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Interpreting and Amending the IMF Mandate, 1944–2011

James M. Boughton

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Prepared by James M. Boughton*

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* Consultant, Independent Evaluation Office of the IMF.

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ABBREVIATIONS

C20	Committee of Twenty (IMF Governors)
CFF	Compensatory Financing Facility
FSAP	Financial Stability Assessment Program
G5	Group of Five (large industrial countries)
G7	Group of Seven (large industrial countries)
G10	Group of Ten (large industrial countries)
G20	Group of Twenty (advanced and emerging market economies)
G24	Group of Twenty-four (developing countries)
GAB	General Arrangements to Borrow
IMFC	International Monetary and Financial Committee
OTM	Office of Technical Assistance Management (IMF, merged with IMF Institute to create a new department, Institute for Capacity Development)
SBA	Stand-By Arrangement
SDRM	Sovereign Debt Restructuring Mechanism
STF	Systemic Transformation Facility
TA	Technical Assistance
TAS	Technical Assistance Secretariat

EXECUTIVE SUMMARY

The Articles of Agreement of the IMF, as adopted in 1944, created a mandate for the new organization to "promote international monetary cooperation" and to "give confidence to members by making the Fund's resources [temporarily] available to them under adequate safeguards," among other purposes. After the world economy evolved and the Fund gained experience, the Articles were amended in 1968 with the creation of the SDR and then in 1978 to codify surveillance, lending, and technical assistance (TA) as distinct strands of the mandate. Article IV was rewritten in 1978 in response to the collapse of the Bretton Woods par value system, to establish a mandate to conduct surveillance over the international monetary system and over a new code of conduct regarding exchange rate policies. Article V, which governs financial transactions, was expanded to define a role for the Fund "to perform financial and technical services" for members on a voluntary basis.

The surveillance mandate was codified in 1978 to help members conduct stable exchange rate policies in whatever manner they chose: maintain fixed exchange rates sustainably, manage exchange rates consistently with market conditions, or allow exchange rates to float freely without giving rise to destabilizing conditions. The Fund responded to the complexity of that task by adopting policy decisions and issuing guidance notes for the staff to follow. In practice, the evolution of surveillance centered on an expanding interpretation to include domains such as the quality of economic governance, multilateral discussions, and coverage of financial sector stability. The main Executive Board decision on surveillance was adopted in 1977, shortly before the amended Articles took effect. Although the decision was widely regarded as too general and vague, it was not altered substantively until 2007. The sticking point was a reluctance to define the extent to which members' obligations under Article IV covered actions other than those that were enacted "for balance of payments purposes." The 2007 decision moved policy cautiously in that direction.

Interpretation of the lending mandate depends importantly on the phrase "under adequate safeguards" in Article I. After just five years of limited experience with lending, the Fund codified the practice of lending through the 1952 Rooth Plan, which provided for Stand-By Arrangements subject to agreements on policy conditions as a "safeguard." Subsequent interpretations of the lending mandate have focused on the types and sizes of loans and on the scope of conditionality. Guidelines issued in 1968 and 1979 aimed to place limits on the number and range of conditions, but practical considerations nonetheless led to an increasing complexity of program design. A comprehensive review in 2002 was completed with more effective guidelines designed to promote greater cooperation with members and a more parsimonious application aimed at limiting conditions to those deemed to be "of *critical importance* for achieving the goals of the member's program or for monitoring its implementation," a concept referred to as "macrocriticality."

The TA mandate originated with the 1978 amendments to the Articles to formalize practices that the Fund had naturally begun carrying out from the beginning of its existence. Under this mandate, the main limitation on the expansion of TA was budgetary, as demand for assistance (which generally has been provided free of charge) continued to grow. The occasional influx of new members with great needs for assistance—newly independent developing countries in the 1960s and 1970s and transition countries in the 1990s—added to the financial and staffing pressures and induced the Fund to take alleviating measures. After the millennium, the Fund enacted new policies aimed at aligning TA more closely with its surveillance and lending activities. By 2011, the stage was set for a more specific reorientation toward linking TA to a strengthening of capacity development in recipient countries.

I. INTRODUCTION

1. **The interpretation and application of the Fund's mandate has evolved, and extended, since the approval of the Articles of Agreement in Bretton Woods**. The fundamental mandate for operations of the International Monetary Fund was embodied in the Articles of Agreement as drafted and approved at the Monetary and Financial Conference in Bretton Woods, New Hampshire (United States) in July 1944. The Articles established the IMF as an intergovernmental agency with powers to help its member countries stabilize and develop their economies through collaboration on international monetary issues, aided as necessary by short-term lending. The interpretation of how that mandate applies in practice has evolved, and the mandate itself has been extended through amendments to the Articles.[1] This paper reviews that evolution, focusing on three general categories of operations: surveillance, lending, and capacity development.

2. **The paper is organized as follows.** The paper begins with a summary of the influences on the original text of the IMF mandate. It follows with an overview of the principal changes that were introduced, up to 2011 (that is, throughout the history prior to the period covered by the main evaluation paper). The bulk of the paper provides more background on how the mandates for the Fund's three roles evolved: surveillance, covered since 1978 primarily in Article IV; use of Fund resources (lending), covered primarily in Article V; and technical assistance (TA), covered since 1978 in Article V, Section 2(b). Source materials include many internal documents, the series of official histories, the author's own prior research while writing two of those histories, books and articles by external analysts, and interviews with senior IMF officials.

II. HOW THE MANDATE EVOLVED

3. **The Articles accorded the Fund substantial powers to interpret the mandate, introduce new policies, and amend the document as necessary.** This built-in flexibility reflected the great uncertainty about how the world economy would evolve after the war and how member countries might call on the Fund to help them cope with new developments. The original text of the Articles derived primarily from a plan formulated in the United States Treasury, known informally as the White Plan, after its principal author, Harry Dexter White. The first full draft of the White Plan was circulated in April 1942, and it underwent numerous revisions in response to comments from other U.S. agencies and from other countries that were allied with the United States in World War II. Inputs from officials in the United Kingdom, especially the lead

[1] To simplify and clarify the analysis, this paper distinguishes between the textual mandate expressed in the Articles of Agreement and interpretations of that text as expressed in policy decisions taken by the IMF. The Fund itself has described the mandate more generally as "originating" in the Articles and including interpretations aimed at producing a "shared understanding" of the text. See IMF (2010b), p. 2. The legal framework is discussed in IMF (2010c). For a discussion of how the IMF mandate relates to international law and the mandates of the United Nations and other international organizations, see Hagan (2021).

British negotiator, John Maynard Keynes, were particularly important. Final details were worked out during the three-week Bretton Woods conference.[2]

4. **Multiple and diverse actors have had important roles in the formulation, evolution, and interpretation of the mandate (Box 1).** On a formal level, the Board of Governors, the Executive Directors, and the Managing Director—as Chair of the Executive Board and head of the staff—all have defined roles and responsibilities. In a less well defined but just as important process, the IMF is governed informally as an agent of its membership. Member countries exercise control and influence both through formal channels and through informal means. Informal governance can be exercised through personal influence such as conversations with the Managing Director, but more often is exercised through meetings of country groups outside the official bodies of the Fund.

Box 1. Timeline of the Evolution of the IMF's Mandate: Governance

1946	Governance of the newly established IMF is led by the Board of Governors (meeting annually), the Executive Board (meeting in continuous session), and the Managing Director (as Chair of the Executive Board and head of the staff).
1961	The Group of Ten (G10) central banks of industrial countries form as an external body influencing IMF policy informally, including through its funding of and control over the General Arrangements to Borrow (GAB).
1971	Developing countries form the Group of Twenty-Four (G24) as a counterpart to the G10.
1972–74	The Committee of Twenty (C20) is established as the first official committee of IMF Governors.
1973	Finance ministers and central bank governors of the five largest industrial economies begin meeting as the Group of Five (G5).
1974–99	The Interim Committee is established as the temporary successor to the C20, pending the planned establishment of the Council.
1976	Heads of state and government of the seven largest industrial economies begin holding annual summit meetings as the Group of Seven (G7) and issuing communiqués that include policy advice for the IMF.
1987	At the ministerial level, the G5 expands to the G7 to match the configuration of summit meetings.
1999	The International Monetary and Financial Committee (IMFC) is established as the successor to the Interim Committee.
1999	Industrial and emerging market countries form the Group of Twenty (G20) at the ministerial level.
2008	Heads of state and government of the G20 begin holding annual summit meetings.

Source: Author's elaboration.

5. **This informal process reflects an ongoing tension between a desire for multilateralism and universalism and the necessity of leadership from a subset of stakeholders.** As the founders of the IMF acknowledged in the planning for the 1944 Bretton Woods conference, if all countries are to participate willingly in a multilateral enterprise, they all must have a reasonable and proportional share of voting power and influence. For a multilateral enterprise to succeed, it must have effective leadership. This natural tension has led to an evolution in IMF governance in response to evolving circumstances in the global economy.

[2] See Horsefield (1969), Vol. 3, for the text of the original Articles; drafts of the White Plan and the competing Keynes Plan; other plans submitted by the Canadian and French authorities and by an official of the Federal Reserve Bank of New York; and related official documents. For analysis of the negotiations and the reasons for the dominance of the U.S. over the British plan, see Boughton (2002, 2021).

6. **Initially, the United States and later the Group of Ten (G10) provided leadership in guiding the evolution of IMF policies.** At the outset, the United States provided the essential leadership because it was the Fund's only creditor, it held some three-quarters of the world's monetary gold stock, and it had the only reserve currency convertible to gold. By the end of the 1950s, however, the spreading recovery from the devastation of World War II had eroded much of that dominance. In recognition of the need for more diverse leadership, in 1961 the central banks of the most advanced economies constituted themselves as the G10. This G10 served to coordinate internal operations such as currency swap lines among their central banks and policies governing conversion between their currencies and gold (known as the "gold pool"), but they also engaged directly with the IMF by establishing the General Arrangements to Borrow (GAB). Through the GAB, the Fund could borrow from the G10 and use the proceeds to lend to any member of the G10 with an external financing problem. The G10 (which also met at a high level with finance ministers together with central bank governors and with similar representation at the deputies' level) thus assumed an implicit leadership role in guiding the evolution of IMF financial policies.

7. **When actions failed to stem the pressures on the Bretton Woods system of par-value exchange rates, it became apparent that the G10 was too narrow a group to provide the leadership that the IMF and the international financial system needed.** By the late 1960s, the combination of rapid world economic growth and fixed exchange rates was leading to a demand for official currency reserves that outpaced the supply from a relatively stagnant stock of monetary gold and an insufficient growth in the international supply of U.S. dollars. The G10 responded by tightening policies regarding the gold pool, by discussing the creation of an international currency for use within its membership, and eventually by holding a meeting in December 1971 at the Smithsonian Institution in Washington, DC, to organize a major realignment of G10 currencies. However, it became apparent that this group was not enough to lead the IMF and the international financial system.

8. **The crucible for expanding the scope of Fund leadership was a series of discussions of options for supplementing dollar and gold reserves with a new international reserve asset.** When G10 officials initially proposed creating an asset for use only by themselves, other IMF members (principally developing countries) objected and argued for an asset that would be available for the full membership. That view received an unexpected but welcome boost from the U.S. government, which favored it to reduce pressure on its own gold reserves. Leadership then came from the IMF Managing Director, Pierre-Paul Schweitzer, who argued forcefully for what soon became the Special Drawing Right (SDR), popularly known at the time as "paper gold."

9. **After the creation of the SDR, leadership for systemic reform thus was broadened from the G10 to include developing countries with equal standing, with the creation of the Committee of Twenty (C20).** The creation of the SDR in 1969 via the First Amendment of the Articles was followed two years later by the G10 Smithsonian Agreement, which in turn initiated a work program to reconstruct the international financial system without the dollar-gold anchor

that had underpinned the Bretton Woods system. After lengthy negotiations, the G10 agreed to a proposal that originated from the Fund (especially owing to interventions by Mr. Schweitzer) to establish a committee of Fund Governors based on the structure of the Executive Board. That is, the committee would have 20 members drawn from the 5 countries entitled to appoint Executive Directors and the 15 constituencies that elected directors. This C20 was enjoined to recommend a reformulation of the system by consensus rather than by weighted voting.

10. **The IMFC, previously known as the Interim Committee, had its origins in the C20.** Although the C20 failed in its goal of re-establishing a system of stable exchange rates, it did succeed in proposing amendments to the Articles that it hoped would lead to the more modest goal of establishing a "stable system." The Second Amendment, which established a formal surveillance function for the IMF, took effect in 1978. The process of negotiating the amendment within the C20 also established a permanent top-level governance structure for the IMF in the form of a committee of Governors. The C20 was succeeded by the Interim Committee in 1974 and by the International Monetary and Financial Committee (IMFC) in 1999.

11. **While the G10 provided informal leadership for the evolution of the Fund mandate under both the original Bretton Woods system and the revamped system after the Second Amendment, other informal groups arose in response to evolving circumstances.** The first such group, formed in 1971, was the Group of Twenty-Four developing countries (G24). Although the G24 has never achieved a comparable level of influence in IMF deliberations to that of the G10, it has from time to time provided an important counterweight to the views of the large industrial countries.[3] Smaller groups of advanced economies also began meeting at ministerial and deputies levels to discuss international financial policy issues and the role of the IMF: first as the Group of Five (G5) from 1973 and later as the Group of Seven (G7) from 1987.[4]

12. **The most substantial revision of this informal structure came in 1999 with the establishment of the G20 at the level of finance ministers.** By that time, the growth of several large emerging market countries, including notably those that became known as the BRICS (Brazil, Russia, India, China, and South Africa), had diminished the economic dominance of the G7. To give those and other rapidly growing countries a greater voice in steering the work of the IMF and other multilateral agencies, leaders in a number of G10 countries agreed to meet with them regularly in a larger forum. Formally, governance of the IMF has resided since 1999 in the IMFC. Informally, the G20 emerged as the primary steering committee and influence over the IMFC. Because the large developing country members of the G24 are also members of the G20, the role of the G24 as a counterweight to the steering committee was compromised, and the voice of

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[3] See, for example, Crockett and Goldstein (1987) and Boughton (2017).

[4] The G7—Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States—met at the summit level starting in 1976. The expansion of the G5 (which excluded Canada and Italy) to the G7 finance officials was designed in part to conform with the pre-existing summit grouping. From 1998 to 2014, the G7 was reconstituted as the G8 with the inclusion of Russia.

small developing countries was diminished.[5] In response to the Global Financial Crisis (GFC), the G20 strengthened its own governance in 2008 by initiating annual summits at the level of heads of state and government.

III. EVOLUTION OF THE SURVEILLANCE MANDATE

13. **Although the IMF did not introduce the term "surveillance" into its lexicon until the 1970s, modern practice evolved naturally from the more general language in the original Articles.** Article I lists the first purpose of the Fund as to "promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." The interpretation of that mandate, however, was initially much more limited than it is today (Box 2).

Box 2. Timeline of the Evolution of the IMF's Mandate: Surveillance

1942–44	Negotiations for Bretton Woods establish an obligation to oversee the establishment of currency convertibility for current transactions.
1946	Fund operations begin; the Executive Board devises procedures for consulting with members on the transition to convertibility.
1952	Following the completion of a five-year transition period, consultations begin with countries that are still operating under Article XIV.
1960	The Executive Board approves a decision to begin holding regular consultations with countries that have already agreed to abide by the convertibility rules under Article VIII.
1961	Voluntary consultations begin with a few Article VIII countries, starting with the United Kingdom.
1973	Following the collapse of the Bretton Woods system of par-value exchange rates, the Fund begins discussing new terms for consultations.
1974	The word "surveillance" first appears in an official IMF document.
1977	The Executive Board issues a Decision establishing policies and procedures for surveillance.
1978	The Second Amendment to the Articles establishes an obligation for the IMF to exercise "firm surveillance over the exchange rate policies of members."
1978–2007	The Fund holds periodic consultations with all members under the terms of the 1977 decision, and it reviews the decision periodically without adopting any major changes.
1991	The Executive Board issues a guidance note for staff to assess relevant structural policies in Article IV consultations.
1996	The Interim Committee defines a "common strategy" for sound economic policies in the document, *Partnership for Sustainable Global Growth*.
1996	The Executive Board directs the staff to incorporate assessments of the soundness of banking systems into Article IV consultations.
1997	The Executive Board amends the 1977 decision to add sustainability of capital flows as a component of the Fund's assessment of members' policies.
1997	The Executive Board issues a guidance note directing the staff to consider governance issues in Article IV consultations as well as in program development.
2007	The Executive Board approves a new decision on bilateral surveillance, replacing the 1977 decision.

Source: Author's elaboration.

[5] The exclusion of small countries was alleviated in September 2023 by the addition of the 55-country African Union as a permanent member of the G20. See the Leaders' Declaration at http://www.g20.utoronto.ca/2023/230909-declaration.html.

1952–73: Consultations Under Articles VIII and XIV

14. **Aside from general collaboration through the regular meetings of the Executive Board, the mandate for bilateral consultations was enunciated in Article XIV.** That Article allows member countries temporarily (albeit with no end date) to retain, subject to certain constraints, exchange restrictions that otherwise are prohibited in Article VIII. Specifically, any member that continued to maintain exchange restrictions on the making of payments and transfers for current international transactions or "discriminatory currency arrangements or multiple currency practices" after the first five years of Fund operations was required to "consult the Fund as to their further retention" (Article XIV, Section 4). To carry out that function, from 1952 onward, the Fund conducted periodic consultations with each "Article XIV country" regarding steps being taken or considered by the country to facilitate the elimination of such restrictions and acceptance of the requirements of Article VIII on avoidance of discriminatory practices or limits on currency convertibility for current transactions.[6]

15. **The decision to hold "Article VIII consultations" raised issues concerning the mandate, because it was not explicitly mentioned in the Articles.** Consultations with "Article VIII countries" (those that had accepted the full obligations of Article VIII) began on a voluntary basis in 1961. The Fund did not have the authority to require such consultations, but by 1960 it had become apparent that Article VIII consultations would be a valuable tool for the Fund to collect information that it would need for its operations. Even after accepting the obligations of Article VIII, a country might have exchange restrictions for purposes other than controlling current account transactions, and the Fund had a responsibility to assess them in the context of the country's economic circumstances. Moreover, many countries were finding that periodic consultations with the Fund were a valuable tool for them to get an independent external assessment of their economic policies. The question thus was how far the Fund could and should go toward expanding its consultation practices beyond those that derived from Article XIV.

16. **By 1958, most advanced economies had dropped all or most of their exchange restrictions on current account transactions and were contemplating moving to Article VIII status, prompting the Fund to consider adjusting its practices and encouraging regular consultations among member countries.** In November 1959, the Legal Department (LEG) of the Fund circulated a memorandum explaining that although the Articles did not require Article VIII countries to hold regular consultations with the Fund, they did permit the Fund to hold consultations with any member to examine any issues that fell under the Fund's purposes as set out in Article I. Three months later, the Exchange Restrictions Department circulated a companion paper covering relevant policy issues. That paper suggested that it would be valuable

[6] Consistent with this narrow interpretation and limited practice, the original name of the Strategy, Policy, and Review Department was the Exchange Restrictions Department.

for all member countries to consult regularly and that discussions should cover each country's "general economic and financial situation."[7]

17. **The result was a formal decision in 1960 to initiate regular consultations with all member countries.** The Executive Board discussed these two papers in March and May 1960.[8] Much of the discussion focused on the threat to national sovereignty if the Fund were to expect all member countries to consult periodically on their "general situation" even after they committed to eschew exchange restrictions on current account transactions. The pertinent paragraph read as follows:

> "3. If members at any time maintain measures which are subject to Sections 2 and 3 of Article VIII, they shall consult with the Fund with respect to the further maintenance of such measures. Consultations with the Fund under Article VIII are not otherwise required or mandatory. However, the Fund is able to provide technical facilities and advice, and to this end, or as a means of exchanging views on monetary and financial developments, there is great merit in periodic discussions between the Fund and its members even though no questions arise involving action under Article VIII. Such discussions would be planned between the Fund and the member, including agreement on place and timing, and would ordinarily take place at intervals of about one year."[9]

18. **Soon after the adoption of this decision, these consultations effectively initiated the practice of bilateral surveillance covering each member's general economic situation.** Beginning with the United Kingdom, all member countries that had accepted the obligations of Article VIII agreed to hold regular consultations with the IMF. Although the "surveillance" terminology was not yet in use, and although consultations under Article VIII were voluntary and justified as a way of providing technical advice, this began the practice of bilateral surveillance.

19. **The practice of holding consultations under Articles VIII and XIV continued through the 1960s and early 1970s, but the collapse of the Bretton Woods system changed the purpose of the consultations.** Throughout that era, while the Bretton Woods system was still in effect, the primary purpose of these consultations was to assess the application of exchange restrictions and the viability of a country's par value. The stress on the system that emerged in the 1960s, the termination of convertibility of U.S. dollars into gold in August 1971, and the final collapse of the system in March 1973 forced the Fund to reconsider the role of consultations and its mandate to oversee members' exchange rate policies. First, however, it was necessary to determine whether it was feasible to design a new system of exchange rates to replace the one devised at Bretton Woods.

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[7] "Legal Aspects of Article VIII and Article XIV," SM/59/73 (November 18, 1959), pp. 55-58; and "Policy and Procedural Aspects of Article VIII and Article XIV," SM/60/8 (February 16, 1960), pp. 4-5.

[8] Minutes of EBM/60/11 (March 21, 1960); EBM60/12 (March 22, 1960); EBM/60/22 (May 18, 1960); EBM/60/23 (May 18, 1960); and EBM/60/27 (June 1, 1960).

[9] Executive Board Decision No. 1034-(60/27); https://www.imf.org/en/publications/selected-decisions/description?decision=1034-(60%2F27).

1972–78: The Birth of Surveillance Under Article IV

20. **The termination of dollar convertibility triggered a request to the Executive Board to propose reforms to the Fund.** When meetings of G10 finance ministers and central bank governors in September 1971 failed to reach a consensus owing to differences in view between the U.S. authorities and other members, the Executive Director for the Netherlands, Pieter Lieftinck, proposed that the IMF Board of Governors authorize the Executive Board to develop proposals for a comprehensive reform of the international monetary system and the role of the Fund. After some discussion, the governors adopted a resolution on October 1 asking Executive Directors to prepare reports "without delay on the measures that are necessary or desirable for the improvement or reform of the international monetary system; and … to include, if possible, the texts of any amendments of the Articles of Agreement which they consider necessary to give effect to their recommendations."[10]

21. **The lack of a body to convey the proposals highlighted a gap in governance.** To fill the gap, the General Counsel of the IMF, Joseph Gold, proposed creating an advisory committee of IMF governors. To whom should the Fund's Executive Directors submit their reports? The Board of Governors was too large and unwieldy a body to discuss and negotiate major reforms; the Executive Board could not very well negotiate reform of itself; and the G10 was too narrow and too divided for this purpose. In January 1972, Joseph Gold circulated a paper proposing creation of an advisory committee of IMF governors.[11] Initially, the U.S. authorities opposed the idea and expressed a preference for discussing systemic reform completely independently from the IMF. The only practical way to achieve that goal would be to empower the G10 to develop recommendations. By 1972, however, the U.S. authorities were disenchanted with the G10, where it was difficult for them to push their agenda when confronted with contrary views from the five European member countries. That disenchantment, combined with pressure from developing and other non-G10 countries to bypass the exclusivity of the G10, softened the U.S. position and contributed to momentum for Gold's proposal.

The Committee of Twenty and its Successors

22. **The creation of the C20 (with a compromise structure to ensure its approval) was a fundamental enhancement of the formal governance structure of the IMF.** A compromise was required to induce the United States to accept the idea of having a committee of Fund governors negotiate systemic reforms while also inducing other countries to accept the idea of moving the talks outside of the Fund. That compromise was to give the committee the same structure as the Executive Board (which at the time had 20 seats) but with a non-IMF chairperson

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[10] Resolution No. 26-9 of the Board of Governors, October 1, 1971; reproduced in de Vries (1976), Vol. 2, pp. 331-32.

[11] "An Advisory Committee of the Board of Governors: Outline of an Illustrative Plan" (January 24, 1972), reproduced in de Vries (1985), Vol. 3, pp. 129-41. The Annex to that paper, which had been circulated separately in 1969, summarized the legal and procedural background to the proposal, including earlier discussions of possible committees of governors.

and without a formal role for Executive Directors or Fund staff in the deliberations. The committee was to be purely advisory, without a voting system, but it was empowered to offer proposals on non-monetary issues such as trade policy. The Executive Board formulated a specific proposal along these lines, and the Board of Governors approved it in July 1972. In September, in the margins of the Annual Meetings, the ad hoc Committee on Reform of the International Monetary System and Related Issues (C20) held its inaugural meeting. The C20 fundamentally enhanced the IMF governance by reducing the necessity of relying on an informal body such as the G10 and affording a substantive role for developing countries in reform discussions for the first time since the Bretton Woods conference.

23. **The C20 had as an initial objective to restore the exchange rate system based on par values, but the U.S. was skeptical.** To prepare for the inaugural meeting of the C20, the Executive Board produced a report in August 1972 based primarily on a draft by IMF staff.[12] Concerning the goal of reform, the report urged restoring the system of "stable but adjustable par values" for exchange rates that had underpinned the system devised at Bretton Woods. The U.S. authorities remained skeptical about the feasibility of that objective, and reconciling their views with those of the European countries was to be the primary task of the Committee.

24. **As the Bretton Woods system collapsed, the work of the committee shifted toward developing proposals for living with floating rates and imagining how the system might evolve toward stability.** The C20 met six times from September 1972 through June 1974, with its work shift. It started, as had the staff report, with the objective of reformulating a system based on par values, that is, fixed but adjustable exchange rates. When the Bretton Woods system collapsed in March 1973, however, it became clear that such a system was not feasible in the prevailing circumstances. Neither the committee nor any external group was able to conceive acceptable procedures for assessing sustainable rates and devising mechanisms for achieving them.

25. **The key practical issue affecting the Fund mandate at the time was the role that the Fund could play in overseeing a monetary system with generalized floating exchange rates.** That question was not initially at the forefront of discussions in the C20, which focused more on the question of how to restore fixed exchange rates. The issue arose organically from the ashes once the participants recognized that restoration could be achieved, if at all, only very gradually. In the meantime, the only way to prevent chaos in international financial relations was to have an institution—the IMF—overseeing the processes and policies by which countries adjusted to stresses in international payments.

26. **At the end of its two-year lifespan, the C20 failed to reach agreement on any of the central issues, but it did agree on an outline for reform and paved the way for the creation of the Interim Committee and a Council of Fund governors.** The positions of the U.S. and

[12] "Reform of the International Monetary System: A Report by the Executive Directors to the Board of Governors" (August 18, 1972); reproduced in de Vries (1985), Vol. 3, pp. 19-56.

European (especially French)[13] authorities were too far apart to be reconciled. The committee nonetheless agreed on an outline for reform and urged, as a matter "of the highest importance that immediate steps should be taken to begin an evolutionary process of reform."[14] The committee's final report envisaged that the Fund eventually would be governed by a Council composed of Fund governors. In the meantime, the Fund reconstituted the C20 as the Interim Committee of the Board of Governors on the International Monetary System, to serve as a bridge to the envisioned Council. The C20 report charged its successor, the Interim Committee, with proposing amendments to the Articles of Agreement to give effect to its recommendations. During this transitional period, the IMF was to have a mandate for "close international consultation and surveillance of the adjustment process": the first time that surveillance was cited explicitly as a responsibility for the IMF, distinct from and in addition to the consultation process.[15]

27. **While the Interim Committee met several times throughout the second half of 1974 and all of 1975, bilateral negotiations between France and the United States were crucial to the amendment process.** In addition, IMF Executive Directors met frequently to draft proposed amendments, the G10 met occasionally to consider those drafts, and six members of the G10 (excluding Belgium, Canada, the Netherlands, and Sweden) met at the summit level in a special meeting in Rambouillet, France, in November 1975. Separately, the deputies for France and the United States: Jacques de Larosière and Edwin H. Yeo, III, held secret bilateral negotiations. The unique need for reliance on bilateral meetings arose when all other members of the Interim Committee were ready to accept a compromise proposal on the Fund's surveillance mandate. If France and the United States could settle their differences, then the amendment process could move forward. A key sticking point was that the French authorities insisted on retaining the goal of restoring fixed exchange rates, although they acknowledged that the goal could not be realized in the short run. The U.S. authorities rejected that approach because they wanted to avoid any suggestion that the United States should be obligated to establish a new peg to gold or any other anchor. After an intense series of trans-Atlantic in-person meetings, de Larosière and Yeo reached an agreement that the Managing Director, Johannes Witteveen, presented to the Interim Committee for approval at its meeting in Jamaica in January 1976.

1977: Surveillance Defined

28. **As regards the Fund's new surveillance mandate, the agreement had two essential features, both of which relied on vaguely defined terms of art.** First, the goal toward which the system was to strive was to be a "stable system of exchange rates" rather than a "system of stable exchange rates," as originally envisaged. That is, floating and managed exchange rates

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[13] As Margaret de Vries, then the IMF Historian, phrased it, "French authorities were almost fanatic in their arguments for fixed rates, and the U.S. authorities were rapidly becoming strong proponents of floating rates." See de Vries (1985), Vol. 2, p. 701.

[14] "Report to the Board of Governors of the International Monetary Fund by the Committee on Reform of the International Monetary System and Related Issues" (June 19, 1974); reproduced in de Vries (1985), Vol. 3, p. 166.

[15] Ibid.

were legitimate policies for countries to choose, and it was accepted that systemic stability could be achieved within that framework. The Bretton Woods system of universal par values was abandoned. Second, in exchange for this concession from the French authorities, the U.S. government accepted that the IMF was to exercise "firm surveillance" over each country's exchange rate policies and over the system as a whole to ensure that national economic policies were consistent with each country's chosen exchange rate regimes; that countries were not manipulating their exchange rate policies so as to gain unfair advantage over others; and that the system was working as it should.

29. **A third feature, which has received less attention in analyses of the Second Amendment and has had much less effect in practice, was a recognition that capital flows were an integral component of the international monetary system that the Fund was to oversee.** The only references to capital flows in the original Articles were negative in nature and primarily in Article VI, which specified that "a member may not make net use of the Fund's resources to meet a large or sustained outflow of capital." Oversight of capital flows was deliberately excluded from the purposes of the Fund set out in Article I. Now, however, the new Article IV specified in part that "the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, *and capital* among countries" (emphasis added). Although this wording referred to the purposes of the system rather than the purposes of the Fund, the Fund's General Counsel informed the Executive Board that it implied that facilitating the exchange of capital was to be part of the Fund's responsibility "to oversee the international monetary system in order to ensure its effective operation" as stated in Article IV, Section 3(a). "It should be noted," he stated, "that for the first time in the history of the Fund a reference to capital will appear as a purpose of the Fund."[16] A staff report later clarified that nothing in the new Article IV limited the right of members to control or restrict capital flows.[17]

30. **The Interim Committee endorsed the draft agreement on a new Article IV at a January 1976 meeting in Kingston, Jamaica, that**

> "establishes a system of exchange arrangements. The new system recognizes an objective of stability and relates it to achievement of greater underlying stability in economic and financial factors. The Committee … agreed [that the] … amended Articles of Agreement should include a provision by which the members of the Fund would undertake to collaborate with the Fund and with other members in order to ensure that their policies with respect to reserve assets would be consistent with the [objective] of promoting better international surveillance of international liquidity."[18]

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[16] Statement by Jacques J. Polak (then the Fund's Economic Counselor); minutes of EBM/77/10 (January 19, 1977), p. 9.

[17] "Surveillance over Exchange Rate Policies – Legal Aspects of the Discussion of SM/77/33," SM/77/59 (March 21, 1977).

[18] Paragraph 7 of the Interim Committee communiqué of January 8, 1976; reproduced in de Vries (1985), Vol. 3, p. 227. The awkward phrasing suggests an effort to paper over differences of view within the committee.

31. **The Second Amendment took effect in April 1978, after being ratified by member countries.** With the green light from the Interim Committee, the Executive Board quickly finished drafting the amendments and sent them to the Board of Governors for formal approval. The Governors moved equally quickly and approved the amendments in April 1976. That triggered a ratification process in member countries that turned out to be complicated and lengthy but ultimately successful. The Second Amendment took effect in April 1978.

32. **While the two-year ratification process was proceeding, the IMF had to figure out how to implement the agreement**. The new Article IV obligated the Fund to exercise "firm surveillance," but the Fund itself had to give practical meaning to that phrase. The staff envisaged a process by which they could judge whether a country's exchange rate policies were impeding adjustment to a state of internal and external equilibrium; that is, reasonably full employment of resources and a sustainable balance of external payments. Such judgments might be different for countries with fixed versus floating or managed rates, but in all cases the central question would be whether the actual exchange rate was consistent with good economic outcomes.

33. **A broader interpretation of the surveillance mandate would be required for the Fund to implement surveillance in practice.** In July 1976, the staff prepared an analysis detailing this line of argument for consideration by the Executive Board. It concluded that for surveillance to be effective, "regular consultations under Article IV would have somewhat broader terms of reference than at present [under Articles VIII and XIV]; and additional criteria would be needed to trigger ad hoc consultations, since peg changes would no longer be the only policy measure requiring special Fund review."[19] In other words, the Fund's surveillance mandate would have to be interpreted more broadly than before.

34. **The chief problem that arose in the initial Board discussion was that the new Article IV did not resolve the differences in view of the objective of surveillance between U.S. and European directors.** The American view was that surveillance should aim to judge whether countries were manipulating their exchange rates to gain a competitive advantage. Countries should allow exchange rates to be determined by market forces, which might require rates to move sufficiently to produce equilibrium. The contrasting European view was that the Fund should warn against exchange rate volatility and encourage countries to stabilize rates. Attempting to distinguish between effective management and "manipulation" of the exchange rate would inevitably inject the Fund into intrusive and inappropriate discussions of a broad range of domestic economic policies. A third view, expressed mainly by directors representing developing countries, was that the staff view would effectively discriminate against countries with pegged rates, because disequilibria would be more obvious in those cases.[20]

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[19] "Surveillance of Members' Exchange Rate Arrangements under the Amended Draft Article IV," SM/76/176 (July 30, 1976), p. 8. Also, see de Vries (1985), Vol. 2, pp. 839-40.

[20] Minutes of EBM/76/136 and EBM/76/137, September 10, 1976.

The Initial Surveillance Decision

35. **As discussions proceeded, it became clear that these views could not be reconciled until the Fund gained experience with surveillance.** Executive Directors generally agreed that consultations under Article IV should be "broad but not all encompassing." Nor should the principles for the guidance of members on their exchange rate policies be "too rigid." Even stronger agreement was expressed that it was premature to set specific guidelines on either principles or procedures. The views of different groups of countries were too divergent, and the staff as yet had no experience upon which it could draw.[21] Consequently, in the initial guidelines, the Fund had to fall back on a vague general statement of principles that did little more than repeat the language in Article IV. As the staff continued to produce successive drafts of a proposed decision to guide the practice of surveillance, the specification of principles necessarily became more general in order to encompass the range of views across the Executive Board.[22] The Fund adopted these general principles in a Board Decision in April 1977.[23] The plan was to review these principles biennially in light of experience, with the hope of eventually making them more specific.

36. **In addition to establishing principles, the Fund had to specify procedures for conducting surveillance.** The easiest decision was to simplify the process from previous practice, under which consultations were held under the terms of Article XIV for some countries and under Article VIII for those that had fully accepted the obligations of that article to eschew exchange restrictions on current account transactions. Henceforth, all consultations would be held under the terms of the new Article IV and would normally ("in principle") be held on an annual cycle. Despite concerns raised by some members, a key element of the 1977 Decision was that all consultations would conclude with consideration by the Executive Board, which would "reach conclusions" to complete the consultations. Previously, the voluntary consultations under Article VIII had typically concluded without a formal finding by the Executive Board. Another procedural element intended to give teeth to surveillance was the possibility of the Managing Director initiating a special consultation if he "considers that a member's exchange rate policies may not be in accord with the exchange rate principles." That procedure, however, would turn out to be of little value because of the stigma attached to it and the possibility that market participants might learn of it and attack the value of the currency.

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[21] The initial staff analysis was in "Surveillance of Members' Exchange Arrangements under the Amended Draft Article IV," SM/76/176 (July 30, 1976). Executive Directors discussed that paper on September 10, 1976. The "broad but not all encompassing" quotation is from the Executive Director from Brazil, Alexandre Kafka, at EBM/76/136 (p. 9 of the minutes). The "too rigid" argument is from the Executive Director from Italy, Lamberto Dini (Ibid.).

[22] Fund staff produced four successive drafts of the proposed decision, beginning with "Surveillance over Exchange Rate Policies," SM/76/235 (December 21, 1976). The Executive Board discussed that paper in January 1977, after which the proposal was redrafted in three revisions of SM/76/235, each one responding to discussion of its predecessor in further Board meetings in March. Final agreement was reached at EBM/77/53 (April 13, 1977).

[23] The guidance note, "Surveillance over Exchange Rate Policies," was attached to Decision No. 5392-(77/63), approved April 29, 1977. For the text, see IMF (1981), pp. 10-14.

37. **The Fund's surveillance mandate, as established in the Second Amendment (Article IV, Section 3), was twofold and set the basis for "bilateral" and "multilateral" surveillance.** First, the Fund was to "oversee the international monetary system in order to ensure its effective operation, and [to] oversee the compliance of each member with its obligations" as specified in Section 1 of the new Article IV. Over time, the systemic oversight function came to be known as "multilateral surveillance." Second, the Fund was to "exercise firm surveillance over the exchange rate policies of members, and … adopt specific principles for the guidance of all members with respect to those policies." This second function, "bilateral surveillance," was the subject of the 1977 Decision.

38. **The foremost issue for the development of the 1977 Decision was how to define the goals of bilateral surveillance in a way that would give substance to the process.** Everyone agreed that simply reviewing members' policies would be insufficient. The Fund had to have some grounds for determining whether those policies were appropriate and consistent with members' obligations under the Articles of Agreement. In the final formulation, the Decision suggested a non-exhaustive list of conditions that "might indicate the need for discussion with a member":

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) an unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term official or quasi-official lending, for balance of payments (BOP) purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for BOP purposes, of restrictions on, or incentives for, current transactions or payments; or (b) the introduction or substantial modification for BOP purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for BOP purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows; and

(v) behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements.[24]

The first three conditions related directly to exchange rate policies, but only the first could be assessed quantitatively by observing data (and even then, only if the country was willing to share intervention data with the Fund, which it was not obligated to do). The second and third conditions required an additional subjective assessment of whether policies were undertaken "for balance of payments purposes." The fourth condition required an assessment of the international effects of "monetary and other domestic financial policies." The fifth condition required a subjective analysis of whether the exchange rate "appears to be" in line with fundamental underlying economic and financial circumstances.

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[24] "Surveillance over Exchange Rate Policies, Decision No. 5392-(77/63), April 29, 1977; de Vries (1985), Vol. 3, pp. 491-94.

39. **The ambiguity of the indicators that were intended to be the backbone of IMF surveillance constituted a major challenge for implementing the mandate in the years after the Second Amendment.** The one concrete condition—protracted one-way intervention—turned out not to be empirically important in most situations. Identification of whether any other policy action was taken for BOP purposes was practically impossible. Measuring the fundamental economic and financial conditions with which the exchange rate was supposed to be consistent was fraught with controversy. The Fund was thus hamstrung in its efforts to exercise firm surveillance over exchange rate policies.[25]

Multilateral Surveillance Begins Informally in 1982

40. **On a separate track from the evolution of bilateral surveillance, the Fund was pressed to undertake an expanding multilateral role.** This role derived from the Fund's responsibility to "oversee the international monetary system in order to ensure its effective operation" (Article IV, Section 3(a)). As the Second Amendment was being finalized and adopted, the major industrial countries were assuming an informal role as overseers of the post-Bretton Woods monetary system. Previously, as noted in Section II, that role had been assumed by the G10, with which the IMF had a formal relationship through the GAB. In the 1970s, the G7 came together at the summit level, and the G5 coalesced at the level of finance ministers and central bank governors. Because the groups had no treaty-based standing and no formal relationship with the IMF, a working relationship had to be constructed from the ground up.

41. **Support for the work of the G7 began when that group issued its annual summit communiqué in 1982.** The document included a "statement on international monetary undertakings" with specific references to the IMF[26]:

(i) We accept a joint responsibility to work for greater stability of the world monetary system. We recognize that this rests primarily on convergence of policies designed to achieve lower inflation, higher employment and renewed economic growth; and thus to maintain the internal and external values of our currencies. We are determined to discharge this obligation in close collaboration with all interested countries and monetary institutions.

(ii) We attach major importance to the role of the IMF as a monetary authority and we will give it our full support in its efforts to foster stability.

(iii) We are ready to strengthen our cooperation with the IMF in its work of surveillance; and to develop this on a multilateral basis taking into account particularly the currencies constituting the SDR.

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[25] See Boughton (2001), Chapter 2.

[26] "Declaration of the Seven Heads of State and Government and Representatives of the European Communities," June 6, 1982; http://www.g7.utoronto.ca/summit/1982versailles/communique.html.

(iv) We rule out the use of our exchange rates to gain unfair competitive advantages.

(v) We are ready, if necessary, to use intervention in exchange markets to counter disorderly conditions, as provided for under Article IV of the IMF Articles of Agreement.

42. **The Fund conceived its engagement with the G7 as part of surveillance, but it had to act without a formal role for the Executive Board. That presented a potential conflict with the mandate set out in Article IV.** At that time, it was not clear whether the Fund could engage in a surveillance exercise of this nature, particularly because the finance ministers of the G5 informed the Fund privately that they wanted these discussions to be confidential. Consequently, the Managing Director, Jacques de Larosière, agreed to participate on request in ministerial meetings "in his personal capacity." He would discuss the assessments of the Fund on international monetary problems and policies, but he would not present an official view and would not need to report back to the Executive Board on what was discussed.[27] For the rest of the 1980s and into the 1990s, de Larosière and then Michel Camdessus (who became Managing Director in January 1987) met several times in this informal manner with G5 and G7 officials.

43. **As these informal arrangements continued, it became evident that although the Fund was supporting a G7 multilateral surveillance process, its role was to provide TA.** The multilateral surveillance process was one in which the G7 mostly oversaw policies and conditions within its own membership, and the Fund's role was to provide TA to the group on a voluntary basis. Indeed, staff occasionally carried out specific tasks requested by the G7, such as producing an index of commodity prices for the group to use as an indicator of price stability and a possible trigger for policy coordination. It thus was covered by the more flexible standards set out in Article V, Section 2(b). The aftermath is taken up below, in Section V.

1986–2004: Surveillance Refined

44. **Because members' obligations under Article IV were limited, the effectiveness of surveillance was also limited.** Although Executive Directors applauded the effort to strengthen surveillance through the biennial reviews, they did not coalesce around any specific suggestions for expanding the list of indicative indicators or for otherwise amending the 1977 surveillance Decision. By 1985, the effectiveness of surveillance was widely considered to be deficient, in large part because the Fund had been powerless to alleviate or even assess fully the very large swings in major-currency exchange rates throughout the first half of the decade. That year, both the G10 and the G24 issued reports calling for refinements to make surveillance both more evenhanded and more effective at promoting stability.

45. **In response, the Fund used the 1986 biennial surveillance review to try to overcome weaknesses that had become apparent through experience**. The staff suggested that the Fund should adopt more specific indicators that would help overcome the restrictions of the phrase "for balance of payments purposes." Specifically, the staff report suggested amending the

[27] See Boughton (2001), Chapter 4.

1977 Decision so as to encourage countries to adopt reference ranges or "target zones" for their exchange rates, restrict the mix of monetary and fiscal policies to help stabilize exchange rates, or adopt medium-term economic targets that could be used to assess the viability of current policies.[28] In February 1986, the Executive Board concluded that the staff could experiment along the proposed lines without amending the decision.[29]

Introduction of a Common Strategy for Achieving Sustainable Growth

46. **In the 1990s, the Fund made a sustained effort to strengthen surveillance. That led to the "Partnership for Sustainable Global Growth," which detailed a "common strategy" for all countries to pursue.** Within the broad constraints of the surveillance mandate, that effort was led by the Managing Director, Michel Camdessus, and the Chair of the Interim Committee, Philippe Maystadt. Together, they persuaded the Interim Committee to issue a series of increasingly detailed standards for sound macroeconomic policies to underpin the international financial system. That effort culminated with the issuance of the document "Partnership for Sustainable Global Growth" by the Interim Committee in September 1996.[30] The "partnership" declaration detailed a "common strategy" for all countries to pursue, and it stressed that "Fund surveillance of member countries' policies … is an integral part of the strategy." It specified a set of objectives encompassing fiscal and monetary discipline, price stability, trade liberalization, freedom of capital movements, currency convertibility, structural reforms to increase the efficiency of markets, good governance including the rule of law and avoidance of corruption, and maintenance of sound banking systems. Although member countries had no obligation to pursue such an agenda, the declaration enjoined the Fund to use its surveillance mandate to encourage them to do so.

47. **Fund management fully embraced the goals of the Partnership Declaration, which steered the scope of bilateral surveillance toward the "common strategy," including by devising "guidance notes" to implement an expanded interpretation of the surveillance mandate.** Camdessus referred to its prescriptions as the "Eleven Commandments" and "the distillation of Fund surveillance lessons."[31] The primary goal of bilateral surveillance had evolved from its initial focus on the consistency of exchange rate policy with underlying economic conditions to a broader but also more measurable focus on the quality of a country's overall policy structure and its consistency with the "common strategy" laid out in the Interim Committee's declaration. In line with the Interim Committee's development of the common strategy, the Fund took concrete steps in the 1990s, including issuing internal "guidance notes"

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[28] Surveillance Over Exchange Rate Policies—Biennial Review of 1977 Document," SM/86/3 (January 10, 1986). Also see the staff analysis and the texts of the G10 and G24 reports in Crockett and Goldstein (1987).

[29] Minutes of EBM/86/29 and EBM/86/30 (February 19, 1986).

[30] https://www.imf.org/external/np/exr/dec.pdf.

[31] Address at the 1996 Annual Meetings, October 1; https://www.imf.org/en/News/Articles/2015/09/28/04/53/spmds9618.

for the conduct of Article IV consultations. The first substantive guidance note, issued in 1991, directed staff to examine countries' exchange rate policies "within the framework of macroeconomic and related structural policies" and with an eye on whether the overall policy stance was "conducive to the achievement of reasonable price stability, sustainable external positions, and orderly economic growth."[32]

48. **An immediate effect of the 1991 guidance note was the endorsement by the Executive Board of an active role for the IMF in assessing the implications of economic policies on protection of the natural environment.** At a Board seminar on March 1, 1991, Managing Director Camdessus proposed, and Executive Directors agreed, that the Fiscal Affairs Department (FAD) should allocate two or three economist staff positions "to liaise with organizations undertaking environmental research … [and] help increase the staff's general awareness of environmental issues." In an implicit acknowledgement that this broadening of the surveillance mandate was highly controversial, Camdessus decided that it "would be given only minimal publicity."[33]

49. **The Fund revised the general surveillance guidance note in 1995, most notably by adding a reference to reporting on the quality of data provided by members:**

> "3. Given the importance of high quality, methodologically and intersectorally consistent and timely data for the exercise of effective surveillance, the staff will draw to the attention of the Board those cases where deficiencies in data quality and/or lack of timely reporting are hampering effective ongoing surveillance and provide recommendations for improvement."[34]

That provision was inserted in response to the Mexican crisis of December 1994, in which the Fund had been unable to assess developments prior to the crisis owing in large measure to a lack of timely information.

50. **The final revision of the guidance note in the 1990s came in 1997, when the note was expanded to include a recommendation to conduct regional surveillance.** Regional surveillance as a component of bilateral surveillance was "becoming increasingly important, reflecting the greater inter-connection of economies and the increasing extent to which economic policy is formulated at a regional or supranational level."[35] The key provision in the 1997 guidance note was that "for members of regional economic or monetary unions whose

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[32] Minutes of EBM/91/15 (February 8), pp. 13-17; the quotations are from paragraph 3 of the guidance note, on p. 14. (An earlier guidance note, issued in 1980, merely repeated the language of the 1977 surveillance decision.)

[33] Minutes of Seminar 91/3 (March 1), pp. 4 and 24. The Managing Director set forth his rationale for examining the macroeconomic aspects of environmental issues in a statement circulated prior to the seminar; BUFF/91/37 (February 22, 1991).

[34] SUR/95/24 (February 27), pp. 6-7.

[35] " Biennial Review of the Implementation of the Fund's Surveillance Over Members' Exchange Rate Policies and of the 1977 Surveillance Decision-Additional Material," SM/97/92 (April 10), p. 6.

union-level policies have significant economic implications, the staff would conduct periodic discussions, generally once a year, assessing the policies at the level of the union."[36] That dictum introduced a mandate under which the IMF has held consultations with regional currency unions, including the euro area, the CFA franc zone in Africa, and the East Caribbean Currency Union.

51. **Additionally, in 1996, the Fund initiated a response to the provision in the Partnership Declaration for it to promote "good governance in all its aspects."** In March, Managing Director Camdessus brought the topic to the attention of the Executive Board at a retreat held outside of Washington. Initially, most Directors thought that the subject lay outside the Fund's purview and mandate. As the record of the meeting reported, "Concerns were expressed by a number of speakers that the Fund should not become involved in the issue of corruption in member countries, which they saw as an essentially political issue that might jeopardize the Fund's close relationship with the authorities and encourage 'witch-hunting' and the politicization of the institution." As the discussion proceeded, however, the tone shifted. By the end of the retreat, "it was broadly agreed that corruption, and more broadly, governance issues, had an identifiable macroeconomic impact. Therefore, the Fund did have a role to play in reducing corruption in member countries."[37]

52. **Guidance was developed to define an active role for the Fund while limiting the institution's active involvement to those aspects of governance that are relevant to Fund operations and are within the staff's field of competence.** Staff prepared an analysis of specific ways in which the Fund could act effectively and appropriately to improve governance in member countries through all three of its core activities: surveillance, design of Fund-supported programs, and TA. With respect to surveillance, the paper specified the legal mandate for examining and advising on the quality of governance issues with a material effect on economic and financial policies.[38] After the Executive Board discussed that paper in January 1997, the staff drafted a separate guidance note on governance, which the Board approved in July.[39] The guidance note covered all dimensions of the Fund's interactions with members. For surveillance, it suggested that "in Article IV consultations, the staff should be alert to the potential benefits of reforms that can contribute to the promotion of good governance." More specifically, "the staff

[36] "Staff Operational Guidance Note Following the 1997 Biennial Surveillance Review," SM/97/178 (July 3), p. 2.

[37] "Summary Record of Retreat Discussion," FO/DIS/96/22 (April 26), pp. 4-5.

[38] "The existence of poor governance—if sufficient to have a substantial impact on the effectiveness of a member's economic and financial policies—could demonstrate that the member is not complying with its obligations under Article IV, Section 1. Therefore, in exercising its surveillance function under this Article, as a general matter the Fund can consider issues of governance that have a material effect on a member's economic and financial policies." (The Role of the Fund in Governance Issues," SM/96/197 (December 20), p. 7.) The obligation to which this passage referred is that each member is required under Section 1 of Article IV "to endeavor to direct its economic and financial policies toward the objectives of fostering orderly economic growth with reasonable price stability, and to seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions."

[39] "The Role of the IMF in Governance Issues: Guidance Note," July 25, 1997, published in IMF (1998); https://www.elibrary.imf.org/display/book/9781557756909/ch01.xml.

should be alert to aspects of poor governance that would influence the implementation and effectiveness of economic policies and private sector activities." This new guidance unleashed the analysis of corruption in a wide variety of contexts, a development that has continued up to the present day (see Levonian, 2024).[40]

Proposal for Oversight of Financial Liberalization

53. **Beyond this evolution in operational guidance, the Fund continued to look for ways to strengthen the 1977 Surveillance Decision or even to expand the mandate by amending the Articles of Agreement.** One particularly controversial proposal that was put forth in the 1990s was to add oversight of capital account liberalization as a purpose of the Fund and as a component of bilateral surveillance. It was noted above that since 1978, Article IV had included facilitating "the exchange … of capital among countries" as an "essential purpose" of the international monetary system (but not explicitly as a purpose of the Fund).

54. **Interest in promoting policies more conducive to open capital flows rose to the fore for a few years in the 1990s.** As a first step, in April 1995, the Executive Director for the United Kingdom, Huw Evans, asked the Executive Board to amend the 1977 decision to make capital account oversight an explicit component of surveillance. The Board agreed, and it approved two amendments. First, it added a sixth indicator "among those which might indicate the need for discussion with a member": "(vi) unsustainable flows of private capital." Second, it inserted this highlighted phrase into the opening sentence in paragraph 3:

> "The Fund's appraisal of a member's exchange rate policies shall be based on an evaluation of the developments in the member's balance of payments, **including the size and sustainability of capital flows,** against the background of its reserve position and its external indebtedness."[41]

55. **Efforts to make capital account liberalization an obligation stalled given the emerging market countries crises at the end of the 1990s.** A few months later, the U.S. Executive Director, Karin Lissakers, suggested amending the Articles of Agreement to create an obligation for members to work toward liberalizing capital account transactions. That led to a nearly three-year effort, led by Camdessus, to win approval for such an amendment. During that time, especially in 1997–98, several emerging market countries experienced devastating financial crises for which a premature liberalization of capital flows was widely judged to have been a major contributing factor. Enthusiasm for the proposed amendment steadily declined.

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[40] References to corruption began earlier, but the database used to generate the chart in Figure 1 does not extend back that far. The staff report for the 1993 Article IV consultation with Italy was an early, albeit circumspect, example. The report called attention to "the widespread corruption scandals" that had led to "the collapse of the traditional centrist parties" (pp. 1-2), and the staff appraisal appealed somewhat delicately for "better budgeting, control and management of public spending … to improve the often poor quality of public services and administration" (p. 17); SM/94/26 (January 27, 1994). A few months later, an IMF Working Paper, Tanzi (1994), set out a framework for analyzing the economic effects of official corruption.

[41] Minutes of EBM/95/37 (April 10, 1995), p. 35.

56. **While a more restrained proposal was presented, it failed to gain traction, and efforts concluded.** In April 1998, Camdessus tried to save the situation by putting forward a milder amendment for consideration. In this last formulation, only Article I (purposes of the Fund) and not Article IV (principles and procedures of surveillance) would be amended. Notably, the fourth purpose of the Fund listed in Article I would be broadened by adding the highlighted words:

> "(iv) To assist in the establishment of a multilateral system of payments in respect of current **and capital** transactions between members, **in the orderly liberalization of international capital movements,** and in the elimination of foreign exchange restrictions which hamper the growth of world trade **and investment**."

Even this watered-down draft amendment failed to gain enough traction, and management finally abandoned the effort in 1999.

57. **In parallel, financial sector surveillance expanded as the Interim Committee encouraged more Fund involvement.** One field that opened naturally was examining the soundness of banking and other financial sector institutions. After the Fund found itself behind the curve when a banking crisis erupted in Sweden in 1993, management realized that it had to have a systematic policy in place for anticipating such developments.[42] The Interim Committee endorsed that view in April 1995, and the Executive Board signaled in March 1996 that assessments of the soundness of banking systems should become a regular part of Article IV consultations.[43] In 1997, the Board issued a formal guidance note to put this recommendation into effect.[44] To minimize the resource costs, the Board called for increased collaboration with other agencies that have more direct responsibilities for overseeing financial sector issues. Nonetheless, the Interim Committee continued to press for greater and more direct Fund attention to financial sector surveillance. By the end of the 1990s, this activity had expanded to include, in addition to the inclusion of financial sector analysis in many Article IV reports, the issuance of separate reports for some countries under the banner of the Financial Sector Assessment Program (FSAP), many of which the Fund conducted jointly with the World Bank.

58. **Surveillance over other structural policies was more controversial, but the concept of "high-quality growth" became engrained in the Fund's vocabulary.** In line with the Partnership Declaration and the Interim Committee's call for the Fund to promote structural reform, Camdessus repeatedly pushed for Fund surveillance to monitor topics such as "unproductive" fiscal expenditures including "excess" military spending. He began this push with a speech to the UN Economic and Social Council (ECOSOC) in 1989, in which he asserted that the primary goal for the IMF was to help its members achieve "high-quality growth," by which he

[42] Boughton (2012), pp. 142-44.

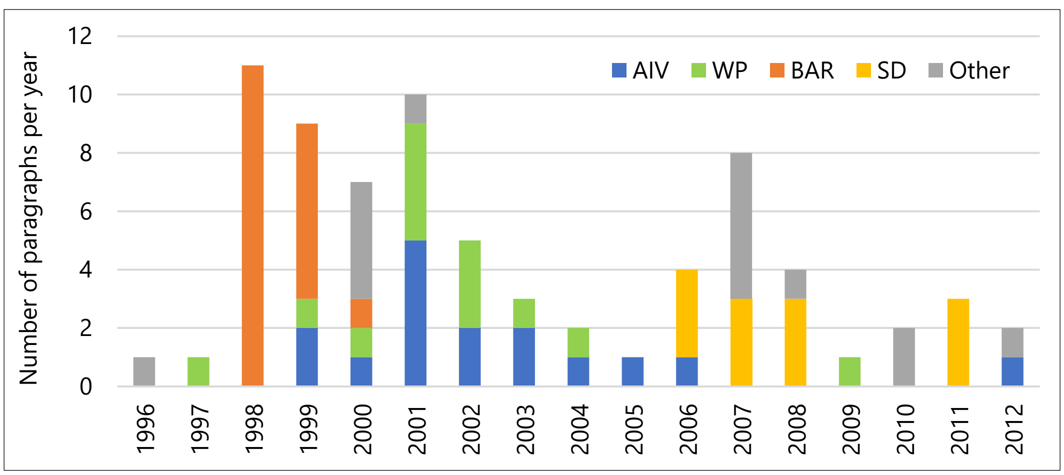
[43] The staff analysis was compiled and published as Lindgren, Garcia, and Saal (1996). For the Executive Board conclusions, see minutes of EBM/96/21.

[44] "Staff Operational Guidance Note Following the 1997 Biennial Surveillance Review," SM/97/178 (July 1997). For more background, see Takagi (2018).

meant economic growth that was both sustainable and beneficial to all segments of society. He continued to refine the concept of high-quality over the next several years to encompass good governance, environmental sustainability, and fiscal policies that aimed to enhance domestic welfare rather than military display or ostentatious public projects. The 1997 guidance note on governance issues would have been a logical vehicle for incorporating these concepts into Fund practices, but the Executive Board and the staff preferred at that time to avoid committing the Fund to such an ambitious and fraught agenda.[45] Even so, despite the initial reluctance, the goal of achieving high-quality growth became embedded in the lexicon of the Fund (Figure 1), most frequently in Article IV surveillance reports.

59. **By the turn of the millennium, the Fund's surveillance mandate was interpreted through two parallel lenses: the prescriptive lens and the aspirational lens.** The lightly amended 1977 Decision cast a prescriptive lens on the obligations of the Fund and its members through Article IV, and a succession of guidance notes cast an aspirational lens on the way that the Interim Committee, the Executive Board, and Fund management wanted countries to conduct economic policies. The former dealt with exchange rate policies, while the latter dealt as well with domestic macroeconomic and structural policies. The well-understood problem was that the Fund's powers with respect to exchange rate policies were vaguely defined and difficult to enforce, while members were under no legal obligation under the Articles to follow the Fund's recommendations on other policies.

Figure 1. High Quality Growth: Count of Relevant Paragraphs in Selected IMF Documents



Source: IEO staff calculations.
Notes: The figure presents number of paragraphs containing the phrase "high quality growth" in selected collections of IMF documents. AIV stands for Article IV reports; WP: IMF Working Papers; BAR: Executive Board's Annual Reports; SD: Selected Decisions and Selected Documents of the International Monetary Fund. Category "Other" contains the following collections (number of relevant paragraphs over the entire 1996–2012 period in parentheses): IEO evaluations (6); World Economic Outlooks (4); Selected Issues Papers (2); Accountability Framework documents (1); IMF Staff Position Notes (1); Policy Discussion Papers (1); G7 and G20 communiqués (0); Fiscal Monitors (0); and Global Financial Stability Reports (0).

[45] On the Fund's approach to assessing military spending, see Boughton (2012), pp. 147-49.

2005–10: Surveillance Redefined

60. **Although it appeared for many years that little further could be done to overcome the limitations inherent in the language of Article IV, the potential for a breakthrough soon arose.** In 2005, the U.S. Administration pressed the Fund to be more aggressive in its surveillance over exchange rate policies. The specific aggravation was that the U.S. Treasury wanted the Fund to pressure China to allow its exchange rate to appreciate, in the hope of reducing the bilateral trade surplus that China had over the United States. Fund management was reluctant to comply, both because of concerns that such pressure would be unlikely to prevail in the Executive Board and because of the constraint in Article IV and in the 1977 Decision that a finding of an inappropriate exchange rate policy required a finding that the policy had been implemented "for the purpose of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade." If the Fund had been "asleep at the wheel," as U.S. officials charged, it was because it had no effective means of proving malintent.

61. **Amending Article IV was not considered to be a practical solution, and so the effort focused on ways to revise or supplement the 1977 Decision while remaining consistent with the Article as written**. The very public contretemps led by U.S. officials forced the Fund to look for ways to strengthen its surveillance capability. The staff proceeded to draft several successive versions of a new decision in response to discussion of each draft by the Executive Board. The central challenge, which persisted through each stage of the process, was that views by Executive Directors ranged widely and were difficult to reconcile without severely watering down the proposed changes in the principles of exchange rate surveillance.[46]

The 2007 Decision on Bilateral Surveillance

62. **Since the new "Decision on Bilateral Surveillance over Members' Policies" (the 2007 Decision) did not alter members' obligations, the substantive changes dealt only with the treatment of general principles.** The Decision, adopted on June 15, 2007, included language clarifying the distinction between members' obligations under Article IV and the desirable (but not required) goals for members' policies. Both were to be subjected to Fund surveillance, and deviations from the pursuit of desirable goals could trigger responses from the Fund in the form of further discussions. The 2007 Decision maintained the three principles of the 1977 Decision for the guidance of members on their exchange rate policies but introduced a fourth. The new principle broadened the scope of surveillance to cover the effects of exchange rate policies, not

[46] For background on the events and discussions leading to the 2007 decision, see Ghosh and Postelnyak (forthcoming).

just the policies themselves, specifically by adding that "A member should avoid exchange rate policies that result in external instability."[47]

63. **The 2007 Decision broadened the list and description of relevant developments.** Following the enumeration of principles, the 1977 Decision had listed the five developments quoted earlier in this paper "as among those which might indicate the need for discussion with a member." The 2007 Decision expanded that description to read "as among those which **would require thorough review and** might indicate the need for discussion with a member" (new wording shown in bold). It also expanded the list of developments as follows:

> "(i) protracted large-scale intervention in one direction in the exchange market;"
>
> "(ii) official or quasi-official borrowing that **either** is unsustainable **or brings unduly high liquidity risks**, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;"
>
> "(iii)
>
> > (a) the introduction, substantial intensification, or prolonged maintenance for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments; or
> >
> > (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;"
>
> "(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;"
>
> "***(v) fundamental exchange rate misalignment;***"
>
> "**(vi) large and prolonged current account deficits or surpluses;" and**
>
> "**(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows**."

The last three developments replaced the fifth and final development listed in the 1977 Decision, which read "behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements."

[47] The 1977 Decision listed three "principles for the guidance of members' exchange rate policies," only one of which was specified as what a member "shall" do: "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." The other two principles described actions that members "should" do: "intervene in the exchange market if necessary to counter disorderly conditions …" and "take into account in their intervention policies the interests of other members …".

Surveillance over Financial Sectors

64. **The Fund further expanded the interpretation of the surveillance mandate by making the assessment of financial stability mandatory for countries that were deemed to have a "systemically important financial sector."** The Executive Board approved an additional guidance note in 2009, covering financial sector surveillance. That note stressed that surveillance of financial sectors (banks and similar institutions) was "a core area of Fund surveillance." For nearly two decades, the Fund had gradually added coverage of financial sectors into bilateral consultations. Going forward, the staff was expected to aim to "move beyond 'coverage' of financial sector issues, toward their 'integration' into the set of analyses and policy advice provided in Article IV surveillance."[48] To alleviate the pressure on staff resources from this expansion, the Board introduced a "revised approach" in which FSAP update reports would be more targeted in scope.[49] A year later, it led to mandatory assessments for countries with a "systemically important financial sector." That decision effectively moved part of the assessment process out of the "technical services" provisions of Article V and into the surveillance provisions of Article IV and thereby stated a new obligation for a subset of the membership.[50]

Assessment

65. **The surveillance mandate evolved in response to progression in global economic conditions.** The original focus of the founders and early leaders of the IMF was on helping member countries maintain fixed exchange rates in the context of multilateral settlement of payments and convertibility of national currencies into gold or U.S. dollars. The forerunner of the surveillance mandate was simply the process of consulting with members on the removal of exchange restrictions. As more and more countries accomplished that initial task, the work of the Fund shifted naturally toward advising members on the macroeconomic policies that would be needed to maintain exchange rate parities. When the widening range of convertible currencies rendered the system of fixed rates unviable, the focus shifted again toward advising members on the full panoply of policies—structural as well as macroeconomic—on which systemic stability depended.

66. **Although the process was essentially reactive rather than proactive, its path traced a clear outline in which bilateral surveillance became increasingly more comprehensive in its coverage of economic conditions and policies.** The Fund's membership was affected by and responded to these evolving conditions in diverse ways. Preferences varied as to whether exchange rates should be fixed or allowed to float and as to the extent to which the Fund should attempt to guide national policymaking through its surveillance activities. Countries formed a shifting array of

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[48] "Financial Sector Surveillance Guidance Note," SM/09/114 (April 24, 2009), p. 4.

[49] IMF (2009c).

[50] The 2010 mandate covered 24 member countries plus Hong Kong SAR, which is part of the People's Republic of China. Coverage was extended in 2013 and again in 2021, after which it included 47 countries, including China as a whole.

groups to develop and promote their interests. Guiding the Fund's responses was the responsibility of the Managing Director, who serves as both the head of the staff and the chair of the Executive Board. The evolution of the surveillance mandate thus mainly reflected a series of compromises as the Managing Director sought to build consensus among competing interest groups. The dominant remaining systemic challenge at the end of 2011, as discussed in the main evaluation paper, was the task of integrating the Fund's work on bilateral and multilateral surveillance.

IV. EVOLUTION OF THE LENDING MANDATE

67. **The IMF's mandate as a lender has two dimensions: the types and purposes of its lending and the conditions it places on borrowers.** Each has evolved greatly since the Fund's founding at the 1944 conference at Bretton Woods (Box 3).

Box 3. Timeline of the Evolution of the IMF's Mandate: Lending

1942–44	Negotiations for Bretton Woods establish a mandate for the Fund to lend to help countries cover balance of payments needs.
1947–52	The Executive Board develops policies and procedures based on interpretations of the Articles and practical experience.
1952	The Executive Board adopts procedures for Stand-By Arrangements (SBA), known as the "Rooth Plan" after the Managing Director, Ivar Rooth.
1954	The Fund approves the first SBA with policy conditions, in which Peru agrees not to change its policies on intervention in foreign exchange markets.
1956	An SBA for Chile introduces the phasing of drawings throughout the period of the arrangement.
1957	An SBA for Paraguay is the first to include "performance criteria" governing the right to draw on the arrangement.
1958	An SBA for Peru inaugurates the use of a "letter of intent" expressing the member's policy commitments.
1963	The Compensatory Financing Facility (CFF) is designed to assist a subset of the membership: exporters of primary commodities.
1968	The Executive Board approves the first formal guidelines for policy conditions in SBAs.
1974	The introduction of trust funds, separate from the IMF's general resources, enables the IMF to lend on concessional terms to a subset of the membership.
1979	The Executive Board approves new conditionality guidelines to replace those issued in 1968.
1982	The Fund introduces the concept of requiring participation from commercial creditors as a condition for approval of arrangements, initially with Argentina and Mexico.
1985	For the first time, the Fund approves a program (for Colombia) that it will monitor without any financial involvement.
1989	The Fund participates in the Brady initiative, which requires private creditors to accept reduction in the value of outstanding loans.
1990s	The Fund gradually increases its use of structural conditions, ultimately making such conditions a nearly universal component of its program support.
1990s	The Fund responds to the collapse of the Soviet Union by taking in 15 new members and devising innovative ways to provide financial support to them.
2002	The Fund adopts new conditionality guidelines aimed in part at streamlining structural conditions. These guidelines replace those approved in 1979.
2002	The Fund adopts a formal policy on exceptional access to its financing.
2009	The Fund simplifies its lending facilities and eliminates the CFF.
2010	The Fund establishes a policy allowing for greater risk of program failure in cases with significant international spillovers.

Source: Author's elaboration.

1944–52: Origins of Conditionality

68. **In the multilateral negotiations that led up to Bretton Woods, views differed on the lending process.** The two main delegations (the United States and the United Kingdom) agreed that a major function of the IMF would be to lend members' pooled financial resources to members in need of BOP financing. The U.S. national interest was in establishing an institution that would provide the financial resources to enable allied countries to restore international trade, purchase imports from the United States and other countries, and avoid the autarky that had prevailed in the years leading up to World War II. The mantra, in the words of the lead U.S. negotiator, Harry Dexter White, was that "prosperity, like peace, is indivisible." The U.S. economy could not prosper after the war unless other countries had the means to purchase American output. The British team, led by John Maynard Keynes, had a similar vision and interest, derived from their own depleted currency reserves. Nonetheless, the two teams had very different interests and views as to how IMF lending was to be controlled. The U.S. position was that the IMF would lend only upon approval by a resident board of directors. The British position was that lending should be automatic in response to legitimate requests from members.

69. **The outcome of the negotiations was to make lending available "under adequate safeguards" and empower the Executive Board to control lending decisions, which was essentially the U.S. position.** As stated in Article I, the IMF would "give confidence to members by making the Fund's resources available to them under adequate safeguards."[51] Article X established a board of Executive Directors, which "shall function in continuous session" and "shall be responsible for the conduct of the general operations of the Fund, and for this purpose shall exercise all the powers delegated to them by the Board of Governors." In practice, that phrasing meant that all requests to borrow from the Fund would be subject to approval by the Executive Directors, who would decide whether the Fund could satisfy the request "under adequate safeguards."[52] The ambiguity of that phrase meant that it would be subject to interpretations that would evolve with experience.

70. **The Executive Board made its first official interpretation of "under adequate safeguards" in September 1946, before the Fund was ready to begin lending.** The initial issue was to define the specific purposes of IMF lending. In response to a request from the Governor for the United States, the Executive Board issued a decision stating that the Fund could lend only "to give temporary assistance in financing balance of payments deficits on current

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[51] Technically, the IMF does not lend its general resources. It engages in currency swaps with members, subject to a repurchase plan and a schedule of charges. Because the economic effects are identical to loans, the IMF now uses the more familiar terminology in its public communications. In 1969, the First Amendment to the Articles amended Article I to read "... making the Fund's resources **temporarily** available ...."

[52] See Joseph Gold, "Use of the Fund's Resources," Chapter 23 in Horsefield (1969), Vol. 2. Rule G-5, adopted in 1947, provided that the Executive Board need not be engaged unless meeting the request would raise the member's drawings above 5 percent of quota; Horsefield (1969), Vol. 3, p. 293.

account for monetary stabilization operations."[53] The Fund could not lend in response to a capital account outflow or a domestic fiscal deficit, and it had to require borrowers to restore their credit balances through timely repayments.[54]

71. **The next issue was to affirm that the Executive Board could reject, postpone, or place conditions on requests that, in its view, were not consistent with the purposes of Fund lending.** The "conditionality" that subsequently became a central feature of Fund lending was not specified in the Articles of Agreement, and so the Board issued a decision in May 1947 that implicitly interpreted "adequate safeguards" as granting these powers. To request a loan from the Fund, a member had only to declare that it needed the currency for current account payments, as specified in the 1946 decision. "But the Fund may, for good reasons, challenge the correctness of this declaration …". In that event, "the Fund may postpone or reject the request, or accept it subject to conditions."[55]

72. **As the Fund began lending, the issues of timely repayment and temporary use of resources became apparent.** The IMF began lending in March 1947, mostly in small amounts that were made immediately available to the borrower but only for short periods. Experience soon showed that the repurchase provisions in the Articles were insufficient to ensure that borrowers would be both able and willing to repay loans in a timely manner. For the next four years, under the leadership of Managing Director Camille Guth, the Executive Board devoted numerous meetings to this issue in an attempt to find a compromise that would be acceptable both to those who were concerned to ensure that Fund resources would be put to good use and repaid promptly and to those who were keen to ensure that members would have the assurance that funds would be available to them when needed.

73. **The Rooth Plan, as it came to be called, contained the germ of the idea for Stand-By Arrangements (SBAs) in which disbursements are made conditional on the borrower's compliance with policy commitments made to the Fund as part of the arrangement.** The Fund finally achieved a breakthrough in 1952 after Ivar Rooth succeeded Guth as Managing Director. Rooth proposed, and the Executive Board eventually approved, proposals to stretch out loan disbursements and strengthen incentives for early repurchases. As Rooth stated in the introduction to the Executive Board decision, "the task of the Fund is to help members that need temporary help…. The Fund's attitude … should turn on whether the problem to be met is of a temporary nature *and whether the policies the member will pursue will be adequate* to overcome

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[53] Pursuant to Decision No. 71-2, September 26, 1946; reproduced in Horsefield (1969), Vol. 3, p. 245. For the background to this decision, see Horsefield (1969), Vol. 2, p. 385.

[54] In 1961, the Executive Board decided "by way of clarification that Decision No. 71-2 does not preclude the use of the Fund's resources for capital transfers in accordance with the provisions of the Articles." Horsefield (1969), Vol. 3, p. 245.

[55] Decision No. 284-4, May 29, 1947; reproduced in Horsefield (1969), Vol. 3, p. 227. For a discussion of the legal origins of conditionality, see "Conditionality in Fund-supported Programs—Purposes, Modalities, and Options for Reform," SM/09/30.

the problem within such a period" (emphasis added). "Sometimes a member may want to submit to the Fund a specific request for drawings, with adequate information as to the particular situation which prompts the request. At other times discussions between the member and the Fund may cover its general position, not with a view to any immediate drawing, but in order to ensure that it would be able to draw if … the need presented itself."[56]

1952–67: Evolution in Lending Practices

74. **The Rooth Plan became the backbone of the interpretation of the Fund's lending mandate, and it remains so to the present day.** Adoption of the Rooth Plan set in motion an evolution in Fund lending in which SBAs gradually supplanted simple drawings and in which formal policy conditions were introduced gradually into many arrangements. The plan itself, however, was subject to further interpretation, including with reference to the consequences of "discussions between the member and the Fund."

75. **After the origination of the SBA, a provision was added to introduce reviews by the Executive Board as a condition for further disbursements under arrangements.** Initially, once the Fund approved an SBA, the member was considered to have the right to draw on it "without further review by the Fund" unless the Fund formally declared the country to be ineligible to use its resources or the Executive Board took a decision to suspend transactions.[57] In 1961, the Fund added a provision that if the Managing Director or an Executive Director proposed a review, "purchases under this Stand-By Arrangement will be resumed only after consultation has taken place between the Fund and the member and agreement has been reached on the terms for the resumption of such purchases."[58]

76. **The next major issue that arose concerned the possibility of more diverse lending patterns to cater to the range of circumstances that member countries were facing**. As the IMF gained experience with lending, a dilemma arose. From the beginning, the Fund interpreted its mandate as requiring it to treat all members alike, without regard to political or other factors outside those delineated in the Articles.[59] Nonetheless, if countries faced a variety of circumstances, it was desirable and even necessary to tailor the Fund's assistance to each country's particular needs. The Fund could not apply conditionality uniformly without regard to circumstances.

[56] Decision No. 102-(52/11), February 13, 1952; reproduced in Horsefield (1969), Vol. 3, pp. 228-30. For a discussion of the specifics of the Rooth Plan, see Horsefield (1969), Vol. 2, pp. 401-03.

[57] Decision No. 270-(53/95), December 23, 1953; reproduced in Horsefield (1969), Vol. 3, pp. 231-32.

[58] Decision No. 1151-(61/6), February 20, 1961; reproduced in Horsefield (1969), Vol. 3, p. 234.

[59] See footnote 15 of "Access Policy in Capital Account Crises", SM/02/246, which provides that "Uniformity is the basic legal principle that governs all the activities of the Fund. This principle is based on the Articles of Agreement, which, with very limited exceptions (Article V, Section 8(c); Article V, Section 12(f)(ii) and (Iii)), establish the same rights and obligations for all members. Moreover, some provisions in the Articles are specific in declaring that uniformity must be observed (Article II, Section 2, second sentence, on membership terms; Article V, Section 8(d), on charges; Article V, section 9a) on remuneration).

Special Lending Facilities

77. **The IMF's response to the economic challenges faced by newly independent developing countries dependent on exporting primary commodities was the establishment of the Compensatory Financing Facility for Export Fluctuations (CFF) in 1963, which provided special financial assistance without policy conditions.** In the early 1960s, the Fund was incorporating many newly independent developing countries into the membership. A number of those countries were economically dependent on exporting primary commodities, the prices of which were set in global markets and were largely out of the control of the exporters. Dips in market prices—which were especially prevalent in the late 1950s and early 1960s—were generating payments shortfalls independently of any policy shortcomings. Throughout that period, multiple agencies within the United Nations system prevailed on the UN Economic and Social Council to ask the IMF to help primary commodity exporters with special financial assistance. In response, the Fund established the CFF in 1963 so that it could lend to countries that had suffered temporary export shortfalls, with lower conditionality and with immediate rather than phased disbursements.

78. **Subsequently, the CFF became the prototype for the Fund to establish other similarly special lending facilities linked to specific economic conditions.[60]** The CFF applied in practice but was not formally limited to countries that depended heavily on exporting primary commodities. The Decision establishing the CFF merely noted that it was intended to "more readily assist members, primarily primary exporters, encountering payments difficulties produced by temporary export shortfalls … where the Fund is satisfied that (a) the shortfall is of a temporary character and is largely attributable to circumstances beyond the control of the member; and (b) the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties."[61] In this same line, other facilities included the Buffer Stock Financing Facility in 1969, to provide financing to members to help finance their contributions to approved commodity price stabilization agreements; and two successive Oil Facilities for oil-importing countries in 1974 and 1975. In each case, the facilities were open to all members, but only when they faced the designated conditions.

1968: Establishment of a Formal Policy

79. **The lack of a general policy of conditionality became a point of contention within the Fund when the United Kingdom applied for financial support in 1967. That event paved the way for the establishment of a formal policy.** Throughout the first two decades of lending, the IMF applied conditionality unevenly, case by case according to the perceived

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[60] The CFF itself has been transformed multiple times. In 1981, it was supplemented by the Facility for Fluctuations in the Cost of Cereal Imports. In 1988, both facilities were replaced by the Compensatory and Contingency Financing Facility. In 2000, that facility was renamed the Compensatory Financing Facility.

[61] Decision No. 1477-(63/8), February 27, 1963; reproduced in Horsefield (1969), Vol. 3, pp. 238-40. At the same time, the Fund relaxed certain limits on how much members could borrow in total so that usage of the CFF would not reduce the capacity for other borrowing; and promised to give favorable consideration to requests from commodity exporters for quota increases so as to boost their overall borrowing limits.

circumstances faced by borrowers. By the mid-1960s, performance clauses had become a standard but not yet universal element in SBAs. In contrast to most other arrangements that were then effective, the Fund allowed the United Kingdom to draw up to the full amount of the stand-by at any time without any review of the completion of its policy commitments. When the Executive Board met to approve the arrangement, some directors from developing countries—led by the Executive Director from Brazil, Alexandre Kafka—noted that they hoped the Fund would be as generous in its confidence in them as it was with this major industrial country. Although the Board approved the arrangement unanimously, the discussion prompted the Fund to develop a formal policy on conditionality.[62]

80. **The 1968 guidelines formalized existing practices, in which SBAs with phased drawings subject to performance criteria were the dominant form of Fund lending.** The new decision did, however, place some guardrails around the Fund's ability to tailor its arrangements to each country's situation. "Phasing and performance clauses" would be required only when a country's overall indebtedness would exceed the "first credit tranche" (25 percent of quota), but "consultation clauses" were to be included in all arrangements. Phasing of drawings could be omitted in exceptional circumstances, but consultations would still be required. Conditionality would have to be targeted to the problem at hand: "Performance clauses will cover those performance criteria necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives, but no others."[63]

81. **The Fund's formal policy on conditionality was also incorporated into the First Amendment of the Articles, which the Board of Governors approved in May 1968 and which took effect in July 1969.** Section 3 of Article V, which governed the use of Fund resources, was amended with the addition of two subsections:

> "(c) A member's use of the resources of the Fund shall be in accordance with the purposes of the Fund. The Fund shall adopt policies on the use of its resources that will assist members to solve their BOP problems in a manner consistent with the purposes of the Fund and that will establish adequate safeguards for the temporary use of its resources.
>
> (d) A representation by a member under (a) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the provisions of this Agreement and with the policies adopted under them, with the exception that proposed gold tranche purchases shall not be subject to challenge."

82. **While the 1968 guidelines remained in place for the next decade, Fund financing under SBAs declined, and use of special facilities with limited conditionality increased.** The guidelines remained through the collapse of the Bretton Woods exchange rate system, the onset of widespread price inflation, the oil price shocks of 1974 and 1978, and a rise in cross-border

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[62] de Vries (1976), Vol. 1, pp. 338-43.

[63] Decision No. 2603-(68/132), September 20, 1968; reproduced in de Vries (1976), Vol. 2, p. 197.

lending by international banks that offered many members an alternative to borrowing from the IMF. During that time, the volume of Fund lending declined, and conditionality became less widely applied. The less conditional special facilities (the CFF and the oil facilities) were drawn upon relatively more, and members availed themselves of the newly guaranteed right to draw on their gold tranche reserves.[64]

1974–78: Further Evolution

83. **The "uniformity of treatment" imperative was raised again in 1974, when the idea of a Trust Fund for concessional lending was envisaged**. At that time U.S. officials asked the IMF to provide longer-term financial assistance to low-income countries on concessional terms, financed by selling a portion of the Fund's stock of gold. After some discussion of options for establishing a separate institution for this purpose or relying instead on the World Bank, Fund officials suggested creating a Trust Fund with the IMF itself as the trustee. This expansion of the IMF into a trustee was a radical departure from the previous structure in which the Fund managed only its own quota-based resources and those that were lent to it, primarily through the GAB. The creation of the Trust Fund in 1976 established a practice that the IMF later used repeatedly to provide loans and grants to members consistently with the uniformity of treatment principle that applies to the General Resources Account and resources from the Special Disbursement Account.[65]

84. **A general criticism arose that the shift in lending toward the special facilities resulted in large measure from conditions in SBAs becoming too severe.** In the years 1974 through 1978, some three-fourths of all IMF credit outstanding had limited conditionality. The sudden large rise in oil prices in 1978 induced a new round of soul-searching at the Fund, as it faced pressures to increase its financial support for oil-importing developing countries. With little room (and little appetite from management or major creditors) for further use of special facilities, the Fund had to reconcile the pressure for more lending with the need for a shift back into lending through SBAs.[66]

1979: New Conditionality Guidelines

85. **The only way to reconcile these competing demands was to relax conditionality by enough to encourage borrowing members to accept it.** To reaffirm the importance of conditionality while responding to these criticisms, the Executive Board approved new guidelines in March 1979.[67] With respect to conditionality, the new guidelines tightened the limitations on the range of policies that could be subjected to performance criteria in SBAs. Instead of vaguely

[64] The gold tranche, which was reconstituted as the reserve tranche in the Second Amendment, represented the member's subscription to the Fund, equivalent to 25 percent of its quota.

[65] For a discussion of the concerns raised about uniformity of treatment and the creation of the Trust Fund as a way around the problem, see de Vries (1985), Vol. 2, Chapter 34.

[66] Boughton (2001), pp. 560-66.

[67] Decision No. 6056-(79/38), March 2, 1979; reproduced in Boughton (2001), pp. 629-31.

restricting performance criteria to those "necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives," as in the 1968 decision, the 1979 guidelines were more specific:

> "The number and content of performance criteria may vary because of the diversity of problems and institutional arrangements of members. Performance criteria will be limited to those that are necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact."

86. **The 1979 guidelines also responded to criticisms from developing countries and others that it had become too dictatorial and dogmatic in its negotiations with members seeking to borrow from it.** Henceforth, the Fund should take greater care to ensure that the policy programs it was supporting reflected the circumstances and preferences of the member country. Specifically, "the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payments problems."

87. **A third innovation in 1979 was to allow explicitly for SBAs longer than one year:**

> "The normal period for a Stand-By Arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the Stand-By Arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years."

88. **The Fund's 1979 guidelines initially aimed to increase loan demand by setting less stringent conditions, but over time, conditionality increased substantially, leading to renewed criticism of the IMF.** The new guidelines had the intended effects of increasing the overall demand for financial support from the Fund, shifting lending more heavily into Fund arrangements rather than the special facilities and outright drawings, and easing the extent and weight of policy conditions. Overall, much of the criticism of IMF practices in the immediate aftermath of the 1979 guidelines focused on the apparent easing of conditionality in SBAs and ignored the corresponding increase in the portion of Fund lending through SBAs.[68] Over the next two decades, however, conditionality increased substantially, and the prevailing criticisms once again focused on the lack of clarity on the scope of conditionality, the monitoring of conditionality, and boundaries between the core areas of Fund and other institutions' areas of expertise.[69]

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[68] See the conference papers collected in Williamson (1983).

[69] See "Conditionality in Fund-Supported Programs – Overview," SM/01/60 (February 20, 2001).

1980–99: Further Expansion and Broadening of Conditions

89. **Following the adoption of the 1979 guidelines, the IMF initiated other expansions in the nature and range of its lending without the need for a formal reformulation or reinterpretation of the mandate.** These innovations included greater interaction with other creditors and changes in the application of conditionality. Until the 1980s, the IMF generally made independent decisions on how to respond to borrowing requests from each member, while sometimes using informal persuasion as necessary to induce other creditors to offer additional support. A clear break occurred in 1982 when the Managing Director informed an international committee of commercial banks that he would ask the Executive Board to approve arrangements for Argentina and Mexico only if the commercial creditors would make a formal commitment to increase their own loan exposure. Throughout the rest of that decade and the next, the Fund's lending to heavily indebted countries became increasingly linked to commensurate actions by commercial and public creditors so as to satisfy the Fund's policy on financing assurances and enable the Fund's own lending to have a positive catalytic effect on others.[70]

90. **The decade of the 1990s stands out as the apex of the implicit expansionary interpretation of the mandate on IMF lending. This expansion took several forms.**

91. **First, when the Soviet Union was imploding in 1990, the IMF took bold steps that did not seem to be obviously within its purview, including by convening a diverse group of multilateral institutions to prepare the first detailed study of the Soviet economy (which was not and never had been a member) and discussing a "special association" for the USSR within the IMF.** After the dissolution of the Union, the IMF quickly accepted all 15 successor states as members and devised a novel lending facility—the Systemic Transformation Facility (STF)—to provide support for the early stages of transition from centrally planned to market economics in relatively small amounts and with limited conditionality. Most of the new members needed a burst of early financing to jump-start their participation in the global market economy, but they would not be able to implement effective and sustainable macroeconomic policies until the transition was further advanced. The Fund designed the STF to be a temporary facility for this purpose. It was in effect for just over two years (1993–95), and 22 countries drew on it before it was dissolved.[71]

92. **Second, through a gradual and informal evolution, the IMF expanded the use of structural policy conditions in its lending arrangements.** As noted above, the Fund could impose structural conditions as performance criteria under the 1979 guidelines "only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact." In the 1990s, the Fund had increasing recourse to "exceptional cases" and often included performance criteria on policies such as ceilings on particular types of public sector borrowing. In addition, it began making regular use of "structural benchmarks,"

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[70] Boughton (2001), Chapters 6-12. The handling of the 1982 crisis is in Chapter 7.

[71] For a detailed account, see Boughton (2012), pp. 198-202.

which often were non-quantitative markers of progress in program implementation. Shortfalls in structural benchmarks could trigger more thorough program reviews and, if judged to be serious enough, could delay disbursements. The IMF modified these practices in response to numerous problems that had cropped up in programs with only macroeconomic conditions, but the changes led to criticisms that the IMF seemed to be evolving beyond both its mandate and its expertise. A decade later, as discussed below, it adopted new guidelines that continued but circumscribed the use of structural conditionality.

93. **Third, the IMF adopted the achievement of "high quality growth" in member countries as an institutional objective.** The Fund's engagement with low-income countries burdened with extreme poverty and weak administrative capacity and with countries weakened by corruption as they attempted to transform away from central planning induced management to broaden the institution's focus. Following the leadership of Managing Director Camdessus on this drive, extreme poverty and income inequality, "unproductive" government spending such as "excessive" military outlays, and fiscal corruption all became targets of the Fund's lending as well as surveillance activities.[72]

94. **Fourth, in response to a financial crisis in Mexico toward the end of 1994, the IMF relied on the danger of "contagion" to other emerging market countries to justify an exceptionally large and rapidly negotiated adjustment program.** The longstanding view that lending had to be aimed solely at resolving the member's own BOP shortfalls was interpreted to allow lending in support of a domestic budget shortfall as long as the arrangement also helped resolve a balance of payments need.[73] set aside. In other cases throughout the decade, the Fund made loans that effectively supported domestic fiscal rather than external BOP problems. The 1946 Executive Board Decision that implicitly prohibited lending to finance domestic deficits was not set aside, but the Fund seems to have interpreted it much more liberally.

2000–11: Easing the Burden on Indebted Countries

95. **The first decade of the 21st century was mostly a period of retrenchment rather than expansion of interpretations of the mandate, in response to significant backlash to earlier Fund practices.** By the turn of the millennium, criticism of the Fund had become so deep-seated and extensive that the annual Governors' meeting in 2000 was held within a

[72] Camdessus' effort to get the IMF to focus on corruption began in 1991 and continued throughout the decade. See Camdessus (2016), pp. 176-79.

[73] Specifically, Fund resources may be used to finance the budget, provided the following conditions are met: (i) the member represents that it has an actual balance of payments need, (ii) the member has committed to implement policies, including in the context of a program, that will assist in resolving its payments problem and ensure repayment, and (iii) the member's program is designed, in broad terms, in a manner that envisages that the amount equivalent to the foreign exchange provided by the Fund will be used to meet a payments deficit or to strengthen reserves (Staff Guidance Note on the Use of Fund Resources for Budget Support, March 23, 2010, EBS/10/55).

blocks-wide security perimeter to keep protestors at bay. The "fifty years is enough" movement that had permeated coverage of meetings in the mid-1990s had given way to the Jubilee 2000 Campaign, which sought to push the Fund and the World Bank toward policies perceived to be more friendly to low-income and other developing countries, including through forgiveness of outstanding loans. Growing pressure from non-governmental organizations was beginning to influence national parliaments and governments. In addition, especially in the wake of financial crises in several East Asian countries in 1997–98, many staff were increasingly receptive to the view that structural conditionality had become so extensive as to be counterproductive.

96. **In 2001, the Managing Director, Horst Köhler, directed the staff to review its lending practices, including the 1979 guidelines.** To better gauge the nature and validity of the intense criticism directed at the Fund, the staff initiated a series of seminars—in Berlin, London, and Tokyo—at which government officials and civil society organizations from many countries explained their positions. A key conclusion was that the Fund's conditionality guidelines should focus on processes as well as outcomes. It had become common practice that the Fund's initial response to a request for financial assistance was for the staff to formulate a tentative set of policy reforms at headquarters. A staff mission would then travel to the country and negotiate a program using that initial formulation as the starting position. In many cases, this practice tended to undermine local political support for the reform program. That in turn made a successful implementation more difficult and less likely.

97. **As for outcomes, the phrase "macroeconomic impact" as the limiting factor on structural conditionality in the 1979 guidelines had proved to be too permissive.** Throughout the 1990s, the number and diversity of structural benchmarks had proliferated. In some cases, the complexity of program design had diverted attention from the issues at the center of the country's economic problems and had further deepened the loss of domestic ownership of the program. The staff concluded that new guidelines should try to limit the use of structural conditionality as much as possible while still retaining it where it was most needed.

New Conditionality Guidelines in 2002

98. **For the first time, the 2002 guidelines prescribe how the Fund should proceed when a member requests financial assistance.** The Executive Board approved new guidelines in September 2002.[74] These guidelines, which (with a few amendments) govern the formulation of Fund-supported programs today, are more specific and detailed than those of 1968 or 1979, and they interpret the Fund's lending mandate in ways that define the Fund's role more specifically than the earlier decisions.

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[74] IMF (2002).

99. **The key provision governing the process of negotiations pays tribute to the crucial importance of "national ownership of sound economic and financial policies and an adequate administrative capacity."** To promote national ownership, "the Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies." The accompanying "Staff Statement," which also was reviewed by the Executive Board, clarified that this principle means that:

> "in responding to a member's request for access to Fund resources, it is expected that the initial response by the staff will be to ascertain, through dialogue, how the authorities intend to adjust policies. Based on those intentions, the staff will endeavor to reach understandings with the authorities on a mutually acceptable means of achieving the program goals, while paying due regard to the domestic social and political objectives, the economic priorities, and the circumstances of the member, including the causes of the balance of payments problem and the member's capacity to implement reforms in the necessary time frame."

100. **The key provision governing the content of Fund-supported programs states that conditionality is to be "applied parsimoniously" and should cover only "those variables or measures that are reasonably within the member's direct or indirect control** and that are, generally, either (i) of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them." The Staff Statement clarified that "parsimony means that program-related conditions should be limited to the minimum necessary to achieve the goals of the Fund-supported program or to monitor its implementation and that the choice of conditions should be clearly focused on those goals."[75]

101. **The guidelines thus introduced "national ownership" and "macrocriticality" into the lexicon as mandated goals of Fund relations with members seeking financial support (Figure 2).** Macrocritical means that conditions should be of critical importance for achieving the goals of the member's program or for monitoring its implementation. Moreover, the goals of all Fund-supported programs were clarified to be: "(a) solving the member's balance of payments problem without recourse to measures destructive of national or international prosperity; and (b) achieving medium-term external viability while fostering sustainable economic growth." Strengthening this last point still further, the Staff Statement noted that "sustainable growth means growth that is strong, durable, and equitable, with reasonable price stability."[76]

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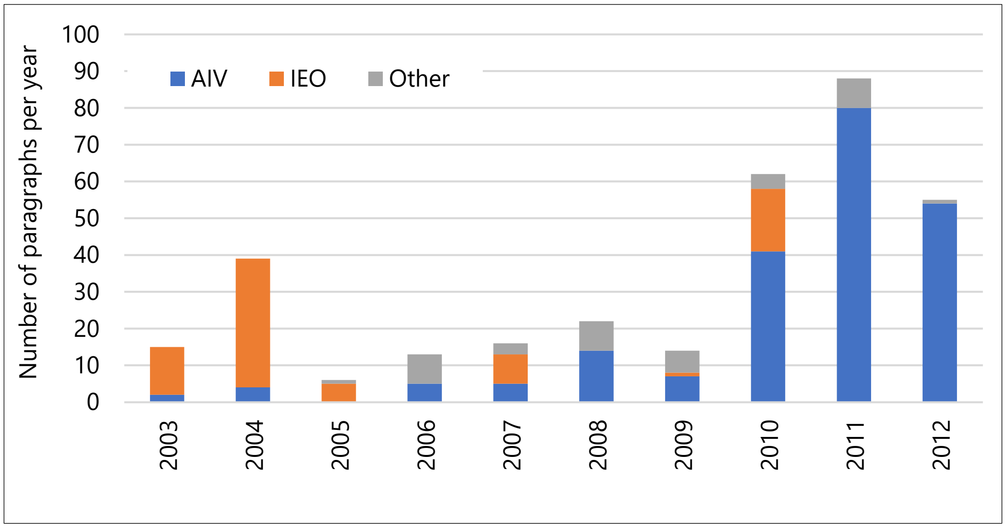
[75] In 2009, the Executive Board reinforced this policy by agreeing to forego all structural performance criteria and to use structural benchmarks only for monitoring the implementation of structural reforms. See IMF (2009a).

[76] This definition of sustainability echoes an observation made in 1977 by Jacques Polak during an Executive Board meeting on the proposed initial surveillance decision: "the term 'sustainable' does not simply refer to an objective situation—one that can be sustained—but also has some normative overtones—a situation that deserves to be sustained," Minutes of EBM/77/10, January 19, 1977, p. 3.

Other key elements that the guidelines strengthened include "tailoring of programs to the member's circumstances, effective coordination with other multilateral institutions, and clarity in the specification of conditions."

Figure 2. Macrocriticality: Count of Relevant Paragraphs in Selected IMF Documents



Source: IEO staff calculations.
Notes: The figure presents number of paragraphs containing the keyword "macrocritical" in selected collections of IMF documents. AIV stands for Article IV reports, and IEO for IEO evaluations. Category "Other" contains the following collections (number of relevant paragraphs over the entire 1996–2012 period in parentheses): Selected Decisions and Selected Documents of the IMF (15); BAR - Executive Board's Annual Reports (7); Regional Economic Outlooks (6); IMF Working Papers (6); Selected Issues Papers (5); IMF Staff Position Notes (0); Policy Discussion Papers (0); G7 and G20 communiqués (0); Accountability Framework documents (0); Fiscal Monitors (0); and Global Financial Stability Reports (0).

102. **Also in 2002, the Fund approved a new policy on "exceptional access" to ensure that it would not lend into conditions in which a borrower was unlikely to achieve a sustainable external debt position.** The Articles of Agreement have always limited each member's indebtedness to the Fund to 100 percent of its quota unless the Fund grants a waiver.[77] Throughout its history, the Fund has routinely granted such waivers. In addition, from the late 1970s through the early 1990s, the Fund occasionally invoked what it called the "exceptional circumstances clause" to approve arrangements that would exceed broader access limits that had been set by the Executive Board.[78] Beginning with an arrangement for Mexico in 1995, approvals of exceptional access became much more frequent.[79] As discipline weakened,

[77] Article V, Section 3(b)(iii) specifies that the Fund may not hold more than 200 percent of the purchasing member's quota. Section 4 specifies conditions under which the Fund may waive this provision.

[78] The exceptional circumstances clause was established as part of the Supplementary Financing Facility in February 1979. For the background, see Boughton (2001), pp. 878-89.

[79] Boughton (2012), pp. 752-53.

pressures intensified for the Fund to approve large programs with relatively low chances of success. In response to these concerns, in 2002 the Fund adopted a formal policy that specified four conditions that would have to be satisfied before the Fund would approve exceptional access to its financing[80]:

(i) The member is experiencing exceptional BOP pressures on the capital account resulting in a need for Fund financing that cannot be met within the normal limits.

(ii) A rigorous and systematic analysis indicates that there is a high probability that debt will remain sustainable.

(iii) The member has good prospects of regaining access to private capital markets within the time Fund resources would be outstanding, so that the Fund's financing would serve as a bridge.

(iv) The policy program of the member country provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

103. **The clearest innovation in this policy was the requirement for prospective debt sustainability.** The Fund had introduced a framework for assessing debt sustainability in the mid-1990s, but only for Heavily Indebted Poor Countries (HIPCs) applying for debt relief and only through numerical ratios. From 2002, it was committed to developing a more rigorous analysis and applying it more broadly. It began applying this new approach in an SBA for Argentina in September 2003.[81] In 2010, however, despite concerns that the IMF could once again be pressured to approve weak programs in select cases, the Fund introduced an important exception: "However, in cases where there are significant uncertainties that make it difficult to state categorically that there is a high probability that the debt is sustainable over this period, exceptional access would be justified if there is a high risk of international systemic spillovers." Instead of the usual procedure in which a general policy would be discussed and approved by the Board on the basis of a staff analysis and then applied in specific cases, this policy was introduced in the staff report on Greece and approved as a general policy as a component of the SBA for Greece.[82] In 2016, this systemic exemption was removed, being seen as having several shortcomings, including unreliability in mitigating contagion.[83]

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[80] IMF (2004), p. 4.

[81] In that case, the Executive Board approved the program despite the finding that two of the criteria for exceptional access were not met, because it found that a process of debt restructuring was underway. See IMF (2004).

[82] See IMF (2010a), p. 20. The quoted sentence was incorporated in the Executive Board decision approving the arrangement, as an addition to the debt sustainability criterion adopted in 2002. For an analysis of the potential risks from this policy, see Schadler (2017).

[83] See forthcoming IEO evaluation on the IMF's Exceptional Access Policy and its issues paper (IEO, 2023).

Proposal for a Sovereign Debt Restructuring Mechanism

104. **In the period 2001–03, the Fund made another attempt to support debt sustainability for its heavily indebted members by promoting the creation of a Sovereign Debt Restructuring Mechanism (SDRM).** The proposal was initiated by First Deputy Managing Director Anne O. Krueger, whose research over many years had convinced her that international financial markets could not function properly without a system akin to bankruptcy. The mechanism that she proposed would have entailed: (i) a request by a member that was facing difficulties servicing its external debt for a stay on creditor action against it; (ii) a determination by the IMF that the country was undertaking appropriate policies to restore a sustainable debt position; (iii) approval of the request by a qualified majority of creditors; and (iv) the possibility of financial support from the Fund while the stay was in place. Because the IMF might have been both a creditor and the adjudicator of the request, the proposal envisaged amending the Articles of Agreement to create an independent judicial body within the Fund as well as establishing the legal basis for a binding collective creditor action through a qualified majority.[84]

105. **In 1996, the Fund had considered supporting such a debt resolution mechanism but had rejected it.** At that time, most Executive Directors thought that the Fund should focus on imposing "tight conditionality" on its lending to induce indebted countries to strengthen their economic policies. Making it less costly to escape from unpayable debt burdens was expected to give rise to moral hazards for both creditors and debtors and to raise borrowing costs going forward.[85] Over the next several years, however, the Fund's experience with waves of financial crises across a broad spectrum of emerging markets opened many minds to the benefits of establishing a formal debt resolution process.

106. **Although this exercise did partially achieve its goal by encouraging a greater use of collective action clauses in sovereign debt instruments, the SDRM itself was not enacted.** The initial response from most officials in both creditor and debtor countries was cautiously positive, led publicly by support from the U.S Treasury Secretary, Paul H. O'Neill. In April 2002, the IMFC encouraged the IMF to develop a specific SDRM proposal. The staff proceeded to draft recommendations, and the Executive Board reviewed them throughout the rest of 2002 and into 2003. By April 2003, Managing Director Köhler was able to send the IMFC a detailed report supported by "most Executive Directors" describing how the statutory mechanism might be

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[84] Krueger (2001, 2002).

[85] For the staff analysis, see "Recent Proposals on International Debt Adjustment," SM/96/25 (February 2, 1996). The Executive Board discussed those proposals at an informal seminar on February 16, 1996. The conclusions were summarized in concluding remarks by the acting chairman, BUFF/96/17 (February 26, 1996), and more briefly in IMF (1996), p. 130. The Fund's internal assessment began a year earlier; see "Note on an International Adjustment Facility for Sovereign Borrowers," EBS/95/50 (May 26, 1995).

structured.[86] Nonetheless, for reasons that have never been fully clarified, political support was by then already waning (including in the U.S. Treasury) and was falling short of the level required for amending the Articles of Agreement.[87] After discussing the report, the committee concluded that it was "not feasible now to move forward to establish the SDRM."[88]

Assessment

107. **Throughout the history of the Fund, evaluations of the effectiveness and limitations of IMF lending have focused primarily on the role of conditionality.** The dominant driver of the evolution of conditionality has been experience with the challenges of program implementation and shortcomings in the success of Fund-supported programs. Each major stage—the introduction of conditional SBAs in 1952, the establishment of a formal policy in 1968, and agreements on guidelines in 1979 and 2002—was motivated by a desire to overcome difficulties observed in the preceding years and to improve the likelihood that programs could and would be implemented and that the stated goals would be achieved.

108. **A natural tension has pervaded this evolutionary process.** Creditor countries have an interest in ensuring that use of the Fund's financial resources will be accompanied by policy reforms and will lead to outcomes that will enable timely repayment. Borrowing countries have an incentive to preserve sovereignty in policy formulation and use of borrowed resources. The intersection of these interests is in the Fund's ability to set and apply guidelines that encourage rather than try to force strong economic policies and effective use of resources. As experience has been gained and understandings have evolved, the Fund's Managing Directors, serving as head of the staff and chair of the Executive Board, have played important roles guiding the search for the right balance and the most effective approach to program design.

V. EVOLUTION OF THE TECHNICAL ASSISTANCE MANDATE

109. **Promoting capacity development in member countries is, in a formal sense, the most recent of the IMF's main tasks, dating only from 2012 in its present form.** It emerged, however, from a longstanding responsibility for providing TA to members. The term "capacity development" encompasses both technical assistance and training.

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[86] "Report of the Managing Director to the International Monetary and Financial Committee on a Statutory Sovereign Debt Restructuring Mechanism" (April 8, 2003); https://www.imf.org/external/np/omd/2003/040803.htm. After discussing the report, the Committee noted in its communiqué that "it is not feasible now to move forward to establish the SDRM;" https://www.imf.org/en/News/Articles/2015/09/28/04/51/cm041203.

[87] For a review of the stakeholder debates on the SDRM proposal, see Setser (2010).

[88] "Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund" (April 12, 2003); https://www.imf.org/en/News/Articles/2015/09/28/04/51/cm041203.

1946–77: The Origins of Technical Assistance

110. **TA was not considered at Bretton Woods to be an IMF activity separate from consultations and lending, but it arose organically from those functions (Box 4).** The purposes of the IMF enumerated in Article I of the Articles of Agreement include "to facilitate … and to contribute … to the development of the productive resources of all members," "to promote exchange stability," and "to assist in the establishment of a multilateral system of payments." Advising members on methods and techniques for achieving these goals was a natural, albeit implicit, component of the Fund's work toward achieving those ends.

Box 4. Timeline of the Evolution of the IMF's Mandate: Technical Assistance

1946–	The Fund develops policies and practices reactively, in response to requests from members. It focuses particularly on helping less developed countries establish and strengthen financial institutions.
1964	The Fund formalizes its technical assistance (TA) programs and establishes new bureaucratic units to structure them.
1978	Article V is amended to provide explicitly for Fund TA
1990	Japan initiates the practice of providing external financing for TA programs.
1990s	A new focus emerges on supplementing bilateral TA with multilateral assistance in the form of training at Fund headquarters and the establishment of regional training centers.
1991	Fund management establishes the Technical Assistance Committee (TAC) as a high-level body to oversee the provision of TA.
1992	The Fund establishes a TA Secretariat (TAS) to coordinate and monitor TA activities.
1995	The Fund establishes the Framework Administered Account for Technical Assistance Activities, to administer external resources contributed for TA.
1999	Together with the World Bank, the Fund introduces the Financial Stability Assessment Program on a voluntary basis.
2001	The Fund establishes a formal policy for providing TA. The TAS is elevated in the hierarchy and becomes the Office of TA Management (OTM), reporting directly to the Managing Director.
2006	Management replaces the TAC with a more comprehensive high-level group, the Committee on Capacity Building (CCB).
2008	The IMF declares a new policy to charge some recipients for TA, but in response to the global financial crisis, it abandons the policy before it takes effect.
2009	The Fund agrees to participate in the Mutual Assessment Process (MAP) of the G20.
2010	The Fund makes FSAP participation mandatory for jurisdictions with a "systemically important financial sector."
2012	The establishment of the Institute for Capacity Development expands the concept from TA to CD.

Source: Author's elaboration.

111. **Even before the Fund was ready to begin lending, it received a request from Ecuador in December 1946 to advise its authorities on banking sector reforms.** The Fund responded positively, and from that time onward, it provided ever-increasing amounts and types of TA. This activity—normally offered without charge to recipients, which are mostly relatively low-income members—absorbed a substantial and growing portion of the administrative budget and staff time.

112. **In 1964, in response to growing demands from members for TA, the Fund formalized the provision of such assistance by establishing three new units in its bureaucracy: the Central Banking Service, the Fiscal Affairs Department (FAD), and the IMF Institute (INS).** Each unit, along with additional staff resources in the Bureau of Statistics and the Legal Department (LEG), provided assistance within its area of expertise. By the 1970s, the Fund

was providing TA to regional institutions such as the African Development Bank (AfDB) and the Arab Monetary Fund (AMF) as well as to member countries.[89] It also established regional centers to train economic officials in their home areas.

1978: The TA Mandate is Formalized

113. **The Second Amendment to the Articles of Agreement provided an opportunity for the Fund to incorporate TA expressly into its legal mandate.** Section 2 of Article V, as originally written, limited the scope of "operations on account of the Fund" to the exchange of currencies or gold. The 1978 amendment added a new subsection:

> "(b) If requested, the Fund may decide to perform financial and technical services, including the administration of resources contributed by members, that are consistent with the purposes of the Fund. Operations involved in the performance of such financial services shall not be on the account of the Fund. Services under this subsection shall not impose any obligation on a member without its consent."

The Fund at that time was not administering resources contributed by members for purposes of TA, but the staff drafted the amendment to give the Fund flexibility to do so in the future. That practice began in 1990 when the government of Japan began financing some of the Fund's TA activities. As that activity expanded, in 1995 the Fund established an account to administer those and other contributed resources.[90]

1980–2000: Expansion of TA Activity

114. **The 1990s ushered in a massive increase in TA, driven in large part by the influx of new members after the collapse of the Soviet Union.** By the mid-1980s, the Fund was devoting as much as 130 staff-years annually to TA. Budget pressures then induced the Fund to try to limit the scope of these activities. That effort was reversed in the 1990s. The economies of the new members had operated on non-market lines, with central planning as an organizing principle. The governments of most of the newly independent countries were seeking to transition into a framework in which they could grow by trading in world markets, establishing institutions for the rule of law, generating sufficient tax revenues, and stabilizing their currencies and financial systems. For that to succeed, they needed a great deal of TA. The IMF was just one of several multilateral institutions offering training and other technical services, but it played a major role. To coordinate and monitor this growing range of activities, the Fund established a Technical Assistance Secretariat (TAS) in August 1992.[91]

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[89] de Vries (1985), Vol. 2, p. 921.

[90] See de Vries (1985), Vol. 2, pp. 694-95, for the background to the drafting of Section 2(b). On Japan's role in the 1990s, see Boughton (2012), pp. 241n and 781. For the establishment of the administered account, see Decision No. 10942-(95/33), April 3, 1995.

[91] See "Budgetary Outlook in the Medium-Term – Activities and Resource Utilization. FY 1992-FY 1994," EBAP/92/168 (December 28, 1992), p. 201.

115. **As the scale and scope of TA activities expanded, the demand for resources also grew. That led to the introduction of external financial support, but it also raised concerns about the potential influence of external contributors on TA.** By the end of the decade, the IMF was devoting more than 300 staff years and more than 15 percent of its administrative budget annually to TA activities. The range of activities also rose, including the establishment of regional training centers jointly with other agencies and the occasional provision of TA to non-members, notably the West Bank and Gaza, Cuba, and North Korea.[92] Some relief from the pressure on resources was provided by external financial support from creditor countries, coordination with other TA-providing agencies, and the use of external consultants rather than regular staff. While reducing the pull on IMF resources, these developments raised concerns about the influence of external contributors on the extent and allocation of TA from the Fund.[93] In total, 1999 was the peak year for TA expenses as a percentage of the administrative budget. Afterward, a sustained decline in large-scale capital account crises and the maturation of transition economies reduced demand for TA services.[94]

2001–10: Policies on TA are Made More Specific

116. **An internal review in 1999 found that demand for Fund TA was generally strong, but recipient countries often failed to follow up on the Fund's advice.** The key problems were that "there is no explicit Fund policy on TA, little evaluation, little reporting on results to management and the Executive Board, and little public dissemination of the lessons learned."[95] In response, the Fund developed its first comprehensive policy on TA, setting out the purposes, scope, and modalities of TA from the Fund.[96]

117. **The 2001 policy statement, similarly to the 2002 conditionality guidelines, stressed that country ownership of reforms was essential for successful implementation of the Fund's advice.** Consequently, it concluded that the Fund should tailor its TA more to the needs of recipient countries, should align it more closely to surveillance and lending activities, and should focus more strongly on the Fund's core areas of competence and purposes. To ensure effective implementation, the Fund moved the TAS out of the Office of Budget and Planning, elevated it to a separate office—the Office of Technical Assistance Management (OTM)—and placed it within the Office of the Managing Director.

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[92] Boughton (2012), pp. 239-44.

[93] See IEO (2022), including several of the background papers therein.

[94] IEO (2005), p. 30.

[95] "Review of Fund Technical Assistance," EBAP/99/59 (May 17, 1999), p. 3. The report was prepared by the Fund's Office of Internal Audit and Inspection. (The IEO had not yet been established.)

[96] IMF (2001).

118. **In the post-millennium decade, overall trends in TA were primarily demand-driven, but some upward pressure on the provision of TA was also driven by ongoing changes in the Fund's other activities.** Aside from Executive Board decisions on general policies and budget implications, the governance of the provision of TA was largely in the hands of management and staff. In contrast to surveillance and lending activities, political involvement in this domain was subdued. The Fund was urging members to improve the reporting of relevant data, observe additional standards and codes, implement more sustainable and equitable macroeconomic and structural policies, take greater care to repel money laundering and the financing of terrorism, and strengthen external debt management. In that context, it became even more important to offer sufficient TA to help members achieve these ambitious goals. Overall, however, the extent of Fund TA remained subdued relative to the strong demands in the preceding decade.

The Mutual Assessment Process

119. **The final expansion of TA in this period occurred in 2009, when the G20 asked the Fund to participate in a new form of assistance, the Mutual Assessment Process (MAP).** Although the subject matter of the exercise was surveillance, the nature of the Fund's involvement was to provide voluntary assistance. As the staff report on the request put it, "the Fund's envisaged engagement would be most appropriately regarded as technical advice provided under Article V, Section 2 (b), which authorizes the Fund to provide technical or financial services 'upon request.' The essential quality of such services is that they are voluntary for both the Fund and the member: the Fund does not have to perform such services and the member does not have to receive them."[97] The Fund's role in the MAP was designed to be like other TA activities, in that the advice to the authorities (in this case, the G20) was the product of technical analysis by the staff and was not subject to prior review, revision, or approval by the Executive Board. It differed from conventional TA in that the staff analysis was to be submitted to the Executive Board at the same time as it was conveyed to the G20, and the Executive Board was to be briefed on the outcome of G20 discussions. These unique arrangements were designed to ensure both the independence of the analysis and control of the process by the G20.[98]

Assessment

120. **To address resource constraints, the IMF focused on core responsibilities and expertise in TA, aiming to help members develop capacity for managing future economic challenges.** Secular growth in the provision of TA from 1946 to 2011 was driven by demand, as the role of the Fund as an advisor to governments and central banks became more complex. Because the Fund offered TA to its members free of charge, the usual economic mechanisms for rationing scarce resources did not apply. Hence, the pressure on the administrative budget and

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[97] IMF (2009b), p. 6.

[98] Ibid., p. 9.

on staff time gradually increased until 2001, when the Fund began taking steps to focus its offerings more closely on its core responsibilities and expertise. In line with the 21st century shift in both surveillance and lending toward more collaborative processes between the Fund and its member countries, the Fund's focused approach to TA also was aimed at helping members develop the capacity to manage future economic and financial challenges. That set the stage for the formal re-orientation of TA and training as a unified strategy for capacity development.[99]

VI. OVERALL ASSESSMENT

121. **The evolution of the IMF mandate from Bretton Woods through 2011 was characterized primarily by interpretations, as the Executive Board responded to changing demands and conditions by issuing a series of formal decisions and approving guidance notes for the staff.** The only major redefinitions of the mandate were portions of the Second Amendment of the Articles of Agreement in 1978.[100] Article IV was rewritten to define a new surveillance role in the era of generalized floating of exchange rates, and Article V was expanded to define the role of TA.

122. **Many of the interpretations raised questions concerning whether the Fund was drifting outside its core areas of work and expertise.** Debates on those issues revealed that the boundary between core and non-core was both ambiguous and subject to change. As one example, early discussions of whether the Fund had a mandate to examine the quality of governance in member countries suggested that to do so would push the Fund out of its core mandate. Once the boundaries of the proposed activity were more clearly defined to limit the Fund's interest to financial corruption and other economic consequences of poor governance, the activity could be seen as an essential element of the core mandate. Another example came in the 2000s, when the Fund decided to restrict its lending conditions to policies that were critical for improving macroeconomic performance. Because the assessment of what was macrocritical was inherently subjective, that decision resulted in an ongoing tug-of-war between those who focused on moving the Fund toward a more collaborative approach to Fund lending and those who were reluctant to reduce the Fund's position as an arbiter of economic policymaking.

123. **The expanding interpretation of the mandate inevitably blurred the border between the role of the IMF and the roles of other multilateral agencies, especially the World Bank.** Consequently, pressures increased for the Fund either to work more closely with those agencies or to leave some requested tasks to them. The latter option was seldom practical, because national leaders in creditor countries often viewed the Fund as the most reliably

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[99] For a detailed analysis of the IMF's TA policy, now identified as Capacity Development, see IEO (2022).

[100] The other five amendments enacted during this period dealt mostly with IMF finances and governance rather than the scope of its activities. The first amendment, in 1969, introduced the SDR. The third, in 1992, strengthened the Fund's options for dealing with payments arrears. The fourth, in 2009, enabled a special allocation of SDRs. The fifth, in 2011, revised the income model by expanding the options for investing assets. The sixth, also in 2011, revised the Fund's voting and representation structure.

effective agency to take the lead role, even when a new task was not clearly within its mandate. One of the sharpest examples came in 1990, when the G7 wanted to help the Soviet Union make a successful transition to a market economy. Although the IMF was far from the most knowledgeable agency on that topic, the Managing Director quickly offered the Fund's services and began taking steps to organize the work of the staff. The G7 accepted the offer, and the IMF convened and led the initial project (a detailed empirical analysis of the Soviet economy), in which other agencies (the World Bank, the OECD, and the EBRD) participated and made invaluable contributions.[101]

124. **As the Fund was called upon repeatedly to cooperate with an expanding roster of other organizations, the need to mesh work programs became a major challenge.** The World Bank had a different mandate that required it to focus on longer-term horizons and more structural economic issues. Coordinating with regional development banks and UN agencies raised similar challenges. In the 21st century, as the achievement of comprehensive debt sustainability became ever more important as a goal of Fund-supported programs, the Fund had to coordinate with the Paris Club of official bilateral creditors, which in turn had to coordinate with Chinese and other newly important creditors outside its orbit. By 2011, many of these challenges were still not fully resolved.

[101] The G7 decision to designate the IMF as the organizer ("convenor") of the study was conveyed in the summit communiqué of July 1990: "We have agreed to ask the IMF, the World Bank, the OECD and the designated president of the EBRD to undertake, in close consultation with the Commission of the European Communities, a detailed study of the Soviet economy, to make recommendations for its reform and to establish the criteria under which Western economic assistance could effectively support these reforms. This work should be completed by year's end and be convened by the IMF." http://www.g7.utoronto.ca/summit/1990houston/declaration.html For the background, see Boughton (2012), pp. 58-61.

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