International Monetary Fund (IMF)

by

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This text is up-to-date to July 1999

2006

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Published by:
Kluwer Law International
P.O. Box 316,
2400 AH Alphen aan den Rijn
E-mail: sales@kluwerlaw.com
Website: http://www.kluwerlaw.com

Sold and distributed in North, Central and South America by:
Aspen Publishers, Inc.
7201 McKinney Circle
Frederick, MD 21704
USA
E-mail: customer.care@aspenpubl.com

Sold and distributed in all other countries by:
Turpin Distribution Services Ltd.
Stratton Business Park
Pegasus Drive
Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
E-mail: sales@kluwerlaw.com

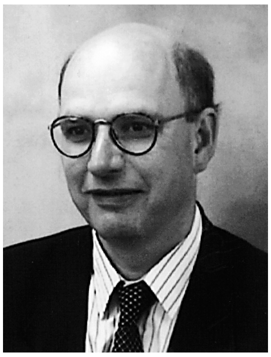
Printed on acid-free paper

9888001242

The monograph *International Monetary Fund* is an integral part of *Intergovernmental Organizations* in the *International Encyclopaedia of Laws* series.

Intergovernmental Organizations was first published in 1996.

The Author



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List of Abreviations

Annual Report	Annual Report of the Executive Board
BIS	Bank for International Settlements
BOP	Balance of Payment
Dec.	Decision of the Executive Board
Doc.	Document
EBRD	European Bank for Reconstruction and Development
EC	European Community
ECB	European Central Bank
ECOSOC	Economic and Social Council of the UN
EMU	Economic and Monetary Union
EU	European Union
GAB	General Arrangements to Borrow
GATS	General Agreements on Trade in Services
GATT	General Agreements on Tariffs and Trade
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICJ	International Court of Justice
IEO	Independent Evaluation Office
IGO	Intergovernmental Organization
ILM	International Legal Materials
ILO	International Labour Organization
IMF	International Monetary Fund
Articles	Articles of Agreement of the International Monetary Fund
IMFC	International Monetary and Finance Committee
LDCs	Least Developed Countries
NAB	New Arrangements to Borrow
NGO	Non-governmental Organization
OECD	Organization for Economic Co-operation and Development
PIN	Public Information Notice
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
ROSC	Report on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Right
Selected Decisions	Selected Decisions and Selected Documents of the IMF
Summary Proceedings	Summary Proceedings of the Annual Meeting of the Board of Governors

List of Abreviations

TARGET	Trans European Automated Real-time Gross settlement Express Transfer system
TEU	Treaty on European Union
UN	United Nations
UNCTAD	UN Conference on Trade and Development
UNDP	UN Development Programme
UNGA	UN General Assembly
UNICEF	United Nations Children’s Fund
World Bank	International Bank for Reconstruction and Development
WTO	World Trade Organization

Part I. Development and Structure

Chapter 1. Introduction

1. The IMF is the only global organization that administers and supervises monetary relations between states. The objects of the IMF Articles of Agreement[1] are the exchange rates and balances of payments of its membership; the overall objective is to create stability in the monetary system and, thereby, pave the way for national and international prosperity. In more practical terms the Fund creates conditions and provides resources that enable its members to take part in the international trading system.

1. The Fund's Articles of Agreement appear in Appendix 1.

2. Since its establishment the Fund has witnessed considerable changes in the global economic conditions. The process of decolonization, increased membership and the emergence of capital markets have created a new environment. Despite pressures to shift the Fund's orientation towards the promotion of economic growth it continues to be a monetary institution. Continuity in the Fund's orientation must also be assumed as its purposes have not been rephrased since its establishment. The amendments that were introduced merely refer to the methods by which the Fund is mandated to pursue its objectives.

3. The activities of the IMF are complex, technical and versatile. The Fund may respond to economic problems of a particular member, a group of members or the global monetary system. Responses are reflected in a myriad of policies, decisions, guidelines and interpretations. Within the framework of the *International Encyclopaedia of Laws*, there is only opportunity to emphasize key activities of the Fund. This Part discusses the Fund's institutional development and structure. Important activities are dealt with in Parts 2 and 3: supervision of the international monetary system and balance of payments support. The final part discusses the Fund in a global context.

4. For further reading there is ample literature available. The most important author on the Fund's legal and institutional aspects is the late Sir Joseph Gold, who was general counsel and director of the legal department. Gold has published dozens of articles and books that explain the purposes and powers of the IMF. Another important source is the historical overview published by the IMF. The material covers four periods: 1945–1965 (by J. Keith Horsefield), 1966–1971 and

1972–1978 (both by Margaret Garritsen de Vries) and 1979–1989 (James M. Boughton). The volumes are published by the IMF and include a chronological overview of policy development, analysis, the Fund's *corpus iuris* and documents that preceded the amendments to the Articles of Agreement.

5. For keeping track with current developments the two-weekly periodical *IMF Survey* and the *Annual Reports of the Executive Board* are useful sources. For scholars and students these publications are freely available. Legal documents are published in *Selected Decisions of the International Monetary Fund*. The *IMF Pamphlet Series* are practical guides for an understanding of the Fund's activities. In addition, the Fund maintains a comprehensive internet site (www.imf.org) that publishes documents and data on the economic position of the Fund and its membership. The index and many cross-references conveniently introduce the reader to the Fund's current activities. Sources and documents discussed in this monograph are available on the Fund's website.

Chapter 2. The Fund's Function in the International Economic System

6. Before studying the IMF in depth it is useful to have a clear understanding of the triangular relationship between the IMF, World Trade Organization (WTO) and World Bank. These institutions have the common objective, directly or indirectly, to foster growth of international trade.

§1. IMF and WTO: Liberalization of Current Payments and Trade

7. Trade involves two primary transactions: the transfer of goods and services on the one hand, and payments on the other. Trade and payments are therefore two sides of the same coin. Accordingly, for the regulation of trade and payments the WTO and IMF function as complementary institutions. The WTO administers multilateral trade agreements, such as GATT, which are 'directed to the substantial reduction of tariffs and other barriers of trade and to the elimination of discriminatory treatment in international trade relations'.[1] In order to *pave the way* for trade liberalization the IMF 'facilitates the expansion and balanced growth of international trade'[2] by promoting the removal of restrictions on international payments for current transactions. Payments for current transactions include *inter alia* 'all payments due in connection with foreign trade'.[3] In short the IMF administers rules that ensure that international payments for trade can be made freely.

1. Preamble GATT, 30 October 1947, 55 UNTS, pp. 194 and 308. Text also available at <www.wto.org>.
2. Article I(ii) Articles.
3. Article XXX (d)(1) Articles.

8. The above suggests that it is imperative for the smooth functioning of international trading system that states are both members of the WTO and the IMF. The argument is that trade cannot be liberalized unless states fully accept the obligations of both institutions. In one sense this is true. WTO-membership compels states to follow the rules of GATT and other multilateral trade agreements. Trade liberalization under these agreements may not be hampered because of restrictions in current payments. From this viewpoint there is substantive overlap of membership: practically all WTO-members are also IMF-member.[1] The reverse question may also be asked. Can an IMF member fulfil its obligation without accepting the obligations under the WTO? In this case no conflict seems to exist. It is feasible that current payments are liberalized without accepting the obligations under the WTO. Practice also shows that not all IMF members have opted for WTO membership.

1. The requirement to opt for IMF membership is recognized in Article XV, para 6 GATT. Parties 'shall (…) become a member of the Fund or, failing that, enter into a special exchange arrangement'. A few WTO members are not IMF member: the European Community, Chinese Taipei, Hong Kong and Macao are non-state member of the WTO, and cannot become an IMF member. Cuba and Liechtenstein are notable exceptions of WTO members not being an IMF member.

9. While the IMF is primarily concerned with monetary issues, it has also urged its members to promote trade liberalization. First, in 1974 the Fund drew up a draft statement, which members could accept voluntarily. This document, which was particularly significant for IMF members who were not party to GATT, binds members subscribing to it 'not on its own discretionary authority [to] introduce or intensify trade or other current account measures for balance of payments purposes that are subject to the jurisdiction of the GATT, or recommend them to its legislature, without a prior finding by the Fund that there is a balance of payments justification for trade or other current account measures'.[1] This regulation has expired and was not renewed. Second, IMF conditions for balance of payment support usually include a standard clause which abrogates the right to use Fund resources when the member imposes or intensifies import restrictions. In this sense the objective of trade liberalization is incorporated *ipso facto* into the practice of the IMF.

1. EB Decision No. 4254-(74/75).

§2. IMF and World Bank: Monetary Stability and Economic Development

10. The World Bank purposes stipulate outright the promotion of long-range balanced growth of international trade and the maintenance of equilibrium in balances of payments. The means to promote growth and equilibrium would the encouragement of international investments for the development of the productive resources of members. A major characteristic, therefore, is the World Bank's focus on economic development by addressing micro-economic items. Whereas the IMF focuses on balances of payment, inflation, currencies and other macro-economic aspects, the World Bank stimulates long-term investment in sectors of the member's economies. Thereby it adopts a longer time frame than the IMF. The Bank-Fund relationship is also special because membership of the Bank is only open to members of the Fund.[1] This points to the fact that countries must first subject themselves to IMF jurisdiction in order to be able to enjoy the benefits of World Bank membership.

1. Article II, Section 1 Articles of Agreement of the International Bank for Reconstruction and Development 22 July 1944, 2 UNTS 39 and 134; and 606 UNTS 295. This applies both to original members and countries that joined after the Bank's establishment. Text also available at <www.worldbank.org>.

Chapter 3. Articles of Agreement

11. The Fund's Articles are summarized below.

Introductory Article	Confirms the rule of law, determines financial structure and principles for financial operations
Article I	Purposes of the Fund
Article II	Explains conditions for membership
Article III	Explains quotas and subscription; quotas determine the degree of participation in the Fund
Article IV	Contains soft law for member States regarding their exchange rate policies; enables the Fund to oversee the international monetary system and exercise firm surveillance over exchange rate policies
Article V	Deals with balance of payments support by the Fund; conditions and scope; enables the IMF to create special accounts for supporting developing countries
Article VI	Explains that the Fund is not designed to support 'large or sustained outflow of capital.'
Article VII	Determines members' obligations on current payments liberalization, discriminatory currency practices, convertibility and furnishing of information
Article VIII	Determines the location of the Fund's offices and designates depositories
Article IX	Establishes the Fund's legal personality, immunity and privileges
Article X	Imposes a duty on the Fund to cooperate with other institutions
Article XI	Deals with relations with non-members
Article XII	Determines the Fund's institutional structure, organs and their powers; allocation and exercise of votes

Introductory Article	Confirms the rule of law, determines financial structure and principles for financial operations
Article XIII	Determines the location of headquarters and designates central banks as depository for the Fund holdings of currencies; members must guarantee assets
Article XIV	Allows for restrictions on current payments through a 'transitional arrangement'; the time frame of the arrangement is not limited
Articles XV to XXV	Contains extensive provisions on SDRs explaining the purpose of SDRs, general conditions for allocations, valuation and many more facets
Article XXVI	Explains voluntary and compulsory withdrawal of members from the Fund and settlement of accounts
Article XXVII	Allows for suspension of provisions in emergencies or unforeseen circumstances
Article XXVIII	Contains provisions on amendments
Article XXIX	Explains the procedure for authoritative interpretations
Article XXX	Interprets key provisions and terms
Article XXXI	Final provisions on entry into force
Schedules A–M	Contains further elaborations of provisions

Chapter 4. Genesis

12. The IMF is an intergovernmental organization established in 1945 with the task to regulate international monetary relations between its members. The drafters of the IMF treaty were preoccupied to avoid repetition of the economic problems that brought considerable economic and social distress in the inter-bellum. These problems manifested themselves during the Great Depression of the early 1930s and related to trade protectionism, the collapse of the Gold Standard following competitive exchange rate devaluations, and stagnant economic development. In the years of the Second World War many observers believed that the economic crises and the failure of international cooperation had contributed to the breakdown in peace in 1939.

13. Three organizations were conceived for global cooperation on economic problems. The Bretton Woods Conference in 1944 gave birth to the IMF and the World Bank, designed for the promotion of international monetary stability and economic growth through international investments. The agreements establishing the 'Bretton Woods Sisters' entered into force by the signature by the original members on 27 December 1945. Both institutions became specialized agencies of the United Nations in 1947. The International Trade Organization was designed to provide for a framework for the reduction of obstacles for international trade. However, many negotiating parties demanded trade exemptions and the organization could not be realized in the form initially conceived.

14. The creation of the Bretton Woods organizations was essentially an American British undertaking. During the war years a series of meetings took place between delegations, headed respectively by John Maynard Keynes (UK) and Henry Dexter White (US). The basis for the discussion was Keynes' idea of an 'International Currency (or Clearing) Union' and White's proposal of an 'International Stabilization Fund.' In April 1944, the discussions led to the 'Joint Statement by Experts on the Establishment of an International Monetary Fund.' The statement formed the basis of negotiations at the Bretton Woods conference. It was the first conference to establish a permanent institutional and legal framework that required firm commitments of States to manage their currencies for the benefit of global monetary stability. Despite considerable problems such as the conditions for use of the Fund's resources and the location of the headquarters, most of the issues were resolved or couched in ambiguous language to be clarified at a later stage through the procedure for interpretation.[1]

1. On this procedure, *see infra*, paras 47–57.

15. A key feature of the post war monetary system was that the IMF, in order to maintain monetary stability, would oversee a system of par values[1] of currencies. This value had to be expressed in terms of gold as a common denominator or in terms of the United States dollar. A member was permitted to change the par value of its currency only to correct a 'fundamental disequilibrium' in its balance of payments. To make such a modification, authorization of the IMF would be necessary.

If a member would make a change in its par value despite the objection of the Fund, the member would not violate the Fund's Articles, but would be ineligible to use the resources of the Fund. In other words: the Fund would cease providing balance of payment support to the country making the unauthorized change. The system of fixed but adjustable exchange rates collapsed in the early 1970s.

1. A 'par value' means the nominal or stated value of a currency.

Chapter 5. Amendments

16. The IMF Articles provide for an amendment procedure by which at least three-fifths of the members, having eighty-five per cent of the voting power, must have accepted a proposed amendment. The Articles of Agreement have been amended several times to adapt to changing global conditions and the desired degree of cooperation.

17. Amendments of the IMF Articles have taken place in 1969, 1978 and 1992.[1] A 1999 amendment is expected to take effect in the future. The 1969 amendment created the option for the Fund to introduce Special Drawing Rights (SDRs)[2] to be able to supplement the monetary reserves, and in this way to help to meet a long-term global need to augment the total of world reserves. In addition, this amendment improved the authoritative procedure for interpretation by the introduction of a Committee for Interpretation.

1. The three amendments were effective: (i) 28 July 1969, by the modifications approved by the Board of Governors in Resolution No. 23–5, adopted 31 May 1968; (ii) 1 April 1978, by the modifications approved by the Board of Governors in Resolution No. 31–4, adopted 30 April 1976; and (iii) 11 November 1992, by the modifications approved by the Board of Governors in Resolution No. 45–3, adopted 28 June 1990.
2. On SDR, *see infra*, paras 88–91.

18. The amendment of 1978 brought a fundamental change. It reflected the changing practice of IMF members with respect to their exchange rate policies. The amendment formally brought an end to the system of par values by allowing members to freely choose the exchange rate policy they deemed fit. Instead a system of supervision was introduced supported by obligations that can be described as soft law. The end of the par value system meant that the Fund ceased to administer 'a system of stable exchange rates' but instead supervised 'a stable system of exchange rates.' This reflected a different role of the IMF: from custodian to supervisor. Other changes concerned the decreasing role of gold and the promotion of the SDR as the principle reserve asset in the monetary system.

19. The amendment of 1992 introduced new rules for the suspension of voting rights for members not meeting their obligations under the Articles. In 1999 an amendment was proposed that authorizes a 'Special One-Time Allocation of Drawing Rights' which benefited particularly the 38 IMF members that had never received any SDR allocation.[1]

1. *See infra*, para 93.

Part II. Management of the International Monetary System

Chapter 1. Introduction

98. The post-war management of the international monetary system has evolved in two subsequent stages. In the early years the Fund was preoccupied with exchange rate stability through the administration of a system of par values. In this system each member was obliged to express the value of its currency in terms of gold or the United States dollar. The US would play a key role in maintaining the integrity of the par value system by guaranteeing the dollar value in terms of gold. Accordingly the dollar and, indirectly, all other currencies were anchored in gold. The system was however not meant to be entirely static. A member could change the par value of its currency only if a correction of a 'fundamental disequilibrium' (read: persistent deficit) in its balance of payments would be required.

99. Due to changes in the world economy and the US policies the 'system of stable exchange rates' collapsed in the early 1970s. It was followed by a more liberal system of exchange rate management that was codified the second amendment of the Articles of Agreement. A major characteristic of the new system was the freedom of members to choose their exchange rate policy that they would find appropriate. To secure stability in the system the Fund would enter into consultation with each member and exercise 'firm surveillance' over exchange rate policies. Article IV stipulates members' obligations regarding exchange rates and enables the Fund to oversee the international monetary system.

Chapter 2. Surveillance: Overseeing the International Monetary System

§1. Article IV Consultations

100. By virtue of Article IV, Section 1, member countries are obliged to co-operate with the IMF and other members in order to ensure orderly exchange arrangements and to promote a 'stable system of exchange rates'. Such cooperation should take place in the light of a framework that facilitates the exchange of goods, services, and capital amongst countries, and that sustains sound economic growth. Moreover, cooperation will be desirable for the continuing development of the orderly underlying conditions that are necessary for financial and economic stability.

101. Section 1 contains soft law, with differences of legal effect, expressing the desirability of: (i) orderly economic growth with reasonable price stability; (ii) orderly underlying economic and financial conditions and a stable monetary system; (iii) abstention from manipulation of exchange rates or the international monetary system in order to prevent balance of payments adjustment or to gain an unfair competitive advantage; and (iv) exchange policies compatible with (i) through (iv) above. Section 1 is couched in opaque language. Its softness is the result of the political compromise after the breakdown of the system of stable exchange rates. No systematic attempt has been made to explain the exact scope of this provision. Instead the Fund has elaborated on the practice of surveillance under Section 3(b).

102. Whereas Section 1 generally requires the Fund and its members to collaborate, a problem is that diverging views exist, within and outside the IMF, on the appropriate policies required for the promotion of stability.[1] Depending on the economic conditions the IMF may urge members to revalue, devalue or float their currency but it may also make its resources available to maintain fixed exchange rates. Economists may even argue that any exchange rate regime can work, provided it is backed by sound economic fundamentals.

1. For a critical appraisal of the Fund's activities *see* Nobel Prize laureate and former World Bank economist Joseph Stiglitz, *Globalization and its Discontents*, New York, 2002.

103. Section 2(a) refers to 'exchange rate arrangements', i.e. to the decision of the national monetary authorities on the exchange rate policy of the national currency. Section 2(b) explains that the domestic currency can, for example, be pegged to another currency or basket of currencies. Another decision may be to allow the exchange rate to float freely according to supply and demand on the currency markets. Section 2(c) also refers to the introduction of general exchange arrangements to accord with the development of the international monetary system. Section 2(b) does not anticipate the formation of a monetary union among a group of members and it is unclear how the Economic and Monetary Union created in the Treaty on European Union would fit therein. Section 2(b) clearly presumes that each member retains its sovereign right to issue and manage its own currency.

104. Section 3 stipulates that the Fund shall oversee the international monetary system in order to ensure its effective operation. It also oversees members' compliance with its obligations under Section 1. In consultations with monetary authorities of each member, the Fund exercises 'firm surveillance' over the exchange rate policy of the members and lays down firm basic principles to which they must adhere. The obligation to cooperate applies to each and every member of the IMF regardless of whether the member has a surplus or a deficit on the balance of payments. Cooperation also includes the willingness to provide information to and receive advice from the Fund.

105. In sum the objective of the Article IV consultation is the creation of external monetary stability not only through exchange rate adjustments but also through rationalization of domestic economic policy. Through the attuning of economic policies, the members should be able to contribute to stable international economic relations.

106. In exercising IMF's supervisory functions member countries' policies are assessed against three obligations:[1] (i) the obligation to refrain from exchange rate manipulation; (ii) the necessity to intervene on the exchange market to counter disorderly conditions; and (iii) the necessity, when intervening, to take into account the interests of other members. The Fund completes the consultation procedure within three months with a report. This report contains a commentary on the policy in the form of non-binding 'conclusions.' The assessments may range from favourable, neutral, critical to strongly critical. Summaries of the concluding discussions are published as 'public information notice'.

1. This guidance is given by Decision No. 5392-(77/63) 29 April 1977, as amended by Decision Nos. 8564-(87/59), 1 April 1987, 8856-(88/64), 22 April 1988, and 10950-(95/37), 10 April 1995.

107. The IMF also consults with non-members, such as intergovernmental organizations (IGOs), that exercise monetary jurisdiction. These IGOs cannot become member of the IMF (membership is country-based) but their policies affect the international monetary system. Based on regional consultations reports have been published on the policies and performance of the European Union, Central African Economic and Monetary Community, West African Economic and Monetary Union and the Eastern Caribbean Currency Union.

§2. Global Surveillance

108. More wide-ranging is the analysis of developments of the world economy. There is a six-monthly IMF publication, the *World Economic Outlook*, which discusses the economic and monetary developments in a global framework. Members are expected to tailor their policies according to the findings of the Outlook. In this process, the Executive Board, which is responsible for assessing 'broad developments in exchange rates', fulfils an important role in analysing and forecasting.

§3. Strengthening Surveillance

109. The surveillance procedure has in practice only limited effect for the simple reason that the obligations have no far-reaching consequences: soft obligations do not make for strict surveillance. In the consultations, only the weight of arguments and, to a certain extent, peer pressure play a role in persuading a country to bring its economic policy more into line with the conclusions of the IMF. However, there are few indications that the important industrialized countries conveniently cede to the Fund's opinions when they do not share those opinions. Effective IMF surveillance thus depends crucially on the willingness of members to take the Fund's advice. To make surveillance more effective members could be asked to respond within a specific time to conclusions made in the Article IV consultations process. In cases where a member's policies appeared to depart for the Fund's advice, the member should be given increasingly stronger warnings to bring its policies on course. However, under the current interpretation of Article IV it is not possible for the Fund to give legally binding directives or to impose sanctions.

110. The surveillance procedure is under constant review and various policies have been developed for improvement. Traditionally, the Fund has primarily focused in its consultations on macroeconomic imbalances, combating inflation, trade liberalization and other market reforms. But an evolving understanding of problems underlying economic instability has brought the Fund to expand its jurisdiction under Article IV. The causes for economic instability are now increasingly associated with poor economic policies, political deficiencies and other shortcomings. Thus, the Fund has adopted policies promoting transparency, sound institutional structures and 'good governance', including the combating of corruption. Surveillance may also focus on social issues and labour markets, income distribution and environmental aspects.

111. Accordingly, the Fund's staff has published reports and studies on unproductive public expenditures and excessive military expenditure. However, the Fund must be cautious not to overstep its jurisdiction. Issues relating to the efficient allocation of resources and priorities in government expenditures are normally not within the Fund's mandate and continue to remain within the exclusive jurisdiction of countries.

Chapter 3. New Practices in Exchange Rate Management

112. Recent years have witnessed a diversity of currency regimes that change patterns of international monetary collaboration. The IMF has not been able to respond adequately to such developments due to institutional limitations or political inertia. These regimes are alternatives to the traditional concept of monetary sovereignty, i.e. a State that maintains its own currency and pursues its own monetary policy under supervision of the IMF. The adoption of specific currency regimes is a more drastic response to monetary instability than the IMF Articles anticipate.

113. A major development has been the creation of the Economic and Monetary Union (EMU) in the European Community. A reason for introducing a European currency is the desire to create a single market in which exchange rate fluctuations, that might impede the free flow of trade, are eliminated. Under the EMU, States have surrendered their sovereign right to issue a currency and to pursue monetary policies. Such transfer has replaced national currencies by a single European currency, the euro. Key monetary policies relating to the euro are determined by the European Central Bank (price stability) and the Council of Finance Ministers (exchange rate policies). It is significant that the European Community and its central bank, as key players in international monetary relations, are not directly placed under IMF supervision.

114. A second development has been the emergence of currency boards that are designed to maintain a tight relationship between foreign exchange and domestic currency. A currency board is committed to issue domestic currency solely in exchange for a specified currency at a fixed rate. A direct consequence is a limitation to create money by extending credit to the government and the banking system. The right to exchange domestic currency for a foreign currency under a currency board system may be suspended or abolished once the domestic economy is sufficiently strong. A major reason for introducing currency boards is a firm commitment to control inflation and to restore international confidence in the domestic currency.

115. A third development is the *de facto* or *de jure* dollarization of countries meaning that the domestic currency is entirely replaced by the dollar or other key currency. By *de jure* dollarization/eurorization a country entirely depends on the dollar/euro (or other dominant foreign currency) and the policies pursued by foreign monetary authorities. Whereas the advantages are clear – moderate inflation and a fully convertible currency – the disadvantages may be considerable. A dollarized economy loses its ability to control liquidity and interest rates and thus its capacity to respond to economic cycles. Moreover, it is not expected that the US monetary authorities will take economic developments in dollarized economies into consideration when monetary objectives are formulated.

Chapter 4. Convertibility and Trade Liberalization

§1. International Payments for Current Transfers and Market Convertibility

116. Under Article I the IMF is authorized to facilitate the expansion and balance of international trade and to assist in the elimination of foreign exchange restrictions which hamper the growth of world trade. For this purpose members are expected to accept the obligations under Article VIII, Sections 2, 3 and 4.[1] By doing so, members agree not to impose restrictions on the making of payments and transfers for current international transactions and not to engage in discriminatory currency arrangements or multiple currency practices without the approval of the IMF. Particularly important for private contracts is the clause under Section 2(b) which stipulates the unenforceability of 'exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement.' The meaning of this provision is that members are obliged not to enforce by the judicial and administrative authorities exchange contracts that violate authorized (by the Fund) exchange restrictions. The interpretation of 'exchange contract' is not without controversy. A broad interpretation would include all contracts involving international payments or transfers and domestic contracts payable in foreign exchange: sales, loans, deposits etc. The Fund may give advice about the consistency of exchange controls regulations with the Articles of Agreement.

1. However, a member may avail itself of the transitional arrangement of Article XIV, Section 2. This means that restrictions may be maintained that were in effect on the date on which it became a member. Early 2005 a total of 163 of the IMF's 184 members have accepted the obligations of Article VIII, Sections 2, 3 and 4.

117. Unrestricted payments and transfers for current transactions are known as 'market convertibility.' Payments for current transactions are payments which are not for the purpose of transferring capital, and include, *inter alia*, all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities. Article XXX(d) explains the scope of a 'current transaction.'

§2. Convertibility of Foreign-Held Balances or 'Official Convertibility'

118. Under Article VIII, Section 4 members are obliged to convert certain balances of its currency held by monetary authorities of other members; 'official convertibility' refers to transactions between central banks or similar monetary authorities. The obligation to convert only applies to balances that have been recently acquired as a result of current transactions or because their conversion is needed for making payments for current transactions. Under the conditions of Section 4(b) the obligation to convert shall not apply.

119. Developments in monetary practice have made a dead letter of Article VIII, Section 4. The reason for its desuetude is the close connection of this provision with the system of fixed (but adjustable) exchange rates that collapsed in the early 1970s. Nevertheless, Section 4 has been maintained in the Articles of Agreement and if a member were requested to convert balances of its currency, the member would *prima facie* be in violation of its obligations if it refused conversion. In practice holdings of foreign currencies that are considered in excess of needs are sold on the currency market. The *Report on the Second Amendment* suggests that no obligation will be applied for a member to convert under Section 4 so long as exchange markets normally serve this function.[1]

1. 'Report of the Executive Board on the Reform of the International Monetary System', 18 August 1972. In *The International Monetary System 1972–1978*, Margaret Garritsen de Vries (ed.), Vol. III, IMF, 35.

§3. Capital Transfers

120. Capital transfers are dealt with in Article VI. Apart from ordinary movements of capital, the Fund's resources may not be used to meet large or sustained outflows and the IMF may ask a member to impose controls. In practice the Fund has not insisted that capital controls be introduced. On the contrary, currency crisis in the 1990s have shown that the IMF is willing to provide balance of payments support when a member is suffering from a sudden and disruptive loss of market confidence reflected in pressures on the capital account and its reserves.

121. The liberalization of capital movements – that is movements not related to current transactions – is not within the Fund's mandate and introducing such regulation would require an amendment of the IMF Articles. Many industrialized countries have already adopted policies ensuring free capital movements. In 1997 and 1998 proposals were made for including provisions in the IMF Articles on liberalization. Many observers consider the unimpeded flow of private capital as an essential element of an efficient international monetary system. However, currency crises in the 1990s have made many members reluctant to further pursue liberalization. There appears to be consensus that liberalization of capital movements can only be effective when particular prerequisites are fulfilled. Therefore, liberalization must be approached cautiously in concert with appropriate macroeconomic and exchange rate policies, and a sound financial sector. More transparency is considered to be an important tool for assessing the soundness of such policies.

Chapter 5. Reforming the IMF

§1. New Architecture

122. The volatility of the international capital markets and occasional currency crises have induced calls for a new architecture of the international monetary system. Various groups, including the G-7, international organizations and NGOs have made proposals for a new design.[1] Some proposals suggest to (re)create global institutions to cope with current international financial and monetary problems. These institutions should have the features to act as a (i) global lender of last resort (a 'global central bank'); (ii) global bankruptcy court (settling debts and providing a fresh start when countries cannot meet their international financial obligations); and (iii) global financial regulator to exercise firm jurisdiction over states and non-sovereign actors. The latter proposal attempts to remedy the lacunae in supervision by 'financial market surveillance'. Publication of documents and, generally, the promotion of transparency are key features of the new architecture. As explained below considerable progress has been made on promoting more transparency.

1. E.g. 'The Managing Director's Report on the Fund's Medium-Term Strategy' of 15 September 2005 outlines a strategy that explains how the IMF should respond to global changes.

123. The new architecture is particularly expected to counter the increasing destabilizing effects of the international capital markets. In this marketplace a conglomerate of international financial entities meet, including, amongst others, commercial banks, investment banks, insurance companies and pension funds. These entities usually buy and sell large quantities of securities, currencies or complex derivative instruments. They may hedge against inflation and depreciation of currencies or engage in securities transactions that reduce the risk on an existing investment position. But they may also take short positions against currencies that are expected to depreciate. The relative strength of international capital markets (*vis-à-vis* central banks) is likely to further increase. Currently the IMF has limited knowledge and capacity to exercise financial market surveillance. A first step to systematically analyse the role of financial markets and modalities for surveillance has been made by the creation of the Review Group on the Organization of Financial Sector and Capital Markets.[1]

1. IMF Press Release No. 05/132, 6 June 2005.

§2. The Promotion of Transparency

124. Increased transparency both on the part of the IMF and the members is a requirement for a more effective functioning of global and domestic financial markets. More systematic and diversified information on macroeconomic data contributes to more transparency. Transparency was improved in particular by standardized publication of macroeconomic data. In April 1996, the Fund adopted the Special Data Dissemination Standard (SDDS) aimed at parties that have, or seek, access to international capital markets. Adherence to the SDDS is voluntary. The SDDS aims at the publication of up-to-date data on economic performance and policy in the real, fiscal, financial and external sectors. Data under the SDDS are available on Internet on the Dissemination Standard Bulletin Board <dsbb.imf.org>.

125. Starting from May 1997 the Fund publishes periodically Public Information Notices (PINs) following Article IV consultations in *IMF Economic Reviews*. PINs reflect the discussions with the member on its macroeconomic and monetary policies and conclusions of the Fund's Executive Board. PINs can only be issued on a voluntary basis at the request of the members' wish to make public the Fund views on their economic policies. In attracting foreign capital and investment, countries may benefit from a publicized favourable conclusion.

126. Furthermore, members may decide to release to the public *letters of intent, poverty reduction strategy papers* and similar documents. These documents, issued by a government requesting balance of payments support, describe policy intentions. The Fund encourages members to publish documents; with approval of the member these can be found on the Fund's website.

127. A salient development in the Fund's practices has been the publication of 'good practices' codes on how to organize governance in the field of fiscal and monetary policies. The codes were drafted in close consultation with the IMF members and intergovernmental and non-governmental organizations. Whereas these codes do not hold mandatory rules for members, they contain standards that may be upheld in consultation procedures. Moreover, these standards may be applied as preconditions before the Fund approves balance of payments support.

128. Reports on the Observance of Standards and Codes (ROSCs) summarize the extent to which countries observe certain internationally recognized standards and codes. The IMF has identified 12 policies and corresponding standards as useful for the operational work of the Bretton Woods institutions. These include: accounting; auditing; anti-money laundering and countering the financing of terrorism; banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation. Reports summarizing countries' observance are published on IMF's website.

129. For the purpose of promoting transparency the IMF has adopted a 'Code of Good Practices on Fiscal Transparency' in April 1998. The Code attempts to clarify the roles and responsibilities in government in the sphere of fiscal administration. The Code was followed by a 'Manual on Fiscal Transparency' prepared by the Fund's Fiscal Affairs Department. The manual translates the principles into practical policy guidelines and draws on experiences in member countries to illustrate, what the IMF considers, good governance.

130. The Code on Transparency is based on four general principles of fiscal transparency. The principle of *clarity of roles and responsibilities* reflects the importance of clear boundaries within government between fiscal, monetary, and public enterprise activities, and between the public and private sectors. The Code does not appear to prescribe any particular allocation of responsibility among government agencies.

131. *Public availability of information* reflects the need for both comprehensive fiscal information and for governments to commit themselves to publish fiscal information at clearly specified times. The concept of comprehensiveness goes beyond that typically covered in government budget and accounts statements. The Code emphasizes the need to report on any quasi-fiscal activities that have been assigned or otherwise undertaken by non-government agencies. The availability of information is greatly enabled by new information technologies such as the Internet.

132. The third general principle, *Open Budget Preparation, Execution, and Reporting*, encompasses traditional standards relating to the coverage, accessibility, and integrity of fiscal information. Emphasis is placed on the development and harmonization of international statistical and accounting standards for government reporting.

133. Finally, *independent assurances of integrity* emphasizes the traditional means of providing such assurances through external audit and statistical independence, but then goes beyond this and calls for openness by governments to allow independent scrutiny.

134. Additionally, the Fund has issued a 'Code of Good Practices on Transparency in Monetary and Financial Policies' that seeks to clarify the relationship between the central banks and governments. For purposes of the Code, transparency refers to an environment in which the objectives of policy are provided to the public on an understandable, accessible and timely basis. Transparency should also clarify the legal, institutional, and economic aspects of decision-making, the rationale of policy decisions and accountability. Thus, practices listed in the Code focus on: (1) clarity of roles, responsibilities and objectives of central banks and financial agencies; (2) the processes for formulating and reporting of monetary policy decisions by the central bank and of financial policies by financial agencies; (3) public availability of information on monetary and financial policies; and (4) accountability and assurances of integrity by the central bank and financial agencies.

Part III. Balance of Payments Support

Chapter 1. Introduction

135. A purpose of the IMF is 'to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.' In the practice of the Fund balance of payments support has become a dominant activity, virtually overshadowing other tasks. Whereas each member is entitled to balance op payments support, currently only developing countries and countries in transition make use of the Fund's resources. The last industrialized countries to use resources were Italy and the United Kingdom, in 1977. With the rise of the international capital markets and special arrangements between central banks, industrialized countries no longer need to ask the IMF for support. The developing countries, conversely, have become more dependent on the IMF, especially since the debt crises of the 1980s and the currency crises of the 1990s, since when creditors have been more reluctant to provide loans without an accompanying IMF programme.

Chapter 2. The Concept of Balance of Payments

136. Each member State has to draw up a balance of payments. In order to promote uniformity in the bookkeeping and to facilitate analysis of the figures, the Fund gives directions to member States about the way in which transactions are recorded. These directions are published in the *Balance of Payments Manual*. The figures relating to the balance of payments of member States are published in the *Balance of Payments Statistics Yearbook*.

137. The Fund defines the balance of payments as a statistical statement for a given period showing (a) transactions in goods, services, and income between an economy and the rest of the world; (b) changes of ownership and other changes in that economy's monetary gold, special drawing rights (SDRs), and claims on and liabilities to the rest of the world; and (c) unrequited transfers[1] and counterpart entries that are needed to balance, in the accounting sense, any entries for foregoing transactions and changes which are not mutually offsetting. Every transaction that is recorded is to be represented by two entries that have exactly equal values. One entry is designated as a credit and conceived as having a positive arithmetic sign, while the other entry is called a debit and given a negative sign. The sum of all entries is therefore, in principle, zero.

1. A transfer without reciprocity, e.g. transfers made by migrant workers.

138. The balance of payments is subdivided in the current account and the capital account. These accounts are further broken down into various categories of transactions: the current account includes the balance of trade, goods and unrequited transfers; the capital account relates to the capital transfers (international credits, repayments, investments). A deficit on the current account may be settled by borrowing abroad or by depleting official reserves, i.e. the foreign currency which is held by central banks to serve as a buffer for financial transactions. Gold is also held as a reserve, since it can be sold against any currency. A surplus on the current account means an increase in the official reserves, while a deficit means a decrease in the reserves. Any changes in the reserve position thus appear in the balance of payments.

Chapter 3. The Need for Support

139. A State has a deficit on the current account when it imports more goods and services than it exports. The capital balance may also be negative because of flights of capital or investments abroad. As long as these deficits are limited and of short duration, the official reserves can offer a solution. It is possible that after a time a surplus will arise so that the reserves can be brought back to the desired level. However, when the deficit is serious or difficult to shift, most countries will come into difficulty, as the reserves will become exhausted. In such cases two responses are possible.

140. First, it is possible to seek elsewhere for a means of covering the deficit. One option is for a country to offer bonds in a foreign currency, within or outside its own territory. Countries can also try to secure loans from commercial banks, operating on the market for currencies which are traded outside the country of issue. Developing countries may also receive balance of payments support in the shape of official development assistance.

141. Particularly for developing countries, calling on external financial sources does however have its limits. The only source of credit, which does not entail future obligations, are grants. This particular source is, however, scarce. As the balance of payments position shows no signs of improvement, and as the creditworthiness of the debtor country worsens, creditors will become ever more reluctant to furnish additional financial resources.

142. Secondly, a country can carry out an adjustment programme aimed at restoring the balance of payments. Such a policy means that the government opts for economic reform through reducing government spending, adjusting exchange rates, fighting inflation and other measures. Adjustment is in fact unavoidable when confidence in the country concerned has fallen to such a level that new credits are no longer offered. If the necessary adjustment fails to materialize, then market forces will come into play: shortage of currency will lead to import restrictions. If market forces are not controlled, these imports may include items which are essential for the economic development of the country. For example, if industry cannot get hold of foreign currency in order to buy machinery or spare parts, production comes to a halt; there is income deprivation and the flow of currency ceases. Scarcity of foreign currency can easily lead to a downward spiral in the economy.

143. Not seldom the IMF comes in when countries are up to their neck in difficulties. The IMF has laid down that structural balance of payments deficits and currency shortages must be countered by a programme of economic adjustment enabling the government to influence and to manipulate public spending, growth in the money supply, interest and exchange rates and other variables of economic and monetary policy. The IMF has set itself the task of helping countries in setting up and carrying out adjustment programmes. At the same time, the Fund provides short-term balance of payments support in order to cover immediate deficits. With few exceptions, a compulsory adjustment programme accompanies IMF financing of deficits.

Chapter 4. The Political Economy

144. Adjustment becomes necessary because circumstances in the preceding period have had an adverse effect on the balance of payments: excessive imports due to over-consumption, disappointing export revenue due to falling commodity prices, wrong exchange rate policy, misguided tax incentives, flight of capital or unfocused investment policy. Some of these causes can be laid at the door of the country concerned, while others, such as falling raw materials prices, can hardly be blamed on the country. However, adjustment is inevitable, regardless of the cause of the balance of payments deficit, and regardless of whether the country itself is to blame for the deficit. Only when an unlimited appeal can be made on international credit is postponement of adjustment possible.

145. Although the Fund cannot prevent adjustment, it can soften it. Member countries call on the organization's help in order to make the adjustment process proceed as smoothly as possible, without seriously endangering the economy. The Fund can also be requested to ensure that the adjustment happens in such a way that the socio-economic position of vulnerable groups is protected as far as possible. It may be expected that IMF-supported adjustment is more gradual and somewhat less painful than market-enforced adjustment.

146. There are several reasons why the IMF insists on adjustment. The first is rather mundane: as credit will only temporality be made available, the IMF wants to make sure that the member is able to pay back. A member that does not reform and continues to spend foreign currency beyond its means will certainly not be able to repay. Secondly, the IMF must facilitate the expansion and balanced growth of international trade. Adjustment is expected to ensure that countries continue to participate in the world trading system. There may also be a third reason: States running out of foreign reserves may become insolvent and create a risky environment for international banks and investors.

147. When an adjustment programme is being negotiated, parties will apply core principles of economic theory. Despite these principles negotiators of the IMF and the country in need may have fundamental differences of opinion. Parties will agree that reforms must be aimed at restoring the balance but they may disagree on the best recipe to find that balance. In the end parties may come up with a deal which is reflected in a document stating the reforms for the next years. What counts, of course, are effective changes in domestic economic policies. Changes usually include drastic budget cuts and tax reform, price liberalization, trade and foreign investment liberalization and private sector deregulation. Generally adjustment follows a predetermined pattern, meaning that the state steps back while the private sector moves in.

148. Governments have not always been eager to do business with the Fund. They would much prefer to rely on unconditional support, which would not thus restrict political priorities and choices. Although the Fund calls on its members to take timely measures, in practice members only turn to the Fund when other creditors have turned their backs and the ship is threatening to sink, or has already sunk. Unintentionally the Fund becomes a lender of last resort. This situation means that adjustment under Fund guidance often entails a radical change in economic policy. Painful choices have to be made. Interest groups who for years have been able to count on special benefits see their financial position undermined by economy drives as a part of conditionality. Government jobs are axed, and the military see their budgets melt away. A government must stand firm to resist the pressure from so many interest groups, and it is not unusual for the Fund, for political reasons, to take the blame for these painful measures. The IMF has been prepared to let these reproaches go unanswered, as a sort of silent contribution to the adjustment effort.

149. The Fund fulfils a pivotal function in the relation between the debtor country and its creditors. For creditors, the Fund is competent to judge the credit-worthiness of a country. Practically all creditors trust the IMF's judgement, and are only prepared to provide support if the debtor, in consultation with the Fund, carries out an adjustment programme. As long as the Fund provides support, creditors will have faith that the adjustment programme is on the right track, and will judge that the risks entailed in providing credit are acceptable. The debtor country also realizes that creditors will place their trust in an adjustment programme which meets with the Fund's approval. There may also be another reason why finance ministers and central bank presidents in particular adhere to IMF adjustment programmes. These authorities, responsible for financial and monetary policy, try to strengthen their position *vis-à-vis* spending departments in seeking support from the IMF. Backed up by the Fund, they hope to induce greater financial discipline among their fellow ministers.

Chapter 5. Purchasing Currencies from the Fund

150. Article V Section 1 explains that only fiscal or monetary agencies may deal with the Fund when operations and transactions are made. Section 2(a) stipulates that transactions made for the purpose of balance of payments support have the character of purchases. Hence SDRs or currencies of other members, which are held in the General Resources Account, may be purchased in exchange for an equivalent amount of the purchasing member's currency. Thereby only the composition of currencies held by the Fund will change. Under Section 2(b) the Fund may provide financial and technical services, including the administration of resources contributed by members. Such additional activities must be consistent with the purposes of the Fund. It is accepted that financial services may be available for specific categories of the member States only. An example is the PRGF, a facility that is financed by a trust fund and created for the benefit of developing countries only.

151. Regular transactions are made through the General Resources Account. Article V, Section 3 lays down rules for conditional balance of payments support. Under (a) the Fund must adopt policies on the use of its resources. Such policies include decisions, (authoritative) interpretations, guidelines, codes etc. The policies must ensure that the balance of payments problems are solved consistently with the IMF Articles and establish adequate safeguards for the temporary use of the Fund's resources. Temporary use is ensured by repurchase obligations: a member must buy back from the Fund its own currency after it has used the foreign currency 'temporarily.'

152. Under Section 2(b) conditions for the right to use resources are elaborated. The member 'shall be entitled to purchase currencies of other members from the Fund in exchange for an equivalent amount of its own currency.' It is important to note that members are 'entitled' to support, meaning that membership already creates an initial right. The IMF merely determines the conditions under which the purchase may be made.

153. After the member has made a request the Fund shall examine it and determine the consistency with the IMF Articles and policies. Under Section 3(d), (e) and (f) arrangements will be made of the selection of currencies to be sold and the exchangeability of currencies that are used in transactions. Resources made available by the Fund must be SDRs or 'freely usable currencies' that are currencies that are widely used to make payments for international transactions and is widely traded in the principal exchange markets. In practice only the currencies of members in sufficiently strong balance of payments and reserve positions are considered usable and constitute the 'operational budget' of the Fund.

154. A purchase may be made under the condition that use of the resources of the Fund would be in accordance with the provisions of this Agreement and the policies adopted under them. Accordingly, the member must declare that it has a need to make the purchase because of its balance of payments or its reserve position or developments in its reserves. Therefore, only balance of payments problems or declining reserves may induce financial support from the Fund. A further condition is that the proposed purchase would be limited up to two hundred per cent of the member's quota, but this limit may be waived under Section 4.

Part IV. The IMF in Global Context

Chapter 1. Introduction

190. The IMF cannot be studied in isolation from its legal and political context. Concepts such as sovereignty, *jus cogens* and the principle of speciality are to be considered when the Fund operates in the international economic arena. The Fund also cannot ignore human rights or UN Security Council decisions when there is a threat against international peace and security. It must accept rules on hierarchy and acknowledge that superior rules of international law may conflict with the Articles of Agreement. Some political realities must also be accepted. The Fund's membership consists on the one hand of a small group of economically powerful creditor countries and on the other hand a large group economically vulnerable debtor countries. Because voting rights in the IMF are based on economic strength, IMF policies are in fact determined by a small group of wealthy countries

Chapter 2. The Duty to Cooperate

191. Under Article X of the Articles of Agreement the IMF 'shall cooperate', within the terms of the IMF Articles, 'with any general international organization and with public international organizations having specialized responsibilities in related fields.' An obligation to cooperate also derives from Article 56 of the United Nations Charter, which commits UN-members to realizing economic and other kinds of cooperation. The IMF may be regarded as a platform for the kind of cooperation which Article 56 urges.

192. Cooperation is intended to lead to forms of interaction between the IMF and other international organizations. This interaction should influence the IMF, and have direct or indirect repercussions on the decision-making process. Conversely, the IMF's own objectives should also have an influence on other institutions. If there were no influence, then the obligation to cooperate would have no consequences. This cannot have been the aim of the authors of the IMF Articles.

193. How 'related fields' should be understood depends to a large extent on how the IMF interprets its own purposes. If the IMF interprets either more broadly or differently, new 'related fields' are opened up and cooperation should ensue. Certainly in fields where the IMF operates but lacks the necessary knowledge and experience, cooperation should be actively sought. To the extent the IMF considers measures to promote lasting economic growth as an essential facet of adjustment programmes, there is a need to seek modes for cooperation with other organizations.

194. Cooperation is also feasible in other areas. The more the IMF becomes concerned with related aspects of adjustment – protection of human rights standards, environmental questions, trade liberalization, fighting corruption – the more cooperation will have to focus on those areas. It is reasonable that the IMF should rely on the expertise of organizations which hold a specific mandate in the related areas.

195. Cooperation may take place informally by representatives of the Fund attending meetings of other organizations and staff members participating in workgroups and seminars. The Managing Director speaks annually to the UN's Economic and Social Council (ECOSOC), and the IMF is represented at other meetings and cooperation bodies set up by the UN. The Managing Director also participates in informal consultative bodies such as the G-7. Representatives of other organizations in their turn attend the IMF annual meetings as well as meetings of the International Monetary and Finance Committee.

196. Cooperation took on a permanent character when the IMF opened European offices for contacts with the OECD, European Union (EU), Bank for International Settlements (BIS), WTO, UN Conference on Trade and Development (UNCTAD) and UN specialized agencies. The Fund also cooperates with regional development banks particularly in connection with the Highly Indebted Poor Countries (HIPC) initiative. With only a few organizations is cooperation formalized through an agreement (e.g. the UN, World Bank and WTO). An example of effective cooperation is the publication of joint BIS-IMF-OECD-World Bank statistics on external debt.[1]

1. *See* the result at <www.oecd.org/statistics/jointdebt>.

Chapter 3. Related Economic and Monetary Group Consultations

197. Since the 1970s there has been a high degree of informal group consultation. The groups have no institutional structure and change their composition by mutual agreement. The government which is acting as host to the group usually provides administrative and secretarial support. More groups and clubs somehow contribute to international coordination on various economic problems. On its website the IMF provides a convenient overview of the composition and function of such groups. Some are briefly discussed below.

198. The G-7 consists of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States, with some additional observers.[1] Well-known meetings resulted in the Plaza accord (1985) and the Louvre accord (1987) which addressed the problems of fluctuating exchange rates of major currencies. The G-7 issues communiqués and convenes immediately prior to the semi-annual IMF meetings. Thereby, the G-7 often confronts the IMF bodies with *faits accomplis*. In case the G-7 group of finance ministers encroaches on territory where the IMF is also active, it poses a direct threat to consultations within the Fund.

1. A distinction should be made between the G-8 or P-8 (formerly G-7) heads of States which was established in November 1975 at the Rambouillet summit and the G-7 of finance ministers, set up by the heads of States at the Tokyo summit in May 1986.

199. The G-10 (G-7, The Netherlands, Belgium, Sweden and (at a later stage) Switzerland was created in 1962 by States participating in the GAB. Its primary purpose is to provide additional resources to the Fund. The G-10 provides some smaller industrialized countries the opportunity to join the debate on global monetary policies. The GAB consists a series of agreements between governments/ central banks of the G-10 countries (and Saudi Arabia) and the IMF.

200. The G-24 consists of three times eight countries from Africa, Asia and Latin America and was created at the G-77 Lima meeting in 1972 for the purpose of representing developing countries in international monetary consultation. The G-24 has been instrumental in the policy-making in the IMF by issuing studies and reports. The IMF provides secretarial services. The group convenes and issues communiqués immediately prior to the semi-annual IMF meetings.

201. In February 1999 the G-7 established a Financial Stability Forum that will 'regularly assess issues and vulnerabilities affecting the financial system and identify and oversee the actions needed to address them, including encouraging, where necessary, the development or strengthening of international best practices and standards and defining priorities for addressing and defining them.' It has 43 members, consisting of 26 senior representatives of national authorities responsible for financial stability in 11 significant international financial centers (in Australia, Canada, France, Germany, Hong Kong, Italy, Japan, The Netherlands, Singapore, the United Kingdom, and the United States); six senior representatives of four international financial institutions (BIS, IMF, OECD and the World Bank); seven senior representatives of three international regulatory and supervisory bodies (Basel

Committee on Banking Supervision, International Organization of Securities Commissions, and International Association of Insurance Supervisors); a representative each of two committees of central bank experts (Committee on the Global Financial System and Committee on Payment and Settlement Systems); a representative of the European Central Bank and the Chairman.

Chapter 4. Relations with the UN

202. The UN and the IMF share some common concerns such as the promotion of sound economic policies. In terms of general international law, it is relevant that the IMF may be confronted with States that are guilty of breaching international peace and security, or with some other violation of international legal obligations.

203. Both the IMF Articles and the UN Charter came into force in 1945. More than two months after the Charter came into force (on 24 October 1945) the IMF Articles were signed by the participants of the Bretton Woods conference at a joint ceremony on 27 December 1945. Interpretation and application of the IMF Articles should proceed in the light of the Charter. The subordination of the IMF Articles arises from the position that the Charter takes towards obligations and other international agreements. The Charter takes precedence over every other international agreement – including agreements made after the Charter – when there is a question of conflict.[1]

1. Article 103 of the Charter states that 'In the event of a conflict between the obligations of the members of the United Nations under the present Charter of the United Nations and their obligations under any other international agreement, their obligations under the present Charter shall prevail.'

204. Further, the agreement of 15 November 1947,[1] which confers on the IMF the status of a specialized agency, is significant. This cooperation agreement emphasizes the necessity for the IMF to function independently, given the nature of international responsibilities and the content of the IMF Articles. Too close an involvement with the UN would carry with it the risk of politicization, and jeopardize the Fund's primarily technical character. The agreement covered, among other things, exchange of information, mutual consultation and the binding nature of Security Council resolutions. The UN and the IMF may also make formal recommendations to each other, but only after consultation.

1. The agreement appears in *Selected Decisions and Selected Documents of the IMF* Twenty-Ninth Issue, as updated as of 30 June 2005, pp. 749–755 and on the Fund's website.

§1. General Cooperation

205. Cooperation with the UN has been troublesome and was often characterized by differences of policies and ideologies. IMF staff members tend to view the UN as inefficient and politicized. In practice cooperation is limited to the exchange of views and information on matters of mutual interest, exchange of statistical data and reciprocal attendance in meetings of both organizations. The cooperation mainly focuses on specific activities with the context of sustainable development, macroeconomic policy dialogue, and to a lesser extent, poverty eradication and protection of the environment.

206. In the 1997 Agenda for Development the UN Secretary General made particular reference to the relationship. The Bretton Woods institutions 'are increasingly active in technical assistance, which has the potential of creating overlap with the central funding role of UNDP, and in areas where competence exists in other specialized agencies.'[1] Special attention needs to be given to considering how these institutions and other organizations of the system could collaborate more closely on the basis of their respective areas of comparative strength.

1. A/RES/51/240, 15 October 1997. At <www.un.org/Docs/SG/> (February 2005).

207. In a joint exploratory review of cooperation between the UN and the Bretton Woods Institutions the UN Secretary General made a number of recommendations for improved collaboration.[1] He calls on the organizations to find new modes for increased cooperation for the establishment and operation of knowledge networks and more systematic information exchange and cooperation in the areas in research and studies. Organizations joined in UN coordinating bodies[2] should be committed to focus on poverty eradication, a key objective of the UN system. The UN Secretary General further suggests that respect for human rights has to be a critical cornerstone for economic and social development. Moreover, partnerships must be developed with civil society, including non-governmental organizations and the private sector. Strengthened collaboration must also be promoted in the sphere of humanitarian assistance, and post conflict recovery and development.

1. UN Doc. E/1998/61 of 10 June 1998.
2. The United Nations System Chief Executives Board (CEB) for Coordination – formerly the Administrative Committee on Coordination (ACC) – is the platform which brings UN bodies and specialized agencies together. IMF participation in the work of the CEB appears to be modest according to CEB's annual reports. See e.g. ECOSOC Doc. E/2005/63, 13 May 2005.

§2. Peace and Security and the IMF

208. The 1947 UN-IMF cooperation agreement includes an important clause describing the relationship between the UN Security Council and the IMF. This clause suggests a certain distance between the two organizations. Article 6 stipulates that the Fund takes note of its members' obligations to abide by the Council's resolutions, 'and will, in the conduct of its activities, have due regard for the decisions of the Security Council under Articles 41 and 42 of the United Nations Charter.'[1] 'Due regard' does not equal 'respect.' According to the letter of this clause, the Fund may continue to provide balance of payments support to a member country which has been targeted by the Security Council by virtue of the Chapter VII procedure. Due regard must be explained in such a way that the Fund could only disregard a binding Security Council decision on the grounds of overwhelmingly convincing arguments. The Fund holds that under no circumstances it can operate in conflict with its own IMF Articles.[2] From this provision it would appear that the Fund is not *ipso jure* bound by binding Security Council resolutions.

1. Article 41 gives the Security Council the right to impose sanctions on a member country that has violated international peace and security. These sanctions are binding to all UN members and may include 'complete or partial interruption of economic relations.'
2. Joseph Gold, 'The rule of law in the International Monetary Fund', IMF Pamphlet Series No. 32, Washington D.C.: IMF, 1980, p. 63. '"Due regard" by the Fund does not amount to an

obligation to act in accordance with decisions of the Security Council under Articles 41 and 42 of the Charter, particularly if acting in accordance with the decisions would be contrary to the Fund's Articles.'

209. It is fair to ask if the ECOSOC and the General Assembly[1] acted *ultra vires* by agreeing to the clause 'have due regard for the decisions of the Security Council.' It is indeed hard to imagine that the authors of the UN Charter on the one hand had given the Security Council the right to declare sanctions against a member, while at the same time permitting that member to receive financial assistance from the IMF. The argument that the UN had made a concession in order to bring the IMF into the fold of specialized agencies is possible to explain on political grounds, but fails to stand up when the IMF is offered the opportunity to provide financial assistance against the spirit of the Charter.

1. These organs are responsible for the content of the cooperation agreements with the specialized agencies, according to Article 63(1) of the Charter.

210. In practice, however, subjection to Security Council decisions will not pose problems for the approval of stand-by arrangements. The permanent members of the Council also have an important voice in the IMF, and it may be assumed that Executive Directors will pay heed to instructions or directions of the member countries in their voting group. It is therefore highly unlikely that the Executive Board would approve a stand-by arrangement after the member concerned has been on the receiving end of a binding decision of the Security Council.

§3. Human Rights and the IMF

211. The internationally recognized system of human rights is based on the Universal Declaration of Human Rights and the Human Rights Covenants of 1966.[1] From these sources spring a number of other treaties pertaining to human rights, such as those outlawing racial discrimination and torture.

1. International Covenant on Civil and Political Rights and International Covenant on Economic, Social and Cultural Rights both adopted on 16 December and entered into force resp. 23 March and 3 January 1976. 6 ILM (1967) 360 and 368.

212. The IMF does not provide a clear basis for linkage between financial support and human rights. However, this should not hinder the application of human rights. Just on grounds of the cooperation agreement with the UN, it could be argued that the IMF in any event may not ignore documents and opinions of the UN relating to human rights. The UN may after all make a recommendation to the Fund which the latter must 'consider.'

§4. Civil and Political Human Rights

213. Responses to violations of civil and political rights should be divided into two types. First, there may be refusal or abrogation of financial support because human rights abuses hinder the performance of the adjustment programme. In this case the violations are of such a nature that the political and economic consequences make a successful performance of the programme unlikely. Second, there may be refusal or abrogation as a sanction. In these cases the violations are not of such a nature as to undermine the member's capacity to successfully implement the adjustment programme; if the Fund proceeds to refusal or abrogation, it is in effect imposing a sanction.

214. Violations, which endanger successful adjustment, should have consequences. Gross human rights violations should influence the decision-making of the IMF if such violations undermine the possibilities of carrying out the adjustment programme. However, sanctions cannot be applied as a matter of formal recourse: in the Fund's practice human rights considerations should be dressed up in economic language.

215. The situation is different where violations of human rights have no influence, or a negligible influence, on the successful implementation of an adjustment programme. If in this sort of case the Fund responds to violations – by refusing balance of payments support – then this is in the nature of a sanction, by which pressure is brought to bear on a government to improve its human rights record. This kind of sanction should be applied with the greatest caution, since it would only affect members who were dependent on the Fund, in other words the poorest members. The corollary is that members who are not dependent on the Fund in the same way have nothing to fear in the way of sanctions. This differential treatment of members should be applied with the utmost circumspection. Furthermore, it is highly debatable whether withholding balance of payments support will lead to an improvement in the human rights situation. On the contrary, withholding assistance will plunge the economy deeper into the mire, which is hardly likely to encourage greater respect for human rights.

§5. Economic, Social and Cultural Human Rights

216. Economic, social and cultural human rights refer to obligations to promote full employment, just and favourable working conditions, social security, adequate living standards (including food, clothing and housing), health and education. The promotion of such rights means in effect the targeting of financial resources. Improved education, adequate health care or better employment prospects all require an allocation of public spending to these sectors. The IMF can make a direct and positive contribution by incorporating socio-economic human rights in its adjustment programmes. This might take the form of sparing socio-economic provisions when laying down conditions for reducing budget deficits in adjustment programmes.

217. The socio-economic position of vulnerable groups during the period of the adjustment programme has received increasing consideration. The Fund decided to pay greater attention to this aspect, based on the belief that socio-economic decline brings in its wake political unrest, which in turn compromises the chances of successful adjustment. In documents describing structural adjustment programmes there is usually a paragraph addressing social needs. The commitment to protect socio-economic standards during adjustment is one which can pre-eminently be realized through cooperation with the UN and its specialized agencies.

218. Therefore, the IMF maintains a dialogue with the United Nations and some of its specialized agencies to identify areas where public expenditure must be maintained or even increased if necessary. Simultaneously, the Fund addresses non-productive spending (including military spending) so that investments in human capital, such as basic health care and primary education, are not displaced. The IMF also claims to protect social sector spending of member countries, in particular on health and education. The Fund has reiterated that it is willing to recognize the crucial link between the level and efficiency of health and education spending and economic growth.

219. In a paper on the relationship between the Covenant and the IMF Articles the legal counsel of the IMF adopts a strict view by arguing that the IMF is primarily a monetary agency and should not be made responsible for upholding human rights. He reiterates that the IMF is not a party to the Covenant and members want the IMF to remain within its own legal domain. If members believe that the IMF should integrate human right in their decision-making, they should amend the IMF Articles. However, there are two points which appear to make the Fund more responsive towards human rights. First, the IMF *de facto* promotes economic, social and cultural rights through its current policies such as the HIPC initiative and the Poverty Reduction Strategy Paper (PRSP) process (*see below*). Second, the Fund is bound to promote economic, social and cultural rights which are part of customary international law. However, the counsel believes that 'the norms contained in the Covenant have not attained the status under general international law that would make them applicable to the Fund independently of the Covenant'.[1]

1. *See* Francois Gianviti, *supra* para 156, fn. 2.

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Appendix 1. Articles of Agreement of the International Monetary Fund

Adopted at the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, July 22, 1944. Entered into force December 27, 1944. Amended on July 28, 1968, April 1, 1978 and November 11, 1992. (Schedule M and Art. XV 1(b) are included but not yet in force, pending the fourth amendment)

The Governments on whose behalf the present Agreement is signed agree as follows:

Introductory Article

(i) The International Monetary Fund is established and shall operate in accordance with the provisions of this Agreement as originally adopted and subsequently amended.

(ii) To enable the Fund to conduct its operations and transactions, the Fund shall maintain a General Department and a Special Drawing Rights Department. Membership in the Fund shall give the right to participation in the Special Drawing Rights Department.

(iii) Operations and transactions authorized by this Agreement shall be conducted through the General Department, consisting in accordance with the provisions of this Agreement of the General Resources Account, the Special Disbursement Account, and the Investment Account; except that operations and transactions involving special drawing rights shall be conducted through the Special Drawing Rights Department.

Article I. Purposes

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its policies and decisions by the purposes set forth in this article.

Article II. Membership

Section 1. Original Members

The original members of the Fund shall be those of the countries represented at the United Nations Monetary and Financial Conference whose governments accept membership before December 31, 1945.

Section 2. Other Members

Membership shall be open to other countries at such times and in accordance with such terms as may be prescribed by the Board of Governors. These terms, including the terms for subscriptions, shall be based on principles consistent with those applied to other countries that are already members.

Article III. Quotas and Subscriptions

Section 1. Quotas and Payment of Subscriptions

Each member shall be assigned a quota expressed in special drawing rights. The quotas of the members represented at the United Nations Monetary and Financial Conference which accept membership before December 31, 1945 shall be those set forth in Schedule A. The quotas of other members shall be determined by the Board of Governors. The subscription of each member shall be equal to its quota and shall be paid in full to the Fund at the appropriate depository.

Section 2. Adjustment of Quotas

(a) The Board of Governors shall at intervals of not more than five years conduct a general review, and if it deems it appropriate propose an adjustment, of the quotas of the members. It may also, if it thinks fit, consider at any other time the adjustment of any particular quota at the request of the member concerned.

(b) The Fund may at any time propose an increase in the quotas of those members of the Fund that were members on August 31, 1975 in proportion to their quotas on that date in a cumulative amount not in excess of amounts transferred under Article V, Section 12(f)(i) and (j) from the Special Disbursement Account to the General Resources Account.

(c) An 85 per cent majority of the total voting power shall be required for any change in quotas.

(d) The quota of a member shall not be changed until the member has consented and until payment has been made unless payment is deemed to have been made in accordance with Section 3(b) of this article.

Section 3. Payments when Quotas are Changed

(a) Each member which consents to an increase in its quota under Section 2(a) of this article shall, within a period determined by the Fund, pay to the Fund 25 per cent of the increase in special drawing rights, but the Board of Governors may prescribe that this payment may be made, on the same basis for all members, in whole or in part in the currencies of other members specified, with their concurrence, by the Fund, or in the member's own currency. A non-participant shall pay in the currencies of other members specified by the Fund, with their concurrence, a proportion of the increase corresponding to the proportion to be paid in special drawing rights by participants. The balance of the increase shall be paid by the member in its own currency. The Fund's holdings of a member's currency shall not be increased above the level at which they would be subject to charges under Article V, Section 8(b)(iii), as a result of payments by other members under this provision.

(b) Each member which consents to an increase in its quota under Section 2(b) of this article shall be deemed to have paid to the Fund an amount of subscription equal to such increase.

(c) If a member consents to a reduction in its quota, the Fund shall, within 60 days, pay to the member an amount equal to the reduction. The payment shall be made in the member's currency and in such amount of special drawing rights or the currencies of other members specified, with their concurrence, by the Fund as is necessary to prevent the reduction of the Fund's holdings of the currency below the new quota, provided that in exceptional circumstances the Fund may reduce its holdings of the currency below the new quota by payment to the member in its own currency.

(d) A 70 per cent majority of the total voting power shall be required for any decision under (a) above, except for the determination of a period and the specification of currencies under that provision.

Appendix 2. Secondary Legislation of the IMF

Article III

QUOTAS AND SUBSCRIPTIONS

Instrument	Doc. Number
Adjustment of Quotas	408-2
Eleventh General Review of Quotas Period for Consent To Increases-Extension	13181-(04/10)
Gold and Currency Subscribed to the Fund and Accounting by Members for Transactions with the Fund	170-3
Guidelines on Payment of Reserve Assets in Connection with Subscriptions	6266-(79/156)

Article IV

EXCHANGE ARRANGEMENTS AND SURVEILLANCE

Instrument	Doc. Number
Notification of Exchange Arrangements Under Article IV, Section 2	5712-(78/41)
Surveillance over Exchange Rate Policies	5392-(77/63)
Surveillance: Procedures	6026-(79/13)
Surveillance over Exchange Rate Policies: 1990 Review	9499-(90/111)
Implementation of Procedures for Surveillance: 1993 Review	10273-(93/15)

Appendix 2

Instrument	Doc. Number
Implementation of Procedures for Surveillance: 2002 Review	12178-(00/41)
Article IV Consultation Documentation-Recent Economic Developments	12661-(02/6)
Summing Up by the Chairman-Biennial Review of the Implementation of the Fund's Surveillance over Members' Exchange Rate Policies and of the 1977 Surveillance Decision; and Transmittal of Fund Documents to Other International Organizations	EBM/97/30
Summing Up by the Acting Chairman Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision	EBM/00/24
Summing Up by the Chairman-Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision	EBM/02/38
Summing Up by the Chairman Biennial Review of the Implementation of the Fund's Surveillance and of the 1977 Surveillance Decision-Follow Up	EBM/02/76
Implementation of Procedures for Surveillance: 2002 Review	12793-(02/76)
Biennial Review of Implementation of Fund Surveillance and of 1977 Surveillance Review-Changes in Article IV Consultation Cycles	12794-(02/76)
Summing Up by the Acting Chair Data Provision to the Fund for Surveillance Purposes	EBM/02/48
Surveillance: Procedures-Implementation of Three-Month Period	7427-(83/83)
Surveillance over Monetary and Exchange Rate Policies: Members of Euro Area	11846-(98/125)
Modalities for Surveillance over Euro-Area Policies in Context of Article IV Consultations with Member Countries	12899-(02/119)
Public Information Notices-Release	11493-(97/45)
The Role of the Fund in Governance Issues-Guidance Note	EBS/97/125

Article V, Section 2(b)

Financial Services

Instrument	Doc. Number
Poverty Reduction and Growth Facility Trust	8759-(87/176)
Establishment of General Policy to Condition Decisions Under the Poverty Reduction and Growth Facility on Accuracy of Information Regarding Implementation of Prior Actions	12253-(00/77)
Establishment of General Policy to Condition Waiver Decisions Under the Poverty Reduction and Growth Facility on Accuracy of Information Regarding Performance Criteria	12254-(00/77)
Contributions to PRGF and PRGF-HIPC Trusts-Value Date for Operations and Transactions	13004-(03/39)
Poverty Reduction and Growth Facility Trust-Other Provisions)	11832-(98/119
Poverty Reduction and Growth Facility Trust-Extension and Enlargement	10530-(93/170)
Administered Account to Subsidize Post-Conflict Emergency Assistance to Poverty Reduction and Growth Facility-Eligible Members-Establishment	12481-(01/45)
Administered Account to Subsidize Post-Conflict Emergency Assistance to Poverty Reduction and Growth Facility-Eligible Members-Use of SDRs	12482-(01/45)
Establishment of the Post-SCA-2 Administered Account	12061-(99/130)
ESAF Successor-Initiation of Operations	10597-(94/14)
The Chairman's Summing Up of the Discussion on the Enhancement of the Structural Adjustment Facility-Operational Arrangements	EBM/87/171
The Chairman's Remarks at the Conclusion of the Discussion on the Enhancement of the Structural Adjustment Facility-Legal Documentation	EBM/87/176

Appendix 2

Instrument	Doc. Number
Enhanced Structural Adjustment Facility-Access Limits	8845-(88/61)
Enhanced Structural Adjustment Facility-Access Limits, 1995 Review	11027-(95/65)
Enhanced Structural Adjustment Facility-Interest Rate on Trust Loans	8846-(88/61)
Poverty Reduction and Growth Facility Trust-Borrowing for Loan Account-Consultation with Creditors, 2001	12559-(01/85)
Establishment of a Trust for Special PRGF Operations for the Heavily Indebted Poor Countries and Interim PRGF Subsidy Operations	11436-(97/10)
The Chairman's Summing Up at the Conclusion of the Discussion on the Modalities for Special ESAF Operations in the Context of the HIPC Initiative and Other ESAF Issues	EBM/97/10
Trust for Special ESAF Operations for Heavily Indebted Poor Countries and Interim ESAF Subsidy Operations-Terms and Conditions for Administration of Account Provided Under Section III, paragraph 5(b) of Trust	11698-(98/38)
Transformation of the Enhanced Structural Adjustment Facility	12087-(99/118)
Summing Up by the Acting Chair Review of the Poverty Reduction and Growth Facility-Issues and Options	EBM/02/24
Summing Up by the Chairman Enhanced Initiative for Heavily Indebted Poor Countries (HIPCs) and Poverty Reduction Strategy Papers (PRSPs)-Progress Reports and Review of Implementation	EBM/00/90
Summing Up by the Acting Chairman Initiative for Heavily Indebted Poor Countries-Proposal for Streamlining Preliminary Documents	EBM/00/108
Summing Up by the Chairman Review of the Poverty Reduction Strategy Paper Approach-Main Findings and Issues for Discussion	EBM/02/24

Instrument	Doc. Number
The Acting Chair's Summing Up HIPC Initiative-Status of Implementation; Background Papers on the Achievement of Long-Term External Debt Sustainability and External Debt Management in HIPCs; and Update on Financing of PRGF and HIPC Operations and Subsidization of Post-Conflict Emergency Assistance	EBM/02/40
The Acting Chair's Summing Up HIPC Initiative-Status of Implementation; and Update of PRGF and HIPC Operations and Subsidization of Post-Conflict Emergency Assistance	EBM/02/94
Concluding Remarks by the Chair Poverty Reduction Strategy Papers-Progress in Implementation; HIPC Initiative-Status of Implementation; and Update on the Financing of PRGF and HIPC Operations and Subsidization of Post-Conflict Emergency Assistance	EBM/03/84

Article V, Section 2(b)

Technical Services

Instrument	Doc. Number
Technical Assistance-Establishment of Framework Administered Account	10942-(95/33)
Framework Administered Account for Technical Assistance Activities-Pacific Financial Technical Assistance Centre Subaccount	12751-(02/52)
Framework Administered Account for Technical Assistance Activities-Africa Regional Technical Assistance Centers Subaccount	12832-(02/88)
Enhanced Surveillance: Procedures for Transmittal of Staff Reports	8222-(86/45)
The Chairman's Summing Up of the Discussion of the Role of the Fund in Assisting Members with Commercial Banks and Official Creditors	EBM/85/132

Appendix 2

Instrument	**Doc. Number**
Enhanced Surveillance: Midterm Review	10365-(93/67)
Summing Up by the Chairman Biennial Review of the Fund's Surveillance Policy	EBM/93/15
Summing Up by the Acting Chairman Settlement of Disputes Between Members Relating to External Financial Obligations-Role of the Fund	EBM/84/99
Summing Up by the Acting Chairman Financial Sector Assessment Program-A Review-Lessons from the Pilot and Issues Going Forward	EBM/03/25
The Acting Chair's Summing Up-Financial Sector Assessment Program-Review, Lessons, and Issues Going Forward Executive Board Meeting 03/25, March 18, 2003	DN1
Confidentiality Protocol: Protection of Sensitive Information in the Financial Sector Assessment Program	00/54
The Acting Chair's Summing Up Offshore Financial Centers-The Assessment Program A Progress Report and the Future of the Program	EBM/03/101
Summing Up by the Acting Chairman Enhancing Contributions to Combating Money Laundering	EBM/01/38
The Acting Chair's Summing Up on Intensified Fund Involvement in Anti-Money Laundering and Combating the Financing of Terrorism	EBM/01/116
Reports on Observance of Standards and Codes	12662-(02/6)
Summing Up by the Acting Chair Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)-Proposals to Assess a Global Standard and to Prepare ROSCs	EBM/02/80
Report on Outcome of FATF Plenary Meeting and Endorsement of Methodology for Assessing Compliance with Anti-Money Laundering and Combating Financing of Terrorism Standard	12884-(02/114)

Appendix 3. IMF Guidelines on Conditionality (September 25, 2002)

A. Principles

1. Basis and purpose of conditionality. Conditions on the use of Fund resources are governed by the Fund's Articles of Agreement and implementing decisions of the Executive Board. Conditionality – that is, program-related conditions – is intended to ensure that Fund resources are provided to members to assist them in resolving their balance of payments problems in a manner that is consistent with the Fund's Articles and that establishes adequate safeguards for the temporary use of the Fund's resources.

2. Early warning and prevention. Conditionality is one element in a broad strategy for helping members strengthen their economic and financial policies. Through formal and informal consultations, multilateral surveillance including the World Economic Outlook and discussions of capital market developments, advice to members on the voluntary adoption of appropriate standards and codes, and the provision of technical assistance, the Fund encourages members to adopt sound economic and financial policies as a precaution against the emergence of balance of payments difficulties, or to take corrective measures at an early stage of the development of difficulties.

3. Ownership and capacity to implement programs. National ownership of sound economic and financial policies and an adequate administrative capacity are crucial for successful implementation of Fund-supported programs. In responding to members' requests to use Fund resources and in setting program-related conditions, the Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies. The Fund will encourage members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation.

4. Circumstances of members. In helping members to devise economic and financial programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems and their administrative capacity to implement reforms. Conditionality and program design will also reflect the member's circumstances and the provisions of the facility under which the Fund's financing is being provided. The causes of balance of payments difficulties and the emphasis to be given to various program goals may differ among members, and the appropriate financing, the specification and sequencing of policy adjustments, and the time required to correct the problem will reflect those and other differences in circumstances. The member's past performance in implementing economic and financial policies will be taken into account as one factor affecting conditionality, with due consideration to changes in circumstances that would indicate a break with past performance.

5. *Approval of access to Fund resources*. The Fund will ensure consistency in the application of policies relating to the use of its resources with a view to maintaining the uniform treatment of members. A member's request to use Fund resources will be approved only if the Fund is satisfied that the member's program is consistent with the Fund's provisions and policies and that it will be carried out, and in particular that the member is sufficiently committed to implement the program. The Managing Director will be guided by these principles in making recommendations to the Executive Board with respect to the approval of the use of Fund resources by members.

6. Focus on program goals. Fund-supported programs should be directed primarily toward the following macroeconomic goals

(a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; and
(b) achieving medium-term external.

7. *Scope of conditions*. Program-related conditions governing the provision of Fund resources will be applied parsimoniously and will be consistent with the following principles:

(a) Conditions will be established only on the basis of those variables or measures that are reasonably within the member's direct or indirect control and that are, generally, either (i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. In general, all variables or measures that meet these criteria will be established as conditions.
(b) Conditions will normally consist of macroeconomic variables and structural measures that are within the Fund's core areas of responsibility. Variables and measures that are outside the Fund's core areas of responsibility may also be established as conditions but may require more detailed explanation of their critical importance. The Fund's core areas of responsibility in this context comprise: macroeconomic stabilization; monetary, fiscal, and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and international financial markets.
(c) Program-related conditions may contemplate the member meeting particular targets or objectives (outcomes-based conditionality), or taking (or refraining from taking) particular actions (actions-based conditionality). The formulation

of individual conditions will be based, in particular, upon the circumstances of the member.

B. Modalities

8. *Responsibility of the Fund for conditionality*. The Fund is fully responsible for the establishment and monitoring of all conditions attached to the use of its resources. There will be no cross-conditionality, under which the use of the Fund's resources would be directly subjected to the rules or decisions of other organizations. When establishing and monitoring conditions based on variables and measures that are not within its core areas of responsibility, the Fund will, to the fullest extent possible, draw on the advice of other multilateral institutions, particularly the World Bank. The application of a 'lead agency' framework, such as between the Fund and the Bank, will be implemented flexibly to take account of the circumstances of members and the overlapping interests of the two institutions with respect to some aspects of members' policies. The Fund's policy advice, program design, and conditionality will, insofar as possible, be consistent and integrated with those of other international institutions within a coherent country-led framework. The roles of each institution, including any relevant conditionality, will be stated clearly in Fund-related program documents.

9. *Nature of Fund arrangements*. A Fund arrangement is a decision of the Executive Board by which a member is assured that it will be able to make purchases or receive disbursements from the Fund in accordance with the terms of the decision during a specified period and up to a specified amount. Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents. Appropriate consultation clauses will be incorporated in all arrangements.

10. *Members' program documents*. The authorities' policy intentions will be described in documents such as a Letter of Intent (LOI), or a Memorandum on Economic and financial Policies (MEFP) that may be accompanied by a Technical Memorandum of Understanding (TMU). These documents will be prepared by the authorities, with the cooperation and assistance of the Fund staff, and will be submitted to the Managing Director for circulation to the Executive Board. The documents should reflect the authorities' policy goals and strategies. In addition to conditions specified in these documents, members requesting the use of Fund resources may in exceptional cases communicate confidential policy understandings to the Fund in a side letter addressed to the Managing Director and disclosed to the Executive Board. In all their program documents, the authorities should clearly distinguish between the conditions on which the Fund's financial support depends and other elements of the program. Detailed policy matrices covering the broader agenda should be avoided in program documents such as LOIs and MEFPs unless they are considered necessary by the authorities to express their policy intentions.

11. *Monitoring of performance*. The implementation of the member's understandings with the Fund may be monitored, in particular, on the basis of prior

actions, performance criteria, program and other reviews, and other variables and measures established as structural benchmarks or indicative targets.

(a) *Prior actions.* A member may be expected to adopt measures prior to the Fund's approval of an arrangement, completion of a review, or the granting of a waiver with respect to a performance criterion when it is critical for the successful implementation of the program that such actions be taken to underpin the upfront implementation of important measures. In reaching understandings on prior actions, the Fund will also take into account the strain that excessive reliance upon such actions can place on members' implementation capacity. The Managing Director will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.

(b) *Performance criteria.* A performance criterion is a variable or measure whose observance or implementation is established as a formal condition for the making of purchases or disbursements under a Fund arrangement. Performance criteria will apply to clearly-specified variables or measures that can be objectively monitored by the staff and are so critical for the achievement of the program goals or monitoring implementation that purchases or disbursements under the arrangement should be interrupted in cases of nonobservance. The number and content of performance criteria may vary because of the diversity of circumstances and institutional arrangements of members.

(c) *Reviews.* Reviews are conducted by the Executive Board.

   (i) *Program reviews.* Program reviews provide a framework for an assessment of whether the program is broadly on track and whether modifications are necessary. A program review will be completed only if the Executive Board is satisfied, based on the member's past performance and policy understandings for the future, that the program remains on track to achieve its objectives. In making this assessment, the Executive Board will take into consideration, in particular, the member's observance of performance criteria, indicative targets, and structural benchmarks, and the need to safeguard Fund resources. The elements of a member's program that will be taken into account for the completion of a review will be specified as fully and transparently as possible in the arrangement. Arrangements will provide for reviews to take place at a frequency appropriate to the member's circumstances. Reviews are expected to be held every six months, but substantial uncertainties concerning major economic trends or policy implementation may warrant more frequent monitoring. In cases of major delays in the completion of a review, the Managing Director will inform Executive Directors in an appropriate manner.

   (ii) *Financing assurances reviews.* Where the Fund is providing financial assistance to a member that has outstanding sovereign external payments arrears to private creditors or that, by virtue of the imposition of exchange controls, has outstanding non-sovereign external payments arrears, the Executive Board will conduct a financing assurances review to determine whether adequate safeguards remain in place for the further use of the Fund's resources in the member's circumstances and whether the member's adjustment efforts are undermined by developments in creditor-debtor relations. More specifically, every purchase or disbursement made available after the approval of the arrangement will, while such arrears remain outstanding, be made subject to the completion of a financing assurances review. Financing assurances reviews may also be established where the member has outstanding arrears to official creditors.

(d) *Other variables and measures.* In monitoring the implementation of a member's program, the Fund may also examine variables and measures established as indicative targets and structural benchmarks. The same principles governing the scope of conditions set out in paragraph 7 apply to these variables and measures as well as to other program-related conditions.

(i) *Indicative targets.* Variables may be established as indicative targets for the part of an arrangement for which they cannot be established as performance criteria because of substantial uncertainty about economic trends. As uncertainty is reduced, these targets will normally be established as performance criteria, with appropriate modifications as necessary. Indicative targets may also be established in addition to performance criteria as quantitative indicators to assess the member's progress in meeting the objectives of a program in the context of a program review.

(ii) *Structural benchmarks.* A measure may be established as a structural benchmark where it cannot be specified in terms that may be objectively monitored or where its non-implementation would not, by itself, warrant an interruption of purchases or disbursements under an arrangement. Structural benchmarks are intended to serve as clear markers in the assessment of progress in the implementation of critical structural reforms in the context of a program review.

C. Evaluation and Review

14. Program evaluation. The staff will prepare an analysis and assessment of the performance under programs supported by use of the Fund's resources in connection with Article IV consultations and as appropriate in connection with further requests for use of the Fund's resources.

15. Periodic review. The Fund will review the application of this Decision at intervals of two years and at such other times as consideration of it is placed on the agenda of the Executive Board. These reviews will evaluate the consistency of conditionality with these guidelines, the appropriateness and implementation of programs, and the effectiveness of policy instruments.

16. Decision No. 270-(53/95), adopted December 23, 1953, Stand-by Arrangements as amended, Decision No. 6056-(79/38), adopted March 2, 1979, Guidelines on Conditionality, and Decision No. C-3220-(01/24), adopted March 9, 2001, Concluding Remarks by the Chairman – Conditionality in Fund-Supported Programs, are repealed.

Appendix 3

Appendix 4. The Role of the IMF in Governance Issues – Guidance Note

I. Introduction

1. Reflecting the increased significance that member countries attach to the promotion of good governance, on January 15, 1997, the Executive Board held a preliminary discussion on the role of the IMF in governance issues, followed by a discussion on May 14, 1997 on guidance to the staff.1 The discussions revealed a strong consensus among Directors on the importance of good governance for economic efficiency and growth. It was observed that the IMF's role in these issues had been evolving pragmatically as more was learned about the contribution that greater attention to governance issues could make to macroeconomic stability and sustainable growth in member countries. Directors were strongly supportive of the role the IMF has been playing in this area in recent years through its policy advice and technical assistance.

2. The IMF contributes to promoting good governance in member countries through different channels. First, in its policy advice, the IMF has assisted its member countries in creating systems that limit the scope for ad hoc decision making, for rent seeking, and for undesirable preferential treatment of individuals or organizations. To this end, the IMF has encouraged, *inter alia*, liberalization of the exchange, trade, and price systems, and the elimination of direct credit allocation. Second, IMF technical assistance has helped member countries in enhancing their capacity to design and implement economic policies, in building effective policy-making institutions, and in improving public sector accountability. Third, the IMF has promoted transparency in financial transactions in the government budget, central bank, and the public sector more generally, and has provided assistance to improve accounting, auditing, and statistical systems. In all these ways, the IMF has helped countries to improve governance, to limit the opportunity for corruption and to increase the likelihood of exposing instances of poor governance. In addition, the IMF has addressed specific issues of poor governance, including corruption, when they have been judged to have a significant macroeconomic impact.

3. Building on the IMF's past experience in dealing with governance issues and taking into account the two Board discussions, the following guidelines seek to provide greater attention to IMF involvement in governance issues, in particular through:

– a more comprehensive treatment in the context of both Article IV consultations and IMF-supported programs of those governance issues that are within the IMF's mandate and expertise;
– a more proactive approach in advocating policies and the development of institutions and administrative systems that aim to eliminate the opportunity for rent seeking, corruption, and fraudulent activity;
– an evenhanded treatment of governance issues in all member countries; and
– enhanced collaboration with other multilateral institutions, in particular the World Bank, to make better use of complementary areas of expertise.

II. Guidance for IMF Involvement

Responsibility for Good Governance

4. The responsibility for governance issues lies first and foremost with the national authorities. The staff should, wherever possible, build on the national authorities' own willingness and commitment to address governance issues, recognizing that staff involvement is more likely to be successful when it strengthens the hands of those in the government seeking to improve governance. However, there may be instances in which the authorities are not actively addressing governance issues of relevance to the IMF. In such circumstances, the staff should raise their specific concerns in this regard with the authorities and point out the economic consequences of not addressing these issues.

Aspects of Governance of Relevance to the IMF

5. Many governance issues are integral to the IMF's normal activities. The IMF is primarily concerned with macroeconomic stability, external viability, and orderly economic growth in member countries. Therefore, the IMF's involvement in governance should be limited to economic aspects of governance. The contribution that the IMF can make to good governance (including the avoidance of corrupt practices) through its policy advice and, where relevant, technical assistance, arises principally in two spheres:

– improving the management of public resources through reforms covering public sector institutions (e.g. the treasury, central bank, public enterprises, civil service, and the official statistics function), including administrative procedures (e.g. expenditure control, budget management, and revenue collection);
– supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities (e.g. price systems, exchange and trade regimes, banking systems and their related regulations).

6. Within these areas of concentration, the IMF should focus its policy advice and technical assistance on areas of the IMF's traditional purview and expertise.

Thus, the IMF should be concerned with issues such as institutional reforms of the treasury, budget preparation and approval procedures, tax administration, accounting, and audit mechanisms, central bank operations, and the official statistics function. Similarly, reforms of market mechanisms would focus primarily on the exchange, trade, and price systems, and aspects of the financial system. In the regulatory and legal areas, IMF advice would focus on taxation, banking sector laws and regulations, and the establishment of free and fair market entry (e.g. tax codes and commercial and central bank laws). In other areas, however, where the IMF does not have a comparative advantage (e.g. public enterprise reform, civil service reform, property rights, contract enforcement, and procurement practices), the IMF would continue to rely on the expertise of other institutions, especially the World Bank. But, consistent with past practice, policies and reforms in these areas could, as appropriate, be part of the IMF staff's policy discussions and conditionality for the IMF's financial support where those measures were necessary for the achievement of program objectives.

7. Although it is difficult to separate economic aspects of governance from political aspects, confining the IMF's involvement in governance issues to the areas outlined above should help establish the boundaries of this involvement. In addition, general principles that are more broadly applicable to the IMF's activities should also guide the IMF's involvement in governance issues. Specifically, the IMF's judgements should not be influenced by the nature of a political regime of a country, nor should it interfere in domestic or foreign politics of any member. The IMF should not act on behalf of a member country in influencing another country's political orientation or behavior. Nevertheless, the IMF needs to take a view on whether the member is able to formulate and implement appropriate policies. This is especially clear in the case of countries implementing economic programs supported by the IMF from the guidelines on conditionality that call on IMF management to judge that 'the program is consistent with the IMF's provisions and policies and that it will be carried out.'3 As such, it is legitimate for management to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation.

The Criteria for IMF Involvement

8. The IMF's mandate and resources do not allow the institution to adopt the role of an investigative agency or guardian of financial integrity in member countries, and there is no intention to move in this direction. The staff should, however, address governance issues, including instances of corruption, on the basis of economic considerations within its mandate.

9. In considering whether IMF involvement in a governance issue is appropriate, the staff should be guided by an assessment of whether poor governance would have significant current or potential impact on macroeconomic performance in the short and medium term, and on the ability of the government credibly to pursue policies aimed at external viability and sustainable growth. The staff could draw upon comparisons with broadly agreed best international practices of economic management to assess the need for reforms.

10. As regards possible individual instances of corruption, IMF staff should continue raising these with the authorities in cases where there is a reason to believe they could have significant macroeconomic implications, even if these effects are not precisely measurable. Such implications could arise either because the amounts involved are potentially large, or because the corruption may be symptomatic of a wider governance problem that would require changes in the policy or regulatory framework to correct. Instances could include, for example, the diversion of public funds through misappropriation, tax (including customs) fraud with the connivance of public officials, the misuse of official foreign exchange reserves, or abuse of powers by bank supervisors that could entail substantial future costs for the budget and public financial institutions. Corrupt practices could also occur in other government activities, including the regulation of private sector activities that do not have a direct impact on the budget or public finances, such as *ad hoc* decisions made in relation to the regulation of foreign direct investment. Such practices would be counter to the IMF's general policy advice aimed at providing a level playing field to foster private sector activity.

11. Instances of corruption that do not meet the threshold of having significant macroeconomic implications are best addressed through the IMF's efforts to promote transparency and remove unnecessary regulations and opportunities for rent seeking – consistent with the broad principles that apply to other issues of economic governance. Staff recommendations could include improvements in government management processes and systems that would have the beneficial side effect of preventing a recurrence of corrupt practices, or advice to the authorities to seek the assistance of competent institutions for advice in these areas.

The Modalities of IMF Involvement in Governance Issues

12. Governance issues are relevant to all member countries although the problems differ depending on the economic systems, institutions, and the economic situation. The mode of IMF involvement will have implications for the manner in which governance concerns are addressed by staff in different member countries. Nonetheless, whatever the mode of involvement, the IMF's main contribution to improving governance in all countries – both countries receiving financial support from the IMF and other countries – will continue to be through support for policy reforms that remove opportunities for rent-seeking activities and through sustained efforts to help strengthen institutions and the administration capacity in member countries.

Article IV. Consultation Discussions

13. In Article IV consultation discussions, the staff should be alert to the potential benefits of reforms that can contribute to the promotion of good governance (e.g.

reduced scope for generalized rent seeking, enhanced transparency in decision making and budgetary processes, reductions in tax exemptions and subsidies, improved accounting and control systems, improvements in statistical dissemination practices, improvements in the composition of public expenditure, and accelerated civil service reform). The potential risks that poor governance could adversely affect private market confidence and, in turn, reduce private capital inflows and investment – even in countries enjoying relatively strong growth and private capital inflows – should also be brought to the attention of the authorities. IMF policy advice should also make use of the broad experience of countries with different economic systems and institutional practices and be based on the broadly agreed best international practices of economic management, and on the principles of transparency, simplicity, accountability, and fairness. In the case of international transactions that involve corruption, the staff should pay equal attention to both sides of corrupt transactions and recommend that such practices be stopped if they have the potential to significantly distort economic outcomes (e.g. the tax deductibility of bribes in member countries or certain operations of official agencies). Where poor governance with a significant economic impact is evident and brought to the staff's attention in its surveillance activities, the staff should discuss the issue with the authorities.

Use of IMF Resources

14. While the policy advice indicated above in relation to Article IV consultations is also relevant in the case of IMF-supported programs, the need to safeguard the IMF's resources must also be taken into account.

15. The use of conditionality related to governance issues emanates from the IMF's concern with macroeconomic policy design and implementation as the main means to safeguard the use of IMF resources. Thus, conditionality, in the form of prior actions, performance criteria, benchmarks, and conditions for completion of a review, should be attached to policy measures including those relating to economic aspects of governance that are required to meet the objectives of the program. This would include policy measures which may have important implications for improving governance, but are covered by the IMF's conditionality primarily because of their direct macroeconomic impact. (e.g. the elimination of tax exemptions or recovery of nonperforming loans). While the IMF staff should rely on other institutions' expertise in areas of their purview (e.g. public enterprise reform by the World Bank), it could nevertheless recommend conditionality in these areas if it considers that measures are critical to the successful implementation of the program.

16. Weak governance should be addressed early in the reform effort. Financial assistance from the IMF in the context of completion of a review under a program or approval of a new IMF arrangement could be suspended or delayed on account of poor governance, if there is reason to believe it could have significant macroeconomic implications that threaten the successful implementation of the program, or if it puts in doubt the purpose of the use of IMF resources. Corrective measures that at least begin to address the governance issue should be prior actions for resumption of IMF support and, if necessary, certain key measures could be structural benchmarks or performance criteria. Examples of such measures include recuperation of foregone revenue and changes in tax or customs administration. The staff would need to exercise judgement in assessing whether the actions adopted by the authorities were adequate to address the governance concerns; as in the case of other policies in which the track record is weak and the commitment of the authorities is in doubt, it may be appropriate in some circumstances to call for a period of monitoring prior to a resumption of financial support. The authorities' policy response could also entail changes in management in public institutions and, as appropriate, the removal of individuals from involvement in particular operations where corruption had occurred, and efforts to recover government funds that have been misappropriated. The staff must, of course, be mindful of the need to avoid action prejudicial to any related domestic legal processes in a particular case.

Technical Assistance

17. The IMF's technical assistance programs should continue to contribute to improving economic aspects of governance. This would apply to areas of IMF expertise, including budget management and control, tax and customs administration, central bank laws and organization, foreign exchange laws and regulations, and macroeconomic statistical systems and dissemination practices. In these areas, technical assistance missions should bring to the attention of the authorities areas in which procedures and practices fall short of best international practices.

Identification of Governance Problems

18. In the context of Article IV consultations, program negotiations, and technical assistance missions, the staff should be alert to aspects of poor governance that would influence the implementation and effectiveness of economic policies and private sector activities. For example, this could be related to a weak and poorly remunerated civil service, which could be addressed through civil service reforms encompassing a restructuring or selective increase in pay scales or the process and transparency of the privatization process. The staff should also pay attention to inconsistencies or improbabilities in the various data and accounts in member countries. For instance, tax collection might fall short of the expected potential yields as a result of weak administration of tax laws, procedural complexities or the widespread abuse of exemptions. The staff should bring data inconsistencies that are not judged to be the result of problems in statistical collection and compilation to the attention of the authorities. The staff should also advise that greater transparency in macroeconomic policy implementation could help build private sector confidence in government policies, for example, the consolidation of all extra budgetary accounts within the budget, the early publication of the budget, and early reporting on the outcome at the end of the fiscal year.

19. It is recognized that there are clear practical limitations to the ability of the staff to identify deficiencies in governance. The availability, quality, and reliability of information are likely to be important factors affecting IMF involvement in corruption cases. The staff should continue to rely on information provided by the authorities. If inconsistencies in public accounts and reports suggest that a problem exists, the staff should, in the first instance, raise the issue with the authorities. In its endeavor to seek information, the staff may need to be prepared to face some tension in the working relationship with country authorities in specific cases potentially involving corrupt practices. The staff may also point out that, in an atmosphere of widespread rumors of corrupt practices, and where the rumors have some genuine credence, an independent audit may be desirable to address such concerns. If the staff considers that further information is required to resolve an issue that has a significant macroeconomic impact, it may be appropriate to make use of information from third parties, including other international organizations and donors. In view of the confidential nature of the information obtained by the staff from member countries, staff enquiries will need to be handled with due discretion and regard for the sensitive nature of the issue.

Coordination with Bilateral Donors and other Multilateral Institutions

20. The IMF should collaborate with other multilateral institutions and donors in addressing economic governance issues. Recognizing that the interests of these bodies are more diverse than the IMF's – ranging from political aspects of governance to specific project-related issues – the IMF staff should exercise independent judgement in formulating policy advice. In addition, the staff should focus its analysis and technical assistance only on those issues that are within its expertise. However, as noted in paragraph 6, conditionality may apply to measures to address governance concerns in areas outside the IMF staff's expertise. IMF staff should also keep abreast of changes in the policies of partner organizations and specific efforts in member countries on governance issues. This should include the activities of partner organizations, particularly the World Bank, in addressing governance issues in areas which are outside IMF staff's competence but nonetheless important for the achievement of the economic policies advocated by the IMF (e.g. the reliable enforcement of contracts).

21. Given the commonality of interest with other multilateral institutions, the IMF should seek to strengthen its collaboration on issues of governance with them, and in particular with the World Bank. This should include, especially when requested by the authorities concerned, coordination of action to improve governance.

22. As regards bilateral donors, it is useful to distinguish two different cases in which donor responses to economic and noneconomic governance issues affect the IMF's relations with its members, although in practice there is seldom a clear separation between such economic and noneconomic aspects:

– In cases where bilateral donors or creditors withhold or interrupt external support because of concern over political and/or economic aspects of governance, the IMF should have an independent view on the economic implications. The IMF staff should examine whether these issues have a direct and significant impact on macroeconomic developments in the short or medium term. If this is the case, the staff should seek to assist the member country concerned through policy advice and technical assistance in areas of its expertise and coordinate as appropriate with donors with a view to helping to address the governance issues before recommending provision of IMF financial support. If this is not the case, but donors continue to withhold support, the staff should seek to assist the authorities in reformulating a program with greater internal adjustment to compensate for reduced external financing, paying due regard to the medium-term sustainability in the absence of a resumption of external assistance. If this were not feasible because of a lack of financing assurances, i.e. adequate external financing for the reformulated program is not in place, as a last resort, the staff should recommend that the IMF withhold its own financial support but continue to provide technical assistance support.

– In cases where governance issues significantly affect short- or medium-term economic developments but donors and creditors continue their financial assistance to the country concerned and do not assist the government in improving governance, IMF staff nevertheless has an independent responsibility for raising the governance issue with the authorities and for reporting to the Board on this issue. There may be occasions when the IMF staff may raise its concerns with donors and creditors, including at consultative group meetings and in round tables. But these instances would need to be addressed with care with the guidance of the Board and due regard to the confidential nature of such information. There are clear limitations to what the IMF's contribution to improvements in governance in member countries can achieve without the active support from the rest of the international community.

Reporting to the Executive Board

23. The Executive Board will be kept informed about developments in significant cases involving governance issues and will have the opportunity to comment on the operation of these guidelines as country cases are brought forward. In addition, there will be a periodic review by the Executive Board of the IMF's experience in governance issues.

Subject Index

The numbers refer to paragraph numbers.

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