

INTERNATIONAL MONETARY FUND

**THE MANAGING DIRECTOR'S REPORT ON
THE FUND'S MEDIUM-TERM STRATEGY**

September 15, 2005

- This paper brings together the many formal and informal discussions over the past year between the staff, management, and the Executive Board on the strategic direction of the Fund. Some ideas have also been discussed with country authorities and with outside observers, as part of the Fund's normal outreach and consultation. While not comprehensive in scope, the paper does aim for a shared vision that could inform the day-to-day work and decisions of the Fund.
- The report draws on the work of the Committee on the Strategic Review of the Fund, chaired by Ms. Krueger, and comprising Messrs. Carstens, Kato, Allen, Burton, Brown, Dawson, Deppler, Hagan, Ingves, Kincaid, Kuhn, Marquez-Ruarte, Potter, Rajan, and Ms. Ter-Minassian.
- This document will be posted on the Fund's external website following its circulation to the International Monetary and Financial Committee.
- A broad endorsement from the membership will trigger follow-up work, including more detailed proposals in many areas and the presentation of a three-year medium-term budget that reflects the priorities suggested here.

I. BACKGROUND

1. **Motivation.** Last year, on the 60th anniversary of the founding of this institution, a consensus emerged on the need to reflect on the future direction of the Fund. Despite a generally positive assessment of the organization's work and adaptability, at least three factors prompted a desire for critical self-reflection:

- First, there is a sense that the challenges of the past decade have pulled the Fund in too many new directions—further straining the original vision of an institution devoted to international monetary stability and the financing of temporary balance of payments problems. Thus, the emerging-market crises of the 1990s elicited major initiatives on data transparency, standards and codes, and financial sector and safeguards assessments, while the response to 9/11 pushed the Fund into combating the financing of terrorism and anti-money laundering. The Fund's role in low-income countries too has expanded to now cover poverty reduction strategies, requiring more staff and more coordination with international institutions, donors, and civil society.
- Second, the accretion of new mandates, without eliminating old ones, has made it difficult to allocate resources effectively and to stay ahead of emerging challenges.
- Third, there is the question of whether the Fund is fully prepared to meet the great macroeconomic challenges that lie ahead. Among other things, these include tackling unprecedented global payments imbalances, responding to capital account crises caused by abrupt shifts in global asset allocation, and helping all members, especially low-income countries, to grow by integrating into the world economy.

2. **Objective.** If the Fund is to remain in step with a rapidly changing world, it must identify an organizing principle that defines its mission and prioritizes its elements. This is the subject of section II. It must also outline a strategy that explains how the Fund might reorganize itself to meet its objectives with concrete actions and outcomes for the next 3–5 years, and do so in a way that addresses the concerns of the entire membership. This is the goal of section III. Some concluding observations are offered in section IV. Finally, a caveat: the thinking is more advanced in some areas than in others, and important details can only be settled once there is a consensus on the way forward. As such, this is very much a strategy paper, not a five-year plan.

II. THE CHALLENGE OF GLOBALIZATION

3. **Its pervasiveness for the membership.** The most important force at play in the world economy today is that of globalization. Real sector globalization—the transfer of goods, services, technology, and production chains across countries—has brought enormous benefits in terms of growth and economic efficiency. Financial globalization is even more advanced in allocating world savings to more productive and diversified investments. But even as it has

pulled the world economy in a hugely beneficial direction, the undercurrent of globalization is also responsible for the scale of the greatest challenges facing the membership:

- The size of world current account imbalances today, and the associated risk of disorderly adjustment, would not have been possible were it not for globalization. Financial market integration has created a global savings pool, enabling some nations to run far larger current account deficits than otherwise, as counterparts with surpluses diversify asset holdings or insure against crises by building up reserves.
- The difficulties associated with the integration of goods and services markets cut across the membership. Chinese efficiency in textiles affects producers in developed and developing countries alike, as does the rise of information and technology services in India. And major efforts would still be needed to modernize the all important cotton sector in West Africa to enable the region to compete with new production techniques in Brazil, China, and India—even if long-standing domestic subsidies in the United States and the European Union were removed at a stroke.
- The integration of capital markets has increased the size, speed, and reach of shocks across mature and emerging-market countries. The fallout from the Mexican crisis may have been relatively contained, but Thailand's problems in 1997 soon spread to much larger economies in Asia. Russia's crisis in 1998 did not just hit Brazil but, via the collapse of Long-Term Capital Management, was also a near miss for an important segment of the financial system in the United States.

4. ***Its centrality to the Fund's mission.*** After two world wars, a world recession, and many competitive devaluations, the international community conceived the Fund in 1944 as a cooperative institution committed to fostering global integration (real globalization), albeit with controls and structures that enabled countries to do so gradually. This mission was enshrined in the first Article of Agreement. But twenty-first century globalization—with overwhelming movements in capital and abrupt shifts in comparative advantage—has altered the context of the Fund's mission. It is not that globalization is new, for clearly it is not, but rather that it is now quantitatively and qualitatively different, and this has exposed gaps in the day-to-day work of the Fund:

- *Surveillance.* The Fund's main products—the World Economic Outlook, the Global Financial Stability Report, and Article IV reports—rank among the best of their kind. Yet even these do not always come to grips with the full dimensions of globalization and its implications for individual countries, regions, or indeed the world as a whole. Moreover, even in an age of globalized communication, Fund advice too often fails to secure timely changes in policies, frameworks, and institutions.
- *Lending facilities.* Globalization has vastly increased the size of private capital flows relative to official flows and Fund quotas, albeit unevenly so. While new financing modalities have become available, there have been calls for an even wider menu. Thus, many emerging-market countries see an unmet need for insurance against large

and volatile capital flows. Among low-income countries, the needs have become more differentiated, some requiring debt relief, others concessional financing, and some no financing at all, but rather signaling and policy support.

- *Governance.* Not only are there different challenges for the membership to face, but also different faces in the membership: newly independent countries have joined, and the economic weight and role of many have changed beyond recognition. This development has raised deep concerns over fair quotas and voice, straining the legitimacy of the institution.

5. *Its potential as an organizing principle.* In what way might globalization serve as an organizing principle for the work of the Fund? A central tenet of the Fund's work should be to help members meet the challenge of globalization—but this means different things to different members. For some, it may be better fiscal and monetary frameworks; for others, structural reforms—rather than protectionism—to adapt to rising trade; and for still others it may imply strengthening the financial system. Correspondingly, these differing needs provide a basis for Fund country teams to prioritize their outputs. For some teams, careful surveillance of emerging risks and trends may be of greatest importance; for others, it may be Fund programs to relieve or forestall a crisis or to catalyze donor aid; and in still others, technical assistance to build institutions that promote policy credibility are paramount.

6. *Conclusion.* Globalization is not a cause but rather a reality for countries to come to grips with. The Fund's role in helping members to adapt is well anchored in its first Article of Agreement mandate to promote a stable and open trading system, which seeks to avoid the destructive protectionism and beggar-thy-neighbor policies that prompted the creation of the institution. Viewing the challenges through the lens of globalization holds the potential to prioritize the elements of the Fund's well-defined mandate in the macroeconomic area and to address the criticisms of limited effectiveness, focus, and preparedness to face the future.

III. THE ELEMENTS OF A RESPONSE

7. *Tasks.* Using the above framework, this section explains what changes might be needed in the Fund's principal outputs—surveillance, financing, capacity building—and in its governance structures. The key tasks are to:

- i. make surveillance more effective;
- ii. adapt to new challenges and needs in different member countries;
- iii. help build institutions and capacity;
- iv. prioritize and reorganize work within a prudent medium-term budget; and
- v. address the issue of fair quotas and voice.

A. More Effective Surveillance

8. *Issue.* Surveillance is one of the most important public goods supplied by the Fund. Over the years, regular Board reviews have sought to strengthen the institution's global and

country surveillance, which assume heightened significance in a globalized world with quickly transmitted shocks. The many recommendations can be summarized in two words: focus and context. These we must certainly build on, with less cover-the-waterfront reporting on economies, more incisive analysis of specific weaknesses and distortions that risk crises and contagion or hinder adjustment to globalization, and more active Fund engagement in the policy debates that shape public opinion and policy choices.

9. **Action.** To implement the above, the following is proposed:

- *Global surveillance.* The World Economic Outlook (WEO) and Global Financial Stability Report (GFSR) will remain at the center of the Fund's surveillance of the world economy. At the same time, there is a need for a deeper analysis of the longer-term aspects of globalization than is currently possible in the six-monthly time frame of the WEO and GFSR. Such an analysis—bringing together staff in the Research and International Capital Markets department, a cross-section of operational staff, and outside experts to focus on just one area for a full year—would seek to break new ground and bring fresh insights to global policy issues. Among these issues are: (i) the benefits, imbalances, and fragilities caused by cross-border movements of goods, people, and capital; and (ii) the ways in which institutions and policies can be developed to allow countries, especially low-income ones, to obtain greater advantage from global flows. Whether such work is most effectively presented as a new Report on the Macroeconomics of Globalization, or via some modification in the content and periodicity of existing publications, is a matter for further consideration.
- *Multilateral dialogue.* Although the G-7 and G-20 can also provide relevant fora, policy collaboration is likely to be most effective when undertaken by a universal institution such as the Fund. The obvious example of such a role for the Fund is the current debate on global imbalances, which is a key problem that needs to be managed—if not resolved—by the international community. The debate now spans many new and large actors. An objective analysis of unilateral versus multilateral action, discussed at the level of the International Monetary and Financial Committee, could yield the sort of cooperative solutions envisaged in the Fund's Articles of Agreement. Such initiatives must become an integral part of our work.
- *Financial market surveillance.* Understanding capital flows has become more difficult in a globalized capital market, with institutional investors now dominant in the allocation of a global pool of savings, and risk transferred not just between countries, but also from banks to other sectors. Drawing the implications of this global phenomenon for individual countries is a key challenge for the institution. While the modalities for doing so await the result of the McDonough group that is seeking to strengthen Fund work in the financial sector, it is clear that better integration of financial experts into area department teams and missions is crucial. Now that two-thirds of the membership has already participated in Financial Sector Assessment Programs, attention can also shift to streamlined updates that are more carefully integrated into Article IV and program discussions on vulnerabilities.

- *Standards and Codes.* Since the inception of such work, great strides have been made in identifying the gaps and improving the quality and transparency of data and decision-making processes. These are key public goods supplied by the Fund, enhancing the quality of economic institutions. As the recent review of work on standards and codes concluded that the larger need now is follow-up, it should be possible to focus our work more, with fewer reviews and selectivity in initiating new reports based on macro-criticality. This would free up resources for higher priorities.
- *Regional surveillance.* As a result of globalization, economic developments in countries have geographical dimensions that do not always conform with national boundaries. As part of the effort to understand the mainsprings of economic development, Fund surveillance will focus more systematically on regional developments, including through increased dialogue with regional institutions and think tanks. Aside from seminars at the Board, area departments will make special presentations to the public around the time of the annual meetings, drawing on the foregoing analysis and highlighting the regional implications of global surveillance.
- *Country surveillance.* The pressure in Article IV reporting to cover too much—and thus deliver too little—must change. Specifically, area department teams should be given explicit flexibility to streamline the coverage of reports, focusing only on the core macroeconomic issues—e.g. exchange rates, fiscal and debt sustainability, and financial sector stability—while identifying globalization challenges and drawing synergies from global and regional surveillance. It also means adapting internal staff and Board procedures, moving away from lengthy questionnaires for the authorities and boiler plate informational annexes for the Board, and towards a more continuous dialogue with country authorities. Some proposals along these lines—e.g., to place certain standard material on the web—have been considered before, but the case for a bold approach remains. Among other things, streamlining should enable the staff to focus more on the reasons why some policy advice is ineffective and on what the Fund might do to foster ownership and help members to press ahead with reform.
- *Communications strategy.* Effective surveillance is not just a matter of correct policy advice, but also of being a trusted and confidential advisor, and of helping to bring about policy change. All too often, there is no basic disagreement on diagnoses and first-best policy prescriptions, but change is held back by politics. This reality, however, only calls attention to the need for the Fund to help convince broader public opinion, which—more so in an age of global communication—shapes the decisions of governments. Fund transparency and outreach therefore must go beyond mere publication of reports to becoming an integral part of the public debate on reforms, bringing to bear the power of ideas and cross-country experience through a more contextually-savvy program of seminars, media events, and regular post-Article IV press conferences. Such engagement with civil society carries obvious risks, but also the prospect of policy advice better attuned to the specific situation in each member country. The External Relations Department will work with area departments on a concise paper that highlights best practices and develops a work program.

B. Role in Advanced and/or Systemic Economies

10. **Issue.** The systemic importance of many surveillance-only cases has been magnified by globalization. However, the incidence of globalization in advanced countries has been varied, with some riding a strong wave of rapid growth in the wake of newly discovered sources of comparative advantage, and others languishing for extended periods, in part because of the policy inertia imparted by already high per capita incomes. To enhance the relevance of Fund policy advice in these countries, more is needed to tailor Fund advice to local circumstances and to integrate country surveillance with global surveillance.

11. **Action.** It is proposed to modify work in two aspects:

- *Adaptation.* Besides continuing to identify first best policies, the staff will report with greater care on the reasons why Fund advice is not accepted and on policy adaptations that might meet those concerns.
- *Global implications.* Staff reports on all regionally or systemically important countries will spell out the regional and global implications of country policies and longer-term trends (e.g., aging) in a separate section. Where possible, the analysis will draw on quantitative models and research by area and functional departments.

C. Role in Emerging Market Economies

12. **Issue.** Emerging-market economies have been among the big winners on the “real economy” side of growth and efficiency gains, but they are also the ones most at risk of boom-bust cycles emanating from the volatility of capital flows. The work on emerging markets therefore has, appropriately, focused on crisis prevention. One aspect has been to improve fiscal policy and debt management, and to analyze the consistency of macroeconomic policies, debt dynamics, and exchange rate regimes. The other aspect has been crisis resolution and the provision, in rare cases, of exceptionally large Fund financing to deal with capital account crises. On both counts, much remains to be done.

13. **Action.** The following steps are proposed:

- *Crisis prevention.* The key priority is to obtain early warning, both of underlying vulnerabilities in emerging-market countries and of supply-side disturbances emanating in advanced-country financial markets. To better reflect this theme in surveillance papers, area departments will more consistently integrate staff from the International Capital Markets and the Monetary & Financial Systems departments.
- *Crisis resolution.* The Fund’s work has given impetus to many market initiatives, including collective action clauses and principles for voluntary debt restructuring. Even so, recovery from financial crises is a complicated endeavor, and among the priorities in the near future must be a review of the effectiveness of the Fund’s instruments to facilitate crisis resolution, including the Lending Into Arrears policy.

- *Financing and Insurance.* The financial assistance available from the Fund is small compared to the scale of capital flows in emerging markets. The perception that adequate and reliable insurance against financial catastrophes is lacking has prompted many countries, especially in Asia, to self-insure through the massive buildup of reserves rather than to depend on the Fund. There is nothing wrong with building up reserves, but it can go too far, and indeed there is a broader case for exploring mechanisms to avoid contagion and self-fulfilling crises. Yet the idea of introducing high access precautionary arrangements has been controversial, as has the call for a successor to the Contingent Credit Line. It is therefore proposed to initiate a second round of debate on both, with a view to addressing the legitimate concerns of emerging markets, while recognizing the moral hazard and financial and reputational risks to the Fund. Further, the Fund should work with members to develop local financial markets and instruments to enhance countries' ability to manage their risks.

D. Understanding Capital Account Liberalization

14. *Issue.* Financial globalization has both caused and been caused by the liberalization of the capital account. However, capital account liberalization has also brought macroeconomic and financial challenges that require careful management, including the orderly sequencing of liberalization with reforms in other areas, especially in the financial system. At times, these challenges have made for a disorderly process, as some controls are taken off and others are re-imposed to tackle various pressures. Yet there is no solid body of analysis on how best to proceed. This is a challenge to which the Fund must rise.

15. *Action.* It is imperative to set out a work program that deepens our knowledge of the issues surrounding capital account liberalization. Capital account liberalization is a reality, a part of globalization, and debating whether it should be an explicit purpose of the Fund is unnecessarily divisive. Rather, what the Fund must be in a position to do is to advise on how best to manage the process. The staff will shortly bring a paper to the Board that lays out the key issues and a program of case studies.

E. Role in Low-Income Countries

16. *Issue.* Although globalization has prompted enormous improvements in living standards, some countries have been left out of the main current. Marginalization of these countries is an outcome that the international community cannot accept. The Fund's role here must be to promote a stable macroeconomic environment conducive to private sector-led growth and poverty reduction. The reality of the work, however, is far more complicated than this simple statement. The effort now spans everything from Fund lending to debt relief, policy signaling, poverty reduction strategies, donor coordination, civil society outreach, investor councils, institution building, and technical assistance. There is a consensus that the Fund must remain engaged in these areas, but how best to do so, and to what degree?

17. *Action.* The strategy for low-income countries would have four components, which taken together make for a *different type*—not lower level—of Fund involvement:

- *More focus.* If the Fund is to be effective, its work cannot be stretched too thin. Macroeconomic aspects of the development challenge must be preeminent. This means helping to put in place the policies and economic institutions—e.g., monetary frameworks, financial sectors, and public expenditure management systems—that allow countries to: (i) maintain macroeconomic stability in those countries that have achieved it, and promote progress in those that lag behind (especially in post-conflict cases); (ii) take advantage of globalized trade and finance as an engine of growth; and (iii) be able to absorb the projected scaling up of aid in a sustainable way. This is not to say that the Fund should abandon the panoply of development activity. The Fund must, for example, at all times be aware of imminent shifts in aid flows, which finance a substantial portion of the budgets of low-income countries. But the current diffusion in Fund activity must give way to a more intensified agenda in the areas of our core expertise, with other agencies handling more of the work on donor coordination and harmonization, and the consultative processes associated with Poverty Reduction Strategy Papers.
- *More flexibility.* Fund facilities can be better tailored to the evolving needs of low-income countries. The immediate work program envisages: (i) a new Policy Support Instrument—for those countries for whom support for high quality macroeconomic policies, rather than Fund credit per se, is most important; (ii) making permanent the Poverty Reduction and Growth Facility (PRGF)—for those members for whom a need for sustained financing has been identified; (iii) establishing a shocks facility within the PRGF—for those that may also require occasional access to concessional financing; and (iv) providing further debt relief to poor and indebted countries.
- *More emphasis on the Millennium Development Goals (MDGs).* These are the defining objectives of the world community for the next decade. The initiatives above are central to our contribution, but so too is careful monitoring of progress. Therefore, in future, staff papers will not only assess whether macroeconomic policies support the MDGs, but will also frankly report the assessment of the World Bank and donors on the achievability of the MDGs under what the Fund would consider to be realistic macroeconomic scenarios and financing envelopes.
- *Less procedure.* Our work in low-income countries is presently overloaded with procedures that absorb substantial resources but yield questionable gains. Among these are numerous types of documents, frequent Board reviews, and complex procedures for even trivial forms of misreporting. The Policy Development and Review department will propose steps to streamline such activity to make the Fund's work procedures less taxing for members and indeed for the Fund itself.

F. Building Institutions and Capacity

18. *Issue.* Globalization has added to the push for strong institutions, as integrated markets—rather than governments or international institutions—have become the dominant

providers of financing and important arbiters of what is acceptable economic policy. Technical assistance and training are key to helping countries put in place the economic institutions crucial to growth and stability. Technical assistance also plays a crucial role in surveillance and the design of Fund-supported programs, bringing specificity to advice and conditionality, and putting in place essential systems in post-conflict countries. Still, technical assistance at times has had a life of its own, driven by short-term needs or supply considerations, including the preferences of the donor countries that finance such activity by the Fund. Recognition of this point has prompted significant efforts in recent years to better align technical assistance with evolving Fund priorities across regions, countries, and functional areas. Nevertheless, much remains to be done.

19. **Action.** The key proposal is to give area departments the central role in setting technical assistance priorities in the context of Article IV surveillance and Fund-supported programs. Such prioritization will require the area department, in close consultation with functional departments and existing regional technical assistance centers, to discuss with the authorities the macroeconomic importance of various technical assistance needs. Efforts will be stepped up to gauge how effectively various forms of technical assistance contribute to building the institutions that yield policy credibility. This will facilitate the implementation of the other important recommendations of the Independent Evaluation Office—and recently made operational by the Executive Board—to ensure government ownership of activities, better tracking of outputs, follow-up of previous advice, and improved internal and external evaluation of effectiveness. Finally, the Fund will continue to work to enhance fiscal transparency and governance, which play a crucial role in the development of broad economic institutions.

G. Prioritization In A Medium-Term Budget

20. **Issue.** The accumulation of mandates over the years has greatly reduced the flexibility in the Fund's budget to respond to new challenges. The pressure will become more palpable to the membership in the next few years if, as is now projected, earnings from large Fund arrangements recede.

21. **Action.** On expenditure, the main task is to use the organizing principle of meeting the challenge of globalization to set priorities for the next few years from the bottom up, based on a country-by-country analysis that draws on members' Article IV consultations and inputs from the functional departments. This must then be brought in consonance with a top down budget constraint that takes into account financial realities on the income side. On income, the challenges are not far in time, lending some urgency to the proposed review of Fund finances that would look into options for broadening the income base, including, for example, through the investment of the Fund's reserves. Both income and expenditure side issues will be taken up next April, when a Medium-Term Budget will be presented to the Executive Board. It would be premature to take a view here on a budgetary envelope, although the focus right now is very much on prioritization. But the continued appropriateness of a zero real growth limit, which has been applied to the budget of the Fund

like other international financial institutions, will need to be assessed after a consensus is reached on the medium-term strategy.

H. Organization

22. *Issue.* Budgets do not deliver results, people do. The effectiveness of the Fund rests on its staff. However, globalization has altered the nature of needed expertise (e.g., more banking experts), while the multiplicity of Board mandates has placed a heavy burden on the staff. The staff of the Fund has always risen to new challenges, but its future effectiveness cannot be taken for granted. Moreover, globalization has led to incremental shifts in the priorities of the institution—shifts that have yet to be fully reflected in the organizational structure of the Fund.

23. *Action.* To improve outcomes, the drive for work prioritization and focus will need to be augmented with organizational reform:

- *Staff.* A compensation system geared to attracting a diverse and high-quality staff is key. But so too is flexibility to change the mix of skills to adapt to changing circumstances: the top staffing priority today may be anti-money laundering, but as technical assistance is ramped up and our efforts succeed in helping members put in place the needed infrastructure, it may be a different expertise five years on. The answers, however, must await the outcome of the upcoming Employment, Compensation, and Benefits Review later this year.
- *Departmental structure.* The search for focus and efficiency must also extend to the way departments are organized. In some cases, it may be a question of size, in others of coherence (e.g., whether the Technology and General Services Department might be losing efficiency from combining information technology with administrative and other services), and in still others of overlap and desired results (e.g., the International Capital Markets, Research, Monetary & Financial Systems, and Policy Development & Review departments are all involved in different aspects of financial sector work). The last point is being taken up by the McDonough Financial Market Review Group, but we will need to continuously reassess the size and role of other departments too.
- *Management.* Despite the multiplication of tasks, decision-making remains quite centralized—making it increasingly difficult for management to give adequate time to broad systemic issues. It has also made it more difficult to trade off: (1) strategic and political tasks, which also require extensive consultation and travel, and (2) clearance of routine papers and day-to-day administration, which require presence at headquarters. The work load has reached a point where the latter is impeding the efficient consideration of broad policy issues. To remedy this situation, some devolution from management to staff is essential—for example, by making department directors responsible for routine and uncontroversial papers and briefs. Greater responsibility at the staff level must also imply more staff accountability, albeit with controls to safeguard the Fund’s reputation for quick and coherent

decision-making and its commitment to uniform treatment of all members. More generally, to ensure that the Fund continues to uphold the highest standards of internal management and control, staff are now working with an international consulting firm to subject its operations to a comprehensive and modern risk management assessment.

- *Executive Board.* The Board's peer review is central to the legitimacy of the Fund's work. However, the broadening of the range of Fund activities has raised the demands on the Board, and by the Board, for the variety, volume, and coverage of documents. Presently, some 90,000 pages of Board documentation are produced each year, including 12,000 pages by the Board itself. The strategic review now underway presents an opportunity to reflect on whether we have the balance right between the Board's (1) oversight over matters that have become too resource-intensive and procedure-laden (e.g., progress reports and misreporting requirements); and (2) ability to focus on larger issues, such as crisis resolution and global imbalances, which are increasingly taken up in other fora. An important task in the period ahead must be to bring forward concrete proposals to reduce the volume of documentation and time spent on routine matters.
- *International Monetary and Financial Committee.* This forum for bringing together top policymakers from around the world can, as noted earlier, play a stronger role in formulating responses to global problems. Consideration should be given to modifying the format of meetings, with more frank and interactive discussions between ministers on the most pressing issues, and more focused communiqués.
- *Division of Labor with the World Bank.* The Bretton Woods Institutions have a long and productive history of collaboration. But the demarcation between macroeconomic and development issues has grown fuzzy, with significant overlaps in areas such as financial sector work, donor coordination, and the PRSP process. As a first step, Fund management will initiate a dialogue with new Bank counterparts on ways to rationalize the division of labor and strengthen the effectiveness of cooperation.

I. Quotas and Voice

24. *Issue.* Fair weight and voice are crucial to the legitimacy of a universal institution. The current allocation puts this legitimacy at risk in many regions, for example in Africa, where the Fund is heavily engaged, and in Asia, whose place in the world economy has grown far more than its role in the Fund. The rising importance of regional institutions is, as a step to global integration, a generally positive development—except insofar as it is also a symptom of unhappiness with representation at the global level. In the view of too many, governance and ownership imbalances in the Fund now rival global current account imbalances. Neither imbalance is sustainable.

25. *Action.* The Thirteenth General Review of Quotas presents an opportunity to come to grips with the issue. On quotas, even if it turns out that there is no basis for a general

increase, we must put on the table the option of reallocating existing quotas. On voice, consideration must be given to the various proposals that have emerged from the membership, such as the provision of more basic votes and consolidation and reallocation of chairs in the Executive Board. With the requisite political will, it is possible to find a solution that gives more vote to countries that now account for a much larger share of the world economy, and more voice to smaller members that now account for a much larger share of the Fund's work. Such rebalancing may, at first glance, seem like a zero sum game, but all members will ultimately gain in belonging to an institution with greater legitimacy.

IV. CONCLUDING OBSERVATIONS

26. **Continuity.** The previous sections have set out some principles for prioritizing the work of the Fund in light of the challenges of globalization. These challenges have, in one form or the other, been recognized over the years, and considerable progress has been made all the areas covered here—integrating global and country surveillance, assessing financial vulnerabilities, tailoring Fund lending facilities, strengthening technical assistance, and at least acknowledging, if not resolving, the governance challenge within the institution. This paper has sought to do no more than bring a common vision to these many elements of the Fund's work, and to make the case for doing more. As such, the strategy outlined here is evolutionary, not revolutionary.

27. **Change.** Nevertheless, some new proposals have been put on the table, including an effort to deepen the analysis of globalization, a more prominent role for external communication, research into capital account liberalization, and assessment of the achievability of the Millennium Development Goals under realistic financing scenarios. How might these activities be financed? The general response must be prioritization and scaling back some activities, specifically through a sharper delineation of the Fund's role in low-income countries, less time spent on procedures and documentation, less work on standards and codes, less research in other areas, and less on overheads and support activity (e.g., via more offshoring of information technology). A more precise answer as to the degree and adequacy of these measures will be provided in the medium-term budget next year.

28. **Next steps.** Wherever possible, key deliverables have been indicated in this paper, and these are summarized in Table 1. But, as noted at the outset, virtually all require further reflection in setting down precise details. Once there is a consensus on the overall agenda, a series of follow up papers on individual issues will be circulated for consideration by the Executive Board.

TABLE 1. STRATEGIC DIRECTION OF THE FUND—SUMMARY OF ACTIONS	
Area	Action
<p>A. MORE EFFECTIVE SURVEILLANCE</p> <ul style="list-style-type: none"> ➤ Global ➤ Regional ➤ Country ➤ Communications Strategy ➤ Standards and Codes 	<ul style="list-style-type: none"> • Long-term economic aspects of globalization to be researched more deeply by cross-section of Fund staff and outside experts • Fund analysis to foster debate on cooperative multilateral solutions to global current account imbalances • Deeper analysis of financial markets; more integration of financial expertise into area department teams and missions; Financial Sector Assessment Programs to shift to streamlined updates and integrated in Article IV and program discussions • Area departments to intensify analysis and contact with regional bodies and present regional outlooks to public • Selectivity in coverage and flexibility to streamline guidance on content of Article IV reports • More contextual and direct outreach to public, including post Article IV media events and seminars • Focus to shift to follow-up; new assessments to become more selective and based on macro-criticality
<p>B. ROLE IN ADVANCED COUNTRIES</p> <ul style="list-style-type: none"> ➤ Global implications ➤ Adaptation 	<ul style="list-style-type: none"> • Staff reports on systemic countries to introduce new section on global implications more regularly • Staff to also report on possible policy adaptations when Fund advice not accepted
<p>C. ROLE IN EMERGING MARKETS</p> <ul style="list-style-type: none"> ➤ Crisis prevention ➤ Crisis resolution ➤ Financing and insurance 	<ul style="list-style-type: none"> • More work on early warning from point of view of vulnerabilities in EMs and disturbances in financial markets; financial experts to be integrated into country teams • Work to include review of Lending Into Arrears policy • Further discussion on high access precautionary arrangements, and successor Contingent Credit Line; help with developing local financial markets and instruments to manage risk
<p>D. CAPITAL ACCOUNT LIBERALIZATION</p> <ul style="list-style-type: none"> ➤ Managing liberalization 	<ul style="list-style-type: none"> • Staff to undertake research on sequencing and other issues

<p>E. ROLE IN LOW-INCOME COUNTRIES</p> <ul style="list-style-type: none"> ➤ More focus ➤ More flexibility ➤ More emphasis on MDGs ➤ Less procedure 	<ul style="list-style-type: none"> • Emphasis on macroeconomic stability, promoting trade, and absorbing the impact of scaled-up aid • Other agencies to handle donor coordination and harmonization, and PRSP consultative processes • New instruments to take account of different needs, including (i) Policy Support Instrument; (ii) a permanent Poverty Reduction and Growth Facility; (iii) a shocks facility within PRGF; (iv) further debt relief to poor countries in need • More careful assessment of the achievability of MDGs under realistic financing scenarios, jointly with Bank and donors • Staff to propose steps to streamline excessive documentation and cumbersome procedures
<p>F. BUILDING INSTITUTIONS AND CAPACITY</p>	<ul style="list-style-type: none"> • Area departments to set technical assistance program, in line with priorities set in Article IV and program discussions • Implementation of IEO/Board recommendations to strengthen ownership, track outputs, follow up recommendations, and more internal and external evaluation
<p>G. PRIORITIES IN A MEDIUM-TERM BUDGET</p>	<ul style="list-style-type: none"> • Above priorities to be reflected in a three-year medium-term budget framework, starting April 2006 • Review of Fund finances to propose means of broadening the Fund's income base
<p>H. ORGANIZATION</p> <ul style="list-style-type: none"> ➤ Staff ➤ Departmental structure ➤ Management ➤ Executive Board ➤ IMFC ➤ Division of labor with World Bank 	<ul style="list-style-type: none"> • Implement new compensation system and expert career streams to adapt to changing skill requirements • Size and overlaps to be examined, starting with work on financial sector and capital markets • Devolution of routine responsibilities to departments along with more accountability and safeguards for uniformity of treatment • Risk management assessment to be put in place • Develop proposals to reduce the volume of documentation and time for routine matters, permitting the Board to focus on larger and more strategic issues • Format of meetings to be modified to yield more frank and interactive discussion and more focused communiqués • Fund staff and management to initiate dialogue with new Bank counterparts on rationalization of overlaps in financial sector work, donor coordination, and PRSP process
<p>I. FAIR QUOTA AND VOICE</p>	<ul style="list-style-type: none"> • 13th General Review of Quotas to explore reallocation even in the absence of a general quota increase • Consideration of measures to increase the role of smaller members at the Board