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The Unique Nature of the Responsibilities of the International Monetary Fund

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Prefatory Note

The author is Associate Director in the Monetary and Exchange Affairs Department of the International Monetary Fund (IMF). The views expressed in the paper are his own and should not be attributed to the IMF. A first draft of the paper was prepared during a period in which the author was a Guest Scholar at The Brookings Institution, and he is grateful to both the Institution and its staff for having provided an environment for reflection and writing that was as close to optimal as any author might wish.

The author would also like to acknowledge his indebtedness and express his gratitude to his colleagues in the IMF, both past and present. He regrets that they are too numerous to be listed here, but he wishes to point out that in their minds they carry a wealth of knowledge and experience rivaled only by the ideals they carry in their hearts. The author has benefited enormously from such knowledge, experience, and ideals ever since he joined the institution toward the end of the Bretton Woods era. This paper is but one proof.

A number of colleagues have contributed cheerfully to the effort of readying the manuscript for publication, and the author wishes to express his gratitude to Ann Greasley and Constance Strayer, who put the draft into readable form, and to Margaret Karsten, who edited the text to the everlasting benefit of its readers. Finally, the author gladly and gratefully acknowledges the support of S.J. Anjaria, who read an early draft, questioned some of its conclusions, and thus stimulated the author to come up with stronger and more persuasive arguments.

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The Unique Nature of the Responsibilities of the International Monetary Fund

> Justice without strength is helpless,
> strength without justice is tyrannical....
> Unable to make what is just strong,
> we have made what is strong just.
>
> —Pascal, Pens\aees <1670>

Introduction

The memories of the economic, political, and social turbulence of the 1930s and the enormous suffering as well as the cost associated with its unfortunate aftermath, the Second World War, provided the impetus for establishing an order in the community of nations that would prevent the recurrence of such painful episodes. On the international front, the efforts that underpinned this order led to the creation of the United Nations and its numerous specialized agencies. In the economic area, the order was based on a framework laid out and agreed upon at the Bretton Woods Conference, which established the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), also known as the World Bank.[1]

Much has been written about the gestation and development of the international consensus that has made possible a globally peaceful and relatively harmonious evolution of the world economy for nearly half a century.[2] Hence, there is no need here to add to what is already a long list of publications mainly historical in nature. It is worth recalling, however, that history conveys that it is only after severe crises and widespread conflicts that fertile grounds are found for the gathering of international consensus on norms of behavior to avert their re-emergence. As has been often pointed out,[3] there have been repeated attempts at laying down internationally agreed principles and conventions to govern economic relations among politically independent nations. Nevertheless, not much was attained by way of formal understandings until the establishment of what came to be known as the Bretton Woods regime. Bretton Woods constituted the first formal international agreement on a code of conduct applicable for economic transactions among the countries that had subscribed to it.

In these times of profound change in the international environment, we may well be at a juncture that offers a unique opportunity to demonstrate that a constructive international consensus can also be gathered without the impetus of a global crisis or serious conflict. For the last few years, remarkable and unexpected events have been under way—indeed, they are yet unfolding—in the world economic and political scenes that carry the potential of altering irreversibly the setting in which the post-World War II order was conceived and operated. I am referring, of course, to the reforms being undertaken by countries formerly with centrally planned economies to establish systems of economic organization based on markets. Account must also be taken of the advances toward economic integration in Western Europe, a process that, after many years in the making, has now taken on a strong and virtually irreversible momentum. 4 And with regard to the developing countries—many of them still struggling with external debt difficulties—the international community continues to face the challenge of helping them set their economies on paths of sound and sustained development and growth. 5

All of these are obviously complex tasks, but tasks the accomplishment of which can be greatly assisted by the existence and implementation of an agreed set of rules of the game. The present, then, is a good point in time to reassess the code of international economic conduct that has developed over the last four and a half decades. Undertaking such a broad reassessment is an ambitious endeavor, however, and it will be important to avoid the trap of reaching beyond one's grasp. In this spirit and for obvious reasons of interest and experience, I will focus in this paper on only one aspect of the code of conduct that I believe to be critical—that is, the norms that have guided the conduct of financial and exchange transactions among countries, as they have been presented in the original Articles of Agreement of the International Monetary Fund and their subsequent amendments. In the process, I will bring out the unique nature of the responsibilities given to this institution and demonstrate the importance of preserving such uniqueness.

The plan of the paper is as follows: First, I will outline the fundamental characteristics of the IMF. Given these characteristics, it will become apparent that economic policy surveillance is at the heart of the institution's responsibilities, a subject to which I will turn next. There are, of course, other institutional responsibilities for the IMF to discharge, but I will contend that these either constitute modalities of surveillance from other perspectives or are equivalent to the exercise of surveillance at a second remove. This line of reasoning will open the way for examining next the direct link between surveillance—international monitoring of national economic policies—and conditionality—the policy conditions that members are expected to observe in order to have access to IMF resources. In a constantly changing world economic environment, it is inevitable that risks and dangers will arise to compromise, if not threaten, certain fundamental features of the institution, and these will also be discussed in the paper. Some of those risks and dangers have to do with the diverse aims of economic policy, as well as with the specific characteristics of the situations in which such policy has to be implemented; accordingly, the operation of the code of conduct in diverse circumstances will be examined from both of these perspectives with a view to ascertaining the opportunities that may have arisen to enhance the effectiveness of internationally agreed norms. Grounds will thus be laid for discussing the implications of experience for the central functions of the institution; from these grounds, a set of ideas and proposals will be presented for keeping the activities of the IMF centered on a path that ensures the continuity of its institutional uniqueness. A summary of those ideas and a number of concluding observations will then complete the paper.

Before discussing all these issues, however, I should state an important caveat. I will resort to the hard-to-rival pen of Michel de Montaigne and use his very words. Like him, I say, "I have here only made a nosegay of culled flowers, and have brought nothing of my own but the thread that ties them together" (Essais <1595>, book III, chap. 12).

Fundamental Character of the Institution

A central idea underlying the establishment of the IMF was the belief that the promotion of international monetary cooperation would be the best means to further a number of other economic objectives that were seen as essential for the welfare of the members of the institution. These objectives were explicitly listed in Article I of the IMF's Articles of Agreement, and they include: the expansion and balanced growth of international trade in a setting of stable and orderly exchange arrangements within a multilateral system of payments free of exchange restrictions. In such a setting, the IMF would promote the free exchange and growing flows of international trade that in turn would help achieve high levels of employment and real income, as well as develop the productive resources of all members. To these ends, the charter of the institution also envisaged the provision of financial resources to members in balance of payments difficulties 6 as a means of helping in their correction and thus reducing the scale and duration of external imbalances. The fundamental purpose of the institution would be to foster, and monitor the observance of, a code of conduct in international exchange and financial affairs on the part of member countries. In subscribing to the Articles of Agreement, members undertake the commitment of conforming to the set of norms of behavior they contain. 7

Basis for Institutional Cooperation

The promotion of international economic cooperation is a permanent feature and the "raison d'\ketre" of the IMF as an institution. But the nature of its practical implementation has changed and will likely continue to change over time. The variations are often linked to developments in the international economic environment, but they also reflect the degree of international cohesion that countries are willing to support and are capable of maintaining.

At the inception of the IMF in the wake of World War II, the international environment was favorable to the notion of economic cooperation as a means of preventing a repetition of the turbulence of past decades. This was reflected in the letter and spirit of the original Articles of Agreement, which centered on the commitment of member countries to a system of par values—that is, to a regime of fixed exchange rates among their respective currencies. Within such a regime, the Articles contained a detailed code of conduct that called for currency convertibility and freedom from exchange restrictions. The essential characteristic of what may be called the Bretton Woods order 8 was that exchange rate relationships, rather than being within the domain of domestic economic policy, were to be governed by a set of internationally agreed rules. Thus, member governments eschewed the use of the exchange rate as either an instrument or an outcome of economic policy and entrusted the IMF with the responsibility of ensuring their observance of the exchange rate rules. 9

The aspect I want to underscore in this type of internationally agreed arrangement is its basically self-enforcing nature. As has often been noted, international exchange rate rules can be seen as a substitute for coordination of national economic policies. In a manner of speaking, "rules-based" systems render domestic policymaking, and with it international policy coordination, endogenous. This is because, when policies become incompatible with the requirements of the system, the rules signal the need for and direction of the required policy adaptation in a typically unambiguous fashion.

There is, therefore, a standpoint from which it can be argued that "rules-based" regimes make policy coordination unnecessary: policy consistency is brought about by each country abiding by the agreed rules. In a deeper sense, however, such regimes are really characterized by a significant measure of actual (though ex ante) policy coordination. It is not coordination based on continuous bargaining among countries; rather, it is coordination based on their a priori willingness to adhere to mutually agreed norms of behavior and to constrain their domestic policies to the discipline imposed by those norms. 1 0 Thus, the general philosophy underlying the Bretton Woods order was based on the widespread acceptance of an agreed set of rules, within which members were left free to determine their own policies. As such, the system could be described as an arrangement based on the recognition of national policy independence subject to the code of conduct.

But within the code of conduct, the Bretton Woods regime provided scope for national discretion on a variety of fronts. An important margin of flexibility could be exercised at the point of individual members' adherence to the rules of the system. The Articles of Agreement contained a provision for transitional arrangements that allowed countries to join the IMF even though their exchange systems did not yet conform to its prescriptions. In effect, the institution's aim was to promote sustained adherence to its basic charter, and in many instances this required time for domestic policy action to set the conditions that would permit an economy to establish a par value and liberalize its exchange system on a durable basis. Countries were also allowed to introduce restrictions for balance of payments reasons, provided that their use was deemed necessary and transitory. And par values could be changed to correct a fundamental disequilibrium in the balance of payments—hence, the description of the Bretton Woods par value system as a regime based on fixed, but adjustable, exchange rates.[11]

Thus, although Bretton Woods was a rules-based system, it provided scope for discretion on many fronts. There was a distinct and fundamental characteristic in this margin for discretion: it was international in nature. That is, the exercise of such discretion was subject to international scrutiny at the IMF. In effect, leeway had been provided for national flexibility in basically all areas covered by the code of conduct—the possibility of maintaining exchange restrictions in effect at the time of accession to the institution, the possibility of temporarily resorting to such practices later on, and the possibility of adjusting par values. All these options were considered matters of legitimate international concern, however. Consequently, though the options were available, members were expected not to undertake such actions unilaterally. The structure of the system was that rules were to be nationally agreed, but discretion was to be internationally supervised.

Much has been written about the reasons for the demise of the Bretton Woods regime of exchange arrangements, and there is no need to reiterate them here.[12] In the early 1970s, the international economy moved from the Bretton Woods par value regime to a system of flexible exchange rate arrangements, which were introduced into the charter of the IMF by the second amendment of its Articles of Agreement adopted in April 1978. The practical implementation of international cooperation underwent changes as the abandonment of the Bretton Woods rules created a vacuum that required filling to ensure that the new system to be established took account of the international dimension. After a brief attempt to revive the rules (the Smithsonian agreement of December 1971), the efforts moved toward setting an institutional framework that would prove responsive to the conditions in the international economy as well as to the growing interest of member countries in pursuing domestic policy objectives on their own.

The Articles of Agreement, as amended in 1978, provide that members can adopt the exchange arrangements of their choice. This provision is supplemented by a prescription that firm surveillance over exchange rate policies will be exercised by the IMF under specific principles adopted for the guidance of all members.[13] In contrast to the Bretton Woods order, under which exchange rates had been subject to agreed rules, the exchange rates of a member became a variable clearly within the domain of its domestic economic policies, either to be used as a policy instrument or to be the result of those policies, or both. As a consequence, the fulcrum of the international system shifted from rules toward national discretion. And, correspondingly, the responsibilities of the IMF changed from those of a guardian of member countries' observance of exchange rate rules to those of an overseer of individual country exchange rate policy. The center of gravity had moved toward a discretion-based regime.

Yet, the fundamental aim of the institution—promoting international cooperation—remained unchanged, as did the nature of its responsibilities—appraising country economic policies from an international standpoint. In fact, the actual fulfillment of those responsibilities increased in complexity. To a large extent, this was because during the Bretton Woods regime there was an unambiguous anchor for purposes of economic policy assessment: the par value or the fixed exchange rate. From an international perspective, national economic policies that threatened the viability of the currency's par value would not be consistent with the country's external commitments and therefore would call for correction. While it was clear that a measure of judgment would be involved in formulating any such assessment, the scope for such judgment was constrained by the anchor. As such, the par value regime represented the simplest and most transparent indicator system for international economic policy surveillance.

In a setting where exchange arrangements are left to the choice of countries, policy assessments need to rely on judgment to a larger extent. Not only should consistency between national policies and international commitments be established, but primary responsibility for policy adjustment among members should also be assigned, a task that can be controversial, if not contentious. This is because country interests differ. Views vary widely about the nature of the transmission mechanism from policy instruments to policy aims, and preferences differ with regard to the importance to be attached to different economic objectives.[14]

Clearly, in such an environment, the absence of a commonly agreed point of reference compounds the difficulties typically involved in any international policy surveillance. The amended Articles of Agreement acknowledge this difficulty when they prescribe that the IMF "shall adopt specific principles for the guidance of all members" with respect to exchange rate policies (Article IV, Section 3(b)). Those principles have been laid out in a 1977 document and decision of the IMF's Executive Board.[15] Apart from describing general norms for the overseeing of exchange rate policies, it contains guidance for members' conduct of such policies and outlines procedures for the institution's exercise of surveillance.[16]

The surveillance principles seek to draw a road map that lays down the constraints that apply to national discretion. In contrast with the Bretton Woods regime, under which nations agreed with the constraint and the international community administered discretion, the current system puts into effect exactly the opposite framework: members have underwritten the predominance of discretion, while the international community is left with the task of administering the constraints to which this discretion is to be made subject.

Key Institutional Functions

The activities developed by the IMF over time to further its aim of international cooperation can be classified into three broad categories of functions. First, a regulatory or jurisdictional function monitors members' exchange arrangements and their compliance with the prescriptions of the Articles of Agreement. The function encompasses the administration of the provision of transitional arrangements. It also includes the exercise of jurisdiction over members' imposition of exchange restrictions or introduction of discriminatory practices. Typically, the IMF's authority is exercised to approve deviations from the rules whenever they are needed and when a member intends to implement policies that provide an assurance that the departures from its obligations will be temporary.

This specific jurisdictional responsibility points to the need for the institution to probe beyond the area of exchange restrictions, strictly speaking, and to enter into the domain of members' economic policies. This is clearly required for the IMF to assess the need for deviations from the code of conduct and the temporary nature of these deviations. The IMF also has a mandate to foster exchange stability, which transcends the narrow area of restrictions as well. In addition, the institution has a policy advisory function which, coupled with the jurisdictional function, is embodied in its exercise of surveillance. This is an essential function for the promotion of international cooperation, and is conducted mainly through regular consultations with member countries.[17]

Finally, the IMF has a financial function to fulfill, which consists of providing resources to members on a temporary basis. The exercise of this function involves the administration of conditionality, a term that encompasses the understandings reached between the IMF and a member requesting financial resources from the institution about the policies the member will pursue in order to render temporary the need for such institutional support.[18] Conditionality ensures that IMF resources will be made available for buttressing efforts by members to resolve their balance of payments problems in ways that do not contravene the code of conduct or endanger the liquidity of those resources and thus impair other members'potential access to IMF support.

Common and Unique Institutional Thread

There is a well-defined common thread that binds together all the activities of the IMF: the promotion and safeguarding of an international code of economic conduct. Although differences can be found among the functions of the institution, all its activities are addressed to the same ultimate objective—that is, the observance of the norms of behavior agreed by the membership. The nature of those norms may vary and has, in fact, varied over time with respect to the weight they lend to rules versus discretion, but the fundamental responsibility of the IMF remains invariably focused on promoting their observance and ensuring their protection. The IMF is primarily a surveillance institution, and its other activities derive their legitimacy from the surveillance mandate laid out in the Articles of Agreement.

In addition to being the common thread running through all IMF activities, surveillance, or, more generally, the overseeing of an international financial code of conduct, is the responsibility that invests the institution with its unique character. This is not to suggest that international economic surveillance is not carried out anywhere else.[19] But the uniqueness of IMF surveillance lies in its well-defined scope (exchange transactions) and the universal character of its membership. Typically, other forums where surveillance is conducted in some modality are either more limited in membership (the Organization for Economic Cooperation and Development (OECD)[20], European Community, Bank for International Settlements (BIS), and various groups of developed and developing countries, including summits[21]) or they focus on different subjects. (For example, trade is supervised by the General Agreement on Tariffs and Trade (GATT) and the OECD, investment and export credits by the OECD, and banking sector issues by the BIS.) Thus, in these other forums either the mandate itself is relatively narrow, or, where the mandate is broad, as with trade, the universe over which it extends is relatively limited.

Surveillance at the Center

It is clear that the motivation of the architects of the new order after World War II was to lay down a broad code of international economic conduct that would minimize the scope for conflict arising out of the economic sphere. If this interpretation is correct, then it follows that, as far as the IMF is concerned, assuring the observance of the code of conduct must represent its central responsibility. Universal consensus that this IMF surveillance is the key priority is of the utmost importance for the institution's ability to fulfill such a crucial responsibility. Experience and observation suggest it is by no means clear that consensus among the membership always exists, however, and therefore the most stimulating, yet very difficult, challenge facing the institution is precisely how to attain and maintain such a consensus. In this endeavor, the IMF confronts a challenge similar to that underlying Pascal's quotation at the outset of the paper. This is because, like Pascal's justice, there is (so far) little strength behind the IMF's exercise of international surveillance, and hence it is often perceived as helpless. Pascal has often been paraphrased in statements that a law without force is impotent. And international laws typically carry limited force. As a result, this lack of force is frequently replaced by the sheer weight of the strongest (from an economic and other standpoints) members of the community. The challenge for the IMF, in order to escape Pascal's critique, is to develop the means of replacing members' strength with the rule of law.

Mandate and Standpoint of Responsibility

A necessary ingredient in the effort to build consensus for the international equivalent of the rule of law is a common vision of the scope of surveillance. To this end, a clear commitment to the mandate given to the IMF by the Articles of Agreement seems required at all times, most particularly to those aspects that apply when the world economy and the degree of cohesion in the membership exhibit a measure of vulnerability. In this context, it should be noted that although surveillance was always at the core of the IMF's activities, the term, as such, did not appear in the international economic vocabulary until after the abandonment of the par value system. This is because until then the term would have been redundant, since the regime was to a significant extent self-enforcing. Since then, however, the rules and parameters of international behavior have become less transparent, and consequently a need has developed for the function of surveillance to become explicit as the vehicle to monitor the exercise of discretion.

The fundamental consideration to bear in mind when examining the concept and scope of surveillance is its international character. This can be seen from a two-dimensional perspective, encompassing on the one hand the obligations undertaken by members when they subscribe to the code of conduct, and on the other the obligation of the institution to oversee their observance.[22]

Although no hard and fast borders can be drawn on the domain of economic policy, the international character of surveillance does imply that its central focus is on external variables. It is with regard to these external variables that members have undertaken specific obligations. Within the Bretton Woods system, the basic premise was that rates of exchange among national currencies were a matter of legitimate "international concern" and, as such, "subject to international scrutiny."[23] Since the abandonment of par values, the notion that exchange rates remained a subject of international interest was carried over into the amended Articles of Agreement, which call for the IMF to "exercise firm surveillance over the exchange rate policies of members."[24]

Broadly speaking, the focus of concern to the international community and, correspondingly, the focus of obligation on the part of members, centers on the point and the terms of intersection of their national economies with each other—that is, the balance of payments, the exchange rate, and the exchange system. This interpretation highlights the notion that balance of payments equilibrium is fundamental to a country's international obligations.

From an institutional standpoint, an appropriate definition of balance of payments equilibrium would be a sustainable external payments position at a realistic exchange rate in a setting free of exchange and trade restrictions. [25] Though such a definition is straightforward from a conceptual standpoint, providing operational content to such a definition can be a complex endeavor. This difficulty is suggested when terms like "sustainable" and "realistic" are used to qualify the external payments position or the exchange rate. Yet a measure of operational content can be derived from the meaning of the code of conduct itself—that is, from the commitment to avoid restrictions on current payments and discriminatory currency practices, as well as from the agreement to promote a stable system of exchange rates and avoid manipulating them to prevent balance of payments adjustment or gain from unfair competitive advantage. Such specific operational content has been spelled out in the Executive Board document and decision on surveillance over exchange rate policies, which focuses on intervention and external funding (e.g., borrowing and lending) policies and on the restrictions or incentives applicable to current and capital transactions. [26]

In essence, the exercise of surveillance entails assessing the ability and willingness of countries to maintain their international affairs in an orderly manner. This requires evaluating the soundness of the balance of payments or, to put it differently, of the country's skill in keeping within the budget constraint it faces vis-\ga-vis the rest of the world. The endeavor calls for a judgment not only about the economy's overall external payments position but also about the appropriateness of the structure of those payments—whether the global external constraint (the balance of payments) is being respected (the adequacy of the global payments position) and whether it is being respected on a durable basis (the adequacy of the underlying structure of external payments). Such a judgment requires in-depth analysis of the current account balance, capital flows, and international reserve management. In turn, it requires the formulation of views on the exchange rate and the exchange system, that is, on members' compliance with the commitments laid out in the code of conduct. Thus, although the focus of surveillance is on external economic variables, because of the nature of the required assessments, its scope must extend beyond those variables.

The comprehensiveness in the scope of surveillance—even if the function itself is confined to the area of external variables—and the interdependence of national economic policies pose another difficult challenge to the exercise of this institutional responsibility. There is no definite frontier to distinguish the external from the internal dimensions of an economy. In order to assess the viability or appropriateness of an external payments position, an evaluation of the stance and mix of domestic policies is unavoidable. Accordingly, the obligations undertaken by members must encompass the field of domestic economic policy by virtue of the inseparability of economic linkages. [27]

The challenge is to identify the domestic policy areas that influence primarily the economy's external position, so as to provide the basis for a general consensus among the membership that they are of legitimate international concern and properly belong within the scope of surveillance. Such consensus is necessary, of course, because the code of conduct does not provide for surveillance in areas where the actions of a member do not affect the interests of other members. [28] Because of the pervasive nature of economic linkages, judgment is required in drawing a line between domestic policies that have a clear bearing on the external sector and those that do not. This is a difficult judgment to make in itself, but one that is even more difficult when the boundary it seeks to outline is not immutable over time. Over time, however, a consensus has developed in the membership about important areas for international policy surveillance. The focus of the discussion that follows will seek to trace the evolution and current status of that consensus. [29]

The interdependence between the balance of payments, the exchange rate, and the exchange system, on the one hand, and the stance of domestic macroeconomic policy or aggregate demand management, on the other, was well established relatively early in the experience of the IMF. Accordingly, member countries have long endorsed the need for the IMF, in its exercise of surveillance, to appraise the appropriateness of domestic fiscal and monetary policies. In fact, during the period of the Bretton Woods order, a conventional but important distinction was drawn on what could be termed stabilization (which fell within the purview of the IMF) and development (which represented the domain of the World Bank). Broad classifications along economic policy lines were based on this distinction, and it could often be heard that in dealing with stabilization problems, the IMF focused on macroeconomic, or aggregate demand, management; in contrast, the World Bank, interested mainly in development issues, tended to concentrate on microeconomic, or aggregate supply and production, management. There were, of course, overlapping areas between these two institutional domains, which reflected the virtual impossibility of drawing firm borders between them. In fact, microeconomics and supply responses affected the process of stabilization just as much as macroeconomics and aggregate demand influenced the process of development. [30]

Broadly speaking, however, the distinction of institutional responsibilities generally reflected the evolution of the international economy during the Bretton Woods period. A strong case can be made that the rules prevailing with the par value system helped identify the extent to which domestic policies conflicted with members' international commitments, thus also helping identify the boundaries of institutional responsibility. The shift from policy rules to policy discretion that followed the Bretton Woods order affected the links between the domestic and external economic policy domains and brought to the forefront the question of the appropriate boundaries for institutional action. In this process, the existing understandings concerning institutional policy assignments and responsibilities were inevitably influenced.

New distinctions were introduced to supplement or replace the old ones. In the IMF, the emphasis moved from stabilization toward adjustment, which encompassed the features of stabilization but went beyond it by reaching into the structure of the economy. In the World Bank, although development retained its importance, attention moved toward so-called structural adjustment. While containing some of the aspects of development, structural adjustment reached back into the broad policy environment in the economy and thus seemed to include some elements that were prerequisites for development. In fact, it very much appeared as if the process of economic evolution encompassed a number of successive and progressively complex phases: stabilization, adjustment, structural adjustment, development, and growth. Institutionally, the specific roles coalesced toward stabilization-cum-adjustment for the IMF and development-cum-structural reform for the Bank. An overlapping interest in structural adjustment and growth developed as both of them, it could be claimed, had a bearing on the balance of payments and investment flows. The areas of common interest came even more to the front with the development of external debt strategy, in which structural adjustment, reform, and growth acquired particular importance. [31]

At present, events in the international economy have paved the way for a new subject of interest, which may be called the economics of reform. This includes the efforts of a number of Central and Eastern European countries as well as the former Soviet republics to move their economies from central planning to a market-based system of economic organization. The subject raises a question regarding the role of surveillance in the context of reform, particularly since the international community most assuredly has an interest in the effectiveness of the process under way.

In sum, even if there is consensus that economic surveillance should properly focus on external variables, its practical implementation requires paying attention to domestic policies. Therefore, surveillance is unlikely ever to become a straightforward exercise. Its complexity derives from the close interdependence of economic policies, both nationally and internationally, and it calls for increasingly fine judgments in drawing the boundaries between the national and international domains.

Fundamental Principles of Operation

There are three essential principles in the operating method of the IMF that, like its functions, provide an important basis for the institution's uniqueness. There is, first, the principle of universality, according to which IMF membership is all-encompassing and does not normally establish distinctions among countries or groups of countries.[32] Also fundamental is the principle of uniformity of treatment, according to which the IMF is expected to act without discrimination: treatment of members must remain equal and comparable, allowing for no preferences in favor of any country or group of countries. Judgment is required in this area, as well, because uniformity cannot be interpreted to mean the provision of equal treatment regardless of circumstances; on the contrary, uniformity must allow room for taking account of unequal circumstances.[33] The third basic principle, political neutrality, aims at keeping the attention of the IMF focused on international issues. It calls for a permanent effort to maintain an appropriate balance between the interests of individual members and those of the membership as a whole. Key to the IMF's observance of this principle is a continuous focus on external economic variables or on the point and terms of intersection of national economic policies and national economies.

The actual application of these principles is tempered in practice by the exercise of discretion. Such latitude is allowed for in a fourth principle of operation of the IMF, flexibility in its relations with members. An appropriate mix of flexibility—sensitivity to a member's circumstances—with universality, uniformity, and neutrality—the common aspects of membership—is required for a sustained balance between national and international interests.

Acknowledgment of Diversity

A singular characteristic of the IMF has been its ability to avert a conflict of its basic operational principles—of universality of membership and uniformity of treatment—with the diversity that prevails among countries. The solution to this potential conflict has been to acknowledge that, from an economic standpoint, member countries are not equal and, correspondingly, to provide them with different weights in the institution. This economic inequality, the sharpest and single most important difference among member countries, underlies the different quotas (subscriptions) and voting powers that countries have in the institution. 3 4

The quota share is related broadly to the economic and financial position of members in the international economy, and it provides the basis for determining and measuring the rights and obligations of membership. In other words, the rights and obligations of members are scaled by their respective economic and financial size. The original intent was to keep rights in line with obligations and both of them commensurate with the economy of the member. In this manner, some potential difficulties that could arise from the operational principles were resolved. For example, implementing the principle of universality was clearly eased by the differentiation in country weights. Though this differentiation can (and does) give rise to delicate issues in the process of determining concrete shares, it also facilitates the membership's willingness to accept new members. Furthermore, the universal acknowledgment of diversity among countries also serves as a basic guidepost for exercising uniform treatment by helping to provide a measure of equality in unequal situations.

From the standpoint of surveillance, a number of inferences can be drawn from the diversity recognized within the membership. A clear responsibility of all members, regardless of their individual weights in the institution, is to observe the commitments they undertake in subscribing to the code of conduct. This is equivalent to keeping their own economies in good order and in line with the prescriptions of the Articles of Agreement. Yet the very acceptance of differences among economies carries as a corollary the acknowledgment that the scope and influence of national economic policies also vary.

For countries with economies relatively small in size, the international environment in which they operate may be considered exogenous. The essence of their commitment is to keep balance in their own economies and respect the code of conduct. Surveillance in these cases appraises the appropriateness of domestic economic policies—that is, it assesses the individual country's observance of the rules of the game in the context of the existing external environment.

For countries with relatively large economies, the international setting cannot be considered as a given, immovable ambient. On the contrary, the external environment reflects to a significant extent the national economic policy decisions those countries make. The nature of their international commitment, therefore, must include concern for the consequences of their actions in relation to the system at large. Beyond assessing the appropriateness of national policies in isolation, the exercise of surveillance must encompass consideration of the extent to which those policies contribute to a stable international setting.

There is, then, a fundamental rationale for the establishment of differentiation in the exercise of surveillance. Indeed, such differentiation is necessary to ensure both symmetry and uniformity of treatment among members. This is yet another prime example that realistic acknowledgment of inequality can be the best means for dispensing equality.

Much progress has been made in the IMF toward developing policies and procedures that take account of the systemic and nonsystemic dimensions of members'domestic economic policies. From the outset, it was well recognized that the fundamental aim of surveillance was to assist in attaining proper balance in country economic policy formulation between national and international considerations. It was generally accepted that each country would be the best judge of its own national interests; but as far as international interests were concerned, the IMF, as representative of the whole membership, would be the best forum to judge the extent to which they were being protected.

The practice of regular, periodic (virtually, annual) consultations with each member to appraise economic policies was developed early in the life of the institution. During the Bretton Woods period, observance of the rules broadly ensured the stability of the system as a whole. Accordingly, no particular emphasis had to be given explicitly to systemic considerations—except, of course, for such global issues as the adequacy of international liquidity. At that time, bilateral consultations between the IMF and each country constituted the central instrument of surveillance.

The move to the current regime, by which members can opt for the exchange arrangements of their choice, provided less assurance that such bilateral consultations, focusing only on individual member policies, would be sufficient to ensure stability to the global economic environment. The effects of national policies on the international economy, as well as the consequences of interdependence among those national policies, began to receive increasing attention. As a result, the scope of bilateral discussions with large countries was broadened to explicitly include international aspects in the annual consultations. The institution also started to devote greater efforts to global assessments of the international economy by conducting World Economic Outlook discussions, which are undertaken regularly in the Executive Board. Country-specific analyses provide critical input for these discussions, but their focus is global, centered on interdependence and aimed at appraising how appropriate the mix of national policies—particularly those of the larger members—is for the stability of the system at large. These discussions supplement the bilateral aspect of surveillance by adding a multilateral dimension in order to discern global trends and their causes. They are the main instrument of multilateral surveillance but not the only one. Additional global overseeing by the institution takes the form of examinations of specific aspects of the international scene and their linkages to country policies (e.g., issues relating to capital flows, international policy coordination, foreign indebtedness, and international liquidity). [35]

At present, an additional challenge confronting surveillance is posed by the growing importance of regional country groupings. The clearest illustration of this is provided by the European Community, where economic integration is proceeding with clear implications for the design and implementation of national economic policies in the participating countries. In this Western European context, neither the bilateral country consultations nor the broad World Economic Outlook discussions fully capture the essence of the regional interrelationships.

In sum, surveillance involves policy discussions between the IMF and individual members as the basis for the formulation of an international community view and assessment of specific country policies. In addition, it encompasses regular examinations of the state of and prospects for the world economy at large, or of particular aspects of the international economic scene. The end-purpose of these various activities is to promote consistency of national policies and aims, to highlight interdependencies, and to point toward a well-balanced and fair assignment of policy responsibilities among members.

Surveillance from Other Perspectives

Taken from a broad vantage point, most of the other functions of the IMF are ultimately diverse modalities of surveillance. This fact does not deny their importance as distinct institutional responsibilities but emphasizes the central unity that characterizes the fundamental identity of the IMF. In many respects, each of the functions of the institution is perceived as separate, and for certain purposes, such a separation is appropriate. It is important, however, to keep in mind their essentially unified character, because this is what gives distinctness to the IMF.

Jurisdictional Aspects

As already noted, two main areas call for explicit exercise of jurisdiction on the exchange arrangements front. First is the administration of transitional arrangements allowed for in the code of conduct, according to which members upon accession to the IMF may notify the institution that they intend to maintain and adapt to changing circumstances the restrictions on current international transactions in effect on the date of their membership. 3 6 Such an allowance, however, is accompanied by an obligation of members to consult annually with the IMF concerning the retention of restrictions inconsistent with the provisions of the code of conduct.

Second is the administration of the observance of the code of conduct. This responsibility calls for the institution to oversee members' compliance with the agreed norms and to judge the acceptability of deviations from these norms. In essence, the IMF has acknowledged that circumstances may arise when a member's actions that represent a departure from the code of conduct may be justified. The criteria for the exercise of jurisdiction in those circumstances focus on the existence of a balance of payments need for those actions and on their temporary nature. The criterion of need requires a judgment that the actions in question are essential to cope with the member's balance of payments problem. The criterion of temporary duration calls for reaching an understanding with the member concerning the policy actions that will be undertaken to eliminate the need for such departures from the rules of the game.

The regular consultation procedure between members and the institution evolved from the relatively narrow jurisdictional responsibility of administering the transitional arrangements. Over time, members recognized the general value of consultations even in the absence of jurisdictional issues. The procedure thus became the central function of the institution, and it extended beyond the narrow domain of restrictions to all economic policies that affect the balance of payments. At present, all members have an obligation to consult with the IMF on their exchange rate policies. Such consultations include an assessment of the observance of the principles of surveillance, as well as the jurisdictional and balance of payments aspects discussed above. [37]

Financial Aspects

A central responsibility of the IMF is the provision of financial assistance to those members which face a potential or an actual balance of payments need and are willing and capable of undertaking the policy measures required to eliminate it. This financial function is the best known activity of the institution, as illustrated by the interest typically given to conditionality, the term that has been coined to refer to the IMF's policies regarding use of its financial resources. This is not surprising in light of the importance financial arrangements with the IMF have gained over time as indicative of members'adjustment efforts, on the one hand, and as guides and catalysts for international financial flows, on the other. [38]

The dimension of conditionality that I want to stress here is its close relationship with surveillance. Financial assistance is among the purposes of the institution that explicitly include the provision of "confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national and international prosperity" (Article I(v)). This general purpose is then supplemented by a prescription that in setting conditions on the use of its resources, the IMF will seek to help members solve their balance of payments problems "in a manner consistent with the provisions" of the Articles of Agreement (Article V, Section 3(a)). Accordingly, financial assistance from the IMF is specifically geared toward encouraging observance of the code of conduct.

A possible way to visualize surveillance as a unifying theme in the IMF is to consider conditionality as the procedure specifically designed to safeguard the code of conduct in the concrete instance of a member confronting balance of payments difficulties. This particular interpretation of conditionality, by linking this function directly with the code of conduct, underscores the distinct character of the financial assistance from the IMF. Although the IMF, like other international institutions, is a lender, and it provides resources to help cover actual or potential foreign exchange needs, the central purpose of its financial activity is to buttress a code of international behavior. The institution's key contribution to international welfare is its commitment to protect this code, and the provision of financial assistance is but a means to that end.

Therefore, although it may well be best known for its financial activities, the IMF nevertheless remains primarily a surveillance institution. Furthermore, it is from this fundamental responsibility that the exercise of conditionality derives its legitimacy. This line of reasoning is critical to address the issue of symmetry in the treatment of members, an issue that often arises in comparisons between the institution's influence with regard to members that use its resources and those that do not. While, in principle, there is no differentiation among member countries beyond recognition of their diverse weights in the system at large, there is a perception that symmetry is lacking either in the influence the IMF has over members or the treatment it gives them, depending on whether they are net debtors or creditors of the institution, or, more specifically, on whether they are drawing or not drawing on its resources.[39]

In part, the perception responds to an aspect of reality which effectively distinguishes deficit from surplus positions. Although it is true that ex post there is symmetry between these two positions, the same proposition does not necessarily hold true ex ante. In terms of policy action, the primary responsibility for the elimination of an imbalance (and it must be stressed that this is a surveillance-based perspective) usually rests with the member in deficit.[40] In principle, and without restrictions or other deviations from the code of conduct, the only responsibility of the member in surplus is to allow the effects of the policy corrections undertaken by the deficit country to work themselves through and influence behavior across the system as a whole. Thus, what may be perceived as greater influence (or different treatment) by the IMF with respect to members using its resources is but the proper (that is, symmetrical) operation of the rules of the game, when these rules are generally observed.

In part, the perception of lack of symmetry has also been fueled by the increasing emphasis the membership has tended to place on the institution's lending activities. To the extent that such an emphasis is viewed as being at the expense of surveillance—in the sense that observance of the code of conduct is not perceived to prevail uniformly across all members, a case can be made that symmetry is lacking. The strength of this case lies in pointing to a loss of balance between the exercise of surveillance and conditionality or, in other words, between surveillance at a first and at a second remove. This line of reasoning stresses that when surveillance is generally effective, not only is the need for IMF resources likely to be relatively limited, but also their use is likely to be revolving in character; that is, balance of payments problems are unlikely either to remain outstanding or to stay with the same members for long periods of time. Consequently, if external deficits characterize the situation of a large and persistent share of the membership, a presumption may well arise that surveillance has not been effective. Indeed, as long as the effectiveness of surveillance remains limited, it can hardly be expected that conditionality will be in a position to provide full assurances regarding the correction of imbalances.

There is, therefore, a need for all members to support surveillance—the responsibility for the general observance of the code of conduct—as much as, if not more than, conditionality—the responsibility for the resolution of external problems within the same code of conduct. Only then will the international environment at large also be orderly.

Technical Assistance Aspects

Over time, the IMF has also engaged in various technical assistance activities with members on a diversity of fronts. Initially, those activities covered areas of specific membership obligations, but later they extended to other related domains. Some of these activities grew from early work undertaken to secure enough country-specific information to enable the IMF to discharge its responsibilities. In these endeavors, the IMF has helped members establish national economic data bases. It has also assisted them in the field of exchange arrangements and controls. As the depository for national statistics, the IMF not only developed expertise in that field but also devised, over time, statistical concepts and definitions based on common and consistent standards, thus helping to create sets of relevant and comparable international data. Similarly, the institution developed an expertise in the sphere of exchange arrangements that could be used to transmit information across the membership.[41] In addition, the IMF shared with its membership a wealth of knowledge regarding the institutions and instruments of economic policy, acquired through the exercise of surveillance. Thus, technical assistance has provided advice to members in areas that include fiscal policy, central banking and monetary policy, external debt and international reserve management, as well as legal and regulatory issues.

Surveillance and Conditionality

Possibly the most important reason to focus on the unity of the role of the IMF as an institution is to highlight the close relationship between its two best known activities, surveillance and conditionality. This section will focus on the dependence of both surveillance and conditionality on the code of conduct and on how variations in that code may influence them.

The Bretton Woods Order

The “rules-based” regime adopted at the Bretton Woods Conference laid out clearly the rationale and scope of international policy surveillance. The aim was to ensure consistency between members’domestic economic policies and their commitment to keep a par value for their currencies without resorting to restrictions on current payments and transfers. In such a setting, the nature of conditionality was fairly unambiguous. Lack of consistency between the stance or the mix of policies (or of both) and the code of conduct tended to manifest itself by the emergence of a balance of payments problem, typically in the form of a deficit. The exercise of conditionality then became the instrument through which IMF assistance would in effect help restore consistency between domestic policies and international commitments. The importance of those commitments rendered monitoring and adjusting domestic policies, when necessary, all the more essential.

A framework for exercising conditionality during the Bretton Woods period was developed that also reflected the clear focus of the code of conduct on the international order. In fact, the code of conduct made it possible to design a relatively straightforward set of policies and procedures to guide the extension of IMF financial assistance. Those policies and procedures conformed to the prescriptions of the Articles of Agreement and had their foundations in well established economic analysis.

Among other things, the Articles of Agreement called for the IMF to assist members by allowing them to use its resources in a manner consistent with the purposes of the institution and under adequate safeguards to ensure that such use would be temporary. In essence, the first requirement directed IMF assistance to support policies that were in accord with the code of conduct; the second requirement intended that those policies would be effective in eliminating balance of payments problems, thus ensuring only transitory use of IMF resources. These two requirements led to the development of stand-by arrangements as the instruments to channel IMF assistance to individual members. It was based on a set of specific policy understandings reached between the member and the institution that gave an assurance of balance of payments recovery.[42]

During the Bretton Woods period, short-term economic fluctuations were typically viewed as traceable to changes in aggregate demand. These changes, together with a relatively stable aggregate supply function, were considered the major factors behind short-run variations in output, prices, and the balance of payments. The analytical perspective therefore focused—though, it must be stressed, not exclusively—on the relationship between aggregate demand developments and the balance of payments. Accordingly, the analysis sought to identify quantifiable policy variables that would influence aggregate demand (or the allocation of resources, when this was perceived as an element of the problem) so as to bring about external balance. In the process, the relevance of fiscal and monetary policies, external debt management, and the critical role of relative prices for the external accounts in particular and for efficiency and balance in the economy in general, became progressively and widely accepted. [43]

There was an important interplay between the code of conduct's clear focus on an international order and the external economic environment, which tended to make surveillance and conditionality relatively unobtrusive. The commitment of members to the rules of the game tended to limit the incidence of national policy-induced shocks and make detailed surveillance and conditionality redundant or unnecessary.

Subsequent Adaptations

The increased scope for discretion in national policymaking had important consequences for the evolution of the world economy at the national and international levels. From a global standpoint, it loosened the link between observance of the code of conduct and the attainment and maintenance of stability in the world economic environment. From a national standpoint, this weaker link contributed to an increase in the likelihood or frequency of conflict between external and internal balance.

A number of adaptations became necessary to align the exercise of surveillance and conditionality with these new and changing circumstances. With respect to surveillance, developments proceeded in several directions and on a number of fronts. Within the IMF, an early need was to supplement the amended code of conduct with a set of principles on surveillance. Those principles aimed at establishing a clear and agreed domain for the assessment of members' policy obligations on the basis of a variety of indicators that spanned the spectrum of policy variables, from policy objectives to policy instruments. Policy objectives encompassed external variables (balance of payments or the exchange rate) as well as domestic variables (output, employment, prices). Policy instruments included monetary, fiscal, and incomes policies, as well as external debt management and structural policies that directly addressed resource allocation and thus aimed at efficiency and supply enhancement. The principles for assessing policies were supplemented by the introduction of procedures for surveillance that, inter alia, provided for regular consultations with all member countries. [44]

In the process, the scope of surveillance was adapted to new needs. It broadened to take account of the interrelationships among sets of policy objectives and available policy instruments within an economy. The standard of measurement of performance moved toward the attainment of a set of objectives, including external balance with price stability and sustained economic growth. It therefore had to focus on a relatively broad set of instruments, which besides those of a macroeconomic nature encompassed policies with an impact on the structure and productive capacity of the economy. The scope of surveillance was also broadened in the area of policy interdependencies across countries. Not only did this aspect become increasingly important in discussions with individual members, but it also constituted the central focus of regular exercises of multilateral surveillance based on the Executive Board's appraisal of the World Economic Outlook.

A parallel set of developments took place with respect to conditionality. The increasing variety of policy objectives also required adaptations in the scope of policy instruments. As with surveillance, the search for external balance, accompanied by the attainment of aims in the domestic sphere (such as inflation control and growth promotion), led to extensions on two different fronts: one was the need to focus on an array of policy instruments beyond the strictly macroeconomic sphere, and the other was allowance for a time framework and scale of assistance commensurate with the broader policy package and aims. 4 5 Conditionality practices, therefore, looked for ways to set economies on a sound growth path in a relatively unfavorable international economic environment.

Challenges Ahead

There are two clear challenges ahead for both surveillance and conditionality. The first is a consequence of the weakening in the post-Bretton Woods era of the link between the code of conduct and economic performance nationally and internationally. In the abstract, this entailed a certain loss of legitimacy for the overseeing functions of the IMF and an accompanying perception of increased IMF obtrusiveness through conditionality and possibly also surveillance. In a sense, such a perception may well correspond to reality, because, paradoxically, the softening of a code of conduct, which typically reflects a desire to avoid constraints on national behavior, is often accompanied by attempts to strengthen its implementation through close monitoring of its observance.

The second challenge is posed by the formerly centrally planned economies of the world currently in the process of reform. It derives from their desire to integrate into the established international economic order, and it opens up two questions. One is implicit in any system based to a large extent on discretion: can such a regime provide the requisite frame of reference for the integration of new parties to it? The other is implicit in the reforming economies themselves: the central task in these economies is to set the foundations for and develop a market, yet the world order into which they want to integrate is based on the market already being in place; so the question is, how can a code of conduct that takes the existence of a market for granted best help in the development of a market framework?

Areas of Risk for the Code of Conduct

Since it sets constraints on behavior, any code of conduct is typically subject to pressure and confronts a variety of risks. The pressure reflects a natural tendency to avoid the constraints; the risks develop out of the incidence or frequency of successful avoidance. There is, then, a relationship between those pressures and risks, on one side, and the balance of rules and discretion within the code of conduct, on the other. While rules may give rise to pressure, they also identify deviations clearly and, to that extent, help contain the risk of their occurrence. In contrast, discretion may contribute to lessening pressure, but by rendering deviations less "deviant" tend to increase their incidence. Pressures and risks have arisen in areas concerned with the principles of operation developed in the IMF to foster the observance of the code of conduct itself. The reason is that such principles must contain all the elements required for balance between rules and discretion, and it is precisely such balance that is always subject to tension.

Universality

A key incentive for sustained cohesion in the membership is provided by the fundamental principle of universality. While membership in the IMF is not an automatic right, it has been open to all countries willing and able to subscribe to the code of conduct. The acknowledgment of diversity of circumstances has eased the process of accession for countries of different characteristics and in different circumstances. The spirit of the institution has been to avoid the emergence of country groupings and to view all countries only from the common perspective of members. This does not mean that pressures do not arise to distinguish groups of members on the basis of different criteria. Generally, the IMF has resisted those pressures in its operations, although for analytical purposes it may separate countries into groups.[46] This is one of the tenets of the institution against which pressure will continue to persist. Yet, cohesiveness will require resistance to such pressure by means of clear focus on the common interest. Otherwise, the framework will become set for members to concentrate instead on attaining the best individual country bargain, with the local rather than the universal interest becoming the common denominator of country behavior.

Uniformity

Uniformity of treatment is possibly the institutional principle most subject to continuous strain. To an important extent, this is inevitable, because uniform treatment of different members or of members in non-uniform circumstances calls for the exercise of a substantial degree of judgment. Balanced judgment is required in ascertaining the different weights to be given to the members themselves and to the differences in their circumstances, in order to ensure effectiveness and relevance to the principle of uniformity. In the area of surveillance, uniformity of treatment requires taking account of a member’s capacity to influence the system as a whole. In the area of conditionality, it requires that the adjustment effort sought from members be broadly commensurate with their adjustment needs.

In a properly functioning system, the exercise of conditionality tends to be more an exception than a norm. If surveillance, in general, is effective in promoting members’ observance of their international obligations, the emergence of external imbalances calling for adjustment should be relatively limited in frequency and duration. In this context, it is worth emphasizing that surveillance, when effective, not only promotes order in each national economy but also in the system as a whole. These considerations suggest that too much concentration on conditionality may indicate ineffectual surveillance. Balance between surveillance and conditionality ensures symmetry in the treatment of members, regardless of whether or not they are using IMF resources. Similarly, perceptions of asymmetry hint at an imbalance in the effectiveness of the two functions.

Neutrality

The risks in the area of neutrality—or in the containment of IMF activities within the legitimate international domain—can be related to the characteristics and scope of the mandate of the institution. The bias toward rules or toward discretion in the code of conduct also plays an important role. Typically, rules must meet certain standards of transparency and clarity that make their application to policy aims and instruments relatively precise. This precision greatly eases the observance of neutrality in the broad exercise of IMF surveillance. In contrast, regimes with a mainly discretionary nature are less likely to exhibit transparency and precision. As a result, the signals that they send tend to be relatively more ambiguous—a characteristic that complicates the observance of neutrality.

In fact, clarity of mandate tends to require a fairly unequivocal definition of its scope. This explains the focus in the IMF's code of conduct on the balance of payments and, more generally, on external variables. As the code of conduct moves from reliance on rules toward discretion, however, the boundaries of the scope of the mandate become less clear. In the Bretton Woods order, the measurement of a balance of payments position was dependent on the par value commitment, which gave an important reference point for its assessment. Since that time, the commitment has been replaced by concepts such as external viability or sustainability, which encompass other aims (growth, price stability) and broaden the range of policy instruments that need monitoring. In this setting, apart from the trade-off that exists between the depth and the breadth of a mandate, determining where to draw a line between the national and international domains increases in complexity and widens the range for emerging differences in judgment.

The Code of Conduct in Diverse Circumstances

The central focus of the code of conduct of the IMF has always been on the external sector of members' economies. And although, from a jurisdictional standpoint, the institutional mandate stressed the areas of exchange and current payments, the aim of a liberal trade system was at the core of the spirit of the code of conduct.[47] In its operations with members, the IMF was also interested in attaining other related aims and in resolving balance of payments problems. 4 8

Since Bretton Woods, the emphasis given to what may generally be called microeconomic issues (those having to do with efficiency in resource use), relative to that given to macroeconomic issues (those dealing with the balance between the aggregate demand for and availability of resources), has tended to increase. Perhaps to an important extent, the shift has reflected the fact that economic imbalances tend to increase in complexity in settings where discretion is the norm rather than the exception. This section will focus on three of the most conspicuous areas of concern.

Structural Adjustment and Growth

In a system where members adopt the exchange arrangement of their choice, subject to constraints aimed at protecting the interests of the membership at large, the concept of an appropriate balance of payments position is not easy to define operationally. The relevant notion is sustainability or viability of the external payments position, which implies a time framework, and not a particularly short one at that. If external imbalance means that the balance of payments has reached a clearly unsustainable position, then the focus of policy must be on restoring viability to the balance of payments over the medium term. This concept includes objectives such as a sound growth rate and relatively stable price performance. Thus, although the balance of payments may remain the primary objective of surveillance and conditionality, the attainment of growth and price stability becomes an integral part of IMF functions. From this vantage point, it may be argued that trade-offs often perceived between balance of payments and price or output outcomes are more apparent than real and that the actual choice is instead between problems today versus problems tomorrow. 4 9

This is the background for the development of the extended Fund facility (EFF) and of the enlarged time horizon for IMF stand-by arrangements. The concern was that balance of payments results achieved at the expense of domestic imbalances (such as sustained periods of growth below potential) would prove to be as short-lived as the attainment of domestic objectives (such as price stability or above potential growth) at the expense of balance of payments deficits. This meant an expansion of the policy understandings between the IMF and its members. It also meant an increasingly close relationship with the World Bank, which in a similar vein initiated its structural adjustment lending program, involving the extension of policy-based loans. [50]

Capital Flows and External Debt

The Bretton Woods order and the amended version of the Articles of Agreement currently in effect focused on attaining freedom of transactions at the current account level. The period that followed the abandonment of the par value system witnessed an unprecedented increase in international capital flows, particularly in the form of contractual lending. These growing transactions were instrumental in safeguarding interdependence in the international economy and as such were perceived as an indication of the resilience of the international financial system. But they also exhibited characteristics that caused problems to develop at a later stage. These were the predominance of contractual lending to sovereign borrowers and the resulting change in the structure or composition of capital flows. Capital movements rose markedly in scale but not uniformly across the full range of the various possible types of flows. Their main channels were commercial bank loans.

It is now a matter of historical record how these capital account developments led to a severe international debt crisis that seriously strained the fabric of the international financial system. Although the debt strategy that was adopted in response proved remarkably successful in achieving its central aim of eliminating the systemic threat, individual country debt problems are still outstanding. [51] The international economy still confronts the fundamental challenge of setting the conditions for restoring normality to capital flows. And normality consists not only of the resumption of those flows on an appropriate scale but also of restoring balance to the structure of capital movements. That restoration should enable private foreign direct investment and equity flows to become important channels for resource transfers. Such a development, important at all times, can be critical at present to help along the reforms under way in previously centrally planned economies.

Of interest in this context is the complete liberalization of capital flows in several countries participating in the European Monetary System (EMS). This is an essential step that takes the EMS well ahead of

Bretton Woods, the regime with which it is often compared. The liberalization of capital movements will pose an important challenge to the resilience of the EMS as well as test the arguments frequently made that viability of the system is contingent on the existence of capital controls.[52] As a general matter, the steps taken within the EMS to provide freedom to capital movements are very much in accord with the aim of European integration as well as with the growing globalization of international financial markets. As such, however, they raise a question about the continuing appropriateness of the distinction in the Articles of Agreement between current and capital transactions, a distinction conceptually and operationally awkward.

Economic Reform

One of the most, if not the most, stimulating of challenges facing the international economy in more than four decades is provided by the events under way in Central and Eastern Europe as well as in the former Soviet states. This is not only because of the opportunity to help these regions in their efforts to raise market economies from the ashes of central planning, but also because of the unique occasion to integrate the reforming economies within the international system and thus establish an economic order of a truly universal character.

Nowhere is the challenge more appealing than from the standpoint of the IMF. The role this institution has begun to play immediately with regard to the reforming member countries encompasses all its fundamental functions. It has started with technical assistance, a relatively less central function from the perspective of the code of conduct but, nevertheless, crucially important from the vantage point of reform. As there is an enormous need in these countries for technical assistance in many areas, the IMF is already providing its own expertise directly as well as in combination with official expertise drawn from member governments on many fronts.[53]

The opportunity to establish a universal economic order challenges the IMF to focus on the broad area of surveillance. This general function can and should play the main role in the IMF's assistance to the reform effort. The rationale for this is that surveillance and reform share common aims: the purpose of reforms is to set the conditions for the establishment of free market economies, and the purpose of surveillance is to foster norms of behavior based on freedom of international transactions among member economies as a means of enhancing their common welfare. The new direction taken by these previously centrally planned economies sets them squarely within the membership, which is based on nationally chosen boundaries between public and private sectors rather than on the virtual dominance of government over the economy.

There are two dimensions of surveillance which acquire particular importance for the reforming economies. The immediate one is the policy advice involved in the exercise of surveillance that can assist them in laying the groundwork for the establishment of a market, an aim that may require surveillance to extend beyond its typical policy domains. The other dimension is the value of the demonstration effect that is generated by observance of the code of conduct by other members. Their example encourages reforming economies also to keep their markets open and abide by market discipline. Surveillance, by bringing the code of conduct to reforming economies, will assist them directly in their aim of setting up a market; and this assistance will be all the more effective if accompanied by the support of other members in the form of "preaching by example."[54]

The other major way by which the IMF can foster economic reform is, of course, through the exercise of conditionality. It is likely that most of the reforming countries will experience balance of payments needs requiring foreign exchange in amounts that exceed those they can earn or secure. Much more important is that they are also certain to experience urgency in making policy decisions that are likely to be required on a widespread front.[55] It is in this sphere that the key input from conditionality should come.

Emphasis on the traditional policy areas of IMF conditionality— appropriate macroeconomic management and rational pricing—is of course necessary for the process of reform to succeed. Less clear, though, is the sufficiency of the emphasis. This question of sufficiency arises from the absence not only of a market but also of a market-oriented institutional framework in the reforming economies. The bulk of general economic policy analysis presupposes the existence of a market and of market-supporting institutions. This is also the background against which conditionality has been developed and has typically operated. To ensure sufficiency, it may be necessary now more than it was in the past for IMF conditionality to broaden its scope in order to encompass microeconomic and institutional aspects of reform. This evolution will require developing adequate monitoring techniques in these new policy areas to ensure the effectiveness of conditionality. An additional requirement will be the establishment of linkages with, and support from, other institutions, such as the World Bank, the OECD, and the recently established European Bank for Reconstruction and Development (EBRD).[56]

Because of the need to break new ground in exercising surveillance and conditionality, certain avenues may be worth exploring. One course to consider would be linking not only the amounts but also the terms of foreign financial assistance to the exercise of conditionality in a broad spectrum of policy areas, including those required for the establishment of a market. This would mean that foreign financial assistance on an adequate scale and on concessional terms could be made available to support determined and wide-sweeping actions to dismantle central planning and help replace it with market-supporting institutions. The bulk of the assistance would come from official bilateral sources and from multilateral development institutions, which have the appropriate resources for financing the reform process.

The essential contribution of the IMF would be the policy content derived from its code of conduct in the exercise of both surveillance and conditionality; thus, Article IV and, if appropriate, other special consultations would be associated with foreign assistance. Use of IMF resources would also be involved, of course, but within the institutional constraints. In this regard, now may well be the right time for the IMF to steer away from playing a role of financial intermediary—as it has, increasingly, since the abandonment of the Bretton Woods order—and move back toward its original role of a cooperative lender; that is, the IMF, as an institution focused on a code of conduct, would stand ready to provide financial support on favorable (below market) terms as an incentive to countries in balance of payments need to continue their observance of the code. The institution would be able to provide financing on such terms because of the willingness of the membership at large to accept a less favorable (below market) return on IMF assets in exchange for the assured prevalence of the rules of the game.[57]

Institutional Implications Apart from the development of monitoring techniques for measuring the reform process, an open question remains regarding the firmness of the linkage between disbursement of assistance and policy action. Financial support should be primarily for undertaking actual reforms, with lesser focus on terms of repayment—an approach that could help prevent potential conflicts between economic and political objectives. Utmost care must be exercised to ensure that the assistance is forthcoming only when policies are being implemented; otherwise, the risk of moral hazard will arise. However, there is no foolproof mechanism to ensure a flawless link between financial assistance and reform. It may be possible for the IMF to proceed a long way toward strengthening the link by adopting a firm attitude that agreed actions be in place prior to disbursements. It could also determine interruptions in those disbursements when there is evidence of deviations from policy understandings. A relatively solid link could go far in encouraging the implementation of necessary policy actions. Even so, risks will inevitably remain in an endeavor as complex as that in which the reforming economies are engaged.

Institutional Implications

The changing circumstances in the world economy, together with the variations in the international code of conduct, obviously influence the functions of the IMF, which is mandated to oversee the observance of that code. Ability and willingness to show an appropriate measure of adaptability are essential to foster cohesiveness among member countries, particularly when such cohesiveness weakens. On the other hand, respect for the code of conduct must be clearly maintained, and that endeavor often requires drawing a line at how far adaptability will be allowed to go. Thus, a measure of rigidity is also needed to ensure order in the system at large. These considerations apply to the three fundamental functions of the IMF.

Surveillance

The fundamental changes under way in the international economy and the modifications in the code of conduct, with their emphasis on national discretion, may have stimulated the emergence of competing settings for surveillance beyond those that already exist among the various established international institutions (IMF, GATT, OECD, BIS). In contrast to the Bretton Woods era, which was characterized by the predominance of a single large economy, present influence over the world economy is distributed among several poles.[58] These changes inevitably affect the principles and the procedures of surveillance.

The central dimension of the implementation of IMF surveillance so far has been basically geographical, that is, country-specific. In its origins, surveillance (Article VIII and Article XIV consultations) was based almost exclusively on discussions between the IMF and each member; although it involved the membership in the Executive Board discussion of individual country's policies, the process was in essence bilateral. With expansion of the scope for discretion, national policy interactions in the international economy—through leakages, spillovers, or externalities—acquired growing importance, but they could not be exhaustively examined in a bilateral surveillance context. Thus, the IMF developed its World Economic Outlook review as the main vehicle for monitoring policy interactions and systemic developments. Still, the dimension of this initiative remained basically geographical, and it focused on a country-specific or country group-specific standpoint, even though its scope was multilateral.

A number of avenues suggest themselves to fill certain gaps in monitoring, which escape or transcend both the bilateral and multilateral dimensions. A need is developing for the conduct of regional surveillance, in view of the advances made toward economic integration in Europe and other areas. The need is created by the closer interdependence among the European economies, and by the constraints on national economic policy set by such pathbreaking events as the liberalization of capital flows among major members of the EMS and the drive toward a single market in Western Europe as a whole. These developments call for supplementing the current exercises of bilateral and multilateral surveillance with discussions on regional issues important from both a regional and a world standpoint. An example of relevant intra-regional issues is the need for developing a degree of flexibility toward domestic national economic policies in the European region, where exchange rate flexibility is largely given up by participation in the EMS. And an illustration of an issue of broader international interest is provided by trade, where policy is already formulated at the European Community level.

Another specific avenue that suggests itself to buttress surveillance in its bilateral, regional and multilateral aspects calls for supplementing the country or country group-specific perspective with a policy-specific or problem-specific approach. This would entail a cross-country analysis of policy issues that are particularly relevant for the international economy as a whole and yet reflect mainly the national policy stance of its larger members. It might also extend to analysis of economic problems that affect in common particular groups of countries. Some progress has already been made in this regard by institutional studies of a general nature, covering subjects such as policy coordination and international debt issues.[59]

In order to move in these various directions, of course, procedures that are simple in character and offer a prospect of ready acceptance by the membership must be developed. Procedures that rely on the array of instruments already at the disposal of the institution can help in this regard. For example, the final statements of consultation missions, which aim at briefly distilling the essence of the relevant policy issues discussed, could serve as the basis for the preparation of a summary policy paper on issues involving several members, for discussion with appropriate officials representing those members. A brief report could then be prepared for the Executive Board's information or for discussion within the Board at large or, if necessary, within appropriately established Executive Board Committees.

Two important benefits would come from the introduction of procedures such as these. One would be to bring within the purview of the IMF membership as a whole issues of interest that are currently discussed within narrower forums, such as the Group of Five (France, Germany, Japan, the United Kingdom, and the United States, which began meeting in 1973 to discuss issues of common interest), the Group of Seven (composed of the Group of Five plus Canada and Italy), and the Group of Ten (consisting of the Group of Seven plus Belgium, the Netherlands, and Sweden). The procedures need not preclude these forums, but linking them to the IMF would strengthen the legitimacy of the surveillance process and of the institution itself. Another important advantage is that procedures involving the full membership strengthen the rule of law and promote observance of the code of conduct. This is because surveillance exercised within limited groups of large countries represents only an extension of the principle of hegemony of a single country passed on to the group. Broadening participation to the whole membership places the rule of law in the role of the hegemon, thus strengthening the legitimacy and the stability of the established order. Here, then, is another opportunity to avoid falling into the trap outlined in Pascal's quotation.

Conditionality and Terms of IMF Assistance

The evolution of the world economy and of the code of conduct, as well as the supplementary aims that accompany balance of payments objectives, have also influenced the exercise of IMF conditionality. The institution continues to focus on macroeconomic management, but growing emphasis has been placed on efficiency issues, microeconomic measures, and structural policies. Furthermore, with the reforms in previously centrally planned economies under way, it may be necessary for conditionality to break new ground, extending to reform policies and the build-up of market-supporting institutions.[60]

Policies regarding financial assistance will have to be adapted to meet new needs and circumstances. Rather than focusing exclusively on the amount of resources to be made available, the institution can exercise flexibility with regard to the terms of repurchase. It would be possible for both the amount and the maturity of IMF resources to be adjusted according to the specifics of the country in need, possibly with the proviso that the longer the maturity term, the more limited the access, and vice versa. The scope of such trade-offs between the scale and the maturity of IMF financial assistance would need to be limited by clear maxima so as to safeguard the monetary character of the institution. It has already been the general practice in the institution to differentiate in the scale of access to IMF resources, subject to a broad set of norms such as the degree of members'needs and strength of their adjustment efforts. This access policy, based on judgment within norms accepted by the membership, represents an instance of the pragmatic blend of the principles of flexibility and uniformity of treatment on which much of the institution's legitimacy ultimately depends. A similarly supple approach could be applied to the maturity of IMF resources and would permit substantial simplification of existing financial facilities in the IMF.[61]

Attention should also be given to the cost of using IMF resources. There is a strong case for setting a below-market cost for—and yield of—IMF resources, thus turning the institution back to its role of a cooperative lending institution, based on quotas, and away from being a financial intermediary, dependent on borrowing. Actually, for a long period of IMF history, levies on its financial assistance were generally unrelated to world market interest rates. Separate from normal budgetary concerns, the structure of IMF charges was designed to deter members from excessive or prolonged use of the institution's resources: the structure of charges rose with the amount and duration of use of IMF resources.[62] The institutional aim was to encourage countries in balance of payments need to resort to the IMF for financial assistance in relatively limited amounts and for relatively short periods of time. An immediate corollary of this aim is that countries were expected to seek access to IMF resources at an early stage of their balance of payments problems.

In time, the rate of remuneration on creditor positions in the institution moved upward, and with quotas declining relative to the world economy and, most particularly, in comparison with members' balance of payments needs, the IMF began to supplement its general resources by borrowing from members at market-related interest rates. It became inevitable that charges for the use of its resources had to rise pari passu, as the level and complexity of the schedule of charges increased with the cost of resources to the institution and with the growing variety of its financial facilities.

Needless to say, the IMF can fulfill its role whether it decides to charge and pay market interest rates or deems it appropriate instead to conduct financial operations with members at rates below those prevailing in world capital markets. The closer the IMF's rates of charges and remuneration are to market interest rates, of course, the closer the resemblance between the institution and other traditional lenders. However, as long as members place visible importance on the IMF's role as the overseer of an international code of conduct, such close resemblance need not detract from the unique distinguishing character of the institution.

If, on the other hand, the cooperative aspect of the IMF is to be stressed, the case for below-market rates of charge and remuneration remains strong. In fact, many of the policies and procedures of the institution actually presuppose its cooperative nature and its primary surveillance role. This is, for example, clearly illustrated by the guidelines on conditionality, which, inter alia, encourage members to seek IMF assistance "at an early stage of their balance of payments difficulties or as a precaution against the emergence of such difficulties."[63] Not only do below-market (concessional) rates of charge provide an incentive for members to resort to the IMF—indeed, this was a key rationale behind the original structure of charges—but in addition, by helping to keep external imbalances from being unduly neglected through early access to the IMF, they also contribute to an improved observance of the code of conduct, the essential aim of the surveillance responsibility of the institution.

In sum, the unique character of the IMF does not depend on whether or not its financial operations are conducted on market-related or concessional terms. Either alternative or a combination (e.g., differentiated market and concessional terms, as presently in effect) is compatible with the institution's purpose of lending resources to support the observance of a code of conduct. But the more IMF transactions are conducted at market prices on competitive terms, the more the IMF's fulfillment of its overseer role will depend on the respect accorded to the code of conduct by the members that lend to the institution, as opposed to those that borrow from it. Below-market rates of charge should enhance the likelihood of appropriate behavior on the part of users of IMF resources. And by helping to ensure smooth and predictable adjustment processes and thus protecting the liquidity and general quality of the IMF's portfolio, members lending to the institution are compensated for receiving below-market rates of remuneration. Whereas market-related rates of charge lower the incentive of borrowers to resort to IMF resources, IMF lenders, on the other hand, benefit from market rates of remuneration, and symmetry would require that they provide an appropriate incentive to borrowers. What better way is there for this than to demonstrate by example the benefits of observance of the code of conduct?

A Cooperative Setting

A distinct and pervasive theme in the paper has been the desirability of restoring or reinforcing the character of the IMF as a cooperative entity. An effort in this direction has implications for all the activities of the institution. A particularly important area relates to the central role played by quotas, which are and should remain the normal source of institutional resources and influence all aspects of activity in the IMF. Quotas are, or should be, the scale factor for members'rights and obligations, and they underpin the exercise of both surveillance and conditionality.

The linkage of quotas to surveillance and conditionality follows the same logic as the relationship between the latter two. If surveillance is effective, the need to exercise conditionality will be relatively limited. This means that under normal circumstances IMF resources are liquid, and the institution will never be “loaned up,” as financial intermediaries typically are. Nevertheless, the quota base must be kept commensurate with the size of the world economy, since it is the relevant scale factor of potential need. Only in this context can symmetry across the membership be achieved.

Normally, therefore, the institution holds liquid assets, and its quota base is unencumbered, that is, largely unused. An unquestionably liquid quota base is a necessary condition for members to place an important portion of their reserves in the IMF.[64] Indeed, it may well be that these considerations provide the necessary ingredients for refocusing the IMF’s role upon surveillance and for easing members’ decisions on quotas, which, according to the Article of Agreement, must be adjusted at intervals of, at most, five years. These considerations would redirect the institution toward its original role of a cooperative entity and strengthen the perception that the liquid nature of its portfolio is indicative of a normal state of affairs. The logical corollary of viewing positions in the IMF equivalent to countries’international reserves would be to manage the IMF’s portfolio as countries manage their reserves, and one of the fundamental principles of such management is the preservation of liquidity.

Concluding Remarks

The fundamental theme of this paper has been the proposition that the IMF is primarily a surveillance institution. All other institutional functions and responsibilities derive their legitimacy from surveillance, which gives the IMF its uniqueness among international agencies.

The essential unity of the institution’s responsibilities lies in the relationship between surveillance and conditionality. Their respective effectiveness and mutually reinforcing nature are indispensable for the IMF to be able to fulfill its mandate. Conditionality not only presupposes but also contributes to the effectiveness of surveillance. As in many other areas of economics, surveillance and conditionality exhibit the characteristics of a razor’s edge-type of relationship. Surveillance, when well conducted at the systemic and individual country levels, tends to avert the emergence of balance of payments needs; as such, it helps contain the frequency of the need for conditionality. Yet balance of payments needs will arise even under the best of circumstances. Conditionality, well implemented, will then help to keep potential balance of payments problems from actually materializing or to prevent actual balance of payments needs from becoming entrenched. Thus, appropriate surveillance provides the setting for efficient conditionality, and conditionality strengthens surveillance by adding to the instruments available to support observance of the code of conduct.

In its effort to fulfill its central responsibility, the IMF often encounters relationships that exhibit characteristics of both substitutability and complementarity, like linkages between adjustment and financing or between debt and growth. Difficult dilemmas are also bound to appear in countries seeking to establish market-based economies. Reform will typically include decisions to eliminate certain inviable economic activities as part of the process of paving the way for new and viable activities. Decisions calling for such “creative destruction” are rarely unambiguous, and they are particularly difficult to implement.

In essence, most of the activities of the IMF involve a search for balance between conflicting aims. The difficulty of the endeavor lies in the different views of members as to where the balance should lie. It is in this context that principles like universality, uniformity, neutrality, and flexibility, if properly combined, can play a critical role. A necessary condition for the effectiveness of the international order is that the common code of conduct must be most respected by those less subject than others, by reason of size or equivalent considerations, to its discipline. However difficult acceptance of this may be, it is nevertheless an important step toward taking away the thunder from the dictum that law without strength is powerless. In practice, such difficulty should not arise, because typically a code of conduct reflects the preferences of those less likely to be constrained by it. Viewed from this perspective, fairness would dictate that observance of the code should be most in evidence on the part of countries that are less within its practical reach. Such behavior would ensure that law, rather than strength, is given predominance.

Another consideration worth emphasizing is that a sound code of conduct allows room for bargaining but is not itself subject to bargain. In the same vein, rules of behavior must provide leeway for discretion, but the rules themselves are not subject to it. Discretion is an element of the implementation of the rule, not a feature of the rule itself. The need for balance between rules and discretion, like the need for balance between principle and practice, or between what is important and what is urgent, is a simple reflection of reality. Even though it is essential, such balance is typically hard to attain.

In the economic sphere, if only because of the uncertainties that surround the effects and the lags in the effects of economic policy, balance is a most elusive aim. This is so even in the absence of complications arising from the code of conduct. The search for balance has at times led policymakers at national and international levels to fine-tune economic policies, even though uncertainties or intertemporal considerations counselled against it. The risks of overburdening economic policy in this way can be diminished significantly by the adoption of a clear, well-defined code of conduct that would bring balance, nationally and internationally, more within a “rules-based” order. And if revealed preference is a relevant indicator, this belief is supported by a trend toward rules at the national policy level. 6 5 It is paradoxical indeed that the period in which national economies have moved away from the concept of “fine-tuning” in economic policy toward the adoption of norms to be observed over time, coincides with the time when the international economy remains mainly dependent on discretion and subject to the principle of bargaining.

This paper has made a few proposals for bringing a greater measure of consistency between current national and regional experiences, which favor rules, and implementation of the international code of conduct on the part of the IMF, which is still based on discretion. In the primary area of surveillance, the proposals seek to expand its dimensions from a country- or world-specific perspective in two directions: first, by adding the regional dimension, already important in the European context, and second, by adding policy-oriented or problem-oriented cross-country analyses.

With regard to conditionality, the proposals focus on the scope of the policies which should be covered, as well as on the terms of the associated financial assistance. On the policy front, although the central focus remains the macroeconomic domain, increasing attention will need to be given to the microeconomic and structural spheres, as well as to the new area of measures for building up markets and market-based institutions. This, of course, will require close coordination with other international institutions. Such coordination, however, while averting duplication and conflicts, should not run counter to competition of ideas, which serves as an efficient principle of collaboration. With regard to the terms of financial assistance, there is room for accompanying the expanding arena of conditionality with access to concessional resources from official and multilateral development sources. Finally, with regard to the IMF, preservation of its uniqueness will certainly require a reassertion of surveillance as its primary responsibility. Most likely (though not necessarily), it will also require a resumption of its role of a cooperative institution in lieu of its becoming another international financial intermediary.

As the world moves into the next century, formidable challenges confront the international economy and those institutions like the IMF with a mandate for surveillance over international economic policy. At present, uppermost in the minds of those concerned with policymaking are the challenges to establish market-based economies in Central and Eastern Europe, as well as in the republics of the former Soviet Union, and to integrate those economies into the world system. Needless to say, challenging tasks also remain outstanding in other areas, such as economic and monetary union (e.g., the post-Maastricht era for a unified Europe), and international indebtedness, development, and growth (still confronted by many countries in the developing world).

In particular, there is an important institutional challenge directly related to the code of international financial conduct, which will be important for the IMF to confront. In concluding this paper, I will briefly sketch out this challenge to indicate areas where work will be needed to keep the institution abreast of developments in the world economy and its charter in line with the dictates of economic logic.

The central challenge confronting the IMF at its inception was to foster integration of war-ridden and distorted economies into a well-defined international economic system. To address this fundamental aim, the Articles of Agreement of the institution, emphasizing importance of freedom of payments and transfers for current international transactions, made that freedom standard (if not the standard) for convertibility. 6 6 This approach and the resulting standard for the institution's jurisdiction on restrictiveness, which cover only current account transactions, have prevailed as features of the international system during the initial epoch of the Bretton Woods par value system and throughout the period of flexible exchange arrangements that has prevailed since then.

Focus on the current account and acceptance of controls and multiple exchange rates for capital transactions underscored the attention being given to the competitiveness of an economy (a relative price issue), as well as the need for a degree of national policy independence or insulation. Domestic interests underlying the international panorama distinguished between external and internal balance, foresaw potential conflicts between the two, and accordingly sought to assign policy instruments which exhibited comparative advantage—hence, exchange rate policy for the safeguard of competitiveness and domestic financial policy for purposes of internal balance.

Since the abandonment of the Bretton Woods par value system, however, the international economy has undergone numerous and important changes. Some of those changes have exhibited an essentially permanent nature and provided a basis for questioning the appropriateness of the scope of the international code of conduct and its implications for the focus of national economic policies. The abandonment of fixed exchange rates was expected to provide national economies with ample margin for domestic policy independence. Attention at the time was directed toward issues like an expected (though not realized) decline in the need for international reserves. The argument could just as well have applied to the obsolescence of restrictions, since, after all, exchange rate flexibility was there to ensure economic insulation. Yet despite the changes in the world economic environment, the code of conduct remained unchanged regarding exchange restrictions. Capital controls continued to be accepted within the rules of the game at a time when capital movements and external debt flows acquired growing importance—a curious illustration of events running ahead of the rules governing them. Thus, the insulation that exchange rate flexibility was supposed to provide turned out to be counteracted to a large extent by fast-rising capital movements and consequent mounting predominance of the capital account in countries'balance of payments. What had properly begun as a close relationship of trade and current account flows with exchange rate management and exchange matters at large, progressively developed into a similarly intimate connection between national monetary policies and international capital movements and exchange rates. 6 7

The predominance of capital flows, which were not subject to the norms applicable to current transactions, has helped direct attention to the limited scope of national monetary and economic policy independence and to the relation between the exchange rate and inflation (an absolute price level issue). In the process, the intricate interconnection between external and internal balance came to the surface, and the more apparent than real nature of conflicts between the two (at least from an intertemporal standpoint) began to be acknowledged. Thus, although competitiveness remained important for an economy, the question at stake became whether or not competitiveness can be purchased at the expense of domestic price discipline. A consensus developed that domestic price discipline was contingent on the quality of monetary and fiscal policy; there could be little, if any, scope for exchange rate management to substitute for appropriate domestic financial policies. On the other hand, it would also be futile to try to purchase price discipline at the expense of competitiveness; here again, the establishment of a nominal exchange rate anchor could hardly compensate for misguided domestic financial management. In the international context, what must be underscored is that the dilemmas posed by conflicts between the external and internal stability of a currency are typically the consequence of the uneasy coexistence of appropriate and inappropriate economic policies, in general, and monetary management, in particular, among nations in the world economy. The growing freedom of capital movements and their increasing importance in international transactions only add urgency to the need for economic policy consistency across countries; in effect, capital flows have made national boundaries increasingly porous so that pursuit of national objectives to the neglect of international considerations has become more and more futile.

As this century closes, the time has come for updating the code of conduct so as to bring it into conformity with economic logic, which argues against restrictions regardless of the nature of the transaction, and with the current prospective world economic environment, where capital movements have established both a permanent and prominent presence. Now that there is a prospect for the world economic order to become fully global in geographical scope, extending the code of conduct to cover all international transactions would be most appropriate for the establishment of true universality.

Notes

Introduction

1. That is, the United Nations Monetary and Financial Conference, which was held at Bretton Woods, New Hampshire, from July 1 to 22, 1944.

2. The list of writings on this subject, even if constrained to the economic domain, is long, and space considerations require selectivity. But see, for example, Dam (1982) and Solomon (1982), and, for background on the IMF, Horsefield (1969), de Vries (1976, 1985, and 1986), and Southard (1979). For a fascinating account of the Bretton Woods negotiations that led to the post-World War II economic and financial order, see Keynes (1980a and b).

3. Early efforts to establish principles and conventions of international economic behavior have been examined, inter alia, by Bloomfield (1959), Dam (1982), and Eichengreen (1985, 1989a and b, 1990, and 1991). Here again, for an insightful account of discussions, this time on the post-World War I economic and financial order, see Keynes (1971, 1977, and 1978). See also Guiti\aan (1992d).

4. The reforms in previously centrally planned economies have rapidly prompted a wealth of studies searching for an efficient model of the reform process. See, for example, Blanchard and others (1991), Dornbusch (1991), Fischer and Gelb (1991), Guiti\aan (1991 and 1992a), Hinds (1990), Collins and Rodrick (1991), Peck and others (1991), and Williamson (1991a, b, and c). Events have also been moving rapidly and remain fluid in the former U.S.S.R. A recent discussion from an economic standpoint will be found in Havrylyshyn and Williamson (1991). For recent developments in the process of economic and monetary integration in Western Europe, see Guiti\aan (1988 and 1992c) and Ungerer and others (1990). In the period during which this paper was under preparation, important additional decisions have been made by the European Community countries in their summit meeting in Maastricht, Netherlands, on December 9-10, 1991, which included an agreement to establish a single currency by the end of the decade.

5. I have examined some of these other events from the standpoint of the importance of a code of conduct in recent papers, where an extensive list of other sources can also be found: see Guiti\aan (1992b and c).

6. The provision of financial assistance was to be subject to adequate safeguards to ensure that the use of Fund resources by members would be temporary. This is one of the most important responsibilities of the institution, to which this paper will return often and which has been extensively discussed elsewhere: see Guiti\aan (1981); see also Gold (1979a), Williamson (1983), and Kenen (1986).

7. The Articles of Agreement have undergone several amendments since their inception, but they continue to contain a code of conduct by which members agree to abide. Issues related to the various amendments have been examined extensively by Gold (1969b, 1978, and 1979b).

 8. Such a term was used by Robert Mundell in his concluding remarks to a conference on “The New International Monetary System,” jointly sponsored by the IMF and Columbia University and held at IMF headquarters in Washington, D.C., on November 11-12, 1976: see Mundell and Polak (1977).

9. For further discussion, see Horsefield (1969) and de Vries (1976); see also Southard (1979), Polak (1981), and Group of Thirty (1988).

10. See, for a similar argument, Group of Thirty (1988) and the collection of papers and comments in International Monetary Fund and HWWA-Institut fur Wirtschaftsforschung-Hamburg (1988). For a discussion of the difference between coordination based on continuous bargaining or on the acceptance of a given regime, see Kenen (1987a and 1990) and Guiti\aan (1992d). See also Hirsch, Doyle, and Morse (1977) for an early discussion of these points.

11. With regard to par values, in the early years of the IMF, efforts were made for members to proceed swiftly in establishing them. However, as experience was gained, the practice became for members to avoid proposing a par value unless there was an assurance that it could be maintained; see, for further discussion, de Vries (1969b). An excellent examination of the transitional arrangements regarding exchange restrictions (contained in Article XIV of the IMF Articles of Agreement) and of temporary deviations from the prescriptions of the Articles of Agreement can be found in Chapter 24 of Gold (1969a).

12. Among the many possible sources where this subject is examined, the following will be of interest: Camps (1974), Williamson

(1977), Dam (1982), Solomon (1982), de Vries (1976 and 1985), and Artus and Crockett (1980).

13. A complete description and analysis of events during the interregnum between the Bretton Woods par value system and the second amendment of the Articles of Agreement will be found in de Vries (1976 and 1985).

14. See, for an extensive discussion of issues of international economic policy coordination, Wallich (1984), Bryant (1987), Bryant and Portes (1987),Williamson and Miller (1987), Frankel (1988), Kenen (1988), and the collections of papers in: Buiter and Marston (1985), Bryant and others (1988 and 1989), and Branson, Frenkel, and Goldstein (1990).

15. See Executive Board Decision No. 5392-(77/63) of April 29, 1977, in International Monetary Fund (1989). The decision has been reproduced in Crockett and Goldstein (1987), where an extensive discussion of its various aspects can be found.

16. An extensive examination of the subject of surveillance can be found in Artus and Crockett (1978 and 1980), and Crockett and Goldstein (1987). See also Brau (1981), and Kenen (1987b).

17. Surveillance is, of course, influenced by changes in the code of conduct. In this context, it is interesting to advance here that in the Bretton Woods order, consultations were mandatory for members availing themselves of the transitional arrangements (Article XIV) as well as for those that, having accepted the general obligations of members (Article VIII), maintained practices inconsistent with those obligations. For members that were not in those circumstances, a practice was developed for conducting regular policy consultations even though no such obligation existed: see Chapter 24 in Gold (1969a and 1978) and Camps (1981). At present, as discussed later in the paper, all members have an obligation to consult with the IMF, and the consultations include an assessment of the observance of the principles of surveillance: see Crockett and Goldstein (1987).

Notes (pages 8-11) 18. As noted earlier (see Note 6), conditionality has been examined extensively and intensively, particularly since the abandonment of the Bretton Woods order. This IMF activity is fundamental also in the context of surveillance, a perspective from which it will be examined later in the paper. Other background material can be found in Gold (1979a), Guiti\aan (1981 and 1987), Kenen (1986 and

1989), and Williamson (1983).

19. The Bretton Woods order, it will be recalled, encompassed three main pillars, which would have, it was thought, a common membership with the IMF: exchange and financial matters, to be overseen by the IMF; reconstruction and development issues, which fell under the purview of the World Bank; and international trade relations, to be taken up by the International Trade Organization (ITO). In the event, the ITO did not materialize, and in its place, a (somewhat more limited) multilateral trade arrangement, the General Agreement on Tariffs and Trade (GATT) was established in 1948. Despite its provisional nature, the GATT has remained the central agency in charge of trade issues and norms. See Dam (1970) and Horsefield (1969). It may be worth recalling here that IMF membership is a requirement for accession to the World Bank, which attests to the importance given to the jurisdictional authority of the IMF: see Gold (1982).

20. Broad international economic policy discussions are conducted in the Organization for Economic Cooperation and Development (OECD) in a variety of frameworks. These include: two main macroeconomic policy committees, the Economic Policy Committee (EPC)—in particular, its Working Party No. 3 (WP3), where surveillance functions are undertaken—which discusses the overall outlook in the OECD area, and the Economic Development Review Committee (EDRC), where individual member country situations are reviewed periodically; a Trade Committee; the Export Credit Arrangement; the capital movements and invisible transactions codes, overseen by the Committee on Capital Movements and Invisible Transactions (CMIT); the Development Assistance Committee (DAC); and various sectoral committees.

21. For further elaboration on these various forums, see Wallich (1984), Putnam and Bayne (1987), and Solomon (1990). See also the reports of the Group of Ten and the Group of Twenty-Four, reproduced in Crockett and Goldstein (1987).

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22. The general formulation would refer to the dual aspect of rights and obligations of members and of the right and obligation of the institution to oversee the system and its parts. These general institutional issues fall beyond the scope of this paper; many of them have been examined

in Gold (1979b).

Notes (pages 11-14) 23. Joseph Gold, author of the quoted words, has written extensively on the subject and described this as a novel idea; it was, indeed, and it provided the basis for the jurisdictional authority of the IMF: see Chapter 24 in Gold (1969a).

24. See Article IV, Section 3(b) of the Articles of Agreement in International Monetary Fund (1978). See also "Planning Surveillance of Exchange Rates," Chapter 43 in de Vries (1985).

25. The notion of balance of payments equilibrium can be refined further, of course, by requiring that it be accompanied by price stability and high levels of employment and growth. Conceptual refinement, unfortunately, adds to the operational difficulties. For an insightful discussion of the subject, see Artus and Crockett (1980); see also Mundell (1991).

26. See Article VIII and Article IV of the Articles of Agreement in International Monetary Fund (1978). See also Executive Board Decision No. 5392-(77/63) in International Monetary Fund (1989) as well as "Surveillance Over Exchange Rate Policies," Chapter II in Crockett and Goldstein (1987). It is to be noted that the Articles of Agreement allow members to exercise controls over capital transfers as "necessary to regulate international capital movements" (see Article VI, Section 3).

27. This much is clearly recognized in Article IV which calls for "fostering orderly underlying economic and financial conditions" (Section 1(ii)). A more explicit formulation will be found in the surveillance decision, where reference is made to "the pursuit, for balance of payments reasons, of monetary and other domestic financial policies ..." (Decision No. 5392-(77/63) in International Monetary Fund (1989).

28. A comprehensive and thoughtful discussion of this subject will be found in Crockett and Goldstein (1987), particularly in Chapter II (see Note 26).

29. The linkages of the domestic to the external policy domains have been discussed within and outside the IMF. For some of the IMF publications, apart from Crockett and Goldstein (1987), see Guiti\aan (1981, 1985, and 1987) and the sources cited in International Monetary Fund (1987). See also de Vries (1987).

30. For examination and discussion of the relationship between the IMF and the World Bank and of their respective spheres of competence, see Gold (1982). The analytical underpinnings of the external implica-

tions of domestic policies have been the subject of the collection of articles in International Monetary Fund (1977); see also Mookerjee (1966).

31. The evolution described in the text underlies the initiatives in the IMF to introduce the extended Fund facility (EFF) and the enlarged access policy, and in the World Bank to undertake structural adjustment lending. These subjects will be discussed further later in the paper, but background on them can be found in Guiti\aan (1981 and 1987), Stern (1983), and Michalopoulos (1987). While the subject is closely related to the lending operations of the IMF and the World Bank, the emphasis here is on its economic policy aspects and hence its linkage, in the case of the IMF, with the issue of surveillance. For a recent examination of these questions in the context of debt strategy, see Guiti\aan (1992b).

32. For a variety of purposes, the IMF may classify countries within the membership into separate groups, but in general, such groupings carry no operational significance. A clear example of such classifications is provided by the analytical groups used in the World Economic Outlook papers which refer to industrial countries, developing countries, oil-exporting countries, etc. It is to be noted that the IMF deliberately sought to avoid operational classifications of member countries by having those members using or returning Fund resources actually “purchase” and “repurchase” them with domestic currency rather than borrow and repay them; in this fashion, no distinction was established formally between Fund borrowers and lenders. See, in this context, Fern\aandez Ord\ao\tnez (1989).

 33. The possibility of difficulties arising from the existence of both the principle of universality and uniformity, as well as their varied resolutions, has been discussed by Gold (1979b). Pressure for distinctions among members have mounted with time and, as will be discussed later in the paper, some have been recently made.

34. To give the subjects discussed in this section the treatment they deserve would call for a separate paper. Many of them, however, have been studied specifically elsewhere. Joseph Gold has written extensively on these and related subjects. For example, in addition to various papers in Gold (1969a), see Gold (1965 and 1980a and b). Let me underscore here that the differentiation among members is made from an economic and financial standpoint; from a legal standpoint, Gold (1980b, p. 70) has stressed that “all members are equal before the law of the IMF,” but he has also added the qualification that “equality before the law does not

connote equality in all conceivable respects."

35. In addition, there is institutional involvement in discussions undertaken in different country groups, such as the Group of Ten and the Group of Seven. See Wallich (1984) and Kenen (1987b), among other sources.

Surveillance from Other Perspectives

36. The Articles of Agreement provide the definition of these terms: see Article XXX(d) in International Monetary Fund (1978); for further elaboration, see Chapter 24 in Gold (1969a).

37. See Note 17, which elaborates on some of these points. See, for further discussion of these questions, Gold (1978), Camps (1981), and Crockett and Goldstein (1987).

38. As Notes 6 and 18 anticipate, conditionality has been the subject of intensive and extensive study within both the IMF and outside circles, and it is beyond the scope of this paper to discuss it in depth. But see Gold (1979a), Guiti\aan (1981), Killick (1982), Williamson (1983), and Muns (1984). See also de Vries (1986 and 1987) and Kenen (1986 and 1989). An in-depth examination of the link of surveillance with conditionality will be found in the next section, which traces its evolution since the inception of the IMF.

39. A very relevant consequence of this perception and, more generally, of the practical differentiation of members as borrowers from and lenders to the IMF, has recently been insightfully drawn by Kafka (1991). It contrasts the interest of borrowers in easing access to Fund resources with that of lenders in keeping such access restrained.

 40. In another context, I have argued the need to avoid the mirage of symmetry if there is to be clarity in the international allocation of policy responsibilities; see Guiti\aan (1992d) for further elaboration of this subject.

41. Members' obligations with respect to furnishing specific information are spelled out in Article VIII, Section 5, of the Articles of Agreement. In the field of statistics, the IMF has become one of the major sources of international economic data. Statistical publications include: International Financial Statistics, Direction of Trade Statistics, Balance of Payments Statistics Yearbook, and Government Finance Statistics Yearbook. In the domain of exchange arrangements, an equivalent

function is served by publication of the Annual Report on Exchange Arrangements and Exchange Restrictions.

Surveillance and Conditionality

42. A complete discussion of conditionality in this period is beyond the scope of the paper and would be redundant since it has already been amply studied: see International Monetary Fund (1977), Gold (1979a), Guiti\aan (1981), and de Vries (1987); on stand-by arrangements, see Gold (1970).

43. The analytical underpinnings of what later became known as the monetary approach to the balance of payments (and its subsequent logical extension to exchange rates) have been examined in International Monetary Fund (1977); see also Frenkel and Johnson (1976 and 1978) and Guiti\aan (1976).

44. Thus (as discussed in the section entitled, “Surveillance from Other Perspectives”), the new code of conduct calls for consultations with all members without any distinction between those that avail themselves of the transitional arrangements and those that do not. The adaptations to surveillance have been extensively examined in Crockett and Goldstein (1987); but see also Artus and Crockett (1978 and 1980).

45. This is another subject that for the sake of brevity cannot be fully pursued here. However, sources abound that examine it extensively. See, for example, Guiti\aan (1981, 1985, and 1987) and Mohammed (1991). For a very comprehensive and recent treatment of the subject, see also Polak (1991).

Areas of Risk for the Code of Conduct

46. There have been exceptions to this general rule, e.g., the lapsed Trust Fund, the structural adjustment facility (SAF) and the enhanced structural adjustment facility (ESAF), which relate to a specific group of countries and not to the membership at large.

The Code of Conduct in Diverse Circumstances

47. As already noted, trade is the domain of the General Agreement on Tariffs and Trade (GATT), an institution with which the IMF collabo-

rates closely. For further discussion on this subject, see de Vries (1969a), Dam (1970), and de Vries (1976 and 1985).

Notes (pages 28-33) 48. These include areas of common interests to the IMF and the World Bank that have already been discussed. The subject of collaboration between the IMF and the World Bank has been studied extensively: besides Gold (1982), see de Vries (1976 and 1985), Narvekar (1983), and Hino (1986).

49. See Guiti\aan (1987), where the argument is laid out in stark terms to stress that economies face resource constraints, of which foreign exchange is only one. Frequently, what emerges as binding foreign exchange constraint is but a manifestation of the broader resource constraint having been breached at an earlier stage. That is, inflation can be kept temporarily low (or growth temporarily high) at the expense of balance of payments deficits. Over time, the choice is typically between low inflation (high growth) today and high inflation (low growth) tomorrow.

50. See, regarding structural adjustment lending in the World Bank, Stern (1983) and Michalopoulos (1987). On IMF-World Bank collaboration, see Narvekar (1983) and Hino (1986).

51. I have discussed the subject of the international debt crisis in more detail elsewhere: see Guiti\aan (1992b), where an extensive list of sources on international debt issues is also provided; see also Guiti\aan (1992e).

52. The issue of capital controls in the European Monetary System (EMS) has been amply investigated in the literature: see, for example, Rogoff (1985) and Artis (1987).

53. See, for example, Starrels (1991). More generally, a wealth of papers and articles on economic reform has already been issued in a relatively short period to shed light on the complexities of the process of moving from central planning to a market system as the basis of economic organization. A fairly extensive list of sources and a discussion of the role of the IMF can found in Guiti\aan (1992a).

54. The philosophy of the Articles of Agreement is based on the superiority of free trade as the organizing principle of international economic interaction. However, there is no presumption in the IMF with regard to members' individual systems of economic organization. In conformity with the principle of universality discussed earlier in the paper, all countries willing and able to abide by the prescriptions of the

code of conduct can join the institution, regardless of their specific type of economic organization. See, for further discussion, Guiti\aan (1983). For an application of the “preaching by example” argument in the area of policy coordination, see Fischer (1988).

55. This subject is closely linked to the issue of sequence in the reform process, which has been discussed in numerous recent papers: see Dornbusch (1991), Fischer and Gelb (1991), Guiti\aan (1991 and 1992a), Calvo and Frenkel (1991a and b), Genberg (1991), and Williamson (1991a).

56. A prime example of such operational collaboration has been given already in the preparation of the study of the U.S.S.R. economy mandated last July 1990 by the Houston Summit: see International Monetary Fund and others (1991).

57. There is, of course, nothing new in the proposal in the text. If anything, it represents a return to the original mode of operation of the IMF; but then, perhaps it is a venturesome proposal, since, after all, the conception of the original role of the institution can be called nothing short of revolutionary.

Institutional Implications

Notes (pages 34-43)

58. The changes in the international economy are widespread and have been underway for some time now. Besides the relatively recent reforms in Central and Eastern Europe as well as in the former Soviet area, there is the impetus toward economic and monetary integration in Western Europe, as well as the broader shift from a regime based on hegemony, to a large extent, to a multipolar system. A discussion of unipolar (hegemonic) and multipolar systems can be found in Eichengreen (1989c). An examination of issues that arise from developments in Europe at large will be found in Guiti\aan (1992a and c).

59. On policy coordination issues, see Polak (1981 and 1988) and Frenkel, Goldstein, and Masson (1988, 1989a and b, and 1990). The subject of international indebtedness has been recently discussed in Guiti\aan (1992b and e).

60. As noted earlier in the paper, the implications of reform for the scope of the functions of the IMF are pervasive. They extend certainly to surveillance and most definitely to technical assistance.

61. For descriptions of IMF financial facilities, see Gold (1980a), Guiti\aan (1981), and Polak (1991). For a description of access policy, see International Monetary Fund (1989, pp. 80 ff). On the issue of maturity of IMF resources or “repurchase” terms, as it is referred to in the institution, see Note 32.

62. For an extensive discussion of the diversity of views on IMF charges, see Horsefield (1969, Vol. II, Ch. 19) and de Vries (1976, Vol. I, Ch. 19, and 1985, Vol. I, Ch. 29).

63. See International Monetary Fund (1989, pp. 54 ff); see also Gold (1979a) and Guiti\aan (1981).

64. This was the rationale for accounting for IMF transactions among official international reserve flows. Incidentally, this rationale also distinguished between the IMF and other lenders in the sense that borrowing from the IMF does not actually belong in gross external debt data. The importance of the issue regarding the monetary character of the IMF has been recently emphasized forcefully by Duisenberg and Sz\aasz (1991). For a broad discussion of alternative functions that could be played by the IMF, see Bryant (1984).

Concluding Remarks

65. This trend is particularly marked in the developments within the European Community, but it is not exclusive to them. The Gramm-Rudman-Hollings legislation in the United States belongs to this trend, as, if strictly applied, it would eliminate fiscal policy discretion altogether.

66. This notion of convertibility applies to the currency of a member not resorting to the transitional arrangements available in the Articles of Agreement that permit the maintenance, adaptation, or even introduction of restrictions on current international transactions. The Articles of Agreement provide an explicit definition of the scope of current transactions, which includes an allowance for a “moderate anount for amortization of loans or for depreciation of direct investments” (Article XXXd). An indispensable source of reference on convertibility can be found in Gold (1971), where the IMF’s concepts of convertibility are discussed extensively. Ample treatment is given to the central concept of convertibility under the Articles of Agreement, in particular, the convertibility under Article VIII. Incidentally, this article warrants reading at this particular time when so many previously centrally planned economies are

contemplating currency convertibility: see, in this context, Polak (1991b).

Notes (page 44) 67. For an interesting elaboration of some of these points in the context of the adjustment process, see Bergsten (1991) and Krugman (1991).

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