

Report on Implementation of Recommendations Made by the International Financial Institutions Advisory Commission

October 2003

The international financial institutions (IFIs) play a pivotal role in the international community's effort to strengthen the foundations for global growth, particularly in reducing the frequency and depth of financial crises and supporting productivity gains essential to poverty reduction.. The March 2000 report by the International Financial Institutions Advisory Commission, chaired by Dr. Alan Meltzer, provided insights into the how the IFIs might better realize their goals.

This is the third and final annual report updating the Administration's progress "to implement such recommendations as are deemed feasible and desirable" in the Department of the Treasury's response to the Commission's report.,' The need to increase the effectiveness of the IFIs is ongoing and, as such, Treasury's work in improving these organizations will continue.

HIPC

The Commission unanimously recommended that the IMF and MDBs "write-off in their entirety all claims against heavily indebted poor countries (HIPC) that implement an effective economic and social development strategy. "

In the three years since the report was published, 27 countries have reached the so-called HIPC Decision Point – when the country begins to receive both IFI and bilateral debt reduction. Eight of the HIPC countries have gone on to achieve the Completion Point – when outstanding debt stock is irrevocably cancelled. The United States and all other G-7 countries now forgive 100 percent of outstanding concessional debt contracted prior to the 1999 Cologne Summit and have called on all bilateral creditors to do the same. Additionally, the U.S. and several other countries have agreed to cancel all non-concessional debt contracted before the Cologne Summit.

To reduce the accumulation of more debt, the World Bank and the African Development Bank have sharply increased proportion of assistance given in the form of grants rather than loans. Measures that reward good policies, strengthen institutions, and encourage growth in developing countries ultimately offer the best hope for sustained growth and poverty reduction.

¹ The Treasury response was prepared pursuant to section 603(i)(1) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999 (section 101(d) of Public Law 105-277) Previous update reports from 2001 and 2002 are available on the U S Department of the Treasury's website at <http://www.treas.gov/press/releases/reports/meltzer.pdf> and <http://www.treas.gov/press/releases/reports/meltzer02.pdf>, respectively

INTERNATIONAL MONETARY FUND

The Commission directed many of its recommendations at the role and functions of the International Monetary Fund (IMF)

A number of the Commission's insights have led to serious debate and, with strong support from the Department of the Treasury, the IMF has undertaken several reforms over the past three years

Crisis Prevention

The prevention of international financial crises lies at the heart of the IMF's mission. The Treasury has focused intensely on strengthening the IMF's performance in crisis prevention over the past three years. The IMF's debt sustainability analyses were recently improved to better account for likely shocks and various policy compliance outcomes.

Industrial countries have by far the largest role to play in crisis reduction. This is why work on standards and codes in industrial countries is a central aspect of the IMF's crisis prevention efforts. The Financial Sector Assessment Program (FSAP), created jointly with the World Bank, now incorporates vulnerability analysis into surveillance and program work with industrial countries. Another joint IMF/Bank undertaking, the Reports on the Observance of Standards and Codes (ROSCs), further helps countries identify sectors for concern and leads to focused technical assistance programs. In existence since 1999, ROSCs cover eleven economic sectors, allowing markets and policymakers to compare country performance against a global benchmark. In November 2002, IMF/World Bank Boards added a twelfth area, anti-money laundering and combating the financing of terrorism (AML/CFT), to the list. Over 50 ROSCs were carried out over the past year, bringing the total number completed to nearly 350, with almost half of IMF members completing at least one. The U.S. has supported this effort, and Treasury has posted the completed U.S. ROSCs on its website.

In addition, three more countries subscribed to the Special Data Dissemination Standard (SDDS) this year, bringing the total to 53 countries (plus the European Central Bank) whose data are available publicly through the IMF's SDDS website. The broader General Data Dissemination Standard (GDDS) continues to serve a dual role as a framework for countries to improve *their* statistical systems as well as a primary database covering countries not yet linked to international capital markets.

Adding Predictability in the Case of Debt Restructuring

Over the last year, major progress has also been made in improving IMF crisis resolution strategies. Collective action clauses in sovereign debt (CACs) are becoming the market standard – an important step in institutionalizing a contractual method of speeding resolution of unsustainable sovereign debt situations. The U.S. led a consultative group of G10 representatives to explore options for the design of CACs, and the IMF provided market research to demonstrate that countries' use of such clauses do not dampen market appetite or otherwise decrease prices on international debt. The IMF now actively

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promotes the uses of CACs in its bilateral and multilateral surveillance and through workshops with issuers and legal practitioners, and the U.S. continues to work with the IMF to ensure that emerging markets consider the use of CACs before they tap international markets. In the second quarter of 2003, new issuances with CACs outpaced those Without CACs for the first time.,

Transparency and Accountability at the IMF

The IMF has improved the transparency of its own operations and its dialogue with member countries. Over the past three years, the IMF has improved transparency of its finances – a strong Commission recommendation. Independent audits of IMF finances are carried out by private independent firms. To improve accountability, a new Independent Evaluation Office (IEO) within the IMF was created in 2002. The IEO is to make arms-length analyses that inform and accelerate reform efforts. The IEO completed two new studies this year on capital account crises and the role of fiscal adjustment in IMF-supported programs, both of which provided insight for IMF management leading to operational changes.

The IMF has increased transparency of program and surveillance (Article IV) consultations with member countries. Since the IMF authorized voluntary publication of Article IV staff reports in June 1999, the majority of these reports have been published. Data ending March 2003 indicate this trend is strengthening: 64% of Article IV and Use of Fund resources staff reports were published over the past year, compared with 59% during the previous year. The same data indicate that 82% of public information notices were published following Article IV consultations. Effective July 2004, the IMF will implement a new transparency policy, including “voluntary but presumed publication” for Article IV documents and Use of Fund resources reports.

Clarifying Limits on Access to Large Scale Loans

As part of a major reform effort to clarify the limits on access to large scale IMF loans, a new exceptional access report is required. Where exceptional access to IMF resources is considered appropriate, the Managing Director will now generally not recommend Board approval unless the country consents to staff report publication, making this exceptional access report public.

More Focused Conditionality

In recent years, the IMF conditions had become too wide ranging and excessively detailed. For this reason, new guidelines for conditionality were adopted in 2002. The guidelines returned the IMF to its core mandate of monetary, fiscal, and exchange rate policy, and limited the IMF’s core responsibilities to efforts to ensure proper functioning of both domestic and international financial markets.

Many IMF programs are provided for “seal of approval” reasons. The practice of linking donor flows to IMF-supported programs can lead to pressure to take on IMF lending when no financial need exists. Treasury has worked with the IMF to identify substitutes for signaling in lieu of funded programs. An IMF policy change in January 2003 created

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an “Assessment Letter” that will allow donors to evaluate the quality of a country’s macroeconomic policy.

The new IMF policy on safeguards ensures country accountability for IMF loans by requiring accounting, reporting and/or auditing assessments under program conditionality for many borrowing countries. New safeguards assessments were completed for 14 member countries in the first six months of 2003

Poor Countries

Strategies for lending to poor countries have been examined over the past year, and the IMF has invited discussion of its role in helping poor countries. In many cases, the IMF need not lend to poor countries in order to have a policy impact. The Treasury has voiced its desire to see poor countries draw on the IMF’s technical assistance and expertise, particularly in countries where accumulation of large debts can be counterproductive. Treasury has been persistent in pressing for up front policy achievements in countries that previously have failed to demonstrate policy commitment to economic stability and growth. The goal is to raise the quality of monetary and fiscal policy in the poorest countries. As the IMF moves forward to develop poor country strategies, Treasury will advocate that the Poverty Reduction and Growth Facility (PRGF) be, at least partly, in the form of grants rather than loans.

MULTILATERAL DEVELOPMENT BANKS

The majority report of the Meltzer Commission recommended a number of operational and policy reforms to improve the policy performance of the multilateral development banks (MDBs).

The MDBs are important instruments for helping to support economic growth and raise living standards around the world. Treasury is working with the MDBs to improve their effectiveness in improving the lives and prospects of the world’s poor. This requires increasing grant financing, mainstreaming results measurement, focusing assistance on good performers, increasing transparency, and supporting private sector-led growth.

Increasing Grant Financing

The Meltzer Commission recommended that grants should replace loans in MDB operations in poor countries without capital market access.

As a result of strong U.S. leadership in the 13th IDA replenishment negotiations in 2001-2002 (the 13th round of replenishment negotiations where donors push for reforms and commit financing for IDA, the World Bank’s concessional arm), the IDA-13 Agreement provides for a significant expansion in grant funding for the world’s poorest countries. Starting in July of 2002 and continuing for three years, IDA grants account for 18-21% of overall IDA resources, a total of about \$4.5 billion. Grants are therefore now a major factor in IDA’s overall assistance – having risen far beyond IDA’s historical level of grant funding of less than 1% of overall IDA resources. 52 projects have come to the IDA Board from July 2002 through September 2003. Of this group, approximately 12”

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projects have begun to disburse funds and are in the early stages of implementation. There have been many examples of strong results measurement frameworks in the grant-financed projects, demonstrating measurable indicators and expected outcomes of the grant financing.

U.S. leadership on grants was also crucial in the 2002 replenishment agreement for the African Development Fund, known as AfDF-9, more than doubling the share of grants to 18-21%. In both IDA and AfDF, grants will be used for productivity-enhancing assistance for education, health, nutrition and potable water and sanitation; for HIV/AIDS projects and natural disaster reconstruction; and for post-conflict assistance. Donors to the International Fund of Agricultural Development (IFAD) also agreed in the IFAD-6 replenishment to increase grants to 10% (from the historical average of 5%) of total annual assistance, beginning in 2004.

Mainstreaming Results Measurement

The MDBs must give top priority to delivering and measuring development results at all levels. At the suggestion of the United States, the World Bank has taken this challenge on by establishing an "Incentive Contribution" structure in its latest IDA agreement that allows donors to increase their levels of funding if concrete measurable results are achieved. Donors and developing countries alike will benefit from routinely quantifying development achievements and understanding the reasons for success or failure. This will significantly increase accountability.

Under IDA-13, World Bank management agreed to measure concrete progress toward

- Establishing a new results measurement system, drawing on timely and high quality diagnostic analyses that identify a country's ability to make the best use of IDA resources. These include assessments of public expenditure processes, financial accountability regulations, and investment climates. World Bank management made good on this commitment, and in April 2003 Treasury pledged the first installment of the U.S. Incentive Contribution (\$100 million). In addition, IDA developed a series of long-term results indicators for the next replenishment (IDA-14).
- Achieving specific targets in IDA borrowing countries relating to education, health and private sector development to which the United States has tied its \$200 million incentive contribution for the coming year. These targets include increasing the primary education completion rate and measles immunization coverage (both in terms of population-weighted average and numbers of countries with positive growth), and decreasing the time and cost required for business start-up by 7%. Treasury has suggested that the World Bank explore the concept of an audit of its own performance in meeting this commitment.

The United States also achieved agreement to improve results measurement in recently completed replenishment agreements for the African Development Bank's concessional window (AfDF), IFAD and the Global Environment Facility (GEF). The AfDF will develop quantifiable and monitorable performance indicators for all sectors, and

rigorously incorporate these in its operations. The African Development Bank (AfDB) is also developing a results-based management system. IFAD will establish a system to measure and report quantifiable results, both for individual projects and aggregated by category across the organization. Donors to GEF agreed to estimate and track project and program results for each environmental focal area, and both GEF and IFAD will establish independent evaluation units. The Inter-American Development Bank (IDB) is also putting in place an enhanced results measurement system that will be led by a Chief Development Effectiveness Officer, a new senior management position. The European Bank for Reconstruction and Development (EBRD) recently created a new monitoring system to measure project results (the Transition Impact Monitoring System) in order to improve its measuring and monitoring of projects during the implementation stage.

This is just the start of actions that Treasury wants to see the MDBs take to fundamentally shift their focus to mainstream measurable results. Outcome goals, baselines and post-completion evaluations must be embedded in the design and implemented throughout the life of country, sector, and institutional strategies as well as loans. Treasury is promoting this in replenishment negotiations, policy statements at the MDB Boards, and meetings with management representatives of the MDBs. We have gained the support of G-8 colleagues – setting out an ambitious results measurement agenda for all of the MDBs to undertake.

Focusing Assistance on Good Performers

Last year at Monterrey, President Bush and other world leaders committed to a new partnership between developed and developing countries that link sound policies, good governance, and the rule of law to the mobilization of additional funds to achieve our common development goals. In the MDBs, we will continue to emphasize the importance of linking assistance to sound policies through performance based allocation systems. Such systems are in place or being developed in the concessional windows of all the institutions. For example, the IDA-13 Agreement called for a stronger emphasis on governance in its performance-based allocation formula – with the result that 17 countries had their IDA lending allocations reduced due to poor governance ratings for FY03. As a result of U.S. leadership, agreement was reached to establish performance based allocation systems for the first time in last year's replenishment negotiations for IFAD and GEF. We have urged the World Bank to move aggressively toward full disclosure of the performance rating system it uses to allocate resources to poor countries, including individual country performance scores used to apportion concessional IDA resources as well as the scores of the components that make up the country performance scores.

Increasing Transparency

As a result of consistent U.S. pressure, the MDBs now systematically disclose to the public a broad range of key documents on their lending operations and country and sector strategies. There has been an extraordinary increase in the disclosure of World Bank documents since its new disclosure policy took effect at the beginning of 2002. The policy, which has been complemented by a more pro-active outreach effort, provided for the release of a greater number of project-related documents; disclosure of the Chairman's

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summaries of Board discussions on Country Assistance Strategies (CASs) and Sector Strategy Papers (SSPs); and a more systematic approach (with a reduced lapse of time) to accessing Bank archives.

In April 2003, the EBRD adopted revisions to its Public Information Policy that increase the scope of information made available to the public through the publication of certain project evaluation documents and a schedule of forthcoming Board discussions. While positive steps, the US. believes them to be insufficient and continues to urge greater disclosure of key documents, including environmental reviews, draft country strategies and summaries of Board discussions. The information disclosure policies at the Asian, African and Inter-American Development Banks are currently under review and the Administration is emphasizing the need for each of these institutions to implement “best practices” and a presumption of disclosure in all cases. Among the specific transparency measures we are pushing for are: disclosure of documents prior to their consideration by the Boards of Directors; issuance of the minutes of the Boards of Directors meetings; publication of output and outcome indicators and results for projects while they are being executed and when they are completed; and posting of annual reports on fraud by corruption investigations units, including statistical summaries and case studies.

Increasing Support for Private Sector Led Growth

Treasury is working with each of the MDBs to find better ways to promote private sector-led growth which is essential for poverty reduction, including through diagnostics and support to improve developing countries’ investment climates. The focus of next year’s World Development Report, the World Bank’s flagship document, is on the links between investment climate improvements, growth and poverty reduction. The World Bank’s “Doing Business” program is helping developing countries to identify and take steps to remove obstacles to investment. IDA has committed to establish targets for beneficiary countries to meet in reducing business start-up times and costs. To emphasize the importance of these actions, the United States has based its \$200 million additional contribution to IDA partially on progress in these areas. The IFC and IDA – because of U.S. insistence – have launched promising initiatives to expand small and micro businesses’ access to credit. The EBRD continues its work supporting loans to small and micro enterprises through local partner banks in many of its countries of operations.

BANK FOR INTERNATIONAL SETTLEMENTS

The Commission made four main recommendations concerning the Bank for International Settlements (BIS) that the BIS continue in its role as a financial standard setter, that the BIS align its risk measures more closely with credit and market risk; that the BIS streamline its organizational structure; and that the BIS undertake only membership expansion “gradually and deliberately

Recent developments at the BIS broadly coincide with these recommendations. The BIS continues to serve as the primary forum for cooperation among central banks to address international financial and monetary stability issues, and also acts as a prime counterparty

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and provider of financial instruments for central banks. The research and publication functions of the BIS add much value to the world of international banking and finance, and the BIS's Financial Stability Institute has expanded its series of seminars and workshops worldwide.

The BIS has focused on the collection of higher quality data and in February announced a series of steps to improve international consolidated banking statistics. The Basel II Capital Accord, slated for implementation at year-end 2006, will improve the international capital adequacy framework through a three-pillared approach: new minimum capital requirements, enhanced supervisory review of capital adequacy, and greater public disclosure. Several countries, including the United States, have already begun work on rules to integrate the new standards.

The BIS this year changed its unit of account from the gold franc to the SDR. The General Manager explained the move would “assist in managing the Bank's operations and economic capital more efficiently and enhance the transparency of its accounts.” The BIS also recently elected to repurchase all privately held shares in order to maintain control exclusively among its central bank shareholders.

Membership in the BIS has risen by six since 1999, to 51 countries. In addition, the BIS has opened two representative offices (one in Hong Kong and the other in Mexico City) to improve information exchange with emerging economies in Asia and the Americas.