REPORT ON IMF REFORMS

Report to Congress
in accordance with Sections 610 (a) and 613 (a) of the
Foreign Operations, Export Financing and Related Programs
Appropriations Act, 1999

U.S. Department of the Treasury
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SELECTED ABBREVIATIONS

Contingent Credit Line (CCL)
Core Labor Standards (CLS)
Extended Fund Facility (EFF)
Enhanced Structural Adjustment Facility (ESAF)
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 Labor Organization (ILO)
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Memorandum of Economic Policies (MEP)
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Poverty Reduction and Growth Facility (PRGF)
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Technical Memorandum of Understanding (TMU)
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Introduction

This is the second report prepared pursuant to Sections 610 and 613 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999.[1] Section 613 provides that "[n]ot later than October 1 of each year, the Secretary of the Treasury shall submit to the Committee on Banking and Financial Services of the House of Representatives and the Committee on Foreign Relations of the Senate a written report on the progress (if any) made by the United States Executive Director at the International Monetary Fund in influencing the International Monetary Fund to adopt the policies and reform its internal procedures in the manner described" in section 610. Section 610 covers a broad range of issues related to, for example, transparency in IMF operations, social policies, core labor standards, trade liberalization, the environment, military spending, exchange rate stability, and reforms to combat corruption[2].

As noted in last year's report, the Treasury Department and the United States Executive Director (USED) at the IMF work consistently to build support in the IMF's Executive Board for the important objectives set out in the IMF legislation. Nearly two years of effort have produced progress in all areas, though the degree of progress differs by issue. As in last year's report, Treasury and USED efforts are reflected in a variety of actions and outcomes, including meetings with IMF staff on the content of a member's program, statements by the USED in the Board, components of IMF programs, policy change in borrowing countries, and actions by the IMF itself (e.g., to increase its own transparency). This report reflects actions and outcomes during fiscal year 2000, and does not include the initial U.S. efforts, which were reported separately in the October 1999 report. This report does, however, include some events that were noted in the March 2000 update of last year's report.

The ongoing effort to promote these objectives takes place in the context of a broader U.S. agenda for IMF reform. In December 1999, the Administration launched a major new initiative to reform the IMF. The steps proposed reflect experience gained in recent crises and our ongoing dialogue with Congress and other interested parties in academia, policy organizations, and civil society. Considerable progress has already been made in implementing the key components of this initiative.

- *More selective financing role that is focused on emergency situations.* With the active support of the United States, the Executive Board has undertaken an overall review of the IMF's lending mechanisms. In April 2000, four facilities were eliminated. In September 2000, the Board agreed to further revisions, which, among other things, shorten the effective

[1] Public Law 105-277, division A, § 101(d), title VI, §§ 610 & 613. The first report was submitted on October 1, 1999, and updated in March 2000. The updated version is available on the Treasury website: <http://www.treas.gov/press/releases/docs/imfrefor.pdf>.

[2] 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 General Accounting Office is currently conducting a review of Treasury's implementation of legislative objectives for IMF reform. Its work will "focus on the measures taken by U.S. agencies to promote IMF practices that are consistent with U.S. policies set forth in federal law and the influence U.S. policy has over the IMF's operations and other members' positions, as illustrated by specific cases."

maturity of IMF lending. These measures include a shortening of the expected repayment period for Stand-By and Extended Arrangements, more limited use of Extended Arrangements, surcharges for higher levels of access to discourage excessive reliance on IMF resources, stronger post-program monitoring, and enhancement of the Contingent Credit Line (CCL) to make it a more usable and effective instrument of crisis prevention. Mexico's early repayment to the IMF helps to underscore the shift to short-term lending. Korea has also announced its intention to repay the IMF ahead of schedule.

- *Promoting the flow of information from governments to markets and investors.* The IMF has worked closely with the World Bank and other international organizations in order to develop and promote the implementation of internationally-accepted standards and codes in areas such as banking supervision, financial and monetary policy transparency, fiscal policy transparency, and data dissemination. In this last category, the IMF has adopted stronger standards for external debt reporting requirements under the Special Data Dissemination Standard (SDDS), including maturity and sectoral breakdowns. In order to draw greater attention to the accuracy and quantity of data that countries disclose, the IMF began in July a new quarterly publication detailing country efforts to comply with the SDDS (see Section 12).

- *Attention to financial vulnerability as well as macroeconomic fundamentals.* At the urging of the USED, the IMF has begun to develop, and work to incorporate into its surveillance, indicators of financial sector soundness, national liquidity, and balance sheet risks. The G-7 has agreed that such indicators should be published regularly, together with explanatory material. In addition, the IMF and World Bank have developed Draft Guidelines on sovereign debt management.

- *Greater emphasis on catalyzing market-based solutions to crises.* As noted in section 5 of this report, the G-7 has issued operational guidelines for case-by-case implementation of the G-7 Köln framework for private sector involvement in the prevention and resolution of financial crises. With the strong support of the United States, the IMF also established the Capital Markets Consultative Group, which met for the first time in September 2000.

- *Safeguards on the IMF's resources.* The United States has vigorously promoted stronger requirements in this area. In April, the Executive Board adopted measures that include a new requirement for IMF borrowers to undertake and publish audited central bank financial statements and a new set of rules and guidelines to safeguard the use of Fund resources and to deal with cases of misreporting.

- *Modernization of the IMF as an institution.* At the urging of the United States, the IMF has taken steps to further improve transparency and accountability. The IMF is establishing a permanent office to undertake ongoing independent evaluation of its operations. Among recent advances on transparency is the publication of the IMF's quarterly Financial Transactions Plan (formerly known as the "operational budget").

Most recently, in a speech to the International Monetary and Financial Committee (IMFC)[3] of the IMF at the 2000 Annual Meetings, Secretary Summers took note of progress made but emphasized the need for ongoing efforts in these areas.

As part of its ongoing work to implement IMF reform, Treasury has in the past year worked to reinforce its internal effort to facilitate implementation of a variety of policy measures in the IMF, including the mandates/objectives in Sections 610 and 613. The Treasury IMF task force is the principal internal mechanism for identifying upcoming opportunities to promote U.S. policy objectives by coordinating timely input for the Board statements or the programs themselves. As noted last year, the task force meets every two weeks, and includes representatives from Treasury's regional offices as well as functional specialists in areas such as trade, environment, and labor. During the meetings, participants discuss the status of programs or Article IV[4] reviews for IMF member countries, and exchange views on how best to promote the legislative objectives in particular country cases. In providing input to country desks and the USED, functional staff continue to work with outside agencies, such as the Department of Labor, the Environmental Protection Agency, the State Department, and the Office of the U.S. Trade Representative.

Legislative Provisions

As noted above, this report covers progress on implementing the policies and reform objectives set out in Section 610 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1999. Specifically, Section 610 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,

[3] Formerly called the Interim Committee.

[4] Article IV of the IMF's Articles of Agreement provides for Fund surveillance of countries' compliance with their obligations as IMF members. Consultations are generally done annually with each member, and examine whether the member is following policies fostering orderly economic growth with reasonable price stability, a stable monetary system, non-manipulation of exchange rates, and the orderly international exchange of goods, services and capital.

eliminating elite monopolies, creating and effectively implementing anti-trust and anti-monopoly laws to protect free competition, and establishing fair and accessible legal procedures for dispute settlement among domestic enterprises;

(C) *Privatizing industry in a fair and equitable manner that provides economic opportunities to a broad spectrum of the population, eliminating government and elite monopolies, closing loss-making enterprises, and reducing government control over the factors of production;*

(D) *Economic deregulation by eliminating inefficient and overly burdensome regulations and strengthening the legal framework supporting private contract and intellectual property rights;*

(E) *Establishing or strengthening key elements of a social safety net to cushion the effects on workers of unemployment and dislocation; and*

(F) *Encouraging the opening of markets for agricultural commodities and products by requiring recipient countries to make efforts to reduce trade barriers.*

(3) *Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in strengthening financial systems in developing countries, and encouraging the adoption of sound banking principles and practices, including the development of laws and regulations that will help to ensure that domestic financial institutions meet strong standards regarding capital reserves, regulatory oversight, and transparency.*

(4) *Vigorously promote policies to increase the effectiveness of the International Monetary Fund, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), in facilitating the development and implementation of internationally acceptable domestic bankruptcy laws and regulations in developing countries, including the provision of technical assistance as appropriate.*

(5) *Vigorously promote policies that aim at appropriate burden-sharing by the private sector so that investors and creditors bear more fully the consequences of their decisions, and accordingly advocate policies which include –*

(A) *Strengthening crisis prevention and early warning signals through improved and more effective surveillance of the national economic policies and financial market development of countries (including monitoring of the structure and volume of capital flows to identify problematic imbalances in the inflow of short and medium term investment capital, potentially destabilizing inflows of offshore lending and foreign investment, or problems with the maturity profiles of capital to provide warnings of imminent economic instability), and fuller disclosure of such information to market participants;*

(B) *Accelerating work on strengthening financial systems in emerging market economies so as to reduce the risk of financial crises;*

(C) *Consideration of provisions in debt contracts that would foster dialogue and consultation between a sovereign debtor and its private creditors, and among those creditors;*

(D) Consideration of extending the scope of the International Monetary Fund's policy on lending to members in arrears and of other policies so as to foster the dialogue and consultation referred to in subparagraph (C);

(E) Intensified consideration of mechanisms to facilitate orderly workout mechanisms for countries experiencing debt or liquidity crises;

(F) Consideration of establishing ad hoc or formal linkages between the provision of official financing to countries experiencing a financial crisis and the willingness of market participants to meaningfully participate in any stabilization effort led by the International Monetary Fund;

(G) Using the International Monetary Fund to facilitate discussions between debtors and private creditors to help ensure that financial difficulties are resolved without inappropriate resort to public resources; and

(H) The International Monetary Fund accompanying the provision of funding to countries experiencing a financial crisis resulting from imprudent borrowing with efforts to achieve a significant contribution by the private creditors, investors, and banks which had extended such credits.

(6) Vigorously promote policies that would make the International Monetary Fund a more effective mechanism, in concert with appropriate international authorities and other international financial institutions (as defined in Section 1701(c)(2)), for promoting good governance principles within recipient countries by fostering structural reforms, including procurement reform, that reduce opportunities for corruption and bribery, and drug-related money laundering.

(7) Vigorously promote the design of International Monetary Fund programs and assistance so that governments that draw on the International Monetary Fund channel public funds away from unproductive purposes, including large "show case" projects and excessive military spending, and toward investment in human and physical capital as well as social programs to protect the neediest and promote social equity.

(8) Work with the International Monetary Fund to foster economic prescriptions that are appropriate to the individual economic circumstances of each recipient country, recognizing that inappropriate stabilization programs may only serve to further destabilize the economy and create unnecessary economic, social, and political dislocation.

(9) Structure International Monetary Fund programs and assistance so that the maintenance and improvement of core labor standards are routinely incorporated as an integral goal in the policy dialogue with recipient countries, so that –

(A) Recipient governments commit to affording workers the right to exercise internationally recognized core worker rights, including the right of free association and collective bargaining through unions of their own choosing;

(B) Measures designed to facilitate labor market flexibility are consistent with such core worker rights; and

(C) The staff of the International Monetary Fund surveys the labor market policies and practices of recipient countries and recommends policy initiatives that will help to ensure the maintenance or improvement of core labor standards.

(10) Vigorously promote International Monetary Fund programs and assistance that are structured to the maximum extent feasible to discourage practices which may promote ethnic or social strife in a recipient country.

(11) Vigorously promote recognition by the International Monetary Fund that macroeconomic developments and policies can affect and be affected by environmental conditions and policies, and urge the International Monetary Fund to encourage member countries to pursue macroeconomic stability while promoting environmental protection.

(12) Facilitate greater International Monetary Fund transparency, including by enhancing accessibility of the International Monetary Fund and its staff, foster a more open release policy toward working papers, past evaluations, and other International Monetary Fund documents, seeking to publish all Letters of Intent to the International Monetary Fund and Policy Framework Papers, and establishing a more open release policy regarding Article IV consultations.

(13) Facilitate greater International Monetary Fund accountability and enhance International Monetary Fund self-evaluation by vigorously promoting review of the effectiveness of the Office of Internal Audit and Inspection and the Executive Board's external evaluation pilot program and, if necessary, the establishment of an operations evaluation department modeled on the experience of the International Bank for Reconstruction and Development, guided by such key principles as usefulness, credibility, transparency, and independence.

(14) Vigorously promote coordination with the International Bank for Reconstruction and Development and other international financial institutions (as defined in Section 1701 (c)(2)) in promoting structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending, especially in the world's poorest, heavily indebted countries.

Report on Specific Provisions

Below, each part of Section 610 is considered in turn.

(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.

As noted in last year's report, the guiding concern of the IMF in discussions with country officials is whether the exchange rate regime is stable and sustainable. The IMF's Articles of

Agreement give each country the right to choose its own exchange rate regime, but the IMF advises countries on whether their regimes appear to be sustainable, and on what macroeconomic and financial sector policies are necessary to support the regime. If the IMF believes that a country's exchange rate regime or the prevailing level of its exchange rate is unsustainable or inconsistent with the country's objectives and policies, the IMF warns the country's authorities and recommends changes. In some circumstances, the IMF may require changes in the exchange rate regime in the context of a program that it is supporting.

The United States supports the IMF's overall approach, while emphasizing the importance of avoiding fixed exchange rate regimes that are not supported by credible institutional arrangements and consistent macroeconomic policies. Prior to recent capital account crises, many countries maintained fixed – but not firmly institutionalized or credible – exchange rate regimes. Such regimes increase vulnerability in a number of ways: they can encourage excessive foreign currency borrowing by both public and private sectors; they can lead governments to borrow even more to defend currencies under pressure; and – when trouble strikes – the breaking of the exchange rate promise exacerbates the loss of investor confidence and the withdrawal of capital, and thus contributes to greater eventual exchange rate instability.

Following the experience of recent crises, many countries have begun to adopt exchange rate policies that are less likely to result in a loss of credibility and in market instability. For those countries committed to a fixed exchange rate, the adoption of legal or institutional arrangements that harden their commitment to subordinate monetary policy to the maintenance of an exchange rate peg can reduce the likelihood of a loss of credibility. In this regard some countries have chosen to adopt a currency board arrangement while others have opted for full dollarization. For countries that wish to retain greater discretion in their domestic monetary policy, the threat of unsustainable pressures from an exchange rate peg that is inconsistent with domestic policy can be reduced by allowing greater flexibility in the exchange rate. Since 1995, 14 countries have moved away from "fixed-but-adjustable" regimes and toward more flexible regimes.

In considering country programs, the USED has promoted consistency between the choice of exchange rate regime and domestic macroeconomic and financial policy. For example, in April 2000, during the discussions leading up to the approval of an IMF Stand-by Arrangement (SBA) for Ecuador, the USED advocated a variety of measures to make the Ecuadorian dollarization regime workable, including creation of a central bank liquidity mechanism. During China's July 2000 Article IV review, the USED supported a gradual move toward greater exchange rate flexibility to facilitate adjustment to ongoing structural changes and China's WTO accession. And for Korea, in August 2000, the USED recommended that the authorities allow market forces to play a greater role in determining exchange rate movements in order to enhance market perception of more flexible price setting in the foreign exchange market and hence deepen the market and reduce volatile inflows based on the perception of upward pressure on the won.

As part of the ongoing review of ways to strengthen the international financial architecture, the United States and the other G-7 nations agreed that the IMF, in the context of its surveillance, should enhance the attention it gives to exchange rate sustainability. In their report to Heads of State and Government at the June 1999 Economic Summit in Köln, G-7 Finance Ministers and Central Bank Governors indicated that countries choosing fixed rates must be willing to subordinate other policy goals to that of fixing the exchange rate and that arrangements to institutionalize this policy can be useful. G-7 Finance Ministers and Central Bank Governors also agreed that the international community should not provide large-scale official financing for a country intervening heavily to support a particular exchange rate level, except where that level is judged sustainable and certain conditions have been met, such as where the exchange rate policy is backed by a strong and credible commitment with supporting arrangements and by consistent domestic policies. In the November 1999 discussion of exchange rates, Executive Directors agreed that the IMF should continue to avoid providing its financial support to defend an unsustainable peg, or an unsustainable exchange rate in the context of a managed float.

Competitive devaluations are never the basis for stability or sustainable growth. Because national authorities often make decisions concerning exchange rates without external consultation, the IMF cannot necessarily prevent poor exchange rate decisions. However, the policy of the IMF, which the United States supports, is that countries should pursue economic growth objectives through policies supportive of economic liberalization and price stability, rather than through short-term competitive devaluations.

(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;

The IMF is a strong proponent of independent monetary authorities, which are important to price and exchange rate stability, as well as consistent with basic principles of market-oriented economies. Independence from political authorities allows the central bank to focus on its core mission of establishing a sound currency and helps reduce opportunities for inefficiency and corruption. The IMF, with strong advocacy by the USED, has promoted greater independence of monetary authorities in a range of countries in recent years. Country programs often include measures to strengthen central bank autonomy and accountability. Between 1995 and 2000, such measures were included as structural benchmarks or performance criteria in programs for 13 countries. Furthermore, the IMF frequently helps countries to achieve these goals through technical assistance. During the same time period, the IMF provided technical assistance on central bank autonomy and accountability to more than 20 countries. In addition, the IMF promotes these issues through its research and through assessments of compliance with standards and codes and the new IMF rules for safeguarding the use of IMF resources.

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

- Over the past two years, Thailand has taken steps to increase the independence of its central bank. Following discussions with the IMF about its monetary regime, the Thai authorities are in the process of establishing an inflation-targeting framework for monetary policy.

- As part of its SBA, Korea passed legislation in 1997 to establish the independence of its central bank. The Korean central bank has been successful in achieving price stability.

- The Fund strongly encouraged Israel during Article IV consultations in April 2000 to take steps to enhance the operational independence of its central bank and reinforce price stability as the main goal of the central bank.

- During the Article IV review for Tajikistan in February 2000, the IMF Board welcomed steps including the abolition of directed lending by the central bank but pressed for further increases in the independence of the central bank.

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

(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;

Recent examples in support of these objectives include:

- The United States has emphasized, through numerous communications with Ecuadorian authorities in 1999 and 2000 and through the USED office, the need for transparency in judicial proceedings, and, more generally, the creation and maintenance of an attractive investment climate. Accordingly, Ecuador's April 2000 Letter of Intent (LOI) indicated that the government is working with the supreme court to reform the country's judicial system to ensure rapid and impartial decisions based on accepted international standards and principles and Ecuadorian law.

- As part of a larger effort to improve the competitiveness and efficiency of its economy, Tanzania developed and implemented, with IMF support, a program for reorganization and privatization of its banking sector. In 1993, Tanzania had one large state-owned bank for the entire country, and one other institution providing some banking services. Following its reorganization program, it now has 20 banks, of which 12 are foreign-owned; in contrast to some developing countries, there is substantial branching into areas outside the capital. The government believes an environment has been created which will foster strong competition in banking, with the potential to expand service and lower interest rates for private sector borrowers. Specifically, in its current IMF program, the Tanzanian authorities have committed to the restructuring and possible privatization of the National Microfinance Bank (NMB) by mid-2002 if it can be made profitable. The authorities are also preparing, with World Bank support, for the restructuring and possible privatization of the Tanzania Postal Bank and the People's Bank of Zanzibar, the last two parastatal financial institutions in the country other than the NMB.

(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;

Privatization has been a key component in IMF programs in countries where significant distortions and government ownership of business enterprises create inefficiencies in the allocation of resources and the production of essential goods and services. Treasury believes that it is appropriate that the IMF support the use of competitive and transparent means of privatization so that borrowing countries might achieve gains in economic efficiency, improve their fiscal positions, and develop domestic capital markets. IMF programs have been effective in encouraging countries to privatize state-owned enterprises, and the United States has advocated further progress.

Examples include:

- In discussions with the IFIs and Indonesian officials, the Treasury has emphasized sales of government-controlled corporations and banks as top priorities for Indonesian economic policy. After the economic crisis of 1997-98, the Indonesian Bank Restructuring Agency (IBRA) acquired massive asset holdings (valued at more than 50% of GDP), including large numbers of Indonesia's private corporations and banks. Treasury continues to urge the government of Indonesia to move ahead with these sales in order to alleviate the public debt burden and move economic activities back to the private sector. This year, Treasury encouraged the IMF to adopt quantitative quarterly targets for IBRA asset sales, which were subsequently made part of Indonesia's program. In addition, Treasury wants to see the government of Indonesia accelerate privatization of traditional state-owned enterprises (SOEs), including the state banks (which dominate the banking system, with more than half of total liabilities).

- On June 7, 2000, Romania completed the first review of its current SBA, and the IMF Board approved an extension through early 2001. Key features of the structural reforms are further strengthening of the banking sector, particularly through the privatization of remaining state-owned banks. In this context, the IMF is insisting on a fully transparent privatization of Banc Agricola. The program also includes further privatization of SOEs, and envisions a reduction in implicit subsidies, such as the accumulation of tax arrears by SOEs.

- Privatization is a key feature of Nigeria's recently approved SBA. The LOI that forms the basis for the program includes extensive commitments to push ahead with regulatory reform and privatization in key sectors of the economy such as energy, telecommunications, and petroleum. In the August 2000 Board discussion of Nigeria's SBA, the USED emphasized that there was no room for continued slippage in meeting the privatization goals of the new program, and that further government investment in inefficient parastatals destined for privatization, such as Nigerian Airways, should be avoided strenuously.

- The government of Albania sold an 85% stake in Albania's phone monopoly in July 2000, and currently is preparing to open a tender for a second mobile phone license. The completion of the privatization of two out of five small- and medium-sized enterprises by end-September 2000 is a structural performance criterion for completion of the first review of the third year arrangement. The announcement of the tender for the privatization of the Savings Bank by November 2000 is also a structural performance criterion. In Albania's June 2000 Article IV and PRGF review, the USED urged authorities to move more assertively forward on further bank and enterprise privatization, highlighting in particular the removal of the National Commercial Bank and the Savings Bank from state hands.

- Bulgaria has made much progress toward a fully privatized banking system. On July 7, Bulbank, the largest state bank in Bulgaria, was sold. The government is committed to issuing a new tender for the sale of Biochim Bank this autumn – which is a structural performance criterion of its IMF program – and to complete the sale of Biochim by March 2001. Once this sale is complete, the Bulgarian authorities will have privatized six banks, accounting for over fifty percent of Bulgaria's banking system, since July 1997. During Bulgaria's March 2000 Article IV and Extended Fund Facility (EFF) review, the USED praised Bulgarian authorities' progress while urging further efforts to accelerate structural reform.

- In the July 2000 discussion of The Gambia's Article IV and its performance under the PRGF, the USED noted the authorities' preparatory steps toward implementing their long-delayed privatization policy, and urged them to establish an explicit and ambitious timetable for moving ahead, especially in priority sectors such as agriculture, tourism, and trade-related businesses. Specific conditionality related to privatization has been incorporated into ongoing lending operations by the World Bank.

(D) Economic deregulation by eliminating inefficient and overly burdensome regulations and strengthening the legal framework supporting private contract and intellectual property rights;

As noted in last year's report, the United States views limited but effective regulation as essential to a sound economy, and the USED actively reflects this view in Board discussions and other interactions within the IMF. Excessive regulation distorts markets and may contribute to unemployment. At the same time, research and practice indicate that a country must enforce contracts and protect property rights in order to draw investment and generate commercial activity.

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

- As noted above, Bulgaria has made progress on structural reform measures under its EFF program with strong support from the USED. For example, in their August 2000 LOI and Memorandum on Economic Policies (MEP), the authorities highlighted various measures they had undertaken in 2000 to improve the business climate, including the removal of 100 licensing requirements, and stressed their commitment to reducing a further 40 such requirements by mid-2001.

- During the June 2000 Article IV and PRGF review for Albania, the U.S. statement strongly supported the IMF staff's proposal for the establishment of a one-stop shop for foreign direct investment (FDI) in Albania. The statement noted that many other countries in the region have developed such facilities, which have been shown in studies to be effective in attracting prospective investors.

- In the March 2000 PRGF and HIPC discussion for Tanzania, the USED noted that the investment climate remains hindered by many obstacles, especially bureaucratic red tape. The U.S. statement encouraged, among other things, initiatives to streamline investment approval procedures and greater openness to foreign portfolio investment. Tanzania's July 2000 LOI notes certain undertakings which could improve the investment climate. Upon completing, in consultation with the World Bank, a thorough review of privatization procedures, the authorities incorporated the results into the work of the Parastatal Sector Reform Commission. The aim is to streamline and standardize investment procedures, and to ensure that bids are judged on well-defined criteria, mainly price. The new procedures were used to select a winning bid for the Tanzania Telecommunications Corporation in June 2000.

(E) Establishing or strengthening key elements of a social safety net to cushion the effects on workers of unemployment and dislocation;

In the 1996 declaration, "Partnership for Sustainable Growth", the IMF gave strong emphasis to measures to improve education, health care, provide affordable social safety nets, and other measures to alleviate poverty. In 1997, IMF issued guidelines to staff for improving the monitoring of social expenditures and social indicators. These issues have been given increased emphasis in the wake of the Asian financial crisis.

In addition to the greater attention to social safety nets in their lending operations, the IMF, along with the multilateral development banks, is actively supporting the APEC Finance Social Safety Net Initiative. The objective of this initiative is to establish a set of guidelines to be endorsed by APEC Finance Ministers regarding the appropriate use of social safety net policies and programs, taking into account recent experience. In this connection, a study is underway to examine selected country experience (including that of Indonesia, Republic of Korea, Thailand, Chile, Mexico, and Peru).

The United States has strongly supported the IMF's overall efforts to ensure that essential adjustments in macroeconomic policies are mitigated by measures to strengthen a program country's social safety net. In particular, as noted in section 7 of this report, the IMF and World Bank have reshaped their concessional lending operations to provide for enhanced attention to social concerns within a sound macroeconomic context. The increased emphasis on social safety nets is evident in all types of IMF operations.

Below are several examples of the use of U.S. "voice and vote" in the IMF to promote attention to social concerns in non-concessional lending program countries[5].

- In Board discussions and meetings with the Indonesian authorities, the United States has stressed that, in order to meet social safety net spending needs, all spending should be closely monitored to avoid governance problems and every effort should be made to improve the efficiency and targeting of spending for the poor and for education while enhancing the role of civil society in this process. In their September 2000 LOI, the Indonesian authorities stated their intention to implement fully their FY 2000 budget, avoiding spending shortfalls for the social safety net, and to meet the conditionality of the World Bank's social safety net adjustment loan.

- In a July 2000 Article IV discussion on Vietnam, the USED concurred with IMF staff advice that Vietnam needs a wider safety net scheme, especially in the context of SOE reform. The U.S. statement urged consideration of income-based social safety net schemes rather than general severance schemes. The public summary of the discussion notes that other Executive Directors also recognized the need for the authorities to increase the share of expenditure directed toward social spending.

- During the June 2000 Article IV review for India, the USED was joined by other Directors in criticizing the fact that India's 2000/2001 budget left the country's extensive subsidy regime largely intact, thus preserving an inefficient, untargeted social safety net.

- In Colombia's program, the IMF explicitly accommodated within fiscal targets a new annual $300 million social safety net, funded by the World Bank and the Inter-American Development Bank. The USED strongly supported this priority in the Board discussion.

- In Board statements on Ecuador, the USED has stressed the importance of improved targeting and protection of resources devoted to social spending. As part of the reforms under its IMF program, Ecuador intends to liberalize fuel prices in a manner that minimizes the impact on the poorest. Similarly, Ecuador intends to modify social spending under the fiscal consolidation program to lessen the impact of the adjustment program on the poor.

(F) Encouraging the opening of markets for agricultural commodities and products by requiring recipient countries to make efforts to reduce trade barriers.

Trade liberalization is often a key component of IMF arrangements. In the Executive Board, the United States is a consistent advocate of more open trade, and has regularly advocated the inclusion of trade measures in country programs. Results include:

[5] Country examples for concessional lending (PRGF) operations are provided in section 7.

- The August 2000 SBA for Nigeria includes numerous trade liberalization measures. These include steps to dismantle a cumbersome system of high rates that has been fertile ground for corruption. This will be done in part through a reduction in tariffs on a range of products, such that the average import tariff is reduced from 24% to 12% in the 2000 budget. In addition, the authorities have agreed to replace certain import bans with tariffs. The USED has supported these measures.

- The Egyptian authorities have over the last year taken steps to streamline customs procedures and reduce tariffs in the context of regional and bilateral trade agreements. In Egypt's July 2000 Article IV review, Executive Directors welcomed these steps. However, the U.S. statement noted that there was considerable scope for further trade liberalization, which would be necessary to expand and diversify Egypt's export base, as well as to attract more FDI. Other Executive Directors also stressed the need for further progress in trade reforms.

- In the May 2000 Board discussion of Belize's Article IV consultation, the USED was joined by other Directors in expressing regret that Belize's trade regime remains restrictive in spite of reducing the CARICOM maximum tariff rate. The USED urged the authorities to move more aggressively toward a more liberalized trade system by scaling back import licensing, reducing import duty exemptions, and lowering tariffs further in order to increase efficiency.

- The USED, at the March 2000 Board discussion to approve a program for Lithuania, applauded the authorities' commitment as part of its LOI to further liberalize trade and encouraged implementation of measures to facilitate accession to the WTO.

- In the March 2000 HIPC and PRGF discussion for Tanzania, the USED statement noted progress on trade liberalization, and welcomed the virtual abolition of non-tariff barriers on imports and duties on traditional exports. Under its Fund program, the last export duty was eliminated in the 2000/01 budget, and duties on imports are now valued on the basis of international prices. The government has committed to bring its import valuation system fully into compliance with WTO valuation methods by January 2001. While recognizing these constructive steps, the USED encouraged Tanzania to go further, for example to eliminate restrictions on exports of particular food items and to accelerate the timetable for additional tariff reductions.

- In its January 2000 LOI, Indonesia indicated its intention to pursue further trade liberalization measures during the course of its new EFF, notably the elimination of all existing non-tariff barriers (except those maintained for health and safety reasons).

- The PRGF program for Honduras includes significant trade liberalization measures, including implementation of Central America Common Market (CACM) tariff reductions, rationalization of the tariff structure to avoid fiscal fraud, restructuring of coffee sector support, and abolition of remaining export taxes on bananas and minerals.

(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.

The IMF employs different approaches to improving countries' financial systems. The IMF participates with the World Bank in the joint Financial Sector Liaison Committee, created in the fall of 1998 with U.S. encouragement, to promote cooperation in program design and implementation. Through the Liaison Committee, the IMF works to develop guidance for assessing the implementation of the *Core Principles for Effective Banking Supervision*, developed by the Basel Committee on Banking Supervision. The IMF has also increased its attention to financial sector soundness in the context of its Article IV surveillance work. In addition, under the joint IMF-World Bank Financial Sector Assessment Program (FSAP), a pilot program launched in 1999, the institutions are jointly carrying out in-depth assessments of selected countries' financial systems. The IMF uses its findings to produce Financial System Stability Assessments (FSSAs), that aim to identify financial system strengths and vulnerabilities, as well as to generate assessments of compliance with key financial sector standards such as the Basel *Core Principles*, the International Organization of Securities Commissions' *Objectives and Principles of Securities Regulation*, the Capital Accord and the IMF's own Code of Good Practices on Transparency in Monetary and Financial Policies. The latter assessments are frequently made public as *Reports on the Observance of Standards and Codes* (ROSCs).[6]

The FSAP pilot program included twelve countries, and thus far eight of these countries have had FSSAs reviewed by the Board. (The remaining four FSSAs will be reviewed in the near future.) Following a review of the experience with the pilot program in March, the Boards of the IMF and the World Bank agreed to expand the FSAP to 24 additional countries in the coming fiscal year which will result in preparation of at least 48 new ROSC "modules." The Executive Boards will review progress on the FSAP program again later this year. The United States will then push to integrate the FSAPs as a regular element of an enhanced surveillance function and, in the interests of transparency and disclosure, to permit members to voluntarily release their FSSA reports.

The IMF Board also reviewed issues surrounding work on assessment of offshore financial centers (OFCs) as recommended by the Financial Stability Forum. In close collaboration with other organizations, the IMF will undertake assessment of OFCs' adherence to international standards and help identify and reduce vulnerabilities stemming from weaknesses in these financial systems.

Through the USED, as well as the G-7 and G-22, we have encouraged the development of indicators of financial sector soundness (macroprudential indicators). The United States strongly believes that the use and development of macroprudential indicators support the IMF's surveillance work. The United States has also called for the inclusion of macroprudential indicators in the SDDS, which would help to ensure comparable and transparent data on financial systems.

[6] See section 12 for a discussion of Standards and Codes.

The following cases are examples of the IMF's increased policy focus on the financial sector and U.S. efforts to promote attention to this sector in IMF programs.

- Under Korea's SBA, the government's blanket guarantee of bank deposits will be phased out in December 2000 and is to be replaced by a limited deposit insurance system. This change should strengthen market discipline, encourage risk assessment, and promote further consolidation in the financial sector. In addition, the transition to mark-to-market asset valuation in the investment trust sector has been proceeding gradually, pursuant to new regulations that came into effect on July 1, 2000. The Korean authorities expect the new rules to be fully implemented by the end of 2000. The United States has supported implementation of these measures and urged further steps. In the August 2000 review of Korea's SBA, the USED emphasized the importance of reducing the high government ownership in the financial sector, which had resulted from the government's handling of the recent financial crisis.

- Financial and corporate restructuring is central to Indonesia's agreed EFF program with the IMF. The strategic objectives of the financial restructuring program are: recapitalizing all banks to achieve 8 percent capital adequacy ratios by December 31, 2001; minimizing the public cost of restructuring; enhancing supervision and governance in the financial sector; and developing debt and equity markets to reduce reliance on bank finance.

- As noted previously, an important feature of Romania's extended SBA is the further strengthening of the banking sector, particularly through the privatization of remaining state-owned banks. During the June 2000 program review, the USED also commented on the serious questions regarding the health of the banking sector and called for aggressive implementation of supervisory and prudential reforms (including and in addition to those the authorities had very recently proposed). During the review, the authorities committed to a strengthened set of financial sector measures in response to the collapse of the National Investment Fund (the largest mutual fund in Romania), including a thorough investigation into the mismanagement that led to the collapse and a program with the World Bank to improve the regulation, supervision and governance of the non-bank financial sector.

- In April 2000, Turkey appointed a new Banking Regulation and Supervisory Agency to oversee its banking system, meeting a key criterion of Turkey's $4 billion SBA. The new agency is a key element of a banking law passed late last year to reform the country's 80-member banking system. The agency is vested with wide regulatory powers, including the ability to close banks. In the July 2000 Article IV and program review for Turkey, the USED stressed that Turkey still faced ongoing risks from inadequate implementation of banking sector restructuring and reform, and urged Turkish authorities to continue to meet program targets in this area. The USED also encouraged Turkey to participate in the FSSA process.

- Banking reforms have been a major part of Ecuador's SBA, and the United States has emphasized the importance of such reform in Board statements and in numerous meetings during 2000 with Ecuadorian authorities and with IMF staff. Among other steps, the government of Ecuador is now phasing in the Basel Core Principles.

- The USED, at the March 2000 Board discussion to approve a SBA for Lithuania, encouraged expeditious privatization of the two largest state-owned banks, and encouraged tighter prudential regulation and adoption of the Basel Core Principles. Bringing the two banks to the point of sale are structural benchmarks for Lithuania's program.

- In its May 2000 LOI, Albania committed to additional steps to strengthen the financial sector, including: privatization by end-2000 of the state Savings Bank; privatization by mid-2001 of the state-owned insurance company, INSIG; and approval in parliament by end-2000 of a new bankruptcy law that is fully consistent with the law on collateralized transactions.

- Peru's EFF program includes several measures to ensure the health of the country's banking system. In Peru's March 2000 program review, the U.S. statement urged the Peruvian authorities to continue proactive measures to strengthen bank balance sheets. The USED also praised Peru's decision to undergo an FSAP in context of its precautionary EFF.

(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.

The IMF, in cooperation with other IFIs, has placed new priority on efforts to strengthen national insolvency regimes, which provide the basis for the efficient resolution of the debt problems of private entities. This is critical for two reasons: the failure to resolve debt problems expeditiously can itself be a barrier to growth; and the efficient resolution of the debt problems of private entities is critical in preventing private debt problems from accumulating and ultimately spilling over to the sovereign. The efforts of the IFIs have built upon the key principles of effective bankruptcy and debtor-creditor regimes identified in 1998 by the G-22 Working Group on International Financial Crises. The 1999 Report of the G-7 Finance Ministers to the Heads of State and Government on Strengthening the International Financial Architecture called attention to the importance of effective national insolvency regimes in efficient crisis resolution.

The IMF is supporting this agenda in several important ways. The IMF published an in-depth study on national insolvency regimes that currently serves as the basis for its dialogue with member countries on improving their insolvency regimes. In September of 1999, it supported and participated (with other IFIs) in a major symposium on insolvency systems, organized by the World Bank. The symposium kicked off a new phase of IFI efforts in this area. As part of this effort, the World Bank and the regional development banks are currently working on a wide-ranging project to analyze and improve national insolvency regimes in emerging market countries, including a set of *Principles and Guidelines on Insolvency Regimes for Developing Countries*. The World Bank is also developing an assessment matrix for use in pilot assessments, which the IMF will help to promote and implement. Finally, 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.

With the active support of the United States, the IMF has been promoting improved insolvency regimes in a number of countries.

- In the case of South Korea, the legal framework for court-supervised insolvencies has been strengthened, including through bankruptcy law amendments adopted in 1999, though the pace of corporate restructuring has been slow. In August 2000, the government announced a new three-stage implementation plan for further restructuring and reform. In the corporate sector, the new plan provides for an accelerated workout process, pre-packaged bankruptcy proceedings, and the formation of corporate restructuring vehicles.

- Thailand's commitments under its SBA with the IMF included steps to achieve accelerated financial and corporate debt restructuring. During Thailand's 9th Review in May 2000, IMF staff and the USED noted concerns on the lack of progress in corporate debt restructuring and urged the Thai government to take further steps to improve its bankruptcy framework. The Thai authorities acknowledged that weaknesses in the bankruptcy framework were impeding corporate reorganizations proceeding out of court. Since then, the government has implemented administrative improvements to its bankruptcy system including the formation of arbitration panels to facilitate out-of-court settlements. In addition, the authorities are considering further amendments to remove certain ambiguities from the existing bankruptcy law and a comprehensive review of all aspects of the bankruptcy framework.

- Indonesia's EFF includes several steps to improve implementation of the 1998 bankruptcy law, including measures to improve the functioning of the Commercial Court, which is a crucial part of the bankruptcy process. The USED has repeatedly encouraged stronger action on this front during Article IV and program reviews for Indonesia.

- During Bulgaria's March 2000 Article IV and EFF review, the USED urged the Bulgarian government to enact improved bankruptcy legislation as a means to improve the banking sector. In the authorities' LOI/MEP of August 2000, the Bulgarian government committed itself to submitting a modern and comprehensive bank bankruptcy law to parliament by September 2000, an action that is a structural benchmark in Bulgaria's EFF program.

- Approval of a new bankruptcy law is a structural benchmark in Albania's PRGF program. In Albania's June 2000 Article IV and program review, the USED highlighted the importance of implementing effective collateral and bankruptcy legislation.

(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 –

The United States has actively promoted, as part of the strengthening of the international financial architecture, an appropriate role for the private sector in the resolution of financial crises. The United States has led efforts to develop a framework for addressing this issue, which has been endorsed by the G-7 and IMF. Over the past year, this approach to private sector involvement has been implemented in a number of cases, including Ukraine, Pakistan, and Ecuador.

As noted in last year's report, the G-7 framework aims to promote appropriate involvement of private creditors and investors in crisis resolution, and a system in which countries can address debt problems in a market-based, orderly way. It recognizes the need to balance competing considerations on a case-by-case basis, in a way that preserves 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. Consistent with this framework, the international community's approach to resolving the debt problems of a number of countries reflects wide recognition both of the importance of private-sector involvement and of the need for solutions to reflect the specific circumstances of each case. At the Interim Committee meeting in September 1999, IMF members endorsed this framework.

To facilitate the implementation of this framework, the April 2000 Statement of G-7 Finance Ministers laid out a set of operational guidelines. These guidelines were subsequently adopted by the IMFC at its spring 2000 meeting. They call on all IMF programs to include analysis of a country's medium-term debt and balance of payments profile. The guidelines recognize that, in some cases, the combination of catalytic official financing and policy adjustment should allow the country to regain market access quickly. In other cases, emphasis will need to be placed on voluntary approaches to help overcome creditor coordination problems. Where possible, the official sector should support approaches -- as in Korea and more recently in Brazil -- that enable creditors to recognize their collective interest in maintaining positions, despite their individual interest in withdrawing funds. In some severe cases, the early restoration of market access may be judged unrealistic and a broader spectrum of actions by private creditors, including comprehensive debt restructuring, may be warranted to provide for an adequately financed program and a viable medium-term payments profile. In their recent Communiqué, IMFC members welcomed the progress that has been made in developing a framework for private sector involvement, and called for further progress in the application of the framework, including the operational guidelines, laid out in April.

Appropriate private sector involvement will continue to be a consideration in reviewing individual country programs. All future programs should include a section explaining the assumptions taken about the source of private finance. In recent cases where the country's underlying financial viability was in question, the restructuring of private external debts, including bonds, has helped to meet the financing requirements identified in Fund programs for policy reform and recovery. This should strengthen incentives for investors to make decisions based on their assessment of the risk and reward associated with a particular investment, and not on expectations that they will be protected from adverse outcomes by the official sector. The Treasury and USED will remain an active voice on this issue.

- In Pakistan, the IMF worked with Pakistan to implement the Paris Club's winter 1999 decision to ask Pakistan to seek a comparable restructuring of its private external bonds in a way that minimized disruption to the broader market. The comparability of treatment provision is designed to limit the risk that financing provided by the restructuring of claims owed to official bilateral creditors will be used to protect private creditors from adverse outcomes, by allowing a country to meet private obligations that otherwise could not have been paid in full and on time. In December 1999, Pakistan's bond holders agreed to restructure roughly $600 million in bonds coming due in 1999 and 2000 into a new, long-term instrument.

- As a condition of Ukraine's EFF, the IMF required that the country's net international reserves stay at or above a defined floor. This had the effect of preventing IMF financing from being used to meet Ukraine's obligations to private creditors. In early 2000, Treasury and the IMF encouraged Ukraine to establish a cooperative framework for resolving its financing difficulties in consultation with its creditors, to develop a comprehensive private debt restructuring package to address the spike in payments due in 2000 and 2001, and to create a payments profile consistent with medium-term financial viability. A comprehensive private debt reprofiling was successfully completed in the spring of 2000.

- U.S. support for Ecuador's reform program has included an emphasis on: (1) appropriate balance in the contributions of the multilateral creditors, official bilateral creditors (the Paris Club) and private external creditors toward meeting Ecuador's near term financing needs; (2) working cooperatively with private creditors to resolve Ecuador's financing difficulties; and (3) the need to establish a more sustainable medium term payments profile. The United States has pushed these points extensively in numerous meetings during 1999 and 2000 with Ecuadorian authorities and IMF staff and in USED board statements. The government of Ecuador recently completed a successful debt exchange with private creditors that substantially reduced Ecuador's debt payment obligations to private creditors in the near term, and improved the medium-term viability of its finances.

(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;

An essential aspect of crisis prevention is effective surveillance. The United States is pressing for ongoing improvements in this area by putting greater emphasis on the provision of data to the markets, greater attention to liquidity and balance sheet risks, and improved debt and reserves management practices.

The IMF promotes, with strong U.S. support, a number of steps by countries to make information on their economies available to private capital markets – including publication of Article IV assessments and program documents as well as regular release of economic and financial data consistent with the *Special Data Dissemination Standard* (SDDS). (See Section 12). The IMF is also helping countries to establish separate systems for high-frequency monitoring of private external liabilities. Systems to monitor interbank lines have been or are being established in Argentina, Brazil, South Korea, Mexico, Thailand, and Turkey.

The IMF is also giving greater attention to liquidity and national balance sheet risk. Recent experience shows that a lack of information about countries' liquidity and balance sheet positions contributed to crises by encouraging (or at least not sufficiently discouraging) the buildup of imbalances, which exacerbated negative sentiment as the crises developed and the bad news inevitably came out. The IMF has already included indicators of such risks in a number of recent Article IV and program documents and will now move to integrate these indicators more systematically into its surveillance process.

In addition to enhanced data provision and surveillance, mitigating the risks associated with large capital flows requires careful management of government debt portfolios. The IMF and the World Bank have developed guidelines for members' debt and reserve management that, for instance, encourage countries not to rely too heavily on short-term debt. During this process, Treasury has worked with the institutions and other governments to focus these guidelines on effective risk management involving adequate reserves, manageable maturity and currency structures, and transparency. The Draft Guidelines have been posted on the IMF's website[7] for public comment. The IMF and World Bank staffs will present final guidelines in the spring of 2001.

The IMF has also supported the efforts of the Basel Committee on Banking Supervision to update and modernize the 1988 Basel Capital Accord, so that the capital requirements imposed on commercial banks better reflect their underlying credit risks. Under proposals released for public comment in June, banks could be subject to higher capital requirements for lending to riskier borrowers, and the regulatory bias toward short-term interbank lending to non-OECD countries could be reduced. The Basel Committee is expected to circulate a revised set of proposals in January 2001, which will incorporate some of the feedback received on the earlier version.

(B) Accelerating work on strengthening financial systems in emerging market economies so as to reduce the risk of financial crises;

As noted in last year's report, the IMF is working with other IFIs to promote stronger financial systems in emerging market economies (see Section 3). The IMF has expanded its expertise in the area, and undertaken research to guide its efforts. It is also actively involved, with the World Bank, in monitoring the implementation of the *Core Principles for Effective Banking Supervision*. Furthermore, the IMF has increased its cooperation with the World Bank in this area, including through the joint FSAP and cooperative assessments of other standards and codes (see Section 12).

(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;

[7] <http://www.imf.org/external/np/mae/pdebt/2000/eng/index.htm>.

The IMF is part of an effort in the official community to broaden the use of contractual provisions in international sovereign debt contracts that can facilitate the efficient and cooperative resolution of sovereign debt problems. Collective action clauses can help to facilitate the inter-creditor coordination needed to help ensure that a small minority of creditors cannot block or disrupt consensual negotiations between the majority of creditors and the sovereign debtor. They can also discourage small minorities of creditors from disrupting orderly negotiations, in a way that can undermine debtors' long-term prospects and also erode the value of claims owed to other creditors.

The expanded use of such contractual provisions was proposed by the 1996 G-10 Report on the Resolution of Sovereign Liquidity Crises and was endorsed by the G-22. The IMF has worked to build understanding about the legal issues associated with these contractual provisions and awareness of various contractual provisions that have already been market tested. In their April Operational Guidelines, the G-7 Finance Ministers reiterated their support for "appropriate measures, including collective action clauses." The United Kingdom and Canada have made use of these provisions in their foreign-currency sovereign bonds. Germany has clarified the application of law in this area, indicating that there are no legal barriers to their use. There are also no legal barriers in U.S. law to the use of collective action clauses in sovereign bonds.

(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);

As reported last year, the IMF has extended, on a case-by-case basis, the scope of the IMF's policy on lending into arrears. This enables the IMF to provide financial support for policy adjustment, despite the presence of actual or impending arrears on a country's obligations to private creditors, including arrears on bonded debt. According to the agreed criteria, such support should be provided where: (1) prompt IMF support is considered essential for the successful implementation of the member's adjustment program; (2) the member is pursuing appropriate policies and is making a good faith effort to reach a collaborative agreement with creditors. This policy has been put into practice in Ecuador, where the IMF supported Ecuador's program of policy adjustment despite arrears on Ecuador's bonded debt. In extending its SBA for Ecuador in the spring of 2000, the IMF noted the need for Ecuador to work with its private creditors to obtain the cash flow relief needed to solve Ecuador's immediate financial difficulties and to put in place a payments profile consistent with a sustainable external and fiscal position over the medium term.

(E) Intensified consideration of mechanisms to facilitate orderly workout mechanisms for countries experiencing debt or liquidity crises;

Under the July 1999 framework established by the G-7, more orderly workouts will be facilitated by: more dialogue between the debtor and its creditors before a crisis strikes; the broader use of collective actions clauses; and application, as appropriate, of the IMF's policy on lending into arrears. The approaches adopted in actual crises will necessarily depend on the circumstances of the particular case, including the country's capacity to pay, its ability to regain full access to the markets, and the nature of the country's outstanding debt instruments. Each case should be addressed in a manner consistent with the principles that debtors and creditors should work cooperatively to find a solution to the country's debt problems, and that no one category of private external creditors should be regarded as inherently privileged. The IMF is working with countries to encourage them to engage in cooperative and transparent negotiations with creditors when they are facing financial difficulties. Increasingly, private creditors, including bondholders, have demonstrated a willingness to participate in the restructuring or reduction of debt. In all three of the previously mentioned cases – Ukraine, Pakistan, and Ecuador – there were successful bond exchanges.

In the new operational guidelines established in April 2000, the G-7 agreed that, in those cases where debt restructuring or debt reduction may be necessary, IMF programs should:

- Put strong emphasis on medium-term financial sustainability;
- Strike an appropriate balance between the financial contributions of private external creditors and official external creditors, in light of the financing provided by the international financial institutions;
- Aim for fairness of treatment of different classes of private creditors and for involvement of all classes of material creditors;
- Place responsibility for negotiations with creditors squarely with debtor countries;
- Provide greater clarity to countries at the start of the process about the possible consequences for their programs, including in terms of official financing, of any failure to secure needed contributions to program financing from private creditors on terms consistent with a sustainable medium-term payments profile; and
- Set out publicly what policy approaches have been adopted when all relevant decisions have been taken.

The application of this approach should contribute to more orderly workouts.

(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;

As reported last year, while there are not always formal linkages between the provision of official financing and private sector involvement, private lenders will necessarily be involved in crisis resolution. In some cases, the combination of catalytic official financing and policy adjustment should allow the country to regain market access quickly and market financing will contribute to the country's stabilization. In some cases, emphasis will need to be placed on encouraging voluntary approaches to overcome creditor coordination problems. In other cases, a broader spectrum of actions by private creditors, including comprehensive debt restructuring, may be warranted to provide for an adequately financed program and a viable medium-term payments profile. In certain exceptional cases, it may be appropriate to link the provision of official finance to the willingness of creditors to refinance, reschedule, or restructure some of the debt falling due. This was the case in Korea in January 1998, when the provision of official finance was linked to the completion of an agreement with Korea's bank creditors to restructure inter-bank claims that had been guaranteed by the government of Korea into instruments with longer maturities.

(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

As reported last year, the United States believes that appropriate communication between debtors and creditors is crucial to orderly crisis prevention and resolution. The United States has built broad support at the IMF for this view. Consequently, the IMF has strongly emphasized the importance of working with creditors cooperatively and transparently to find an appropriate solution to a country's financing difficulties. Ideally, countries would develop mechanisms for more systematic dialogue with their main creditors before a crisis strikes. Several countries, including Mexico, Argentina, and South Africa, have already established closer and regular contact with creditors. Other countries that have not previously maintained such ties with creditors are beginning to take appropriate steps to strengthen their communication with private creditors.

(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.

As stated previously, the new framework for private sector involvement promotes appropriate contributions from private sector lenders, and aims at a system in which countries can address debt problems in a market-based, orderly way. It recognizes the need to balance competing considerations on a case-by-case basis, in a way that preserves 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. This approach has been put in place in a number of recent crises, as described earlier.

(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.

Building on the emphasis given to governance issues in the IMF's 1996 Declaration on "Partnership for Sustainable Global Growth," the IMF has demonstrated a strong commitment to good governance. Guidelines published in August 1997, inter alia, instruct IMF staff to accord a high priority to promoting good governance and outline procedures to be followed in this regard. Consistent with this guidance, attention to good governance is reflected throughout a range of IMF work, including promotion of market-based reforms, increased transparency, specific governance-related program conditionality, and safeguarding of IMF funds.

Governance issues have received heightened attention in the last year as the United States and the G-7 have undertaken a major initiative to strengthen efforts to fight abuses of the financial system and as the IMF has moved to strengthen safeguards on the use of its resources. These issues are treated separately below, and are followed by a sub-section entitled "Ongoing Governance-related Activity."

Protecting against Abuse of the Financial System

Leaders of the Group of Seven at their July 2000 Summit in Okinawa expressed a strong shared commitment to intensify the international fight against financial abuse, including money laundering and corruption, in order to protect the integrity and credibility of the global economy and the international financial system. G-7 leaders proposed a strong role for the international financial institutions in helping countries implement relevant international standards in the context of financial sector assessments, as well as in program design and assistance.

G-7 Finance Ministers called on the international financial institutions to help countries adopt international standards, including the recommendations of the Financial Action Task Force (FATF), and to encourage and support countries in their fight against money laundering in the context of financial sector program design and assistance where money laundering is identified as a particular vulnerability or risk. They further proposed that the Fund-Bank Financial Sector Assessment Program (FSAP) and the IMF's surveillance process include evaluation of anti-money laundering measures, where appropriate. In addition, they welcomed the report of the Financial Stability Forum's Working Group on Off-Shore Financial Centers (OFCs) and called on the IMF to play its part in implementing the recommendations regarding assessment of OFCs' adherence to international standards.

Discussions have begun in the IMF (as well as the World Bank) on how to implement the Okinawa Summit initiative on financial abuse, including consideration of appropriate opportunities and modalities to incorporate in Fund programs and surveillance relevant elements from the international efforts relating to uncooperative or problematic jurisdictions.

The Fund's role in protecting against abuse of the financial system, including the fight against money laundering, was considered at the IMFC meeting in Prague in September. In its Communiqué, the Committee asked the Fund to explore incorporating work on financial abuse, particularly with respect to international efforts to fight against money laundering, into its various activities, as relevant and appropriate. It called on the Fund to prepare a joint paper with the World Bank on their respective roles in combating money laundering and financial crime, and in protecting the international financial system, for discussion by their Boards before April 2001. The IMF and the World Bank are to report to the Spring IMFC/Development Committee meetings on the status of their efforts.

The United States has already taken up financial abuse issues in the context of IMF surveillance and country programs. For example:

- Nigeria's new SBA, approved in August 2000, includes commitments by the Nigerian authorities to strengthen the enforcement of Nigeria's anti-money laundering law, to approach FATF to ensure that this law is in conformity with international standards, and to adopt FATF's Forty Recommendations on anti-money laundering efforts. In the August Board discussion, the USED highlighted Nigeria's expressed intention to adopt FATF recommendations, and strongly emphasized the importance of putting in place an appropriate legal framework at a time when the Nigerian authorities are pressing other countries to assist in recovering assets of the previous regime.

- In the September 2000 Article IV and EFF review for Indonesia, the USED stressed the importance of strong anti-money laundering regimes, pointing out that Indonesia does not now appear to have adequate anti-money laundering measures in place to meet the standards recommended by the FATF. The statement urged the Indonesian authorities to pass strong anti-money laundering legislation, which is also a condition for the next tranche of Indonesia's financial sector loan from the Asian Development Bank.

- In July 2000, the USED abstained in the Board on the fifth review of the Philippines' SBA as a result of the Philippines' need for expeditious adoption of anti-money laundering legislation, as well as other concerns. The Philippine authorities subsequently committed to move quickly on anti-money laundering legislation.

- In the June 2000 Board discussion of Panama's SBA, the USED drew attention to Panama's failure to meet international standards under three international efforts focused on financial abuses -- the Financial Stability Forum on problematic OFCs, FATF's money laundering (NCCT) list, and the OECD's Initiative on Tax Havens and Harmful Tax Practices. The USED supported the program, but stated that future support would be contingent upon an understanding that the program's first review would address regulatory weakness, including in the areas of money laundering and international cooperation. Subsequently, Panama's legislature passed legislation to bring its anti-money laundering regime into line with international standards.

- In the January 2000 Article IV statement on Dominica, the USED noted that the IMF staff paper was inadequate in addressing the areas of regulating the offshore financial sector and preventing money laundering. The USED pointed out that, given the poor record of Dominica in these areas, such an oversight seemed at odds with standards of good governance promoted by the IMF. The USED further urged the authorities to take more decisive steps to tackle these issues in keeping with international standards. Other Executive Directors agreed with the United States and urged strengthening the supervision of nonbank and offshore financial institutions and measures to prevent money laundering.

Safeguards

Following a review begun last year, the IMF has undertaken a serious and far-reaching initiative to strengthen further the system for safeguarding the use of Fund resources and for deterring the misreporting of data to the IMF. This process began with a review of the current system last November to consider potential enhancements, including consultation with a panel of eminent external experts from the public and private sector. In April 2000, the IMF adopted a new framework for safeguarding its resources that took effect on July 1, 2000. The framework:

- requires all countries making use of IMF resources to undertake and publish central bank financial statements audited by an independent external auditor;

- establishes a process of assessments to provide assurances that member countries' central banks have adequate control, accounting, reporting and auditing systems in place to protect the central bank's resources, including IMF disbursements; and

- requires that any critical vulnerabilities identified be remedied before additional Fund resources are disbursed.

Experience with the new safeguards assessment policies will be reviewed by the group of external experts in 12-18 months.

In a series of steps taken in April and July, the IMF also moved to strengthen procedures for handling instances of misreporting by countries in the context of IMF programs. Among other things, these changes provide for extension of the statute of limitations for all cases of alleged misreporting from two to four years, a report to the Executive Board on all cases of actual misreporting, corrective actions as appropriate for violations of commitments to the IMF, and publication of cases of misreporting after the Board has reviewed each case and issued its conclusions.

The new safeguards framework and misreporting procedures are already reflected in IMF work with member countries, and Treasury and the USED have been forceful advocates of their rigorous implementation. For instance:

- In meetings with IMF staff on Russia in June and August 2000, Treasury and the USED raised concerns about progress on financial safeguards to guard against the misuse of Fund resources, including divestiture of Central Bank of Russia (CBR) off-shore subsidiaries, publication of CBR quarterly audits and publication of a PricewaterhouseCoopers report on off-shore CBR subsidiaries. IMF staff noted that Russia has made limited progress on these issues so far. The IMF continues to raise these issues with the Russian authorities, and progress in these areas will be an important factor in the USED evaluation of any new program for Russia.

- Following up on a case of misreporting by Ukraine, the IMF has implemented a series of steps, with the strong support of the United States. These include a requirement that Ukraine undergo transactions-based audits and publication of information about the incident. Ukraine also voluntarily repaid $100 million to the IMF that Ukraine had received based on misreporting. Going forward, the Fund required that Ukraine take a number of corrective measures, including strengthening reserve management practices and instituting quarterly audits of central bank reserves by a reputable international accounting firm. Ukraine has agreed to these actions and has committed to deposit possible future IMF disbursements into an SDR account at the IMF.

- The government of Pakistan disclosed in Spring 2000 that the previous administration underreported its fiscal deficit by 1.4% of GDP last year and 2% the year before. As a result of this incorrect data, Pakistan was able to make two purchases from the Fund totaling $76 million that were, according to the Fund's interpretation, non-compliant. As a remedial action, the new Pakistani authorities made one early and one "voluntary"[8] repurchase, totaling $54 million. The authorities also agreed to a series of corrective measures intended to avoid a repeat of this situation. At the Board meeting in April 2000, the USED made a strong statement that these measures must be comprehensive, address all factors that contributed to the problem, and put Pakistan on track to having a robust system that will prevent such problems in the future. Subsequently, the IMF sent technical assistance teams to Pakistan to improve data and statistical systems.

In addition, the IMF is examining potential weaknesses in internal procedures that contributed to recent incidents of misreporting. The IMF Office of Internal Audit and Inspection (OIA) has now completed an internal review of the circumstances surrounding misreporting by Ukraine to the IMF from 1996 to 1998. It found that staff did not bring to the attention of management sufficiently early the evidence of misreporting by Ukraine, and did not follow up on the implication of misreporting. The review also showed that the Fund did not follow its own internal procedures, in part as a result of the perceived urgency of reaching an agreement with Ukraine as rapidly as possible, so as to minimize the spread of the Russian financial crisis to Ukraine and other countries. The Executive Board concluded on this basis that management, the Board, and the staff share responsibility for not following up adequately on early indications of misreporting. Going forward, management will prepare a formal note to all staff to ensure a systematic focus on data issues and weaknesses, and to call on staff to promptly alert management of data weaknesses and inconsistencies.

Corruption and Governance

As noted in the 1999 report, the IMF’s emphasis on transparency and free markets reduces the scope for corruption and enhances good governance. The IMF’s fiscal policy advice, embodied in surveillance and country programs, promotes transparency and strengthened fiscal management systems. Measures to liberalize trade and exchange regimes and to eliminate price controls, which are among the key components of IMF reform programs, can also reduce the scope for corruption. The establishment of central bank independence helps to end directed credits, preferential lending, and inflationary quasi-fiscal financing. Private sector development helps to build respect for contracts and transparent rules of the game.

Consistent with the IMF’s increased greater emphasis on promoting good governance, measures to strengthen governance and eliminate corruption are now regularly included in IMF programs and surveillance activity. The USED has actively supported this agenda. Recent examples include the following**.**

- The USED has consistently emphasized the importance of governance issues in Uganda, which has taken several steps in this area, consistent with its PRGF program with the IMF.

[8] One repurchase is "voluntary" because one of the offending purchases was a violation of Article VIII regulations but not a missed performance criterion, and is therefore not subject to a mandatory repurchase.

This includes increases in the budget for anti-corruption, enabling the Office of the Inspector General of Government to increase its professional staff from 40 to 100 and to establish regional offices to investigate allegations of corruption at the district level. Going forward under its Fund program, Uganda is reforming its procurement policy, working to enact legislation requiring public officials to disclose their assets and making further improvements in key area.

- Kenya's previous IMF program was suspended in August 1997, primarily over governance/ transparency issues. Prior to the establishment of a new program in July 2000, the USED was involved in numerous meetings and informal discussions with IMF staff and other Executive Directors' offices to push for strong anti-corruption measures in the program conditionality. The Treasury and the USED were in close consultation during this period to formulate the U.S. policy position, and effectively advocated strengthened governance measures in the LOI. In the July 2000 Board discussion, the USED supported the program based on several significant steps taken toward implementing anti-corruption measures, but clearly stated that future support would depend on further implementation of key governance measures.

- In Albania's January 2000 PRGF review, the USED stressed the importance of civil service reform, improved budgetary management and customs reforms as areas crucial to a functioning market economy and to Albania's medium term growth prospects. In its May 2000 LOI, the Albanian government committed to a number of steps (all prior actions required for IMF financing) in order to strengthen governance and reduce opportunities for corruption, especially in the customs area.

- In the March 2000 PRGF and Heavily Indebted Poor Countries (HIPC) discussion for Tanzania, the USED praised the authorities for having developed a National Anti-Corruption Strategy and established the Prevention of Corruption Bureau under the President's office with authority to investigate allegations of corruption. The U.S. statement also urged the authorities to follow through on policy implementation and enforcement, including allocating adequate resources for investigating and prosecuting those alleged of corruption-related malfeasance. Tanzania's LOI of July 28, 2000 notes that all government ministries have been charged with preparing sector-specific action plans for combating corruption in their respective jurisdictions. The LOI also notes that the recently established commercial court is resolving commercial disputes expeditiously and helping to restore respect for the judiciary.

- As noted in Ghana's Interim PRSP, Ghana is among the eleven African countries (including seven HIPCs) that participated in developing, with the World Bank and other development partners, a new integrated strategy for fighting corruption. During Ghana's PRGF review in August 2000, the USED welcomed authorities' efforts to improve transparency and governance, and collaboration with the World Bank on devising a comprehensive strategy. However, the USED pressed for an explanation for why budgetary resources to fight corruption have been allocated but not yet released, and why the government has not appointed a representative to the anti-corruption coalition. The U.S. statement also signaled U.S. interest in seeing, at the next program review, the extent to which Ghana has adhered to new reporting rules related to safeguarding the use of IMF resources.

- During the February 2000 Article IV, PRGF, and HIPC discussion for Bolivia, the USED noted that Bolivia ranked 80 out of 99 countries on the Transparency International Corruption index, and that widespread corruption has hindered its ability to reduce poverty and has serious consequences for FDI. The U.S. statement welcomed efforts to combat corruption, through recent reform of customs administration, public administration and judicial system, but cautioned that these would need to be deepened to be truly effective. In its program, the government of Bolivia has several structural benchmarks that aim to improve customs and tax administration.

(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.

The IMF, in part at the urging of the USED, has increasingly placed emphasis on how to reduce unproductive spending in program countries. To promote more economically and socially sound government spending, the IMF advocates strengthening social safety nets (see Section 2E), collaborates with the World Bank to produce public expenditure reviews, advocates adherence to the *Code of Good Practices on Fiscal Transparency* (see Section 12), and tracks military spending trends on an annual basis.

- As noted previously, the IMF's focus on strengthening social safety nets is intended to mitigate some of the pain resulting from difficult, but necessary, adjustments, and to distribute the benefits of economic growth more equitably.

- Particularly in designing its concessional lending operations, the IMF encourages countries to conduct "public expenditure reviews" with the World Bank. These reviews focus on the efficiency and efficacy of resource allocation, including, among other things, examination of public sector enterprises and the composition of government spending.

- In 1998, the IMF adopted a *Code of Good Practices on Fiscal Transparency*. To assist countries in adhering to the *Code*, the IMF developed a questionnaire and self-evaluation report, with which member countries are encouraged to assess their fiscal practices. The *Code* aims to enhance the transparency of fiscal policy, promote quality audit and accounting standards, and reduce or eliminate off-budget transactions and accounts, which are often the source of unproductive government spending.

- The IMF reviews trends in military spending, and publishes its findings on an annual basis in its publication, *IMF Survey*, which is available on the IMF website. The most recent review finds that global military spending declined from 2.3 percent of GDP in 1995 to 2.1 percent of GDP in 1999. In a sample of 64 countries with IMF programs, military spending declined from over 2 percent of GDP in 1995 to 1.7 percent of GDP in 1998-1999.

Audit of Military Expenditures

The Treasury has implemented legislation that required the USED at the IFIs, beginning October 1, 1999, to oppose disbursements (other than for basic human needs) to any country that does not have in place a functioning system for reporting audits of military expenditures to civilian authorities. The Treasury has led an interagency policy group to determine which countries' military audit systems do not meet the standards of the legislation, and has kept the USED informed of U.S. voting obligations. Further, the Treasury and the USED have worked together to promote more systematic consideration of this issue among IMF staff and management. Together, we have informed the relevant countries of our interagency-established legislative compliance criteria and we have urged them to make their military audit systems meet the standards of the legislation. For example:

- At U.S. urging, Indonesia's EFF contains commitments from the government of Indonesia to audit receipts and expenditures from private foundations and other extra-budgetary sources that fund military activities. These commitments, among other steps taken by the Indonesian authorities, aided in making Indonesia's military audit system meet the standards set forth in the legislation. The Treasury works closely with the U.S. embassy in Jakarta to monitor Indonesia's continued compliance with the legislative standards.

- Following consultations with the USG and the IMF, the government of Nigeria reactivated the role of its Auditor General, subjected defense spending to the same accountability standards as other ministries, and committed to consolidate all extra-budgetary military expenditures into the budget.

- In the July 2000 PRGF review for Rwanda, the USED abstained in accordance with its obligations under the legislation, expressed concern about the level of military spending, and urged initiation of an annual military audit. The audit is now underway.

- In the December 1999 request by Guinea-Bissau for Emergency Post-Conflict Assistance from the IMF, the USED abstained due to shortcomings in the country's military audit procedures. The USED had already raised the importance of such a measure during Guinea-Bissau's previous request for Post-Conflict Assistance in September of 1999. The USED, with the help of various branches of the USG, continues to raise this issue with IMF staff and the authorities of the Guinea-Bissau government.

- During Burkina Faso's September 1999 request for Enhanced Structural Adjustment Facility (ESAF) lending, the USED encouraged the Burkinabe authorities to carry out annual audits of military expenditures. In conjunction with several discussions between the USED office and the IMF mission chief in May, June, and July, and with the help of the IMF staff who echoed U.S. concerns to the Burkinabe authorities, Burkina Faso reactivated the military audit procedure ahead of its HIPC completion point in July 2000, clearing the way for the United States to support Staff's decision.

- The IMF's Article IV Review of China in July 2000, the IMF drew attention to fiscal management. The USED emphasized in particular the results of a recent World Bank Public

Expenditure Review, which concluded that public sector management, particularly the institutional framework for setting and accounting for public expenditures, is critical for budgetary outcomes. The USED also called on the Chinese to bring extra-budgetary funds – including those of the military – into the budget. The Board discussion reflected positive recognition of a more comprehensive treatment of expenditure in the 2000 budget. Nonetheless, the Board emphasized to the Chinese authorities the importance of further widening the coverage of the budget and further improving fiscal transparency, including by improving accounting, reporting, and treasury management for budgetary and extra-budgetary funds alike.

The USED is also seeking more systematic Fund surveillance of military spending in the context of routine Article IV consultations and the General Data Dissemination System (GDDS).[9] The United States advocated language in the G-8 Köln Summit Communiqué which states that it is necessary to "monitor systematically military expenditures in the larger context of public expenditure patterns and in the macroeconomic context for growth and development."

Enhanced Poverty Reduction Framework

At the July 1999 G-7 Summit in Köln, the United States and the other G-7 nations called for the development by the IMF and World Bank of an enhanced framework for poverty reduction and growth. Subsequently, the United States worked in collaboration with the IMF, the World Bank, the G-7, NGOs, religious organizations, outside observers, and other experts to develop a strategy for a more integrated approach to IFI operations. In designing this new approach, a strong effort was made to incorporate suggestions put forward in past evaluations of the ESAF, many of which echoed concerns that had been expressed by members of Congress.

This new approach was created both to guide all future concessional lending operations, and to provide the policy context for the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Under this new framework, the IMF is to play a more tightly focused role in support of macroeconomic reform, with the World Bank taking the lead and working with countries to develop poverty reduction strategies and implement structural reforms.

The integrated poverty reduction strategy, set out in a Poverty Reduction Strategy Paper (PRSP), is at the heart of the new framework. The PRSP process seeks to establish the policy foundation for poor countries, and their development partners, to establish the growth and poverty reduction efforts needed to deliver sustainable results. After soliciting views and concerns from different segments of the population, the recipient country will prepare the PRSP in cooperation with the World Bank and the IMF, and in consultation with civil society groups. The PRSP will focus on identifying the steps needed to achieve a set of clear, monitorable poverty reduction and growth objectives in areas such as primary education, health, and good governance. The precise mix of goals and policies will vary from country to country, consistent with priorities identified as most critical for poverty reduction.

[9] The IMF works through the GDDS to assist member countries in improving the quality and integrity of data (financial, economic, socio-demographic) and to encourage the public release of this data.

Reflecting the new context for IMF concessional lending operations for low-income members, the IMF replaced the ESAF with the new Poverty Reduction and Growth Facility (PRGF). One of the core objectives of the PRGF is to ensure that fiscal and other adjustments needed to restore macroeconomic stability are designed and implemented in ways that support growth and poverty reduction efforts as laid out in the PRSP. This approach reflects a consensus that economic growth and poverty reduction must be mutually reinforcing.

The IMF and World Bank Executive Boards endorsed these reforms late last year and early implementation is well underway. During a recent review of the new framework, the United States advocated clarification of the core content of PRSPs (including the importance of more strategic review of growth strategies), transparency in the use of fiscal resources (including those deriving from HIPC debt relief), and full review of the outcomes of participatory processes.

The following are a few examples of the new approach in the context of IMF concessional lending[10].

- Under Kenya's PRGF program, and with strong urging from the IMF and the USED, the authorities have committed to a number of steps to accelerate growth and reduce poverty, notably: consolidation of macroeconomic stability (a necessary condition for achieving growth); establishment of measures to ensure that more public resources are directed to priority areas such as health, education, and infrastructure; acceleration of structural reforms to improve the environment for private investment; privatization of public enterprises; and reduction of the size of the civil service in line with identified core government functions. Given that Kenya's program was suspended several years ago due to governance problems, a significant number of governance-related commitments regarding, for example, transparency in procurement and removing rent-seeking opportunities, are identified in the government's LOI along with a timetable for implementation. These measures are reflected in Kenya's interim PRSP; many have been submitted to parliament in the form of legislation and are being considered.

- In Albania's January 2000 midterm PRGF review, the USED stated that revenues would be required to finance additional social spending, which would be needed as authorities developed their poverty reduction strategy. In its LOI of May 2000, the Albanian government committed itself to increase expenditures on health and education by nine and eight percent in real terms, respectively. The government also committed itself to widening participation in the social security system, with the goal of introducing social security numbers for all individuals by early 2001. Furthermore, the government also stated its intention to submit to parliament by October 2001 amendments to the social security law, which will include measures to strengthen the authority of inspectors in collecting contributions. This last measure is a structural benchmark in Albania's program.

- In the 1999 Benin Article IV discussion and review of performance under its ESAF loan, the USED highlighted how much more work remains to be done to improve demographic and

[10] A discussion of social safety nets, with country examples for IMF non-concessional lending operations, is provided in section 2E of this report.

social indicators, which remain weak, even relative to the Sub-Saharan African average. In the July 2000 PRGF and HIPC review, the USED welcomed authorities' efforts to improve budgetary management though implementing recommendations from the World Bank Public Expenditure Review, but stated that Benin needed to make further improvements on improving amounts and type of social spending.

- Cameroon's PRGF program includes several measures to improve governance, including a commitment to prepare a comprehensive strategy aimed at improving governance and reducing corruption based on the National Governance Program, which was developed with assistance from the United Nations Development Program (UNDP). In Cameroon's June 2000 PRGF review, the USED urged consolidation of PRGF structural conditions and a narrowed focus on structural measures related to public expenditures management, transparency and accountability, governance and corruption, and decisive efforts to accelerate privatization.

Early this year, the IMF and the World Bank began to review programs to grant debt relief under the Enhanced HIPC Initiative. Thus far, ten HIPC cases have come to the Executive Board for discussion of their decision points. At the decision point, the Executive Boards of the IMF and World Bank assess a country's eligibility for enhanced HIPC debt relief, including the government's efforts in preparing a PRSP. Once this is satisfactorily completed, the international donors begin to provide debt service relief. At the completion point, if a HIPC country has demonstrated credible performance under its poverty reduction strategy, the international donors provide debt stock reduction. Examples of efforts to target resources toward poverty reduction include the following:

$ Honduras is planning to create a Poverty Reduction Support Fund (PRSF) that will be funded by HIPC debt relief and privatization receipts. The PRSF will be part of the central government budget and will be guided by the PRSP. The projects to be funded by savings from HIPC include extending compulsory education from six to nine years and hiring 1000 additional teachers. At the June 2000 discussion of the Honduran HIPC decision point, the USED also supported the inclusion of specific conditionality associated with governance among the requirements to reach the completion point.

$ In its Interim PRSP, Bolivia commits to take action to increase access to primary and secondary education, improve the quality of higher education, increase availability of health care, and improve housing and public sanitation. The USED requested, at the February 2000 discussion of Bolivia's HIPC decision point and interim PRSP, that clear costing estimates for the poverty strategy be included in the final PRSP. The USED noted that some progress has already been made in the area of poverty reduction, particularly in education.

- In its Decision point review in July 2000, Burkina Faso's PRSP had a sobering account of the state of poverty, a frank sense of development priorities and a forward thinking growth strategy that targeted manufacturing. However, although Burkina Faso has a tradition of participation, the USG used its Board statement to encourage broader participation in the evolution of this PRSP as well as the implementation of its strategic goals. The USED also emphasized the need to improve social spending on AIDS/HIV through the PRSP process.

- Senegal's Interim PRSP, reviewed by the IMF Board in June 2000 along with the decision to move ahead with debt relief for Senegal under HIPC, outlines steps necessary to develop an anti-poverty agenda. In the Board discussion, the USED urged Senegal, inter alia, to identify poverty reduction priorities with monitorable outcome indicators and to ensure broad-based participation of civil society. There was consensus in the Board on the need for stronger statistics on poverty and for better mechanisms to monitor poverty reduction outcomes, as well as a better link between the poverty alleviation strategy and the macroeconomic framework. The USED will monitor progress in these areas in subsequent reviews and prior to the completion of debt relief under the HIPC initiative.

- Mozambique's Interim PRSP includes a comprehensive set of measures to address poverty, including channeling the savings from debt relief to socially productive investments, such as improving education for girls and developing a national strategy to fight the spread of HIV/AIDS. When enhanced HIPC debt relief for Mozambique was discussed in April 2000, the USED statement stressed the importance of following through in channeling funds for these purposes.

- The IMF's PRGF program for Chad, approved in January 2000, places priority on a re-examination of the composition of public spending in light of the priorities established in Chad's poverty reduction strategy – with the goal of more precisely targeting resources to social expenditures that will be effective in reducing poverty. In a review of this program and a preliminary discussion of Chad's candidacy for debt relief under the HIPC initiative in July, the USED called for enhancements of the Chad's poverty reduction strategy, including to detail plans for improving budgetary management and monitoring budgetary commitments and to outline specifically how resources freed up by interim debt relief would be used. Following the July discussion, the statement by Stanley Fischer, the Acting Chairman in the Board, emphasized the need to improve targeting and efficiency and to launch the planned public expenditure review as soon as possible. Progress in these areas will be central to further decisions in the IMF to disburse resources to Chad and to proceed with a decision to undertake HIPC debt relief.

(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.

The policy conditionality that accompanies IMF financing necessarily differs according to the individual circumstances of the recipient country. In its efforts to address the causes of external vulnerability in those countries affected by the recent financial crises, the IMF has focused considerable attention on strengthening financial systems, improving debt and reserves management, and encouraging appropriate exchange rate regimes. In other countries in transition from authoritarian regimes or struggling with widespread poverty, the IMF seeks to focus on economic reforms necessary to remove impediments to growth. Overall, the IMF's approach seeks to identify problems of each individual country.

In addition, the IMF is encouraging – and, in the context of its concessional lending and debt relief programs, requiring – government consultation with all sections of society in developing IMF programs. This approach intends to encourage country ownership of IMF programs, which is essential to successfully implementing important reforms. To assist in this process, where PRGF programs contain major reforms, an analysis of the impact on the poor – usually carried out by the World Bank – will be conducted and countervailing measures will, as necessary, be incorporated into the PRGF program. Stronger involvement of all segments of society should help to develop IMF programs that suit the individual circumstances of each country and to distribute the pain of adjustment in an equitable manner.

(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.*

In the winter of 1999, in compliance with the 1995 Foreign Operations, Export Financing, and Related Programs Appropriations Act, the Treasury produced the *1999 Annual Report to Congress on Labor Issues and the International Financial Institutions*. This is an extensive report on the Administration's approach to advancing Core Labor Standards (CLS) internationally, recent Treasury and USED efforts in this area, and actions planned by the IFIs to integrate CLS into their operations and analytical work. The 2000 Annual Report will be completed and published this autumn.

The USED takes an active role in promoting, in the context of economic reform, consistency with the five internationally recognized CLS: (1) freedom of association; (2) right of organization and collective bargaining; (3) prohibition against exploitative child labor; (4) prohibition against forced or compulsory labor; and (5) protection against discrimination in employment.

As noted last year, there is some reluctance by many member countries to address this issue; however, some progress has been made. During this past year, the USED raised labor issues repeatedly, and, in some cases, labor issues were addressed in IMF programs. For example:

- During the March 2000 SBA review for Mexico, the USED asked that IMF staff follow up on earlier efforts to engage the authorities on the need to establish a legal and institutional framework that promotes the expeditious and equitable resolution of industrial disputes in a manner consistent with internationally recognized workers' rights of association and collective bargaining.

- In the February 2000 discussion of a new EFF program for Indonesia, the USED commended the Indonesian authorities for having ratified the seven core ILO conventions. However, the USED also noted concern about reports that workers are being arrested and employers are undertaking reprisals against workers for engaging in union activities. Indonesia was urged to adhere to its timetable to enact changes to its labor laws to make them fully consistent with the seven ILO core conventions and to cease arrests and reprisals.

- In the January 2000 Board discussion of Bangladesh's Article IV Consultation, the USED stated its desire to see an improvement in the rights of workers in Bangladesh's export processing zones. Specifically, concern was expressed over violations of those workers' rights to freedom of association and collective bargaining. The USED noted that these concerns may lead the United States to suspend Bangladesh's export privileges to the U.S. market this year under the Generalized System of Preferences.

- In its December 1999 LOI with the IMF, the government of Bolivia reported that last autumn the Congress approved a law intended to protect the rights of children and prevent the exploitation of child labor. During Bolivia's Article IV and PRGF program review in February 2000, the USED urged that efforts to enhance labor market flexibility should include measures to support workplace representation and a measure of security for workers, and urged that workers' representational and organizational rights be consistent with ILO standards. A new draft law is expected to be introduced in October 2000, which will aim to modernize the labor market and bring Bolivian labor regulations in line with the norms of the ILO, particularly with respect to labor safety and equality of treatment between men and women.

- The Bulgarian government has been working with the ILO on a new labor code. Thus far, there have been changes in the code to ensure consistency with EU standards in regard to non-discrimination and protection of women's jobs during pregnancy. The United States has welcomed these steps and, more generally, urged that efforts to enhance labor market flexibility in Bulgaria be conducted in a manner consistent with CLS. Most recently, at the fourth program review in September 2000, the USED urged the authorities to take the necessary steps to ensure the rights of workers to organize and bargain collectively in newly privatized enterprises and newly established private companies, while also considering the establishment of alternative means to resolve individual and collective labor disputes in those sectors where strikes are prohibited, such as energy, health, and telecommunications.

The above actions are, in many cases, only first steps in advancing CLS as part of the IMF's ongoing dialogue with member governments, and the United States will continue to be engaged on this issue.

As noted in last year's report, the United States is also seeking, through the USED, to engage other international organizations on this issue. We have vigorously promoted improved cooperation between the IMF and the ILO, and the ILO now participates as a permanent observer in the biannual meetings of the IMFC. At U.S. urging, the G-8 Communiqué issued for the Okinawa Economic Summit recognized increased ILO-IFI cooperation and called for the IFIs to incorporate adequate social protection and CLS in their policy dialogue with member countries. During the Annual Meetings in September 2000, Secretary Summers reinforced this message in his statement to the IMFC, and G-7 Finance Ministers and Central Bank Governors also called on "the IMF to enhance its cooperation with other international institutions, including … the ILO."

Partially in response to U.S. urging, the IMF's top leadership met with an international delegation of trade union leaders in January 1999 to discuss labor issues in the context of IMF programs and policies. The delegation included representatives from Europe, North and South America, Africa, and Asia. A similar meeting is planned for late October 2000.

As noted in last year's report, to assist the USED on labor issues, Treasury works closely with the U.S. Labor Department and the State Department as well as other institutions, such as the ILO. For instance, the Labor Department systematically receives IMF documents on surveillance and lending programs, and provides input to Treasury and the USED.

Partly as a result of U.S. efforts, labor standards are increasingly a part of IMF discussions, and the Treasury and the USED will continue their efforts in this area.

(10) Vigorously promote International Monetary Fund programs and assistance that are structured to the maximum extent feasible to discourage practices which may promote ethnic or social strife in a recipient country.

In helping to create the conditions for a sound economy, the IMF facilitates the reduction of ethnic and social strife, which are often driven in part by economic deprivation. The IMF also takes several specific steps in its lending operations that help to reduce ethnic and social strife in recipient countries. First, with strong urging from the USED, the IMF increasingly encourages the strengthening of social safety nets. Combined with sound economic policies, adequately funded and targeted social programs help to create more equitable growth, which is important in reducing social and ethnic strife. Second, as noted in other sections of the report, the IMF is encouraging – and in many cases, requiring – consultation with various segments of society in the development of programs. This approach seeks to ensure that all interests have an opportunity to participate in the establishment and implementation of national priorities. Third, where PRGF programs contain major reforms, an analysis of the impact on the poor – usually carried out by the World Bank – will be conducted and countervailing measures will, as necessary, be incorporated into the PRGF program. All of these measures should help to reduce social and ethnic strife in countries with IMF programs.

(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.

In assessing IFI programs, the Treasury recognizes that environmental and macroeconomic policies are inextricably linked, in that economic policies impact the environment and vice versa. While recognizing that the IMF relies on the expertise of the World

Bank for analysis of environmental issues in individual countries, the United States has used its voice in the Executive Board to encourage the inclusion of measures in IMF programs to tax polluting activities or to remove subsidies on environmentally-harmful products or activities. In addition, the USED presses the IMF staff to examine any potentially negative environmental consequences of its recommended policies.

In part as a result of U.S. urging, the IMF staff has recommended that countries adopt appropriate environmental policies in support of macroeconomic stability. Some examples follow.

- One of the structural performance criteria in Indonesia's EFF program required the government to bring the Reforestation Fund onto the budget and perform a comprehensive audit of the fund. Indonesia subsequently performed the audit and published it. The government of Indonesia has also committed to use resources from this fund only for reforestation. In addition, there is currently a moratorium on new forest conversion licenses, which will remain in place until transparent, rule-based procedures are developed to minimize further conversion of the remaining natural forest. There is still room for improvement in this area, however, and the IMF, World Bank, and other donors are fully engaged with the Indonesian authorities to bring about further reforms. The USED is a strong advocate of such measures.

- The United States has often stated its concern about Cambodia's forestry management practices, and there has been some progress. Cambodia's August 2000 LOI and MEFP reported, among other things, that the Forest Crime Monitoring Unit (FCMU) had begun to issue quarterly reports on its operations, and a review of forestry concessions was completed in May 2000. In the September 2000 Article IV and PRGF review, the U.S. statement noted Cambodia's progress in controlling illegal logging outside of concessions, including through the FCMU, and also acknowledged the strong actions taken to address the problem of overly numerous forestry concessions that have not been well regulated and monitored. The USED joined IMF staff in urging the authorities to continue taking decisive steps to develop an effective and comprehensive system for managing forestry resources, including further implementing the new system for concession management, updating legislation, and strengthening further the FCMU. The USED, in accordance with current legislation, abstained from the decision to provide further disbursements under Cambodia's arrangement.

- The IMF has agreed to work with the World Bank to reinforce the environmental conditions the World Bank has proposed with respect to the prospective Chad-Cameroon oil development project.

- In the August 2000 discussion approving a precautionary SBA for Nigeria, the USED stressed that, in light of the fiscal restraint envisaged in this program, it will be critical for these assessments to ensure that expenditure cuts not fall on environmentally critical outlays such as spending on pipeline safety. This work will be undertaken in cooperation with the World Bank in the context of a Public Expenditure Review.

- In the May 2000 Board discussion of Belize's Article IV consultation, the USED commended the authorities on their environmental efforts, and staff for incorporating environmental concerns into their analysis in recognition of the tight link between Belize's economic potential and the preservation of the country's tropical forests and coral reefs.

(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.

The United States has worked with its partners in the G-7 to build on the growing international consensus in favor of transparency and accountability, and there has been tremendous success in this area. Over the last several years, there have been significant increases in the release of information to the public, and important ongoing work in the development and implementation of international standards and codes.

IMF Transparency

There has been a sea change with respect to transparency in the IMF. Prior to the 1997 introduction of Public Information Notices (PINs) – with strong U.S. urging and despite resistance in some quarters – little information about the IMF was made public. Following that initial step, the IMF has begun to release routinely a wealth of documentation, including country analyses, program documents, policy papers, and documents on IMF operations. However, there is more to be done, and the United States will continue to push for greater openness.

Following on progress across a number of fronts in recent years, the IMF Executive Board agreed in August on several measures to provide further documentation to the public. The measures include:

- Decision to make permanent the voluntary publication of Article IV and combined Article IV/ Use of Fund Resources (UFR) staff reports.

- Decision to adopt a policy of voluntary publication of UFR staff reports.

- Continuation of the presumption that documents stating a government's policy intentions would be published. These include Letters of Intent (LOIs), Memoranda of Economic and Financial Policies (MEFPs), Technical Memoranda of Understanding (TMUs), Interim Poverty Reduction Strategy Papers (I-PRSPs), and Poverty Reduction Strategy Papers (PRSPs).

- Continuation of the presumption of publication for HIPC papers, and extension of this presumption to joint IMF-World Bank staff assessments of PRSPs.

- Decision to publish I-PRSPs and PRSPs before the Board discussion; IMF staff will not recommend Board endorsement of a PRSP that has not been released to the public in advance.

- Continuation of the policy of voluntary publication of Public Information Notices (PINs) following Article IV consultations and Board discussions of policy issues, concluding statements of IMF missions, and transparency assessments (see below).

During this discussion, the USED stated our preference for a presumption of publication for UFR staff reports. The USED also continued to advocate mandatory release of LOIs/MEFPs and TMUs and to press for consistency across countries in release of PINs following Board discussions of Article IV consultations.

The steps agreed by the Board in August should contribute to the ongoing enhancement of public knowledge and understanding of the IMF – as well as the institution's accountability – at the same time that earlier measures continue to show concrete results.

- In June 1999, the presumption of publication took effect for documents stating a country's policy intentions in a program. Between then and mid-July 2000, such program documents were released (or soon to be released) for 79 of 87 arrangements (91 percent) discussed by the Board.

- At the urging of the Treasury and USED, the IMF Executive Board reached an agreement on quarterly publication of the operational budget – renamed the Financial Transactions Plan – with a one quarter lag.[11] The first such "FTP", covering the period March-May 2000, was posted on the IMF website in August. This publication adds to the wealth of financial and operational material available on the recently created "IMF Finances" page on the IMF website. This page provides links to the IMF's quarterly financial statements and the Annual Report, as well as detailed information about the IMF's financial organization, financial resources and liquidity position, IMF interest rates, disbursements and repayments, and a range of other issues.

- As of mid-July, 46 countries, including the United States, had posted their Article IV staff reports on the IMF website, and 20 other countries had committed to doing so. (The United States posted its Article IV staff report in both 1999 and 2000.) When the pilot program to release these staff reports started, it was expected that 20 countries might publish the reports.

- Since 1998, PINs have been issued for roughly 80 percent of the Article IV consultations discussed in the Board.

- In 1999, the IMF began posting Country Pages on its website. The Country Pages assemble in one place the official public documents and financial information for each of the IMF's 182 member countries and other economies (such as Hong Kong).

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[11] This is consistent with the legislative mandate that was enacted in last year's authorization of IMF nonpublic gold sales.

The IMF has also posted on its website considerable information on policy issues.

- PINs have been used to inform the public of Board conclusions following discussions of policy issues and regional surveillance. In 1999 and 2000, PINs were released on the following issues: Publication of Staff Reports and Other Decision to Enhance Transparency, Private Sector Involvement, Changes to Fund Financial Facilities, HIPC Initiative Modifications, Euro-area Monetary and Exchange Rate Policies, IMF Transparency, Safeguards on the Use of IMF Resources, Economic Surveillance for the West African Economic and Monetary Union, Debt and Reserve-Related Indicators of External Vulnerability, Data Standards, Data Provision for IMF Surveillance, and Standards for the Special Data Dissemination Standard with respect to reserves reporting.

- The IMF has also posted "Summings Up" of Board discussion on various issues, including the establishment of the Contingent Credit Line, Review of Social Issues and Policies in IMF-Supported Programs, and Review of Fund Facilities. The staff papers are also available on the IMF's website for many of these issues.

In addition to these changes, the IMF is considering further steps to increase the transparency and accountability of its operations. With the support of the United States, the Executive Board established a working group to assess the process for selecting the managing director, and to determine how the process might better reflect the principles of transparency and accountability and take fully into account the views and interests of all countries, while ensuring consideration of the highest quality candidates. In addition, the Executive Board decided in April to create an independent Evaluation Office to assess the effectiveness of IMF operations (see Section 13). The Terms of Reference to make the office operational were approved by the Executive Board in September, and have been posted, with a report to the IMFC, on the IMF's website[12].

Standards and Codes

In addition to these significant measures to increase the transparency of its operations, the IMF has actively promoted greater transparency in member governments through its involvement in the development and implementation of various international standards and best practices to reinforce the ability of national governments to make informed choices and measure their own performance. As noted in last year's report, important components of this initiative include strengthening the standards for data dissemination, adoption of a code for fiscal transparency in 1998, and the adoption of a code for monetary and financial policy transparency in 1999.

- The Special Data Dissemination Standard (SDDS) was created to provide for more comprehensive and timely disclosure of countries' economic and financial data. Thirty-three economies now comply with the standard, and fourteen others are working to come into compliance. The IMF is now implementing a new reserves standard, which took effect in

[12] <http://www.imf.org/external/np/eval/2000/091200.htm>.

April 2000. In April, the Executive Board also approved steps to strengthen reporting of external debt data, which will take effect after a three-year transition period.

- The General Data Dissemination Standard (GDDS) was established in 1997 for countries that do not have regular market access. The IMF has been working with eleven participating countries to guide them in the provision to the public of comprehensive, timely, accessible, and reliable economic, financial, and socio-demographic data.

- The IMF's *Code of Good Practices on Fiscal Transparency* was adopted by the IMF's Interim Committee in April 1998. The IMF staff prepared and disseminated an implementation manual, a questionnaire, and a self-evaluation report to aid member countries in assessing the transparency of their fiscal policies and operations. (The U.S. Treasury's submission of the IMF's Transparency Questionnaire and Transparency Self-Evaluation Report was completed in the autumn of 1999 and is available on the Treasury website.)

- A *Code of Good Practices on Transparency in Monetary and Financial Policies* was adopted by the Interim Committee on September 26, 1999. The Code seeks to establish standards for monetary and financial authorities in the following areas: clarity of roles, responsibilities, and objectives; openness of the process for formulating and reporting policy; public availability of information; and accountability and assurances of integrity. Among other specific elements, the Code calls for regular independent audits of central banks' financial statements, which will help to ensure that IMF funds are accurately accounted for. The Executive Board approved, on July 24, 2000, a Supporting Document to the *Code* in order to provide further description of the *Code* and considerations for implementation.

- As noted previously (see Section 5), the IMF and World Bank have developed a set of draft guidelines for members' debt and reserve management, which are posted on the IMF's website.

In the wake of the Asian Financial Crisis, the international community, in addition to agreeing to develop international standards, recognized the importance of producing comprehensive reports that summarize the degree to which economies meet internationally recognized disclosure standards. The IMF, in close collaboration with the World Bank and other standard setting bodies, is leading this effort. Australia, Argentina, and the United Kingdom prepared an initial round of "transparency reports." The Executive Board discussed these on several occasions and agreed to widen the scope of the exercise to more thoroughly understand countries' observance of standards in core areas of IMF expertise and to invite the World Bank to experiment in preparing assessments in areas of its expertise. A second set of experimental *Reports on the Observance of Standards and Codes* (ROSCs)[13] -- including reports on Bulgaria, Cameroon, the Czech Republic, Hong Kong, Tunisia, Uganda and Ukraine -- was released by the IMF on September 21, 1999. Further reports have been posted on the IMF website by Albania, Algeria, Canada, Estonia, Greece, and Turkey.

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[13] ROSCs represent the evolution of the transparency reports recommended by the G-22.

The ROSCs assess, in varying scope, the extent to which countries observe key international standards. While initially focusing on areas of direct operational relevance to the IMF (e.g., SDDS, fiscal policy transparency and monetary and financial policy transparency codes, and the Basel *Core Principles for Effective Banking Supervision*[14]), the "modular" nature of the ROSC program accommodates assessments of a broader range of financial and economic policy codes and standards in areas outside of traditional Fund surveillance (such as accounting and securities regulation). These assessments are developing into a fundamental building block in the effort to strengthen national financial systems and a keystone to enhancing surveillance. Recent outreach exercises by the IMF and FSF have evidenced that publication of ROSC assessments serves to spur countries to implement standards while providing important information to market participants for incorporation into their risk assessments. This in turn will feed into sharpening the focus of IMF surveillance and make it even more relevant to promoting financial stability.

Numerous countries have begun to incorporate the array of new transparency initiatives into their IMF programs and ongoing practices. The USED has consistently advocated ongoing progress in this area. Several examples include:

- With the encouragement of the United States, Brazil has improved its reporting on debt and other vulnerability indicators and intends to subscribe to SDDS.

- Indonesia's EFF program includes measures to audit and improve the quality and transparency of the central bank's accounts. In addition, under the program, the central bank is now publishing international reserves data in line with the IMF's SDDS.

- Mozambique has been an early participant in the IMF's ROSCs. It completed the questionnaires for both the *Code of Good Practices on Transparency in Monetary and Financial Policies* and the *Code of Good Practices on Fiscal Transparency*.

- In the July 2000 Article IV and EFF program review for Jordan, the USED welcomed the authorities' intention to subscribe to the Fund's GDDS, which will help further improve the availability and reliability of statistics.

- In the March 2000 discussion, in which the Board approved a precautionary SBA for Estonia, the USED commended Estonia's commitment to transparency, demonstrated by subscription to the SDDS, a strong record of publishing its economic data and policy positions, and receptivity to conducting and publishing the findings of diagnostics such as the FSSA in the context of its next Article IV consultation.

- During India's June 2000 Article IV review, the USED commended the authorities for their extensive participation in diagnostic exercises such as the fiscal and monetary/financial ROSCs, expressing hope the insights derived from these evaluations will prove useful in the authorities' efforts to expand and gain public support for a second generation of far-reaching reforms.

[14] For more detail on banking supervision, see Section 3.

- As part of its new precautionary SBA, approved in May 2000, Uruguay has made a renewed commitment to increase the transparency of financial and non-financial public sector firms to make more explicit the quasi-fiscal costs of these operations and to build support for their eventual privatization. The authorities have decided to undertake statistical and fiscal ROSCs and a self-evaluation of adherence to Basel criteria. The USED asked about adding Uruguay to the list of countries participating in the FSAP, given the importance of the country's financial sector domestically and regionally.

- During the March 2000 review of Bulgaria's EFF program, the USED commended the authorities for participating in the ROSC program and lauded Bulgaria's willingness to publish the results of the ROSC on the IMF website.

- In July 2000, the United States made clear that its abstention on the review of the Philippine SBA was partly based upon the Philippine central bank's decision to report its non-deliverable forward liabilities in a manner that was inconsistent with the SDDS reserve template.

- In Egypt's Article IV discussion in July 2000, the USED encouraged the Egyptian authorities to improve the provision of fiscal and monetary data, in part by subscribing to the GDDS. Other Executive Directors reinforced this recommendation. Egyptian authorities requested technical assistance from the IMF to further develop indicators of real economic activity.

(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.

The USED has consistently supported measures to increase the accountability of the IMF and to allow independent evaluations of the IMF's operations. The significant increase in the release of documents on IMF policy issues is one clear step toward greater accountability. As noted in last year's report, there are also established evaluation policies. For example, the IMF's Office of Internal Audit is responsible for ongoing reviews within the Fund through several distinct functions: institutional review of operational methods; liaison with the External Audit Committee, which oversees annual financial audits; regular internal audits, including financial, operational, and systems audits; ad hoc investigations, with or without the help of specialized experts; work practice reviews; and liaison for external evaluations. In addition, with the support of the USED, the IMF in 1998 established procedures for independent evaluations. Under these procedures, external evaluations were completed of the IMF's Enhanced Structural Adjustment Facility, Economic Research Activities, and Surveillance. All of these evaluations are available on the IMF's website.

In addition, in April 2000, with the strong urging the USED, the Executive Board agreed to establish an independent Evaluation Office (EVO), which will complement the existing internal and external evaluation activities. The EVO will conduct objective and independent evaluations on issues of relevance to the mandate of the IMF. Prior to the August Board discussion on the EVO, the USED met with NGOs to gather outside opinions on the structure and function of the new office. The background paper and the Chairman's concluding remarks from the August Board discussion are posted on the IMF's website to provide an opportunity for public comment. In September, the Executive Board approved the terms of reference (TOR) for IMFC review, and the IMF has posted the TOR, along with a brief report, on its website[15].

The TOR provides that the EVO will be independent from IMF management and operate at "arm's length" from the Executive Board. Appropriately, the Director will not be eligible for appointment or reappointment to the regular IMF staff following the term of service, and the majority of full-time EVO staff will come from outside the IMF. The EVO will be free to consult freely and widely both within and outside the IMF. Importantly, there will be a strong presumption that EVO reports will be published shortly after completion. The EVO is expected to fulfill major objectives expressed by the Congress in section 1624(4) of the International Financial Institutions Act.[16]

The Executive Board expects the evaluation office to be operational prior to the Spring Meetings in Washington, D.C. in April 2001.

(14) Vigorously promote coordination with the International Bank for Reconstruction and Development and other international financial institutions (as defined in Section 1701 (c)(2)) in promoting structural reforms which facilitate the provision of credit to small businesses, including microenterprise lending, especially in the world's poorest, heavily indebted countries.

As noted in last year's report, the general working premise of IMF programs, as they relate to the banking sector, is that credit should be made available on equal terms and on a commercial basis to small- and medium-size enterprises, as well as to large companies. The provision of micro-credit is a recognized component of structural adjustment, especially in cases where either state-directed credit was formerly in use, or where large conglomerates or monopolies provided such credit.

While responsibility for assistance in establishing micro-finance programs lies with the World Bank and regional development banks, several countries have included in their poverty reduction strategies (approved by both the IMF and the World Bank) plans to develop micro-finance programs.

- In its 1997 Poverty Eradication Action Plan (PEAP), which serves as Uganda's PRSP under HIPC, Uganda identified the need to establish a framework for the development of micro-finance institutions. The government of Uganda has subsequently (in the April 2000 PEAP)

[15] <http://www.imf.org/external/np/eval/2000/091200.htm>. The other documents on evaluation in the IMF can also be accessed from this site.
[16] Added in section 502 of H.R. 3425, enacted in November 1999 as Appendix E to section 1000(a)(5) of Public Law 106-113.

established a micro-finance forum and will shortly submit to its parliament a bill providing for the supervision of micro-finance institutions.

- In the course of privatizing the country's largest bank, the government of Tanzania carved out the microcredit functions and made them the responsibility of a separate entity, the National Microfinance Bank (NMB). The NMB is now being reorganized under an American manager with World Bank technical assistance, and if it can be made profitable, will be privatized as well.

- Mozambique's poverty reduction strategy includes increasing credit to small farmers.

- In Burkina Faso's PRGF arrangement, the IMF urged increases in credit availability to rural communities through decentralized financial systems, of which micro-credit is one form.

Conclusion

The Treasury and the USED at the IMF have actively sought to use the voice and vote of the United States to promote the measures set out in U.S. legislation. While progress may be more evident in some areas than others, Treasury and the USED have been and will continue to be active in all areas. It is important to note that there is not uniform agreement within the IMF or the G-7 on the application of all the provisions set forth above; nonetheless, other IMF members generally have demonstrated a willingness to work with the United States to achieve common ground on these issues. The United States will continue to engage the IMF management, staff, and member countries to build on the efforts described in this report.