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International Monetary Fund Handbook

Its Functions, Policies, and Operations

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editors

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FOREWORD

This Handbook is intended to give a general overview of the IMF's functions, policies and operations, although it is not intended to serve as an authoritative description of the rules governing these functions, policies, and operations. The Handbook provides, without commentary, a general and factual description of the IMF's mandate, its governance and internal organization, the policies that guide its day-to-day operations and interactions with member countries, and the internal procedures through which these policies are executed. The Handbook should be useful to new IMF staff members, to Executive Directors and their staff, and to members of the public in general who are interested in the IMF's mandate, policies, and operations. However, it is important to note that the publication provides but a snapshot of the IMF at the time of writing, as the continued evolution in the demands of the global economy and the role of the IMF therein will be persistent forces of change that will continue shaping the IMF's functions, policies, and operations.

The Handbook draws heavily on IMF documents and, for accuracy, the language is kept as close as possible to the originals. The source documents include the Articles of Agreement, Executive Board decisions, summings up of Executive Board discussions, annual reports of the IMF, staff reports and memoranda, pamphlets, fact-sheets, and IMF staff publications. All of the documents are available to the public and many are also accessible through the IMF's external website. The Handbook provides references in the endnotes to the relevant IMF documents, while footnotes provide some additional information that could be of interest to the reader.

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Abbreviations and Acronyms

ACB	Africa Capacity-Building Initiative
ACBF	African Capacity Building Foundation
AFRITAC	African Regional Technical Assistance Center
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AREAER	Annual Review of Exchange Arrangements and Exchange Restrictions
ASEAN	Association of Southeast Asian Nations
BIS	Bank of International Settlements
CAC	Collective Action Clause
CAM	Committee on Executive Board Administrative Matters
CARTAC	Caribbean Regional Technical Assistance Center
CCL	Contingent Credit Lines
CEMAC	Central African Economic and Monetary Community
CFF	Compensatory Financing Facility
CMCG	Capital Markets Consultative Group
DC	Development Committee
DQAF	Data Quality Assessment Framework
DSA	Debt Sustainability Analysis
DSBB	Dissemination Standards Bulletin Board
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
ECOSOC	Economic and Social Council
EFF	Extended Fund Facility
EFM	Emergency Financing Mechanism
ENDA	Emergency Natural Disaster Assistance
EPCA	Emergency Post Conflict Assistance
ESAF	Enhanced Structural Adjustment Facility
ESF	Exogenous Shocks Facility
EU	European Union
EURIBOR	Euro Interbank Offered Rate
FAA	Framework Administered Account for Technical Assistance Activities
FAD	Fiscal Affairs Department
FATF	Financial Action Task Force
FCC	Forward Commitment Capacity
FIRST	Financial Sector Reform and Strengthening Initiative
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicator
FSLC	Bank-Fund Financial Sector Liaison Committee
FSRB	FATF-Style Regional Body
FSSA	Financial System Stability Assessment
FY	Fiscal Year
GAB	General Arrangements to Borrow

GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GDDS	General Data Dissemination System
GFSR	Global Financial Stability Report
GRA	General Resources Account
HIPC	Heavily-Indebted Poor Countries
IEO	Independent Evaluation Office
IIF	Institute for International Finance
IMFC	International Monetary and Financial Committee
INS	IMF Institute
I-PRSP	Interim Poverty Reduction Strategy Paper
JIC	Joint IMF/World Bank Implementation Committee
JSA	Joint Staff Assessments
JSAN	Joint Staff Advisory Note
LEG	Legal Department
LIBOR	London Interbank Offered Rate
LOI	Letter of Intent
MCM	Monetary and Capital Markets Department
MD	Managing Director
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MEFP	Memorandum on Economic and Financial Policies
METAC	Middle Eastern Regional Technical Assistance Center
MTS	Medium Term Strategy
NAB	New Arrangements to Borrow
OECD	Organization for Economic Cooperation and Development
OFC	Offshore Financial Center
OIA	Office of Internal Audit
PACT	Partnership for Capacity Building in Africa
PFTAC	Pacific Financial Technical Assistance Center
RAP	Rights-Accumulation Program
PIN	Public Information Notice
PPM	Post-Program Monitoring
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty Reduction Strategy
PRSP	Poverty Reduction Strategy Paper
PSI	Policy Support Instrument
PSIA	Poverty and Social Impact Analysis
ROSC	Report on the Observance of Standards and Codes
RTAC	Regional Technical Assistance Center
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SDA	Special Disbursement Account
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Right
SEC	Secretary’s Department

SM	Staff Memorandum
SMP	Staff-Monitored Program
SRF	Supplemental Reserve Facility
STA	Statistics Department
TIM	Trade Integration Mechanism
TMU	Technical Memorandum of Understanding
TPRM	Trade Policy Review Mechanism
UN	United Nations
UNDP	United Nations Development Programme
WEMD	World Economic and Market Developments
WAEMU	West African Economic and Monetary Union
WEO	World Economic Outlook
WTO	World Trade Organization

CHAPTER 1

OVERVIEW OF THE IMF

Mandate

The IMF is an independent international organization. It is a cooperative of 185 member countries, whose objective is to promote world economic stability and growth.[1] The member countries are the shareholders of the cooperative, providing the capital of the IMF through quota subscriptions (Box 1.1 and the Appendix). In return, the IMF provides its members with macroeconomic policy advice, financing in times of balance of payments need, and technical assistance and training to improve national economic management.

The IMF is one of several autonomous organizations designated by the United Nations (UN) as "Specialized Agencies," with which the UN has established working relationships.[2] The IMF is a permanent observer at the UN.

The Articles of Agreement that created the IMF and govern its operations were adopted at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, on July 22, 1944, and entered into force on December 27, 1945.[3] Article I sets out the mandate of the IMF as follows:

- To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems;
- 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;
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation;
- 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;
- To give confidence to members by making the general resources of the IMF 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; and
- To shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

This mandate gives the IMF its unique character as an international monetary institution, with broad oversight responsibilities for the orderly functioning and development of the international monetary and financial system.

Functions

The IMF pursues the various facets of its mandate in a number of ways. These are summarized below, and described more detail in later chapters.

Surveillance over Members' Economic Policies

In becoming members of the IMF, countries agree to pursue economic policies that are consistent with the objectives of the IMF. The Articles of Agreement confer on the IMF the legal authority to oversee compliance by members with this obligation, making the IMF "the only organization that has a mandate to examine on a regular basis the economic circumstances of virtually every country in the world."[4]

Financing Temporary Balance of Payments Needs

The Articles of Agreement enable the IMF to lend to member countries that have a balance of payments need to provide temporary respite and enable countries to put in place orderly corrective measures and avoid a disorderly adjustment of the external imbalance. Such lending is usually undertaken in the context of an economic adjustment program implemented by the borrowing country to correct the balance of payments difficulties, which also safeguards IMF resources. In addition to providing direct financing to its member countries, the IMF plays an important catalytic role in helping member countries to mobilize external financing for their balance of payments needs.

Combating Poverty in Low-Income Countries

The IMF provides concessional loans to low-income member countries to help support these countries' efforts to eradicate poverty. In this venture, the IMF works closely with the World Bank and other development partners. In this area the IMF also plays a critical catalytic role to mobilize external financing and donor support for the countries' balance of payments and development needs. The IMF also participates in two international initiatives to provide debt relief: the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI).

Mobilizing External Financing

IMF endorsement of a country's policies serves as an important catalyst for mobilizing resources from bilateral and multilateral lenders and donors. They rely on an IMF endorsement of a country's economic policies or might even require a formal IMF-supported economic program before committing or disbursing their own resources to that country or granting debt relief. IMF policy assessments and recommendations also provide important signals to investors and financial markets regarding a country's economic future, and impact on investor and market confidence in the economy.

Strengthening the International Monetary System

The IMF is the central institution in the international monetary system. It serves as a forum for consultation and collaboration by members on international monetary and financial matters, and works with other multilateral institutions to devise international rules that would facilitate the prevention and orderly resolution of international economic problems.

Increasing the Global Supply of International Reserves

The IMF is authorized to issue an international reserve asset called the Special Drawing Right (SDR) if there is a global need to supplement existing reserve assets. These allocated SDRs are part of the net international reserves of members and can be exchanged for convertible currencies. They are not a claim on the IMF. The SDR is also the IMF's unit of account for all financial transactions with members.

Building Capacity through Technical Assistance and Training

Technical assistance and training are provided in the core areas of IMF expertise to help member countries design economic policies and improve economic management capabilities, which in turn can help reduce the risk of policy failures and the countries' resilience to shocks, and facilitating program design and implementation. These activities are particularly important in developing countries, where resources are scarce and institutions often weak.

Dissemination of Information and Research

The IMF is a premier source for economic analysis of its member countries' economic policies and statistical information. Information is disseminated through its numerous economic reports and research studies on member countries, as well as specialized statistical publications. The IMF also conducts research in areas relevant to its mandate and operations, mainly to improve its economic analysis and its advice to member countries. The results of this research are disseminated through books, IMF and academic journals and working papers, occasional papers, and the internet.

Medium-Term Strategy

In light of the economic transformation wrought by 21st century globalization, the IMF embarked on a review of its future direction, publishing the Managing Director's Report on Implementing the Fund's Medium-Term Strategy (MTS) in April 2006. The strategy concluded that the emergence of new economic powers, integrated financial markets, unprecedented capital flows, and new ideas to promote economic development required an updated interpretation of the IMF's mandate as the steward of international financial cooperation and stability. Without new focus and carefully chosen priorities, the institution risked being pulled in too many directions and losing its relevance to large parts of the membership.

The proposals put forward in the MTS cover the following issues:

- ***New directions in surveillance***. The difficulties in tackling unprecedented global imbalances, and the challenges facing individual countries, underscore the need for stronger exercise of surveillance by the IMF. At the global level, the MTS calls for efforts to identify—and promote effective responses to—risks to economic stability, including from payments imbalances, currency misalignments, and financial market disturbances. At the country level, the MTS calls for efforts to choosing focus and effectiveness over comprehensiveness, with deeper analysis of financial systems, a greater multilateral perspective to surveillance, and more regional context and outreach.[5] In this context, discussions are ongoing about the introduction of a new surveillance remit—understood as a statement of objectives, priorities, and responsibilities—to strengthen the effectiveness of surveillance.[6]

- ***The changing role of the IMF in emerging market countries***. In the many countries that have already emerged to become major global players, the MTS calls for efforts to augment candid and focused macroeconomic analysis with enhanced surveillance over financial and capital markets. At the same time, the MTS calls for efforts to improve crisis prevention and response.

- ***More effective engagement in low-income countries***. The MTS calls for efforts to marshal the expected rise in aid flows, including from debt relief, to achieve higher growth and the Millennium Development Goals. Helping countries do so requires a deeper but more focused engagement by the IMF, including new understandings with the World Bank and other agencies on the division of labor.

- ***Governance***. Quota and voice reform is central to the legitimacy and effectiveness of the IMF. During the 2006 Singapore Annual Meetings, a two-year package was initiated with, as a first step, an ad-hoc increase in quotas for four countries. The MTS calls for efforts to address other aspects of governance, including transparent selection of management and better definition of the role of the Board.

- ***Capacity building***. The MTS calls for targeted efforts in this area to help members implement reforms. Capacity building also needs to be part of the strategy to address vulnerabilities identified in surveillance. The IMF's efforts to build macroeconomic institutions can be strengthened with better prioritization and country ownership.

- ***Streamlining***. The MTS calls for action to control procedure and documentation, lest the work, messages, and governance of the institution are lost in a sea of paper, and to enable management and the Board to shift attention from routine and detail to broader, strategic issues.

- ***Medium-term budget***. The MTS calls for these efforts to be reconciled within a medium-term budget that deals with the projected fall in the IMF's income. But even with a decline in real spending, the MTS notes that a new business model is needed to finance IMF activity in the future, with less reliance on margins from lending and more on steady, long-term sources of income.

A number of initiatives derived from the MTS have already been put in place or are near-completion. These include the ad-hoc changes in the quotas of four member countries or initiatives such as the streamlining of consultations.

Origins of the IMF

The origin of the IMF lies in the experience of countries during the inter-war period, including the

Great Depression. In the 1920s and 1930s, many countries attempted to maintain domestic income in the face of shrinking markets through competitive devaluation of their currencies and resort to exchange and trade restrictions. Such measures could achieve their objectives only by aggravating the difficulties of trading partners who, in self-defense, were led to adopt similar policies, leading to a destructive vicious cycle. There was growing recognition of the largely self-defeating nature of these policies at the country level and the increasing global welfare losses, resulting in a widening acceptance of the need for a globally agreed code of conduct in international trade and financial matters.

It was in this context that representatives of 45 countries reached an agreement in Bretton Woods, New Hampshire during July 1-22, 1944, on the constitution and functions of an international institution to supervise and promote an open and stable international monetary system.[7] The IMF came into existence on December 27, 1945, when 29 countries signed the Articles of Agreement.[8] The inaugural meeting of the Board of Governors was convened in Savannah, Georgia, on March 8, 1946, and the first meeting of the Executive Board was held in Washington, D.C. on May 6, 1946. The IMF began its operations on March 1, 1947, and France became the first country to draw funds from the IMF in May 1947.

Size and Membership

Since its inception, the IMF's size and structure, responsibilities and priorities, and mode of operations have undergone considerable expansion or transformation in response to changes in the world economic environment. To continue to fulfill its core mandate as set out in the Articles of Agreement, the IMF has continuously adapted to meet new challenges in the evolving world economy.[*] In this context, it is important to bear in mind that this Handbook presents a snapshot of the IMF today, and today's IMF is the product of historical forces that will continue to evolve and to shape the future of the institution. Its present governance and organizational structures are described in more detail in Chapter 10.

Since 1945, membership has expanded steadily to include nearly all countries in the world today. Eligibility for membership is based on three basic requirements: the applicant must be a country; it must be in control of its foreign affairs; and it must be willing and able to fulfill the obligations of membership. Informal inquiries and discussions usually precede the formal membership process, while the operational procedure of the formal membership process is: (i) an application is submitted to the Managing Director; (ii) the Executive Board decides whether to proceed with a formal investigation of an application for membership; (iii) a staff membership mission produces a report that contains quota recommendations; (iv) an ad hoc membership committee considers the staff report to determine the terms and conditions of membership and the quota; (v) the chairman of the ad hoc committee ascertains whether the proposed terms and conditions and quota are acceptable to the applicant; (vi) the Executive Board considers the ad hoc committee's report, and, if the recommendations are acceptable, the draft membership resolution is submitted to the Board of Governors for adoption; and (vii) the Board of Governors may adopt a membership resolution with a simple majority, provided the requisite quorum is achieved.

Members also have the right to withdraw from the IMF at any time by transmitting a notice in writing to the IMF. Article XXVI also makes provision for the compulsory withdrawal of a member that fails to fulfill its obligations under the Articles of Agreement, and sets out a procedure for compulsory withdrawal. However, compulsory withdrawal is a last resort and the member is given ample opportunities to correct its policies and fulfill its obligations to the IMF.

The size of the IMF is often also viewed in terms of the total quota of all its members. In nominal (SDR) terms, the total quota has expanded significantly over time, reflecting the growth in membership, in the size of the world economy, and in the financing needs of the membership (Box 1 and Appendix). However, the total quota has been declining relative to world GDP.

Staff

As the membership has expanded, so has the size and diversity of the staff of the IMF. In September 1946, about 100 staff members from 15 countries worked in

[*] A substantive account of the historical evolution of the IMF in response to the changing global economic needs can be found in some of the sources cited in endnote 1.

five Divisions: a Research Division, an Operations Division, a Legal Division, the Secretary's Office, and an Administrative Services Unit. At end-2006 there were about 2,800 staff members, from more than two-thirds of the member countries, and a much more elaborate organizational structure, as described in Chapter 10.

The IMF staff comprises mainly economists, but also includes financial specialists, accountants, statisticians, lawyers, linguists, writers, editors, and support personnel. Most staff members work at the IMF's headquarters in Washington, D.C., USA. The IMF currently maintains small offices in Paris, Brussels, Geneva, and Tokyo, and at the United Nations in New York. In addition, the IMF has resident representative offices in many member countries and a number of regional technical assistance and training centers.

The Articles of Agreement state that the IMF staff should be of the highest caliber in terms of standards of efficiency and technical competence, while the appointments should also pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.[9] Furthermore, the Articles of Agreement indicate that the staff of the IMF, in the discharge of their functions, shall owe their duty entirely to the IMF and to no other authority, and require each member country to respect the international character of this duty and to refrain from all attempts to influence any of the staff in the discharge of their functions. Staff are immune from legal process with respect to acts performed by them in their official capacity, except when the IMF waives this immunity.

Box 1.1. The IMF's Quota System[1]

Quotas as the Basis of Capital Subscriptions to the IMF. Each member of the IMF is assigned a quota expressed in special drawing rights (SDRs), the IMF's unit of account for financial transactions with member countries. The member's capital subscription to the IMF is equal to its quota. Members pay up to 25 percent of their quota in the form of reserve assets and the remainder in their own currency. A member borrows from the IMF by purchasing reserve assets using its own currency, and repays the IMF by repurchasing its own currency using reserve assets. The total quota or capital subscription of all members is currently SDR 212.8 billion.

Other Functions of Quotas. Quotas determine the size of the IMF and play a central role in the IMF's operations.

- **Lending Capacity.** Quota subscriptions by members provide by far the bulk of the resources (reserve assets) available to the IMF to finance its lending operations. Therefore, quotas to a large extent determine the lending capacity of the IMF.

- **Voting Power.** Quotas largely determine the distribution of the voting power of the IMF and, therefore, the relative influence of individual members in decision-making at the IMF.

- **Access Limits.** The limit of members' access to IMF resources is stated as a percent of quota, so that quotas in principle determine the maximum level of a country's access. These access limits vary according to the type of borrowing arrangement between the member and the IMF. For example, under the credit tranches and the Extended Fund Facility, borrowing is subject to an annual limit of 100 percent of quota and a cumulative limit of 300 percent of quota.

- **SDR Allocations.** Quotas determine a member's share in a general allocation of Special Drawing Rights.

How Quotas Are Determined. The Board of Governors determines the aggregate quota and the distribution of this aggregate among the individual member countries. The aggregate quota is set taking into account the IMF's capacity to satisfy the projected financing needs of the membership, while individual quotas are based broadly on members' relative economic sizes in the world economy. The IMF normally conducts general quota reviews every five years with a view to adjusting, if necessary, the aggregate size and distribution of members' quotas to reflect developments in the world economy and changes in members' relative economic sizes. Quota reviews have focused on the role and size of the IMF; the adequacy of IMF resources and the need for a possible quota increase; the distribution of quotas, including possible changes to quota formulas; and governance and representation. The IMF may also undertake ad hoc quota adjustments at the request of individual members, both within and outside the context of a general review, although significant adjustments in quota shares have tended to take place in the context of general quota increases. The twelfth general review of quotas was concluded in January 2003 with no change in quotas. An 85 percent majority of the total voting power of the Board of Governors is required for any change of quotas.

Quota Formulas. Quota formulas exist to calculate the quotas of member countries. Five quota formulas are currently used for this purpose, incorporating variables that measure the economic size, external position, openness to trade, and variability of export earnings of member countries. In principle, calculated quotas help guide decisions regarding the aggregate size and distribution of members' actual quotas. In practice, the IMF has tended to distribute the bulk of quota increases as a uniform percentage of existing quotas, with the result that actual quotas of individual members differ significantly from the calculated quotas. The quota formulas have not produced quota shares that would be considered acceptable to the IMF's membership, in part because of the politically-sensitive nature of quota shares and perceived deficiencies of the formulas themselves. The formulas are currently being reviewed with a view to simplifying and updating them.

[1] See *Articles of Agreement*; IMF, *Financial Organization and Operations of the IMF*, Pamphlet Series No. 45, sixth edition, 2001.

CHAPTER 2

SURVEILLANCE OVER MEMBERS' ECONOMIC POLICIES

Surveillance in the Articles of Agreement

The Articles of Agreement set out the obligations of member countries and the IMF, which form the legal basis of IMF surveillance over members' economic policies. [10] The core article in this respect is Article IV of the IMF's Articles of Agreement. The principles and procedures of surveillance were set out in further detail in a 1977 Executive Board Decision, which established how surveillance would be conducted after the adoption of the Second Amendment to the Articles.[*]

Article IV of the IMF's Articles of Agreement

Article IV is the core article outlining the members' and the IMF's responsibilities in surveillance.

Section 1 requires member countries to pursue economic policies consistent with the IMF's purpose, and stipulates that "each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates." In addition to this general undertaking to collaborate with the IMF and other members, Section 1 identifies four specific obligations for members. Each member is required to:

- Endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability.
- Seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions.
- Avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.
- Follow exchange policies compatible with the undertakings of Article IV, Section 1.

Section 2 allows members to set the exchange rate arrangements of their choice, with the exception of arrangements that would set gold as a value denominator. It requires members to notify the IMF promptly of these arrangements and any changes to them.

Section 3 (a) empowers the IMF to "oversee the international monetary system in order to ensure its effective operation" and to "oversee the compliance of each member with its obligations under Section 1 of this Article."

Section 3 (b) states that, in order to fulfill its functions under Section 3 (a), the IMF "shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." Furthermore, "Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies."

The 1977 Decision on Surveillance over Exchange Rate Policies adopted principles for the guidance of members on their exchange rate policies, and principles of IMF surveillance providing guidance to the IMF in monitoring the observance by members of these principles through the specification of indicators.

The IMF relies upon the information provided by the members to conduct its surveillance under Article IV. In this context, Article VIII, Section 5 of the IMF's Articles of Agreement stipulates that the IMF may require members to furnish it with information as it deems necessary for its activities (including surveillance), and specifies a list of data that the IMF deems the minimum necessary to conduct its duties.

[*] The implementation of the IMF's surveillance and of the 1977 decision on surveillance is reviewed on a triennial basis by the Executive Board.

The list includes data relating to the central government, the balance of payments, external reserves, exchange controls, the international investment position, national accounts, prices, the central bank, and the banking system.[11]

The term "surveillance" refers to bilateral surveillance that is conducted pursuant to Article IV and is mandatory for all members. Some activities associated with surveillance, such as the multilateral surveillance exercises initiated in 2006, the Financial Sector Assessment Program (FSAP), and the work on standards and codes, are voluntary arrangements between member countries and the IMF (see Chapter 7). These activities are not mandatory for countries and have been developed in recent years to strengthen surveillance. Nevertheless, they are often included under the general term of "surveillance"—for example, the FSAP is referred to as "financial sector surveillance." For this reason, when speaking of members' obligations under the Articles of Agreement, surveillance is usually referred to as "Article IV surveillance."

Articles VIII and XIV of the IMF's Articles of Agreement

The IMF, within the context of an Article IV consultation, often addresses issues that fall outside the scope of surveillance entirely and are beyond its oversight of a member's compliance with the obligations specified under Article IV, Section 1. For example, as explained in the section on modalities of surveillance, the IMF uses the occasion of an Article IV consultation to consult with members with respect to the retention of exchange restrictions under Articles VIII and XIV. These Article VIII and XIV consultations are "comprehended" by the Article IV consultation but they do not form part of the Article IV consultation. They are legally different from the IMF surveillance activities and serve different purposes.

Article VIII, Sections 2, 3, and 4, provides the legal basis for the member countries' obligations to maintain currency convertibility and exchange regimes free of restrictions or discriminatory practices, and to provide adequate information.

- **Section 2** prohibits members from imposing restrictions on the making of payments and transfers for current international transactions without the approval of the IMF. The IMF will only approve restrictions if it is satisfied that they are necessary for balance of payments purposes, and that their use will be temporary, and that they are not discriminatory, while the member is seeking to eliminate the need for them.[12]
- **Section 3** prohibits members from engaging in any discriminatory currency arrangements or multiple currency practices except as authorized under the Articles of Agreement or approved by the IMF. Members maintaining such arrangements or practices are expected to consult with the IMF as to their progressive removal, unless they are maintained or imposed under the Article XIV, Section 2.
- **Section 4** requires members to maintain the convertibility of their currency, by buying balances of their currency held by other members when requested by these other members.

Article XIV provides transitional arrangements for countries that have not yet accepted the obligations under Article VIII.

- **Section 1** requires members to notify the IMF upon joining whether they intend to avail themselves of the transitional arrangements in Section 2 of this Article, or whether they are prepared to accept the obligations of Article VIII, Sections 2, 3, and 4.
- **Section 2** permits members to maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which they became members. However, members are expected to withdraw restrictions maintained under this Section, and to accept the obligations under Article VIII, Sections 2, 3, and 4, as soon as balance of payments conditions permit.
- **Section 3** stipulates that the IMF shall make annual reports on the restrictions in force under Section 2 of this Article. Any member retaining any restrictions inconsistent with Article VIII, Sections 2, 3, and 4 is required to consult annually with the IMF as to their further retention.

Characteristics of Surveillance

Universality

Bilateral surveillance under Article IV is mandatory for all member countries. Furthermore, according to the 1977 surveillance decision, the principles and procedures that guide surveillance apply "to all member countries whatever their exchange arrangements and whatever their balance of payments position."[13] Surveillance consultations are held routinely with every IMF member country, irrespective of their level of development or the strength or weakness of their economic policies.

Uniformity of Treatment

The Executive Board has at various times stressed the importance of maintaining the uniformity of treatment of member countries.[14] This principle applies to all IMF activities, and not just to the conduct of surveillance. It requires that members in similar circumstances be treated similarly.

Flexibility

Article 3 (b) states that surveillance principles "shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members." The 1977 Decision on Surveillance over Exchange Rate policies also provides that the surveillance of exchange rate policies shall be adapted to the needs of international adjustment as they develop, while the 2002 biennial review reiterated its support for flexibility in surveillance procedures, emphasizing that coverage of surveillance should be molded to country-specific circumstances.[15]

Flexibility is applied in two ways. First, there have been changes in the breadth, depth, and intensity of surveillance over the years in response to new challenges and demands in the global economy, to new research findings on relevant policy issues, and to the need to better manage staff and Executive Board resources. Second, the conduct of surveillance varies with individual country circumstances—for example, with respect to timing, frequency, and focus of consultations with members.

Cooperation

Although the conduct of bilateral surveillance is an obligation for both the IMF and the members, the IMF seeks to work in a cooperative spirit with member countries, based on mutual trust and confidence. The Executive Board has repeatedly expressed strong support for the cooperative approaches underlying the IMF's relations with members.[16] The IMF recognizes that the success of surveillance depends in part on the extent to which member countries implement its advice, and that implementation will be more likely if members "own" the policies that IMF staff recommend. Thus it emphasizes, among other things, effective communication and close policy dialogue with countries, including with legislative bodies, in order to enhance ownership. In addition, some of the IMF's monitoring activities, such as the financial sector assessment program and the work on standards and codes, rely on the voluntary participation of members.

Candor

The effectiveness of surveillance depends crucially, among other things, on sound policy advice based on accurate analysis of a country's economic problems and challenges. The IMF recognizes that the quality of its analysis and advice depends in part on complete frankness by IMF staff in the surveillance exercise. At the 2002 biennial review, the Executive Board stressed the importance of candid staff reports and summings up to convey clear and strong messages to member governments on required policy actions. During the discussion of the IMF's transparency policy in June 2005 the Board again emphasized that candor in the IMF's dialogue with members and in reporting to the Board remains essential for effective surveillance.[17] Also, the Board stressed in 2004 that a thorough and candid discussion of exchange rate issues remains critical for surveillance.[18] However, under the IMF's policy for deletions and corrections, market-sensitive information in staff reports may be deleted prior to publication of the reports, at the request of the member country.

Comprehensiveness

Comprehensiveness is understood to mean coverage of all policies that are relevant for macroeconomic performance. The 1977 surveillance decision states: "The Fund's appraisal of a member's exchange rate policies shall ... be made within the framework of a