

**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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Introduction

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

The Treasury Department and the Office of the United States Executive Director (“USED”) at the IMF consistently endeavor to build support in the IMF’s Executive Board for the objectives set out in this legislation. These efforts include meetings with IMF staff and other Board members on country programs and IMF policies, formal statements by the USED in the IMF Board, and USED votes in the Executive Board. The Treasury Department’s objective is to support strengthened commitments in IMF programs, policy actions by program countries, and policy decisions at the IMF itself.

Assessments of the overall effectiveness of the Treasury and USED’s office in promoting the legislative provisions are published annually by the GAO and are available online.³ The most recent report states that the “Treasury continues to promote the task force as a tool for monitoring and promoting legislative mandates and other policy priorities.” The Treasury Department task force is charged with increasing awareness among Treasury staff about legislative mandates and identifying opportunities to influence IMF decisions.

Report on Specific Provisions

I. 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.” The IMF advises countries that exchange rate stability can only be achieved through the adoption of sound macroeconomic policies. While the Fund recognizes the right of each member country to choose its own exchange rate regime, it advises countries on macroeconomic and financial policies necessary to support the sustainability of that regime and raises a note of caution where it views arrangements to be

¹ These provisions were enacted in Sections 610 and 613 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999 (Public Law 105-277, division A, § 101(d), title VI, §§ 610 & 613). Section 1705(a) was amended by Section 803 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001 (Public Law 106-429, title VIII, § 803).

² Public Law 106-429, title VIII, § 801(c)(1)(B).

³ *Treasury Continues to Maintain Its Formal Process to Promote U.S. Policies at the International Monetary Fund*, General Accounting Office (GAO), September 2005.

inconsistent with broader macroeconomic policy choices. The U.S. Treasury has urged the Fund to exercise firm surveillance over exchange rates.

- In China's most recent Article IV discussions, the USED strongly supported the move toward greater exchange rate flexibility. The Chinese authorities allowed a 2% revaluation in July 2005, and in September widened the daily trading band for major currencies (excluding the US dollar) to 3 percent from 1.5 percent.⁴
- In its January 2005 statement on Korea's Article IV, the USED urged the Koreans to allow more flexibility in their exchange rate and noted that this would "provide scope for an independent monetary policy and the delinking of domestic and foreign interest rates."

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

(A) Establishment of an independent monetary authority

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

- In its August 2005 statement on Paraguay's SBA review, the USED urged continued efforts on increasing the independence of the central bank.⁵
- In a statement on the Kyrgyz Republic's PRGF review in October 2005, the USED supported IMF staff's recommendation to strengthen the legal basis for an independent central bank.⁶
- In its statement on Mongolia's Article IV review in September 2005, the USED emphasized the need to improve governance at the independent oversight body at the central bank and strengthen governance in general.

(B) Fair and open internal competition among domestic enterprises

⁴ Article IV reviews are surveillance reports that provide a comprehensive economic analysis of member country economic policies, including: (i) exchange rate, monetary, and fiscal policies; (ii) financial sector issues; (iii) risks and vulnerabilities; (iv) institutional issues; and (v) structural policies.

⁵ The Stand-By Arrangement (SBA) is the Fund's standard lending instrument for middle-income countries with short-term balance of payments needs. The basic (SDR) rate of charge is applied, and repayment is typically expected within 2 ¼ - 4 years.

⁶ The Poverty Reduction and Growth Facility (PRGF) is the IMF's lending instrument for low-income countries. The PRGF carries a below-market interest rate of 0.5% and a 5 ½-10 year repayment schedule.

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

- The USED noted the importance of the establishment of a commercial court in the November 2004 Board IMF statement on Peru. The creation of the court was a performance criterion under the IMF program and is expected to help promote investment and competitiveness.
- In its March 2005 Board statement on Lithuania's Article IV, the USED commended the authorities for strengthening the business environment and making good progress on privatization. The statement also calls for progress on increasing the competitiveness of small and medium enterprises.

(C) Privatization

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

- The USED supported Pakistan's PRGF, which called for far-reaching structural reforms, including those in the financial sector. Nearly 80 percent of the country's banking sector assets are now in private banks, compared with 34 percent five years ago.
- In a September 2005 Board statement on Post-Program Monitoring for the Philippines, the USED welcomed the government's commitment to sell 70% of the national power company's generating assets.
- In board statements for the November 2002 and May 2004 Article IV reviews of Egypt, the USED stressed the importance of privatizing the four state-owned banks that dominate the Egyptian banking sector. In late 2004, Egypt agreed and began the process of privatizing the first of the four state-owned banks.

(D) Economic deregulation and strong legal frameworks

Markets are distorted and entrepreneurship is stifled without strong property rights, enforcement of contracts, and fair and open competition. While these issues are often addressed as part of the World Bank's mandate, the IMF periodically includes policy advice in its programs or surveillance on measures considered critical to the member country's macroeconomic

performance. Examples of United States' efforts to encourage these reforms include the following:

- In its February 2005 Board statement on the Article IV for Italy, the USED noted the importance of simplifying legal procedures to improve the environment for private sector-led growth. Soon after, the Italian authorities unveiled plans to increase competitiveness and reform of the bankruptcy law; faster procedures in the judicial system were key features. The reform package was passed into law in May.

(E) Social safety nets

While growth is an essential ingredient for poverty reduction, investment in human development and basic social services is also critical. Cost effective social safety nets can play an important role in promoting building domestic support for economic reform, and in alleviating the direct impact of poverty. Against this background, the United States has been a strong advocate of strengthened IFI support for productivity-building investments in public education, health and other social services. Importantly, the US has secured grants windows in the International Development Association of the World Bank Group, the African Development Fund, and the Asian Development Fund that will strengthen MDB assistance in these important sectors.

The IMF does not lend directly for budget support to build social safety nets. However, the Fund's policy advice, and its focus on macroeconomic stability, encourage domestic policy makers to develop fiscal strategies that address the needs of the poor. IMF advice is developed within a country-specific poverty reduction strategy (PRS) that encourages accountability between donors and recipients. In a September 2005 review of the PRS approach, the USED welcomed the increased focus on accountability, results, the critical link between improved budgeting systems and the success of PRS initiatives, and the importance of participation.

- Approximately 2/3 of PRGF-supported programs include countervailing measures aimed at offsetting the impact of macroeconomic and structural policies on the poor.
- As a result of its financial crisis, the poverty rate in Uruguay increased from 18% to over 30% between 2000 and 2003. The USED supported the government's introduction of a Social Emergency Program to provide monetary support and social services to families meeting income and other eligibility requirements. At the same time, the USED supported IMF staff's call for careful targeting of the program and a timely phase-out to avoid weakening fiscal and debt sustainability.

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

The IMF encourages a multilateral, rules-based approach to trade liberalization across all sectors of the global economy, including, but not limited to, the agricultural sector. The IMF has played a supportive role in promoting trade liberalization, particularly in the context of the WTO

trade negotiations under the Doha Development Agenda (DDA). In April 2004, the Fund approved the Trade Integration Mechanism (TIM) to provide financial support to countries facing balance of payments problems resulting from trade adjustment. The proposal represents a concrete response to developing country concerns over the potential negative impacts from multilateral trade liberalization. The IMF is prepared, along with the World Bank, to provide transitional assistance to member countries experiencing payment imbalances arising from the passage of trade reform.

- In its 2004 Board statement on the Article IV for France, the USED urged France to support an ambitious conclusion to the Doha round, including the liberalization of trade on specific agricultural products and noting that early and aggressive implementation of CAP (Common Agricultural Policy) reform would greatly enhance this effort.
- In its Board statement for the German Article IV, the USED welcomed Germany's efforts within the EU to advance the Doha round, including the liberalization of trade on specific agricultural products and efforts to decouple CAP support from production.

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

The joint IMF-World Bank *Financial Sector Assessment Program* (“FSAP”) has emerged as a critical instrument for financial sector surveillance and advice. As of February 2005, eighty-two FSAP assessments had been completed with seventeen additional reviews planned.

Results from the FSAPs are used to generate assessments of compliance with key financial sector standards such as the Basel Committee’s *Core Principles for Effective Banking Supervision*, the International Organization of Securities Commission’s *Objectives and Principles of Securities Regulation*, and the IMF’s own *Code of Good Practices on Transparency in Monetary and Financial Policies*. The FSAPs are also used to develop *Financial System Stability Assessments* (“FSSA”) which are often provided to the public through the *Reports on the Observance of Standards and Codes* (“ROSCs”). In the March 2005 review of the FSAP program, the USED underlined the importance of improving coordination and follow-up of the FSAP process to ensure that lessons learned on how to strengthen financial systems are embedded in surveillance and program work of the World Bank and IMF. In the July 2005 discussion of the Standards and Codes Initiative, the U.S. pushed for increased integration of the ROSC into other IFI activities and improved accessibility and publication of the reports. Some key examples of where the USED has supported the strengthening of financial systems are:

- Under the U.S.-supported IMF program for Argentina, the Argentine Central Bank established a clear regulatory framework and a plan for banks to rebuild capital in order to minimize remaining vulnerabilities.
- In the August 2005 Article IV discussion on China, the USED encouraged the Chinese to address the stock of non-performing loans (NPLs) in the predominantly state-owned banking system, and underscored the importance of improved bank supervision, more effective corporate governance, and state bank privatization to prevent the creation of new NPLs.

- The USED board statement in May 2005 supported key structural economic reforms in Turkey's IMF program, including strengthening of the banking regulatory and supervisory framework through swift passage and implementation of key amendments to the banking act. The Turkish Parliament passed the necessary legislation in this area in October.
- Under its U.S.-supported IMF Stand-By Arrangement, the Brazilian Central Bank has created a centralized credit information bureau. This enables loan applicants and banks to have access to the central bank's centralized credit rating system, with a view to make available to competing banks information on a borrower's credit.

(4) Internationally acceptable domestic bankruptcy laws and regulations

The IFIs have continued to build upon work started after the Asian financial crisis to promote more effective insolvency and debtor-creditor regimes. While the World Bank normally leads reviews of domestic insolvency laws, the IMF actively supports this agenda. The IMF and the World Bank have 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. The IFIs also provide technical assistance to help emerging market economies develop efficient insolvency regimes. With the support of the United States, the IMF has worked with the World Bank to promote improved insolvency regimes in a number of countries.

- During the July 2005 ROSC review, the United States urged the IMF, World Bank and UNCITRAL to swiftly reach agreement on a unified standard for insolvency.
- The USED has pressed for a reform of Brazil's bankruptcy law in the context of its IMF program. The Brazilian Congress has passed a bankruptcy law that provides a chapter 11-type system and encourages extra-judicial workouts in cases of default.
- Regarding the Czech Republic's continual delays in adopting bankruptcy legislation, the USED notes in its 2005 Article IV Board statement that bankruptcy reform remains an urgent priority for the Czech Republic.

(5) Private Sector Involvement

The United States continues to work to ensure that the private sector plays an appropriate role in the resolution of financial crises. Over the past several years, the IMF, with the support of the United States, has taken important steps towards strengthening crisis prevention and resolution. The Fund has strengthened its surveillance of member countries and instilled more discipline in the use of official sector financing, especially through the establishment of rules and procedures governing exceptional access to Fund resources. Additionally, the use of collective action clauses (see Section C, below), supported by the IMF, as an accepted contractual, market-based approach to sovereign debt restructurings should help a sovereign restructure its debt when under financial distress. The IMF recognizes the need to preserve the fundamental principles that

(a) creditors should bear the consequences of the risks they assume and (b) debtors should honor their obligations.

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

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

The United States has urged the IMF to strengthen further its surveillance function and crisis prevention capabilities. In particular, the USED has supported the balance sheet approach to measure vulnerabilities in emerging markets and has called for greater focus on debt sustainability in both low-income and emerging market countries.

- In two recent reviews of program design (December 2004 and August 2005), the U.S. Board Statements in both cases emphasized that the Fund needs to increase its focus on debt sustainability in addition to appropriate fiscal adjustment.
- In its September 2005 statement on the Philippines, the USED called for greater fiscal consolidation in order to improve public debt dynamics.

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

- Fund members subscribing to either the General or Special Data Dissemination Standards increased from 60% of all members in 2005 to 75% in 2005. In an October 2005 USED statement on data standards, the USED called for mandatory reporting on the currency composition of reserves in order to improve crisis prevention.

(B) Strengthening of Emerging Markets' Financial Systems

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

(C) Strengthened Crisis Resolution Mechanisms

The United States, in cooperation with the IMF and the broader international financial community, has promoted a strengthened framework for crisis resolution through use of collective action clauses (CACs), application of the lending into arrears policy, and clear limits on the use of official finance.

(i) Collective Action Clauses

Sovereign bonds governed by New York law conventionally had not included provisions which would permit modification of key payment terms by less than unanimous consent. This restriction made these bonds harder to restructure when a sovereign experienced financial distress. The United States has worked actively with the IMF and the private sector to promote the market's adoption of CACs in order to improve debt restructuring processes. CACs have now become the market standard under NY law.

CACs are now included in 53 percent of the stock of external sovereign debt issued by emerging markets, and all new issuances since March 2005 – with only one exception – have included CACs. The IMF, encouraged by the United States, has made CACs an important element of its crisis resolution agenda. The IMF has indicated it will continue to encourage future issuers to follow this trend in strengthening market practices.

(ii) Lending into Arrears

The IMF lending into arrears policy permits the Fund to provide financial support for policy adjustments, despite the presence of actual or impending arrears on a country's obligations to private creditors, where: (i) prompt IMF support is considered essential for the successful implementation of the member's adjustment program; and (ii) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors. IMF efforts in recent years have focused on applying the “good faith” criterion to specific cases, including Argentina, the Dominican Republic, Iraq, and Dominica.

(iii) Clear Limits on Official Finance

The United States continues to press the IMF to improve its lending selectivity. In 2002 explicit criteria were developed for extending loans to countries seeking to borrow beyond normal limits (“exceptional access”). These include: (i) the member must be experiencing “exceptional balance of payments pressures on the capital account” which cannot be addressed with normal resources, (ii) an analysis of sustainable debt levels, (iii) reasonable prospects exist that the member will regain access to private capital markets during the program term, and (iv) the member's policy program can reasonably be expected to succeed. In addition, procedures were introduced to require: (i) a “higher burden of proof in program documentation”, (ii) early consultation with the Board on sovereign creditor negotiations, (iii) the issuance of a staff note specifically outlining all of the relevant considerations, and (iv) an ex-post evaluation of such a program within twelve months of its completion. In an April 2005 review of access policies, the USED argued for retaining the existing limits on exceptional access and maintaining a strong presumption of a one-program exit strategy.

(6) Good governance

The IMF's commitment to promoting good governance is outlined in its 1996 *Declaration on Partnership for Sustainable Global Growth* and its 1997 *Guidelines on Good Governance*. The IMF also supports good governance through its emphasis on transparency and its promotion of

market-based reforms.⁷ Recently, the IMF has been particularly active in promoting good governance through its efforts to protect against abuse of the financial system and to fight corruption.

The Fund's involvement has focused on those governance aspects that are generally considered part of the IMF's core expertise, such as improving public administration, increasing government transparency, enhancing data dissemination, and implementing effective financial sector supervision. The IMF promotes best practice principles through its code and standards, such as the *Report on the Observance on Standards, Codes on Fiscal Transparency*, and is collaborating with the World Bank on strengthening the capacity of HIPC countries to track public sector spending. Examples of U.S. efforts to encourage good governance include the following:

- The USED strongly supported the recently issued *Guide on Resource Revenue Transparency* and encouraged the Fund to promote these principles in countries with large extractive industries sectors.
- The USED emphasized the critical importance of aggressively implementing anti-corruption measures in its December 2004 statement on Kenya's Article IV and PRGF review. IMF staff postponed the subsequent program review (and associated loan disbursements) until specific conditions on anti-corruption measures were met.
- The USED encouraged Nigeria to undertake a public investment review, develop an expenditure tracking system, and strengthen transparency in public procurement in its July 2005 statement on Nigeria's Article IV.

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

The Fund published a *Code of Good Practices on Fiscal Transparency* in 1998 that aims to enhance fiscal policy transparency, promote quality audit and accounting standards, and reduce or eliminate off-budget transactions, which are often the source of unproductive government spending. The IMF also encourages countries to conduct “public expenditure reviews” with the World Bank.

- In Rwanda, a reduction in military spending enabled a reallocation of government resources to priority areas such as education (spending as a percentage of GDP from 1998-2004 increased from 2.2% to 4.0%), health (increased over the same period from 0.4% to 1.0%), and infrastructure (increased over the same period from 0% to 1.1%).

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

⁷ IMF financing is provided to central banks to address balance of payments difficulties. The IMF does not lend to fund specific projects in member countries aimed at procurement and financial management controls.

The United States has supported flexibility in Fund programs while emphasizing the need to focus conditionality on issues critical to growth and macroeconomic stability using measurable results. Partly as a result of U.S. efforts, program conditions have focused increasingly on debt and financial vulnerability in middle-income countries and macroeconomic management in low-income countries. In low-income countries, the U.S. has supported the use of Poverty Reduction Strategy Papers (“PRSP”), which are developed by local authorities and civil society and help ensure that IMF programs meet specific needs of the country.

(9) *Core Labor Standards (CLS)*

Core labor standards provide a useful benchmark for assessing countries’ treatment of workers against internationally agreed-upon standards. The Treasury Department monitors labor standards in all IFI borrower countries and is mandated to submit a separate report to Congress assessing progress made with respect to internationally recognized worker rights.

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

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

- In its November 2004 statement on Estonia, the USED advocated the targeting of labor market policies to the depressed Northeast region (which has a high concentration of ethnic Russians) in order to reduce the high unemployment rate in this area.
- For Zimbabwe’s Article IV review in September 2005, the USED condemned the “devastating economic and social consequences” of Mugabe’s demolition and eviction operations conducted under “Operation Restore Order.”

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

With respect to its individual lending operations, the IMF does not itself evaluate positive or negative linkages between conditions and environmental sustainability. Rather, the IMF coordinates with the World Bank which, unlike the IMF, possesses the internal expertise to address such linkages. In the past, the United States has urged the inclusion of measures in IMF programs to tax polluting activities, fund environmental protection efforts, and remove subsidies on environmentally-harmful products or activities.

- Gabon’s 2005 Article IV discussed progress made in reforms to the forestry sector, including simplifying forestry taxation, improving transparency in the allocation of forestry permits, and announcing the elimination of the monopoly on the export of logs. The USED welcomed progress, and noted staff’s recommendations to accelerate land titling, strengthen transparency and governance, and ensure productive use of public resources.

(12) *Greater transparency*

Over the last several years, the IMF has increased significantly the amount of information on its programs that it has made available to the public. The United States has stressed the need to build on this progress and expand the number of publications and IMF practices open to public scrutiny. As of July 2004, publication of all Article IV and Use of Fund Resources staff reports is presumed unless a country objects. In addition, all exceptional access reports will generally be published as a pre-condition for the Board’s approval of such an arrangement.⁸ The USED consistently encourages countries to publish the full Article IV staff report on the IMF's public website. As of end-2004, 78% of IMF staff reports were published, up from 71% as of mid-2003.

- Following prompting by the USED in this year's board statement, Egypt agreed to publish its 2005 Article IV for the first time.

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

In April 2000, with the strong urging of the USED, the Executive Board agreed to establish an Independent Evaluation Office (“IEO”) to supplement existing internal and external evaluation activities. The IEO provides objective and independent evaluation on issues related to the IMF and operates independently of Fund management and at arm's length from the IMF Board. Since its inception, the IEO has published seven comprehensive reviews, including assessments of the IMF’s engagement in Argentina, recent capital account crises, and fiscal adjustment in IMF-supported programs. Reports on structural conditionality, the IMF’s assistance to Jordan, and others are forthcoming. All reports are publicly available from the IEO’s website at (<http://imf.org/external/np/ieo/index.htm>).

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

The lack of financial services available to the poor is a significant obstacle to growth for many developing countries. The Treasury Department engages with the IFIs to promote structural reforms that encourage the provision of credit to small and micro enterprises. The microfinance sector is frequently reviewed in the context of the Financial Sector Assessment Program (FSAP) in developing countries.

- In the March 2005 discussion on Senegal’s 2nd PRGF program review, the USED welcomed progress on structural reforms such as enhanced access to information and judicial reform,

⁸ “Exceptional access” refers to financing arrangements in amounts that exceed the Fund's normal limits.

which would improve the overall business climate and boost access to credit for small and medium business.

- In Cameroon's May 2005 Article IV, the USED welcomed the authorities' progress on various structural reforms, including the licensing of microfinance institutions, but also emphasized that much remains to be done on governance and the judiciary to improve the investment climate.

(15) Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

Comprehensive integration of the IMF and the other IFI efforts as part of the global war on terrorism has been a consistent policy priority for the United States and its partners. We have encouraged collaboration between the IFIs and the Financial Action Task Force (FATF) to assess global compliance with the anti-money laundering (AML) and counter-terrorist financing (CFT) standards based on the FATF 40 Recommendations on Money Laundering and the 9 Special Recommendations on Terrorist Financing.

Collaboration with the FATF and the FATF-style regional bodies, with the assessors using the same common assessment methodology, institutionalizes the global fight against terrorist financing and money laundering, broadens the effort world-wide, and helps countries identify shortfalls in their AML and CFT regimes.

As a result of U.S. leadership, in March 2004, the IMF and World Bank Boards endorsed a common, uniform assessment methodology drafted by the FATF that provides a consistent framework for assessing compliance with the FATF Recommendations. At the same time, in recognition of the importance of effective AML/CFT regimes to sound financial systems and growth, the Boards agreed that assessments of countries' compliance with the FATF recommendations would form a regular part of their financial sector assessments, surveillance, and diagnostic activities and offshore financial center assessments. By the end of 2005, the IMF and World Bank will have conducted over 50 assessments of country compliance with AML/CFT.

The IMF is also a substantial source of funding for countries' efforts to strengthen their own counter-terrorist financing regimes – an activity that the U.S. Treasury has supported and has joined to leverage our own bilateral efforts.

Most recently, Treasury, along with our G7 colleagues, persuaded the IMF and World Bank to increase technical assistance. During the period January 2002 to December 2003, the Fund and the Bank undertook 117 TA projects, providing assistance to 130 countries. Of these, 85 projects provided direct assistance to 63 countries while 32 projects were undertaken on a regional basis. The pace of TA delivery has quickened, and between January 1, 2004 and June 30, 2005, the Bank and the Fund delivered 210 TA projects.

This major effort is reflected in the latest Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund (IMFC) - the Treasury Secretary is the Governor for the U.S. - where the IMFC reiterated its support for the IMF's

efforts to implement its intensified AML/CFT work program, and noted the critical importance of supporting countries' efforts with well-targeted and coordinated technical assistance.

The USED/IMF office played a crucial role in mobilizing the IMF Board support for this initiative, as well as making sure note is taken of AML/CFT issues in Article IV reports, IMF programs, and other regular reviews of country progress. Examples include:

- China became an observer to the Financial Action Task Force (FATF) in early 2005. In discussions on China's 2005 Article IV statement, the USED welcomed China's efforts to draft AML/CTF legislation consistent with FATF recommendations.
- The Philippines has established a Financial Intelligence Unit (FIU) that will analyze financial data, coordinate national efforts and facilitate international cooperation – and in doing so have been removed from the Financial Action Task Force (FATF) non-cooperative list.
- In a June 2005 IMF Board statement, the USED commended the leadership role taken by Peru's new Financial Intelligence Unit in anti-money laundering efforts in South America.

II. 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

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

The IMF's safeguards framework requires countries receiving funds to submit to external financial audits of their central bank's data. This process is designed to ensure that central banks have adequate control, accounting, reporting and auditing systems in place to protect central bank resources, including IMF disbursements. Any critical gaps identified during the assessment process must be remedied before additional IMF resources can be disbursed.

As of March 2005, the IMF had completed 111 safeguard assessments covering 69 central banks. Member countries had implemented 97% of the Fund's recommendations, proposed under program conditionality or letter of intent commitments.

- The USED statement stressed that the IMF should not allow standards to be weakened out of a desire to remain engaged, and that as a rule, key weaknesses should be addressed *prior* to the second program review.
- Mauritania was found to have serious and prolonged data misreporting to the IMF in 2004. The IMF subsequently cancelled Mauritania's lending program and was repaid in full. Most recently in a July 2005 Board statement, the USED has insisted that the authorities resolve all outstanding data issues prior to re-establishing relations with the IMF.

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

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

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

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

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

The IMF has been a consistent advocate of open markets and trade liberalization. The Fund also recognizes that trade adjustments can cause temporary balance of payments problems and has developed the Trade Integration Mechanism to provide transitional financial assistance to countries.

- In Nigeria, the U.S. has consistently encouraged dismantling of the various import bans, most recently in an October 2005 statement on Nigeria's request for a Policy-Support Instrument (PSI). The import bans provide rent-seeking opportunities and 'tax' Nigerian consumers and foreign-input dependent exporters.
- In 2004, Bangladesh became the first country to access the TIM.

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

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

- In a June 2005 review of charges, the USED called for increased level- and time-based charges and application of both types of charges to address concerns related to exceptional access and prolonged use.
- In addition, the US has supported the creation of a "shocks" window within the PRGF that would focus specifically on short-term balance of payments needs among low-income countries.

(VI) Graduation from receiving financing on concessionary terms

The United States supports comprehensive growth strategies to move countries from concessional to market-based lending. The United States works closely with the IMF and World Bank to promote a growth-oriented agenda in developing countries based on strong monetary and fiscal policies, trade liberalization, and reduction of impediments to private sector job creation. The IMF extends concessional credit through the PRGF. Eligibility is based principally on a country's per capita income and eligibility under the International Development Association (“IDA”), the World Bank's concessional window (the current operational cutoff point for IDA eligibility is a 2004 per capita GNI level of \$965). Factors that would contribute to reduced reliance on concessional resources include a country’s growth performance and prospects, capacity to borrow on non-concessional terms, vulnerability to adverse external developments such as swings in commodity prices, and balance of payments dynamics.

- In 2005, the US gained support at the Board for the creation of a non-borrowing arrangement (“Policy Support Instrument,” or PSI) that would be used primarily by countries graduating from Fund assistance but which desire the benefits of close Fund engagement. Nigeria became the first user in October 2005.
- In addition, the US has championed the cause of 100% debt relief for HIPC (Highly Indebted Poor Countries) in an effort to improve these countries’ balance of payments needs and, over time, reduce their dependency on Fund finance. As of the writing of this report, formal IMF and World Bank Board approval of the G-8 debt relief initiative was pending.