IMPLEMENTATION OF
CERTAIN LEGISLATIVE PROVISIONS
RELATING TO THE
INTERNATIONAL MONETARY FUND

A Report to Congress

in accordance with

Section 1705(a) of the International Financial Institutions Act, as amended

United States Department of the Treasury
January 2023

Introduction

This report is submitted by the Department of the Treasury in accordance with legislation that requires Treasury to report annually to Congress on the status of reform efforts and policy implementation undertaken by the International Monetary Fund (IMF).

IMF Policies Reform Report: Section 1705(a) of the International Financial Institutions Act, as amended (IFI Act), 22 U.S.C. § 262r-4(a), requires the Secretary of the Treasury to submit a report on the progress made by (1) the U.S. Executive Director in influencing the IMF to adopt various policies and reforms as described in section 1503 of the IFI Act, 22 U.S.C. § 262o-2, and (2) the IMF in adopting and implementing the policies described in Section 801(c)(1)(B) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 2001, Pub. L. 106-429.

Treasury supports strong implementation of IMF country programs and promotes sound policy decisions within the IMF. To achieve these goals, Treasury and the Office of the U.S. Executive Director (OUSED) at the IMF vigorously seek to build support for these policies in the IMF's Executive Board and with IMF management. Treasury and OUSED discuss these policies with IMF management and staff and with other Board members. Additionally, OUSED advances these reform policies in statements and votes on programs and policies in the IMF Executive Board. Treasury officials vote on IMF governance matters and major policy issues through our Governor to the IMF.

In addition, Treasury's Office of International Monetary Policy and OUSED communicate with other Treasury offices and U.S. Government agencies, as appropriate, to increase awareness about legislative mandates affecting U.S. participation in the IMF and identify opportunities to influence IMF decisions in line with broader U.S. international economic policy objectives.

Progress of OUSED in Promoting Policies at the IMF Described in Section 1503

While Treasury and OUSED continue to advance all of the policies described in Section 1503, this report specifically highlights new developments in relevant policy areas since October 1, 2021.

(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 trading systems.

During the period of this report, Treasury and OUSED continued to promote the IMF's rigorous analysis of exchange rates and global imbalances. IMF staff consulted with Treasury and OUSED during its methodology review for assessing exchange rate misalignments and excessive global imbalances to improve the IMF's ability to conduct an assessment of its members' exchange rate policies. The review led to refinements to the IMF's assessment methodology, including in the External Balance Assessment (EBA) and EBA-lite models. Treasury and OUSED broadly supported the findings and policy advice in the 2022 External Sector Report

(ESR), which incorporated these refinements. In its Board statement, OUSED welcomed the addition of three new countries to the EBA database but called on staff to include these in the assessments in the ESR. OUSED also asked staff to consider an in-depth analysis of strategies to reduce excessive current account gaps and pressed for greater focus on the publication of foreign exchange intervention data.

In 2022, Treasury and OUSED engaged with IMF staff to finalize the review of the IMF's Multiple Currency Practices (MCPs) policy – the first formal review in 41 years – which is a critical part of the IMF's framework for jurisdiction over exchange rates. MCPs refer to a country maintaining multiple exchange rates for a currency within its territory, typically in segmented foreign exchange markets where rates differ beyond a permissible spread. IMF members are obligated to refrain from engaging in MCPs under the IMF's Articles of Agreement under most circumstances. MCPs are broadly objectionable as they are considered distortionary, can result in an unfair competitive advantage for the country, and generally hinder trade. The recent review modernized the IMF's methodology for identifying MCPs to bring it in line with current exchange rate practices, and IMF staff agreed to enhance the discussion of MCPs and exchange restrictions in its regular surveillance. Treasury and OUSED also pressed for strengthening the IMF's approach to noncompliance – to include declaring censure or noncooperation – for members that continued to violate the MCP policy.

Finally, Treasury and OUSED promote exchange rate regimes consistent with economic fundamentals to avoid disorderly adjustment and avoid competitive devaluation, emphasizing greater exchange rate flexibility in many reviews of members' surveillance reports and programs. For example, in China's Article IV review in January 2022, Treasury and OUSED pushed the IMF for enhanced analysis on the policy tools that the authorities may be using to impact currency valuations. In Vietnam's June 2022 Article IV review, Treasury and OUSED called on Vietnam to allow further exchange rate flexibility, which will in turn support Vietnam's external adjustment and foster increased long-term macroeconomic resilience.

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—

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

During Article IV and program reviews, Treasury and OUSED support members strengthening their social safety nets. For example, during the second review of Madagascar's Extended Credit Facility in September 2022, OUSED called for the government to improve execution of its budgeted social spending amid heightened food insecurity. Additionally, Treasury and OUSED support maintaining protection for vulnerable populations through targeted assistance instead of costly, untargeted fuel subsidies amid the energy price shock following Russia's invasion of Ukraine. For example, during the fifth review of São Tomé and Príncipe's Extended Credit Facility, OUSED called for the authorities to prioritize spending on the most vulnerable while reforming implicit fuel subsidies.

Treasury and OUSED also supported the IMF's robust financial response to the twin shocks of the COVID pandemic and Russia's war against Ukraine. Since the start of Russia's war in February 2022 (up through September 2022), the IMF approved over $87 billion in financing to countries responding to crisis conditions, including $3 billion of concessional financing for vulnerable low-income countries. This financing comes on top of over $171 billion of financing previously approved since the beginning of the pandemic, with more than $18 billion of that amount at concessional rates. This financing has been critical to allowing vulnerable countries to weather shocks and ease the pain of adjustment for their populations by maintaining a strong social safety net.

OUSED supported the approval of the Food Shock Window (FSW) at the IMF Executive Board on September 30, 2022. The FSW offers emergency financing through the IMF's Rapid Financing Instrument and Rapid Credit Facility to support countries dealing with urgent balance-of-payments needs from the global food price and availability shock, resulting from Russia's war against Ukraine. Recipients can use FSW financing to maintain their social safety net expenditures amid the price shock and rising food insecurity.

(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.

Treasury and OUSED promote strengthened financial systems through a consistent focus on promoting independent monetary authorities, flexible exchange rates, and well-provisioned banking sectors during Article IV and program reviews. Treasury and OUSED consistently emphasize the importance of sound banking and monetary systems that can provide a basis for sustained growth. For example, during the Board review of the Solomon Islands' Article IV consultation in January 2022, OUSED encouraged authorities to proactively address financial sector vulnerabilities and monitor accumulating non-performing loans before they threatened financial sector stability.

Treasury and OUSED provide input on Financial Stability Assessment Programs (FSAPs), a comprehensive financial sector assessment that the IMF periodically conducts for its members in concert with Article IV reviews. At the Board review of:

- South Africa's FSAP in February 2022, OUSED highlighted risks from the tightening sovereign-bank nexus and agreed with IMF staff recommendations for the government to complete a bank resolution framework and deposit insurance scheme.
- Germany's FSAP in July 2022, OUSED welcomed the authorities' use of macroprudential policies in response to potential housing sector risks, including by raising the counter-cyclical capital buffer.
- The West African Economic and Monetary Union FSAP in May 2022, OUSED commended authorities for employing digital financial services to boost financial

inclusion while also encouraging close monitoring of the asset quality of micro financial institutions.

- Ireland's July 2022 FSAP, OUSED welcomed FSAP stress tests that showed banks could withstand additional severe macro-financial shocks and agreed that the authorities should continue to use tools developed for intensified banking supervision during the COVID-19 crisis to continue identifying potential sources of stress going forward.

Overall, this FSAP engagement plays an important role in strengthening financial systems in both developing and advanced economies.

(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—

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

Treasury and OUSED press for equal burden sharing and timely and orderly debt restructurings in the G20 Common Framework and in engagement with IMF Management and staff on the relevant IMF policies. The Common Framework brings together all official bilateral creditors to provide coordinated debt treatments for eligible low-income countries on a fair burden sharing basis. One of the requirements of the Common Framework is comparability of treatment between the official bilateral and private creditors, with the modalities of achieving comparable treatments determined on a case-by-case basis. We are also pursuing enhancements to relevant IMF policies. For example, during the IMF's recent review of its Lending into Arrears policies, Treasury and OUSED pressed for improvements that would encourage more proactive public and private sector participation and burden sharing by increasing the IMF's flexibility to lend into arrears in cases when a holdout creditor is not engaging in good faith. Additionally, we are continuing to engage with the IMF to develop market-based, contractual enhancements that promote constructive creditor participation in debt restructuring processes by discouraging holdout and other disruptive creditor behavior. We look forward to continuing to promote this work through resolute engagement with the IMF Board, staff, and in the G20 going forward.

In July 2022, the IMF modified its transparency policy to allow for the publication of increased data on debt as required under its newly revised Debt Sustainability Framework for Market Access Countries (MAC SRDSF), while redacting data that could be market sensitive. Treasury and OUSED strongly supported these improvements to the IMF's debt sustainability analysis and transparency policy.

(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.

Treasury and OUSED pressed IMF staff to report on pandemic-related spending by the institution's members, especially by those that used IMF resources. Partly in response to this engagement, in May 2022 Fund staff published a note on the "Implementation of Governance Measures in Pandemic-Related Spending.". Recipients of IMF financing during the pandemic committed to good governance and transparency, and this document provided updates on measures taken in each country, noting overall progress. Common actions include reporting spending, publishing beneficial ownership information, and conducting emergency spending audits. These initiatives promote good governance and limit opportunities for corruption and bribery.

Treasury and OUSED engage IMF staff and other constituencies at the IMF Board to promote good governance principles within countries receiving IMF financing. For example, in its formal statement to the IMF Board during review of Moldova's request for a blended Extended Fund Facility and Extended Credit Facility in September 2022, OUSED noted the importance of the program's focus on strengthening Moldova's governance and institutional frameworks through the country's completion and publication of its Country Governance Diagnostic. Going forward, this exercise will anchor future governance reforms under the IMF program. OUSED also supported the Moldovan authorities' ongoing work to safeguard the National Bank of Moldova's independence and improve its financial sector supervision and regulation practices, including recognizing asset quality issues accurately and promoting a smooth and transparent debt restructuring process in the banking sector.

In the March 2022 review of the IMF's Data Standards Initiatives, OUSED emphasized that transparency is a core principle of good governance. Treasury and OUSED encouraged further strengthening of the IMF's Special Data Dissemination Standards (SDDS). These standards, to which IMF members adhere voluntarily, are intended to facilitate access to international capital markets by increasing the timeliness and accuracy of key data. Treasury and OUSED also encouraged the graduation of several countries from SDDS to SDDS Plus, the highest standard of data transparency, to which the United States adheres. Treasury and OUSED will continue to advocate for IMF efforts to increase its members' data transparency and quality efforts, including through adherence to increased standards. For example, in Panama's second Precautionary and Liquidity Line review in July 2022, OUSED welcomed the authorities' progress on continuing to improve data adequacy and working towards SDDS adherence, thereby strengthening governance.

In other country reviews, OUSED also welcomed IMF staff's focus on the importance of economic governance for public confidence while stressing that political governance is also macro-critical. In El Salvador's Article IV discussion in January 2022, OUSED noted that deteriorating political governance, as exemplified by interference with judicial independence and targeting of civil society organizations, was a cause for concern, with implications for fiscal policy, financial stability, and growth.

(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.

Treasury and OUSED engage with IMF staff to support strengthening policy advice for members to promote strong and sustainable growth while responding to fluctuations in global financial markets. To this end, in March 2022 the IMF reviewed its Institutional View on the Liberalization and Management of Capital Flows (IV), which provides the foundation for the IMF's advice to members facing heightened volatility in capital flows. During the review, OUSED supported changes to the IV to integrate findings from recent research, including the IMF's Integrated Policy Framework (IPF). In this review, the IMF Board reaffirmed the core principle that international capital flows are beneficial, while providing some flexibility for members to adopt policies to address capital flow volatility in limited circumstances.

Going forward, Treasury and OUSED will advocate for transparent application of the IV and development of the IPF as well as focus on the effects of using measures to moderate capital flows, including the potential for spillovers to other countries. Going into 2023, the IMF will continue its work conducting pilot cases for applying the IPF in members' Article IV surveillance reports and will follow up with guidance for staff on its implementation.

(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.

Treasury and OUSED have pressed for IMF programs and assistance to be designed in such a way to mitigate ethnic or social strife. For example, the establishment of the IMF's FSW, discussed above, will provide vulnerable countries with critical balance of payments financing to address the food price and availability shock, thereby alleviating food insecurity, which can spur internal conflict and social strife.

In March 2022, the IMF Executive Board approved a new strategy for Fragile and Conflict-Affected States (FCS). Treasury and OUSED engaged extensively with staff during the development of this strategy and supported its approval. The FCS strategy outlines how staff should analyze the impact of fragility and conflict on macroeconomic stability, employ lending effectively, and scale up capacity development. IMF staff will ground these engagements in newly developed Country Engagement Strategies, which Treasury and OUSED emphasized should be tailored to the drivers of fragility. As part of this work, Treasury also supported a targeted increase in the IMF's administrative budget, a portion of which will go to increasing IMF staff positions in FCS countries.

In July 2022, the IMF Executive Board approved a new strategy on gender issues, with a focus on determining when gender-based economic disparities are macro-critical and identifying how economic and financial policies can impact gender disparities. Treasury and OUSED supported this strategy on the basis that the IMF will engage on gender issues where there are clear macro-critical impacts, thus ensuring the IMF's work on gender is within its mandate. Additionally, Treasury and OUSED pushed the IMF to closely collaborate with other relevant institutions, like the World Bank, to develop policy advice for addressing gender disparities. The gender strategy can spur growth, development, and resilience in certain countries while helping limit social strife in countries with large disparities.

(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.

With support from Treasury and OUSED, the IMF Executive Board adopted a climate strategy in June 2021; this strategy details how climate change is a critical macroeconomic policy challenge and how the IMF an increase its engagement on climate in line with its mandate. Throughout the period covered in this report, the IMF implemented this strategy across its activities.

In 2015, the IMF developed the Public Investment Management Assessment (PIMA) to assist countries in improving infrastructure governance. In December 2021, the IMF released a policy paper proposing a new Climate-PIMA (C-PIMA) module to help tailor investment management to support climate change mitigation and adaptation. Prior to this proposal, the C-PIMA had been tested in eleven countries. In 2022, the C-PIMA was deployed across countries including Georgia, Gabon, and the Cook Islands, with several other upcoming assessments planned. Deployment of the C-PIMA aligns with the climate strategy's emphasis on increasing climate-related capacity development, in this case on fiscal issues. The IMF also launched the Climate Macroeconomic Assessment Program (CMAP) as part of the climate strategy's focus on capacity development; it is intended to assist countries in building resilience and developing policy responses to the economic impacts of climate change. In December 2021, the IMF completed the first pilot of the CMAP in Samoa.

In April 2021, the IMF started publishing its Climate Change Indicators Dashboard to strengthen macroeconomic analysis of climate issues. As set out in the climate strategy, the dashboard has been updated quarterly and coverage has been expanded to new indicators. The climate strategy also outlined how multilateral surveillance should analyze climate issues, with chapters in the IMF's flagship reports highlighted as an outlet for disseminating the IMF's analytical and policy work. In line with this recommendation, Chapter 3 of the April 2022 World Economic Outlook report studied the labor market implications of the green economic transition.

The IMF has also deployed the climate strategy in the context of Article IV reports and program reviews, in which the IMF highlights where climate change could cause macro-critical policy challenges. For example, in the 2022 Article IV and Fourth Review of the Extended Credit Facility for Liberia, the IMF highlighted the importance of adaptation given the economic risks posed by flooding and harm to sensitive industries like agriculture and fishing, and it suggested policy recommendations for authorities. At the Board review, OUSED concurred with IMF staff's assessment, pointed to the potential for damage to key export industries, and emphasized the urgency of adapting to physical risks.

Treasury and OUSED have also been deeply engaged with the IMF staff and other Executive Directors in operationalizing the new Resilience and Sustainability Trust (RST). The RST will help members address long-term structural challenges, including climate change, energy security, and pandemic preparedness, by providing balance of payments support and catalyzing additional public and private financing. In the case of climate, the RST will provide space for eligible and qualifying emerging market and developing economies to address potential macroeconomic risks from climate change and natural disaster risks.

(15) Work with the International Monetary Fund to—

(C) ensure note is taken of AML and CFT issues in Article IV reports, International Monetary Fund programs, and other regular reviews of country progress.

Treasury and OUSED engage IMF staff and other constituencies at the IMF Board on the promotion of reforms to anti-money laundering/combating the financing of terrorism (AML/CFT) policies. In formal statements to the Board on Article IV and country program reviews, OUSED consistently promotes country engagement with the Financial Action Task Force (FATF) to ensure that these reforms are adopted. For example, Pakistan, as a part of its current IMF program, completed a structural benchmark that requires progress to enhance the effectiveness of AML/CFT, including completion of Pakistan's 2018 and 2021 Action Plans in the summer of 2022.

During the second review of Panama's Precautionary and Liquidity Line in July 2022, OUSED highlighted that compliance with AML/CFT best practices is macro-critical for the country to preserve the smooth functioning of its financial system and safeguard its position as a regional financial center and pressed for Panama's authorities to address the deficiencies in its AML/CFT framework. OUSED urged the importance of anti-corruption and AML/CFT reforms during the review of Liberia's Extended Credit Facility in August 2022, which occurred shortly after several senior Liberian officials faced U.S. sanctions for corruption.

Treasury and OUSED also pressed for greater focus on AML/CFT in the IMF's capacity development and technical assistance work. This assistance is critical to strengthening AML/CFT frameworks and institutions in member countries. Going forward, the IMF expects to increase its AML/CFT assistance budget from \$3.7 million in FY2022 to \$7.7 million by FY2025.

<u>Progress of the IMF in Implementing Policies Described in Section 801(c)(1)(B) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act</u>

While Treasury and the OUSED continue to advance the range of policies described in Section 801(c)(1)(B), this report specifically highlights new developments in relevant policy areas since October 1, 2021.

Implementation by the fund of certain policies. The Fund is implementing:

(i) policies providing for the suspension of a financing if funds are being diverted for purposes other than the purpose for which the financing was intended;

Treasury and OUSED engage with the IMF to exercise oversight of funds disbursed via programs to verify that the financing is achieving its intended purpose. For example, Treasury and OUSED have pushed to increase transparency in cases where countries have accessed funding through the IMF's emergency lending programs, the Rapid Credit Facility or Rapid Financing Instrument, including through implementing spending audits.

(ii) policies seeking to ensure that financing by the Fund normally serves as a catalyst for private sector financing and does not displace such financing;

Treasury and OUSED advocate for policies that will encourage IMF financing to be a catalyst, not replacement, for private sector financing. Lending through the General Resources Account, which is the non-concessional arm of the IMF, requires that countries address the underlying balance-of-payments issue during the program, which facilitates private sector financing upon completion. Additionally, the Exceptional Access framework requires that countries regain market access in a timeframe and on a scale that will enable the country to meet its obligations falling due to the IMF.

(iii) policies requiring that financing must be disbursed-- (I) on the basis of specific prior reforms; or (II) incrementally upon implementation of specific reforms after initial disbursement;

For countries accessing IMF funding through Upper Credit Tranche (UCT) programs, IMF staff have continued to measure country progress against agreed-upon quantitative criteria and structural benchmarks. Treasury and OUSED have strongly supported disbursement of funds from a UCT program only when the borrower has demonstrated meaningful progress toward achieving agreed-upon criteria and benchmarks, consistent with achievement of the program's objectives.

(iv) policies vigorously promoting open markets and liberalization of trade in goods and services;

IMF programs include conditionality that reduce restrictions on trade and market access, especially where these restrictions are macro-critical or contribute to balance-of-payments issues. Treasury and OUSED have also focused attention on the role that regulations and dominant state-owned enterprises can play in restricting market entry and competition. Amid the ongoing challenges to global food security, the IMF has also highlighted the need to maintain open trade and avoid food export restrictions.