

The Nordic-Baltic Office  
International Monetary Fund

Report 2008/1

Recent Policy Developments in the  
International Monetary Fund



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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 Executive Board has made considerable progress on the priorities suggested by the International Monetary and Financial Committee (IMFC) in October 2007. An agreement was reached on a package of quota and voice reforms and on the necessary steps to build a new income and expenditure framework. The Fund has also stepped up its financial sector analysis and the analysis' integration with macroeconomic surveillance – made all the more urgent by the ongoing financial market turmoil.

The new Managing Director, Mr. Dominique Strauss-Kahn, deserves his part of the credit for reaching these results. He has skillfully spotted the areas of common ground to build broad consensus in the Executive Board on important policy items. At the same time, he has traveled around the world, reflecting the global focus of the Fund's work and the importance of the Fund being visible and responsive to members' needs. Building on the work under the previous Managing Director, Mr. Rodrigo de Rato, the strategic directions to be implemented in the medium-term budget are in line with the Medium-Term Strategy launched in 2005.

This report covers the main policy issues dealt with by the Executive Board since the last meeting of the IMFC in October 2007, with references to the positions taken by the Nordic-Baltic chair.<sup>1</sup> In addition to presenting the quota and voice agreement and the income-expenditure framework, the report also describes discussions on surveillance and related policy implications, on the Fund's lending policies and its role in low income countries and fragile states.

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<sup>1</sup> The main references of the report are the documents transmitted to the IMFC spring meeting 2008 (<http://www.imf.org/external/spring/2008/index.htm>) and the Fund's website in general, including the Issues Briefs ([http://www.imf.org/cgi-shl/create\\_x.pl?ibeng](http://www.imf.org/cgi-shl/create_x.pl?ibeng)) and the Factsheets (<http://www.imf.org/external/np/exr/facts/eng/list.aspx>).

Concerning the results of the Fund's economic surveillance, including for countries in the Nordic-Baltic constituency, the reader is referred either to the Fund's general website ([www.imf.org](http://www.imf.org)) or the websites of each of our countries' authorities, where staff reports, press information notices etc. are published.

## II. QUOTA AND VOICE REFORM

The Fund's internal governance reform, one of the key elements of its Medium-Term Strategy, took a big step forward at the end of March when the Executive Board agreed on a new quota formula and recommended the Board of Governors to adopt a package of reforms. The package was approved by the Board of Governors in April with 175 countries representing 93 percent of the total voting power voting in favor of the reforms. The package involves:

- Ad hoc quota increases (according to the new quota formula) to better align quota shares with members' relative weight and role in the global economy and to make quota shares more responsive to future shifts in the global economy;
- Amending the Articles of Agreement to triple basic votes and to maintain the share of basic votes in total votes to prevent their erosion in the future.<sup>2</sup> The ratio of basic votes has declined steadily and this will be the first increase since the Fund was established;
- Amending the Articles of Agreement to enable Executive Directors elected by a large number of members to appoint an additional Alternate Executive Director. Once implemented, Executive Directors of constituencies with at least 19 members – capturing the two constituencies representing Sub-Saharan African countries – will be entitled to appoint two Alternate Executive Directors.

The Executive Board's recommendation for quota increases for 54 member countries is based on the new quota formula (see Box 1). These increases complement those agreed upon at the Annual Meetings in Singapore in 2006. To reinforce the objectives of the reform, the quota increases reflect three additional one-time elements: (i) several under-represented advanced countries have agreed to forego part of the quota increases they are entitled to according to the new quota formula, (ii) emerging market and developing countries whose shares of global GDP, as measured on the basis of purchasing power parity (PPP), substantially exceed their current quota shares receive a minimum nominal increase of 40 percent, and (iii) the four members that received quota increases at the 2006 Annual Meetings, but still remain under-represented, are ensured an additional minimum nominal increase of 15 percent.

The combined effect of the increases in quotas and basic votes is an increase in voting shares for 135 member countries. The aggregate shift in voting shares for these countries is 5.4 percentage points. Increasing the basic votes – and maintaining their share of total votes in the future – serves to avoid the erosion in voting shares of low income countries. Together with the additional Alternate Executive Director, this enhances the voice of these countries. The Nordic-Baltic chair will see a small reduction in the overall voting share even though five of our members are entitled to a modest quota increase. The shift will become effective once the amendments to the Articles of Agreement are accepted by a sufficiently broad part

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<sup>2</sup> A Fund member's votes consist of its basic votes (presently 250) and a vote for each SDR 100,000 in quota.

### Box 1: The New Quota Formula

The new quota formula consists of a single equation of four variables that improves the existing five formulae by providing a simpler and more transparent means of capturing the multiple roles of quotas, including capturing members' relative positions in the world economy. More specifically, the weight given to members' GDP, measured in a blend of market and purchasing power parity (PPP) exchange rates, is increased; the definitions of the formula variables are updated and modernized; and the role of members' economic size is reduced by introducing a compression factor that reduces the dispersion of calculated quotas across the membership. After 20 years, the Executive Board will review the scope for continuing measuring GDP partially at PPP exchange rates and retaining compression.

According to the new quota formula, a member's calculated quota share (*CQS*) is:

$$CQS = (0.5 \times GDP + 0.3 \times Openness + 0.15 \times Variability + 0.05 \times Reserves)^k$$

The variables are expressed in shares of global totals.

*GDP* is a blend of GDP converted at market rates and PPP exchange rates averaged over a three year period. The weights of market-based and PPP GDP are 0.60 and 0.40, respectively;

*Openness* is the annual average of the sum of current payments and current receipts (goods, services, income, and transfers) for a five year period;

*Variability* is the standard deviation of current receipts and net capital flows from the centered three-year trend over a thirteen year period;

*Reserves* is a twelve month average over a year of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold); and

*k* is the compression factor of 0.95. The compression factor is applied to the uncompressed calculated quota shares which are then rescaled to sum to 100.

of the membership and members eligible for a quota increase have paid in their part of the increase.

While these changes conclude the discussions on a Quota and Voice Reform initiated at the Annual Meetings in Singapore in 2006, they also represent only the first step in a longer-term reform process. The recommended package thus includes a commitment that the Executive Board will recommend further realignment of quota shares in the context of future general quota reviews, which takes place every five years. The Executive Board also stipulated that further work will be needed in refining some of the variable definitions going forward.

*The Nordic-Baltic chair* has played an active role in the Quota and Voice Reform. Our chair has promoted a simple and transparent quota formula and an outcome that enhances the representation and voice of low-income countries in the Fund. We were among the first to call for a tripling of basic votes. We thus supported the proposed quota increases as well as the amendments to the Articles of Agreement to triple the basic votes and to enable large constituencies to appoint more than one Alternate Executive Director. Moreover, we made a significant contribution to introducing a compression factor in the quota formula, which ensures a more balanced distribution of calculated quotas and helps guaranteeing a rules-based and robust result in the long run.

### III. A NEW INCOME-EXPENDITURE FRAMEWORK

In October 2007, the IMFC called on the Executive Board to develop specific proposals on a new income model and a new expenditure framework by the time of the 2008 Spring Meetings. Just before the Spring Meetings, the Board reached agreement on steps towards an integrated income-expenditure framework, building on a new income model and a refocusing of the Fund's work within the medium-term budget. To address the expected income-expenditure gap of USD 400 million, the Executive Board agreed to cut expenditures by approximately USD 100 million over the next three years and to bridge the remaining gap by additional income sources under a new income model.

*The Nordic-Baltic chair* was from the outset of the discussions ready to consider means to obtain additional income sources to support the Fund's work. At the same time, our chair has emphasized expenditure restraint as an important part of the solution.

#### A. A New Income Model

The primary source of additional income under the new income model derives from increased investment activities. The Fund's investment authority will be broadened and additional investment resources will be obtained via the proceeds from selling approximately 1/8<sup>th</sup> of the Fund's gold holdings (the proposed sale is restricted to the amount of gold the Fund has acquired after the Second Amendment of the Articles of Agreement in 1978 – 403 metric tons). Finally, the practice of repaying the Fund for the administrative expenses related to concessional lending under the PRGF-ESF Trust fund will be resumed, as long as this does not impair the Fund's ability to provide concessional lending to low income countries. Hence, under the new income model, the income derived from the Fund's lending activities is not intended to fully cover the Fund's provision of public goods and capacity building activities, but rather to cover costs related to lending activities and the necessary reserve accumulation.

There is general support within the Executive Board for this new income model, although a decision on selling gold has not yet been taken, since approval by the U.S. Congress is needed before the U.S. Executive Director can vote in favor of gold sales. Also, broadening the investment authority requires changing the Articles of Agreement. This element is now pending approval by the Fund's Board of Governors (deadline May 5, 2008) and further legislative action in most member countries.

*The Nordic-Baltic chair* considered it important to find a package solution that would put the Fund's finances on a sustainable footing. With regard to gold sales, we emphasized that such a sale should be ring-fenced, be conducted to observe maximum prudence, transparency and accountability and be coordinated with the Central Bank Gold Agreement-participants if sold on the market. Our chair was also ready to consider changing the Articles of Agreement to enable the Fund to invest quota resources in order to have a marginal source of income, in case the elements above did not provide sufficient income. However, this proposal has not gained sufficiently broad support in the Board and thus does not constitute a part of the new model.

#### B. Refocusing in the Medium-Term Budget

In April, the Executive Board considered a **new medium-term budgetary envelope** for financial years 2009–11, which includes spending cuts in the amount of 13.5 percent of

the Fund's administrative budget. The Executive Board approved the proposed administrative, restructuring and capital budgets for financial year 2009. A key driver of this new budgetary framework was a refocusing of the Fund's work (see below). Around 70 percent of the spending cuts will come from reducing the number of personnel. Following a phase to volunteer for separation, that ended in April, it is envisaged that up to 500 people will leave the Fund during the course of the financial year 2009 without the need for a general mandatory phase. Furthermore, effectiveness gains will come through better internal processes, including through more effective use of new technologies in support services and less exhaustive internal review processes. In addition, the Fund will seek additional external funding, including from donors, for some services that could be classified as bilateral services (and not the public good), e.g. technical assistance.

*The Nordic-Baltic chair* agreed with the Fund's medium-term budget as it was proposed, reflecting our view that the untenable budget situation should not be solved only by increasing the revenue side without looking at the expenditure side. Within the strategic directions agreed upon by the Executive Board, the management of the Fund should then decide on exact measures when it comes to specific budgetary actions. With regard to capacity building in member countries, our chair is ready to consider the possibility of some element of differentiated fee structure for technical assistance, combined with increased external financing. In our view, it is important to design a fee structure that does not prevent low income countries from seeking much needed technical assistance. We have also agreed that the budget of the Nordic-Baltic office will be decreased by more than 10 percent. This will mean some rearrangements in the way the office works, but all eight countries will remain represented in the office.

In the context of the budget deliberations, the Executive Board discussed a **refocusing of the Fund's work** in March and confirmed the main tasks of the Fund as they were seen in the Medium-Term Strategy. The Fund's core work will not be changed, but the Fund will need to focus more on where its comparative advantages lie. Surveillance will stay a core task, with bilateral surveillance being strengthened by the insights the Fund gains via increased focus on multilateral and regional surveillance. Also, the Executive Board emphasized that there needs to be stronger integration of financial sector work and real sector surveillance. As for other pillars of the Fund's work, the Board agreed to step up work on an appropriate crisis prevention financial line, and that the Fund continues to have a role in low income countries building on its comparative advantages. The work in areas farther away from the Fund's core would be decreased, especially those where the World Bank or other international organizations have the lead.

*The Nordic-Baltic chair* emphasized the need to maintain the high quality and coverage of the Fund's surveillance, but agreed that its focus could be improved, especially through the knowledge the Fund has from its cross-border and regional analysis. In our view, surveillance should focus on spill-over effects and linkages between the real and financial sectors and be guided by a risk-based approach. The Fund should continue to play an important role in low income countries by focusing on creating stable macroeconomic frameworks and by being able to provide selective, limited and temporary concessional financial assistance. Close cooperation with the World Bank remains essential for the Fund to stay focused and effective.

#### IV. SURVEILLANCE

The ongoing financial market turmoil has naturally dominated the Fund's surveillance landscape for the past few months. It was the main factor underlying the downward revisions in the Fund's global growth-rate forecast in this spring's World Economic Outlook (WEO) and formed the overarching theme for the Global Financial Stability Report (GFSR). On a bilateral level, the turmoil and other financial sector issues have also been given more emphasis in the relevant Article IV consultations.

Since the Annual Meetings, the Executive Board has had several opportunities to discuss the policy implications of the global financial turmoil and other issues of global relevance, namely globalization and financial markets, ways to facilitate the development of a set of voluntary best practices for Sovereign Wealth Funds and the fiscal implications of climate change.

##### **A. The Global Financial Turmoil, Financial Sector Surveillance and the Role of Fiscal Policy**

In the run up to the Spring Meetings, the Executive Board discussed the tentative outcomes from the Fund's collaboration with the Financial Stability Forum (FSF), the Bank for International Settlements (BIS) and other stakeholders on analyzing and drawing policy lessons from the present financial turmoil, in accordance with the IMFC Communiqué from October 2007, under the headline **Recent Financial Turmoil – Initial Assessment, Policy Lessons, and Implications for Fund Surveillance**. The analysis develops a framework around five key areas for analyzing the structural causes of the ongoing crisis: risk management practices related to structured finance products; the role and design of credit ratings of structured products; the valuation, accounting and disclosure of structured products; crisis and emergency liquidity management by central banks; and the regulation and prudential oversight of banks and other financial entities.

The Executive Board supported staff's tentative medium-term policy proposals and underscored the importance of a better understanding of both the macro-financial and the cross-country financial linkages that had been inherent in the ongoing turmoil. The Board also encouraged staff to continue its work in close collaboration with national authorities, other international bodies and market participants.

Related to the global financial market developments, the Executive Board held a seminar in February on **Globalization, Financial Markets and Fiscal Policy**, which provided an opportunity for an exchange of views on how fiscal policy can contribute to realizing the benefits from globalization and financial deepening.

While the analytical and empirical work in this area are suggestive of some policy implications, on the whole the Board cautioned against drawing strong conclusions as the causal relationship between globalization, financial deepening and fiscal policy often remains unclear. Among other things, the Board considered the evidence inconclusive on whether fiscal policy has become a more or less effective stabilization tool due to increasingly intertwined global financial markets, and on whether the fiscal policy spillovers, magnified by globalization, warrant enhanced international policy coordination.

*The Nordic-Baltic chair* has consistently promoted closer integration of financial sector issues into the Fund's surveillance and shares the sentiment that the Fund, in collaboration with other stakeholders, needs to be responsive to the ongoing developments in financial markets. We were in broad agreement with the tentative policy recommendations that emerged from the Fund's collaboration with the FSF and other stakeholders. In particular, we highlighted the ongoing crisis' rapid dispersion across borders and markets and the need for the Fund to continue to expand its focus beyond individual country borders by taking a more regional stance in its surveillance. Regarding the implications of the turmoil and the increasingly integrated financial markets on fiscal policy, we agreed that the empirical evidence is too mixed to draw firm conclusions, especially in the context of strengthening cross-country policy coordination that may risk reducing the effectiveness of fiscal measures.

## **B. Sovereign Wealth Funds**

In the course of 2007, the international debate on the benefits and challenges of Sovereign Wealth Funds (SWFs) intensified. At its meeting in October 2007, the IMFC noted the growing importance of SWFs in international financial markets. While recognizing their positive role in enhancing market liquidity and financial resource allocation, the Committee called on the Fund to engage in a dialogue with countries on identifying sound practices in the management of SWFs. Following up on this, the Fund in November 2007 convened the First Annual Roundtable of Sovereign Asset and Reserve Managers where a discussion was held with the SWFs to learn from their experience and views. Norway was represented at this meeting. It was decided to continue the dialogue.

The Executive Board discussed issues surrounding SWFs - especially work by the Fund to facilitate and coordinate the development of best practices, in March 2008. In the view of the Board such best practices would be expected to focus on governance, institutional and risk management arrangements, investment policies and transparency. Best practices should be adopted on a voluntary basis. It was agreed to establish an International Working Group on SWFs to begin technical discussions towards the end of April, and Norway has accepted to participate in this Working Group. A set of best practices should be developed by the 2008 Annual Meetings. The IMFC in its April 2008 meeting welcomed the Fund's initiative and the timeframe. The Committee noted that such best practices should be developed on a collaborative and voluntary basis, and go hand in hand with the work in OECD and elsewhere on best practices for countries receiving SWF-investments.

At the Board meeting, *the Nordic-Baltic chair* noted that SWFs offer various economic and financial benefits, but saw a need to work towards a high degree of transparency to ensure trust and proper functioning of financial markets. We also emphasized that work must be done in cooperation with countries having SWFs, recipient countries and other stakeholders.

## **C. Fiscal Implications of Climate Change**

In March, the Executive Board held a seminar on the Fiscal Implications of Climate Change. Fiscal implications relate to policies both to mitigate climate change (by reducing emission and hence the extent of warming) and to adjust to the effects of climate change (by reducing damage caused by warming). Climate change constitutes a global externality, making a case for international cooperation on fiscal policies, and many low

income countries, including low-lying nations, may be disproportionately affected by the changes.

The Executive Board considered that the Fund could provide valuable contributions in understanding and dealing with the fiscal challenges from climate change within its core competencies. Climate change-concerns tend to reinforce established Fund advice on fiscal management, for instance in relation to energy subsidies. Fiscal instruments will in many countries help to ensure effective pricing of emissions and to provide a supportive environment for innovation. In countries particularly exposed to climate risk, adjusting to the effects may impose significant pressures on public spending, and a better understanding will be needed.

*The Nordic-Baltic chair* has been pushing hard to put macroeconomic aspects of climate change on the Fund's agenda, and we agreed that it can be a useful forum for discussing and exchanging experiences on economic instruments for cost-effective mitigation. We also agreed that the Fund's supportive role in these matters could be accommodated within the existing resource envelope. Concerning mitigation, our chair particularly underscored the importance of the broadest possible participation to avoid so-called carbon leakages whereby emission is shifted to non-participants. With respect to adjustment, we highlighted the principled problems in earmarking mitigation revenues to adjustment measures, including the resulting constraints to public finances and the risk of inefficient spending.

## **V. LENDING POLICIES AND THE FUND'S ROLE IN LOW INCOME COUNTRIES**

Since the Annual Meetings in October 2007, the Executive Board has discussed aspects of the Fund's lending policies and several items specifically related to low income countries. Several of these matters will stay on the Board's agenda, as follows from below.

Looking forward, the Fund's work in low income countries will also be affected by the sharp rise in food and energy prices, which have a strong impact on the poorest segments of the population. The IMFC at its Spring Meeting urged the Fund to work closely with the World Bank and other partners in an integrated response through policy advice and financial support. The Managing Director is actively engaged in this issue and the Fund is already in dialogue with several members regarding advice on appropriate policy responses and financing possibilities.

### **A. Review of Access Policies**

In February, the Board conducted the periodic review of the Fund's access policy, i.e. of the rules governing the financing amount available for member countries under different types of economic programs. It was decided to maintain the current access limits (see box 2), reflecting that most Directors considered that the guidelines and limits underlying the access policy as well as the framework determining exceptional access remain broadly appropriate. In particular, Directors considered that the current limits provide an important threshold in the sense that access decisions beyond these limits are subject to greater scrutiny. However, at the Spring Meeting, the IMFC encouraged the Board to consider increasing the level of normal access limits, referring to the recognition that

emerging markets and developing countries are not immune to a broadening of the problems in financial markets.

*The Nordic-Baltic chair* supported the Fund staff's proposal to maintain the existing policies. While recognizing the uncertainties in forecasting countries' future financing needs, we considered that the current limits provide an important threshold for imposing greater scrutiny on access decisions.

### **Box 2: Summary of Current Access Limits**

**Normal access limits:** Access by a member to resources in the credit tranches, under the Extended Fund Facility (EFF) and, overall, the Fund's General Resources is subject to limits of 100 percent of quota annually, and 300 percent of quota cumulatively.

**Exceptional access:** In exceptional circumstances, a member in capital account crisis could be granted access beyond the normal access limits were it to meet a set of substantive criteria for exceptional access under the *exceptional access framework*. Also, in rare instances of non-capital account crises, a member could similarly be granted exceptional access under the *exceptional circumstances clause*, whereby the case would be judged "in light of" the substantive criteria.

**PRGF access limits:** The access limit for a three-year Poverty Reduction and Growth Facility (PRGF) arrangement is 140 percent of quota, with the possibility of access up to 185 percent of quota in exceptional circumstances. However, the expected average access under the initial three-year arrangement is 90 percent of quota and access is subsequently reduced for successor arrangements.

## **B. Independent Evaluation of Structural Conditionality**

In December last year, the Executive Board welcomed a report by the Independent Evaluation Office (IEO) on structural conditionality in Fund-supported programs. The Board viewed the findings in the report as an important contribution to the efforts to make the Fund a more relevant institution, and welcomed the finding of a shift in program designs towards greater focus on the Fund's core areas. This was attained by targeting fewer areas of reform, while the use of conditionality had become more selective.

The Board agreed that there is scope for further improvements. Besides only focusing on the number of conditions, structural conditionality could be better tailored after country-specific circumstances to match the goals that are critical for the program, while taking better account of the quality of the conditions. Moreover, the Executive Board recognized that program ownership has to be enhanced. Going forward there was agreement around the IEO's recommendation to strengthen the efforts to streamline conditionality, while enhancing ownership by involving the authorities in setting the conditions. In this context, the Board also discussed the necessity for strengthened collaboration with the World Bank, and the desirability of improving the Fund's outreach to enhance the understanding

among the public of the purpose of conditionality. An implementation plan following this report of the IEO will soon be put to the Executive Board.

*The Nordic-Baltic chair* was broadly supportive of the findings and recommendations of the IEO report. In particular, our chair underlined that the Fund should continue to streamline conditionality with the overarching aim of improving country ownership. We also agreed that structural conditionality should be used sparingly by aiming at conditions critical for achieving the program objectives within the Fund's core areas. Moreover, the Nordic-Baltic chair was supportive of enhanced outreach efforts. In this regard, our Norwegian authorities have hosted a conference on conditionality, and initiated a dialogue on the findings of the IEO report.<sup>3</sup>

### **C. Changes to the PRGF-HIPC Trust Instrument**

The Executive Board discussed in January a proposal to modify the PRGF-HIPC Trust Instrument to make it possible for a few remaining pre-decision Heavily Indebted Poor Countries (HIPC) to build a track record toward the HIPC Initiative decision point on the basis of a staff monitored program (SMP). The change was aiming at giving these countries credit for their strong program performance under an SMP during the time when the Fund is securing financing assurances to enable arrears clearance and debt relief. By adopting the proposed modification, delivery of debt relief to Liberia (see below) could be achieved without delay.

The Executive Board was supportive of the proposal, but clarified that the individual assessment of whether a given SMP meets the policy standards associated with Fund supported programs in the so called upper credit tranches will be used only to consider a member's eligibility for HIPC Initiative debt relief.

*The Nordic-Baltic chair* supported the proposal to alter the rules governing the PRGF-HIPC Trust Instrument, emphasizing the importance of retaining a critical role for the Board in assessing the quality and implementation record of an SMP in individual country cases.

### **D. Liberia**

The Executive Board has met several times over the past year to discuss the normalization of Liberia's relation with the Fund, the financing of arrears clearance and subsequent debt relief. In early February, the Board agreed that Liberia was eligible for HIPC Initiative debt relief, and that Liberia was – provided continued strong performance under its Staff Monitored Program – close to accomplishing the qualifications for its HIPC decision point.

Since the Fund's management around the same time had obtained adequate financing assurances from member countries, the Board discussion in February laid the ground for the historical Executive Board meeting in mid-March, when Liberia's arrears to the Fund were finally cleared, and its voting and related rights in the Fund were restored. At the mid-March meeting, the Board also concluded that Liberia had reached its HIPC decision

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<sup>3</sup> See <http://www.regjeringen.no/en/dep/ud/Documents/Reports-programmes-of-action-and-plans/Reports/2006/Oslo-Conditionality-Conference.html?id=437791>

point, and approved a three-year PRGF program. Nonetheless, the Board pointed out that the Liberian authorities are still facing many challenges and risks. It was noted that the involvement of the international community in providing the necessary financial and technical assistance will be pivotal.

*The Nordic-Baltic chair* warmly welcomed the normalization of the relationship between Liberia and the Fund. All eight countries in the constituency have contributed to the financing of Liberia's future HIPC debt relief, and in so doing supported the arrears clearance. Our chair also agreed that the SMP was strong enough to qualify as a track record leading up to the HIPC decision point.

#### **E. The Fund's Engagement in Fragile States**

The Executive Board recently discussed ways for the Fund to better engage with fragile states, whose economic and social performance is substantially impaired by weak governance, limited administrative capacity, persistent social tensions and a tendency to conflict and political instability. Normal Fund-supported programs have in some cases proven to be too challenging for these countries due to their wide-spread capacity constraints.

The Board acknowledged that there is scope for modifying existing Fund modalities to assist these countries, while emphasizing that such an approach has to remain flexible. The Board considered that Fund support to fragile states should be tailored to their evolving macroeconomic prospects and implementation capacities, contribute to the joint international efforts to address their needs and adhere strictly to the Fund's mandate. The Fund should foremost focus on helping these countries to rebuild their institutional capacity, while many of the challenges facing fragile states are typically developmental and should, therefore, fall under the responsibility of the World Bank, regional development banks and donors. In this regard, the Board's discussion on introducing new accessible financial assistance for fragile states, depending on their level of institutional capacity and balance of payment needs, was inconclusive. The Board's discussion in March will be followed-up taking into account views expressed at the meeting.

*The Nordic-Baltic chair* agreed that the current framework could be improved to help fragile states over the medium term. Our chair, therefore, welcomed a more structured approach to intensified technical assistance and to enhanced signaling, which may underpin bilateral and multilateral donor efforts in capacity building. Our chair was also supportive of closer coordination among external partners and donors. However, we expressed hesitance regarding financial support, but showed willingness to further explore different options in forthcoming discussions.

**VI. STAFF OF THE NORDIC-BALTIC IMF OFFICE**  
as of April, 2008

Jens Henriksson	SWE	Executive Director
Jarle Bergo	NOR	Alternate Executive Director
Darius Abazorius	LIT	Senior Advisor
Cecilia Roos Isaksson	SWE	Senior Advisor
Björn G. Ólafsson	ICE	Senior Advisor
Janne Hukka	FIN	Advisor
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