

**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

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SELECTED ABBREVIATIONS

Asia-Pacific Economic Cooperation (APEC)
Contingent Credit Line (CCL)
Core Labor Standards (CLS)
Extended Fund Facility (EFF)
Enhanced Structural Adjustment Facility (ESAF)
Federal Republic of Yugoslavia (FRY)
Financial Action Task Force (FATF)
Financial Sector Assessment Program (FSAP)
Financial Stability Forum (FSF)
Financial System Stability Assessment (FSSA)
Foreign Direct Investment (FDI)
General Data Dissemination Standard (GDDS)
Heavily Indebted Poor Countries (HIPC)
International Financial Institutions (IFIs)
International Labor Organization (ILO)
International Monetary and Financial Committee (IMFC)
Letter of Intent (LOI)
Memorandum of Economic Policies (MEP)
Memorandum of Economic and Financial Policies (MEFP)
Non-Cooperative Countries and Territories (NCCT)
Off-Shore Financial Center (OFC)
Poverty Reduction and Growth Facility (PRGF)
Poverty Reduction Strategy Paper (PRSP)
Public Expenditure Review (PER)
Public Information Notice (PIN)
Report on Standards and Codes (ROSC)
Special Data Dissemination Standard (SDDS)
Stand-By Arrangement (SBA)
Staff Monitored Program (SMP)
State-Owned Enterprise (SOE)
Technical Memorandum of Understanding (TMU)
United States Executive Director at the IMF (USED)
Use of Fund Resources (UFR)

Introduction

This report is prepared pursuant to Sections 1503 and 1705(a) of the International Financial Institutions Act (the IFI Act – codified at 22 U.S.C. 262o-2 and 262r-4). These provisions were enacted in Sections 610 and 613 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999,¹ and Section 1705(a) was amended by Section 803 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001 (FOAA 2001).² Section 1705 of the IFI Act provides that annually “the Secretary of the Treasury shall submit to the Committee on Banking and Financial Services of the House of Representatives and the Committee on Foreign Relations of the Senate a written report on the progress (if any) made by the United States Executive Director at the International Monetary Fund in influencing the International Monetary Fund to adopt the policies and reform its internal procedures in the manner described” in Section 1503 of the IFI Act. Section 1503 covers a broad range of issues related to, for example, transparency in IMF operations, social policies, core labor standards, trade liberalization, the environment, military spending, exchange rate stability, and reforms to combat corruption. This report also covers policies set forth in Section 801(c)(1)(B) of FOAA 2001,³ as required by amended Section 1705 of the IFI Act. A full description of both the 1999 and 2001 legislative provisions follows the introduction.

This is the third report on Treasury and United States Executive Director (USED) efforts to influence the policies of the IMF, and reflects actions and outcomes during fiscal year (FY) 2001. Earlier reports are available on the Treasury website.⁴

The Treasury Department and the USED at the IMF work consistently to build support in the IMF’s Executive Board for the objectives set out in the IMF legislation. These efforts include meetings with IMF staff on individual programs, statements by the USED in the Board, commitments in IMF programs, policy actions taken by program countries, and policy decisions at the IMF itself. In order to promote legislative provisions effectively, the Treasury has, since early 1999, maintained a task force to disseminate information on the various objectives outlined in Section 1503 of the IFI Act, Section 801(c)(1)(B) of FOAA 2001 and other legislation and to coordinate U.S. actions. The task force includes several offices within International Affairs in Treasury, and also interacts, as appropriate, with other departments of government. The task force and the overall effectiveness of the Treasury and USED’s office in promoting the legislative provisions is described in a GAO Report published in January 2001.⁵ 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.” The report also noted that “the Fund’s willingness to adopt policy positions that are consistent with U.S.

¹ Public Law 105-277, division A, § 101(d), title VI, §§ 610 & 613.

² Public Law 106-429, title VIII, § 803.

³ Public Law 106-429, title VIII, § 801(c)(1)(B).

⁴ See: <http://www.treas.gov/press/releases/reports.htm>.

⁵ *Efforts to Advance U.S. 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 U.S. agencies to promote IMF practices that are consistent with U.S. policies set forth in federal law and the influence U.S. policy has over the IMF’s operations and other members’ positions, as illustrated by specific cases.”

legislatively mandated policies is affected by whether a majority of Fund members perceive a given policy to be part of the Fund's core mission to promote monetary cooperation and currency exchange rate stability and to provide resources to Fund members experiencing balance-of-payments problems.”

In reviewing efforts over the past year to promote policies set out in legislation, one should understand the IMF's framework for conditionality. “Prior actions” are policy actions that must be adopted before the Board will consider a program or program review. “Performance criteria” are targets for macroeconomic or structural items that must be met for the Board to approve disbursements under the program, unless the Board approves a waiver. “Structural benchmarks” are additional measures (frequently not quantitative) that are key to supporting a country's macroeconomic stability and growth prospects in the medium-to-longer term. These benchmarks provide guidance on how well a country is implementing its program, and non-fulfillment of the benchmarks occasionally leads to delays in program reviews. Finally, there are also other policy commitments made in the context of a country's Letter of Intent, which informs the IMF of the government's overall policy framework during the program.

Finally, it is important to note that U.S. advocacy of legislative provisions occurs in the context of a broader U.S. agenda for IMF reform. In his April statement to the International Monetary and Financial Committee – which provides general oversight of IMF activities – Secretary O'Neill emphasized three areas:

- *Improved effectiveness in crisis prevention.* This requires identification of problems in their early stages and taking effective action before a crisis erupts. As Secretary O'Neill has stated, implementation of standards, such as the 12 key standards and codes identified by the FSF, can play a critical role in strengthening crisis prevention. As one part of this effort, the IMF actively promotes and assesses widespread adherence to international standards in areas such as macroeconomic policy and data transparency, institutional and market infrastructure, and financial supervision and regulation.
- *More focused conditionality in IMF programs.* The United States and other IMF members have taken steps to focus program conditions on those factors that are considered most significant to establishing macroeconomic stability.
- *An enhanced IMF role in the fight against abuse of the global financial system.* In its assessments of members' financial systems, the IMF has begun to examine anti-money laundering regimes. The IMF is also in the process of collaborating with the Financial Action Task Force to develop a separate anti-money laundering module which will assess and monitor members' adherence to the international money laundering standard, one of the 12 key international standards and codes; it should step up its efforts in this area.

Legislative Provisions

As noted above, this report covers progress on implementing the policies and reform objectives set out in Section 1503(a) of the IFI Act and Section 801(c)(1)(B) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001.

Section 1503(a) of the IFI Act provides that:

The Secretary of the Treasury shall instruct the United States Executive Director of the International Monetary Fund to use aggressively the voice and vote of the Executive Director to do the following:

- (1) Vigorously promote policies to increase the effectiveness of the International Monetary Fund in structuring programs and assistance so as to promote policies and actions that will contribute to exchange rate stability and avoid competitive devaluations that will further destabilize the international financial and trade systems.*
- (2) Vigorously promote policies to increase the effectiveness of the International Monetary Fund in promoting market-oriented reform, trade liberalization, economic growth, democratic governance, and social stability through –*
 - (A) Establishing an independent monetary authority, with full power to conduct monetary policy, that provides for a non-inflationary domestic currency that is fully convertible in foreign exchange markets;*
 - (B) Opening domestic markets to fair and open internal competition among domestic enterprises by eliminating inappropriate favoritism for small or large businesses, eliminating elite monopolies, creating and effectively implementing anti-trust and anti-monopoly laws to protect free competition, and establishing fair and accessible legal procedures for dispute settlement among domestic enterprises;*
 - (C) Privatizing industry in a fair and equitable manner that provides economic opportunities to a broad spectrum of the population, eliminating government and elite monopolies, closing loss-making enterprises, and reducing government control over the factors of production;*
 - (D) Economic deregulation by eliminating inefficient and overly burdensome regulations and strengthening the legal framework supporting private contract and intellectual property rights;*
 - (E) Establishing or strengthening key elements of a social safety net to cushion the effects on workers of unemployment and dislocation; and*
 - (F) Encouraging the opening of markets for agricultural commodities and products by requiring recipient countries to make efforts to reduce trade barriers.*
- (3) Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in strengthening financial systems in developing countries, and encouraging the adoption of sound banking principles and practices, including the development of laws and regulations that will*

help to ensure that domestic financial institutions meet strong standards regarding capital reserves, regulatory oversight, and transparency.

- (4) Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in facilitating the development and implementation of internationally acceptable domestic bankruptcy laws and regulations in developing countries, including the provision of technical assistance as appropriate.*
- (5) Vigorously promote policies that aim at appropriate burden-sharing by the private sector so that investors and creditors bear more fully the consequences of their decisions, and accordingly advocate policies which include –*
 - (A) Strengthening crisis prevention and early warning signals through improved and more effective surveillance of the national economic policies and financial market development of countries (including monitoring of the structure and volume of capital flows to identify problematic imbalances in the inflow of short and medium term investment capital, potentially destabilizing inflows of offshore lending and foreign investment, or problems with the maturity profiles of capital to provide warnings of imminent economic instability), and fuller disclosure of such information to market participants;*
 - (B) Accelerating work on strengthening financial systems in emerging market economies so as to reduce the risk of financial crises;*
 - (C) Consideration of provisions in debt contracts that would foster dialogue and consultation between a sovereign debtor and its private creditors, and among those creditors;*
 - (D) Consideration of extending the scope of the International Monetary Fund’s policy on lending to members in arrears and of other policies so as to foster the dialogue and consultation referred to in subparagraph (C);*
 - (E) Intensified consideration of mechanisms to facilitate orderly workout mechanisms for countries experiencing debt or liquidity crises;*
 - (F) Consideration of establishing ad hoc or formal linkages between the provision of official financing to countries experiencing a financial crisis and the willingness of market participants to meaningfully participate in any stabilization effort led by the International Monetary Fund;*
 - (G) Using the International Monetary Fund to facilitate discussions between debtors and private creditors to help ensure that financial difficulties are resolved without inappropriate resort to public resources; and*
 - (H) The International Monetary Fund accompanying the provision of funding to countries experiencing a financial crisis resulting from imprudent borrowing with efforts to achieve a significant contribution by the private creditors, investors, and banks which had extended such credits.*
- (6) Vigorously promote policies that would make the International Monetary Fund a more effective mechanism, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), for promoting*

good governance principles within recipient countries by fostering structural reforms, including procurement reform, that reduce opportunities for corruption and bribery, and drug-related money laundering.

- (7) Vigorously promote the design of International Monetary Fund programs and assistance so that governments that draw on the International Monetary Fund channel public funds away from unproductive purposes, including large “show case” projects and excessive military spending, and toward investment in human and physical capital as well as social programs to protect the neediest and promote social equity.*
- (8) Work with the International Monetary Fund to foster economic prescriptions that are appropriate to the individual economic circumstances of each recipient country, recognizing that inappropriate stabilization programs may only serve to further destabilize the economy and create unnecessary economic, social, and political dislocation.*
- (9) Structure International Monetary Fund programs and assistance so that the maintenance and improvement of core labor standards are routinely incorporated as an integral goal in the policy dialogue with recipient countries, so that –*
 - (A) Recipient governments commit to affording workers the right to exercise internationally recognized core worker rights, including the right of free association and collective bargaining through unions of their own choosing;*
 - (B) Measures designed to facilitate labor market flexibility are consistent with such core worker rights; and*
 - (C) The staff of the International Monetary Fund surveys the labor market policies and practices of recipient countries and recommends policy initiatives that will help to ensure the maintenance or improvement of core labor standards.*
- (10) Vigorously promote International Monetary Fund programs and assistance that are structured to the maximum extent feasible to discourage practices which may promote ethnic or social strife in a recipient country.*
- (11) Vigorously promote recognition by the International Monetary Fund that macroeconomic developments and policies can affect and be affected by environmental conditions and policies, and urge the International Monetary Fund to encourage member countries to pursue macroeconomic stability while promoting environmental protection.*
- (12) Facilitate greater International Monetary Fund transparency, including by enhancing accessibility of the International Monetary Fund and its staff, foster a more open release policy toward working papers, past evaluations, and other International Monetary Fund documents, seeking to publish all Letters of Intent to the International Monetary Fund and Policy Framework Papers, and establishing a more open release policy regarding Article IV consultations.*

- (13) *Facilitate greater International Monetary Fund accountability and enhance International Monetary Fund self-evaluation by vigorously promoting review of the effectiveness of the Office of Internal Audit and Inspection and the Executive Board's external evaluation pilot program and, if necessary, the establishment of an operations evaluation department modeled on the experience of the International Bank for Reconstruction and Development, guided by such key principles as usefulness, credibility, transparency, and independence.*
- (14) *Vigorously promote coordination with the International Bank for Reconstruction and Development and other international financial institutions (as defined in Section 1701 (c)(2)) in promoting structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending, especially in the world's poorest, heavily indebted countries.*

Section 1705(a) of the IFI Act further requires that Treasury report on the progress made by the IMF in adopting and implementing the following policies as set forth in Section 801(c)(1)(B) of FOAA 2001–

- (I) *Policies providing for the suspension of financing if funds are being diverted for purposes other than the purpose for which the financing was intended;*
- (II) *Policies seeking to ensure that financing by the Fund normally serves as a catalyst for private sector financing and does not displace such financing;*
- (III) *Policies requiring that financing must be disbursed (i) on the basis of specific prior reforms; or (ii) incrementally upon implementation of specific reforms after initial disbursement;*
- (IV) *Policies vigorously promoting open markets and liberalization of trade in goods and services;*
- (V) *Policies providing that financing by the Fund concentrates chiefly on short-term balance of payments financing;*
- (VI) *Policies providing for the use, in conjunction with the Bank, of appropriate qualitative and quantitative indicators to measure progress toward graduation from receiving financing on concessionary terms, including an estimated timetable by which countries may graduate over the next 15 years.*

Report on Specific Provisions

Section 1503(a)

(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". While the Articles also recognize the right of each member country to choose its own exchange rate regime, the IMF does advise countries on whether a regime appears to be sustainable, and what macroeconomic and financial policies are necessary to support the sustainability of that regime. In exceptional circumstances, the IMF might recommend policy changes to make an existing exchange rate regime more sustainable, or alternatively, might recommend changes to the regime in order to make it more consistent with the country's other economic objectives.

More broadly, exchange rate stability can only be achieved through the adoption of sound macroeconomic policies. In its programs and routine surveillance, the IMF promotes anti-inflationary policies, fiscal responsibility, sound financial systems, transparency in economic and financial policy-making, and improved data dissemination – all of which contribute to an economic environment conducive to exchange rate stability. The USED supports the IMF's approach in each of these areas.

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

The IMF, with USED advocacy, supports all the goals listed in this section. Some of the policies necessary to reach these goals are part of the IMF's central areas of expertise, while others are not. That said, macroeconomic stability, which is the key objective of IMF programs, is a necessary though not sufficient condition for growth, which in turn is critical for raising living standards and reducing poverty. In the context of the IMF's new, more focused, approach to program conditionality, the IMF will continue to include structural conditions in its programs when fulfilling those conditions is considered essential to the success of the program. On other issues, where structural measures are relevant but not critical to macroeconomic stability, or where an issue does not fall within the IMF's central set of expertise, the World Bank will be the principal institution involved in implementation and oversight.

(A) Establishment of an independent monetary authority

The IMF has been a consistent advocate of independent monetary authorities, and, with the support of the United States, has promoted greater independence of monetary authorities in a range of countries in recent years. It does so in several ways. IMF programs frequently include measures to strengthen central bank autonomy and accountability. The IMF also provides technical assistance to help countries achieve these goals. In addition, the IMF promotes these objectives through assessments of compliance with standards and codes and the new IMF rules for safeguarding the use of IMF resources.

As more countries relinquish political control of monetary policy, a greater number of IMF member countries are adopting an inflation-targeting framework. Among the 49 subscribers to the Special Data Dissemination Standard (SDDS) (see Section 12), 14 have formally adopted an inflation targeting monetary regime, and several other countries are actively considering doing so. To assist these countries, the IMF is planning to hold a seminar on the implications of inflation targeting for data collection.

In addition, one of the IMF's goals is to promote policies that support progress toward fully convertible currencies. Collaboration to ensure orderly exchange arrangements and to promote a stable system of exchange rates is a general obligation of all members. The Articles of Agreement also create a specific obligation to avoid restrictions on current payments and discriminatory currency practices and to ensure convertibility of foreign-held balances. These obligations have been fully accepted by 149 of the IMF's member countries. Further, the IMF pursues these issues on an ongoing basis, through both programs and policy dialogue, encouraging governments, *inter alia*, to end multiple currency regimes and loosen controls on foreign exchange operations.

Examples of these issues arising in Fund work with member countries include:

- A new law to enhance central bank independence was a prior action for the May 2001 augmentation of Turkey's program. The United States expressed its support of this measure in high-level meetings with IMF management and Turkish authorities.
- In its Fund program, Brazil is seeking to pass in its Congress an amendment, which would strengthen central bank independence and facilitate implementation of the existing inflation-targeting regime.
- In its appraisal following the 2001 Article IV Consultation for Algeria, IMF staff noted concerns over the independence of the monetary authorities. Earlier in the year, the government had eliminated fixed terms for the central bank governor and instituted a political appointment system to the board of governors, effectively reducing the central bank's influence on monetary policy. In the August 2001 Board discussion, the USED stated U.S. concerns about this issue, and called on the government to reverse this trend.

(B) Fair and open internal competition among domestic enterprises

The IMF actively promotes, with USED support, measures to improve the efficiency of a country's economy. Depending on the country, these measures may include ending directed lending (or other relationships between government and business based on favoritism), improving anti-trust enforcement, and establishing a sound judicial system. Such measures can be critical to a country's stabilization program – off-budget central bank lending to private or state banks has often been monetized, thus ratcheting up inflation. These issues are most usually addressed through the World Bank, but the IMF has at times incorporated these measures into programs when it considered them to be critical to the program's success. In addition, when the

IMF has been better positioned to address these issues than other IFIs, IMF staff has included them into program design.

Recent examples in support of these objectives include:

- Turkey's current IMF program includes several measures to improve the country's competitive environment. The program promotes reductions in directed lending and subsidies by state-owned banks through greater fiscal transparency. It also includes deep agricultural reform, by reducing subsidies and quotas, resulting in a less distorted agricultural sector. The United States has strongly supported these moves in the Board and in numerous meetings with IMF staff.
- During the February 2001 PRGF review for Senegal, the USED identified the petroleum sector as needing to open up to more internal competition. The lack of such competition was cited as a cause of high prices, which in turn was a major barrier to private sector development.
- In Korea's Stand-By Arrangement (SBA), which ended in December 2000, several structural benchmarks were designed to foster internal competition by eliminating government-directed lending. A prior action before Board review pertaining to inclusion of independent budget for the Financial Supervisory Commission (FSC) and the specifications of its powers was also important in ensuring that the FSC was independent.
- The USED has noted in the past two Board reviews of Mexico that the electricity and petroleum sectors face daunting investment needs. The USED supported Mexican government's approach to introducing greater private-sector participation in the electricity sector, and encouraged the authorities to move more rapidly.
- The U.S. raised the importance of breaking up monopolies in several cases in the former Soviet Union. For example, in Kyrgyzstan, the IMF has included conditionality on preparing to break up and privatize the state energy monopoly. The World Bank is overseeing implementation of this effort.

(C) Privatization

Privatization is an important issue for country reform programs, especially as government ownership of business enterprises often creates significant inefficiencies in the allocation of resources and the production of essential goods and services. It also has important fiscal ramifications, especially as privatization proceeds can be an important non-inflationary source of budget financing. Treasury believes that it is appropriate that the IMF support the use of competitive and transparent means of privatization so that borrowing countries might achieve gains in economic efficiency and finance their fiscal positions. While privatization is best addressed through the World Bank, the IMF at times incorporates these privatization benchmarks in its programs when it considers them to be critical to the program's success.

Examples of IMF programs in which the USED advocated privatization include:

- Under its current IMF program, Turkey has achieved progress in privatization that is unprecedented in the country's history, which has helped to improve the country's fiscal balances as well as the overall efficiency of its economy. In particular, Turkey enacted legislation in May 2001 as prior action that facilitates the future privatization of Turk Telekom (the national land-line monopoly) and creates the regulatory framework for a competitive telecommunications industry in the future.
- Under its current IMF program, Brazil has successfully privatized large portions of its telecommunications, energy, and financial sectors, generating \$10.7 billion in privatization revenue last year alone. These revenues are critical in helping Brazil to meet its external financing requirements.
- For Indonesia, one of the top messages in the recent U.S. statements at the MDBs and IMF is the importance of privatization of financial assets nationalized during the 1997-8 financial crisis, which is crucial to reviving the Indonesian economy and alleviating Indonesia's heavy public debt burden. At the second and third reviews of Indonesia's IMF program (September 2000 and 2001), the U.S. strongly emphasized that the GOI's asset sales targets (in particular, bank privatizations) are crucial to setting the stage for sustained positive market sentiment, stimulating higher growth and alleviating the heavy public debt burden.

(D) Economic deregulation and strong legal frameworks

The United States views a sound legal and regulatory environment as an essential condition for a strong and dynamic economy. A market-based economy cannot function effectively in the absence of the property rights and the enforcement of contracts. Similarly, the regulatory environment must be strong enough to ensure fair and open competition, without stifling entrepreneurship, distorting markets, or contributing to unemployment. While these issues might frequently be addressed through the World Bank, the IMF at times incorporates these measures into programs, when it considers them to be critical to the program's success.

Examples of USED efforts to promote progress in implementing this policy framework include:

- Ecuador has partially liberalized gas and fuel prices as a condition of its IMF program. Ecuador has approved during the past year a number of new laws that facilitate joint ventures and privatization. These efforts were critical in reaching agreement with U.S. and other companies to commence construction of an important new oil pipeline that could eventually double Ecuador's oil exports and strengthen the country's finances.
- In Brazil's IMF program, the government has taken steps to liberalize domestic oil prices, which is key to reducing the country's fiscal burden.
- In the context of its IMF program, the Bulgarian government committed to remove 40 license requirements and expand a "one-stop-shop" program to all municipalities by June 2001. In the March 2001 program review, the USED stressed that progress on energy-sector

liberalization should be accompanied by the development of an adequate regulatory framework that would ensure the efficient allocation of market risk and protection of consumer rights.

(E) Social safety nets

The IMF and the World Bank have also been increasingly focused on the establishment of effective social safety nets in borrowing countries, particularly since the Asian financial crisis. This focus is reflected in several developments. For countries receiving concessional assistance, the institutions have revised their lending frameworks in order to focus on the reduction of specific poverty indicators. For countries receiving non-concessional financing as well, the targeting of social safety nets can help mitigate the social disruption sometimes caused by essential adjustments in macroeconomic policies and allow for rationalization of spending within a country's overall fiscal envelope. Thus, the United States supports the IMF in focusing attention on more effective social safety nets in the context of IMF programs. Below are a few examples:

- The United States, in discussions with IMF staff and Turkish authorities, had advocated stronger efforts to improve Turkey's social safety net, through increased spending on health and education as a proportion of total spending.
- In Board statements on Sudan's Staff-Monitored Program (SMP), the USED has repeatedly urged the government to spend more of its windfall from new oil production on poverty reduction and social sector expenditures, as opposed to increased military expenditures.
- During the Algeria's Article IV discussion in October 2000, the USED underscored the importance of Algeria's social safety net to the country's social fabric and economic wellbeing of society's most vulnerable. The USED called attention to the financial health of the social security system, which was noted as precarious by staff, and urged the authorities to take stock of the national pension scheme.

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

The IMF emphasizes, as a general principle, the benefits of open markets and trade liberalization in the context of programs, annual surveillance, and through its research. Indeed, one of the stated purposes of the IMF in the Articles of Agreement is "to facilitate the expansion and balanced growth of international trade". Trade liberalization can also have important fiscal implications, which need to be considered in the context of IMF advice and programs. The United States backs this focus of the IMF, especially insofar as it overlaps with the Fund's central areas of expertise. A few examples are below:

- In Board statements on Uganda, the USED has commended the authorities for harmonizing and lowering external tariffs and excise taxes that impede free trade, while undertaking this liberalization within the context of a sound fiscal policy.

- In India's Article IV review in May 2001, the USED lauded the steps taken to further liberalize trade but urged a concerted effort to reduce the poorly-targeted subsidies.
- In Tunisia's January 2001 Article IV review, the USED underlined the need for continuing trade reforms such as rationalizing import duties, removing import licenses, and streamlining customs procedures beyond the EU and neighboring countries to all trading partners.

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

The IMF's approach to strengthening countries' financial sectors takes a variety of forms. The joint IMF-World Bank *Financial Stability Assessment Program* (FSAP) has emerged as the preferred instrument for financial sector surveillance and advice. The FSAP was first launched in 1999. The initial 12 pilot country assessments have been completed and currently 24-30 assessments per year are anticipated. Findings derived from an FSAP are used by the IMF to produce *Financial System Stability Assessments* (FSSAs) that focus on financial system strengths and vulnerabilities, as well as to generate assessments of compliance with key financial sector standards such as the Basel Committee *Core Principles for Effective Banking Supervision*, the International Organization of Securities Commissions' *Objectives and Principles of Securities Regulation*, and the IMF's own *Code of Good Practices on Transparency in Monetary and Financial Policies*. The latter assessments are often provided to the public through the *Reports on the Observance of Standards and Codes* (ROSCs).

In order to better understand the health of a country's financial sector, the U.S. urged the IMF to develop a set of important financial sector indicators which the IMF is now monitoring in a significant number of Article IV reports. The U.S. has also called for the inclusion of financial sector indicators in the SDDS, which would help to ensure comparable and transparent data on financial systems.

- Strengthening the banking sector has been a centerpiece and major achievement of Turkey's program, especially since the November 2000 crisis. The program has achieved stronger oversight and prudential regulation, creation of a new regulatory agency, the closure of a weak state-owned bank, and is now in the process of commercializing of remaining state banks. The program also supported the intervention of 18 insolvent banks, of which 7 have already been closed or sold. The United States took the lead in advancing these issues in the IMF program, through discussions with IMF staff and the Turkish authorities, and advocacy in Board discussions.
- Yugoslavia has adopted a strategy for bank restructuring in consultation with the IMF and the World Bank. As required under the SBA, it has intervened at the six largest, illiquid banks and closed seven smaller banks.
- The USED welcomed Croatia's stronger bank supervision requirements of the new Central Bank Law, which were highlighted in its March Article IV/SBA review, and noted that it should include provisions to detect and track money laundering.

- Fund programs for Asian countries have regularly included important steps to strengthen financial sectors. For example, Indonesia's re-started program includes numerous measures to strengthen the financial sector, including a timetable for the sales of assets taken over by the bank restructuring agency and sales of majority stakes in state-owned banks.
- Treasury has urged Ecuador in bilateral meetings and through the IMF and other international financial institutions (IFIs) to liberalize and strengthen its financial system. In the past year, Ecuador has liberalized interest rates, established a bank liquidity fund, improved measures for asset collection, improved restructuring procedures, and strengthened bank supervision. Much work remains, however, to bring the system back to health.
- During the final review of Mexico's SBA, the USED encouraged the Mexican authorities to continue monitoring closely banks' compliance with the new capital regulations. Since then, Mexico has made considerable progress in restoring the financial sector to health, with strides taken in transparency.

(4) Internationally acceptable domestic bankruptcy laws and regulations

The IFIs place strong priority on efforts to strengthen national insolvency regimes, which provide the basis for the efficient resolution of the debt problems of private entities. This is critical for the IMF for two reasons: the failure to resolve debt problems expeditiously can itself be a barrier to growth; and the efficient resolution of the debt problems of private entities is critical in preventing private debt problems from accumulating and ultimately spilling over to the sovereign. The efforts of the IFIs have built upon the key principles of effective bankruptcy and debtor-creditor regimes identified in 1998 by the G-22 Working Group on International Financial Crises.

This issue is primarily a World Bank responsibility, but the IMF is supporting this agenda in several complementary ways. The IMF published an in-depth study on national insolvency regimes that currently serves as the basis for its dialogue with member countries. It has worked with the World Bank to put out a draft of a paper that includes a set of *Principles and Guidelines on Insolvency Regimes for Developing Countries*. The World Bank is also developing an assessment matrix for use in pilot assessments. Additionally, the IMF has supported adoption of the Model Law on Cross-Border Insolvency developed by the UN (the UNCITRAL Model Law) to facilitate the resolution of increasingly complex cases of insolvency, where companies have assets in several jurisdictions at once. Finally, the IMF continues to provide technical assistance to help emerging market economies develop efficient insolvency regimes, particularly in the context of Fund-supported programs in the aftermath of the Asian financial crisis.

With the support of the United States, the IMF has helped to promote improved insolvency regimes in a number of countries in conjunction with the World Bank.

- The USED has pressed Indonesia on numerous occasions to reform its bankruptcy system. As it stands, bankruptcy proceedings are extremely vulnerable to corruption in Indonesia. As a result, debtors have little incentive to reach debt restructuring agreements with creditors and Indonesia continues to suffer from an overhang of non-performing debt.

- In their Memorandum of Economic and Financial Policies (MEFP), FRY and Serbian authorities committed to review existing bankruptcy legislation and enforcement practices to increase the security of property and to reform a regime that currently favors debtors over creditors.
- In October 2000, the Bulgarian parliament approved amendments to the commercial code designed to expedite the completion of bankruptcy proceedings, including for state-owned enterprises, and judges were trained on bankruptcy issues. This was a structural benchmark in Bulgaria's Extended Fund Facility (EFF) arrangement. In the March 2001 Board review of this program, the USED pushed for continued improvement in the enforcement of creditor rights, including amendments to the Civil Procedures Code.
- The USED has supported in Board statements Mexico's efforts to update its bankruptcy law and to revise the law governing collateral guarantees. Subsequently, the Mexican authorities have passed legislation to achieve these purposes.

(5) Private Sector Involvement

The United States has continued to work to assure that the private sector plays an appropriate role in the resolution of financial crises. The IMF and G-7 continue to work together to develop a system in which countries can address debt problems using voluntary, market-based approaches. This approach has been applied in Turkey and Argentina.

With the support of the United States, the IMF has consulted with other international institutions, member governments, and the private sector over the past year on the use of collective action clauses, investor relations programs, corporate workouts, and bond restructuring techniques. The IMF, with the help of the United States, also continues to address the practical issues involved in resolving crises, including: an improved basis to assess debt sustainability; prospects for regaining market access; the risk of contagion; and the comparability of treatment between official and private creditors.

In particular, the United States has advocated policies that include:

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

Effective surveillance and sound debt and reserve management policies are essential aspects of crisis prevention. The United States continues to press for ongoing improvements in this area by putting greater emphasis on the provision of data to the markets and improved guidelines for debt and reserves management practices.

The IMF promotes, with strong U.S. support, efforts by countries to make information on their economies available to private markets, including publication of Article IV assessments and program documents as well as regular release of economic and financial data consistent with the SDDS. (See Section 12). This data recently has been bolstered by IMF efforts to enhance

reporting on reserves. Further, the IMF also has sought to deepen its own understanding of international capital markets through the creation of an International Capital Markets Department. This department should help the IMF better anticipate financial crises and provide better guidance to member countries to avoid these crises.

In addition to enhanced data provision and surveillance, mitigating risks associated with large capital flows requires careful management of government debt and foreign exchange portfolios. In spring 2001, the IMF and World Bank finalized guidelines for members' debt management that, for instance, encourage countries not to rely heavily on short-term debt.⁶ To further promote sound reserve management practices, the IMF recently released draft foreign exchange management guidelines, designed to increase a country's resilience to financial shocks.

(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). The IMF has expanded its expertise in the area, and undertaken research to guide its efforts. It is also actively involved, with the World Bank, in monitoring the implementation of the *Core Principles for Effective Banking Supervision*. The IMF, with U.S. 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) Increased Use of Debt Contract Provisions

The IMF is part of an effort in the official community to broaden the use of contractual provisions, such as collective action clauses, in international sovereign debt contracts. Collective action clauses facilitate the efficient and cooperative resolution of sovereign debt problems by limiting the ability of a minority of dissident creditors to obstruct an agreement supported by the majority of creditors. The IMF has continued to hold discussions with other international institutions, member governments, and the private sector to promote the expanded use of collective action clauses.

(D) Extension of Lending into Arrears

In 1998, the IMF extended, on a case-by-case basis, the scope of the IMF's policy to allow lending into arrears. This policy enables the IMF to provide financial support for policy adjustment, despite the presence of actual or impending arrears on a country's obligations to private creditors, including arrears on bonded debt. According to the agreed criteria, such support should be provided where: (1) prompt IMF support is considered essential for the successful implementation of the member's adjustment program; (2) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors.

(E) Promotion of Orderly Workouts

⁶ For further information on these guidelines, see *Guidelines for Public Debt Management* (March 21, 2001). The text can be found at the following link: <http://www.imf.org/external/np/mae/pdebt/2000/eng/index.htm#II>.

Orderly workouts are facilitated by: improved dialogue between the debtor and its creditors; the broader use of collective action clauses; and application, as appropriate, of the IMF's policy on lending into arrears. The IMF, with USED support, encourages countries facing financial difficulties to engage in cooperative and transparent consultations with creditors. Increasingly, private creditors, including bondholders, have demonstrated a willingness to participate in market-based operations that ease a country's debt payment schedule. For example, both Turkey and Argentina implemented successful market-based debt exchange operations this year. Most notably, Argentina swapped \$29.5 billion of debt, significantly decreasing its debt service obligation between 2001 and 2005.

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

Private lenders necessarily are involved in crisis resolution, though there are not always formal linkages between the provision of official financing and steps to assure the involvement of specific groups of private creditors. In a July 2001 IMF seminar on private sector involvement, participants agreed that limits on the availability of official financing made some form of private sector involvement essential. In some cases, the combination of catalytic official financing and policy adjustment should allow the country to regain market access quickly, contributing to the country's stabilization. In other cases, voluntary, market-based operations to re-profile debts may be warranted. In certain exceptional cases, it may be appropriate to provide official financing to support efforts to refinance, reschedule, or restructure some of the debt. Argentina's recent \$8 billion IMF package includes a clause stating that payment of \$3 billion of the \$8 billion may be accelerated if the Argentina concludes a voluntary, market-based operation to improve its debt profile.

(G) Facilitation of Discussions between Debtors and Creditors

The United States believes that appropriate communication between debtors and creditors is crucial to orderly crisis prevention and resolution and has built broad support at the IMF for this view. Improving interaction between debtor countries and private creditors has been a key focus of the IMF's new Capital Market Consultative Group (CMCG). A working group of the CMCG recently released recommendations to improve dialogue between debtor countries and their private sector creditors, including recommendations to help member countries establish more formal Investor Relations Programs (IRPs).

(H) Accompanying the Provision of IMF Funding with Efforts to Achieve Private Sector Contribution

As stated previously, the IMF's framework for private sector involvement promotes appropriate contributions from private sector lenders, and aims at a system in which countries can address debt problems in a market-based, orderly way. It recognizes the need to preserve the fundamental principle that creditors should bear the consequences of the risks they assume, while not undermining the equally essential principles that debtors should honor their obligations and that the IMF should not encourage default.

(6) Good governance

The IMF has been increasing its attention to governance issues for several years. Its efforts include the emphasis given to governance issues in the IMF's 1996 Declaration on "Partnership for Sustainable Global Growth" and the guidelines on good governance established by the IMF in August 1997. Much of the existing work of the IMF has always supported good governance, such as the emphasis on transparency and promotion of market-based reforms.⁷ More recently, with strong USED advocacy, the IMF has taken further steps to help improve governance in program countries, and the IMF is now working with the Financial Action Task Force (FATF) to help combat abuse of the global financial system. (For a discussion on the IMF's improved efforts to safeguard its resources, see part I below regarding Section 801(c)(1)(B) policies.)

Protecting against Abuse of the Financial System, including Money Laundering

Leaders of the Group of Seven at their July 2001 Summit in Genoa reaffirmed their support for the multilateral effort against abuses of the global financial system. G-7 leaders endorsed a program of action to continue the international combat against money laundering and financial abuse for the coming year. They noted the important role of the IMF (and other international financial institutions) in helping jurisdictions improve their anti-money laundering regimes and urged them to step up their efforts in this regard. In addition, they encouraged continued progress in on-going IMF assessments of offshore financial centers (OFCs) regarding their adherence to international standards.

During the Spring 2001 Meetings, the IMF and World Bank Boards generally agreed that the FATF 40 Recommendations be recognized as the appropriate standard for combating money laundering. Both Boards also generally agreed that work should go forward to determine how the FATF 40 could be adapted and made operational to the Fund's and Bank's work. Fund Directors agreed the IMF would: intensify its focus on anti-money laundering elements in all relevant supervisory principles, work closely with major international anti-money laundering groups; increase the provision of technical assistance; include anti-money laundering concerns in its surveillance and other operational activities when relevant to macroeconomic issues; and, undertake additional studies and publicize the importance of countries acting to protect themselves against money laundering.

A number of these elements are already under way. Work is progressing on intensifying the focus on anti-money laundering elements in the methodology used for IMF FSAPs and the Fund's OFC initiative. Discussions are also underway on how the IMF and the World Bank, working in collaboration with the FATF, could incorporate the FATF 40 into a separate ROSC module on money laundering.

⁷ Because IMF financing is provided to central banks to address balance of payments difficulties, it is not in the nature of IMF lending to fund specific projects in member countries aimed at procurement and financial management controls.

Over the past year, at the urging of the US and other members, IMF surveillance and country programs have incorporated additional focus on money laundering. Examples of such efforts include:

- In a statement before the Board on June 29, 2001, the USED noted the FATF decision to include Nigeria on the list of non-cooperative countries in the fight against money laundering. In addition, the USED stressed that the Nigerian authorities should be taking this issue more seriously, especially at a time when Nigeria is pressing other countries to assist in recovering assets of the previous regime.
- The IMF staff paper on Israel, prepared for the July 2001 Article IV Board discussion, highlighted Israel's Non-Cooperative Countries and Territories (NCCT) status in the fight against money laundering, and noted the FATF recommendations. The USED statement raised concerns regarding Israel's NCCT status, and specifically called upon Israel to move swiftly to implement its anti-money laundering regime and put in place a system that is comprehensive and fully compliant with international standards. The USED also encouraged Israeli authorities to work closely with the appropriate institutions in correcting FATF-identified deficiencies in its anti-money laundering regime.
- The United States has played an important role in encouraging the Philippines to take stronger measures against money laundering. On July 31, 2001, the USED's office abstained on a vote to support resumption of the IMF program for the Philippines. Among the factors the USED raised was the Philippines' poor performance on money-laundering.
- The United States advocated through IMF and bilateral channels for Panama to improve its anti-money laundering regime. In part as a result of these efforts, over the past year, Panama has significantly strengthened anti-money laundering framework. As a result, Panama was removed from the FATF's list of "non-cooperative" countries in June 2001.

Other Good Governance and Anti-Corruption Measures

In February, the Board met to review the IMF's experience with respect to governance issues. It re-affirmed the IMF's 1997 Guidance Note on the Role of the IMF in Governance Issues. The Board also agreed that the IMF's involvement in this area should be focused on aspects of governance that could have a significant macroeconomic impact. This includes many areas that are generally considered part of the IMF's core areas of expertise, such as improving public administration, increasing the transparency of government operations, enhancing data dissemination, and implementing effective financial sector supervision. However, the IMF's role also extends into other areas, where anti-corruption efforts would clearly have a positive impact on the macroeconomic environment. The IMF will continue to play an important role in promoting good governance, through its programs, economic surveillance, and technical assistance.

Examples of U.S. emphasis on good governance are below:

- In Kenya, concerns over corruption led to the suspension of the country's IMF program. Although IMF staff had been working with Kenyan authorities to re-start the program, the IMF chose to postpone the resumption of the program after opposition parties in the Kenyan parliament defeated legislation to establish an independent anti-corruption authority. Resumption of the program will depend on establishing this authority.
 - The United States has urged the IMF and World Bank programs in Bosnia and Herzegovina to include provisions for strengthening governance, particularly by improving the capacity of the state and entity Treasuries to monitor and control expenditures.
 - In a July 2001 statement on Cambodia's program, the USED urged improved governance reform. More specifically, the USED urged better public resource management. The United States reinforced this position in a subsequent discussion on Cambodia in the Asian Development Bank (AsDB), where the United States supported the AsDB's role in a new land law, which could have a major impact on improved governance and environmental management.
 - In the past year, the Nicaraguan government, in the context of its Fund program, has implemented a new law on government procurement practices, improved transparency and internal controls over public operations in order to reduce corruption, established property courts and arbitration centers, and approved a law on settling administrative disputes.
 - In the July 2001 review of Azerbaijan's program, the USED emphasized the importance of governance reforms, specifically noting that it is critical that Azerbaijan's Oil Fund be managed in an open and transparent fashion. Azerbaijan has agreed to publish accounts of the consolidated budget every quarter, and to publish an independent audit of the Oil Fund annually.
 - The USED has repeatedly emphasized the importance of governance in its Board statements on Tajikistan's PRGF arrangements in October 2000, April 2001 and July 2001. The program includes conditions on setting up an independent auditing agency and a treasury system.
 - During the PRGF review for Georgia in January 2001, the USED stressed the importance of anti-corruption efforts in overseeing expenditure and raising tax revenues. Georgia established in July 2000 a Presidential anti-corruption commission, which was charged with implementing the strategy set out in the July 2000 presidential decree. The decree outlines six specific areas of improvement including the financial management of state resources and the state management system.
- (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 as well as social programs to protect the neediest and promote social equity.*

The IMF emphasizes, particularly in its work with low income countries, the importance of targeting scarce public resources effectively. The IMF promotes better targeted expenditure in

several ways. Since 1998, it has emphasized adherence to the IMF's *Code of Good Practices on Fiscal Transparency*, which aims to enhance the transparency of fiscal policy, promote quality audit and accounting standards, and reduce or eliminate off-budget transactions and accounts, which are often the source of unproductive government spending. The IMF also encourages countries to conduct "public expenditure reviews" with the World Bank.

In addition, the IMF does an annual survey of global military expenditures, and publishes its findings in its publication, *IMF Survey*, which is available on the IMF website.⁸ The most recent review finds that military spending has continued to decline in developing countries, both as a percentage of GDP and a percentage of expenditure. As a percentage of GDP, military expenditure in developing countries was 2.5 percent in 1990, 2.2 percent in 1995, and 2.1 in 2000. As a percentage of government expenditure, the figures are 12.2 percent in 1990, 11.3 percent in 1995, and 10.1 percent in 2000. In Africa, the figures show more progress. In the past decade, military expenditure has dropped from 3.2 percent of GDP to 2.2 percent, or 12.1 percent of government expenditure to 7.4 percent. While these figures are still too high, the trend is clearly in the right direction.

The IMF is engaged in additional efforts with low income countries. As noted in previous reports and other public documents, the IMF and the World Bank, in consultation with nongovernmental organizations (NGOs), religious organizations, and other interested parties, have developed a new poverty reduction framework, centered on a country-driven poverty reduction strategy. This new approach provides the framework for the IMF's concessional lending through the PRGF, as well as for its participation in the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Under this new framework, the IMF is to play a more tightly focused role in support of macroeconomic reform, with the World Bank taking the lead on longer-term development projects and social and structural reforms. Together, the two institutions support the efforts of countries to develop poverty reduction strategies.

Below are several examples of efforts to focus government expenditure on investment in human capital or other productive purposes:

- In the June 2001 discussion of India's Article IV consultation, the USED questioned the Indian authorities' public expenditure management. The USED noted that military expenditures continued to be a significant portion of overall expenditures, and commended the government for its consent to a Public Expenditure Review by the World Bank this year.
- In a review of Mali's PRGF on July 25, 2001, the USED expressed serious concern about some of the expenditures related to elections and the military made by the Malian authorities. The USED statement made clear that we expected to see mechanisms in place that allowed for adequate tracking of HIPC expenditures.
- Under its SMP, Slovakia has committed to improved targeting of social services, which should bring costs in line while ensuring access to those in need. The authorities will also

⁸ See: <http://www.imf.org>.

restructure the Slovak railroad company, which is currently a large drain on government resources, and bring most off-budget funds onto the central government's budget.

- The FRY is moving forward with measures to improve fiscal management. It is also reducing military spending as part of its 2001 federal budget. Much of 2000 military spending could be explained by elevated expenditures to repair damage from NATO bombing.

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

In its programs and ongoing surveillance, the IMF promotes macroeconomic stability and the conditions for strong economic growth. In certain core areas, even countries from different regions may have common goals. For example, whether a country is located in Eastern Europe or in sub-Saharan Africa, it must control inflation in order to establish a functioning economy. In other areas, the impediments to economic stability and growth may differ across countries. This is broadly recognized within the IMF. For example, the outcomes of the recent conditionality review emphasized the wide range of circumstances under which countries request assistance, and the subsequent need for flexibility and customization in programs. In addition, the IMF has increased its cooperation with the World Bank in order to assist countries to target government expenditures more effectively to reduce poverty. Such expenditures help to mitigate the sometimes disruptive effects associated with necessary reforms to provide macroeconomic stability. (See Section 7)

In addition, in the context of its concessional lending and participation in the enhanced HIPC Initiative, the IMF requires government consultation with all sections of society in developing IMF programs. This process is designed to ensure that the program meets the specific needs of a given country. In addition, the IMF and the World Bank have been working to develop an approach to social impact analysis. Where PRGF programs contain major reforms, an analysis of the impact on the poor – carried out by the World Bank – will be conducted and countervailing measures will, as appropriate, be incorporated into the PRGF program.

(9) *Core labor standards (CLS)*

The five internationally recognized CLS are: (1) freedom of association; (2) right of organization and collective bargaining; (3) prohibition against exploitative child labor; (4) prohibition against forced or compulsory labor; and (5) protection against discrimination in employment.

To assist the USED in addressing CLS, consistent with the legislation, Treasury works closely with the U.S. Labor Department and the State Department as well as other institutions, such as the International Labor Organization (ILO). For instance, the Labor Department systematically receives IMF documents on surveillance and lending programs, and provides input to Treasury and the USED.

As has been noted in past reports, there is some reluctance by many member countries to address this issue, particularly in the context of the effort to focus conditionality more narrowly. However, during the past year, consistent with the legislation, the USED has raised labor issues,

and, in some cases, labor issues are discussed in the context of the IMF staff's work. For example:

- The FRY authorities introduced new labor legislation into the federal and Serbian parliaments that, *inter alia*, guaranteed core labor standards, including the freedom of association and participation in collective bargaining for employees and employers. In the Board, the USED supported the government's inclusion of this commitment in its MEFP.
- In the July 2001 statement on Cambodia's program, the USED raised the issue of working conditions in the Cambodian textile and apparel industries and advocated Cambodia's compliance with internationally recognized core labor standards.
- In the May 2001 Article IV review on Guatemala, the USED urged improvement of Guatemalan labor conditions, specifically citing the failure to comply with ILO standards. Labor standards subsequently improved when the authorities formally recognized unions' rights to organize and to strike.

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

In helping to create the conditions for a sound economy, the IMF facilitates the reduction of ethnic and social strife, to the extent such strife is driven in part by economic deprivation. There are also steps in the IMF's lending operations that can help to promote greater societal cohesion in recipient countries. First, with U.S. support, the IMF has increasingly encouraged the strengthening of social safety nets. Second, as noted in other sections of the report, the IMF encourages – and in many cases, requires – consultation with various segments of society in the development of programs. This approach seeks to ensure that all interests have an opportunity to participate in the establishment and implementation of national priorities. Third, where PRGF programs contain major reforms, an analysis of the impact on the poor – carried out by the World Bank – will be conducted and countervailing measures will, as appropriate, be incorporated into the PRGF program.

(11) Link between environmental and macroeconomic conditions and policies

Environmental issues can have a bearing on macroeconomic policies and vice versa. While recognizing that the IMF relies on the expertise of the World Bank for analysis of environmental issues in individual countries, the United States has used its voice in the Board to encourage the inclusion of measures in IMF programs to tax polluting activities or to remove subsidies on environmentally-harmful products or activities, especially when such issues are relevant to a country's fiscal situation. In addition, the USED presses the IMF staff to examine any potentially negative environmental consequences of its recommended policies. For example:

- Over the past year, there has been a significant decrease in illegal logging in Cambodia. In the context of its Fund program, the Cambodian government has committed to passing a new forestry law (which the United States encouraged), aimed at establishing sound legal conditions for sustainable forest resource management. The government has also committed

to working with NGOs on sustainable forestry policy. These policies are important for Cambodia to secure a sounder fiscal footing.

- In meetings with staff and in the Board statement for Liberia's SMP review, the United States raised concerns about the government's mismanagement of the forestry sector and were critical of the excessive tax and import duty exemptions for new forestry concessions. The USED urged the authorities to evaluate the economic consequences of rapid deforestation on soil erosion, water resources, biodiversity and communities living in forests.

(12) Greater transparency

As noted in earlier reports, the United States has worked with its partners in the G-7 to build on the growing international consensus in favor of transparency and accountability, and there has been tremendous success in this area. Over the last several years, there have been significant increases in the release of information to the public.

The IMF currently releases a wealth of information on its members and on its own operations. The United States welcomes this change in the IMF, but will continue to push for more improvements in the openness of the institution. Under current policy:

- Publication of program and Article IV staff papers is voluntary, and 82 countries have chosen to publish at least one staff paper.
- There is a presumption of publication for Letters of Intent (LOIs) or other documents related to a country's policy intentions under a program. Over 90 percent of program countries release their LOIs.
- For countries receiving assistance on concessional terms, Interim Poverty Reduction Strategy Papers (I-PRSPs) and PRSPs must be published prior to Board discussion, and there is a presumption of publication for HIPC documents and staff assessments of PRSPs.
- The IMF releases summaries of Board discussions on country programs. For Article IV reviews, release of a Public information Notice (PIN) is voluntary; however, PINs are now released for nearly 90 percent of Article IV reviews.
- The voluntary release by countries of IMF reports on the observance of key international standards and, to a lesser extent, assessments of financial sector vulnerabilities have also contributed to the significant increase in the release of information to the public.

The United States has made clear that it favors stronger disclosure requirements for these documents. For example, the United States has advocated a presumption of publication for staff reports on IMF programs, mandatory release of LOIs, and greater use of PINs following Board discussions of Article IV consultations.

Finally, with respect to the IMF's financial operations, the IMF established an "IMF Finances" page on its website in the summer of 2000. This page includes access to the IMF's

operational budget (the “Financial Transactions Plan”), quarterly financial statements, and the most recent Annual Report, as well as a wide range of other relevant information.

These steps have contributed significantly to the public knowledge and accountability of the IMF.

(13) Greater IMF accountability and enhanced self-evaluation

As noted in previous reports, the USED has consistently supported measures to increase the accountability of the IMF and to allow independent evaluations of the IMF’s operations. Evaluation in the IMF takes several forms.

First, there has long been an Office of Internal Audit, which is responsible for reviews of IMF operations. Among other things, this office performs audits of IMF finances, operations, and systems, and also conducts investigations on an ad hoc basis.

Second, in 1998, with the support of the USED, the IMF established procedures for independent evaluations. Under these procedures, external evaluations were completed of the IMF’s Enhanced Structural Adjustment Facility, Economic Research Activities, Surveillance, and overall Experience with Evaluation in the IMF. All of these evaluations are available on the IMF’s website.

Finally, in April 2000, with the strong urging the USED, the Executive Board agreed to establish an Independent Evaluation Office (IEO), which will complement the existing internal and external evaluation activities. The IEO is currently in the process of hiring staff and determining its work program. IEO staff have already met, and will continue to meet, with outside experts – academics, policy analysts, NGO representatives, and representatives from developing countries. It is expected that the work program will be finalized in December 2001. Once fully operational, the IEO will conduct objective and independent evaluations on issues of relevance to the mandate of the IMF. The terms of reference (TOR) provide that the IEO will be independent from IMF management and operate at “arm’s length” from the Executive Board. There will be a strong presumption that IEO reports will be published shortly after completion. The TOR and other documents are available on the IMF’s website.

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

The provision of micro-credit is a recognized component of structural adjustment, especially in cases where either state-directed credit was formerly in use, or where large conglomerates or monopolies provided such credit. Responsibility for assistance in establishing micro-finance programs lies with the World Bank and regional development banks. However, countries may include plans to develop micro-finance institutions in their poverty reduction strategies, which are approved by both the IMF and the World Bank.

Section 801(c)(1)(B)

(I) Suspension of IMF financing if funds are being diverted for purposes other than the purpose for which the financing was intended

In part as a result of strong U.S. advocacy, 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 new framework for safeguarding its resources took effect on July 1, 2000. The framework:

- requires all countries making use of IMF resources to undertake and publish central bank financial statements audited by an independent external auditor;
- establishes a process of assessments to provide assurances that member countries' central banks have adequate control, accounting, reporting and auditing systems in place to protect the central bank's resources, including IMF disbursements; and
- requires that any critical vulnerabilities identified be remedied before additional Fund resources are disbursed.

Transitional procedures requiring publication of independently audited external central bank financial statements apply for members with arrangements in effect on June 30, 2000. Fuller two-stage assessments are conducted for arrangements after June 30, 2000. Stage one assessments examine documents submitted by member countries. If necessary, a stage two on-site assessment is conducted to address any concerns identified in the first stage. Experience with the new safeguards assessment policies is expected to be reviewed in the next six months and will include input from a panel of eminent external experts.

In 2000, the IMF also moved to strengthen procedures for handling instances of misreporting by countries in the context of IMF programs. Among other things, these changes provided for extension of the statute of limitations for all cases of alleged misreporting from two to four years, a report to the Executive Board on all cases of actual misreporting, corrective actions as appropriate for violations of commitments to the IMF, and publication of cases of misreporting after the Board has reviewed each case and issued its conclusions. During the past fiscal year, there have been three cases of misreporting – Ghana, Tajikistan, and Niger. In each case, the misreporting incident was made public through a PIN following the Board discussion.

In cases involving misuse of IMF resources and/or misreporting to the IMF, financing is suspended until the cause of such problems is identified and remedial actions are undertaken as appropriate to ensure that similar problems do not occur again in the future. Repayment of resources to the Fund may also be required.

(II) IMF financing as a catalyst for private sector financing, which does not displace such financing

Under its current framework, the IMF seeks to provide official financing and promote policy adjustment in order to catalyze private flows, which should allow the country to regain market access quickly, contributing to the country's stabilization. (See Section 5 of this report 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 IMF bases its decisions to release resources on the program country's policy actions, both prior to and during the program. The United States has been a strong support of this conditions-based approach. Program conditionality is designed to help close the balance of payments gap and improve a country's future external position, creating the foundation for renewed growth. It is also essential to ensure that resources are safeguarded and that the IMF is repaid.

Prior to the initial approval of a program, the IMF and national authorities determine the program objectives. The national authorities produce a Letter of Intent (and frequently a Memorandum of Economic and Financial Policy), which details the government's proposed policy actions. Key actions are identified as performance criteria or structural benchmarks, which then help to guide decisions about program disbursements.

Particularly, in cases where a country has serious economic distortions and/or a poor track record of implementation under past Fund programs, the IMF may require "prior actions" before disbursements are made. These "prior actions" are intended to be a signal from the program country of its commitment to honor the measures in the program. The United States strongly backs the use of prior actions as a generalized feature in IMF program design.

Once the program is underway, disbursements are contingent upon implementation of the program conditions. Prior to disbursements, the IMF reviews the commitments made by the national authorities and the actions taken. If a country has failed to meet its commitments, then the program may be put on hold – and disbursements cease until the government takes the necessary steps to put the program back on track.

Turkey provides an important recent example of this approach. For the May 2001 augmentation of the SBA, Turkey implemented an exceptionally deep and broad package of economic reforms as prior actions, with the high-level initiative of the U.S. playing an important role. Subsequent disbursements have also been conditioned on implementation of further reforms.

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

The IMF is a consistent advocate of open markets and trade liberalization. For elaboration and examples, see Section 2F.

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

In September 2000, with strong U.S. support, the IMF agreed to reorient IMF lending to focus more on short-term financing, 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. In addition, the IMF committed to limiting the use of Extended Arrangements to those countries with a financial need that justifies a longer repayment period - generally to poorer countries with limited access to private capital.

- In 2000, only two new arrangements were made under Extended Arrangement terms; in 2001 (as of October), no new arrangements were made under these extended terms.
- By contrast, the IMF has recently used the Supplemental Reserve Facility (SRF), which carries higher interest rates, for several large programs, including Brazil (2001), Turkey (2000), and Argentina (2000).

Further, the Contingent Credit Line (CCL) was enhanced to provide an improved vehicle for countries with strong economic policies and no current balance of payment problem to put in place a contingency agreement to access IMF resources if contagion strikes – thus forestalling the occurrence of a balance of payment problem. The initial surcharge on this facility was reduced, to distinguish the CCL from emergency resources of similar amounts available through the SRF. The fee paid when resources are initially committed was also dramatically reduced.

(VI) Graduation from receiving financing on concessionary terms

The IMF, in conjunction with the World Bank, has implemented policies providing for the use of appropriate qualitative and quantitative indicators to measure progress toward graduation from receiving financing on concessionary terms. However, the IMF has not implemented policies providing for the use of an estimated timetable by which countries may graduate over the next 15 years.

The IMF has specific eligibility criteria for its concessional operations; while some countries have “graduated” from concessional financing, it is uncertain whether the remainder of low income countries will do so during the next 15 years. The IMF extends concessional credit through the PRGF. While final PRGF eligibility determinations are made by the IMF’s Executive Board, eligibility generally mirrors eligibility for financing through the International Development Agency (IDA) of the World Bank. IDA’s primary eligibility criteria are a country’s relative poverty (the operational cutoff is 1999 per capita income of \$885) and its lack of creditworthiness. A country’s graduation from IDA and PRGF financing is primarily related to its growth performance and prospects, its capacity to borrow on non-concessionary terms, its vulnerability to adverse external developments such as swings in commodity prices, its debt profile, and its balance of payments. Given the inherent uncertainty in these factors, it is difficult to project when countries might graduate. Treasury and the USED will continue to work with the IMF to help ensure that PRGF countries graduate from reliance on concessionary lending in the

shortest possible period. In the past year, China, Egypt, and Equatorial Guinea have progressed economically such that they have been removed from the list of PRGF-eligible countries.

Conclusion

The Treasury and the USED have continued to use the voice and vote of the United States to promote the policies set out in U.S. legislation. As noted in past reports, there is not uniform agreement among IMF members or the G-7 on the suitability of all the mandates discussed in this report. It is generally the case that we have had the most success in promoting those provisions that have a clear link to macroeconomic stability and growth. Treasury and the USED will continue to engage IMF management, staff, and member countries to build support for the policies described in this report.