CHAPTER 5

Poverty Reduction and Debt Relief for Poor Countries

The Committee urges all those with a stake in the HIPC Initiative to work for faster and effective implementation, and to give the HIPC process the highest priority so that as many countries as possible can reach the decision point by the end of the year. The Committee welcomes the progress made in developing-country-owned poverty reduction strategies as the framework for IMF and World Bank concessional lending and for linking debt relief under the enhanced HIPC Initiative to concrete poverty programs and growth strategies, so as to ensure that the resources freed are directed to key poverty reduction measures. The Committee urges all countries involved to move ahead as quickly as possible with the preparation of Poverty Reduction Strategy Papers in a participatory manner, integrating priority measures for poverty reduction and structural reforms within a growth-oriented macroeconomic framework.

—*Communiqué of the International Monetary and Financial Committee, April 16, 2000*

Over the past fifteen years, the IMF's role in helping its poorest member countries achieve sustainable improvements in their balance of payments positions, economic stability, and living standards has increased considerably. Beginning with the Structural Adjustment Facility (SAF) in 1986 and then the Enhanced Structural Adjustment Facility (ESAF) in 1987, concessional assistance to poor countries has become a major feature of the IMF's work.

This focus has also brought with it growing attention to the social impact of IMF-supported economic adjustment programs and to the broad range of requirements for economic development and poverty reduction, including trade policy reform.

But the persistence of poverty—and mounting public pressure—underscored that more had to be done. While the design of antipoverty programs remains the primary responsibility of member countries with the assistance of the World Bank and other development agencies, the IMF plays an important role, particularly in the areas of macroeconomic and financial sector policies. The IMF and World Bank are cooperating closely, and working with governments in individual countries, on a new approach that strengthens the links among poverty reduction, economic growth, and debt relief.

For the IMF, the centerpiece of the strategy is its concessional loan facility, the Poverty Reduction and Growth Facility (PRGF). In effect, the IMF transformed the ESAF into the PRGF to make poverty reduction a key element of a growth-oriented, country-owned strategy by combining concessional lending from the IMF in support of appropriate macroeconomic policies with antipoverty assistance from the World Bank and other development agencies. The programs supported by the PRGF are framed around a comprehensive poverty reduction strategy developed by the authorities of the country in consultation with civil society and supported by the international community. Macroeconomic stabilization and external viability—central goals of IMF lending—are fundamental to the approach because they are essential to sustainable economic growth, the key to poverty reduction.

The PRGF is being combined with a stronger effort to bring debt relief to heavily indebted poor countries (HIPCs). During FY2000, the joint World Bank–IMF HIPC Initiative was enhanced to provide deeper, broader, and faster assistance to eligible countries that are following sound economic policies, to help them reduce their external debt burdens to sustainable levels in a way that promotes effective poverty reduction.

Notwithstanding the broad support for the enhanced HIPC Initiative, by the end of the financial year more remained to be done on the issue of financing for the Initiative: about 60 percent of contributions pledged by many industrial, developing, and transition

Table 5.1
Expected Beneficiaries of the Enhanced HIPC Initiative[1]

Decision points reached[2] or expected by end-2000	Decision points expected for 2001 or later
Benin[3]	Burundi
Bolivia[4]	Central African Republic
Burkina Faso[5]	Congo, Democratic Republic of the
Cameroon	Congo, Republic of
Chad	Ethiopia
Côte d'Ivoire[5]	Gambia, The
Guinea	Liberia
Guinea-Bissau	Madagascar
Guyana[6]	Myanmar
Honduras	Niger
Malawi	São Tomé and Príncipe
Mali[5]	Sierra Leone
Mauritania	Somalia
Mozambique[4]	Sudan
Nicaragua	Togo
Rwanda	
Senegal[3]	
Tanzania	
Uganda[7]	
Zambia	

[1]Ghana and Lao P.D.R. have indicated that they do not intend to request assistance under the enhanced HIPC Initiative.
[2]As of April 30, 2000, five countries had reached their decision points under the enhanced HIPC Initiative: Bolivia, Mauritania, Mozambique, Tanzania, and Uganda.
[3]Countries not requiring assistance under the original HIPC Initiative, but eligible for reconsideration under the enhanced HIPC Initiative.
[4]Countries that received assistance under the original HIPC Initiative (i.e., that reached the completion point) and have qualified for additional assistance under the enhanced Initiative.
[5]Countries to which assistance had been committed under the original HIPC Initiative (i.e., that reached the decision point).
[6]Guyana had already reached the completion point under the original HIPC Initiative.
[7]Uganda has reached the completion point under the original and the enhanced HIPC Initiatives.

member countries had either been received or were being contributed according to an agreed schedule. (See Chapter 6 for further information on financing the PRGF and the HIPC Initiative.)

To underline their support for strong coordination to implement the enhanced HIPC Initiative and Poverty Reduction Strategy Paper (PRSP) process, the IMF and World Bank announced the establishment of a Joint Implementation Committee as of May 1, 2000. The Joint Committee will oversee implementation of the enhanced HIPC Initiative and PRSP programs so as to ensure that both are carried out smoothly. The Committee, co-chaired by senior IMF and World Bank staff, will monitor progress in carried out both programs and coordinate the production of regular reports and briefings to the Executive Boards of the two institutions.

Debt Relief

The international community recognized, in the mid-1990s, that the external debt situation for a number of low-income countries, mostly in Africa, had become extremely difficult. Without comprehensive debt relief, most of these countries would remain indefinitely dependent on exceptional financing in the form of flow reschedulings of official bilateral debt, even with the continued provision of concessional financing and their pursuit of sound economic policies.

Launched in 1996, the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) marked the first time that multilateral, Paris Club, and other official bilateral and commercial creditors united in a joint effort to reduce the debt stock of the world's most debt-distressed poor countries to sustainable levels. Central to the Initiative is the debtor country's continued effort toward macroeconomic adjustment and structural and social policy reforms. The Initiative also seeks to ensure additional financing for social sector programs—including basic health and education.

Assistance under the HIPC Initiative is limited to countries eligible for PRGF and World Bank International Development Association (IDA) loans that have established strong track records of policy performance. This strong track record is intended to ensure that debt relief is put to effective use. Currently, of the 80 members of the IMF that are PRGF-eligible, as many as 37 might qualify for assistance under the enhanced HIPC Initiative (Table 5.1).

Enhancing the HIPC Initiative

Under the original HIPC Initiative, a country seeking debt relief had to complete a two-stage qualification period that normally could run up to six years before disbursement of debt relief. During the first, three-year stage, the country had to work with the IMF and the World Bank to establish a track record of sound economic and social policies. The end of the three-year period triggered a "decision point," when the IMF and the World Bank together with the debtor country reviewed the country's debt burden to determine whether it was "unsustainable" (see Figure 5.1).

For most countries potentially eligible for debt relief under the original HIPC Initiative, debt generally was deemed "unsustainable" if it exceeded 200–250 percent of exports and if debt service exceeded 20–25 percent of exports.[1] But in the case of a country with a

[1]Debt sustainability ratios measure debt in net present value terms: the discounted market value of debt if repaid in one lump sum. Sustainable debt-to-export levels are defined on a case-by-case basis within the relevant target ranges.

Figure 5.1
Enhanced HIPC Initiative Flow Chart

First Stage

- Country establishes three-year track record of good performance and develops together with civil society a Poverty Reduction Strategy Paper (PRSP); in early cases, an Interim PRSP may be sufficient to reach the decision point.
- Paris Club provides flow rescheduling on Naples terms, i.e., rescheduling of debt service on eligible debt falling due (up to 67 percent reduction on a net present value basis).
- Other bilateral and commercial creditors provide at least comparable treatment.[1]
- Multilateral institutions continue to provide adjustment support in the framework of World Bank- and IMF-supported adjustment programs.

Decision Point

EITHER

Paris Club stock-of-debt operation under Naples terms and comparable treatment by other bilateral and commercial creditors

is adequate

for the country to reach external debt sustainability.
================>***Exit***
(Country does not qualify for HIPC Initiative assistance)

OR

Paris Club stock-of-debt operation under Naples terms and comparable treatment by other bilateral and commercial creditors

is not sufficient

for the country to reach external debt sustainability.
============>**World Bank and IMF Boards** determine eligibility for assistance.

All creditors (multilateral, bilateral, and commercial) commit debt relief to be delivered at the floating completion point. The amount of assistance depends on the need to bring the debt to a sustainable level. This is calculated based on latest available data at the decision point.

Second Stage

- Country establishes a second track record by implementing the policies determined at the decision point (which are triggers to reaching the floating completion point) and linked to the (Interim) PRSP.
- World Bank and IMF provide interim assistance.
- Paris Club provides flow rescheduling on Cologne terms (90 percent debt reduction on NPV basis or higher if needed).
- Other bilateral and commercial creditors provide debt relief on comparable terms.[1]
- Other multilateral creditors provide interim debt relief at their discretion.
- All creditors continue to provide support within the framework of a comprehensive poverty reduction strategy designed by governments, with broad participation of civil society and the donor community.

"Floating Completion Point"

- Timing of completion point is tied to the implementation of a comprehensive poverty reduction strategy, including macroeconomic stabilization policies and structural adjustment.
- All creditors provide the assistance determined at the decision point; interim debt relief provided between decision and completion points counts toward this assistance.
- All groups of creditors provide equal reduction (in NPV terms) on their claims as determined by the sustainability target. This debt relief is provided with no further policy conditionality.
  - — Paris Club provides stock-of-debt reduction on Cologne terms (90 percent NPV reduction or higher if needed) on eligible debt.
  - — Other bilateral and commercial creditors provide at least comparable treatment on stock of debt.[1]
  - — Multilateral institutions provide debt relief, each choosing from a menu of options and ensuring broad and equitable participation by all creditors involved.

[1]Recognizing the need for flexibility in exceptional cases.

large export sector, the debt sustainability thresholds could be lowered. To qualify for the lower thresholds under the original HIPC mechanism, a country had to have an export-to-GDP ratio of at least 40 percent and a fiscal-revenue-to-GDP ratio of at least 20 percent. Assuming these criteria were met, the debt-to-export target for the country was set at a level to achieve a 280 percent ratio of debt to fiscal revenue on arriving at the "completion point," which was generally reached three years later.

The completion point also marked the point at which debt relief promised at the decision point was actually delivered. The period between decision and completion points under the original HIPC Initiative has been shortened to less than three years for countries with an extended track record of sound economic performance.

In response to calls for restructuring the HIPC Initiative to provide faster, broader, and deeper debt relief, the IMF and the World Bank reviewed the Initiative in early 1999, consulting with civil society organizations and public officials. In June 1999, the Group of Eight (G-8) at the Cologne Summit recommended relaxing the eligibility criteria to provide speedier and deeper debt relief to more countries.

In September 1999, the International Monetary and Financial Committee and the Development Committee endorsed—subject to the availability of funding—enhancements to the HIPC framework.

The enhanced HIPC Initiative seeks to provide *deeper debt relief* by lowering several of the mechanism's qualifying thresholds:

- Under the external window, the debt-to-export target is now 150 percent, down from 200–250 percent.
- Under the fiscal window, the debt-to-fiscal-revenue target is now 250 percent, down from 280 percent; the exports-to-GDP ratio is now 30 percent, down from 40 percent; and the fiscal-revenue-to-GDP ratio is now 15 percent, down from 20 percent.

Moreover, the amount of debt relief determined at a country's decision point is now based on actual data available at the decision point, rather than on projections for the country's completion point.

The enhanced HIPC Initiative aims to deliver *debt relief more quickly* by introducing "floating" completion points not linked to a rigid timeframe, but rather focusing on a set of predefined reforms. In addition, under the enhanced Initiative, interim relief is provided between a country's decision and completion points—as well as faster provision of relief as soon as the completion point is reached in many cases. The main aim is to free up more funds more rapidly to be reallocated to poverty reduction.

The pace at which countries have qualified for debt relief has been slower than hoped, primarily because of armed conflicts, political unrest, and delays in countries' reform programs. IMF and World Bank staff are taking all steps to ensure speedy implementation; the Joint Implementation Committee seeks to smooth this process and to ensure that implementation receives the highest priority.

The enhancements to the HIPC Initiative framework also result in *broadening debt relief* by expanding the number of eligible countries. While up to 20 countries are expected to qualify for debt relief by the end of 2000 (see Table 5.1), timing depends on countries' progress toward implementing IMF- and World Bank-supported programs and developing nationally led poverty reduction strategies. (For the status of some country cases, see Table 5.2 and Box 5.1.)

In its discussions on the HIPC enhancement, the Executive Board emphasized retaining the basic elements that guided the original HIPC Initiative—including participation by all creditors—and maintaining the financial integrity of multilateral institutions and support for strong policies of adjustment and reform. Directors also stressed that the financing of the enhanced framework had to be secured before it could be implemented.

Linking Debt Relief and Poverty Reduction: The Poverty Reduction Strategy Paper

At the September 1999 Annual Meetings, the Interim Committee (now the International Monetary and Financial Committee) and the Development Committee sought to strengthen the link between debt relief and poverty reduction by making HIPC debt relief an integral part of broader efforts to implement results-oriented poverty reduction strategies. The new approach was the focus of intensive work by the IMF and World Bank staffs, as well as of formal and informal Board discussions during the fall of 1999.

The Committees endorsed the adoption of the Poverty Reduction Strategy Paper (PRSP)[2] as the central mechanism for developing and coordinating concessional lending to poor member countries under the Poverty Reduction and Growth Facility and International Development Association—including the commitment of resources under the enhanced HIPC Initiative.

The PRSP is formulated by the country with the participation of stakeholders, including central and local government, civil society, donors, and international organizations. It describes and diagnoses the causes of poverty in a country and outlines a medium-term action plan to reduce poverty based on explicit

[2]The PRSP replaces the Policy Framework Paper (PFP) that underpinned reform programs supported by the IMF's former Enhanced Structural Adjustment Facility.

Table 5.2

HIPC Initiative: Status of Country Cases Considered Under the Initiative, May 2000

Country	Decision Point	Completion Point	NPV-of-Debt-to-Export Target (in percent)	Assistance Levels[1] (in millions of U.S. dollars, present value) Total	Bilateral	Multi-lateral	IMF	World Bank	Percentage Reduction in NPV of Debt[2]	Estimated Total Nominal Debt-Service Relief (in millions of U.S.dollars)	Satisfactory Assurances from Other Creditors
Completion point reached under enhanced framework											
Uganda				1,003	183	820	160	517		1,950	
Original framework	Apr. 97	Apr. 98	202	*347*	*73*	*274*	*69*	*160*	20	*650*	Received
Enhanced framework	Feb. 00	May 00	150	*656*	*110*	*546*	*91*	*357*	37	*1,300*	Being sought
Decision point reached under enhanced framework											
Bolivia				1,302	425	876	84	194		2,060	
Original framework	Sep. 97	Sep. 98	225	*448*	*157*	*291*	*29*	*53*	14	*760*	Received
Enhanced framework	Feb. 00	Floating	150	*854*	*268*	*585*	*55*	*141*	30	*1,300*	Being sought
Mauritania	Feb. 00	Floating	137[3]	622	261	361	47	100	50	1,100	Being sought
Mozambique				1,970	1,235	736	141	434		4,300	
Original framework	Apr. 98	Jun. 99	200	*1,716*	*1,076*	*641*	*125*	*381*	63	*3,700*	Received
Enhanced framework	Apr. 00	Floating	150	*254*	*159*	*95*	*16*	*53*	9	*600*	Being sought
Tanzania	Apr. 00	Floating	150	2,026	1,006	1,020	120	695	54	3,000	Being sought
Completion point reached under original framework											
Guyana	Dec. 97	May 99	107[3]	256	91	165	35	27	24	410	Received
Decision point reached under original framework											
Burkina Faso	Sep. 97	Spring 00	205	115	21	94	10	44	14	200	Being sought
Côte d'Ivoire	Mar. 98	Mar. 01	141[3]	345	163	182	23	91	6[4]	800	Being sought
Mali	Sep. 98	Spring 00	200	128	37	90	14	44	10	250	Being sought
Total assistance provided/committed				**7,767**	**3,422**	**4,344**	**634[5]**	**2,146**		**14,070**	
Preliminary HIPC document issued[6]											
Ethiopia	. . .	. . .	200	636	225	411	22	214	23	1,300	. . .
Guinea	. . .	. . .	150	638	256	383	37	173	34	1,150	. . .
Guinea-Bissau	. . .	. . .	200	300	148	153	8	73	73	600	. . .
Honduras	. . .	. . .	137[3]	569	208	361	18	85	18	900	. . .
Nicaragua	. . .	. . .	150	2,507	1,416	1,091	32	188	66	5,000	. . .
No assistance required under original framework—to be reassessed under enhanced framework											
Benin	Jul. 97	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
Senegal	Apr. 98	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .

Sources: IMF and World Bank Board decisions, completion point documents, decision point documents, preliminary HIPC documents, and staff calculations.

[1]Assistance levels are at countries' respective decision or completion points, as applicable.

[2]In percent of the net present value of debt at the decision or completion point (as applicable), after the full use of traditional debt-relief mechanisms.

[3]Eligible under fiscal criteria; figures provided show the ratios of debt-to-exports that correspond to the targeted debt-to-revenue ratio. For Guyana and Côte d'Ivoire, a 280 percent NPV-of-debt-to-revenue ratio was targeted at the completion point; for Honduras and Mauritania, a 250 percent ratio was targeted at the decision point.

[4]Nonreschedulable debt to non–Paris Club official bilateral creditors and the London Club, which was already subject to a highly concessional restructuring, is excluded from the NPV of debt at the completion point in the calculation of this ratio.

[5]Equivalent to SDR 472 million at an SDR/US$ exchange rate of 0.744.

[6]Figures are based on preliminary assessments at the time of the issuance of the preliminary HIPC document and are subject to change. Assistance levels for Ethiopia and Guinea-Bissau were based on the original framework and applied at the completion point; for Nicaragua, Guinea, and Honduras targets are based on the enhanced framework and assistance levels are at the decision points.

antipoverty measures, as well as faster and more inclusive economic growth. The PRSP is intended to provide a framework for concessional assistance from the IMF and the Bank, and it is hoped that bilateral donors and other multilateral financial institutions will link their support to this strategy.

Box 5.1

Country Cases Under the Initiative for Heavily Indebted Poor Countries

During FY2000, five countries[1] reached their decision points under the enhanced HIPC framework—Bolivia, Mauritania, Mozambique, Tanzania, and Uganda—with total commitments estimated at $12.6 billion. This represented an average stock-of-debt reduction of more than 50 percent on top of traditional debt relief mechanisms. Earlier in the year, Guyana and Mozambique had reached the completion point under the original Initiative.

Bolivia

Bolivia is the first country in Latin America to be declared eligible for debt relief under the enhanced HIPC Initiative. Under the enhanced Initiative, the debt relief to Bolivia will amount to $854 million in net present value terms. This amount is in addition to the $448 million relief committed under the original Initiative. Over the past decade, Bolivia has experienced a dramatic improvement in its macroeconomic performance. Inflation fell from hyperinflationary rates in 1985 to just 3.1 percent in 1999; official international reserves and foreign direct investment have increased significantly; and the external debt burden—while still high—has eased significantly. Although annual growth has increased from virtual stagnation in the previous decade to an average of about 4 percent in real terms during the 1990s, it remains below potential, and about 70 percent of Bolivia's population still lives in poverty.

Guyana

On reaching the completion point under the original Initiative in May 1999, Guyana received $410 million in debt-service relief ($256 million in net present value terms). Agreement on the economic and social framework to be supported by the enhanced Initiative is expected to be reached in the second half of 2000.

During the mid-1990s, Guyana reduced financial imbalances substantially while implementing major structural reforms aimed at increasing efficiency through market-oriented policies. Real GDP growth increased to an average annual rate of 7 percent and inflation fell to 3½ percent from more than 100 percent. In 1998, the economic program went off track, in part because of sizable public sector wage increases. The government's firm resolve to implement the programmed wage policy in 1999 prompted a two-month strike by civil service unions, which led to a binding arbitration tribunal award of large wage increases for 1999 and 2000. The authorities contained other expenditures to reduce the overall public sector deficit in 1999 and made substantial progress in implementing the structural reforms (particularly privatization) envisaged in the 1999 program. The authorities remain committed to reducing poverty and achieving sustainable growth over the medium term. To this end, they are discussing with IMF staff a revised medium-term economic program that could be supported by the second arrangement under the Poverty Reduction and Growth Facility.

Mauritania

On reaching the decision point under the enhanced HIPC Initiative in February 2000, Mauritania qualified for $1.2 billion in debt relief ($622 million in net present value terms).

Mauritania has established a good track record of adjustment and reform on the macroeconomic, social, and political fronts. It has implemented substantial structural reforms and achieved fiscal consolidation. Reflecting this effort, GDP has grown by an annual average of close to 5 percent since 1992, with significant improvement in social indicators. Still, 50 percent of the population lives in poverty.

Mozambique

In April 2000, Mozambique qualified for total relief under the enhanced HIPC framework equal to $600 million ($254 million in net present value terms). This amount was in addition to the $3.7 billion relief committed under the original HIPC Initiative.

[1]Up to 20 countries in all are expected to qualify for debt relief by the end of calendar year 2000 (see Table 5.1).

Under the PRSP process, key macroeconomic policies—including targets for growth and inflation, and the thrust of fiscal, monetary, and external policies, as well as structural policies to accelerate growth—will need to reflect the priorities identified in the participatory process. Key social and sectoral programs and structural reforms aimed at poverty reduction and growth also are to be identified and prioritized during the participatory PRSP process, and their budgetary impact costed, taking into account the need for efficient, well-targeted spending. The bottom-up approach to costing is to be reflected in the design of the macroeconomic framework, including the level and composition of government expenditures, and the fiscal and external deficits. In this, the authorities need to take into account effects on domestic demand, implementation capacity, and the need to maintain an adequate level of international reserves. They need to ensure that spending programs can be financed in a sustainable, noninflationary manner.

The new approach also places additional emphasis on improvements in governance as a fundamental underpinning for macroeconomic stability, sustainable growth, and poverty reduction. The primary focus is on improving the management of public resources, achieving greater transparency, active public scrutiny, and generally increased government accountability in fiscal management.

The new approach requires closer World Bank–IMF collaboration in assisting low-income members. At the

Mozambique has made substantial progress in implementing economic reforms. During the previous four years, average annual inflation fell to 2 percent from about 47 percent, while real GDP grew by almost 10 percent a year on average. Mozambique has also made a strong structural adjustment effort in recent years, including in the areas of fiscal management, governance and public administration, and private sector development. While 68 percent of the population was still living in poverty in 1996–97, substantial improvements in social indicators have been recorded during the 1990s, most notably in rising school enrollment and a falling infant mortality rate. Household food security has also improved.

In response to the emergency brought on by the extensive floods in the first quarter of 2000, both the World Bank and the IMF decided to rephase the delivery of debt relief; as a result, Mozambique's debt service to the IMF will be zero for the next 12 months.

Tanzania

In April 2000, Tanzania reached the decision point under the enhanced Initiative, qualifying for more than $2 billion in total relief (in net present value terms), reflecting Tanzania's progress in macroeconomic stabilization and growth-oriented structural reform. During the past four years, inflation has come down to less than 7 percent, after exceeding 20 percent for many years, and the government has been repaying domestic debt, after many years of borrowing more than 3 percent of GDP annually. Tanzania has also made a strong structural adjustment effort in recent years, including far-reaching reforms in the external, financial, and public sectors. Poverty remains widespread, however, and the authorities are placing increasing emphasis on poverty reduction policies.

Uganda

In February 2000, Uganda reached the decision point under the enhanced HIPC Initiative qualifying for debt relief worth $656 million in net present value terms. This latest debt relief agreement for Uganda was in addition to $347 million in net present value terms of relief provided in April 1998 under the original HIPC Initiative. In early May 2000, the IMF and the World Bank Boards broadly endorsed Uganda's Poverty Reduction Strategy Paper (PRSP), enabling the country to reach the completion point under the enhanced HIPC Initiative.

Uganda's eligibility for debt relief under the enhanced HIPC Initiative acknowledges the effectiveness of Uganda's poverty reduction strategy to date, the application of resources from debt relief under the original HIPC framework to its poverty reduction programs, the highly participatory process involving civil society in the formulation of the poverty reduction strategy, and the government's continued commitment to macroeconomic stability.

In preparing poverty reduction strategies for its PRSP, Uganda was able to build on a considerable "base" in the form of a preexisting national plan for poverty alleviation: the Poverty Eradication Action Plan (PEAP), which had been launched in 1997 with the central goal of reducing poverty to 10 percent or less by 2017.

While Uganda remains one of the poorest countries in the world, analytic work supported by the World Bank indicates that poverty was reduced to 44 percent in 1996/97 from 56 percent in 1992/93, led by strong economic growth. The country's various welfare indicators have also improved substantially, most notably in primary education, where the net primary enrollment rate rose to 94 percent in 1998/99 from 56 percent in 1995/96.

The full text of news releases and HIPC progress reports are available on the IMF's website. In particular see The Heavily Indebted Poor Countries Initiative and Poverty Reduction Strategy Paper: Progress Reports*, submitted on April 14, 2000, by the IMF and World Bank staffs to members of the International Monetary and Financial Committee and Development Committee.*

same time, there is a sharp division of labor between the Bank and IMF in supporting preparation of PRSPs. The IMF's role will be that of seeking to ensure that countries' social and sectoral programs aimed at poverty reduction can be accommodated and sustainably financed within a supportive, growth-enhancing, low-inflation, macroeconomic and budgetary framework. The World Bank—along with the regional development banks and UN agencies—will take the lead in discussions with national authorities, civil society, and the poor themselves on how poverty reduction policies should be designed, and in lending in support of those policies. In reviewing a country's PRSP, the Bank and IMF Boards will consider and broadly endorse the overall strategy as an integrated whole; each institution will focus on those policies and programs in its area of responsibility.

Operational Issues

At a December 1999 meeting to discuss PRGF operational issues, IMF Executive Directors stressed that poverty reduction strategies must be country-driven, developed and monitored with broad participation, and tailored to country circumstances, as such strategies were more likely to enjoy broad public ownership and result in effective and sustained policy implementation. These strategies should build on work already under way on poverty eradication in these countries and should be developed from an understanding of the nature and determinants of poverty and the links between public actions and poverty outcomes. Well-designed strategies to achieve quantified medium- and long-term goals for poverty reduction—including key outcome and intermediate indicators—are necessary to ensure that policies are effectively carried out and monitored. Development of a poverty reduction strategy is also important in coordinating the work of the World Bank and the IMF, as well as that of regional development banks and other multilateral institutions, bilateral donors, and private sector organizations. The resulting strategy, Directors agreed, should integrate institutional, structural, and sectoral policies into a coherent macroeconomic framework.

The Board also strongly agreed that there could be no rigid blueprint for the PRSP process. Rather, PRSPs must reflect individual country circumstances. They should, however, emphasize consistency between macroeconomic policy and effective poverty reduction measures, and provide for sound use of additional resources released through debt relief. The process for developing and monitoring the PRSP is a participatory one, and Directors recognized that it would vary according to country circumstances and that governments would face challenges in developing these processes. Directors urged governments to ensure that the views of the poor were adequately represented, recognizing that this was an enormous challenge, both in terms of human and financial resources. The international community needs to support governments' efforts to develop participatory processes.

Directors stressed the value of informal country-specific briefings while the PRSP was being developed. This would help Directors formulate views on the emerging strategy, and would be particularly useful when the member-country-led process appeared to be generating policy options that might not have the support of the staff members or the Boards of the World Bank and IMF. Such briefings could also inform Directors of the nature of the participatory process. Directors generally agreed that the PRSP should be published by the country authorities prior to Board discussion to enhance the participatory process.

Avoiding Delays in Implementation: Interim PRSPs

The development of a PRSP with broad participation is likely to take time—as long as one to two years—depending on individual country circumstances. Thus, Directors saw an unavoidable tension, on the one hand, between PRSPs prepared with the participation of a broad spectrum of stakeholders and, on the other hand, the need to avoid delays in bringing as many countries as possible to their HIPC decision points within a timeframe appropriate to their need for debt relief, or in providing needed assistance through the IMF's Poverty Reduction and Growth Facility or the Bank's International Development Association. To address this problem, the Boards of the Bank and the IMF have agreed that countries may, for a transition period, prepare "Interim" PRSPs. The Interim PRSP covers many of the same basic elements as a full-fledged PRSP, but it focuses mainly on where the country is at present and the steps it expects to take to complete a full PRSP.

As with full-fledged PRSPs, there is no single prescription for Interim PRSPs. At a minimum, they should include a statement by the government of its commitment to poverty reduction; a description of the main elements of its poverty reduction strategy consistent with available diagnostics; and a three-year macroeconomic framework and policy matrix, both focusing on poverty reduction and specifically noting that outer-year commitments and targets are tentative and subject to revision as necessary in the full PRSP. Interim PRSPs should also contain a timeline and a description of the participatory process the government plans to adopt in preparing its full PRSP. While a broad participatory process is not a requirement for interim PRSPs, many are expected to involve at least some participation.

Experience with the Interim PRSPs for Bolivia, Mozambique, and Tanzania—considered by the IMF and World Bank Boards in FY2000—indicates that countries are addressing key proposed program elements.

- As to poverty diagnostics, while the quality of data has varied, all the countries concerned have been able to provide poverty estimates that give a concrete sense of the size of the problems countries face, both absolutely and in terms of meeting International Development Goals by 2015 (Box 5.2). In Bolivia, for example, 70 percent of households are estimated to live below the national poverty line. In Tanzania, this proportion is about 50 percent, while in Mozambique it is about 68 percent.
- Countries have also provided quantified long-term goals by 2010 for poverty reduction. In Bolivia, the goal is to reduce poverty to 45 percent of the urban population from 55 percent, and to 68 percent of the rural population from 80 percent; in Mozambique, the aim is to cut poverty to about 60 percent by 2004, and to about 50 percent by 2009.
- All countries have identified key structural areas for reforms that are focused on poverty reduction; not surprisingly, there has been a high degree of commonality, with measures to promote sustainable economic growth and social sector improvements (education and health) generally prominent, including institutional reform, infrastructure, and agriculture; several countries have also identified improvements in the business environment, especially for small and medium-sized enterprises.
- As to macroeconomic developments, countries in the group are targeting rapid GDP growth based on

strong macroeconomic policies over the proposed three-year time horizon.
- Finally, all country documentation has provided information on how to incorporate participatory processes into the program, building on existing arrangements and, in several cases, proposing well-defined and timebound expansion of the process (Bolivia and Tanzania).

Most Interim PRSPs are expected to benefit from consultative processes. Bolivia has been able to benefit from the existence of a National Dialogue since 1997, which produced a document on "Proposals Against Poverty" as early as September 1998. Ghana and Honduras, among others, serve as examples of draft Interim PRSP preparation in close consultation with civil society and the donor community. Nicaragua plans to undertake similar consultations with civil society as part of its Interim PRSP preparation.

While reaffirming that, in principle, countries seeking relief under the enhanced HIPC Initiative should have a PRSP in place at the decision point, Directors noted that this could unduly delay assistance for early cases. In these early cases, Directors agreed that a decision point could be reached with an Interim PRSP in place. In general, however, countries should have adopted a participatory full-fledged PRSP and completed at least one year of satisfactory implementation, as evidenced in the government's PRSP progress report, by the completion point.

Recognizing that this latter requirement could delay the provision of enhanced assistance under the HIPC Initiative to those countries that have already reached decision points, Directors agreed that some flexibility in the timing of debt relief was required in these cases.

Poverty Reduction and Growth Facility

In September 1999, the Interim Committee endorsed the transformation of the IMF's concessional lending facility—the Enhanced Structural Adjustment Facility (ESAF)—into the Poverty Reduction and Growth Facility. The name of the facility was officially changed in November, and in December, Directors supported the thrust of the proposed policies and procedures for implementing the PRGF and for linking programs supported under the facility to the PRSP. They asked IMF staff to begin implementation quickly, recognizing that it would involve considerable experimentation and innovation. At the end of FY2000, 80 low-income member countries were eligible for assistance (Table 5.3).

The PRGF and Poverty Reduction Strategies. Regarding the framework linking the PRGF and the poverty reduction papers, Directors emphasized that IMF arrangements under the PRGF must support and be consistent with the country's poverty reduction strategy. That strategy would be country-owned, with the World Bank taking the lead—between the Bank and the IMF—in helping the country formulate the antipoverty strategy and in lending to support it. A current poverty reduction paper that had been broadly endorsed by the Boards of the World Bank and IMF would be a condition for IMF approval of a PRGF arrangement, or for completion of a review thereunder. Such a framework would ensure that IMF resources support a comprehensive poverty reduction strategy.

Timing. Directors generally agreed that discussion of poverty reduction papers could take place at the same time as a PRGF discussion, and at the time of requests for new three-year PRGF arrangements or yearly reviews. They also generally agreed that a prerequisite for a new PRGF arrangement, or completion of a review, would be endorsement of a PRSP or progress report by both IMF and World Bank Boards within the preceding 12 months.

Midyear reviews under the PRGF would normally take place without a simultaneous discussion of a PRSP or progress report. In such situations, Directors agreed that management would recommend Board action only if it felt that implementation of the poverty reduction strategy remained satisfactory, or sufficient corrective measures had been taken to put it back on track. IMF staff and management would continue to assess the progress in macroeconomic and structural areas within the IMF's mandate. For social policies, most poverty-reducing measures, and other structural policies that fall within the World Bank's primary mandate, the IMF staff should ascertain whether the Bank staff had any major outstanding concerns about the adequacy of

Box 5.2
Development Goals for 2015

The 1990s saw a series of world conferences organized by the United Nations on international development goals. Based on agreements at these meetings on the steps needed to reduce poverty and achieve sustainable development, seven goals have been proposed, most to be reached by 2015.

Economic well-being
- Reduce extreme poverty by half relative to 1990 levels.

Social development
- Ensure universal primary education.
- Eliminate gender disparity in education (2005).
- Reduce infant and child mortality by two-thirds relative to 1990 levels.
- Reduce maternal mortality by three-fourths relative to 1990 levels.

Environmental sustainability and regeneration
- Implement a national strategy for sustainable development in every country by 2005, so as to:
- Reverse trends in the loss of environmental resources by 2015.

Table 5.3
Countries Eligible for the Poverty Reduction and Growth Facility, as of April 30, 2000[1]

Afghanistan	Kyrgyz Republic
Albania	Lao P.D.R.
Angola	Lesotho
Armenia	Liberia
Azerbaijan	Macedonia, FYR
Bangladesh	Madagascar
Benin	Malawi
Bhutan	Maldives
Bolivia	Mali
Bosnia and Herzegovina	Mauritania
Burkina Faso	Moldova
Burundi	Mongolia
Cambodia	Mozambique
Cameroon	Myanmar
Cape Verde	Nepal
Central African Republic	Nicaragua
Chad	Niger
China, People's Republic of[2]	Nigeria
Comoros	Pakistan
Congo, Democratic Republic of the	Rwanda
Congo, Republic of	St. Lucia
Côte d'Ivoire	St. Vincent and the Grenadines
Djibouti	Samoa
Dominica	São Tomé and Príncipe
Egypt	Senegal
Equatorial Guinea	Sierra Leone
Eritrea	Solomon Islands
Ethiopia	Somalia
Gambia, The	Sri Lanka
Georgia	Sudan
Ghana	Tajikistan
Grenada	Tanzania
Guinea	Togo
Guinea-Bissau	Tonga
Guyana	Uganda
Haiti	Vanuatu
Honduras	Vietnam
India	Yemen, Republic of
Kenya	Zambia
Kiribati	Zimbabwe

[1]The Poverty Reduction and Growth Facility (PRGF) replaced the Enhanced Structural Adjustment Facility (ESAF) effective November 22, 1999.

[2]China has indicated that it does not intend to use ESAF (now PRGF) resources.

implementation before IMF management determined whether to recommend Board approval of disbursements under the PRGF arrangement. Directors welcomed the proposal that IMF staff reports would record the views of Bank staff regarding implementation of the poverty reduction strategy in areas within their mandate.

In cases where Board consideration of a poverty reduction paper (or progress report) and a PRGF arrangement (or a review) do not coincide, the PRGF documents should assess whether unexpected developments had affected the relevance of the latest paper. Any proposed departure from the poverty reduction strategy framework in the PRGF-supported program would have to be identified, agreed with the relevant country authorities and Bank staff, and reconciled in the PRSP when the PRSP was next prepared.

Reducing Overlapping Conditionality. Taking note of the new framework for very close cooperation and communication with the World Bank, Directors welcomed the proposals to reduce overlapping conditionality. They agreed that, for policies identified in the PRSP, the staffs of the Bank and the IMF would decide jointly—on the basis of established guidelines for their collaboration in assisting member countries—in which areas the Bank or the IMF would take primary responsibility for supporting the government's policy formulation and for monitoring or, where appropriate, liaising with other interested development partners. On the basis of this division of responsibilities, there would be a presumption that PRGF letters of intent and policy memoranda would cover and reach understandings only in those areas where the IMF was primarily responsible (and in these areas conditionality would be used sparingly). Thus, conditionality in areas within the primary mandate of the Bank will be the responsibility of the Bank, except where a condition is judged to have such a direct, critical macroeconomic impact that the PRGF-supported program would be derailed if the measure were not implemented. Directors generally considered it appropriate that the IMF rely on the Bank to monitor implementation of structural reforms consistent with the PRSP in the Bank's areas of expertise, and welcomed the sharpening of the lines of institutional responsibility and accountability. They emphasized that the IMF staff should not be expected to—and should not—offer assistance in areas that are primarily the responsibility of the Bank.

The macroeconomic conditions in PRGF arrangements would derive from the framework elaborated in the Poverty Reduction Paper, Directors agreed. Structural conditionality in IMF programs would be drawn from, or elaborate on, the structural measures identified in the paper, and would cover only those areas identified as being within the IMF's area of responsibility, except as noted above.

Transitional Arrangements. During the transitional period needed for countries to prepare their first PRSP under a participatory process, Directors agreed that an Interim PRSP would underpin new PRGF arrangements or new yearly programs under the PRGF (see discussion above).

Review. The PRGF would be reviewed by the end of 2001, in conjunction with a general review of the PRSP approach. These reviews would include contributions from member countries, international institutions, other aid providers, and civil society.

Social Issues and Policies in IMF-Supported Programs

In September 1999 discussions, Executive Directors underscored the importance of economic growth for poverty alleviation, but recognized that the IMF had to be sensitive to the social implications of its policy advice. In particular, Directors noted that:

- IMF-supported programs had tried to help members address the potentially harmful impact on vulnerable groups of their adjustment and reform efforts as well as external shocks;
- such efforts in turn could make a vital contribution toward sustaining economic reforms and protecting living standards;
- sound macroeconomic policies, coupled with effective social and infrastructure spending, foster faster long-term growth; and
- social safety nets and appropriately targeted, productive public spending, particularly in the social area, could thus provide critical support for the success of members' adjustment and reform programs.

Directors discussed broader requirements for raising living standards, including faster growth and employment creation and better integrating poorer countries into the international economy. They suggested that the international community should work to improve the access of these countries to industrial country markets and to halt the excessive flow of weapons to developing countries. Directors also emphasized the importance of good governance, transparency, and accountability for ensuring the effective use of public resources.

In discussing the IMF's role with regard to social policies, the Board saw the need for mutually reinforcing macroeconomic and social policies. Directors emphasized the importance of closer integration, with the help of the World Bank, of social issues and poverty concerns into IMF-supported programs. Greater attention to social issues was necessary in the context of low-income countries, including Heavily Indebted Poor Countries, where structural reforms were particularly critical.

The Board underlined that the World Bank and other relevant international organizations had the primary mandate and expertise with regard to social issues. The social components of countries' IMF-supported programs should thus rely on the work of these institutions.

Trade, Development, and Poverty Reduction

Trade reform, broadly conceived, goes far beyond reducing border restrictions and plays a critical role in supporting growth and poverty reduction. The World Bank and the IMF both see trade policy reform as an important element of a more comprehensive framework for economic development and poverty reduction.

At its September 1999 meeting, the Development Committee called on the World Bank, the IMF, and the World Trade Organization (WTO) to cooperate with other parties in supporting enhanced trade performance and capacity building, especially with respect to the least-developed countries. In a follow-up report for the April 2000 meeting of the World Bank–IMF Development Committee, staff indicated that while the percentage of the world's population living on less than $1 a day has fallen in recent years, the absolute number of people living in dire poverty in 1998 remained at nearly 1.2 billion. Taking a higher cutoff point of $2 a day, the total number of poor was an estimated 2.8 billion in 1998—nearly half the world's population.

Although these numbers conceal wide regional variations, projections for the coming decade are not encouraging. World Bank estimates suggest that under a "business as usual" scenario of continued relatively slow growth and intermittent crises, the number of people living on less than $1 a day would remain roughly constant, at about 1.2 billion, through 2008. Under a brighter scenario of steady, more rapid growth, the total would fall to about 700 million. Nonetheless, two regions—Latin America and the Caribbean and sub-Saharan Africa—would see little change; in fact, in sub-Saharan Africa, where the bulk of least-developed countries are concentrated, projections are for an increase of nearly 40 million, or about 14 percent. Can trade expansion help change the picture?

Trade, Growth, and the Speed of Integration

Economic growth alone cannot guarantee substantial and sustained reductions in poverty and inequality, but accelerated growth is necessary to make continuing progress in reducing poverty. A large body of empirical literature has suggested that more open economies tend to grow faster than closed ones. But available evidence suggests that many of the poorest developing countries have not as yet been able to integrate successfully into global markets, and, hence, to participate in the growth-inducing (and potentially poverty-reducing) benefits of trade.

Priority Areas for Trade Reform

If economic growth is integral to poverty reduction, and if trade opening supports growth, then further trade reform is clearly a priority. Developing countries need to implement appropriately sequenced, outward-oriented reforms that will allow trade expansion to help promote development and poverty reduction. Developed countries also have much to do to improve market access for developing countries' exports. And the global trading system as a whole needs to be more inclusive. A quick examination of recent patterns in world trade suggests some priority areas for further reform.

Global trade expansion has far outstripped global GDP growth for many years. During the past decade, world trade grew at an annual average rate of 6.3 percent, compared with world output growth of 3.0 percent. Developing countries as a group have played a major role in this process, including by substantially, and often unilaterally, liberalizing their trade regimes. They now account for almost 20 percent of total goods exports and some 16 percent of services exports. Taking all developing countries as a group, manufacturing exports have increasingly dominated, now accounting for more than 70 percent of their total exports. Meanwhile, South-South trade has been growing from about 20 percent of developing countries' total merchandise exports in the 1960s to more than 40 percent at the end of the 1990s. Developing countries have also tended in recent years to come together in regional groupings that liberalize intraregional trade and investment.

These groupings offer the promise of larger and more integrated markets, with the prospect of achieving increased returns to scale and greater foreign direct investment, and other dynamic benefits. Cuts in interregional tariffs, however, must be accompanied by lower external tariffs, if welfare-reducing trade diversion is to be avoided.

The recent improvements in some developing countries' trade participation have taken place against the background of high, albeit declining, barriers to their export diversification, in both developed and in other developing countries. While average tariff rates in developed countries against developing countries' manufactured exports are now relatively low (about 4 percent), they mask tariff peaks and escalation on products in which developing countries have a comparative advantage. Developing countries' tariffs against other developing countries' manufactures are higher—averaging nearly 13 percent.

For agricultural products, the situation is substantially worse. Industrial countries impose tariffs on developing countries' agricultural exports exceeding 15 percent, on average. Developing countries' tariffs against other developing countries' agricultural exports are even higher—over 18 percent. In addition, developing country exports are frequently subject to nontariff barriers, such as restrictive quotas (for example, bananas); as well as to antidumping and other forms of contingent protection; and to competition from subsidized agricultural production. High trade barriers to agricultural exports clearly have not helped poor developing countries become increasingly integrated in world trade. Moreover, the least-developed countries, as well as the Heavily Indebted Poor Countries (HIPCs), depend disproportionately on agriculture for both national income and exports.

The past decade has been characterized by marked progress in trade liberalization around the world, including developing countries, and most notably, developing countries that are potentially eligible for International Development Association (IDA) and Poverty Reduction and Growth Facility assistance—many of which have substantially reduced tariffs and nontariff barriers. The data nevertheless suggest considerable scope for further liberalization by developing countries, especially the poorest. In addition, substantial new efforts by the international community to enhance the market access opportunities of poorer developing countries would be valuable. Agricultural liberalization is a prime candidate. Moreover, agricultural trade liberalization would actually create larger benefits in aggregate for industrial countries than for developing countries, through more efficient resource allocation, reduced budgetary costs, and enhanced consumer welfare. Quantitative analysis suggests that complete liberalization of global agricultural trade could yield benefits to developing countries of over $40 billion annually.

Further liberalization of trade in manufactures is also important because of their greatly increased weight in the exports of many (predominantly middle-income) developing countries, and because export diversification provides opportunities for the poorest countries to reduce their vulnerability to commodity price shocks. Within manufactures, textiles and clothing are of special significance, because they represent an area of comparative advantage for developing countries, are subject to many tariff peaks, and are seriously constrained by quotas. Industrial countries could abolish these quotas to the benefit of their own economies, and to the export opportunities of developing countries.

Special efforts may also be warranted to help the poorest developing countries. The current systems of trade preferences operated under the former Lomé Conventions[3] and the Generalized System of Preferences (GSP) have benefited mainly the higher-income developing countries.[4] Moreover, the benefits of many of these schemes to the poorest countries have been diminished by the exclusion of a number of so-called sensitive products, chiefly in the areas of agriculture, textiles, and footwear—the very areas in which many poor countries have the greatest potential to expand and diversify their exports. In addition, the schemes are

[3]Lomé IV, signed in 1989 and replacing the previous Lomé trade and aid agreements, expired in February 2000. A successor to Lomé IV is to be signed in mid-2000.

[4]As an example, only 1 percent of U.S. imports under the GSP originate in Africa, with the main beneficiaries of the system being middle-income countries such as Brazil, Malaysia, the Philippines, and Thailand. For the European Union, the share of African products in EU imports is only 3.5 percent and has been declining.

complex and nontransparent, and the preferences can be withdrawn unilaterally in case, for example, imports from any country increase significantly. To be more effective, new market access initiatives for qualifying poor countries should be comprehensive, predictable, simple, and transparent.

The Director-General of the World Trade Organization has advocated granting duty-free and quota-free access for exports from least-developed countries, and members of the organization have been considering various proposals to this end. In the same vein, the President of the World Bank and the former Managing Director of the IMF have called upon members of the World Trade Organization to approve an initiative that covers all exports from least-developed countries and HIPCs as part of a coherent approach that would also include a reversal of the declining trend in foreign aid flows to these countries. This approach recognizes the critical importance of complementarity between debt relief and enhanced market access.

Supporting Trade Reform and Poverty Reduction

As noted above, economic growth, while essential, is not always sufficient for sustained poverty reduction. Equally, trade liberalization alone cannot guarantee economic growth. A strategy for trade expansion needs to embrace a far broader set of country-level initiatives, framed within an appropriate macroeconomic environment (including fiscal responses to change in tariffs) and a comprehensive approach to development goals and poverty reduction strategies. Specifically, attention needs to be paid to investments in the necessary infrastructure and human capital development that enhance the payoff to developing countries from trade liberalization. Supportive institutional reform efforts and improvements in the legal environment that increase investor confidence are also critical. Countries are likely to need substantial help from their development partners in undertaking these complementary efforts and investments.

In addition, the social dimension must be addressed. Countries need to have in place social programs including safety nets, retraining, and other transitional arrangements to offset the adjustment costs of freeing trade for those who may initially suffer as a result of moves toward liberalization. Increasingly, World Bank and IMF assistance strategies for a number of economies have supported liberalization efforts with measures to strengthen social safety nets.

The Poverty Reduction Strategy Paper will influence the formulation and implementation of trade reform in at least three ways. First, transitory adverse consequences that planned trade reforms may have on poor groups in the country will be made explicit and the PRSP will provide a framework to design appropriate policies to offset them. Second, the PRSP will be the result of a participatory process, which should strengthen the authorities' and the public's sense of ownership of the policies. This is particularly significant in the context of trade reform, because it should help to counter affected interest groups' resistance to trade reforms and support the implementation of agreed policies. And third, the PRSP process includes monitoring of changes in poverty outcomes over time, as well as evaluation of the impact of key policies, which can be used to inform and enhance the ongoing dialogue about the impact of trade reform on different groups in the society.

Working with the WTO

The World Bank, the IMF, and the WTO share some common objectives and have taken steps to strengthen mutual coordination and policy coherence. The WTO concluded Cooperation Agreements with the IMF and the Bank in 1996–97. These provide for regular consultations between the heads of the three organizations; a High-Level Working Group on Coherence, consisting of senior staff of the three institutions; enhanced procedures for the exchange of documents; attendance by staff (as observers) at appropriate Board and Committee Meetings in the other institutions; and both formal and informal contacts among the staff, including the pursuit of joint research projects and seminars (see Appendix IV).

The three organizations have continued to explore ways to strengthen cooperation and coherence, each within its own jurisdiction and respecting its own mandate and expertise.

Trade-Related Technical Assistance

The World Bank and the IMF provide their developing country members with trade-related technical assistance to support trade policy reforms. IMF technical assistance tends to be in the areas of customs administration and reform, statistics, and broad-based tax reforms, including reduction of dependence on trade taxes. Bank technical assistance covers a wider range of areas, such as competition policy, infrastructure development, institution building, and elements of trade facilitation.

CHAPTER 6

Financial Operations and Support for Member Countries

The IMF is a cooperative institution—in some ways like a credit union—in which member countries provide temporary financial assistance to other members experiencing difficulties in paying for imports of goods and services and/or servicing their foreign debt; in return, the recipient countries agree to undertake policy reforms to correct the problems that underlie their balance of payments difficulties. The temporary financial assistance from the IMF provides members the "opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity."[1]

The most common type of IMF financial assistance to members takes the form of Stand-By or Extended Arrangements (see Box 6.1). During FY2000, 11 new Stand-By Arrangements and 4 new Extended Arrangements were approved for member countries by the IMF. Including augmentations of several existing arrangements, total new commitments of IMF resources under Stand-By and Extended Arrangements amounted to SDR 22.3 billion.[2] The IMF also approved 10 new Poverty Reduction and Growth Facility Arrangements for eligible low-income member countries with commitments totaling SDR 0.6 billion. An additional SDR 0.6 billion was committed under special facilities and policies. (Table 6.1 sets out financial assistance approved during FY2000 by member country.)

Member countries' drawings from the IMF's General Resources Account amounted to SDR 6.4 billion in FY2000, and SDR 0.5 billion of Poverty Reduction and Growth Facility (PRGF) loans were disbursed. Net IMF credit outstanding decreased to SDR 50.4 billion as of the end of FY2000, reflecting the large volume of scheduled and advance repayments of credit extended under several very large financial arrangements approved for members in previous years.

[1]Article I (v) of the IMF's *Articles of Agreement*.

[2]As of April 30, 2000, SDR 1=US$1.31921.

As of the end of FY2000, the Executive Boards of the IMF and World Bank had made decisions to assist nine countries that had reached their decision points under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative); the IMF had committed SDR 467 million to these countries, five of which had received grants totaling SDR 213 million.

On a broader policy level, the Executive Board began a comprehensive review of the IMF's lending facilities and policies during FY2000, to determine whether they were all still needed and appropriately designed; as a result of the review, four facilities were eliminated. The Board also, in response to reports of misreporting of data and misuse of IMF financing, acted to:

- strengthen safeguards on members' use of its financing;
- deal with misreporting of information to the IMF by member countries; and
- consider helping members achieve sound practices in foreign exchange reserves management.

In addition, the Board considered program design issues, notably, the implications for IMF conditionality of the use of inflation targeting by member countries.

Quotas

Under the Eleventh General Review of Quotas, on January 30, 1998, the Board of Governors approved an increase in total IMF quotas to SDR 212 billion from SDR 146 billion. On January 22, 1999, the IMF determined that the participation requirement for the Eleventh Review quota increase (consents from member countries having 85 percent of the total quotas on December 23, 1997) had been fulfilled, and the quota increase took effect. The size of total IMF quotas relative to world trade during 1946–98 is shown in Figure 6.1.

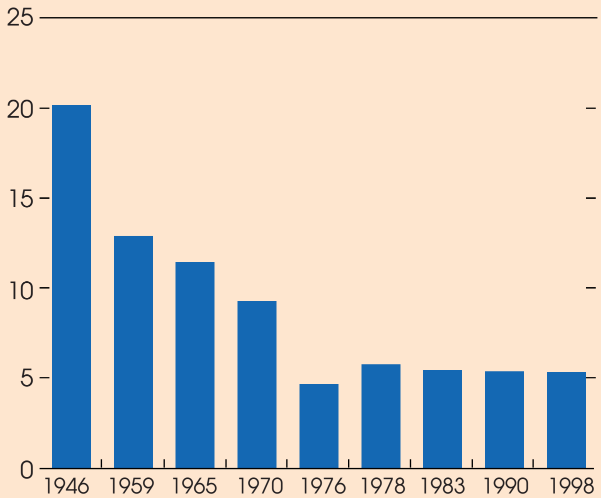
As of April 30, 2000, 172 member countries, accounting for 99 percent of total quotas proposed under the Eleventh Review, had consented to and paid for their quota increases, and total quotas had reached

Table 6.1
IMF Financial Assistance Approved in FY2000
(In millions of SDRs)

Member	Type of Financial Assistance	Date of Approval	Amount Approved[1]
Albania	Second annual PRGF and augmentation	June 14, 1999	9.7
Algeria	CCFF	May 26, 1999	223.5
Argentina	Three-year Stand-By Arrangement	March 10, 2000	5,398.6
Bolivia	Second annual PRGF	February 7, 2000	46.1
Bosnia and Herzegovina	Augmentation to Stand-By Arrangement	June 28, 1999	16.9
	Augmentation to Stand-By Arrangement	March 30, 2000	16.9
Burkina Faso	Three-year PRGF	September 10, 1999	39.1
Cambodia	Three-year PRGF	October 22, 1999	58.5
Cameroon	Third annual PRGF	September 7, 1999	54.0
Cape Verde	Augmentation to Stand-By Arrangement	May 24, 1999	0.4
Chad	Three-year PRGF	January 7, 2000	36.4
Colombia	Three-year Extended Arrangement	December 20, 1999	1,957.0
Djibouti	Three-year PRGF	October 18, 1999	19.1
Ecuador	One-year Stand-By Arrangement	April 19, 2000	226.7
Estonia	18-month Stand-By Arrangement	March 1, 2000	29.3
Gambia	Second annual PRGF	November 19, 1999	8.6
Georgia	Augmentation and extension of PRGF	July 23, 1999	5.6
Ghana	Three-year PRGF	May 3, 1999	155.0
Guinea	Third annual PRGF	December 21, 1999	23.6
Guinea-Bissau	Emergency postconflict assistance	September 14, 1999	2.1
	Emergency postconflict assistance	January 7, 2000	1.4
Indonesia	Three-year Extended Arrangement	February 4, 2000	3,638.0
Kazakhstan	Three-year Extended Arrangement	December 13, 1999	329.1
Kyrgyz Republic	Second annual PRGF	February 9, 2000	21.5
Latvia	16-month Stand-By Arrangement	December 10, 1999	33.0
Lithuania	15-month Stand-By Arrangement	March 8, 2000	61.8
Macedonia, FYR	CCFF	August 4, 1999	13.8
Madagascar	Second annual PRGF and extension	July 23, 1999	27.2
Mali	Three-year PRGF	August 6, 1999	46.7
Mauritania	Three-year PRGF	July 21, 1999	42.5
Mexico	17-month Stand-By Arrangement	July 7, 1999	3,103.0
Mongolia	Second annual PRGF	June 16, 1999	14.8
Mozambique	Three-year PRGF	June 28, 1999	58.8
	Augmentation to three-year PRGF	March 27, 2000	28.4
Nicaragua	Second annual PRGF	September 16, 1999	33.6
Papua New Guinea	14-month Stand-By Arrangement	March 29, 2000	85.5
Peru	Three-year Extended Arrangement	June 24, 1999	383.0
Romania	10-month Stand-By Arrangement	August 5, 1999	400.0
Russia	17-month Stand-By Arrangement	July 28, 1999	3,300.0
Rwanda	Second annual PRGF	November 19, 1999	23.8
São Tomé and Príncipe	Three-year PRGF	April 28, 2000	6.7
Senegal	Second annual PRGF	July 12, 1999	35.7
Sierra Leone	Emergency postconflict assistance	December 17, 1999	15.6
Tajikistan	Second annual PRGF	July 2, 1999	30.0
Tanzania	Three-year PRGF	March 31, 2000	135.0
Turkey	Emergency assistance	October 13, 1999	361.5
	Three-year Stand-By Arrangement	December 22, 1999	2,892.0
Uganda	Third annual PRGF	December 10, 1999	26.8
Ukraine	Augmentation to three-year Extended Arrangement	May 27, 1999	274.4
Zimbabwe	14-month Stand-By Arrangement	August 2, 1999	141.4

[1]For augmentations, only the amount of the increase is shown.

Figure 6.1
IMF Quotas Relative to World Trade[1]
(In percent)



[1]World trade is defined as the average of exports and imports. Data for 1946 refer to the IMF quotas set in 1945 and world trade data for 1946. The other data points refer to years in which resolutions for increases in quotas were adopted by the Board of Governors under general quota reviews. A resolution for a general increase in quotas for all members, along with special increases for some members, was first adopted in 1959.

SDR 210.25 billion.[3] Four member countries eligible to consent to the proposed increases in their quotas had not yet done so, and six member countries were ineligible to consent to their proposed increases because of their arrears to the IMF's General Resources Account. The Executive Board approved on July 13, 2000, an extension of the periods for consent to and payment of quota increases under the Eleventh Review until January 31, 2001. Individual members' quotas in the IMF at the end of April 2000 are shown in Appendix II, Table II.16.

In June 1999, the Executive Board authorized a panel of external experts to review the formulas used to guide the apportionment of quota increases resulting from general reviews and the setting of new member countries' initial quotas.[4] The terms of reference of the panel were to:

- review the quota formulas and their working, and assess their adequacy to help determine members' calculated quotas in the IMF in a manner that reasonably reflects members' relative positions in the world economy and their relative needs for, and contributions to, the IMF's financial resources; the review would take into account changes in the functioning of the world economy and the international financial system in light of the increasing globalization of markets;
- propose, as appropriate, changes in the variables and their specification to be used in the formulas; and
- examine other issues directly related to the quota formulas.

The report of the panel was submitted to management and the Executive Board on May 1, 2000. The Board is scheduled to discuss the report and an accompanying staff commentary in August 2000.

The IMF's Liquidity

Following the expansion of IMF resources resulting from the increases in members' quotas under the Eleventh General Review of Quotas, the IMF's resource position continued to strengthen throughout FY2000. The improvement occurred against a background of improving global economic and financial conditions and returning investor confidence in many emerging market economies.

The demand for IMF resources declined from the exceptionally high levels experienced in FY1999, and, with the faster-than-anticipated recovery in the economies of a few member countries with large IMF arrangements, repayments rose considerably. Brazil, Mexico, Korea, and Russia, which had drawn large amounts during earlier financial crises, together repaid SDR 19.6 billion in FY2000. Taking advantage of a strong improvement in its balance of payments, Korea made advance repayments of SDR 4.7 billion and eliminated the balance of its credit outstanding under the Supplemental Reserve Facility (SRF) by mid-September 1999. Similarly, in early 2000, Brazil repaid SDR 3.3 billion in advance and eliminated the balance of its outstanding SRF credit.

The IMF's liquid resources consist of usable currencies and SDRs held in the General Resources Account.

[3]During FY2000, the IMF's membership remained at 182 countries. The Federal Republic of Yugoslavia (Serbia/Montenegro) has not yet completed arrangements for succession to membership in the IMF following the breakup of the former Socialist Federal Republic of Yugoslavia. The Executive Board decided on December 13, 1999, that the country had until June 14, 2000, to complete such arrangements; on June 13, 2000, this period was extended until December 14, 2000. When these arrangements are completed, the IMF will have 183 members.

[4]The panel was chaired by Professor Richard Cooper, Harvard University, and included Joseph L.S. Abbey, Center for Economic Analysis, Accra, Ghana; Montek Singh Ahluwalia, Member, Planning Commission, India; Muhammad Al-Jasser, Vice-Governor, Saudi Arabian Monetary Agency; Professor Horst Siebert, President, Institute of World Economies, Kiel, Germany; Gyorgy Suranyi, President, National Bank of Hungary; Makoto Utsumi, Keio University, Japan; and Roberto Zahler, former President, Central Bank of Chile.

Usable currencies, the largest component of liquid resources, are holdings of currencies of members whose balance of payments and reserve positions are considered sufficiently strong to allow the use of their currencies in the quarterly financial transactions plan (see Box 6.2).

The IMF's *usable resources* rose steadily throughout FY2000, reflecting the margin of repayments over new drawings, the inclusion of additional members in the financial transactions plan during the course of the financial year, and the receipt of some payments for Eleventh Review quota increases during this period.

At the end of April 2000, the IMF's usable resources reached SDR 108.2 billion, an increase of SDR 24.5 billion from a year earlier. The related increase in the stock of *net uncommitted usable resources* (usable resources less resources committed under current arrangements and considered likely to be drawn, and less working balances of usable currencies) was not as steep—SDR 74.8 billion at the end of April 2000, compared with SDR 56.7 billion a year earlier—as the number of arrangements in place and the associated undrawn balances of commitments rose over the course of FY2000.

The IMF's liquid liabilities at the end of April 2000 totaled SDR 48.8 billion, compared with SDR 63.6 billion a year earlier. The ratio of the IMF's net uncommitted usable resources to its liquid liabilities—the "liquidity ratio"—increased to 153.1 percent at the end of April 2000 from 89.2 percent at the end of April 1999, reaching levels that prevailed before the onset of the Asian crisis (Figure 6.2).

The IMF's Articles of Agreement authorize it to borrow to supplement the resources provided through members' quota subscriptions. To date, the IMF has borrowed only from official sources (such as governments and central banks), but it may also borrow from private sources. The IMF has two sets of credit arrangements—the New Arrangements to Borrow (NAB) and the General Arrangements to Borrow (GAB)—whose purpose is to make supplementary resources available to the IMF when needed to forestall or cope with an impairment of the international monetary system. Total resources available to the IMF under the NAB and GAB combined are up to SDR 34 billion.

The NAB is a set of credit arrangements between the IMF and 25 member countries and institutions. It entered into force in 1998 and is the borrowing facility of first and principal recourse, unless a GAB participant (all GAB participants are also participants in the NAB) requests the use of IMF resources, in which case a proposal for drawings may be made under either the NAB or GAB. The NAB was activated for the first time in December 1998 to help finance a Stand-By Arrangement for Brazil. These drawings were repaid in March 1999, following the increase in IMF resources resulting from Eleventh Review quota payments. Table 6.2

Figure 6.2
IMF Liquidity Ratio and Net Uncommitted Usable Resources
(As of April 30)

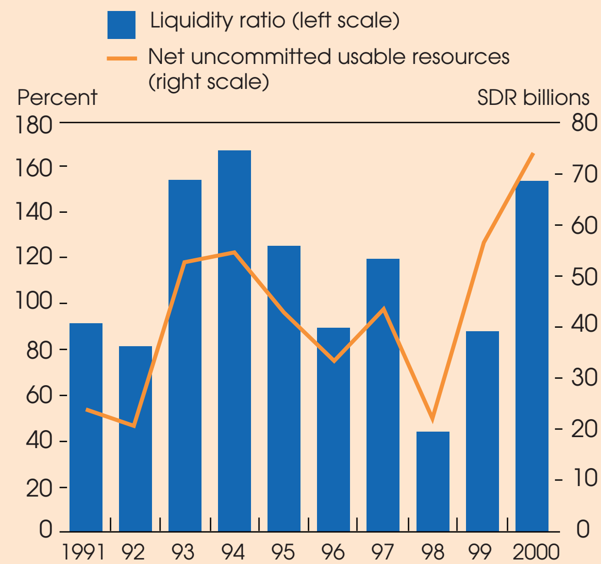


Table 6.2
New Arrangements to Borrow (NAB)
(In millions of SDRs)

Participant	Amount
Australia	810
Austria	412
Belgium	967
Canada	1,396
Denmark	371
Deutsche Bundesbank	3,557
Finland	340
France	2,577
Hong Kong Monetary Authority	340
Italy	1,772
Japan	3,557
Korea	340
Kuwait	345
Luxembourg	340
Malaysia	340
Netherlands	1,316
Norway	383
Saudi Arabia	1,780
Singapore	340
Spain	672
Sveriges Riksbank	859
Swiss National Bank	1,557
Thailand	340
United Kingdom	2,577
United States	6,712
Total	**34,000**

Box 6.1

IMF Financial Facilities and Policies

Financial assistance provided by the IMF is made available to member countries under a number of policies, or facilities, the terms of which reflect the nature of the balance of payments problem that the borrowing country is experiencing.

Regular Lending Facilities

IMF credit is subject to different conditions, depending on whether it is made available in the first credit "tranche" (or segment) of 25 percent of a member's quota or in the upper credit tranches (any segment above 25 percent of quota). For drawings in the first credit tranche, members must demonstrate reasonable efforts to overcome their balance of payments difficulties. Upper credit tranche drawings are made in installments ("phased") and are released when performance targets are met. Such drawings are normally associated with Stand-By or Extended Arrangements.

- **Stand-By Arrangements (SBAs)** are designed to deal with short-term balance of payments problems of a temporary or cyclical nature, and must be repaid within 3¼–5 years. Drawings are normally made quarterly, with their release conditional upon borrowers' meeting quantitative performance criteria—generally in such areas as bank credit, government or public sector borrowing, trade and payments restrictions, and international reserve levels—and not infrequently structural performance criteria. These criteria allow both the member and the IMF to assess progress under the member's program. Stand-By Arrangements typically cover 12–18 month periods (although they can extend for up to three years).
- Financial assistance provided through Extended Arrangements under the **Extended Fund Facility (EFF)** is intended for countries with balance of payments difficulties resulting primarily from structural problems and has a longer repayment period, 4½–10 years, to take account of the need to implement reforms that can take longer to put in place and have full effect. A member requesting an Extended Arrangement outlines its goals and policies for the period of the arrangement, which is typically three years but can be extended for a fourth year, and presents a detailed statement each year of the policies and measures to be pursued over the next 12 months. The phasing of drawings and performance criteria are like those under Stand-By Arrangements, although phasing on a semiannual basis is possible.
- **Precautionary arrangements** are used to assist members interested in boosting confidence in their economic management. Under a Stand-By or an Extended Arrangement that is treated as precautionary, the member agrees to meet the conditions applied for such use of the IMF's resources but expresses its intention not to draw on them. This expression of intent is not binding; consequently, as with an arrangement under which a member is expected to draw, approval of a precautionary arrangement signifies the IMF's endorsement of the member's policies according to the standards applicable to the particular form of arrangement.

Special Lending Facilities and Policies

- The **Supplemental Reserve Facility (SRF)** was introduced in 1997 to supplement resources made available under Stand-By and Extended Arrangements in order to provide financial assistance for exceptional balance of payments difficulties owing to a large short-term financing need resulting from a sudden and disruptive loss of market confidence, such as occurred in the Mexican and Asian financial crises in the 1990s. Its use requires a reasonable expectation that strong adjustment policies and adequate financing will result in an early correction of the member's balance of payments difficulties. Access under the SRF is not subject to the usual limits but is based on the financing needs of the member, its capacity to repay, the strength of its program, and its record of past use of IMF resources and cooperation with the IMF. Financing is committed for up to one year, and repayments are expected to be made within 1 to 1½ years, and must be made within 2 to 2½ years, from the date of each drawing. For the first year, the rate of charge on SRF financing is subject to a surcharge of 300 basis points above the usual rate of charge on other IMF loans; the surcharge then increases by 50 basis points every six months until it reaches 500 basis points.
- **Contingent Credit Lines (CCLs)** were established in 1999. Like the Supplemental Reserve Facility, the CCL is designed to provide short-term financing to help members overcome exceptional balance of

shows the amounts of credit arrangements of participants in the NAB.

Under the GAB, 11 participants (industrial countries or their central banks) have agreed to provide resources to the IMF in certain circumstances. The GAB was activated in 1998 for the first time in 20 years to finance an augmentation of the Extended Arrangement for Russia, with the drawings repaid upon receipt by the IMF of the bulk of quota payments under the Eleventh Review. Table 6.3 shows the amounts of credit arrangements of participants in the GAB and the associated agreement with Saudi Arabia.

Members' Use of IMF Resources and Credit Outstanding

In FY2000, member countries' drawings (purchases) from the General Resources Account (GRA), excluding payments problems arising from a sudden and disruptive loss of market confidence. A key difference is that the SRF is for use by members already in the midst of a crisis, whereas the CCL is a preventive measure solely for members concerned with their potential vulnerability to contagion but not facing a crisis at the time of the commitment. In addition, the eligibility criteria confine potential candidates for a CCL to those members implementing policies considered unlikely to give rise to a need to use IMF resources; whose economic performance—and progress in adhering to relevant internationally accepted standards—has been assessed positively by the IMF in the latest Article IV consultation and thereafter; and which have constructive relations with private sector creditors with a view to facilitating appropriate private sector involvement. Resources committed under a CCL can be activated only if the Board determines that the exceptional balance of payments financing needs faced by a member have arisen owing to contagion—that is, circumstances largely beyond the member's control stemming primarily from adverse developments in international capital markets consequent upon developments in other countries. The repayment period for and rate of charge on CCL financing are the same as for the SRF.

- **The Compensatory Financing Facility (CFF),** formerly the *Compensatory and Contingency Financing Facility (CCFF)*, provides timely financing to members experiencing a temporary shortfall in export earnings or an excess in cereal import costs, as a result of forces largely beyond the member's control. In January 2000, the Executive Board decided to eliminate the contingency element of the CCFF since it had rarely been used; see the discussion in this chapter.
- The IMF also provides **emergency assistance** to a member facing balance of payments difficulties caused by a **natural disaster**. The assistance is available through outright purchases, usually limited to 25 percent of quota, provided that the member is cooperating with the IMF to find a solution to its balance of payments difficulties. In most cases, this assistance has been followed by an arrangement with the IMF under one of its regular facilities. In 1995, the policy on emergency assistance was expanded to include well-defined **postconflict** situations: where a member's institutional and administrative capacity has been disrupted as a result of conflict, but where there is still sufficient capacity for planning and policy implementation and a demonstrated commitment on the part of the authorities; and where there is an urgent balance of payments need and a role for the IMF in catalyzing support from official sources as part of a concerted international effort to address the postconflict situation. The authorities must state their intention to move as soon as possible to a Stand-By, Extended, or Poverty Reduction and Growth Facility Arrangement.
- The **Emergency Financing Mechanism (EFM)** is a set of procedures that allow for quick Executive Board approval of IMF financial support to a member facing a crisis in its external accounts that requires an immediate IMF response. The EFM was established in September 1995 and was used in 1997 for the Philippines, Thailand, Indonesia, and Korea, and in 1998 for Russia.

Concessional Lending Facility

On November 22, 1999, the Enhanced Structural Adjustment Facility (ESAF)—the IMF's concessional financial facility to assist poor countries facing protracted balance of payments problems—was renamed the **Poverty Reduction and Growth Facility (PRGF)** and given a more explicit antipoverty focus (see Chapter 5). PRGF-supported programs are expected to be based on country-designed poverty reduction strategies, and formulated in a participatory manner involving civil society and developmental partners. The strategy, to be spelled out in a Poverty Reduction Strategy Paper produced by the borrowing country in cooperation with the World Bank and the IMF, should describe the authorities' goals and macroeconomic and structural policies for the three-year program to be supported by PRGF resources, as well as the associated external financing needs and major sources of financing. PRGF loans carry an interest rate of 0.5 percent a year and are repayable over 10 years with a 5½-year grace period on principal repayments.

For explanations of IMF quotas and other sources of funds, IMF liquidity, and the purchase-repurchase mechanism, see the Factsheet "How We Lend" on the IMF website.

reserve tranche drawings,[5] amounted to SDR 6.3 billion, well below the SDR 21.4 billion drawn in FY1999 (Appendix II, Table II.7). These drawings consisted of SDR 4.1 billion under Stand-By Arrangements (compared with SDR 12.6 billion in FY1999), SDR 1.6 billion under Extended Arrangements (SDR 5.9 billion in FY1999), SDR 0.2 billion under the Compensatory and Contingency Financing Facility (SDR 2.6 billion in FY1999), and SDR 0.4 billion of emergency financing (SDR 0.2 billion in FY1999) for natural disasters and postconflict assistance. The largest borrowers from the

[5]Reserve tranche drawings, which represent members' use of their own IMF-related assets and not use of IMF credit, totaled SDR 66.4 million by 11 members in FY2000, compared with 93 members drawing SDR 2.7 billion in FY1999. In both years, members drawing their newly created reserve tranche positions arising from the payment of their quota increases under the Eleventh Review accounted for the bulk of the drawings.

Table 6.3
General Arrangements to Borrow (GAB)
(In millions of SDRs)

Participant	Amount
Belgium	595.0
Canada	892.5
Deutsche Bundesbank	2,380.0
France	1,700.0
Italy	1,105.0
Japan	2,125.0
Netherlands	850.0
Sveriges Riksbank	382.5
Swiss National Bank	1,020.0
United Kingdom	1,700.0
United States	4,250.0
Total	**17,000.0**
Associated Agreement with Saudi Arabia	1,500.0
Total	**18,500.0**

IMF in FY2000 were Mexico and Brazil—which drew SDR 1.9 billion and SDR 0.8 billion, respectively, under Stand-By Arrangements—and Indonesia, which drew SDR 0.9 billion under an Extended Arrangement. (For the general terms of the IMF's financial assistance to member countries, see Table 6.4.)

Repayments (repurchases) in the GRA during FY2000 totaled SDR 23.0 billion, compared with SDR 10.5 billion in FY1999 (Appendix II, Table II.8), including scheduled and advance Supplemental Reserve Facility (SRF) repayments of SDR 6.5 billion by Brazil, SDR 5.5 billion by Korea, and SDR 3.2 billion by Russia.

Taking into account both drawings and repayments, net credit outstanding in the GRA decreased by SDR 16.7 billion in FY2000, to SDR 44.0 billion as of end-April 2000, from SDR 60.7 billion a year earlier. Including also net lending under the ESAF/PRGF (see below), total net IMF credit outstanding decreased to SDR 50.4 billion as of end-April 2000, from SDR 67.2 billion a year earlier, or by SDR 16.8 billion.

Stand-By and Extended Arrangements

New commitments of IMF resources under Stand-By and Extended Arrangements in FY2000 amounted to SDR 22.3 billion. Eleven new Stand-By Arrangements were approved in FY2000; including augmentations of the existing Stand-By Arrangements for Bosnia and Herzegovina and Cape Verde, commitments totaled SDR 15.7 billion (Appendix II, Table II.1). The largest commitments under Stand-By Arrangements were for Argentina (SDR 5.4 billion), Mexico (SDR 3.1 billion), Russia (SDR 3.3 billion), and Turkey (SDR 2.9 billion). As of end-April 2000, 16 member countries had Stand-By Arrangements with the IMF, with commitments totaling SDR 45.6 billion and undrawn balances of SDR 17.4 billion (Appendix II, Tables II.2 and II.3).

Four new Extended Arrangements were approved in FY2000, and the existing Extended Arrangement for Ukraine was augmented, with total commitments of SDR 6.6 billion. The largest commitments under Extended Arrangements were for Indonesia (SDR 3.6 billion) and Colombia (SDR 2.0 billion). As of end-April 2000, 11 member countries had Extended Arrangements, with commitments totaling SDR 9.8 billion and undrawn balances of SDR 8.2 billion (Appendix II, Table II.4).

Special Facilities and Policies

In January 2000, the Executive Board reviewed the IMF's Compensatory and Contingency Financing Facility (CCFF) and the Buffer Stock Financing Facility (BSFF). Directors agreed to eliminate the BSFF as it had not been used for 16 years, buffer stocks had not been proven useful in meeting their objectives, there were no longer any commodity agreements for which BSFF eligibility had been approved, and other IMF facilities were sufficient for the purposes the BSFF could serve.

Regarding the *contingency* element of the CCFF, Directors noted that while the idea behind that mechanism—helping members keep adjustment programs on track when faced with unexpected, adverse current account developments—had some appeal, it had seldom been used, and not at all in the previous eight years. Most Directors favored retaining a streamlined *compensatory* element of the CCFF—which provides timely financing to members experiencing a temporary shortfall in export earnings or an excess in cereal import costs for reasons largely beyond their control—at least pending a broader review of all IMF facilities. They, however, supported limiting the compensatory element to cases in which an arrangement with upper credit tranche conditionality was in place—with simplified access limits and with phasing of drawings—or where the member's balance of payments position was satisfactory apart from the temporary export shortfall or cereal import excess.

During FY2000, Algeria and the former Yugoslav Republic of Macedonia drew a total of SDR 237.3 million under the CCFF. The IMF also provided emergency postconflict assistance (totaling SDR 19.1 million) to Guinea-Bissau and Sierra Leone, and emergency natural disaster assistance of SDR 361.5 million to Turkey.

Another special facility—one related to potential Y2K problems—expired unused in March 2000 (see Box 6.3).

Poverty Reduction and Growth Facility

The IMF provides concessional financial assistance to low-income member countries under the Poverty Reduction and Growth Facility (PRGF)—successor to the Enhanced Structural Adjustment Facility (ESAF)—which focuses explicitly on poverty reduction. Currently, 80 member countries of the IMF are PRGF-eligible (see Chapter 5).

During FY2000, the Executive Board approved 10 new PRGF Arrangements with commitments totaling SDR 0.6 billion for Burkina Faso, Cambodia, Chad, Djibouti, Ghana, Mali, Mauritania, Mozambique, São Tóme and Príncipe, and Tanzania; in addition, augmentations totaling SDR 44 million were approved of the arrangements for Albania, Georgia, and Mozambique (Appendix II, Table II.1). As of the end of April 2000, 31 member countries' reform programs were supported by PRGF Arrangements, with IMF commitments totaling SDR 3.5 billion and undrawn balances of SDR 2.0 billion (Appendix II, Table II.5). Total disbursements amounted to SDR 0.5 billion during FY2000, compared with SDR 0.8 billion in FY1999.

Table 6.4
General Terms of IMF Financial Assistance

Facility or Policy[1]	Charge(s)	Repurchase Terms: Period (years)	Repurchase Terms: Number of installments
Credit tranches, emergency assistance, and Compensatory Financing Facility (CFF)	Basic rate[2]	3¼–5	8 (quarterly)
Extended Fund Facility (EFF)	Basic rate[2]	4½–10	12 (semiannual)
Supplemental Reserve Facility (SRF)	Basic rate plus surcharge[3]	2–2½[4]	2
Poverty Reduction and Growth Facility (PRGF)	0.5 percent a year	5½–10	10 (semiannual)
Memorandum			
Service charge[5]	0.5 percent		
Commitment charge (fee)[6]	0.25 percent		

[1]The Buffer Stock Financing Facility (BSFF) and the contingency element of the Compensatory and Contingency Financing Facility (CCFF) were eliminated by Executive Board decision on February 15, 2000. The Executive Board also decided on April 13, 2000, to terminate the policies on IMF support for Debt and Debt-Service Reduction (DDSR) operations and for Currency Stabilization Funds (CSF).

[2]The basic rate of charge is set as a proportion of the weekly SDR interest rate and is applied to the daily balance of all outstanding GRA drawings during each IMF financial quarter, with an additional surcharge for any outstanding credit under the SRF.

[3]The surcharge is 300 basis points during the first year following a drawing under the SRF, and increases by 50 basis points at the end of that first year and every six months thereafter until it reaches 500 basis points.

[4]Repurchases are expected to be made within 1–1½ years after a purchase; however, the IMF may, upon a member's request, decide to extend such repurchase expectation by up to one year. There is an obligation to repurchase within 2–2½ years after purchase.

[5]A one-time service charge is levied on each drawing of IMF resources in the GRA, other than reserve tranche drawings, at the time of the transaction.

[6]An up-front commitment fee is charged on the amount that may be drawn during each (annual) period under a Stand-By or Extended Arrangement. The fee is, however, refunded on a proportionate basis as subsequent drawings are made under the arrangement.

Financing for the PRGF is provided outside of the IMF's quota-based resources. Loans and grant contributions from a broad cross section of the IMF's membership constitute the bulk of the financing of the PRGF Trust, which is administered by the IMF. The Trust borrows resources at market-related interest rates from loan providers—central banks, governments, and government institutions—and lends them to PRGF-eligible borrowers. The Trust receives contributions to subsidize the rate of interest on PRGF loans and maintains a Reserve Account (providing security for creditor claims on the Trust) in the event of nonpayment by PRGF borrowers.

In August 1999, the Executive Board increased the borrowing limit of the PRGF Trust Loan Account to SDR 11.5 billion from SDR 11 billion in order to meet the potential demand for PRGF resources in the period ahead. As of end-April 2000, total effective lending commitments to the PRGF Trust amounted to SDR 10.9 billion. New borrowing agreements concluded during FY2000 include with Belgium (SDR 200 million), Canada (SDR 200 million), France (SDR 350 million), Italy (SDR 250 million), the Netherlands (SDR 250 million), and Spain (SDR 125 million). A borrowing agreement with Denmark (SDR 100 million) became effective in May 2000 and an agreement with Germany (SDR 350 million) became effective in June 2000. The commitment period for PRGF Trust loans to eligible members runs through December 31, 2001, with disbursements to be made through the end of 2003.

Contributions to the Subsidy Account are used to enable loans from the PRGF Trust to be made at a highly concessional rate of interest (currently 0.5 percent a year). The total value of bilateral subsidy contributions is estimated at SDR 3.4 billion. In addition, SDR 0.4 billion was transferred from the SDA to the Subsidy Account in early 1994. This contribution by the IMF, including the interest it will earn, is valued at SDR 0.6 billion.

The resources in the Subsidy Account were SDR 1.7 billion as of end-April 2000. During FY2000, the PRGF Trust made interest payments to lenders of

Box 6.2
Financial Transactions Plan

The amounts of currencies and SDRs to be used in new drawings and repayments by member countries are specified by the Executive Board for successive quarterly periods in the framework of a financial transactions plan (formerly referred to as the operational budget). Use of a member's currency in new borrowing from the IMF essentially involves the transfer of foreign exchange from the member whose currency is used (the creditor) to the borrowing member, and results in an equivalent increase in the creditor member's position in the IMF. Similarly, when borrowing members repay the IMF in currencies, this results in the receipt of foreign exchange by the creditor member and in an offsetting decline in its claims on the IMF. These amounts are carefully managed to ensure that the creditor positions in the IMF of the members making their currencies available for use by other members remain broadly equal in relation to quota, the key measure of each member's rights and obligations in the IMF.

The IMF recently began publishing the outcome of the financial transactions plan. Data on the amounts of resources provided by members to finance IMF transactions are posted on the IMF website after the completion of each quarterly plan, together with an explanatory note to guide readers unfamiliar with the IMF's particular financial structure and terminology.

SDR 201 million; of this amount, SDR 28 million represented interest payments by borrowers from the Trust and the balance of SDR 173 million was drawn from the resources of the Subsidy Account.

Box 6.3
Temporary Y2K Facility

The IMF—like the rest of the world—faced a one-time challenge in FY2000: as 1999 ended, would computers read the term "00" as representing the year 1900 or the year 2000? The IMF ensured that its own systems were "Y2K compliant" and played a role in raising member countries' awareness of the risks of systems failure and of the importance of developing contingency plans for dealing with key problems.

In September 1999, the Executive Board approved the establishment of a temporary Y2K facility. Under this facility, the IMF would extend short-term financing to countries that encountered balance of payments difficulties arising from potential or actual Y2K-related failures of computer systems. The borrowing country had to be cooperating with the IMF and addressing the Y2K problems that gave rise to its balance of payments problems, to the extent that they were within the country's control. The country also had to have a generally sound policy stance—including policies to address other sources of balance of payments difficulties, if any—and be making appropriate use of its reserves and other available sources of external financing to meet its balance of payments difficulties.

As it turned out, no member made use of the Y2K facility, which expired at the end of March 2000.

For details of PRGF Arrangements, and of borrowing agreements and subsidy contributions for the PRGF Trust, see Appendix II, Tables II.5 and II.10.

Enhanced HIPC Initiative

The Initiative for Heavily Indebted Poor Countries (HIPC Initiative), launched in 1996 by the IMF and World Bank, was considerably strengthened in FY2000, to provide deeper, faster, and broader debt relief for the world's heavily indebted poor countries (see Chapter 5). The IMF provides HIPC assistance in the form of grants that are used to service part of a member country's debt to the IMF.

As of end-April 2000, the Executive Boards of the IMF and World Bank had decided to assist nine countries that had reached their decision points under the Initiative (Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mauritania, Mozambique, Tanzania, and Uganda); the IMF had committed SDR 467 million to these countries, and five countries (Bolivia, Guyana, Mozambique, Tanzania, and Uganda) had received assistance in the form of grants from the IMF totaling SDR 213 million.

The total cost of the IMF's participation in the enhanced HIPC Initiative and of the continuation of concessional lending under the PRGF is estimated at $3.5 billion (end-1998 net present value (NPV) terms), with the HIPC Initiative accounting for about two-thirds of the total. The envisaged financing package consists of pledged contributions by member countries of $1.4 billion (end-1998 NPV terms) and contributions by the IMF of $2.1 billion (end-1998 NPV terms). In December 1999, the Executive Board made the necessary decisions for the financing of these initiatives to proceed: namely, to terminate the second Special Contingent Account (SCA-2) (see below) and to undertake off-market gold sales of up to 14 million ounces (see Box 6.4).

Substantial progress has been made in securing the necessary financing. Ninety-three members have pledged contributions to the PRGF-HIPC Trust, a number of them by contributing all or part of their SCA-2 balances. As of end-April 2000, about 60 percent of pledged contributions had either been received or were being provided on the basis of an agreed schedule (Appendix II, Table II.11). As to the IMF, the bulk of its contribution will come from the investment income on the profits generated by off-market sales of 12.9 million ounces of gold, which were completed in early April 2000. The IMF will also provide $0.5 billion from other sources, of which about 45 percent has already been contributed to the PRGF-HIPC Trust. The available resources in the PRGF-HIPC Trust amounted to SDR 511 million as of end-April 2000 (see Box 6.5)

Income, Charges, and Burden Sharing

At the beginning of each financial year, the IMF sets a rate of charge on the use of its resources that is intended to allow it to achieve a target amount of net income to add to its reserves. In deciding on the amount of income that should be added to reserves, the Executive Board is guided by two principles: precautionary balances should fully cover the credit outstanding to member countries in protracted arrears to the IMF, and precautionary balances should include a margin for the risk related to credit outstanding to other members in good standing.

The basic rate of charge is set as a proportion of the SDR interest rate and is adjusted for burden sharing, described below. In addition, the IMF levies a surcharge on the use of resources under the Supplemental Reserve Facility (SRF) and the Contingent Credit Lines (CCL) (see Table 6.4). The IMF pays remuneration on member countries' remunerated reserve tranche positions, which on average are equivalent to 88 percent of their total reserve tranche positions. The rate of remuneration is set at 100 percent of the SDR interest rate and is also adjusted for burden sharing.

Since 1986, the Executive Board has employed burden-sharing mechanisms to strengthen the IMF's financial position against the consequences of overdue obligations and to distribute the financial burden of overdue obligations among debtor and creditor members:

- The Board has adjusted the rates of charge and remuneration to generate amounts equal to unpaid charges due from members in protracted arrears. When deferred charges that have led to these burden-sharing adjustments are settled, an equivalent amount is refunded to members that have paid additional charges or received reduced remuneration.
- From FY1989 through FY2000, an amount equal to 5 percent of the IMF's reserves at the beginning of the financial year was added each year to the first Special Contingent Account (SCA-1) to strengthen the IMF's financial position. In FY2001, an amount equal to 3.3 percent of the IMF's reserves at the beginning of the year will be added to the SCA-1.
- From 1990 through 1997, debtor and creditor members contributed SDR 1 billion to the second Special Contingent Account (SCA-2) to provide liquidity for—and to protect the IMF's financial position against the risks associated with—disbursements from the GRA to member countries formerly in protracted arrears to the IMF following the completion of a rights accumulation program[6] and the clearance of arrears. Subsequently, to facilitate the completion of the financing package for the continuation of the PRGF and the HIPC Initiative, the SCA-2 was terminated in 1999 and the balances in the account were distributed to contributing members.

In April 1999, the basic rate of charge for FY2000 was set at 113.7 percent of the SDR interest rate in order to achieve a net income target of SDR 128 million, or 5 percent of the IMF's reserves at the beginning of the year; the allocation to the SCA-1 was also set at 5 percent of reserves. Any income in excess of the target, other than income from the SRF, Y2K Facility, or CCL, would be used to reduce the rate of charge retroactively. The net income target was effectively reduced to SDR 101 million in December 1999, when the Executive Board decided that the income effects of accepting gold in the settlement of financial obligations to the IMF would be borne by the IMF.

[6]See discussion of progress under the strengthened cooperative strategy for an update on the rights approach.

Box 6.4

IMF Off-Market Gold Transactions Help Finance the HIPC Initiative

To help finance its contribution to the HIPC Initiative, the IMF in FY2000 conducted a series of off-market transactions in gold with two member countries over a four-month period, thereby realizing profits corresponding to the difference between the value of the gold at the market price and at the official price of gold in the IMF's balance sheets.

During December 1999–April 2000, the IMF sold a total of 12.944 million fine ounces of gold to Brazil and Mexico at the prevailing market price on the day of each transaction. The total amount sold was equivalent to SDR 2.7 billion ($3.7 billion). After each sale, the gold was immediately accepted back by the IMF at the same price in settlement of financial obligations of these members to the IMF. The net effect of these transactions left the IMF's holdings of physical gold unchanged, but the gold accepted back was revalued at the market prices of the transactions. No gold was released to the market, and thus there was no impact on the balance of supply and demand in the market.

In accordance with the Articles of Agreement, the equivalent of SDR 35 per fine ounce from the proceeds of the sales was placed in the General Resources Account. The proceeds in excess of this amount (totaling SDR 2.2 billion, or $3.0 billion, net of transaction costs) are held in the Special Disbursement Account and invested (see Box 6.5 on the recent modification of the IMF's investment approach). The income from these investments, which will be transferred to the PRGF-HIPC Trust when needed, will be used only to help finance the IMF's contribution to the HIPC Initiative. To date, the Executive Board has authorized the transfer of nine-fourteenths of the investment income to the PRGF-HIPC Trust; the transfer of the remainder will require a further Board decision.

The gold transactions reduce the IMF's liquidity as well as its net income. For FY2000, the Board decided that the IMF would absorb the loss of net income through a reduced accumulation of reserves; it subsequently adopted a decision on how to deal with the loss of income in FY2001 (see text).

Box 6.5
Investment of SDA, PRGF, and PRGF-HIPC Resources

The resources held in the Special Disbursement Account (SDA), in the Reserve and Subsidy Accounts of the PRGF Trust, and in the PRGF-HIPC Trust are the main resources used to finance IMF lending under the PRGF and its contribution to the HIPC Initiative. These resources are invested by the IMF, with the return on the investments used to supplement the resources.

The IMF introduced a new investment approach in March 2000, which is expected to increase investment returns over time while limiting risk. This should enhance the protection provided to lenders to the PRGF Trust, generate additional resources for subsidizing PRGF lending and for interim PRGF and HIPC operations, and expand the size of the self-sustained PRGF.

The large increase in resources available for investment—including those arising from off-market gold sales and the termination of the second Special Contingent Account (SCA-2) in support of interim PRGF and HIPC operations—made the change in investment strategy particularly timely. These resources will peak at about SDR 10 billion in 2003 before declining gradually thereafter.

Previously, investments had been made in short-term SDR-denominated deposits with the Bank for International Settlements. Under the new approach, the maturity of the investments will be lengthened by shifting part of the resources to portfolios consisting mainly of bonds issued by the governments of the countries whose currencies are included in the SDR basket and medium-term instruments issued by the Bank for International Settlements.

Unpaid charges due from members in protracted arrears and the allocation to the SCA-1 resulted in adjustments to the basic rate of charge of 16 basis points, and to the rate of remuneration of 17 basis points, in FY2000. The adjusted rates of charge and remuneration averaged 4.33 percent and 3.50 percent, respectively, for the financial year.

The IMF's net income in FY2000, excluding the effect of the adoption of International Accounting Standard 19 (IAS 19), totaled SDR 271 million. Of this amount, SRF income, net of the annual expenses of administering the PRGF Trust, was SDR 167 million. The GRA was not reimbursed for the expenses of administering the PRGF Trust in FY2000; instead, an equivalent amount was transferred through the Special Disbursement Account to the PRGF-HIPC Trust. Non-SRF income was SDR 104 million. At the end of the financial year, non-SRF income of SDR 3 million in excess of the net income target was returned to members that paid charges, retroactively reducing the FY2000 rate of charge to 113.5 percent of the SDR interest rate.

Following the retroactive reduction in the rate of charge, SDR 268 million was placed to the IMF's reserves—SDR 167 million of SRF income to the General Reserve and the SDR 101 million of non-SRF income to the Special Reserve. In addition, the adoption of IAS 19 on employee benefits resulted in a one-time accounting gain of SDR 268 million, which was placed to the Special Reserve (see Box 6.6). Total reserves rose to SDR 3.1 billion as of April 30, 2000, from SDR 2.6 billion a year earlier.

Precautionary balances (that is, reserves net of the IAS 19 accounting gain plus the balance in the SCA-1) totaled SDR 4.0 billion as of April 30, 2000, compared with SDR 3.6 billion as of April 30, 1999; they were equal to 409 percent of GRA credit outstanding to members in arrears to the IMF by six months or more and 9.0 percent of total outstanding GRA credit.

In April 2000, the Executive Board decided to set the FY2001 net income target at SDR 48 million (excluding SRF and CCL income)—in light of the loss of income resulting from the off-market gold transactions—and to generate SDR 94 million for the SCA-1 through burden sharing. The FY2001 basic rate of charge was set at 115.9 percent of the SDR interest rate. The Board also renewed the burden-sharing mechanism for deferred charges and agreed to forgo the reimbursement to the GRA for the expenses of administering the PRGF Trust for the financial years from FY2001 through FY2004; an equivalent amount will be made available to the PRGF-HIPC Trust. Finally, the Board decided that net income from the SRF and CCL for FY2001, after meeting the expenses of administering the PRGF Trust, would be placed to the General Reserve at the end of the year.

Overdue Financial Obligations

Total overdue financial obligations to the IMF increased slightly in FY2000, to SDR 2.32 billion as of end-April 2000, from SDR 2.30 billion a year earlier.[7] All overdue members as of end-April 2000 were in protracted arrears, that is, overdue by six months or more. No new cases of protracted arrears emerged in FY2000, nor were any of the existing cases resolved, which left the number of member countries in protracted arrears to the IMF at seven. Data on arrears to the IMF by member, type, and duration are shown in Table 6.5.

Overdue financial obligations continued to be concentrated among four member countries—the Democratic Republic of the Congo, Liberia, Somalia, and Sudan—whose arrears accounted for 94 percent of

[7]The data in this section include the overdue financial obligations of the Federal Republic of Yugoslavia (Serbia/Montenegro), which has not yet completed arrangements for succession to IMF membership.

Table 6.5
Arrears to the IMF of Countries with Obligations Overdue by Six Months or More, by Type and Duration, as of April 30, 2000
(In millions of SDRs)

		By Type			By Duration			
	Total	General Department (incl. SAF)	SDR Department	Trust Fund	Less than one year	1–2 years	2–3 years	3 years or more
Afghanistan, Islamic State of	4.8	—	4.8	—	1.1	1.2	1.2	1.3
Congo, Democratic Republic of the	378.6	367.1	11.5	—	19.2	27.8	34.9	296.7
Iraq	40.9	0.1	40.8	—	3.8	4.2	4.1	28.9
Liberia	472.5	423.1	19.3	30.1	9.7	10.6	10.8	441.4
Somalia	203.4	188.9	7.7	6.8	4.8	5.2	6.2	187.3
Sudan	1,126.6	1,048.9	—	77.7	19.6	22.9	25.1	1,059.0
Yugoslavia, Federal Republic of (Serbia/Montenegro)	96.3	75.3	21.0	—	5.0	5.5	5.5	80.3
Total	**2,323.2**	**2,103.4**	**105.1**	**114.6**	**63.1**	**77.4**	**87.8**	**2,094.9**

total overdue obligations to the IMF as of end-April 2000. As of that date, these four members were ineligible under Article XXVI, Section 2(a) to use the general resources of the IMF. Declarations of noncooperation—a further step under the strengthened cooperative arrears strategy (see below)—were also in effect for the Democratic Republic of the Congo (issued on February 14, 1992) and Liberia (issued on March 30, 1990); a declaration of noncooperation regarding Sudan issued on September 14, 1990, was lifted on August 27, 1999. The voting rights of the Democratic Republic of the Congo and Sudan were suspended (effective June 2, 1994, and August 9, 1993, respectively). In addition, a complaint with respect to the compulsory withdrawal from the IMF of Sudan (issued on April 8, 1994) remained outstanding.

Progress Under the Strengthened Cooperative Strategy

The strengthened cooperative strategy on overdue financial obligations to the IMF was initiated in 1990. *Prevention* of the emergence of new cases of arrears is the first line of defense under the strategy. Preventive measures include IMF surveillance of members' economic policies, policy conditionality required for the use of IMF resources, technical assistance by the IMF in support of members' adjustment and reform efforts, and the assurance of adequate balance of payments financing for members under IMF-supported programs.

The *intensified collaborative element* of the strategy provides a framework for cooperating members in arrears to establish a strong track record of policy performance and payments to the IMF and, in turn, to mobilize bilateral and multilateral financial support for their adjustment efforts and to clear arrears to the IMF and other creditors. Pursuit of the intensified collaborative approach has resulted in the normalization of relations between the IMF and most of the members in protracted arrears at the time of establishment of the intensified cooperative strategy.

The rights approach, established in 1990, allows eligible members (limited to the 11 members in protracted arrears to the IMF at the end of 1989) to build a track record of policy performance and payments, and thereby to accumulate "rights" to a future disbursement under a subsequent IMF arrangement following the conclusion of the rights accumulation program and the clearance of arrears to the IMF. In light of the risks associated with large disbursements to members previously in protracted arrears, the second Special Contingent Account (SCA-2) was established as a precautionary balance and source of additional liquidity to assist in the financing of encashments of rights under arrangements in the GRA. Similarly, the IMF pledged to mobilize up to three million ounces of gold in respect of encashments of rights under PRGF Arrangements, in the event of a potential shortfall in resources available to meet PRGF Trust obligations.

At meetings in late August and early December 1999, the Executive Board considered a proposal for an early termination of the SCA-2 to complete a financing package for the continuation of the PRGF and the HIPC Initiative. The Board agreed that under plausible assumptions, the IMF's other precautionary balances would provide adequate protection against the risks associated with outstanding and future rights-related disbursements, and that termination of the SCA-2 would not prevent a continuation of the rights approach. Subsequently, the Board decided to extend the availability of the rights approach until end-June 2000.

Box 6.6
IMF's Financial Statements and External Audit

The IMF's financial statements for FY2000 are presented in full compliance with International Accounting Standards as promulgated by the International Accounting Standards Committee, and have been revised to enhance completeness and transparency.

The financial statements are audited in accordance with International Auditing Standards by an external audit firm. The arrangements for the external audit were revised in FY2000 by shifting the formal responsibility for the audit from the External Audit Committee to the external audit firm, and giving the External Audit Committee an oversight role. The external audit firm is selected by the Executive Board in consultation with the External Audit Committee.

In December 1999, the IMF appointed Pricewaterhouse-Coopers as the external audit firm for a five-year period starting in FY2000, and at the same time named the three members of the External Audit Committee: K.N. Memani of India, Chairman and Country Managing Partner of S.R. Batliboi & Co., a member firm of Ernst & Young International; Giorgio Loli of Italy, Professor of Accounting at Bocconi University in Milan and former Managing Partner of KPMG, Italy; and Juan Humud Giacaman of Chile, Chairman of Ernst & Young Chile.

The final element of the strategy is the timetable of *remedial measures* applied to member countries with overdue obligations that do not actively cooperate with the IMF in seeking a solution to their arrears problems. This timetable guides Executive Board consideration of remedial measures of increasing intensity, although the application of each particular step is considered in light of the individual circumstances of the member concerned. In the cases of Afghanistan, the Democratic Republic of the Congo, Iraq, and Somalia, where civil conflicts, the absence of a functioning government, or international sanctions have prevented the IMF from reaching a judgment regarding the member's cooperation, the application of remedial measures has been delayed or suspended until such a judgment can be reached.

In July 1999, the Executive Board decided to establish clear understandings regarding the de-escalation of certain remedial measures to further strengthen incentives for members in protracted arrears to cooperate with the IMF, with the ultimate objective of full clearance of arrears and the restoration of access to IMF resources. Basic steps in the de-escalation process would include a determination by the Board that the member had begun to cooperate in solving its arrears problems, the establishment of an evaluation period during which cooperation would be expected to strengthen further, and the phased lifting of a declaration of noncooperation and, if applicable, the suspension of voting and related rights in the IMF. Shortly after its introduction, de-escalation was applied for the first time in August 1999 in the case of Sudan.

The Executive Board conducted several reviews of member countries' overdue obligations to the IMF during FY2000. It reviewed Liberia's overdue obligations on three occasions, deciding to defer further remedial measures in the light of commitments by the authorities to improve policy performance. In February 2000, following the formulation of a new staff-monitored program, Directors decided to provide time for the authorities to implement the program and urged Liberia to continue to strengthen its cooperation with the IMF.

No meeting was held during FY2000 on the decision to suspend the Democratic Republic of the Congo's voting and related rights. In August 1999, prospects for peace improved in the Congo with the signing of a peace agreement by the countries involved in the military conflict that began in August 1998. With the cessation of hostilities, a staff team visited the Congo in February 2000 to review economic developments and discuss with the authorities their readiness to renew cooperation with the IMF. The next review of the Congo's arrears to the IMF will be held by June 10, 2000.

On two occasions, the Board reviewed the overdue obligations of Sudan, which has the largest and most protracted arrears to the IMF. In August 1999, in view of Sudan's improved record of cooperation regarding policies and payments to the IMF, the Board decided to lift the declaration of noncooperation with respect to Sudan in place since 1990, and to consider lifting the suspension of Sudan's voting and related rights in the IMF if Sudan's cooperation continued to strengthen over the next 12 months. In February 2000, the Board decided not to proceed with a recommendation to the Board of Governors regarding compulsory withdrawal, in light of Sudan's payments to the IMF and its broadly satisfactory performance under the 1998 and 1999 staff-monitored programs.

SDR Department

The SDR is an international reserve asset created by the IMF under the First Amendment to its Articles of Agreement to supplement other reserve assets. First allocated in January 1970, total SDR allocations currently amount to SDR 21.4 billion. SDRs are held largely by member countries—all of which are participants in the SDR Department—with the balance held in the IMF's General Resources Account and by official entities prescribed by the IMF to hold SDRs. Prescribed holders do not receive SDR allocations but can acquire and use SDRs in operations and transactions with participants in the SDR Department and with other prescribed holders under the same terms and conditions as participants. During FY2000, the number of prescribed holders remained at 15.[8]

The SDR is the unit of account for IMF operations and transactions. It is also used as a unit of account, or the basis for a unit of account, by a number of other international and regional organizations and international conventions. In addition, to a very limited extent, the SDR has been used to denominate financial instruments created outside the IMF by the private sector (private SDRs). At the end of FY2000, four member countries' currencies were pegged to the SDR.

The Board of Governors adopted a resolution in September 1997 proposing a Fourth Amendment to the IMF's Articles of Agreement to enable all participants in the SDR Department to receive an equitable share of cumulative SDR allocations. The proposed amendment, when approved, will authorize a special one-time allocation of SDR 21.4 billion, which would raise all participants' ratios of cumulative SDR allocations to quota under the Ninth General Review to a common benchmark ratio of 29.32 percent. Appendix II, Table II.12, shows the amounts of SDRs that existing participants will be eligible to receive under the special allocation. The proposed amendment also provides for future participants to receive a special allocation following the later of the date of their participation, or the effective date of the amendment. The amendment will become effective when ratified by three-fifths of member countries having 85 percent of the total voting power. As of the end of FY2000, 79 members representing 50.2 percent of the total voting power had ratified the proposed amendment. The amendment does not affect the IMF's existing power to allocate SDRs based on a finding of a long-term global need to supplement reserves.

SDR Valuation and Interest Rate Baskets

The SDR's valuation is determined using a basket of currencies, the composition of which is reviewed every five years. Since 1981, the currencies of five countries—France, Germany, Japan, the United Kingdom, and the United States—have been included in the basket, as successive five-yearly reviews have determined that these are the five countries with the largest exports of goods and services. The five-yearly reviews also specify the initial weights of the currencies in the basket, reflecting their relative importance in international trade and reserves, as measured by the value of exports of goods and services of the countries issuing them and the balances of the currencies held as reserves by members of the IMF.[9]

With the introduction of the euro on January 1, 1999, the currency amounts of the deutsche mark and French franc in the SDR basket were replaced with equivalent amounts of the euro, based on the fixed conversion rates between the euro and the deutsche mark and the French franc announced by the European Council on December 31, 1998. The calculation of the value of the SDR for the last (business) day of FY2000 is shown in Table 6.6.

Table 6.6
SDR Valuation
(As of April 28, 2000)

Currency	Amount of Currency Units	Exchange Rate[1]	U.S. Dollar Equivalent
Euro (Germany)	0.2280	0.90620	0.206614
Euro (France)	0.1239	0.90620	0.112278
Japanese yen	27.2000	107.27000	0.253566
Pound sterling	0.1050	1.56810	0.164651
U.S. dollar	0.5821	1.00000	0.582100
			1.319209

Memorandum
SDR 1 = US$1.31921
US$1 = SDR 0.758030

[1]Exchange rates in terms of U.S. dollars per currency unit except for the Japanese yen, which is in currency units per U.S. dollar.

Since 1983, the SDR interest rate has been calculated weekly as a weighted average of interest rates on selected short-term instruments in the five countries whose currencies are included in the valuation basket. The financial instruments are reviewed every five years to ensure that they are representative of the instruments actually available to investors in a particular currency and maturity, that the interest rates on the instruments are responsive to changes in underlying credit conditions in the respective markets, and that they have risk characteristics similar to the official standing of the SDR. Since 1991, the financial instruments and rates have been the market yield on three-month treasury bills for France, the United Kingdom, and the United States; the three-month interbank deposit rate for Germany; and the three-month rate on

[8]Prescribed holders of SDRs are the African Development Bank, African Development Fund, Arab Monetary Fund, Asian Development Bank, Bank of Central African States, Bank for International Settlements, Central Bank of West African States, East African Development Bank, Eastern Caribbean Central Bank, International Bank for Reconstruction and Development, International Development Association, International Fund for Agricultural Development, Islamic Development Bank, Latin American Reserve Fund, and Nordic Investment Bank.

[9]Specific currency amounts consistent with these weights are fixed on the date on which the decision becomes effective. While these currency amounts remain unchanged for the subsequent five-year period, the actual weights of the respective currencies in the value of the SDR change on a daily basis as a result of changes in exchange rates.

Table 6.7
Transfers of SDRs
(In millions of SDRs)

	Financial Years Ended April 30								
	1992	1993	1994	1995	1996	1997	1998	1999	2000
Transfers among participants and prescribed holders									
Transactions by agreement	5,019	5,056	3,122	8,987	8,931	7,411	8,567	13,817	6,639
Transactions with designation	—	—	—	—	—	—	—	—	—
Prescribed operations	240	5,610	406	124	1,951	88	86	4,577	293
IMF-related operations	149	94	436	301	704	606	901	756	684
Net interest on SDRs	441	337	121	174	319	268	284	289	214
Total	**5,848**	**11,097**	**4,085**	**9,586**	**11,905**	**8,372**	**9,839**	**19,439**	**7,831**
Transfers from participants to General Resources Account									
Repurchases	1,838	583	642	1,181	5,572	4,364	2,918	4,761	3,826
Charges	1,883	1,798	1,425	1,386	1,985	1,616	1,877	2,806	2,600
Quota payments	11	12,643	71	24	70	—	—	8,644	528
Interest received on General Resources Account holdings	57	128	336	262	53	51	44	35	138
Assessments	4	3	4	4	4	4	4	3	3
Total	**3,794**	**15,155**	**2,478**	**2,857**	**7,683**	**6,035**	**4,844**	**16,249**	**7,094**
Transfers from General Resources Account to participants and prescribed holders									
Purchases	1,881	5,769	2,676	5,970	6,460	4,060	4,243	9,522	3,592
Repayments of IMF borrowings	500	350	300	862	—	—	—	1,429	—
Interest on IMF borrowings	77	92	162	97	—	—	—	46	18
In exchange for other members' currencies									
Acquisitions to pay charges	253	699	166	99	49	224	20	545	1,577
Acquisitions to make quota payments	—	—	—	—	—	—	—	—	—
Reconstitution	—	—	—	—	—	—	—	—	—
Remuneration	1,009	922	958	815	1,092	1,055	1,220	1,826	1,747
Other	89	73	108	51	259	27	90	74	1,007
Total	**3,808**	**7,905**	**4,370**	**7,894**	**7,859**	**5,366**	**5,574**	**13,442**	**7,942**
Total transfers	**13,450**	**34,157**	**10,933**	**20,336**	**27,448**	**19,773**	**20,256**	**49,130**	**22,867**
General Resources Account holdings at end of period	**680**	**7,930**	**6,038**	**1,001**	**825**	**1,494**	**764**	**3,572**	**2,724**

certificates of deposit for Japan. With effect from January 1, 1999, the French and German instruments have been expressed in euros. The next review of the SDR valuation and interest rate baskets will take place before the end of 2000, with any changes to take effect on January 1, 2001.

SDR Operations and Transactions

After having peaked in FY1999 at SDR 49.1 billion—largely as a result of the payments of Eleventh Review quota increases—total transfers of SDRs by participants, the GRA, and prescribed holders decreased in FY2000 to SDR 22.9 billion. In addition to the winding down of the quota payments, the decline in transfers can be attributed to delays in a number of large disbursements under arrangements with members during FY2000. Summary data on transfers of SDRs are presented in Table 6.7 (see also Appendix II, Table II.13).

Transactions in SDRs are facilitated by arrangements with 12 member countries that stand ready to buy or sell SDRs for one or more freely usable currencies provided that their SDR holdings remain within certain limits. These arrangements have helped ensure the liquidity of the SDR system, obviating the need in recent years for recourse to the designation mechanism (under which participants whose balance of payments and reserve positions are deemed sufficiently strong may be obliged, when designated by the IMF, to provide freely usable currencies in exchange for SDRs up to specified amounts). During FY2000, transactions totaling SDR 6.6 billion were conducted under such arrangements, including sales of SDR 3.9 billion and purchases of SDR 2.7 billion.

Transfers of SDRs among participants and prescribed holders fell to SDR 7.8 billion in FY2000 from SDR 19.4 billion in FY1999, mainly because of substantial decreases in transactions by agreement and in the use of the same-day SDR borrowing facility by members paying the reserve asset portion of their Eleventh Review quota increases.

SDR transfers from participants to the GRA declined to SDR 7.1 billion in FY2000 from SDR 16.2 billion in FY1999, reflecting the decrease in quota payments, lower use of SDRs in repayments of IMF credit, and a decline in charges. The large accumulation of SDRs by the GRA in the early part of the year led to an increase in interest received by the GRA on its SDR holdings.

Drawings from the IMF in SDRs amounted to SDR 3.6 billion during FY2000 and represented the largest category of transfers from the GRA, followed by remuneration payments of SDR 1.7 billion to members with creditor positions. Other transfers included the termination of the second Special Contingent Account (SCA-2) in December 1999, which led to the distribution of SDR 1.0 billion from the GRA to participants.

Pattern of SDR Holdings

The IMF's holdings of SDRs in the GRA are targeted to be within the range of SDR 1.0–1.5 billion. By the end of FY2000, these holdings had fallen to SDR 2.7 billion, from SDR 3.6 billion a year earlier. Holdings of SDRs by participants increased correspondingly to SDR 18.1 billion at the end of FY2000, from SDR 17.4 billion a year earlier.

The SDR holdings of the industrial countries relative to their net cumulative allocations increased to 95.0 percent at the end of FY2000, from 94.6 percent a year earlier. The holdings of the nonindustrial countries rose to 62.5 percent of their net cumulative allocations, from 52.5 percent a year earlier, mainly as a result of the distribution of the balances in the SCA-2 (Appendix II, Table II.14). The SDR holdings of prescribed holders increased during FY2000, mainly reflecting the IMF's investment of Structural Adjustment Facility (SAF) and PRGF resources in official SDRs held by the Bank for International Settlements.

Issues Related to IMF Support for Member Countries

Review of IMF Financial Facilities

In March 2000, the Executive Board initiated a general review of IMF financing facilities in the light of changes in the world economy. The discussion was preliminary and part of the broader debate on the reform of the architecture of the global financial system (see Chapter 4).

With regard to eliminating facilities not being used or no longer serving members' needs, Directors agreed that the policies on Currency Stabilization Funds (CSF) and on IMF support for commercial bank Debt and Debt-Service Reduction (DDSR) operations[10] could be eliminated. This would bring to four—including the Buffer Stock Financing Facility and the contingency element of the Compensatory and Contingency Financing Facility eliminated earlier in the year—the number of facilities eliminated. At the same time, Directors thought it appropriate to retain policies on the first credit tranche and on emergency assistance for natural disasters and postconflict cases.

As to the Compensatory Financing Facility, Directors' views were essentially the same as in January 2000 (see discussion above under "Special Facilities and Policies"). Most Directors favored adopting a streamlined CFF along the lines discussed in January for a period of two years, at which time it could be reviewed again, including the cereal import element, in the light of experience with, and of developments in, other facilities.

Considering the IMF's financing role more broadly, Directors took note, in particular, of the fact that the bulk of IMF financing in recent years was in support of countries hit by financial market crises and, to a lesser degree, in support of transition economies. Directors emphasized that the globalization of capital markets raised important issues regarding the role of the IMF. They recognized the possibility that the large-scale financing provided by the IMF in the crises of capital market confidence of recent years could create an element of moral hazard. Efforts to stem this effect were important. Directors recalled that the Supplemental Reserve Facility (SRF) was created in 1997 in response to the distinct nature of these new crises—notably, the likelihood that they could be reversed relatively quickly—and its design had been influenced by concerns about moral hazard. These considerations were behind the SRF's shorter maturity and higher charges. The SRF appeared to have proven itself an appropriate tool, and the expectation that members would be able to repay relatively quickly was well-founded. While it was not proposed that modifications be made to the

[10]IMF support for commercial bank DDSR operations partially financed the upfront cost of these operations, to help members reach agreement with their commercial bank creditors. Set-asides (25 percent of access under IMF arrangements) and additional resources from augmentations (up to 30 percent of quota) could be used for instruments involving either debt or debt-service reduction. The set-asides and additional resources could be released once the member had reached an agreement with its commercial bank creditors.

SRF at the time of the discussion, the issues could be revisited at a later stage.

Directors stressed the importance of continued efforts to strengthen the IMF's policies in the area of crisis prevention, including by redesigning its facilities to encourage members' efforts in this area. The idea that large precautionary arrangements could perhaps substitute for the Contingent Credit Lines (CCL) was raised. Many Directors, however, noted that a separate CCL facility brought greater flexibility, particularly in terms of maturity and charges, and that the signaling role of the CCL would be difficult to replicate in the context of precautionary arrangements. Most Directors thus favored additional experimentation with the design of the CCL.

Many Directors favored considering a number of suggestions for adjusting the CCL's design—in particular, lowering the surcharge on the use of CCL resources, reducing the commitment fee, and reducing the IMF's discretion in its activation; these would increase the incentives for members to use the CCL, rather than relying on access to the SRF once a crisis had begun. A few Directors cautioned against any weakening in CCL conditionality. A few others suggested that modifying the CCL, as well as possibly changing the SRF, should await progress on the issue of private sector involvement in resolving crises.

Many Directors saw merit in permitting precautionary arrangements to be larger than typically in the past, even as experimentation with the design of the CCL continued. Nevertheless, they agreed, average access under precautionary arrangements should continue to be relatively small, with high access limited to a small number of cases.

Directors differed on the use of IMF resources by members with access to capital markets. The Board recognized that, under the Articles of Agreement, these members, like any others, had the right to represent that they had a balance of payments need that justified the use of IMF resources. At the same time, the Board noted that the IMF had instruments through which it could limit access to its resources by members and through which it could influence their incentives to use IMF resources. Most Directors, however, did not see access to IMF resources by members with access to capital markets as a source of concern. They did not believe that such access either discouraged members from, or substituted for, access to capital markets; rather, IMF financing was clearly in some cases complementary to market access as it helped catalyze private financing.

A number of other Directors, however, were concerned that some members might rely unduly on IMF financial assistance in place of market financing. These Directors emphasized that IMF financial support should be available where required in support of a member's adjustment efforts, thus helping to avoid "excessive" adjustment. But they cautioned against the possibility that members might use IMF resources only to reduce their borrowing costs. They believed that countries should make significant efforts to meet their own financing needs, and stressed that the structure of IMF facilities was a key element in the degree to which the IMF helped market discipline work and supported countries in working with capital markets.

Noting that the rate of charge was key in determining whether and for how long members used IMF resources, a few Directors argued that the rate of charge on credit tranche and/or Extended Fund Facility (EFF) resources should be raised. However, some Directors argued that a "subsidy" element in the rate of charge could be justified based on the positive externalities for the world economy from stronger economic policies. A number of Directors, moreover, indicated that other "costs" not captured by the rate of charge were involved in using IMF resources and emphasized the IMF's cooperative nature. All in all, Directors wished to consider further the issue of the rate of charge, and possible differentiation of charges among facilities.

The Board discussed what should be the maximum maturities offered by the IMF, consistent with the revolving character of its resources and with members' evolving needs. It agreed that IMF resources should be used to resolve temporary balance of payments problems, but that interpretations could differ as to what constituted a "temporary" need. Most Directors argued that, within this framework, the EFF continued to play an important role and should be retained. They stressed that certain balance of payments problems required a long time to resolve; by way of example, these Directors cited the transition economies with limited access to capital markets and some of the lower-income members that were ineligible for the Poverty Reduction and Growth Facility. In this connection, many of these Directors believed the 10-year maturity of the EFF remained appropriate. A number of other Directors, however, questioned whether 10-year maturities were consistent with the revolving nature of IMF facilities, and the degree to which the IMF should finance structural reforms. They observed that primary responsibility for such policies had to remain with the World Bank and other development institutions. Some Directors also felt that the distinctions between Extended and Stand-By Arrangements had become less clear, as many Stand-By Arrangements had come to feature important structural reforms, and as multiyear Stand-By Arrangements had become more common. A few Directors proposed that successive Stand-By Arrangements could be a more effective way to address longer-term balance of payments problems. As to the EFF, Directors agreed it was important to ensure that access was granted only when balance of payments difficulties were expected to be longer term, and when an ambitious structural reform program was being pursued. A number of Directors indicated that precautionary extended arrangements should be discontinued, as it was unlikely that a potential balance of payments need would ever be of an extended nature. It was agreed that the discussion would need to continue in the light of the many ideas tabled to modify the EFF's terms.

Directors noted that the question of tailoring maturities, under both the credit tranches and the EFF, would become a less-pressing issue if the IMF had a well-functioning early repurchase (repayment) policy. Many Directors saw a need to strengthen that policy, although they recognized the difficulty of doing so.

While noting that few members drew on IMF resources year after year, a number of Directors were concerned about repeated IMF arrangements for a relatively large number of members. In particular, Directors were concerned about the number of instances of such arrangements going off-track, and thought that this issue warranted further investigation. Many Directors saw room for the IMF to strengthen its review of country programs when there had been successive arrangements, including the extent to which implementation capacity had constrained performance. Some Directors also emphasized the need for front-loading of policy actions and back-loading of financing in cases where previous IMF-supported programs had not been successful or had gone off-track.

In his summary, the Acting Chairman noted that the Board had made progress in understanding, and narrowing, the differences of view on many points. The area of "streamlining" had proved relatively uncontroversial. On more fundamental issues, there was a broad consensus that the Supplemental Reserve Facility represented an important tool, and that the IMF must continue to make strong efforts to limit moral hazard and involve the private sector in resolving crises. The Board agreed, also, to reconsider the design of the Contingent Credit Lines with a view to strengthening their potential contribution to crisis prevention. Directors expressed various views on the Extended Fund Facility, agreeing that the IMF should grant access only when balance of payments difficulties were expected to be of an extended nature and when the structural reform content was substantial. There was a strong sense that the Stand-By Arrangement in the credit tranches would remain the IMF's principal instrument, but many Directors felt the need to ensure that there was no undue reliance on IMF resources, particularly by members with ongoing access to capital markets. Concern was also expressed that the IMF had to do more to prevent a succession of arrangements for a given country, and to better monitor members' performance after their IMF-supported programs had ended.

The Board asked the staff to come back to it with specific proposals for follow-up in FY2001.

Strengthening Safeguards and Addressing Misreporting

Several episodes of misreporting and allegations of misuse of IMF resources in FY2000 led to a reassessment of the adequacy of the IMF's existing procedures to safeguard its resources. While such episodes have been rare, the IMF views them with the gravest concern, as they represent a breach of trust by certain members and could undermine the IMF's credibility and reputation as a careful and prudent manager of the resources entrusted to it and as a provider of financial assistance and policy advice to its members. This, in turn, could undermine the IMF's ability to operate effectively in the longer term.

In September 1999, the Interim Committee called on the IMF to review its procedures and controls to identify ways to strengthen safeguards on the use of its resources. The review of safeguards was aided by a panel of eminent outside experts, who provided the Executive Board with an independent assessment of staff proposals. In October 1999, the IMF's Executive Board also initiated a separate review of the IMF's legal framework, policies, and procedures related to misreporting.

In early 2000, the Executive Board discussed both misreporting and safeguards issues. Directors noted that reliable information was essential to every aspect of the IMF's work—including surveillance, financing, and technical assistance—and that it was critical to ensure that the IMF's resources were used for their intended purposes.

The existing safeguards for the reliability of information stem from program design, conditionality, and monitoring, and the availability of technical assistance, as well as transparency and governance initiatives; the latter include the establishment and monitoring of codes and standards for data dissemination, fiscal transparency, and transparency in monetary and financial policies (see, for example, Box 6.7 on managing foreign exchange reserves). The IMF also had legal procedures for addressing cases of misreporting that arise.

Nevertheless, Directors felt that strengthening safeguards within member countries would be both desirable and appropriate. The Executive Board agreed on a multifaceted approach to strengthening safeguards on the use of IMF resources. A key element of safeguards within member countries is that central banks publish annual financial statements, independently audited in accordance with internationally accepted standards. Members with existing arrangements and possible disbursements subject to program review after September 2000 are required to furnish the IMF with items 1–3 listed in the Annex. IMF staff would review these documents to assess the adequacy of the external audit

Box 6.7
Managing Foreign Exchange Reserves

At an Executive Board seminar in November 1999, Directors discussed the importance of good reserve management practices to ongoing work within the IMF on ways to strengthen safeguards on the use of its financial resources. The discussion, many Directors observed, was an initial airing of views on a complex set of issues.

Directors underscored that strong IMF-supported programs and the IMF's preferred creditor status remained the first line of defense for safeguarding IMF resources and preventing crises. At the same time, the IMF had to address how, and to what extent, recent events had underscored the need for improved governance and transparency in reserve management, and possibly in the broader area of the use of governmental resources. Although intentional misuse of IMF resources appeared to have been rare, cases of mismanagement of foreign exchange reserves may have been more common, with implications for the IMF's assessment of a country's external position and policies, and, consequently, for the safeguarding of IMF resources. These cases had raised the issue of how to ensure that the IMF's resources were being used for their intended purposes, and that members accurately reported their true foreign reserve position.

Directors broadly supported an attempt by the IMF staff to identify generally accepted sound reserve management practices and the auditing and control of these practices, including by promoting greater transparency in members' foreign exchange operations and reserve holdings. The IMF staff would rely as much as possible on information on member country practices already collected during Article IV consultations and by others, including the World Bank and the Financial Stability Forum. Recognizing, however, the need for consistency and completeness of information, Directors asked the IMF staff to review current risk management and control and transparency practices relating to central bank and exchange fund reserve management operations in several countries. They asked the staff to minimize the demands on both country authorities and IMF staff resources and emphasized that participation in the survey should be voluntary.

The focus of the staff paper on reserve management had potential implications for IMF surveillance. Directors offered a range of views on the merits of including in the surveillance process an assessment of the risk control and management systems that safeguard the integrity of foreign exchange and reserve management operations and supported the transparent reporting of reserves. They noted that a member's observance of the IMF's transparency codes and the Special Data Dissemination Standard (SDDS) initiative—supported by sound accounting standards—would be seen as contributing to good governance and, specifically, to good reserve management practices. Directors also noted that faulty reserve management practices could have implications for protecting the use of IMF resources, in the context of both the perceived integrity and credibility of IMF operations, and possible financial risks to the IMF. They stressed that sound management of reserves was indeed a precondition for protecting the use of IMF resources.

arrangements and report to the Board their findings together with any recommendations for improvements.

The IMF will also introduce two-stage safeguards assessments for countries with new IMF arrangements to evaluate whether the control, accounting, reporting, and auditing systems within their central banks are adequate to control and monitor the resources entrusted to these central banks, including resources provided by the IMF under financial arrangements. In the first stage, the central bank will be asked to provide information and documents related to its internal control and external auditing procedures (see Annex below). If these procedures are judged adequate, the IMF would regard the safeguards assessment as complete. In other cases, a second stage, of an on-site assessment, would follow. The assessment teams for the second stage will be headed by IMF staff, and will include experts from central banks, other multilateral agencies, and private accounting firms. The assessment teams will then propose actions to address any identified weaknesses in internal procedures.

The safeguards assessments and the transitional procedures for countries with existing arrangements are required, on an experimental basis, for all countries starting in mid-2000. The experience with these assessments will be reviewed within 12–18 months with the involvement of the same panel of outside experts that reviewed the original staff proposals.

Remedial Actions on Misreporting

Experience in FY2000 also underlined the need to ensure that the IMF's framework of rules adequately covers cases of misreporting that may arise. The main pillars of the IMF's existing legal framework for addressing cases of misreporting are its Articles of Agreement and the 1984 Guidelines on Misreporting and Corrective Action for the IMF's general resources (plus analogous guidelines adopted in 1998 for the Poverty Reduction and Growth Facility (PRGF)). The Articles establish the obligations of member countries to provide the IMF with information it needs for its work and specify legal remedies—such as a temporary declaration of ineligibility to use the IMF's resources—if a country breaches this obligation. The guidelines state that, if the Board has approved a country's use of IMF resources on the basis of information that proves to be incorrect, the country is expected to repay the IMF promptly.

The Executive Board agreed to broaden the application of the tools for addressing misreporting. In particular, it will act to strengthen the guidelines by applying them to prior actions and other essential information, lengthening the two-year limitation, and applying them to outright drawings. The staff will return to the Board with detailed proposals for implementation. The Board also decided to make public appropriate information on each case of misreporting, after the Board had made its determination, and with Board review of the text.

The IMF's procedures for gathering and using economic and financial information from members are being reinforced. These procedures have typically been among the institution's strengths, as the process of assembling information to form an overall assessment of the economic situation provides the opportunity to cross-check, question, and refine the information initially received. IMF staff are taking steps to tighten these procedures further and will continue their efforts to ensure that the information on which the IMF's decisions are based is the best available.

Summary

The Board agreed that in the past the IMF had been able to rely primarily on trust in members' readiness to provide needed information and to use the IMF's resources for the purposes envisaged. While it should be able to continue to operate on this basis, recent cases of misreporting had driven home the need to strengthen the IMF's procedures. The IMF's response to misreporting of information and the misuse of its resources combines three elements:

- strengthening safeguards within member countries,
- broadening the application of the available legal procedures, and
- strengthening procedures for handling information in the IMF.

None of these is necessarily sufficient in itself to prevent misreporting—particularly if it is intentional. But a combination of actions on all three fronts, the Board agreed, represented a constructive way of addressing these issues and narrowing the scope for potential problems.

Annex: Information/Documents to Obtain from Member Country Central Banks Under the Safeguards Assessments Policy

1. Copies of audited (or unaudited if no audit is performed) financial statements for the past three years, together with related audit reports.
2. Copies of all management letters issued by the external auditors in connection with their audit of the financial statements for the past three years.
3. Copies of all audit reports (including agreed-upon procedures engagements) issued by the external auditors during the past three years.
4. A description of the central bank's management structure, including the organizational reporting structure.
5. A description of the organizational structure and reporting lines of the internal audit department, including details of the senior management staff in the department and a summary of staff resources (experience and qualifications).
6. A summary of high-level internal controls in place for the banking, accounting, and foreign exchange departments of the central bank.
7. Listing of all reports issued by the internal audit department in the past three years and a summary description of findings. Potentially, copies of reports dealing with operational and financial controls during the same period.
8. Details of the full legal names of any subsidiaries of the central bank, and a description of their business and the nature of their relationship with the central bank. A listing of all correspondent banks.
9. A listing of all accounts held by government agencies with the central bank.
10. Copies of current legislation governing the central bank.

Program Design Issues: Inflation Targeting and Conditionality

The Executive Board met in January 2000 to discuss the implications of inflation targeting for IMF conditionality.[11] Directors noted that, in light of the growing consensus that price stability should be the main objective of monetary policy, formal inflation targeting had been increasingly used as a framework for monetary policy, typically in the context of flexible exchange rate arrangements. Inflation targeting generally implies that the monetary authorities' discretion is constrained by the announcement of an explicit inflation target, accompanied by a considerable degree of transparency regarding the link between current monetary policy actions and the pursuit of that inflation target.

Directors saw no inherent obstacle to carrying out monetary policy on the basis of inflation targeting in the context of an IMF-supported program, and they considered the goals of the two to be broadly complementary. Indeed, in the case of Brazil, the IMF had already approved a program with some modifications to traditional conditionality prompted by the government's inflation-targeting regime.

[11] Conditionality refers to the explicit commitments that member countries make to implement remedial policy measures in return for IMF financial support. These commitments ensure that the member is pursuing policies that will ameliorate or eliminate its balance of payments problems and that the IMF will be repaid in a timely way so that its limited pool of resources can be lent to others in balance of payments need.

Successful inflation targeting requires central bank independence and other supportive institutional features, the absence of fiscal dominance, a reasonably good understanding of the inflation process, and a considerable degree of exchange rate flexibility. Although the staff paper did not discuss how frequently these conditions were likely to be met in emerging market economies, a number of Directors thought it essential to examine whether these conditions were in place in a given case before determining if it was appropriate to make use of the "reviews-based" approach to program monitoring proposed by staff. Under such an approach, monetary policy would be subject to periodic reviews focusing on recent inflation results, together with indicators of the implications of monetary policy for future inflation.

Directors generally noted that inflation targeting could be accommodated within the traditional structure of IMF conditionality, including a floor on net international reserves and a ceiling on net domestic assets. While this structure was designed mainly to safeguard IMF resources and check against excessively accommodative monetary policies that would jeopardize macroeconomic stability, Directors thought it could continue to serve those purposes under inflation targeting. A number of Directors, however, saw the possibility of inconsistencies between net domestic asset ceilings and inflation targeting in some circumstances, and consequent confusion about the country's monetary policy priorities. It was generally acknowledged that this possibility warranted close attention and that the relationship between net domestic asset ceilings and inflation targets—the latter serving as the primary guide to monetary policy—would need to be made clear to the public.

At the same time, Directors noted that bringing conditionality more closely into line with the inflation-targeting framework could help enhance the credibility of inflation targeting, and the effectiveness of monetary policy. Such congruence was particularly desirable because of the increasing transparency of the IMF, together with the greater transparency of central bank decision making required by inflation targeting.

Discussing the reviews-based approach to monetary policy conditionality, Directors underscored the importance of broad advance agreement between the IMF and the government on timely monetary responses to possible deviations from the targeted inflation path. The reviews would be held quarterly, or more frequently if needed. If there were no issues of particular concern, completion of such reviews could be proposed on a lapse-of-time basis. At the same time, Directors emphasized that the main responsibility for day-to-day conduct of monetary policy should continue to reside with governments and that the IMF should not seek to micromanage the implementation of monetary policy.

Directors stressed the indispensable need to safeguard the IMF's resources, regardless of the monetary policy framework. A floor on net international reserves would remain essential, under the reviews-based approach, as well as under traditional conditionality. Directors agreed that, in any case in which it was necessary to set the net international reserves floor allowing a significant margin for unprogrammed intervention, some mechanism would be needed to limit sterilization. Such a mechanism could entail a reaction function of monetary policy (how the central bank would adjust interest rates in response to threatened target breaches) to unprogrammed reserve losses, or simply the traditional ceiling on net domestic assets. The specific mechanism would have to be worked out case by case.

For an inflation-targeting country, the reviews-based approach had both advantages and disadvantages. Most Directors were therefore ready to support the staff proposal that the reviews-based approach be made an option for countries conducting monetary policy on the basis of inflation targeting. The choice of whether to use the reviews-based approach had to take account of the country's economic circumstances. Directors believed, therefore, that the appropriate form of monetary policy conditionality should be decided on a case-by-case basis in consultation with governments.

Directors recognized the practical challenges entailed both in adopting an inflation-targeting approach and in implementing the reviews-based approach to conditionality. They suggested that the staff proceed cautiously, advising that further consideration be given to the broad issues related to a reviews-based approach; these included the role of current versus forward-looking indicators of policy, how to address likely data limitations, preparation of inflation forecasts, and similar issues. Directors agreed, however, that, in negotiating programs, the staff should be allowed to set monetary policy conditionality experimentally according to the reviews-based approach. This approach would be reviewed, possibly after about a year.