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COMMUNICATION FROM THE IMF

Reproduced hereunder are the statements made by the observer representatives of the International Monetary Fund at the meeting of 15 April 2002.

IMF Conditionality

1. When the Fund provides financial support to member countries, it must be sure that the members are pursuing policies that will improve or eliminate their external payments problems, so that IMF resources are safeguarded and eventually repaid. The explicit commitment that members make to implement corrective measures in return for the Fund's support is known as "conditionality". By ensuring that members are able to repay loans in a timely manner, the Fund can make its limited pool of financial resources available to other members with balance of payments problems. IMF financing, and the important role it plays in helping a country secure other financing, enables the country to adjust in an orderly way without resorting to measures that would harm its own or other countries' prosperity.
2. Conditions for IMF financial support may range from general commitments to cooperate with the Fund in setting policies, to the formulation of specific, quantified plans for economic and financial policies. The Fund requires a "letter of intent" or a "memorandum of economic and financial policies", in which a government outlines its policy intentions during the period of the adjustment program; any policy changes it will make before the arrangement can be approved; performance criteria, which are objective indicators for certain policies that a country must implement in order to draw IMF funds; and periodic reviews that allow the Executive Board to assess whether the member's policies are consistent with program objectives.
3. Conditions have been attached to IMF lending since the mid-1950s, focusing initially on monetary, financial, fiscal, and exchange rate policies. Beginning in the late 1980s, the Fund increasingly emphasized economic growth as a goal of its programs while also expanding its involvement in countries whose severe structural problems prevented them from achieving a sustainable balance of payments position. While the average program involved two to three structural conditions a year in the mid-1980s, by the second half of the 1990s, that number had risen to 12 or more.
4. This increase raised concerns that the Fund might be overstepping its mandate and expertise by applying conditions outside its core areas of responsibility. Excessively detailed policy conditions could undermine a country's sense of "ownership" of a reform program—without which reform will not happen. Moreover, poorly focused conditionality could strain the administrative capacity of countries attempting to implement nonessential reforms at the cost of reforms truly needed for economic growth and continued access to IMF financing.

5. Driven by the Managing Director, the Fund has given high priority to streamlining conditionality—to make it more efficient, effective, and focused, without weakening it—and strengthening national ownership.

6. The broad lines of reform of conditionality are:

- Structural reforms crucial for achieving a program's macroeconomic objectives need to be covered by IMF conditionality.
- Reforms that are relevant, but not crucial, to the program's objectives require a more focused and parsimonious application of conditionality.
- The appropriate coverage and content of conditionality are likely to vary, depending on countries' circumstances as well as on the applicable IMF facility.
- Coordination with the World Bank and other agencies is important.
- Increased reliance on program reviews, useful for both forward- and backward-looking assessments of countries' economic policies, should not weaken member countries' confidence in continued access to IMF resources.
- Structural benchmarks, useful for tracking progress in implementing structural reforms, should be limited to important and representative steps towards a policy outcome that is important to program objectives.
- Letters of intent should either focus only on those aspects of policy covered by conditionality, or, in cases in which the authorities wish to use the letters to present their broad policy agenda, clearly indicate with program elements are subject to conditionality.
- The negotiations of reform programs should allow country authorities to consider various policy alternatives so that the resulting program reflects the circumstances and priorities of the country, thus ensuring its "ownership" of the program.

Remaining issues and challenges

7. Drawing the line between measures crucial for program objectives and those relevant but not so critical, and determining whether (or how) IMF conditionality would be applied to the latter are issues requiring judgment on a case-by-case basis. Related to that issue is the need to construct a framework for coordination with the World Bank and other development institutions for those program areas outside the IMF's core areas of responsibility. On program design, the pace and sequencing of structural reforms need further consideration, and work on tailoring conditionality to a country's ability to implement the reforms must continue. If the IMF were to be more selective in providing financial support to programs with weak country ownership—which can be difficult to assess—it must also consider the costs to the country of withholding support.

IMF Financial Facilities

8. The IMF provides financial assistance to member countries with temporary balance of payments problems; it does not provide financing for specific purposes or projects, as development banks typically do. The Fund's financial assistance is intended to enable the member to rebuild its reserves or to make larger payments for imports and other external purposes that would not have been possible without it. Financing must be approved by the Executive Board.

9. The IMF provides two kinds of financial assistance: nonconcessional and concessional. Nonconcessional assistance is made available to member countries under a number of policies and facilities, whose terms reflect the severity and duration of the balance of payments problem that the facility is designed to address. An individual line of credit normally takes the form of a financial arrangement with the member, under which the IMF gives assurances to the member that it will provide funding in accordance with the terms of the arrangement.

10. Separately, the IMF also provides concessional (low-interest) loans to low-income member countries through the Poverty Reduction and Growth Facility (PRGF), and provides grants or loans under the Heavily Indebted Poor Countries (HIPC) Initiative to help reduce their external debt.

1. Regular financing facilities

11. The IMF provides financing to members from a revolving pool of funds consisting of members' subscriptions, which are held in the General Resources Account. The recipient member uses its own currency to "purchase" reserve assets (in the form of widely accepted foreign currencies and SDRs) from the IMF. These assets are usually deposited in the member's central bank and can then be used in the same manner as all other international reserves. The IMF levies charges on the financing, and repayment periods vary by facility. To repay, members "repurchase" their own currency from the Fund. The amount of financing a member can obtain from the Fund (access limits) is generally based on its quota.

12. IMF credit is subject to the recipient country's observance of specific economic and financial policy conditions, depending on the relative size of the financing involved. For purchases of up to 25 percent of a member's quota (called the first "credit tranche"), members must demonstrate that they are making reasonable efforts to overcome their balance of payments difficulties. Purchase above 25 percent of quota (upper credit tranche drawings) are made in installments as the member meets certain established performance targets. Such drawings are normally associated with Stand-By and Extended Fund Facility Arrangements. The Fund has also developed special facilities that seek to provide additional nonconcessional assistance for certain specific balance of payments difficulties.

• Credit tranches and Extended Fund Facility

Credit tranche (1952): Designed to address balance of payments difficulties that are short- term or cyclical; length of **Stand-By Arrangements** is typically 12–18 months with a legal maximum of three years.

Access limits: Annual: 100 percent of quota; cumulative: 300 percent of quota.

Maturities (early repayment) / (obligatory repayment): 2¼–4 years / 3¼–5 years.

Charges: GRA¹ rate of charge + level-based surcharges: 00 basis points on amounts above 200 percent of quota, and 200 basis points above 300 percent of quota.

Conditions: Member adopts policies that provide confidence that its balance of payments difficulties will be resolved within a reasonable period.

Phasing and monitoring: Quarterly purchases contingent on observance of performance criteria and other conditions

- ***Extended Fund Facility Arrangement (1974):*** Provides longer-term assistance to support structural reforms that address longer-term balance of payments difficulties. Extended Fund Facility Arrangements have upper credit tranche conditionality for access above 25 percent of quota.

Access limits: Annual: 100 percent of quota; cumulative: 300 percent of quota.

Maturities (early repayment) / (obligatory repayment): 4½ – 7 years / 4½ – 10 years.

Charges: GRA rate of charge + level-based surcharges: 100 basis points on amounts above 200 percent of quota, and 200 basis points above 300 percent of quota.

Conditions: Member adopts 3-year program, with structural agenda, and provides annual detailed statement of policies for the next 12 months.

Phasing and monitoring: Quarterly or semiannual purchases contingent on observance of performance criteria and other conditions.

2. Special facilities

- ***Supplemental Reserve Facility (1997):*** Provides short-term assistance to members with balance of payments difficulties related to a sudden and disruptive loss of market confidence.

Access limits: None; this facility is available only when access under associated regular arrangements would otherwise exceed either annual or cumulative limit.

Maturities (early repayment) / (obligatory repayment): 1–1½ years / 2–2½ years.

Charges: GRA rate of charge + 300 basis points rising to 500 after 2½ years.

Conditions: Available only in context of a regular arrangement with associated program and with strengthened policies to address a loss of market confidence.

Phasing and monitoring: Facility available for one year; front-loaded access with two or more purchases; subsequent purchases subject to conditionality.

- ***Contingent Credit Lines (1999):*** Serves as a precautionary line of defense for members with strong track records of good policies in normal times to help them resist external financial contagion.

Access limits: None, but expected to be 300–500 percent of quota in practice.

¹ GRA: General Resources Account.

Maturities (early repayment) / obligatory repayment): 1–1½ years / 2–2½ years.

Charges: GRA rate of charge + 150 basis points rising to 350 after 2½ years.

Conditions: Eligibility criteria: (i) no balance of payments need from the outset; (ii) positive assessment of policies by the IMF; (iii) constructive relations with private creditors and satisfactory progress in limiting external vulnerability; (iv) satisfactory economic program.

Phasing and monitoring: Resources approved for up to one year. Small purchase (5–25 percent of quota) available on approval. Presumption that one-third of committed resources will be released on activation, with the disbursement of the remainder determined by a post-activation review.

- ***Compensatory Financing Facility (1963):*** Covers a shortfall in a member's export earnings and services receipts as well as an excess in cereal import costs that are temporary and arise from events beyond the member's control. (This facility was streamlined in 2000, with the elimination of the contingency component of the former Compensatory and Contingency Financing Facility.)

Access limits: Maximum 45 percent of quota for each element—export shortfall and excess cereal import costs—for a combined limit of 55 percent of quota.

Maturities (early repayment) / (obligatory repayment): 2¼ – 4 years / 3¼ – 5 years.

Charges: GRA rate of charge; not subject to surcharges.

Conditions: Available only when a member has an arrangement with upper credit tranche conditionality or when its balance of payments position, apart from its export shortfall, is otherwise satisfactory.

Phasing and monitoring: Typically disbursed over a minimum of six months in accordance with the phasing provisions of the arrangement.

- ***Emergency assistance***

1. *Natural disasters (1962):* Provides quick, medium-term assistance to members with balance of payments difficulties related to natural disasters.

2. *Postconflict (1996):* Provides quick, medium-term assistance for balance of payments difficulties related to the aftermath of civil unrest or international armed conflict.

Access limits: 25 percent of quota, though larger amounts can be made available in exceptional cases.

Maturities (early repayment) / (obligatory repayment): No early repayment expectation / 3¼ – 5 years.

Charges: GRA rate of charge; not subject to surcharges; possibility of interest subsidy if financing is available.

Conditions: Reasonable efforts to overcome balance of payments difficulties, and focus on institutional and administrative capacity building to pave the way toward an upper credit tranche arrangement or an arrangement under the Poverty Reduction and Growth Facility.

Phasing and monitoring: None.

3. Facility for low-income members

- ***Poverty Reduction and Growth Facility (1999):*** Provides longer-term assistance for deep-seated, structural balance of payments difficulties; aims at sustained, poverty-reducing growth (replaced the Enhanced Structural Adjustment Facility, created in 1987).

Access norms and limits: Norm for first-time users, 90 percent of quota; others, 65 percent of quota; maximum, 40 percent of quota; exceptional maximum, 185 percent.

Maturities (early repayment) / (obligatory repayment): No early repayment expectation / 5½–10 years.

Charges: Concessional interest rate: ½ of 1 percent a year; not subject to surcharges.

Conditions: Based on a Poverty Reduction Strategy Paper (PRSP) prepared by the country in a participatory process, and integrating macro, structural, and poverty-reduction policies.

Phasing and monitoring: Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews.

The IMF-World Bank HIPC Initiative

1. The HIPC Initiative is a framework designed by the IMF and the World Bank to provide special assistance for heavily indebted poor countries (HIPC) that pursue IMF- and World Bank-supported adjustment and reform programs, but for whom traditional debt relief mechanisms are insufficient.

2. The HIPC Initiative entails coordinated action by the international financial community, including multilateral institutions, to reduce to sustainable levels the external debt burden of those countries.^{2 3}

3. The HIPC Initiative is designed to deal with one of three key elements of longer-term debt sustainability—the outstanding stock of external debt at the decision point. By reducing the stock of external debt to sustainable levels at the decision point, the HIPC Initiative aims at eliminating any debt overhang, thereby creating the conditions for strong growth and long-term debt sustainability. However, debt relief alone, no matter how generous, cannot guarantee that a country will not fall back to unsustainable levels of debt, nor does it deal directly with a country's vulnerability to future exogenous shocks. While the existing stock of debt (and associated debt service) sets the point of departure for determining long-term debt sustainability, the growth of income, exports, and fiscal revenue—which, to a large extent, reflect a country's economic policies—are the underlying determinants of the evolution of a country's capacity to service external debt over the longer term. Similarly, the volume and terms of new external borrowing have a direct impact on the burden of external debt, and an indirect offsetting effect through its effect on future investment and growth.

4. All countries requesting HIPC Initiative assistance must have (i) adopted a Poverty Reduction Strategy Paper (PRSP) through a broad-based participatory process, by the *decision point*; and (ii) have made progress in implementing this strategy for at least one year by the *completion point*. On a transitional basis, given the time country authorities need to prepare a participatory PRSP, countries can reach their decision points based on an interim PRSP (I-PRSP) which sets out the government's commitment to and plans for developing a PRSP. For retroactive cases—countries that have already reached their decision points under the original Initiative—depending on overall progress is poverty reduction, a requirement for the completion point is adoption of a PRSP.

² At present, the following developing countries are classified as being the heavily indebted poor countries: Angola, Benin, Bolivia, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Congo, Côte d'Ivoire, Democratic Republic of the Congo, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Kenya, Lao PDR, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Uganda, Vietnam, and Zambia. However, it should be noted that a debt sustainability analysis in 2000 indicates that Yemen has a sustainable debt burden after the application of traditional debt relief mechanisms. Angola, Kenya, and Vietnam are also expected to be sustainable without special help from the Initiative. This list may change from time to time.

³ External debt sustainability is a comprehensive concept and no single debt indicator or a particular level of a debt indicator can fully inform an assessment of debt sustainability. Analytically, public sector external debt sustainability depends on three key determinants (and their development over time): the existing stock of public and publicly guaranteed debt; the development of fiscal and external repayment capacity, which is closely related to the outlook for output and export growth; and the prospective volume and concessionality of new external borrowing. An assessment of debt sustainability would thus involve a range of indicators, including both stock concepts and debt-service concepts relative to variables associated with a country's potential repayment capacity.

5. *First phase:* to qualify for assistance, the country must adopt adjustment and reform programs supported by the IMF and the World Bank and establish a satisfactory track record. During that time, it will continue to receive traditional concessional assistance from all the relevant donors and multilateral institutions, as well as debt relief from bilateral creditors (including the Paris Club).

6. *Decision point:* at the end of the first phase, a debt sustainability analysis will be carried out to determine the current external debt situation of the country. If the external debt ratio for that country after traditional debt relief mechanisms is above 150 percent for the net present value of debt to exports, it qualifies for assistance under the Initiative. In the special case of very open economies (with exports-to-GDP ratio above 30 percent) with a high debt burden in relation to fiscal revenues, despite strong revenue collection (above 15 percent of GDP), the net present value of debt-to-exports target may be set below 150 percent. In such cases, the target is set so that the net present value of debt would be 250 percent of fiscal revenues at the decision point.

7. At the decision point, the Executive Boards of the IMF and World Bank will formally decide on a country's eligibility, and the international community will commit to provide sufficient assistance by the completion point for the country to achieve debt sustainability calculated at the decision point. The delivery of assistance committed by the Fund and Bank will depend on satisfactory assurances of action by other creditors.

8. *Second phase:* once eligible for support under the Initiative, the country must establish a further track record of good performance under IMF/World Bank-supported programs. The length of this second period under the enhanced framework is not time bound, but depends on the satisfactory implementation of key structural policy reforms agreed at the decision point, the maintenance of macroeconomic stability, and the adoption and implementation of a poverty reduction strategy developed through a broad-based participatory process. The use of "floating" completion points would permit strong performers to reach their completion point earlier. During this second phase, bilateral and commercial creditors are generally expected to reschedule obligations coming due, with a 90 percent reduction in net present value. Both the World Bank and the IMF are expecting to provide "interim relief" between the decision and completion points, and other multilateral creditors are considering also to advance some of the assistance from the completion point.

9. *Completion point:* remaining assistance will be provided at this point. This will imply the following:

- For bilateral and commercial creditors: a reduction in the net present value of the stock of debt proportional to their overall exposure to the HIPC. Many bilateral creditors have announced that they will also provide debt forgiveness over and above HIPC Initiative assistance, particularly on ODA debt.
- For multilateral creditors (the IMF, the World Bank, and the other multilateral institutions): a (further) reduction in the net present value of their claims on the country based on broad and equitable action by all creditors sufficient to reduce the country's debt to a sustainable level.

10. At this stage and in the current international context, the implementation of the Initiative will continue to face challenges. First, countries already past their decision points will need to strive to remain on track in their economic reform and poverty reduction programs to reach their floating completion points. Several countries in this group have encountered problems in the implementation of their macroeconomic programs (Guinea, Guinea-Bissau, Guyana, Honduras, Malawi, Nicaragua, Niger, Rwanda, Senegal, and São Tomé and Príncipe⁴) although for some (Honduras, Niger, and Rwanda), this was temporary. Some other countries (e.g., Mauritania) have found that

⁴ A staff-monitored program has recently been agreed with São Tomé and Príncipe.

implementation of certain completion point triggers in social and structural areas would take longer than previously anticipated. Other countries (e.g., Benin, Burkina Faso, Cameroon, and Mali) have experienced delays in preparing full PRSPs. In addition, for many of these countries, securing the delivery of relief from creditors, as anticipated at the decision point, remains an important challenge.

11. Second, the remaining countries (most of which are conflict-affected and/or have substantial arrears problems) need to be brought to their decision points as soon as conditions in these countries permit. The challenges are daunting as these countries strive to achieve peace and internal stability, pursue sound economic policies, and develop their economic management capacity. The PRSP process may be particularly difficult for some of these countries, as many of them have large displaced populations and are facing difficulties in undertaking a broadly-based participatory process. Staffs continue to work with the authorities in these countries to develop, where possible, strategies for moving ahead, acknowledging the need for flexibility in these strategies. Some progress has been made with the Democratic Republic of Congo, and a preliminary HIPC document is under preparation.

12. Finally, the challenge of achieving and maintaining external debt sustainability has become more difficult with the deterioration of the global economic environment.⁵ Virtually all HIPCs are heavily dependent on primary commodities for their export earnings and government revenue, and as a result they would remain vulnerable to declines in world commodity prices and other adverse exogenous developments. In such circumstances, it would be unrealistic to expect external debt indicators to follow a smooth monotonic downward trend after the HIPCs have reached their completion points, or that countries will always stay below the HIPC debt sustainability thresholds. Instead, there may be fluctuations over time, and the objective of policies should be to ensure that the underlying trend is downward. This underscores the need for all HIPCs to implement policy reforms to diversify their export base, supported by appropriate external financing. Given the HIPCs' limited repayment capacity, the latter will have to be on highly concessional terms or in the form of grants. For countries in the interim period, the enhanced HIPC Initiative provides for the possibility of additional debt relief at the completion point in exceptional cases where exogenous factors have caused fundamental changes in a country's economic circumstances. In the near term, to deal with the cash-flow impact of the recent shocks, these countries could also benefit from increased interim HIPC debt relief, as well as concessional loans and more grant financing from donors. It is essential that all HIPCs pursue prudent debt management policies as a means of achieving long-term debt sustainability.

13. For the 26 countries that have reached their decision points under the enhanced HIPC Initiative, debt relief worth US\$25 billion in net present value (NPV) terms has been committed to date. This amounts to about US\$40 billion in nominal debt-service relief over time. The debt stocks for these countries taken as a whole will fall from a level of around US\$62 billion in NPV terms to US\$27 billion after the full application of traditional relief mechanisms and assistance under the HIPC Initiative, and to US\$22 billion after bilateral debt relief beyond the HIPC Initiative committed by several bilateral donors—an overall fall of nearly two-thirds.

⁵ The recent global economic slowdown has had an impact on the external debt sustainability outlook of the 24 heavily indebted poor countries that had reached their decision points under the enhanced HIPC Initiative. Specifically, the recent global economic slowdown, coupled with a significant decline in many primary commodity prices, has weakened the HIPCs' growth and export performance in the last two years and led to a deterioration of their external debt indicators for many but not all of these countries. There are considerable differences in the evolution of the debt indicators among the HIPCs, reflecting largely differences in the implementation of economic reform programs and their different exposure to shocks. The impact of these adverse developments on the debt sustainability outlook of the HIPCs will depend on a number of factors including notably the adequacy of policy responses and of supporting resource transfers.

14. Relief under the HIPC Initiative will enable governments to increase substantially resources devoted to reducing poverty. On average, the 26 decision point countries will spend on social sectors in 2002–05 more than three times than what they plan to spend on debt service over the same period. More specifically, this is projected to be the case for 13 out of the 19 countries for which data are available during the entire period 2002–05. Of the remaining countries, all six will spend at least one and a half times as much on social sectors as on debt service. Although there is significant variability among HIPCs regarding debt service and social expenditure, social spending increased from 38 percent to 48 percent of revenue, on average, between 1999 and 2001. This reflects a significant re-orientation of government expenditure, with spending on social expenditures projected to rise from 6 percent of GDP in 1999 to 9 percent of GDP in 2002. As a share in government revenue, social spending would increase from 38 percent before HIPC relief to an average of 54 percent after HIPC relief.

15. Of the four countries that have passed their completion points, two (Mozambique and Tanzania) seem to be in a good position to maintain long-term debt sustainability. The picture for the other two (Uganda and Bolivia) is more mixed, with Bolivia experiencing worrisome debt-service ratios and Uganda facing very high debt indicators primarily as a result of sharply lower exports. The external debt sustainability outlook for most of the 20 countries in the interim period has worsened primarily because of lower exports, but has not necessarily been seriously impaired. The NPV of debt-to-exports ratios at the completion point are now projected to be above the 150 percent threshold in 8–10 countries; deviations for six of these had already been anticipated at the time of the decision points, although to a lesser degree.

16. For countries in the interim period, the enhanced HIPC Initiative allows some flexibility in exceptional cases to top-up debt relief at the completion point to countries where exogenous factors have caused fundamental changes in their economic circumstances. The enhanced HIPC Initiative thus provides for the possibility of additional debt relief at the completion point. However, additional HIPC relief is not meant to compensate for slippages in policy reform, nor can it be provided on an ongoing basis to deal with future economic shocks. In the near term, to help countries deal with the impact of the deterioration in the external environment, some countries may require additional donor support, and increased interim relief may be helpful.

17. The provision of any additional debt relief at the completion point would increase the overall costs of the HIPC Initiative. The financing implications of this will need to be explored in due course.

18. Virtually all HIPCs are heavily dependent on primary commodities for their export earnings and government revenue, and as a result they will remain vulnerable to adverse exogenous developments. In such circumstances, it would be unrealistic to expect external debt indicators to follow a smooth monotonic downward trend after the HIPCs have reached their completion points or that countries will always stay below the HIPC debt sustainability thresholds. Instead, there may be fluctuations over time, and the objective of policies should be to ensure that the underlying trend is downward.

19. The paper underscores the need for HIPCs to implement structural and policy reforms to diversify their export base, supported by improved access for their exports to world markets and by appropriate external financing. Given the HIPCs' limited repayment capacity, the latter will have to be on highly concessional terms and in the form of grants.

20. Under the existing HIPC framework, it is possible to reassess the amount of debt relief at the completion point in exceptional cases where severe exogenous shocks fundamentally change the HIPCs' economic circumstances and pose prolonged debt sustainability problems for them. However, HIPC relief is not intended to compensate for slippages in policy implementation, nor could it be provided to deal with debt problems arising from poor governance and imprudent new borrowing.

Under the existing operational modalities, the reassessment of the amount of HIPC relief committed at the decision point would not be automatic, and each country's long-term debt outlook and the nature of the exogenous shock faced will be considered on a case-by-case basis at the completion point. This reassessment will take fully into account the impact of all debt relief already provided, including additional debt relief beyond the HIPC Initiative announced by a number of official bilateral creditors.

21. For the countries beyond their completion points, over and above any topping up of relief, the emphasis must be on achieving the right blend of growth-enhancing policy reforms and external financial support from the donor community on appropriate terms. Adjustments may need to be considered in the policy framework for poverty reduction and growth, in borrowing strategies, and in overall debt management. For the objective of debt sustainability to be achieved, it is essential that creditor countries help by providing financing that is consistent with these countries' repayment capacity and opening their markets further to HIPC exports. The appropriate blend between these support options will depend upon the specific-country circumstances, including the devastating effects of the HIV/AIDS epidemic in many HIPCs and the constraints stemming from high domestic debt.

22. When facing unexpected adverse developments, HIPCs will have to decide on the appropriate combination of policy adjustment and recourse to financing. Admittedly, adjustment policies, while beneficial in the long run, may adversely affect certain segments of the society in the short run. However, avoiding adjustment in most cases is neither feasible nor desirable. The resources for financing the impact of all external shocks in many HIPCs are simply not available and delaying adjustment may indeed prolong the negative effects of an external shock and impair the ability of the HIPCs to face future shocks instead of reducing external vulnerabilities.

Table 1. Enhanced HIPC Initiative: Committed Debt Relief and Outlook, Status as of March 2002
(In millions of U.S. dollars, in NPV terms in the year of the decision point)

	Reduction in NPV Terms			Nominal Debt Service Relief			Date of Approval
	Original	Enhanced	Total	Original	Enhanced	Total	
	HIPC Initiative	HIPC Initiative		HIPC Initiative	HIPC Initiative		
Countries that have reached their Completion Points (4)							
Total	2,511	3,842	6,353	5,110	6,200	11,310	
Bolivia	448	854	1,302	760	1,300	2,060	Jun-01
Mozambique	1,716	306	2,022	3,700	600	4,300	Sep-01
Tanzania	...	2,026	2,026	0	3,000	3,000	Nov-01
Uganda	347	656	1,003	650	1,300	1,950	May-00
Countries that have reached their Decision Points (22)							
Total	606	17,642	18,248	1,060	28,120	29,180	
Benin	0	265	265	0	460	460	Jul-00
Burkina Faso	229	169	398	400	300	700	Jul-00
Cameroon	0	1,260	1,260	0	2,000	2,000	Oct-00
Chad	0	170	170	0	260	260	May-01
Ethiopia	0	1,275	1,275	0	1,930	1,930	Nov-01
The Gambia	0	67	67	0	90	90	Dec-00
Ghana	...	2,186	2,186	0	3,700	3,700	Feb-02
Guinea	0	545	545	0	800	800	Dec-00
Guinea-Bissau	0	416	416	0	790	790	Dec-00
Guyana	256	329	585	440	590	1,030	Nov-00
Honduras	0	556	556	0	900	900	Jul-00
Madagascar	0	814	814	0	1,500	1,500	Dec-00
Malawi	0	643	643	0	1,000	1,000	Dec-00
Mali	121	401	522	220	650	870	Sep-00
Mauritania	0	622	622	0	1,100	1,100	Feb-00
Nicaragua	0	3,267	3,267	0	4,500	4,500	Dec-00
Niger	0	521	521	0	900	900	Dec-00
Rwanda	0	452	452	0	800	800	Dec-00
São Tomé and Príncipe	0	97	97	0	200	200	Dec-00
Senegal	0	488	488	0	850	850	Jun-00
Sierra Leone	0	600	600	0	950	950	Mar-02
Zambia	0	2,499	2,499	0	3,850	3,850	Dec-00
Countries still to be considered (12)							
Côte d'Ivoire	345	...	345	800	...	800	Mar-98 1/
Burundi	...	...	...	...	...	...
Central African Republic	...	...	...	...	...	...
Comoros	...	...	...	...	...	...
Congo, Dem. Rep. of	...	...	...	...	...	...
Congo, Rep. of	...	...	...	...	...	...
Lao P.D.R.	...	...	...	...	...	...
Liberia	...	...	...	...	...	...
Myanmar	...	...	...	...	...	...
Somalia	...	...	...	...	...	...
Sudan	...	...	...	...	...	...
Togo	...	...	...	...	...	...
Memorandum item:							
Debt relief committed under original and enhanced frameworks 2/	3,462	21,484	24,946	6,970	34,320	41,290	

Sources: HIPC Initiative country documents; World Bank and IMF staff estimates.

1/ Approved debt relief under the original framework.

2/ Countries that have reached their decision points under the enhanced HIPC framework through late March 2002 and Côte d'Ivoire, which had reached the decision point under the original framework earlier.

Table 2. Progress Status of Countries Under the Enhanced HIPC Initiative
as of late March, 2002

Completion Points Reached (4)	Decision Points Reached (22)			Decision Point not yet Reached (12)		Sustainable Cases (4)
Bolivia Mozambique Tanzania Uganda	Benin Burkina Faso Cameroon Chad Ethiopia The Gambia Ghana Guinea	Guinea-Bissau Guyana Honduras Madagascar Malawi Mali Mauritania	Nicaragua Niger Rwanda São Tomé and Príncipe Senegal Sierra Leone Zambia	Burundi Central African Rep. Comoros Congo, Dem. Rep. Congo, Rep. of Cote d'Ivoire Lao P.D.R.	Liberia Myanmar Somalia Sudan Togo	Angola Kenya Vietnam Yemen 1/

Sources: HIPC documents; and IMF and World Bank staff estimates.

1/ Yemen reached its decision point in June 2000. Its debt sustainability analysis indicated that the country has a sustainable debt burden after the application of traditional debt relief mechanisms (See SM/00/138 and IDA/SecM2000-359, June 28, 2000). The Paris Club provided a stock-of-debt operation on Naples terms in July 2001.

Table 3. HIPC Initiative: Estimates of Potential Costs by Creditor Group
(34 countries)

	September 2001 Costing Exercise 2000 NPV Terms 1/	March 2002 Costing Exercise 2000 NPV Terms 1/ 2/	March 2002 Costing Exercise 2001 NPV Terms 2/ 3/	March 2002 Share of Total Costs
	(In billions of U.S. dollars)			(In percent)
Total costs	33.2	34.4	36.4	100.0
Bilateral and commercial creditors	17.1	17.8	18.8	51.7
Paris Club	12.8	13.3	14.1	38.6
Other official bilateral	2.8	3.0	3.2	8.8
Commercial	1.5	1.4	1.5	4.2
Multilateral creditors	16.1	16.6	17.6	48.3
World Bank	7.4	7.6	8.1	22.2
Of which: IDA	6.7	7.0	7.4	20.3
IBRD	0.8	0.7	0.8	2.2
IMF	2.5	2.6	2.7	7.5
AfDB/AfDF	2.6	2.9	3.0	8.4
IaDB	1.1	1.1	1.2	3.3
Other	2.4	2.4	2.6	6.8
Memorandum item:				
Total costs including Liberia, Somalia, and Sudan	41.6	42.7	45.3	124.2

Sources: HIPC Initiative country documents; and Fund and Bank staff estimates.

1/ All HIPCs, excluding Liberia, Somalia, Sudan, Angola, Kenya, Lao P.D.R., Vietnam, and Yemen (see Annex I).

2/ Reflects updated DSAs for Democratic Republic of Congo, Côte d'Ivoire, Ethiopia, Ghana, and Sierra Leone.

3/ The cost figures in 2001 NPV terms are derived from the figures in 2000 NPV terms compounded by a factor of 6 percent.

Reform of the International Financial Architecture:
An Overview of the Fund's Work

I. INTRODUCTION

1. It's a pleasure to be here today to talk about international financial architecture.
2. I will first outline for you the major reforms undertaken by the Fund and its members to enhance the stability and integration of the international financial system, in response to the crises in the 1990s and the calls for change from the international financial community.
3. I will then focus my comments mostly on the Fund and Bank's work on standards and codes which the international community sees as a "*critical pillar*" in the international financial architecture. I think this of all of the initiatives may be of greatest interest to you. In my view, the Fund/Bank reports on standards and codes are in some ways similar to the WTO's Trade Policy Review Mechanism (TRPM): it is intended to provide enhanced transparency and third party assessment with the objectives of promoting trade and investment—which are a prerequisite for growth. Moreover, while standards and codes are different from the WTO's Financial Sector Agreement (which is a multilateral legally binding agreement), there are some similarities: the FSA seeks to harmonize rules on trade in financial services while standards seek to harmonize domestic practices. The standards and codes initiative focuses on how to set good practices which are internationally agreed, yet which take into account different country characteristics and capacities.
4. As you know, the new international financial architecture has its roots in the financial crises that shook emerging market economies in the 1990s. In response, the international community launched a series of initiatives—referred to collectively as the new international architecture—to strengthen the operation of the global financial system and the Fund and its members' crisis prevention capacity. The major building blocks encompass transparency and accountability, the strengthening of financial systems, strengthened external vulnerability analysis at the national and system levels, international standards and codes. Other elements of our crises prevention work include a deeper focus on exchange rate and capital account issues, and the Fund's Contingent Credit Lines (CCL).⁶ Of course, as we will never be 100 percent successful in preventing crises, crisis resolution and private sector involvement remain an important and still challenging issue on our agenda.

A. BUILDING BLOCKS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

1. Transparency

5. The Fund has been assisting member countries' efforts to improve their transparency and has also taken significant steps to improve its own transparency. The crises in the 1990s made apparent the importance of transparency in policy making and implementation; and also for a less volatile financial system based on better differentiation of risk.
6. Under its transparency policy, the Fund encourages the publication of documents, while taking into account the specific circumstances of each country, including those relating to different institutional and political contexts. One of the important and ongoing concerns of our members has been to preserve the candour of consultation discussions and reporting to the Board. Fun members and

⁶ The CCL is a precautionary facility designed to assist member countries with strong economic policies and sound financial systems that are seeking to resist contagion from disturbances in global capital markets, and hence a tool for crisis prevention

staff are increasingly acknowledging the benefits of transparency as evident from the following: as of end March 2002,

- for Fund lending, virtually all documents outlining the authorities' policy intentions are published. In addition, Executive Board views on Fund-supported programs are published. To provide a context for members' programs, now over half of staff reports for use of Fund resources (UFR) are released.
- For IMF surveillance, the increase in the publication of information has been as dramatic. The release of Board views through publication of Public Information Notices (PINs) after Executive Board surveillance discussions is now the norm. More than half of Fund members publish Article IV staff reports. Mission concluding statements and in addition, Reports on the Observance of Standards and Codes (ROSCs) and Financial System Stability Assessments (FSSAs) are published providing in-depth information on countries' institutional capacity and financial sector soundness.
- Staff papers discussing key policy issues (such as reviews of conditionality and the poverty reduction and growth facility, standards and codes and transparency) are now published in most cases (21 of 26 such papers discussed in 2001 were published). The summaries of Executive Board discussions of these papers are published for about half of these. In addition, the Fund has engaged in a dialogue with the public on some key policy issues. In June 2001, the Fund's work program statement was published for the first time. Finally, the work program and issues papers of the Independent Evaluation Office (established in July 2001 to provide objective and independent evaluation of issues related to the Fund) are published.

7. I referenced the balance that needs to be struck between transparency and the Fund's role as confidential advisor. In the review of transparency in May 2002 the Board will examine implementation of the transparency and publications policies focusing on this important topic and will also consider next steps.

2. Strengthening Financial Systems

8. The Fund has intensified its focus on financial issues at both the national and international level in bilateral and multilateral surveillance:

- The Financial Sector Assessment Program, launched in collaboration with the World Bank provides comprehensive analysis of members' financial sectors. As of end 2001, 25 FSAPs had been completed, with an additional 40 countries committed to participate in the program. FSAPs are contributing to our thinking on the appropriate sequencing and pace for financial sector and capital account liberalization. They could make a contribution in assessing members' readiness to benefit from opening of financial sector services. The design and implementation of prudential standards—one of the core standards assessed under the FSAP—is pertinent in this regard. Our Executive Board will review the experience with the FSAP in June 2002.
- The Fund has extended its financial sector work to include offshore financial sectors. This involves voluntary assessments of OFCs at three possible levels of intensity. A progress report on this initiative was posted on the Fund's website this month.
- The Fund and the Bank are working to enhance their contributions to global efforts to fight money laundering. Work has advanced with the FATF on a methodology for an anti-money laundering standard and on how assessments would be undertaken consistent with the Fund's uniform, voluntary and cooperative approach to standards assessments. A progress report to the

International Monetary and Financial Committee for the Spring 2002 meetings has been prepared and will be published.

- As part of its commitment to being a center of excellence for work on financial market issues, the Fund has created a new International Capital Markets department which began operation in August 2001. The first Global Financial Stability Report was discussed by the Fund Board and published on our external website.

3. External Vulnerability Assessment

9. I noted that we have strengthened our vulnerability assessment at the national and international levels. This has involved the development of better analytical tools and also bringing together our specialized and country expertise. Our external vulnerability analysis the Fund draws systematically on a number of independent inputs:

- The World Economic Outlook
- Assessment of the global financial system
- Early warning system models
- A country's financing requirements including its reserve adequacy
- Market information and contagion risks
- Financial sector vulnerability assessments
- And our country expertise.

10. In particular, we are now focusing on foreign exchange exposures in the public, financial, and corporate sectors and are helping our members to improve the availability of critical data for vulnerability assessment. In this regard, our Board will discuss data provision to the Fund for surveillance and strengthened vulnerability assessment in May 2002.

B. AN OVERVIEW OF STANDARDS AND CODES

11. The standards initiative focuses on the development and implementation of internationally agreed standards and codes to promote strong institutional underpinnings for a stable international financial system. This work is not just for emerging market countries. The recent dramatic unfolding of shortfalls in corporate governance in industrialized countries underscores the universal relevance of standards and codes. The New Partnership for the Development of Africa (NEPAD) has placed great weight to adhering to international standards in the conduct of policy.

12. The Fund, in partnership with the World Bank, has contributed to the development of standards; has undertaken monitoring and assessment of standards; has disseminated information on standards; and has encouraged their implementation, including through the provision of focused and targeted technical assistance, and in accordance with countries' circumstances and priorities. The IMF has recognized 11 areas and associated standards as useful for the operational work of the Fund and the World Bank. The areas include data dissemination, monetary and financial policy transparency; fiscal transparency; banking supervision; securities; insurance; payments systems; corporate governance; accounting; auditing; and insolvency and creditor rights. In addition, as I noted, we are working with the Financial Action Task Force with the objective of agreeing on a global standard on Anti-Money Laundering which could be added to this list of standards.

13. Standards promote good practices and have been developed after much consultation with international organizations and our member countries. Some standards such as the data dissemination standards are tailored for specific groups of countries: for instance, the Special data dissemination standard targets countries with access or near access to international financial markets; while the

General Data Dissemination Standards focus on the building of statistical capacity for developing countries. The code of fiscal transparency is a standard of good rather than best practices. These Fund-led standards have been developed with the broad participation of member countries and other international organizations.

14. With regard to standard assessments, the IMF and World Bank produce Reports on the Observance of Standards and Codes (ROSCs). ROSCs summarize the extent to which countries observe certain internationally recognized standards and are produced in the form of modules. Participation by Fund members is voluntary and the modular approach allows countries to take up assessments most relevant to them. The Fund's approach is to encourage countries to focus on areas which are priorities for them and to progress as quickly as possible in those areas.

15. ROSCs are used to help sharpen policy discussions with national authorities; by rating agencies in their assessments; and in the private sector for risk assessment. Short updates are produced regularly and new reports are produced every few years.

C. TRADE AND STANDARDS AND CODES

16. The adoption of internationally recognized standards of good practices in key areas of economic and financial policy contributes to improved transparency, accountability, credibility of policy, and the robustness and effective functioning of markets. In turn, these create an enabling environment conducive for investment (and the flow of capital) and spur trade, both in goods and services. Internationally accepted standards also contribute to an effective and undistorted market framework for financial sector participants. The prospect of significant liberalization of international trade in financial and accounting services, for example, is probably limited in the absence of a comprehensive, internationally-agreed framework of principles for the regulation.. The WTO, among others, recognizes this important aspect of the work on standards and codes, stating at the Singapore Ministerial that “[we] encourage the successful completion of international standards in the accountancy sector by IFAC, IASC, and IOSCO”.⁷ Let me now provide you with information on how the response by members and markets to the standards initiative..

D. RESPONSE BY MEMBERS AND MARKETS

Response by members

- We have seen a shift in perceptions among our members of the importance of international standards. This is reflected in the growing interest in volunteering for these assessments from a wide range of advanced, developing, emerging market, and transition economies.
- By end-March 2002, 221 ROSCs had been completed for 73 countries, and 162 of these had been published along with the authorities' views on the assessments provided. Of the total ROSCs, 93 were undertaken by developing countries, and more than half of these have been published.
- We have received positive feedback from developing country authorities that ROSCs, and the prioritized recommendations that they contain, have been useful for designing programs of economic reform, strengthening institutions, and serving as the framework for requesting technical assistance.
- **Our work suggests that improving observance of standards has tangible benefits for all countries, not just emerging market countries.** In general, we have found that countries with

⁷ World Trade Organization, Singapore Ministerial Declaration Adopted on 13 December 1996. The IFAC is the International Federation of Accountants. Note that the IASC is now the IASB.

strong institutional underpinnings (including shareholder and creditor rights) have more developed financial systems, allocate capital more efficiently, and are less prone to crisis. Transparency in policy is associated with better fiscal management and lower inflation. Let me illustrate:

- Mozambique’s fiscal ROSC helped clarify the agenda for reform, precipitating significant technical assistance and improving transparency.
- In Uganda, an innovative approach to transparency has led to significant improvement in school funding.
- Tunisia and South Africa responded positively to the recommendations in ROSCs and were able to improve credit ratings and lower cost of borrowing by improving their observance to internationally agreed standards.

Response of markets

17. The markets are also responding to these initiatives/. Surveys and our meetings with participants show that ROSCs are increasingly being used as an input into risk assessment and investment decisions. Staff have been informed about –though have not assessed—several private sector standards initiatives: these include the e-Standards Forum, which is subscription-based, and provides summaries of each country's compliance with standards, based solely on information already in the public domain. Standard and Poor’s rating agency is undertaking assessments of firms' adherence to corporate governance standards. PriceWaterhouseCoopers (PWC), the international accounting firm, has produced an "opacity index"—an indicator which intends to measure opacity and its costs, based on some standards-related dimensions.

18. In February, one of the largest pension funds in the U.S. (the California Public Employees Retirement System, CalPERS) announced that it was using measures of transparency, corporate governance, and financial regulation (including ROSCs) among its criteria for determining the countries in which it will invest.

E. CONCERNS WITH STANDARDS AND CODES

19. The Fund and the World Bank have sought to address concerns initially raised by some Fund members including the perception of a “one size fits all” approach to standards development and less than universal participation in the development of standards.

20. First, the governance structure of the Fund—as you know we have 183 members countries—and the process we have set up for modifying standards means that there is broad country participation in this initiative.

21. In addition, , we have held seminars—for example, at a high level conference on standards held in March 2001— and engaged in an ambitious outreach program to the public and private sectors in Asia, Latin America, Europe, the Middle East and Africa aimed at consideration of next steps for this initiative. The Fund and Bank have also redoubled efforts to identify technical assistance needs and coordinate with others—including the multilateral development banks—in coordinating the provision of technical assistance. Periodic reviews of the standards initiative by the Fund Board—the next in July 2002—also provide a mechanism for considering the direction of this work.

22. Research is being undertaken at the Fund on the relationship between implementation of standards and macroeconomic development . Our preliminary results suggest that there are signs that investors are starting to differentiate among borrowing countries more clearly than before, reflected in

the greater dispersion of spreads on emerging market debt and less contagion in response to credit events. reports.

23. Finally, the Fund and its members are working together to develop creative means of better involving all countries in the standards and codes initiative. Peer review of standards implementation and informal fora at which members can exchange their experiences with undertaking ROSCs are some of the measures being considered.

24. The results of all of these efforts will hopefully help to increase ownership and commitment across the Fund membership.
