

**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 sixth 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 on 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 have a systematic process in place to advance U.S. legislative mandates at the Fund,” a reference to a Treasury Department task force which 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 inconsistent with broader macroeconomic policy choices. Most recently, the USED commented

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 its Formal Process to Promote U.S. Policies*, General Accounting Office (GAO), July 2004.

on the Fund's biannual review of surveillance in July 2004, and stressed the need for more candid discussion of exchange rate policy and further work on exit strategies from managed exchange 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 July 2004 statement on China, the USED supported the authorities' intention of introducing greater flexibility in exchange rates, and urged them to take action soon.
- The United States has strongly supported IMF efforts in Azerbaijan to secure the independence of the National Bank through the passage of a new Central Bank law. IMF program conditionality in this area has played an important role in supporting the efforts of economic reformers at the National Bank and the Ministry of Finance to prevent political manipulation of monetary policy and establish the means for financial stability and sound macroeconomic management.
- The USED encouraged the IMF's prioritization of central bank independence in Malawi's macroeconomic stabilization program. As a result, the Malawian central bank has minimized budget deficit monetization and maintained relatively stable inflation in spite of recent economic difficulties.

(B) Fair and open internal competition among domestic enterprises

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

- In the January and July 2004 Board Statements, the USED strongly backed IMF conditionality to end directed credits from the National Bank of Tajikistan (NBT) to state-

owned enterprises. Under the program, the IMF has focused also on improved management and oversight within the NBT to prevent future lapses.

(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:

- In its 2003 Article IV report, the IMF commended and encouraged Israel's efforts to push forward with privatization. The USED reiterated this point in its Board statement, expressing strong support to further promote privatization in Israel. In the six months since the report's publication, Israel privatized Bezeq Telecom and Zim Shipping, and has made significant progress toward carrying out privatization of Bank Leumi and Discount Bank in 2004.
- The USED has consistently encouraged Cameroon's privatization program through formal statements and bilateral dialogue. As a result, several agricultural public enterprises have been sold, CAMTEL (a local telecom utility) will be re-tendered, and the water and electricity utilities have been restructured and partially privatized.

(D) Economic deregulation and strong legal frameworks

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

- With the strong support of the USED, the IMF program with Argentina launched in September 2003 sought to facilitate the restructuring of 63 contracts (covering sectors such as telecom, energy, gas, water, and transport) that had lapsed during the financial crisis in 2002 and to restore a reliable legal and regulatory framework for the companies to operate. The program also called for Argentina to adopt and implement (in conjunction with the World Bank) new legislation covering the contract renegotiation process and to restore market oriented regulatory systems.
- In a July 2004 review of the Democratic Republic of the Congo's Poverty Reduction and Growth Facility, the USED emphasized that sustaining a higher growth path over the medium and long term would require addressing impediments to private initiative, including lowering the cost of starting a business.

(E) Social safety nets

While growth is the key ingredient for poverty reduction, social safety nets can play an important role in promoting ownership and alleviating the impact of poverty on the most affected segments of society. Against this background, the United States has been a strong proponent of increased IFI funding 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 social safety nets. However, the Fund's policy advice, and its focus on macroeconomic stability, encourages domestic policy makers to develop fiscal strategies that address the needs of the poor. In addition, in July 2004 Board meetings, the USEDs in the IMF and World Bank strongly welcomed the recommendations for strengthening the effectiveness of the PRGF that were made by the IMF's Independent Evaluation Office, including the recommendation to invite suggestions from country officials on critical social programs to be protected in the case of an adverse shock.

(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 July 2004, Bangladesh became the first user of the TIM in order to mitigate possible adverse effects of the Multi-Fiber Arrangement ("MFA") quota phase out. The USED commended the use of the TIM in Bangladesh and emphasized that attention to the broader policy mix, including exchange rate flexibility, tariff reform and trade reforms, will be instrumental to mitigate the impact of the MFA quota removal.

(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. Seventy FSAP assessments had been completed with thirteen additional reviews underway and twenty-two reviews planned as of July 2004.

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"). Some key examples of where the USED has supported the strengthening of financial systems are:

- In the Japan Article IV discussion in April 2004, the United States welcomed positive actions in the past year to further the needed restructuring of the banking system, including stronger bank capitalization and reduction of non performing loans. However, the USED office urged authorities to make increased use of forward-looking provisioning, particularly since historical loan loss figures may be understated due to earlier regulatory forbearance.
- In the Article IV discussion in July 2004 on China, the USED commended the authorities' commitment to strengthen the financial infrastructure and increase the efficiency of capital allocation. The US welcomed actions to address the stock of non-performing loans (NPLs) in the largely state-owned banking system and recommended increased attention to the flow of new NPLs through improved credit practices.
- In the discussion of a Standby Program for the Ukraine in March 2004, the USED commented upon the vulnerability of the financial sector in the wake of rapid credit expansion. In its comments on the IMF debt sustainability assessment of the Ukraine, the United States cautioned that financial sector vulnerability may seriously threaten medium-term economic performance and urged the authorities to implement the recommendations of the Fund-Bank FSAP assessment.

(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 Bolivia's third review in July 2004, the USED stressed the importance of the evaluation of forthcoming bankruptcy legislation and legislative proposals.
- In its May 2004 statement on Indonesia, the USED cited the need for greater political support for bank restructuring and improved legal and judicial frameworks to facilitate insolvency cases.

(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 year, 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 principle that creditors should bear the consequences of the risks they assume, while neither undermining the equally essential principle that debtors should honor their obligations.

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 its Biennial Surveillance Review in July 2004, the IMF agreed to take steps to improve the depth and quality of surveillance by focusing on the core competencies of the IMF (fiscal, monetary, exchange rate and financial sector issues), ensuring candid analysis of exchange rate regimes, and better integrating bilateral, multilateral and global surveillance efforts. This broad-ranging review of surveillance also pointed to the need for more thorough coverage of financial sector issues and continued work to incorporate analysis of debt sustainability and balance sheet vulnerabilities.
- In September 2004, the IMF conducted a Board seminar on the Application of the Balance Sheet Approach to Emerging Market Economies, which assessed progress to date in using the balance sheet approach to measure vulnerabilities and proposed additional ways in which the balance sheet approach could be applied to surveillance going forward.

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).

- In July 2004, new document publication guidelines came into effect which determined that the publication of Use of Fund Resources staff reports and Article IV surveillance reports will remain voluntary, but presumed. Additionally, all exceptional access reports will generally be published as a pre-condition for the Board's approval of such an arrangement.

(B) Strengthening of Emerging Markets' Financial Systems

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

(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 have 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. Building on the initial use of CACs in 2003, progress over the past year in making CACs the market standard under New York law has been better than expected. CACs are now included in 42 percent of the stock of external sovereign debt issued by emerging markets. 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 over the past year have focused on applying the "good faith" criterion to specific cases.

(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 a review of its exceptional access policy in April 2004, the IMF affirmed that the existing criteria should be retained and found that the new procedures requiring early consultation and a higher burden of proof were functioning well.

(6) Good governance

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

(i) Protecting against Abuse of the Financial System, including Money Laundering

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. A key step in this process was the Fall 2002 decision by the Executive Boards of the IMF and the World Bank to undertake a pilot program of collaboration with the 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 8 Special Recommendations on Terrorist Financing.

In March 2004, the Boards evaluated the results of the pilot program and agreed to make such AML/CFT assessments a regular part of their financial sector assessments, surveillance, and diagnostic activities. Collaboration with the FATF and the FATF-style regional bodies, with the assessors using the same common assessment methodology, is expected to result in up to 40 countries or jurisdictions being assessed every year. This initiative 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.

The USED/IMF office played a crucial role in mobilizing the IMF Board support for this initiative, as well as taking the following country-specific positions in the AML/CFT area:

- In the July 2003 discussion of Pakistan's Poverty Reduction Growth Facility, the USED strongly encouraged the Pakistani authorities to enact anti-money laundering legislation to improve their ability to combat money-laundering and the financing of terrorism. As of August 2004, the U.S. continues to encourage Pakistan to enact critical AML legislation that conform to international standards.

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

- Also in July 2003, the United States urged the Government of India to follow through on its AML law by creating the institutional framework that would implement and enforce the law. The Anti-Money Laundering Law for 2004 has been enacted; however, the necessary implementing rules and regulations must also follow to ensure that India's AML/CFT regime has the adequate legislative strength to combat money laundering and the financing of terrorism.
- In the July 2004 discussion of China's Article IV review, the USED welcomed China's efforts to strengthen its Anti-Money Laundering (AML) framework and has encouraged China's efforts to develop an AML/CFT regime on par with international standards.

(ii) Other Good Governance and Anti-Corruption Measures

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. It promotes best practice principles through its code and standards, such as the *Report on the Observance on Standards and Codes on Fiscal Transparency*. Examples of United States and IMF support for policies that encourage good governance include the following:

- The USED supported the passage of legislation in Turkey in May 2004 that would improve the public sector personnel system and included a code of ethical conduct for civil servants and public administrators.
- During consideration of Madagascar's 4th PRGF review in March 2004, the USED statement commended progress made by the authorities to control corruption, including restructuring of 40% of personnel at the Customs Administration.
- The USED insisted that increased prosecutorial authority for the Malawian Anti-corruption Board remain a 'prior action' for Malawi's 2nd PRGF review. The measure, eventually adopted by the Malawian legislature, has improved transparency and guaranteed that the government may no longer hold-up corruption prosecutions indefinitely.

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

- In its January 2004 staff report on Burundi’s Article IV consultation, the USED expressed concern over the country’s high military spending as a percentage of GDP (7 percent), and abstained on the Board vote to approve a PRGF until the government performed an audit of military expenditures.
- In a May 2004 statement on Indonesia, the USED urged the authorities to approve a system of regular audits of military expenditures.

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

The United States has supported flexibility in Fund programs while emphasizing the need to focus conditionality on issues critical to growth and macroeconomic stability using measurable results. Further, countries that borrow from the IMF on concessional terms prepare Poverty Reduction Strategy Papers (“PRSP”) through a participatory process designed to ensure that each program meets the specific needs of the country that prepares it. The Independent Evaluation Office (IEO) at the IMF completed a comprehensive report in 2003 on fiscal adjustment in IMF programs. In August 2003, the Executive Board reviewed the report and supported its recommendation that program documents should more fully justify fiscal adjustment requirements.

(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 submits a separate report to Congress assessing progress made with respect to internationally recognized worker rights. As has been noted in past reports, many member countries are reluctant 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, including the following:

- In its October 2003 statement on China, the USED welcomed steps taken to mitigate the social costs of reforms, particularly the easing of restrictions on the movement of rural labor and payments to laid-off SOE workers. In addition, the United States urged the authorities to follow up on their program of cooperation with the ILO and encouraged China to support core labor standards, such as freedom of association and collective bargaining.

(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 they have an opportunity to participate in the implementation of national priorities. IMF assistance has helped to free up resources for more

productive public investment by contributing to a reduction in country military expenditures. The United States has also advocated that an analysis of the impact on the poor, carried out by the World Bank, be conducted and that remedial measures, as appropriate, be incorporated into Fund programs. As an example of United States advocacy in this area:

- In a June 2004 review of Sudan’s Staff Monitored Program, the USED stated that the conflict in western Sudan presented a major obstacle to securing the resources necessary to support the normalization of the United States’ relations with Sudan.

(11) Link between environmental and macroeconomic conditions and policies

The World Bank has the lead responsibility for environmental issues in individual countries, and the IMF works in conjunction with the World Bank to establish sustainable environmental policies within the context of the IMF’s core mandate of fostering economic growth and stability. 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. The United States has also encouraged the inclusion of environmental standards as performance criteria or structural benchmarks in IMF lending programs.

(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. In September 2003, the Board amended the Fund’s document publication guidelines, determining that the publication of Article IV and Use of Fund Resources staff reports will be presumed. This policy was implemented in July 2004. In addition, all exceptional access reports will generally be published as a pre-condition for the Board’s approval of such an arrangement.⁵

(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. In 2003, the IEO completed reports on the PRSP/PRGF experience and a country case study of Argentina. An additional report on the role of the IMF in providing technical assistance is forthcoming.

- In July 2004, the Board responded to the recommendations put forth in the IEO’s report on PRSPs and the PRGF. Executive Directors agreed that PRSPs suffer from a multiplicity of objectives and that the Fund’s current approach in low-income countries can be improved. These issues are being addressed further in the Bank-Fund Annual PRSP Progress in

⁵ “Exceptional access” refers to financing arrangements in amounts that exceed the Fund’s normal limits.

Implementation Report and ongoing discussions on the role of the Fund in low-income countries.

- The Executive Board discussed the IEO's report on Argentina in July 2004. Directors broadly agreed with the lessons and recommendations of the report, which addressed important weaknesses in surveillance and crisis management. The Board also noted that although many of the recommendations are in line with policies the Fund adopted following the Argentine crisis, additional work is needed especially in the area of policy implementation.

(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, as evidenced in the following examples:

- In Peru, the USED called for greater financial sector competition as a means of improving bank lending to SMEs.
- The June 2004 USED statement for Mali approved of the PRGF's strategy to develop the microfinance sector and non-bank financial institutions.

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 June 2004, the IMF had completed 98 safeguard assessments; 13 additional assessments were in progress. Member countries had implemented 91% of the Fund's high-priority recommendations, proposed under program conditionality or letter of intent

commitments.⁶ The USED continues to focus on implementation of this policy, raising its concerns with the Board where appropriate.

- Vietnam's PRGF was terminated (and disbursements ended) in April 2004 when the Vietnamese authorities refused to conduct an independent audit of the State Bank of Vietnam, as required under the IMF safeguards criteria. The USED repeatedly voiced dissatisfaction with Vietnam's weak implementation of the safeguards criteria and supported the final decision to end IMF financial support for Vietnam.

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

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

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

The United States has been an advocate of conditionality on IMF loans and has supported the Fund's 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 (See Section 2).

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

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

(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

⁶As of June 2004, member countries had implemented 74% of the Fund's lower priority recommendations, not proposed by program conditionality or letters of intent. The implementation rate was 78% for all recommendations.

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 2003 per capita GNI level of \$895). Factors that would contribute to reduced reliance on concessional resources include a country's growth performance and prospects, capacity to borrow on non-concessionary terms, vulnerability to adverse external developments such as swings in commodity prices, and balance of payments dynamics. To reduce 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.