Contemplating compliance: European compliance mechanisms in international perspective
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CHAPTER 7

IMF
The IMF is as relevant and effective as its member governments (especially the largest) want it to be.

1. INTRODUCTION

The previous two chapters have analyzed the functioning and effectiveness of compliance mechanisms in the OECD and the WTO. Chapter 5 showed how a soft mechanism based on mutual surveillance and peer review can work effectively when compliance with the underlying soft obligations is not expected in the short-term, but rather seen as a process that takes time and effort before results are obtained. Chapter 6 then showed how a soft (the TPRM) and a hard compliance mechanism (the Dispute Settlement Mechanism) can function alongside one another within one international organization, and how the existence of one type influences the functioning of the other. Once again, the importance of the character of the underlying obligations was seen, and it became clear that a soft mechanism potentially functions less effectively for hard obligations then it theoretically could when a costly and bilateral adversarial mechanism looms in the background. It was argued that a further integration of the two systems could enhance the effectiveness of both the TPRM as well as the Dispute Settlement Mechanism.

This current chapter will analyze how a soft mechanism functions in the International Monetary Fund (IMF), where the underlying obligations are partly of a soft and partly of a hard character. The IMF does have the possibility of imposing enforcement measures, but these are considered inefficient and almost never applied. The ultimate sanction of involuntary expulsion from the organization has been applied only once in its history. First, an overview is given of the history and functioning of the IMF, followed by a discussion of one of the most important mechanisms of the IMF: the Article IV consultations. Second, an analysis is made of the functioning and effectiveness of this mechanism in inducing compliance with the underlying obligations.

2. ABOUT THE IMF: HISTORY AND FUNCTIONING

Before the First World War, there was no legal regime that covered international monetary affairs. All currencies of the major Western economies were tied to gold, meaning that de facto exchange rates were essentially fixed – the so-called gold standard – while other states tied their currencies to one of the key currencies and held reserves in either gold or those key currencies.¹ This gold stan-

¹ This in contrast with international trade or customs agreements. See also Lowenfeld, A.F., International Economic Law (Oxford University Press, Oxford 2008).
standard system collapsed at the outbreak of the First World War. The interbellum that followed was a period with mixtures of floating and fixed exchange rates, while the Great Depression of the thirties led to states increasing subsidies, trade restrictions, competitive devaluations of currencies and restrictions on foreign exchange. These beggar-thy-neighbor attempts to counter the effects of the depression only had adverse effects, which in the end led to a sharp decline in world trade, employment and living standards in many countries, and eventually contributed to the outbreak of World War II.

As early as 1942, negotiations for what later became the Bretton Woods Agreement began. The Agreement itself was signed in 1944, before the Second World War was even officially over, and came into force in December 1945 after ratification by 29 countries. The Bretton Woods Conference created two institutions: the International Monetary Fund and the International Bank for Reconstruction and Development (The World Bank). The World Bank would be devoted to long-term economic development, while the IMF was to enable states to achieve financial stability by making its resources available to them in accordance with the Articles of Agreement (AoA). In practice, this meant that the IMF Member States agreed to surrender some of their monetary sovereignty to the IMF in exchange for a rules-based monetary system. One of the main decisions taken by the Bretton Woods negotiators was to commit to fixed exchange rates, with the idea that this would produce the stability that had been lacking in the inter-war period.

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2 Article I of the Articles of Agreement reads as follows:
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.

3 Bradlow, D., ‘Stuffing New Wine into Old Bottles: The Troubling Case of the IMF’ (2001) 3 (1)
Journal of International Banking Regulation, p. 3.
Under Article IV of the AoA, each Member State was required to adopt a par value for its currency in terms of either gold or the US dollar (which itself had been fixed to gold since 1934 at $35 per ounce). Although this par value system was only partially adhered to, the system functioned well due to the fact that the United States kept to the duties agreed upon in the AoA, regarding the conversion of dollars to gold – and vice versa – at the rate set by the AoA.

Everything changed on August 15, 1971, when the United States unilaterally decided to no longer convert foreign-held dollars into gold, except when in the interest of monetary stability and “in the best interests of the United States”. Nor would it continue to intervene in exchange markets to maintain the par value of the dollar to other currencies. It was becoming clear that the rules as they existed could no longer be upheld, while the effects of the oil crisis had shown that fixed exchange rates were also no longer opportune. It was thus necessary to change the rules of the organization, rather than uphold the existing ones.

Subsequently, the AoA were amended to reflect the actual behavior of floating exchange rates. The new AoA entered into force on April 1, 1978. The most important amendment concerned Article IV, where the par value system contained in that article was now replaced by obligations regarding exchange arrangements. Article IV(2)(b) now allows practically every type of exchange arrangement, as well as changes in Member State policies at any time – provided the Fund is notified promptly. Two restrictions contained in Article VIII remain for the Member States, prohibiting restrictions on the making of payments and transfers for international transactions, as well as multiple currency practices without the approval of the IMF.

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4 Currencies of the Member States were pegged to within 1% of the value of the US Dollar, which itself was fixed to the value of gold. Article IV(1)(a) of the original AoA read: “The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944”.

5 France made a change in its par value in the 1948. Canada had a floating currency in the 1950s, while many of the developing countries never established a par value at all (see Lowenfeld (2008), p. 624).

6 Ibid., p. 625.

7 In fact the only type of exchange arrangement that is specifically prohibited is one that uses gold as the denominator: “exchange arrangements may include (i) the maintenance by a member of a value for its currency in terms of the special drawing right or another denominator, other than gold, selected by the member, or (ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, or (iii) other exchange arrangements of a member’s choice.” (emphasis added)

The role of the IMF today is largely to oversee economic stability, foster growth, provide policy advice and financing for Member States in economic difficulties and achieve macroeconomic stability for developing countries. The tasks of the Fund can be classified in three categories. First, surveillance: the monitoring of economic and financial developments, and the provision of policy advice aimed especially at crisis prevention. Second, financial assistance: The IMF lends to countries with balance of payments difficulties to provide temporary financing and to support policies aimed at correcting the underlying problems. Third, technical assistance: The IMF helps member countries to manage their economic policy and financial affairs effectively. These three main functions of the Fund are all related to the overall goal of promoting financial stability in and among its member countries.

The two systems that are key to performing these roles of the IMF are the Article IV consultations (Article IV AoA), and the Balance of Payments Support Programs (Article I AoA). These systems will be discussed in sections 3 and 4, after an overview of the IMF institutional structure and its instruments.

2.1. IMF Institutional Structure

Article XII AoA established the three organs of the IMF: a Board of Governors, an Executive Board and a Managing Director, who also functions as chairman of the Executive Board.

The Board of Governors consists of one governor and one alternate appointed by each Member State, usually the Minister of Finance or the President of the Member’s Central Bank. The board meets at least once a year, or when called into special session. All powers of the Fund are vested in the Board of Governors, but it has delegated most of its powers to the Executive Board. The most important rights it has retained include the right to approve quota increases, SDR allocations, admittance and withdrawal of Members, as well as amendments to the AoA.

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9 See the AoA, e.g. Article I for general purposes of the IMF, as well as the IMF website www.imf.org.
11 Article XII(1) AoA.
12 Article XII(2).
13 SDRs are Special Drawing Rights, which represent a claim by the IMF Member States on Member States’ foreign exchange reserve assets. The value of an SDR is defined by a weighted currency basket of the US Dollar, the Euro, the British Pound and the Japanese Yen. In practice, SDRs function mostly as the IMF’s unit of account.
and by-laws. The Board also elects or appoints the executive directors that make up the Executive Board discussed below, and makes final interpretations of the IMF’s AoA.

Two committees advise the Board: the International Monetary and Financial Committee (IMFC) and the Development Committee (DC). The IMFC meets every six months to discuss matters regarding the global economy. The communiqué it produces at the end of the meeting serves as a guiding document for the IMF’s work program until the next meeting. The DC is a joint committee of the IMF and the World Bank, and serves as a forum to build intergovernmental consensus on development issues.14

The Executive Board consists of at least 20 directors – five appointed by the five members with the largest quotas,15 and at least 15 as elected by the other members.16 The Board takes care of the IMF’s day-to-day business, and is in continuous session at the offices of the IMF.17 Voting in the Board is weighted according to the Member State’s economic importance as reflected in the quotas in the Fund with a minimum voting power for each member.18 Voting is officially by a majority of the weighted votes,19 however, decisions are in practice usually made by consen-

15 The US (16.75% of the total), Japan (6.23%), Germany (5.81%), France (4.29%) and the UK (4.29%).
16 At the moment there are 19 Directors other than the largest five. Each usually represents a group of Members according to their regional situation, linguistic background or other reasons. Mr. Jose Rojas from Venezuela, for example, is currently (2013) the Director of a group which consists of Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Spain, and Venezuela. On the other hand, three Directors represent just one Member each (aside from the largest five): China, Russia and Saudi Arabia.

Proposals to reform the quota and governance system have been accepted by the Board of Governors in 2010, which after ratification will lead to significant changes in the IMF governance structure. This involves, among other things, a doubling of quotas, a shift of quota shares to developing countries and under-represented countries, as well as a more representative, all-elected Executive Board. The package is awaiting ratification by Member States representing at least 85% of the votes in order to come into effect (at the time of writing this thesis it had been ratified by around 70%). See Press Release no 10/477, IMF Board of Governors Approves Major Quota and Governance Reforms, December 16, 2010 (found on IMF website: http://www.imf.org/external/np/sec/pr/2010/pr10477.htm).
17 Article XII(3).
18 The rather complicated method of vote distribution is detailed in Article XII(5) AoA.
19 This can be either by (simple) majority of the total voting power, 70% concerning more important decisions (24 possible occasions in total can be found in the AoA, including votes on the rate of interest on SDRs or the determination of a remuneration rate under Article V(9)(a), or 85% for very important decisions (23 possible occasions in the AoA, such as voting on compulsory withdrawal of a Member, or amendments to the AoA).
sus before it comes to an official vote. The Executive Board, like the Board of Governors, is made up of representatives of (groups of) Member States. The Executive Directors are supposed to represent their appointing or electing states and take instructions from them. The fact that they work at the Fund, live in Washington, D.C. where the Fund is seated, and are paid their salaries by the Fund, leads to their being seen as less political than the members of the Board of Governors. However, they remain representatives of the countries and groups that elected them and are not independent experts or international civil servants.

The Managing Director and the Staff form the third pillar of the Fund’s three-tier structure. The Managing Director is selected by the Executive Board and is neither a Governor nor an Executive Director. He is chairman of the Executive Board, but without the right to vote. The Director is chief of the operating staff and conducts the ordinary business of the Fund, as well as the organization, appointment and dismissal of the Staff. According to Article XII(4)(c) AoA, both the Managing Director as well as the staff of the IMF owe their duty to the IMF and no other authority, and thus function independently from the influence of the Member States.

2.2. IMF Instruments

To perform its three tasks of performing surveillance, providing lending facilities and technical assistance, the IMF has several legal instruments. Apart from the Articles of Agreement themselves, the legal instruments include the by-laws, rules and regulations of the IMF, decisions, interpretations and recommendations by the Executive Board and the Board of Governors.

The by-laws of the IMF are adopted by the Board of Governors, meant as complementary to the AoA and binding upon the Member States under Article V AoA. The rules and regulations are supplements to the AoA and the by-laws and are not intended to replace them in any manner. They provide operating rules, procedures, regulations and interpretations as necessary and desirable to carry out the purposes and powers as contained in the AoA and by-laws.

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2 See IMF Rules and Regulations, Rule C-10: “The Chairman shall ordinarily ascertain the sense of the meeting in lieu of a formal vote. Any Executive Director may require a formal vote to be taken with votes cast as prescribed in Article XII, Section 3(i), or Article XXI(a)(ii).” One reason for the preference for decision-making by consensus is in order to ensure the possibility for all Members to effectively participate in the decision-making process. This goes in particular for developing countries, which hold about 30% of the voting power in the IMF (40% when including emerging market economies), as compared with developed countries having around 60% of the votes.
Decisions are taken either by the Board of Governors, by the Executive Board according to the voting rules as laid down in the AoA, or by consensus as is preferred according to the by-laws of the IMF.\textsuperscript{21} They are binding upon the Member States. One example of a decision is found in Article XXIX AoA, decision of interpretation. This article gives the Executive Board exclusive power to interpret the AoA, and if a Member does not agree with the interpretation it can ask for a final decision by a Committee of Interpretation of the Board of Governors. Interpretative decisions are also binding decisions.\textsuperscript{22}

Recommendations are not binding on the Member States. An example of a recommendation can be found in the principles for the guidance of members’ exchange rate policies under Article IV. By complying with these recommended guidelines a member is in compliance with its obligation to cooperate with the Fund under this Article, but non-compliance with the guidelines does not necessarily imply non-compliance with the obligation of cooperation. Cooperation can take other forms than those recommended by the Fund.

For those obligations that are binding on the IMF Member States, no hard enforcement mechanism exists. In fact, there are only a few options under the Articles for dealing with non-compliant Member States, options that do not include the existence of a dispute settlement system. The options are mentioned in the AoA in several different places, but amount to roughly the same idea: The Fund may declare the Member ineligible to use the general resources of the Fund, its voting rights may be suspended, and it may ultimately be required to withdraw from membership in the Fund.\textsuperscript{23} These options have rarely been used throughout the Fund’s history, as they are often considered too heavy a tool to address the non-compliance at issue.\textsuperscript{24} Another oft-heard argument for the lack of application

\textsuperscript{21} See previous footnote.

\textsuperscript{22} In December 2011, the total number of decisions taken by the IMF was 303, complemented by 15 resolutions by the Board of Governors and four interpretations under Article XXIX(a) AoA.

\textsuperscript{23} Article XXVI AoA. The Member State deemed to be in non-compliance is also given the opportunity to state its case, both orally and in writing. Although suspension of voting rights and the use of the fund’s resources are applied from time to time (e.g. in the case of Sudan, Somalia and Zimbabwe over the past years), there is only one example where a Member State was expelled: the expulsion of Czechoslovakia in 1954, when it refused to provide certain information to the Fund. It was readmitted in September 1990, and ceased to be a member in 1993 when it was succeeded by the Czech Republic and the Slovak Republic (see IMl website www.imf.org). A procedure for compulsory withdrawal following continued arrear in payments by Zimbabwe was started in 2003, but in the end did not lead to withdrawal.

\textsuperscript{24} See e.g. IMF (2003) \textit{Strengthening the Effectiveness of Article VIII, Section 5}, p. 9. For failure to pay obligations to the IMF (the most prevalent type of non-compliance), the preferred solution is the so-called rights approach, as explained in e.g. IMF (2004) \textit{Review of the Fund’s Strategy on Overdue Financial Obligations}. 
of enforcement measures is the fact that Member States are afraid to apply harsh measures to non-compliant peers, as they fear similar treatment in the future.25

As stated earlier, the IMF’s purposes can be classified in three categories: surveillance, financial assistance and financial advice. In fulfilling its third function of providing technical assistance, no binding obligations are produced for the Member States, since these usually take the form of recommendations. From Article V(2)(b) AoA it follows that when requesting technical assistance from the Fund, “Services under this subsection shall not impose any obligation on a member without its consent”.

In order to fulfill the other two functions, however, two mechanisms exist within the IMF that involve hard obligations for the Member States to comply with: a soft surveillance mechanism overseeing adherence to Article IV of the AoA, which falls under the IMF’s surveillance function26; and the hard compliance mechanisms that exist for the Balance of Payments Support Programs, which fall under its financial support function. The following sections discuss the functioning and effectiveness of these two basic mechanisms of the IMF.

3. ARTICLE IV SURVEILLANCE

Article IV(1) AoA articulates one general and four specific obligations for the Members of the IMF:

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 particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;


26 There are more specific obligations for the IMF Member States under the AoA. Most importantly, these include the general obligations under Article VIII regarding restrictions on current payments, discriminatory currency practices, the convertibility of foreign-held balances, and the furnishing of information to the Fund. Adherence to these (voluntarily accepted) obligations is also reviewed during the Article IV consultation process.
(iii) 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; and

(iv) follow exchange policies compatible with the undertakings under this Section.

This article thus contains two soft and two hard obligations. Soft as in: Members shall endeavor to direct their policies towards economic growth with price stability, and they shall seek to promote stability. Hard as in: Members shall avoid manipulation and they shall follow compatible exchange policies. In order to ensure compliance with these obligations, Article IV(3) provides for the possibility for the Fund to “exercise firm surveillance” over Member States’ exchange rate policies, and to adopt principles for the guidance of the Member States with respect to those exchange rate policies. The Member States in turn are obligated to provide the Fund with the information necessary for such surveillance. IMF surveillance has two components: Article IV(3) gives the Fund the responsibility to “oversee the international monetary system in order to ensure its effective operation” (multilateral surveillance), as well as to “oversee the compliance of each member with its obligations under Section 1 of this Article” (bilateral surveillance over members’ exchange arrangements). A description is given here of the functioning of the IMF’s Article IV consultations: the bilateral surveillance, followed by a brief overview of the Fund’s multilateral surveillance and an assessment of the changes introduced by the 2013 decision on integrating the two types of surveillance.

3.1. Bilateral Surveillance

Article IV of the IMF Articles of Agreement, “Obligations Regarding Exchange Arrangements”, states the following: “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”. This obligation is then further elaborated upon in the subsections of this Article, where three obligations for the Member States can be found:

1) The obligation to refrain from exchange rate manipulation,

2) The necessity to intervene on the exchange market to counter disorderly conditions, and
3) The necessity, when intervening, to take into account the interests of other members.

Bilateral surveillance refers to the Fund’s periodic consultations with the Member States to assess economic and financial developments in each Member’s economy: the Article IV consultations. Originally, the core of the IMF surveillance was macroeconomic, where analysis was focused on the choice of exchange rate and the consistency between the fiscal and monetary policy regimes. From the 1990s onward, however, IMF surveillance has slowly evolved to include financial sector issues. The 1990s financial crises taught the IMF the importance of the two-way relationship between the financial sector and macroeconomic stability. The Fund had not been able to identify the risks coming from the domestic financial sector in the Mexican and Asian crises, making it clear that it needed to develop its knowledge on financial sector issues – involving changes to its staff, whose knowledge had been mostly macroeconomic in nature – as well as its instruments to conduct surveillance in order to include financial sector issues. Most importantly, in 2007 the Executive Board adopted a decision on bilateral surveillance, which introduced the standard of external stability to assess Members’ domestic policies, thus taking into account the external effects of domestic exchange rate policies and introducing the idea of systemic stability.

The Article IV consultations take place roughly once every year. During a consultation, a group of IMF economists visits a country to assess its economic and financial developments as well as discuss the Member’s economic and financial policies with government and central bank officials. The aim of the mission is fact-finding as well as holding bilateral discussions with high-level officials. At the end of the mission, the team presents its concluding statement, on which the local officials can comment. Any difference in opinion needs to be reported on by the team to the IMF.

The findings are then presented to IMF management, followed by a staff country report, containing information on the economic situation of the reviewed country, policy recommendations, an account of the policy discussions as well as the final appraisal by the staff. One month later, the Executive Board discusses the report and multilateral discussion takes place. There are no pre-appointed reviewers, nor specific country delegation participants; all members

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28 Ibid., pp. 131-134.
can participate in the discussion. A summary of the views of the Executive Board is then sent to the government of the Member State under review. Three months after the consultations, the Fund issues a confidential report, containing non-binding conclusions on the Member’s exchange rate policy. Although the report itself is confidential, the Members have agreed to the publication of Public Information Notices (PINs), which summarize the views of the IMF staff and the Executive Board.\(^{31}\) Often, the report itself is also published on the IMF website.\(^{32}\)

In contrast with the peer review process in the OECD, there is no need to come to a consensus view on the report. Instead, the staff report is published unchanged, while a PIN is issued containing a summary account by the chair of the day the report was discussed, including the different views of the Executive Directors as aired during the board meeting. Since consensus is not required and the views of the Staff and the Executive Board are published separately, also detailing the views of the country under review, the IMF allows for more transparency in the process than the OECD, for instance.\(^{33}\)

The determinations and recommendations made in the IMF reports are of a soft nature and therefore cannot be followed up by ‘hard’ enforcement. As with the OECD and the TPRM, it is through the weight of the arguments, the quality of the assessment, the involvement to a certain extent of the national policy makers in the peer review process, as well as the peer pressure that ensues from the discussion and usually publication of the reports that a country might be persuaded to change its economic policy to bring it in line with IMF conclusions. There are some indications that especially the larger (more powerful) industrialized countries do not adhere to IMF conclusions when they do not agree with those opinions, in contrast to the smaller countries.\(^ {34}\) This is one of the reasons why over the past years, strong critiques have been heard regarding the role of the IMF with respect to global financial stability. If the IMF cannot force Member States to comply with its conclusions, then how can it guarantee its function as a forum for a stable global economy?

\(^{31}\) PINs are issued after consent of the relevant Member State only. As of July 2013, PINs have been integrated into the IMF’s Press Release Series: see http://www.imf.org/external/news/default.aspx?pn (last accessed July 2013).

\(^{32}\) For the country reports, see IMF website: http://www.imf.org/external/ns/cs.aspx?id=51 (last accessed July 2013).

\(^{33}\) Moschella (2011).

\(^{34}\) The richer, developed countries are less likely to need the Fund’s financial assistance, and their incentive to comply may thus be smaller than for those countries that are smaller, less rich and are more likely to need the IMF’s funds. For an analysis of the influence of bargaining power, see e.g. Lombardi, D. and N. Woods, ‘The politics of influence: An analysis of IMF surveillance’ (2008) 15 (5) Review of International Political Economy.
One example where criticism of the IMF has been especially harsh was in the light of China’s currency peg. For years China maintained a currency peg to the US dollar, leading the Renminbi to be (significantly) undervalued. Many believe the IMF should have condemned China’s exchange rate policy at that time, as it was argued that the currency peg and the ensuing undervaluation of the currency against the dollar could be seen as a form of currency manipulation, specifically prohibited by Article IV. The 2007 bilateral surveillance decision provided guidance on what defines currency manipulation; however, it remains extremely difficult to prove the existence of a manipulation situation. In fact the IMF never went further than stating the Chinese Renminbi was significantly undervalued.

As said before, the IMF has no hard enforcement mechanism – the options available to the Fund under Article XXVI are rarely applied, as they are considered inadequate in addressing the issue of non-compliance at hand, or too strong a measure to remedy the non-compliance. Rather, the IMF resorts to soft mechanisms of peer pressure and persuasion. Country officials in general regard the IMF’s recommendations and policy advice as useful, where especially “discussions with mission teams were usually candid, constructive, and of high quality, bringing useful and independent third-party views to the policy debate”. However, it was often deemed difficult to implement policy recommendations, as they were presented in a “laundry list of warnings, with no prioritization”, with the usual economist approach of “on the one hand (list of economic positives), followed by on the other hand (list of downside risks)”, where it was unclear how to respond to which risks with what prioritization.

Moreover, policy recommendations were often obvious, but contained no advice on how to implement them, while the Executive Board’s contribution in its Summings Up was usually seen as belated and superficial. In short, the con-

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35 From 1995 to 2005, China pegged its currency at slightly over eight yuan to the dollar. In 2005 China allowed its currency to appreciate relative to the dollar until July 2008, when it was again pegged at 6.8 yuan to the dollar (or more accurately, a managed float with a bandwidth of 0.5%). Since 2010, gradual appreciation through a managed float has been allowed again.


37 In the last Article IV Consultation available, from 2013, the Renminbi is seen as moderately undervalued by 5 to 10% (IMF (2013) IMF Country Report no. 13/211, People’s Republic of China, 2013 Article IV Consultation, p. 28).


39 Ibid.

40 Ibid., p. 35.
sultations and recommendations are seen to be of high quality, but the operationalization of the advice and recommendations is seen as difficult and unclear. Furthermore, Article IV Staff Reports do not show in how far previous policy advice has been followed up by the Member State under review, in contrast with for example the OECD Reports. This makes it difficult to evaluate to which extent the Article IV consultations have indeed had an effect on Member State policies.\footnote{More on this below in section 5: IMF Compliance.}

Another oft-heard comment on the Article IV consultations was its lack of systemic analysis, including spillover risks and externalities. Multilateral surveillance – the second responsibility of the IMF under Article IV discussed in the next section – has always been conducted separately from the actual Article IV consultations. Due to the financial crisis after 2007, a proposal has been adopted integrating the two types of surveillance into the \textit{Integrated Surveillance Decision} (ISD) of June 2012.\footnote{IMF (2012) \textit{Modernizing the Legal Framework for Surveillance - An Integrated Surveillance Decision}.}

3.2. Multilateral and Integrated Surveillance

Besides the bilateral version of surveillance, the IMF also reviews global and regional economic trends under its multilateral surveillance mechanism. The result are the semi-annual publications the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR).\footnote{The WEO and GFSR are the most important outputs of the multilateral surveillance process. Other processes and outputs of the multilateral surveillance processes include the vulnerability exercise, the Coordinating Group on Exchange Rate Issues, World Economic and Market Developments, and regional outlooks. The Fund has also introduced multilateral consultations (the first took place in 2006), where global economic imbalances are addressed and Member States voice their opinion on how this can be done as well as their own individual intentions to deal with the situation. For an evaluation of these processes, see IEO (2006) \textit{Evaluation Summary Multilateral Surveillance}.} The WEO is prepared twice a year to report on global economic developments, prospects and risks, as well as an analysis of selected policy issues. The report is published as a staff document, together with a Summing Up of the Executive Board after it discusses the report in their meeting. The GFSR is meant to identify vulnerabilities in the global financial system. It is also published as a staff document together with the Executive Board’s Summing Up. The WEO is seen as the intellectual foundation for much of the IMF’s other multilateral surveillance work.\footnote{Ibid., p. 15.}

Due to the onset of the global financial crisis, the Fund realized that a more systemic approach to surveillance was warranted. In the years that preceded the
crisis, the IMF had failed to recognize the risks to global financial stability and to demand action from policy makers. The IMF is not expected to predict a crisis, as crises are inherently unpredictable. However, it is expected to be able to identify risks and vulnerabilities in order to warn the Member States in order to prevent a possible crisis in the future. The IMF had not been able to “anticipate the crisis, its timing, or its magnitude, and, therefore could not have warned the membership”.\footnote{IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004-07.} In order to be better able to do so in the future, two important changes have been made to the surveillance system. On the one hand, IMF surveillance has been expanded to bring financial sector surveillance up to the same level as macroeconomic surveillance. On the other hand, bilateral surveillance has been reformed in order to include systemic analysis and spillover effects. It was felt that, although the two types of surveillance (bilateral and multilateral) are legally distinct, the two needed to be operationally integrated to enhance the effective functioning of the surveillance system. The ISD updates the 2007 surveillance decision by laying out a conceptual link between bilateral and multilateral surveillance, while including both types of surveillance in the Article IV consultations in order to provide the Fund with the opportunity to discuss the spillovers from Member State policies that affect global stability.\footnote{Modernizing the Legal Framework for Surveillance - An Integrated Surveillance Decision, pp. 2-3.}

An important distinction between bi- and multilateral surveillance is that under multilateral surveillance Member States are under no obligation to modify their economic policies in light of the views expressed by the Fund, whereas bilateral surveillance involves an assessment of substantive obligations. The inclusion of multilateral surveillance in the Article IV consultations therefore offers the opportunity to discuss the implications of a Member State’s policies, but the Fund may go no further than offer suggestions for alternatives to enhance the effective functioning of the international monetary system.\footnote{Ibid., p. 8.} Hence, the ISD speaks of “principles” in the case of bilateral surveillance, and “guidance” for multilateral surveillance. The Article IV consultations now include a discussion with members of the “impact of their policies on the operation of the international monetary system”,\footnote{§26, ISD.} and the option for multilateral consultations between the Fund and Member States when an issue has arisen that requires collaboration among members.\footnote{§31-33 ISD.}
Given the short period that has lapsed since the introduction of the ISD, it remains to be seen what the effects of the enhancements made to the surveillance system will be. However, the Article IV reports will remain the product of a peer review process, and thus part of a soft compliance mechanism – perhaps to an even greater extent since the integration of the even softer multilateral surveillance element in the review process. One possible influence on the adherence of the Member States to the recommendations made under the Article IV consultations can be identified in the existence of the Balance of Payments Support system. The next section briefly explains the workings of that particular system.

4. BALANCE OF PAYMENTS SUPPORT

One essential element in attaining the IMF’s goal of financial global stability is the Fund’s financial support function. One of the core responsibilities of the IMF is to provide loans to countries with balance of payments problems, since a country in severe financial trouble poses not only problems for itself, but for the international financial system as well. The possibility for providing such loans is provided in Article I of the Articles of Agreement, the Purposes of the IMF, sub (v): “To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, ...”.

A Member State can request financial assistance when it has a balance of payments need, meaning when it cannot find sufficient financing to meet its international payments. IMF resources are usually made available under the so-called lending arrangements, where certain conditions may be stipulated to resolve the Member State’s balance of payments problems. These conditions relate to macro-economic variables and structural measures within the Fund’s core areas of responsibility, as well as variables and measures that are outside the Fund’s core areas of responsibility that require more detailed explanation of their critical importance in the program designed specifically for a certain Member.

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51 Such as privatization and public enterprise policies; labor market policies; transparency and disclosure policies; poverty-reduction and social safety-net policies; pension policies; corporate governance policies (including anti-corruption measures); and environmental policies (ibid, pp. 2-3; and Goldstein, M., ‘IMF Structural Programs’ NBER Conference on Economic and Financial Crises in Emerging Market Economies <http://www.iie.com/publications/papers/goldstein1000.pdf>, p. 4).
country must agree to implement these conditions in order to qualify for the loans.

The Member State then formulates the specific economic policy program contained in the arrangement in consultation with the IMF, which is subsequently presented to the Executive Board in the so-called “Letter of Intent”. Once the Executive Board approves the arrangement, the Fund’s resources are released in installments throughout the implementation of the program.\textsuperscript{52} The Balance of Payments programs can be classified as hard compliance mechanisms, since non-compliance with the undertakings in the Letters of Intent entails non-disbursement of the Fund’s resources. However, the IMF itself has always been careful not to label the commitments in the Letters of Intent and related documents as legally binding obligations. The suspension of the right to draw funds under the arrangements is never characterized as sanctioning or punishment by the Fund.\textsuperscript{53} The failure to repay the loans to the Fund, however, after completion of the program and passing of the repayment deadline, does constitute a breach of a legal obligation. In that case sanctions may be imposed, with the compulsory withdrawal of the Member State as the ultimate sanction.\textsuperscript{54}

Several different types of loan arrangements exist, such as concessional, zero percent interest loan facilities,\textsuperscript{55} as well as non-concessional, market interest rate loans.\textsuperscript{56} The intensity of use of the programs has fluctuated throughout the years, influenced by the onset of several different crises. Lending by the IMF has increased sharply again since the start of the 2008 global financial crisis. Currently, there are programs involving 50 Member States amounting to commitments of more than $325 billion since the start of the crisis.\textsuperscript{57}

The effectiveness of the Balance of Payments programs and the accompanying conditionality has been strongly criticized over the years, including concerns regarding political influence over conditionality,\textsuperscript{58} the ineffectiveness or

\begin{itemize}
\item \textsuperscript{52} See IMF website: http://www.imf.org/external/about/lending.htm (last accessed July 2013).
\item \textsuperscript{53} Lowenfeld (2008), pp. 663-664.
\item \textsuperscript{54} Ibid.
\item \textsuperscript{55} Such as the Extended Credit Facility, the Standby Credit Facility or the Rapid Credit Facility, meant for low-income countries.
\item \textsuperscript{56} Such as the Stand-By Arrangements, the Flexible Credit Line, the Precautionary and Liquidity Line, or the Extended Fund Facility.
\item \textsuperscript{57} See IMF website: http://www.imf.org/external/about/lending.htm (last accessed July 2013).
\item \textsuperscript{58} It has for example been argued that politically strong countries face weaker conditionality (see e.g. Dreher, A. et al., ‘Politics and IMF Conditionality’ (2013) 338 KOF Working Papers). However, for a counterargument see e.g. Stone, R.W., ‘The Scope of IMF Conditionality’ (2008) 62 International Organization.
\end{itemize}
even adverse effects of the program conditions,\textsuperscript{59} or the connection between the Balance of Payments loans and the Article IV consultations. The Article IV consultations are often used as a precursor for the conditions laid on the Member States under the Balance of Payments Programs. The IMF guidelines for Conditionality state quite clearly: “The member’s past performance in implementing economic and financial policies will be taken into account as one factor affecting conditionality”.\textsuperscript{60} The fact that the soft Article IV consultations and their conclusions are linked to the hard balance of payments loans indicates that it may not be peer pressure alone that induces Members’ adherence to the IMF’s conclusions. Since the richer Member States are less likely to one day need to avail themselves of the Fund’s lending facilities, the effect of this linkage is most likely strongest for the less-developed, low-income countries. In how far this has an effect in general on compliance with the IMF’s Article IV consultations will be analyzed in the next section.

5. IMF COMPLIANCE

Compliance with IMF rules can be examined in two contexts. The first is the context of compliance with IMF rules as such, meaning the IMF Articles of Agreement, while the second refers to compliance with conditions as laid out in the IMF Balance of Payments lending programs. Since compliance with this conditionality is firstly program- and Member-specific and secondly governed by the Fund’s Articles of Agreement, it is more useful to investigate what is meant by compliance in general with the Articles of Agreement by the IMF Members.

The IMF defines compliance in a manner similar to the EU or the WTO: It means fulfillment of a Member’s obligations under the IMF Articles of Agreement.\textsuperscript{61} The AoA contain a limited amount of legal obligations, of which many are of a soft nature and not enforceable in court. It was seen that enforcement options under the AoA are indeed very limited and have been seldom applied. Moreover, it is debatable in how far these existing sanctions may influence the larger and richer members of the Fund in particular, who are least likely to be


\textsuperscript{61} As seen in Article XXVI section 2(a) on compulsory withdrawal: “If a member fails to fulfill any of its obligations under this Agreement, the Fund may declare the member ineligible to use the general resources of the Fund”.

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benefit from eligibility to use the resources of the Fund. In fact, they are more likely to be the greater contributors to the resources of the Fund. On the other hand, as enforcement by the Fund has rarely been called for over the course of its existence, it could also be that non-compliance is not actually a problem.

In the case of the WTO it was shown that the litigating parties are the Masters of the Dispute and the ones deciding whether there is cause to start and continue legal proceedings or not. In later stages the panels and the AB ultimately decide whether a Member State’s measures are in compliance with the obligations under WTO rules. In the case of the IMF, however, there is no dispute settlement system, and thus no direct possibility for redress by an IMF member. An explanation for this difference between the systems is that when a Member does not comply with its obligations under WTO rules, the rights of other Member States are somehow directly or indirectly hurt. Under the IMF rules, on the other hand, obligations are created that are owed to the institution as such, rather than to its Member States. The rules on financial issues such as exchange restrictions in the IMF Articles are meant to protect the integrity of the entire financial system, as well as the possibility for Member States to call upon financial support by the Fund, rather than protecting the rights of individual Member States. The Fund’s articles do require that a Member State remove all restrictions that affect other members, but regardless of whether other members have issued a complaint regarding these restrictions. Any Executive Director is required to bring instances of breach of obligation to the Executive Board. Ultimately, the Board of Governors would decide on issues such as compulsory withdrawal if non-compliance indeed led to that stage.

The case is different for compliance with the Balance of Payments programs. In those cases not only the organization as a whole, but – through non-adherence to the conditions underlying the programs and the possibility for borrowing funds – other Member States are also indirectly affected. Stronger enforcement measures are therefore called for and applied in those programs.

Three elements are important when assessing the effectiveness of the IMF peer review process. First: Member State involvement in the process is limited to providing information to the Fund during the peer review and participating in the meetings and discussions regarding the peer review reports. Member State views, however, are published separately from the reports themselves. This cre-

63 E.g. Article IV, section 1(iii): each member shall “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”.

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ates less of a feeling of “ownership”, and could therefore to some extent influence the level of acceptance of IMF recommendations in the Member States. On the other hand, this could also possibly make the conclusions in the reports more objective, giving them more force of quality, for example.

Second: Although formulated as recommendations or guidelines, the reviews include an assessment of substantive obligations. In that light, even though the recommendations themselves are not legally enforceable, the analysis and conclusions of the report can be used as a basis for applying enforcement measures at one point in time. For example, if during one of the Article IV consultations in the past the conclusion had been drawn that China’s exchange rate policy could at that time have been seen as currency manipulation, this determination could have been the basis of the application of enforcement measures. In contrast with the TPRM therefore, there is a connection between the peer review process and enforcement measures. However, given the very weak enforcement possibilities under the IMF, the connection is rarely made.

Third: As with the OECD country reviews as well as under the TPRM, Member States are obligated to provide the organization with information that is relevant for the peer review process. For the IMF, there has been at least one instance where enforcement measures were taken against a Member State that refused to provide the information requested by the organization. This would be impossible under OECD or TPRM rules.

6. THE EFFECTIVENESS OF IMF COMPLIANCE MECHANISMS

Now that the workings and character of the two compliance mechanisms of the IMF have been outlined, an analysis of their effectiveness may be attempted by following the steps formulated in chapter 2.1: A: the goal, B: the compliance, C: the effectiveness. The final chapter will address the last step D: the comparison. The analysis in the current chapter focuses on the Article IV consultations only, but takes into account the possible effect of the existence of the Balance of Payments programs.

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64 In case of Czechoslovakia, see supra fn 23.
65 Since the OECD does not provide for hard enforcement possibilities at all, while the TPRM does not fall under the agreements covered by the DSU, and enforcement is thus not possible.
6.1. The Goal of the IMF Compliance Procedures

The purpose of the Article IV consultations is to “oversee the compliance of each member with its obligations” under Article IV. Today this includes both bilateral as well as multilateral surveillance, keeping in mind that under multilateral surveillance the Member States are under no obligation to modify their policies in light of IMF suggestions.

6.2. Compliance

According to the compliance model developed in this study, four compliance-related questions now need to be asked regarding the Member State obligations, the character of these obligations, the definition of non-compliance and the causes of non-compliant behavior.

Expected behavior
The first question regards the obligations the Member States are expected to adhere to. The Article IV consultations seek adherence to the obligations as stated in that particular article: 1. to collaborate with the Fund with regard to orderly exchange arrangements and a stable system of exchange rates; 2. to direct policies toward fostering orderly economic growth; 3. to promote stability; 4. to avoid manipulating exchange rates or the international monetary system; and 5. to follow exchange policies compatible with the undertakings under this Section.

Hard or soft obligations
The second question deals with the character of the underlying obligations. Apart from the general obligation of collaboration with the Fund, Article IV contains two softer obligations (Members shall endeavor to direct its policies towards economic growth with price stability, and they shall seek to promote stability), and two hard ones (Members shall avoid manipulation and they shall follow compatible exchange policies). Moreover, Member States are obligated to provide the necessary information to the Fund for it to be able to exercise the firm surveillance as mentioned in Article IV.

Actual behavior given the element of discretion
The third question goes to the core of the compliance problem: When is an IMF Member State non-compliant, and who makes this determination? Ultimately, the Executive Board determines whether a Member State complies with IMF obli-
gations or not, since it is that body which adopts the Article IV reports. The Member State under review is able to present its views on the report, but in contrast to the OECD and similarly to the TPRM peer review processes, these views are not taken into account in the final draft of the report, but rather published separately. The reports thus reflect the views of the Fund only (of its staff as adopted by the Executive Board), although they are based upon information provided by the Member State.

**Intentional or non-intentional non-compliance**

When the compliance pyramid is applied to IMF compliance mechanisms, three of the four steps can be recognized, with a strong focus on the bottom steps and weak enforcement possibilities at the top. As with the OECD and the TPRM, prevention and monitoring form the core of the peer review system. Working through clarification of the rules, information dissemination, transparency and ongoing discussion, the aim of the system is to prevent non-compliance and monitor ongoing trends. A legal system is absent in the IMF. When there is a dispute between Member States, or between Member States and the organization, recourse can be taken to the Board of Governors when the dispute regards to the interpretation of the AoA. When the Fund is of the opinion that a Member State “is using the general resources of the Fund contrary to the purposes of the Fund”, a report is sent to the Member State. At that time the Fund may already limit the availability of the resources to the Member State, and if no or an unsatisfactory reply is received, a continuation of limitation or even a declaration of ineligibility may be declared. The same protocol is followed regarding other types of infringements.66 Some options exist, therefore, in case of disputes, but do not amount to a legal or dispute settlement system of the kind encountered in other international organizations such as the EU or the WTO.

*Sanctions* as such also do not exist in the IMF. Enforcement measures, intended to induce compliance with the obligations under the AoA, do exist in the shape of restricting or ending eligibility to use the Fund’s resources, or eventually even compulsory withdrawal of membership. However, as was pointed out, these are rarely applied, as they are considered either inadequate for some types of infringements, or too strong for others. Furthermore, some Member States will feel the consequences less strongly than others. The richer, more developed Member States will not have the same need of the Fund’s resources as poorer, less developed economies. Summing up, then, it is evident that the enforcement

66 See Article V(5), or VI(1)a AoA for example.
side of the IMF surveillance mechanism as represented by the top two steps of the pyramid is virtually non-existent or very weak to say the least.

The Article IV consultations target both intentional as well as non-intentional non-compliance, while taking into account the reasons for non-compliant behavior. Article IV states: “These principles [for the guidance of all members with respect to their exchange rate policies] 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”. As with the OECD, the IMF thus aims to change the ideas and the mindset of the countries under review, in order for them to follow the advice put to them by the organization. A strict enforcement system does not fit in with this aim. However, when persistent non-compliance occurs, and when it is obviously intentional non-compliance and persists after due warning from the Fund, the available enforcement measures can be applied. And so both intentional and non-intentional compliance are targeted by the Article IV consultations.

6.3. Conclusions on Effectiveness

The effectiveness of the Article IV consultations is debatable. On the one hand, the quality and usefulness of the reports are praised. On the other hand, it was shown that the Member States often find it difficult to implement the recommendations made by the Fund. The effectiveness of the system is influenced by several different elements. First, there is less Member State involvement throughout the process than was seen in the OECD peer review process, for example. This creates less of a feeling of “ownership” of the proposed recommendations than possibly would be the case if Member State views were taken into account in the final report. It now potentially feels more judgmental, and therefore less likely to be accepted by the Member States. On the other hand, the quality of the reports is deemed very high, while a certain degree of objectiveness is introduced by not including Member State opinions, but rather publishing them separately.

Second, the Fund recommendations under Article IV are potentially discriminatory towards the poorer, developing countries. As compliance with the recommendations is seen as a precursor to the Balance of Payments programs, those countries that expect to need the programs are more inclined to follow Article IV recommendations than those that do not expect to need them. Since countries in financial difficulty are usually the poorer, less developed economies, the peer review programs probably will work more effectively for those Member States due to the existence of the Balance of Payments Programs.
Third, there is no legal system which can “back up”, so to speak, the recommendations made by the Fund. Additionally, the reports do not check the extent to which previous recommendations have been followed up. Combined with a lack of hard enforcement measures, this can be a genuine drawback of the system. Member States may well feel less inclined to follow the recommendations when they know there will be no real consequences to non-compliance. On the other hand, the willingness to share information and transparency may be greater under the IMF consultations than it could be if a legal system were in place – as was observed with the WTO TPRM, for example. However, given the fact that the IMF peer reviews can already be backed up to a certain extent by (albeit weak) enforcement measures, the influence of a hard legal system may have the effect of either decreasing transparency and thereby the effectiveness of the soft mechanism (as with the TPRM), or increased compliance through the soft mechanism precisely due to its existence, knowing the consequences will be felt when the legal system is applied at a later stage (as with the EU). Then again, Article IV contains both hard and soft obligations. In that respect, the interplay between a hard legal system and a soft peer review mechanism may have more beneficial effects than it has in an organization where only hard obligations are concerned, such as the WTO.

7. CONCLUSIONS

The IMF has a compliance system that oversees adherence to the obligations under one specific legal article: Article IV of the Articles of Agreement. This article contains both hard and soft obligations, but surveillance is performed through a soft peer review mechanism only. This system has several elements that can potentially hinder its effective functioning. These elements concern Member State involvement throughout the process, a bias towards more developed economies as well as the lack of a legal system reinforcing the functioning of the soft mechanism. The peer review mechanism of the IMF targets both soft and hard obligations under Article IV. The recommendations that follow the peer reviews are not legally binding. The imperfect working of the system may be explained precisely by this mismatch between hard underlying obligations and a soft compliance mechanism without the existence of an interacting legal back-up system. In the next section, a comparison is made of the findings for the mechanisms discussed in this chapter on the IMF and the previous chapters on the WTO and OECD. This comparative analysis shows how the character of the underlying obligations influences the need for a particular type of compliance mechanism.