



# Strengthening IMF program support and crisis resolution

CHAPTER | 3

The provision of temporary financial support, in the form of loans of foreign exchange, to member countries with balance of payments difficulties is one of the IMF's main responsibilities. Its financial assistance is provided under a variety of policies and lending instruments (Table 3.1). Most forms of IMF financing are made conditional on the adoption by the recipient country of policies of adjustment and reform designed to correct the problems that gave rise to its need for support. Such conditionality is important also to ensure that the IMF's resources are safeguarded for the use of members in future need.

To ensure that IMF financing operations and instruments are well designed, up-to-date, and sufficiently flexible to support country-driven adjustment and reform efforts in a wide range of circumstances, the Fund undertook a broad review of program design and conditionality during the financial year. The review, which covered the design and effectiveness of programs during 1995–2000, as well as the initial experience with programs formulated under new conditionality guidelines adopted in 2002, gave the Fund valuable insights that will inform its operations and set a broad agenda for further work. The adequacy of program design was also examined as part of ex post assessments of programs in 18 member countries during the period.

Besides this wide-ranging reexamination of its policies on conditionality, the Board reviewed its policy on access to the Fund's financial resources. The amount of borrowing to which a country has access is linked both to its quota in the Fund (a reflection of the country's economic size, openness to the global economy, and other factors) and to the terms of the particular lending window. In FY2005 the Board looked at the access policy limits under the credit tranches, the Extended Fund Facility (EFF), and the Poverty Reduction and Growth Facility (PRGF). Also during FY2005, the Trade Integration Mechanism—a way to make new IMF resources more predictably available to qualifying member countries under existing Fund facilities—was activated.

Finally, during FY2005 the Fund continued to work with other concerned parties to promote mechanisms aimed at the orderly resolution of crises, such as the inclusion of collective action clauses (CACs) in sovereign bonds, the development of the Principles for Stable Capital Flows and Fair

Debt Restructuring in Emerging Markets, and the evolution of the so-called Evian approach adopted by the Paris Club for restructuring the debt of non-HIPC countries.

For more details about developments in IMF financial operations and policies during the financial year, see Chapter 5.

## 2004–05 Conditionality Review

An IMF-supported program is a package of economic policy measures that, combined with approved financing from the IMF, is intended to accomplish specific economic objectives such as orderly adjustment of the balance of payments, lower inflation, and stronger, sustainable growth and poverty reduction. Conditionality relating to implementation of the agreed policies, usually in a phased way, gives the country confidence that it will continue to receive financing from the IMF through the duration of the program as long as it implements the policies agreed, while also safeguarding the IMF's resources.

During the Fund's previous, 2000–02 Conditionality Review, Executive Directors requested that the next review address broad issues of program design. In response to this request, the 2004–05 Conditionality Review had two parts. The first was a critical review of the design and effectiveness of IMF-supported programs over 1995–2000, and the second considered the Fund's initial experience with new conditionality guidelines introduced in 2002, which replaced previous guidelines adopted in 1979.

### Design of IMF-supported programs

The first part of the review, conducted by the Board in December 2004, examined key features of IMF-supported programs over 1995–2000.<sup>1</sup>

<sup>1</sup>The Board's discussion is summarized in Public Information Notice No. 05/16, [www.imf.org/external/np/sec/pn/2005/pn0516.htm](http://www.imf.org/external/np/sec/pn/2005/pn0516.htm); the staff papers include "The Design of Fund-Supported Programs—Overview," [www.imf.org/external/np/pdr/2004/eng/design.htm](http://www.imf.org/external/np/pdr/2004/eng/design.htm); "Fund-Supported Programs—Objectives and Outcomes," [www.imf.org/external/np/pdr/2004/eng/object.htm](http://www.imf.org/external/np/pdr/2004/eng/object.htm); and "Macroeconomic and Structural Policies in Fund-Supported Programs: Review of Experience," [www.imf.org/external/np/pdr/2004/eng/macro.htm](http://www.imf.org/external/np/pdr/2004/eng/macro.htm).

Table 3.1 IMF financial facilities

Credit facility	Purpose	Conditions	Phasing and monitoring <sup>1</sup>	Access limits <sup>1</sup>
<b>Credit tranches and Extended Fund Facility<sup>4</sup></b>				
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	Annual: 100% of quota; cumulative: 300% of quota
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 semiannual purchases (disbursements) contingent on observance of performance criteria and other conditions	Annual: 100% of quota; cumulative: 300% of quota
<b>Special facilities</b>				
Supplemental Reserve Facility (1997)	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; frontloaded access with two or more purchases (disbursements)	No access limits; access under the facility only when access under associated regular arrangement would otherwise exceed either annual or cumulative limit
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	45% of quota each for export and cereal components; combined limit of 55% of quota for both components
Emergency Assistance	Assistance for balance of payments difficulties related to:		None, although post-conflict assistance can be segmented into two or more purchases	Generally limited to 25% of quota, though larger amounts can be made available in exceptional cases
(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		
<b>Facility for low-income members</b>				
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 macro-economic, structural, and poverty reduction policies	Semiannual (or occasionally quarterly) disbursements contingent on observance of performance criteria and reviews	140% of quota; 185% of quota in exceptional circumstances

<sup>1</sup>Except for 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—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 Box 5.1 on the IMF's Financing Mechanism. PRGF lending is financed by a separate PRGF Trust.

<sup>2</sup>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 (from May 1, 2005, the margin is expressed in basis points over the SDR interest rate; prior to that the margin was expressed as a proportion of the SDR interest rate). 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% 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 drawings are made under the arrangement.

<sup>3</sup>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.

Charges <sup>2</sup>	Repurchase (repayment) terms <sup>3</sup>		Installments
	Obligation schedule (Years)	Expectation schedule (Years)	
Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts of 300%) <sup>5</sup>	3¼-5	2¼-4	Quarterly
Rate of charge plus surcharge (100 basis points on amounts above 200% of quota; 200 basis points on amounts above 300%) <sup>5</sup>	4½-10	4½-7	Semiannual
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)	2½-3	2-2½	Semiannual
Rate of charge	3¼-5	2¼-4	Quarterly
Rate of charge; however, the rate of charge may be subsidized to 0.5 percent a year, subject to resource availability	3¼-5	Not applicable	Quarterly
0.5%	5½-10	Not applicable	Semiannual

<sup>4</sup>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.

<sup>5</sup>Surcharge introduced in November 2000.

*Objectives and outcomes.* Directors agreed that a viable balance of payments and medium-term external debt sustainability remain a core objective of IMF-supported programs.

For programs supported by nonconcessional lending under the General Resources Account (GRA), targeted external adjustment has been broadly in line with this objective, and IMF support seems to have mitigated the short-term negative effect of adjustment on growth. But in a number of cases, especially but not exclusively those of capital account crises, external adjustment has been sharper and larger than needed to stabilize external debt. Directors encouraged the IMF staff to undertake further analysis of the optimal mix between financing and adjustment in situations of capital account pressures as well as of the determinants of private capital flows and of the catalytic effects of IMF-supported programs.

For programs supported by concessional lending under the PRGF, targeted improvements in current account balances have, on average, been smaller than those required to stabilize external debt ratios. In addition, actual improvements have tended to be smaller than targeted. Directors called for further reflection on how to correct this phenomenon. Program outcomes for growth and inflation have been broadly favorable. Directors stressed that the design of programs in low-income countries should be based on full consideration of the implications of policies for poverty reduction.

*Analytical frameworks.* No single model or analytical framework is universally applicable to policy formulation in IMF-supported programs. Directors welcomed the fact that, in advising national authorities, IMF country teams normally draw on a variety of models and methods for policy formulation and combine them with economic judgment. The IMF's financial programming framework provides a useful consistency check on policies. This eclectic approach to policy formulation has generally worked well in practice. However, medium-term growth projections have been overly optimistic, which risks undermining the reliability of debt sustainability assessments and the credibility of programs. More analytical "reality checks" on growth projections, more systematic comparisons with forecasts by other analysts, and greater use of cross-country analysis were recommended.

*Exchange rate policies.* Directors noted that exchange rate regimes are no more likely to be altered at the outset of an IMF-supported program than at other times, and drew from this finding a variety of inferences. Coherence between the exchange rate regime and macroeconomic and structural policies is critical, and Directors emphasized that the IMF should avoid supporting policy mixes that do not sufficiently underpin the exchange rate regime. Disinflation has been achieved equally successfully under fixed or flexible exchange rate strategies, and success has depended instead



## Emergency post-conflict assistance

The IMF provides emergency assistance (see Table 3.1) to member countries with urgent balance of payments financing needs in the wake of natural disasters and armed conflicts. (For a discussion of emergency natural disaster assistance, see Chapter 4.) Emergency financial assistance is designed to be disbursed rapidly and is supported by policy advice and, in many cases, technical assistance.

Beginning in 1995, emergency assistance was made available to countries emerging from conflict that are unable to develop and carry out a comprehensive economic program because their capacity has been damaged by the conflict but that still have the capacity for planning and policy implementation. IMF assistance is designed to help them expedite their economic recovery by rebuilding and strengthening their administrative and institutional capacity and by catalyzing additional funds from international donors for reconstruction. The rate of charge on loans for low-income countries eligible for assistance under the Fund's Poverty Reduction and Growth Facility is subsidized by grant contributions made by other members (see Chapter 5).

During FY2005, the Board approved emergency post-conflict assistance for three countries: the Central African Republic (\$8.2 million), Haiti (\$15.6 million), and Iraq (\$436 million).<sup>1</sup> In February 2005, the IMF's Board discussed the provision of technical assistance to post-conflict countries (see Chapter 6).

<sup>1</sup>Details are available on the Fund's website: [www.imf.org/external/np/sec/pr/2004/pr04158.htm](http://www.imf.org/external/np/sec/pr/2004/pr04158.htm), [www.imf.org/external/np/sec/pr/2005/pr0504.htm](http://www.imf.org/external/np/sec/pr/2005/pr0504.htm), and [www.imf.org/external/np/sec/pr/2004/pr04206.htm](http://www.imf.org/external/np/sec/pr/2004/pr04206.htm).

mainly on whether the targeted fiscal adjustment was achieved. At the same time, countries with more flexible exchange rates have tended to achieve external adjustment with fewer adverse effects on output.

*Monetary policies.* Monetary policies have been broadly aligned with program objectives, and there is no evidence that monetary policies have been too tight.

*Fiscal policies.* Directors observed that program practice in fiscal policy has been significantly more diverse and has matched overall economic objectives more systematically than is commonly assumed. Fiscal slippages have often occurred, especially in the later years of a program. Directors stressed the need for greater focus on fiscal consolidation in program design, with an emphasis on high-quality fiscal measures that are politically feasible and sustainable. Attention should also be paid to contingent liabilities, including those stemming from financial sector restructuring costs. Fiscal consolidation has generally contributed to improvements in the external current account balance, while generally not being associated with lower output growth, suggesting that confidence effects play a significant role. Directors underscored the importance—in the context of the PRGF—of elements that help to reduce poverty and of analysis of the distributional impact of policies.

*Structural policies.* Structural reforms are often necessary to buttress adjustment efforts by enhancing efficiency and eliminating structural distortions that inhibit long-term growth, and to reduce vulnerabilities to financial crises. Broad alignment was found between structural measures and the objectives of IMF-supported programs. Measures intended to underpin demand management seem to have contributed to sustained fiscal adjustment, and measures geared toward enhancing efficiency have been associated with higher growth. While these initial indications were seen as useful, Directors underscored that the linkages between structural reforms and macroeconomic performance remain uncertain, and a more detailed analysis will be required.

Recognizing the changes the Fund made after the Argentine crisis, the Board agreed that the discussion following the assessment by the Independent Evaluation Office (IEO) of the Fund's role in Argentina during 1991–2001 also provided important insights (Box 3.1).

To ensure that the lessons learned during the review are applied, a number of internal seminars and training initiatives have been planned to raise awareness of the issues within the IMF, including disseminating information on best practices in some specific areas, such as forecasting growth. These internal education efforts will be complemented by significant efforts at external outreach to stimulate a wider debate on some key issues.

**Box 3.1 IEO review of the Fund's role in Argentina, 1991–2001**

In July 2004, the Executive Board discussed the Independent Evaluation Office's review of the IMF's role in Argentina from 1991 to 2001—a period that began with the introduction of the convertibility regime that pegged the Argentine peso at par with the U.S. dollar and ended with the regime's collapse, which was accompanied by a default on Argentina's public debt. The 2001 crisis was one of the most severe in any country in recent years and brought considerable hardship to the Argentine people.

Recognizing the progress that had already been achieved since the Argentine crisis, Directors agreed that the report provided valuable insights for the Fund's financing and surveillance frameworks.

The following are among the key conclusions related to policy recommendations from the Executive Board discussion:

- Where the sustainability of a country's debt or the exchange rate is threatened, the Fund should clearly indicate that its support is conditional upon a meaningful shift in policies. Up-to-date and comprehensive information is critical for the Board to make necessary judgments in such cases. The debt sustainability template and procedures on exceptional access provide important support in this regard.
- Further reflection is needed on the issue of contingency planning in the context of Fund assistance to countries in crisis. There is potential value in such planning from the outset of a crisis, but also a need to establish what can constructively be done in ways that enhance confidence.
- Directors emphasized the importance of, and recent progress in, ensuring that medium-term exchange rate and debt sustainability analysis are the focus of IMF surveillance. While the choice of the exchange rate regime must remain with the member's authorities, the Fund is obliged to exercise firm surveillance to ensure that other policies and constraints are consistent with that choice. Directors saw a need for greater candor in the treatment of exchange rate policy in the context of Article IV discussions, but most also stressed the need to strike an appropriate balance between candor and confidentiality. Analytical work on medium-term debt sustainability has also supported a reassessment, in the Fund and more broadly, of what level of debt is sustainable for emerging market countries, with the concept of "debt intolerance" playing an important role.
- Directors noted the possible risks associated with precautionary Fund arrangements, especially where there are serious political obstacles to needed policies and reforms. Directors reiterated the value of precautionary arrangements as a tool for supporting sound policies. They confirmed the importance of ensuring that program standards and requirements for precautionary arrangements are the same as those for all other arrangements, and most did not think that precautionary arrangements tended to be weaker than other arrangements, noting that, in some cases, precautionary arrangements signaled superior performance.
- The Fund is continuing to reflect on how to strengthen further the role of the Board during a crisis, including through improvements in the provision of full information on all issues relevant to decision making and open exchanges of views between management and the Board on all topics, including the most sensitive ones.
- In all cases of use of Fund resources, particularly those involving exceptional access, close cooperation with the country authorities should be presumed, and the Board kept fully informed of the state of policy discussions.

### Experience with 2002 Conditionality Guidelines

In September 2002, the Board adopted new guidelines to encapsulate ongoing efforts to streamline and focus IMF conditionality. An important objective of the new guidelines was to enhance country ownership and improve the prospects for sustained implementation of Fund-supported programs, most importantly by concentrating the IMF's policy conditions on areas critical to their success.

The second part of the Fund's 2004–05 Conditionality Review examined the initial experience with applying these new guidelines, which had replaced guidelines that dated back to 1979. When Directors met in March 2005,<sup>2</sup> they

noted that the new guidelines emphasized national ownership of policies, parsimony in conditions, tailoring of policies to member circumstances, coordination with other multilateral institutions, and clarity in the specification of conditions. Although it was too soon to draw definitive conclusions on experience with the guidelines, the review highlighted a number of preliminary findings focusing on structural conditionality and on processes of program development:

- There is evidence that considerable progress has occurred in streamlining the breadth of coverage (though not the number) of structural conditions and in clearly identifying program-related conditions.
- There are some encouraging signs of stronger program implementation in the form of fewer permanent program interruptions—although there has been little change in the rate at which programs are temporarily interrupted because of failures to meet conditions.
- The shift of conditionality away from growth- and efficiency-related structural reforms is a sign of stream-

<sup>2</sup>The Board's discussion is summarized in Public Information Notice No. 05/52, [www.imf.org/external/np/sec/pn/2005/pn0552.htm](http://www.imf.org/external/np/sec/pn/2005/pn0552.htm); the staff papers include "Review of the 2002 Conditionality Guidelines," [www.imf.org/external/np/pp/eng/2005/030305.htm](http://www.imf.org/external/np/pp/eng/2005/030305.htm); and "Review of the 2002 Conditionality Guidelines—Selected Issues," [www.imf.org/external/np/pp/eng/2005/030405.htm](http://www.imf.org/external/np/pp/eng/2005/030405.htm).

lining, but it will need to be monitored and the implications studied when program outcomes are known. Effective World Bank–IMF collaboration remains crucial in this connection.

- Care should be taken not to specify conditions at a level of detail that could be seen as unwelcome micro-management—although detailed specification can sometimes be helpful to the authorities.
- Focusing on the linkages between program goals and conditions is critical, Directors emphasized, as are specifying and explaining in staff reports the strategies underlying conditionality and the basis for deeming measures to be critical. Directors considered that improvements in the elaboration and presentation of clear strategies—which tailor conditionality to country circumstances and capacity and clearly link conditions to program goals in the context of the authorities’ broader objectives—can enhance program ownership and implementation.
- Directors noted that overly ambitious timetables appear to be a major reason for the high waiver rate—the failure of countries to meet performance criteria—and encouraged realistic, but still appropriately ambitious, implementation timetables.
- In light of the difficulty of gauging program ownership, some Directors saw a role for conditionality, and especially prior actions, as a screening device. However, other Directors observed that higher numbers of prior actions did not bring subsequent program implementation up to the Fund-wide average.

An assessment of structural conditionality in IMF-supported programs by the IEO is scheduled for early 2006. The project is expected to shed further light on these issues. However, Directors agreed that a more comprehensive assessment of the appropriateness of the new guidelines would have to await the availability of data on program outcomes, in both the short and the medium terms, and instructed the staff to return to this issue in 2008. The staff will explore how it can help the Board monitor the application of the guidelines in the interim.

### Ex post assessments

In addition to the conditionality review, the adequacy of program design was examined in the course of the IMF’s “ex post assessments” of experience in countries in which the IMF has been providing program support over a longer term. Ex post assessments have proven to be a useful vehicle for distilling lessons from experience, for both program design and implementation. The first ex post assessments were conducted in 2003 as part of the IMF’s response to the IEO assessment of the prolonged use of IMF resources.

A total of 27 ex post assessments have been conducted so far, including 18 during FY2005 (for Albania, Armenia, Benin, Bolivia, Bulgaria, Cambodia, Cameroon, Ethiopia, Guinea, Guinea-Bissau, Kazakhstan, the Kyrgyz Republic, Lesotho, Malawi, Niger, the former Yugoslav Republic of Macedonia, Uruguay, and Vietnam). The lessons drawn from ex post assessments are often widely applicable. For example, a key lesson from the ex post assessment of the PRGF arrangements with Vietnam was the importance of allowing sufficient time for the institutional changes that underpin structural reforms. A comprehensive review of experience with ex post assessments will take place later in 2005. A forthcoming IEO evaluation of IMF assistance to Jordan is also expected to yield insights into program design.

### Financial facilities and policies

Following major changes to its lending policies in recent years, the IMF has continued to review many aspects of its lending facilities to ensure that they meet members’ needs, including those related to members’ growing financial interdependence.

#### Access policy

In April 2005, the Board conducted its biennial review of members’ access to financing from IMF resources in various circumstances, including in the credit tranches (see Table 3.1), under the EFF, and under the PRGF. The review included consideration of the limits on lending by the IMF from the General Resources Account (GRA)—currently 100 percent of a member’s quota each year up to a cumulative maximum of 300 percent of quota—as well as the conditions and circumstances that may lead to lending beyond those limits, as set out in the framework for exceptional access. The Board also considered the policies for lending under the PRGF, under which the IMF makes concessional loans to its low-income members.

The Board considered that the criteria for access in individual cases, the access limits in the GRA, and the access limits and norms applying to PRGF resources all remain broadly appropriate. However, a number of Directors felt that member countries’ quotas, which provide the basis for determining access, may not always faithfully reflect the size of an economy and, accordingly, should not be viewed as the best metric in all cases.

The review also revisited the policy on exceptional access. Directors recognized that requests for exceptional access can come from members not experiencing capital account crises. Some Directors felt that there would be merit in considering changes to the exceptional access policy to provide

greater clarity on the IMF's actions in such cases. However, most Directors believed that, overall, changes to the existing framework of exceptional access were not needed, particularly considering the flexibility to grant access under the exceptional circumstances clause, including in those rare cases where a member could not be expected to meet all criteria. Most Directors agreed that a discussion of exit strategies in program documents would help foster better communication with capital markets and facilitate earlier reaccess, with many Directors calling for a strong presumption that exit strategies would be formulated in the context of a single IMF arrangement.

The Board also conducted a review of maturities and charges in FY2005, which is discussed in Chapter 5.

### Activation of Trade Integration Mechanism

The Trade Integration Mechanism (TIM) was established in April 2004 to help developing countries address the short-term effects on their balance of payments of multilateral trade liberalization. The TIM is not a new lending facility but a mechanism making IMF resources more predictably available to qualifying member countries under existing IMF facilities. A major concern in this financial year was the effect that the expiration in January 2005 of the World Trade Organization's Agreement on Textiles and Clothing would have on some developing countries. Bangladesh became the first member country to obtain support in accordance with the TIM, in July 2004, followed by the Dominican Republic in early 2005. At end-April, discussions were under way with a number of other members. The availability of assistance under the TIM should also help assuage concerns of some developing countries that an ambitious outcome to the Doha Round could place undue adjustment pressures on them. (The TIM is also discussed in Chapter 2, Box 2.1.)

### Crisis resolution

Despite the best efforts of both member countries and the IMF, not all financial crises stemming from debt-servicing difficulties can be prevented. The Fund has therefore continued its work on improving techniques to resolve such crises, particularly those stemming from debt-servicing difficulties (Box 3.2). The Fund's crisis resolution efforts continue to promote the use of collective action clauses in international sovereign bond contracts; encourage a broadening of the consensus on the draft *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* promoted by the Institute for International Finance; and consider other ways to resolve financial crises in an orderly fashion. The Executive Board issued progress



## Zambia

In April 2005, Zambia became the seventeenth country to reach the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. Full delivery of HIPC assistance by all creditors will reduce Zambia's debt by \$2.5 billion, in net present value terms, allowing Zambia to save about 2 percent of GDP in debt-service payments annually over the next 10 years.

Since Zambia reached the HIPC decision point in December 2000, its economy has grown by an average of 4½ percent a year—a marked turnaround from the economic decline of the previous two decades. Inflation has remained high, however, and the government's domestic debt rose substantially, largely because of expenditure overruns. In 2004, initially under a staff-monitored program and then under a new PRGF-supported program, the authorities achieved a substantial fiscal adjustment, which cut the government's net domestic borrowing by more than 4 percent of GDP, to less than 1 percent of GDP. The fiscal adjustment eased pressure on inflation and interest rates and allowed for a substantial expansion of bank credit to the private sector.

### Zambia-IMF activities in FY2005

June 2004	Approval of a new three-year arrangement for Zambia under the PRGF
December 2004	Completion of the first review of Zambia's PRGF-supported program
February 2005	Publication of the Report on Observance of Standards and Codes (module on data transparency)
April 2005	Completion of the second review of Zambia's PRGF-supported program
	Zambia reaches the completion point under the enhanced HIPC Initiative
	Publication of joint IMF-World Bank advisory note on the Poverty Reduction Strategy Paper (PRSP) Progress Report

### Box 3.2 Debt restructuring in the Caribbean: Dominica, Dominican Republic, and Grenada

In the past year, a number of countries in the Caribbean decided to approach their creditors for restructurings of their sovereign debt. The origins of the problems and the degree of debt restructuring differed across countries. In all cases, the IMF has played a key role in the design and implementation of the macroeconomic adjustment policies, provided financial assistance, and helped ensure that the restructuring process remains orderly and consistent with best practices. This has included providing—at the country authorities' request—assessments to creditors and donors of the countries' economic conditions, adjustment policies, and prospects.

*Dominica* determined in late 2003 that its public debt, at about 120 percent of GDP, was unsustainable and, based on this assessment, embarked on a strategy to restructure sovereign debt preemptively, with a view to avoiding unilateral default. Substantial progress has been made—as of end-May 2005, creditors (official and private) holding over 70 percent of eligible debt have agreed to the restructuring. In the case of nonparticipating creditors, although payments on original terms have stopped, good faith

efforts continue to be made to reach understandings—the authorities are committed to paying into escrow accounts on restructured terms for such creditors. The Fund is providing financial support to *Dominica* under a three-year PRGF arrangement approved in 2003. Policy implementation under the program has been strong and macroeconomic outcomes have been favorable—after contracting sharply during 2001–02, the economy grew by 3½ percent in 2004.

The *Dominican Republic's* economy experienced a crisis in 2003 that was triggered by problems in the banking sector, among other things. The currency depreciated sharply from 20 to nearly 55 pesos to the dollar, and GDP declined by 2 percent during 2003, while inflation accelerated to 29 percent during 2004. Following the country's 2003 Stand-By Arrangement with the Fund, which went off track because of poor policy implementation, the *Dominican Republic* embarked in 2004 on a robust adjustment program supported by a new Stand-By Arrangement approved in January 2005. Part of the authorities' strategy for addressing macroeconomic imbalances and resolving the country's liquidity problem

involves a debt restructuring. Following a period of discussions with creditors, an offer launched in April 2005 to exchange external bonds was well received, with almost 94 percent participation. The country has indicated that it will continue to service debt to nonparticipating creditors. It is also engaged in discussions to reschedule debts to external commercial banks and suppliers. Paris Club creditors provided relief during 2004 and could provide additional relief in 2005.

Hurricane Ivan devastated *Grenada* in September 2004, causing destruction amounting to over 200 percent of GDP. IMF emergency financial assistance was provided in the wake of the hurricane. Soon after the hurricane, the authorities publicly announced that they could no longer service their public debt, which had reached almost 130 percent of GDP. Supported by donor-financed legal and financial advisors, they are developing a debt restructuring strategy and maintaining a dialogue with both official and private creditors. Fund staff are assisting the authorities in the design of an economic adjustment program aimed at restoring medium-term viability and debt sustainability.

reports to the IMFC on crisis resolution in September 2004 and April 2005.<sup>3</sup>

#### Collective action clauses

The IMF has taken an active role in promoting the inclusion of CACs—which prevent small minorities of creditors from blocking restructuring deals to which large majorities agree—in international bond issues in all markets, through increased dialogue with sovereign issuers (including during Article IV discussions) and with private market participants. Partly as a result, the use of CACs has become the market standard in international sovereign bonds issued under New York law. In addition, the inclusion of CACs in New York-law bonds has had no observable effect on pricing: no premium seems to have been associated with it. Sovereign issues containing CACs represented over 90 percent of the total value of bonds issued between March 2004

and April 2005. The share of issues with CACs in the total value of the outstanding stock of sovereign bond issues from emerging market countries grew from 39 percent at the beginning of 2004 to 48 percent at the end of April 2005.

#### *Principles for Stable Capital Flows and Fair Debt Restructuring*

In November 2004, the Institute for International Finance (IIF) published draft *Principles* aimed at developing a market-based, voluntary, and flexible framework that would outline standards of behavior and responsibilities for sovereign debtors and their private creditors.<sup>4</sup> The draft *Principles*—whose origins can be traced to earlier proposals for a Code of Conduct—are the result of extensive consultations since early 2003 between several emerging market countries and private groups, notably the IIF. The draft *Principles* are based on four pillars: (1) transparency and timely flow of information; (2) close debtor-creditor dialogue and cooperation to avoid restructuring; (3) good

<sup>3</sup>“Progress Report to the International Monetary and Financial Committee on Crisis Resolution,” September 28, 2004, [www.imf.org/external/np/pdr/cr/2004/eng/092804.htm](http://www.imf.org/external/np/pdr/cr/2004/eng/092804.htm), and “Progress Report to the International Monetary and Financial Committee on Crisis Resolution,” April 12, 2005, [www.imf.org/external/np/pp/eng/2005/041205.htm](http://www.imf.org/external/np/pp/eng/2005/041205.htm).

<sup>4</sup>For the current version of the *Principles*, see [www.iif.com/data/public/Principles.pdf](http://www.iif.com/data/public/Principles.pdf).

faith actions during debt restructuring; and (4) fair treatment of all parties.

The draft *Principles* have received support from a number of emerging market issuers and private creditor associations, although market views are varied. While supporting the drafting of such *Principles*, the Fund has left their specification to sovereign debtors and their creditors, since the effectiveness of voluntary rules hinges critically on their acceptability to the affected parties.

While the draft *Principles* can be applied in a manner consistent with the Fund's lending into arrears (LIA) policy, in practice, differences arise in a few areas. For example, the draft *Principles* call for a resumption of partial debt service, to the extent feasible, as a sign of good faith to facilitate a restructuring. However, such payments are not a feature of the Fund's good faith criterion under the LIA policy. Despite these differences, the draft *Principles* are, in most respects, consistent with IMF policies. Looking ahead, while there is uncertainty on how the process of further broadening the consensus among issuers and the investor community would evolve, efforts to integrate the draft *Principles* into policies adopted by debtors and creditors would be welcome.

### Evian approach

The Evian approach—a flexible approach adopted by the Paris Club in October 2003, following the agreement reached at the G-8 Summit of June 2003 in Evian, France, for addressing debt sustainability concerns of non-HIPC countries—continued to evolve in FY2005. Under the Evian approach, Paris Club creditors agreed that they would participate in a comprehensive debt treatment for non-HIPC countries that have debt deemed to be unsustainable by the Paris Club, that are committed to policies that will secure an exit from the Paris Club in the framework of their Fund arrangements, and that will seek comparable treatment from their other external creditors, including the private sector. The Paris Club decision on the appropriate extent of debt relief to be provided will be informed by the Fund's debt sustainability analysis.

In April–July 2004, the Paris Club provided flow reschedulings to the Dominican Republic, Gabon, and Georgia under the Evian approach. In November 2004, Paris Club creditors reached an agreement with Iraq on a comprehensive restructuring of its public external debt. And, in March 2005, the Kyrgyz Republic received a comprehensive debt treatment from the Paris Club.

In another move, Paris Club creditors decided in January 2005 to offer a temporary deferral of debt payments to countries affected by the December 2004 earthquake and tsunami. Creditors emphasized that they expect the resources freed by this deferral to benefit directly the populations affected by the tsunami. Given the exceptional circumstances, traditional Paris Club principles will not apply to the deferral. More specifically, there is no requirement of an accompanying Fund arrangement, nor is there any expectation of comparable treatment from other creditors.

### Looking forward

The IMF's lending function continues to make an essential contribution to the reestablishment of external viability and economic stability and therefore to sustainable growth in member countries. The institution's traditional role of providing financing to help smooth the adjustment of temporary current account imbalances remains vital for many countries, while for others the IMF's main task is to help prevent or mitigate capital account crises and contagion. Strong ownership and institutional backing remain key for the success of IMF-supported programs, while the IMF, for its part, needs to be selective in supporting only programs that put members firmly on the road to external viability.

In their March 2005 discussion of the Fund's medium-term strategy, Directors looked forward to further reflection on how the needs of members could be met through Fund arrangements, and whether new instruments or revisions to existing facilities were needed. Many felt that further progress needed to be made toward reaching clearer understandings on the appropriate circumstances and scale of IMF lending, and a number of Directors stressed the importance of specifying eventual exit strategies from IMF financial support. Directors also exchanged views on instruments that could meet the needs of members who wished to signal their adherence to sound policies or that could provide a degree of insurance against potential crises. Regarding the appropriate role of the IMF in helping to resolve financial crises, there was recognition of the role of market-based mechanisms as well as interest by a number of Directors in a clearer and more consistent role for the IMF in sovereign debt restructuring and assessment of the adequacy of the instruments available for this purpose. In particular, some Directors called for an early discussion of the Fund's policy on lending into arrears.



# The IMF's role in low-income countries

CHAPTER | 4

**t**he central goal of the IMF's work with its low-income member countries is to help them promote macroeconomic stability and growth, and thereby achieve deep and lasting poverty reduction. The Fund pursues this goal in close collaboration with other development partners—particularly the World Bank. In doing so, the IMF focuses on its core areas of responsibility and expertise, namely, helping member countries achieve stable macroeconomic conditions by providing them with policy advice supported by financial and technical assistance.

In 1999, the IMF and the World Bank launched the Poverty Reduction Strategy Paper (PRSP) approach and the enhanced Heavily Indebted Poor Countries (HIPC) Initiative (the original HIPC Initiative was launched in 1996). In the same year, the IMF established the Poverty Reduction and Growth Facility (PRGF) to make poverty reduction and growth more central to its lending operations in its poorest member countries. These initiatives stress country ownership of policy programs, including through the broad participation of civil society. Subsequently, at the International Conference on Financing for Development, held in Monterrey, Mexico, in 2002, the international community formally adopted the declaration of intent known as the “Monterrey Consensus.” The conference provided a forum at which both industrial and developing countries could examine the internationally agreed development goals, including halving the number of people living in absolute poverty by 2015. The Monterrey Consensus stipulated that, to achieve these goals, low-income countries must implement sound policies, strengthen institutions, and improve governance, while the international community must provide strong support, in the form of greater trade opportunities and increased aid flows, to those countries that carry out sound policies and reforms.

During FY2005, the IMF continued to pursue a range of initiatives to strengthen its ability to respond, within its mandate, to the needs of low-income members, in collaboration with other lenders and donors. Key initiatives included the following:

- working to improve the design of programs supported by the PRGF and the PRSP process;
- strengthening other instruments for supporting low-income members, including the subsidization of Emer-

gency Assistance for Natural Disasters (see Chapter 5), the Trade Integration Mechanism (see Chapter 3), and the possibility of a new shocks window within the PRGF Trust;

- increasing its efforts under the enhanced HIPC Initiative to help low-income member countries achieve debt relief and maintain debt sustainability; and
- mobilizing international support for low-income countries in 2005—a year that represents an important milestone toward the Millennium Development Goals (MDGs).

A priority for the Fund in the short term will be to define more clearly its role in supporting low-income members by unifying its work in program design, signaling, PRSP involvement, and debt relief in a single framework. This work will build on the Board's recommendations following its August 2004 discussion of the IMF's role in low-income countries, which underscored that these countries must take the lead in their own reform efforts and that the Fund should focus on supporting the macroeconomic policy reforms needed to boost growth and reduce poverty over the medium term, through its policy advice and technical and financial assistance.

### Review of the Fund's role and operations in low-income countries

A committee of senior staff on low-income country work, headed by First Deputy Managing Director Anne O. Krueger, was formed in 2004. One of its first tasks was to craft a succinct preliminary statement on the role of the Fund in low-income member countries, drawing on previous Executive Board documents and a recent study by the IMF's Independent Evaluation Office (IEO) on PRSPs and the PRGF (see Box 4.1). The paper was discussed, along with a number of other issues, by the Executive Board in August 2004.<sup>1</sup>

<sup>1</sup>For the summary of the Board's discussion, see Public Information Notice No. 04/110, at [www.imf.org/external/np/sec/pn/2004/pn04110.htm](http://www.imf.org/external/np/sec/pn/2004/pn04110.htm); the background paper can be found at [www.imf.org/external/np/pdr/lic/2004/eng/081304.htm](http://www.imf.org/external/np/pdr/lic/2004/eng/081304.htm).

In their discussion, Directors welcomed the creation of the committee and agreed that a statement stipulating a framework for Fund engagement in low-income countries would usefully clarify its objectives and responsibilities, as well as guide the IMF's work in these countries in line with its mandate. At the same time, they recognized that the paper was not comprehensive in its coverage of all Fund policies in low-income countries and acknowledged that it was a work in progress involving interrelated components of Fund policies where discussions were still at a preliminary stage and consensus had yet to be reached. The proposed framework would therefore need to be revisited following separate discussions of these specific issues.

Most Directors agreed that it was the responsibility of low-income countries to put in place the policies and

institutions needed for their development, while the Fund's support should focus on helping members establish and maintain macroeconomic and financial stability to foster durable growth and poverty reduction. They concurred that the Fund should continue to support the efforts of its low-income member countries through policy advice, capacity building, and financial assistance, including debt relief. They also emphasized international partnerships, which are essential if low-income countries are to make significant progress toward achieving the MDGs over the next decade. Directors underscored the need for the Fund to cooperate closely with other multilateral institutions, especially the World Bank, and bilateral donors under the Monterrey Consensus, as well as with low-income member countries through the Poverty Reduction Strategy (PRS) process.

#### Box 4.1 Independent Evaluation Office's review of the IMF's support for low-income countries

In July 2004, the Fund's Independent Evaluation Office published a report<sup>1</sup> on the role of the IMF in the Poverty Reduction Strategy Paper (PRSP) process and on the extent to which programs supported by the Poverty Reduction and Growth Facility (PRGF) were fulfilling the objectives of poverty reduction and economic growth. The IEO report found that, while the PRS approach has resulted in some important changes, its implementation has fallen short of its potential. The report identified, in particular, a need to shift incentives toward improving underlying domestic policymaking processes and institutions and away from the production of documents.

In discussing the evaluation in July 2004, Directors agreed that the PRS approach has yielded benefits but that substantial scope exists for better implementation. They observed that the approach is perceived to be externally driven; participation by concerned domestic groups in the development of the strategy has sometimes been narrow, particularly in the formulation of the macroeconomic framework underlying the PRSP;

<sup>1</sup>The IEO's Report on the Evaluation of Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility is available at [www.imf.org/external/np/ieo/2004/prspgrgf/eng/index.htm](http://www.imf.org/external/np/ieo/2004/prspgrgf/eng/index.htm).

and PRSPs have often lacked operationally viable strategies. But they also cautioned against drawing premature conclusions about the ultimate success of the PRSP approach based on only five years of experience.

For programs supported under the PRGF, the IEO report found that such programs are increasingly being aligned with country-owned PRSPs, even though such alignment is still somewhat limited. The design of these programs has improved in a number of ways. For example, fiscal targets have become more flexible to accommodate increased expenditures on pro-poor programs, and there is no evidence of an excessive disinflationary bias. But major challenges remain. Directors noted, in particular, the challenge of basing Fund-supported programs on a full understanding of micro-macro linkages—which the IEO emphasized were crucial to understanding sources of growth. Directors also considered that more should be done to integrate the results of poverty and social impact analysis into program design.

The report had a number of constructive recommendations, which will continue to inform the Fund's efforts to strengthen the PRS approach, clarify the Fund's role in this approach, and enhance the Fund's advice and assistance to low-income countries. Individual recommendations include the following:

- introducing greater flexibility in the implementation of the PRS approach;
- shifting the emphasis of the initiative away from the production of documents to the development of sound domestic policy formulation and implementation processes;
- clarifying the purpose of the Fund's and the World Bank's Joint Staff Assessment of the PRSP and redefining the vehicle accordingly;
- clarifying what the PRS approach implies for the Fund's own operations and strengthening the implementation of the agreed role;
- strengthening the prioritization and accountability of what the Fund is supposed to deliver within the broader partnership framework, building around the priorities emerging from the PRS process, and ensuring resources match commitments; and
- encouraging a strengthening of the framework for establishing the external resources envelope as part of the PRS approach.

The Fund has responded to many of these recommendations in its joint review with the World Bank of the implementation of the PRS approach and in its work program for 2004–05.

## Strengthening instruments for supporting low-income countries

### PRSPs: progress in implementation

Poverty Reduction Strategy Papers present low-income countries' macroeconomic, structural, and social policies and programs over a two- to five-year horizon that are aimed at promoting broad-based growth and reducing poverty. PRSPs form the crucial link between national public actions, donor support, and development outcomes. The Monterrey Consensus underlined the importance of national ownership of poverty reduction strategies in progress toward the Millennium Development Goals. PRSPs provide the basis for Fund concessional lending and for debt relief under the enhanced HIPC Initiative. They are also being used to help countries develop their statistical systems, which are critical to policy development and monitoring (Box 4.2).

The core principles underlying the PRS approach are that poverty reduction strategies be (1) country-driven, with broad-based participation by civil society in the adoption and monitoring of the poverty reduction strategy; (2) results-oriented and focused on outcomes that benefit the poor; (3) comprehensive in recognizing the multidimensional nature of poverty; (4) partnership-oriented, aimed at improved coordination among all development partners; and (5) based on a long-term perspective of the challenges of, and need for, commitments to reduce poverty.

The Executive Boards of the IMF and the World Bank have asked the staff of the two institutions to prepare annual reports on progress in implementing the PRS approach. The 2004 report considered by the Boards in September 2004 was the latest in this series.<sup>2</sup>

<sup>2</sup>The IMF Board discussion is summarized in Public Information Notice No. 04/113, [www.imf.org/external/np/sec/pn/2004/pn04113.htm](http://www.imf.org/external/np/sec/pn/2004/pn04113.htm); "Poverty Reduction Strategy Papers—Progress in Implementation" is available at [www.imf.org/external/np/prspgen/2004/092004.htm](http://www.imf.org/external/np/prspgen/2004/092004.htm).

### Box 4.2 Using PRSPs to improve statistical data in low-income countries

The availability of high-quality, timely statistics is an important prerequisite for policy development and monitoring. PRGF-eligible and other low-income countries, in particular, face special challenges in compiling such statistics. Data inadequacies and limited data dissemination also hamper stakeholders from participating fully in policy development. The Fund's General Data Dissemination System (GDDS) (see Chapter 2) provides a framework for developing national statistical systems that comprises economic and sociodemographic data, including indicators of progress toward the Millennium Development Goals (MDGs). The GDDS fosters sound statistical methods, professional data compilation, and effective data dissemination practices.

Including statistical development programs in Poverty Reduction Strategy Papers (PRSPs) makes it possible for countries to address their statistical needs more comprehensively. The PRSP process and the GDDS are based on similar premises—country ownership, a medium-term strategy, and an emphasis on monitoring and evaluation. Building the capacity to produce good statistics often requires wide-ranging legal and institutional

reform, development of data compilation practices based on international norms, and dissemination in accordance with best practices to support transparency. The GDDS provides a systematic approach for addressing these issues and facilitates coordination among statistics-producing agencies, interactions between data producers and data users, and collaboration with and among potential donors.

Under the PRSP process, development of the statistical system should be addressed in the context of governance issues, together with the overall evaluation and monitoring of PRS implementation. The PRSP for Sierra Leone, for example, includes an "Empowerment with Statistics" section under "Good Governance, Peace, and Security"—the first of the four pillars of the country's poverty reduction strategy. The improvement in Sierra Leone's statistics using the GDDS complements the country's overall poverty reduction strategy, including pursuit of the MDGs. Such an approach is all the more important given that Sierra Leone's capacity for production, management, and analysis of statistics has suffered gravely during the past decade of economic deterioration and civil war.

Fund Directors underscored the importance of the country-driven nature of the PRSP approach and of country ownership as the key to its success. While several countries had made considerable progress in customizing the MDGs to country-specific goals, there was still a need for closer linkages between the PRS process and its integration with country-specific decision-making processes and institutions, particularly the medium-term expenditure framework and the annual budget. Directors emphasized the need for countries to set priorities among the many objectives and goals of their poverty reduction strategies. This would be critical to fully integrating the programs and policies of the PRSP into annual budgets, thus raising the likelihood of their implementation.

On the operational level, Directors broadly supported the staffs' suggested redefinition of the objectives and audience of the joint staff assessment (JSA) and agreed that its primary objective should be to provide detailed feedback to the country authorities on the strengths and weaknesses of their Poverty Reduction Strategies, including those aspects



## Armenia

During 1996–2004, Armenia completed two IMF-supported programs. These programs supported the authorities' efforts to establish and maintain macroeconomic and financial stability, sustain economic growth, reduce poverty, promote structural reforms, and tackle a banking crisis that forced the closure of one-third of the banking system.

During 2001–04, under Armenia's most recent program supported by the IMF's Poverty Reduction and Growth Facility, real economic growth averaged 12 percent a year, while annual inflation averaged 4 percent. Poverty and inequality indicators have fallen rapidly. The authorities improved fiscal management by clearing all external and domestic expenditure arrears. Moreover, Armenia significantly reduced its debt burden, while building up its foreign exchange reserves. The authorities also introduced major structural reforms that transformed the energy sector and significantly reduced quasi-fiscal deficits. Toward the end of the program, the financial sector began to recover.

that require further work. Eliminating the requirement of a standard statement in the JSA that the PRSP is a suitable basis for concessional assistance could contribute to reducing the perception of a Washington "sign-off." Directors therefore supported the staffs' proposal to lift the requirement of an explicit endorsement of the PRSP by the Executive Boards in connection with approvals of new PRGF arrangements, reviews of decisions under existing arrangements, and determinations concerning the decision and completion points and interim assistance under the HIPC Initiative. The Board amended the PRGF Trust and PRGF-HIPC Trust Instruments accordingly.<sup>3</sup>

Going forward, 2005 will mark the fifth anniversary of the PRS approach. In this context, a more comprehensive review of progress, challenges, and good practice related to key issues identified by stakeholders, past staff reviews,

<sup>3</sup>The proposed decisions were adopted on November 9, 2004, as Decision No. 13373-(04/105) PRGF and No. 13374-(04/105) PRGF. See "Poverty Reduction Strategy Papers—Proposed Amendments to the Poverty Reduction and Growth Facility (PRGF) Trust and the PRGF-HIPC Trust Instruments," November 4, 2004, [www.imf.org/external/np/prsp/2004/110404.htm](http://www.imf.org/external/np/prsp/2004/110404.htm).

In May 2005, the IMF approved the authorities' new three-year program supported under the PRGF. The new program, which aims to build on the achievements of the previous programs, focuses on reforming tax and customs administration as well as on improving the financial sector. Both of these are key to macroeconomic and financial stability.

The IMF has also provided significant technical assistance to Armenia in the financial and fiscal sectors, enabling it to make great strides in strengthening public sector management and to identify important reform objectives for the new program.

### Armenia-IMF activities in FY2005

May 2004	Completion of the fifth review of Armenia's performance under the country's PRGF-supported program
December 2004	Completion of Article IV consultation and ex post assessment of Armenia's performance under Fund-supported programs. Completion of the sixth review of Armenia's performance under the PRGF-supported program
April 2005	IMF and World Bank staff prepare a joint advisory note on the authorities' Progress Report on the country's Poverty Reduction Strategy Paper
May 2005	IMF Executive Board approves a new three-year PRGF arrangement for Armenia

and the IEO evaluation will be undertaken in advance of the 2005 Annual Meetings. This review will draw lessons from the experience of countries in preparing and implementing poverty reduction strategies and of donors in supporting these efforts. It will focus on five themes: (1) strengthening the medium-term orientation of the PRS; (2) using the PRS as a mutual accountability framework between recipient countries and donors; (3) broadening and deepening meaningful participation; (4) enhancing linkages among the PRS, planning documents, medium-term expenditure frameworks and budgets; and (5) tailoring the approach to conflict-affected and fragile states. Other work under way includes a review of the Fund's role in the PRS process.

### Access to financial support

As part of the implementation of the Board's decision to adopt norms for tapered access to PRGF resources under successive arrangements, operational guidance to staff has been finalized. This guidance clarifies also the policy on blended use of PRGF resources and resources from the General Resources Account, and on the augmentation of PRGF arrangements in response to a

shock.<sup>4</sup> More specifically, a shocks window within the PRGF Trust for countries hit by a shock (whether these countries are already using PRGF resources or not) is being considered.

### Emergency assistance for natural disasters

The Executive Board agreed in January 2005 to subsidize emergency assistance for natural disasters to PRGF-eligible members, subject to the availability of subsidy resources.<sup>5</sup> Members that have previously received emergency assistance for natural disasters but have not yet fully repaid such assistance (for example, Grenada and Malawi) will be able to benefit from this initiative, as well as members affected by the December 2004 tsunami—notably, Maldives and Sri Lanka, whose requests for emergency assistance were approved in March 2005. To help the latter two members and others affected by the tsunami, the Fund moved quickly to provide an assessment of the macro-economic impact of the natural disaster (see Chapter 1). These efforts also facilitated the Paris Club creditors' recent decision to provide a one-year moratorium on debt service (see Chapter 3). It is estimated that subsidy needs for natural disaster assistance could amount to about \$68 million–\$98 million over the next five years, which would need to be met through new contributions from other IMF members.

### Post-program monitoring

The IMF continues to monitor closely the circumstances and policies of members that have substantial Fund credit outstanding following the expiration of their arrangements. In March 2005, the Board adopted a decision extending post-program monitoring (PPM) to PRGF resources. Most Directors felt that the extension of PPM would enhance the comparability of treatment across members and help safeguard scarce PRGF resources. Specifically, when a member has outstanding PRGF loans or PRGF loans combined with GRA credit in excess of 100 percent of its quota, there would be a presumption that the member would be subject to PPM. The proposed decision provides a consolidated framework for PPM, expanding the presumption of PPM to cover any case in which outstanding credit arising from the combined (or separate uses) of GRA and PRGF resources exceeds 100 percent of quota and the member does not

have a program supported by a Fund arrangement or is not implementing a staff-monitored program with reports issued to the Board.

### Policy support and signaling

The Board will take up in FY2006 the issue of whether and how the IMF's instruments might be adapted to support sound policies in low-income countries, particularly when these do not have a need for, or want to use, Fund resources. The work under way in FY2005 to lay the basis for this discussion drew on extensive consultations with donors and low-income members on their needs for signals and considered whether there is a need to fill information gaps and how this might be done, either within or outside the context of a Fund arrangement (see Chapter 2).

### Debt relief and sustainability

The IMF continues to work with other official creditors to support low-income countries' efforts to achieve and maintain robust debt sustainability. Through debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative (Box 4.3) and improved tools for analyzing and managing debt, the Fund is playing an important role in supporting low-income member countries' efforts to achieve and monitor debt sustainability even as financing is needed to achieve the MDGs.<sup>6</sup>

During FY2005 five additional members—Ghana, Honduras, Madagascar, Rwanda, and Zambia—reached their completion points under the enhanced HIPC Initiative. A total of 18 members reached this stage by end-April 2005—two-thirds of the 27 countries that have reached their decision points.

The Fund's disbursement of debt relief at the completion point, together with already disbursed interim relief, accounted for just over 70 percent of the total amount the IMF has committed to the enhanced HIPC Initiative. As of end-April 2005, total disbursements of HIPC Initiative assistance by the Fund amounted to SDR 1.5 billion (see Chapter 5).

Maintaining macroeconomic stability has proved a challenge for many of the nine member countries that are in the interim period between their decision and completion points. The Fund is providing interim relief to three mem-

<sup>4</sup>The "Operational Guidance Note on Access under the Poverty Reduction and Growth Facility" can be found at [www.imf.org/external/np/prgf/2004/110904.htm](http://www.imf.org/external/np/prgf/2004/110904.htm).

<sup>5</sup>The Board discussion is summarized in Public Information Notice No. 05/8, [www.imf.org/external/np/sec/pn/2005/pn0508.htm](http://www.imf.org/external/np/sec/pn/2005/pn0508.htm).

<sup>6</sup>"Enhanced HIPC Initiative—Status of Implementation," [www.imf.org/external/NP/hipc/2004/082004.htm](http://www.imf.org/external/NP/hipc/2004/082004.htm), and Public Information Notice No. 04/111, [www.imf.org/external/np/sec/pn/2004/pn04111.htm](http://www.imf.org/external/np/sec/pn/2004/pn04111.htm).

**Box 4.3 How the HIPC Initiative works**

To qualify for HIPC assistance, a country must pursue strong economic policies supported by the IMF and the World Bank. There are three phases. In the first phase, leading up to the decision point, the country needs to establish a track record of good performance (normally, over a three-year period) and develop a Poverty Reduction Strategy Paper (PRSP) or an interim PRSP. Its efforts are complemented by concessional aid from all relevant donors and institutions and traditional debt relief from bilateral creditors, including the Paris Club.

In this phase, the country's external debt situation is analyzed in detail. If its external debt in net present value (NPV) terms, after the full use of traditional debt relief, is above 150 percent of exports (or, for small open economies, above 250 percent of government revenue), the country qualifies for HIPC relief. At the *decision point*—the second phase—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.

Once it reaches the decision point, the country must continue its good track record with the support of the international community, satisfactorily implementing key structural policy reforms, maintaining macroeconomic stability, and adopting and implementing a poverty reduction strategy. Paris Club bilateral creditors reschedule obligations coming due, with a 90 percent reduction in NPV terms, and other bilateral and commercial creditors are expected to do the same. The IMF and the World Bank and some other multilateral creditors may provide interim debt relief between the decision and completion points.

A country reaches its *completion point*—the third phase—once it has met the objectives set at the decision point. It then receives the balance of the debt relief committed. This means that all creditors are expected to reduce their claims on the country, measured in NPV terms, to the agreed sustainable level.

ber countries (Chad, the Democratic Republic of the Congo, and Sierra Leone) whose macroeconomic programs are supported by a PRGF arrangement. In another two countries (Malawi and São Tomé and Príncipe), work is under way to put in place macroeconomic adjustments and reform programs that could be supported under the PRGF. Restoring macroeconomic stability in the remaining four members during the interim period (Cameroon, The Gambia, Guinea, and Guinea-Bissau) will require strong efforts to address obstacles in public resource management and structural reforms.

Of the remaining countries that have yet to reach their decision point, two (Burundi and the Republic of Congo) are making considerable progress on that route, while others still face significant challenges. Many of these have been affected by conflict, and several have large arrears to various creditors. Directors urged the staff to continue to work

with the authorities in these countries, where possible, to overcome these obstacles. In this context, Directors underscored the urgent need to mobilize financial resources to enable the Fund to provide assistance under the HIPC Initiative to Liberia, Somalia, and Sudan once they become eligible.

In September 2004 the Boards of the Fund and the World Bank extended the HIPC *sunset clause* by another two years, to end-2006, to provide the opportunity for the remaining eligible countries to establish a track record that would allow their consideration for HIPC relief. This extension will apply only to members eligible for support from the World Bank's International Development Association and the Fund's PRGF that have not yet benefited from HIPC debt relief and that are deemed to have public debt in excess of the enhanced HIPC Initiative thresholds after full application of traditional debt relief mechanisms based on end-2004 debt data. Many of the countries that could benefit from the extension of the sunset clause are affected by conflict, and several, in particular Liberia, Somalia, and Sudan, have large and protracted arrears to various creditors.

**Further debt relief**

In response to the International Monetary and Financial Committee's call at the 2004 Annual Meetings for the international community to provide assistance, including "further debt relief," to enable low-income countries to achieve the Millennium Development Goals (MDGs), the Board discussed issues related to possible further debt relief for low-income countries and possible means of financing such relief at two seminars in March 2005. The Board will also look into the G-8 Finance Ministers' proposal of June 11, 2005, for additional debt relief to low-income countries, which is to be put to the September 2005 Annual Meetings of the Fund and the Bank (see Box 5.5).

**Debt sustainability framework**

To preserve the potential benefits of debt relief, it will be critical to help countries avoid excessive borrowing in the future. This is the purpose of the new debt sustainability framework for low-income countries. The Executive Boards of the Fund and the World Bank discussed the framework in February and September 2004<sup>7</sup> and endorsed

<sup>7</sup>"Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications," [www.imf.org/external/np/pdr/sustain/2004/020304.pdf](http://www.imf.org/external/np/pdr/sustain/2004/020304.pdf); Public Information Notice No. 04/34, "IMF Discusses Operational Framework for Debt Sustainability in Low-Income Countries," [www.imf.org/external/np/sec/pn/2004/pn0434.htm](http://www.imf.org/external/np/sec/pn/2004/pn0434.htm);

its key elements, including a standardized forward-looking analysis of debt and debt-service indicators, an assessment of sustainability informed by indicative policy-dependent debt-burden thresholds, and a consistent financing strategy. The framework has implications for PRGF program design, since it suggests a more systematic use of indicative targets on the net present value (NPV) of external debt, increased flexibility in the application of limits on non-concessional debt, and more systematic use of overall fiscal deficit limits. (Examples include the PRGF arrangements for Guyana and the Kyrgyz Republic. Guyana employs overall fiscal deficit limits and indicative targets on the net present value of external debt, while the Kyrgyz Republic's program includes a ceiling on concessional borrowing.)

The Board had a further discussion of the debt sustainability framework for low-income countries in April 2005.<sup>8</sup> Directors endorsed indicative thresholds for the ratio of net present value of debt to exports of 100, 150, and 200 percent, depending on the quality of a country's policies and institutions as assessed by the World Bank's CPIA (a formal Country Policy and Institutional Assessment), and corresponding thresholds for the other four debt and debt-service indicators. The thresholds are centered on the operational thresholds of the HIPC Initiative. The new framework will be applied as soon as possible to all low-income member countries, including HIPCs. Specific modalities for collaboration between Fund and World Bank staffs in preparing joint debt sustainability assessments for individual countries have been formulated, taking into account each institution's responsibilities in line with its mandate. Directors asked the staff to report to them on experience with the implementation of the framework after six to twelve months.

### Mobilizing international support

The international community recognized in the 2002 Monterrey Consensus that decisive progress toward the

<sup>8</sup>“Operational Framework for Debt Sustainability in Low-Income Countries—Implications for Fund Program Design,” [www.imf.org/external/np/pdr/sustain/2004/091304.htm](http://www.imf.org/external/np/pdr/sustain/2004/091304.htm); “Debt Sustainability in Low-Income Countries—Further Considerations on an Operational Framework and Policy Implications,” [www.imf.org/external/np/pdr/sustain/2004/091004.htm](http://www.imf.org/external/np/pdr/sustain/2004/091004.htm); and Public Information Notice No. 04/119, “IMF Discusses Operational Debt Sustainability Framework for Low-Income Countries,” [www.imf.org/external/np/sec/pn/2004/pn04119.htm](http://www.imf.org/external/np/sec/pn/2004/pn04119.htm).

<sup>8</sup>“Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations,” [www.imf.org/external/np/pp/eng/2005/032805.pdf](http://www.imf.org/external/np/pp/eng/2005/032805.pdf), and Public Information Notice No. 05/59, [www.imf.org/external/np/sec/pn/2005/pn0559.htm](http://www.imf.org/external/np/sec/pn/2005/pn0559.htm).



## Senegal

In April 2003, the IMF's Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) arrangement for Senegal covering 2003–05 to support implementation of the government's Poverty Reduction Strategy Paper (PRSP). The PRGF-supported program emphasizes improving revenue collection, increasing capital and pro-poor spending, strengthening the efficiency and transparency of public expenditure management, and removing impediments to private sector development. Senegal also requested an updated assessment, under the joint IMF-World Bank Financial Sector Assessment Program (FSAP), of the stability and development potential of its financial sector.

In 2003–04, Senegal's economic growth was robust, inflation was low, and the fiscal and external deficits and government indebtedness were maintained at sustainable levels. Structural reforms were implemented, albeit with some delay, and the authorities took steps to correct fiscal slippages. Senegal reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in April 2004, paving the way for debt relief of \$0.5 billion, in net present value terms, and a reduction in debt service of about 2 percent of GDP annually during the next 10 years.

### Senegal-IMF activities in FY2005

May 2004	Submission of Senegal's Annual PRSP Progress Report
March 2005	Completion of Senegal's 2004 Article IV consultation and of the second review of Senegal's PRGF-supported program
	Publication of joint IMF-World Bank advisory note on Senegal's PRSP Progress Report
April 2005	Publication of report on Financial System Stability Assessment update

Millennium Development Goals (MDGs) would require ambitious country-led reform efforts supported by increased aid and its more effective delivery. The Fund offers low-income countries advice on how to manage aid inflows, which is crucial given the international effort to mobilize more aid for the MDGs. Mobilization and coordination of financing for the MDGs has figured prominently on the international agenda.

The year 2005 represents an important milestone on the way to the Millennium Development Goals for 2015. The United Nations Millennium Project report, published in January 2005, marked the opening of a period of stock-taking on the progress made toward the MDGs and how to accelerate it—discussions that will culminate at the UN Summit Conference on Implementing the Millennium Declaration in September 2005. An important step in this process was the Second High-Level Forum on Aid Effectiveness held in Paris in March 2005. This Forum focused on ways to achieve greater aid effectiveness and better development results in support of efforts to reach the MDGs by harmonizing donor aid delivery procedures and reporting requirements and by aligning donor support programs with recipient countries' priorities. The Fund, although not a donor, supports the principles and commitments in the Paris Declaration on enhancing aid effectiveness and will promote its implementation. In particular, the Fund will work within its mandate with multilateral development partners toward enhancing the predictability of aid flows and achieving greater policy coherence on the part of development partners.

### Board review of aid effectiveness

In September 2004, Directors discussed the issue of aid effectiveness and the merits of various options for mobilizing more resources in support of the MDGs, on the basis of a paper prepared jointly by Fund and World Bank staff.<sup>9</sup> Directors emphasized that increased aid is not a panacea and that action is also required in other areas—further improvements in recipient countries' policy environments, better market access for developing countries' exports, better aid management and implementation, and a relaxation of absorptive capacity constraints. Directors generally considered that an increase in official development assistance was the best way to mobilize additional resources in pursuit of the MDGs, and most stressed that donor countries needed to move more forcefully toward meeting the UN target of 0.7 percent of gross national income devoted to

aid. Directors' views varied widely, however, on alternative financing mechanisms to complement official development assistance, with most Directors calling for further work by the Fund on these issues.

Subsequently, in response to requests by the IMFC and the Development Committee to continue work on innovative sources of development financing, such as the International Finance Facility (IFF) and global taxes, Fund and World Bank staffs produced a joint note outlining progress that has been made in advancing the analysis of these issues. This includes continuing assessment by the Fund of proposed global tax instruments, such as aviation taxes, and a World Bank analysis of progress in putting in place the IFF for Immunization (IFFIm), a fund to support an enhanced vaccination program.

### Global Monitoring Report

The second *Global Monitoring Report* was published in April 2005. The annual reports, prepared jointly by the IMF and the World Bank, track the progress made toward the achievement of the MDGs and the obstacles remaining. While the first report, published in June 2004, provided a comprehensive assessment of the policy agenda for achieving the MDGs and related development outcomes, the 2005 report had a more selective focus on key areas of the policy agenda but provided a more in-depth assessment in those areas.<sup>10</sup> It paid special attention to Africa, the region most at risk of failing to achieve the MDGs.

The Fund staff's primary contribution to the 2005 report was on the agenda for growth, which is central to reducing poverty and meeting the MDGs. The broad priorities emphasized are macroeconomic stability and institutions and policies that promote private sector growth. Better expenditure management and policies are critical to improving the expenditure composition and sustaining macroeconomic stability. To invigorate the private sector, countries must remove excessive regulatory and institutional constraints. To underpin these efforts, recent progress on political governance must lead to improvements in economic governance. Transparency is a theme of many of the key interventions discussed in the report. Trade liberalization is also a critical domestic policy priority in many cases.

<sup>9</sup>"Aid Effectiveness and Financing Modalities" is available at [www.worldbank.org](http://www.worldbank.org).

<sup>10</sup>New IMF-World Bank Report Calls for Urgent Action to Cut Global Poverty and Win Better Development Results for Poor Countries," Press Release No. 05/83, April 12, 2005, [www.imf.org/external/np/sec/pr/2005/pr0583.htm](http://www.imf.org/external/np/sec/pr/2005/pr0583.htm). The *Global Monitoring Report* is available at [www.imf.org/external/pubs/ft/gmr/2005/eng/pdf/gmr.pdf](http://www.imf.org/external/pubs/ft/gmr/2005/eng/pdf/gmr.pdf).

Meeting the MDGs, the report said, would require substantial increases in the amount of official development assistance reaching the poorest countries. While aid volumes had risen since the UN Financing for Development Conference in Monterrey in 2002, when donors pledged to

increase assistance to the poorest countries significantly, debt relief and technical cooperation had accounted for a full two-thirds of the increase. Given reforms under way, many countries could effectively use a doubling of aid over the next five years.