Independent Evaluation Office (the IEO)⁵

2.55 The IEO was established in 2001 with the strong support of the UK, and is proving its worth. The IEO exists to improve the effectiveness and credibility of the IMF by systematically conducting objective, independent, and transparent evaluations on issues relevant to the Fund mandate. The IEO is fully independent of IMF management and staff, and operates at arms length from the Executive Board. In line with presumption, the Executive Board has published all IEO reports promptly after consideration, and the IEO has also developed its capacity for outreach to stakeholders. The UK welcomed the first three IEO reports, and their useful lessons for IMF surveillance, which are covered in last year's edition of this report. The UK has maintained support for full and effective implementation of the recommendations of these reports, and welcomes the vital ongoing work of the IEO.

Reports in 2004

2.56 In the course of 2004 the IEO has worked on three reports in line with its 2003/04 work programme. These are:

- An evaluation of Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility;
- An evaluation of IMF technical assistance; and
- An evaluation of the IMF's role in Argentina.

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 an amendment to alter.

⁵ The IEO's most recent Annual Report can be found from the IMF's website at www.imf.org

2.57 Further information on the first two reports is covered in the appropriate sections of Chapter 4. The box below draws out some key elements from the Argentina evaluation.

Evaluation of the Role of the Fund in Argentina, 1991 - 2001

The severe economic crisis in Argentina of 2000-02 has particular lessons for the Fund given its heavy engagement with Argentina from 1991, with five successive financing arrangements. The IEO report provides a rigorous analysis of this Fund engagement, and concludes that the crisis resulted from the failure of the Argentine policy makers to take necessary corrective measures sufficiently early, particularly in the consistency of fiscal policy with their choice of exchange rate regime. However, the IEO identifies that Fund surveillance failed to highlight and address vulnerabilities building up during the 1990s, and that the Fund supported unsustainable policies for too long.

The UK welcomed this evaluation and will support further follow up by staff to meet those recommendations not already being addressed. The summing up of the Executive Board discussion provides more information on follow up⁶. The UK draws particular attention to these lessons drawn by the IEO on surveillance and decision making, given the overlap to the biennial surveillance review and the UK focus on surveillance (see chapter 3) and UK support for accountable and effective decision making in the Fund.

Ongoing work programme

2.58 Following its establishment the IEO developed an outline rolling three year work programme, which has been reviewed annually with wide consultation to define those projects to be covered in the coming year. During 2005 the IEO will expand its efforts to four projects, which will include: the Financial Sector Assessment Programme (FSAP) and Financial Sector Stability Assessments; the IMF's approach to capital account liberalization; the role of multilateral surveillance; and a country case study of Jordan. The IEO will also undertake consultation to draw up its outline work programme for the coming three years. Given the valuable lessons on surveillance already drawn out of the IEO's work, and the crucial role of surveillance to the Fund's mission, the UK looks forward to continued IEO work in this area. The UK also supports further work to assist the Executive Board in ensuring follow up on IEO recommendations. When it was established it was agreed that a review of the IEO would be conducted after three years of operation. This review will take place later in 2005. The UK also welcomes the appointment in April 2005 of Thomas Bernes to the position of the Director of the IEO.

Management and Budgets

2.59 In line with the domestic policies of the Government, the UK has continued to look for efficiency and effectiveness in the conduct of the institution, seeking to contain administrative budget increases to levels that can be clearly justified. Increased concern in this area from a large number of shareholders encouraged the Fund to bring forward proposals in 2004 on further budget reforms. The proposal is based around providing a more strategic work management and budgeting procedure, and will include the following elements:

⁶ The Chairman's summing up; Independent Evaluation Office Report on the Role of the Fund in Argentina, 1991-2001; July 26, 2004; available at www.imf.org

- A strategy document - to set out the high level strategy of the Fund over a number of years;
- A medium term budget framework – which matches resources to the strategic planning of the Fund, within an overall budget envelope set by the Executive Board; and
- Over the longer term, the introduction of performance indicators to assess the effectiveness of resource use and match resources to outcomes.

2.60 The UK welcomes this approach, which builds on experience of countries, including the UK, who have implemented modern outcome based public expenditure management systems. There will clearly be challenges to implementing this agenda, but the UK will seek rapid progress on the earlier elements, and seek to ensure that the introduction of performance indicators proceeds over the coming few years, in line with the envisaged timetable.

Board discussions

2.61 In discussions on the budget and staff compensation settlement⁷ the UK sought no real increase in the administrative budget. This reflects the UK position that budgets should only increase in line with inflation, unless a deliberate and costed decision is taken to undertake new activities and opportunities for reprioritisation or efficiency savings have been exhausted. This contrasts to the existing IMF framework, that seeks to retain the Fund at ‘broadly its present size’, but allows for increases in line with rising costs of inputs (e.g. staff costs, based on international comparison). The UK, with others, made clear that it could not support proposals on staff compensation that would result in an above inflation increase in the administrative budget. The UK supported the final staff compensation package and administrative budget, which was in line with inflation recorded in the Washington area.

2.62 In response to concerns raised in the spring 2004 discussions the IMF brought forward the proposals on ‘further budget reforms’ in summer 2004. The UK has strongly supported this process in ongoing discussions, with interventions focussed on the desire to see a clear comparator, such as a recognised inflation measure, used as the starting basis for the budget’s resource envelope; and the need for the staff compensation and benefits frameworks to be fully integrated into the budget and made consistent with the requirement to manage in line with a top down budget constraint.

⁷ Staff pay and benefits form the majority of the administrative budget, and are also considered in the spring period leading up to the new financial year.

3

SUPPORTING STABILITY AND GROWTH

Supporting its members in building sustainable economies with strong growth, and thereby enhancing global welfare, is the core mission of the IMF. Chapter 4 provides more details on meeting the particular challenges to achieving this that arise in low income countries. This chapter sets out progress on the UK agenda in improving the Fund's ability to back strong policy frameworks - and so prevent crises and support growth - through: surveillance advice; codes and standards work; and facilities that support crisis prevention. It also looks at meeting challenges to financial stability from debt crises and abuse of the financial system by terrorists and money launderers.

SUPPORTING STRONG POLICIES

Enhanced Surveillance and Policy Advice

3.1 The global economy is undergoing a major transformation, with far reaching and fundamental changes in technology, production and trading patterns. As the recent paper 'Long Term Global Economic Challenges and Opportunities for the UK' highlights, these changes bring enormous opportunities, but to ensure that each country benefits, governments must establish stable macroeconomic foundations that are robust to shocks. In this context, the UK believes that the Fund should be an institution devoted to the prevention of crises as well as their resolution, and that strengthening surveillance is the single most important step in achieving this. The UK has consistently supported a wide agenda in strengthening the Fund's toolkit and elements of its surveillance conduct, as well as ensuring surveillance is seen to be free from potential conflicts of interest from lending decisions. To tackle any such conflicts, the UK has supported greater independence, both in the form of a fresh perspective for surveillance in programme countries, and objective and independent processes within the Fund.

3.2 The Fund has made considerable progress in recent years in this wide agenda, with a strengthened analytical toolkit, in particular through: debt sustainability analysis and the balance sheet approach; increased publication rates and stakeholder engagement; and the widespread adoption of vulnerability assessments and the greater use of cross country studies. In addition, the Fund has embarked upon policies to strengthen surveillance in programme countries, in line with bringing a fresh perspective to this work. These policies provide for: a comprehensive assessment of recent economic developments; a frank analysis of the short and medium term outlook; a candid account of the policy dialogue between the staff and authorities; more flexibility in the Article IV consultation schedule; the introduction of systemic ex-post assessments for countries with longer term programme engagement; and innovations in the staffing of missions, their reporting to the Board, and Board discussions, to separate out surveillance and programme work. While welcoming these developments the UK is concerned that a truly fresh perspective has not as yet been fully and comprehensively ensured.

The Biennial Surveillance Review

The IMF reviews its implementation of surveillance, and the legal basis for its surveillance work – “the 1977 surveillance decision”¹ - every two years. The 2004 review considered the content and the modalities of surveillance, before setting out the wide range of areas where work should be progressed to further strengthen IMF surveillance. The review affirms that its key objective is to make surveillance more effective across the membership. The priorities for implementation endorsed by the IMFC are:

- sharpening the focus of Article IV consultations, including a deepening of the discussion of exchange rate issues;
- enhancing financial sector surveillance; and
- better integration of debt sustainability analysis and regional and global spillovers into country surveillance.

These priorities form measurable elements of the Fund’s agenda to improving surveillance, implementation of which should be evaluated as part of the next review. In addition the IMFC endorsed further progress in reducing balance sheet vulnerabilities, and further work on surveillance in low income countries, as issues to be monitored in the next review. The UK welcomed the work on the review and the approach of setting monitorable objectives. The UK particularly emphasised the need to assess the effectiveness of surveillance, and drew attention to the review’s finding that the Millennium Development Goals do not generally form a significant focus of IMF surveillance reports.

Measuring Effectiveness: a key challenge

3.3 The essential characteristic of Fund surveillance should be its effectiveness in identifying appropriate policy prescriptions and influencing national authorities policy priorities. The review draws attention to the complexity of evaluating the effectiveness of surveillance, but also identifies its central importance to strengthening surveillance. The review suggests consideration of the use of monitorable strategic objectives in reviews of surveillance, promoting identification of priorities, and enhancing discussions of effectiveness in individual Article IV consultations.

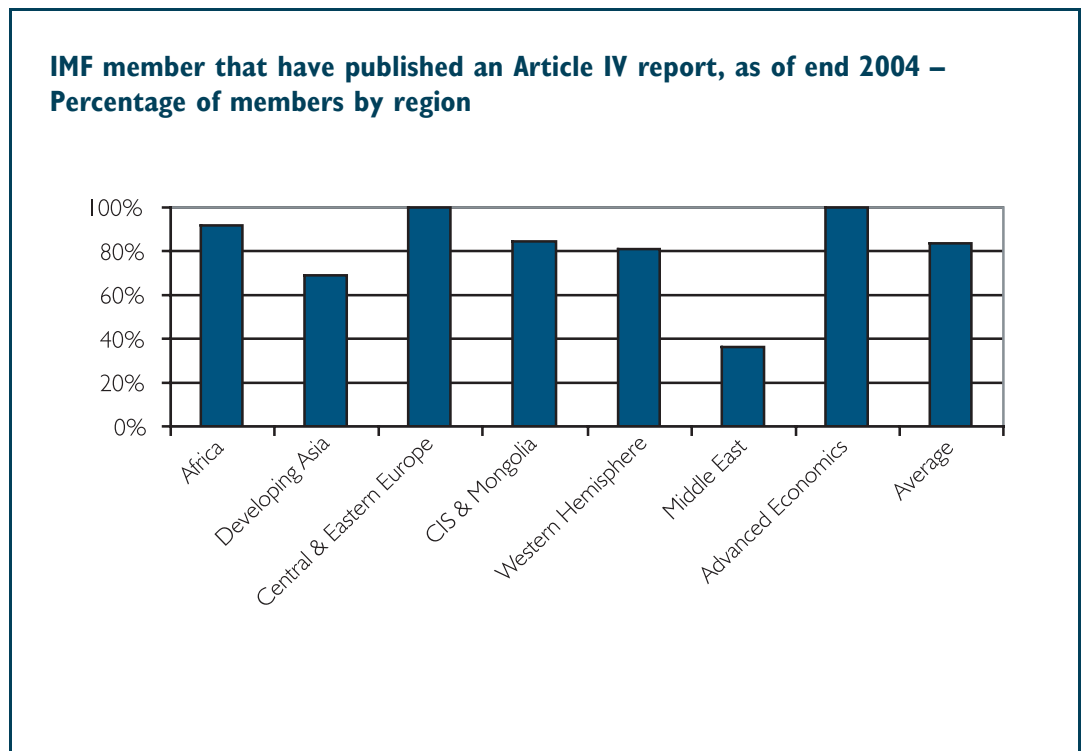
3.4 The UK supports immediate follow up on the identified elements, but has emphasised that a greater priority must be given to this question overall, particularly as part of the IMF’s ongoing review into its medium-term strategy. The UK calls for a clear methodology for assessing the effectiveness of surveillance to be in place by the next review. The need for progress on such a methodology was also identified by the IMFC. Furthermore, the assessment of effectiveness should not only focus on the question of traction - the extent to which advice is adopted - but must include an assessment of the accuracy of assessments made by the IMF. This last element is an especially difficult challenge, but is important to the credibility of surveillance, and would represent best practice in an organisation’s conduct of its activities. As noted in Chapter 2, the UK welcomes the role the IEO can play in reviewing IMF surveillance work, and supports further IEO work in this area.

¹ The IMF has a mandate under Article IV of its Articles of Agreement to exercise surveillance over the exchange rate policies of its members in order to ensure the effective operation of the international monetary system. In 1977, an Executive Board Decision recognized that the IMF’s appraisal of exchange rate policy requires a comprehensive analysis of the general economic situation and policy strategy of each member country.

Increasing Transparency

3.5 The above work on assessing the effectiveness of surveillance is one means to strengthen Fund surveillance, but as a complement to internal processes, the UK has long been a supporter of increasing the transparency of the Fund’s work. Greater transparency can serve to both improve the quality of Fund advice by opening it to wider scrutiny, and increase the traction of surveillance by encouraging pressure on authorities to respond to well justified recommendations.

3.6 Following the agreement of a new transparency policy in 2003², including the introduction of presumed publication for Article IV papers, this fully came into effect in July 2004. Rates of publication of Article IV reports have continued to rise, with the overwhelming majority of African, European, and advanced economy countries having published at least one report. Rates for some regions however remain notably lower. Overall 84% of members have published an Article IV report.



3.7 The biennial surveillance review took forward this work by considering the Fund’s communication of its policy messages to markets and the public. The IMFC supported strengthening of this communication, while preserving the IMF’s role as a candid and confidential advisor.

² Public Information Notice: IMF reviews the fund's transparency policy- issues and next steps; IMF; September 2003

3.8 The UK welcomes the fact that the overwhelming majority of the membership now publishes Article IV reports, and welcomes implementation of the new transparency policy and further work on communication processes. While acknowledging the potential tension between transparency and candour, and the IMF's mandate to provide confidential advice, the UK believes that all countries will benefit in the long term from increased transparency. It is the responsibility of the IMF and countries who have already embraced transparency over their economic policies, such as the UK, to encourage and support others to make this transition. We will continue to urge countries to meet the spirit of the agreed transparency policy, and to go further where possible, including through the publication of codes and standards work (see below).

Independent and objective surveillance

3.9 The UK sees a central role for greater independence of IMF surveillance activity in strengthening surveillance overall. The UK continues to believe in the following objectives to more independence in Fund surveillance:

- 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.

3.10 Evidence of problems due to the lack of political independence from earlier IEO reports has been added to by its report on the Fund in Argentina (see Chapter 2), and by the conclusion of the Fund's biennial surveillance review, in line with academic studies, that many market participants believe political pressures already excessively influence published staff assessments³.

3.11 The UK will continue to emphasise the need for further follow up on bringing a fresh perspective to surveillance in programme countries. The UK will continue to encourage best practice where staff teams make use of innovative practices to separate out surveillance and lending considerations, such as the July 2004 programme review and Article IV for Turkey. The IMF will review its experience with ex post assessments (assessments carried out after the end of an IMF programme in a country) in the course of 2005. The UK wishes to see this brought forward as quickly as possible, and to fully consider options to strengthen independence of surveillance activity in the light of this review.

3.12 The UK believes that ensuring that Fund analysis is objective, and seen to be objective, is an important way to strengthen surveillance. As well as the benefits of transparency in this area, the UK welcomes the IMFC call for strengthened objectivity, including through enhanced debt sustainability analysis covering all members. By ensuring the best tools for objective analysis, combined with transparent opportunities for review and clear processes to ensure objectivity is preserved, the Fund can ensure that the Board and outside actors receive the best possible information. It can also help prevent some of the problems emphasised by the IEO Argentina report.

³ IMF 2004; The Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision – Overview; paragraph 64

3.13 In conclusion the UK will support the follow up to the work in the biennial review, support the continued evolution of the IMFC's role in setting a remit for surveillance (see surveillance section, Chapter 2) and push for further progress on the fresh perspective and objectivity, to ensure more independent and objective Fund surveillance. However, the UK continues to believe that these objectives may be best advanced through institutional reform, and will pursue opportunities in this area.

Codes and standards

3.14 To complement stronger surveillance, the UK believes that countries adopting and implementing internationally agreed codes and standards - which cover transparency in economic policymaking, financial regulation and supervision, and market infrastructure and integrity - can play an important role in helping to reduce the likelihood of financial crises. These standards provide clear and transparent benchmarks of good practice. Assessing countries against them can improve the functioning of markets by facilitating the making of objective comparisons between countries.

3.15 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 the end of April 2005, 631 ROSC modules for 122 economies had been completed, 75 per cent of which had been published.

3.16 The importance attached to this by the UK Government is shown by the inclusion of codes and standards as part of HM Treasury's Public Service Agreement (PSA) targets⁴. 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 2004 12 more countries completed a ROSC for the first time. This combines with a 23 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 4 - the first country to commit to all 12 modules. Follow up on the remaining 4 modules is continuing.

3.17 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 2004, 79 countries had completed an FSAP. All Article IV consultations now routinely provide an overview of members' performance against ROSCs and the FSAP. The Independent Evaluation Office will review the FSAP and the contributory Financial Sector Stability Assessments, as part of its 2005 work programme, and the UK looks forward to the useful lessons that this work will draw.

⁴ 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 FN Preliminary Figures

Technical Assistance For Codes and Standards

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

3.19 In April 2002, a multi donor technical assistance initiative called FIRST (the Financial Sector Reform and Strengthening Initiative) was launched to promote broad, deep and robust financial sectors in low and middle income countries to reduce financial instability and its impact on the poor. FIRST provides technical assistance grants for short and medium term capacity building projects to address financial system weaknesses. For example, countries that wish to improve their financial supervision and accounting standards following on from weaknesses identified in a ROSC or FSAP could seek FIRST assistance. The UK provided an initial contribution of £20 million to FIRST for the first four year period.

Appropriate Facilities

3.20 The UK strongly supports the view that the IMF through its policy advice and its facilities can and should be used to prevent crises, as well as to resolve them. As such we continue to support the efforts of the Fund to review its role in crisis prevention. The UK welcomes consideration of whether there are gaps in the IMF's range of instruments and policies, and supports the IMFC's call for further work on the range of proposals that have been discussed in this context. The UK looks forward to effective follow up and consultation in this area.

Enhanced precautionary arrangements

3.21 The twin objectives of providing incentives to implement good policies, and preventing crises in those countries pursuing good policies, lay behind the introduction of the Contingent Credit Lines (CCL) facility in 1999. The CCL recognised that emerging market countries' vulnerability to capital account crises means that large-scale Fund financial support might be needed. The CCL lapsed at the end of November 2003, at which time no country had applied for it. The UK continues to support the original objectives of the CCL as the natural complement to improvements in surveillance. The UK also feels that a contingent facility could be helpful in assisting countries with large exposures to the Fund to achieve an orderly exit from Fund support.

3.22 The Fund has been examining how precautionary arrangements could play an enhanced role in crisis prevention. Precautionary arrangements have been a very successful tool, and could be adapted to address the vulnerabilities of emerging market economies. Such a programme would:

- Enhance incentives for members to adopt strong policies.
- Provide increased assurances of the availability of Fund resources.
- Provide appropriate access.

3.23 Taken together these features would encourage countries to take measures to reduce economic vulnerabilities and strengthen their financial positions, and contribute to crisis prevention by stabilising market expectations and reducing the risk of large-scale capital flight.

3.24 As gross financing needs can be very large in capital account crises, it should be possible for such programmes to provide large scale financing (known as exceptional access, see Chapter 2, Lending) to countries that have taken appropriate policy measures, should they face capital account pressures. The UK, along with some other advanced economies and many emerging market countries, remains strongly supportive of keeping open the possibility of exceptional access under precautionary programmes. Further work will be taken forward in this area in an Executive Board seminar looking at domestic and international policies and arrangements that allow countries to mitigate the consequences of shocks.

**Precautionary
Poverty
Reduction and
Growth
Facility**

3.25 To ensure consistency across the membership precautionary PRGF programmes could provide a valuable addition to the Fund's existing instruments for low-income countries. Previous experience with precautionary programmes for middle-income countries has been very successful, giving countries the ability to choose whether and when to draw financing. The same arrangements should be available for all IMF member countries, including low-income countries. Precautionary PRGFs could provide a signal of strength that a country's position is robust enough not to rely on IMF finance, and at the same time that IMF support is readily available in case of adverse events. Such a facility could aid graduation from PRGF support and help countries progress toward market access. It could also provide a cushion for countries that are vulnerable to exogenous shocks.

**Policy Support
Instruments**

3.26 In autumn 2004 IMF staff proposed a possible Policy Monitoring Arrangement (PMA), subsequently renamed the Policy Support Instrument (PSI), which will be discussed further. PSIs would be a voluntary and country-led programme designed to promote a close policy dialogue between the Fund and a member country and to provide more frequent Fund assessments of a member's economic and financial policies. Unlike other programmes, PSIs would not include IMF lending. Instead, they would complement rather than replace such programmes and countries would continue to have the option of a full IMF lending programme. A PSI could possibly be useful for a country that does not want or need a full IMF lending programme but that does want IMF engagement as a signal to donors, investors and the financial markets of the strength of its economic policies.

3.27 This idea is at an early stage and it is essential to establish that there is demand for such a programme and to ensure that it complements existing Fund instruments. It is therefore important that the Fund engages in outreach with countries and other stakeholders to assess what features would usefully complement existing instruments and surveillance. The IMF committed to further work into the creation of such an instrument at the Spring Meeting 2005.

Public Investment and Fiscal Policy

Following calls from a number of IMF members, the Fund undertook work in 2004 looking at the issue of public investment and fiscal policy⁵. This work considered ways in which high-quality public investment in infrastructure can be promoted in a fiscally responsible manner, and protected when fiscal adjustment is called for. The Fund also looked at the coverage of fiscal indicators and targets, and the treatment of public-private partnerships in the fiscal accounts.

The UK agreed that more attention should be paid to determining the scope to increase productive public investment and to using the current balance as a fiscal indicator, in line with the UK's own approach in its fiscal rules. However, the UK also acknowledged that the sustainability of countries' debt is crucial, and it is necessary to look at both measures in order to ensure sustainable finances.

The UK also agreed that if it were possible to determine when a public enterprise is clearly commercially run, then excluding its operations from fiscal indicators and targets would allow a more appropriate assessment of a country's fiscal stance. Pilot case studies were undertaken by the Fund into the different approaches in this area with the IMF publishing its findings in April 2005. The UK supported all the main conclusions of the paper and continues to support practical moves to ensure that vital investment is protected, and all countries can ensure they have the necessary infrastructure to support growth and meet public needs whilst ensuring that macroeconomic stability is preserved.

The design of Fund supported programmes

3.28 It is essential to ensure the Fund's current facilities are well designed and implemented. As part of the 2004-05 Conditionality Review the Fund have undertaken a study of country experiences with Fund programmes. They reviewed a range of different types of Fund programmes, including classic current account cases, capital account crises, transition economies, and low-income cases, between 1995 and 2000. We welcomed the detailed analysis that the Fund have done in this study, and look forward to further discussions to draw out the key lessons from this to improve programme design going forward.

3.29 The Fund will build on this work in 2005 with further papers on issues related to PRGF supported programmes. It will be important that this includes an assessment of how effective PRGF programmes are in reducing poverty and supporting countries' own poverty reduction strategies. More information on the UK's approach to conditionality is included in Chapter 4.

⁵ "Public Investment and Fiscal Policy" March 2004

MEETING CHALLENGES TO STABILITY AND GROWTH

Resolving Unsustainable Debt

3.30 As recent cases such as Argentina demonstrate, sovereign debt crises entail significant economic costs for all parties. Improving the timeliness and clarity of the framework for restructuring unsustainable sovereign debt would help to minimise these costs. The UK has been at the forefront of efforts by the international community to improve the framework for crisis resolution (information on the UK agenda for the particular challenge of debt in low income countries is in Chapter 4). A number of proposals have been explored which aim to facilitate the orderly resolution of sovereign debt crises, based upon the following three complementary approaches:

- a voluntary approach, involving the adoption of a set of voluntary Principles to guide the actions of debtors and creditors before and during a crisis;
- a contractual approach, involving the use of Collective Action Clauses (CACs) in international sovereign bonds; and
- a statutory approach, based on the Fund's proposal for a Sovereign Debt Restructuring Mechanism.

Principles for Stable Capital Flows to Emerging Markets and Fair Debt Restructuring Process

On 22 November 2004, a set of "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" were released⁶. The Principles were agreed as the culmination of a co-operative dialogue involving the Institute of International Finance (IIF), other private sector representatives and major sovereign issuers of international bonds. The UK and the diverse member governments of the G20 have also stated their support for the Principles.

The voluntary Principles are aimed at promoting dialogue and guiding the behaviour of sovereign debtors and their creditors. Their implementation could help contribute to more stable capital flows and strengthen both crisis prevention and crisis resolution. The Principles cover four broad areas: transparency and information flow, debtor-creditor co-ordination, good faith actions, and fair treatment. It is expected that these Principles will evolve over time, adapting to experience. It will also be necessary to ensure they remain relevant to the changing global economy.

Collective Action Clauses (CACs)

3.31 Collective Action Clauses in bond contracts allow a qualified majority of bondholders to agree changes to the terms of a bond with the issuer, and ensure that those changes are binding on all bondholders. 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.

⁶ see full text at www.iif.com/data/public/principles_1104.pdf

3.32 Prior to 2003, the inclusion of CACs was standard practice under English and Japanese law, but not New York law. Following the work of the G10 to develop a set of model clauses and the efforts of the international community to encourage their take-up worldwide, the inclusion of CACs in sovereign bonds issued under New York law has become the market standard. As a result, in the first nine-months of 2004, 93% of sovereign bonds issued in New York contained CACs. This development should be helpful in ensuring the more orderly resolution of potential future crises. However, since CACs are only being included in new issues, it will be some years before the entire stock of foreign currency sovereign bonds includes them; currently, approximately 40% of the total outstanding stock contain CACs. There are also some differences in the CACs used in different bonds, including on whether they contain features to reduce disruptive litigation. Going forward, the UK will continue to work with the IMF and others to promote the inclusion of effective CACs in international sovereign bonds issued by all countries.

**Sovereign
Debt
Restructuring
Mechanism
(SDRM)**

3.33 In 2003, the IMF put forward a proposal to establish a Sovereign Debt Restructuring Mechanism (SDRM), which would create a statutory framework under international law to allow a qualified majority of a country's creditors to approve a restructuring agreement which would be binding on all. The Mechanism aims to facilitate negotiation and creditor co-ordination, curb the ability and incentives for creditors to litigate against sovereigns in default, and 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.

3.34 This proposal was presented to the International Monetary and Financial Committee in April 2003. The Committee concluded that the institutional changes needed to establish an SDRM were considerable and at that time it was not feasible to move forward but that work should focus on improving orderly debt restructuring. To date this proposal has not been further progressed. However the UK continues to support the development of a practical operational framework for the restructuring of unsustainable sovereign debts.

Preventing Abuse of the Financial System

3.35 Following on from the success of the 12-month pilot project in assessing countries anti money laundering and countering terrorist financing (AML/CTF) systems, the UK welcomes the decision taken by the IMF and WB Boards in March 2004 to make the 12 month pilot project a permanent and comprehensive part of the work of the international financial institutions. The IMF has endorsed the Financial Action Task Force (FATF) revised methodology for conducting AML/CTF assessments, which it will apply to the third round of mutual evaluations to begin in 2005.

3.36 Over the past 12 months the UK has further strengthened its AML/CTF system. The UK's Money Laundering Regulations were implemented in March 2003 which extend the scope of the regulated sector and complete the implementation in the UK of the 2nd EC Money Laundering Directive. Negotiations are underway for a third Money Laundering Directive, principally to take account of new money laundering/terrorist financing trends and risks and to implement the revised Forty Recommendations of the FATF. In October 2004, the government published its Anti-Money Laundering Strategy Paper to improve awareness of its work in this important policy area and strengthen engagement with key stakeholders.

3.37 In July 2004, HM Treasury hosted a study tour for IMF delegates of the UK's system for combating money laundering and terrorist financing. The visit provided an opportunity to exchange information on the UK's underlying policy objectives in this area and to discuss key aspects of the UK's regulatory system with the relevant government departments and agencies.

3.38 The IMF has intensified its technical assistance, providing in particular assistance on legal drafting and working with regulators to assist in the training of assessors in preparation for the third round of mutual evaluations in collaboration with the FATF and FATF-style regional bodies (FSRBs). The IMF has also been working with the UN on developing model legislation for common law countries; this has been circulated to the Secretariats of the FATF and FSRBs. In 2005, the IMF will conduct a study tour to Africa to assess the risks of money laundering and terrorist financing in cash based economies to understand difficulties and target technical assistance.

3.39 In 2004 the IMF conducted a series of study tours on the operation and regulation of alternative remittance mechanisms. This information will be used by FATF working groups which are currently assessing the vulnerabilities and risks of money laundering associated with specific sectors including alternative remittance.

The Millennium Development Goals provide the key framework for global assistance to low income countries. This chapter sets out: the challenge presented by these goals; the UK priorities to ensure the necessary finance is available to meet this challenge through trade, debt relief, and aid; and the direct role that the IMF has in low income countries, to support this effort over the medium to long term. The Fund's engagement in low-income countries has undergone significant changes in recent years with the introduction of the Poverty Reduction and Growth Facility (PRGF) and the enhanced Heavily Indebted Poor Countries (HIPC) initiative. The UK strongly supports ongoing efforts to intensify Fund support through policy advice and financial assistance, aligned behind Poverty Reduction Strategies, through the new framework for debt sustainability to ensure debt problems do not re-emerge, and through the provision of crucial technical assistance to build capacity in the Fund's poorest members.

THE MILLENNIUM DEVELOPMENT GOALS (MDGs)

4.1 At the United Nations Millennium Summit in September 2000, all UN member states and every major international body, including the IMF, committed to meeting the Millennium Development Goals in 2015.

The Millennium Development Goals (MDGs)

The IMF will continue to align its programmes in low-income countries with broader efforts to reach the MDGs. The goals are 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 The MDGs provide the high-level framework through which international efforts are channelled towards poverty reduction. Progress towards the goals is primarily driven by poor countries themselves, including efforts to improve governance. But crucially it also depends on the actions of the broader international community – to increase and improve aid, relieve countries from unsustainable debt built up in the past, and also to reform global trade so that poor countries can participate and benefit more. The MDGs establish benchmarks for measuring progress and also help to orientate the development programmes of donor countries and the multilateral institutions – including the IMF. Progress towards the MDGs will be assessed at a UN summit in September 2005, but it is already clear that many of the goals will be missed in Africa.

FINANCE FOR GROWTH AND POVERTY REDUCTION

Progress on trade and the role of the IMF

4.3 The Doha Development Agenda negotiations in the WTO, launched by Ministers in November 2001 represent a commitment to making the global trading system fairer, and to prioritising the needs of developing countries, while pursuing the reduction of trade barriers on a multilateral basis.

4.4 Trade is a key driver for economic growth and poverty reduction. According to the World Bank, a successful, liberalising, pro-development conclusion to the Doha Round could lift up to 140 million people out of poverty. Progress on agricultural liberalisation is of particular importance for developing countries. A significant reduction in developed country barriers to agricultural trade could benefit developing countries by up to \$75 billion a year – more than total annual aid flows.

4.5 Agreement on a framework for taking forward negotiations was finally reached by WTO members in Geneva on 1st August 2004, putting the round back on track after the disappointing breakdown of talks in Cancun in 2003. The UK Government is committed to making substantial progress by the time of the Hong Kong Ministerial at the end of 2005, which enables an ambitious and pro-poor conclusion to the Round in 2006. This will require engagement and flexibility on the part of all WTO members.

4.6 The framework agreed in Geneva, which included elimination of all forms of export subsidies, provides the basis for progress. The commitments in that framework should be implemented and taken further, in order to deliver substantial increases in market access, seriously address other production related subsidies, not just export subsidies, and provide effective special and differential treatment to enable developing countries to capture the gains from trade.

4.7 The UK believes that the way forward is both for developed countries to commit to tackling agricultural protectionism, and to provide the additional assistance to better enable developing countries to benefit from access to rich country markets, by helping developing countries build the capacity to trade, ensuring they have the economic and infrastructure capacity to produce and deliver goods to international markets competitively. Research also shows that, for individual families, opening up of trade can bring hardship as well as opportunity, so we also need to deliver additional assistance to help vulnerable countries and their most vulnerable people adjust to more open markets.

4.8 At the same time, developing country governments recognise that it is important to create the right domestic conditions for trade and commerce – a stable economic environment, improved infrastructure, and sound legal processes that can strengthen property rights and deter corruption. It is also important that developing countries are able to carefully design and sequence trade reform into their own development and poverty reduction strategies so that trade does not undermine development and to ensure that the most vulnerable people are protected.

4.9 While the WTO is the forum for multilateral trade negotiations, other international institutions, including the IMF, can and should take actions to support and facilitate the process. The IMF and the World Bank have key and complementary roles to play in enabling all developing countries to benefit from trade liberalisation. The key starting point for each developing country is its own strategy for development and poverty reduction, within which trade reform packages should be carefully designed and sequenced.

4.10 Since the launch of the Doha Round, the WTO, IMF and World Bank have increased their co-operation with a view to improving the coherence of global economic policy-making and assisting developing countries to realise the gains from liberalisation. Recent years have seen an expansion of co-operative activities in three areas: policy analysis; technical assistance and capacity building; and adjustment assistance.

4.11 In April 2004, the IMF formally approved the establishment of the Trade Integration Mechanism (TIM), designed to assist member countries experiencing short-term balance of payments difficulties arising from trade liberalisation. In particular, the TIM is targeted at mitigating the impact of preference erosion, the end of textile quotas, and at helping vulnerable countries deal with potential adverse terms of trade changes resulting from OECD liberalisation, e.g. in agriculture. Bangladesh and the Dominican Republic have both now requested and received support through the TIM. The TIM is an important step towards acknowledging the need to tackle the adjustment costs which certain countries face in the transition to more open markets.

4.12 We welcome the work of the IMF, through the TIM and the Integrated Framework, to help vulnerable countries and their most vulnerable people adjust to more open markets. However, many developing countries will not be able to benefit from trade even with greater market access because they lack the economic capacity and infrastructure to trade competitively. At the spring meeting 2005, the IMFC supported the IMF's role in advocating trade liberalisation and assisting members to benefit from it. The IMFC also encouraged the IMF to work with other partners in the Integrated Framework to explore further ways of easing adjustment to trade liberalisation, including through the TIM, and building capacity in low-income countries. The UK welcomes this and looks forward to consideration of proposals in this area at the 2005 Annual Meetings.

Relieving Debt

The Heavily Indebted Poor Countries Initiative

4.13 The UK is committed to ensuring that no poor countries face unmanageable debt burdens and is at the forefront of international efforts to cancel the debts of the most heavily indebted poor countries. The UK was instrumental in securing international agreement to the joint IMF/World Bank original (1996) and enhanced (1999) HIPC Initiatives, and has continued to champion the debt relief agenda, securing G8 agreement this June to a proposal which will cancel 100 per cent of these countries debts to the international financial institutions (see box).

G8 Proposal for 100 per cent multilateral debt relief

At the meeting in London on 10-11 June, G8 Finance Ministers agreed a proposal to complete the process of debt relief for the Heavily Indebted Poor Countries by providing 100 per cent stock cancellation on debts owed to the IMF and the concessional financing arms of the World Bank and African Development Bank: the International Development Association (IDA) and the African Development Fund (AfDF). The proposal was endorsed by heads of state and government at Gleneagles later on 8 July. This relief matches the 100 per cent debt relief which the UK and other creditors provide on their bilateral loans to these countries. This proposal would also provide additional development resources to support countries' efforts to reach Millennium Development Goals, while ensuring that the financing capacity of the International Financial Institutions is not reduced.

Under the proposal, HIPC countries would receive irrevocable cancellation of 100 per cent of debt stock owed to the IFIs. 18 countries¹ could immediately benefit from this relief, worth US\$40 billion. This number will rise as more countries progress through the HIPC Initiative, with up to US\$55 billion provided for the 38 HIPC countries.

To ensure the financing capacity of the IFIs is not reduced, donors would provide additional contributions to IDA and the AfDF to offset the foregone repayments of the cancelled debt. Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the MDGs and ensure that assistance is based on country performance and that all resources are used for poverty reduction. For the IMF, the proposal envisages using a combination of internal resources to fund the relief.

The G8 will put these proposals to the Annual Meetings of the IMF, World Bank and African Development Bank later this year.

The UK attaches great importance to all developing countries having access to the finance necessary to achieve the Millennium Development Goals, including those which have not been deemed eligible under the HIPC Initiative. Therefore in addition to the G8 debt cancellation proposal, the UK will continue to pay its share of the debt service owed to the World Bank and African Development Bank by other low-income countries which meet criteria for ensuring that the debt service savings are used for poverty-reducing expenditure. Countries eligible for the UK's initiative will be those low-income countries accessing only concessional lending from the World Bank, and which have strong public financial management, as demonstrated by their receipt of Poverty Reduction Support Credit from the World Bank.

G8 Finance Ministers' conclusions on Development are included in this report as Annex F.

4.14 The Heavily Indebted Poor Countries (HIPC) Initiative was launched in 1996 with the aim of ensuring that no poor countries face unmanageable debt burdens. The Initiative involves the international financial community, including multilateral organisations and governments, taking coordinated action to reduce the external debt burdens of the most heavily indebted poor countries to sustainable levels.

¹ Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia.

4.15 In order to ensure debt relief is focused on supporting poverty reduction, countries under the HIPC initiative develop a Poverty Reduction Strategy Paper (PRSP) in partnership with civil society. The IMF and World Bank then carry out a debt sustainability analysis to determine the debt relief required to bring the debt ratio down to the agreed threshold of 150 per cent of exports. 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 known as Decision Point.

4.16 Once Decision Point is reached, the country may immediately begin receiving interim relief on its debt service falling due. However, in order to receive the full and irrevocable reduction in debt, the country must establish a further track record of good performance under IMF and World Bank supported programmes.

4.17 Once a country has met these criteria, it can reach its Completion Point, when all lenders, including the International Financial Institutions, the Paris Club of major official bilateral creditors, and other official creditors, are expected to provide the full and irrevocable debt relief committed to at the decision point.

4.18 The UK has provided commitments of around £2.4 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 going further by providing 100 per cent relief for eligible HIPCs when they reach Completion Point.

4.19 Since 2004, Nicaragua, Niger, Ethiopia, Senegal, Ghana, Honduras, Madagascar, Rwanda and Zambia have reached their Completion Point under the Enhanced HIPC Initiative, bringing to 18 the number of countries that have received debt relief on an irrevocable basis. A further 12 countries have passed the Decision Point under the HIPC Initiative and are receiving debt relief on an interim basis. Since the implementation of the Initiative began, over \$70 billion in debt service relief has been committed. An extension of the Initiative for two years was agreed in October 2004. This will enable a further ten countries to receive debt relief, making possible a further debt write-off of more than £30 billion.

Topping up at Completion Point **4.20** 'Topping up' can be used to provide additional debt relief at Completion Point to a country that - due to exogenous factors - will otherwise graduate from the HIPC Initiative with a debt-to-export ratio still in excess of 150 per cent. The UK has been a strong supporter of providing this additional relief for all such countries. In 2004, both Niger and Ethiopia were awarded this additional relief, amounting to an extra \$143 million and \$700 million respectively in NPV terms. Rwanda also received "topping up" of over \$243 million in NPV terms when it reached completion point in 2005.

Further debt relief **4.21** In building the case for 100 per cent multilateral debt relief, the UK led discussions during 2004 of the case for further debt relief at the IMF, financed by releasing the value of the IMF's gold reserves. The IMF holds reserves of 103.4 million ounces of gold, valued in the IMF's accounts at its historic price of SDR 35 (\$53) per ounce, considerably below current market prices. The IMF's holdings of gold provide a fundamental strength to its balance sheet, and maintaining the IMF's financial integrity is a priority for all members. In 1999 the IMF revalued 12.9 million ounces of gold, releasing financing of approximately \$3.8 billion, which was used to finance relief for the enhanced HIPC initiative, and to subsidise the IMF's lending to low-income countries.

Bringing Aid Forward: The International Finance Facility

4.22 Freer and fairer trade, and the reduction of debt burdens are essential steps in releasing the finance necessary to meet the MDGs. But alone they are not enough; this challenge will also require greater aid levels, delivered in time. Estimates suggest that development assistance must be doubled and focused on the poorest countries if the MDGs are to be met – an increase of at least \$50 billion a year. The EU has made a commitment to double aid from over \$40 billion in 2004 to over \$80 billion by 2010, and the commitments of the G8 and other donors will lead to a increase in aid to Africa of \$25 billion a year by 2010, more than a doubling aid to Africa compared to 2004. However, the focus must now be on delivery and to provide these increases as soon as possible.

4.23 For some countries, innovative financing mechanisms will play a key role in achieving these increases, as well as supporting progress towards meeting the target for donors to provide ODA of 0.7% GNI. The UK has proposed the International Finance Facility (IFF) as a vital step to support this progress. The IFF is a stable and predictable financing mechanism that could provide the critical mass of aid needed to meet the MDGs by 2015.

4.24 The IFF would provide an immediate and substantial increase in the level of resources available. By “frontloading” long-term aid commitments, the IFF will allow donor countries to play their full part in delivering the MDGs within current fiscal constraints. The funds disbursed by the IFF would be a complement to donors’ long-term commitment to the 0.7% ODA/GNI target.

4.25 There is good evidence to show that the countries needing the most support to meet the MDGs have the capacity to absorb much higher levels of aid. Studies indicate that the marginal benefits of aid depend on how it is managed, and that diminishing returns are often caused by unpredictable aid flows. The World Bank has estimated that countries in Asia and Sub-Saharan Africa could effectively manage at least a 60-100% increase in aid flows in the short term.

4.26 The IFF would not only immediately increase aid flows to the poorest countries, but would help improve the way aid works. The IFF would improve donor coordination and harmonization, so that developing countries would not have to deal with the huge administrative burden of reporting to several donors, and target aid towards the specific purpose of achieving the MDGs. The long-term, multi-year commitments that donors would make to the IFF, according to an agreed set of high-level principles to ensure aid effectiveness, would increase the predictability and stability of aid, allowing recipient countries to make sustainable investments in their futures.

4.27 Progress towards the UN target of 0.7 per cent ODA/GNI is a crucial element of the provision of the levels of predictable funding needed to make progress on meeting the MDGs. The EU has pledged to reach 0.7 per cent ODA/GNI by 2015 with a new interim collective target of 0.56 per cent ODA/GNI by 2010. The EU will approximately double its ODA from current levels of around \$40 billion to over \$80 billion by 2010. At least 50 per cent of this increase will go to sub-Saharan Africa. The UK has announced a timetable to reach 0.7 per cent ODA/GNI by 2013 and will double its bilateral spending in Africa between 2003/04 and 2007/08. On this timetable, by 2007/8, the UK will reach an ODA/GNI ratio of 0.47 per cent from a level of 0.26 per cent in 1997 and 0.34 per cent in 2003. The additional funding provided by an IFF would allow the UK to reach the equivalent of 0.7 per cent ODA/GNI as early as 2008-9. G8 Heads have agreed that to ensure some countries meet their targets and other countries could bring their timing forward, a working group would consider the implementation of innovative financing mechanisms including the International Finance Facility (IFF), and the pilot IFF for Immunisation to be launched soon.

The IFF for Immunisation

4.28 An estimated 2-3 million children under 5 die each year from diseases that could be prevented by vaccines available now or likely to be available in the near future. The UK has been working with partners in the Global Alliance for Vaccines and Immunization (GAVI) and other donors to explore using the IFF principles to fund an IFF for Immunization (IFFIm), to be launched early in 2005. The IFFIm will demonstrate the technical feasibility of the IFF and the significant benefits of frontloading resources for development. Without the use of the frontloaded investments, it will not be possible to scale up immunization coverage to the level needed to reduce child mortality and help meet the MDGs. By frontloading \$4 billion over 10 years through the IFFIm mechanism, an estimated 5 million lives could be saved in the years to 2015, and a further 5 million adult deaths could be prevented after 2015. This would make a significant contribution to the MDGs in the poorest countries throughout the world. Technical details of the IFFIm are currently being finalised and Eurostat, the European Statistical Agency, is currently considering the appropriate treatment of the IFFIm in Member States' national accounts.

4.29 In spring 2005, the Development Committee noted that negotiations among interested parties on the proposed pilot IFFIm are well-advanced and that the analysis of technical feasibility of the IFF has created the conditions for the necessary political decisions on participation. The Committee encouraged interested donors to proceed with these proposals.

INTENSIFYING FUND SUPPORT FOR LOW-INCOME COUNTRIES

4.30 The IMF can make an important contribution to development and poverty reduction in low-income countries. The IMF's mandate and expertise in macroeconomic stability makes it an essential element of the international development system, alongside donors and the multilateral development banks. A stable macroeconomic environment is critical for establishing a basis for growth, essential for poverty reduction, avoiding adverse effects of high inflation on the poor and protecting government expenditure that benefits the poor. The IMF provides advice and finance to support reform programmes aimed at stabilising countries' macroeconomic positions and reducing their vulnerabilities, creating a macroeconomic foundation for development and poverty reduction. The appropriate mix of IMF support will vary according to countries' circumstances and the extent to which they have entrenched stability. It is important that policy reforms advocated by the IMF to reach and maintain stability are coherent with other efforts to reduce poverty – such as scaling up investment in basic health, skills, and infrastructure. Working within the Poverty Reduction Strategy approach, the UK continues to encourage the IMF to take full account of the poverty implications of its operations, specifically by enhancing its capacity to conduct Poverty and Social Impact Assessments (PSIA) in its work.

Working with the World Bank

In its work in low-income countries it is essential that the IMF remains focussed on its areas of expertise, and works closely with the World Bank to ensure a comprehensive approach to meeting these countries needs, combined with an appropriate division of labour. The Fund and the Bank maintain close collaboration through the framework of Poverty Reduction Strategies, including identifying which institution will lead on a particular policy area in each low-income country in question (“the lead agency model”). The review bodies of the two institutions have recently conducted a joint review of their work in this area. The Fund and Bank have also worked together on the new debt sustainability framework for low-income countries.

The Bank and Fund also work closely together in a number of 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 Reports on the Observance of Standards and Codes (ROSCs) and an expansion of their work on Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT).

The UK approach to the organisations ensures coordination via a single Executive Director and office to represent the UK in the Boards of the institutions. This coordination is supported by close work between HM Treasury and the Department for International Development (DFID), the lead UK department for relations with the World Bank. The UK supports the intention of the institutions to continue to strengthen their joint working, including through the reconstituted Joint Implementation committee, and will seek progress on this work, including coordinated follow up to the recommendations of the PRS reviews, and measures to ensure the coordinating framework the PRS provides in low income countries is matched in middle income members. UK aims for the debt sustainability framework are covered below. Further information on UK engagement with the World Bank is included in an annual statement to Parliament produced by DFID.

Poverty Reduction Strategies

4.31 The poverty reduction strategy (PRS) process, introduced in 1999, is strongly supported by the UK. PRSs provide a framework for concessional support from the international financial institutions, including the IMF, and increasingly for that of other donors. 45 PRSs are now being implemented in total. 27 countries have produced one or more Annual Progress Reviews (APRs)². There are about 30 countries that could become engaged in the process that have yet to complete a full PRS – most of these are Low Income Countries Under Stress (LICUS). Of these 30, 10 have completed interim PRSs.

4.32 PRSs 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. PRSs 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.

IMF and World Bank PRS Review

Five years since the inception of PRSs, the IMF and World Bank are currently undertaking a joint review of the PRS process. Launched in February 2005, this aims to inform future policy by providing a comprehensive assessment of several key issues. The five themes to be addressed are:

- Strengthening the medium-term orientation of the PRS approach;
- Utilising the PRS as a mutual accountability framework between countries and donors;
- Broadening and deepening meaningful participation;
- Enhancing linkages between the PRS, medium term expenditure frameworks and budgets;
- Tailoring the approach to conflict-affected and fragile states.

The UK supports the Review and considers the main challenge to be adapting the PRS approach to increase country ownership. The focus should be on processes that strengthen country systems rather than produce a PRS paper, and the PRS needs to be flexible enough to encourage this. Country leadership should be at the heart of all these changes in approach.

It has been agreed that Bank/Fund assessments of PRS' will now play an informational role and will not be requirements of future support.

² World Bank 2004 Progress in Implementation Report

The Poverty Reduction and Growth Facility (PRGF)

4.33 The PRGF is the IMF's concessional lending programme for low-income countries. As of March 2004, about two-thirds of PRGF eligible countries had arrangements under the PRGF3. The creation of the PRGF in 1999 reflects the fact that the IMF has a vital role to play, alongside development institutions and donors, in supporting its poorest member countries, and that these countries required softer lending terms than standard IMF financing. The IMF's role is both technical and financial. The PRGF provides a framework for policy advice, and provides financial resources to enable macroeconomic adjustment.

4.34 The UK believes that the provision of a PRGF programme on a precautionary basis could provide a valuable addition to the Fund's existing instruments for low-income countries, providing donors and investors with a signal of strength that a country's position is robust enough not to rely on IMF finance, and at the same time that IMF support is readily available in case of adverse events. It could aid graduation from PRGF support and help countries progress toward market access. It could also provide a cushion for countries that are particularly vulnerable to exogenous shocks. The broader issues of the Fund's role in respects of shocks and signalling will be discussed further during 2005. Further consideration of the IMF facilities available to low income members, and their signalling value, is included in the consideration of the Fund's range of facilities in Chapter 3.

Conditionality in IMF programmes

4.35 The use of conditionality on aid is contentious, especially in sensitive policy areas such as privatisation and trade liberalisation. Inappropriate conditionality brings high transaction costs for countries, threatens national ownership of reform, and has largely been ineffective in leveraging sustained policy reform.

4.36 In March 2005 the UK published a new paper on conditionality⁴, calling for a new approach between donors and developing countries based on shared commitment to poverty reduction and achieving the MDGs, strengthening financial management and accountability, and respect for human rights. In this new approach the UK established that agreed benchmarks for measuring progress on the reduction of poverty will be the basis for UK bilateral support. The benchmarks will focus on the impact of the government's overall programme, rather than specific policy choices. To make aid flows more predictable, the UK will seek to be clear in advance about how much aid will be given and the basis on which funds will be reduced or stopped. A legitimate reason for retaining safeguards relating to financial management and accountability systems is to demonstrate to UK citizens and Parliament that overseas aid is well spent, and not misused through weak administration or corruption.

4.37 The IMF recently conducted an internal review of its own conditionality guidelines. This demonstrated progress in narrowing the range of conditions, but indicated room to improve the stress on country ownership, implementation and poverty focus. In addition, the Independent Evaluation Office will be conducting a review of IMF structural conditionality in 2006. The UK will work within the framework of these reviews, and in individual country discussions, to promote the new approach proposed by the UK.

³ Evaluation of the IMF's role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility; IMF Independent Evaluation Office; July 2004 available at www.imf.org

⁴ Available at <http://www.dfid.gov.uk/pubs/files/conditionality.pdf>

The Debt Sustainability Framework

4.38 The primary responsibility for determining debt policies lies with each country. The IMF and World Bank have a role to ensure that overall donor assistance is provided in a form that supports development and will not lead to the build up of unsustainable debt levels in the future. Borrowing should be in step with progress in strengthening capacity to repay, prudent debt management, and resistance to shocks.

4.39 In the course of the last year the IMF, working closely with the World Bank, has elaborated a framework aimed at avoiding future debt crises by ensuring that poor countries receive their aid in the appropriate combination of grants and concessional loans. The economic evidence suggests that the likelihood of unsustainable debt varies according to the strength of a country's institutions and policies, and the debt sustainability framework suggests that each country's debt thresholds be set in a way that takes account of these factors.

4.40 The UK has been a strong supporter of the work of the IMF and World Bank to refine this framework, and has helped ensure that the framework will be operationalised in a way that allow these countries to access the resources they need to make progress towards the MDGs, without risking a return to unmanageable debt levels. Directors of both the Fund and the Bank have endorsed a collaborative process in the preparation of debt sustainability analyses, with the objective of the IMF and the World Bank being to agree a single DSA, based on a clear division of labor, and in line with the mandates of the two institutions. The UK supports the Bank and the Fund making joint assessments to give countries clear advice on how to finance progress towards the MDGs. Further close collaboration between the IMF and World Bank will be needed to ensure that the framework is implemented in a manner which supports each country's development objectives.

Technical Assistance

4.41 In low-income countries, technical assistance is one of the key pillars of IMF engagement. The objective of the IMF's technical assistance programme is to enhance the effectiveness of economic policy and financial management. The technical assistance provided either seeks to support the efforts of members to strengthen the capacity of both human and institutional resources or to assist countries in the design of appropriate macroeconomic and structural policy reforms. The specific programme of technical assistance is influenced by issues that emerge in the course of the IMF's surveillance and programme activities. The UK would like the IMF to play a more positive role in moving towards more harmonised and coordinated provision of technical assistance in countries. In the low-income country context, it is particularly important that priorities for technical assistance are established through the PRS process.

The IEO review of IMF Technical Assistance

The Independent Evaluation Office recently evaluated IMF Technical Assistance. The evaluation emphasised the importance of embedding assistance within a sound institutional structure and in country reform programmes for it to prove effective. The Managing Director endorsed the study's recommendations and has called on staff to ensure effective follow up. The UK also endorses the importance attached to country leadership, working in harmony with other donor efforts and ensuring the capacity of host institutions to harness expert advice.

Regional Centres 4.42 The IMF has four regional technical assistance centres in the Pacific, Caribbean, East and West Africa. The two African centres were established in late 2002. Their goal is to strengthen the capacity of African countries to design and implement their poverty-reducing strategies, as well as to improve the coordination of capacity-building technical assistance in the PRS process. The initiative also aims to increase the volume of capacity-building assistance from the IMF to Africa in the IMF's core areas of expertise. A recent external evaluation of the two centres found their regional presence added to the effectiveness of the assistance provided.

A

THE UK VOTING RECORD - A SUMMARY

A.1 This Annex provides information on the formal votes taken by the Board of Governors of the IMF in 2004, and an explanation of the UK position in each vote. Most decisions are taken in the IMF Executive Board, which usually works on the convention of consensus, without recourse to formal voting. Detail on the UK stance in the Executive Board is provided in Chapter 2, including our framework for regular interventions in discussions, and an explanation of those points where the UK has departed from consensus. A summary of Board votes registered by the UK is also included below.

Votes by the Board of Governors

A.2 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.3 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'. Governors voted on the following decisions in 2004:

No.	Resolution	Voting Result	Effective Date	UK Position
59-1	Salary of the Managing Director	Passed	June 16, 2004	Abstain
59-2	Direct Remuneration of Executive Directors and their Alternates	Passed	July 28, 2004	Oppose
59-3	2004 Regular Election of Executive Directors	Passed	August 18, 2004	Approve
59-4	New Period for Consent—Increases of Quotas of Members under the Eleventh General Review	Passed	September 20, 2004	Approve
59-5	Financial Statements, Report on Audit, and Administrative and Capital Budgets	Passed	October 3, 2004 Annual Meeting	Approve

Explanation of Votes

A.4 Consistent with the firm stance of the UK on budget and remuneration issues (see chapter 2, management and budgets) the UK abstained on the salary decision for the new Managing Director and opposed the increase in remuneration for Executive Directors and their Alternates. The UK believes that the remuneration of Executive Directors and their Alternates should reflect their primary role as appointed public officials and representatives.

A.5 The resolution on the 2004 regular election of Executive Directors confirmed the continuation of policies regarding the number and procedure for election of Executive Directors. It left unchanged the decision to have 19 elected members of the Executive Board (in addition to the 5 appointed members for the 5 member countries with the largest quota share). This required a vote of governors because the Articles allow for 15 elected members, unless the governors decide to increase this number. The resolution also mandated that the next such vote be held in 2006. The UK supports measures to ensure that all countries are adequately represented in the IMF (see Chapter 2, voice and governance) and approved the resolution.

A.6 Resolution 59-4 extended the deadline by which countries can agree to a quota increase, dating back to the last increase at the Eleventh General Review. This applies to those countries that have been unable to consent because they have arrears to the Fund: Iraq, Sudan, Somalia, and Liberia.

A.7 Decision 59-5 gave 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. The UK is content that this is the case, but did not register a vote on this resolution, as the Governor was not in attendance at the Annual Meeting at the time the vote took place.

A Summary of Executive Board Votes

Issue	Date of Board Meeting	UK Vote	Board Decision
Argentina: First review of stand by arrangement	28 January 2004	Abstain	Approved

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 2004, was SDR 10,739 million about £8.6 billion. (see Chapter 2 for more information on the IMF's finances).

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' (SDRs 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.

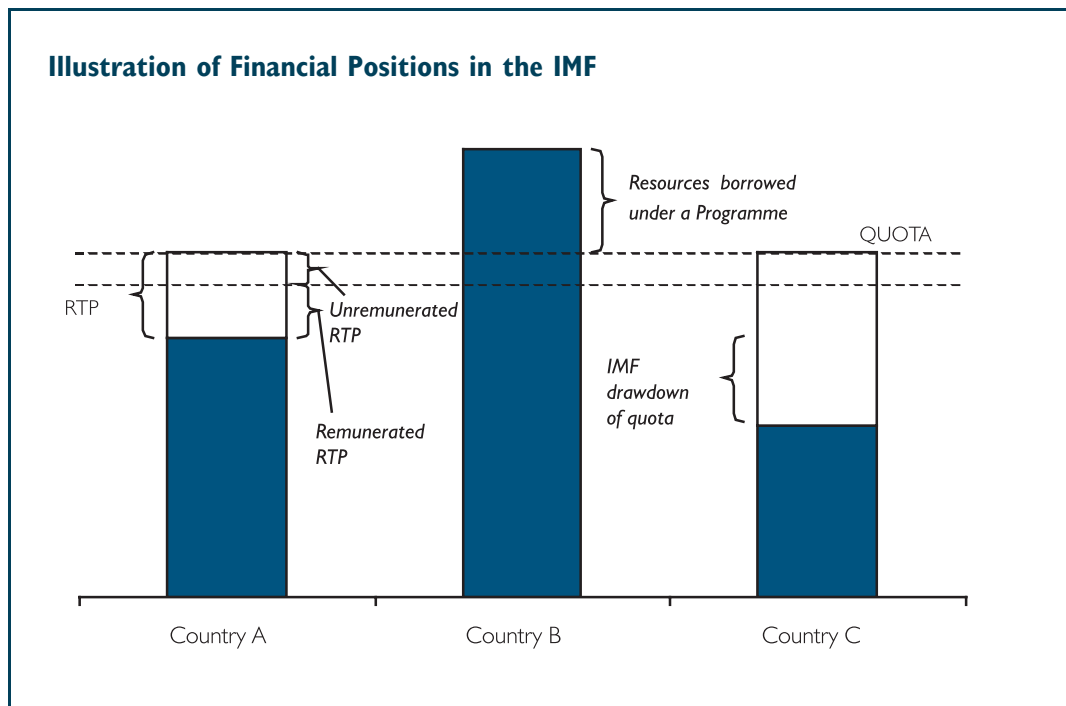
B.4 When the IMF lends to a country, it provides them with reserve assets. Therefore, in the first instance, the borrowing country can call back the proportion of its quota originally paid in reserve assets from the IMF. However, the borrowing country can also request additional funds. The IMF finances 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 (net lending) 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 our 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 2003-04. 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 2003-04, 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 2004 was SDR 4,262 million, about £3.4 Billion and approximately 40 per cent of quota, which is funded by the National Loans Fund (NLF).



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 members' 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.

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 regards to the UK's RTP, this forms part of our reserves and as such, any increases in its size are not regarded as increases in public expenditure. SDRs 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 in 2003-04, the interest loss (driven by the difference between the sterling interest rates used for the liability to the NLF against the SDR rate) was £89 million and the capital loss (due to exchange rate movements) was £280 million. The total loss on the UK RTP was therefore £369 million.

SDR Allocation

B.12 In addition to our quota, the UK has received one-off SDR allocations totalling SDR 1.9 billion (averaging 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 we held our 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 SDRs and invest the proceeds in dollars, euros and yen assets for portfolio management reasons. In FY 2003-04, we held on average £0.2 billion in SDRs and £1.4 billion in foreign currency. As a result, we paid interest to the IMF on our full allocation and received interest from the IMF on our holdings of £0.2 billion. We also received interest on our £1.4 billion in foreign exchange holdings at the foreign exchange interest rate. If this interest rate is lower than the SDR rate we make a net loss on the allocation. This was the case in 2003-04 for the UK when we made a net loss of £5 million. Capital gain on the allocation was flat over the year giving a total loss of £5 million overall on the UK SDR allocation.

Net Financial Cost of IMF Membership

B.14 The estimated net financial cost to the UK of membership of the IMF is therefore driven by movements in the sterling, SDR and foreign interest rate differentials and by exchange rate movements (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).

B.15 For 2003-04, the portfolio of reserves associated with the IMF membership cost the UK approximately £375 million. However, had we not been a member of the IMF and instead held a portfolio of conventional reserves, the net cost would have been approximately £530 million. This figure is calculated by assuming that the amounts of the RTP and SDR allocation are funded in sterling from the NLF and invested in reserve assets, keeping total UK reserves unchanged, in line with existing policies on neutralising changes in the RTP. The difference between the UK membership of the IMF and holding conventional reserves was approximately £155 million for 2003-04.

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

A summary of the cost of UK membership of the IMF

Financial Year	Gain/loss from membership (£m)	Gain/loss of non-membership (£m)	Net benefit/cost of membership (£m) ²⁰
2003-04	-374.56	-529.56	+155.00
2002-03 ²¹	-67.67	-44.7	-22.96

C.1 The International Monetary and Financial Committee held its ninth meeting in Washington, D.C. on April 24, 2004 under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

The Global Economy and Financial Markets—Sustaining the Recovery

C.2 The Committee welcomes the strengthening of the global economic recovery since its meeting last September. Industrial production and global trade have picked up sharply, and improved prospects in most regions point to stronger global growth going forward. However, a number of risks remain. These arise from large global imbalances, medium-term fiscal challenges in many countries, and the implications of the eventual transition to a higher interest rate environment. Continuing geopolitical uncertainties and developments in oil markets also remain important concerns.

C.3 The priority now is to implement the macroeconomic and structural policy measures that will help achieve a robust, balanced, and sustainable recovery. Structural reforms are essential to improve growth potential. Priority should be given to medium-term fiscal consolidation; reforms of pension and health care systems; better functioning labor and product markets; and reducing vulnerabilities in banking and corporate sectors. The Committee calls on all countries and regions to play their part and cooperate in addressing global imbalances.

C.4 The economy of the United States is expanding briskly, and Japan's economy continues to recover. The recovery in the euro area so far is more subdued. Monetary policy in advanced economies will need to remain consistent with price stability and support the recovery; in many countries where growth is strengthening, interest rates will over time need to rise to more neutral levels; and it will be important to communicate policy intentions clearly. The Committee encourages countries to take advantage of the current environment to strengthen the foundations for sustainable growth. Priorities for action include: medium-term fiscal consolidation in the United States; acceleration of structural reforms in the euro area; and continued banking and corporate reforms in Japan. Fiscal consolidation is also needed in the euro area and Japan.

C.5 The Committee is encouraged by the strong performance and recovery in many emerging market and developing countries, which has been aided by improved fundamentals and a rebound in private capital flows. Countries should continue to use the opportunity provided by the favorable financial market environment to strengthen growth prospects and reduce vulnerabilities. This will require steps to further strengthen fiscal positions and improve the structure and sustainability of debt, sustained and broad-ranging structural reforms, and, in some emerging market countries, a move toward more exchange rate flexibility as appropriate. The Committee welcomes the improvement in Argentina's macroeconomic performance, and calls on the government to continue to push ahead with full implementation of the policies and provisions of its economic recovery program aimed at strengthening growth, including negotiations aimed at reaching a sustainable debt restructuring through a collaborative agreement with creditors.

C.6 Economic performance in many low-income countries continues to improve. Nevertheless, the Millennium Development Goals (MDGs) set out in the UN Millennium Declaration remain at risk, particularly in sub-Saharan Africa, and much remains to be done by all partners in the global effort to deliver them. The Committee underscores that stronger domestic institutions, sound economic policies, trade integration, and less burdensome regulation will be needed to underpin faster growth and poverty reduction. It welcomes the recent steps taken through the New Partnership for Africa's Development (NEPAD) and the African Union to improve governance and eradicate corruption. It calls on the international community to provide additional and coordinated assistance—including technical assistance, policy advice, increased and more effective aid including grants, debt relief, and greater access to industrial country markets.

C.7 The Committee received the report of Dr. Supachai Panitchpakdi, Director-General of the World Trade Organization. It reiterates the critical importance of open markets for supporting broad-based global economic growth and prosperity. The Committee calls for constructive and determined efforts by all countries to achieve early progress with the Doha Round, focusing 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. A successful completion of the round is a shared responsibility, important for all countries, particularly developing countries. The Committee supports the IMF's role in advocating trade liberalization and helping members to take all the necessary actions to gain full advantage of the opportunities provided by more open trade. It welcomes the IMF's decision to establish a Trade Integration Mechanism, designed as a temporary policy to address concerns associated with the current round of multilateral trade negotiations.

Crisis Prevention and IMF Surveillance Across the Membership: Priorities, Tools, and Modalities

C.8 Effective and evenhanded IMF surveillance remains an essential element of the international community's efforts to enhance crisis prevention, promote financial stability, and foster high and sustainable growth. The Committee especially welcomes the increased focus of surveillance on: financial sector and capital market issues—including the work from the Financial Sector Assessment Program, Reports on the Observance of Standards and Codes, and Offshore Financial Center assessments; economic developments and policies in countries of systemic or regional importance; early identification of potential vulnerabilities; and institutional foundations of growth. It also welcomes the work already underway and the proposed pilots on the treatment of public investment in IMF advice and arrangements with a view to protecting infrastructure investment, consistent with macroeconomic stability and debt sustainability.

C.9 The Committee welcomes efforts to bring a fresh perspective to the surveillance of program countries, and the decisions taken to increase the transparency of surveillance. It calls for a strengthening of efforts to ensure the objectivity of surveillance (including through debt sustainability analysis), and requests the IMF to explore ways to support countries' own economic efforts when the IMF is not providing financial assistance. The Committee looks forward to the forthcoming biennial review of surveillance, which should provide a thorough assessment and candid review of surveillance, and propose ways to enhance its focus, quality, persuasiveness, impact, and overall effectiveness.

C.10 The Committee welcomes the greater focus on vulnerabilities and key issues for surveillance identified at its meeting in Dubai: improving debt sustainability; reducing balance sheet vulnerabilities; and making progress on structural reform and sustainable medium-term fiscal frameworks. It agrees that further progress in these areas, as well as with policies to facilitate the adjustment of global imbalances, remain key priorities for surveillance in the coming year. Surveillance will also need to pay due attention to relevant political risks and to vulnerabilities to exchange rate and interest rate movements.

C.11 The Committee looks forward to further work on ways to reduce vulnerabilities and provide support for members with strong policies in dealing with external financial developments. It looks forward to the upcoming discussion of precautionary arrangements and their potential to assist members' own efforts to prevent balance of payments crises and as a possible exit strategy from IMF financial support.

C.12 The Committee welcomes the inclusion by an increasing number of countries of collective action clauses (CACs) in their international sovereign bonds and the convergence toward a market standard. It calls on the IMF to continue to promote progress in this area. The Committee also encourages sovereign debtors and private creditors to continue their work on a voluntary Code of Conduct, and looks forward to reviewing further work on issues of general relevance to the orderly resolution of financial crises. The Committee takes note of the Executive Board's ongoing review of the framework, and application of procedures, for exceptional access to IMF resources. It calls on the IMF to continue reviewing implementation of its lending into arrears policy.

Enhancing IMF Support to Low-Income Members: Instruments and Financing; IMF-World Bank Collaboration; and Promoting Debt Sustainability

C.13 The Committee reiterates that the IMF—in partnership with multilateral development banks and donors—has an important role to play in assisting its low-income members with effective policy advice, financing, and technical assistance to achieve high and sustained growth and poverty reduction. It welcomes the progress on better tailoring the IMF's assistance to the differing financing and policy needs of low-income countries. The Committee looks forward to further work on a strengthened process of surveillance for those countries where the IMF is not providing financing, with a view toward enhancing the signaling role of surveillance and promoting country ownership. It underscores the importance of improving the macroeconomic design of PRGF-supported programs, including the social impact. The Committee underscores the importance of maintaining an adequate PRGF financing capacity. In order to meet future needs, it calls for further discussions on the financing of a self-sustained PRGF. The Committee welcomes that some countries have indicated a willingness to provide additional resources.

C.14 The Committee reiterates that the Monterrey Consensus and Poverty Reduction Strategy Paper (PRSP) approach provide the appropriate framework for the IMF's engagement with low-income countries and its participation in global efforts toward achieving the MDGs. It encourages a further sharpening of the focus of PRSPs and PRGF-supported programs to enhance their linkage to the MDGs and their operational usefulness for policy choices and donor coordination. The first Global Monitoring Report on meeting the MDGs highlights the significant remaining challenges. The Committee expresses concern that on current trends, most MDGs will not be met without an increase in the level and effectiveness of financial resources in support of strong policies. It looks forward to reviewing at its next meeting the ongoing joint work with the World Bank on aid effectiveness, absorptive capacity, results-based measurement mechanisms, and various policy options and financing mechanisms, such as an international financing facility and other options. In this regard, it welcomes the consultation with emerging markets and developing countries. The Committee welcomes the recent review of IMF-World Bank collaboration, and supports the plans for improved coordination.

C.15 The Committee welcomes the progress in providing debt relief under the enhanced HIPC Initiative, with a further five countries reaching their completion point since the Annual Meetings. It looks forward to continued further progress toward full implementation of the Initiative, and takes note of the work being undertaken on options for addressing the sunset clause. The Committee urges all creditors that have not yet done so to deliver debt relief in full. It welcomes the development by the IMF and the World Bank of a debt sustainability framework for low-income countries, and looks forward to further work to make it operational.

Other Issues

C.16 The Committee underscores the importance of IMF technical assistance in supporting members' efforts to build institutional capacities and implement sound economic policies and financial systems, which will lay the foundations for sustained growth and poverty reduction.

C.17 The Committee underscores the importance of further determined action by the international community to combat money laundering and the financing of terrorism. It welcomes the significant progress that has been made under the 12-month IMF/World Bank pilot program of AML/CFT assessments. The Committee endorses the recent decision by the Executive Board to make the scope of the IMF's involvement in AML/CFT assessments comprehensive and a regular part of the IMF's work. It encourages all international organizations and bodies to work together closely in conducting assessments and delivering critically needed technical assistance. The Committee urges all members to adopt and implement the revised FATF 40 + 8 Recommendations as the accepted international standard.

C.18 The IMF's effectiveness and enhanced credibility as a cooperative institution also depends on all members having appropriate voice and representation. Efforts should continue to be made to enhance the capacity of developing and transition countries to participate more effectively in IMF decision-making. The Committee calls on the Executive Board to continue its work on IMF quotas, voice and representation, and looks forward to a report on progress at its next meeting. The Committee recommends completion of the ratification of the Fourth Amendment. The IMF's liquidity is adequate to meet the near-term projected needs of its members although continued monitoring will be important.

C.19 The Committee welcomes the high-quality work of the Independent Evaluation Office, and looks forward to its reports on PRSP/PRGFs, technical assistance, and the role of the IMF in Argentina from 1991 to 2002.

C.20 The Committee pays tribute to Mr. Horst Köhler for his leadership of the International Monetary Fund as Managing Director during the past four years. In the face of a difficult world economic situation and unprecedented challenges for the international community, Mr. Köhler has worked tirelessly to promote close international cooperation so that all can share in the benefits of globalization. He has strengthened the IMF's role in working for the stability of the international financial system, has helped the IMF lead the international effort to assist low-income countries, and has instilled a listening and learning culture in the IMF that will change the way in which the IMF interacts with members and civil society.

C.21 The Committee also acknowledges the contribution of Mr. Jacques J. Polak through 57 years of service to the IMF.

C.22 The next meeting of the IMFC will be held in Washington, D.C. on October 2, 2004.

D.1 The International Monetary and Financial Committee held its tenth meeting in Washington, D.C. on October 2, 2004, under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom. The Committee welcomes Mr. Rodrigo de Rato as the new Managing Director, and looks forward to working closely with him on furthering the goals of global stability and prosperity.

The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

D.2 The Committee welcomes the strengthening and broadening of global economic growth in 2004, supported by a strong upturn in global trade, supportive policies, and favorable financial market conditions. The global expansion is expected to continue at a solid pace provided all countries implement policies and reforms that will promote robust, balanced, and sustainable growth. The Committee notes that downside risks to the recovery have recently increased, stemming in part from the increase and volatility in oil prices. These reflect geopolitical tensions, strong global demand, and market dynamics. The IMF stands ready to assist members that may be adversely affected.

D.3 The Committee reiterates the desirability of stability in oil markets and prices which are consistent with lasting global prosperity. To this end, it welcomes the decisions by oil-producing countries to continue to expand production and urges further measures to increase capacity, and calls on oil-consuming countries to take measures to promote energy sustainability and efficiency. The Committee also stresses the importance of dialogue between consumers and producers, and of further progress to improve oil market information and transparency.

D.4 The strength of the global recovery has set the stage for a gradual return to more neutral monetary policies, with the desirable pace and timing of tightening varying across countries, depending on cyclical positions. Continued good communication of policy intentions will be essential to facilitate orderly adjustment in financial markets to higher interest rates, where needed. Inflation remains low and risks to price stability remain moderate. However, policymakers should be ready to contain any inflationary pressures, including from higher commodity prices, thereby ensuring noninflationary growth.

D.5 All countries should take advantage of the recovery to address medium-term vulnerabilities and challenges with renewed commitment. The Committee considers that bold reforms on a wide front are needed to strengthen fiscal positions, remove structural impediments to growth, support the correction of global imbalances, reduce financial and corporate vulnerabilities, and accelerate poverty reduction.

D.6 Fiscal consolidation remains a key priority in many countries. In the advanced economies, credible medium-term fiscal frameworks should be based on well-defined policies, and ensure progress on consolidation particularly in good times. Reforms of pension and health care systems will also be critical to address the fiscal pressures from population aging. Although many emerging market countries are making good progress in improving the structure of public debt and strengthening fiscal positions, further efforts are needed to bring public debt down to levels that will build adequate resilience to shocks. Broad tax bases, effective and transparent public expenditure management, and structural measures to boost growth will be important to improve debt sustainability and meet social and infrastructure spending priorities.

D.7 Structural reforms remain crucial to strengthen the foundations for sustained growth. Most advanced economies should step up their efforts to increase economic efficiency and flexibility to take full advantage of the opportunities from rapid technological change and global integration. Boosting sustainable growth and increasing economic resilience across emerging market countries, depending on country circumstances, will involve: completing financial and corporate sector reforms; strengthening banking supervision and developing domestic capital markets; improving the investment climate; and promoting economic diversification. The Committee notes the importance of addressing the economic implications of demographic changes. Depending on country circumstances, policies will need to focus on boosting labor supply, increasing public and private savings, and lifting productivity.

D.8 Policies to support an orderly resolution of global imbalances are a shared responsibility, and key to reinforcing the basis for more balanced and sustainable growth. The Committee underscores the importance of progress on medium-term fiscal consolidation in the United States, continued structural reforms to boost growth in Europe and Japan, and, in emerging Asia, steps toward greater exchange rate flexibility, supported by continued financial sector reform, as appropriate. Also, improving information and transparency in markets, including the role of hedge funds, would help strengthen market surveillance. The Committee welcomes the recent improvement in Argentina's fiscal position since 2002. The Committee supports that Argentina decisively addresses all the outstanding structural issues in their program, completes a comprehensive and sustainable debt restructuring, and ensures a sustainable medium-term fiscal framework. We welcome the efforts by Argentina toward completing a comprehensive and sustainable debt restructuring and hope for an expeditious conclusion to the process.

D.9 The Committee emphasizes that in the coming months IMF surveillance should focus on a number of key issues, including: the impact of higher oil prices, especially on the most vulnerable; the sustainability of medium-term fiscal positions and debt in many members; and managing the policy response to potential inflationary pressures.

D.10 The Committee calls on all partners to strengthen their commitment to the global effort to reduce poverty. The recent strong growth in most low-income countries is welcome, but the Committee is concerned that in many cases, particularly in sub-Saharan Africa, growth remains inadequate for achieving the Millennium Development Goals (MDGs).¹ The key challenge for these countries—as recognized in the New Partnership for Africa's Development—is to press ahead with efforts to further strengthen institutions and governance, to build on the macroeconomic stabilization that has been achieved. The international community needs to support these efforts with more open markets for these countries' exports, increased and better-coordinated aid and technical assistance, further debt relief, and sound policy advice.

D.11 An open and inclusive multilateral trading system is central to global growth and economic development, especially for developing countries. The Doha Round offers a unique opportunity for substantial progress toward this objective, and the Committee is encouraged by the recent decisions on negotiating frameworks. We endorse the "July Package" and urge all parties to work toward concrete advances in liberalizing trade, strengthening multilateral trade rules, and reducing trade-distorting subsidies, notably in agriculture. To achieve ambitious trade liberalization will require the full commitment of all parties, in particular strong leadership from the major trading nations and readiness of all countries to embrace the opportunities provided by more open trade. The Committee supports the IMF's continued role in advocating trade liberalization and assisting members, including through the Trade Integration Mechanism.

Making Surveillance More Effective and Strengthening Crisis Prevention

D.12 Effective and evenhanded IMF surveillance across the whole membership is central to promoting high and sustainable growth in member countries and to crisis prevention. The increasing interdependence of the membership reinforces the importance of effective surveillance of systemically-important countries and capital markets. The Committee welcomes the progress made in strengthening surveillance, and the steps identified during the recent biennial surveillance review to enhance its overall effectiveness. A focus on implementation is now needed. The Committee calls upon the IMF to continue its efforts to strengthen its economic analysis and policy advice; systematically evaluate the appropriateness of that advice; complement multilateral and bilateral surveillance with a focus on regional issues; improve the quality of the policy dialogue with members (including through increased cross-country analysis where relevant); strengthen communications to markets and the public of the IMF's policy messages while preserving its role as a candid and confidential advisor; and develop a methodology for better assessing the effectiveness of surveillance.

D.13 Toward meeting these objectives, the achievement of which should be assessed in the next surveillance review, the Committee agrees that priority should be given to sharpening the focus of Article IV consultations, including a deepening of the discussion of exchange rate issues; enhancing financial sector surveillance; and better integrating debt sustainability analysis and regional and global spillovers into country surveillance. Further progress in reducing balance sheet vulnerabilities, and further work on surveillance in low-income countries will also be monitored in the next review of surveillance.

D.14 Progress in bringing a fresh perspective to the surveillance of program countries should be kept under review, and lessons learned from ex-post assessments of program performance should be carefully implemented. It is important to assess the extent to which earlier IMF advice was acted on by countries, taking account of the countries' views. The Committee looks forward to the forthcoming reviews of the standards and codes initiative and the Financial Sector Assessment Program, reflecting the increasing importance of financial system stability. The Committee calls for a strengthening of efforts to ensure the objectivity of surveillance, including through enhanced debt sustainability analysis covering all member countries.

D.15 The Committee welcomes the increased adoption of collective action clauses (CACs) in international sovereign bonds, and calls on the IMF to continue to promote progress in this area. It notes recent initiatives aimed at achieving a broad consensus between sovereign issuers and their creditors on voluntary principles for emerging markets' crisis management and debt restructuring. The Committee looks forward to reviewing further work on general issues of relevance to the orderly resolution of financial crises, including implementation of the IMF's lending into arrears policy.

Enhancing International Support for Low-Income Members

D.16 The Committee supports the ongoing work to clarify and strengthen the IMF's role in low-income countries, which should be based on country ownership and close cooperation with other multilateral institutions and bilateral donors. The IMF has an important role in supporting—through policy advice, capacity building, and financial assistance, including debt relief—low-income countries' efforts to achieve the macroeconomic stability and high growth needed to make progress toward the MDGs. The Committee looks forward to further work on the financing and modalities of the IMF's engagement with low-income members, including the financing of the PRGF after 2006 to maintain adequate capacity to meet future needs, instruments to help members face shocks, and ways to improve monitoring and signaling. The Committee notes the joint report of the IMF and the World Bank on aid effectiveness and financing modalities. It encourages further analysis by the World Bank and IMF of aid effectiveness, absorptive capacity, results-based measurement mechanisms, and financing modalities and mechanisms to augment aid flows, such as the International Finance Facility, global taxes, and other innovative mechanisms, and looks forward to a further report.

D.17 The Committee supports continued efforts to strengthen the Poverty Reduction Strategy Papers (PRSP) approach and IMF support to low-income countries under the PRGF. It welcomes the report of the Independent Evaluation Office on the PRSP/PRGF, and the work underway to follow up on its recommendations. To support implementation of the Monterrey Consensus, the Poverty Reduction Strategy (PRS) process should be improved and become better integrated into each country's domestic policy-making processes, and international assistance, including from the IMF, should become more fully coordinated with domestic economic priorities. The Committee looks forward to the work on improving the role of the IMF in the PRS process, and on the design of policy programs supported by the PRGF. It calls for increased incorporation of poverty and social impact analysis into PRGF-supported programs, and for more extensive analyses of the sources of and obstacles to growth, and the linkages between poverty reduction and economic growth.

D.18 The Committee welcomes the progress in providing debt relief under the HIPC Initiative, which has been extended for two more years, encourages eligible countries to take the necessary actions to benefit from the Initiative, and urges full creditor participation. The Committee supports the IMF's and the World Bank's work on a single framework to assist low-income countries' efforts to achieve and maintain robust debt sustainability while pursuing their development objectives. It looks forward to further consideration of outstanding issues in the proposed framework for debt sustainability, before it is made fully operational, and of further debt relief, including its financing.

Other issues

D.19 The IMF's effectiveness and credibility as a cooperative institution depend on all members having appropriate voice and full participation in its processes. The Committee takes note of the IMF Executive Board's status report regarding work on quotas, voice, and representation. It encourages the Board to consider further issues of voice, quotas, and participation, noting as the Board agreed, that progress will require broad consensus among the shareholders. The Committee recommends completion of the ratification of the Fourth Amendment.

D.20 The IMF's liquidity is adequate to meet the near-term projected needs of its members, although continued monitoring will be important.

D.21 The Committee expresses its appreciation of the work of Mr. Montek Singh Ahluwalia as first Director of the Independent Evaluation Office (IEO). It looks forward to continued high-quality reports by the IEO.

D.22 The 60th anniversary of the IMF is a timely opportunity to reflect on the forces that will help shape the institution's priorities going forward. The Committee welcomes the preliminary consideration by the Executive Board of the work on the IMF's strategic direction initiated by the Managing Director, and looks forward to a discussion at its next meeting. It also welcomes the continuing progress in reforming the IMF's budgetary framework.

D.23 The next meeting of the IMFC will be held in Washington, D.C. on April 16, 2005.

E.1 The International Monetary and Financial Committee held its eleventh meeting in Washington, D.C. on April 16, 2005 under the Chairmanship of Mr. Gordon Brown, Chancellor of the Exchequer of the United Kingdom.

The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

E.2 The Committee welcomes the continuing global economic expansion, underpinned by supportive macroeconomic policies, improving corporate balance sheets, and benign financial market conditions. While returning to a more sustainable pace, global growth will likely remain robust in 2005. The Committee notes, however, that widening imbalances across regions and the continued rise in oil prices and oil market volatility have increased risks. The potential for a sharper-than-expected rise in long-term interest rates from their very low levels and for increased exchange rate volatility also calls for vigilance. The Committee emphasizes that in the coming months IMF surveillance should focus on promoting policies for reducing global imbalances over time; addressing the impact of higher oil prices, in particular on the most vulnerable countries; managing the policy response to potential inflationary pressures; and ensuring the sustainability of medium-term fiscal frameworks.

E.3 The Committee reiterates that all countries have a shared responsibility to take advantage of the current favorable economic conditions to address key risks and vulnerabilities. To ensure orderly adjustment of global imbalances and to help achieve more sustainable external positions and stronger medium-term growth, the Committee calls for concrete actions by all to implement the agreed policy response in a timely and effective manner. This includes fiscal consolidation to increase national savings in the United States; greater exchange rate flexibility as appropriate, supported by continued financial sector reform, in emerging Asia; further structural reforms to boost growth and domestic demand in Europe; and further structural reforms, including fiscal consolidation, in Japan.

E.4 The Committee notes that conditions in the oil market will remain tight in the medium term, reflecting strong global demand, low excess capacity, and supply concerns even after investments in some countries. It underscores the importance of stability in oil markets for global prosperity, and recognizes the impact of higher oil prices especially on poorer communities. In this context, the Committee calls for efforts to remove disincentives to investment in oil production and refining capacity, and to promote energy sustainability and efficiency, including through new technologies and removing barriers to the development of alternative fuels. It encourages closer dialogue between oil exporters and importers, and further efforts to improve oil market data and transparency.

E.5 Inflation remains relatively subdued in most countries, reflecting in part greater credibility of monetary policy. However, with inflationary pressures likely to increase as the expansion matures, a smooth transition to more neutral interest rates remains a priority in many countries, although the appropriate timing and pace will vary, depending on countries' cyclical positions. In countries receiving strong capital inflows, exchange rate flexibility would facilitate monetary management.

E.6 Steps to strengthen fiscal positions within sound frameworks and address structural weaknesses will also be critical for supporting medium-term growth and macroeconomic stability, and meeting demographic challenges. Fiscal deficits remain high in many industrial countries and should be reduced. In emerging markets, fiscal indicators have generally improved, but in countries with high levels of public debt continued efforts will be needed to reduce them to more sustainable levels. In both industrial and developing economies, structural reforms need to be advanced to remove rigidities and ensure sustainable growth. The Committee welcomes Argentina's rapid recovery. The recent debt exchange offer represents an important step toward the long-term goal of sustainable growth. Argentina will now need to formulate a forward-looking strategy to resolve the remaining arrears outstanding to private creditors consistent with the IMF's lending into arrears policy, and to continue with necessary structural reforms.

E.7 Poverty reduction must remain at the top of the international agenda. The Committee welcomes the strong growth performance across developing countries, particularly in sub-Saharan Africa, but notes with concern that most of them are at risk of falling well short of the Millennium Development Goals (MDGs).¹ With improved macroeconomic stability in most countries, the key challenge remains to press ahead with reforms to strengthen the investment environment and foster private sector-led growth. The global community, in turn, needs to support these reform efforts through meeting commitments to increased and better coordinated financial and technical assistance, further debt relief, policies to improve remittance flows, and improved market access for developing countries.

E.8 The Committee emphasizes that successful and ambitious multilateral trade liberalization is central to sustained global growth and economic development. The immediate priority is for WTO members to translate the mid-2004 framework agreements into a viable policy package in time for the December 2005 WTO Ministerial Conference. The Committee encourages Doha participants to aim for ambitious and comprehensive results, notably in agriculture; substantial reductions in barriers to other trade, including liberalization in financial and other services; and strengthened multilateral trade rules. The Committee supports the IMF's continued role in advocating trade liberalization and assisting members to benefit from it. It encourages the IMF to work with other partners in the Integrated Framework to explore further ways of easing adjustment to trade liberalization, including through the Trade Integration Mechanism, and building capacity in low-income countries. The Committee looks forward to consideration of proposals at its next meeting.

Shaping the IMF's Strategic Direction

E.9 The Committee welcomes the discussions underway on the IMF's medium-term strategy, and looks forward to reaching conclusions by the 2005 Annual Meetings and further reflection on longer-term issues. The Committee agrees that the central elements of the IMF's mandate as set out in its Articles of Agreement remain as important as ever. The challenge is to enhance the IMF's effectiveness in pursuing its core objectives, while continuing to adapt to changing global economic circumstances. This would ensure that the IMF remains relevant for all its members, which would further foster the coherence, credibility, and evenhandedness of the IMF.

E.10 The Committee calls for further work on the following emerging priorities that will help shape the institution's strategic direction:

- Surveillance is a central task of the IMF and determined efforts are required to enhance its effectiveness and impact, building on the conclusions of the Biennial Review of Surveillance. Surveillance should become more focused and selective in analyzing issues, in an evenhanded way across the membership. Regional and global surveillance should play an increasingly important role, and be better integrated with bilateral surveillance.
- Work on financial sector issues and international capital markets should be further strengthened to reduce vulnerabilities and promote financial stability. This, including the Financial Sector Assessment Program, should be integrated more fully into surveillance and other activities, and complemented by advice to members on ways to improve access to international capital markets and on orderly capital account liberalization.
- The IMF's lending function is a central pillar of its mandate. All lending should be selective and anchored in strong country ownership and institutional frameworks, putting members firmly on the road to external viability. The Committee looks forward to further reflection on how the needs of members could be met through IMF arrangements, and whether new instruments or revisions to existing facilities are required.
- The IMF has a critical role to play in helping low-income countries in their efforts to reduce poverty and achieve strong, sustainable growth through sound policies and institutions for macroeconomic stability. Efforts should continue to adapt the IMF's activities and instruments to the special circumstances and challenges of low-income countries, based on strong cooperation and clarity of responsibilities with the World Bank.
- The IMF must meet the highest standards of internal management, control, auditing, and governance. This will require further deepening of budget reforms, further work on the IMF's finances and financial structure, and efficient deployment of resources to reflect priorities. The Committee also looks forward to further work on risk management and control, and personnel management systems.
- The IMF's effectiveness and credibility as a cooperative institution must be safeguarded and further enhanced. Adequate voice and participation by all members should be assured, and the distribution of quotas should reflect developments in the world economy. The Committee emphasizes that the period of the Thirteenth General Review of Quotas provides an opportunity for the membership to make progress toward a consensus on the issues of quotas, voice, and participation.

IMF Support for Low-Income Members' Efforts Toward Poverty Reduction and Strong, Sustainable Growth

E.11 The Committee underscores the conclusion of this year's Global Monitoring Report that bold actions are urgently needed by the developing countries and their partners to realize the MDGs. The U.N. Summit in September 2005 will mark an important milestone to review progress and lay out actions going forward. The IMF has a critical role in supporting—through policy advice, capacity building, and financial assistance, including debt relief—low-income countries' efforts to achieve macroeconomic stability, debt sustainability, and strong, sustainable high growth needed to make progress toward the MDGs.

E.12 Work is underway to refine the operational aspects of the Poverty Reduction Strategy (PRS) approach, improve the design of PRGF-supported programs, and enhance PRGF-PRS alignment. This will be underpinned by more extensive analyses of the sources of and obstacles to growth, and of the linkages between growth and poverty reduction. The Committee looks forward to further work to ensure adequate financing of the PRGF to meet future demands as assessed by the IMF, and other IMF instruments to assist low-income countries, including to help members deal with shocks. It also looks forward to further work on a policy monitoring arrangement to enhance the IMF's signaling role for countries that do not need or want IMF financing.

E.13 The Committee supports work by the IMF and World Bank on aid effectiveness and financing modalities. On innovative sources of development financing, such as the International Finance Facility (IFF) and its pilot—the IFF for immunization—global taxes which could also refinance the IFF, the Millennium Challenge Account, and other financing measures, it welcomes the joint IMF and World Bank note outlining progress that has been made. The Committee asks to be kept informed of the further work ahead of the U.N. Summit.

E.14 The Committee notes the recent progress in providing debt relief under the HIPC Initiative. It encourages countries to take the necessary actions to benefit from the Initiative, and urges full creditor participation. The Committee supports the joint IMF-World Bank framework to assist low-income countries' efforts to achieve and maintain debt sustainability while pursuing their development objectives, and a review of experience under the framework.

E.15 The Committee welcomes the IMF's work and the preliminary discussion of key issues regarding proposals for further multilateral debt relief and its financing options, and calls for further discussion with shareholders and examination of these issues, including the possible use of the IMF's resources, by the time of its next meeting. It notes that any possible further debt relief from the IMF should be part of a wider international effort.

Other Issues

E.16 The Committee welcomes progress toward meeting the objectives of IMF surveillance identified at its last meeting, including in the areas of exchange rate issues, financial sector surveillance, better integrating debt sustainability analysis and regional and global spillovers into country surveillance, and balance sheet vulnerabilities. It also welcomes the Africa Regional Economic Outlook. The Committee looks forward to the upcoming review of the Standards and Codes Initiative to assess its effectiveness in informing surveillance, enhancing crisis prevention, and strengthening countries' institutions.

E.17 The Committee welcomes the increased adoption of collective action clauses in international sovereign bonds, and calls on the IMF to continue to promote progress in this area. It notes the "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets" being developed by a number of sovereign issuers and the investor community, and encourages further efforts to improve the Principles aimed at achieving a broad consensus. The Committee looks forward to further work on the orderly resolution of financial crises, including the implementation of the IMF's lending into arrears policy.

E.18 The Committee takes note of the recent review of IMF conditionality, including the design of IMF-supported programs. Progress has been made in streamlining conditionality and fostering national ownership. The Committee encourages the IMF to incorporate the findings of the review into its operational work, and to deepen further its analysis of key elements of program design.

E.19 The Committee recommends completion of the ratification of the Fourth Amendment.

E.20 The Committee wishes to thank James Wolfensohn for his great contribution as President of the World Bank. During his time at the helm of the Bank, great strides have been made in cooperation and partnership between the IMF and the World Bank, and in progress toward realizing our dream of a world free of poverty.

E.21 It is expected that the next meeting of the IMFC will be held in Washington, D.C. on September 23, 2005.

G8 FINANCE MINISTERS' CONCLUSIONS ON DEVELOPMENT, JUNE 2005

F.1 We reaffirm the commitments we made at our meeting in February this year to help developing countries achieve the Millennium Development Goals by 2015, to make particular efforts in Africa, which on current rates of progress will not meet any of the Millennium Development Goals by 2015, and to set out for G8 Heads of Government and States the steps we believe can be taken to further implement the Monterrey Consensus on an open world trade system; increased aid effectiveness; absorptive capacity; increased levels of aid; and debt relief.

F.2 We reaffirm our view that in order to make progress on social and economic development, it is essential that developing countries put in place the policies for economic growth, sustainable development and poverty reduction: sound, accountable and transparent institutions and policies; macroeconomic stability; the increased fiscal transparency essential to tackle corruption, boost private sector development, and attract investment; a credible legal framework; and the elimination of impediments to private investment, both domestic and foreign.

F.3 We reaffirm our view of February that it is crucial that the international community improves the effectiveness of aid. In particular bilateral and multilateral donors need to: harmonise their operational procedures; align aid behind country-owned priorities for growth and poverty reduction; and provide for measurable results. Donors must also: focus their aid on poverty reduction; enhance efforts to untie aid, based on DAC principles; and deliver aid in a more predictable way. We welcome the progress made at the Paris OECD DAC High Level Forum in March, and call on the OECD DAC to set by September this year, ambitious and credible targets against all the indicators of progress agreed at the March meeting.

F.4 A successful outcome for the Doha Development Agenda, our highest common priority in trade policy for the year ahead, will bring real and substantial benefits to poor countries. The Hong Kong Ministerial in December will be a critical step towards a successful outcome of the DDA in 2006, which delivers substantial increases in market access for developing countries; establishes a timetable for the elimination of all trade-distorting export support in agriculture; and provides effective special and differential treatment for developing countries.

F.5 However, not all countries will benefit in the short term from reductions in trade barriers. Some countries lack the capacity to produce and deliver goods to international markets competitively; for others, the transitional costs of moving to more open markets may be substantial. We also recognise that poor countries face particular problems and need the flexibility to decide, plan and sequence reforms to their trade policies to fit with country-owned development programmes. We commit to provide support to enable developing countries to benefit from trade opportunities. We call on the IFIs to submit proposals for the Annual Meetings for additional assistance to countries to develop their capacity to trade and ease adjustment in their economies, based on a systematic analysis of transition costs, so they can take advantage of more open markets.

F.6 Tackling diseases that undermine growth and exacerbate poverty in developing countries will require not only strengthened health systems, but also improved treatment, including universal access for AIDS treatment by 2010 and development of vaccines, including for HIV and malaria. We have made progress this year in implementing the Global HIV Vaccine Enterprise agreed at Sea Island, and are committed both to taking this further; and to scaling up our support for vaccines and medicines research through the successful Public Private Partnerships model. We call for a report on progress by the end of the year. We recognise also that advance purchase commitments (APCs) are potentially a powerful mechanism to incentivise research, development and the production of vaccines for HIV, malaria and other diseases. We asked Minister Siniscalco to consult the relevant institutions, governments and industry, with the aim of developing concrete proposals by the end of this year.

F.7 The Enhanced HIPC Initiative has to date significantly reduced the debt of 27 countries, and we reaffirm our commitment to the full implementation and financing of the Initiative. Moreover, individual G8 countries have gone further, providing up to 100 per cent relief on bilateral debt. However, we recognise that more still needs to be done and we have agreed the attached proposal. We call upon all shareholders to support these proposals which we will put to the Annual Meetings of the IMF, World Bank and African Development Bank.

F.8 We also recognised at Monterrey that a substantial increase in ODA and private capital flows will be required to assist developing countries to achieve the Millennium Development Goals. We acknowledge the efforts of all donors, especially those who have taken leading roles in providing and increasing ODA and committing to further increases.

F.9 Specifically we welcome: the progress the EU has made towards the 0.39 per cent ODA/GNI target agreed at Barcelona; the announcements by France and the UK of timetables to reach 0.7 per cent ODA/GNI by 2012 and 2013 respectively; and the recent EU agreement to reach 0.7 per cent ODA/GNI by 2015 with an interim target of 0.56 per cent ODA/GNI by 2010 - a doubling of EU ODA between 2004 and 2010. In line with the EU agreement, Germany (supported by innovative instruments) and Italy undertake to reach 0.51 per cent ODA/GNI in 2010 and 0.7 per cent ODA/GNI in 2015. We welcome the tripling of US ODA to Sub-Saharan Africa and the near doubling of US ODA to all developing countries since 2000. The US now accounts for roughly 25% of all ODA to Sub-Saharan Africa. In addition, we welcome the launch of the Millennium Challenge Account and the President's Emergency Plan for AIDS Relief. We welcome Japan's commitment to double its ODA to Africa over the next three years and Canada's budget plans to finance its commitment to double aid levels from 2001 to 2010, and to double aid to Africa by 2008. In addition, we welcome Russia's \$2.2 billion contribution to the HIPC Initiative.

F.10 As we prepare for decisions at the G8 Summit in Gleneagles we continue our work programme on: the IFF and its pilot, the IFF for Immunisation; some of the revenue proposals from the Landau Report, including a pilot project, supported and led by France and Germany, for a contribution on air travel tickets to support specific development projects and to refinance the IFF; the Millennium Challenge Account; the Enhanced Private Sector Assistance with the African Development Bank; and other financing measures; so that decisions can be made on how to deliver and bring forward the financing urgently needed to achieve the Millennium Development Goals.

F.11 Nigeria is key to the prosperity of the whole continent of Africa. We welcomed Nigeria's progress in economic reform as assessed in the IMF's intensified surveillance framework, noted its move to IDA-only status, and encouraged them to continue to reform. We are prepared to provide a fair and sustainable solution to Nigeria's debt problems in 2005, within the Paris Club.

G8 Proposals for HIPC debt cancellation

F.12 Donors agree to complete the process of debt relief for the Heavily Indebted Poor Countries by providing additional development resources which will provide significant support for countries' efforts to reach the goals of the Millennium Declaration (MDGs), while ensuring that the financing capacity of the IFIs is not reduced. This will lead to 100 per cent debt cancellation of outstanding obligations of HIPCs to the IMF, World Bank and African Development Bank. Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems. Such action will further assist their efforts to achieve the MDGs and ensure that assistance is based on country performance. We ask the World Bank and IMF to report to us on improvements on transparency on all sides and on the drive against corruption so as to ensure that all resources are used for poverty reduction. We believe that good governance, accountability and transparency are crucial to releasing the benefits of the debt cancellation. We commit to ensure this is reaffirmed in future bilateral and multilateral assistance to these countries.

Key elements:

- Additional donor contributions will be allocated to all IDA and AfDF recipients based on existing IDA and AfDF performance-based allocation systems.
- 100 per cent IDA, AfDF and IMF debt stock relief for Completion Point HIPCs¹.
- For IDA and AfDF debt, 100 per cent stock cancellation will be delivered by relieving post-Completion Point HIPCs that are on track with their programmes of repayment obligations and adjusting their gross assistance flows by the amount forgiven. Donors would provide additional contributions to IDA and AfDF, based on agreed burden shares, to offset dollar for dollar the foregone principal and interest repayments of the debt cancelled². Additional funds will be made available immediately to cover the full costs during the IDA-14 and AfDF-10 period. For the period after this, donors will commit to cover the full costs for the duration of the cancelled loans, by making contributions additional to regular replenishments of IDA and AfDF.

¹ The following 18 countries would be eligible immediately: Benin, Bolivia, Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, Senegal, Tanzania, Uganda, Zambia. As the remaining unsustainable HIPCs reach Completion Point they will also become eligible.

² Additional donor contributions would be provided on the basis of IDA-13 and normalised AfDF-10 burden shares

- The costs of fully covering IMF debt stock relief, without undermining the Fund's financing capacity, should be met by the use of existing IMF resources. In situations where other existing and projected debt relief obligations cannot be met from the use of existing IMF resources (e.g. Somalia, Liberia, and Sudan), donors commit to provide the extra resources necessary. We will invite voluntary contributions, including from the oil-producing states, to a new trust fund to support poor countries facing commodity price and other exogenous shocks.
- Globally and on this basis we are committed to meeting the full costs to the IMF, World Bank and African Development Bank. We will provide on a fair burden share basis resources to cover difficult-to-forecast costs, in excess of existing resources, to the IMF, IDA and AfDF over the next three years. Subject to further analysis by the institutions we will provide up to \$350-500 million for this purpose. We are also committed, on a fair burden share basis, to cover the costs of countries that may enter the HIPC process based on their end-2004 debt burdens. We will also seek equivalent contributions from other donors to ensure all costs are covered and we will not jeopardize the ability of these institutions to meet their obligations. Utilize appropriate grant financing as agreed to ensure that countries do not immediately re-accumulate unsustainable external debts, and are eased into new borrowing.

F.13 We call upon all shareholders to support these proposals which would be put to the Annual Meetings of the IMF, World Bank and African Development Bank by September.

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