

**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 fourth report prepared in accordance with Sections 1503 and 1705(a) of the International Financial Institutions Act (the IFI Act – codified at 22 United StatesC. 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 during fiscal year 2002 to promote these legislative provisions in IMF country programs. A full description of both legislative provisions is included in the appendix. Earlier reports under these provisions are available on the Treasury website.³

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

An assessment of the overall effectiveness of the Treasury and USED’s office in promoting the legislative provisions is provided in a GAO Report published in January 2001.⁴ The report found that the **“Treasury has instituted a systematic process for applying legislative mandates concerning the Fund to individual countries, based on their economic circumstances.”**

Report on Specific Provisions

I. 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

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

⁴ *Efforts to Advance United States Policies at the Fund*, General Accounting Office (GAO), January 2001. As required under section 504 of H.R. 3425, as enacted in Appendix E to section 1000(a)(5) of Public Law 106-113 (making consolidated appropriations for Fiscal Year 2000), the GAO conducted a review of Treasury’s implementation of legislative objectives for IMF reform. Its work focused “on the measures taken by UNITED STATES agencies to promote IMF practices that are consistent with UNITED STATES policies set forth in federal law and the influence UNITED STATES policy has over the IMF’s operations and other members’ positions, as illustrated by specific cases.”

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

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

(A) Establishment of an independent monetary authority

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

Examples of United States activities with regard to these issues include the following:

- In a February 2002 discussion on Thailand, the United States Executive Director at the IMF (USED) encouraged Thai authorities to enhance the legal basis for central bank independence.
- The United States has highlighted the benefit of increased central bank independence in a number of discussions on Brazil over the course of the past year.
- The United States was a leading supporter of making central bank reform a prior condition of Turkey's program. The Turkish government has made significant progress implementing the central bank reform agenda, which has helped bring inflation expectations below 35% for end-2002, compared to inflation in 2001 of 68.5%.
- During a review of the Democratic Republic of Congo's (DROC) Staff Monitored Program (SMP) implementation, the USED emphasized the need to increase central bank independence. Publication of the statutes providing for the independence of the Banque Centrale du Congo (BCC) was a prerequisite for approval of DROC's Poverty Reduction and Growth Facility (PRGF) in June 2002. Completion of a financial audit of the BCC is a performance criterion for the next scheduled review of DROC's PRGF program in September 2002.

(B) Fair and open internal competition among domestic enterprises

With United States support, the IMF encourages member countries to pursue policies that improve internal economic efficiency. These measures may include ending directed lending (or other relationships between government and business 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 incorporated related measures related to them into programs when it considered them critical to macroeconomic stability.

Recent actions in support of these objectives include:

- In a Board statement in May 2002 on Hong Kong's Article IV Consultation, the United States urged authorities to limit sector-specific government intervention and inquired about what remaining sectors could benefit from being further opened to competition.

- During an IMF Board discussion of Burkina Faso's PRGF program in April 2002, the United States expressed support for authorities' efforts to include private operators in the Burkinabe cotton sector. The United States statement highlighted the gains in productivity and poverty reduction that resulted from these measures and encouraged the authorities to continue on the current reform trajectory.
- In several IMF Board discussions over the past year, the United States has consistently urged Uruguayan authorities to do more to encourage private sector development. Though further privatization of state assets is unconstitutional, authorities recently agreed to complete partnership agreements in the energy and transportation sectors before the end of the year.

(C) Privatization

While privatization lies primarily in the domain of the World Bank, the IMF has made it a key component of programs in countries where significant distortions and government ownership of business enterprises have created substantial inefficiencies in the allocation of resources and the production of goods. Working in collaboration 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 FY 2002 in which the USED has advocated privatization include the following:

- In an IMF Board discussion of Korea's February 2002 Article IV review, the USED welcomed the government's plans to begin privatization of state-owned financial institutions. The USED cautioned that experience does not support delays based on optimism that higher prices will appear in the future and urged the authorities to move more rapidly with the sale of government shares.
- In August 2002, the USED expressed disappointment over the continued use of quasi-fiscal financing for state-owned enterprises (SOEs) in Romania and urged Romanian authorities to fully implement their commitments to privatization and enterprise restructuring.
- In a recent Board discussion of Moldova's current PRGF, the USED recommended that the IMF incorporate additional structural benchmarks on privatization into its program.

(D) Economic deregulation and strong legal frameworks

Without strong property rights, enforcement of contracts, and fair and open competition, markets are distorted and entrepreneurship is stifled. While these issues might frequently be addressed through the World Bank, the IMF at times includes these measures in programs when they are considered critical to macroeconomic performance.

Examples of USED efforts to promote progress concerning these issues include the following:

- The United States has repeatedly cautioned Indonesia about the negative impact of a weak and unfair legal system on the country's attractiveness to investors. In June 2002, at the sixth review of Indonesia's IMF program, the United States noted that reforms in the legal sphere, and efforts to combat corruption, have been lagging.

- In a review of Bosnia's SBA in August 2002, the USED stressed the need to improve governance, particularly in relation to the business environment, and observed that progress in this area will be essential to the success of the overall program.
- In a Board discussion of Ukraine's Article IV review, the USED expressed support for the government's recent adoption of a new land law and urged authorities to take additional steps to improve the investment environment.

(E) Social safety nets

Encouraged by strong USED advocacy, the IMF and the World Bank have been increasingly focused on the establishment of effective social safety nets in borrowing countries. The United States has been a strong proponent of increased IFI funding for productivity-building investments in public education, health and other social services. In addition, the United States has supported steps taken by the IMF and World Bank to revise their lending frameworks to focus more on the reduction of poverty indicators.

Below is an example of United States support for this policy goal:

- With United States and IMF support, the Government of Uruguay has emphasized its commitment to minimizing the impact of the recent recession and current crisis on the most vulnerable segments of its people. Authorities have signaled their intention to reduce taxes for low-income pensioners, shield budget expenditures on social programs, and maintain the current system of unemployment benefits.
- The United States has emphasized to the Government of Turkey the importance of maintaining a social safety net. Despite the country's ongoing crisis, authorities have kept real spending on social services and education constant while overall primary expenditures and GNP have fallen sharply.

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

The IMF, with the support of the United States, has been a consistent advocate of open markets and trade liberalization. The IMF encourages trade liberalization across all sectors of an economy – including, but not limited to, the agricultural sector. The following are some examples in which the United States has supported trade liberalization in IMF country programs:

- In a recent Board discussion on Brazil, the USED urged authorities to pursue both multilateral and bilateral trade liberalization.
- In a statement to the IMF Board on Benin's PRGF review in July 2002, the United States recognized the government's leadership on regional trade integration issues through its advocacy of full implementation of a common external tariff for the West African Economic and Monetary Union (WAEMU) customs union.
- The same month, in a review of Seychelles' Article IV Consultation, the USED supported IMF staff's call for trade liberalization as part of Seychelles' economic reform program.

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

The joint IMF-World Bank *Financial Stability Assessment Program* (FSAP) has emerged as a critical instrument for financial sector surveillance and advice. As of August 2002, 33 FSAP assessments had been completed. Results from the FSAPs are used 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 report is often provided to the public through the *Reports on the Observance of Standards and Codes* (ROSCs). The Executive Boards of the IMF and World Bank recently reached conditional agreed on incorporating Anti-Money Laundering / Countering the Financing of Terrorism (AML/CFT) assessments into the ROSC process.

The following are some examples where the USED has promoted policies in support of strengthened financial systems:

- Strengthening the banking sector has been a centerpiece of Turkey's program. Authorities have taken significant steps to recapitalize struggling private sector banks and have toughened oversight and prudential regulation. The United States took the lead in advancing these issues through discussions with IMF staff and Turkish authorities.
- In successive statements, the USED has highlighted the importance of addressing inefficiencies in the Uruguayan banking sector and has urged authorities to fully implement promised reforms. The GOU has responded by moving to enforce greater disclosure of financial statements, broader compliance with the Basle Core Principles, and greater sanctioning power for the oversight arm of the Central Bank.
- In its Board statements, the USED has repeatedly encouraged the Philippines' authorities to make necessary regulatory changes to facilitate the restructuring/closing of troubled banks. With the strong support of the United States, the IMF has also cautioned the Philippine government against loosening prudential standards, particularly provisioning requirements for new loans.
- In Board discussions on PRGF programs for Vietnam and Laos, the USED has emphasized the importance of encouraging growth of private banks and limiting that of state banks. With United States support, IMF staff have expressed doubt that a banking sector dominated by state banks will promote growth.
- In a review of the Federal Republic of Yugoslavia's SBA, the USED emphasized to the government the importance of strengthening the financial sector by closing down four of the largest state-owned banks, which represented over 70% of the book-value of assets in the banking sector. FRY authorities initially sought financing to recapitalize these banks, but after strong signals from the US and other IMF members that the money would not be forthcoming, ultimately shut them down in January 2002.

(4) Internationally acceptable domestic bankruptcy laws and regulations

The International Financial Institutions (IFIs) have continued to build upon work launched in the wake of the Asian financial crisis in promoting more effective insolvency and debtor-creditor regimes. While domestic insolvency law is an issue on which the World Bank normally takes the lead, the IMF is supporting this agenda in several important ways. The Fund published an in-depth study on

national insolvency regimes that currently serves as the basis for its dialogue with member countries. 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 provides 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:

- In a recent IMF Board discussion on Thailand, the USED encouraged the Thai government to amend its bankruptcy law in order to provide adequate incentives for defaulting debtors to negotiate restructuring arrangements in good faith and in a timely manner.
- During a Board discussion of Korea's February 2002 Article IV review, the USED supported IMF staff's recommendations for reforming Korea's insolvency regime. The USED stressed that creditors must have the ability to force operational restructuring or liquidation and that, while the United States supports "cram down" provisions, it is important to provide some minimum level of protection to minority shareholders.
- With the strong support of the United States, the adoption of additional changes to Argentina's bankruptcy code is a prior action required for approval of a new program.

(5) Private Sector Involvement

The United States continues to work to assure that the private sector plays an appropriate role in the resolution of financial crises. Efforts in the past year have been particularly focused on developing more orderly methods for sovereign debt workouts and more transparent methods for involving the private sector. These efforts are the focus of a unified G-7 Action Plan on this subject released in April 2002 that can be found on the Treasury website at www.ustreas.gov/press/releases/po3015.htm. The United States is now working closely with the G-7 and the IMF to enact the provisions outlined in this plan, which include work toward implementing a market-based approach to sovereign debt restructuring.

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 continues to press for 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 United States support, efforts by countries to make information on their economies available to private markets by publishing Article IV assessments and program documents as well as regularly releasing economic and financial data consistent with the IMF's Special Data Dissemination Standard (SDDS) (see Section 12, Part I). These data have 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 in 2001.

(B) Strengthening of Emerging Markets' Financial Systems

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

(C) Use of Collective Action Clauses in Sovereign Bonds

The United States has made encouragement of use of collective action clauses in international sovereign debt contracts a central aspect of its crisis resolution agenda. In response to strong interest by the United States and others in the G-7, the IMF held Board discussions in June 2002 on how to broaden the use of such 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 where: (1) prompt IMF support is considered essential for the successful implementation of the member's adjustment program; and (2) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors. In September 2002, the IMF held discussions on how to clarify ways to assess "good faith" actions in an effort to reduce market uncertainty about when the IMF will lend into arrears.

(E) Promotion of Orderly Workouts

With strong United States encouragement, the IMF is working aggressively to develop processes that would promote more orderly workouts of sovereign debt. Currently, as directed by the United States and the G-7, the IMF is pursuing two complementary approaches: a contractual approach that would encourage greater use of contractual clauses to facilitate workouts and a statutory approach to establish a sovereign debt restructuring mechanism. In addition, the IMF, with USED support, continues to encourage countries facing financial difficulties to engage in cooperative and transparent consultations with creditors.

(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 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 February 2002 the IMF Executive Board discussed how various methods to involve

the private sector in the resolution of financial crises and increase burden-sharing by the private sector could best be achieved. In addition, a Board discussion in September 2002 on access policy on capital access cases will provide the basis for providing greater clarity on official sector lending decisions.

(G) Facilitation of Discussions between Debtors and Creditors

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

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

The IMF's framework for private sector involvement promotes contributions from private sector lenders, and aims to develop 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 principle that debtors should honor their obligations and that the IMF should not encourage default.

(6) Good governance

The IMF has devoted increased attention to governance in its structural benchmarks, a commitment underpinned by its 1996 Declaration on Partnership for Sustainable Global Growth and 1997 Guidelines on Good Governance. The IMF also supports good governance through emphasis on transparency and promotion of market-based reforms.⁵

Protecting against Abuse of the Financial System, including Money Laundering

Combating the financing of terrorism and anti-money laundering has been a priority of the Treasury in its work with the IMF. In the immediate aftermath of the September 11 attacks, the Fund established an internal Task Force to examine its contribution to the effort against money laundering and explore ways in which the institution could otherwise contribute to the campaign against terrorism. At the fall 2001 meeting of the IMF and World Bank, the United States stressed the importance of integrating Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) issues into the International Financial Institutions' (IFIs) financial sector assessments and surveillance activities. Further, the United States has emphasized the need for the Fund and World Bank to increase their involvement in strengthening financial regulatory frameworks and to provide technical assistance to authorities on AML/CFT issues.

⁵ 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.

Significant progress has been made toward these objectives in recent months. The IMF has begun to include assessments of members' AML/CFT regimes in the course of their Financial Sector Assessment Program (FSAP) reviews and its offshore financial sector assessments. Additionally, the Fund and Bank have been collaborating closely with the FATF, other international standard setters (the Basle Committee of Banking Supervisors, the International Association of Insurance Supervisors, the International Organization of Securities Commissions), and the Egmont Group to develop a comprehensive and unified methodology for measuring countries' implementation of AML/CFT principles, based on the FATF Recommendations. In mid-summer 2002, the IMF and World Bank Executive Boards agreed conditionally to incorporate assessment of anti-money laundering and terrorist financing principles into their operations using the comprehensive FATF methodology, and endorsed a 12-month pilot program to assess members' compliance with the anti-money laundering and terrorism financing standards in participation with FATF and FATF-style regional bodies.

Over the past year, many IMF country programs have incorporated measures on money laundering and countering terrorist financing. Examples of such programs include the following:

- In a February 2002 discussion of Korea's Article IV review, the USED commended the Korean authorities for the establishment of their Financial Intelligence Unit and issuance of blocking orders to freeze the assets of terrorists.
- In a Board review in March 2002, the United States encouraged the Philippines to take stronger measures against money laundering and terrorist financing by bringing their financial and legal infrastructure more closely in line with international best practice.
- During a July 2002 Board discussion of Benin's PRGF, the USED welcomed plans by the regional central bank (the BCEAO) to set up an anti-money laundering and financial information unit in Benin. The USED also recognized the leadership role that the BCEAO has played in the region on anti-money laundering issues.
- In a January 2002 Board statement, the USED commended the Federal Republic of Yugoslavia (FRY) government's new requirement that transactions in excess of DM 20,000 be reported and its use of external consultants to advise on policies for combating money laundering. We have encouraged the FRY authorities to follow through on recommendations of advisors concerning this matter.

Other Good Governance and Anti-Corruption Measures

The Fund's involvement in good governance and anti-corruption measures has focused on those aspects of governance that are generally considered part of the IMF's core expertise, such as improving public administration, increasing the transparency of government operations, enhancing data dissemination, and implementing effective financial sector supervision. However, members have agreed that the IMF's role should also extend into other areas, where anti-corruption efforts would clearly have a positive impact on the macroeconomic environment.

Examples of United States and IMF support for policies that encourage good governance include the following:

- The IMF and the World Bank have jointly promoted fiscal transparency in Laos, encouraging authorities to resume publication of a detailed government budget. The Laos authorities complied

in early 2002, in line with specific conditions associated with a World Bank Financial Management Adjustment Credit.

- The United States has urged the IMF to require prior actions on good governance and anti-corruption in Kenya before it resumes lending. Authorities have begun to make progress on this front, through the recent passage of a government ethics bill and the establishment of an anti-corruption unit in the police force. The United States continues to insist that additional steps on governance and anti-corruption take place prior to resumption of Kenya's IMF program.
- During the combined 1st and 2nd Review of Latvia's SBA in July 2002, the United States welcomed authorities' progress on anti-corruption efforts, particularly the government's opening of an anti-corruption office.
- In a 2002 Board statement on the second review of Georgia's PRGF, the USED noted the need for stronger implementation of the government's commitment to step up efforts to combat corruption.

(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.

Since its publication in 1998, the Fund has encouraged 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, which are often the source of unproductive government spending. As of August 2002, 45 countries had completed IMF-led fiscal transparency reviews, which compare local budgetary practices with internationally-agreed upon standards and codes. The IMF also encourages countries to conduct "public expenditure reviews" with the World Bank.

In addition, the IMF does an annual survey of global military expenditures, publishing these results in its periodical, *IMF Survey*. The most recent review in June 2002 found that military spending as a percentage of GDP has leveled off in developing countries, after declining steadily in the early 1990s. Military spending as a percentage of total expenditure, however, has continued to fall. In December 2001, the IMF released a research report on the global decline in military spending which found that in countries with IMF programs, the ratio of military spending to GDP is on average 1% smaller than in countries without Fund programs.

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

- In a Board statement in August 2002, the United States expressed concern about the accuracy of China's reported military spending and encouraged the government to verify the accuracy of military expenditure statistics provided to civilian leadership.
- In an October 2001 Board discussion of Rwanda's PRGF, the USED urged the authorities to eliminate off-budget accounts and to ensure that they do not reemerge. To enhance accountability, the USED also called for annual audits of government budgets to be made public. Further, the USED stressed that any increases in military spending should not threaten social expenditures and should be offset by compensating revenue or spending measures. The government has begun the process of taking stock of off-budget items.

- With IMF support and United States encouragement, Cambodia has made progress in shifting fiscal spending away from defense toward the social sectors. Social sector spending reached 3% of GDP in 2001, from less than 1½ % of GDP in 1998.
- In a June 2002 Board review of Albania's PRGF, the USED welcomed the program's proposed increases in primary education and healthcare, particularly in rural areas. The United States also supported the PRGF's call for better expenditure tracking and domestic revenue collection.
- In various Board statements, the USED has expressed support for Peru's fiscal program, designed to replace military spending with social spending. Under its IMF program, Peruvian authorities intend to shift unfocused, less accountable social expenditures administered by the Office of the Presidency to the social services ministry. This shift is expected to increase the quality and coherency of Peru's social expenditures program.

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

The United States has supported flexibility and customization in Fund programs while emphasizing the need to focus conditionality on issues critical to growth and macroeconomic stability with measurable results. Further, countries that borrow from the IMF on concessional terms prepare Poverty Reduction Strategy Papers (PRSPs) through a participatory process involving domestic stakeholders as well as external development partners. This process is designed to ensure that each program meets the specific needs of the country that prepares it.

(9) *Core Labor Standards (CLS)*

To assist the USED in addressing labor issues, the Treasury works closely with the United States Labor Department and the State Department to assess labor standards in IMF program countries. Core labor standards provide a useful benchmark for assessing countries' treatment of workers against internationally agreed upon standards.

As has been noted in past reports, there is some reluctance by many member countries to address this issue in the IMF, particularly in the context of the effort to focus Fund conditionality more narrowly. However, during the past year, the USED has made an effort to raise critical labor issues in Board discussions. For example:

- In a statement to the Board on February 8, 2002, the USED noted the efforts of the Thai government to improve labor standards and welcomed authorities' restoration of trade union rights to employees of state enterprises. However, the USED also expressed concern over the apparent failure to protect workers who attempt to unionize.
- In a review of the Dominican Republic's Article IV Consultation in June, the USED encouraged authorities to fully implement laws protecting the rights of workers to freely engage in collective bargaining and organizational activities.

(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. This approach seeks to ensure that all parties have an opportunity to participate in the implementation of national priorities and that resources are employed in the public interest. 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 countervailing measures, as appropriate, be incorporated into Fund programs.

Below are some examples of United States advocacy in the IMF Board in support of ethnic and social stability:

- In Fiji's August 2002 Article IV review, the USED expressed concern about Fijian authorities' refusal to include opposition party seats in the Cabinet as stipulated in the Fijian Constitution. The United States has opposed a resumption of international financial institution lending to the government of Fiji.
- At the combined first and second reviews of Sri Lanka's SBA in April 2002, the United States raised concerns about the potential for social strife and noted that our support for further reviews is premised on authorities' efforts to resolve the country's 13 year old civil conflict.

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

Recognizing that the World Bank has lead responsibility for environmental issues in individual countries, the United States has used its voice and vote in the IMF Board to encourage staff to review the potentially negative environmental consequences of recommended policies. 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.

The following are a few examples in which the United States has commented on environmental policies in country programs:

- In a June 2002 Board statement, the USED expressed support for environmental provisions contained in Vietnam's PRSP, including measures requiring estimates of environmental impacts in all projects, incentives for cleaner production, and amendments to the foreign investment approval process designed to protect the environment.
- In an April Board discussion, the USED encouraged Indonesian authorities to focus on stronger enforcement of environmental regulations, particularly in the forestry sector, where significant fiscal losses have been incurred as a result of illegal logging.
- During a July Board discussion, the United States expressed concern with the Cambodian government's delay in implementing sustainable management plans for the forestry sector and its lax enforcement of a logging ban.
- In a February Board discussion of Peru's SBA request, the US expressed concern over the environmental costs of mining sector policies and urged the authorities to consider implementing pollution taxes.

(12) *Greater transparency*

Over the last several years, the IMF has significantly increased 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.

- Publication of program and Article IV staff papers is voluntary, and 82 countries have chosen to publish at least one staff paper. Between January 2001 and February 2002, 64% of Article IV staff reports and 95% of Letters of Intent were published.
- To date, 293 Reports on Observance of Standards and Codes (ROSC) modules for 81 economies have been completed, of which 217 have been published for 66 economies.
- The United States has made available on its website self-assessments on 10 of the 12 ROSC modules and is currently working with the IMF on a fiscal policy ROSC.
- The United States has pushed for a presumption of publication for most IMF documents, including mandatory release of Letters of Intent (LOIs), publication of Technical Assistance reports and greater use of Public Information Notices (PINs) following Board discussions of Article IV consultations.

The following are some examples of country programs with respect to which the United States has advocated greater transparency:

- In a review of Brazil's SBA, the United States expressed disappointment that the government had decided not to publish the IMF staff report and urged authorities to increase transparency.
- In Yemen's Article IV review in July 2002, the USED highlighted the importance of enhanced budget transparency, particularly to help the authorities manage scarce funds for PRSP spending priorities and to enhance the delivery of government services.
- The USED welcomed the decision of Jordanian authorities to participate in an FSAP in 2003, particularly given recent instances of bank fraud, and signs of weakness in the banking sector such as high rates of Non-Performing Loans (NPLs), for which there has not been sufficient provisioning.

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

The USED has consistently supported measures to increase the accountability of the IMF and to allow independent evaluations of the IMF's operations. The IMF's Office of Internal Audit has long had responsibility for reviewing Fund finances, operations, and systems. In 1998, with the encouragement of the United States, the IMF established procedures for independent evaluations. Under these procedures, independent evaluations were completed on a variety of topics, including the IMF's Enhanced Structural Adjustment Facility, as well as Surveillance and Economic Research Activities. These evaluations are available on the IMF's website.

Finally, 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's Executive Board. Terms of reference for the IEO and its work program have been published on the IMF website

and the IEO's first report – on Prolonged Use of Fund Resources – was discussed by the IMF's Board this fall.

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

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

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, which took effect in 2000, requires countries receiving funds to submit to external financial audits of their central bank's data. This process is designed to provide assurances that member countries' central banks have adequate control, accounting, reporting and auditing systems in place to protect central bank resources, including IMF disbursements. Any critical gaps identified during the assessment process must be remedied before additional IMF resources can be disbursed.

In April 2002, with the support of the United States, the Executive Board agreed to adopt safeguards assessments as a permanent policy. As of May 2002, 27 countries had undergone full assessments and an equal number had completed abbreviated safeguard reviews.

- In a June 2002 Board statement, the USED expressed strong concern over Vietnam's delay in completing its safeguards assessment and questioned the independence of the auditor assigned to review central bank financial statements.
- In Yemen's August 2002 Article IV review, the USED agreed with IMF staff's recommendation that a full safeguard assessment will need to be completed before a new Fund program can be brought to the Board.

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

The IMF recognizes that if structured effectively, official financing can complement and attract private sector flows. The Fund promotes policy reforms that catalyze private financing and allow countries to regain access to international private capital markets as quickly as possible. (See Section 5, Part I 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 a strong advocate of tight conditionality on IMF loans, including greater use of prior actions, and has supported the Fund's stepped-up 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.

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

The IMF has been a consistent advocate of open markets and trade liberalization. For elaboration, see Section 2 of Part I, above.

(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 addition, the IMF committed to limiting the use of Extended Arrangements to those countries with a financial need that justifies a longer repayment period.

(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 cutoff point for IDA eligibility is a 1999 per capita GDP level of \$885). Factors that would contribute to reduced reliance on concessional resources include a country's growth performance and prospects, capacity to borrow on non-concessional terms, vulnerability to adverse external developments such as swings in commodity prices, and balance of payments dynamics. To lower reliance on concessional lending and promote debt sustainability, the G-7 countries, acting on the initiative of the United States, have agreed to expand the use of grants in Multilateral Development Bank lending to the world's poorest countries.

Appendix

Selected Abbreviations

Anti-Money Laundering (AML)
Asia-Pacific Economic Cooperation (APEC)
Compensatory Financing Facility (CFF)
Countering the Financing of Terrorism (CFT)
Contingent Credit Line (CCL)
Core Labor Standards (CLS)
Combating the Financing of Terrorism (CFT)
Democratic Republic of Congo (DROC)
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)
Non-Performing Loan (NPL)
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)

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 that 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 that 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.*