Chapter 3

Chapter 3 Program support

The IMF provides financial and other kinds of support to its member countries through a variety of instruments, including lending facilities, tailored to their different circumstances (Table 3.1). Review and approval of members' requests for financial assistance and program support are core responsibilities of the Board, alongside surveillance.

Under the Fund's lending facilities, the Board makes temporary financing available to members to help them address a variety of balance of payments problems, such as a lack of sufficient foreign exchange to purchase needed imports or make payments on external obligations. IMF loans give countries time to adjust their policies so as to overcome short-term balance of payments problems, stabilize their economies, and avoid similar problems in the future. IMF lending is not intended to cover all of a borrower's needs but, rather, to have a catalytic effect—enabling a country to restore confidence in its policies and attract financing from other sources. Loans are accompanied by economic reform programs developed by the borrowers in collaboration with the IMF. The Executive Board regularly reviews borrowers' performance under their programs, and, in most cases, funds are disbursed as program targets are met.

Regular financing activities. The bulk of the IMF's loans are provided through Stand-By Arrangements (SBAs), which address members' short-term balance of payments difficulties, and the Extended Fund Facility (EFF), which focuses on external payments difficulties caused by longer-term structural problems. For members experiencing a sudden and disruptive loss of access to capital markets, these loans can be supplemented with short-term resources from the IMF's Supplemental Reserve Facility (SRF). In addition, special Emergency Assistance is available to countries recovering from conflicts or natural disasters. All of these loans incur interest charges, and many may be subject to surcharges, depending on the type and duration of the loan and the amount of IMF credit outstanding. Repayment periods vary by type of loan. The IMF's regular lending activities are financed out of a revolving pool of funds held in the General Resources Account (GRA) and consisting mainly of members' quota subscriptions. In addition, the IMF has in place two formal borrowing arrangements with member countries and can borrow to supplement its quota resources.

Financing for low-income countries. The IMF provides support to its low-income members through a variety of instruments. These include highly subsidized lending through the Poverty Reduction and Growth Facility (PRGF) and the Exogenous Shocks Facility (ESF); subsidized Emergency Assistance for eligible post-conflict countries and countries hit by natural disasters;[34] and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).[35] The PRGF, the main instrument for provision of IMF financial support to low-income countries, focuses on poverty reduction in the context of a growth-oriented economic strategy, while the ESF provides concessional assistance to low-income members that are facing sudden exogenous shocks but do not have a PRGF arrangement in place. A low-income country seeking a PRGF or ESF loan or debt relief must prepare a Poverty Reduction Strategy Paper (PRSP) in a participatory process involving civil society; the PRSP is considered by the Boards of the IMF and the World Bank, but the strategy is developed and owned by the country. The funds for PRGF loans come from trust funds administered by the IMF, and the subsidy resources are financed by contributions from the IMF and a broad spectrum of its member countries.

Special Drawing Rights. The IMF can create international reserve assets by allocating Special Drawing Rights (SDRs) to members (Box 3.1). Recipient countries can use SDRs to obtain foreign exchange from other members and to make payments to the IMF. SDRs are also the IMF's unit of account.

Box 3.1 Special Drawing Rights

The SDR is a reserve asset created by the IMF in 1969 in response to the threat of a shortage of international liquidity. SDRs are "allocated"—distributed—to members in proportion to their IMF quotas. Since the SDR's creation, a total of SDR 21.4 billion has been allocated to members—SDR 9.3 billion in 1970–72 and SDR 12.1 billion in 1979–81.Today, the SDR has only limited use as a reserve asset. Its main function is to serve as the unit of account of the IMF and some other international organizations and a means of payment for members in settling their IMF financial obligations. The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF's designating members with strong external positions to purchase SDRs from members with weak external positions in exchange for freely usable currencies.

The value of the SDR is based on the weighted average of the values of a basket of major international currencies, and the SDR interest rate is a weighted average of interest rates on short-term instruments in the markets for the currencies in the valuation basket. The method of valuation is reviewed every five years. The latest review was completed in November 2005, and the IMF Executive Board decided on changes in the valuation basket effective January 1, 2006. The SDR interest rate is calculated weekly and provides the basis for determining the interest charges on regular IMF financing and the interest rate paid to members that are creditors of the IMF.

34 *CD-Tables 3.1 and 3.2, which show subsidy contribution pledges as of April 30, 2007, for the ESF and for Emergency Assistance, respectively, can be found on the CD-ROM.*

35 *The HIPC Initiative was launched by the IMF and the World Bank in 1996 and enhanced in 1999 to provide faster, deeper, and broader debt relief and to strengthen the links between debt relief, poverty reduction, and social policies. CD-Tables 3.3 and 3.4, which show the delivery of debt relief as of April 30, 2007, can be found on the CD-ROM. More information about the HIPC Initiative can be found on the IMF's Web site, at* www.imf.org/external/np/exr/facts/hipc.htm.

Table 3.1 IMF lending facilities

Credit facility *(year adopted)*	Purpose	Conditions	Phasing and monitoring[1]
Credit tranches and Extended Fund Facility[4]			
Stand-By Arrangements (1952)	Medium-term assistance for countries with balance of payments difficulties of a short-term character.	Adopt policies that provide confidence that the member's balance of payments difficulties will be resolved within a reasonable period.	Quarterly purchases (disbursements) contingent on observance of performance criteria and other conditions.
Extended Fund Facility (1974) (Extended Arrangements)	Longer-term assistance to support members' structural reforms to address balance of payments difficulties of a long-term character.	Adopt 3-year program with structural agenda, with annual detailed statement of policies for the next 12 months.	Quarterly or seminannual purchases (disbursements) contingent on observance criteria and other conditions.
Special facilities			
Supplemental Reserve Facility (1977)	Short-term assistance for balance of payments difficulties related to crises of market confidence.	Available only in context of Stand-By or Extended Arrangements with associated program and with strengthened policies to address loss of market confidence.	Facility available for one year; front-loaded access with two or more purchases (disbursements).
Compensatory Financing Facility (1963)	Medium-term assistance for temporary export shortfalls or cereal import excesses. .	Available only when the shortfall/excess is largely beyond the control of the authorities and a member has an arrangement with upper credit tranche conditionality, or when its balance of payments position excluding the shortfall/excess is satisfactory.	Typically disbursed over a minimum of six months in accordance with the phasing provisions of the arrangement.
Emergency Assistance	Assistance for balance of payments difficulties related to the following:		None, although post-conflict assistance can be segmented into two or more purchases.
(1) Natural disasters (1962)	Natural disasters	Reasonable efforts to overcome balance of payments difficulties.	
(2) Post-conflict (1995)	The aftermath of civil unrest, political turmoil, or international armed conflict.	Focus on institutional and administrative capacity building to pave the way toward an upper credit tranche arrangement or PRGF.	
Facilities for low-income members			
Poverty Reduction and Growth Facility (1999)	Longer-term assistance for deep-seated balance of payments difficulties of structural nature; aims at sustained poverty-reducing growth.	Adopt 3-year PRGF arrangements. PRGF-supported programs are based on a Poverty Reduction Strategy Paper (PRSP) prepared by the country in a participatory process and integrating macroeconomic, structural, and poverty reduction policies.	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews.
Exogenous Shocks Facility (2006)	Short-term assistance to address a temporary balance of payments need that is due to an exogenous shock.	Adopt a 1–2 year program involving macroeconomic adjustments allowing the member to adjust to the shock and structural reform considered important for adjustment to the shock, or for mitigating the impact of future shocks.	Semiannual or quarterly disbursements on observance of performance criteria and, in most cases, completion of a review.

1 *Except for the PRGF, the IMF's lending is financed from the capital subscribed by member countries; each country is assigned a* quota *that represents its financial commitment. A member provides a portion of its quota in foreign currencies acceptable to the IMF—or SDRs (see Box 3.1)—and the remainder in its own currency. An IMF loan is disbursed or drawn by the borrower* purchasing *foreign currency assets from the IMF with its own currency. Repayment of the loan is achieved by the borrower* repurchasing *its currency from the IMF with foreign currency. See CD-Box 5.1 on the IMF's financing mechanism. PRGF lending is financed by a separate PRGF-ESF Trust.*

2 *The* rate of charge *on funds disbursed from the General Resources Account (GRA) is set at a margin over the weekly interest rate on SDRs. The rate of charge is applied to the daily balance of all outstanding GRA drawings during each IMF financial quarter. In addition, a one-time service charge of 0.5 percent is levied on each drawing of IMF resources in the GRA, other than reserve tranche drawings. An up-front commitment fee (25 basis points on committed amounts up to 100 percent of quota, 10 basis points thereafter) applies to the amount that may be drawn during each (annual) period under a Stand-By or Extended Arrangement; this fee is refunded on a proportionate basis as subsequent*

Access limits[1]	Charges[2]	Repurchase (repayment) terms[3] Obligation schedule *(Years)*	Expectation schedule *(Years)*	Installments
Annual: 100% of quota; cumulative: 300% of quota.	Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts above 300% of quota).[5]	$3\frac{1}{4}$–5	$2\frac{1}{4}$–4	Quarterly
Annual: 100% of quota; cumulative: 300% of quota.	Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts above 300% of quota).[5]	$4\frac{1}{2}$–10	$4\frac{1}{2}$–7	Semiannual
No access limits; access under the facility only when access under associated regular arrangement would otherwise exceed either annual or cumulative limit.	Rate of charge plus surcharge (300 basis points, rising by 50 basis points a year after first disbursement and every 6 months thereafter to a maximum of 500 basis points).	$2\frac{1}{2}$–3	2–$2\frac{1}{2}$	Semiannual
45% of quota each for export and cereal components. Combined limit of 55% of quota for both components.	Rate of charge.	$3\frac{1}{4}$–5	$2\frac{1}{4}$–4	Quarterly
Generally limited to 25% of quota, though larger amounts of up to 50% can be made available in exceptional cases.	Rate of charge; however, the rate of charge may be subsidized to 0.5 percent a year, subject to resource availability.	$3\frac{1}{4}$–5	Not applicable	Quarterly
140% of quota; 185% of quota in exceptional circumstances.	0.5%	$5\frac{1}{2}$–10	Not applicable	Semiannual
Annual: 25% of quota; cumulative: 50% of quota except in exceptional circumstances.	0.5%	$5\frac{1}{2}$–10	Not applicable	Semiannual

drawings are made under the arrangement.

3 *For purchases made after November 28, 2000, members are expected to make repurchases (repayments) in accordance with the schedule of expectation; the IMF may, upon request by a member, amend the schedule of repurchase expectations if the Executive Board agrees that the member's external position has not improved sufficiently for repurchases to be made.*

4 Credit tranches *refer to the size of purchases (disbursements) in terms of proportions of the member's quota in the IMF; for example, disbursements up to 25 percent of a member's quota are disbursements under the* first credit tranche *and require members to demonstrate reasonable efforts to overcome their balance of payments problems. Requests for disbursements above 25 percent are referred to as* upper credit tranche drawings*; they are made in installments as the borrower meets certain established performance targets. Such disbursements are normally associated with a Stand-By or Extended Arrangement. Access to IMF resources outside an arrangement is rare and expected to remain so.*

5 *Surcharge introduced in November 2000.*

The Fund can also provide loans under its lending facilities through the Trade Integration Mechanism (TIM), which it introduced in FY2004. The TIM is not a lending facility itself, but, rather, a policy. It is designed to help mitigate concerns among some developing countries that their balance of payments positions could suffer, albeit temporarily, as multilateral trade liberalization changes their competitive position in world markets.

Detailed information about the amounts of lending approved by the IMF, credit outstanding, and repayments, broken down by lending facility and financial year, can be found in the Appendix II tables on the CD-ROM.

The IMF's Executive Board frequently reviews and refines the IMF's policies and instruments to ensure that they meet members' evolving needs. During FY2007, the IMF's Executive Board began work on the development of a new contingent financing instrument that emerging market countries active in international capital markets could draw on if they experience a sudden, temporary loss of liquidity. To help low-income countries avoid building up excessive debt after benefiting from debt relief, the Boards of the IMF and the World Bank decided to strengthen the Debt Sustainability Framework (DSF) developed by the two institutions in 2005, and the IMF and the World Bank engaged in outreach on ways to use the DSF more effectively. The Board also reviewed the report of the Independent Evaluation Office (IEO; Box 5.3), "The IMF and Aid to Sub-Saharan Africa," concluded a review of "ex post assessments"—assessments of the successes and failures of IMF-supported programs with repeat or longer-term borrowers—and reviewed the IMF's experience over 1992–2005 with precautionary arrangements, which give countries not facing immediate balance of payments problems the right to draw on financial assistance from the IMF should the need arise, conditional on the implementation of specific policies.

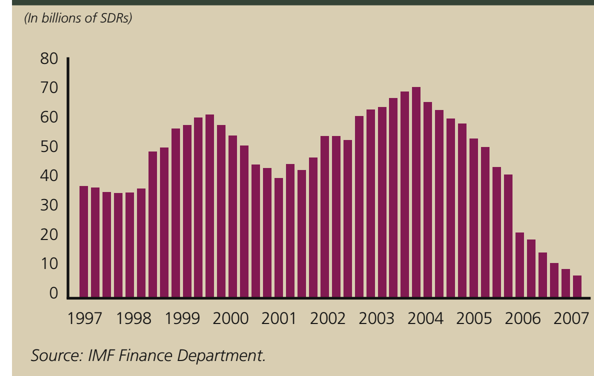
Emerging Market Economies

Many emerging market economies have moved from programs to a surveillance-only relationship with the IMF. As these countries have gained access to international capital markets, they have repaid their IMF loans ahead of schedule and their need for new IMF lending has decreased dramatically.

Lending

IMF credit outstanding at the end of FY2007 declined to SDR 7.3 billion from SDR 19.2 billion in April 2006, owing to continued early repayments of outstanding loans and a low level of new disbursements (Figure 3.1).[36] During FY2007, nine members—Bulgaria, the Central African Republic, Ecuador, Haiti, Indonesia, Malawi, the Philippines, Serbia, and Uruguay—repaid their outstanding obligations to the IMF ahead of schedule, for a total of SDR 7.1 billion. IMF disbursements totaled SDR 2.3 billion, the bulk of which went to Turkey.

Figure 3.1 Regular loans outstanding, FY1997–FY2007



Source: IMF Finance Department.

New IMF commitments fell sharply, from SDR 8.3 billion in FY2006 to SDR 237 million in FY2007, with two new Stand-By Arrangements approved for Paraguay and Peru. Seven Stand-By and Extended Arrangements were in effect as of the end of FY2007, of which four are being treated as precautionary since borrowers have indicated their intention not to draw on them. At the end of April 2007, undrawn balances under all current Stand-By and Extended Arrangements amounted to SDR 3.9 billion.

36 The IMF's liquidity, as measured by the Forward Commitment Capacity (FCC), rose to an all-time high of SDR 126.1 billion at the end of April 2007, from SDR 120.1 billion at the end of April 2006, largely because of the significant decline in lending.

New financing instrument

A number of the IMF's members have called for consideration of a new financing instrument designed specifically to support crisis-prevention efforts by members active in international capital markets. As part of the analytical backdrop to the design of such an instrument, in May 2006 the Executive Board held an informal seminar to discuss a study on the role of IMF-supported programs in crisis prevention.[37] Based on theoretical and empirical work, that study found that the availability of IMF resources can have a significant impact on lowering the likelihood of a crisis. Moreover, the marginal impact of IMF support depends on the quality of the member's policies and economic fundamentals—accordingly, the availability of IMF financial resources can have a strong complementary effect to the member's own crisis-prevention efforts. Building on this analytical work, at a seminar in August 2006, the Executive Board discussed the objectives for a new financing instrument, taking into account the IMF's experience with an earlier instrument, the Contingent Credit Lines (CCL).[38]

A successful instrument would reduce the risk of a crisis by granting qualified members—that is, countries following sound policies—access to a credit line, thereby lowering the incentive for private investors to reduce their exposure early, at the first sign of trouble. It would also need to balance predictable access to IMF financing against adequate safeguards for IMF resources, and manage the tension between the provision of strong positive signals when conditions are good and the possibility that entry or exit from the instrument could generate negative signals when circumstances deteriorate.

At the September 2006 Annual Meetings, the IMFC requested that the IMF continue to work on designing a new instrument, tentatively called the Reserve Augmentation Line. Outreach by IMF management and staff with officials and market participants facilitated further work on the instrument's design, and in March 2007 Executive Directors discussed a paper that sought further convergence of views on key design issues, such as qualification, monitoring, access, terms, and a sunset clause.[39] The discussion clarified areas of emerging common ground and revealed areas where further progress is needed. The Executive Board called on IMF staff to prepare a follow-up paper refining the proposals.

Low-Income Countries

The MTS identifies the need to make the IMF's engagement with low-income countries more flexible, as well as more focused on what is essential and on areas where the IMF has a comparative advantage and expertise. Over the past few years, the Board has approved a wide array of instruments to help the IMF's low-income members achieve macroeconomic stability and sustainable growth, which are critical to the achievement of the Millennium Development Goals (Box 3.2). In addition to the advice given to countries in the course of its surveillance activities, the IMF provides advice, financial assistance, and debt relief in connection with the facilities described above, and 90 percent of its technical assistance goes to low- and lower-middle-income countries (see Chapter 4). For low-income countries eligible for PRGF lending that do not want financial assistance from the IMF but do want support of their policies through counsel and advice, the IMF created the Policy Support Instrument (PSI) in FY2006. As of April 30, 2007, four countries had applied for and received PSIs. The Fund also continues to advocate a successful outcome to the Doha Round of trade negotiations (Box 3.3).

Concessional lending

During FY2007, the Executive Board approved 10 new PRGF arrangements (Table 3.2), with commitments totaling SDR 401.2 million. The Board also approved the augmentation of two PRGF arrangements, for a combined total of SDR 36.8 million. In addition, the Board approved Kenya's request to reduce access under its PRGF arrangement by SDR 75 million, in light of its improved external position. As of April 30, 2007, the reform programs of 29 member countries were supported by PRGF arrangements. Total concessional loans outstanding amounted to SDR 3.9 billion (Figure 3.2). To date, no country has requested assistance under the ESF.

37 *"The Role of Fund Support in Crisis Prevention" (March 23, 2006) can be found on the IMF's Web site,* www.imf.org.

38 *The summing up of the Board's discussion is contained in PIN 06/104, which can be found on the CD-ROM and on the IMF's Web site, at* www.imf.org/external/np/sec/pn/2006/pn06104.htm. *A fact sheet about the Contingent Credit Lines can be found at* www.imf.org/external/np/exr/facts/ccl.htm. *The IMF introduced the CCL in 1999 as part of its response to the rapid spread of turmoil through global financial markets during the Asian crisis of 1997–98. The instrument was intended to provide a precautionary line of defense for members that had sound policies and were not at risk of an external payments crisis of their own making, but that were vulnerable to contagion effects from capital account crises in other countries. Despite changes intended to make the CCL more attractive to members, it was never used, and the Board decided in 2003 to allow it to expire.*

39 *The staff paper, "Further Consideration of a New Liquidity Instrument for Market Access Countries—Design Issues," February 13, 2007, can be found on the IMF's Web site, at* www.imf.org/external/pp/longres.aspx?id=4044. *The summing up of the Board's discussion, PIN 07/40, can be found on the CD-ROM as well as on the Fund's Web site, at* www.imf.org/external/np/sec/pn/2007/pn0740.htm.

Table 3.2 PRGF arrangements approved in FY2007

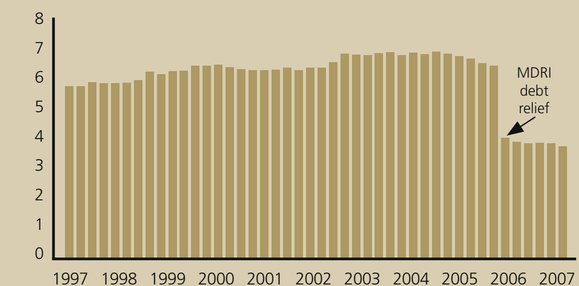
(In millions of SDRs)

Member	Effective date	Amount approved[1]
New arrangements		
Afghanistan	June 26, 2006	81.0
Burkina Faso	April 23, 2007	6.0
Central African Rep.	December 22, 2006	36.2
Gambia, The	February 21, 2007	14.0
Haiti	November 20, 2006	73.7
Madagascar	July 21, 2006	55.0
Mauritania	December 18, 2006	16.1
Moldova	May 5, 2006	80.1
Rwanda	June 12, 2006	8.0
Sierra Leone	May 10, 2006	31.1
Subtotal		**401.2**
Augmentations/reductions		
Burkina Faso	September 8, 2006	6.0
Moldova	December 15, 2006	30.8
Kenya	April 11, 2007	(75.0)
Subtotal		**(38.2)**
Total		**363.0**

Source: IMF Finance Department.

1 For augmentations/reductions, only the amount of the increase/decrease is shown.

Figure 3.2 Concessional loans outstanding, FY1997–FY2007



Source: IMF Finance Department.

Debt relief

Debt relief efforts under the enhanced HIPC Initiative and the MDRI continued during FY2007. A sunset clause was introduced at the start of the HIPC Initiative in 1996, restricting eligibility to countries that had embarked on programs supported by the IMF or the International Development Association (IDA)[40] within a two-year period to prevent the Initiative from becoming permanent, minimize potential moral hazard arising from excessive borrowing in anticipation of debt relief, and encourage early adoption of reforms. Following numerous extensions over the years, at a meeting in September 2006 the Executive Boards of the IMF and the World Bank acknowledged that letting the sunset clause take effect at end-2006 without any modification could leave several countries with debt burdens in excess of the Initiative's thresholds and no further possibility of benefiting from this comprehensive framework. Accordingly, agreement was reached to let the sunset clause take effect while grandfathering all countries assessed to have met the income and indebtedness criteria based on end-2004 data, including countries that might be assessed to have met these criteria at some point in the future.

Executive Directors called on the staff to conduct a stocktaking exercise in a few years' time to review the options for the remaining duration of the HIPC Initiative. They also urged staff to continue working with country authorities to develop and implement reform strategies and to assist these countries in qualifying for HIPC Initiative assistance promptly. At the same time, they encouraged the remaining countries to make every effort to establish a track record of policy performance and implement satisfactorily their poverty reduction strategies so that they can begin receiving debt relief.[41]

As of April 30, 2007, 30 countries had reached the decision point under the enhanced HIPC Initiative; of these, 22 had reached their completion points.[42] The IMF has committed SDR 1.9 billion under the HIPC Initiative and disbursed SDR 1.7 billion. During FY2007, one member (Haiti) reached its decision point, three others (Malawi, Sierra Leone, and São Tomé and Príncipe) reached their completion points, and Afghanistan was added to the list of countries eligible for assistance under the HIPC Initiative.

40 IDA is the World Bank agency that provides interest-free loans and grants to the poorest member countries.

41 For the summing up of the Board's discussion, see "IMF Executive Board Discusses Issues Related to the Sunset Clause of the Initiative for Heavily Indebted Poor Countries," PIN 06/107, on the CD-ROM or at www.imf.org/external/np/sec/pn/2006/pn06107.htm.

42 To qualify for HIPC assistance, a country must pursue strong economic policies supported by the IMF and the World Bank. After establishing a track record of good performance and developing a PRSP or an interim PRSP, the country is said to have reached its decision point, at which time the IMF and the World Bank formally decide on the country's eligibility and the international community commits itself to reducing the country's debt to a sustainable level. The country must then continue its good track record with the support of the international community, implementing key policy reforms, maintaining macroeconomic stability, and adopting and implementing a PRSP. Paris Club and other bilateral and commercial creditors reschedule obligations coming due. A country reaches its completion point once it has met the objectives set at the decision point. It then receives the balance of the debt relief committed.

Box 3.2 Tracking progress toward the Millennium Development Goals

The IMF and the World Bank track the progress made by low-income countries toward the achievement of the Millennium Development Goals (MDGs), jointly publishing their findings annually in the *Global Monitoring Report* (GMR). The fourth GMR, issued in April 2007, found that progress on the first goal—halving poverty by 2015—was on track in all developing regions except sub-Saharan Africa, but that efforts to attain the goals of reducing child mortality and disease and achieving environmental sustainability were falling short. It called for greater attention to gender equality—not only because of equity considerations but also because empowering women is essential to economic well-being and the advancement of the other MDGs—and to fragile states, which account for 27 percent of the developing world's extreme poor (those living on less than $1 a day).[1] Fragile states—low-income countries and territories deemed to have especially weak institutions and governance that undermine economic performance and the delivery of basic social services—are, in general, the least likely to achieve the MDGs. Many are emerging from conflict.

A substantial increase in aid will be needed if developing countries are to accelerate their efforts to reach the MDGs. However, actual commitments of aid in 2005–06 as registered by the OECD-DAC (Organization for Economic Cooperation and Development–Development Assistance Committee)—excluding exceptional debt relief transactions—have declined, and projections through 2008 have aid volumes falling well short of the pledges made by the international community at the International Conference on Financing for Development that took place in Monterrey, Mexico, in 2002, and at the Group of 8's Gleneagles summit in 2005. The IMF continues to urge bilateral donors to increase aid levels and make aid more predictable. The Fund is also providing advice and technical assistance in its areas of expertise to aid recipients to ensure that they can use increased aid effectively without undermining macroeconomic stability, crowding out private investment, or falling back into situations of unsustainable external indebtedness.

The IMF works closely with the World Bank on many issues related to low-income countries in addition to the GMR, including the PRSP process, debt relief under the HIPC Initiative and the MDRI, the Debt Sustainability Framework, and the Financial Sector Assessment Program (the FSAP is described in Chapter 2). An External Committee carried out a study on Bank-Fund collaboration, which is discussed in Chapter 5, during FY2007.

1 The Global Monitoring Report: Confronting the Challenges of Gender Equality and Fragile States *can be found on the IMF's Web site, at* www.imf.org/external/pubs/cat/longres.cfm?sk=20364.0.

The MDRI was launched in early 2006 to further reduce the debts of qualifying low-income countries and provide them with additional resources to help meet the MDGs. Proposed by the Group of 8 countries, the MDRI is a different mechanism from the HIPC Initiative but linked to it operationally. Under the MDRI, the IMF, IDA, the African Development Fund, and the Inter-American Development Bank provide 100 percent debt relief on eligible claims of countries reaching the completion point under the enhanced HIPC Initiative. In addition, the IMF provides MDRI debt relief to all its members with yearly per capita incomes at or below $380 (including two non-HIPCs, Cambodia and Tajikistan).[43]

As of April 30, 2007, the IMF had delivered MDRI debt relief totaling SDR 2.7 billion to 24 countries. The debt relief was financed by a combination of resources from undisbursed

43 For more information on the MDRI, see PIN 05/164, at www.imf.org/external/np/sec/pn/2005/pn05164.htm.

Box 3.3 Trade liberalization and low-income countries

In August 2006, the Executive Board discussed the "Doha Development Agenda and Aid for Trade," a paper jointly prepared by the staffs of the IMF and the World Bank.[1] Executive Directors stressed that work on Aid for Trade should proceed regardless of the status of the Doha Round. Although Aid for Trade cannot substitute for an ambitious outcome to the Doha Round, by helping developing countries address infrastructural and other supply constraints, it may enable them to take full advantage of trade opportunities arising from global market opening. The IMF should continue with selective interventions within its mandate and core areas of competence, including the macroeconomic implications of changes in trade policies and the global trade environment, and advice on tax and customs reform.

The Board took note of the proposals of the WTO Task Forces on an Enhanced Integrated Framework for Trade-Related Technical Assistance (IF) and on Aid for Trade. At present, trade-related priorities in many of the least-developed countries remain disconnected from the PRSP process. Against this background, Executive Directors observed that implementation of the recommendations of the IF Task Force could allow the IF to play a more effective role in helping to identify aid-for-trade needs and coordinating trade-related technical assistance. They welcomed the recommendations for strengthened capacity in IF beneficiary countries and improved IF governance, and recognized donor commitments for the financing of this effort.[2]

Although the benefits of trade liberalization outweigh the costs overall, certain low-income countries may be hurt in the short run by trade liberalization measures that expose their exports to greater competition, reduce their revenues as tariffs are lowered, or raise the cost of food imports as agricultural subsidies are abolished. In 2004, the IMF introduced the Trade Integration Mechanism (TIM), a vehicle that allows countries to increase their access to IMF resources under an existing arrangement or a new arrangement within one of the Fund's facilities if necessary to cope with the erosion of trade preferences and the effect of other countries' trade liberalization on their balance of payments. In FY2007, the Executive Board approved the activation of the TIM for Madagascar, in light of the possible impact on the country's textile exports of the expiration of textile quotas in 2005 as called for by the WTO's Agreement on Textiles and Clothing and the implementation of the U.S. African Growth and Opportunities Act in 2007. With the activation of the TIM, Madagascar became eligible for an augmentation of access to IMF resources under its PRGF arrangement. It is the third IMF member for which the TIM has been activated.

1 *The paper is available on the IMF's Web site, at* www.imf.org/external/pp/longres.aspx?id=3886; *PIN 06/105, which contains the summing up of the Board's discussion, can be found on the CD-ROM or at* www.imf.org/external/np/sec/pn/2006/pn06105.htm.

2 *The recommendations include the establishment of a new executive secretariat in the WTO Secretariat, measures to strengthen capacity in the least-developed countries, a funding target of $400 million over an initial five-year period, and a monitoring and evaluation framework.*

HIPC accounts (SDR 0.4 billion), IMF resources (SDR 1.2 billion), and bilateral contributions (SDR 1.1 billion). During FY2007, four members (Malawi, Mauritania, Sierra Leone, and São Tomé and Príncipe) received debt relief totaling SDR 189.2 million under the MDRI.[44]

Debt Sustainability Framework

The primary aim of the DSF is to help guide the borrowing decisions of low-income countries, balancing their need for funds against their ability to service debt. The Executive Board had a second discussion in FY2007 about how the DSF, which was

44 CD-Table 3.3 and CD-Table 3.4 on the CD-ROM list the countries covered by the MDRI and describe the implementation of the MDRI.

endorsed by the Boards of the IMF and the World Bank in April 2005, could be used to help low-income countries that have received debt relief avoid reaccumulating excessive debt.[45] The November 2006 discussion, which was based on a paper prepared jointly by the staffs of the IMF and the World Bank, focused on how best to integrate into the DSF the policy challenges arising from the perceived increase in borrowing space created by debt relief in some low-income countries, the emergence of new creditors, and the rising weight of domestic debt. These developments, while welcome, create new risks that need to be addressed as countries make progress toward implementing prudent debt-management policies. The Board therefore called for improvements to the rigor and quality of debt sustainability analyses.

Executive Directors reiterated that concessional flows remain the most appropriate source of external finance for low-income countries and called for continued efforts by the international community to improve the availability and predictability of such financing. However, they recognized that consideration should be given, on a case-by-case basis, to nonconcessional finance, depending on its impact on debt sustainability, on the overall strength of a borrowing country's policies and institutions, and on the quality of both the investment to be financed and the overall public expenditure program.

Executive Directors underscored that the effectiveness of the DSF ultimately depends on its broader use by debtors and creditors and stressed the need for further outreach to official creditors. They also stressed the importance of timely, high-quality data on borrowing and lending operations and encouraged IMF staff, working with Bank staff, to disseminate more broadly and effectively the results of debt sustainability analyses.[46] The Board welcomed the creation of a dedicated Web page on the IMF's Web site where debt sustainability analyses can be easily located and supported the establishment of a similar Web page on concessionality.[47] The IMF and the World Bank have stepped up their outreach on the DSF, including to non-OECD creditors, to foster responsible lending practices, and they stand ready to help design principles in this area. They are also increasing efforts to provide borrowing countries with training and technical assistance to strengthen their debt-management capacities.

Agricultural worker in Tajikistan

Policy Support Instrument

In recent years, several low-income countries have made significant progress toward economic stability and no longer require IMF financial assistance. However, regardless of whether they seek the Fund's financial support, they may still seek IMF monitoring and support of, and advice and counsel on, their economic policies. Approved by the Executive Board in FY2006, PSIs are designed to address the needs of these members by providing policy support and "signaling."[48] Signaling refers to the information Fund activities can indirectly provide about countries' performance and prospects. Such information can be used to inform the decisions of outsiders, including private creditors, official donors and creditors, and the public at large. In low-income countries, such signals have been sent mainly in the context of the PRGF and the related PRSP process. PSIs mirror the design and achieve many of the purposes of the PRGF, and like PRGF arrangements and debt relief, are based on development of a PRSP. They are also voluntary—members that want PSIs must request

45 *The first discussion took place in April 2006; see PIN 06/61, at* www.imf.org/external/np/sec/pn/2006/pn0661.htm.

46 *For the summing up of the Board's discussion, see PIN 06/136, "IMF Executive Board Discusses the Application of the Debt Sustainability Framework for Low-Income Countries Post Debt Relief" on the CD-ROM or at* www.imf.org/external/np/sec/pn/2006/pn06136.htm. *The staff report can be found on the IMF's Web site, at* www.imf.org/external/pp/longres.aspx?id=3959; *a staff guidance note on the application of the DSF is also posted on the IMF's Web site, at* www.imf.org/external/np/pp/2007/eng/041607.pdf.

47 *See* www.imf.org/external/pubs/ft/dsa/lic.aspx *for debt sustainability analyses included in country reports. The Web page on the IMF's concessionality was launched in January 2007; see* www.imf.org/external/np/pdr/conc/index.htm.

48 *See PIN 05/145 at* www.imf.org/external/np/sec/pn/2005/pn05145.htm *for the summing up of the Board discussion at which the PSI was approved.*

them—and thus demonstrate strong country ownership of policy programs, and programs are expected to meet the same high standards as programs supported by Fund financial assistance. In the event of a shock, an on-track PSI could provide the basis for rapid access to PRGF resources through the ESF. The publication of PSI documents, like that of PRGF documents, is voluntary but presumed.

The IMF provides emergency financial assistance to emerging market economies and low-income countries recovering from conflicts or natural disasters.

In addition to promoting a close policy dialogue between the IMF and its low-income members, PSIs provide more frequent Fund assessments of members' economic and financial policies than is possible under the Article IV consultation process: while Article IV consultations usually take place yearly, the Board reviews performance under PSIs semiannually. Members with PSIs are expected to provide timely and accurate data to the Fund to ensure the integrity of these assessments.

In the past two years, the Board has approved PSIs for four countries: Nigeria and Uganda in FY2006, and Cape Verde and Tanzania in FY2007.[49] In FY2007, the Board reviewed Uganda's 16-month PSI and approved a new, 3-year PSI at Uganda's request.

Emergency Assistance

The IMF provides emergency financial assistance to both emerging market economies and low-income countries recovering from conflicts (Emergency Post-Conflict Assistance, or EPCA) or natural disasters (Emergency Natural Disaster Assistance, or ENDA). The interest charged on Emergency Assistance provided to PRGF-eligible members is subsidized subject to the availability of subsidy resources contributed by member countries; the subsidized rate is 0.5 percent a year.

During FY2007, the Executive Board approved Emergency Assistance of SDR 50.8 million for Lebanon under EPCA, and the Central African Republic and Haiti repaid their EPCA loans, totaling SDR 33 million, earlier than scheduled. As of April 30, 2007, two countries, Iraq and Lebanon, had outstanding EPCA credit, which amounted to SDR 347.9 million. No new ENDA loans were made during FY2007. During FY2007, Malawi repaid ENDA loans totaling SDR 8.7 million. Three countries—Grenada, Maldives, and Sri Lanka—had outstanding ENDA credit, for a total of SDR 111.5 million, at end-April 2007.

Review of the IMF's Role and Instruments

In FY2007, the Executive Board reviewed the IMF's advice on the use of aid in sub-Saharan Africa, based on an IEO evaluation; considered the findings and value of ex post assessments; and compared the performance of countries under precautionary arrangements with that of countries that had arrangements on which they drew financial assistance. The Board also requested additional policy papers to define more clearly the IMF's role in low-income countries.

IMF and aid to sub-Saharan Africa

In March 2007, the Executive Board discussed the IEO evaluation of the IMF and aid to sub-Saharan Africa.[50] The IEO report confirmed the steady improvement in the region's macroeconomic performance during 1999–2005 and attributed this improvement in part to the advice and actions of the IMF, including on debt relief, while also recognizing the contribution of the authorities' own efforts and exogenous factors. Nevertheless, the report

49 *For details, see Press Releases 06/172, "IMF Executive Board Approves a Three-Year Policy Support Instrument for Cape Verde," and 07/13, "IMF Executive Board Completes the First Review Under the Policy Support Instrument for Cape Verde," at* www.imf.org/external/np/sec/pr/2006/pr06172.htm *and* www.imf.org/external/np/sec/pr/2007/pr0713.htm, *respectively; Press Releases 05/229, "IMF Executive Board Approves a Two-Year Policy Support Instrument for Nigeria," and 06/293, "IMF Executive Board Completes the Second Review Under the Policy Support Instrument for Nigeria," at* www.imf.org/external/np/sec/pr/2005/pr05229.htm *and* www.imf.org/external/np/sec/pr/2006/pr06293.htm, *respectively; Press Release 07/26, "IMF Executive Board Completes Sixth Review Under Tanzania's PRGF Arrangement and Approves a Three-Year Policy Support Instrument," at* www.imf.org/external/np/sec/pr/2007/pr0726.htm; *and Press Releases 06/14, "IMF Executive Board Completes Final Review of Uganda's PRGF Arrangement and Approves 16-Month Policy Support Instrument," and 06/281, "IMF Executive Board Completes the First Review Under the Policy Support Instrument for Uganda and Approves a New Three-Year Policy Support Instrument," at* www.imf.org/external/np/sec/pr/2006/pr0614.htm *and* www.imf.org/external/np/sec/pr/2006/pr06281.htm, *respectively.*

50 *The IEO's report and press release, as well as the summing up of the IMF Board's discussion, can be found at* www.ieo-imf.org/eval/complete/eval_03122007.html.

Post-conflict reconstruction in Lebanon

identified areas where further improvements were needed, including the IMF's role in poverty reduction efforts, the mobilization of aid, the preparation of alternative scenarios for reaching the MDGs, and the application of poverty and social impact analysis. The IEO found that IMF staff did not receive clear directives on work in these areas because of differences in the views of Executive Directors on the IMF's role and policies in low-income countries, and that management and the Board should have done more to resolve these differences. The report also found a disconnect between the IMF's external communications on aid and poverty reduction and its practice in low-income countries.

The IEO made the following recommendations: (1) the Executive Board should clarify IMF policies on macroeconomic performance thresholds for the accommodation of additional aid, the mobilization of aid, alternative scenarios, poverty and social impact analysis, and pro-poor and pro-growth budget frameworks; (2) IMF management should establish transparent mechanisms for monitoring and evaluating the implementation of the clarified policy guidance, including with respect to collaboration with the World Bank, and ensure that institutional communications are consistent with Fund policies and operations; and (3) management should clarify its expectations of, and the resources available to, the IMF's resident representatives and mission chiefs with respect to their interactions with local donor groups and civil society.

In their discussion of the IEO's report, Executive Directors were encouraged by the improvements in sub-Saharan Africa's macroeconomic performance. They noted that the HIPC Initiative and the MDRI had greatly reduced debt-related vulnerabilities and the costs of debt servicing. Executive Directors also noted the improvements in the IMF's assistance to low-income countries. They considered that the IMF's engagement in low-income countries should remain focused on its core mandate and that the IMF should not play a coordinating role in aid mobilization. They also confirmed that distributional policies lie outside the IMF's core mandate and emphasized the importance of improving IMF collaboration with development partners, in particular the World Bank, to take these issues into account when helping countries formulate their macroeconomic policies. Many Executive Directors thought staff should be prepared to design alternative scenarios related to the scaling-up of aid, but most thought that normative advice would fall outside the IMF's mandate: they considered that the IMF's role should be limited to assessing the consistency of

additional aid flows with macroeconomic stability and the absorption capacity of the country. The Board supported the report's recommendation on the need for further clarification of IMF policy and asked staff to come back with specific proposals in this area. Early in FY2008, Fund management submitted its plan for implementing Board-endorsed recommendations to the Board.

Ex post assessments

Ex post assessments (EPAs) provide the IMF with an opportunity to step back from ongoing longer-term program engagement with a member country so that it can take a fresh look at its overall strategic approach and draw lessons for future programs. In May 2006, the Executive Board discussed the IMF staff's "Review of Ex Post Assessments and Issues Relating to the Policy on Longer-Term Program Engagement."[51] Through May 15, 2006, 57 members had been identified as having longer-term program engagement, of which more than 80 percent were low-income countries, and 42 EPAs had been completed. The IMF introduced EPAs in 2003 in response to the IEO's report on prolonged use of Fund resources because of concerns that, in some cases, longer-term program engagement might indicate inadequate progress in dealing with members' economic problems and a lack of effectiveness of IMF-supported programs. There were also concerns that longer-term program engagement might hinder the development of domestic institutions, undermine the Fund's credibility, and decrease the resources available to other members in need of support.

In their May 2006 discussion, Executive Directors reviewed the findings of 32 EPA reports completed by end-August 2005.[52] In most cases, EPAs found that the design of policies in IMF-supported programs had been consistent with the multiple macroeconomic and structural challenges faced by members with longer-term program engagement, and that IMF involvement had not undermined members' institutional development. The Board noted, however, that several EPAs had been critical of the design of structural reforms, in terms of both the scope and the number of structural conditions, and that efforts to streamline conditionality should continue.

The Board considered that, by and large, EPAs have served their purpose and remain an important institutional mechanism for distilling lessons and enhancing the learning culture of the IMF. However, their value could be enhanced by greater selectivity and focus on a few critical issues. Executive Directors suggested that systematic discussions in EPAs of the reasons for program success or failure and of potential exit strategies would provide further useful lessons and generally agreed that, the IMF's budget situation permitting, the staff should expand efforts to reach out and consult with donors, outside experts, and country authorities, while safeguarding the confidentiality of information.

Precautionary arrangements

Also in May 2006, the Board discussed a study by IMF staff comparing precautionary programs with lending programs on which borrowing countries intend to draw. The study was undertaken at the Board's request to determine whether there were systematic differences in terms of program policies, conditionality, or macroeconomic outcomes, and, if so, whether such differences were attributable to the nature of the program or to the circumstances that had led the member to seek the IMF's support. Executive Directors concurred that drawing programs were more likely to be requested by members with weaker macroeconomic performances, whereas precautionary programs tended to be requested by members that had stronger macroeconomic fundamentals but faced uncertainties.[53] It was also recognized that members used precautionary programs to signal policies to markets. The Board noted that, in the first program year, output growth was significantly higher, and inflation significantly lower, in members with precautionary programs than in those with drawing programs. However, these differences could be explained largely by the differences in initial conditions. Executive Directors welcomed the analysis of market reactions, as reflected in interest rate spreads, to IMF-supported programs. Spreads did not widen when members sought precautionary programs, suggesting that markets did not attach a stigma to such programs.

Executive Directors expressed a variety of views on the role of precautionary arrangements in supporting a successful exit for members from IMF-supported programs. They considered that all IMF-supported programs should aim to achieve an exit from IMF financing. Overall, Executive Directors agreed that precautionary programs are a most useful instrument in the IMF's toolkit, lending the IMF's credibility in support of the authorities' policies and enhancing policy discipline. Many Executive Directors also considered that these programs send a well-calibrated signal to markets of the authorities' commitment. Comparisons of policy objectives and conditionality between precautionary and non-precautionary programs suggested to most Executive Directors that IMF policies are being applied consistently.

51 *The paper can be found on the IMF's Web site, at* www.imf.org/external/np/pp/eng/2006/032006R.pdf. *The summing up of the Board discussion can be found in PIN 06/96, on the CD-ROM, as well as on the IMF's Web site,* www.imf.org/external/np/sec/pn/2006/pn0696.htm.

52 *These EPAs were for the following countries: Albania, Armenia, Azerbaijan, Benin, Bolivia, Bulgaria, Cambodia, Cameroon, Chad, Ethiopia, The Gambia, Georgia, Guinea, Guinea-Bissau, Honduras, Kazakhstan, the Kyrgyz Republic, Lesotho, the former Yugoslav Republic of Macedonia, Madagascar, Malawi, Mali, Moldova, Mozambique, Niger, Peru, Romania, Sierra Leone, Uganda, Uruguay, Vietnam, Zambia.*

53 *PIN 06/94, which contains the full summing up of the Board discussion, can be found on the CD-ROM and on the IMF's Web site, at* www.imf.org/external/np/sec/pn/2006/pn0694.htm.