October 2008

The Nordic-Baltic Office
International Monetary Fund

Report 2008/2

Recent Policy Developments in the International Monetary Fund

CONTENTS

This report is prepared by the Nordic-Baltic Office (NBO), representing Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden in the International Monetary Fund's Executive Board.

I. Introduction

The unfolding of the international financial crisis and the elevated food and fuel prices have determined a large part of the Fund's agenda since the Spring Meeting. An extensive amount of research has been conducted, the Fund has engaged in intense dialogue with member countries affected by either or both of these crisis, and some member countries have sought financial assistance to support their adjustment policies in the face of these challenges. The Fund's toolkit has also been amended and expanded.

This report covers the main policy issues dealt with by the Executive Board ("the Board") since the Spring Meeting of the International Monetary and Financial Committee in April 2008, and outlines the *Nordic-Baltic chair's* position. Surveillance and lending policy aspects related to the abovementioned international shocks are described together with other key areas where important discussions have taken place since the Spring Meeting, namely bilateral surveillance issues more generally, Sovereign Wealth Funds, the Fund's financing role and conditionality, the Fund's Role in Low Income Countries, and finally the Fund's Governance.

II. Surveillance

A. The Financial Sector and Links to the Real Economy

As the crisis in the world financial markets has intensified, the Fund's focus has increasingly turned to financial sector issues. It has actively helped its members deal with the crisis through its bilateral surveillance, Financial Stability Assessment Programs (FSAPs) and Technical Assistance. In addition to scheduled discussions on financial sector matters, the Board has also held a number of ad hoc briefings on recent market developments and policy challenges.

The Fund has also promoted dialogue within its membership. In late September, the Fund organized a conference call among senior officials from systemically important advanced and emerging market economies around the September 2008 Global Financial Stability Report (GFSR) and the World Economic Outlook (WEO). In early October, it held a high-level seminar in collaboration with the Financial Stability Forum (FSF) focusing on risks and policy challenges in the regulatory and supervisory area. Furthermore, the fast pace of market events in the early days of October and the growing concerns over a global financial and economic meltdown overshadowed the other items on the agenda of the October Annual Meetings, and the International Monetary and Financial Committee (IMFC) agreed to endorse a coordinated plan of action as set up by the G7.

The September 2008 GFSR underscored the likelihood that the ongoing deleveraging by financial institutions is to be a protracted process. The limited near-term pace of credit growth is expected to hold back recovery of the real economy, in turn adding to the deterioration of banks' balance sheets and credit quality across a wider range of credit segments. Meanwhile, institutions' recapitalization efforts have become increasingly difficult. Accordingly, staff had revised its loss estimate up to a total of $1.4 trillion from the April estimate of $945 billion. In their base scenario, credit degradation would continue until end-2009. As predicted, the crisis has increasingly spread beyond its epicenter of the US to other advanced and emerging market economies. It is important to recall that the increased globalization of the crisis may also have implications on the financing needs of some low income countries.

Over the course of the fall, the immediate policy priority advocated by the Fund has been to mitigate the risks of adverse feedback loops between the real economy and the financial sector. Accordingly, it has largely endorsed the unprecedented policy responses taken in many advanced economies. However, as the crisis has intensified, the Fund has more actively encouraged prompt, internationally coordinated and more comprehensive policy solution that spans the core problems of lack of liquidity, shortage of capital and counterparty risk. Also, regarding the impact of the crisis on developing and emerging market countries, the Fund has expressed its preparedness to deploy its emergency procedures and to exert flexibility to rapidly approve high access financial programs. Some countries have already approached the Fund for such assistance, cf. section III.

The main focus of strengthening the Fund's analytical work has concerned the linkages between the real and financial sectors. Accordingly, the MD has announced a special staff unit focusing on macro-financial linkages to coordinate work in this area. The latest WEO dedicated a chapter *"Financial Stress and Economic Downturns"* to the issue. Furthermore, macro-financial linkages were also examined in the context of emerging market countries in the late July Board discussion *"Macro-Financial and Cross-Border Risks for Emerging Market Economies"* as well as the chapter *"Spillovers to Emerging Equity Markets"* in the latest GFSR. Macro-financial linkages have also been given more attention in the Fund's day-to-day surveillance work.

Besides discussing the WEO and the GFSR, the Board also had an opportunity to review the Fund's role in the current crisis in the context of the early October discussion *"The Fund's Response to the 2007-08 Financial Crisis – Stocktaking and Collaboration with the Financial Stability Forum"*, where Directors shared the view that the Fund should, in general, play a more proactive role. Subsequently, the October IMFC called on the Fund to take the lead, in line with its mandate to promote international financial stability, in drawing the necessary policy lessons from the current crisis and recommending effective actions to restore confidence and stability. The Fund will also enhance its collaboration with other relevant international bodies and standard setters such as the FSF and the G20. Work will continue in expanding the Fund's early warning capabilities to advanced countries, including through quantitative indicators that help signal build-up of medium-term vulnerabilities and the presence of near term risks. The Fund is to report to the IMFC on its progress at the 2009 Spring Meeting.

The Nordic-Baltic chair considers re-establishing confidence in the global financial system an immediate priority and has promoted close cooperation between authorities both at the national and international levels to avoid negative cross-country spillovers from policy responses. Our chair has been a proponent of giving the Fund a stronger role in promoting global financial stability, while enhancing its collaboration with other international bodies and standard setters. We have also strongly supported greater integration of financial sector issues into the Fund's bilateral surveillance.

B. The Fund's Surveillance Response to the Food and Fuel Price Surge

The Fund has paid much attention to the macroeconomic impact and policy responses to the recent hike in food and fuel prices. An Interdepartmental Task Force was established in order to diagnose the problems and to set the Fund's strategy for assisting at the country level, including policy advice and financing strategies. Impact studies have been conducted on affected countries and macroeconomic- as well as financial market-aspects have been covered in the latest editions of the WEO and the GFSR. For instance, a Fund study finds that about 50 net food- and fuel-importing countries are suffering significantly from these price developments. Also, for 37 countries the fiscal cost from rising food and fuel price-related measures is expected to exceed 1 percent of GDP, in particular because of the resort to higher fuel subsidies or reduced food taxes. The Fund's policy advice regarding responses to the price increases are guided by minimizing disincentives, prioritizing the poor through targeted measures, fully passing through the price shock over time and avoiding trade restrictions, maintaining fiscal sustainability and enhancing regional collaboration. The Board has met three times in less than 6 months to discuss food and fuel price developments and policy measures. The Fund has also assisted a number of countries with additional financial resources and amended the lending instrument for low income countries faced with exogenous shocks to better accommodate the potential needs of low income countries, see section III.

The Nordic-Baltic chair has appreciated the Fund's analytical work in this area and has underscored the Fund's unique position in providing policy advice and technical assistance when required. Solid analytical work on the underlying forces behind the price increases would be important to determine the appropriate policy response. Our chair has stressed the need to keep the global food markets open. In the present situation, a full pass through of food and fuel price changes to domestic prices, with appropriate compensating measures for the poor, would be the first best strategy. Our chair, therefore, stressed the importance of stepping up national efforts to build political support for subsidy reforms, gradually replacing general subsidies with better targeted schemes to protect the poor.

C. Bilateral surveillance

The implementation of the 2007 Bilateral Surveillance Decision has appeared to be a complex and difficult issue. While the primary reason for the 2007 Decision was to make bilateral surveillance more effective and transparent and to strengthen the Fund's exchange rate oversight mandate, the more detailed and methodical focus on equilibrium exchange rates has lead to discussions between members and mission teams over the last year on how this should be evaluated. As a result, some consultations have been delayed. According to management, the major complexity relates to the lack of candor and clarity on external stability and exchange rate issues. Therefore, the Managing Director (MD) introduced the Guidance on Operational Aspects of the 2007 Surveillance Decision over the summer 2008. The MD intends to exercise the authority granted under Paragraph 20(a) of the 2007 Surveillance Decision to propose ad hoc consultations, subject to approval by the Board, with those members where the MD has significant concerns that (i) a Principle for the Guidance of Member's Exchange Rate Policies might not be observed; or (ii) the exchange rate is fundamentally misaligned. Following the initiation of the ad hoc consultations, staff is expected to visit the country and come back with evidence supporting (or rejecting) the MD's concerns in a six months period. Moreover, it gives the authorities some time for implementing necessary adjustment policies aimed at correcting the underlying policies.

The Nordic-Baltic chair considers that the 2007 Decision has been important to enhance the focus of surveillance. However, we recognize that a number of challenges are associated with its application. Therefore, while we generally agreed with the MD's proposal, our chair has also emphasized the concerns regarding the potential labeling risks before the special consultations are completed, as well as the potential risks and destabilizing effects of exchange rate recommendations when the exchange rate is judged as misaligned. We also encouraged continued analytical work on conceptual issues.

Triennial Surveillance Review and Statement of Surveillance Priorities for 2008-2011

In September, staff presented a review of the Fund's surveillance during the 2004-2007 period and suggested surveillance priorities for the period of 2008-2011. The Board discussion of **the surveillance review** yielded two main conclusions. First, many Directors were of the view that the Fund's surveillance has so far focused too little on financial stability issues in major global currency markets, and some considered that the Fund has been too benign with respect to financial market policies pursued in the major advanced economies over the last years. Hence, financial sector surveillance was viewed as an increasingly important part of the Fund's surveillance in the future, and as part of this, work still remains to integrate it better into the regular Article IV consultations. Second, many Directors stressed that the assessment of exchange rates is only one part of a much broader macroeconomic policy framework over which the Fund conducts surveillance.

In a **Statement of Surveillance Priorities**, the Board has laid out economic and operational priorities for the next three years. Drawing on the internal review as well as on an external evaluation, and following the discussions in the Board, four broad areas were identified where significant progress must be achieved over the next three years. Those were formulated as **operational priorities**, and include the following: (i) refining the assessment of risks to provide clear early warnings to members; (ii) improving financial sector surveillance and the real sector-financial sector linkages; (iii) increasing focus on multilateral perspective by more frequent use of cross-country analysis; (iv) provide a clear and robust exchange rate analysis that is well integrated into the overall assessment of the policy mix. Management and staff are responsible for delivering progress on the operational priorities.

Additionally, a set of **economic priorities** was established, highlighting areas where management and staff are expected to provide candid high-quality analysis and effective communication. Those include: (i) resolving current financial market distress; (ii) efforts to prevent disruptive capital flows from jeopardizing stability and growth; (iii) designing policies to adjust to sharp changes in commodity prices; (iv) promoting the orderly reduction of global imbalances. The Executive Board is responsible for guiding and evaluating surveillance in order to ensure the achievement of these priorities.

The Nordic-Baltic chair supported the areas of focus for the next three years. Our chair joined Directors who argued for the Fund to be able to provide timely and relevant advice on financial sector surveillance issues. We have asked for a greater clarity on how the exchange rate assessments are done in the Fund well before the next Triennial Surveillance Review. In addition, our chair emphasized the importance of focusing the analysis on consistency and sustainability of a broad policy mix as opposed to a sometimes tilted focus on exchange rates, and called upon staff to ensure that the evaluation of external stability will always be followed by constructive policy advice.

D. Sovereign Wealth Funds—The Santiago Principles—Generally Accepted Principles and Practices Developed by the International Working Group

In early October, the Board discussed a voluntary set of Generally Accepted Principles and Practices (GAPPs) - also known as the Santiago Principles created by the International Working Group of Sovereign Wealth Funds (IWG). The group included 23 countries with Sovereign Wealth Funds, including Norway. The Fund staff co-chaired the working group, provided secretarial support to the group and helped to facilitate and coordinate the work. The purposes of the principles are; to establish a transparent and sound governance structure, to ensure compliance with relevant regulation and disclosure requirements, to ensure that Sovereign Wealth Funds invest on the basis of economic and financial risk and return-related considerations, and to maintain a stable global financial system.

Directors welcomed the intention of the working group to consider establishing a Standing Group that could review the Principles and provide a forum for the exchange of ideas among SWFs and recipient countries, as well as examine ways in which aggregate information on SWF operations could be collected and made available to the public. They looked forward to the guidelines by the OECD for recipient countries.

The Nordic-Baltic chair supported the principles and further engagement of the Fund. On monitoring, our chair stated that it was in the spirit of the voluntary approach that the monitoring would be done by the SWFs, i.e. by the proposed standing group and that the Fund should not be responsible for this. However, we saw a possible role for the Fund as secretariat to the group. Our chair underlined that SWFs in our constituency would not have been able to operate if not for a high degree of disclosure and transparency.

III. LENDING POLICIES

As the ongoing financial crises is starting to be felt around the world, the Fund stands ready to deploy its emergency procedures to rapidly approve financial programs potentially involving high access, in addition to the increased dialogue with member countries under stress. The interest of several countries in new lending arrangements, see table 1a, comes at a time when credit outstanding remains at historically low levels with the expiration of the last large scale financial arrangement to Turkey in May.

Meanwhile, the Board has launched a review of the Fund’s financing role to evaluate if the present set of lending instruments needs to be adjusted to remain suitable for the needs of the overall membership. In light of the financial crisis, work on a new short-term liquidity instrument has been expedited. And the Board has already amended the Exogenous Shocks Facility for low income countries in an accelerated procedure in light of the financing needs of several members suffering from the recent food and fuel price shocks. The Fund has also provided additional financial support to some countries via the Poverty Reduction and Growth Facility, see table 1b.

Table 1a. Countries hit by the financial crisis seeking Fund financing

Belarus	Not yet specified
Hungary	12.5 billion EUR (1,020 pct. of quota)
Iceland	1.4 billion SDR (1,190 pct. of quota)
Pakistan[1]	Not yet specified
Ukraine	11 billion SDR (800 pct. of quota)

[1] Pakistan has also been severely affected by the food and fuel price shock

Table 1b. Additional Financing Under PRGF Arrangements Related to Food and Fuel Price Shocks

In millions of US dollars

	2008
Under new PRGF arrangements	
Burundi	17.9
Djibouti	3.7
Mali	28.9
Niger	14.5
Under existing PRGF arrangements	
Benin	14.4
Burkina Faso	14.0
Central African Republic	12.9
Grenada	2.3
Guinea	33.2
Haiti	25.4
Kyrgyz Republic	13.8
Madagascar	28.4
Malawi	16.1
Nicaragua	10.1
Total	**235.4**

Source: IMF Food and Fuel Prices—Recent Developments, Macroeconomic Impact, and Policy Responses, An Update, September 19, 2008

A. Review of the Fund's Financing Role to its Member Countries

The Board had an initial discussion on the Fund's Financing Role in Member Countries in mid-September. Based on this discussion, the MD and the Board set up a roadmap to advance work concurrently in five broad areas: (i) exploring analytical considerations for Fund lending, including issues such as market gaps, the balance of payments criterion for lending, as well as the scope for innovation in and streamlining of instruments; (ii) advancing the work on a new liquidity instrument; (iii) re-examining conditionality; (iv) reviewing the Fund's lending role and facilities for low-income members; and (v) reviewing access limits and financing terms for using Fund resources. Preliminary discussions in these areas are to be held before the 2009 Spring Meeting. Decisions are to be taken as quickly as possible in those areas where there is a strong consensus and particular urgency, and to reach decisions before the 2009 Annual Meetings in remaining areas.

The Nordic-Baltic chair welcomed the launch of the review process, while underscoring that the objective should not be to reinvigorate demand for Fund credit as such. Our chair saw considerable scope for streamlining the Fund's lending toolkit. Generally, we did not wish to preclude any particulars of the outcome, but we did not want to see the potential stigma associated with Fund lending tackled by reducing transparency. Finally, we supported continuing the work to improve conditionality with a view to increase efficiency in attaining the program objectives (see also section III D).

B. New Short-Term Liquidity Facility for Market Access Countries

In late October the Board discussed a new facility for market access countries – The Short-Term Liquidity Facility. This new facility is designed to help members facing balance of payments needs arising from external market developments despite strong fundamentals. The facility is intended for countries that are well integrated into capital markets with sustainable debts and a record of strong economic policies. Relying on this, it is exceptional in that it would allow access of up to 500 pct. of quota without normal conditionality and monitoring applied.

The Nordic-Baltic chair supported this new instrument but emphasized *inter alia* the need for careful monitoring and that the country using the facility should immediately move to an ordinary Fund arrangement if any doubts arise that the problems are not short-term and "self-correcting". In particular, our chair cautioned that users should be prepared to accept a minimum degree of streamlined and focused conditionality as the underlying problems become clearer. Our chair considered that the cost of using the facility seemed low, but recognized that it would need to be considered in conjunction with the upcoming review of charges.

C. Amendment of the Exogenous Shocks Facility (ESF)

In light of the recent episode of rising food and fuel prices – and supported by the IMFC at its 2008 Spring Meeting, the Executive Board accelerated a review of the Exogenous Shocks Facility (ESF) and came to an agreement on modifications in early September.[1] The review took place separately from the more comprehensive review of Fund facilities discussed above.

The modifications allow more rapid access to the Fund's concessional resources for members hit by sudden exogenous shocks. The ESF now consists of separate rapid and high access components. The former allows faster disbursements of up to 25 percent of a member's quota based on up-front policy commitments and streamlined requirements (i.e. is not subject to more standard conditionality and there is no requirement of developing a Poverty Reduction Strategy). If necessary, it could be followed by an arrangement providing up to 75 percent of quota under the high-access component, which retains the upper-credit tranche conditionality and resembles the old ESF in key aspects. A further key feature of the reform is to increase flexibility in the use of the modified ESF with other Fund instruments. Crucially, the rapid-access component can be used concurrently with the Policy Support Instruments, Staff Monitored Programs and, in some circumstances, off-track PRGFs. Members with an on-track PRGF suffering from sudden exogenous shocks will continue to be supported via program augmentations.

The Nordic-Baltic chair, albeit regretting the delay in bringing the issue to a conclusion, strongly welcomed the review and supported the proposed changes to the ESF. However, we noted that it should not replace a PRGF program in cases where the balance of payments effects of a shock turn out to be more protracted than anticipated, and we

[1] The decision will take effect once all lenders to the Loan Account of the PRGF-ESF Trust, and all contributors to the Subsidy Accounts of the PRGF-ESF Trust, consent to the amendments.

underlined the need to evaluate each request on a case-by-case basis. Finally, our chair advocated further review of the Fund's concessional financing structure with a view to make the use of subsidy resources more flexible.

D. Implementation Plan in Response to Board-Endorsed Recommendations Arising from the IEO's Evaluation of Structural Conditionality

In May, the Executive Board considered an implementation plan to follow up on those recommendations from the Independent Evaluation Office (IEO) on structural conditionality that the Board had endorsed.[2] The Board generally considered that the plan laid out an appropriate strategy. Directors continued to see a need for strengthening efforts to achieve parsimony and to focus on criticality in setting structural conditionality, including structural benchmarks. In this regard, they welcomed the plans to revise staff's guidance note to underline these objectives. They also welcomed the work on how program documentation could serve to highlight the criticality of proposed conditionality.

The Nordic-Baltic chair found the follow-up plan balanced and stressed the abovementioned considerations that were shared with the rest of the Board. However, we stressed the Board's role in the monitoring process and in that regard, we saw merit in a discussion of the planned annual monitoring report in the Board's Evaluation Committee. We reiterated our emphasis on close cooperation with the World Bank when setting conditions in areas outside the Fund's core expertise. Finally, we emphasized how more readily available updates on implementation and data could be an important contribution from the Fund to enhance accountability and improve the public's understanding for program conditions.

IV. THE FUND'S ROLE IN LOW INCOME COUNTRIES (LICS)

The Fund's role in Low Income Countries (LICs) has since the Spring Meeting mostly been concentrated on how the Fund could assist countries affected by the recent spark in food and fuel prices in meeting these challenges (see section II B and III C). However, the Board has also had an overarching discussion of the Fund's role in LICs based on a stocktaking exercise in July. Directors agreed that the main channels for the Fund's engagement will continue to be macroeconomic policy advice, capacity-building assistance and concessional balance of payments support, though some noted that the Fund is not a donor agency, and that its financing is relatively less concessional. Directors underscored that supporting LICs in ensuring debt sustainability and avoiding a new unsustainable debt build-up is a cornerstone of the Fund's work. They also recognized that the Fund's work on LICs will be shaped by its broader refocusing, and build on close collaboration with partner institutions. Within the stocktaking exercise, a mission statement was formulated and the work on staying effective in low income countries will in the coming time be advanced within different areas, including a review of the Policy Support Instrument and another discussion on the Fund's engagement in fragile states. The Board has also discussed reforms to enhance the effectiveness of technical assistance, cf. below.

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[2] See the Spring 2008 NBO-report for a brief description of the Board's view on the recommendations.

The Nordic-Baltic chair agrees that the Fund shall remain closely involved with its low income members in a focused manner within the Fund's mandate. We welcomed the discussion as a stocktaking exercise. We appreciated the emphasis on the Fund's core competences of macroeconomic stabilization, fiscal, monetary, financial and exchange rate policies as well as underlying institutions, and agreed that close cooperation with development partners will be crucial in areas outside the Fund's core expertise.

A. Enhancing the Impact of Technical Assistance (TA)

Over the summer, the Board has discussed reforms to enhance the impact of Technical Assistance (TA) and training. Changes are being made to make Fund TA more effective, ensure that TA resources are allocated more efficiently, and that it is better coordinated with recipient countries and other providers of TA. As part of this, the Board considered a change in the policy for country contributions for TA and training services. The new policy for country contributions will be implemented beginning in May 2009.

The Nordic-Baltic chair believes that TA is a core activity of the Fund and that it should remain a central part of the Fund's tool box. From the Fund's perspective, lending and surveillance should be guiding for the delivery of TA. However, TA should be demand driven and aligned to country-specific circumstances. To support this objective, our chair saw merit in a differentiated charging regime, though we stressed that it should not unduly ration TA for those who need it the most. We, therefore, argued for lowering the charging rate for low income countries. We considered that efforts to mobilize donor financing should be strengthened, but noted that the availability of such recourses should not define the TA output. Finally, we suggested that a wider publication of TA findings should be presumed and not just "encouraged".

V. INTERNAL MATTERS

With attention increasingly focused towards the challenges posed by the two shocks to the world economy, internal matters have received less attention. The most important contribution has been the IEO's report on the Fund's Corporate Governance, see below. The implementation of the refocusing of the Fund is under way, as staff members opting for voluntary leave in March 2008 leave the Fund gradually. Also the Nordic-Baltic Office has reduced it staffing by one senior advisor position.

A significant step forward was taken in terms of governance when a new chairman of the IMFC was selected prior to the Annual Meetings. Being the first from among the emerging market and developing countries, Dr. Youssef Boutros-Ghali, Minister of Finance for Egypt, was selected.

In another effort to improve the Fund's governance, an integrity hotline has been established. This was used for a claim of possible improper personal behavior involving the MD, and an outside counsel was used to investigate the facts. Based on the counsel's report and legal advice on the standards of conduct applying to the MD, the Board concluded that there was no harassment, favoritism or any other abuse of authority by the MD.

The changes to the Articles of Agreement – to increase basic votes, to increase the number of Alternate Executive Directors for large constituencies and to broaden the investment mandate – are awaiting that a sufficient majority of member states accepts them. In many countries, this requires executive or legislative approval. Since the quota increases agreed upon as part of the Quota and Voice Reform are dependent on the acceptance of the changed Articles of Agreement, these have not been effected yet.

A. Independent Evaluation of the Fund's Corporate Governance

The Independent Evaluation Office (IEO) of the Fund released in May a report assessing the governance of the institution. The report calls for changes in the Fund's governance, including clarifying the respective roles of various bodies within the Fund, i.e. International Monetary and Financial Committee, the Management of the Fund, and reorienting the job of the Executive Board. The IEO finds that effectiveness has been the strongest aspect of Fund governance, while accountability and voice have been the weakest. If left unaddressed, these weaknesses would likely undermine effectiveness over time.

During the summer of 2008, the Board formed a Working Group to propose timelines for discussing specific recommendations and for implementing the ones that will be agreed upon, since many suggestions are interlinked and need different level of decision-makers to be involved in the discussions. The Working Group, in which the Nordic-Baltic Office participated, found that some recommendations could be implemented faster (for example, the recommendations to make the Board's surveillance more effective), whereas others may take more time to find a common ground. A Steering Committee with members from the Board and staff will be established to coordinate the upcoming work on specific recommendations. It was also noted that follow-up and more specific discussions would require the engagement of all parties at many different levels, involving not only the Board and Management, but also the Fund's membership and other stakeholders, such as civil society organizations, more broadly. In parallel to this work, the MD has assigned a group of external high-level experts to review the IEO's recommendations, and to report back to him by spring 2009. This Committee will be lead by Mr. Trevor Manuel.

The Nordic-Baltic chair agreed with the IEO that there is not one simple solution to improve the Fund's institutional arrangement, but this should not be the argument for status quo. We argued that the Board should remain sufficiently broad to ensure adequate representation of poor and rich, small and large countries. The effectiveness of the Board is not defined by its size, but rather by its ability to be operational, to perform effective oversight over management, and to deliver high-quality surveillance output in a timely manner. Our chair was supportive of using the Board's committee structure more effectively and welcomed the accountability framework for Management underway. We also reiterated our support for a more transparent and open selection process of the IMFC Chairman, the Managing Director and his Deputies.

B. Implementing the new Income Model

To lessen the heavy bunching of discussions on the Board's agenda in the last months up to the Annual Meetings, further discussions on implementing the Fund's new income model (in terms of broadening the investment mandate and reviewing the Fund's precautionary balances) have been postponed. Neither has there been progress in the Fund to approve a gold sale - a part of the new income model - which requires approval by the US congress for the US Executive Director to vote in favor. A review of charges and maturities has not taken place yet either.

Hence, the primary consideration in relation to the Fund's income has been the lending rate for the financial year 2009 (ending April 30, 2009). In April, the Board agreed to lower the lending rate to a margin of 100 basis points above the SDR rate. This rate would be consistent with the principle under the new income model that the lending rate should only cover costs related to lending and to the build up of precautionary reserves. Two years earlier, the Board suspended the previous rules for setting the margin and fixed it to the level at that time of 108 basis points, while developing a more sustainable income model less dependent on high credit outstanding. It should also be noted that management – in consultation with the Board – in August decided to strengthen the contributions required in return for providing Technical Assistance, see section IV A. However, this was not decided with a view to provide additional income per se, but rather to strengthen the role of recipients and improve accountability.

The Nordic-Baltic Constituency supported the proposed margin of 100 basis points, which would be sufficient to cover the Fund's average lending costs over the past three years and allow a modest amount of reserve accumulation. However, our chair also called for further reflections on how an appropriate reserve accumulation policy could be reflected in the margin in a simple and transparent manner.

VI. Staff of the Nordic-Baltic IMF office
as of October, 2008

Jens Henriksson	SWE	Executive Director
Jarle Bergo	NOR	Alternate Executive Director
Darius Abazorius	LIT	Senior Advisor
Björn G. Ólafsson	ICE	Senior Advisor
Janne Hukka	FIN	Advisor
Martins Bitans	LAT	Advisor
Katrine Graabaek Mogensen	DEN	Advisor
Maris Leemets	EST	Advisor
Marjatta Quini	FIN	Adm. Assistant (on leave)
Kari Romdahl	NOR	Adm. Assistant

International Monetary Fund. Tel.: 1 202 623 7000
Nordic-Baltic Office. Tel.: 1 202 623 4571, Fax: 1 202 623 5385