3 SUPPORTING GLOBAL RECOVERY

SUPPORTING GLOBAL RECOVERY

FINANCIAL SUPPORT TO COUNTRIES DURING THE CRISIS

Global safety net

Financing activities in 2012

The IMF continued in FY2012 to respond flexibly to members' financing needs in an environment of heightened global uncertainty. The demand for Fund resources remained strong and commitments increased further, although at a slower pace compared to the previous year.

In January 2012, the Executive Board reviewed the adequacy of the IMF's resources for providing financing to members.[4] Following the Board's discussion, the Managing Director observed that it had provided an opportunity to assess whether the Fund's resources were sufficient to fulfill its mandate and to play a full and constructive role in securing global stability. She noted that in the discussion, many Executive Directors had stressed the necessity and urgency of collective efforts to contain the debt crisis in the euro area and protect economies around the world from spillovers and excessive output/income contractions. In this context, Executive Directors welcomed the recently announced commitment of European members to contribute to the Fund's resources, while stressing the importance of European firewalls and other policies being sufficiently strong to respond to the crisis in the euro area.

Going further, during the 2012 Spring Meetings, members committed to take the necessary actions to secure global financial stability. Together with the G-20, the IMFC reached agreement to enhance IMF resources for crisis prevention and resolution. A significant number of countries made firm commitments to increase IMF resources by more than US$430 billion (see Chapter 5) in addition to the quota increase under the 2010 quota and governance reform. These resources will be available for the full membership of the IMF, and not earmarked for any particular region. The commitments, coming after national and regional structural, fiscal, and monetary actions were put in place in the early months of 2012, showed the international community's commitment to safeguarding global financial stability and putting the global economic recovery on a sounder footing.

Member countries may request IMF financial assistance to meet their net balance of payments needs and maintain adequate reserve buffers. IMF financing is usually provided under an "arrangement," in support of a member's economic program that includes adjustment policies and measures the member has committed to implementing to resolve its balance of payments problem. Over the years, the IMF has approved various policies setting forth financing instruments and facilities, some of which are flexible enough to assist with addressing any type of balance of payment need, whereas others are tailored to address the specific circumstances of its diverse membership. Low-income countries may borrow on concessional terms through a number of facilities; during FY2012, most IMF concessional financing carried an interest rate of zero, which will be in effect until the end of 2013. Nonconcessional financing is also provided, through additional instruments and facilities; all nonconcessional instruments and facilities are subject to the IMF's market-related interest rate, known as the "rate of charge" (based on the SDR interest rate, which is revised weekly),[5] and large amounts financed (above certain limits) carry a surcharge. Depending on the nature of a member's balance of payments need, an arrangement can be approved on a precautionary basis (which is not followed by an immediate disbursement) or as a disbursing one (under which the approved financing is generally released in phased installments as the program is implemented).[6] An IMF member's access to Fund resources is determined in terms of its quota (see Chapter 5) and is subject to "access limits" (see Table 3.1).

By far the largest share of transactions between the IMF and its membership are handled through the General Resources Account (GRA), a pool of currencies and reserve assets built up from members' quotas and from bilateral and multilateral borrowing arrangements. For arrangements through the GRA, access limits may be exceeded in exceptional circumstances ("exceptional access"), provided the substantive criteria set forth in the exceptional access policy are met, and subject to early Board involvement. For arrangements through the PRGT, access to Trust resources in excess of normal limits is subject to special procedures, most notably, early Board involvement.

Nonconcessional financing

In FY2012, the Executive Board approved seven arrangements under the Fund's nonconcessional financing facilities, for a gross total of SDR 52.60 billion[7] (US$81.62 billion). More than 90 percent of the new gross commitments in FY2012 (SDR 47.5 billion, or US$73.36 billion) was for two arrangements under the Extended Fund Facility (EFF) for Greece and Portugal (see Box 3.1). Four Stand-By Arrangements (SBAs) were also approved, of which one (for St. Kitts and Nevis) involved exceptional access and two (for Serbia and Georgia)[8] were treated, upon approval, as precautionary. In addition, a new SDR 3.87 billion (US$6.22 billion) arrangement under the Flexible Credit Line was approved for Colombia, succeeding an earlier FCL arrangement with lower access that expired in May 2011.

Box 3.1

Fund engagement in the euro area

The IMF's involvement in the euro area continued in FY2012 with new arrangements approved for Greece and Portugal and ongoing policy efforts under the existing extended arrangement under the Extended Fund Facility (EFF) for Ireland.

Long-standing structural problems—including low productivity, weak competitiveness, and high private debt—have severely undermined growth in Portugal and given rise to large external and fiscal imbalances. In May 2011, the Executive Board approved a three-year extended arrangement of approximately SDR 23.7 billion (€26 billion) under the EFF for Portugal in support of the authorities' economic adjustment and growth program. The arrangement for Portugal, part of a three-year, €78 billion cooperative package of financing with the European Union, entails exceptional access to IMF resources, amounting to 2,306 percent of Portugal's quota. The authorities' program focuses on structural reforms to boost growth and employment; an ambitious but balanced fiscal stabilization path, supported by structural fiscal reform; and safeguards to ensure financial stability and prevent a protracted credit contraction. The third review of Portugal's performance under the extended arrangement was completed successfully in April 2012; total disbursements under the arrangement through the end of FY2012 were approximately SDR 15.9 billion (€18.6 billion).

A second new program in the euro area during the financial year was supported by the four-year, SDR 23.7853 billion (€28.0 billion) extended arrangement under the EFF for Greece approved in March 2012, upon cancellation by the Greek authorities of an earlier three-year Stand-By Arrangement (SBA). Like the arrangement for Portugal, that for Greece also entails exceptional access to IMF resources, amounting to 2,158.8 percent of Greece's quota. The Greek authorities' economic program aims, over time, at restoring competitiveness, growth, and fiscal sustainability and securing financial stability. While building on progress made under the SBA, the authorities recalibrated their program strategy to place additional emphasis on the implementation of structural reforms to accelerate economic growth and employment. Official sector support for the Greek program entails €130 billion in new financing through 2014, in addition to the remainder of the financing support under an earlier program of €34 billion, and an additional €8 billion from the IMF in 2015 and the first quarter of 2016. The first disbursement, in an amount equivalent to SDR 1.3991 billion (€1.65 billion), was made upon the program's approval in March. The Fund's peak exposure will remain broadly unchanged relative to that under the SBA.

Ireland's program implementation (now in its second year) continues to be strong. The Irish authorities have advanced wide-ranging reforms to restore the health of the country's financial system so it can support economic recovery. Major progress in downsizing the country's banking system has been made, and fiscal consolidation remains on track. The Executive Board completed the fifth review under Ireland's extended arrangement under the EFF in February 2012, enabling the disbursement of SDR 2.8 billion (€3.2 billion), bringing total disbursements under the arrangement to SDR 13.8 billion (about €16.1 billion). The three-year, SDR 19.5 billion (about €22.6 billion) arrangement for Ireland, which was approved in December 2010, is a part of an €85 billion financing package also supported by Ireland's European partners and Ireland's own contributions.

Table 3.1

IMF financing facilities

Credit facility (year adopted)[1]	Purpose	Conditions	Phasing and monitoring
CREDIT TRANCHES AND EXTENDED FUND FACILITY[3]			
Stand-By Arrangements (1952)	Medium-term assistance for countries with balance of payments difficulties of a short-term character.	Adopt policies that provide confidence that the member's balance of payments difficulties will be resolved within a reasonable period.	Quarterly purchases (disbursements) contingent on observance of performance criteria and other conditions.
Flexible Credit Line (FCL) (2009)	Flexible instrument in the credit tranches to address all balance of payments needs, potential or actual.	Very strong ex ante macroeconomic fundamentals, economic policy framework, and policy track record.	Approved access available up front throughout the arrangement period, subject to a midterm review after one year.
Extended Fund Facility (EFF) (1974) (Extended Arrangements)	Longer-term assistance to support members' structural reforms to address balance of payments difficulties of a long-term character.	Adopt up to four-year program, with structural agenda, with annual detailed statement of policies for the next 12 months.	Quarterly or semiannual purchases (disbursements) contingent on observance of performance criteria and other conditions.
Precautionary and Liquidity Line (PLL) (2011)	Instrument for countries with sound economic fundamentals and policies.	Strong policy frameworks, external position, and market access, including financial sector soundness.	Large front-loaded access, subject to semiannual reviews (for one- to two-year PLL).
SPECIAL FACILITIES			
Rapid Financing Instrument (RFI) (2011)	Rapid financial assistance to all member countries facing an urgent balance of payments need.	Efforts to solve balance of payments difficulties (may include prior actions).	Outright purchases without the need for full-fledged program or reviews.
FACILITIES FOR LOW-INCOME MEMBERS UNDER THE POVERTY REDUCTION AND GROWTH TRUST			
Extended Credit Facility (ECF) (2010)[5]	Medium-term assistance to address protracted balance of payments problems.	Adopt three-year ECF arrangements. ECF-supported programs are based on a Poverty Reduction Strategy Paper (PRSP) prepared by the country in a participatory process and integrating macroeconomic, structural, and poverty reduction policies.	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews.
Standby Credit Facility (SCF) (2010)	To resolve short-term balance of payments and precautionary needs.	Adopt 12- to 24-month SCF arrangements.	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews (if drawn).
Rapid Credit Facility (RCF) (2010)	Rapid assistance for urgent balance of payments needs where an upper-credit-tranche-quality program is not needed or feasible.	No review-based program necessary or ex post conditionality.	Usually in a single disbursement.

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

2 The *rate of charge* on funds disbursed from the General Resources Account (GRA) is set at a margin over the weekly interest rate on SDRs. The rate of charge is applied to the daily balance of all outstanding GRA drawings during each IMF financial quarter. In addition, a one-time service charge of 0.5 percent is levied on each drawing of IMF resources in the GRA, other than reserve tranche drawings. An up-front commitment fee (15 basis points on committed amounts of up to 200 percent of quota; 30 basis points for amounts in excess of 200 percent and up to 1,000 percent of quota; and 60 basis points for amounts in excess of 1,000 percent of quota) applies to the amount that may be drawn during each (annual) period under a Stand-By, Flexible Credit Line, Precautionary and Liquidity Line, or Extended Arrangement; this fee is refunded on a proportionate basis as subsequent drawings are made under the arrangement. For facilities for the low-income members under the Poverty Reduction and Growth Trust, an interest rate mechanism was established in 2009 linking the concessional interest rates to the SDR interest rate and regular reviews. At these reviews, the applicable interest rates are set as follows: if the average SDR interest rate observed in the most recent 12-month period is less than 2 percent, the interest rate for ECF and RCF loans shall be set at 0 percent per year, and at 0.25 percent per year for SCF loans; if the average SDR interest rate is 2 percent or more, up to 5 percent, the interest rate for ECF and RCF

Access limits	Charges[2]	Schedule (years)	Installments
Annual: 200% of quota; cumulative: 600% of quota.	Rate of charge plus surcharge (200 basis points on amounts above 300% of quota; additional 100 basis points when outstanding credit remains above 300% of quota for more than three years).[4]	3¼–5	Quarterly
No preset limit.	Same as above.	3¼–5	Quarterly
Annual: 200% of quota; cumulative: 600% of quota.	Same as above.	4½–10	Semiannual
250% of quota for six months; 500% of quota available upon approval of one- to two-year arrangements; total of 1,000% of quota after 12 months of satisfactory progress.	Same as above.	3¼–5	Quarterly
Annual: 50% of quota; cumulative: 100% of quota.	Same as above.	3¼–5	Quarterly
Annual: 100% of quota; cumulative: 300% of quota.	0% (January 7, 2010, to December 31, 2013).	5½–10	Semiannual
Annual: 100% of quota; cumulative: 300% of quota.	0% (January 7, 2010, to December 31, 2012); 0.25% in 2013.	4–8	Semiannual
Annual: 25% (up to 50% of quota); cumulative: 75% (up to 100% of quota).	0% (January 7, 2010, to December 31, 2013).	5½–10	Semiannual

loans shall be set at 0.25 percent per year, and at 0.5 percent per year for SCF loans; if the average SDR interest rate is greater than 5 percent, the interest rate for ECF and RCF loans shall be set at 0.5 percent per year, and at 0.75 percent per year for SCF loans. A precautionary arrangement under the SCF is subject to an availability fee of 15 basis points per year on the undrawn portion of amounts available during each six-month period.

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

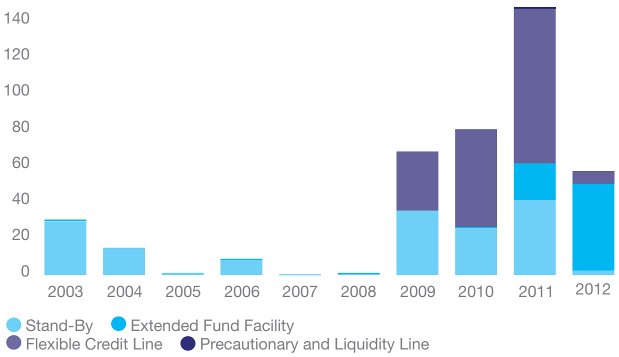
4 Surcharge introduced in November 2000. A new system of surcharges took effect on August 1, 2009, replacing the previous schedule: 100 basis points above the basic rate of charge on amounts above 200 percent of quota, and 200 basis points surcharge on amounts above 300 percent of quota. A member with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

5 ECF previously known as Poverty Reduction and Growth Facility.

Figure 3.1

Arrangements approved during financial years ended April 30, 2003–12

(Billions of SDRs)

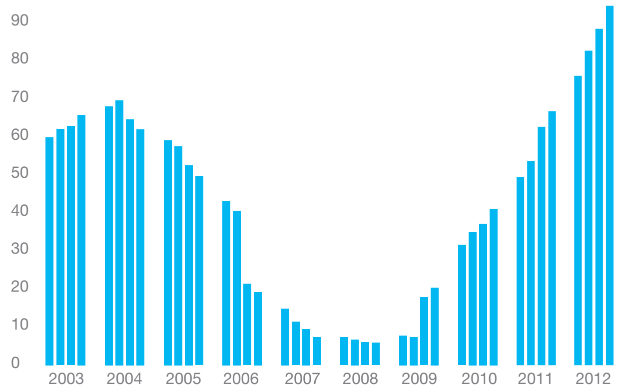


Source: IMF Finance Department.

Figure 3.2

Nonconcessional financing outstanding, FY2003–12

(Billions of SDRs)



Source: IMF Finance Department.

In total, by end-April 2012, purchases[9] from the GRA reached SDR 32.2 billion (US$49.9 billion), with purchases by the three euro area program countries (Greece, Ireland, and Portugal) accounting for more than 95 percent of the total. Repurchases for the period amounted to SDR 3.6 billion.

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

Box 3.2

Support to Arab transition countries

The Arab countries in transition are undergoing historic changes that offer opportunities for a more prosperous future but also pose significant economic challenges in the near term. The IMF is supporting these countries through policy advice, capacity building, and financial assistance.

The IMF has been tailoring its policy advice to focus on issues of importance to the region. In addition to the IMF's focus on macroeconomic and financial stability, this includes greater emphasis on promoting inclusive growth, with a focus on topics such as tackling unemployment and improving social protection. Given the IMF's core macroeconomic expertise, it is cooperating with other international organizations, such as the World Bank and the International Labour Organization, which have greater expertise in these areas.

IMF capacity-building efforts in the region have been refocused on promoting strong institutions, producing good data, and making fiscal policies more equitable. To those ends, efforts under way have included, for example, technical assistance in Egypt to improve tax equity, in Jordan to reform fuel subsidies, in Libya to improve public financial management, in Morocco and Tunisia to strengthen the financial sector, and in Yemen to improve customs administration. The Middle East Technical Assistance Center provides hands-on training and facilitates peer discussions in these areas. The new IMF–Middle East Center for Economics and Finance in Kuwait provides training on the formulation and implementation of macroeconomic policies.

With regard to financial assistance, the IMF has upgraded its lending toolkit in part to address the region's needs, approved a US$93.75 million Rapid Credit Facility purchase for Yemen in April 2012, has been in discussions with Egypt on a possible Stand-By Arrangement, and is engaging with other countries on financing needs and possible support.

Left Workers pack pasta at a factory in Demerara, Guyana. **Right** A boy cleans a window outside a shoe shop in Cairo, Egypt.

Concessional financing

As noted earlier, low-income countries that are IMF members are eligible for IMF financing at concessional rates, through the Poverty Reduction and Growth Trust. In FY2012, the Fund committed financing amounting to SDR 1.9 billion to 17 low-income member countries under the PRGT. Total concessional financing outstanding for 64 members amounted to SDR 5.55 billion at April 30, 2012. Detailed information regarding new arrangements and augmentations of access under the Fund's concessional financing facilities is provided in Table 3.3. Figure 3.3 illustrates amounts outstanding on concessional financing arrangements over the last decade.

No assistance was provided in FY2012 through the Post-Catastrophe Debt Relief Trust, established in June 2010 to allow the IMF to join international debt relief efforts when poor countries are hit by the most catastrophic of natural disasters. The Fund continues to provide debt relief to eligible countries that qualify for such relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI); details are provided in Chapter 4.

The IMF determines which member countries are eligible to use concessional financial resources under the PRGT via a framework established for this purpose in 2010. The framework, reviewed every two years, provides transparent criteria for Executive Board decisions regarding entry onto and graduation from the list of eligible countries. In broad terms, countries enter the list if their annual per capita income is below a certain threshold[10] and they lack capacity to access international financial markets on a durable and substantial basis. They are expected to "graduate" from the list if they have either a persistently high level of income[11] or capacity to access international financial markets on a durable and substantial basis, and they do not face serious short-term risks of a sharp decline in per capita income, loss of market access, and/or debt vulnerabilities. The framework also comprises special entry and graduation criteria for small countries that are less stringent as regards per capita income, to account for these countries' higher vulnerabilities.

In February 2012, the Executive Board reviewed the framework, as well as the list of PRGT-eligible countries.[12] Executive Directors agreed that, based on the application of the framework, no members were eligible at that time for entry onto or graduation from the list, and decided to keep the list of PRGT-eligible countries unchanged, noting that the framework allows for interim updates where warranted by the existing criteria and requirements. Executive Directors also agreed to increase the population threshold used to define small states to 1.5 million, aligning it with the definition adopted by the World Bank. They further agreed to advance to early 2013 a more comprehensive review of PRGT eligibility. On the basis of extensive consultations and analytical work, the review could assess, among other things, the suitability of the various criteria and whether the balance among the criteria used in the framework remains appropriate. The review would also consider whether additional or alternative variables could be used to better capture members' circumstances, particularly those of small states.

As part of a financing package aimed at boosting PRGT resources to SDR 11.3 billion (US$17 billion) by 2014, the Executive Board endorsed, in July 2009,[13] the use of a portion of the windfall profits[14] from IMF gold sales (see Chapter 5) to help raise an additional SDR 1.5 billion (US$2.3 billion) to subsidize the PRGT's concessional financing. As the windfall gold sales profits are part of the IMF's general resources available for the benefit of all IMF members, deriving PRGT subsidies from these

Table 3.2

Arrangements under main facilities approved in FY2012

(Millions of SDRs)

Member	Type of arrangement	Effective date	Amount approved
NEW ARRANGEMENTS			
Colombia	24-month Flexible Credit Line	May 6, 2011	3,870.0
Portugal	36-month Extended Fund Facility	May 20, 2011	23,742.0
St. Kitts and Nevis	36-month Stand-By	July 27, 2011	52.5
Serbia	18-month Stand-By	September 29, 2011	935.4
Greece	48-month Extended Fund Facility	March 15, 2012	23,785.3
Georgia	24-month Stand-By	April 11, 2012	125.0
Kosovo	20-month Stand-By	April 27, 2012	91.0
Total			**52,601.2**

Source: IMF Finance Department.

resources involves a strategy whereby members indicate to the Fund that amounts in proportion to their quota shares should be transferred by the IMF or otherwise provided for PRGT subsidies. In February 2012, the Board approved a distribution to IMF members of SDR 700 million (US$1.1 billion) from the Fund's general reserve, subject to the Fund's receiving satisfactory assurances from members that at least 90 percent of the amount distributed (that is, SDR 630 million, or US$977 million) will be made available for PRGT subsidy resources. As of end-April 2012, 69 of the IMF's 188 member countries, including 27 African countries, representing the aggregate amount of SDR 340.38 million (US$527.76 million), had indicated that they would support subsidizing lending to low-income countries.

Evaluation of and modifications to the IMF's financing framework

At the start of the global crisis, the IMF embarked on a reform process to strengthen its toolkit for financing from the GRA, with the objective of increasing the usefulness of Fund instruments and facilities in meeting members' financing needs, while preserving the simplicity and coherence of the financing framework and safeguarding Fund resources. Reforms in 2009 (creation of the FCL) and 2010 (enhancement of the FCL and creation of the PCL) significantly improved the Fund's ability to provide financing for crisis prevention and resolution.

Review of Flexible and Precautionary Credit Lines and Reform of the Financing Toolkit

In November 2011, in conjunction with its first review of the FCL and PCL instruments, the Executive Board approved a set of reforms designed to bolster the flexibility and scope of the Fund's financing toolkit to provide liquidity and emergency assistance more effectively to the Fund's global membership. These reforms are expected to enable the Fund to respond better to the diverse liquidity needs of members with sound policies and fundamentals, including those affected during periods of heightened economic or market stress—crisis bystanders (that is, countries with relatively strong fundamentals and solid policy track records for which the likelihood of an idiosyncratic crisis would normally be low)—and to address urgent financing needs arising in a broader range of circumstances than the natural disasters and post-conflict situations previously covered under special policies.

Under the reforms, and based on the outcome of the Board's review of the decision establishing it, the PCL was replaced with a more flexible Precautionary and Liquidity Line. The PLL can be used under broader circumstances than could the PCL, including through a new "short-term liquidity window." Under that window, financing (up to 250 percent of quota) is provided through a PLL arrangement of a six-month duration, available to qualifying members that have an actual or potential short-term balance of payments need such that they can be generally expected to make credible progress in addressing their vulnerabilities during the arrangement. In this window, and under exceptional circumstances in which a member is experiencing, or has the potential to experience, larger short-term balance of payments needs due to the impact of exogenous shocks, including heightened regional or global stress conditions, access is subject to a higher limit: 500 percent of quota, net of scheduled PLL repurchases, per arrangement, as insurance against future shocks and as a short-term liquidity window. The Fund's existing policies for emergency assistance (Emergency Natural Disaster Assistance and Emergency Post-Conflict Assistance) were consolidated and replaced with a new Rapid Financing Instrument, which can be used to support a full range of urgent balance of payments needs, including those arising from exogenous shocks. Box 3.3 provides the essentials of these two new financing instruments.

Box 3.3

Key elements of the new instruments

Precautionary and Liquidity Line

•Qualification criteria remain the same as under the PCL. A member must be assessed as having sound economic fundamentals and institutional policy frameworks, having a track record of implementing sound policies, and remaining committed to maintaining such policies in the future.

•A member can seek support when it has either a potential or an actual balance of payments need at the time of approval of the arrangement (rather than only a potential need, as was required under the PCL).

•Under the liquidity window, allows for approval of six-month arrangements to meet short-term balance of payments needs. Access under a six-month arrangement would not exceed 250 percent of a member's quota, which could be augmented to a maximum of 500 percent in exceptional circumstances, as decided by the Executive Board on a case-by-case basis.

•Under the standard window, allows for approval of a 12- to 24-month arrangement, with maximum access upon approval equal to 500 percent of a member's quota for the first year and up to 1,000 percent of quota for the second year (the latter of which could also be brought forward to the first year where needed, following a Board review). As under the PCL, arrangements of these durations include Executive Board reviews every six months.

Rapid Financing Instrument

•Broadens coverage of urgent balance of payments needs beyond those arising from natural disasters and post-conflict situations and can also provide a framework for policy support and technical assistance.

•Funds are available immediately, upon approval, with access limited to 50 percent of the member's quota annually and to 100 percent on a cumulative basis.

•Member must outline its policy plans to address its balance of payments difficulties, and the IMF must assess that the member will cooperate in finding solutions for these difficulties.

Figure 3.3

Concessional financing outstanding, FY2003–12
(Billions of SDRs)

Source: IMF Finance Department.
Note: MDRI: Multilateral Debt Relief Initiative.

In their November 2011 discussion, most Executive Directors endorsed the main findings of the IMF staff's review of the FCL and PCL.[15] Executive Directors supported the staff's proposals to enhance transparency in the assessments of access under FCL and PLL arrangements, which would facilitate comparison and evenhandedness across arrangements. They saw merit in linking the assessment of balance of payments needs in each case more closely with adverse scenarios, which would help guide reserve use assumptions—carefully anchored on measures of reserve needs that are relevant for the particular country.

Executive Directors generally supported the greater focus proposed by the staff on qualitative and forward-looking factors embedded in the FCL/PLL qualification frameworks. They noted that access under the FCL and PLL instruments is a temporary supplement to reserves during periods of heightened risks. They reaffirmed the normal expectation of reduced access under successor FCL arrangements whenever improvements in official and private financing prospects have reduced the member's potential or actual balance of payments needs in a sustained manner by the time the successor arrangement is requested, and agreed that the same expectation would apply to successor PLL arrangements.

Executive Directors underlined the importance of appropriate ex ante and ex post conditionality in regard to the PLL. They welcomed procedures for early Board involvement that would be applicable to all PLL arrangements, irrespective of access or duration. They noted the staff's assessment that the proposed reforms might increase up-front calls on Fund resources, but that the net effect was likely to be relatively limited.

Table 3.3

Arrangements approved and augmented under the Poverty Reduction and Growth Trust in FY2012

(Millions of SDRs)

Member	Effective date	Amount approved
NEW THREE-YEAR EXTENDED CREDIT FACILITY ARRANGEMENTS		
Afghanistan	November 14, 2011	85.0
Bangladesh	April 11, 2012	640.0
Burundi	January 27, 2012	30.0
Côte d'Ivoire	November 4, 2011	390.2
Guinea	February 24, 2012	128.5
Kyrgyz Republic	June 20, 2011	66.6
Mali	December 27, 2011	30.0
Niger	March 16, 2012	79.0
Subtotal		**1,449.3**
AUGMENTATIONS OF EXTENDED CREDIT FACILITY ARRANGEMENTS[1]		
Burundi	July 13, 2011	5.0
Djibouti	February 6, 2012	9.5
Kenya	December 9, 2011	162.8
Lesotho	April 9, 2012	8.7
Liberia	June 27, 2011	8.9
Mali	June 13, 2011	25.0
Subtotal		**219.9**
NEW STANDBY CREDIT FACILITY ARRANGEMENTS		
Georgia	April 11, 2012	125.0
Solomon Islands	December 6, 2011	5.2
Subtotal		**130.2**
DISBURSEMENTS UNDER RAPID CREDIT FACILITY[2]		
Côte d'Ivoire	July 19, 2011	81.3
Dominica	January 19, 2012	2.1
St. Vincent and the Grenadines	August 3, 2011	1.2
Yemen	April 17, 2012	60.9
Subtotal		**145.5**
Total		**1,944.9**

Source: IMF Finance Department.

1 For augmentation, only the amount of the increase is shown.

2 Rapid Credit Facility resources are provided as outright disbursements without an arrangement.

Amendment of the Extended Financing Facility

In March 2012, the Executive Board approved an amendment to the Extended Fund Facility to allow extended arrangements to be approved for up to a maximum of four years from the outset.[16] Previously, the policy allowed approval only for up to three years, with the possibility of subsequently extending the arrangement to a maximum of four years. Consistent with the spirit of the reforms of the IMF lending toolkit since 2009, which have injected substantial flexibility and allowed better tailoring to countries' varying circumstances and needs, the use of the EFF over time has broadened from low- and middle-income countries with prolonged balance of payments needs to more-developed countries facing larger financing needs, such as those that have arisen in the euro area crisis. Purchases under extended arrangements would be expected to be evenly phased, consistent with normal Fund practice. Implications of this change to the EFF for the design of blended EFF-PRGT financing, it was noted, would be considered in a subsequent review of facilities for low-income countries.

Policy Support Instruments

The Policy Support Instrument (PSI) supports low-income countries that do not wish—or need—to access Fund financial assistance but seek to consolidate their economic performance with IMF monitoring and support. This nonfinancial instrument is a valuable complement to the IMF's financing facilities under the PRGT. The PSI helps countries design and implement effective economic programs that, once approved by the Executive Board, deliver clear signals to donors, multilateral development banks, and markets regarding the Fund's endorsement of the strength of a member's policies.

Left Farmers view information about local government systems in Mwaro Province, Burundi. **Right** Villagers extract jute fiber near the India-Bangladesh border.

To date, the Board has approved PSIs for seven members: Cape Verde (2006 and 2010), Mozambique (2007 and 2010), Nigeria (2005), Rwanda (2010), Senegal (2007 and 2010), Tanzania (2007 and 2010), and Uganda (2006 and 2010). No new PSIs were approved in FY2012.

Macroeconomic and operational challenges in countries in fragile situations

Discussing macroeconomic and operational challenges in countries in fragile situations in July 2011,[17] Executive Directors were heartened that, overall, IMF engagement with those countries had focused on the Fund's areas of expertise and helped strengthen macroeconomic frameworks, build up institutional and human capacity, and secure debt relief. However, Executive Directors noted that program implementation had been uneven, owing in part to overly ambitious program targets in some cases. Against this background, they saw merit in considering some changes to the modalities of the Fund's engagement, but stressed that—to be effective—efforts should remain focused on the Fund's core mandate and continue to be closely coordinated with the international community.

Most Executive Directors supported, or were open to considering, more flexible use of the Rapid Credit Facility for low-income countries in fragile situations as a stepping stone to upper-credit-tranche arrangements.[18] Nevertheless, given the protracted balance of payments needs typically faced by countries in fragile situations, it was felt that upper-credit-tranche arrangements should remain the main vehicle of Fund engagement.

Executive Directors generally welcomed the call for greater flexibility in program design to better reflect the limited implementation capacity in states in fragile situations. At the same time, they underlined that the conditionality standards applicable to different financing facilities should be maintained. They agreed that IMF financing should taper out over the medium term, and that the long-term financing needs of countries in fragile situations should largely be met using concessional donor resources.

Executive Directors stressed the importance of technical assistance in lifting countries out of fragile situations. In this regard, they saw the need for grounding it in realistic and adequately supported medium-term plans, including reliance on resident advisors and continued training of country officials.

Systemic crises, financial linkages, and the role of global financial safety nets

In a June 2011 discussion on the analytics of systemic crises and the role of global financial safety nets,[19] Executive Directors noted that the growing complexity of linkages among countries carries with it the risk of systemic instability, raising the odds of severe economic and financial distress and widespread contagion. They observed that the unprecedented policy response during the recent global crisis was commensurate with the scale of the crisis, which helped mitigate—and subsequently reverse—the loss of output and market confidence. More broadly, Executive Directors recognized that major central banks had played a crucial role in providing hard-currency liquidity during several systemic events, complementing efforts by the Fund and other international financial institutions. Although monetary policy decisions, in the context of the recent financial crisis, remained governed by central banks' domestic mandates and objectives, it was observed that these objectives happened to coincide with global interests. Going forward, it was noted, greater predictability and coordination of policy responses to systemic events would be desirable.

Most Executive Directors saw scope for exploring further enhancements to the global financial safety nets to provide timely and adequate liquidity to crisis bystanders, and, more generally, to foster greater global cooperation, particularly involving regional financing arrangements. Executive Directors underscored that strengthening the global financial safety net goes hand in hand with efforts to better identify the buildup of systemic risks and improve crisis prevention.

Subsequent to this discussion, in November 2011, the Board approved a set of reforms to the Fund's financing toolkit to better address liquidity and urgent balance of payment needs of the membership, as discussed earlier in the chapter.

STRONGER SURVEILLANCE TO SUPPORT A RETURN TO SUSTAINABLE GLOBAL GROWTH

Strengthening surveillance

The IMF is mandated, by its Articles of Agreement, to oversee the international monetary system and monitor the economic and financial policies of its 188 member countries, an activity known as "surveillance." As part of this process, which takes place both at the global level (multilateral surveillance) and in regard to individual countries (bilateral surveillance), the IMF highlights possible risks to stability and advises on needed policy adjustments. In this way, it helps the international monetary system serve its essential purpose of facilitating the exchange of goods, services, and capital among countries, thereby sustaining sound economic growth.

Multilateral surveillance

The IMF's key instruments of multilateral surveillance are three publications, the *World Economic Outlook* (WEO), the *Global Financial Stability Report* (GFSR), and the *Fiscal Monitor* (FM). These twice-yearly publications, along with the *Regional Economic Outlook* reports (see "Engagement with External Stakeholders" in

Chapter 5), constitute the IMF's World Economic and Financial Surveys; they aid the Fund in its examination of economic and financial developments among the membership. Interim updates for the WEO, GFSR, and FM are issued twice a year.

The WEO provides detailed analysis of the state of the world economy and evaluates economic prospects and policy challenges at the global and regional levels. It also offers in-depth analysis of issues of pressing interest. The September 2011 issue of the WEO focused on rising risks with the slowdown in global economic growth. It included chapters on the appropriate monetary policy response to the inflationary effects of commodity price movements, and how changes in taxes and government spending affect an economy's external balance. The April 2012 issue examined the dangers remaining as growth resumed, with an analysis of how government policies can reduce the economic costs in the aftermath of housing busts, and a discussion of what policies commodity exporters should implement to handle price swings. The GFSR provides an up-to-date assessment of global financial markets and prospects and addresses emerging market financing issues in a global context. Its purpose is to highlight vulnerabilities that could pose risks to financial market stability. The main topic covered in the September 2011 issue was the legacies of the crisis; analytical chapters explored whether changes in investor behavior pose downside risks for global financial stability and offered guidelines for operationalizing macroprudential policies. The quest for lasting stability was the theme of the April 2012 GFSR, with an analysis of the role of safe assets as a cornerstone of financial stability and an assessment of the financial impact of longevity risk. The FM surveys and analyzes the latest public finance developments, updates reporting on fiscal implications of the global economic situation and medium-term fiscal projections, and assesses policies to put public finances on a sustainable footing. The September 2011 issue of the FM considered the topic of addressing fiscal challenges as a means of reducing economic risks, with analyses of fiscal devaluation, privatization episodes, debt monitoring, and stock-flow adjustments; the April 2012 edition examined ways of balancing fiscal policy risks, and included discussions of analytical work on fiscal multipliers, fiscal adjustment plans, and crisis impacts on subnational government finances. A survey of the issues covered in the WEO, GFSR, and FM in FY2012 is presented in Chapter 2.

As the global crisis underlined the need for more analysis of linkages between sectors (for example, real, financial, and fiscal) and countries, the IMF has taken a number of actions to help make its surveillance as interconnected as the global economy. Pilot "spillover reports" were prepared for the first time in 2011, assessing the impact of economic policies in the world's five largest systemic economies—China, the euro area, Japan, the United Kingdom, and the United States—on their partner economies.[20] In September 2011, the IMF began preparing a new Consolidated Multilateral Surveillance Report, which highlights the top-line messages from the IMF's multilateral surveillance products (the WEO, GFSR, FM, and spillover reports); a second report was issued the following April. In 2012, the Executive Board held its first joint discussions on the WEO, GFSR, and FM, first in an informal session in January, and then in a formal Board meeting in April.

Bilateral surveillance

The centerpiece of the IMF's bilateral (or individual-country) surveillance is the Article IV consultation (see Web Box 3.2), normally held regularly with each member of the Fund in accordance with Article IV of the Fund's Articles of Agreement. In these consultations, the IMF conducts a thorough assessment of relevant economic and financial developments, prospects, and policies for each of its members, and provides candid policy advice based on its analysis. A total of 122 Article IV consultations were completed during FY2012 (see Web Table 3.1). In the vast majority of cases (for FY2012, 107, or 88 percent; see Web Table 3.1), the staff report and other analysis accompanying the consultation are also published on the IMF's website. The Executive Board reviews the implementation of the Fund's bilateral surveillance every three years, as part of its Triennial Surveillance Review.

2011 Triennial Surveillance Review

In October 2011, the Executive Board concluded a comprehensive review of the IMF's surveillance activities—the Triennial Surveillance Review—and of the legal framework for surveillance.[21] Executive Directors broadly agreed with the main conclusions of the IMF staff's review, in particular, that significant progress had been made in the way surveillance is conducted since the 2008 TSR, but that important gaps remained. They concurred with the staff that six areas of work deserve particular attention: interconnections, risk assessments, financial stability, external stability, the legal framework, and traction. They broadly endorsed the action plan described in the Managing Director's statement on strengthening surveillance,[22] while noting differences of views on a number of points. They also endorsed the corresponding operational priorities for 2011–14 as proposed by the staff.

Interconnections. Executive Directors saw merit in strengthening the link between global and country-level analyses to inform policy recommendations at the bilateral level. They agreed that the analysis of outward spillovers, such as that employed in the spillover reports for five systemic economies (see "Multilateral Surveillance" earlier in the chapter), had been a useful contribution to Fund surveillance and should be repeated for those economies before taking stock in FY2013. Executive Directors strongly supported further use of cross-country analysis.

Risk assessments. Executive Directors agreed on the need to pay more attention, in bilateral and multilateral surveillance, to risks and their transmission channels, while not paying less attention to the baseline. In this regard, they generally supported the staff's proposals, including those in regard to better drawing on the results of existing risk assessment tools.

Left Fiscal Affairs Department Director Carlo Cottarelli and colleagues brief press on the September 2011 *Fiscal Monitor* in Washington, D.C. **Right** A worker surveys construction of a shopping center in Pristina, Kosovo.

Financial stability. Executive Directors emphasized the importance of continued progress in financial sector surveillance. They recommended adopting a strategic work plan (see "Work Agenda for Financial Sector Surveillance" later in the chapter for a subsequent Board discussion related to this topic), promoting work on financial interconnections, strengthening financial sector analysis in bilateral surveillance, and addressing data gaps, while encouraging close coordination with other international bodies. They supported increasing the participation of financial sector experts in Article IV consultation missions[23] for economies with systemic financial sectors or with high financial sector vulnerabilities.

External stability. Executive Directors supported efforts to broaden the analysis of external stability beyond exchange rates, while emphasizing that exchange rate analysis should not be diluted in the process. In this regard, most agreed that the Fund should regularly publish multilaterally consistent staff assessments of external balances, building on refined exchange rate assessments conducted by the Consultative Group on Exchange Rates.

Legal framework. Most Executive Directors considered it appropriate to update the existing legal framework to enable more effective conduct of surveillance (and in April 2012, the Board held a follow-up discussion on modernizing the legal framework for IMF surveillance). Most supported, or were open to, the adoption of a new integrated surveillance decision, which would encompass both bilateral and multilateral surveillance and reflect a broader approach to global stability, and looked forward to follow-up work on the integrated surveillance decision.

Traction. Executive Directors agreed that traction has to be earned. In addition to quality, they were of the view that candor, evenhandedness, the need to tailor advice to country circumstances, and adequate follow-up to past advice are key to achieving greater traction. They welcomed the new Consolidated Multilateral Surveillance Report (see "Multilateral Surveillance" earlier in the chapter) as a useful tool to foster discussion among policymakers and strengthen the role of the IMFC. Executive Directors agreed that the Fund could pay more attention to inclusive growth, employment, and other social issues that have significant macroeconomic impacts, drawing from the expertise of other institutions. They noted the importance of an exchange of views between the staff and country authorities on the key issues prior to Article IV consultation discussions. Executive Directors welcomed organizational changes that would address the shortcomings identified by the IMF's Independent Evaluation Office (IEO)[24]—including those to enhance collaboration and promote diversity of views among staff and greater continuity of mission teams—and encouraged their timely implementation.

Executive Directors welcomed IMF management's commitment that the costs of implementing TSR proposals would be contained and that offsetting savings would be sought in the next budget round, while ensuring the quality of surveillance for all members.

Strengthening financial sector surveillance

Given the potential for financial sector developments to rapidly ignite and propagate crises, effective financial sector surveillance is critical. Since the global crisis, the IMF has increased the emphasis given to financial sector issues in its multilateral and individual-country surveillance and has prepared a strategic plan for financial sector surveillance. Additional resources have been devoted to research and surveillance on financial markets and complex financial institutions.

Monitoring financial interconnectedness

In May 2011, the Executive Board discussed progress in closing identified data gaps related to financial interconnectedness, particularly with reference to the Financial Stability Board's data template for global systemically important financial institutions.[25]

Executive Directors shared the IMF staff's view that, for the Fund to better assess risks and understand cross-border financial linkages in an increasingly integrated global environment, more granular data are needed. Financial data on a residence basis, disaggregated by country, sector, instrument, maturity, and currency denomination, would facilitate, it was observed, the identification of interest rate and exchange rate risks, maturity mismatches or funding gaps, and the potential for spillovers. Executive Directors therefore encouraged the staff to continue to work to close the data gaps that had been identified.

Most Executive Directors also encouraged the staff to continue to work closely with the FSB Secretariat to finalize the data template for global systemically important financial institutions, develop statistical guidance, and establish an appropriate mechanism for data sharing among relevant official institutions. At the same time, Executive Directors emphasized that confidentiality rules and legal limitations on sharing firm-specific data in some jurisdictions would need to be addressed.

Executive Directors welcomed initiatives to improve the availability of data, including the Coordinated Portfolio Investment Survey and the Coordinated Direct Investment Survey. They encouraged the staff to further explore ways of reducing the reporting burden on member countries. They broadly supported efforts to expand the currency and country coverage of the Currency Composition of Foreign Exchange Reserves (COFER) database, while preserving current confidentiality arrangements. They welcomed the proposal to initiate bilateral consultations before implementing any changes. They also generally supported exploring the possibility of generating less-aggregated data for COFER, securities held in foreign exchange reserves, and instruments held in foreign exchange reserves, to facilitate better understanding of global capital flows and financial interconnections.

Executive Directors welcomed proposed enhancements of the Bank for International Settlements (BIS) International Banking Statistics, noting that this would help close important data gaps essential to the Fund's surveillance work.

The Executive Board also met informally in March 2012 to take up the topic of interconnectedness in the context of the Fund's work to enhance surveillance. In that informal discussion, Board members considered a staff paper that proposed a conceptual framework for better understanding the direct and indirect linkages of countries. Work on this important topic is ongoing.

Macroprudential policy development

Following an Executive Board discussion in April 2011 on an organizing framework for macroprudential policy, work proceeded in FY2012 on research for and development of the framework. The Board met informally to discuss two papers. The first analyzed institutional arrangements for macroprudential policy, set out criteria for assessing different models, and examined their strengths and weaknesses. The second analyzed country experiences with the use of macroprudential tools and assessed their effectiveness, concluding that most of the macroprudential instruments were effective in dampening procyclicality in the financial sector.

Anti–money laundering and combating the financing of terrorism

In their June 2011 discussion of an IMF staff paper on the effectiveness of the Fund's anti–money laundering and combating the financing of terrorism (AML/CFT) program,[26] Executive Directors noted that the IMF's work had significantly contributed to the international community's response to money laundering and the financing of terrorism. (See Box 3.4 for highlights of AML/CFT efforts in two countries with IMF-supported programs.) They saw merit in exploring ways to strengthen AML/CFT assessments, including the possibility of conducting targeted, risk-based assessments. They agreed that, under a framework for risk-based assessments, the first AML/CFT assessment for a member would be comprehensive, while subsequent assessments would focus on those areas that presented the greatest risk of money laundering and/or terrorist financing taking place without being detected or sanctioned. They also agreed that a shift to targeted and risk-based AML/CFT Reports on the Observance of Standards and Codes[27] would need to be agreed upon with the Financial Action Task Force (FATF)—the standard setter—and other stakeholders. In particular, the methodology for conducting such assessments and criteria for the selection of issues to be assessed with respect to specific countries needed to be developed in cooperation with the FATF and the FATF-style regional bodies, along with other stakeholders. Most agreed to maintain the mandatory link of AML/CFT assessments with every assessment under the Financial Sector Assessment Program.

Executive Directors continued to support Fund collaboration with the FATF, including its International Cooperation Review Group process toward noncooperating jurisdictions. Consistent with guidance provided in the Board review of the Standards and Codes Initiative,[28] Executive Directors agreed that the staff should continue to participate in the review group, play a "good offices" role, and provide relevant information on member countries under review with the consent of the relevant members, while refraining from participating in those aspects of the process that are coercive in nature. Executive Directors noted that staff participation in such cases should not be seen as an endorsement of possible public statements on noncooperating jurisdictions.

The majority of the Board endorsed the approach and considerations outlined in the paper for the coverage of AML/CFT issues and their related crimes in the context of modular financial stability assessments under the Financial Sector Assessment Program and bilateral surveillance. In addition, Executive Directors broadly supported the continued inclusion of AML/CFT issues in Article IV discussions on a voluntary basis. They noted that the next review of the AML/CFT program would be expected to be completed within the next five years.

Box 3.4

Using anti–money laundering measures in Fund-supported programs: Afghanistan and Greece

Since stronger anti–money laundering controls can help prevent and mitigate the consequences of criminal behavior,[a] conditionality related to anti–money laundering (AML) measures is included in Fund-supported programs in Afghanistan and Greece.

In Afghanistan, the failure of Kabul Bank (the largest bank in the country as of July 2010) followed an alleged massive fraudulent and related-party lending scheme. If criminal behavior is proven, the loss, which amounts to more than US$900 million (5 percent of GDP and more than 50 percent of government revenue for 2010), would represent one of the largest criminal bank losses relative to GDP in history. In the context of the IMF's Extended Credit Facility–supported program with Afghanistan, the authorities are, among other things, strengthening the country's legislation in the areas of banking and anti–money laundering and combating the financing of terrorism (AML/CFT). Economic governance measures being taken include improving AML/CFT compliance, prioritizing fit and proper testing of persons who own and control financial institutions, and strengthening the supervisory framework and the independence of supervisors. Steps are also being taken to seek recovery of assets pilfered from Kabul Bank to minimize the fiscal cost of the crisis.

In October 2011, to strengthen their anti–tax evasion strategy, the Greek authorities decided to enhance the use of existing AML tools by implementing obligations on financial institutions to report, to the country's Financial Intelligence Unit, transactions suspected of being related to the proceeds of tax evasion. In March 2012, after the Financial Intelligence Unit had begun freezing assets allegedly related to the laundering of such proceeds, two AML measures designed to increase the flow of information from financial institutions and the tax administration to the Financial Intelligence Unit were introduced.

a More information on the Fund's work on AML/CFT issues can be found on the IMF's website at www.imf.org/external/np/leg/amlcft/eng/.

Work agenda for financial sector surveillance

As noted in the discussion of the 2011 Triennial Surveillance Review earlier in the chapter, one of the review's key recommendations was development of a strategic plan in regard to promoting financial stability. As a first step toward developing such a strategic plan, in April 2012, the Executive Board discussed a financial sector surveillance work agenda developed by the IMF staff.[29]

Executive Directors endorsed the key elements of the work agenda, which spans immediate priorities to contain the current crisis and medium-term priorities in two broad areas: enhancing systemic risk monitoring and distilling country experiences to derive best practices for resilient financial systems. They concurred with the staff that the immediate priority is to restore financial stability, notably but not only in the euro area, and limit spillovers to other regions. They stressed, however, that it is equally important for the IMF to continue engaging in all member countries and regions facing policy challenges, including emerging markets and low-income countries.

As regards medium-term priorities, Executive Directors stressed the need to understand better and monitor more effectively global systemic risk, build more resilient and growth-enhancing financial systems, and strengthen member countries' ability to prevent and manage crises. To that end, they supported efforts to refine the analysis of interconnectedness of financial sectors, understand better the linkages between the financial and real sectors, assess vulnerabilities in bank and nonbank institutions, and promote financial sector deepening. They also supported the Fund's efforts, alongside those of other stakeholders, to close data gaps and monitor risks arising from global systemically important institutions and markets.

Executive Directors agreed that it is important to engage other global stakeholders, including national authorities, on the development of a strategic plan. In doing so, it was noted, the Fund should focus on its mandate and areas of core competency, drawing on the expertise of other global stakeholders as needed. They urged that the plan contain specific actions, with clear priorities and timelines for implementation, and an assessment of the resource requirements.

Fiscal policy

Modernizing the framework for fiscal policy and public debt sustainability analysis

Noting that the recent global crisis had highlighted the need for increased focus on public debt sustainability in market access countries, especially advanced economies, in August 2011, the Executive Board discussed an IMF staff paper on modernizing the framework for fiscal policy and public debt sustainability analysis.[30] Executive Directors generally supported the staff's proposals for giving greater consideration to several elements, such as the realism of baseline assumptions, the level of public debt as one of the triggers for further in-depth study, the analysis of fiscal risks, vulnerabilities associated with the debt profile,

Left A farmer threshes his crop in Momirak, Tajikistan. **Right** A banana vendor moves down a busy street in Niamey, Niger.

and the coverage of fiscal balance and public debt. They also generally supported a more risk-based approach to assessing debt sustainability for market access countries, in which the depth of the analysis would be commensurate with the extent of identified country-specific vulnerabilities. Nevertheless, they emphasized maintaining a reasonable degree of standardization to ensure evenhandedness and comparability across countries.

Most Executive Directors saw merit in the use of a reference point of 60 percent for the debt-to-GDP level as an important trigger, among others, for more stringent analysis of debt vulnerabilities. They called for flexibility and judgment, using a broader set of indicators in deciding whether to conduct more in-depth analysis. Indeed, Executive Directors noted that the presence of other vulnerabilities stemming from the profile of debt or fiscal risks more generally could call for a more stringent analysis even for countries in which debt is below the reference point.

Executive Directors agreed that the coverage of fiscal balance and public debt should be broadened to include the general government. They saw merit in assessing pressures from age-related and health care spending and, where available, net debt measures to complement gross debt analysis. Most broadly supported the inclusion of contingent liabilities in the debt sustainability analysis. Executive Directors called for greater consideration of the debt structure and liquidity indicators in the analysis and agreed that the indicative benchmarks discussed in the staff paper could add value. They also noted that the analysis should take into account additional country-specific factors, such as the capacity of the market to absorb debt.

Managing global growth risks and commodity price shocks: Vulnerabilities and policy challenges for low-income countries

In November 2011, the Executive Board discussed an IMF staff report on vulnerabilities and policy challenges facing low-income countries in a highly uncertain global environment.[31] Executive Directors welcomed that most low-income countries had recovered swiftly from the global crisis. Looking ahead, however, Executive Directors cautioned that downside risks to global growth had increased at a time when the capacity of many low-income countries to absorb further shocks had yet to be rebuilt. As a result, they expressed concern that many low-income countries were less well prepared since the crisis to deal with external shocks.

Executive Directors observed that the scope for fiscal stimulus to counter a sharp weakening of global growth was more limited than before the crisis for most low-income countries, given depleted fiscal buffers and constrained aid envelopes. Nevertheless, it was felt that countries with sufficient fiscal room should maintain spending levels to avoid aggravating the negative economic and social effects of such a shock. In addition, most Executive Directors considered that, in countries with moderate inflation, monetary and exchange rate policy could be used actively for countercyclical support. If the downturn were to persist over the medium term, however, further realignment of macroeconomic policies might be necessary, it was noted.

Executive Directors generally supported a pragmatic policy response in the event of commodity price shocks, which could include targeted measures to protect the poor, depending on the available fiscal space. They highlighted, as a central policy challenge for low-income countries, the need to continue rebuilding macroeconomic buffers while also meeting pressing spending needs to support poverty reduction and growth. They recognized that this challenge could involve difficult trade-offs and that the variety of country circumstances precludes a one-size-fits-all policy approach.

External and exchange rate surveillance

The October 2011 Triennial Surveillance Review identified progress in strengthening Fund surveillance, but also important gaps, especially from the perspective of members and outside users, including gaps relating to the analysis of external stability. The Managing Director's April 2012 action plan calls for the IMF to bring multilateral consistency to its analysis of external stability with a new external sector report, which will examine what is driving imbalances and some of the associated risks to external stability. One important component of this report is expected to be external balance assessments, and an interdepartmental working group began developing the methodology for these assessments (the successor to the Consultative Group on Exchange Rates methodology), which will focus on current accounts, exchange rates, and net foreign assets. An informal Board meeting was held in March 2012 regarding the methodology and process for the external sector report, with a formal Board discussion expected in FY2013.

Capital flows

The Executive Board in FY2012 continued its earlier work toward formulating a comprehensive, flexible, and balanced approach for the management of capital flows, drawing on country experiences. Previous work focused on the policies of recipient countries and addressed the circumstances in which capital flow management measures would be appropriate.

Multilateral aspects of policies affecting capital flows

In November 2011 the Executive Board discussed an IMF staff paper on the multilateral aspects of policies affecting capital flows.[32] Noting that policies of both source and recipient countries play a role in reaping the benefits of capital flows while limiting their risks, Executive Directors concurred with the staff that national policymakers should pay more attention to the multilateral transmission of their policies, including with respect to prudential frameworks and monetary policy. They agreed that improved national prudential frameworks benefit all countries and the global system as a whole. They noted that completing and fully implementing the national and international regulatory and supervisory reforms underway and developing new macroprudential frameworks would help reduce arbitrage opportunities and mitigate cross-border risks.

Most Executive Directors noted that, given the complicated transmission process, the case for major central banks to proactively consider the multilateral effects of their monetary policy is limited. Most agreed that the renewed interest in capital flow management measures suggested that their multilateral implications warrant attention, as capital flow management measures could transmit multilaterally by increasing or decreasing capital flows to countries with similar characteristics. Most also agreed that a moderate use of capital flow management measures has few implications for the overall riskiness of capital flows and global stability, noting, however, that such measures, if they proliferated or intensified, would have escalating global costs.

Liberalizing capital flows and managing outflows

In an April 2012 Executive Board meeting on liberalizing capital flows and managing outflows, Executive Directors concurred with IMF staff observations that full liberalization is not an appropriate goal for all countries at all times and that a country's appropriate degree of liberalization depends on its specific circumstances, notably the stage of its institutional and financial development.[33] They noted that there is no single best approach to capital flow liberalization. They emphasized the need for a cautious approach to liberalization, paying attention to the institutional and market capacity to absorb capital flows and manage risks in an increasingly financially integrated world. Most Executive Directors considered

Left A man repairs the roof of a building in Cité Soleil, Haiti.
Right A batik vendor markets her wares in Banjul, The Gambia.

the approaches proposed by staff for liberalizing capital flows and on the use of capital flow management measures to manage outflows as providing a broadly appropriate basis for developing a comprehensive institutional approach to inform policy discussions with member countries.

Most Executive Directors stressed that close attention should be paid to the multilateral effects of capital flow liberalization. It was observed that liberalization by large, systemically important emerging market economies could have significant multilateral effects, including through higher gross capital flows, a diversion of capital flows to or from other countries, implications for financial stability, and greater exchange rate flexibility. Many Executive Directors stressed that appropriate macroeconomic, structural, and financial sector policies should be the first line of defense against excessive, volatile capital outflows. A number of others saw a broader role for capital flow management measures as part of the permanent toolkit, which could be used effectively where macroeconomic or other policies are constrained.

Executive Directors acknowledged that the proposals discussed in the meeting would need to be reviewed periodically as the understanding of the underlying issues advanced. It was noted that a subsequent staff paper requested by the IMFC would articulate a comprehensive, balanced, and flexible approach for the management of capital flows, drawing on country experiences.

Risk assessment and management

The IMF has sharpened its risk assessments in the wake of the financial crisis. In 2009, the IMF introduced the Early Warning Exercise—to identify and assess low-probability but high-impact risks to the global economy—and has also developed analytic frameworks tailored to assessing vulnerabilities and emerging risks in advanced economies, emerging markets, and low-income countries. The exercise is typically conducted (in collaboration with the FSB) twice each year; following discussions at the Executive Board and with the FSB, the exercise's findings are presented to senior officials during the Spring and Annual Meetings. Closely connected to the Early Warning Exercise is the Early Warning List, a distillation of the key risks, vulnerabilities, and trends observed in work associated with that exercise that is shared with the IMF's Executive Board and members of the FSB.

The IMF's Vulnerability Exercises for Advanced Economies and Emerging Economies are a critical component of the broader research and analysis that feeds into the Early Warning Exercise's quantitative results. These Vulnerability Exercises use information from various models as an input to assess regional and global vulnerabilities to different types of shocks. Given their country-specific nature, the results inform the Early Warning Exercise but are not circulated to the IMF's Executive Board or FSB members.

Role of the SDR

In October 2011, the Executive Board discussed criteria for broadening the SDR currency basket, a key element of the work program on SDR valuation and the reform of the international monetary system.[34] Most Executive Directors were of the view that the existing criteria for SDR basket selection remained appropriate. Executive Directors stressed that the bar for SDR basket inclusion should not be lowered. They welcomed as a useful step indicators put forward by the IMF staff for the freely usable criterion[35] in the context of the regular review of SDR basket valuation. They emphasized that the indicators should not be used mechanistically and that ultimately, the determination of free usability would need to rely importantly on judgment, framed by the definition of freely usable currency set out in the Articles of Agreement. A number of Executive Directors also stressed the importance of allowing changes in the basket to keep pace with developments in the international monetary system.

Most Executive Directors agreed that there continues to be an important role for a size-related criterion for SDR basket selection. While agreeing that augmenting the existing exports criterion with financial inflows would, in principle, be desirable, most Executive Directors preferred to maintain exports as the sole size criterion for the time being, pending further improvements in financial accounts data.

The Executive Board reviews the SDR basket, including candidate currencies for the basket and their weights, every five years. The next such review is expected to take place by 2015.