IMPLEMENTATION OF LEGISLATIVE PROVISIONS RELATING TO THE INTERNATIONAL MONETARY FUND

A Report to Congress

in accordance with

Sections 1503 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

United States Department of the Treasury
November 2006

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Introduction

This is the eighth 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(a)).[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 Section 1705(a) 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. Annex 1 covers new IMF lending arrangements per section 605(d) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999. Earlier reports under these provisions are available on the Department of the Treasury's website (www.treas.gov/press/reports.html).

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

Assessments of the overall effectiveness of the Treasury and USED's office in promoting the legislative provisions are published annually by the GAO and are available online.[3] The most recent report states that the "Treasury continues to promote the [IMF] task force as a tool for monitoring and promoting legislative mandates and other policy priorities." Treasury's IMF task force is charged with increasing awareness among Treasury staff about legislative mandates and identifying opportunities to influence IMF decisions in line with broader U.S. international economic policy objectives.

Report on Specific Provisions

I. <u>Section 1503(a)</u>

(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

[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 Has Sustained Its Formal Process to Promote U.S. Policies at the International Monetary Fund,* Government Accountability Office (GAO), June 2006.

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. The U.S. Treasury has urged the Fund to exercise firm surveillance over exchange rates.

- In its statement on China's Article IV review in July 2006, the USED emphasized that the strength of China's domestic economy makes it an opportune time to allow greater exchange rate flexibility.

- In its statement on the March 2006 Article IV review for Malaysia, the USED emphasized the benefits of introducing a significantly greater degree of exchange rate flexibility and encouraged IMF staff to consider more precisely the systemic effects of Malaysia's exchange rate policies.

- In a January 2006 statement on Nepal's Article IV review, the USED noted that the peg to the Indian rupee provides an effective nominal anchor and enhances policy credibility due to stable monetary conditions in India.

(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 Vietnam's October 2005 Article IV discussion, the USED in its statement called for strengthening the central bank's independence; Vietnam's central bank is currently part of the ministry of finance.

- In its statement on Argentina's July 2006 Article IV review, the USED noted that over the long term, Central Bank independence, along with sound fiscal policy, is the best guarantor of maintaining a prudent monetary policy.

(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 antitrust enforcement, and establishing a sound and transparent legal system. While the World Bank has the lead mandate on these issues, the IMF has at times provided related policy advice through surveillance or programs when it considered them critical to macroeconomic stability. For example,

- In a statement on Ecuador's January 2006 Article IV discussion, the USED called for further improvement in Ecuador's domestic business climate, such as the reduction of legal uncertainties and the pursuit of fair resolutions to outstanding arbitrations. The USED also noted the need for the GOE to pursue further reforms in the oil sector and ensure that private firms enjoy the same legal protections and treatment as public firms.

(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 and surveillance discussions in which the USED has advocated privatization include the following:

- In a February 2006 Board statement on an Article IV review for the Philippines, the USED urged the government to press forward in privatization of the energy sector to avoid future budget shortfalls and to assure future energy supplies.

- In the Board statement for the June 2006 Article IV discussion for Egypt, the USED welcomed Egypt's success in carrying out major structural reforms, and encouraged continued strong progress on privatization.

(D) Economic deregulation and strong legal frameworks

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

- In India's most recent Article IV discussions, the USED in its Board statement highlighted the role that India's lack of binding international arbitration and a backlogged domestic court system play in deterring foreign investment and dampening economic growth.

(E) Social safety nets

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

The IMF does not lend directly for budget support to build social safety nets. However, the Fund's policy advice and its focus on macroeconomic stability encourage domestic policy makers to develop fiscal strategies that address the needs of the poor. IMF advice is developed within a country-specific poverty reduction strategy (PRS) that encourages accountability between donors and recipients.

- In numerous low-income countries, the IMF helps authorities more effectively track public spending aimed at poverty reduction and increase the share of the budget devoted to such spending. For example, in Malawi the IMF is providing technical assistance to improve budgetary tracking of pro-poor spending. In Burundi, the PRGF aims to support a shift away from military spending and toward social spending. In Cameroon, the PRGF supports channeling debt relief savings into an expansion of poverty-reducing spending.

- During the sixth review of Guyana's Poverty Reduction and Growth Facility (PRGF) in September 2006, the USED expressed disappointment that higher social sector spending had not yet produced a significant impact on reducing poverty, and emphasized increased monitoring and transparency to ensure effective allocation of resources.

- In Panama's 2005 Article IV review, the USED in its Board statement highlighted that the key challenge for the authorities is to reduce the level of public debt while increasing expenditures on poverty reduction programs.

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

The IMF encourages a multilateral, rules-based approach to trade liberalization across all sectors of the global economy, including, but not limited to, the agricultural sector. The IMF has played a supportive role in promoting trade liberalization, particularly in the context of the WTO trade negotiations under the Doha Development Agenda (DDA). In April 2004, the Fund approved the Trade Integration Mechanism (TIM) to provide financial support to countries facing balance of payments problems resulting from trade adjustment. The proposal represents a concrete response to developing country concerns over the potential negative impacts from multilateral trade liberalization. The IMF is prepared, along with the World Bank, to provide transitional assistance to member countries experiencing payment imbalances arising from the passage of trade reform.

- In its statement on Japan's Article IV review, the USED commented on the importance of reducing Japanese barriers to agricultural trade, noting that such reforms would benefit Japanese consumers in addition to enhancing total productivity.

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

The joint IMF-World Bank *Financial Sector Assessment Program* ("FSAP") has emerged as a critical instrument for financial sector surveillance and advice. As of June 2006, one hundred four FSAP assessments had been completed with twenty-four additional reviews underway or planned.

Results from the FSAP 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 FSAP assessment results are summarized in *Financial System Stability Assessments* ("FSSA") which are often provided to the public. In the IMF Executive Board discussion on the January 2006 Independent Evaluation Office's review of the FSAP, the USED underlined the importance of improving coordination and follow-up of the FSAP process to ensure that lessons learned on how to strengthen financial systems are embedded in surveillance and program work of the World Bank and IMF. Some key examples of where the USED has supported the strengthening of financial systems are:

- Pursuant to its Stand-by Arrangement which the United States supported, Turkey has made strides in strengthening its financial sector, particularly the banking sector, by restructuring the sector and improving supervision. These efforts proved effective in helping Turkey weather recent market volatility.

- In its statement in the 2006 Article IV discussion on China, the USED urged the Chinese to undertake reforms to improve financial intermediation, strengthen regulation, modernize capital markets, and reform and restructure domestic banks and securities firms.

- In its statement on Japan's Article IV review in July 2006, the USED called for continued efforts to reduce the legal uncertainty that regulated firms face in interpreting Japanese financial laws. The USED emphasized that such efforts would help foster innovation and increase the efficiency of financial intermediation.

(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. Both the UN Commission on International Trade Law (UNCITRAL) and the World Bank have worked to compile recommendations in this area covering, respectively, insolvency law and sound insolvency/creditor rights regimes. At the urging of the United States, staff from the World Bank, IMF and UNCITRAL worked together to develop a standardized, unified assessment methodology to assess implementation of those recommendations. The Financial Stability Forum, also with strong U.S. support, has called on World Bank and UNCITRAL staff to continue this cooperation and complete a concise, unified international standard for insolvency and creditor rights.

The IFIs also provide technical assistance to help emerging market economies develop efficient insolvency regimes. 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. 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. Specific examples of U.S. efforts to encourage improvements in insolvency regimes include:

- In Romania's Article IV review, the USED's statement took note of recent reform in that country's bankruptcy procedures, welcoming the authorities' commitment to further improve the investment climate.

- During the 2006 discussion of Bahrain's Article IV review, the USED in its statement agreed with IMF staff that development of contingency plans and a Prompt Corrective Action framework aimed at early improvement or least-cost resolution of problem banks would be beneficial.

- The USED's statement in Brazil's 2006 IMF Article IV review noted that bankruptcy reform and legalizing payroll deduction loans have had a positive effect on bank lending, and that the volume of bank loans, though still low, is increasing.

(5) *Private Sector Involvement*

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

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

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

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

- The USED, in its March 2006 Board Statement, warned of a looming financial crisis in Eritrea driven by high inflation, unsustainable public debt, and a monetary policy beholden to fiscal demands.

- The USED strongly protested the proposed inclusion of a high ceiling of USD 700 million in non-concessional borrowing in Sudan's 2006 Staff-Monitored Program (SMP) in light of Sudan's already unsustainable external debt burden. The USED stressed the proposal was all the more troubling given the Sudanese authorities' previous decision to disregard the 2005 SMP framework by borrowing $935 million at non-concessional rates.

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

- Fund members subscribing to either the General or Special Data Dissemination Standards increased from 75% of all members in 2005 to 82% in 2006.

(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 Basel 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 in assessing countries' observance of other standards and codes.

(C) Strengthened Crisis Resolution Mechanisms

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

(i) Collective Action Clauses

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

As of October 2006, CACs are included in 63 percent of the stock of external sovereign bonds 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.

(ii) Lending into Arrears

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

(iii) Clear Limits on Official Finance

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

(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.

The Fund's involvement has focused on those governance aspects that are generally considered part of the IMF's core expertise, such as improving public administration, increasing government transparency, enhancing data dissemination, and implementing effective financial sector supervision. The IMF promotes best practice principles through its codes and standards, such as the *Code of Good Practices on Fiscal Transparency,* and is collaborating with the World

[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.

Bank on strengthening the capacity of HIPC countries to track public sector spending. Examples of U.S. efforts to encourage good governance include the following:

- The USED called forcefully for improving governance and fighting corruption through the passage and implementation of anti-corruption laws that meet international standards in its July 2006 Board statement on Cambodia's Article IV review.

- At the March 2006 Board Meeting, the USED recommended that the government of Ethiopia improve its system of budget preparation, execution, and reporting in the interest of heightening transparency and better prioritizing of expenditures.

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

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

- In India's most recent Article IV discussions, the USED in its Board statement urged greater public spending efficiency, including subsidy reform, pension reform, and reform of the pricing mechanism of petroleum products.

(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. Partly as a result of U.S. efforts, program conditions have focused increasingly on debt and financial vulnerability in middle-income countries and macroeconomic management in low-income countries. In low-income countries, the U.S. has supported the use of Poverty Reduction Strategy Papers ("PRSP"), which are developed by local authorities and civil society and help ensure that IMF programs meet specific needs of the country.

(9) ***Core Labor Standards (CLS)***

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

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

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

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

With respect to its individual lending operations, the IMF does not itself evaluate positive or negative linkages between conditions and environmental sustainability. Rather, the IMF coordinates with the World Bank which, unlike the IMF, possesses the internal expertise to address such linkages. The United States has encouraged the inclusion of conditions on environmental issues in cases where such issues have significant macroeconomic consequences.

(12) ***Greater transparency***

Over the last several years, the IMF has increased significantly the amount of information on its programs that it has made available to the public. The United States has stressed the need to build on this progress and expand the number of publications and IMF practices open to public scrutiny. As of July 2004, publication of all Article IV and Use of Fund Resources staff reports is presumed unless a country objects. In addition, all exceptional access reports will generally be published as a pre-condition for the Board's approval of such an arrangement.[5] The USED consistently encourages countries to publish the full Article IV staff report on the IMF's public website.

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

In April 2000, with the strong urging of the USED, the Executive Board agreed to establish an Independent Evaluation Office ("IEO") to supplement existing internal and external evaluation activities. The IEO provides objective and independent evaluation on issues related to the IMF and operates independently of Fund management and at arm's length from the IMF Board. Since its inception, the IEO has published ten comprehensive reviews, including assessments of the IMF's engagement in Jordan, multilateral surveillance, and the IMF's approach to capital account liberalization. Reports on other topics such as the IMF's advice on exchange rate policies are forthcoming. All reports are publicly available from the IEO's website at (http://www.imf.org/external/np/ieo/index.htm).

In response to recommendations of a 2002 IEO study on prolonged use of IMF resources, the IMF now requires "Ex Post Assessments" (EPAs) of IMF engagement in countries where the IMF has had a program in place for at least 7 out of the past 10 years. The EPAs are intended to provide a long-term, arms-length perspective and are led by someone other than the country mission chief, ideally someone outside of the area department. EPAs provide valuable insights to guide future engagement with "prolonged use" countries.

[5] "Exceptional access" refers to financing arrangements in amounts that exceed the Fund's normal limits.

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

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

- In the May 2006 Board Statement regarding Sierra Leone's new PRGF, the USED supported the recent adoption by that government of the Microfinance Investment and Technical Assistance Facility and the establishment of new banks that will bring more financial services to the rural population.

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

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

In May 2006, largely as a result of US and G7 leadership, the Executive Board of the IMF reiterated the importance of AML/CFT standards to strengthening the integrity of financial systems and deterring financial abuse, and affirmed the collaborative arrangements presently in place with the FATF and FATF-style Regional bodies (FSRBs) for assessing AML/CFT regimes in the context of the IMF's financial sector work. The Board also endorsed the efforts underway to strengthen the quality and consistency of assessments prepared by all assessor bodies, and adopted measures for enhancing cooperation with the FATF and the FSRBs.

Collaboration with the IMF, FATF and FSRBs, with the assessors using the same common methodology, institutionalizes the global fight against terrorist financing and money laundering, broadens the effort world-wide, and helps countries identify shortfalls in their AML and CFT regimes and implement reforms. As of June 2006, the IMF and World Bank have conducted over 60 assessments of country compliance with AML/CFT.

The IMF is also a substantial source of funding for countries' efforts to strengthen their own CFT regimes – an activity that Treasury has supported and has joined in to leverage Treasury's own bilateral CFT assistance. The IMF and World Bank together have substantially increased technical assistance (TA), delivering 250 missions and events from May 2005 to April 2006.

In the latest Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund (IMFC) - the Secretary of the Treasury is the Governor for the United States - the IMFC reiterated the importance of these issues and called for closer cooperation between the IMF and FATF in promoting stronger implementation of AML/CFT standards and encouraged publication of comprehensive country evaluations.

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

- The July 2005 FATF assessment noted that Irish guidelines are not legally enforceable, and questioned whether financial system supervisors had sufficient sanction powers to address AML/CFT infractions in supervised institutions. The USED emphasized, in its Statement on Ireland's Article IV review, the need for these issues to be addressed by the Irish authorities.

- In its February 2006 statement on India's Article IV review, the USED encouraged IMF staff to pay closer attention to AML/CFT issues during the next Article IV consultation and asked that India address the deficiencies found by the Asia Pacific Group on Money Laundering, such as in India's AML law, the regulation of alternative remittance systems, and the operation of India's Financial Intelligence Unit.

- The USED July 2006 Board statement on Cape Verde's Article IV review called on the Cape Verde Government to criminalize terrorist financing, citing its obligations under the UN's International Convention for the Suppression of the Financing of Terrorism.

II. <u>Section 801(c)(1)(B)</u>

(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.

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

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

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

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

- In Gabon's June 2006 Article IV review, the USED in its statement expressed willingness to support a proposed precautionary Fund arrangement if Gabon and the Fund could agree to appropriate conditionality to address fiscal slippages seen since the end of the previous 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. 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.

- The USED in its statement during the July 2006 Article IV review recognized that El Salvador's ratification of the CAFTA-DR Free Trade Agreement promises to bring about an improvement to the country's business and investment climate. The U.S. also expressed the need for continued trade-related reforms to further enhance investment prospects and diversify the export base.

*(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 continued or prolonged 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 early 2006 the IMF activated an Exogenous Shocks Facility (ESF) for low-income countries, which the U.S. supported because of the IMF's focus on addressing short-term balance of payments needs. The U.S. also successfully pressed for the adoption of the non-borrowing Policy Support Instrument (PSI), to provide a framework for IMF policy advice and donor signaling without the need for IMF lending. The U.S. has discouraged low-income countries from pursuing serial PRGF programs. The U.S. urges those countries without a clear balance of payments financing need to opt for a PSI, in which case they would retain the option of seeking ESF financing in the event of sudden adverse developments in the balance of payments.

*(VI) **Graduation from receiving financing on concessionary terms***

The United States supports comprehensive growth strategies to move countries from concessional to market-based lending. The United States works closely with the IMF and World

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

ANNEX 1: Report to Congress on International Monetary Fund Lending
October 1, 2005 – September 30, 2006

Board Approval Date	Country	Amount	Type	U.S. Position	Reason for Position
10/19/05	Haiti	SDR 10.23 million ($14.7 million)	Emergency Post-Conflict Assistance	Support	
10/24/05	Cameroon	SDR 18.57 million ($26.8 million)	PRGF	Support	
11/14/05	Niger	SDR 19.7 million ($21.8 million)	PRGF Augmentation	Support	
12/23/05	Iraq	SDR 475.4 million ($685 million)	SBA	Support	
01/27/06	Albania	SDR 17.045 million ($24.7 million)	PRGF	Support	
01/27/06	Central African Republic	SDR 6.962 million ($10.2 million)	Emergency Post-Conflict Assistance	Support	
4/17/06	Grenada	SDR 10.530 ($15.8 million)	PRGF	Support	
5/5/2006	Republic of Moldova	SDR 80.8 million ($121 million)	PRGF	Support	
5/10/2006	Sierra Leone	SDR 31.1 million ($46.6 million)	PRGF	Support	
5/31/06	Paraguay	SDR 65.0 million ($97.5 million)	SBA	Support	
6/12/06	Rwanda	SDR 8.010 ($12 million)	PRGF	Support	

Board Approval Date	Country	Amount	Type	U.S. Position	Reason for Position
6/26/06	Afghanistan	SDR 81.0 million ($121 million)	PRGF	Support	
07/21/06	Madagascar	SDR 55.0 million ($80.8 million)	PRGF	Support	
09/08/06	Burkina Faso	SDR 6.0 million ($8.9 million)	PRGF Augmentation	Support	