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**Reinhard Munzberg, Associate Secretary, effective May 1, 1996.
***Redesignated as the Office of Internal Audit and Inspection—with Eduard Brau, Director—effective May 1, 1996.

Box 1

FISCAL PROBLEMS AND POLICIES

As countries look ahead, it is clear that a number of problems need to be addressed more adequately to reduce risks of adverse financial market reactions, to enhance countries' resilience to adverse economic disturbances, and to strengthen growth in the medium to longer run. Because many of these problems fall in the fiscal area, the Board's discussion of the World Economic Outlook in March 1996 paid special attention to fiscal policy.

Fiscal Overview

Directors generally agreed that budget deficits were too large in many countries and that this represented a major economic problem. Such deficits were seen as giving an upward bias to real world interest rates, crowding out investment spending, and adversely affecting long-term growth. The problem of potentially unfavorable spillover effects through highly integrated financial markets was noted, as was the considerable—albeit less visible—debt burden that many countries faced because public pension systems would experience large imbalances between inflows and outflows as populations aged during coming decades.

Overall, the discussion revealed that there was more to the fiscal problems facing all countries than met the eye. In particular, Directors agreed that there was a need to reform budgeting processes and to provide for greater transparency in government balance sheets so that the assessment and formulation of fiscal policy could be improved and made more forward-looking. Among the proposals suggested to improve fiscal transparency, and thereby discipline, were multiyear budget forecasts, assessments of contingent liabilities and fiscal risks, and statements of unfunded liabilities.

Industrial Countries

Directors shared the staff's assessment that, despite progress, budgetary imbalances remained a serious problem in most industrial countries. They generally agreed that the root cause of budget deficits over the past 25 years in these countries had been excessive expenditure growth, which had persistently outstripped revenue growth. This growth had been largely the result of rapidly rising outlays for transfer payments, public pensions, and interest costs. There had been a particular problem with entitlement spending, especially with health care in the United States and public pensions in Europe. Steady increases in Europe's structural unemployment had also contributed to budgetary imbalances in that part of the world. Although ratios of debt to GDP had flattened out in some of these countries in the mid-1990s, they remained on unsustainable trajectories for many countries, and in almost all cases debt levels were much higher than 15 years ago.

Noting that the present value of unfunded future claims associated with public pension plans in many countries now exceeded total GDP, and that pension plans in some of the major industrial countries were likely to face contribution gaps, Directors concurred that a solution would need to include higher contributiµon rates, lower benefits, and increased retirement ages.

Directors observed that fiscal consolidation could give a powerful boost to industrial countries' medium- and long-term performance, and they emphasized that bolder policy actions were more likely to succeed than more limited efforts. In particular, budget cuts focused on reducing transfer payments and other government outlays would tend to be more effective than those that relied more heavily on tax increases.

Developing Countries

The Board welcomed the marked improvement in the fiscal stances of many developing countries since the 1980s, noting that better fiscal policies had played a key role in promoting a more stable macroeconomic environment, stronger domestic saving and investment, and market-oriented structural reform. Directors generally agreed that the growth and composition of public expenditure in many developing countries often reflected excessive state involvement in activities that could be carried out more efficiently by the private sector. Many Directors emphasized that weakness in government revenues was also often a critical problem, and that priority should be given to broadening the tax base and improving collection.

Directors observed that a large number of public sector activities conducted through quasi-fiscal institutions did not result in immediate budgetary outlays but frequently entailed the creation of contingent or unfunded liabilities. They warned that, in some developing countries, improvements in the central government's fiscal balance might misrepresent the true evolution of the public sector's overall financial position. In such cases the appearance of fiscal discipline in the central government's accounts might not be sufficient to ensure macroeconomic stability.

Regarding the link between fiscal policies and economic growth, several Directors noted that whether fiscal policies promoted growth depended on the extent to which the level and composition of government expenditure boosted the stock of physical and human capital, and on whether government services complemented private sector activity. Although some governments might be able to resort to foreign saving, the buildup of external imbalances raised a country's vulnerability to sudden reversals of capital flows, with disruptive consequences for domestic policies and economic activity. Indeed, the need to limit reliance on foreign saving and short-term capital inflows might justify a strengthening of fiscal policies in countries that had already achieved a high degree of fiscal balance.

Economies in Transition

Directors acknowledged the substantial progress toward fiscal consolidation made by most transition countries. Those more advanced in transition to a market economy had generally held fiscal deficits to modest levels as a percent of GDP or had recorded small surpluses. Directors also welcomed the fiscal consolidation efforts in those countries less advanced in transition, noting that sound public finances were a fundamental prerequisite for the prudent monetary and credit policies essential for stabilization. Several Directors expressed concern about the apparent weakness of tax revenue systems in countries less advanced in transition; they concurred with the staff's assessment that, if not corrected, weak tax revenues, compounded by poor tax administration, posed a serious threat to stabilization.

Directors welcomed the progress made by transition countries in redefining the role of the state. They expressed concern, however, that government intervention in the economy through various off-budget and quasi-fiscal measures remained a problem, since these activities constituted contingent liabilities with potentially large fiscal costs. (See the section on Fiscal Considerations in Policymaking.) By shielding inefficient state enterprises from market forces, off-budget and quasi-fiscal measures also distorted resource allocation and undermined fiscal stabilization. Directors also underscored the need for strengthening social safety nets, in order to alleviate the adverse effects of enterprise restructuring and other reforms, and for reforming pension plans, in order to secure the progress being made toward fiscal consolidation.

Box 2

SDR SEMINAR ADDRESSES SEVERAL ISSUES

The seminar on the future of the SDR, held in March 1996, brought together a number of outside experts as well as Fund staff. Some of the key questions addressed at the seminar included:

- Does the global economy still benefit from the existence of the SDR?
- Would the SDR's benefits be enhanced by an allocation targeted at specific groups?
- How could the SDR be redesigned to make it more attractive to private financial markets?
- Is the SDR likely to become the principal international reserve asset, an objective set forth in the Articles of Agreement?

Three broad themes emerged from the seminar discussions:

- The prospect of the SDR being established as the principal reserve asset of the international monetary system is unlikely. Nor does the SDR appear destined to evolve from an unconditional line of credit into a full-fledged world currency. Some proposals, requiring amendments to the Articles, were put forward, however, that could facilitate greater demand for SDRs, within the public and private sectors.
- The SDR should not be abolished, because it might provide a valuable "safety net" if the international monetary system got into serious difficulties.
- The Fund and the international community agree on the need to find ways to solve what is known as the equity issue—that is, the fact that many Fund members have never received an SDR allocation.

Other points emerging from the seminar included:

- The impasse over SDR allocations reflects the continuing lack of consensus on how to interpret the criterion for allocation under the Fund's Articles—that there must be a "long-term global need" to supplement existing reserves. On the one hand, several speakers at the seminar emphasized that, although the demand for international reserves is expected to increase in line with the growth of world output and trade, it could be argued that "global need" does not necessarily mean that a large majority of members must simultaneously face a need to supplement their existing reserves. Since the great majority of the Fund's membership faces costs of holding reserves that are substantially higher than the true economic costs of creating reserves, it could be argued that an SDR allocation would meet the criterion of global need. On the other hand, others maintained that the growth in world trade over the past decades does not appear to have been hindered by the limited supply of SDRs, and an expansion of SDRs would not necessarily help to increase world trade. Further, there is currently no shortage of liquidity in the international monetary system, and the current regime of floating exchange rates has nullified the danger of systemic instability in the absence of the creation of additional reserves. Countries could acquire reserves—albeit at a cost—by running a current account surplus or a capital account deficit. The view was also expressed that creating freely usable exchange reserves through SDR allocations for support payments to needy countries would not be appropriate and would be detrimental to the adjustment process.
- Although the present Articles do not permit selective or targeted allocations, some speakers were of the view that a case might be made for a global allocation followed by a voluntary post-allocation redistribution to those countries that would benefit from an enhancement of their reserve assets. Alternatively, amendments to the Articles for a targeted equity allocation could be considered.

Box 3

INITIATIVES TO STRENGTHEN SURVEILLANCE

The Mexican crisis led to important efforts to strengthen Fund surveillance in 1995/96. These efforts have crystallized around three main themes: the provision of economic data, the continuity of surveillance, and the focus of surveillance.

Provision of Economic Data

The quality of surveillance depends critically on the timely availability of reliable data. Thus, the Fund has put additional emphasis on members' data provision for surveillance purposes. A core set of indicators has been identified, which all members are encouraged to report monthly to the Fund. Data issues have also figured more prominently in the annual consultations with members. Where shortcomings in data provision have been identified, a cooperative strategy between the Fund and the members has been devised to remedy them. The Fund is providing technical assistance to members to improve their ability to compile and report economic data.

The timely provision of reliable data to the markets is also of great importance. This issue has been addressed by the Fund, leading to the establishment of a Special Data Dissemination Standard (SDDS) for members having or seeking access to international capital markets. The more general standard for other countries will be established by the end of 1996. The issue of data standards is discussed in the next section.

Continuity of Surveillance

The globalization of international capital markets and the rapidity of developments in these markets following changed perceptions of a country's economic fundamentals put a premium on the continuity of Fund surveillance. Thus, the Fund has taken a number of initiatives to make its surveillance more continuous:

- For some members, annual consultations have been supplemented with interim staff visits. In several cases, Fund management has followed up on the Board's annual consultation discussions with letters to country authorities on important policy issues.
- The frequency of informal meetings, in which Directors review major recent developments in selected member countries, has been increased to once a month; these are designed to facilitate the early identification of emerging financial tensions through focusing on potential problems and providing additional factual material.
- Biannual Board discussions of members' policies in the context of surveillance have been instituted to review the principal issues repeatedly surfacing in consultations with members; a report of these discussions is transmitted to the Interim Committee, thus providing a bridge between the Board's daily work on surveillance and the Committee's oversight role.

Focus of Surveillance

The evolution of the world economy calls for greater attention to new issues and risks. At the same time, traditional areas of surveillance should not be neglected. To make these competing objectives compatible, the following principles have been agreed upon:

- Article IV consultations will concentrate on core topics directly linked to the Fund's statutory mandate to exercise "surveillance over exchange rate policies of members."
- Greater attention will be paid to capital account developments.
- Countries where developments have potential spillover effects on others will be more closely followed.
- Where important economic policies are formulated at a supranational level, with a potential impact on several national economies, the Fund will continue to strengthen its focus on regional surveillance.

Box 4

INITIATIVES IN OPENNESS

In its surveillance activities, the Fund encourages countries to be open in disseminating economic information and in explaining reforms fully to the public. It also encourages them to promote debate and discussion of policies and consensus building for policy choices. Better understanding of economic policies by the public enhances the credibility and acceptability of policies and also ensures accountability on the part of governments.

Similarly, in recent years the Board has increasingly supported greater transparency in the Fund's policies and activities, opening up the work of the institution to more intensive public scrutiny. In all such initiatives, issues have been debated carefully, balancing the desire to promote improved public awareness and understanding of the Fund's responsibilities and of the benefits of economic reforms with the need to take account of the critical importance of maintaining confidentiality in the Fund's relations with members so as not to jeopardize the frankness, candor, and content of the Fund's policy discussions with members.

Release of Information

Greater openness has implied a wider range of information on the Fund being provided to a broader audience. In July 1994 Directors approved the release of background reports on recent economic developments and related matters that are prepared for the Fund's Article IV consultations with members. In the 1995/96 financial year, 136 reports were released (see Appendix IV). The Fund has also encouraged countries to disclose details of their Fund-supported adjustment programs by releasing the letter of intent and, when such a document is drawn up, the policy framework paper prepared in close collaboration with staff of the World Bank as well as of the Fund. In recent years, the coverage of the *Annual Report* has increased considerably, including an expansion of information on Article IV consultation discussions with individual members: 23 countries were covered in the 1993 Report, and 34 in this year's Report. The Fund's publications program has also grown substantially, with publication of a larger number of analytical papers discussed by the Board. For the first time, in early 1996 the Fund issued a "Green Paper" soliciting reactions from market participants and policymakers in preparation of its initiative on developing standards for data dissemination.

Public Access

As part of the ongoing efforts toward greater openness, in January 1996 the Board agreed to grant access by the public, on request, to documentary materials held in the Fund's archives that are over 30 years old, subject to certain provisions. Documents originally classified as "secret" or "strictly confidential" will be released upon the Managing Director's consent to their declassification, which is expected to be granted in virtually all instances.

Box 5

FUND DATA STANDARDS AT A GLANCE

The data dissemination standards considered by the Board are designed to provide the public with comprehensive, timely, accessible, and reliable economic and financial statistics in a world of increasing economic and financial integration. They consist of two tiers: a *general data dissemination standard*, which provides guidance to all member countries for publishing data; and a *Special Data Dissemination Standard* (SDDS), which provides guidance to countries participating in international financial markets or aspiring to do so.

The two tiers have the same four dimensions, with the special standard setting more demanding norms for the first dimension. The following gives an overview of the four dimensions of the SDDS, which is now open for countries to subscribe to:

(1) *Coverage, periodicity, and timeliness.* The SDDS focuses on basic data that are most important in shedding light on economic performance and policy in four sectors across the economy. The data categories and components that are prescribed or encouraged are shown in Table 3.

The SDDS prescribes the minimum coverage necessary, but countries are encouraged to disseminate other relevant data. Periodicity refers to the frequency of compilation, and timeliness refers to the speed of dissemination (that is, the lapse of time between a reference date and dissemination of the data).

(2) *Access by the public.* Ready and equal access to basic data is a principal requirement for the public, including market participants. To support such access, the SDDS prescribes (a) advance dissemination of release calendars and (b) simultaneous release to all interested parties.

(3) *Integrity.* To fulfill the purpose of providing the public with information, official statistics must have the confidence of their users. In turn, confidence in the statistics ultimately becomes a matter of confidence in the objectivity and professionalism of the agency producing the statistics. Transparency of its practices and procedures is a key factor in creating this confidence. To assist users in assessing integrity, the SDDS prescribes (a) dissemination of the terms and conditions under which official statistics are produced, including those relating to the confidentiality of individually identifiable information; (b) identification of internal government access to data before release; (c) identification of ministerial commentary on the occasion of statistical release; and (d) provision of information about revision and advance notice of major changes in methodology.

(4) *Quality.* Although quality is difficult to judge, monitorable proxies, designed to focus on information the user needs to judge quality, can be useful. To assist users in assessing quality, the SDDS prescribes (a) dissemination of documentation on methodology and sources used in preparing statistics; and (b) dissemination of component detail, reconciliations with related data, and statistical frameworks that support statistical cross-checks and provide assurance of reasonableness.

Box 6

FUND FACILITIES AND POLICIES

The Fund provides financial assistance to its members through several facilities and policies tailored to members' needs. The size of the Fund's financial support and the conditionality attached to it vary according to the nature of the macroeconomic and structural problems that the member seeks to address and the Fund facility or policy designed to meet this need. Access to Fund resources is determined in relation to a member's quota. In October 1994—in order to give confidence to members that the Fund would be able to respond quickly and on an appropriate scale in support of strong programs of economic adjustment—the Board increased for three years the annual access limit in the General Resources Account (GRA) from 68 percent to 100 percent of quota, while keeping the cumulative access limit unchanged at 300 percent of quota.

Regular Facilities

Credit tranche policies. The Fund's credit under its regular facilities is made available to members in four tranches or segments of 25 percent of quota each. For first credit tranche purchases, members are required to demonstrate reasonable efforts to overcome their balance of payments difficulties. Upper credit tranche purchases are normally associated with stand-by arrangements. These typically cover periods of one to two years and focus on macroeconomic policies—such as fiscal, monetary, and exchange rate policies—aimed at overcoming balance of payments difficulties. Performance criteria to assess policy implementation—such as budgetary, credit, and external debt ceilings and targets for reserves—are applied during the period of the arrangement, and purchases are made in quarterly installments. Repurchases are made in 3¼ to 5 years.

Extended Fund facility (EFF). In addition to stand-by arrangements, the Fund makes credit available for longer periods under extended Fund facility arrangements. Under the EFF, the Fund supports medium-term programs that generally run for three years (up to four years in exceptional circumstances) and are aimed at overcoming balance of payments difficulties stemming from macroeconomic and structural problems. Typically, a program states the general objectives for the three-year period and the specific policies for the first year; policies for subsequent years are spelled out in program reviews. Performance criteria are applied, and repurchases are made in 4½ to 10 years.

Special Facilities

Compensatory and contingency financing facility (CCFF). The purpose of this facility is twofold. The compensatory element provides resources to members to cover shortfalls in export earnings and services receipts and excesses in cereal import costs that are temporary and arise from events beyond their control. The contingency element helps members with Fund arrangements to maintain the momentum of reforms when faced with a broad range of unforeseen adverse external shocks, such as declines in export prices, increases in import prices, and fluctuations in interest rates. Repurchases are made in 3¼ to 5 years.

Buffer stock financing facility. Under this facility the Fund provides resources to help finance members' contributions to approved buffer stocks. Repurchases are made in 3¼ to 5 years.

Emergency Assistance

In addition to balance of payments support under its regular and special facilities, the Fund provides emergency assistance in the form of purchases to help members overcome balance of payments problems arising from sudden and unforeseeable natural disasters or in post-conflict situations. Such purchases involve neither performance criteria nor, normally, the phasing of disbursements. Repurchases must be made in 3¼ to 5 years.

Facilities for Low-Income Countries

Structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF) arrangements. Under these facilities the Fund provides resources on concessional terms to support medium-term macroeconomic adjustment and structural reforms in low-income countries facing protracted balance of payments problems. The member develops and updates, with the help of the Fund and the World Bank, a medium-term policy framework for a three-year period, which is set out in a policy framework paper. Within this framework, detailed yearly policy programs are formulated and are supported by SAF or ESAF arrangements. ESAF arrangements differ from SAF arrangements in the scope and strength of structural policies, and in terms of access levels, monitoring procedures, and sources of funding. All available resources under the SAF were fully utilized as of December 1995, and no further SAF commitments are expected. There was broad consensus in the Board at an April 1995 meeting that an ESAF-type facility should continue to be available, provided that the revolving nature of the Fund's resources and the monetary character of the Fund were respected. Directors also agreed that the basic modalities of the existing ESAF had worked well and should be retained. SAF and ESAF programs include quarterly benchmarks to assess performance. The rate of interest on SAF and ESAF loans is 0.5 percent, and repayments are made in 5½ to 10 years.

Box 7

GUIDELINES ON PERFORMANCE CRITERIA WITH RESPECT TO FOREIGN BORROWING

The Executive Board adopted a decision in October 1995 to modify a 1979 decision establishing guidelines on performance criteria with respect to foreign borrowing. The main rationales for such performance criteria are to ensure the overall consistency of the monetary and financial program so that restraint of domestic demand is not threatened by unforeseen foreign borrowing, and to prevent an undue buildup of external debt during the medium term.

The guidelines on the performance criteria with respect to foreign borrowing provide that when the size and the rate of growth of external indebtedness is a relevant factor in the design of an adjustment program, a performance criterion relating to official and officially guaranteed foreign borrowing will be included in arrangements subject to upper credit tranche conditionality. The criterion will include foreign loans with maturities of over one year and, in appropriate cases, other financial instruments that have the potential to create substantial external liabilities for governments.

Flexibility will be exercised to ensure that the use of the performance criterion will not discourage capital flows of a concessional nature by excluding concessional loans from the coverage of performance criteria. Under the new guidelines, loans will be treated as concessional if they have a grant element of at least 35 percent, calculated on the basis of currency-specific discount rates based on the OECD Commercial Interest Reference Rates (CIRRs). A higher grant element may be required in exceptional cases. Normally, the performance criterion will include a subceiling on foreign debt with maturities of over one year and up to five years. Additional subceilings may also be included on debt with specified maturities beyond five years or with a specified grant element lower than 35 percent (see Appendix V).

The Board further decided in April 1996 that, to avoid frequent changes in the assessment of concessionality, six-month average CIRRs will be used to calculate the concessionality of loans, and 10-year average CIRRs to calculate the concessionality of loans with a repayment period of 15 years or more.

Box 8

THE EMERGENCY FINANCING MECHANISM AND SUPPLEMENTARY BORROWING

Use of the emergency financing mechanism would involve exceptional procedures that, in the event a member faced a financial crisis, would facilitate a rapid response by the Fund. In certain situations, there may also be a need for large and front-loaded access to Fund resources.

However, there is not necessarily a link between use of emergency financing mechanism procedures and either the level of access to Fund resources or the need for supplementary financing.

Therefore, no formal link has been established between the emergency financing mechanism and the General Arrangements to Borrow or other supplementary borrowing arrangements.

Box 9

GUIDELINES FOR FUND SUPPORT FOR CURRENCY STABILIZATION FUNDS

General Considerations

Framework and purpose. In the framework of an upper credit tranche stand-by or extended arrangement, Fund financial support for the specific purpose of establishing a currency stabilization fund could provide, for a transitional period, additional confidence in support of an exchange-rate-based stabilization strategy. For currency stabilization funds to play their intended role, economic policies would need to be sufficiently tight to deliver an inflation path compatible with the targeted exchange rate anchor, so that little, if any, use of the currency stabilization fund would be expected. It would also be understood that economic policies would be adapted promptly as necessary in response to changing circumstances, and that the underlying program would be fully financed.

Adjustment strategy. Fund support for currency stabilization funds would be considered in cases of high inflation where a nominal exchange rate anchor is part of a comprehensive adjustment strategy to sharply reduce inflation from high levels and, where close monitoring is possible, to ensure that the exchange rate anchor and supporting policies continue to be appropriate.

Exchange rate arrangement. The most appropriate arrangement to be supported by a currency stabilization fund would be an exchange rate peg with relatively narrow margins, or a preannounced crawl.

Policy conditions. Policy conditions for Fund support for a currency stabilization fund would include (1) fiscal adjustment and credit creation consistent with targeted inflation, (2) appropriate measures to deal with backward-looking automatic wage and other indexation schemes, (3) establishment of current account convertibility and an open trade regime, (4) contingency plans to deal with large capital account outflows or inflows, (5) integrated management of foreign exchange reserves and intervention policy, and (6) other structural and institutional elements designed to reduce inflation sharply.

Cofinancing. While cofinancing would be considered, the Board would retain control over the use of all Fund resources in support of a currency stabilization fund; cofinancing should not complicate the operations of the currency stabilization fund; the terms of resources provided through cofinancing would be at least as favorable to the borrower as those associated with Fund financing; and cofinancing resources should not affect the safeguarding of Fund resources and the Fund's preferred creditor status.

Operational Characteristics

Structure. A currency stabilization fund would be established as a "window" within a Fund upper credit tranche arrangement and would have revolving features permitting repeated use under specified conditions. ESAF-eligible members would be able to use such stabilization funds through arrangements that would operate parallel to an ESAF arrangement.

Access. Access under a currency stabilization fund could be up to 100 percent of quota but would be subject to the limits applicable to stand-by and extended arrangements. Actual access would vary on a case-by-case basis, depending on the assessed need for reserves.

Tranches. Normally, a currency stabilization fund would have four equal tranches, although there would be some flexibility to vary both the number and the size of tranches.

Reporting requirements. Daily reporting of key financial variables would be expected and would be specified in the documentation establishing a currency stabilization fund. These requirements could be modified as a condition for approving availability of resources from the currency stabilization fund or for completing reviews under the program.

Other operating procedures for a currency stabilization fund, such as activation provisions, repurchase and reconstitution obligations, and charges were also specified in the guidelines.

Box 10

OPERATIONAL BUDGET

In accordance with principles laid out in the Fund's Articles of Agreement, the Board adopts for each upcoming quarterly period an operational budget specifying the amounts of SDRs and selected members' currencies to be used in purchases, repurchases, and other Fund financial operations and transactions expected to take place during that period.

Assessment of Members' External Positions

An important element of each quarterly operational budget is the selection of those members with sufficiently strong external positions to warrant the inclusion of their currencies for use in outward transfers under the operational budget. The currencies of these members are then made available for purchase by members experiencing balance of payments difficulties. In proposing a member country for inclusion in the operational budget and designation plan (see Box 12), the Fund takes into account recent and prospective movements in the member's gross reserves, developments in its balance of payments, the relationship of the member's gross reserves to its imports and Fund quota, and developments in exchange markets; recent movements in the member's net reserves are also taken into account, to the extent that the necessary data are available. The balance of payments and gross reserve positions of a country are considered jointly, and strength in one element may compensate for moderate weakness in the other. In practice, the assessment of a member's combined balance of payments and reserve position involves a significant element of judgment.

Convertibility

The members whose currencies have been proposed for use in transfers by the Fund are obliged to convert them into one of the five freely usable currencies at the request of purchasing members. In exchange for the use of their currencies in transfers, "strong members" receive a claim on the Fund in the form of an increase in their reserve tranche position that can be drawn without challenge in the case of balance of payments need.

Guidelines on the Use of Currencies

The Board has established a set of guidelines governing the allocation of the amounts of currencies to be used in both transfers and receipts under the Fund's operational budget. The present guidelines call for the use of currencies on the *transfers side* of the budget (that is, the currencies that finance extensions of Fund credit) to be determined in proportion to members' holdings of gold and foreign exchange reserves. A limit is, however, placed on the use of a member's currency in transfers, so that the Fund's holdings of that currency do not fall below two thirds of the Fund's average holdings, expressed in percent of quota, of members' currencies included in the budget. The guidelines specify that transfers of U.S. dollars be made on the basis of ad hoc proposals, with the aim of maintaining, to the extent possible, and in relation to quotas, the Fund's holdings of U.S. dollars close to the average level of the Fund's holdings of other members' currencies included in the budget.

On the *receipts side* (that is, the currencies used primarily to service past extensions of Fund credit), the guidelines call for the allocation of currencies to be determined in relation to members' reserve tranche positions in the Fund. The Board reviews the guidelines governing the allocation of currencies under the operational budget periodically to ensure that the objective of promoting "balanced positions" in the Fund over time is achieved. On the occasion of the last review, in February 1995, it was decided to continue to apply the present guidelines until the end of December 1996.

Box 11

THE FUND'S HOLDINGS OF GOLD

As of April 30, 1996, the Fund held about 103.4 million fine ounces of gold at four designated depositories, valued in the Fund's financial statements at SDR 3.6 billion on the basis of SDR 35 per fine ounce (except for a minor amount acquired in 1992 in partial settlement of a member's overdue obligations, and valued at the then-prevailing market price).[1] These holdings represent the balance of the Fund's stock of gold after the gold auctions to finance the Trust Fund, a concessional facility for eligible low-income countries, and the restitution of gold to members in the period 1976–80.

Following the Second Amendment of the Articles of Agreement in April 1978, the monetary role of gold was eliminated from the Articles. Among other changes, the Second Amendment eliminated gold as the basis of the value of the SDR, abolished the official price of gold (0.888671 gram of fine gold per SDR), removed the limits to the price at which members may deal in gold, ended restrictions on dealings in gold among member countries, and required the Fund to be guided by the objective of avoiding the management of the price, or the establishment of a fixed price, in the gold market. In addition, the Second Amendment eliminated the obligatory use of gold as a means of payment to and by the Fund and also barred the use of gold as a currency peg by members of the Fund. Any use of gold in payments must be acceptable to both the Fund and the members using it. The Fund can accept gold in settlement of obligations only if approved by members holding 85 percent of the total voting power.

While gold is reflected as an asset in the Fund's balance sheet and financial statements, it is not used in the Fund's operations and transactions, and any disposal of the remaining stock of the Fund's gold requires approval by an 85 percent majority of the total voting power. The Fund may sell gold but may not engage in such gold transactions as loans, leases, or swaps, and may not use gold as collateral. Even after sale, the use of the proceeds is subject to specific provisions of the Fund's Articles.

In 1995 the Executive Board reviewed the role of gold in the Fund. The Board concluded that use of the Fund's gold must take account of the overriding need to maintain and, where possible, strengthen the Fund's financial base. In this regard, there was broad agreement that the Fund's policy on gold should be governed by the following principles:

- As an undervalued asset held by the Fund, gold provides a fundamental strength to the Fund's balance sheet. Thus, any mobilization of the Fund's gold should avoid weakening the Fund's overall financial position.
- The Fund's gold holdings provide the Fund with operational maneuverability both as regards its policies on the use of its resources and through adding credibility to the level of the Fund's precautionary balances. In these respects, the benefits of the Fund's gold holdings are passed on to the membership at large, to both creditors and debtors.
- The Fund should continue to hold a relatively large amount of gold among its assets, not only for prudential reasons, but also to meet unforeseen contingencies.
- The Fund has a systemic responsibility, given that it is the second-largest official holder of gold in the world, with about 10 percent of total official gold stocks of member countries. The Fund must take great care to avoid causing disruptions that would have an adverse impact on all gold holders and gold producers, as well as on the functioning of the gold market.
- The importance attached to the view that a sale of gold by the Fund must not weaken its financial position, and if possible should strengthen it, means in practice that the capital profits of any sale of gold should be retained and only the income deriving from the investment of those profits used for any current operations that might be agreed.

Also in the course of 1995/96, in the context of discussions on the modalities of financing a self-sustained ESAF, Directors considered the possibility of use of a modest amount of the Fund's gold. While there was general agreement that any such mobilization should reflect the principles outlined above, the necessary 85 percent voting majority required for a sale of gold has not been forthcoming.

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[1] On the basis of the market price prevailing on April 30, 1996, the Fund's holdings would be valued at US$40.3 billion (SDR 27.8 billion).

Box 12

DESIGNATION PLAN

Article XIX of the Fund's Articles of Agreement provides for a designation mechanism under which participants whose balance of payments and reserve positions are deemed sufficiently strong are obliged, when designated by the Fund, to provide freely usable currencies in exchange for SDRs up to specified amounts. The designation mechanism ensures that in case of need participants can use SDRs to obtain foreign exchange reserves at short notice. The participant wishing to sell its SDRs in transactions with designation is required to make a representation to the Fund that it has a need to use its SDRs. While a request to sell SDRs through designation cannot be challenged at the time of use, the Fund examines recent developments in the participant's combined balance of payments and reserve position immediately afterward to determine that the requirement of need has been met, that is, the use of SDRs was in accordance with Article XIX, Section 3(*a*). If, in the judgment of the Fund, the transaction was not in accordance with that Article, the participant may be designated to receive SDRs in order to offset the effect of the previous use. Adherence to the principle of this Article ensures that SDRs are not used under designation for the sole purpose of changing the composition of reserves.

The designation mechanism is executed through quarterly designation plans, approved by the Board, which list participants subject to designation and set maximum limits on the amounts of SDRs they can be designated to receive during the quarter. Apart from a participant being "sufficiently strong" for designation, the amounts of designation for individual participants are determined in a manner that promotes over time equality in the "excess holdings ratios" of participants (that is, SDR holdings above or below allocations as a proportion of participants' official gold and foreign exchange reserves). A participant will therefore be subject to designation if its excess holdings ratio is below the projected common ratio used in calculating the proposed plan. A participant's obligation to provide currency against SDRs in designation is limited, however, to twice the level of its net cumulative allocations, unless the participant and the Fund agree to a higher limit.

Since September 1987 there have been no transactions with designation as potential exchanges of SDRs for currencies have been accommodated through voluntary transactions by agreement with other participants, primarily the 12 participants that have established with the Fund standing arrangements to buy or sell SDRs for one or more freely usable currencies at any time, provided that their SDR holdings remain within a certain range. These "two-way" arrangements have helped accommodate members' desires to both buy and sell SDRs and have facilitated the circulation of SDRs in the system.

Box 13

THE EVALUATION FUNCTION IN THE FUND

The Fund has a long tradition both of extensive interdepartmental review of its operational activities on a day-to-day basis, and of periodic in-house evaluation of core areas of its work that is reviewed by the Board. Occasional studies are also commissioned from outside experts on aspects of that work. Partly for this reason, and in keeping with the objective of maintaining a lean organizational structure and containing costs, the Fund—unlike most multilateral development banks—does not have a separate evaluation unit.

During 1995/96, the Board reexamined the Fund's evaluation functions. At a meeting in February 1996, it confirmed its desire to strengthen these functions. It adopted, for a two-year trial period, a pragmatic approach on the basis of which it would identify annually with management which activities of the Fund would warrant an evaluation study, and would set the terms of reference for each project, including the selection of outside experts. The number of studies would realistically be limited to two or three a year.

It was also agreed that the existing practices for in-house evaluation carried out by the staff should be strengthened, as well as the review and evaluation work undertaken by the Board as part of its regular activities.

As part of this effort, the Office of Internal Audit and Review was reorganized and redesignated the Office of Internal Audit and Inspection, effective May 1, 1996. The mandate of the office was expanded to permit it to conduct more reviews of all aspects of the Fund's organizational structure and work practices. It could also be drawn upon to assist the Board and management in developing and facilitating the agreed evaluation projects.

Box 14

DEPARTMENTS OF THE FUND AND THEIR MAJOR RESPONSIBILITIES

The major activities of the Fund comprise the areas of surveillance, the use of Fund resources, and technical assistance, and its departmental structure is designed to support these activities (see Chart 12). Surveillance is at the heart of the Fund's operations. Recent developments, including the trend toward globalization, have reaffirmed the essential need for surveillance to foster policy cooperation. Not surprisingly, therefore, surveillance-related activities, including multilateral surveillance work and the data dissemination initiative, form the largest category of the Fund's work load, directly absorbing about a quarter of staff resources. Use of Fund resources work—including program design, negotiation, and implementation; mobilizing other financial resources; financial operations; and policy development, research, and evaluation work related to the use of Fund resources—absorbs one fifth of staff resources. Technical assistance and training, mainly in the central banking, fiscal, and statistical fields, draw on more than one tenth of staff resources. The remainder of staff resources is devoted to administrative support, support for the Board of Governors and Executive Board, training, professional development, and related activities, and external relations.

Area Departments

The primary function of the *area departments* is to advise management and the Board on matters concerning the economies and economic policies of the member and nonmember countries in their areas, to assist in the formulation of Fund policies in relation to these countries, and to carry out such policies. The area departments are also at the center of the use of Fund resources. Area department staff negotiate arrangements for the use of Fund resources with member country authorities for approval by the Board and review and document performance under Fund-supported arrangements. In cooperation with other departments, the area departments provide these countries with policy advice and technical assistance and maintain contact with regional organizations and multilateral institutions in their areas.

The bulk of the Fund's bilateral surveillance work is carried out by the area departments through their direct contacts with member countries, supplemented by staff in functional departments, in part through their participation in area department missions. In response to the need for strengthened surveillance, increased attention is being given to those economies that are of systemic importance to the international monetary system. In addition, in 1996/97, the number of resident representatives assigned to member countries is being expanded.

Functional and Special Services Departments

The *Fiscal Affairs Department* is engaged in all Fund activities involving the public finance of member countries. It participates in area department missions focusing on fiscal issues, reviews the fiscal content of Fund policy advice and of Fund-supported adjustment programs, and provides technical assistance in public finance. It also conducts research and policy studies on fiscal issues and is primarily responsible for work on income distribution and poverty, social safety nets, public expenditure policy issues, and the environment.

The *IMF Institute* provides technical assistance through training officials of member countries, particularly developing countries, in a wide range of topics, including financial programming and policy, external sector policies, balance of payments methodology, national accounts and government finance statistics, and public finance.

The *Legal Department* advises management, the Board, and the staff on the applicable rules of law. It prepares most of the decisions and other legal instruments necessary for the Fund's activities. It acts as counsel to the Fund in litigation and arbitration cases, provides technical assistance to members for legislative reform, and responds to inquiries of national authorities and international organizations on the law of the Fund.

The *Monetary and Exchange Affairs Department* provides technical assistance to central banks of members in a number of areas, particularly on monetary and exchange rate policies, banking supervision, and prudential regulation, and on issues related to the functioning of payments systems. Specialized short- and long-term experts are placed in central banks that request assistance in these areas. The department supports the work of area departments, by reviewing topics in its area of expertise in the context of surveillance and requests for the use of Fund resources. It also contributes to the exercise of Fund jurisdiction on exchange practices and restrictions. In addition, it carries out research and training, including through workshops and seminars, in coordination with cooperating central banks.

The *Policy Development and Review Department* plays a central role in the design and implementation of Fund financing facilities and operations related to the use of Fund resources under those facilities, in the development and application of policies regarding Fund surveillance, and in other areas as directed by management. Together with the Research Department, it is a lead department in the areas of multilateral surveillance, policy coordination, and associated review and support activities. It carries out its responsibilities through the preparation of Board papers, through the review process, and through participating in operational work, including country missions. In conjunction with area departments, it has a large role in mobilizing other financial resources for members availing themselves of Fund assistance, including work on debt and program financing (through the Paris Club and international banks).

The *Research Department* carries out policy analysis and research in areas relevant to the Fund's work. This includes research on the international monetary system, the world economic situation and outlook, issues of external debt and the international financial markets, the international adjustment process and program design, and exchange rates, capital flows, and trade flows. The department plays a leading role in the development of Fund policy directed at the working of the international monetary system, the surveillance function, and, in cooperation with other departments, in the analysis and design of the Fund's policy advice to member countries. It also coordinates the semiannual interdepartmental forecasting exercise and the drafting of the *World Economic Outlook* and the *International Capital Markets* reports, as well as the analysis for the Group of Seven policy coordination exercise and background notes for other ministerial meetings and for the Board's seminars on World Economic and Market Developments. The department develops and maintains the Fund's contacts with the academic community and with other research organizations.

The *Statistics Department* has responsibility for assembling and maintaining a time-series database of country, regional, and global economic and financial statistics and for the review of country data in support of the Fund's surveillance role. It is also responsible for the development of statistical concepts in balance of payments, government finance, and money and financial statistics, and for producing methodological manuals in these areas. The department provides technical assistance and training in support of the development of members' statistical systems and produces the Fund's statistical publications. In addition, it is responsible for the development and maintenance of standards for the dissemination of data by member countries.

The main functions of the *Treasurer's Department* are (1) the formulation of the Fund's financial policies and practices; (2) the conduct and control of all financial operations and transactions in the General Department, SDR Department, and Administered Accounts (including the ESAF Trust and related accounts); (3) the payment and control of expenditures under the administrative and capital budgets; and (4) the maintenance of the Fund's accounts and financial records. In this context, the department undertakes work on quotas, borrowing, the Fund's liquidity, and the Fund's policies on its currency and gold holdings. It reviews the financial terms and conditions of Fund operations and transactions, including repurchases, the level of precautionary balances and burden-sharing arrangements, the income target, the rate of charge, overdue financial obligations, and policies on the SDR, including the method of valuing the SDR and SDR interest rate. The department is responsible for the Fund's policies on accounting and on financing its capital projects and expenditures.

Information and Liaison

The *External Relations Department* is concerned with the editing, production, and promotion of the Fund's nonstatistical publications; the provision of information services to the press and the general public; and maintenance of contacts with nongovernmental organizations and member country parliamentary bodies.

The Fund's Offices in Europe, in Geneva, and at the United Nations are charged with maintaining close contacts with other international and regional institutions in the areas of their responsibilities.

Support Services

This category comprises the *Administration Department,* the *Secretary's Department,* Bureaus, and Offices. The Administration Department is responsible for the personnel and space management activities of the Fund. It manages recruitment, training, and career planning programs; supervises the operation of the headquarters building and leased space; provides administrative services to the Fund; and administers the Joint Fund-Bank Library. The Secretary's Department assists management in preparing and coordinating the work program of the Board and other official bodies, including scheduling and assisting in the conduct of Board meetings. The department also manages the Annual Meetings, in cooperation with the World Bank, and is responsible for the Fund's archives, communications, and security program. The Fund's bureaus and offices are responsible for such aspects as computer services, language services, auditing, budget matters, technical assistance, work practices, and investments under the staff retirement plan.