Statement by the Managing Director on
Strategic Directions in the Medium-Term Budget
April 12, 2008

I. Introduction

1. ***The long view***. I try never to forget that the Fund was founded at the close of the Second World War to avoid the human devastation that too often follows economic disasters. The specifics may change from one era to the next—reversals in capital flows, not war reparations; financial collapses from asset market bubbles, not hyperinflations—but the dynamic of economic shock transmitted to political and social convulsion has not changed. As we look ahead ten or twenty years beyond today's budgetary and staffing preoccupations, we must not lose sight of the raison d'etre of the Fund: to deliver the economic analysis and multilateral collaboration that ensures financial stability and prosperity for all—and thereby avoid the tragedies that ensue when these are absent.

2. ***The imperative for change***. In my interactions with the membership I have found a genuine appreciation for the work of the staff towards this end, and for our role as a universal institution that facilitates global cooperation and action. But there is also a clear sense that the institution needs to change with the times and that a new income model to set the Fund on a sustainable financial path must also be paired with a new business model. In my January 10 statement to the Executive Board's Budget Committee, I argued that, to better serve the needs of our members, the principle of comparative advantage should guide our work program, allowing us to grasp the issues at the center of global debate and cast aside yesterday's priorities and modes of functioning. I envisioned an institution more alert to emerging issues, more critical in its assessments (especially in good times), and more assertive in communicating its concerns, especially with regard to:

- Global surveillance—with deeper analysis of macro-financial linkages, exchange rates, and spillovers, especially emanating from advanced economies and markets.
- Bilateral surveillance—with a more global perspective and cross-country experience brought to bear on policy dilemmas of countries, especially in emerging markets.
- Low-income country work—with our contribution emphasizing macro-financial stability focusing on our associated core expertise.
- Capacity building—with technical assistance focused on macroeconomic issues, prioritized through a mechanism for charges, and augmented by more fund-raising.
- A more modern Fund—with a governance structure better reflecting its membership, a sustainable income model, and lower administrative costs.

3. ***Where we are***. We have known for some time that this would be a difficult period—and it has been. The prospect of job cuts in one of the best educated and most talented staff in the world is, however necessary, also deeply unsettling. Agreeing on the scope of additional budgetary cuts ($100 million), and staffing reductions (around 380) over the next three years to pre-Asian crisis levels, has been a painful responsibility. The Board has forged difficult compromises on a framework for staff separations and on instruments to encourage, as much as possible, voluntary separations. I thank Executive Directors for this effort.

4. ***The task ahead***. However, downsizing seems also to have overshadowed the underlying goals and imperatives of reform, and undermined our sense that change for the better is possible. After all, the vision speaks to what we must do *more* of, while the budget debate emphasizes the things we would do *less* of. Is reform even achievable in an environment of budget cuts? Absolutely, I have no doubt that it is. Explaining the reasons for this and conveying my broader sense of the direction for the Fund are the main themes of this note. Based on the Board's discussion of the paper, staff will circulate a specific set of proposals on the budget and income for approval in early April. After that, we will embark on the most difficult—and most critical—part of the process: implementing reforms at the working level.

II. Surveillance for Stability and Growth

5. ***Overview***. Surveillance, our premier output, is a mix of many different activities—from oversight of the global economy and financial markets, to analyses of country-specific policies and issues, to regulatory and data standards. In a nutshell, the proposed strategy is to shift staff resources to objectives at the front of this list, and to integrate better strands of staff work such as macro-financial linkages and cross-country perspectives. We need to do this in the same way that we bring together the analysis of fiscal, monetary and exchange rate policies into our assessment of the real economy. What might this mean in practice?

6. ***Macro-financial linkages***. The current disruption in financial markets, and the associated threat of recession, is a timely reminder of an issue at the core of our mandate. Understanding the channels of transmission and feedback between the real and financial sectors is not easy, but it is essential. Our members need clear guidance from the Fund on the ways in which financial market developments can affect macroeconomic outcomes—growth, inflation, exchange rates—and the ways in which developments in the real economy, in turn, feed back into the financial sector. The proposed budget will provide key departments the resources required for this task, but it will be equally important to bring focus and coordination to the work scattered across the Fund. I take the point made by Directors in previous discussions that a major organizational change—e.g., a new global surveillance department—could detract from the challenges facing the institution and that it may be wiser at this stage to work within existing structures. As such, we should build on the idea of staff working groups that traverse departmental boundaries to overcome coordination problems. It is my intention to make the already existing Surveillance Committee a focal point of this

effort, with a small secretariat to assist it in taking forward the work on macro-financial linkages and other surveillance activities. The budget proposal will thus include provision for a small macro-financial unit—with staff drawn from across relevant departments—to serve this function. The unit would be placed within an existing department to avoid creating new layers, and be led by a high-ranking staff member with direct management access to oversee Fund-wide collaboration and underline the importance of this strategic priority.

7. ***Financial markets***. We need to face up to an unpleasant reality: even when we have warned of financial risks and destabilizing trends, the message often has not come across to policymakers, leaving the Fund on the sidelines of important debates, such as the current one on the integrity and stability of world financial markets. However, there is now a growing acknowledgement of the need for the Fund to build on its Financial Sector Assessment Program and step forward to become a source of timely and well-informed analysis for members on financial matters—on market developments and transparency, stress testing models, crisis planning, and sovereign wealth funds. I have asked the Monetary and Capital Markets department to work closely with the Financial Stability Forum to prepare a series of presentations on financial market reform for discussion by the Board. My hope is that, in the months ahead, it will be possible to put forward a framework for such reform commanding broad support across the membership. This will be a major challenge for the department, requiring it to find the resources by scaling back activities such as review of country papers and lower priority technical assistance.

8. ***A multilateral perspective in bilateral surveillance***. Bilateral surveillance is both part of the Fund's core mandate and the foundation of multilateral surveillance. Getting right the analysis of each member's problems, and the impact on external stability, must continue to anchor our work. However, it is also true that many country authorities are demanding a wider perspective. Global and regional events now have a larger bearing on individual countries, and the latter's problems simply cannot be seen or resolved in isolation—global current account imbalances is an obvious case in point. Thus, the resources allocated to departments will be calibrated to encourage a broader perspective via: (i) larger divisions, with staff working on similar countries brought together; (ii) desk economists working on more than one country, to yield a mindset of comparison and linkages; (iii) analytical groups on core issues (e.g., assessing exchange rates); and (iv) more regional surveillance and efforts to bring similar Article IVs to the Board at the same time. (In such cases, one option might be to have a main report picking up common themes and short papers on individual countries.) A revived and more actively engaged Surveillance Committee will oversee efforts to integrate global perspectives into Article IVs, especially in systemically important cases.

9. ***Engagement with emerging economies***. Many emerging economies have indicated that they would find it useful for the Fund to engage more closely with them on macro-financial and cross- border linkages. A sharper focus on this area, and greater responsiveness to the specific challenges that emerging economies face from volatile capital flows, will be key. At present, it seems unlikely that there will be greatly increased demand from emerging

economies for traditional Fund programs, especially given the extent of self-insurance through reserves by many of them. Thus, there is an opportunity to redeploy some resources previously allocated to program work. However, risks remain: insurance from reserves may have gone up but so have capital flows. Therefore, we must maintain preparedness to respond quickly and continue to explore, with the membership and with various regional groupings, whether our instruments of financial support and the access available under them meet the needs of emerging economies. To this end, we will expedite work on developing a new liquidity instrument, and in taking this forward, will draw on the suggestions made by some Executive Directors for a facility to help countries integrate into global capital markets.

10. ***New practices***. The aggregate output of paper has reached a point where it is an obstacle to internal and external effectiveness. Moreover, too many reports are out of date by the time they have been written, reviewed, discussed by the Board, and finally published. It is my intention to instruct staff to cut back on unnecessary review and reduce associated delays in the production process. Departmental review will generally be restricted to the earlier briefing paper stage where inputs are crucial, with a more streamlined clearance process for Board papers. Moreover, while I believe that Article IV consultations should generally remain on a 12-month cycle, it should be possible to reap substantial savings from less extensive consultation reports in alternate years, focusing on just core issues and presented to the Board in innovative ways, e.g., short reports and slide presentations based on the staff's concluding statement and the authorities' reactions. I will also explore with the Board methods of bringing Board discussions of Article IV material closer to completion of the mission, where possible holding Board discussions soon after the mission's return. Staff is preparing examples of concise reports that the Board could discuss shortly. I have also asked staff to extend the vulnerability exercise to the advanced economies in order to provide early warning signals of emerging risks and difficulties. Finally, building on the idea of Multilateral Consultations, I do believe we need to find new ways of facilitating collective action among key players in the global economy—e.g., by convening discussions as necessary among groups of members, with subsequent reports to the Board and the IMFC.

11. ***Budgetary implications***. The table below gives a qualitative indication of the rebalancing of staff work, in order that new priorities might be accommodated within a tighter budgetary envelope. A broader quantitative indication is provided in the last section, with details following in the final budget paper.

SURVEILLANCE		
	Doing More	**Doing Less**
Review		✓
Standard consultations with wide coverage		✓
More focused consultations	✓	
Selected Issues papers in non-core areas		✓
Cross-country analysis	✓	
Macro-financial linkages	✓	
Coverage of financial issues	✓	
International linkages and spillovers	✓	
Program work in emerging market economies		✓

III. A CHANGING ROLE IN LOW-INCOME COUNTRIES

12. ***A new landscape***. The Fund's role in low-income countries is changing as these countries grow and mature. In more and more cases, I expect our engagement to emphasize issues such as the policy response to capital inflows, commodity price booms and busts, financial market development, and debt sustainability. The experience of emerging market countries on these issues provides an opportunity for useful cross-country work by staff. For other LICs, the Fund's financial support continues to be important in itself and in catalyzing support from others, including traditional and emerging donors. More generally, our analysis of LICs has proved to be particularly useful to national policy-makers and to the international community. Thus, even if some resources are freed up as the debt relief process winds down, it will be important that substantial resources continue to be devoted to LIC work.

13. ***Focus and coherence***. Nevertheless, there is a need for change in the way we approach work on LICs. We are not a development agency: our role is to help create stable macroeconomic frameworks in which development institutions and agencies can be effective. Therefore, we must speed up the progress made in focusing more on helping LICs secure and maintain macroeconomic stability, and less on structural issues outside of the Fund's core mandate. We should not attempt to coordinate donor activity, but we should exchange information with donors and engage them more, especially with a view to generating additional external financing for capacity building. We also need more coherence within the Fund in our policy work on LICs. To this end, I propose to revive the currently dormant management-chaired interdepartmental Committee on Low-Income Countries. As with the Surveillance Committee, it too will need a secretariat to be effective. The budget will therefore provide for a small unit, within an existing department, led by a high-ranking staff member with direct management access. The unit would coordinate LIC work across the Fund and be at the forefront of emerging issues relevant to LICs.

14. ***Fewer papers***. As with surveillance, a less paper-intensive approach can free up staff time for advice and support to low income countries. I see several areas where we can save time and resources. For example, in the current budgetary environment, we could make more

selective use of Ex-Post Assessments, while preserving their role as providing independent assessments of program effectiveness. We should also explore the scope for streamlining mid-year reviews of PRGFs and Policy Support Instruments. I would also like to review our involvement in Joint Staff Advisory Notes. I have already discussed these issues with World Bank President Zoellick, who has been supportive while emphasizing the importance of continued cooperation between the Fund and the Bank. I will also need the Board's support to make these changes, and will consult with Executive Directors on this extensively.

15. ***Budgetary implications***. The table below gives a qualitative indication of how new priorities will be met in a tighter budgetary envelope.

LOW-INCOME COUNTRY WORK		
	Doing More	**Doing Less**
Work on HIPC/MDRI		✓
Ex-post Assessments		✓
JSANs		✓
Engagement with Donors	✓	
Coordination on Low-Income Issues	✓	
Building on lessons from emerging economies	✓	

IV. CAPACITY BUILDING

16. ***Toward a demand-driven approach***. The Fund's technical assistance and training is greatly appreciated and demanded by our members. In many areas, such as the development of sound fiscal and monetary institutions, the Fund is the best source of advice and training for its members. In some areas, it is the only source. However, in an environment of resource constraints, we need to find a way to prioritize. I intend to propose to the Board a framework of charges that would be applied when TA is provided to countries that do not have Fund arrangements, with the charges graduated according to the income of the member.

17. ***External fund raising***. I have asked Office of Technical Assistance Management to step up fundraising efforts, including exploring the scope for bundling our products in topical trust funds, such as TA for fragile states or for public debt management. We might also consider changes in the way technical assistance is coordinated, with the aim of promoting external financing, in a manner consistent with quality control and integration of TA with surveillance and program work. If these ideas come to fruition, they could allow the Fund to leverage its own resources, and catalyze the provision of more TA and training for members.

18. ***Capacity building in the budget***. As we cannot assume a charging, fundraising and coordination policy not yet in place, the budget provides for lower expenditure, deployed under the current framework. Departments would decide on TA requests based on relevance to the Fund's core mandate, comparative advantage, and overlaps with other TA providers. In addition, there is scope to modify the way the Fund provides capacity-building activities:

- *RTACs.* There is scope for increased TA delivery through regional centers.
- *ROSCs.* FAD will reduce the number of new fiscal transparency ROSCs; STA will slim down the ROSC data module program.
- *FSAPs*. MCM will take a more risk-based approach to updates.
- *Training.* INS will shift more courses from HQ to co-financed locations abroad; increase cost recovery for HQ courses; and rely more on electronic means for internal economics courses.
- *AML/CFT.* Work on AML/CFT issues will now focus mainly on assessments of countries that are systemically important or that present acute risk, including emerging and middle-income economies whose financial systems have outpaced their AML/CFT capacity. At the same time, to supplement the internal resources available for TA, including to support legal and regulatory assessment, the Fund will seek to mobilize additional resources from external financing for AML/CFT work.

19. ***Budgetary implications***. The table below gives a qualitative indication of how new priorities will be met in a tighter budgetary envelope.

CAPACITY BUILDING

	Doing More	Doing Less
ROSCs		✓
TA/Training (Fund-Financed)		✓
AML/CFT work		✓
TA/Training (External-Financed)	✓	
TA/Training through RTACs	✓	

V. MODERNIZATION AND EFFICIENCY

20. ***Economies of scale and scope***. Too many of our structures and practices date back to a time when the Fund was smaller, technology offered fewer options, and the budget was less constrained. Implicit in the budget is a significant modernization of operations, the most important elements of which are a revamping of administrative processes, automation, and outsourcing. Key areas to be modernized include the areas of human resources, information technology, and administration. For example, TGS, which has already offshored the maintenance of many information technology applications, will expand the global sourcing model to more areas and will increase outsourcing of translation services. On automation, although there will be temporary offsetting costs (e.g., investment in new technologies), important savings should accrue over the medium term. Other efforts to improve organizational efficiency include larger division sizes (which economize on supervisors and assistants, while encouraging cross-country and functional synergies); fewer publications and more use of the web for outreach; cutting back on non-staff expenses such as the volume of non-essential travel and seminars and certain subsidies.

21. ***Staff overseas***. The reduction in Fund programs affords an opportunity to reduce resources spent on resident representatives and overseas offices. Bearing in mind that each person in the field costs about two staff positions at HQ, my view is that we should concentrate our resources in program countries and in countries of systemic importance. Accordingly, I plan on recommending a cut in staff overseas by nearly one-third. In both cases where cuts are planned, and in cases where we aim to maintain resident representatives and overseas offices in non-program countries, area departments will consult host-country authorities regarding the scope for contributions from them to maintain the offices. Several countries have already indicated their willingness to support our offices in this way.

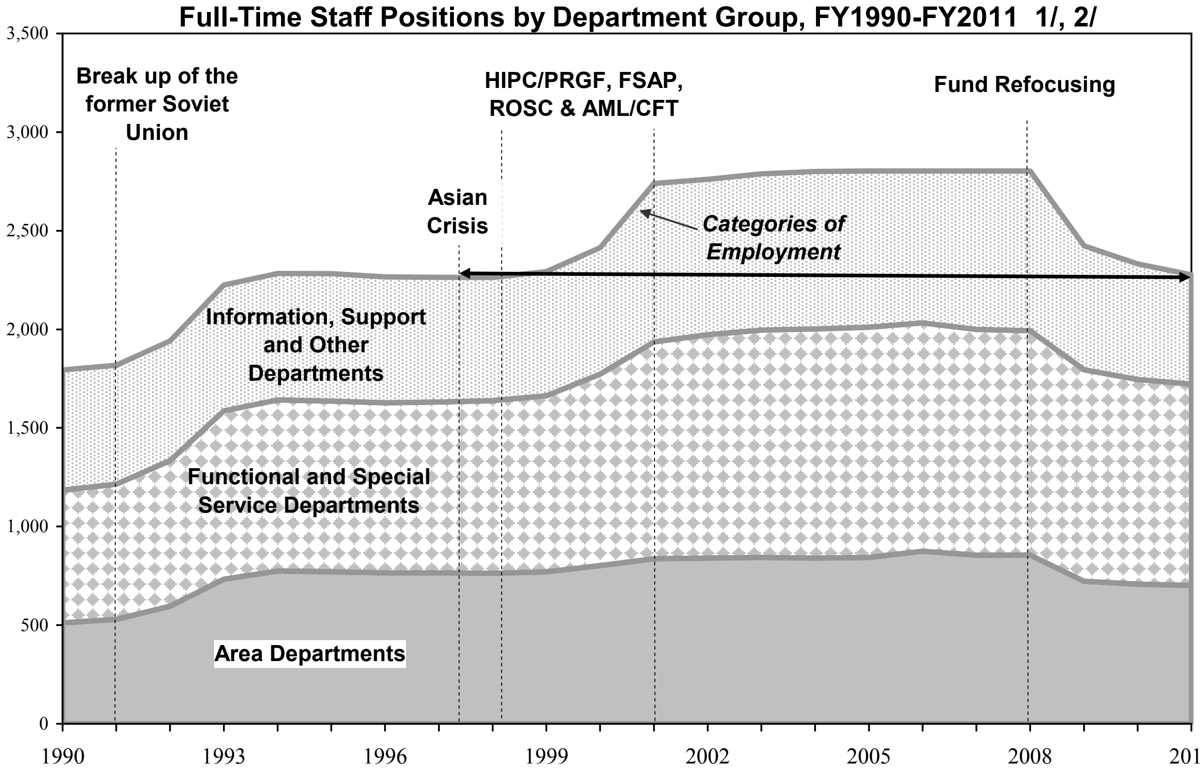
VI. Implementing the Strategy

22. ***Organizational aspects***. Change of the scope we are considering is an enormous responsibility, and will need constant attention. Many reforms require formal Board approval, and will be brought for the Board's consideration in due course. Other changes—e.g., mechanisms for ensuring that financial and cross-country perspectives are reflected in our work—require management to work closely with senior staff. For this reason, the role of cross-departmental groups, such as the Surveillance Committee and the Committee on Low-Income Countries, in integrating staff work will be strengthened, as will their *ability* to take up and follow through on strategic priorities through the creation of two the small units previously mentioned—within existing structures—to serve as secretariats.

23. ***Budgetary savings***. The themes developed here have been at the focus of my discussions with departmental managers on how to allocate the envisaged staffing reductions as we refocus our work. A preliminary picture is now emerging, with a restructured Fund saving staff resources through targeting efficiency gains (including larger divisions, improved work practices, and outsourcing); less review and greater delegation of responsibilities; rationalizing the resident representative program; streamlining administrative, human resource, and budgetary systems; and some reduction in overlaps in Fund-financed capacity building. The proposed staff reduction of 380 would return Fund personnel to a level that existed prior to the onset of the Asian crisis.

Composition of Savings
(In millions of 2008 dollars)

Personnel Savings	**67**
Efficiency gains and other	27
Fewer programs, less review, fewer layers	16
Fewer resident representative/overseas staff	7
Streamline systems and administrative processes	7
Refocus capacity building	5
Refocus LIC work	2
Refocus surveillance	2
Eliminate policy overlaps	1
Nonpersonnel Savings	**33**
Travel related expenses	10
Less resident representative/overseas office costs	9
Increased leasing of HQ2	5
Funding investment office through SRP	2
Annual meetings' savings	2
IT services	2
Elimination of subsidies	2
More revenues (Concordia)	1
Total	**100**



1/ Excluding OED and IEO. 2/ All figures are full-time staff (FTS) positions, except for FY2009-FY2011, which are budgeted full-time equivalents (FTEs). For FY2008, budgeted FTEs are about 150 lower than the FTS ceiling of 2,802.

24. ***Budgetary shifts***. In preceding sections, I have tried to give a sense of how our priorities can be met in a smaller Fund. While internal discussions will continue I expect that we will devote a larger *amount*—not just a larger *share*—of resources to key surveillance priorities such as regional and multilateral analysis. Our relationships with many emerging market and low- income countries would naturally shift toward surveillance as these countries prosper and their need for Fund-supported programs lessens. Of course, we will remain fully engaged in program activities where necessary. The decline in capacity building reflects a lower Fund contribution, although outputs would be higher if we are successful in securing more external funding, including from new partners.

Expenditure Allocation, 2008–11
(Real percent change)

Surveillance	
Multilateral surveillance	+9
Bilateral surveillance	-13
of which: systemic countries	+20
Regional surveillance	+18
Country Programs	-15
Fund-financed Capacity Building	-19
Overhead	-13

25. ***Final thoughts***. Implementing the proposed medium-term budget will be demanding, not least on account of the painful reality of staff separations. This is not a task we welcome, but it is an institutional responsibility that we cannot shy away from. However, the budget is also a mechanism for setting our priorities, with more focus on our mandate, greater edge in responding to new developments, and a more prominent role for the Fund as the guardian of international financial stability. This vision will need to come together with other elements of our work, especially the reform of quotas and voice and the new income model to place our finances on a sustainable path. Only when these are complete, I believe, would we have put in place the building blocks of an institution that meets the needs of the membership.