IMPLEMENTATION OF LEGISLATIVE PROVISIONS RELATING TO THE INTERNATIONAL MONETARY FUND

A Report to Congress

in accordance with

Sections 1503(a) and 1705(a) of the
International Financial Institutions Act

and

Section 801(c)(1)(B) of the
Foreign Operations, Export Financing, and Related Programs
Appropriations Act, 2001

United States Department of the Treasury
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Introduction

This is the fifth report prepared in accordance with Sections 1503 and 1705(a) of the International Financial Institutions Act (the IFI Act – codified at 22 United States code sections 262o-2 and 262r-4).[1] This report also covers policies set forth in Section 801(c)(1)(B) of the Foreign Operations, Export Financing, and Related Program Appropriations Act 2001, [2] as required by amended Section 1705 of the IFI Act. The report reviews actions taken by the United States during fiscal year 200.3 to promote these legislative provisions in International Monetary Fund ("IMF" or the "Fund") country programs. Earlier reports under these provisions are available on the Department of the Treasury's website (www.treas.gov/press/reports.html).

The Treasury Department and the Office of the United States Executive Director ("USED") at the IMF consistently endeavor to build support in the IMF's Executive Board for the objectives set out in this legislation. These efforts include meetings with IMF staff and other Board members on individual program and IMF policies, as well as formal statements by the USED in the IMF Board. Our objective in doing so has been to support strengthened commitments in IMF programs, policy actions by program countries, and policy decisions at the IMF itself.

An assessment of the overall effectiveness of the Treasury and USED's office in promoting the legislative provisions was published in a GAO Report dated January 2001.[3] The report found that the "Treasury has instituted a systematic process for applying legislative mandates concerning the Fund to individual countries, based on their economic circumstances."

Report on Specific Provisions

I. <u>Section 1503(a)</u>

(1) Exchange Rate Stability

Article I of the IMF's Articles of Agreement states that one of the purposes of the IMF is "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation." The IMF advises countries that exchange rate stability can only be achieved through the adoption of sound macroeconomic policies. While the Fund recognizes the right of each member country to choose its own exchange rate regime, it

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[1] These provisions were enacted in Sections 610 and 613 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999 (Public Law 105-277, division A, § 101(d), title VI, §§ 610 & **613).** Section 1705(a) was amended by Section 803 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001 (Public Law 106-429, title VIII, § 80.3).
[2] Public Law 106-429, title VIII, § 801(c)(1)(B).
[3] *Efforts to Advance United States Policies at the Fund*, General Accounting Office (GAO), January 2001. As required under section 504 of H R. 3425, as enacted in Appendix E to section 1000(a)(5) of Public Law 106-113 (making consolidated appropriations for Fiscal Year 2000), the GAO conducted a review of Treasury's implementation of legislative objectives for IMF reform Its work focused "on the measures taken by United States agencies to promote IMF practices that are consistent with United States policies set forth in federal law and the influence United States policy has over the IMF's operations and other members' positions, as illustrated by specific cases."

advises countries on macroeconomic and financial policies necessary to support the sustainability of that regime and raises caution where it views arrangements to be inconsistent with broader macroeconomic policy choices.

(2) Policies to increase the effectiveness of the IMF in promoting market-oriented reform, trade liberalization, economic growth, democratic governance, and social stability through:

(A) Establishment of an independent monetary authority

With the support of the United States, the IMF has been a consistent advocate of greater independence of monetary authorities across a range of countries. IMF conditionality frequently includes measures to strengthen central bank autonomy and accountability. The IMF also provides technical assistance to help countries achieve these goals. In addition, the Fund promotes these objectives through assessments of compliance with internationally-agreed upon standards and codes, as well as rules for safeguarding the use of IMF resources. Examples of United States activities in the last year with regard *to* these issues include the following:

- In discussions with the Brazilian authorities, the United States continued to highlight the benefit of increased central bank independence, including the importance of operational autonomy to strengthen the credibility of the inflation-targeting regime, to reinforce lower inllationary expectations, and to allow interest rates to fall.

- In a June 200.3 discussion on Argentina, tlie USED emphasized the importance of steps to strengthen central bank autonomy and legal protection for its officials.

(B) Fair and open internal competition among domestic enterprises

With United States support, the IMF encourages member countries to pursue policies that improve internal economic efficiency. These measures may include ending directed lending (or other relationships between government and businesses based on favoritism), improving anti-trust enforcement, and establishing a sound and transparent legal system. While the World Bank has tlie lead mandate on these issues, the IMF has at times incorporated related measures into programs when it considered them critical to macroeconomic stability. For example,

- The USED recently supported the inclusion of structural benchmarks in Uruguay's IMF program that require tlie issuance of decrees to foster competition in the telecommunications (observed in March 200.3) and oil (scheduled for December 200.3) sectors.

(C) Privatization

While the World Bank is primarily concerned with privatization, tlie IMF has made it a component of country program where significant distortions and government ownership of business enterprises have created substantial inefficiencies in the allocation of resources and tlie production of goods. Collaborating with the World Bank, the Fund lias supported tlie use of competitive and transparent means of privatization so that borrowing countries might achieve gains in economic efficiency and improve their fiscal positions. Examples of IMF programs in wliicli tlie USED has advocated privatization include tlie following:

- The state-owner1 bank, Guyana National Cooperative Bank ("GNCB"), was privatized in March 200.3. **In** September 2002, tlie USED supported tlie approval of Guyana's three-year PRGF, which called for tlie privatization or resolution of GNCB. This was also made a completion point trigger under its Heavily Indebted Poor Countries ("HIPC") program.

- In tlie IMF Board discussion of South Africa's Article IV review in August 200.3, the USED welcoined the sale of a significant share of Telekom and encouraged the government to follow through on plans to accelerate tlie privatization and restructuring of public enterprises to increase efficiency and growth.

(D) Economic deregulation and strong legal frameworks

Markets are distorted and entrepreneurship is stifled without strong property rights, enforcement of contracts, and fair and open competition. While these issues are addressed as part of tlie World Bank's mandate, tlie IMF periodically includes measures in its programs, in collaboration with the World Bank, when they are considered critical to tlie member country's macroeconomic performance. Examples of USED efforts to encourage these reforms include the following:

- During discussions of Bosnia in 2003, tlie USED encouraged the government to take steps to improve tlie business climate and raise its growth rate, including through deregulation.

- **In** April 200.3, tlie USED noted that Belarus had not taken tlie steps needed to put tlie economy clearly on a market-oriented path and urged a number of steps, including deregulation, to improve tlie inhospitable business climate.

(E) Social safety nets

The World Bank takes tlie lead on issues involving tlie design and implementation of social safety nets, but it is imperative that social safety nets fit into a sound fiscal framework, an issue in which tlie IMF takes tlie lead. While growth is tlie key ingredient for poverty reduction, social safety nets can play an important role in promoting ownership and alleviating tlie impact of poverty on the most affected segments of society. Against this background, tlie United States encouraged efforts by tlie IMF, World Bank, Asian Development Bank and Inter-American Development Bank to develop social safety net guidelines, building on tlie lessons of experience in Latin America and East Asia. Additionally, the United States has been a strong proponent of increased IFI funding for productivity-building investments in public education, health and other social services. Finally, tlie United States continues to press its grants initiative with tlie multilateral development banks and has supported steps taken by tlie IFIs to revise their lending frameworks to focus more on tlie reduction of poverty indicators. The United States has supported this policy goal in tlie following examples:

- At a Board discussion in May 2003, the USED urged Kazakhstan to focus on increasing resources devoted to education, health, and the provision of a well-targeted social safety net.

- In July 2003, the USED argued that Dominica should enhance its social safety net to help cushion the blow of potential civil service layoffs, assuming resources could be found.

(F) Opening of markets for agricultural goods through reductions in trade barriers

The IMF, with the support of the United States, has been a consistent advocate of open markets and trade liberalization, while recognizing that further reform is primarily a matter for member countries to pursue. The IMF encourages a multilateral, rules-based approach to trade liberalizatioii across all sectors of the global economy, including, but not limited to, the agricultural sector. Tlie Fund is prepared, along with tlie World Bank, to provide transitional assistance to member countries, which are experiencing payment imbalances arising from the passage of trade reform. Examples of when tlie United States has supported trade liberalization:

- In its 2003 Board statements, the USED urged Brazil to pursue further trade liberalization

- In 2002 and 2003, the USED suggested that certain European countries, including Belgium and Germany, could act as voices within the European Union for more rapid trade liberalization.

(3) *Strengthened financial systems and adoption of sound banking principles and practices*

Tlie joint IMF-World Bank *Financial Sector Assessment Program* ("FSAP") has emerged as a critical instrument for financial sector surveillance and advice. Fifty-seven FSAP assessments had been completed with fourteen additional reviews underway and twenty-nine reviews planned as of August 200.3

Results from the FSAPs are used to generate assessments of compliance with key financial sector standards such as the Basel Committee's *Core Principles for Effective Banking Supervision,* tlie International Organization of Securities Commission's *Objectives and Principles of Securities Regulation,* and the IMF's own *Code of Good Practices on Transparency in Monetary* **arid** *Financial Policies*. The latter report is often provided to the public through the *Reports on the Observance of Standards and Codes* ("ROSCs").

In 2002, the Executive Boards of the IMF and World Bank reached conditional agreement on incorporating Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) into areas and standards useful to their work, and endorsed a 12-month pilot prograin of AML/CFT reviews as part of their FSAP and Off-Shore Financial Center ("OFC") assessments. Some key examples of where the USED lias supported tlie strengthening of financial systems are:

- Strengthening the banking sector has been a central pillar of Turkey's program. The United States took the lead in advancing these issues through discussions with IMF staff and Turkish authorities. Some of tlie program's conditions include addressing weak state banks (including designing and adliering to a privatization strategy for three state banks), reducing nonperforming loans in tlie banking system, and strengthening tlie regulatory oversight of tlie bank regulator.

- In tlie discussion of Bangladesh's request for a PRGF in June 2003, the USED strongly recommended that all national commercial banks be privatized during tlie PRGF term. Tlie USED noted experiences in other countries where state ownership of large banks led to repeated mismanagement and public bailouts.

- In Board statements in 200.3, tlie USED encouraged Uruguay to restructure Banco de la Republica, tlie largest state owned bank, and to ensure that it meets prudential norms.

(4) *Internationally acceptable domestic bankruptcy laws and regulations*

Tlie IFIs have continued to build upon worlc started after tlie Asian financial crisis to promote more effective insolvency and debtor-creditor regimes. While tlie World Bank normally leads reviews of domestic insolvency laws, tlie IMF is supporting this agenda in several important ways. Additionally, tlie IMF and tlie World Bank have supported adoption of tlie Model Law on Cross-Border Insolvency developed by tlie UN (the UNCITML Model Law) to facilitate tlie resolution of increasingly complex cases of insolvency, where companies have assets in several jurisdictions. Finally, tlie IFIs provide technical assistance to help emerging market economies develop efficient insolvency regimes. With tlie support of the United States, tlie IMF has worked with tlie World Bank to promote improved insolvency regimes in a number of countries.

- In 2002 aiid 2003, tlie USED continued to emphasize the need for a clear and impartial legal framework for bankruptcy proceedings in Argentina that would, among other things, help to improve investor confidence.

- During 2002 and 2003, tlie USED encouraged Brazil to reform weak bankruptcy laws and allow lenders to collect on collateral, which would boost bank lending aiid contribute to lower borrowing spreads. Tlie USED also stressed that increasing tlie efficiency of the ,judicial system would be necessary to maximize tlie benefits of banluuptcy reform, particularly in light of tlie large bacltlog of bankruptcy cases.

(5) *Private Sector.Involvement*

The United States continues to work to assure that tlie private sector plays an appropriate role in tlie resolution of financial crises. In tlie last year, tlie IMF, with tlie support of tlie United States, has taken important steps towards achieving tlie reform agenda on crisis prevention and resolution, as specified in tlie G-7 Action Plan of April 2002. The Fund lias strengthened its surveillance of member countries and instilled more discipline in tlie use of official sector financing, especially through tlie establishment of rules aiid procedures governing exceptional access to Fund resources. Additionally, tlie emergence of collective action clauses (see Section C, below), supported by tlie IMF, as an accepted contractual, market-based approach to sovereign debt restructurings will lend predictability aiid efficiency to crisis resolution frameworks. In particular, tlie United States lias advocated policies that include:

(A) Increased Crisis Prevention through Improved Surveillance and Debt and Reserve Management

The United States has urged the IMF to strengthen further its surveillance function and crisis prevention capabilities, especially its assessment of debt sustainability, balance sheet vulnerabilities, and currency mismatches.

- In the past year, the IMF took additional steps to iinprove its assessment of public and external debt sustainability. In April 200.3, the Fund incorporated a revised, more robust analytical framework for evaluating debt sustainability into selected surveillance assessments and all Use of Fund Resources reports.

- In July 200.3, tlie Board reviewed tlie role of balance sheet impacts and currency mismatches in financial crises and determined that a strengthened analytical framework was required to identify related vulnerabilities during the Fund's surveillance assessments.

The IMF continues to encourage, with strong United States support, member countries to make their economic and financial conditions more transparent. Countries are urged to provide additional information to private market participants by publishing Article IV assessments and program documentation as well as by regularly releasing data consistent with the IMF's Special Data Dissemination Standard (SDDS) (see Section 12).

- In September 2003, the Board amended tlie Fund's document publication guidelines, determining that the publication of Use of Fund Resources staff reports and Article IV surveillance reports (after July 2004) will remain voluntary, but presumed. Additionally, after July 2004, all exceptional access reports will generally be published as a pre-condition for tlie Board's approval of such an arrangement.

(B) Strengthening of Emerging Markets' Financial Systems

The IMF continues to work with other IFIs to promote stronger financial systems in emerging market economies (see Section *3)*. It is also actively involved, with the World Bank, in monitoring the implementation of the ***Core Principles for Effective Banking Supervision.*** The IMF, with United States support, has increased its cooperation with the World Bank in this area, through the joint FSAP and cooperative assessments of other standards and codes (see Section 12).

(C) Use of Collective Action Clauses in Sovereign Bonds

Sovereign debt instruments governed by New York law conventionally have included majority enforcement but not inajority restructuring provisions. As a result, debt restructurings of these emerging market instruments have tended to be protracted, with adverse consequences for sovereigns and bondholders.

The United States has worked actively with the IMF and the private sector to promote the market's adoption of majority restructuring provisions (together with inajority enforcement provisions, "collective action clauses") in order to improve debt restructuring processes. Critical advances were made in 200.3, and emerging market issuers, including Brazil, Korea, South Africa, and Turkey, are increasingly including collective action clauses in sovereign debt offerings governed by New Yorlc law.

Tlie IMF, encouraged by tlie United States, has made collective action clauses an important element of its crisis resolution agenda. Tlie IMF will continue to encourage future issuers to follow this trend in strengthening market practices through bilateral and multilateral surveillance.

(D) Lending into Arrears

The IMF's policy enables tlie Fund to provide financial support for policy adjustments, despite tlie presence of actual or impending arrears on a country's obligations to private creditors, where: (i) prompt IMF support is considered essential for tlie successful implementation of the member's adjustment program; and (ii) tlie member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors. In September 2002, tlie IMF, with support from tlie United States, took steps to clarify its assessment of "good faith" actions, seeking to reduce tlie market's uncertainty about when and under what conditions tlie IMF will lend into arrears. To meet the IMF's criteria, member countries should (i) expeditiously initiate a dialogue with creditor classes and continue these discussions until the debt restructuring is resolved, (ii) provide creditors with lion-confidential information in a timely manner, and (iii) provide creditors with tlie opportunity to influence the restructuring program.

(E) Promotion of Orderly Workouts

In April 200.3, tlie International Monetary and Financial Committee, with the strong support of tlie United States, concluded that collective action clauses, rather than a statutory restructuring mechanism, would more effectively address workout problems while retaining private iiiarlcet support.

(F) Formal Linkage between Provision of Official Financing and Private Sector Involvement

The United States continues to press tlie IMF to improve tlie selectivity with which it lends

- In September 2002, tlie United States worked to clarity that for tlie Fund to extend resources beyond normal borrowing limits, the following criteria must be met at a minimum: (i) the member must be experiencing "exceptional balance of payments pressures on tlie capital account" which cannot be addressed with normal resources, (ii) an analysis concludes that debt levels will be sustainable, (iii) reasonable prospects exist for the member to regain access to private capital markets during tlie program term, and (iv) tlie member's policy program can reasonably be expected to succeed.

- In January and February 200.3, tlie Fund, with support from the United States, published procedures to guide its decision-making process on granting exceptional access. These guidelines require tlie following: (i) a "higher burden of proof in program documentation",

(ii) early consultation with the Board on sovereign-creditor negotiations, (iii) the issuance of a staff note specifically outlining all of the relevant considerations, and (iv) an ex-post evaluation of such programs within twelve months of their completion.

(G) Facilitation of Discussions between Debtors and Creditors

As noted above, the United States is working closely with the IMF and others in the official and private sectors to promote the use of collective action clauses in external sovereign bond contracts, to encourage early dialogue, coordination and communication between sovereigns and bondholders, and to discourage disruptive legal action. In addition, improving interaction between debtor countries and private creditors has been a key focus of the IMF's Capital Market Consultative Group (CMCG).

(H) Combining the Provision of IMF Funding with Efforts to Achieve Private Sector Involvement

The IMF promotes private sector involvement and aims to develop a system in which countries can address debt problems in a market-based, orderly fashion. It recognizes the need to preserve the fundamental principle that creditors should bear the consequences of the risks they assume, while neither undermining the equally essential principle that debtors should honor their obligations nor encouraging default.

(6) Good governance

The IMF's commitment to promoting good governance is outlined in its 1996 *Declaration on Partnership for Sustainable* Global *Growth* and its 1997 Guidelines *on Good Governance*. The IMF also supports good governance through its emphasis on transparency and its promotion of market-based reforms.[4] Recently, the IMF has been particularly active in promoting good governance through its efforts to protect against abuse of the financial system and to fight corruption.

Protecting against Abuse of the Financial System, including Money Laundering

The United States and other IMF members have stressed the importance of integrating anti-money laundering and counter-terrorist financing issues into the IFI's financial sector assessments, surveillance, and diagnostic activities., As a result, and after a year of preparatory work among the FATF, the IMF and World Bank, in the fall of 2002, the Executive Boards of the IMF and World Bank endorsed a 12-month pilot project. The program will assess global compliance with the anti-money laundering and counter-terrorist financing standards based on the FATF 40 Recommendations on Money Laundering and the 8 Special Recommendations on Terrorist Financing.

These assessments are being conducted by the IMF and World Bank, with the FATF's and the FATF-style regional bodies' (FSRBs) participation, in the context of financial sector and off-

[4] IMF financing is provided to central banks to address balance of payments difficulties The IMF does not lend to fund specific projects in member countries aimed at procurement and financial management controls

shore financial center assessments. Tlie methodology applied in these assessments was developed jointly by the IFI's and the FATF, with input from the FSRBs, and represents a comprehensive and unified method for measuring countries' implementation of the FATF Recommendations. Over 50 assessments are expected to be completed during tlie pilot project which ends in October 2003. Tlie pilot is progressing well and will be reviewed by the IMF and World Bank policy-making bodies during tlie first half of next year. 'Tlie goal is that such AML/CFT assessments will become a permanent part of tlie IMF and World Bank's oversight aiid surveillance of financial systems. This is crucial to the wai on terrorism and will help anchor the foundations of sustainable growth and development.

- In April 200.3, tlie USED recognized Russia's efforts to combat money laundering and the financing of terrorism that led FATF to remove Russia from the list of non-cooperative countries. However, further progress is needed on the legal framework and enforcement mechanisms, such as allowing banks to terminate relationships with customers suspected of laundering funds.

- In June 2003, the USED urged additional steps by Madagascar to regulate the gemstone mining sector since its current unregulated status leaves the country vulnerable to money-laundering and other criminal activity aiid serves as a source of possible terrorist financing. The USED also encouraged Madagascar to continue working with the World Bank on a Mineral Resources Governance project to help reduce illegal activities in tlie mining sector.

Other Good Governance nnd Anti-Corruption Measures

The Fund's involvement has focused on those governance aspects that are generally considered part of tlie IMF's core expertise, such as improving public administration, increasing government transparency, enhancing data dissemination, aiid implementing effective financial sector supervision. However, members have agreed that the IMF's role should also extend into other areas, where anti-corruption efforts would clearly have a positive impact on tlie macroeconomic environment. Transparency is central to good governance and accountability, and the 2003 *G-8 Declaration on Fighting Good Governance and Improving Transparency* called for full disclosure of IMF Article IV staff reports. Tlie IMF Board of Directors has since agreed that the publication of the staff reports will be presumed beginning in July 2004 (see Section 5). Examples of United States aiid IMF support for policies that encourage good governance include the following:

- Commenting on Kenya in May 200.3, the USED cited "corruption as perhaps the single most immediate barrier to good policies and growth – and poverty reduction" and stressed the importance of implementing recently passed anti-coiruption measures.

- Tlie 2003 Interim Poverty Reduction Strategy Paper ("PRSP") for Bangladesh has the promotion of good governance as one of its key focal areas. With the help of the Bank aiid the Fund, Bangladesh has begun to take steps to address its fiduciary and financial management weakness, but more is needed, and we have encouraged the IFIs to remain active in this area.

- Haiti's IMF Staff-Monitored Program includes steps to reduce discretionary ministerial accounts and to audit public enterprises. The United States has put great emphasis on the inclusion of these measures to improve transparency and accountability in Haiti.

(7) *Channeling public funds away from unproductive purposes, including large "show case" projects and excessive military spending, and toward investment in human and physical capital to protect the neediest and promote social equity*

The Fund published a *Code of Good Practices on Fiscal Transparency* in 1998 that aims to enhance fiscal policy transparency, promote quality audit and accounting standards, and reduce or eliminate off-budget transactions, which are often the source of unproductive government spending. As of May 2003, 55 countries had completed IMF-led fiscal transparency reviews, which compare local budgetary practices with internationally-agreed upon standards and codes. The IMF also encourages countries to conduct "public expenditure reviews" with the World Bank. Below are several examples of efforts to focus government expenditure on investment in human capital and other productive purposes:

- In a June 2002 Board statement, the USED expressed concern about the accuracy of Rwanda's military spending reports and supported bringing all spending on-budget as transparency is critical for maintaining donor confidence. The USED also stressed that Rwanda's continued involvement in the Congo diverts resources from priority sectors and deters foreign investment in the region.

- At the July 200.3 review of the Democratic Republic of Congo's PRGF, the USED expressed disappointment that the government did not meet its commitment on priority spending for the poor. The USED highlighted that the sum of defense, security, and institutional expenditure again amounted to approximately 50% of total government primary expenditure, while social expenditures, at 7% of primary expenditures, fell far short of the program's 15% target.

(8) *Economic prescriptions appropriate to the economic circumstances of each country*

The United States has supported flexibility in Fund programs while emphasizing the need to focus conditionality on issues critical to growth and macroeconomic stability using measurable results. Further, countries that borrow from the IMF on concessional terms prepare PRSPs through a participatory process designed to ensure that each program meets the specific needs of the country that prepares it.

(9) *Core Labor Standards (CLS)*

To assist the USED in addressing labor issues, the Treasury Department works closely with the United States Labor Department and the State Department to assess labor standards in IMF program countries. Core labor standards provide a useful benchmark for assessing countries' treatment of workers against internationally agreed-upon standards. As has been noted in past reports, there is some reluctance by many member countries to address this issue in the IMF, particularly in the context of the effort to focus Fund conditionality more narrowly. However, during the past year, tlie USED lias made an effort to raise critical labor issues in Board discussions. For example,

- In October 2002, tlie USED urged Guatemala to continue implementing labor reforms regarding the rights of association and collective bargaining.
- In March 2003, the USED called for further analysis of new labor market legislation in Indonesia and encouraged adherence to core labor standards.
- In April 2003, the USED argued that core labor standards in Sri Lanka should be fully respected, including in export processing zones.

(10) *Discouraging practices that may promote ethnic or social strife*

By helping lo create the conditions for a sound economy, IMF assistance facilitates the reduction of ethnic and social strife, to the extent such strife is driven in part by economic deprivation. For example, with United States support, tlie IMF has increasingly encouraged the strengthening of social safety nets. Tlie IMF also encourages consultation with various segments of society in the development of prograins so that they have an opportunity to participate in the implementation of national priorities. IMF assistance has helped to free up resources for more productive public investment by contributing to a reduction in country military expenditures. The United States has also advocated that an analysis of tlie impact on tlie poor, carried out by the World Bank, be conducted and that remedial measures, as appropriate, be incorporated into Fund programs. As an example of United States advocacy in this area:

- In a June 2003 review of Sudan's Staff-Monitored Program, the USED opposed the government's request for credit towards a "Rights Accumulation Program", which would have permitted Sudan to accumulate credit in the IMF, to be disbursed at a future dale. Tlie USED argued that Sudan must first achieve peace before proceeding to such a level of engagement with the Fund.

(11) *Link between environmental and macroeconomic conditions and policies*

Tlie World Bank has the lead responsibility for environmental issues in individual countries, but environmental policies at times can be transparent from a fiscal perspective. Tlie United States has urged tlie inclusion of measures in IMF programs to tax polluting activities, fund environmental protection efforts, and remove subsidies on environmentally-harmful products or activities. Tlie following are a few examples in which the United States has commented on environmental policies in country programs:

- In a February 200.3 Board discussion, the USED highlighted the importance of forestry policy to Cambodia's economy and stressed tlie need to develop sustainable forestry management plans that would help raise rural incomes, in particular, by fixing tlie forestry concession process so that it is more transparent and effective.

- In June 2003, the USED noted tlie importance of forestry to Papua New Guinea's economy and stressed tlie need to implement sustainable policies to maximize tlie long-run benefits from this sector.

(12) ***Greater transparency***

Over tlie last several years, tlie IMF has increased significantly the amount of information on its programs that it lias made available to tlie public. The United States lias stressed the need to build on this progress and expand the number of publications and IMF practices open to public scrutiny. In September 200.3, tlie Board amended the Fund's document publication guidelines, determining that tlie publication of Article IV (effective July 2004) and Use of Fund Resources staff reports will be presumed. After July 2004, all exceptional access reports, including a special report setting out tlie justification for tlie proposed program and supporting data, including debt sustainability, will be published generally as a pre-condition for the Board's approval of such an arrangement.

- 135 countries, 73% of IMF members, have chosen to publish at least one staff Article IV paper, compared to only 82 countries when this Treasury Department report was last published in October 2002. Additionally, 170 countries, or 92% of members, have published at least one Public Information Notice ("PIN").

- 459 *Reports on Observance of Standards and Codes* ("ROSCs") modules for 98 members have been completed, of which 318 have been publislied for 81 economies.

- The United States has made available self-assessments on 9 of tlie 12 ROSC modules aiid recently completed an IMF-led fiscal policy transparency ROSC.

The United States lias advocated greater transparency in member countries in the following examples:

- At Malaysia's Article IV review in October 2002, tlie USED stressed that greater transparency with respect to nonfinancial public enterprises would clarify tlie counter-cyclical role of fiscal policy, support more efficient use of public resources, and permit a better understanding of public debt dynamics.

- In a September 2003 program review for Mongolia, tlie USED expressed strong concern about tlie lack of transparency in tlie financing arrangements for several large infrastructure projects and urged that mining sector revenues be handled in a transparent manner as they come on line.

(13) ***Greater IMF accountability and enhanced self-evaluation***

In April 2000, witli tlie strong urging of the USED, tlie Executive Board agreed to establish an Independent Evaluation Office ("IEO") to supplement existing internal and external evaluation activities. The IEO provides objective and independent evaluation on issues related to the IMF and operates independently of Fund management and at arm's length from the IMF Board.

- In 2002-200.3, the IEO completed three evaluations, examining (i) the prolonged use of IMF resources, (ii) the role of the IMF in the capital account crises in Brazil, Indonesia, and Korea, and (iii) fiscal adjustment in IMF-supported programs.,

- The Executive Board discussed the IEO's report on prolonged use in September 2002 and again in March 2003, following the release of findings by a designated staff-level Task Force. The Board has taken steps to implement the IEO's recommendations, including suggested changes to its surveillance functions, program conditionality terms, and program design

- In May 2003, the Board discussed the IEO's report on the IMF's role in selected capital account crises. Executive Directors agreed with the central recommendation that the Fund's surveillance functions must be enhanced through more rigorous stress-testing of capital account exposure. The Board endorsed the report's conclusions on program design and is examining ways to evaluate more effectively balance sheet effects and to improve program conditionality and flexibility in capital account crises.

- In August 2003, the Executive Board reviewed the IEO report on fiscal adjustment in IMF-supported programs and supported its recommendations that program documents should more fully justify fiscal adjustment requirements and that internal reviews should more carefully assess near-term program implications.

(14) ***Structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending***

The provision of micro-credit is an important component of structural adjustment, especially in economies where state-directed lending is prevalent and the provision of credit to individuals and small companies is limited., Responsibility for assistance in establishing micro-finance programs lies with the World Bank and regional development banks. The Treasury Department strongly supports these efforts by the multilateral development banks.

- In an IMF Board statement, the USED commended the Brazilian government's plans to develop credit cooperatives and to increase lending to microenterprises and SMEs. The United States also encouraged the authorities to adopt best practices for lending in the SME sector in order to guarantee the long-term durability of these initiatives,.

11. <u>Section 801(c)(1)(B)</u>

(I) ***Suspension of IMF financing if funds are being divertedfor purposes other than the purposefor which the financing was intended***

With strong United States support, the IMF has taken steps in the past several years to ensure that IMF resources are used solely for the purposes for which they are intended. These steps constitute a serious and far-reaching initiative to strengthen the system for safeguarding the use of Fund resources and for deterring the misreporting of data to the IMF.

The IMF's safeguards framework, which toolc effect in 2000, requires countries receiving funds to submit to external financial audits of their central bank's data. This process is designed to provide assurances that central banks have adequate control, accounting, reporting and auditing systems in place to protect central bank resources, including IMF disbursements. Any critical gaps identified during the assessment process must be remedied before additional IMF resources can be disbursed. In April 2002, with the support of the United States, the Executive Board agreed to adopt safeguards assessments as a permanent policy.

As of **June** 2003, the IMF had completed 79 safeguard assessments, comprising 52 full and 27 transitional reviews and covering 65 central banks. Member countries had implemented **88%** of the Fund's high-priority recommendations, proposed under program conditionality or letter of intent commitments? The USED continues to focus on implementation of this policy, raising its concerns with the Board where appropriate.

- In March 2003, the USED encouraged continued efforts to address weaknesses identified in Indonesia's safeguards assessment.

- In **June** 2002, the USED strongly emphasized the importance of completing a safeguards assessment in Vietnam. To date in 2003, no IMF disbursements have been made due to the government's failure to make progress on this issue.

(II) IMF financing as a catalyst for private sector financing

The IMF recognizes that if structured effectively, official financing can complement and attract private sector flows., The Fund promotes policy reforms that catalyze private financing and allow countries to regain access to international private capital markets as quickly as possible. (See Section 5 above for a more in-depth discussion of private sector involvement.)

(III) Financing must be disbursed (i) ON the basis of specific prior reforms; or (ii) incrementally upon implementation of specific reforms after initial disbursement

The United States has been an advocate of conditionality on IMF loans and has supported the Fund's stepped-up focus on results-oriented lending. IMF disbursements are tranched based on a country's performance against specified policy actions, both prior to and during the program.

- In September 2002, the IMF approved new guidelines on the conditionality terms of Fund programs, seeking to tailor reforms to country specific economic conditions, eliminate provisions not central to reaching program objectives, and increase national responsibility for reforms. These policies are also expected to improve the consistency between structural conditions and the Fund's core expertise, reduce costly and inefficient overlap with the World Bank, and focus greater attention on performance measurement and structural

[5] As of June 2003, member countries had implemented 64% of the Fund's lower priority recommendations, not proposed by program conditionality or letters of intent The implementation rate was 71% for all recommendations

benchmarks in Stand-By Arrangements and Extended Fund Facility arrangements. The IMF will complete a review of these guidelines in 2004.

(IV) ***Open markets and liberalization of trade in goods and services***

The IMF has been a consistent advocate of open markets and trade liberalization. (See Section 2)

(V) ***IMF financing to concentrate chiefly on short-term balance of payments financing***

In September 2000, with strong United States support, the IMF agreed to reorient IMF lending to discourage casual or excessive use, and provide incentives to repay as quickly as possible. In particular, the IMF shortened the expected repayment periods for both Stand-By and Extended Arrangements and established surcharges for higher levels of access.

(”I) ***Graduation from receiving financing on concessionary terms***

The United States supports comprehensive growth strategies to move countries from concessional to market-based lending. The United States works closely with the IMF and World Bank to promote a growth-oriented agenda in developing countries based on strong monetary and fiscal policies, trade liberalization, and reduction of impediments to private sector job creation. The IMF extends concessional credit through the PRGF.. Eligibility is based principally on a country’s per capita income and eligibility under the International Development Association (“IDA”), the World Bank‘s concessional window (the current cutoff point for IDA eligibility is a 1999 per capita GDP level of $885). Factors that would contribute to reduced reliance on concessional resources include a country’s growth performance and prospects, capacity to borrow on non-concessionary terms, vulnerability to adverse external developments such as swings in commodity prices, and balance of payments dynamics. To lower reliance on concessional lending and promote debt sustainability, the G-7 countries, acting on the initiative of the United States, have agreed to expand the use of grants in multilateral development bank lending to the world’s poorest countries.