

INTERNATIONAL MONETARY FUND

**Periodic Monitoring Report on the Status of Board-Endorsed IEO
Recommendations and Management Implementation Plans**

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(In consultation with other Departments)

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I. INTRODUCTION

1. IEO evaluations are an integral part of the Fund's learning culture, helping the Fund absorb lessons that improve its work. In addition, the objectivity of IEO evaluations has bolstered the Fund's credibility. In discussing the report of the External Evaluation of the IEO (the "Lissakers report"), Executive Directors welcomed the suggestions to strengthen follow-up to the IEO recommendations—including more Board involvement—and supported a more systematic approach for following up and monitoring the implementation of IEO recommendations approved by the Board. This periodic monitoring report (PMR) is the first such effort under the new procedures approved by the Executive Board in January 2007.^{1 2} In particular, it responds to the instruction that "Management shall present to the Board a periodic monitoring report on the state of implementation of actions contained in the forward-looking implementation plans already in force and not deemed completed on the occasion of a prior periodic monitoring report. These reports shall indicate difficulties in implementing the original plan and propose remedial or substitute actions whenever appropriate. The first periodic monitoring report shall be prepared following the delivery of the 2007 IEO Annual Report. As the IEO Annual Reports cover the status of all past IEO recommendations, it is expected that the first periodic monitoring report produced by Management would also review the implementation of recommendations made to date."

2. As the first PMR, implementation of Board-endorsed IEO recommendations from all past IEO evaluations—except the last three—are reviewed. For the ten IEO evaluations covered in this report (Box 1), there were 51 Board endorsed recommendations; however, some recommendations contain sub-recommendations, thus bringing the total to 73 recommendations. Two forward-looking management implementation plans (MIP) pertaining to the Board-endorsed recommendations (i.e., the IEO evaluations on the *IMF and Aid to Sub-Saharan Africa* and *IMF Exchange Rate Policy Advice: 1999–2005*) have been discussed by the Board on June 29 and September 12, 2007.³ Since only a short period has elapsed since those Board meetings, progress on the implementation of these MIPs is not reported in this PMR.

¹ See "External Evaluation of the Independent Evaluation Office" (<http://www.imf.org/external/np/pp/eng/2006/032906.pdf>).

² This is not, however, the first effort at monitoring follow-up to IEO recommendations. The IEO's Annual Report contains a matrix listing all IEO recommendations, the Board's views on these recommendations, and their implementation status. In addition, the Board has reviewed the implementation of the Fund's policy on ex post assessment on prolonged program engagement (<http://www.imf.org/external/np/pp/eng/2006/032006r.pdf>); this policy was established by the Board in response to recommendations contained in the IEO's first evaluation on prolonged use of IMF resources.

³ Respectively, <http://www.imf.org/external/np/ieo/2007/ssa/eng/index.htm> and http://www.ieo-imf.org/eval/complete/eval_05172007.html.

Box 1. Completed IEO Evaluations ^{1/}

Evaluations Covered in this Report

Evaluation of Prolonged Use of IMF Resources (September 2002)
 The IMF and Recent Capital Account Crises (May 2003)
 Fiscal Adjustment in IMF-Supported Programs (August 2003)
 The IMF and Argentina, 1991–2001 (July 2004)
 Poverty Reduction Strategy Papers/Poverty Reduction Growth Facility (July 2004)
 IMF Technical Assistance (January 2005)
 IMF’s Approach to Capital Account Liberalization (April 2005)
 IMF Assistance to Jordan (October 2005)
 Financial Sector Assessment Program (November 2005)
 Multilateral Surveillance (February 2006)

Evaluations Not Covered in this Report

IMF and Aid to Sub-Saharan Africa (June 2007)
 IMF Exchange Rate Policy Advice 1999–2005 (September 2007)
 Evaluation of Structural Conditionality in IMF-Supported Programs (November 2007)

^{1/} Board discussion dates in parentheses. For evaluations not covered in this report, the Board date reflects discussion of MIPs or date of official distribution to the Board of the IEO Evaluation.

3. The IEO’s fourth Annual Report was published in August 2007. This report (Appendix III, pages 28-52) presents a matrix of all IEO Recommendations, staff and management responses, Board views, and follow-up actions; the latter was provided by Fund staff to the IEO at its request and will not be reproduced here. A number of “cross-cutting” issues were identified by the IEO as emerging from its evaluations to date. First, institutional change at the IMF needs to be better managed. Second, there is a need for greater clarity about the goals of various IMF initiatives and a properly aligned external communications policy. Third, the IMF needs to strengthen partnerships with other IFIs and donors. Finally, the absence of clear metrics impedes the assessment of the impact of IMF’s policy advice and whether the IMF is meeting its commitments to countries.

II. METHODOLOGY AND SUMMARY OF MONITORING STATUS

4. In preparing this first PMR, the staff encountered several challenges. First, the breadth of subjects—multilateral surveillance, technical assistance (TA), FSAPs, capital account liberalization, PRSPs/PRGFs—and the sheer number of recommendations (73) represented a daunting assignment. Second, Board-endorsed recommendations—as set out in the relevant summings up or reproduced in the IEO Annual Report—are typically couched in very general terms, reflecting in part the broad nature of IEO recommendations themselves. The introduction of forward-looking implementation plans should enhance future monitorability; to the extent that specific measures are identified, their implementation can be objectively measured. Third, this PMR represents a departure from the traditional assessment and review processes (such as the review of ex post assessments) because it only documents follow-up to the IEO recommendations but does not evaluate the effectiveness of

this follow-up. Fourth, it was introduced long after a number of Board-endorsed recommendations have been adopted, making it hard to collect retrospective data. Fifth, staff has conducted this monitoring exercise within a tight pre-existing budget envelope.

5. Against this background, staff has relied upon the description of the Board-endorsed recommendations presented in the IEO's fourth Annual Report (Appendix III), with some amplification by reference to the relevant summings up. Staff then elaborated upon the implementation (or monitoring) status of each IEO recommendation endorsed by the Executive Board. A two-step procedure was used wherein an initial effort was undertaken within PDR and then reviewed by other departments, particularly those with special expertise in the subject (e.g., FAD for the evaluation on "Fiscal Adjustment in IMF-Supported Programs" and MCM for the evaluation on "Financial Sector Assessment Program"). To the extent possible, the monitoring status is meant to be factual and has relied on existing data sets. It has also drawn upon, where possible, Board summings up of subsequent staff reports dealing with these issues. The attached Annex provides the resulting findings on the monitoring status for each recommendation and is organized by IEO evaluation as in the IEO's Annual Report. It also provides an assessment of the extent to which the lessons for improvements have been absorbed into new work practices. These assessments have been indicator-driven and process-oriented, and have not tried to evaluate results, which would have taken more time and required substantial additional resources. Complete evaluations will need to await regularly scheduled policy reviews.

6. That said, what does staff conclude regarding the status of implementation of Board-endorsed IEO recommendations? First, it is difficult to summarize this effort because it covers more than 70 recommendations whose scope ranges over all areas of Fund activity and has varying degrees of detail and specificity. Second, many influences have been at play in the development of the Fund's work agenda over the past few years, notably the Medium-Term Strategy. Therefore, it is difficult to isolate whether certain actions were adopted in response to specific IEO recommendations. Nonetheless, IEO recommendations have had a substantial impact on how the Fund operates, and thus it could be said that the lessons have been absorbed and the recommendations substantially completed. The clearest examples of such impact include the Board-endorsed recommendations contained in the IEO evaluations on: Prolonged Use of IMF Resources; Recent Capital Account Crises; IMF and Argentina; Capital Account Liberalization; Financial Sector Assessment Program; and Technical Assistance. Completed recommendations for purposes of the PMR do not mean, however, that the Fund can rest on its laurels. It only means that we can move from monitoring via PMRs to more in-depth assessments as part of the Board established policy review cycle.

Box 2. Outstanding Recommendations

- Monitor whether staff reports contain greater candor on risks and enhanced analysis of political economy issues (Evaluation of Prolonged Use of Fund Resources).
- Introduce measures to address excessive staff mobility (Evaluation of Prolonged Use of Fund Resources).
- Conduct a periodic follow up to assess implementation of greater focus in the assessment of members' external vulnerabilities (The IMF and Recent Capital Account Crises).
- Assess the appropriate size, pattern, and composition of fiscal adjustment and evaluate the degree of protection of critical social spending when formulating advice and incorporate the costs of social safety nets into program design (Fiscal Adjustment in IMF-Supported programs).
- Introduce external evaluations to enhance accountability and provide a fresh perspective to the TA process (IMF Technical Assistance).
- Establish more systematic procedures for feeding back into the TA program the lessons learned from self-assessments and evaluations (IMF Technical Assistance).
- Conduct assessments of vulnerability and development issues in the financial sector (Financial Sector Assessment Program).
- Establish whether the quality of the FSAP has improved over time (Financial Sector Assessment Program).

7. While there has been substantial progress in implementation of Board-endorsed recommendations, further progress is needed in several recommendations (Box 2). Consistent with the new procedures, remedial actions have been identified. For instance, the next Triennial Surveillance Review (TSR) will discuss the issue of candor in staff assessments of macroeconomic policy and also whether greater emphasis is being applied in the assessment of members' external vulnerabilities. Regarding staff mobility, Human Resources Department (HRD) has examined the issue and has put in place IMF-wide mobility guidelines on the minimum time a staff member spends in a department. Data on the duration of country assignments and composition of mission teams is maintained and monitored by area departments, although definitions and systems differ across departments. Such data could be collected on a systematic and consistent basis allowing Fund-wide aggregation to discern Fund-wide trends. Statistics could also be reported to the Board periodically, for example in area departments' business plans. Regarding the appropriate size, pattern, and composition of fiscal adjustment in Fund-supported programs, an assessment could be conducted in the context of the next review of Fund-supported programs. This review would also be a suitable vehicle to study whether recent programs have incorporated adequately the costs of social safety nets. Regarding the recommendations involving technical assistance, consideration will be given to: (i) developing standard indicators, based in part on the Standards and Codes Initiative, in each TA area with

performance measured by the degree to which TA has helped countries achieve these indicators; (ii) ensuring that TA-providing departments share best practices including through the use of TAIMS and staff training; and (iii) enhancing accountability by undertaking selected ex-post evaluations by units not directly involved in providing TA. The final two recommendations on the financial sector will be evaluated in the context of MCM's next review of FSAPs. In other areas, such as PRSPs/PRGFs (e.g., the Fund's engagement in low-income countries), a course of action has been laid out in the Managing Director's Medium-Term Strategy, the recent Management Implementation Plan (MIP) on the IMF and Aid to Sub-Saharan Africa, and the Joint Management Action Plan developed with the World Bank in response to the Malan report on Bank-Fund Collaboration. A summary paper is planned to describe the full range of the Fund's activities in low-income countries and the cost implications. The next PMR will report on the implementation plan on the IMF and Aid to Sub-Saharan Africa, and also on the progress implementing the MIP for IMF Exchange Rate Advice. Efforts will continue to integrate more fully bilateral and multilateral surveillance and to enhance the quality of financial sector surveillance more generally.

8. Some valuable lessons have also been gleaned from the preparation of this first PMR. As observed by the IEO, clear metrics would contribute to gauging progress in implementation of Board-endorsed recommendations. Toward that end, management implementation plans could formulate specific deliverables and set milestones to assist in periodic monitoring. Key performance indicators to monitor implementation of these MIPs are listed in Box 3 and will be covered in subsequent PMRs. This effort should also be viewed in a wider context—the move to output-driven budgeting by the Fund and the introduction of performance indicators. To minimize departments' compliance and monitoring costs associated with performance indicators, OBP has developed two reporting applications in the integrated Budget and Business Intelligence System (iBBIS), thus bringing performance information into the same framework for budget formulation and implementation. Consideration could be given to developing simple quantitative indicators and adapting iBBIS. For some indicators—for instance, to track staff turnover on country teams—the resource costs for monitoring would be modest; for others, monitoring costs would be more significant and this would require making the case that the information content is of sufficient interest to justify the collection costs. Clear responsibility and accountability for monitoring and implementing the MIPs should ideally be established, but such structures could prove difficult for cross-cutting issues affecting area and functional departments, including at times HRD and EXR. A budget envelope for these monitoring efforts would need to be authorized based on value-for-money criteria. More generally, however, it should be recognized that not all Board-endorsed IEO recommendations lend themselves to easy quantification or annual monitoring.

9. One recurring theme for Board-endorsed IEO recommendations is the need for candor in staff reports. Apart from the inherent difficulties involved in measuring candor, staff are faced with two additional difficulties. First, candor may conflict with the Fund's role as confidential advisor and, second, Board members may express concerns that undermine staff's candor. For example, in the context of the IEO report on IMF Exchange Rate Policy Advice, the Board discussed the potentially difficult trade-off between staff and management's role as confidential advisor and the critical importance of ensuring that the

Executive Board has all the information it needs to carry out its surveillance activities. It is also engaged in a similar discussion in the context of Fund-supported programs. The Board has also grappled with disclosure issues in its deliberations on the Fund's transparency policy particularly related to the deletion of highly market-sensitive information. An assessment of the degree of candor in staff reports would require several techniques (e.g., case studies, surveys). On a related note, external communications of Fund activities need to explain and clarify better the role of the Fund and be closely aligned with policies approved by the Board.⁴ Progress on this topic is best dealt in future reviews of the Fund's communications strategy.

Box 3. MIPs for IEO Follow Up—Key Performance Benchmarks

IMF and Aid to Sub-Saharan Africa

- Prepare paper on The Role of the Fund in Managing Aid Inflows and Impact on the Design of Fund-supported Programs.
- Prepare analysis of Fiscal Policy response to Scaled-Up Aid.
- Prepare paper on The Role of the Fund in the PRSP and Donor Coordination Processes.
- Prepare joint management implementation plan as follow-up to Malan Report.
- Conduct 2010 Review of PRGF.

IMF Exchange Rate policy Advice: 1999–2005

- Adopt the 2007 Decision on Bilateral Surveillance.
- Revise Surveillance Guidance Note to reflect 2007 Surveillance Discussion.
- Conduct Review of the Stability of the System of Exchange Rates.
- Expand and improve CGER work (including refining methodologies and expanding it to key low-income countries and producers of exhaustible resources).
- Develop surveillance agendas, seeking input from authorities.
- Develop initiatives to increase MCM participation in Article IV missions.
- Conduct Review of Exchange Arrangements, Restrictions, and Markets.
- Conduct Review of Data Provision to the Fund.
- Conduct Triennial Surveillance Review.

10. The next periodic monitoring report on the status of Board-endorsed IEO recommendations will be prepared after the next IEO Annual Report is issued. Moreover, the format for the PMR will be adapted as the format of the IEO's Annual Report evolves; in particular, the PMR will be adapted if the summary matrix listing all IEO recommendations and their implementation status in the IEO Annual Report is modified. The next PMR will

⁴ See <http://www.imf.org/external/np/sec/pn/2007/pn0774.htm>.

review the implementation status of the two recent MIPs for Aid to Sub-Saharan Africa and for Exchange Rate Advice and also the implementation status of the performance benchmarks in Box 3.

III. ISSUES FOR DISCUSSION

11. Do Executive Directors find this first Periodic Monitoring Report useful for assessing the implementation status of Board-endorsed IEO recommendations? Do Directors have any suggestions for changes in coverage or format?
12. Do Executive Directors agree that substantial progress has been made in implementing Board-endorsed recommendations for the first ten IEO evaluations and that further monitoring should take place in the context of more in-depth topic specific reviews? Do Directors support the proposed actions laid out in paragraph 7 to address outstanding IEO recommendations (list in Box 2)?
13. Do Executive Directors agree that the recently formulated forward-looking implementation plans, such as those for the evaluations on the IMF and Aid to Sub-Saharan Africa and on IMF Exchange Rate Policy Advice, should only be taken up in a periodic monitoring report after sufficient time has elapsed—say six months—since Board feedback was given to the management implementation plan?
14. What are Directors' views as regards the monitoring issues laid out in paragraph 8?

Annex: IEO Recommendations, Board Discussion, and Implementation Status

1. This Annex is organized as follows. For each of the first ten IEO reports, the recommendations are presented and followed by the views of the Executive Board regarding those recommendations. The latter are based upon the summing up of the Board's discussion, and—in those cases where a task force was established—the Board's views on the recommendations of the task force. The references to these documents are listed at the beginning of the Executive Board discussion of the first IEO recommendation in each evaluation. Finally, the implementation status of each recommendation is reviewed and a summary assessment of implementation is provided at the end of the discussion of each IEO evaluation.

A. Evaluation of Prolonged Use of IMF Resources

IEO Recommendation 1

2. Adopt an operational definition of prolonged use as a trigger for enhanced “due diligence” (i.e., *ex post* assessments and forward-looking consideration of “exit” strategies). The criterion could distinguish between general and concessional resources.

*Executive Board Discussion*⁵

3. Directors saw merit in the IEO's recommendation to develop a definition of prolonged use, to enable the Fund to pursue greater due diligence in these cases. Many Directors, however, noted that any definition must be carefully crafted and differentiated to take into account the specific situation of low-income countries relying on Fund-administered concessional resources.

*Executive Board Discussion of Conclusions of the Task Force*⁶

4. Most Directors saw the definition of prolonged use proposed by the task force and building on the IEO's recommendations as an appropriate way to identify countries for the process of *ex post* assessments and strategic planning. A country would be considered a prolonged user when it has spent seven or more of the last ten years under upper credit tranche stand-by or extended arrangements, including precautionary arrangements, or a mix of GRA and PRGF or ESAF resources. Most Directors also supported the proposal that, for countries using the Fund's concessional resources, the new assessment process be triggered when a country has gone through two or more multi-year arrangements under the PRGF or ESAF.

⁵ See <http://www.imf.org/External/NP/ieo/2002/pu/index.htm>.

⁶ See <http://www.imf.org/external/np/sec/pn/2003/pn0349.htm>.

Monitoring Status

5. The Board reviewed experience gained with carrying out the policy of longer term program engagement (LTPE) in May 2006.⁷ To ensure even-handed treatment of all members, Directors agreed to make two changes. First, all members will now be considered as having LTPE if they have spent at least seven out of the last ten years under programs supported by the IMF. Second, time spent under precautionary arrangements that remain undrawn does not count toward LTPE, parallel to the treatment of members using the Policy Support Instrument. Semi-annual reporting of the incidence of prolonged use is taking place on this basis. In addition, an interval of at least five years between ex post assessments is required

IEO Recommendation 2

6. Make greater efforts to judge whether countries are ready to implement credible programs and be more selective in extending financial support. Use of IMF resources proposals should contain an explicit and frank assessment of the readiness of borrowers to implement programs.

Executive Board Discussion

7. Directors supported the IEO recommendation that staff papers presented to the Board in support of requests for Fund financial assistance should be more transparent and candid in assessing the adequacy of institutional capacity and the degree of ownership—both essential for program success. In particular, Directors underscored the importance of explaining clearly the downside risks surrounding a program, and of avoiding any bias toward over-optimism, including by ensuring that the program is based on realistic growth and export assumptions.

Executive Board Discussion of Conclusions of the Task Force

8. Directors stressed the need for the staff to combine clarity and candor with a recognition of the social and political realities that shape economic policy; to complement sound advice on economic objectives with discussions of alternative ways to achieve those objectives; and to reach out more broadly, including to legislative bodies.

Monitoring Status

9. The revised Conditionality Guidelines adopted in 2002 emphasize that national ownership of sound economic and financial policies and an adequate administrative capacity are crucial for successful implementation of Fund-supported programs. The member also has primary responsibility for the selection, design, and implementation of its economic and

⁷ See <http://www.imf.org/external/np/sec/pn/2006/pn0696.htm>.

financial policies, and the Fund encourages members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation.

10. The operational guidance note on the 2002 Conditionality Guidelines indicates that staff reports will be expected to include a candid discussion on concerns about ownership of policies in Fund-supported programs. Staff reports now routinely contain an explicit discussion of risks to program implementation. Moreover, ex post assessments are supposed to ascertain whether program risks were correctly identified, including the impact of prolonged program engagement on domestic policy ownership. The 2006 Ex Post Assessment (EPA) Review analyzed 32 EPA reports and found that policies in Fund-supported programs had been consistent with the multiple macroeconomic and structural challenges faced by those members and that Fund involvement had not undermined members' institutional development. By and large, Directors considered this to be a balanced assessment. Reflecting resource constraints, however, no mechanism has been established to monitor annually candor in staff reports. This subject could be taken up in the next conditionality review.

IEO Recommendation 3

11. Aim to provide the international community with credible alternatives to IMF lending arrangements as a condition for other official flows.

Executive Board Discussion

12. Directors noted that cases of prolonged use are often related to the demand for Fund-supported programs as a signaling device that gives a seal of approval to the country's economic policies and is required by some donors and creditors. Noting that it would be desirable to develop credible alternative ways for the Fund to indicate to the outside world its approval of a member's policies, Directors looked forward to a forthcoming discussion on the signaling function. They noted that such alternatives would need to be prepared carefully and on the basis of consultations, including with the Paris Club.

Executive Board Discussion of Conclusions of the Task Force

13. Directors confirmed the conclusions of their recent discussion on mechanisms for signaling the Fund's assessment of members' policies. This discussion reiterated that the Fund should not enter into financial arrangements in support of programs that fail to meet reasonable standards of policy content in order to fulfill the expectations of donors. It will therefore be important to consider carefully, on a case-by-case basis, how best to use Article IV consultation reports, press information notices (PINs), PRSP assessments, and other devices for signaling the Fund's views on policies to a broader audience, including donors and creditors. In the case of low-income countries, where the Fund's signaling role and the linkage of external assistance to Fund-supported programs is a particularly important issue, Directors encouraged the staff to continue to explore the scope for alternative signaling mechanisms, in consultation with member countries, donors, and other creditors, including the Paris Club and World Bank.

Monitoring Status

14. The issue of signaling was taken up in the Board’s discussion of the policy signaling instrument in September 2004 which resulted in the discontinuation of Staff Monitored Programs for signaling purposes.⁸ The Board returned to the issue of signaling on several occasions in 2004–05, culminating in the establishment in October 2005 of the Policy Support Instrument, which provides policy support and endorsement to low-income countries that do not need IMF financing and whose policies meet the standards of upper credit tranche conditionality. To date, 7 members have utilized PSIs.

IEO Recommendation 4

15. Conduct systematic ex post assessment of programs, with priority to identified prolonged users and key messages reported to the Board. Programs for identified prolonged users should include an explicit exit strategy.

Executive Board Discussion

16. Directors stressed especially the desirability of more systematic ex post assessment of cases where prolonged use occurs, with follow-up monitoring of program implementation, and where appropriate the elaboration of corrective measures as part of a conscious exit strategy.

Executive Board Discussion of Conclusions of the Task Force

17. Directors supported a strengthening of the Fund’s “due diligence” in cases of prolonged use, through systematic *ex post* assessment and strategic forward planning in the context of Article IV surveillance. The exercise will cover an analysis of the economic problems facing the country, a critical and frank review of progress during the period of Fund-supported programs, and a forward-looking assessment that takes into account lessons learned and presents a strategy for future Fund engagement. Where appropriate, the assessment will present an explicit exit strategy.

Monitoring Status

18. A periodic review of ex post assessments was completed in May 2006 and the Executive Board concluded that EPAs have served their purpose and have delivered balanced assessments on the Fund’s long-term relations with its members, explaining the macroeconomic and structural issues involved, and presenting a medium-term policy program and a plan for continued Fund engagement.⁹ However, they also found their quality to be uneven and suggested systematic discussions of the reasons for program success or

⁸ See <http://www.imf.org/external/np/pdr/2004/eng/090804.htm>.

⁹ See <http://www.imf.org/external/np/sec/pn/2006/pn0696.htm>.

failure and of potential exit strategies. Following the meeting, revised guidelines for improved implementation of the policy on longer-term program engagement were prepared and circulated to the Board. As of end-October 2007, an additional 15 ex post assessments had been discussed by the Board. Staff will evaluate performance relative to the revised guidelines in its next periodic review of EPAs.

IEO Recommendation 5

19. Introduce a differentiated rate of charge for prolonged users as a signaling device.

Executive Board Discussion

20. There was virtually no support for the idea of imposing a differentiated rate of charge.

IEO Recommendation 6

21. Greater selectivity in program content with: (1) further strengthening collaboration with the World Bank; (2) a more differentiated use of conditionality; (3) greater efforts to tailor the time frame of program design to foreseeable length of reform and adjustment; and (4) more in-depth analysis of real economy responses to key policy elements and less attention to fine-tuning financial programming. Key internal database on program targets and outcomes (MONA) should be upgraded to facilitate such assessments.

Executive Board Discussion

22. Directors were encouraged that some key IEO recommendations regarding streamlining of Fund conditionality, the importance of country ownership, and the need for more effective collaboration with the World Bank are already being internalized as elements of the review of Fund conditionality.

Executive Board Discussion of Conclusions of the Task Force

23. Directors also agreed that improvements in conditionality will need to be accompanied by greater selectivity in recommending and approving Fund financial support, based on a careful assessment of the member's implementation capacity and ownership.

Monitoring Status

24. In the 2005 Review of the Conditionality, Directors indicated that the implementation of the new conditionality guidelines has delivered positive results.¹⁰ Moreover, they welcomed the streamlining of the breadth of coverage of structural conditionality; indeed, this streamlining in the breadth of coverage was judged to be consistent with a greater focus on critical measures. Structural conditionality will be reviewed every five years in the

¹⁰ See <http://www.imf.org/External/np/pp/eng/2005/030305.htm>.

Review of Conditionality.¹¹ A new web-based MONA system was introduced in 2006 that has facilitated the analysis of conditionality.

IEO Recommendation 7

25. Steps should be taken to further strengthen surveillance in program cases. A case exists for greater institutional separation between surveillance and programs, especially in the context of prolonged use. Additional steps should be taken to increase the impact of surveillance, including through making staff assessments more candid.

Executive Board Discussion

26. Regular Fund surveillance of program countries should reassess economic developments and strategy from a fresh perspective.

Executive Board Discussion of Conclusions of the Task Force

27. Directors concurred with the priority accorded by the IEO and the task force to increasing the effectiveness of Fund surveillance. Directors highlighted the importance of ongoing efforts to ensure that Article IV consultations in program countries “step back” from the program context.

Monitoring Status

28. At the 2004 review of surveillance, Directors concluded that the quality of surveillance in program countries had improved since 2002. As for stepping back from the program context, it is worth noting that some area departments have experimented with having a different mission chief for Article IV consultations in program countries or have a senior staff member not assigned to the country concerned participate in Article IV consultation missions.

IEO Recommendation 8

29. A review of internal incentives facing staff should be undertaken with a view to minimizing turnover of staff working on countries and to foster increased candor and accountability.

¹¹ This Review of Conditionality will be informed by the findings of the IEO’s most recent evaluation report on Structural Conditionality (December 2007) and the follow-up management implementation plan.

*Executive Board Discussion of Conclusions of the Task Force*¹²

30. Several Directors highlighted the conclusion of the task force that excessive staff mobility has at times posed challenges for policy advice and program design and, in some cases, adversely affected the Fund's dialogue with members. Management will pay greater attention to continuity and stability in mission chief and other economist assignments, reinforced by appropriate incentives. At the same time, however, Directors noted that human resource management needs to be framed more broadly than in the context of prolonged use.

Monitoring Status

31. The Human Resources Department (HRD), at the request of management, developed a centralized scheme for economist mobility in 2004. After a trial run, the scheme was discontinued in favor of a decentralized approach. In collaboration with senior personnel managers in area departments, HRD emphasizes the acquisition of new competencies while minimizing excessive mobility. In order to avoid excessive mobility, IMF-wide mobility guidelines specify the minimum period a staff member should spend in a department. These guidelines also serve as a guide to intradepartmental mobility. As regards country teams, area departments and relevant functional departments monitor duration and turnover, although definitions and systems are specific to departmental needs. Thus, consistent data are not available IMF-wide. Available data suggest that a staff member's country assignments have an average duration of 2 to 3 years.

IEO Recommendation 9

32. The ability of staff to analyze political economy issues should be strengthened.

*Executive Board Discussion of Conclusions of the Task Force*¹³

33. Directors encouraged the staff to enhance its analysis and reporting of political economy issues in staff reports.

Monitoring Status

34. The number of training courses in political economy has increased since the IEO evaluation. Over the four year period prior to the IEO report, 21 courses in political economy were offered, while over the subsequent four year period, 44 courses were held. Moreover, the number of participants per political economy course has risen from 33 prior to the IEO

¹² Recommendation 8 was largely absent from the Summing Up but re-appeared in the recommendations of the task force.

¹³ Recommendation 9 was largely absent from the Summing Up but re-appeared in the recommendations of the task force.

report to over 40 afterwards. Altogether, staff training in political economy has increased by 133 percent in the most recent four year period compared to the preceding four year period.

Assessment

35. Most of the recommendations endorsed by the Executive Board have been carried out successfully. In particular, EPAs have been introduced and lessons learnt from these assessments are being integrated into subsequent Fund-supported programs. Indeed, when reviewing in 2006 experience with EPAs, the Board concluded that EPAs were serving their purpose, while noting the need for improvements in some areas. Drawing on the Board's views, the EPA guidelines were revised and have been in effect since late 2006. The Board requested greater candor concerning risks and enhanced analysis of political economy issues. While improvements have been made in these areas, a fuller analysis could be done in the context of the next conditionality review. Excessive staff mobility is an issue which is not confined to cases of prolonged use and therefore should be considered in a broader context.

B. The IMF and Recent Capital Account Crises (Indonesia, Korea, and Brazil)

IEO Recommendation 1

36. To increase the effectiveness of Fund surveillance, Article IV consultations should take a stress-testing approach to the analysis of a country's exposure to a potential capital account crisis. Staff should develop greater understanding of political constraints on policy, in part through wider dialogue. Market views and political economy analysis should be reflected in staff reports.

*Executive Board Discussion*¹⁴

37. Directors agreed that it is essential to strengthen the focus and effectiveness of Fund surveillance by extending and systematizing assessments of crisis vulnerabilities. Surveillance discussions should identify major shocks that the economy could face in the near future, explore the real and financial consequences of these shocks, and discuss the authorities' plans for dealing with these shocks should they materialize. Directors emphasized that vulnerability assessments should focus on the key risks and economic realities facing the member in question.

38. Most Directors agreed that the Fund should try to develop a greater understanding of the political constraints that may affect program implementation in a crisis, while cautioning that this should not lead to interference in domestic affairs.

¹⁴ See http://www.ieso-imf.org/eval/complete/eval_07282003.html.

39. Directors saw great value in systematic discussions with the domestic and international financial and business communities, to better understand their concerns—but emphasized that the staff would need to assess private sector views critically.

Monitoring Status

40. In the discussion of the Biennial Review of Surveillance,¹⁵ the Executive Board noted that the Fund had improved its vulnerability assessments in member countries and that its balance sheet analysis was having a positive impact. Indeed, the identification of balance sheet vulnerabilities has been highlighted as a key area in guidance to staff on surveillance, and methodological tools, including statistical frameworks and training, have been developed that will help gradually mainstream balance sheet analysis in Fund surveillance. Some area departments have established active working groups on external and intra-regional linkages and on financial sector issues to improve the assessment of cross-country and regional vulnerabilities and to further strengthen bilateral and multilateral surveillance. Moreover, the Fund’s vulnerability exercise is conducted semi-annually and general assessments are shared in the context of WEMD sessions.

IEO Recommendation 2

41. Management and the Executive Board should take additional steps to increase the impact of surveillance, including through making staff assessments more candid and more accessible to the public. In particular, there should be a presumption of publication for Article IV staff reports. A clear presumption of publication for country-related staff working papers should also be established. Biennial reviews of surveillance should focus on assessing the impact of surveillance on key systemic issues in major emerging market economies. Escalated signaling should be used when key vulnerabilities identified over several rounds of surveillance are not addressed. Such a policy would help strike the necessary balance between the role of the Fund as confidential advisor and its role as a vehicle for transmitting peer reviews on members’ policies and for providing quality information to markets. Moreover, management and the Board should explore the possibility of seeking “second opinions” from outside the Fund as part of the surveillance process when the authorities disagree with the staff’s assessment on issues that are judged to be of systemic importance. This would also serve as a building block for the idea of escalated signaling.

Executive Board Discussion

42. Directors strongly supported greater candor in the assessment of country risks and vulnerabilities in staff reports, building on the increase in candor that has already occurred. Directors expressed a range of views regarding the potential conflict between candor and transparency, and the implications of the proposed shift from voluntary to presumed publication of staff reports. Many Directors warned that greater candor could adversely

¹⁵ See <http://www.imf.org/external/np/pdr/surv/2004/082404.htm>.

affect both the Fund's dialogue with countries and market confidence in the context of the publication of staff reports. Many other Directors strongly supported presumed publication and that surveillance would be more effective in building ownership and influencing policy if Fund analyses and recommendations are made public.

43. While some Directors considered that escalated signaling might be an idea worth pursuing, many felt that escalated signaling would undermine the Fund's role as confidential advisor, and doubted that it would help in preventing crises or designing more effective programs.

44. Many Directors were not in favor of inviting second opinions from outside the Fund. Whereas some Directors considered that a second opinion would bring a fresh perspective that could help resolve differences of opinions with the authorities, many were concerned that it could encroach on the role of the Board and undermine the work of the staff. A few Directors also noted that this approach has been tried and has failed.

Monitoring Status

45. Under the Fund's transparency policy, staff reports are to be drafted to include the staff's candid assessment of risks, their frank views on the authorities' policy stance, and their policy advice on all areas deemed relevant. Staff reports are to be drafted independently of the authorities' publication intentions and draft staff reports cannot be shared with the authorities. At the 2005 Review of Transparency Policy, most Directors were satisfied that increased publication has not led to a significant erosion of candor, although in the view of a few other Directors the staff paper provided distinct evidence of loss of candor associated with the new publication policy. Directors emphasized the critical importance of preserving frankness and stressed the need for continued monitoring of this issue. Following this review, the transparency guidelines to staff were revised and strengthened. The Board agreed that the next review of the Fund's transparency policy would take place by 2010.

46. Since July 1, 2004, publication of staff reports for Article IV consultations is now "voluntary but presumed." Moreover, the member country's agreement to publish staff reports is now required for management to recommend to the Board a Fund-supported program with exceptional access. As of September 2007, all staff reports for advanced economies discussed by the Board were published compared to an 88 percent publication rate among emerging market and developing countries. Moreover, public information notices for 97 percent of the membership were published during this period.

47. Turning to efforts to increase the impact of surveillance, the IMF's Medium-Term Strategy has this as one of its main objectives. Toward that end, the 1977 Surveillance Decision was modernized and a new Bilateral Surveillance Decision adopted in June 2007 that stresses external stability. Staff have also engaged in regional and country-level outreach strategies for this purpose. In February 2007, a Board seminar discussed methodological issues to assess the effectiveness of surveillance and concluded that effectiveness should be based on the relevance, practicality, candor, and evenhandedness of Fund advice. While acknowledging the difficulties involved in measuring the Fund's impact on outcomes, most Directors felt that it would be important to address issues of attribution through the broader

use of ad hoc case studies and surveys of country authorities and other relevant audiences. This discussion will inform the next triennial review of surveillance.

IEO Recommendation 3

48. A comprehensive review of the Fund’s approach to program design in capital account crises should be undertaken. In particular, (1) greater attention should be paid to balance-sheet interactions and their consequences for aggregate demand; (2) program design should allow for a flexible response, in case unfavorable outcomes materialize; (3) conventional financial-programming-based conditionality should be reviewed, and possibly adapted for capital account crisis circumstances; (4) parsimony and focus should be basic principles of structural conditionality, and crises should not be used for pushing reforms that are not critical to crisis resolution, however desirable they may be in the long run; and (5) there should be an agreed communications strategy, characterized by a high degree of transparency.

Executive Board Discussion

49. Directors agreed that the primary objective of a crisis management program should be to help restore confidence by implementing a comprehensive set of policies that effectively address the root causes of the crisis. Directors noted that the Fund’s increased attention to financial sector surveillance has reduced the risk that vulnerabilities in the financial sector will be neglected in program design.

50. Many Directors also concurred that much greater attention needs to be paid to the interaction of balance-sheet weaknesses and key macroeconomic variables. Several Directors reiterated that the balance sheet approach should be closely linked to debt sustainability analysis and, in particular, to the implications of the currency and maturity structure for the debt dynamics. Directors called for more analytical work to design a framework for dealing with “twin” (exchange rate and banking) crises, including the implications for the sovereign’s policies and financial position.

51. Directors agreed that program design should allow for a flexible response in case unfavorable outcomes materialize; that conditionality should be reviewed to see how it can be adapted to the rapidly evolving circumstances of capital account crises; and that, at a minimum, the broad outlines of the program should be communicated to the public and the markets. Directors recognized that program design plays a critical role in the determination of program success.

52. Directors supported the recommendation that a crisis should not be used as an opportunity to force long-standing reforms, however desirable they may be, in areas that are not critical to the resolution of the crisis or addressing vulnerability to future crises. They agreed that parsimony and focus should be the principles to guide the design of structural conditionality in a program whose objective is to restore confidence quickly.

Monitoring Status

53. The December 2004 Review of the Design of IMF-Supported Programs examined the analytical toolkit for program design, including tools for balance sheet and debt sustainability analysis, and the performance of these tools for macroeconomic projections underlying program design.¹⁶ Directors noted that external adjustment in GRA-supported programs has been broadly in line with considerations of medium-term debt sustainability but that, in a number of these programs, private market financing has turned out to be much less abundant than expected, resulting in current account adjustment that is both larger than envisaged and larger than required to stabilize external debt at moderate levels. Directors called for further careful analysis of program design issues relating to (i) capital account crises including wider application of balance-sheet analysis, (ii) determinants of capital flows, and (iii) the catalytic effects of Fund-supported programs.

54. In April 2006, in the discussion of whether systematic differences existed between precautionary and nonprecautionary programs, Directors observed that, by the end of the program period, growth rates in member countries with non-precautionary programs had caught up with growth rates in members with precautionary programs, notwithstanding weaker initial conditions.¹⁷ Directors also observed that precautionary and non-precautionary programs had similar records of achieving program targets. In the context of designing programs for crisis prevention, a recent staff study found that during periods of heightened vulnerability,¹⁸ Fund financing over the preceding year as a share of short-term debt can be effective in lowering the likelihood of a crisis. More recently, the Board has been discussing the introduction of the RAL as a possible vehicle that could provide substantial financing in times of uncertainty to countries with strong policies.¹⁹

55. The 2005 review of the conditionality guidelines found that substantial changes have been made in the direction of greater parsimony in structural conditionality, and made suggestions to enable further progress in this direction.²⁰

56. Continued efforts to strengthen focus on financial sector vulnerabilities (including on balance sheets) are in line with the Report of the IMF Financial Sector Review Group that was discussed at an informal Board seminar and the Medium-Term Strategy. Balance sheet analysis is a regular feature in Article IV surveillance with about 20 country cases having used the methodology, and balance sheet indicators have been incorporated into the new vulnerability exercise. Indeed, some of these indicators (such as the ratio to GDP of public

¹⁶ See <http://www.imf.org/external/np/sec/pn/2005/pn0516.htm>.

¹⁷ See <http://www.imf.org/external/np/pdr/cp/eng/2004/090304.htm>.

¹⁸ See <http://www.imf.org/external/np/pdr/cp/eng/2004/090304.htm>.

¹⁹ See <http://www.imf.org/external/np/pp/eng/2007/021307.pdf>.

²⁰ See <http://www.imf.org/external/np/sec/pn/2005/pn0552.htm>.

debt exposed to foreign exchange and rollover risk) have been found to play a very important role in identifying vulnerabilities to crises.²¹ Finally, the International Capital Markets and Monetary and Financial Systems Departments were merged to form the Monetary and Capital Market Department with a view to enhance financial sector surveillance, as well as provide a center of expertise on banking crisis resolution issues.

IEO Recommendations 4 and 5

57. Since restoration of confidence is the central goal, the IMF should ensure that the financing package, including all components, should be sufficient to generate confidence and also of credible quality. In particular, (1) packages should not rely on parallel official financing unless the terms of access are transparently linked to a Fund-supported strategy; and (2) terms for the involvement of other institutions providing parallel financing should be specified at the outset.

58. The Fund should be proactive in its role as crisis coordinator. In particular, (1) management should provide a candid assessment of the probability of success to the Executive Board and shareholders; (2) management should ensure that the technical judgment of staff is protected from excessive political interference; and (3) the nature of private sector involvement will have to be determined on a case-by-case basis. The Fund should play a central role in identifying circumstances where concerted efforts can help overcome collective action problems, based on meaningful dialogue with the private sector.

59. Human resource management should be adapted to develop and better utilize country expertise, including political economy skills, and to establish “centers of expertise” on crisis management issues. In particular, (1) the length of staff assignments should be monitored to ensure continuity of staff expertise and a critical mass of country expertise in each systemically important emerging market economy should be developed; (2) resident representatives should play a more central role in surveillance and program design; and (3) internal procedures should protect those who raise uncomfortable issues through proper channels, but consequently attract complaints from the authorities.

Executive Board Discussion

60. Directors agreed that, to the extent that financing packages supporting the member’s program rely on parallel financing from official or multilateral sources, it is essential that the terms of such support be clear and the amount be adequate.

61. Directors noted that management should provide the Executive Board and member countries with candid assessments of the probability of success of a proposed strategy. While Directors were in favor of early involvement of the Board in program discussions, a number of them observed that the Board and major members should not seek to micro-manage the

²¹ See <http://www.imf.org/external/pubs/ft/survey/so/2007/NEW0924B.htm>.

operational details of programs or influence Fund missions in the field. Many Directors attached particular importance to the early involvement of the private sector in crisis resolution.

62. Directors generally agreed on the need to ensure that the Fund is in a position to respond rapidly with relevant expertise to member countries facing crises. Some Directors supported the creation of “centers of expertise” in crisis management, whereas others put greater emphasis on mechanisms for drawing upon available expertise and experience in the event of a crisis.

63. A number of Directors favored longer country desk assignments to ensure that sufficient country experience is maintained within the staff, while others noted the importance of staff mobility in broadening the experience and perspectives of the staff and maintaining its impartiality.

64. Most Directors favored a greater role for resident representatives in surveillance and program design, in countries with resident representative offices, with a few noting that only relatively senior resident representatives would be sufficiently acceptable to the authorities to play such a role.

Monitoring Status

65. The framework for exceptional access decisions, which was introduced in 2002, was reviewed by the Board in 2004 access framework provides for strengthened procedures for decision making on proposals for access above normal access limits, thus providing additional safeguards and enhancing accountability.²² This framework raised the burden of proof required in program documents, formalized early Board consultations, and mandated ex post evaluations by staff within a year after the end of the arrangement. Directors emphasized that efforts to involve private creditors in program financing should be continued, but it was recognized that concerted or involuntary action by such creditors could be associated with a slow return of confidence and market access. Voluntary efforts to address collective action problems among private creditors should be encouraged, including where steps to address an unsustainable debt burden is needed as part of a strategy to restore growth and financial viability. In reviewing the framework (in 2004), Directors felt that it had helped to improve the clarity and predictability of the Fund’s response to capital account crises for both markets and members, and endorsed the strengthened decision-making procedures. More generally, informal country matter sessions are now used more frequently to flag key program-related developments to the Board.

66. The Board paper for the August 2004 Biennial Review of Surveillance (BRS)²³ called for a reassessment of mechanisms for staff rotation and mobility to achieve greater continuity

²² See <http://www.imf.org/external/np/sec/pn/2004/pn0454.htm>.

²³ See <http://www.imf.org/external/np/pdr/surv/2004/082404.htm>.

in the policy dialogue, enhance mutual trust, and build up country-specific knowledge. As noted earlier, HRD works with departments to ensure a balance between acquisition of new competencies through mobility and avoiding excessive mobility through its regular discussions with Senior Personnel Managers. Following the 2004 BRS review, it was decided not to implement a policy requiring mobility for promotion to Grade A15 to avoid the perception that mobility is encouraged. Guidance issued to staff following the 2004 BRS highlights a number of steps to foster good policy dialogue with the authorities. The internal review process has been strengthened to provide greater continuity, for instance through mainstreaming of pre-brief meetings. The introduction of three-year surveillance agendas should also contribute to providing needed continuity.

67. Rather than following the IEO recommendation that resident representatives should play a more central role in surveillance and program design, Executive Directors supported the view of the Committee on the Review of the Resident Representative Program that highlighted that resident representatives should focus instead on capacity building and outreach activities; for instance, the committee noted that resident representatives could help organize seminars and workshops for government officials and civil society.

Assessment

68. The Fund has improved its vulnerability assessments in member countries and has incorporated balance sheet analysis in its work on financial sector vulnerabilities as well as vulnerabilities assessments more generally. The exceptional access framework has introduced safeguards and strengthened accountability while adding clarity and predictability to decision-making. Ex post evaluations have been completed for all arrangements with exceptional access that have expired for one year—only one member now has exceptional access compared with 7 members in 2000. Access policy including the exceptional access framework will be reviewed in 2008. A review of the Fund policy on lending into arrears of private creditors is also under preparation. In terms of the Fund's transparency policy, its publication policy has been clarified and enhanced in recent years. As noted in the assessment of prolonged program engagement, striking the proper balance between the Fund's role as confidential advisor (e.g., candor) and publication (e.g., market discipline and market disruptions) remains a difficult task. The recent adoption of a new Surveillance Decision should promote greater focus on the assessment of member countries' external vulnerabilities; periodic follow up will be necessary to assess implementation.

C. Fiscal Adjustment in IMF-Supported Programs

IEO Recommendation 1

69. Program documentation should provide a more in-depth and coherent justification for the magnitude and pace of programmed fiscal adjustment and how it is linked with assumptions about the recovery of private sector activity and growth. This will also facilitate the review process and discussions at the Board, as well as provide external audiences with a

more convincing explanation for the rationale for the program and identify possible risks and subsequent corrective measures.

*Executive Board Discussion*²⁴

70. Directors supported this recommendation, and deemed that this initiative would instill greater discipline in program design, enhance transparency, and provide the public and the private sector with a more convincing rationale for the program, thereby helping to overcome political obstacles to implementation. Nevertheless, they recognized that uncertainties regarding key macroeconomic variables, particularly in countries in crisis, and concerns about the implementation of policy measures and reforms complicate this task. A few Directors cautioned against spurious precision in such justifications, and others noted that the magnitude and pace of programmed fiscal adjustment may also reflect political constraints. Several Directors stressed the importance of better integrating debt sustainability analyses into program work. Directors looked forward to further staff analysis of the issue of growth projections in the context of the program design discussions.

*Executive Board Discussion of Follow-up on the Recommendations*²⁵

71. Directors welcomed the preparation of a guidance note for the staff on the presentation of the rationale for the magnitude and pace of fiscal adjustment, which should, over time, be reflected in an improvement in the extent to which staff reports justify the fiscal targets, or changes in the fiscal targets, agreed with country authorities.

Monitoring Status

72. The Fiscal Affairs Department (FAD) in January 2004 prepared a guidance note on how reports might best present the appropriate size, pattern, and composition of fiscal adjustment. Since then, staff reports have carefully distinguished between debt sustainability and internal/external balance considerations in assessing the composition of fiscal adjustment and in considering additional targets for the cyclically-adjusted fiscal stance. However, stricter word limits in staff reports has limited the description of the fiscal structural reform agenda and there has not been a formal assessment of this recommendation

IEO Recommendation 2

73. The internal review mechanism should place more emphasis on the early stages of the process. A more intensive process of brainstorming is needed at the time of the initial brief, and the brief should also articulate more clearly the basis for the fiscal program, and its links with debt sustainability issues.

²⁴ See <http://www.imf.org/External/NP/ieo/2003/pr/pr0303.htm>.

²⁵ See <http://www.imf.org/external/np/pdr/fa/2004/eng/020904.htm>.

Executive Board Discussion

74. Directors supported this recommendation. They welcomed Management's recent initiative aimed at enhancing the effectiveness of the review process, which, *inter alia*, encourages early consultation between departments.

Executive Board Discussion of Follow-up on the Recommendations

75. Directors were encouraged by the increasing prevalence of interdepartmental pre-brief meetings and noted their role in promoting internal debate about critical policy issues at an early stage.

Monitoring Status

76. Following the assessment of the internal review process by a staff task force in 2004, management endorsed several changes to the process, including more systematic discussions of key issues prior to the preparation of briefing papers. In particular, pre-brief meetings that bring together originating and reviewing departments for a discussion of the main policy issues are required for all Article IV consultations and new program briefs. The number of pre-brief meetings has increased by 12 percent in 2007 to a total of 156. Moreover, a new series of country seminars has been introduced by FAD, which facilitates interdepartmental exchange on the assessment of member countries' fiscal policy. The introduction of surveillance agendas also serves as an opportunity to define the broader roadmap of reforms.

IEO Recommendations 3 and 4

77. Programs should give greater emphasis to the formulation and implementation of key institutional reforms in the fiscal area, even if (as is likely) they cannot be fully implemented during the program period. Programs should make stronger efforts to specify those structural reforms that should be carried out during the program horizon as part of a broader road map of priority reforms. This road map, and its prioritization, should ideally have emerged in the course of surveillance and be updated regularly.

78. The surveillance process should be used more explicitly to provide a longer-term road map for fiscal reforms and to assess progress achieved. In collaboration with the authorities, the IMF should clearly identify in surveillance reports the most critical distortions in a country's public finances from the perspectives of equity and efficiency. Such an analysis would provide a road map for fiscal reform in the future, with a clear sense of priorities. It would help to provide the basis for identifying critical reforms—particularly in areas where these reforms have been lagging—that would need to be addressed should Fund financing be required in the future.

79. The identification in advance of areas considered critical will allow the authorities flexibility in the timing and packaging of reforms that is often lost if these reforms are flagged at the last minute in the context of a crisis situation. This approach would also help foster greater domestic debate on key reforms and hence would encourage homegrown

solutions and greater ownership. Early and clear prioritization of reforms is also consistent with streamlining objectives—and will avoid last minute bunching of reforms during crises.

80. The analysis of fiscal reform priorities should be accompanied by an assessment of why certain important distortions were not addressed in the past and what lessons have been learned from experience. This should include an effort to identify and unbundle the various constraints to critical reforms, including lack of technical capacity, areas where additional legislative action is necessary, and areas where key decisions from the executive branch are required.

81. Public debt sustainability could help anchor the road map of fiscal reform priorities proposed above and to assess tradeoffs over time. At the same time, debt analysis provides a check of cumulative progress in improving fiscal systems that could also be reported in successive surveillance reports.

Executive Board Discussion

82. Directors agreed that key institutional reforms can be more critical for fiscal sustainability than short-term expenditure and revenue measures. However, they recognized that short-term measures are hard to avoid in many cases, especially if the immediate objective is economic stabilization. Medium-term institutional reform may be of particular relevance in countries that have achieved macroeconomic stability and where “second generation” reforms are necessary to foster growth and reduce longer-term vulnerabilities. Some Directors agreed with the report’s suggestion that reforms should be broken down into those that require executive action, legislation, and capacity building.

83. Directors, however, pointed out that in crises, the pressing need to resolve the crisis may pose serious constraints on a medium-term approach. They reiterated the conclusion of the discussion on the Evaluation of the Role of the Fund in Recent Capital Account Crises that a crisis should not be used as an opportunity to force long-awaited reforms, however desirable they may be, in areas that are not critical to the resolution of the crisis or to address vulnerability to future crises. Careful judgment will continue to be needed to focus conditionality on those reforms judged critical while at the same time ensuring that adequate progress is made in addressing vulnerabilities and achieving the program’s goals during the period of the arrangement, thus safeguarding the Fund’s resources.

84. Most Directors agreed that Article IV consultations should play a stronger role in identifying longer-term reform priorities and the causes of past failures in addressing fiscal problems, and that these analyses should inform subsequent program design. In this respect, the various initiatives to distinguish Article IV surveillance from program work are aimed at providing fresh perspectives.

Executive Board Discussion of Follow-up on the Recommendations

85. Directors saw the staff’s proposal to encourage wider use of Fiscal Strategy Briefs and produce 10-15 Article IV reports over the next year with a special focus on the fiscal

reform agenda as a constructive way, at least initially, of resolving the tension between heightened concentration on these issues and resource constraints.

86. Directors considered that more extensive cross-country analysis of structural fiscal issues would be helpful in drawing common elements from the vast experience accumulated by the Fund.

87. They also encouraged the staff to include in staff reports short assessments of progress in implementing previous Fund policy advice and the recommendations of technical assistance and ROSC missions, as well as to identify constraints on reform by distinguishing among those requiring legislation, executive action, and capacity building.

Monitoring Status

88. A pilot exercise was conducted in 16 countries to strengthen discussions of structural fiscal issues, building on fiscal strategy briefs, prepared by the Fiscal Affairs Department (FAD) in collaboration with area departments. Following this pilot, FAD now maintains and regularly updates fiscal strategy briefs for about 75 countries. These fiscal briefs contain cross-country analysis. These briefs can be used by area departments to inform discussions with the authorities on critical structural and institutional fiscal issues that can be covered subsequently in Article IV and program reports. In a number of countries, staff reports have included enhanced coverage of structural fiscal issues and prioritized agendas for reform.

89. As part of the implementation of the recommendations of the 2005 review of the standards and codes initiative and the Fund's Medium-Term Strategy, staff should mention in the staff appraisals of Article IV reports when they judge that a fiscal ROSC is a high priority, without feeling constrained by the extent of the authorities' perceived or actual willingness to volunteer for the ROSC.²⁶

IEO Recommendation 5

90. The IMF should clearly delineate the operational framework in which social issues will be addressed within program design in non-PRGF countries. This should include a clear indication of the IMF's responsibilities and activities in this area. The objective should be to assist middle-income countries to prepare and improve their institutional framework to allocate resources to critical social programs and to establish mechanisms to protect the most vulnerable groups in the face of external shocks and budgetary retrenchment.

91. The IMF could invite the authorities regularly during Article IV consultations to identify the existing critical social programs and social services that they would like to see

²⁶ See <http://www.imf.org/external/np/pp/eng/2006/062906.pdf> and <http://www.imf.org/external/np/rosc/rosc.asp?sort=date>.

protected in the event of adverse shocks. Participation on the part of the authorities would clearly be voluntary.

- Successful implementation will depend heavily on having better and more transparent expenditure monitoring systems. On the basis of the priorities identified by the authorities, the IMF and the World Bank could join their accelerated efforts to reform public expenditure management (PEM) systems, specifically geared toward the social area, with a view to protecting the specified programs and spending categories.
- This concrete application of the PEM initiative is particularly important because in many cases where there is an IMF-supported program the World Bank is also active with adjustment lending supporting the budget.
- Surveillance would routinely report on these initiatives and their progress over time.

Executive Board Discussion

92. Directors agreed that an important aim of program design should be to protect critical social expenditures. However, they stressed, as recognized in the IEO report, that the Fund should not become involved in the detailed selection and design of social policy; this task is outside both the Fund's mandate and its expertise. A number of Directors supported the IEO's call for updating of the 1997 guidelines that direct Fund work in the social area, in order to improve their clarity and effectiveness as an operational tool in protecting the most vulnerable from economic shocks and budgetary retrenchment. Other Directors, however, viewed the existing guidelines as adequate, and a few considered that the annual and medium-term budgets of non-PRGF countries already adequately identify critical social sector programs. These Directors recalled that the new framework for Bank-Fund collaboration on public expenditure issues should enhance countries' public expenditure reform strategies, including measures to protect critical social spending. Many Directors agreed with the recommendation that staff should inquire (during Article IV consultations) whether the authorities have identified social programs that they would like to protect in the event of a crisis, as they believed this would help dispel the criticism that Fund-supported programs unduly curtail social spending. A few others considered this recommendation impractical, as it would create significant costs and pressures for the authorities with little benefit.

Executive Board Discussion of Follow-up on the Recommendations

93. Directors welcomed the staff's efforts to focus, in close collaboration with the World Bank, on protecting critical social spending and incorporating the costs of social safety nets into program design.

Monitoring Status

94. During the discussions of the 2004 Biennial Review of IMF Surveillance, the Executive Board concluded that in "members where shocks could have a sizable impact on social conditions, most Directors were of the view that Article IV consultations and other

contacts can offer an opportunity to solicit interested members' views on protection of social safety nets or of other priority expenditures in times of economic stress." Subsequently FAD wrote a paper on large fiscal adjustments that were submitted to the Board for information.²⁷ The surveillance guidance note issued to staff in early 2005 calls for social and related issues—such as poverty, income distribution, social safety nets, and social expenditures—to be addressed, with due regard to principles of focus and selectivity. Moreover, the PSIA group in FAD (set up in 2004) evaluates program measures that could have unintended adverse consequences for poor and vulnerable households. Where compensatory measures are required, an attempt is made to identify measures that could be adopted over the short term, as well as measures that could be taken to enhance the cost-effectiveness of a more comprehensive safety net. Toward this end, the PSIA group had carried out 34 PSIA exercises by mid-2007; these are transmitted to the Board through various avenues including staff reports, PSIA aide-mémoires, TA reports, selected issues papers, and working papers.

95. Finally, the surveillance guidance note is currently being revised in line with the 2007 Surveillance Decision, which reaffirms and sharpens the principles of focus and selectivity. Moreover, the 2007 Board papers on the management of aid inflows provided further proposals for program design, including program adjusters, to protect priority spending against shortfalls in aid.²⁸ These proposals were supported by most Executive Directors.

Assessment

96. A guidance note was prepared in January 2004 on how reports might best present the appropriate size, pattern, and composition of fiscal adjustment and has been implemented since then. Meetings are also called by area departments before briefing papers are prepared and involve brain-storming on fiscal (and other) issues, including the prioritization of fiscal measures that rely, inter alia, on fiscal ROSCs. Moreover, the development of surveillance agendas and Fiscal Strategy Briefs have elicited a proper medium-term focus on fiscal issues and institution building. The IEO's request for staff to protect critical social spending when formulating advice, in close collaboration with the World Bank, is scheduled to be done as part of the follow up to the Malan report. Finally, work still needs to be done on incorporating the costs of social safety nets into program design.

D. The IMF and Argentina, 1991–2001

IEO Recommendation 1

97. The IMF should have a contingency strategy from the outset of a crisis, including in particular “stop-loss rules”—that is, a set of criteria to determine if the initial strategy is

²⁷ See <http://www.imf.org/external/pubs/cat/longres.cfm?sk=18309.0>.

²⁸ See <http://www.imf.org/external/np/pp/2007/eng/071907.htm>.

working and to guide the decision on when a change in approach is needed. Where the sustainability of debt or the exchange rate is in question, the IMF should indicate that its support is conditional upon a meaningful shift in the country's policy while remaining actively engaged to foster such a shift. High priority should be given to defining the role of the IMF when a country seeking exceptional access has a solvency problem.

Executive Board Discussion²⁹

98. Most Directors viewed contingency planning as useful. However, many Directors noted that in a crisis or pre-crisis setting, it is not always possible to assess the various contingencies that might occur. Concern was also expressed that any indication that the Fund was developing contingency strategies could undermine confidence in the program. As regards “stop-loss” rules, while some Directors supported their consideration, most felt that defining and implementing such rules would be difficult or impractical.

99. Directors agreed with the IEO's recommendation that in cases where the sustainability of debt or the exchange rate is threatened, the Fund should clearly indicate that its support is conditional upon a meaningful shift in the country's policy. At the same time, they noted that assessing sustainability in these two complex areas, particularly in a crisis, will necessarily entail judgment. To this end, it is essential that the Board be provided with up-to-date and comprehensive information and analysis to make such judgments. Directors recognized that steps have been taken since the Argentine crisis to strengthen the basis on which such assessments are made. Directors looked forward to an opportunity to assess whether further changes in the Fund's policies and procedures may be needed.

Monitoring Status

100. No consensus emerged at the Board meeting on contingency planning and on “stop-loss” rules. In terms of assessing debt sustainability, this is regularly done in the context of Article IV reports for low and middle-income countries with the aid of the debt sustainability template. Moreover, in high access cases, Directors noted in its review of the exceptional access framework that some of the features of the exceptional access cases, particularly the high debt levels, will require the relevant members to sustain high primary fiscal surpluses into the medium term.³⁰

IEO Recommendation 2

101. Medium-term exchange rate and debt sustainability should form the core focus of IMF surveillance. To fulfill these objectives (which are already current policy), the IMF needs to improve tools for assessing the equilibrium real exchange rate that are more forward looking and rely on a variety of criteria, examine debt profiles from the perspective of “debt

²⁹ See http://www.ieso-imf.org/eval/complete/eval_07292004.html.

³⁰ See <http://www.imf.org/external/np/sec/pn/2004/pn0454.htm>.

intolerance,” and take a longer-term perspective on vulnerabilities that could surface over the medium term.

Executive Board Discussion

102. Directors concurred with the IEO’s recommendation that medium-term exchange rate and debt sustainability analyses should form the core focus of Fund surveillance. Directors continued to see a need for greater candor in the treatment of exchange rate policy in the context of Article IV discussions. In this connection, it was suggested that the scope for establishing procedures for handling sensitive topics during surveillance exercises should be explored by the staff. On exchange rate sustainability, Directors cautioned that finding an appropriate operational measure would be difficult; however, a few suggested that the development of such a measure by the staff should be a priority.

103. Recent events have led to a reassessment of what level of debt is sustainable for emerging market countries. Such a reassessment is already reflected in the Fund’s work with the development of the debt sustainability framework. Directors asked staff to continue to sharpen its analytical tools in this area, and a few called for examining ways to strengthen the organization and independence of DSA work.

Monitoring Status

104. In June 2002, the Board adopted a framework for more objective and standardized debt sustainability analysis;³¹ refinements to this framework were endorsed by the Board in July 2003. Debt sustainability analyses, including a specialized framework for low-income countries, are now regularly included in staff reports for Article IV consultations and are required in all documents requesting the use of Fund resources. They also play a central role in the Evian approach of Paris Club creditors. Moreover, any exceptional access request must be assessed against the criterion of a high probability that the debt profile remains sustainable and the criterion that the member’s policy framework provides a reasonably strong prospect of success. The Board has also considered the issue of managing systemic banking crises in the context of debt restructuring and analytical work has been carried out which specifically examined sovereign debt restructuring and debt sustainability.³²

105. Upon completing the 2004 Biennial Review of Surveillance, the Executive Board established sharper exchange rate surveillance and improved analysis of debt sustainability as priority objectives. Since then, both areas have been receiving special emphasis in staff guidance, training, research and in the internal review process. The Medium-Term Strategy includes a number of initiatives to strengthen the analysis of exchange rates, including the extension of the work of CGER to major emerging markets.³³ Some area departments have

³¹ See <http://www.imf.org/external/np/pdr/sustain/2003/052303.htm>.

³² See <http://www.imf.org/external/pubs/cat/longres.cfm?sk=19634.0>.

³³ See <http://www.imf.org/external/np/pp/eng/2006/110806.pdf>.

established active working groups on exchange rate issues and the follow up to the IEO evaluation on Exchange Rate Policy provides a detailed road map on how to tackle these recommendations.

106. The 2007 Surveillance Decision uses the concept of external stability—a concept linked to both equilibrium exchange rates and debt sustainability—as the organizing principle of the Fund’s bilateral surveillance. The Decision provides further guidance to members on the conduct of exchange rate policies and clarifies expectations as to how surveillance should assess exchange rate policies.

IEO Recommendation 3

107. The IMF should refrain from entering or maintaining a program relationship with a member country (in the form of a precautionary arrangement) when there is no immediate balance of payments need, when the member has weak policies, and when serious political obstacles to needed policy adjustment or structural reform are present. Exceptional access should entail a presumption of close cooperation between the authorities and the IMF, and special incentives to forge such close collaboration should be adopted, including mandatory disclosure to the Executive Board of any critical issue or information that the authorities refuse to discuss with (or disclose to) staff or management.

Executive Board Discussion

108. Directors noted the possible risks associated with precautionary Fund arrangements, especially where there are serious political obstacles to needed policies and reforms. Most Directors did not support the implication in the IEO report that the Fund should not enter into a program relationship with a member country when there is no immediate balance of payments need. Directors reiterated the value of precautionary arrangements as an important tool for supporting sound policies and promoting crisis prevention more generally. Directors agreed that there is a need to ensure that program standards and requirements for precautionary arrangements are the same as those for all other arrangements.

Monitoring Status

109. The Board did not support the recommendation. Board has reviewed precautionary arrangements as background to its discussions of a new liquidity instrument for market access (RAL).³⁴

³⁴ See <http://www.imf.org/external/np/sec/pn/2006/pn0694.htm>.

IEO Recommendation 4

110. In order to strengthen the role of the Executive Board, procedures should be adopted to encourage (1) effective Board oversight of decisions under management's purview; (2) provision of candid and full information to the Board on all issues relevant to decision making; and (3) open exchanges of views between management and the Board on all topics, including the most sensitive ones.

Executive Board Discussion

111. Directors stressed that all cases of the use of Fund resources, particularly cases of exceptional access, should entail a presumption of close cooperation. Many Directors agreed with the IEO's suggestion that there should be a requirement of mandatory disclosure to the Board of any critical issues which the authorities refuse to discuss.

Monitoring Status

112. Procedures for exceptional access were adopted in 2002 following the Argentine crisis. The exceptional access framework provides for strengthened procedures for decision making on proposals for access above normal access limits to provide additional safeguards and enhance accountability. This framework raised the burden of proof required in program documents, formalized early Board consultations, and mandated ex post evaluations by staff within a year after the end of the arrangement. In reviewing the framework, Directors felt that it had helped to improve the clarity and predictability of the Fund's response to capital account crises for both markets and members and endorsed the strengthened decision-making procedures.³⁵ In 2006, an ad hoc Board committee on confidential information was formed to consider possible modifications to the existing framework governing the treatment of confidential information in the context of the use of Fund resources.

Assessment

113. The Board-endorsed IEO recommendations have been implemented in the context of monitoring and review frameworks and of policies agreed by the Board. Regular reviews have been established by the Board for these frameworks and policies and, therefore, annual monitoring would neither be productive nor cost-efficient. A Board Committee is discussing issues related to the handling of confidential information under the side letter policy. Any recommendations that emerge from this Committee should be monitored outside the context of these PMRs.

³⁵ See <http://www.imf.org/external/np/sec/pn/2004/pn0454.htm> and <http://www.imf.org/external/np/acc/2004/eng/032304.htm>.

E. Poverty Reduction Strategy Papers/Poverty Reduction Growth Facility

IEO Recommendation 1

114. Introduce greater flexibility in the implementation of the PRS approach to fit better the needs of countries at different stages of the process and with different capacities and political and administrative systems. Countries would be put more firmly in the driver's seat by determining themselves: (1) how the policy formulation, implementation, and monitoring processes will be built up over time (progress would be monitored against an explicit set of country-determined intermediate benchmarks) and (2) what the output of these processes will be in terms of documents, with IMF process requirements minimized.

*Executive Board Discussion*³⁶

115. Directors agreed that the PRS approach will need to be implemented pragmatically and flexibly, taking due account of country-specific circumstances and capacity constraints. In this regard, it will be important to have a clear idea of the core objectives of the PRS approach.

Monitoring Status

116. PRS processes are now more closely aligned with domestic processes, giving the country an opportunity to assess progress and set the agenda for the period ahead. Indeed, in some cases they have become the national development plan (Ethiopia, Tanzania) although they are seldom done on an annual schedule. In most cases, Annual Progress Reports (APR) are not discussed by the Fund and World Bank Boards and are distributed for their information only. Moreover, the requirement that the PRS and the PRGF be fully consistent has been eased, with the aim of eliminating the need for last minute adjustments to the strategy document.

IEO Recommendation 2

117. Shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes. This would involve the following elements: (1) build in greater results orientation and (2) shift the emphasis of the incentives structure to achieving substantive changes in domestic policies and processes that are objectively measured.

³⁶ See http://www.ieso-imf.org/eval/complete/eval_07062004.html.

Executive Board Discussion

118. Directors agreed there should be less emphasis on document preparation, and more emphasis on improving the capability of countries to develop and implement policies supportive of growth and poverty reduction. Some Directors agreed that countries should set explicit criteria for judging progress towards key intermediate objectives related to the domestic policy formulation, implementation and monitoring process for their PRSPs, and that Fund and Bank staff should provide candid assessments of those benchmarks. Many Directors cautioned, however, that this could imply excessive Fund involvement in assessing the country's decision-making processes, and establish an unwarranted direct linkage between such assessments and the Fund's lending decisions. Directors noted that further reflection and discussion will be needed on how the Fund should react in cases where the pace of progress chosen is not ambitious enough.

Monitoring Status

119. Poverty Reduction Strategy Papers are country-owned and prepared documents. Joint Staff Advisory Notes (see below) are intended to provide constructive feedback to the authorities, focusing on a limited number of suggested key improvements that could be made to the strategy. This increased selectivity is intended to focus efforts on substantive changes in policies and processes.

IEO Recommendation 3

120. Clarify the purpose of the Joint Staff Assessments and redefine the vehicle accordingly.

Executive Board Discussion

121. Directors emphasized the need for a reformulation of the Joint Staff Assessment with an emphasis on graduated rather than binary (yes or no) assessments.

Monitoring Status

122. The Board accepted the staff proposal to replace the JSA with a JSAN that focuses on providing feedback to the authorities on the PRSP and that drops the binary assessment of the suitability of the PRSP as a basis for concessional lending. Subsequently, the Bank and Fund launched a working group to revisit arrangements for JSANs and has tentatively made proposals to retain the JSAN for the full PRSP while replacing the JSANs for Annual Progress Reports (APR) with feedback mechanisms rooted in country processes.

IEO Recommendation 4

123. Clarify what the PRS approach implies for the IMF's own operations and strengthen the implementation of the agreed role. This would affect the following areas: (1) IMF engagement in the PRS process, (2) PRGF-related activities including clarifying the IMF role where the PRSP does not yet provide an operational road map, and (3) streamline IMF documentation and Board scrutiny.

Executive Board Discussion

124. Directors agreed that the Fund needs to set out more clearly its own role in the PRS approach in each country, based on the Fund's core mandate in macroeconomic and related structural policy issues.

125. Many Directors also supported a more active role for the Fund in the public debate on macroeconomic policy design and implementation.

Monitoring Status

126. Work with LICs has been undertaken in the context of the Managing Director's Report on the IMF's Medium-Term Strategy and includes the establishment of a Working Group on Low-Income Countries. The Medium-Term strategy set out a framework for re-focusing the Fund's work in low-income countries on its core areas of competence, with a more active effort to reach country-level agreement with the World Bank and other development partners based on an appropriate division of labor. The MTS emphasizes the need for deeper Fund involvement in helping LICs manage the macroeconomic impacts of debt relief and aid inflows. In October 2007, the Board reviewed the Role of the Fund in the Poverty Reduction Strategy Process and its Collaboration with Donors and the Joint Management Action Plan which provides concrete follow up to the recommendations of the Malan Committee—an External Review Committee on Bank Fund Collaboration.³⁷ The Board concluded that the primary focus of the Fund's work in low-income countries in the context of the PRSP process should be to provide policy advice and technical support on the design of appropriate macroeconomic policies.³⁸ Fund staff should draw on available analysis of the sources of growth and related constraints prepared by the World Bank and other development partners, but not take the lead in microeconomic or sector-specific growth analysis. They stressed that Fund staff have an important role in helping the authorities to manage the macroeconomic impact of aid inflows and avoid a re-accumulation of unsustainable debt.

127. Board scrutiny has been simplified, as APR documents and corresponding JSANs will no longer automatically be put on the Board agenda. Instead, they will be issued for information and discussed only at an Executive Director's request.

128. Where PRS documents do not provide an operational strategy, this can be set out in the context of relevant program documentation (be it a PRGF-supported program or a PSI). Where the strategy has weaknesses that are critical to the success of PRGF-supported programs, the Letter of Intent or Memorandum of Economic and Financial Policies and staff report for the PRGF request or review is expected to set out how the weaknesses are being addressed.

³⁷ See <http://www.imf.org/external/np/pp/2007/eng/092107.pdf>.

³⁸ See <http://www.imf.org/external/np/sec/pr/2007/pr07235.htm>.

129. A separate JSAN is no longer required for PRSP preparation status reports, except when such a report is the PRS document for a HIPC decision point decision. Instead, a brief discussion of the status report is included in the PRGF staff report.

IEO Recommendation 5

130. Strengthen the prioritization and accountability on what the IMF is supposed to deliver within the broader partnership framework, built around the priorities emerging from the PRS process, and ensure resources match commitments.

Executive Board Discussion

131. Directors welcomed the IEO report's emphasis on the need to define priorities for the work of the Fund in low-income countries. The prioritization of budget resources must be guided by the Fund's overall mandate. Directors called for a careful assessment of the resource implications of adapting the Fund's role along the lines of the report's recommendations.

Monitoring Status

132. The Executive Board discussed in October 2007 the Role of the Fund in the PRSP Process and its Collaboration with Donors. Directors underscored the importance of effective collaboration based on clearly defined lead roles and responsibilities. Directors stated that the Fund's principal contribution lies in helping countries maintain macroeconomic stability, debt sustainability, and appropriate fiscal frameworks. The Fund should press for more predictable and more effective aid, but staff should not actively engage in mobilizing and coordinating aid or attempt to estimate resources requirements for reaching the MDGs. The Fund and World Bank (AFR and World Bank Africa Region) are currently implementing a pilot aimed at enhanced collaboration to support country reforms in the areas of financial sector development, public financial management, and the management of natural resources. A report on the pilot program is expected in time for the 2008 Spring Meetings, at which point an assessment will be made whether to expand the pilot program. In addition, a Joint Management Action Plan outlines new measures, such as improving coordination on country issues, enhancing communication between the staff of the two institutions working on thematic issues, and improving incentives for collaboration on policies.

133. As regards resources requirements for the PRSP process, Directors emphasized that the current budgetary constraints facing the Fund require a careful assessment of priorities in each country by the relevant area department. Most Directors felt that any re-focusing of the Fund's activities in low-income countries should not lead to net additional costs to the Fund. Directors suggested that work in non-core areas that are non-macro critical as well as other existing activities, may need to be scaled back or eliminated where possible to meet the costs of more intensive engagement.

IEO Recommendation 6

134. The IMF should encourage a strengthening of the framework for establishing the external resources envelope as part of the PRS approach.

Executive Board Discussion

135. Directors stressed that adequate, timely, and predictable donor support is crucial to the success of the PRS approach and the Fund should play a supportive role with donors and low-income members to help ensure adequate provision of aid to achieve the MDGs. In this regard, the Fund needs to consider how its signals can be clear and useful to its members.

Monitoring Status

136. Staff encourage donors to provide timely and comprehensive information on their financial commitments early in the budget preparation process, and to discuss with the authorities progress in implementing the associated disbursement conditions. Staff use this information to generate realistic projections of likely actual aid disbursements, and use these projections as the baseline for Fund-supported programs and policy advice as discussed in two Board papers on the management of aid inflows.³⁹ The Executive Board argued that the Fund's baseline aid projections should represent the staff's best estimate based on available information and that they should be consistent with the maintenance of debt sustainability. Directors stressed that staff should provide assessments of the ability of countries to handle existing trade volumes to donors on a timely basis.⁴⁰ They also noted that donor assessments would be an essential input into the staff's own evaluations, its projections of aid inflows, and its advice to the country authorities on the macroeconomic management of aid. The Fund should press for more predictable and more effective aid, but staff should not actively engage in mobilizing and coordinating aid or attempt to estimate resource requirements for reaching the MDGs. Directors considered that Fund-supported programs should support the full spending and absorption of aid, provided that macroeconomic stability is maintained. They supported the formulation of a conceptual framework to guide country teams in giving policy advice without specific quantitative thresholds for the spending and absorption of additional aid.

Assessment

137. Since the IEO's evaluation on the IMF's Role in PRSPs and the PRGF in 2004, the Fund has implemented many changes, clarifying its role and modifying its instruments. The

³⁹ See <http://www.imf.org/external/np/pp/eng/2005/080805a.htm> and http://www.imf.org/external/ns/search.aspx?filter_val=Y&NewQuery=aid+inflows&col=SITENG&collection=&lan=eng&f.

⁴⁰ See <http://www.imf.org/external/np/sec/pn/2007/pn0783.htm>.

Medium-Term strategy set out a framework for re-focusing the Fund's work in low-income countries on its core areas of competence, with a more active effort to reach country-level agreement with the World Bank and other development partners based on an appropriate division of labor. The MTS emphasizes the need for deeper Fund involvement in helping LICs manage the macroeconomic impacts of debt relief and aid inflows.

138. Over the last few years and in the wake of debt relief and MDRI, the Fund has made progress in refining and clarifying its positions and tool-kit for its work with low-income countries. To this end, it established in 2005 the Policy Support Instrument (PSI) aimed at low-income members that have achieved macroeconomic stability and no longer need Fund financial support but want the Fund to endorse the quality of their policies. It also established the Exogenous Shocks facility (ESF) to allow for rapid access to Fund financing for LICs faced with sudden exogenous shocks that did not have a concurrent PRGF program. While the ESF has not been used so far, staff is in contact with contributors and potential users to assess what changes might be considered for this instrument to be used. In addition, a new debt sustainability framework was introduced to assess the debt profile of LICs. Recent Board papers have addressed various aspects of this refocused role, including those on the management of aid inflows and updates on MDRI and LIC-DSAs, and a report on the Fund's role in the PRS process and in donor collaboration. The Board therefore has clarified further the role of the Fund in low-income countries, especially pertaining to the PRSP process, management of aid flows, and collaboration with donors.⁴¹ Following the Malan report on Bank-Fund Collaboration, the Fund and Bank managements have taken steps to improve collaboration and build on existing practices as outlined in the Joint Management Action Plan. As regards next steps, the aim is to consolidate the work of recent years into a comprehensive operational framework and clarify the Bank-Fund division of responsibilities. A summary paper is planned for the first quarter of 2008 and will describe the full range of the Fund's activities in low-income countries and the cost implications.

F. IMF Technical Assistance

IEO Recommendation 1

139. The IMF should develop a medium-term country policy framework for setting TA priorities, incorporating country-specific strategic directions and linked to more systematic assessments of factors underlying past performance.

⁴¹ See <http://www.imf.org/external/np/pp/2007/eng/092107.pdf> and <http://www.imf.org/external/np/sec/pn/2007/pn07130.htm>.

*Executive Board Discussion*⁴²

140. Directors endorsed this recommendation. In particular, most Directors agreed that in low-income countries, the PRSP should increasingly serve as a vehicle for identifying medium-term TA needs and improving coordination of TA among various agencies. In a number of cases, the focus of PRSPs will need to be sharpened to carry out this role effectively. In other countries, Directors stressed the importance of developing country-centered frameworks for identifying TA needs, but noted that a variety of approaches—possibly including greater use of Article IV consultations to assess needs—may be appropriate.

Executive Board Discussion of Conclusions of the Task Force

141. Directors supported the recommendation of the Task Force for a central role for area departments in developing a country-focused, medium-term, holistic TA strategic framework. They broadly welcomed the Task Force's proposal to achieve this objective through the production of Technical Assistance Country Strategy Notes (TACSNs) for intensive Fund technical assistance users and countries in which TA is particularly important from a strategic point of view.

Monitoring Status

142. On a pilot basis, Technical Assistance Country Strategy Notes (TACSNs) for 10 countries were completed in April 2006. TACSNs identified TA needs for a particular country, formulated in a consultative process that involved area departments, TA departments, and country authorities. Because TACSNs were country-specific, they did not assist in prioritizing between countries. There was also a need for better prioritization across sectors and integration with the Fund's Medium-Term Budget (MTB). In response, staff revamped the TA prioritization process:

- A new instrument—the Regional Strategy Notes (RSNs)—was introduced in FY2008, to strengthen the TA prioritization process and to better align TA with the Fund's surveillance and lending. RSNs incorporate the views of TA departments and country authorities. Through a consultative and iterative process, the country-specific strategies underlying the RSN reflect a joint agenda for TA that is subscribed to by all departments and the countries themselves. The expertise of TA departments provides the technical underpinnings of TA needs assessments and analyses, while discussions with country authorities in the context of the Fund's regular surveillance or policy dialogue ensure ownership.
- TA prioritization is being integrated in the resource allocation process and the MTB. RSNs are mapped to TA departments' Resource Allocation Plans, which inform

⁴² See <http://www.imf.org/external/np/sec/pn/2005/pn05114.htm>.

departmental business plans. Management will be involved more effectively in the resource allocation process, including through mid-year reviews of priorities.

IEO Recommendation 2

143. The IMF should develop more systematic approaches to track progress on major TA activities and to identify reasons behind major shortfalls in the authorities' implementation of Fund TA recommendations.

Executive Board Discussion

144. Directors supported the recommendation that at the outset of major TA activities, staff and the authorities should agree on measurable indicators of progress covering all the major stages of the activity. Directors saw a need for better tracking progress by unbundling the different stages of the TA project life cycle, careful explanation of the shortfalls in project execution, and candid reporting by the staff on obstacles to progress. However, it was pointed out that, in tracking progress, care should be taken to avoid imposing conditions on members without their consent. While Directors generally supported the view that a country's record of implementation should be an important guide in weighing requests for TA, a number of Directors cautioned against using tracking indicators mechanistically for making decisions on future TA allocations.

Executive Board Discussion of Conclusions of the Task Force

145. Directors agreed that the Fund should develop more systematic approaches to tracking progress on technical assistance, to identify reasons behind major shortfalls, and to shift emphasis to monitoring results. In this respect, Directors endorsed the Task Force's proposal to utilize the Technical Assistance Information Management System (TAIMS) as a vehicle for this purpose.

146. Directors saw particular merit in greater involvement by country authorities in the design and follow up of technical assistance activities, based on the needs and priorities set out, where possible, in PRSPs. Most Directors agreed that countries' track records in implementing TA recommendations should guide future TA allocations by the Fund.

Monitoring Status

147. As part of the Fund-wide introduction of performance indicators, TA performance measurement is being strengthened. TA will be primarily organized and assessed as projects and TA departments will use a results chain for project management. Every project has pre-defined objectives, outputs, and expected outcomes and TA managers are required to specify *ex ante* how the attainment of these outcomes would be verified objectively *ex post*. To ensure strong ownership, country authorities are expected to be involved in the articulation and design of the results chain. Work is under way to enhance TAIMS as a repository to record the results of TA projects.

IEO Recommendations 3 and 4

148. Greater involvement by the authorities and counterparts in the design of TA activities and arrangements for follow-up should be emphasized as a signal of ownership and commitment. Stronger efforts should be made by TA experts to identify options and discuss alternatives with local officials prior to drafting TA recommendations.

Executive Board Discussion

149. Directors concurred that greater involvement and ownership by the recipient authorities and discussion of options are crucial to greater TA effectiveness. They welcomed the proposals for more participation by country authorities in drawing up terms of reference (TORs) building on the discussions that already take place. Directors recommended that tangible commitments to the contemplated TA strategy or advice be systematically sought from the authorities at the design stage. At the same time, a number of Directors cautioned that these indications of commitment should not be treated as conditionality for access to TA.

Executive Board Discussion of Conclusions of the Task Force

150. Directors agreed that the Fund staff and experts should identify options and discuss the feasibility of alternatives with the authorities prior to drafting technical assistance recommendations, as this greatly enhances the prospects of their effective implementation. Directors supported the Task Force's proposals to invite staff and experts to be attentive to the political and institutional environment for the design and implementation of technical assistance projects, to discuss constraints and identify risks, and to reflect them in the design of the technical assistance activity.

Monitoring Status

151. Actions suggested by the Task Force have been implemented by all departments. TA departments have made efforts to enhance the dialogue with the authorities, including efforts to clearly lay out the authorities' and TA departments' expectations for TA operations. Staff are encouraged to share draft terms of reference with counterparts from national authorities and to hold meetings with counterparts during mid-mission to obtain their inputs on various options. Moreover, the Annual and Spring Meetings are systematically used to discuss TA priorities with country authorities. The work plans by the Regional TA Centers are developed in collaboration with country authorities and are also endorsed by the respective steering committees, comprising representatives of member countries.

IEO Recommendation 5

152. The program of ex post evaluations of TA should be widened and more systematic procedures of disseminating lessons put in place, thereby strengthening recent trends, including through periodic stocktaking exercises and regular reviews.

Executive Board Discussion

153. Directors highlighted the importance, in this context, of ensuring that the scope of the ex post evaluations is considered carefully and integrated fully into a broader strategy aimed at more effective TA delivery. They concurred that external evaluations are a useful tool to enhance accountability and provide a fresh perspective. The Office of Technical Assistance Management (OTM), in collaboration with other departments, should continue to prepare and update its program of ex post evaluations and to assess shifts in TA demands across subject areas.

Executive Board Discussion of Conclusions of the Task Force

154. Directors supported the Task Force's proposal to strengthen and expand the Technical Assistance Evaluation Program, and also called on staff, including in area departments, to develop and implement more systematic procedures for feeding back into the TA program the lessons learned from self-assessments and evaluations.

Monitoring Status

155. TA departments have listed their existing evaluation practices and completed evaluations. The IMF-wide TA Evaluation Program has been completed for 2006, and the Board papers have been issued.⁴³ The evaluations are organized as a rolling work plan of three to four evaluations per year (five evaluations were covered in the 2006 report) and have covered technical assistance in the legal, fiscal and financial areas as well as the regional technical assistance centers. In general, the evaluations concluded that the technical assistance projects were successful although the effectiveness of the TA was at times compromised by factors outside the control of the parties involved.

IEO Recommendation 6

156. The prioritization filters should be discontinued or replaced by ones that would more effectively guide TA allocation.

Executive Board Discussion

157. Directors concurred that the case for discontinuing the current filters was strong, although several Directors observed that some elements of this approach might usefully be preserved.

158. Directors considered that prioritization of TA resources should flow from a shared vision of the Fund's overall medium-term objectives—reflecting its core competencies—while at the same time retaining the flexibility to respond to the urgent needs of members.

⁴³ See <http://www.imf.org/external/np/pp/eng/2006/071206.htm>.

159. Directors agreed that the IEO's recommendations would entail more staff-intensive approaches to providing TA, including greater collaboration with country authorities and other TA providers. They called for a careful consideration and quantification of these resource implications.

Executive Board Discussion of Conclusions of the Task Force

160. Directors concurred with the Task Force's proposal that the prioritization filters should be discontinued.

Monitoring Status

161. Prioritization filters were discontinued. In their place, the Committee on Capacity Building (CCB) has endorsed the adoption of Regional Surveillance Notes (RSN) and their close integration into the Resource Allocation Process (RAP). This is expected to strengthen the alignment of TA resources with other Fund core activities and the strategic priorities established in the Medium-Term Strategy. In addition, in FY2008, a Central TA Reserve has been established. The reserve will be allocated to functional departments at mid-year FY2008 by the CCB. The aim of the reserve is to provide flexibility to respond to unanticipated TA needs cutting across functional and regional areas.

Assessment

162. Progress has been made in strengthening the prioritization of technical assistance, with RSNs setting regional priorities, which are integrated in the Fund's surveillance and lending, and a strong link between the RSNs and TA departments' RAPs to properly reflect these priorities in the budgetary process.

163. Performance measurement is also being improved, in particular through the adoption of the project concept for TA delivery. The project concept reflects principles pertaining to performance measurement generally, but takes into account also the nature of Fund TA to inform TA planning and policy formulation. In particular, the results-focused project management distinguishes which areas are within the Fund's control and which require action by the authorities.

164. Efforts have begun to make the Fund's TA evaluation framework more systematic, spearheaded by the Office of Technical Assistance Management. First, the adoption of the project concept and tracking under TAIMS provides the basis for a more systematic evaluation framework; further, harmonization of departmental practices is being explored to permit greater applicability of lessons learned across departments. Second, to enhance accountability and give a fresh perspective to evaluation, there is merit in having selected ex post evaluations supervised by units not directly involved in providing TA. This issue is under consideration by staff. The Board will discuss an update on implementing the MTS on TA in early 2008.

G. IMF's Approach to Capital Account Liberalization

IEO Recommendation 1

165. There is a need for more clarity on the IMF's approach to capital account issues, including through the provision of policy advice based on solid analysis of the particular situation and risks facing specific countries. Moreover, the Executive Board could issue a statement clarifying the common elements of agreement on capital account liberalization.

*Executive Board Discussion*⁴⁴

166. Directors welcomed the IEO's confirmation that the Fund did not apply an inappropriate "one-size-fits-all" approach to capital account liberalization, concurring with the finding that the Fund did not pressure countries to liberalize. They expressed a variety of views on the merit of an Executive Board statement clarifying the agreement on capital account issues. Most Directors did not wish to explore further at present the possibility of giving the Fund jurisdiction over capital movements. Directors saw scope for sharpening the Fund's advice on capital account issues, drawing upon all available research to base staff's policy advice on solid analysis of individual country situations. With regard to the IEO's suggestion that the Fund staff should aim to provide more quantitative assessments of the benefits, costs, and risks of liberalizing the capital account at different speeds, a few Directors saw merit in the proposal, while others considered it to be very difficult to implement because of the technical challenges and economic complexities involved.

Monitoring Status

167. The Executive Board did not reach a consensus on how to clarify the Fund's approach to capital account issues. Instead staff was encouraged to deepen and extend its analysis and to continue to exercise their informed professional judgment and discretion. Staff has been working on multiple research projects on various dimensions of capital account liberalization. A paper titled "Reaping the Benefits of Financial Globalization" was presented to the Board in June 2007.⁴⁵ It reports empirical results broadly supportive of the Fund's "integrated approach" toward capital account liberalization, and shows that the impact of financial globalization depends on the strength of countries' policies and institutions. Staff initiated further analytical work, with a special focus on the interaction of prudential measures and capital controls that updates the integrated approach for the sequencing of capital account liberalization (OP 190 and OP 211).

168. A paper titled "Country Insurance—The Role of Domestic Policies" was presented to the Board in July 2006 and analyzed how countries can use domestic policies to reduce their vulnerability to shocks and, in particular, to sudden stops in capital flows or to external debt

⁴⁴ See <http://www.imf.org/External/NP/ieo/2005/pr/eng/pr0502.htm>.

⁴⁵ See <http://www.imf.org/external/np/res/docs/2007/0607.htm>.

crises.⁴⁶ Beginning with the 2009 edition, the Annual Report on Exchange Arrangements and Exchange Restrictions will be modified to facilitate the analysis of capital account liberalization, and to reflect the interaction of prudential measures and capital controls. The 2007 Surveillance Decision, which emphasizes that surveillance should focus first and foremost on assessing external stability and the extent to which members' policies promote it, has provided additional clarity to the place of capital account developments and issues in bilateral surveillance. External stability requires both (i) a capital account that does not create risks of abrupt shifts in capital flows and is unlikely to hit upon a binding financial constraint and (ii) an underlying current account broadly in equilibrium (i.e., consistent with an equilibrium evolution of net external assets). In assessing the latter, the determinants of capital flows are expected to receive due consideration, reflecting their prime importance.

IEO Recommendation 2

169. The IMF's analysis and surveillance should give greater attention to the supply-side factors of international capital flows and to what can be done to minimize the volatility of capital movements.

Executive Board Discussion

170. Directors welcomed the various initiatives under way in the Fund to strengthen research, analysis, and surveillance of the supply side of capital flows, and agreed with the IEO's view that considerable progress has already been made in this area. Directors encouraged the staff to continue to build on the work already being undertaken at the Fund in order to further its understanding of supply-side factors and their operational and policy implications.

Monitoring Status

171. The Fund is working to further its understanding of supply-side factors and their operational and policy implications. For example, in its review of recent Global Financial Stability Reports (April and October 2007) Executive Directors welcomed the staff's renewed focus on the challenges and related policy responses associated with surges in capital flows and praised the analysis of Sovereign Wealth Funds. Directors underscored that the Fund should be able to act in a timely and proactive fashion in sharing its perspectives with national authorities, drawing on its unique insights gained from financial surveillance of its membership. The Fund also conducts periodic meetings with the Bank for International Settlements (BIS), FSF, and Capital Markets Consultative Group (CMCG) during which policies on capital flows are frequently discussed. For example, during the most recent meeting with the CMCG in May 2007, a working group of private sector and Fund representatives was set up to analyze "best practices" in the development of emerging capital markets.

⁴⁶ See <http://www.imf.org/external/np/pp/eng/2006/061906.pdf>.

Assessment

172. Staff has devoted considerable efforts to sharpen its advice on capital account issues and has increased its focus on supply-side factors affecting international capital flows and market risks and volatility. The creation of MCM has also contributed to a better understanding of supply side factors and has allowed greater integration of balance sheet analysis in the Fund's work. The Board will have opportunities to provide feedback to staff on the coverage of capital account issues, including through the Board discussions on the WEO and GFSR and through meetings on the work program.

H. IMF Support to Jordan, 1989–2004

173. This IEO evaluation assessed the extent to which the IMF contributed to tackling Jordan's major macroeconomic challenges during a prolonged period of program engagement.⁴⁷ The IEO drew nine lessons from this evaluation. The IEO considered seven lessons to be relevant to IMF operations in other countries and many tended to echo recommendations in earlier IEO evaluations. Two key messages pertained to the IMF's future role in Jordan but these were "not couched as specific recommendations." Indeed, the IEO's fourth Annual Report states that "the Jordan evaluation report made no explicit recommendations, presenting instead a number of lessons arising from IMF experience in Jordan."

IEO Recommendation 1

174. The underlying rationale for key program design elements should be explained clearly in Board papers. In particular, judgments on the magnitude and composition of targeted adjustment need to be grounded in an explicit assessment of external and public debt sustainability over the medium term.

*Executive Board Discussion*⁴⁸

175. Many Directors agreed that the Jordanian experience reinforces the need for Board papers to provide clearly the underlying rationale for key elements of program design. They also supported the IEO's call for greater candor in staff report assessments, especially of the risks to the program and recommendations on how best to mitigate and manage them.

⁴⁷ Separately, Fund staff undertook an ex post assessment of Jordan (<http://www.imf.org/external/np/sec/pn/2006/pn0602.htm>) under the Fund's policy on prolonged program engagement, which stemmed from the first IEO evaluation.

⁴⁸ See <http://www.imf.org/External/NP/ieo/2005/jor/eng/index.htm>.

Monitoring Status

176. Debt sustainability analysis is now a standard element in Board documents for Article IV consultations and requests to use Fund resources. The mix between adjustment and financing as well as the suitability of that financing is addressed utilizing DSA frameworks, particularly for low-income countries. Under the Fund's transparency policy, staff reports are to be drafted to include the staff's candid assessment of risks, their frank views on the authorities' policy stance, and their policy advice on all areas deemed relevant. Staff reports are to be drafted independently of the authorities' publication intentions and draft staff reports should not be shared with the authorities. At the 2005 Review of Transparency Policy, most Directors were satisfied that increased publication has not led to a significant erosion of candor, although in the view of a few other Directors the staff paper provided distinct evidence of loss of candor associated with the currency publication policy. Directors emphasized the critical importance of preserving frankness and stressed the need for continued monitoring of this issue. Following this review, the transparency guidelines to staff were revised and strengthened. The Board agreed that the next review of the Fund's transparency policy would take place by 2010.

IEO Recommendation 2

177. In certain circumstances, structural conditionality can add significant value in terms of encouraging and monitoring progress on reforms. However, underlying issues such as large and abrupt surges in grants require that programs be set in an explicitly longer-term perspective. Timetables need to be designed carefully, taking account of the political economy situation, especially when legislative action is involved.

Executive Board Discussion

178. While agreeing that structural conditionality had been well designed, many Directors also pointed to the lessons for the timing of these conditions offered by the Jordanian experience. In particular, they noted the importance of ambitious but realistic timetables that take into account a country's implementation capacity as well as the prevailing political and social environment.

Monitoring Status

179. No special monitoring necessary. The need for ambitious, but realistic timetables is highlighted in the Conditionality Guidelines. A Board review of the implementation of the Conditionality Guidelines is currently scheduled for 2010.

IEO Recommendation 3

180. A wider dissemination of IMF technical assistance reports would have contributed to more informed public discourse and shed light on the rationale for IMF policy advice on key issues.

Executive Board Discussion

181. Directors concurred with the IEO's lesson that a wider dissemination of Fund TA reports for Jordan could have contributed to more informed public discourse and shed light on the IMF policy advice on key issues. Wider dissemination could also prove beneficial to other countries in similar circumstances. At the same time, Directors noted that decisions on disseminating such reports are for the authorities to take.

Monitoring Status

182. Dissemination of Fund technical assistance reports requires a request from the country authorities and the consent of Fund management, which to date has always been granted.

Assessment

183. The Board-endorsed recommendations are not specific to Jordan and are therefore covered in the assessments of the other reports.

I. Financial Sector Assessment Program**IEO Recommendation 1**

184. The IMF Board and management should refine the criteria for setting priorities on IMF resource inputs into financial sector surveillance, including the FSAP. Based on these priorities, IMF staff should indicate, as part of its medium-term planning, what components are needed for strengthening financial sector surveillance in each country, drawing upon a range of possible modalities. These strategies would form the basis for more explicit accountability on results.

*Executive Board Discussion*⁴⁹

185. While a few Directors considered that the IEO report does not provide sufficient evidence that current mechanisms are inadequate, many Directors agreed on the need for clearer guidance—including on the trade-off between assessments of vulnerability and development issues—as part of a medium-term strategy aimed at efficient resource allocation in line with the Fund's core mandate.

⁴⁹ See <http://www.imf.org/External/NP/ieo/2006/fsap/eng/index.htm>.

Monitoring Status

186. The Monetary and Capital Markets Department (MCM) was created in 2006 as the merger of the International Capital Markets and Monetary and Financial Systems departments. Against the backdrop of the Fund's Medium-Term Strategy, the role of the newly formed department is to provide policy relevant analysis of global financial risks, ensure increased coverage and more extensive analysis of financial sector issues in Article IV consultations and regional surveillance, and support capacity building by member countries. To facilitate these tasks, area departments have identified a senior staff member who will be responsible for the department's financial sector surveillance (FSS) and coordination of the FSS work program with MCM; and MCM and area departments are increasing efforts to work together in FSS, including through further MCM support to Article IV teams. FSS training will be provided to staff at all levels as needed, with new training under development. The introduction of country-specific three-year surveillance agendas and the related Financial Sector Task Force (FSTF) recommendation for multi-year financial surveillance planning should help ensure adequate follow through of financial sector surveillance priorities. In addition, a Financial Sector Steering Group that includes representatives of area and relevant functional departments has been set up by the Managing Director to ensure high-level coordination of the work of all departments involved in financial sector surveillance.

IEO Recommendation 2

187. To strengthen incentives and drawing upon these country-specific plans, IMF management should clearly signal to the Board those countries that it sees as the highest priorities for FSAPs and FSAP updates, irrespective of whether these countries have volunteered. These lists should be the basis for periodic discussions by the Board of country specific priorities.

Executive Board Discussion

188. Most Directors agreed with the IEO proposal that management should indicate to the Board which countries it considers the highest priorities for FSAP assessments and updates.

Monitoring Status

189. Scheduling of FSAPs is based on a prioritization process established by staff, based on criteria approved by the Fund and Bank Boards, which is carried out twice a year. Staff assessment of prioritization for individual countries is used to encourage participation of high priority countries in the program and is reflected in the staff appraisal of Article IV consultation reports. Annual reporting on country participation, as instituted following the

2005 internal FSAP review, is also being used to provide the Executive Board with overall information on program coverage.⁵⁰

IEO Recommendation 3

190. Strengthen the links between the FSAP and surveillance by mainstreaming FSAPs and follow-up work into regular surveillance activities.

Executive Board Discussion

191. Directors concurred with the IEO recommendation to strengthen links between FSAPs and surveillance. Specifically, they underscored the need to follow up on key vulnerabilities and gaps relevant for stability and macroeconomic developments and respective recommendations raised in FSAPs/FSAP Updates in country work, and to integrate such issues into Article IV surveillance reports. Directors stressed that in cases where financial stability issues, including any potential global repercussions, are judged to be of high importance, they should be a major focus of Article IV consultations.

Monitoring Status

192. The internal review process of FSAP-related documents and Article IV reports has been strengthened to ensure that (i) the Executive Summary summarizes the main macro-relevant findings using candid language, (ii) the FSSAs clearly highlight and summarize macro-relevant findings, (iii) these findings are adequately reflected and incorporated in the analysis of Article IV reports.

IEO Recommendation 4

193. Implement steps to improve further the quality of the FSAP and strengthen its impact.

Executive Board Discussion

194. Directors encouraged the staff to follow up on IEO recommendations to improve further the quality of FSAPs and strengthen their impact. They noted that recommendations should be clearly prioritized and the potential consequences of not addressing key weaknesses candidly discussed. Directors emphasized in particular the importance of treating financial sector and cross-border linkages more systematically in FSAP analysis.

Monitoring Status

195. Initial revisions were made to FSAP procedures to stress that recommendations need to be candidly discussed and clearly prioritized by macro-relevance, and missions should cover all major risks, including those that may be politically sensitive. In cases where data

⁵⁰ See <http://www.imf.org/external/np/fsap/2005/022205.pdf>.

are inadequate, potential major risks should nevertheless be identified and limitations transparently discussed. The revised procedures will also stress the need to have more informative and candid discussions on methodological and data limitations in FSSAs. Further, specific guidance is being developed to strengthen implementation of these principles.

196. Staff is developing the stress testing methodology and establishing “minimum standards” for stress tests, to ensure that stress test methodologies are applied more consistently across countries. Work on regional financial sector assessments and cross-border issues has been stepped up and off-shore financial center reports now include a section on cross-border cooperation and information exchange and periodically review its effectiveness. Specific guidance to FSAP teams is also being developed in these areas.

197. To improve the quality and consistency of standards assessments, an internal review was conducted to evaluate assessments of the Basel Core Principles (BCP), the International Organization for Securities Commission (IOSCO), Objectives and Principles of Securities Regulation, and the Insurance Core Principles. A BCP assessor’s workshop has been convened for later this year. A joint IMF/WB/IOSCO assessor’s workshop was conducted in 2006 and a follow-up workshop will take place early 2008. Additional guidance to assessors has also been included in the assessment toolkits.

IEO Recommendation 5

198. Introduce changes in the organization of IMF mission activities to utilize scarce financial sector technical expertise more effectively in the surveillance process.

Executive Board Discussion

199. Many Directors welcomed the IEO’s recommendation to introduce changes in the organization of IMF mission activities to utilize scarce financial sector expertise more effectively in the surveillance process. Directors noted that this will be considered in the broader context of improving financial sector surveillance as part of the medium-term strategic review.

Monitoring Status

200. While strengthening Fund work in financial sector surveillance is a responsibility shared across departments, one of the main objectives of the new MCM department is to facilitate stronger support for financial sector work in the bilateral surveillance process. The new organizational structure (one-stop-shop regional divisions and functional divisions concentrating on technical expertise) is designed to facilitate more continuous and more flexible support for IMF missions. The specific modalities to do this are being assessed as part of the Medium Term Strategy and as part of the follow-up to the Financial Sector Task Force. An important interim indicator of progress is the significant increase in demand for financial surveillance-related work. MCM participation in Article IV missions has almost doubled to 70 countries in the current fiscal year and the number of FSAPs conducted this fiscal year are also up relative to the number originally programmed.

IEO Recommendation 6

201. Maintain the current joint approach, but clarify further the distinctive contributions the IMF and Bank can make, with the IMF taking the lead where significant domestic or global stability issues are present and the Bank taking the lead where financial sector development issues are more paramount. Such clarity should include a clear delineation of primary responsibilities for setting priorities (and contributing resources).

Executive Board Discussion

202. Directors were in broad agreement with the report's recommendations regarding Bank-Fund collaboration. They concurred that the current joint approach, including the central role for the Bank-Fund Financial Sector Liaison Committee (FSLC), should be maintained. At the same time, further efforts should be made to take full advantage of the distinctive contributions that the two institutions can make—with the Fund focusing on stability issues and the Bank on financial sector development and institution building.

Monitoring Status

203. The External Review Committee on Bank-Fund Collaboration (the Malan Committee) issued in December 2006 a report examining areas of collaboration and proposing improvements. In the financial sector sphere, the Malan Report endorsed the principle that the Fund focus on stability issues and the Bank on development issues. Nonetheless, it observed that the responsibilities could not be precisely demarcated. Specific recommendations are being developed to take forward the issues raised in the Malan Report and summarized in a joint Bank-Fund Management Action Plan which was issued in September 2007.

IEO Recommendation 7

204. The IMF, in conjunction with the World Bank and other technical assistance providers, should seek to establish a clearer framework for coordinating Monitoring Status capacity building technical assistance activities, based on the country's own action plans.

Executive Board Discussion

205. Directors concurred that there is room to improve the coordination of FSAP-related technical assistance activities, based on the country's own action plans. At the same time, Directors cautioned against overburdening the FSAP with additional expectations regarding the assessment and planning of technical assistance needs.

Monitoring Status

206. The Financial Sector Liaison Committee (FSLC) has in the past sponsored meetings of Bank-Fund teams to discuss TA follow-up for countries recently completing FSAP assessments. Following the Malan report, this practice is being renewed to help promote broader collaboration on TA strategies.

207. Staff will also include in the transmittal letter for the FSAP package, when appropriate, a suggestion that a Monitoring Status meeting or “providers forum” on TA be organized. The decision on whether to include such a suggestion will be based on discussion with the area departments and the World Bank, and following the Board’s guidance not to overburden the FSAP with additional expectations and excessively formal approaches to follow-up.

Assessment

208. The newly-created MCM has been charged with providing policy relevant analysis of global financial risks; ensure increased coverage and more extensive analysis of financial sector issues in Article IV consultations and regional surveillance; and support capacity building by member countries. As an indication of the quality of its work, the Malan report felt that FSAPs and ROSCs were good examples of collaboration between the Fund and the Bank on financial sector issues and suggested that the FSLC be given an “elevated” status to facilitate coordination more generally. The next review of the FSAP, which is scheduled to be submitted to the Bank and Fund Executive Boards in 2009, will take stock of progress achieved and ways to strengthen the program, including in light of tighter budget constraints in both institutions. With a view to providing input to this review, the FSLC intends to establish a subcommittee to review FSAP policies and practices, also taking account of the results of an ongoing Bank project focusing on the treatment of development issues in the FSAP.

J. Multilateral Surveillance

IEO Recommendation 1

209. Strengthen the IMF’s role at the center of a more robust global peer review system by establishing a more proactive engagement with relevant intergovernmental groups.

*Executive Board Discussion*⁵¹

210. Most Directors concurred that, while the Executive Board and the IMFC remain the most appropriate fora for discussions of policy spillovers and possible responses, the IMF should also enhance the effectiveness of its participation in other fora—such as, but not limited to, the G-7 or the G-20—which also provide opportunities for a frank exchange of views on these issues.

⁵¹ See <http://www.imf.org/external/np/ieo/2006/ms/eng/index.htm>.

Monitoring Status

211. No follow up monitoring required because the recommendation was not endorsed by the Executive Board.

IEO Recommendation 2

212. Enhance the roles of the Executive Board and the IMFC in multilateral surveillance.

Executive Board Discussion

213. Many Directors saw merit in the Board identifying and agreeing on key issues for ministers to discuss during the IMFC meetings, focusing on matters related to policy spillovers and scenarios for collective action. Most Directors did not support the setting up of a standing Board committee to monitor progress on strengthening the Fund's and the Board's surveillance activities. They considered, rather, that the full Board should retain ownership and oversight of this central surveillance function of the Fund.

Monitoring Status

214. The Executive Board reached agreement, in principle, on the adoption of a Statement of Surveillance Priorities (SSP)—a new instrument periodically setting out key surveillance priorities relevant to both bilateral and multilateral surveillance. The SSP will be set by the Board in the context of the 2008 Triennial Surveillance Review and could be endorsed by the IMFC.

IEO Recommendation 3

215. Streamline and better focus the products of multilateral surveillance, present shorter and clearer messages, and deliver them more strategically to target groups.

Executive Board Discussion

216. Directors observed that to increase the impact of the Fund's multilateral surveillance work on the global economic policy debate, the output of such process should be focused on the key issues faced by the world and targeted to the core audience of multilateral issues.

Monitoring Status

217. The World Economic Outlook (WEO) is placing even greater focus on key cross-country messages and further strengthening risk analysis. Work is ongoing to broaden post-WEO outreach on the key policy messages and to target issues of particular concern in specific regions.

218. A new procedure has been implemented in 2007 by which quarterly WEO updates are published—twice a year—between the publications of the Spring and Fall WEO. These update the staff's view of the global outlook on the basis of recent developments and provide greater continuity for the Fund's surveillance and outreach.

219. The Global Financial Stability Report (GFSR) now includes a “global risk map” to help make the staff’s overall judgment about global financial stability easier to convey. More public outreach is being coordinated with the External Relations Department to bring GFSR messages to a greater global audience, perhaps outside financial centers.

IEO Recommendation 4

220. Define more clearly the goals of multilateral surveillance and the mechanisms to achieve them. Particular effort should also go into better integrating multilateral perspectives into bilateral surveillance.

Executive Board Discussion

221. They agreed that it would be beneficial to clarify the operational goals of multilateral surveillance, but were not persuaded about the need for broad organizational changes. Directors agreed that priority should be given to strengthening the integration between multilateral and bilateral surveillance, particularly of systemically important countries.

Monitoring Status

222. Consistent with the Medium-Term Strategy, a new mechanism of multilateral consultations has been introduced at the Fund and guidance has been issued for the inclusion of analysis and discussion of regional or global spillover effects in Article IV reports for systemically important countries. Moreover, all Article IV consultations are expected to make a greater use of cross-country analysis and to bring to bear other countries’ experience in addressing similar problems. To aid integration of bilateral and multilateral surveillance, the results of the WEO are now presented to staff in internal seminars, in addition to the Power Point presentations on individual chapters that are made available to all staff. The new Surveillance Decision in force since June 2007 emphasizes that bilateral surveillance should be embedded in a multilateral perspective, implying in particular that country assessments should bear in mind spillover effects from the global environment to a country, and from a country’s policies to the stability of the international monetary system. The Statement of Surveillance Priorities should further help identify key multilateral surveillance issues that should provide context for bilateral surveillance.

223. The GFSR has been, and will continue to be, presented to each area department before publication in an effort to both inform bilateral surveillance of global trends and have multilateral surveillance be informed about country-specific and regional financial trends requiring greater attention.

Assessment

224. A new mechanism of multilateral consultations has been introduced at the Fund and Executive Directors have embraced this new approach indicating that it is timely and fully in accordance with the Fund’s core responsibility to promote the stability of the international monetary system. Moreover, in the context of the discussion of the implementation plan of the IEO Evaluation of the Fund’s Exchange Rate Policy Advice, Directors supported a

review of the system of exchange rates in 2009 and, in the meantime, suggested better integration of spillovers into bilateral and regional surveillance. Finally, a number of changes have been made to the Fund's flagship publications to place an even greater focus on highlighting key cross-country messages and further strengthen risk analysis. The usefulness of these changes will be signaled through press coverage of these publications and feedback from the reading public.