A. Introduction

Although the overall objective of the International Monetary Fund (the 'Fund')—the purpose of the International Monetary Fund—are to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems, the maintenance of high levels of international trade, and to avoiding competitive exchange rates.}

2.01 The purpose of the Fund is to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary issues, to facilitate the expansion and balanced growth of international trade, and to avoid competitive exchange rates.}

A somewhat stylized overview:

• When it was established, the Fund performed primarily a regulatory function. Under the Article of Agreement, each member maintained the value of its currency relative to the currencies of other members, and the Fund was charged with overseeing the performance of these obligations. While the Fund also had financial powers, these powers could be seen as supporting this regulatory function: by making its resources available to meet balance-of-payments problems—problems which would put pressure on a member's exchange rate— the Fund helped members adhere to their obligations.

• Following the collapse of the par value system in the early 1970s, the Fund relied increasingly on its financial powers. The steady growth of private capital flows to emerging market economies, while generally beneficial, generated periods of instability when these economies borrowed—sometimes with the encouragement of their creditors—more than they could repay. By providing financial support for members' economic adjustment programmes during these periods, the Fund facilitated the normalization of relations between sovereign creditors and their creditors, a process which sometimes necessitated the restructuring of unsustainable debts.

• The Fund also exercised its financial powers in other contexts. Following the collapse of the former Soviet Union, Fund-supported adjustment programs played a critical role in the integration of Central and Eastern European countries into the global economy. Separately, since the mid-1970s, the Fund has provided concessional financing to address the specific types of balance-of-payments problems experienced by low-income countries.

During the period of 2004-8, the Fund took advantage of the relatively benign conditions in the global financial markets to reflect on whether, given the evolution of the global economy, it is adequately prepared to address future challenges. During this unusual period...
of introspection, a consensus emerged around several themes. First, the Fund needed to update the role it performed in overseeing members' exchange rate policies, referred to as its 'surveillance function'. Second, if it wished to continue to remain relevant to its emerging market members, it also needed to modify the design of its financial facilities. Third, the system the Fund relied upon to finance its administrative expenditures would require reform in order to place its own finances on a sustainable footing. Finally, and as with other international organizations established in the wake of the Second World War, the Fund's mission in the world economy.

2.03 A considerable amount of progress has been made with respect to these issues. Shortly before the 2008 spring meetings of the International Monetary and Finance Committee, the Fund modernized both its income and governance structure. In addition, the Fund revalued its assets, its own exchange rate, and accelerated the reform process. In the lending area, a key breakthrough has been the establishment of a Facility for Grade Members to address the need for further reform. Perhaps most importantly, recent global events have demonstrated that the Fund's capacity to respond to and implement global responses to crises and emerging market crises is greater than ever.

2.04 This chapter discusses the reforms that have been announced and their implications for the Fund and its membership going forward.

B. Revising the Legal Framework for Surveillance

2.06 Article IV of the Articles of Agreement sets forth obligations of members regarding both their exchange rate policies and those domestic policies that have an impact on their exchange rates. Article IV, Obligations Regarding Exchange Arrangements

Section 1. General obligations of members

Recognizing 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, and that a principal objective is the continuing development of the Fund's surveillance function, each member shall:

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

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

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

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

The current text of Article IV was incorporated into the Articles by the Second Amendment of the Articles of Agreement in 1978 (the 'Second Amendment'). Prior to the Second Amendment, a new system had to be developed that would express the value of its currency in terms of gold, either directly or through the US dollar. A member who changed the value of its currency beyond a certain limit would become ineligible to use the Fund's resources. Under the Articles, the Fund could concur only if it was satisfied that the change was necessary to correct a 'fundamental disequilibrium'.

With the adoption of the Second Amendment, members were given flexibility with respect to their choice of exchange arrangement, which could include, for example, a floating exchange rate. However, it did not abandon the principle that exchange rates are a matter of international concern. In this respect, the present text of Article IV represents a delicate political compromise among the Fund's members and, as is sometimes the case with language that is the product of negotiation, a number of terms are vague and obscure.

In 2006 and as a means of facilitating a review that led to the adoption of the 2007 Decision (discussed below), the Fund's Legal Department prepared a paper that analyzed the legislative history of Article IV (hereinafter The Legal Department Paper). This analysis identified several principles that guided the drafters of Article IV, which may be summarized as follows:

First, Fund members should no longer resist an adjustment in their exchange rates if such an adjustment is necessary in light of underlying economic and financial conditions. There was a concern that the fixed exchange rate system had been excessively rigid, with members failing to adjust even in circumstances of fundamental disequilibrium. This rigidity was perceived as having undermined the sustainability of the overall system. Accordingly, by allowing exchange rates to move in response to underlying conditions, the Second Amendment was designed to enhance the long-term stability of the system.

Second, the Second Amendment recognized the important relationship between domestic policies and exchange rates. The view was taken that the overall stability of the exchange rate system would be enhanced by the pursuit of appropriate domestic policies; eg by fostering orderly underlying conditions for economic and financial stability.

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4 For the consolidated text of the Second Amendment and a commentary on its provisions, see: 'Proposed Second Amendment to the Articles of Agreement, a Report by the Executive Directors to the Board of Governors', IMF (1976).

5 Art IV, Section 5(a) of the original Articles of Agreement.

Accordingly—and unlike the text of the original Articles—the Second Amendment introduced obligations with respect to members' domestic policies. However, as can be seen in para. 2.06 above, these obligations (set forth in Article IV, Section 1(i)) are of a particularly 'soft' nature, taking into account that the principle that members should not have to give up a significant degree of sovereignty with respect to policies that, while they may have an international impact, are of a domestic nature.

2.12 Finally, members should avoid pursuing exchange rate policies that pose particular problems for other members or the system more generally. Accordingly, a specific obligation rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage 11. Unlike the obligations with which was considered appropriate given their direct international impact. As will be discussed below, the potential applicability of the obligation to avoid manipulation is constrained by the need to determine intent. 12

2.13 As noted in the Legal Department Paper, the present Article IV also sets forth obligations international monetary system to ensure its effective operation and to prevent exchange rate policies and to adopt exchange rate policies under Article IV. 13 Given the relative importance the Fund to exercise firm surveillance over the exchange rate policies of members and to adopt this obligation, the Fund conducts consultations with members, normally on an annual basis, which are generally referred to as 'Article IV Consultations.' 14

2.14 The surveillance decision adopted in 2007 (the '2007 Decision') establishes a comprehensive surveillance framework designed to guide the Fund in the performance of its Executive Board in 1977, which was generally recognized as being incomplete and out-of-date. The 2007 Decision may be described as comprising three elements. First, it provides for surveillance activities. Second, it updates the principle that is designed to guide the domestic policies of members that the Fund will assess for purposes of conducting surveillance. Each of these elements will be discussed in turn. This section also briefly discusses the application of the decision to members that form part of a currency union.

(4) Exchange rate manipulation
A key achievement of the 2007 Decision is that it provides guidance as to the meaning of the relatively complex and obscure text of Article IV, Section 1(iii), which requires members to 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. While it was not possible to provide clarity with respect to all elements of this provision (for example what constitutes manipulation of the international monetary system?) agreement was reached on a sufficient number of concepts to make the provision operational for the first time since its adoption in 1978. 15 Specifically,

1. First, 'manipulation' of the exchange rate is only carried out through policies that both target and affect the level of an exchange rate. Policies that have an effect on the exchange rate but are not directed at it cannot give rise to manipulation. However, it is recognized that manipulation can be carried out in a number of different ways. For example, it could occur through excessive intervention in the exchange markets or through the imposition of capital controls. Importantly, there is agreement that manipulation would not necessarily require movement of the exchange rate. It may also be designed to prevent movement in the rate.

2. Second, even if it is demonstrated that a member is 'manipulating' its exchange rate, the member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken for the purpose of either (a) preventing effective balance of payments adjustment or (b) gaining an unfair competitive advantage over other members. It was agreed that a member could only be considered to be manipulating its exchange rate to gain an unfair competitive advantage if two elements were found to be present. First, it would need to be determined that the member was pursuing these exchange rate policies for purposes of securing fundamental exchange rate misalignments in the form of an undervalued exchange rate; the concept of 'fundamental exchange rate misalignment' corresponding to a situation where a member's underlying current account (which comprises trade and services) differs from its equilibrium rate. 16 Second, it would also need to be demonstrated that the member was seeking to secure such misalignment for the purpose of increasing net exports. 17

3. Third, as evident from the above analysis—and indeed from the text of Article IV, Section 1(iii) itself—it is necessary for the Fund to determine intent, which makes the provision more difficult to apply. It was agreed, however, that this did not mean that...

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11 The guidance provided the Executive Board regarding the meaning of Article IV, Section 1(iii) is set forth in the Notes to the 2007 Decisions; see Selected Decisions, 33, 34.
13 Importantly, the 2007 Decision does not attempt to provide guidance with respect to the alternative basis for a violation of Article IV, Section 1(iii), namely, where a member manipulates its exchange rate in order to prevent effective balance of payments adjustment.
the Fund would be required simply to accept the representation made by the member regarding the purpose for its actions. Rather, while such a representation would be given the benefit of any reasonable doubt, the Fund would take into account all other available evidence regarding members' policies; that is, the Fund would make its own independent and objective assessment of intent. 16

(6) Principles on exchange rate policies

2.16 As is discussed above, in the context of its exercise of surveillance over the exchange rate policies of members, the Articles require the Fund to adopt specific principles for the guidance of members with respect to those policies. Although an important component of resolution of a number of legal questions, in particular, since it was recognized that the Fund was required as to what obligations—other than the obligation relating to manipulation, other obligations existed, what implications would the non-observance of a principle have?

Paper may be summarized as follows:

1. With respect to the specific obligations that are enumerated in Article IV, Section 10(b), the Fund is required to specify exchange rate policies in the only obligation that is being limited to policies that are imposed for balance of payments reasons. As is evident in Article IV, Section 10(e) and (ii), all apply to domestic policies. Regarding Article IV, undertaking to follow exchange policies compatible with the and the legislative history provides various principles of interpretation. Consistent with general understanding of the term 'exchange policies' should be the change in the use of exchange controls.

2. Notwithstanding the above, the general obligation to collaborate under Article IV to take those specifically identified in Article IV, Section 10(e)–(iv). This conclusion is taken into account the general collaboration obligations. The specific obligations read 'in the use of exchange controls.' Based on the use of the term 'in particular' in this context, they represent particularly important ways in which the general obligations may be fulfilled, for the only measures needed to meet this general obligation.

However, the activity precluded by the new principle is more limited than exchange rate manipulation. While, in the latter case, it is not necessary to demonstrate that fundamental

specific obligations. A contrary interpretation—one which would conclude that the specific obligations exhaust the general obligation—would render the general obligation redundant, contrary to general principles of statutory construction. Moreover, the concept of using the general obligation of collaboration to require members to take more specific actions was relied upon by the Fund after the breakdown of the par value system but prior to the adoption of the Second Amendment.

3. In light of the above, it would be legally feasible for the Fund to rely upon the general collaboration obligation set forth in Article IV, Section 1 as a basis for requiring that members take—or refrain from taking—those actions that, while not included in the specific obligations listed in Article IV, Section 1, are considered by the Fund to be necessary, in light of changing circumstances—to assure orderly exchange arrangements and promote a stable system of exchange rates. It was recognized, however, that the Fund could—relaying again on the practice followed prior to the Second Amendment—stop short of identifying such actions as an obligation but, instead, give them the status of a non-binding 'recommendation.'

Taking into account the above analysis, the Executive Board established a new principle which would have the legal status of a non-binding recommendation. This principle provides that 'a member should avoid exchange rate policies that result in external instability.' The concept of 'external stability' merits some discussion since it is critical not only to the new principle but also to the 2007 Decision more generally. The central thesis of the 2007 Decision is that members satisfy their obligations under Article IV to collaborate in the promotion of a 'stable system of exchange rates' by promoting their own 'external stability,' which is defined as a balance of payments that does not and is likely to give rise to disruptive exchange rate movements.' This definition seeks to capture the concept that the Fund is concerned not only with the stability of the member in question but also the effect of the member's external position on the stability of other members.

In light of the definition of 'external stability' described above, the new principle introduced by the 2007 Decision covers a broader range of situations than exchange rate manipulation in a number of respects. First, there is no requirement that the Fund demonstrate intent: if the exchange rate policies—whatever their intent—result in external instability, there is a problem. Second, the concept of 'external instability' is broader than the concept of fundamental misalignment in the form of an undervalued exchange rate (which, as noted above, is an important component of the definition of exchange rate manipulation). Specifically, an unstable balance of payments position—unlike fundamental misalignment—may arise from either the current or capital account. Moreover, it may manifest itself in either an overvalued or undervalued exchange rate. In one respect, however, the activity precluded by the new principle is more limited than exchange rate manipulation. While, in the latter case, it is not necessary to demonstrate that fundamental

16 As noted by the Legal Department Paper, this approach is consistent with the term 'balance of payments' below at para 2.16.

17 As noted by the Legal Department Paper, this approach was followed by the collapse of the par value system but prior to the Second Amendment, relying on Art IV, Section 4(a) of the original Articles of Agreement, which required members to collaborate with the Fund to promote exchange stability: see Legal Department Paper, 10–11.
2.19 When the Fund's Executive Board approved the adoption of the above principle, a number of Executive Directors sought—and received—assurances regarding the implications of the recognition that, upon such a determination, the member may need considerable change in the 2007 Decision specifically provides for recognition purposes. In the circumstances where the Fund has determined that a member is implementing policies that are not consistent with these principles and situation, the Fund will take into consideration the disruptive impact that excessively rapid policy adjustment would have on the member's economy. Separately, and in light of the recognition to an obligation, Executive Directors sought some assurance that such a step would provide a determination that the Fund is of the opinion that the member's policies would need to be taken without adequate procedural safeguards. To that end, the 2007 Decision provides that where the Fund determines that a member is not following one of these requirements under Article IV, Section 1. Moreover, the relevant staff paper pointed out that the Fund could be in breach of the general obligation of cooperation. First, the Fund member—whether provided that the conduct identified in the recommendation was applicable to the obligations of Article IV—should be in breach of its obligations. This decision would need to be general in application and from requiring certain conduct from one country and only recommending it to another, their policies into conformity with the new obligation before the Fund determined the

2.20 The original 1977 Decision did not provide guidance to members with respect to domestic policies, notwithstanding the fact that, as noted earlier, Article IV makes it clear that such policies are a matter of legitimate interest to the Fund. While, as a matter of practice, a key objective of the 2007 Decision was to articulate explicit guidance to the Union's consultation with individual members typically include an analysis of domestic policy membership in a manner that ensured that the Fund would have the breadth of the 2007 Decision's objectives. Several aspects of the 2007 Decision's objective of such policies, the 2007 Decision states that 'a member promotes external stability' that the Fund could not require the member to change these domestic policies in the interest of external stability. Second, consistent with the text of Article IV, Section 1(iii) and (iv), the concept of 'domestic stability' recognizes the imperative of achieving an appropriate balance between economic growth and price stability. Finally, with respect to the range of domestic policies that will generally be assessed by the Fund, the 2007 Decision provides for balance and price stability that the Fund may assess. However, other policies will always be subject to Fund surveillance, other policies may be examined only to the extent that they significantly influence present or prospective external stability. This last feature was designed to encourage greater focus during the Article IV Consultation process.

2.21 (d) Currency unions

During the discussions that led to the adoption of the 2007 Decision, the question arose as to how the conceptual framework set forth in the decision would be applied to members that form part of a currency union. From a legal perspective, the issue is relatively straightforward. The obligations of Fund members under the Articles of Agreement are not modified when they become members of currency unions. Accordingly, while certain policies that are relevant to the performance of a member's obligations under Article IV may be delegated by the members to union-level institutions, individual members remain accountable to the Fund for those policies and fulfill their individual obligations by ensuring that union-level institutions act consistently with these obligations. When conducting surveillance under Article IV, the Fund considers the policies of the union-level institutions as being conducted on behalf of the currency union's members.

2.22 From an economic perspective, however, it became clear during the discussion of the 2007 Decision that application of the framework to currency unions posed some challenges. First, it was necessary to distinguish between those policies relevant to Article IV that are carried out at the union level and those that are carried out at the individual member level. Although the allocation may differ depending on the union in question, it was recognized that exchange rate and monetary policies will generally be carried out at the union level, while other financial and fiscal policies may be carried out at the level of the individual members. Accordingly, the content of Fund discussions with individual members and union institutions would be shaped by this allocation. Second, the 2007 Decision specifically recognizes that, given the definition of external stability—a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements—this concept must be understood as relating to the balance of payments of the union, as it is at this level that disruptive adjustments in exchange rates can arise. Accordingly, when union-level institutions implement policies that promote the external stability of the union, such policies would be consistent with the obligations of individual members under Article IV. When evaluating the domestic policies implemented by the individual union members, the Fund would assess whether these policies promote the domestic stability of the individual member concerned. If so, these policies would be considered to be promoting the external stability of the union.¹⁹

¹⁹ For further analysis of the implications of the 2007 Decision for currency unions, see Companion Paper. 10-11.
2.23 Although discussion of the merits of changes in the Fund’s governance structure has been a concern that failure by the Fund to take meaningful action to address perceived inequities and inefficiencies in the decision-making process could undermine its legitimacy and effectiveness. It is possible to identify several different strands of criticism.

2.24 First, there is concern that the Fund has failed fully to adhere to the key principle that guides its decision-making process: a member’s voting power in the Fund; namely that of relative economic size of quotas—which determines both the size of their voting power and the level —now-and then-reflect their relative size in the global economy. After a series of financial crises in Asia and Latin America where Fund decisions played a major role in guiding the economic policies of these countries, there is a growing perception that, unless steps were taken to increase the influence of the countries in the Fund’s decision-making process, they would rely, instead, on their own regional arrangements.

2.25 Second, a separate, but related, issue pertains to perceived problems with the size and composition of the Executive Board, which makes the most key strategic and operational decisions. While the steps taken to increase the voting power of emerging-market economies will eventually address concerns that they are inadequately represented on the Executive Board, there has been the view that, separately, the representation of Europe in the Executive Board should be increased in a single chain, appropriately reflecting Europe’s larger role in the economy and, to a lesser extent, concerns that the Board’s composition has grown too large to be effective.

2.26 Finally, a specific problem exists regarding the representation of low-income members: the absence of low-income member countries on the Executive Board. While the voting power of these member countries is small, it is often the case that, given the needs of the Fund, the Fund should not excessively dilute this voting power, especially in times of financial crisis.

(1) Quota Adjustments

When a country becomes a member of the Fund, it receives a quota, which has a number of important implications in its relationship with the Fund. First, it determines the size of the member’s financial subscription to the Fund. Second, the Fund makes available to members credit operations consist of the proceeds of member subscriptions rather than the proceeds of capital market borrowing. Finally, it generally determines the amount of financial assistance it may receive from the Fund in the event of balance of payments difficulties. Finally, a member’s quota determines a member’s voting power in the Fund (along with the relatively small number of ‘basic votes’ it receives, discussed below).

The primary basis for determining a member’s quota is the ‘quota formula’, which has been made up of several variables that are relevant to the role of the quota. As described above, a member’s quota is based on the level of GDP and reserve level, which are included as indicators of a member’s capacity to finance Fund operations. A member’s current payments and receipts and the variability of these payments and receipts were also included in the quota formula.

The quota formula has never been applied mechanically. Rather, it always provides a basis for discussion. Other factors are also taken into account, including how the economy of the new member compares with that of other members with similar characteristics. Moreover, members’ quotas have been regularly increased across the board periodically in order to satisfy the Fund’s need for liquidity, irrespective of whether this increase was consistent with the application of the quota formula.

For these reasons, a member’s actual quota does not always conform to the quota formula that corresponds to the direct application of the quota formula.
2.30 A key element of reform was the modification of the quota formula. There was a broad consensus that the quota formula was excessively complicated and needed to be made more transparent: the formula actually consisted of a combination of five formulae, all of which used the variables described above, but with different weights. Views differed, however, regarding the extent to which the variables themselves should be modified and the amount of weight that should be accorded to each of them. A number of Executive Directors were of the view that overall economic size was the most relevant variable and, accordingly, GDP should be given greater weight. Perhaps most importantly, there was a strong view held by some that GDP should be measured by purchasing power parity rather than by market exchange rates. Reliance on purchasing power parity, which would benefit large emerging-market economies, was considered by these Executive Directors to be the best—and most economically—way of measuring the relative volume of goods and services produced by economies.29

2.31 It was recognized at the outset that the agreement on a new quota formula would be two stages. The first stage involved increasing the quotas of those members who—ever since was completed during the 2006 Annual Meetings when the Fund’s Board of Governors increased by 27 per cent, 79 per cent, 24 per cent, and 22 per cent, respectively.28 The quota formula and, on the basis of this new formula, the Board of Governors approved increases in the quotas of 54 members, of which a total of 50 per cent of member exchange rates and purchasing power parity (50 per cent and 40 per cent, respectively).30

2.32 By one standard, the outcome of the reform is very modest: the overall size of Fund quotas increased by 11.5 per cent, with the aggregate shift in relative quota shares to those that in the voting share of emerging-market and developing economies of 2.7 per cent. Perhaps adjustment process. Specifically, the relevant Board of Governors Resolution process. Thus, the change in member quotas is to reflect their relative positions in the world economy, the Executive Board is requested to recommend further

realignments of members’ quota shares in the context of future general quota reviews.34 Under the Fund’s Articles, while such general reviews are required to take place every five years, they have typically only resulted in quota increases when the Fund’s overall liquidity position requires replenishment. The above-quoted text indicates that adjustments will be made in the context of these general reviews, irrespective of overall liquidity needs, if such adjustments are judged to be needed to realign members’ relative quota shares in the Fund.

The financial crisis that erupted in 2008 has given fresh momentum to further shifts in voting power. As the Fund’s financing function has emerged as a critical element of the effort to contain the crisis (to be discussed further below), emerging markets have pressed for a further transfer of voting power in their direction, emphasizing that, given the far-reaching implications of the Fund’s decisions in this—and other—areas, emerging markets needed to have a greater say in the decision-making process. In October 2009, the Fund’s International Monetary and Financial Committee issued a communiqué indicating its support for a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented countries to under-represented countries using the current quota formula as the basis to work from. Although the communiqué is non-binding—and the relevant language somewhat obscure—it signals considerable political support for a further shift in voting power.

(2) Addressing the Needs of Low-Income Members

The treatment of low-income members within the governance reform framework presented the Fund with a particular challenge. On the one hand, it was abundantly clear that by any metric, the weight of these countries in the world economy is still relatively small and, accordingly, there was no likelihood that their quotas would be increased to any significant way under the reforms discussed above. On the other hand, as an operational matter, the Fund was more actively engaged with this group of members than perhaps any other. With the decline of lending to emerging-market members, most of the Fund’s financial assistance over the past several years has been provided to low-income countries through the Fund’s concessional lending facility. Moreover, the Fund provides a considerable amount of technical assistance and advice to these members in areas that are relevant to the Fund’s work (for example monetary and fiscal policy, legal and regulatory frameworks to support the financial sector). For this reason, there was a consensus that steps needed to be taken to enhance the voice of these members in the Fund.

It should be noted that the measures taken by the Fund to address this issue take into account the fact that the Fund is not, in fact, a development institution. Accordingly, while the measures taken are of particular benefit to low-income members, they are of broader applicability. As discussed below, they involve two components: (a) an increase in ‘basic votes’ and (b) the appointment of a second Alternate Executive Director. Both require an amendment of the Fund’s Articles.

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28 See Report on Quota and Voice, 2, for a discussion of the benefits of purchasing power parity; see also

29 The new quotas offered China, Korea, Turkey, and Mexico were 27%, 79%, 24%, and 22%, respectively; Singapore Board of Governors Resolution No 63-1, April 2008, available at: http://www.imf.org/external/pd/

20 Board of Governors Resolution No 63-2, April 2008, Section B, above.

34 Board of Governors Resolution No 63-2, April 2008, Section B, above.
of basic votes possessed by each member and (b) and ensure that the ratio of the sum of basic votes of all members to the sum of members' total voting power remains constant following this tripling. In the event of any subsequent changes in the total voting power of members. Accordingly, in the event that future quota increases this will automatically result in an increase in basic votes for all members, without the need for a further amendment of the Articles or, indeed, any decision by the Fund. While each member will be always be allocated a number of basic votes that is identical to the number allocated to other members (reflecting the principle of equality of states) the introduction of a mechanism to avoid the future erosion of basic votes as a ratio of total voting power will—as noted above—be of particular benefit to members with small quotas, including low-income members.

(b) Appointing a second alternate executive director
The Fund's Executive Board currently consists of 24 Executive Directors. As mandated by the Articles, five of these Executive Directors are appointed by the members with the largest quotas (currently France, Germany, Japan, the UK, and the USA). The remaining 19 Executive Directors are elected every two years through a process where, subject to certain election rules, members are free to form member constituencies for election purposes. Because the voting power of African members is relatively small, there are only two Executive Directors elected by African members, one of these Executive Directors being elected by a constituency made up of 19 African members and the other being elected by a constituency of 24 African members.

For African members seeking greater representation on the Executive Board, the optimum reform measure would have been to expand the size of the Executive Board to allow for the election of a third Executive Director from Africa. There was no appetite among the larger members of the Fund to expand the Executive Board, at least at this stage of the reform process. There was a recognition, however, that the size of the African constituencies placed a considerable strain on the ability of the relevant Executive Directors to represent their members effectively. This problem is exacerbated by the fact that members within these constituencies have traditionally had, as noted earlier, a disproportionately large number of basic votes.

Under the proposed amendment, Art XII, Section 5(a) would be amended to read as follows:

(a) The total votes of each member shall be equal to the sum of its basic votes and its quota-based votes.
(b) The basic votes of each member shall be the number of votes that result from the equal distribution among all the members of 5,502 percent of the aggregate sum of the total voting power of all the members, provided that there shall be no fractional basic votes.
(c) The quota-based votes of each member shall be the number of votes that result from the allocation of one vote for each part of its quota equivalent to one hundred thousand special drawing rights.

The operation of the mechanism set forth in the amendment may, in some circumstances, also result in a decline in the number of basic votes possessed by each member. Specifically, because each member is to be allocated the same number of basic votes, the aggregate number of basic votes that corresponds to the percentage set forth in the proposed amendment will be divided by the number of members to arrive at the number of basic votes to be allocated to each member. Applying this mechanism, the number of basic votes possessed by each member could decline, as a result of the admission of a new member whose quota is smaller than the average of Fund quotas. See Report on Basic Votes, above, at 7–8.

54 Articles of Agreement, Art XII, Section 3(b)(i).
Fund-supported programmes. In that context, it should be noted that when the Fund was established there were 38 members, the largest constituency consisted of 9 members, with the average constituency consisting of 5 members. Although the Executive Board has expanded since then (from 12 to 24) this expansion has not kept up with the growth in members, with the 2 African constituencies, as noted above, being the largest.

2.41 To address the above concerns, the second feature of the amendment of the Articles of Agreement approved by the Fund's Board of Governors was to allow for the Executive Board to expand under the new Articles, each Executive Director is entitled—and required—to appoint an Alternate with full power to act for him or her when he or she is not present. The Executive Board at Fund headquarters, on the one hand, and the need for Executive Directors to travel, and maintain close contact with, the members opposing the second amendment was generally regarded as providing meaningful support to these Executive Directors, given the workload, including travel, involved.

2.42 Two specific aspects of this element of the amendment merit attention. First, to prove for better, the Board of Governors does not specify how large a constituency must be, although flexibility, the test of the amendment is concerned. First, to provide for better, the Board of Governors does not specify how large a constituency must be expanded, the Board of Governors adapted the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constituencies to appoint an Alternate, as well as the Board of Governors to the need for a resident Director to be present, the Executive Directors to their constituencies, and must adopt rules that enable large constitut

2.43 Finally, it should be emphasized that both of these reform measures—an increase in basic votes and the appointment of a second Alternate—are not yet complete. Although the test of the amendment containing both these elements has been approved by the Board of Governors, the amendment will not enter into force until it has been accepted by three-fifths of the members, having 85 per cent of the total voting power. For most members, acceptance of an amendment of the Articles—an international treaty—requires approval by the domestic legislature. Importantly, the relevant Board of Governors Resolution provides that the increases in quotas, discussed above, will not become effective until the amendment becomes effective.

(3) The Size and Composition of the Executive Board

Although decisions have not yet been taken to modify the size and composition of the Executive Board, there is increasing momentum for reform in this area. In some respects, changes in the composition of the Executive Board will flow from the shifts in voting power that will occur if—and when—the ongoing quota adjustment process described above is fully implemented. For example, if China's quota becomes one of the five largest, it will be able to appoint its own Executive Director. More generally, as the quotas of emerging-market economies increase, some of them will obtain a sufficiently dominant position within their constituencies to ensure that some of their nationals will be elected as Executive Directors. However, beyond these longer-term implications of shifting voting power, there are other forces that may lead to reform in this area. The first relates to a concern with the Board's size: with 24 Executive Directors, there is a perception that the Board is too large to operate efficiently as an executive decision-making body. The second concern relates to the composition of the European Executive Directors. The countries of the European Union currently provide 6 of the 24 Executive Directors, 3 of whom are appointed (nationals of France, Germany, and the UK) and 3 of whom are elected from constituencies (nationals of Belgium, Italy, and the Netherlands). With European economic and financial integration, there have been growing calls for European 'consolidation' into a smaller number of seats at the Executive Board. Although originating from elsewhere, these calls can now be heard from within Europe itself. More specifically, a member of the Executive Board at the European Central Bank argues forcefully that consolidation resulting in a single EU Executive Director would actually enhance the voice and influence of the EU within the Fund. Since, when voting on a proposed decision, Fund Executive Directors are not permitted to split the votes of the constituents who have elected them, consolidation would force EU countries to take a single position—and vote in a single, powerful block—on issues of relevance to the Fund. Given the breadth of the Fund's mandate, however, it is not clear that the policies of individual EU countries need, in fact, converged sufficiently to enable them to be represented by a single Executive Director. For example, while France has traditionally urged greater Fund involvement in low-income countries, Germany has stressed that the Fund is a monetary institution—not a development agency.
2.45 If a single Executive Director were to represent all of the EU members, such a step would require an amendment of the Articles of Agreement. This is because the Articles specify each of the members with largest five quotas to appoint their own Executive Director. Accordingly, as long as an EU member’s quota is among the five largest, the member concerned could not participate in such a consolidation. Perhaps because of this fact, there have also been calls recently for the election of all Executive Directors, most notably from the USA, a step which would facilitate future EU consolidation. 53

D. Reforming the Fund’s Lending Instruments

2.46 Until October 2008—when the financial crisis began to affect the balance of payments positions of emerging markets—members’ demand for the Fund’s general resources had declined significantly. As of 31 July 2008, outstanding credit was SDR 7.8 billion, or 2.5% of the Fund’s total resources. However, in this period, the Fund provided new financing to emerging markets, mainly in Latin America and Eastern Europe. The Fund’s credit was 3.5% of the total volume in June 2009. While this decline in the use of funds was partly due to the prolonged period of global liquidity, there was an increasing awareness of the risks associated with emerging markets economies. It was recognized that the Fund could play a role in supporting member countries in times of distress. The fact that members were willing to support the Fund in this way raised concerns about the Fund’s future role. The Fund’s arrangements were designed to address potential risks associated with emerging market economies. The Fund also took measures to address potential risks associated with emerging market economies. The Fund’s arrangements were designed to address potential risks associated with emerging market economies. The Fund also took measures to address potential risks associated with emerging market economies.

2.47 Taking into account the above concerns, the Fund decided to launch a comprehensive review of its lending policies in September 2008. However, shortly after the initiation of the review, the global financial crisis had originated in the USA and had spread to the rest of the world.

2.48 Reforming the IMF

To understand the basis and implications of this development, it is important to provide an overview of the legal and operational framework for Fund financing.

(1) The Existing Framework for Fund Financing

One of the purposes of the Fund, as set forth in the Articles of Agreement, is as follows:

To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, that is, providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

Consequently, the Fund makes its resources available to members, subject to conditions designed to satisfy itself that two conditions have been met:

(a) First, since its resources are to be used to help countries resolve their balance of payments problems, it is important that the country be implementing policies that will address—rather than simply delay the resolution of—its balance of payments problems. Second, the Fund must ensure that ‘adequate safeguards’ are in place to ensure that the member will be in a position to repay the Fund if it is necessary.

(b) Conditionality refers to the mechanism that the Fund uses to ensure that Fund financial assistance is made conditional on the effective implementation of a credible adjustment programme. The adoption of appropriate adjustment policies is designed not only to give the Fund some assurance that the member’s balance of payments problems will be corrected, but is also designed to provide the Fund with an adequate basis to conclude that the member will have sufficient foreign exchange to repay once the adjustment programme has been successfully implemented.

The stand-by arrangement is the principal instrument relied upon by the Fund to make conditionality operational. It constitutes a decision of the Executive Board made an overall amount of resources available in support of an adjustment programme as described in a letter of intent prepared by the member. Under the terms of the stand-by arrangement, the Fund finances the adjustment programme, and the conditions for the disbursement of resources are announced in the letter of intent and specified by the Fund’s Executive Board. It should be emphasized that the amount of financing provided by the Fund has traditionally been relatively modest in comparison with a member’s needs. However, the fact that the Fund has made a judgement that the member’s adjustment programme merits financial support is intended to ‘catalyse’ the member’s actions and to encourage other countries to support the Fund’s programme.

2.49 The stand-by arrangement is the principal instrument relied upon by the Fund to make conditionality operational. It constitutes a decision of the Executive Board to make an overall amount of resources available in support of an adjustment programme as described in a letter of intent prepared by the member. Under the terms of the stand-by arrangement, the Fund finances the adjustment programme, and the conditions for the disbursement of resources are announced in the letter of intent and specified by the Fund’s Executive Board. It should be emphasized that the amount of financing provided by the Fund has traditionally been relatively modest in comparison with a member’s needs. However, the fact that the Fund has made a judgement that the member’s adjustment programme merits financial support is intended to ‘catalyse’ the member’s actions and to encourage other countries to support the Fund’s programme.

53 Articles of Agreement, Art IV, Section 3(b) provides, in part, that, of the Executive Directors, five shall be appointed by the five members having the largest quotas (emphasis added).


56 Articles of Agreement, Art IV.

57 More specifically, Art V, Section 3(a) requires the Fund to adopt policies 'on the use of its general resources ... that will assist members to solve their balance of payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards'.

58 Consistent with the requirement set forth in Art V, Section 3(a) of the Fund has adopted a general policy regarding the design and implementation of its conditionality, which is reviewed periodically; see Guidelines on Conditionality, Selected Decisions.
### 2.50 The Flexible Credit Line

Although this chapter does not try to identify the causes of—or disentangle the lessons from—the global financial crisis that erupted in September 2008, it is clear that its impact on capital markets was both swift and significant. The disruption in short-term funding and the overall loss of confidence are all factors that resulted in a sharp reduction in capital flows to emerging-market countries. For some of these countries, this significant reduction in economic adjustment is supported by a Fund arrangement that has been relied upon for financing.

While the Fund has stood ready to provide assistance to these members, they have been traditional lending instruments of the Fund and the conditionality associated with these.

To address this perceived gap in the Fund's toolkit, the Fund established the Flexible Credit Line (FCL) in March 2009. The key distinguishing features of the FCL are that (a) it makes it easy to provide funding (that is, phased and performance criteria) that are associated with the traditional absence of an actual balance of payments need. Clearly, the design of the FCL takes into Fund conditionality. Moreover, the fact that the FCL can be used on a precautionary but also to prevent crises. Several features of the FCL merit elaboration.

#### Qualification

As noted above, 'conditionality' is required under the Articles; that is, the Fund must satisfy itself that the policies being taken by the member are adequate to ensure both the resolution of the FCL (i.e., the achievement of the objective of traditional and other conditions that are found in stand-by arrangements; surprisingly, the qualification criteria identified in the decision are those that are designed to give the Fund the assurance that, given the strong policy stance of the member and its balance of payments pressures—or, if the FCL arrangement is approved on a precautionary basis, will be in such a position in the event the pressures emerge. In addition to a very positive assessment of the member's policies in the context of the recent Article IV Consultation, the decision establishing the FCL provides that the relevant criteria for the purposes of assessing qualification for an FCL arrangement shall include: (a) a sustainable external position; (b) a capital account dominated by private flows; (c) a track record of steady sovereign access to capital markets at favourable terms; (d) a reserve position that is relatively comfortable, when the FCL is approved on a precautionary basis; (e) sound public finances, including a sustainable public debt position; (f) low and stable inflation, in the context of a sound monetary and exchange rate policy framework; (g) the absence of bank solvency problems that pose an immediate threat of a systemic banking crisis; (h) effective financial sector supervision; and (i) data transparency and integrity.

(b) Amount of financing

Importantly, the decision establishing the FCL did impose strict limits on the financing that could be made available under an FCL arrangement. This reflects an underlying assumption behind the FCL: large amounts of financing would need to be available if the FCL was to fulfil the key objective of preventing crisis in large emerging-market economies. More specifically, the FCL would only succeed in calming nervous markets if the limits had the assurance that large amounts of financing had been committed on an upfront basis. Of course, consistent with the Fund's catalytic function, it is envisaged that the Fund members would also take comfort from the judgement made by the Fund that the member's policies were adequate to address any pressures should they emerge; that is, the satisfaction of the relevant qualification criteria are designed, in part, to enhance the crisis prevention objective.

(c) Commitment period

A key issue that arose in the design of the FCL was the maximum length of the arrangement—this was the length of the period during which the financing would be conditionally available to the member. There were two competing considerations. The one hand, there was a recognition that the period had to be sufficiently long to serve the key objective of providing comfort to both the member and the markets. On the other hand, there was a concern that an excessively long commitment period would pose risks for the Fund's resources: as time passed, there was a risk that the Executive Board's positive assessment of the member's policies vis-à-vis the established qualification criteria would become somewhat stale as a result of developments with respect to the member's policies or the external environment. As a means of balancing these considerations, it was agreed that an FCL arrangement could be approved for either a 6-month or a 12-month duration. In the event that an FCL was approved for a 12-month period, the availability of financing beyond the initial 6-month period would be subject to completion of a positive assessment by the Executive Board to the effect that the member continued to meet the relevant qualification criteria.

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10 While the Summary of the Executive Board that was adopted at the time of the FCL decision indicates that the Executive Board welcomed staff's expectation that access would not normally exceed 1,000 percent of quota, this did not give rise to a binding limit of 1,000% of quota.
Since its establishment, an FCL arrangement has (as at December 2009) been approved for Mexico (SDR 31.258 billion), Colombia (SDR 6.966 billion), and Poland (SDR 13.69 billion). In all cases, the arrangements were approved on a precautionary basis and, since their approval, none of them have been drawn upon. The fact that members have not had to draw suggests that the crisis-prevention objective has been achieved. More generally, it may be argued that the mere addition of the FCL to the Fund's lending toolkit has fostered broader confidence in the market also for the benefit of members who, although they may not have actually requested an FCL arrangement, are generally perceived to satisfy the qualification criteria.

E. Developing a New Income Model

A critical element of the Fund's reform programme has been the development of a new means of financing the administrative expenditures of the Fund. The process was launched in May 2006, when the Managing Director established a Committee of Eminent Persons (the 'Committee'). The Committee, chaired by Andrew Crockett, the former general manager of the Bank for International Settlements, delivered its recommendations in January 2007. Taking into account these recommendations, the Managing Director and the Executive Board developed Articles, required approval by the Fund's Board of Governors, which was received in April 2008. The process is not yet complete, however, since—as with the case of the governance amendment discussed earlier—the income amendment will not become effective until it is formally accepted by the requisite threshold of the membership.

At one level, the need to develop a new income model can be seen as simply an inevitable consequence of the decline in Fund lending. Since its establishment, the Fund has financed its administrative expenditures primarily from the interest income derived from such lending. Utilizing its general resources (the 'rate of charge') and the rate of interest it pays to those members whose currencies are used in these credit operations (the 'rate of remuneration')—although it is difficult to project the future demand for Fund credit, Fund staff had projected the low credit environment would persist over the medium term.

The other remaining members of the Committee were Mohamed El-Erian, Alan Greenspan, Lito Mbowo, and Jean Claude Trichet.


60 Amendment of the Articles of Agreement of the International Monetary Fund To Expand the Investment Authority of the International Monetary Fund.


Even though, as discussed above, Fund lending has recently increased, there is a growing recognition that there are other problems with the Fund's traditional income model. The existing model is flawed because it relied on this credit function to finance a range of activities that was much broader than the provision of credit. These activities included not only the Fund's surveillance function, which involves annual consultation with each Fund member, but also the provision of a substantial amount of technical assistance. Indeed, of the total US$930.3 billion incurred in administrative expenditure in financial year 2006, only US$220.6 million were incurred in credit intermediation activities. It was recognized that it was neither equitable nor sustainable for the cost of all these activities to be financed by those members receiving financing from the Fund's general resources, particularly in an environment where such financing is expected to be somewhat concentrated within the membership. More generally, and as noted by the Committee, the existing income model 'has the curious feature that the Fund's financial well-being depends on it being unsuccessful in its primary mission, which is to prevent financial crises'.

Viewed from a purely financial perspective, the problem was not particularly urgent. As a result of the significant amount of credit extended over the previous ten years, particularly during the Asian crisis, the Fund had accumulated reserves of SDR 5.9 billion, which could have technically been used to finance the Fund's anticipated income shortfall for a number of years to come. But for an institution whose mandate includes advising member countries on principles of fiscal rectitude, it was recognized that it would be somewhat hypocritical for the Fund to use reserves—which should be used primarily to mitigate the effects of future credit losses—to finance a structural income shortfall. Moreover, unless this problem was fixed, the nature of the Fund's dialogue with members could be clouded by perceptions of a conflict of interest: was the Fund's recommendation to seek a Fund finance programme motivated primarily by an interest in the well-being of the member's economy or a desire to finance the Fund's operational expenses?

As is evidenced by its report, the Committee reviewed a wide range of options, a number of which were rejected on the ground that they would risk undermining the Fund's effectiveness. In particular, the idea of introducing annual levies that would be required to be paid by each member in order to finance the Fund's operations was considered problematic since the annual appropriation process that would be involved in each member for this purpose could risk undermining the independence of the Fund's regulatory assessments policy and policy advice.

The underlying principle that formed the basis for the Committee's recommendations was that, since the Fund was undertaking distinct activities—some of which benefited the entire membership and others benefited only a group of members—it was both logical and fair that these activities should have different funding sources. Accordingly, since

62 The nature of the Fund's technical assistance is described further, below at para 2.70ff.

63 Final Report of the Committee, Annex 5. Moreover, of this US$220.6 million, only 130.7 were expenditures related to CFA financing. Ibid.

64 Final Report of the Committee, 5.

65 Ibid. 5.

66 Ibid. 8.
surveillance is a ‘public good’ that is provided to the membership at large, the Committee concluded it appropriate that, for these activities, all members should contribute to the necessary financing. Regarding the cost of the Fund’s credit intermediation activities, the cost of these activities should be borne out of the intermediation margin and should not be included in the broader credit environment. Finally, members that receive technical assistance from the Fund should be charged for this assistance.\footnote{Ibid. 6.}

2.63 The Fund supported the overall approach taken by the Committee and decided to implement many of its recommendations. However, a consensus could not form around a key recommendation of the Committee: that the Fund generate income by investing the quotas subscribed by its members.\footnote{See Report of the Executive Board on the Proposed Amendment of the Articles of Agreement of the International Monetary Fund To Expand the Investment Authority of the International Monetary Fund at 4.} Regarding those recommendations that were accepted and key operational and legal features.

(1) The Sale of Gold

2.64 The Fund currently holds approximately 3,217 metric tons of gold, which are derived from subscriptions made by Fund members prior to the Second Amendment, when the par value system was still in existence and gold played a central role in the international monetary system.\footnote{For a discussion of the Fund’s holdings of gold and the relevant legal and accounting frameworks that apply to such holdings, see Final Report of the Committee, Appendix 6.} As required under the Articles, this gold is carried on the Fund’s balance sheet as an asset.\footnote{This corresponds to the value identified in Art V, Section 12(e), namely one special drawing right per 0.00656 gram of fine gold.} The remaining amount of gold held by the Fund (about 400 tons) was acquired when the gold market was constrained and remained relatively low until 1999.\footnote{Final Report of the Committee, Appendix 6.} This gold was acquired at the average price of SDR 207 per ounce and is carried on the Fund’s balance sheet at the value at the time of acquisition.

2.65 The Committee recommended that the Fund exercise authority under the Articles and sell a limited portion of its gold, the profits being invested pursuant to an expanded investment fund’s administrative budget.\footnote{Ibid. 6.} Since the Fund’s gold holdings are at risk of the Fund’s membership, it would be equitable to use these resources. The recommendation on gold sales was qualified by two important respects. First, the amount of gold to be sold should be limited in amount and conducted in coordination with existing central bank gold sales agreements so as not to add to the announced volume of gold sales from official sources. The objective was to limit the total amount of gold sold to 4% of the gold held by the Fund during the period of 1999–2000, the distinct nature of this gold providing a useful means of “ring fencing” the amount that would be expected to be sold.\footnote{Ibid., 12, 13.} Second, in recognition that the gold held by the Fund provides fundamental strength to the Fund’s balance sheet, the Committee recommended that the investment policy have a prescribed pay-out ratio that preserves the real value of the profit on the sale over time; that is, that portion of the annual investment income that compensates for inflation should be retained.\footnote{When the Board of Governors approved the proposed amendment, it did so in the context of gold price assumptions that were lower than the actual market prices prevailing when the Executive Board adopted the amendment to sell the gold in question. In recognition of this development, the Executive Board had approved the decision to sell the gold in question. Article of Agreement, Art XII, Section 6(f)(ii).}

2.66 Consistent with the Committee’s recommendations, on 18 September 2009, the Executive Board adopted a decision to sell 12,965,649 fine troy ounces of gold (approximately 400 tons) that have been acquired by the Fund since the date of the Second Amendment. While the actual sale transactions will be negotiated and conducted by the Managing Director on the basis of market prices, the Executive Board decision provides some direction on how these sales are to be carried out. In particular, the decision established a framework that allows for sales to be made both directly to official holders and on the market. Consistent with the recommendations of the Committee, however, any gold sales on the market must be phased over time and conducted in a manner that ensures that such sales can be accommodated within the limits on official gold sales set forth in the Central Bank Gold Agreement dated 7 August 2009.

(2) Expansion of Investment Authority

The objective of generating income from the proceeds of the sale of the Fund’s gold required the amendment of a number of provisions in the Fund’s Articles that restricted the Fund’s investment authority.\footnote{Ibid.} These restrictions included: (a) the requirement that resources held in the Fund’s Investment Account be invested only in obligations of a member or an international organization; (b) the need to obtain the concurrence of the member whose currency is being used to make the investment; and (c) the requirement to invest exclusively in obligations denominated in Special Drawing Rights or in the currency used for investment.\footnote{Ibid.}

Under the amendment approved by the Board of Governors, these restrictions are eliminated and the Fund is given the authority to use a member’s currency held in the Investment Account as it may determine, in accordance with rules and regulations adopted by the Board.\footnote{Article of Agreement, Art XII, Section 6(f)(ii).}
by the Fund by a seventy percent majority of the total voting power. This text was signed to strike a balance between two different considerations. On the one hand, there was a desire to provide for the broadest possible grant of investment authority in the Articles themselves so as to avoid the need for a further amendment in the future. On the other hand, the requirement that the investments be made pursuant to policies adopted by a significant majority of voting power (no investments could be made until such rule and regulations were in place) ensured that any investments would not be made on a discretion within the membership.

2.69 Although the above-referenced investment rules and regulations will not be adopted until the amendment enters into force, there is a consensus within the Executive Board (the Board) (rules and regulations should be guided by several principles. First, given the Executive Board's responsibilities to conduct the business of the Fund, it is understood that the monitoring and implementation of the Fund's investment strategy and account a range of factors, including the Fund's mandate and its income needs. Thus, for public nature of the resources being invested. Moreover, the 'endowment' investment to generate income for the Fund's administrative expenditures while, at the same time, rules and regulations would need to ensure that the Fund's expanded investment authority particular importance given the fact that the Fund, in the conduct of its other responsibilities—surveillance and the provision of financial and technical assistance, regularly receives

(3) Charging for Technical Assistance

2.70 In addition to its surveillance and financial assistance responsibilities, the Articles authorize functions. These financial and technical services. Unlike an other not required to meet the Fund is discretion. The Fund may decide to perform the financial or technical service and absorb the

the condition that it be reimbursed in full or in part for this cost—either from the member or from a third-party donor.

Over the years, the Fund's provision of technical services—including training—has grown considerably and, for the large part, such services have been provided free of cost. These services are performed in the Fund's core area of expertise (for example, monetary, fiscal, and financial sector policies, including the design and implementation of the legal and regulatory frameworks that support these policies) and, in some cases, provide input into both the Fund's surveillance work and the programmes of the members that are supported by the Fund's financial resources. While the Committee, in its report, recognized that the bilateral technical services represent a 'fundamental contribution of the Fund to the well-being of many of its member countries', it expressed the view that charging members for such services had 'positive aspects', including providing an incentive for members to take a disciplined approach to their costs and benefits and enhancing Fund transparency and accountability.

Building on this recommendation, the Fund's Managing Director, following consultation with the Executive Board, has introduced a new country contribution policy for Fund technical assistance. The stated objective is not to raise revenue—and, it is recognized that the budgetary implications of a charging policy are likely to be small—but, rather, to ensure that the assistance is consistent with the priorities and objectives of the recipients. As noted in the new policy, it creates a 'market test' for Fund technical assistance; namely, recipients' willingness to pay provides a signal of their interest and the value they attach to the Fund's capacity-building services. This signal serves as an important input into the Fund's prioritization and efficient allocation of limited resources. An alternative market test is the willingness of donors to finance the Fund's capacity-building services. The newly established country contribution policy incorporates a 'means-testing element': members are divided into different GNI per capita categories, with those in the higher category having to pay for the full cost of such services while those in the lowest category have to pay only 10 percent. Importantly, the policy includes exemptions for those technical assistance that are judged to provide important inputs into the Fund's other—non-discretionary—function and, using the Committee's lexicon, are judged to be 'public goods'. In particular, the Fund's assessment of members under the Financial Sector Assessment Program and the programme entitled 'Reports on Standards and Codes' while a form of technical assistance, are judged to provide important inputs into the Fund's surveillance responsibilities and are exempt from charging. A similar exemption applies to technical assistance that helps members implement a programme that is supported by
2.73 Although, at a certain level of abstraction, all international organizations may be described as having the objective of enhancing human welfare, their charters direct them to make their own distinct contribution to that objective. In the case of the IMF, the ‘public good’ it seeks to deliver is international monetary and financial stability. The assumption in 1944—when the Articles of Agreement were signed by its original members—was that such stability was a necessary precondition for the enhancement of economic welfare. Particularly in light of the financial crisis that swept through the global economy in 2008 and 2009, there can be little question that, 65 years later, this assumption still holds. Indeed, one of the distinguishing features of the existing financial turmoil is its global reach. Although it originated in the mature economies, the crisis was transmitted not only to financial integration of the world economy, the need for an institution that can organize cooperation effectively among members to achieve international financial stability has been greater. Accordingly, the issue is not whether the IMF is needed but whether it can organize cooperation effectively among members to achieve international financial stability. The IMF is currently equipped both to maximize the benefits of this integration and to minimize its costs. As discussed, a process has been under way that is designed to update both the Fund’s and, by extension, the needs of its members. Looking forward, perhaps the key outstanding challenge relates to governance reform. The willingness of countries to rely on the Fund to address the challenges that have been exposed by the recent crisis may depend on whether they feel that they are adequately represented in the decision-making process.

### 3. CRISIS PREVENTION: LESSONS FROM EMERGING MARKETS FOR ADVANCED ECONOMIES

**Jonathan T Fried and James A Haley**

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**A. Introduction**

Slightly more than a decade ago, a wave of financial crises swept across Asia, plunging the region into economic and social upheaval before engulfing Brazil, Russia, Turkey, and other emerging-market economies. These crises affected economies that had been growing rapidly and which, for the most part, had hitherto been widely regarded as models for economic and social development. Although some economists had preciously warned of potential problems, the speed with which the crisis spread took most by surprise. In their wake, however, the official sector responded quickly, and a series of exceptionally

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1. The onset of the Asian financial crisis is generally attributed to the devaluation of the Thai baht on 2 July 1997. Although serious problems were evident well before that date, growing losses of foreign exchange reserves prompted the authorities to devalue the currency by 15% in an attempt to stem the outflow. But rather than stabilize the situation, the devaluation triggered even greater speculation that quickly spread throughout the region.