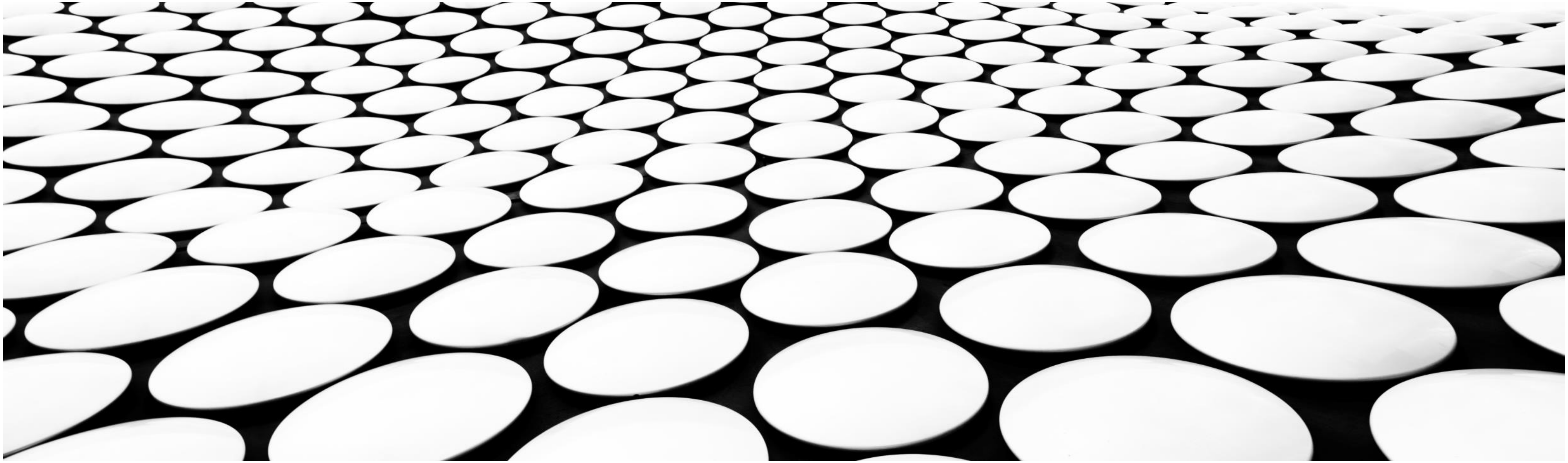
NEGOTIATIONS AND INTERNATIONAL ORGANIZATIONS

SETTING THE STAGE IV: NEGOTIATING ABOUT AND IN INTERNATIONAL ORGANIZATIONS

Panagiotis Konstantinou, AUEB



TODAY'S LECTURE

- The IMF
- Negotiating with the IMF

READING: THE IMF

- The IMF website:
  - https://www.imf.org/external/pubs/ft/ar/2016/eng/quota.htm
  - https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility
  - https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/45/Precautionary-and-Liquidity-Line
  - Articles of Agreement of the International Monetary Fund
  - The dirty details: https://www.imf.org/en/About/Factsheets

INTERNATIONAL MONETARY RELATIONS

- Historical Evolution:
  - Classical Gold Rule (1870-1914): states link their currency to gold (…) – fixed exchange rate
  - Interwar period (1918-1944): New Golden Rule – fixed exchange rates (reserves in gold and in British pounds)
  - Bretton Woods Regime (1944-1973): link with gold through the exchange rate vis-à-vis the USD
  - Collapse of the Bretton Woods (1973): Flexible (supposedly) exchange rates

BRETTON WOODS SYSTEM, 1946-1973 (1)

- Semi-fixed exchange-rate system
- Adjustable pegged exchange rates
- Currencies were tied to each other
- Provide stable exchange rates for commercial and financial transactions
- A nation could repeg its exchange rate via devaluation or revaluation policies
- Use fiscal and monetary policies first to correct payments imbalances

BRETTON WOODS SYSTEM, 1946-1973 (2)

- Agree to defend existing par values
- Correct fundamental disequilibrium by repegging their currencies
- Up to 10% without permission from the IMF
- By greater than 10% with the fund's permission
- Par value set in terms of gold
- Or gold content of the U.S. dollar in 1944
- Market exchange rates were almost but not completely fixed

INTERNATIONAL MONETARY FUND: HISTORICAL BACKGROUND

- The IMF was set up to lend to countries with persistent balance of payments deficits (or current account deficits), and to approve of devaluations.
  - Loans were made from a fund paid for by members in gold and currencies.
  - Each country had a quota, which determined its contribution to the fund and the maximum amount it could borrow.
  - Large loans were made conditional on the supervision of domestic policies by the IMF: **IMF conditionality**.
  - Devaluations could occur if the IMF determined that the economy was experiencing a "fundamental disequilibrium."
- Due to borrowing and occasional devaluations, the IMF was believed to give countries enough flexibility to attain an external balance yet allow them to maintain an internal balance and stable exchange rates.

THE IMF TODAY

- The IMF, promotes **international financial stability** and **monetary cooperation.** It also facilitates **international trade**, promotes **employment** and **sustainable economic growth**, and helps **to reduce global poverty.**
- The IMF is governed by and accountable to its **190** member countries.

THE IMF: ITS PURPOSE

- The IMF’s primary purpose is to ensure the stability of the international monetary system – the system of exchange rates and international payments that enables countries (and their citizens) to transact with each other. The IMF’s mandate was updated in 2012 to include all macroeconomic and financial sector issues that bear on global stability.
- Articles of Agreement of the International Monetary Fund
- The dirty details: https://www.imf.org/en/About/Factsheets

THE IMF: THE FACTS

Fast Facts About the IMF

1944	Year the IMF was established	$1 trillion	Total amount the IMF is able to lend to its member countries
190 ~~189~~	Member countries	~~36~~ 34	Current lending arrangements
150	Nationalities represented by staff	0%	Interest rate on loans to low-income countries
24	Executive Directors representing 189 member countries	$303 million	For hands-on technical advice, policy-oriented training, and peer learning

Total quotas: SDR 477 bln ($687 bln)

credit arrangements: SDR 182 bln ($253 bln)

bilateral borrowing agreements: SDR 317 bln ($440 billion)

Capacity development spending (1/3 of budget in FY2020)

THE IMF: WHAT IT DOES (1)

I. Economic Surveillance

- It oversees the international monetary system and monitors the economic and financial policies of its 190 member countries
- This process takes place both at the global level and in individual countries.
- The IMF highlights possible risks to stability and advises on needed policy adjustments.
- Suggests policies that promote economic stability, reduce vulnerability to economic and financial crises, and raise living standards
  - Adapts surveillance to evolving global conditions

THE IMF: WHAT IT DOES (2-A)

II. Lending

- Provides loans to member countries experiencing actual or potential **balance of payments** problems to help them
    - *rebuild* their international reserves,
    - ***stabilize their currencies***,
    - continue paying for imports, and
    - ***restore*** conditions for strong economic growth, while correcting underlying problems.

THE IMF: WHAT IT DOES (2-B)

II. Lending

- Crises occur due to domestic or external factors.
- Domestic factors
  - inappropriate fiscal and monetary policies, which can lead to large economic imbalances (such as large current account and fiscal deficits and high levels of external and public debt);
  - an exchange rate fixed at an inappropriate level, which can erode competitiveness and lead to persistent current account deficits and loss of official reserves;
  - weak financial system, which can create economic booms and busts.
  - Political instability and/or weak institutions can also trigger crises by exacerbating economic vulnerabilities.

THE IMF: WHAT IT DOES (2-C)

II. Lending

- Crises occur due to domestic or external factors.
- External factors
  - shocks ranging from natural disasters to large swings in commodity prices. These are common causes of crises especially for low-income countries, which have limited capacity to prepare for such shocks and are dependent on a narrow range of export products.
  - in an increasingly globalized economy, sudden changes in market sentiment can result in capital flow volatility. Even countries with sound fundamentals could be severely affected by the impact of economic crises and policies in other countries.

THE IMF: WHAT IT DOES (2-D)

II. Lending

- various lending instruments are tailored to different types of balance of payments need as well as the specific circumstances of its diverse membership.
- Low-income countries may borrow on concessional terms through facilities available under the Poverty Reduction and Growth Trust (PRGT), currently at zero interest rates.
- For emerging and advanced market economies in crises, the bulk of IMF assistance has been provided through Stand-By Arrangements (SBAs) to address short-term or potential balance of payments problems (Greece 09/05/2010 – 14/03/2012).
- The Standby Credit Facility (SCF) serves a similar purpose for low-income countries.

THE IMF: WHAT IT DOES (2-E)

II. Lending

- The **Extended Fund Facility (EFF)** and the corresponding **Extended Credit Facility (ECF)** for low-income countries are the Fund's main tools for medium-term support to countries facing protracted balance of payments problems [Greece 15/03/2012 – 15/01/2016].
  - Their use has increased substantially since the global financial crisis, reflecting the structural nature of some members' balance of payments problems.

THE IMF: WHAT IT DOES (3-A)

III. Capacity Development

- The IMF works with governments to modernize their economic policies and institutions and train their people.
- This helps countries strengthen their economy, improve growth and create jobs.

THE IMF: WHAT IT DOES (3-B)

III. Capacity Development

- It focuses on:
  - Public Finances
  - Monetary and Financial Sector
  - Legal Frameworks
  - Statistics
- Aims at helping countries tackle their developmental priorities.
  - Reducing Inequality
  - Gender Equality

THE IMF: RESOURCES (1)

- The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. The value of the SDR is based on a basket of five currencies—the U.S. dollar, the euro, the Chinese renminbi, the Japanese yen, and the British pound sterling.
- Member quotas are the primary source of IMF financial resources.
- A member's quota broadly reflects its size and position in the world economy. The IMF regularly conducts general reviews of quotas. The latest review (the 14th Review) was concluded in 2010 and the quota increases became effective in 2016.

THE IMF: RESOURCES (2)

- The Quota formula.
- $(0.50\times GDP + 0.30 \times Openness + 0.15 \times Economic\ Variability + 0.05 \times Reserves)^{k}$
  - **Openness**: the annual average of the sum of current payments and current receipts (goods, services, income, and transfers) for a 5-year period
  - **Variability** = variability of current receipts and net capital flows (measured as a standard deviation from the centered three-year trend over a 13 year period)
  - **Reserves** = 12-month average over a year of official reserves (foreign exchange, SDR holdings, reserve position in the Fund, and monetary gold)
  - The formula also includes a "compression factor" $k=0.95$ that reduces the dispersion in calculated quota shares across members.

THE IMF: RESOURCES (3)

- The SDR was initially defined as equivalent to 0.888671 grams of fine gold—which, at the time, was also equivalent to one USD.
- Currencies included in the SDR basket have to meet two criteria: the export criterion and the freely usable criterion.
  - Export criterion: its issuer is an IMF member or a MU that includes IMF members, and is also one of the top five world exporters.
  - “freely usable”: widely used to make payments for international transactions and widely traded in the principal exchange markets. Freely usable currencies can be used in Fund financial transactions.

THE IMF: RESOURCES (4)

- The SDR

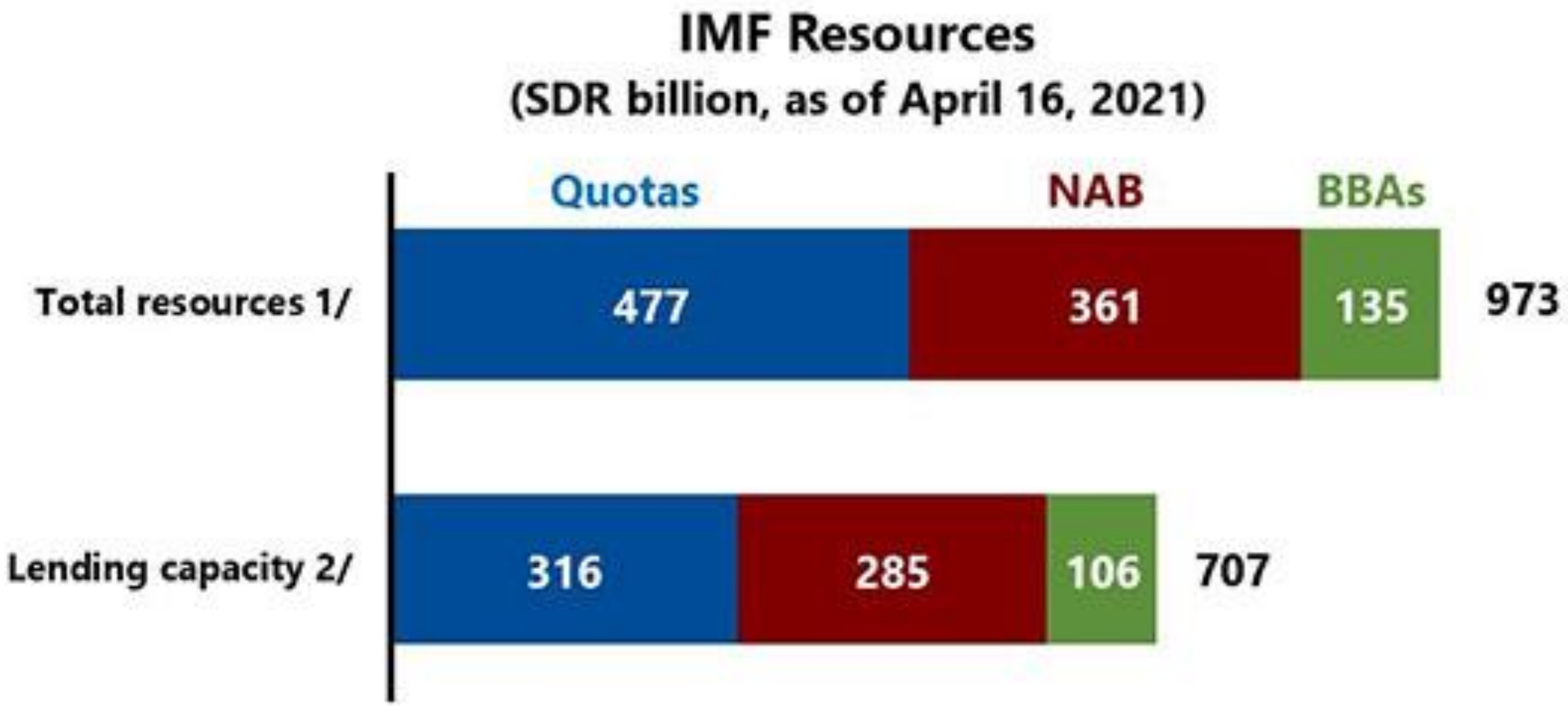
CURRENCY	WEIGHTS DETERMINED IN THE 2015 REVIEW	FIXED NUMBER OF UNITS OF CURRENCY FOR A 5-YEAR PERIOD STARTING OCT 1, 2016
U.S. Dollar	41.73	0.58252
Euro	30.93	0.38671
Chinese Yuan	10.92	1.0174
Japanese Yen	8.33	11.900
Pound Sterling	8.09	0.085946

THE IMF: RESOURCES (5)

- The latest review (the 14th Review) was concluded in 2010 and it doubled quota resources to SDR 477 billion (about US$ 661 billion).
- **In addition**, credit arrangements between the IMF and a group of members and institutions provide supplementary resources of up to about SDR 182 billion ($253 billion) and are the main backstop to quotas.
- As a **third line of defense**, member countries have also committed resources to the IMF through bilateral borrowing agreements, totaling about SDR 318 billion ($434 billion).

THE IMF: RESOURCES (6)

- The latest review (the 14th Review) was concluded in 2010 and it doubled quota resources to SDR 477 billion (about US$ 661 billion).



THE IMF: RESOURCES (7)

- New Arrangements to Borrow (NAB): a number of member countries and institutions stand ready to lend additional resources to the IMF.
  - In January 2020, the IMF's Executive Board approved a doubling of the NAB resources from the current SDR 182 billion to SDR 365 billion, for a new NAB period from 2021 to 2025.
  - This doubling is subject to creditors' consents and is targeted to become effective on January 1, 2021.

THE IMF: MULTIPLE ROLES OF QUOTAS

Resource Contributions	Voting Power	Access to Financing	SDR Allocations
Quotas determine the maximum amount of financial resources a member is obliged to provide to the IMF.	**Quotas are a key determinant of the voting power in IMF decisions. Votes comprise one vote per SDR100,000 of quota plus basic votes (same for all members).**	**The maximum amount of financing a member can obtain from the IMF under normal access is based on its quota.**	**Quotas determine a member's share in a general allocation of SDRs.**

Access to financing: Quotas, subject to limits set by the Articles of Agreement and the Executive Board. For example, under **Stand-By Arrangements** and **Extended Arrangements**, a member can borrow up to 145% of its quota annually and 435% cumulatively under normal access. In exceptional circumstances, these access limits may be exceeded

- https://www.imf.org/external/pubs/ft/ar/2016/eng/quota.htm
- https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/56/Extended-Fund-Facility
- https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/45/Precautionary-and-Liquidity-Line

THE IMF: GOVERNANCE (1)

- The IMF is accountable to its member country governments. At the top of its organizational structure is the Board of Governors, consisting of one governor and one alternate governor from each member country, usually the top officials from the central bank or finance ministry.
- The Board of Governors meets once a year at the IMF–World Bank Annual Meetings. Twenty-four of the governors serve on the International Monetary and Financial Committee, or IMFC, which advises the IMF's Executive Board on the supervision and management of the international monetary and financial system.

THE IMF: GOVERNANCE (2)

- The day-to-day work of the IMF is overseen by its 24-member Executive Board, which represents the entire membership and is supported by IMF staff.
  - 8 members are appointed by their governments (USA, Japan, Germany, France, China, Great Britain, Saudi Arabia, Russia)
  - The other 16 come from different constituencies/groupings of countries (Bahamas, Canada, Ireland, ...;)
  - http://www.imf.org/external/np/sec/memdir/eds.htm

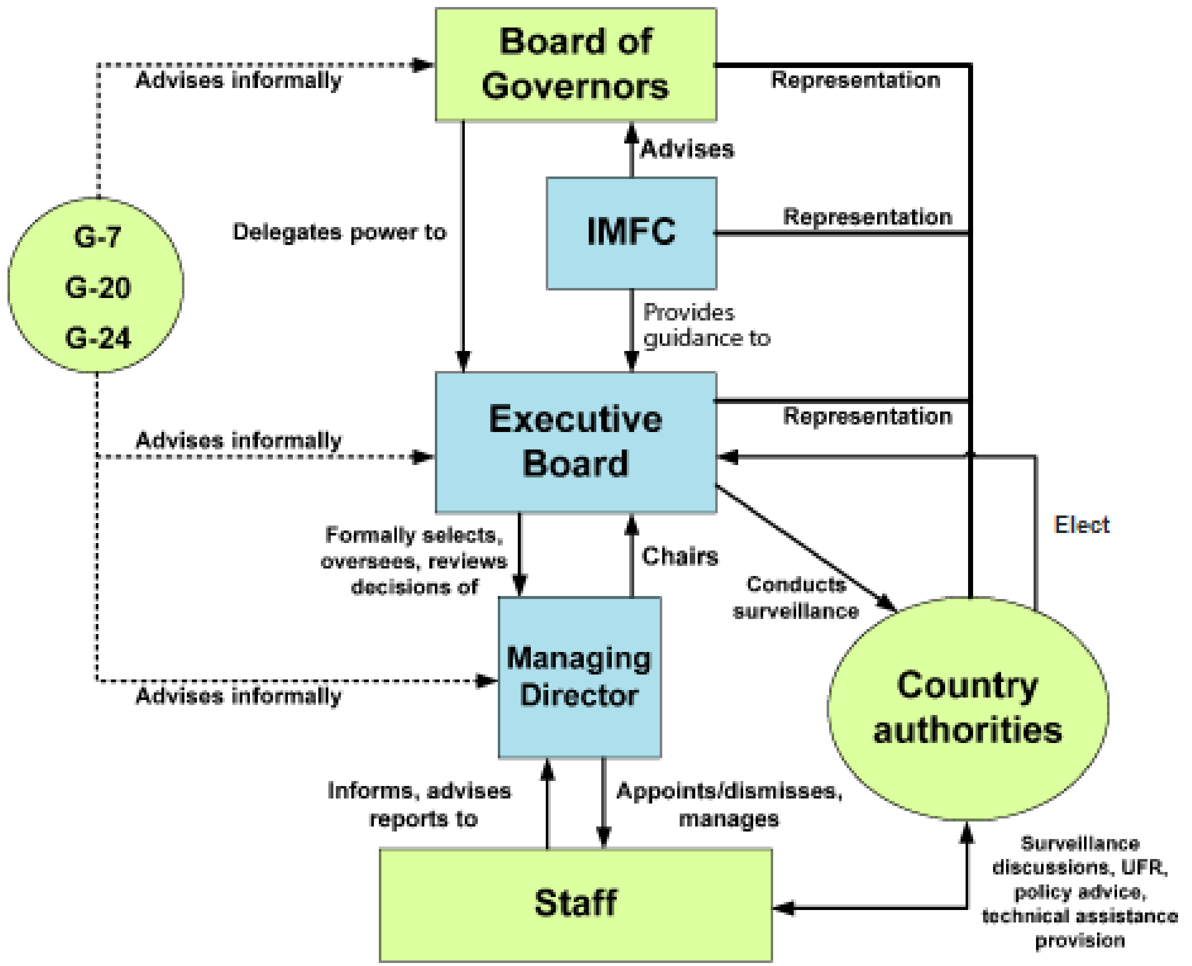
THE IMF: GOVERNANCE (3)

- The Managing Director is the head of the IMF staff and **Chair** of the Executive Board and is assisted by four Deputy Managing Directors
    - Managing Director: always a European – in World Bank: always an American

	QUOTA			VOTES	
MEMBER	MLN OF SDRS	% OF TOTAL[1]	GOVERNOR/ ALTERNATE	NUMBER[2]	% OF TOTAL[1]
Gabon [3]	216	0.05	Nicole Jeanine Lydie Roboty epse Mbou Patrick Alili	3,619	0.07
Gambia, The [3]	62.2	0.01	Mambury Njie Buah Saidy	2,081	0.04
Georgia [3]	210.4	0.04	Koba Gvenetadze Lasha Khutsishvili	3,563	0.07
Germany [3]	26,634.4	5.59	Joachim Nagel Christian Lindner	267,803	5.31
Ghana [3]	738	0.15	Ernest Kwamina Yedu Addison Maxwell Opoku-Afari	8,839	0.18
Greece [3]	2,428.9	0.51	Christos Staikouras Yannis Stournaras	25,748	0.51
Grenada [3]	16.4	0.003	Gregory Bowen Mike Sylvester	1,623	0.03
Guatemala [3]	428.6	0.09	Sergio Francisco Recinos Rivera Alvaro Gonzalez Ricci	5,745	0.11
Guinea [3]	214.2	0.04	Lanciné Conde Karamo Kaba	3,601	0.07
Guyana [3]	181.8	0.04	Bharrat Jagdeo Ashni Kumar Singh	3,277	0.07

IMF: DECISIONS/GOVERNANCE

Stylized view of IMF governance



Source: Martinez-Diaz, 2008. (Updated October 2017)

IMF AND GREECE

- https://www.imf.org/external/np/fin/tad/exfin2.aspx?memberKey1=360&date1key=2099-12-31

I. Membership Status: Joined: December 27, 1945;		Article VIII		
II. General Resources Account:	SDR Million	%Quota		
Quota	2,428.90	100		
IMF's Holdings of Currency (Holdings Rate)	6,410.05	263.91		
Reserve Tranche Position	575.02	23.67		
III. SDR Department:	SDR Million	%Allocation		
Net cumulative allocation	782.36	100		
Holdings	9.36	1.2		
IV. Outstanding Purchases and Loans:	SDR Million	%Quota		
Extended Arrangements	4,554.19	187.5		
V. Latest Financial Commitments:				
Arrangements:				
	Date of	Expiration	Amount Approved	Amount Drawn
Type	Arrangement	Date	(SDR Million)	(SDR Million)
EFF	Mar 15, 2012	Jan 15, 2016	23,785.30	10,224.50
Stand-By	May 09, 2010	Mar 14, 2012	26,432.90	17,541.80

Financial Position in the Fund as of October 31, 2020

Financial Position in the Fund as of November 30, 2014

I. Membership Status: Joined: December 27, 1945;				Article VIII
II. General Resources Account:	SDR Million	%Quota		
Quota	1,101.80	100		
Fund holdings of currency (Exchange Rate)	21,868.80	1,984.82		
Reserve Tranche Position	240.99	21.87		
III. SDR Department:	SDR Million	%Allocation		
Net cumulative allocation	782.36	100		
Holdings	553.99	70.81		
IV. Outstanding Purchases and Loans:	SDR Million	%Quota		
Stand-by Arrangements	10,783.44	978.71		
Extended Arrangements	10,224.50	927.98		
V. Latest Financial Arrangements:				
Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Mar 15, 2012	Mar 14, 2016	23,785.30	10,224.50
Stand-By	May 09, 2010	Mar 14, 2012	26,432.90	17,541.80

International Monetary Fund

Cyprus and the IMF

Press Release:
IMF Executive Board Approves €1 Billion Arrangement Under Extended Fund Facility for Cyprus
May 16, 2013

Country's Policy Intentions Documents

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Cyprus: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

April 29, 2013

The following item is a Letter of Intent of the government of Cyprus, which describes the policies that Cyprus intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Cyprus, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

I. Cyprus: Letter Of Intent

Nicosia, April 29, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington D.C.

Ms. Lagarde:

Cyprus is facing an unprecedented crisis originating from our oversized banks, some of which faced solvency problems, compounded by lax fiscal policies. The crisis will have severe implications for economic growth and fiscal sustainability. To face the challenges ahead, we are proposing a strong and ambitious reform program, backed by substantial financing from international organizations, aimed at stabilizing our financial system, achieving fiscal sustainability, and supporting the recovery of economic activity to preserve the welfare of the population and social cohesion.

We have already taken major steps to address these challenges. In the financial sector, these include: divestment of the Greek operations of the domestic banks; the prompt intervention and resolution of Cyprus Popular Bank and transfer of part of it to the Bank of Cyprus; recapitalization of the transferred part with the participation of shareholders, bank debt holders, and partial conversion of uninsured deposits into equity, while fully protecting insured depositors; recapitalization of Bank of Cyprus with the participation of shareholders, bank debt holders, and partial conversion of uninsured deposits into equity, while fully protecting insured depositors; and imposition of temporary restrictions on financial flows to preserve financial stability. On the fiscal side, key recent measures include: the inclusion in the 2013 budget of substantial consolidation measures for the period 2013-15; reform of the public sector COLA wage indexation mechanism; and implementation of reforms of the pension system to improve its long-term sustainability.

But more needs to be done. Under the proposed program, we intend to implement a comprehensive strategy to restore the viability of the financial system and strengthen the banking supervision and regulatory framework. We are also committed to an ambitious fiscal consolidation path that protects the most vulnerable. We will target a primary balance of 4 percent of GDP by 2018, required to ensure that that the public debt-to-GDP ratio is placed on a sustained downward trajectory toward a level of 105 percent of GDP by 2020. Finally, we are proposing substantial structural reforms to improve the efficiency of the public sector, including through the timely privatization of viable state-owned enterprises.

We are turning to our international partners for support as we implement these far-reaching objectives. Our estimate is that the external financing need would be up to €10 billion until the first quarter of 2016. We therefore request that the Fund support our policy program through an arrangement under the Extended Fund Facility which can be drawn over a period of 36 months in the amount of SDR 891 million (about €1 billion and 563 percent of quota). This arrangement, along with support of about €9 billion from the European Stability Mechanism, will help ensure financial stability as we restore market confidence and return to durable growth.

The attached Memorandum of Economic and Financial Policies (MEFP), which has been approved by the Council of Ministers on April 3, outlines the economic and financial policies that the Cypriot government and the Central Bank of Cyprus will implement during the next three years to restructure Cyprus' financial system and ensure fiscal sustainability. The government is fully committed to the policies stipulated in this document and its attachments. We are confident that by the end of the program we will achieve robust growth - eventually supported by the development of prospective gas resources - and lasting stability that will enable us to maintain social cohesion and create entrepreneurial opportunities for our people.

The implementation of our program will be monitored by the Fund through quarterly reviews, quantitative performance criteria and indicative targets, as well as structural benchmarks as described in the attached MEFP and the Technical Memorandum of Understanding (TMU). There will be 11 quarterly reviews under the arrangement. The quarterly reviews will assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives.

While we are confident that the policies set forth in the MEFP are adequate to achieve the objectives under the program, we stand ready to take any corrective actions that may be needed for this purpose. In accordance with the Fund's policies, we will consult with the Fund on the adoption of such actions in advance of revisions to the policies contained in this letter and the MEFP.

Sincerely,

/s/	/s/
Minister of Finance	Governor of the Central Bank of Cyprus

II. Cyprus: Memorandum Of Economic And Financial Policies

A. Objectives, Strategy, and Outlook

1. **Cyprus is going through an unprecedented banking crisis.** The crisis came to a head following a buildup of large vulnerabilities in recent years. In part, these were related to significant bank exposure to Greece, which resulted in sizeable losses following the Greek debt restructuring (an amount in excess of €4 billion of losses was suffered by the Cypriot banks as a result of the Greek Government Bond restructuring). But the unwinding of a domestic housing boom and the economic downturn in Cyprus also contributed to the deterioration of the banks' loan portfolio. As a result, the two largest banks, comprising about 80 percent of our domestic banking sector and 400 percent of GDP in assets, were confronted with solvency problems. Loss of confidence in the system required prompt resolution of one bank, restructuring of the other bank, and imposition of temporary restrictions to financial flows, which constitute a severe strain on economic activity.

2. **Our weak public finances cannot fully support the large needs of the banking sector without significantly affecting public debt sustainability**. Over the last few years, expenditures have grown faster than revenues, leading to rising fiscal deficits and public debt. Last year, we took significant fiscal consolidation measures to correct these imbalances. However, given massive needs of the financial sector, burden sharing with bank creditors, including uninsured depositors, was also required to ensure that public debt does not become unsustainable. In this way, we have ensured that the Cypriot taxpayer does not need to bear the full burden of bank recapitalization costs. Still, given the difficult economic outlook and significant financing needs, in the absence of policy action, our public finances and sustainability would remain vulnerable.

3. **The country faces two key challenges**. The first challenge is to repair the banking sector, whose business model will need to adapt, so as to restore financial intermediation and support the economic recovery. The second challenge is to attain a sizeable primary fiscal surplus required to place public debt on a firmly downward path. These efforts need to be complemented with structural reforms aimed at raising the efficiency of Cyprus' public sector.

4. **To address these challenges, the government is undertaking a policy adjustment program based on two main pillars**:

- **The first pillar focuses on restructuring the financial sector**. We have already taken steps to deal with insolvency problems in the two largest banks: the Greek branches of the domestic banks have been sold; Bank of Cyprus (BOC) has been recapitalized through partial conversion of uninsured deposits into equity; and Cyprus Popular Bank (CPB) has been resolved and its insured deposits, central bank liabilities (ELA) and certain assets were folded into to BOC. Our efforts will continue to be focused on completing the bank recapitalization process, gradually restoring normal financial flows, and facilitating private sector debt restructuring. Moreover, the credit cooperative institution (CCI) sector will be recapitalized and restructured. To prevent the build-up of risks in the future, we will reform supervision and regulation and enhance transparency.

- **The second pillar entails a comprehensive fiscal consolidation plan underpinned by structural reforms.** This will build on the fiscal consolidation measures introduced last year, while taking into account short-run cyclical conditions and the need to protect vulnerable groups. In the short run, we will implement additional measures focused on increasing our corporate income tax and tax on interest. Other measures needed to attain our primary fiscal targets will be defined in future budgets. Structural fiscal reforms will focus on revenue administration, public financial management, and privatization. We are also planning to supplement the recent reform of the pension system with additional measures as needed to ensure its long-run sustainability.

5. **Our program will help to build the foundation for sustainable growth over the long run.** Nevertheless, in the short run, the outlook remains challenging and subject to high uncertainty:

- **Real GDP** is projected to contract by 12½ percent cumulatively in 2013-14. Short-run economic activity will be negatively affected by the restructuring of the banking sector and temporary restrictions on transactions, which have been required to safeguard financial stability. This, compounded by the impact of fiscal consolidation already underway, will result in a sharp fall in domestic demand. Little reprieve can be expected from exports amid uncertain external conditions and a shrinking financial service sector. Having had addressed our banking sector problems upfront, we expect growth to rebound in 2015 and attain close to 2 percent over the long run. Upside potential from exploitation of our recently discovered gas resources could further boost growth prospects.

- **Inflation** is projected to fall in the short-run as a result of the downturn. The recent reform of the COLA wage-indexation mechanism will help to ensure that public wages are aligned with developments in economic activity. Over the medium run, this will lead to an adjustment in overall wages and prices that can improve competitiveness and support the economic recovery.

- **The current account** deficit is expected to contract to less than 1 percent of GDP in 2013 from 5 percent of GDP in 2012, in tandem with the improvement of the trade balance. A modest adjustment is expected to continue in the medium term, with the current account stabilizing roughly in balance. External debt, in particular related to external liabilities of financial institutions, is expected to decline as part of the broader deleveraging of the financial sector.

1. **The policies contained in our program will put public debt on a sustainable path**. Given that Cyprus has lost access to the international capital markets, financing needs for the coming years will be largely covered by official loans. The banking sector restructuring strategy has been designed to minimize costs to the government. Nevertheless, support to our credit cooperative sector, together with fiscal deficit needs, are expected to lead to an increase in public debt, which is expected to reach around 120 percent of GDP by end-2016. Debt will continue to

decline steadily thereafter, reaching about 105 percent of GDP by 2020, as a result of the rebound in the economy and sustained fiscal efforts to maintain a primary fiscal surplus. Achieving debt sustainability will require full and timely implementation of the program, which is essential to providing a sound foundation for long-run growth.

B. Financial Sector Policies

7. **We are committed to restoring the health of our financial sector and reducing contingent risks from the banks to the sovereign**. Our oversized banking sector has experienced large losses and liquidity pressures. We are addressing these through a strategy based on five pillars: (i) resolving one insolvent bank and restructuring another at least cost to the Cypriot taxpayer, and restructuring and recapitalizing remaining financial institutions; (ii) normalizing financial flows; (iii) deleveraging core and non-core operations of deposit-taking institutions to reduce the size of the domestic banking sector to the EU average by end-2018; (iv) upgrading the supervisory and regulatory framework; and (v) enhancing preparedness to deal with troubled borrowers. We will also strengthen our AML framework.

Resolving, recapitalizing, and restructuring weak institutions

8. **We have identified capital needs in the banking sector.** In late 2012, in close consultation with program partners, PIMCO was commissioned to undertake an independent due diligence of Cypriot financial institutions accounting for about ¾ of the banking system assets. In February 2013, the final report identified an overall capital shortfall of close to €9 billion for the system, required to reach a core tier I ratio of 6 percent under a stress scenario. It also showed that the two largest banks were confronted with solvency problems, with negative capital of close to €6 billion and overall capital needs of about €8 billion. A sample of 17 cooperatives and the third largest bank were found to be undercapitalized by about €1 billion.

9. **In a first step, we have decisively addressed institutions facing solvency problems without recourse to public resources.** We have taken the following actions:

- **Effective intervention and restructuring of the two largest Cypriot banks**. To address insolvency problems in these banks, on March 25, 2013 the CBC intervened CPB and BoC. The Greek branches of the two banks were sold to Piraeus Bank. CPB was split according to a "good bank—bad bank" strategy. Insured deposits were fully protected by separating them, together with central bank liabilities (ELA) and with sufficient assets to attain a Core Tier I capital ratio of 9 percent under PIMCO's stress scenario by end-program, and were immediately folded into BoC. Shareholders and other bank creditors, including uninsured depositors and remaining assets were kept in CPB, which is to be liquidated over time. The resolution of CPB was done under the auspices of our new bank resolution law, passed on March 22, which provides for burden sharing, thus minimizing fiscal costs.

- **Completion of BoC's recapitalization**. On March 29, 2013 the resolution authority initiated the recapitalization of the bank with the participation of equity and bond holdings and subsequent conversion of 37.5 percent of uninsured deposits into shares with preferred voting and dividend rights. This was required to attain a CT1 capital ratio of 9 percent under PIMCO's stress scenario by end-program. This resulted in an immediate increase in the CT1 ratio to well above 9 percent. Part of the remaining uninsured deposits was temporarily frozen until the completion of an independent valuation (see below). As with CPB, this process minimized fiscal costs.

10. **In a second step, we will continue working toward finalizing the resolution process and ensuring the viability of the intervened banks.** Our work in this area aims to:

- **Complete an independent valuation of BoC and CPB assets by end-June 2013 (structural benchmark) as mandated in the resolution law**. This is needed to ensure that capitalization targets can be met based on a more detailed and updated valuation of assets. To this end, no later than end-April 2013, we will agree with the EC/ECB/IMF staff on the terms of reference of this valuation exercise.

- **Finalize the recapitalization of BoC.** Following the independent valuation described above, if required, an additional conversion of uninsured deposits into shares with preferred voting and dividend rights will be undertaken to ensure that the CTI target of 9 percent under stress by end-program can be met. Should the bank be found to be overcapitalized relative to the target, a share-reversal process will be undertaken to refund depositors by the amount of over-capitalization.

- **Ensure that BoC can operate with maximum safeguards to preserve stability and continued viability during a transition period**. In this regard, we plan to appoint a Board of Directors to manage the bank, in accordance with the resolution law. This team will take over the responsibilities of the special administrator once the resolution process is completed and until a new general assembly is convened. The CBC will require the board to prepare a restructuring plan defining the bank's business objectives by end-September-2013 (**structural benchmark**). To ensure that these issues do not affect its normal business activities, by end-June 2013 we will have ready institutional arrangements to insulate BoC from reputational and governance risks.

11. **In a third step, we will ensure adequate recapitalization of other commercial banks.** The CBC will increase minimum CT1capital requirement to 9 percent by end-2013. We have communicated the identified capital needs to remaining banks covered in the PIMCO due diligence. We will instruct them to take the necessary steps to ensure they meet regulatory requirements under PIMCO's stress scenario by end-September. If needed, public funds from the program will be used to recapitalize these institutions.

12. **We are also taking steps to recapitalize and restructure the CCI sector.** The government is committed to preserving a viable credit cooperative sector, as it provides valuable services while maximizing stakeholders' value. To this end:

- Sufficient program resources will be provided at the time of the first review in a dedicated account at the central bank to support the recapitalization and restructuring of the CCI sector.

This will help to boost confidence in the sector. The amounts will be injected in the sector following the identification of capital needs and in accordance with the strategy below.

- We will instruct the CCIs covered by the PIMCO due diligence to meet capital requirements by end-July. If they are unable to raise capital, they will be recapitalized and/or restructured in the context of the overall strategy.

- For individual CCIs not covered by the PIMCO due-diligence exercise, the CBC jointly with the CCI supervisor will complete an assessment of capital needs and viability by end-June 2013 (**structural benchmark**). This will be done in accordance with terms of reference prepared in consultation with EC/ECB/IMF by end-April.

- By end-July 2013, the CBC will develop a strategy to recapitalize and restructure the sector with public money as needed **(structural benchmark)**.

Normalizing financial flows and ensuring adequate liquidity

13. **To safeguard financial stability, it was necessary to impose temporary administrative measures.** Following the intervention of the two banks and recapitalization of BoC, which required a bank holiday of six days, on March 28, 2013 the banks were opened with temporary capital controls and deposit withdrawal restrictions. Cash withdrawals, electronic payments and transfers abroad have been temporarily restricted to prevent deposit outflows and protect the liquidity position of the banks. The implementation of these measures has been appropriately differentiated across transactions to minimize disruptions in the payments system and ensure the execution of essential transactions.

14. **We aim to gradually lift deposit restrictions and capital controls**. We are committed to removing restrictive measures, including those that are inconsistent with our obligations under Article VIII of the IMF's Articles of Agreement, as soon as conditions allow. To this end, we will monitor liquidity conditions and the impact of restrictions in the banks on a daily basis and will review and relax current restrictions as needed in consultation with the EC/ECB/IMF. In the meantime, we request approval from the Fund of any measures that require such approval under Article VIII.

15. **We will ensure adequate liquidity in the banking system**. The CBC, in close cooperation with the ECB, stands ready to take appropriate measures to maintain sufficient liquidity in the banking system in accordance with Eurosystem rules and procedures. To this effect, the CBC and the ECB will require banks to submit funding plans and closely monitor their progress on returning to a sustainable funding model. Restrictions will be lifted as soon as funding conditions normalize. We commit not to impose any new restrictions or intensify any existing restrictions on the making of payments and transfers for current international transactions, nor to introduce any new multiple currency practices.

Deleveraging of the banking sector

16. **We are taking resolute steps to reduce the size of our banking sector.** Our aim is to downsize our domestic banking sector to the EU average by end-2018 from more than 500 percent of GDP at end-2012. This will better serve the needs of our economy and ensure that contingent liabilities from the banks to the sovereign are further reduced. To this end:

- On March 25, 2013 we sponsored the agreement through which Cyprus Popular Bank (CPB), Bank of Cyprus (BoC), and Hellenic Bank (HB) transferred the assets and liabilities of their branches in Greece to the Greek bank Piraeus. This helped to reduce the size of our banks by about 130 percent of GDP, limiting contingent liabilities on the state and transferring responsibility to cover €9 billion of insured Greek deposits from Cyprus to Greece.

- In the context of the resolution of CPB and restructuring of BoC, fair value their asset portfolios as part of the independent valuation exercise mandated by the resolution law. The recognition of fair value losses on the asset portfolio will help to further reduce the size of our domestic banking sector to about 350 percent of GDP.

- We will encourage banks to further deleverage non-core assets and will downsize the CCI sector. This will help to meet the target of reducing the system to the euro-area average by end-2018.

Enhancing the supervisory and regulatory framework

17. **We remain committed to strengthening the supervisory and regulatory framework of the banking system.** This is paramount to prevent buildup of new vulnerabilities in the system and limit potential future contingent liabilities onto the state. To this end, we will:

- **Ensure conservative implementation of accounting standards on loan provisioning.** By end-May, the CBC will amend its regulations to classify as nonperforming (NPL) all loans past due by more than 90 days. To enhance transparency, the reclassified historical NPL series will be promptly published. Provisioning for NPLs will be done following international accounting standards and conservative provisioning practices. In this regard, by end-September 2013, we will complete, with the support of an international accounting firm, a technical comparison of the accounting practices followed by the Cypriot banks against those followed by other international financial institutions in other relevant jurisdictions.

- **Assess and strengthen oversight of bank credit-risk management practices.** New prudential regulations covering underwriting standards, proper loan-collection practices, and appropriate collateral valuation practices, will enter into force by end-March 2014. Additionally, legislation will be passed by end-September 2013 to strengthen governance by prohibiting commercial banks from lending to their independent board members including their related parties and removing any board members in arrears on existing debts to their banks.

- **Set up a central credit register.** This register aims to monitor credit risk concentration and enhance the monitoring of large business groups (including those related to bank owners), and become an important tool of off-site and on-site banking supervision. The legal framework for the credit register will be set up by end-September 2013 (**structural benchmark**) and the register will be operational by end-September 2014.

- **Introduce early corrective measures.** To provide stronger safeguards against forbearance and enhance supervisory independence, by end-March 2014 we will pass a law establishing a framework for mandatory supervisory action based on capitalization levels. This framework will require prompt supervisory remedial action at a bank or CCI upon deterioration of its capitalization (such as suspension of dividend payments, etc.).

18. **Supervision and Regulation of CCIs will also be revamped.** To prevent excessive risk taking and protect consumers, we will undertake a reform of supervisory practices for the credit cooperative sector. The reform will include the following elements:

- **Transferring supervisory responsibility to the CBC**. By end-June 2013 we will submit legislation establishing the CBC as the supervisor of CCIs with the view to completing the operational, supervisory, and regulatory transfer of powers by end-July 2013. By end-March 2014, regulatory and supervisory frameworks for CCIs will be harmonized with those of commercial banks to ensure a level playing field and reduce potential mispricing of risks.

- **Enhancing transparency of financial information.** To enhance transparency, by end-September 2013 the largest CCIs (threshold to be determined by the CBC in consultation with the EC, ECB and IMF), will be required to have an annual audit performed by a recognized and independent auditing firm, starting with the 2013 annual accounts.

- **Revising lending practices.** We plan to submit legislation by end-September 2013 to strengthen the governance of CCIs to *inter alia* limiting the CCIs from lending to natural persons that are non-members, independent board members including their related parties, and removing any board members in arrears on existing debts to the cooperative credit institution.

Enhancing preparedness to deal with troubled borrowers

19. **We will take measures to provide for private sector debt restructuring.** We plan to establish a framework for targeted private sector debt restructuring following the implementation of the resolution and recapitalization of weak banks. This will help to revive financial activity, facilitate new lending, and diminish credit constraints. We are working on three fronts:

- **Temporary moratorium.** Before end-April, 2013 the CBC will issue a directive to recommend banks to provide borrowers a grace period of 60 days without penalties to pay interest only on loans coming due. This measure aims to prevent disruptive effects in related payments throughout the whole economy.

- **Tax incentives to facilitate debt restructuring.** By end-May, 2013 we will amend legislation if needed to eliminate any tax deterrents to credit institutions and customers that may currently be in place with respect to loan restructurings. This will include elimination of any tax deterrents with respect to any losses of income associated with voluntary early loan repayments or discounts given for such repayments to problematic but viable borrowers.

- **A well-targeted approach to debt restructuring of viable debtors.** By end-June 2013 we will identify measures as needed to address legal, administrative, or other impediments affecting the restructuring of viable borrowers while preserving credit discipline. Our approach will be based on market-based voluntary workouts underpinned by measures to strengthen the legal framework to support debt restructuring. In this regard, in addition to the central credit registry, a framework for seizure and sale of loan collateral will be implemented by end-2014, macroeconomic conditions permitting. Moreover amendments to ensure the reduction of built-in costs (fees, requisites) for credit institutions and clients during restructuring will be introduced. Finally, we will establish by end-June 2013 a mediation service to intermediate between banks and their clients to achieve fair debt restructuring.

Strengthening the AML framework

20. **We remain fully committed to strengthening our anti-money laundering (AML) framework in line with the FATF standards**. While Cyprus' AML regime has received an overall positive evaluation in the 2011 MONEYVAL report, we have agreed to an independent audit of the implementation of the AML framework in credit institutions. We remain committed to strengthening our AML legal and implementation framework. To this end:

- We will further build on recent revisions to our legal framework, as appropriate to:(i) ensure the exchange by the financial intelligence unit of financial intelligence on money laundering, associated predicate offenses and terrorist financing with foreign counterparts without the need to secure a court order; (ii) ensure that all trustees of trusts under Cyprus law are regulated or otherwise registered; (iii) ensure that adequate and accurate information on the beneficial ownership of legal entities registered in Cyprus can be obtained in a timely manner by competent authorities; and (iv) ensure that the use of "nominee directors" (i.e., professionals who provide director services) or nominee shareholders does not create any obstacle to the timely access to adequate, accurate and current information on the beneficial ownership and control of companies. We will finalize these by end-September 2013 (**structural benchmark**).

- To implement the revised legal framework related to the transparency of Cypriot corporations and trusts, we will: (i) conduct a third party assessment of the functioning of the Registrar of Companies and appropriately resource the department of the Registrar; and (ii) strengthen the AML/CFT supervision of lawyers, accountants and trust and company service providers by providing adequate staffing of supervisors, applying a risk-based approach to supervision, and revising the methodology used for supervision and inspection by end-December 2013.

- The supervision department of the CBC will revise its off-site and on-site supervisory procedures to further implement a risk-based approach to AML supervision by end-December 2013.

- Finally, should the independent audit reveal that there is a need, we stand ready to take corrective actions in the implementation of the preventive measures by financial institutions. These will be agreed by end-June 2013.

C. Fiscal Policy

21. **To place debt on a sustained downward path, the government is committed to achieving a primary fiscal surplus of 4 percent of GDP by 2018.** We will pursue a balanced fiscal consolidation that boosts credibility in our public finances and lowers debt in the long run, while taking into account cyclical considerations. For 2013, we will target a primary balance of -2.4 percent of GDP, after taking into account a significant consolidation already underway, as well as some one-off revenues. Our target may be revised down to incorporate compensation for pension funds in CPB with program funds to ensure equal treatment with such funds in BoC following the conversion of deposits into equity. With the economy continuing to contract and no additional one-off revenues, we will aim for a primary balance of -4.3 percent of GDP in 2014. Thereafter, we will plan to reach a primary deficit of -2.1 percent of GDP in 2015, and surpluses of 1.2, 3, and 4 percent of GDP in 2016, 2017, and 2018 and beyond, respectively.

22. **In a first step toward fiscal consolidation, last December we legislated a comprehensive package of measures for 2013-15.** Under our revised macroeconomic framework, these are estimated to yield about 5 percent of GDP. On the expenditure side, we implemented permanent wage cuts applying to the broad public sector, abolished and/or reduced a number overlapping benefits, increased the mandatory retirement age in the public pension scheme, and implemented an early retirement penalty, while preserving acquired rights. On the revenue side, we increased excise taxes and VAT rates, extended the existing extraordinary contributions on wages scheduled to expire in 2014, and further increased the contribution rate to the general pension system by both employees and employers.

23. **Achieving our planned fiscal path will require additional consolidation measures amounting to about 7 percent of GDP during 2013-2018**. To this end, we will implement an additional 2.2 percent of GDP in measures in 2013. To secure our long-term primary fiscal target of 4 percent of GDP, we commit to identifying an additional 4.7 percent of GDP of measures to be implemented during 2015-2018. Given our still relatively high budget spending, we will ensure that our consolidation efforts deliver at least 60 percent of total specified yields for 2013-18 in expenditure rationalization.

24. **At the onset of the program, we will implement measures amounting to 2.2 percent of GDP through the adoption of legislation and Council of Minister decisions, as needed (prior action).** On the revenue side, these measures will include: (i) increasing the corporate income tax

rate from 10 to 12.5 percent; (ii) raising the bank levy rate from 0.11 to 0.15 percent; (iii) raising the withholding tax rate on interest received to 30 percent; and (iv) reforming the property tax; and (v) other. These measures are expected to yield 2 percent of GDP. On the expenditure side, we will rationalize housing benefits, which will save 0.2 percent of GDP.

25. **During upcoming reviews, we commit to identifying an additional 4.7 percent of GDP in measures to attain a primary balance target of 4 percent of GDP by 2018**. These will be included in the annual budgets for 2015-18 and the corresponding medium term frameworks. Fiscal structural reforms in the areas of expenditure rationalization and revenue administration will help us to achieve these needed budget savings. In the event of revenue shortfalls or higher social spending needs, the government stands ready to take additional measures to preserve the program's medium-term fiscal balance and debt objectives, including by reducing discretionary spending. Conversely, if there is an over-performance, to the extent that it is deemed permanent, it will reduce the need for additional measures in the outer years. Finally, one-off windfall revenues will not be used to increase spending.

A. Structural Fiscal Reforms

26. **We are committed to implementing structural reforms to support our fiscal consolidation efforts and ensure the sustainability of our pension system**. Last year, we implemented a comprehensive reform of the COLA wage indexation mechanism to limit the growth of the public sector wage bill. We also implemented parametric pension reforms to improve the system's financial viability and make it more equitable. Building on these efforts, we will: (i) review the system of social insurance and social welfare schemes to contain spending while protecting the vulnerable and preserve long-run viability; (ii) improve public financial management by strengthening our budget framework, and enhancing the management of fiscal risks and future revenues from natural resources; (iii) reform our revenue administration to fight tax evasion and improve revenue collection; and (iv) rationalize the public sector by discontinuing non-core activities and privatizing public assets.

Social Insurance and Social Welfare System

27. **We will continue our reforms of the general insurance pension scheme (GSIS) and the public sector occupational pension scheme (GEPS) to enhance their intra- and inter-generational fairness and to ensure their financial viability**. Taking into account the recent reforms, by end-July 2013 we will conduct an actuarial analysis to determine options to ensure the long-run viability of GSIS until 2060 without the need for government transfers beyond credited contributions. In this context, we will separate in accounting terms the non-contributory pension benefit from the insurance-based (contributory) GSIS pension scheme. Reforms resulting from the actuarial analysis will be adopted by end-December 2013 and enter into force by end-March 2014. The reform will encompass an adequate combination of benefit reduction, statutory retirement age increases, and/or contribution rate increases, taking into account the latter's impact on labor costs. The recent GEPS pension reforms will also be extended to the broader public sector.

28. **We will also reform the social welfare system to minimize overlaps in benefits and improve targeting**. Spending on social programs has increased rapidly in recent years to levels well above the EU average, in part due to overlapping benefits and suboptimal targeting. Building on earlier reforms, by end-June 2013, we will prepare an action plan based on a review that will cover all social programs (i.e., social assistance, housing benefits, family benefits, education allowances, and any other transfer schemes) provided by all public entities. The plan, which will include proposals to consolidate welfare programs, improve targeting, and streamline administration, will aim to attain the budget savings required to reach our program fiscal targets, while ensuring that the poor and vulnerable groups are adequately protected. We will implement this reform by end-2013 (**structural benchmark**).

Public Financial Management

29. **We are committed to improving our budget processes.** We have legislated a medium-term budget framework (MTBF) in line with EU directives, including a rolling three-year budget framework with a view of enhancing fiscal discipline. In consultation with the EC/ECB/IMF, through regulations in the form of an expanded budget circular, we will ensure that the MTBF will be fully effective starting with the 2014 budget. In the context of a broad review of our PFM system to be completed by end-June 2013 we will develop a new comprehensive *Law on Fiscal Responsibility and Budget Systems* including supplementary secondary legislation to address any remaining inconsistencies between the MTBF law and existing legislation, which will be submitted to parliament by end-December 2013 (**structural benchmark**). The new law will provide an enabling framework for a medium-term PFM reform program.

30. **We will establish a framework for the management of natural resources in line with best practices**. To ensure transparency and accountability, the framework's legal basis and governance structure will be based on internationally recognized best practices. In this context, we plan to establish a resource fund with clear rules governing inflows and outflows as part of our budgetary framework, taking into account the need to develop the hydrocarbons industry, the need to bring public debt on a steady downward path, and the need to invest for future generations. We will submit both a draft legal framework and a strategy to the EC/ECB/IMF by end-September 2013.

31. **Management of and reporting on fiscal risks from public-private partnerships (PPPs) will be strengthened.** We will put in place a legal and institutional framework for assessing and entering into PPPs or concession agreements, as well as for monitoring their execution by end-2013 through: (i) establishing an effective "gateway process" that verifies the fiscal affordability of projects; (ii) adapting fiscal management laws to formalize the role of the Ministry of Finance in reviewing and approving PPPs at critical points in the gateway process; and (iii) developing financial reporting and accounting rules that ensure timely and transparent communication of PPP related obligations. We will not enter into any new PPPs or concessions (except for any project having reached commercial close by end October 2012) at any government level until the new framework is in place.

Revenue Administration

32. **We will modernize our revenue administration to increase its efficiency, improve taxpayer compliance, and boost revenue collection.** Enforcing the timely collection of tax revenues and controlling tax evasion remain a challenge, as the current arrangements do not provide for modern and harmonized systems and procedures, good sharing of information between tax agencies, alignment of filing and payment arrangements, and adequate enforcement tools and approaches. The tax administrations need to find ways to benefit from economies of scale and optimized operations. Correcting this means that not only will tax administration be more effective and efficient, but taxpayer compliance costs can be reduced. We will reform the revenue administration in line with the recommendations provided by recent technical assistance on inland revenue and VAT. To this end, we will present by end-June 2013, a comprehensive reform agenda to improve the efficiency and effectiveness of revenue collections, taxpayer services, and compliance, in line with best international practices.

Rationalization of Broader Public Sector and Privatization

33. **To ensure debt sustainability and improve the efficiency of the public sector, we will streamline extra-budgetary entities and consider divesting state-owned enterprises (SOEs).** While many extra-budgetary entities do not perform essential public services, they are costly to the budget, receiving almost 2 percent of GDP in transfers. To reduce costs, we will take the following steps:

- **Based on their functionality, extra-budgetary entities will be assessed with a view to determine the need to reclassify, restructure, or divest them.** All extra-budgetary entities will be assessed on their relevance for the public sector and their operational performance. On this basis, entities will be classified according to functionality. Entities that perform necessary public functions will be considered to be integrated into the budget, the rest will be either restructured or divested by the end of the program period.
- **We will develop a privatization plan for SOEs and other state assets**. As a first step, by end-June 2013 we will create an inventory including assets with the highest commercial value and at least one third of SOEs, while the full inventory will be completed by end-December 2013. A privatization plan will be developed by end-September 2013 with the aim of achieving proceeds of at least €1.4 billion by end-2018. To support the privatization process, we will implement a legal and institutional framework by end-December 2013.
- **Other SOEs will be closely monitored or closed if needed.** To improve the monitoring of SOEs and semi-government entities, starting with the 2014 budget, we will include a "Statement of SOEs and semi-government entities" as an Appendix I to the annual budget law and annual financial reports. Non-viable SOEs will be either restructured or closed.

B. Program Financing

34. **Cyprus will face sizable financing needs during the program period.** To reduce these needs and their impact on public debt, we will undertake several measures during the program period:

- Rolling over and extending the maturity of at least €1 billion of domestic debt held by residents. In order to implement this, we will undertake a voluntary sovereign bond exchange covering bonds maturing in 2013-15. The maturing bonds will be exchanged for new longer dated sovereign bonds with maturities between 5 and 10 years. This offer would be par for par and with no change in annual interest cost. The recapitalization bond of €1.9 billion injected in CPB in June 2012 will also be rolled over (both rollovers are an end-June 2013 **structural benchmark**).

- Realizing privatization receipts of at least €500 million for financing purposes.

- Intensifying efforts to obtain financing assurances from the Russian authorities to reschedule the Russian bond falling due in 2016 and extend its maturity to be paid in 5 equal installments starting in 2018 and lower the interest rate to 2 ½ percent.

- Using the allocation of future central bank profits of EUR €0.4, in line with the CBC duties under the Treaties and the Statute (subject to the same safeguards, balance sheet adjustments by the central bank decided by the Board of Directors of the CBC and in accordance with the Treaty will also contribute approximately €1.4 billion in terms of debt reduction).

35. **Remaining balance of payments financing needs of about €10 billion will need to be covered through official financing**. Cyprus faces sizable balance of payments financing needs that are medium term in nature, in particular (a) pressures on the capital account, (b) the need to refinance external debt and (c) a small current account deficit. Beyond our request to the Fund for a three-year EFF (in an amount of SDR891 million, equivalent to about €1 billion, or 563 percent of quota), we have secured additional financial resources from our European partners to fill remaining needs. Euro area partners have committed a total of €9 billion over the period covering May 2013–March 2016. To ensure that this financing helps to maintain debt on a sustainable debt trajectory delivering a debt-to-GDP ratio of about 100 percent by 2020 and declining thereafter, they have committed to new lending at an average maturity of 10-15 years and at favorable interest rate (2.5-3 percent), using the ESM as a financing vehicle. We are confident that resolute implementation of our economic program will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than expected, or if market conditions improve significantly during the program period, we would refrain from drawing on the IMF support on an as needed basis.

C. Program Monitoring

36. **Progress in the implementation of policies under our program will be monitored through quarterly (and continuous) quantitative performance criteria (PCs) and indicative**

targets, and structural benchmarks. These are detailed in Tables 1 and 2. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria, indicative targets, and structural benchmarks under the program. Quantitative targets up to September 2013 are PCs. The remaining targets for end-2013 and 2014 are indicative. Quarterly targets for the remainder of 2013 will be converted into PCs at the time of the first review. A Memorandum of Understanding (MoU) on specific policy conditionality agreed with the EC, on behalf of the European Stability Mechanism, specifies additional structural policies, and sets a precise timeframe for their implementation.

37. **As is standard in all Fund arrangements, a safeguards assessment of the CBC will be completed by the first review.** In this regard, the CBC will receive a safeguards mission from the Fund and provide the information required to complete the assessment by the first review. As a related matter, and given that financing from the IMF, in the context of addressing Cyprus' balance of payment needs, will be used to provide direct budget support, a framework agreement will be established between the government and the CBC on their respective responsibilities for servicing financial obligations to the IMF. As part of these arrangements, Fund disbursements will be deposited into the government's account at the CBC.

Table 1. Cyprus: Quantitative Conditionality, 2013 1/
(millions of Euros)

	Performance criteria		Indicative targets	
	Jun-13	Sep-13	Dec-13	Mar-14
Floor on the general government primary balance 2/	-222	-248	-395	-54
Ceiling on the general government primary expenditure 2/	3230	4911	7069	1576
Ceiling on the stock of general government debt	17153	17464	17917	18076
Ceiling on the accumulation of new general government guarantees 2/ 3/	145.3	145.3	145.3	0
Ceiling on the accumulation of external arrears 4/	0	0	0	0
Ceiling on the accumulation of domestic arrears 2/	0	0	0	0
Ceiling on the accumulation of new VAT refund arrears by the general government 5/	10	10	10	10

1/ As defined in the technical memorandum of understanding.
2/ Cumulative since January of the corresponding year.
3/ The figures for 2013 reflect guarantees already approved by the government on loans not yet drawn.
4/ Continuous performance criterion.
5/ Cumulative since March 2013.

Table 2. Cyprus: Structural Conditionality	
Measures	**Timing**
Prior action	
Adopt legislation and Council of Minister decisions, as needed, implementing measures consistent with the program targets. Measures include: increasing the CIT rate from 10 to 12.5 percent, raising the bank levy rate from 0.11 to 0.15 percent, raising the tax rate on interest from 15 to 30 percent, and reforming the property tax (for a total consolidation of 2 percent of GDP with immediate effect); and rationalizing the housing benefits (savings of 0.2 percent of GDP).	Before Board meeting
Structural benchmarks	
A. Strengthen financial stability	
There will be no measures to intensify restrictions on the making of payments and transfers for current international transactions or to introduce multiple currency practices	Continuous performance criterion
Complete the due diligence valuation of CPB and BoC assets as described in the resolution law in accordance with the terms of reference agreed with the EC/ECB/IMF	End-June 2013
For individual CCIs not covered by the PIMCO due-diligence exercise, the CBC jointly with the CCI supervisor will complete an assessment of capital needs and viability in accordance with terms of reference prepared in consultation with EC/ECB/IMF	End-June 2013
Develop a strategy to recapitalize and restructure the CCI sector with public money as needed	End-July 2013
Revise the anti-money laundering legal framework (TMU ¶15)	End-September 2013
CBC to require the BoC board to prepare a restructuring plan defining the bank's business objectives	End-September 2013
Adopt the legal framework for a central credit register (TMU ¶16)	End-September 2013
B. Strengthen fiscal institutions, reduce fiscal risks and protect vulnerable groups	
Roll over and extend the maturity of at least €1 billion of domestic debt held by residents through a voluntary debt exchange covering maturities falling due in 2013-15 and roll over the € 1.9 billion recapitalization bond of CPB.	End-June 2013
Submit to Parliament a law on fiscal responsibility and budget systems (TMU ¶17)	End-December 2013
Adopt measures to improve the targeting of social assistance, consolidate welfare programs, and streamline administration costs.	End-December 2013

Table 3. Cyprus: Actions Taken Prior to the Signature of the MEFP

A. Strengthen financial stability	B. Strengthen fiscal institutions and reduce fiscal risks
Anti-money laundering. Amended legislation with a view to providing the widest possible range of cooperation to foreign counterparts (December 2012) **Identification of capital needs**. Hired a consultant to assess the capital needs of the financial institutions accounting for about 75 percent of total financial system assets (February 2013) **Bank Resolution**. Adopted legislation putting in place a modern bank resolution framework (March 2013) **Deleveraging of non-core assets**. Sponsored the agreement through which CPC, BoC, and HB transferred the assets and liabilities of their branches in Greece to the Greek bank Piraeus (March 2013) **Bank intervention and resolution**. Intervened CPB, split it according to a "good bank-bad bank" strategy, sold the "good bank" to BoC while safeguarding insured deposits (March 2013) **Recapitalization**. Recapitalized BoC through the full dilution of equity and bond holdings and conversion of 37.5 percent of uninsured deposits into preferred shares (March 2013).	**COLA reform**. Implemented a reform of the COLA wage indexation mechanism in the public sector by extending its freeze to the end of the program and limiting its application to 50 percent of the price index thereafter. **Pension reform.** Introduced reforms to the General Social Insurance Scheme, including freezing pensions under the Social Security Fund until end-2016 and raising employee and employer contributions in 2014. Also introduced reforms to the government pension scheme and froze public sector pensions. **Medium-term budget framework.** Legislated a framework in line with EU directives, including a rolling three-year budget framework. **2013 budget**. Implemented a budget with significant fiscal consolidation measures for 2013-15, including: • Reduced outlays for social transfers through the abolition of a number of redundant and overlapping schemes. • Introduced a graduated reduction of the remuneration of the public and broader public sector employees (6.5-12.5%) and legislated a 3% flat reduction for 2014. • Extended the freeze of general wage increases in the public and broader public sector and temporary contribution in the public, broader public and private sectors on gross earnings and pensions until end-2016. • Took steps with a view to reducing the number of public sector employees by at least 4,500 over the period of 2012-16. • Reduced transfers to SOEs and semi-public institutions. • Increased excise duties on tobacco products, alcoholic beverages, and oil products with effect in 2013; and legislated an additional increase for energy products in 2014. • Increased the standard VAT rate from 17 to 18% in 2013 and to 19% in 2014, and the reduced rate from 8 to 9% starting in 2014. • Increased fees for public services by at least 17%. • Abolished all exceptions for paying the annual company levy of EUR 350.

International Monetary Fund

For more information, see Argentina and the IMF

Buenos Aires, Argentina
December 21, 2000

Dear Mr. Köhler:

In our memorandum of economic policies dated February 14, 2000, we outlined the Argentine government's policy framework for 2000-02, in support of which we requested a three-year stand-by arrangement from the IMF, which we have been treating as precautionary. These policies aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts. The program centered on fiscal consolidation and wide-ranging structural reform efforts.

Although, as outlined in our subsequent policy memorandum of September 5, 2000, substantial progress was made in the implementation of these policies, in recent months adverse domestic and external developments have hindered a sustained recovery of confidence and activity. This, in turn, contributed—in an international environment of heightened market concerns about emerging economies—to a sharp tightening of financing constraints for both public and private Argentine borrowers, making it more difficult to restart growth, and impacting adversely the fiscal performance. The government is reacting to this more adverse environment by strengthening its economic program, as outlined in President De la Rua's speech on November 9, and further detailed in the attached policy memorandum.

To strengthen market confidence in the appropriateness of this policy response, and its prospects of success, we are seeking enhanced financial support from the official and private international community. In particular, we are requesting an increase of the amount made available by the IMF under the stand-by arrangement, from SDR 5,399 million to SDR 10,586 million (500 percent of Argentina's quota), of which SDR 2,117 million would be provided under the Supplemental Reserve Facility (SRF). We are also requesting the World Bank and the IDB to increase their new loan commitments to US$2.4 billion each over the next two years. We have obtained assurances from the government of Spain that it will extend Argentina a loan of up to US$1 billion, to be disbursed pari-passu with the resources under the IMF stand-by arrangement. And we have secured, on a strictly voluntary basis, financing assurances from major domestic and international financial institutions active in Argentina of around US$10 billion.

We trust that the determined implementation of the government's strengthened economic strategy, in conjunction with this enhanced financial support package, will be instrumental in bolstering market confidence in Argentina, facilitating a progressive return of borrowing costs to more normal levels, and a sustained pickup in domestic activity and investment. We will maintain the customary policy dialogue with the Fund in the months ahead, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out with the Fund before May 30, 2000, August 31,2000, November 30, 2000, and February 28, 2001.

Sincerely yours

/s/	/s/
Pedro Pou President Central Bank of the Republic of Argentina	Jose Luis Machinea Minister of Economy

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street NW
Washington, D.C. 20431

Attachments:
Memorandum on Economic Policies
Technical Memorandum of Understanding

Memorandum of Economic Policies

I. Background

1. As described in detail in the Memorandum of Economic Policies (MEP) of February 14, 2000, **the economic program of the Argentine government** supported by the stand by arrangement (SBA) from the Fund aimed at creating conditions for a sustainable recovery of output and employment, with continued price stability and improvement in the external accounts, through policies geared to increasing national savings and investment, and promoting further modernization and competitiveness of the economy. Building on the important gains in financial stability and structural reform already achieved under the convertibility regime, these policies centered on a progressive reduction of the public sector deficit (including the provinces) from over 4 percent of GDP in 1999 to under 3 percent of GDP in 2000, with further reductions in subsequent years, to reach equilibrium by 2003; and on a wide-ranging structural reform effort in the public finances, the financial system, the labor market, the health system and other important sectors of the economy.

2. The **progress made in the implementation of these policies** in the first several months of the government's tenure was outlined in the MEP of September 5, 2000, which also reviewed economic developments in the first half of 2000, and prospects for the rest of this year. Economic indicators available at that time, albeit mixed, provided some comfort that a recovery of domestic demand was under way and, in conjunction with a robust volume growth of exports, especially in manufacturing, would lead to a sustained pickup in output in the second half of 2000 and into 2001. This, together with continued expenditure restraint, was expected to facilitate a strengthening of the fiscal performance, and help reduce the federal deficit from the equivalent of 2.5 percent of GDP in 1999 to 1.8 percent of GDP in

International Monetary Fund

For more information, see Argentina and the IMF

Buenos Aires, Argentina
May 3, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

Our memorandum of economic policies dated February 14, 2000 outlined the Argentine government policy framework for 2000-02, in support of which we requested a three-year stand-by arrangement from the Fund. This program centers on fiscal consolidation and wide-ranging structural reforms aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts. As outlined in our subsequent policy memoranda of September 5, 2000 and December 21, 2000, substantial progress was made in the implementation of these policies. However, adverse domestic and external developments have repeatedly led to crises that resulted in a sharp tightening of the financing constraints and hindered a sustained recovery of confidence and activity. As a result, the government was not able to observe the deficit, primary expenditure, and debt targets specified under the program for March 31, 2001, for which we are requesting waivers. The government believes that the resumption of strong economic growth and attainment of a sustainable fiscal position are at the core of the success of its program. To that effect, it is implementing a comprehensive package of fiscal and pro-growth, pro-competitiveness measures, which is described in the attached memorandum and annexes outlining the policies of the government for 2001 and beyond.

During the period of the arrangement, we will maintain the customary dialogue with the Fund, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out before September 15, 2001, December 15, 2001, and March 15, 2002.

Sincerely yours,

/s/	/s/
Roque Maccarone President	Domingo Cavallo Minister of Economy

Argentina—Letter of Intent, Memorandum of Economic Policies, Technical Memorandum of Understanding

Buenos Aires, August 30, 2001

The following item is a Letter of Intent of the government of Argentina, which describes the policies that Argentina intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Argentina, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Mr. Horst Köhler
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Köhler,

1. The economic policy framework of the government of Argentina for the period 2000-02, in support of which we requested a three-year Stand-By Arrangement from the Fund, was outlined in our memorandum of economic policies dated February 14, 2000. These policies center on fiscal consolidation and wide-ranging structural reforms aimed at promoting a sustained recovery of output and employment, with price stability and a continuing improvement in the external accounts.

2. Substantial progress has been made in the implementation of these policies, as described in the policy memoranda accompanying the previous reviews under this program. Nevertheless, adverse domestic and external developments have continued to impede a sustained recovery of confidence and have led to a sharp tightening of financing constraints for both public and private Argentine borrowers, making it more difficult to restart growth and affecting adversely the fiscal performance. Confronted in early July with a sharp worsening of financing conditions, the government decided to move boldly to correct the fiscal imbalance and set the public finances on a sustainable path. To this end, it proposed, and obtained legislative approval for, a zero-deficit law designed to maintain fiscal equilibrium from July onwards. Firm and continued implementation of this law, to which the government, as well as the provincial governments, is fully committed, will result in a major strengthening of the fiscal adjustment, and therefore in the attainment of fiscal balance and a sustainable public debt position much earlier than anticipated in our original program. On the basis of this new program, and to strengthen market confidence in the appropriateness of this policy response, and its prospects of success, we are requesting an increase in the amount made available by the IMF under the Stand-By Arrangement, from SDR 10,586 million to SDR 16,937 million (800 percent of Argentina's quota), of which SDR 6,087 million (288 percent of quota) would be provided under the Supplemental Reserve Facility (SRF).

3. We trust that the determined implementation of the government's strengthened economic strategy, in conjunction with this enhanced financial support package, will bolster market confidence in Argentina, facilitating a progressive return of borrowing costs to more normal levels, and a sustained recovery of domestic activity and investment. We will

maintain a close policy dialogue with the Fund, and take any further steps that may be needed to promote the achievement of the government's economic policy objectives, in the light of evolving circumstances. Reviews of the program will be carried out before December 15, 2001 and March 15, 2002.

Sincerely yours,

/s/	/s/
Roque Maccarone President Central Bank of the Republic of Argentina	Domingo Cavallo Minister of Economy

Memorandum of Economic Policies

I. Background

1. Despite a difficult environment, the government implemented decisively the measures agreed under the program and the quantitative targets for end-June were met, some with large margins. However, financial market sentiment about Argentina took a negative turn in July: spreads on Argentine bonds reached peak levels, bank deposits and international reserves declined, interest rates rose sharply, and the government lost access to the credit markets. The government responded quickly to this deterioration with measures aimed at eliminating the fiscal deficit and speeding up structural reform. This memorandum of economic policies (MEP) describes recent developments and the policies adopted by the government to strengthen the program.

II. Recent Developments

2. In recent months, the government has moved to address a series of adverse developments:

- **Economic activity continues to be weak**. Real GDP declined by 2.1 percent (year-on-year) in the first quarter of 2001, after falling by ½ percent in 2000. However, indicators of economic activity, such as industrial production and construction activity showed modest increases in the second quarter. Despite the creation of 275.000 jobs relative to the previous year, the unemployment rate rose to 16 percent in May from 15 percent a year earlier. Consumer prices fell further in July 2001 to 1.1 percent below their level a year earlier, while wholesale prices fell by 1.8 percent.

- **Financial market indicators deteriorated sharply** in recent months, with spreads on Argentine bonds widening to over 1,700 basis points in July, before narrowing subsequently; domestic interest rates increased; and international agencies downgraded Argentina's debt further in the same month.

- **Despite the weak economy, the fiscal targets of the program for June were met with comfortable margins.** Tax revenue was Arg$160 million lower than programmed, reflecting also the deterioration in financing conditions, and continued difficulties with tax

Argentina—Letter of Intent, Memorandum of Economic Policies, and Technical Memorandum of Understanding

Buenos Aires, Argentina
January 16, 2003

The following item is a Letter of Intent of the government of Argentina, which describes the policies that Argentina intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Argentina, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The attached Memorandum of Economic Policies describes the economic program and objectives of the Government of Argentina for the first six months of 2003. In support of this program, the Government requests a Stand-By Arrangement in the credit tranches from the Fund for the period through August 31, 2003 in an amount equivalent to SDR 2.1745 billion. We also request that the repurchase expectations arising during the arrangement period be moved to an obligations basis, and hereby cancel Argentina's existing Stand-By Arrangement, which was approved by the Fund in March 2000.

We are firmly committed to ensure the continued timely honoring of the obligations that the Republic of Argentina has to the International Monetary Fund. In this context, we request that under the proposed new Stand-By Arrangement, amounts be disbursed in SDRs and held in the SDR account of the Republic of Argentina, solely for the purpose of the timely honoring of the obligations of Argentina to the International Monetary Fund. We do not intend to convert SDR amounts in foreign currencies for other purposes. Accordingly, we confirm that the Treasurer's Department of the International Monetary Fund is authorized to debit the SDR account of the Republic of Argentina when obligations of the Republic to the Fund become due.

During the period of the requested arrangement, the Government will maintain a continuous dialogue with the Fund, in accordance with the policies on such consultations, on the adoption of any measures that may be appropriate to achieve the objectives of the program. Reviews under the arrangement will be completed by March 14, 2003, May 15, 2003, and July 15, 2003. These reviews will be associated with financing assurances reviews and will assess overall performance under the program, compliance with the IMF's Lending into Arrears Policy, and observance of the performance criteria for end-January, end-March, and end-May, respectively.

Sincerely yours,

/s/	/s/
Dr. Roberto Lavagna Minister of Economy	Lic. Alfonso Prat-Gay President of the Central Bank

Memorandum of Economic Policies of the Government of Argentina for a Transitional Program in 2003

I. Introduction

1. The government has formulated a short-term transitional program aimed at maintaining macroeconomic stability and strengthening economic recovery during the upcoming political transition. Presidential elections are scheduled for April 2003 and a newly elected government will take office in late May. The transitional program will lay the foundation for a more comprehensive program of fundamental reforms that will be developed after the elections and that is needed to tackle the deep structural problems that confront Argentina. The key objectives of the transitional program are to ensure fiscal, monetary, and banking soundness and to rebuild domestic and foreign investor confidence by maintaining equal treatment of all parties, protecting contract rights, and defending the rule of law.

2. The main components of the transitional program are: (i) the 2003 budget, which seeks to keep the federal fiscal deficit under control; (ii) implementation of the federal-provincial bilateral pacts; (iii) a monetary program to maintain inflation at a low level; (iv) preparatory steps toward structural measures needed to strengthen the fiscal position over the medium term; (v) progress toward debt restructuring; (vi) a strategy to restore the health of the banking system; and (vii) ensuring full respect for the rights of creditors, restoring legal certainty, and making a start on corporate restructuring.

3. We will observe the standard performance criteria against imposing or intensifying exchange restrictions, multiple currency practices, and import restrictions for balance of payments reasons. Quantitative performance criteria and indicative targets of the program are set out in Table 1 and in the attached Technical Memorandum of Understanding (TMU). There will be three program reviews, including for financing assurances.

II. Macroeconomic Policies for 2003

A. Macroeconomic Framework

4. The macroeconomic framework for 2003 assumes that real GDP grows by about 2-3 percent (compared to an estimated decline of 11 percent in 2002) and that 12-month consumer price inflation could be held within 35 percent by the end of the year. A significant current account surplus is projected of about US$6.5 billion in 2003. Gross international reserves are targeted to be broadly unchanged over the period of the arrangement. IFI lending to Argentina is assumed to cover obligations falling due to these institutions during the period January-August 2003, including the clearance of arrears.

B. Fiscal Policy and the Social Safety Net