CHAPTER 4

INTERNATIONAL ECONOMIC COOPERATION

4.1 Introduction

An integrated world economy requires cooperation among major economic powers. Without determined cooperation among the principal powers, globalization is unlikely to survive the inevitable shocks to which it is subjected. The world faces a difficult adjustment to reduce the macroeconomic imbalances that were a major cause of the current crisis. This means reducing the surpluses of the major surplus countries in East Asia and Europe, and reducing the deficits of the major deficit countries in North America and Europe^1. Both processes require substantial domestic economic changes; economies and people will be tempted to turn inward, and governments will be tempted to reduce the priority they give to their external ties. This increases the risks of a breakdown in international cooperation^2.

4.2 Mutual dependence of nations

The first country, Germany, ran deficits for largely political reasons. Its weak governments had to pay reparations to the victorious belligerents, finance reconstruction, and satisfy massive social demands. So Germany borrowed very heavily from abroad, largely from the United States, and this borrowing helped fuel a consumption boom that, among other things, dampened some of the underlying social tensions that beset that country’s Weimar Republic. This was no small matter: without American financing to sustain the dynamism of the German economy, social and political instability might have caused serious problems for the rest of Europe^3. Yet there was ambivalence on both sides of the relationship, both about the relationship itself and more broadly about the nature of their ties to the world economy. When a crisis hit, things fell apart quickly. Although there were plenty of Americans willing to lend to Germany, the American public, in this heyday of American isolationism^4, rejected any official involvement of the United States in European political or economic affairs.

International cooperation is a human rights approach to growth and development. The conclusion of the Cold War saw the emergence of a more distinguished outlook of both international problems and the concerns that the cooperation brings to international relations. International cooperation draws many different reactions from various people. For businesses, internal economic cooperation is a good thing that assures augmented trade and improved profits for them. Many industrial countries have that view and for the same cause, increased business and augmented profit for their people. Many upcoming states fear it; however, as a fresh tactic to entrench or even augment inequality between countries and within countries. And many people, particularly young people, in developed nations see it as a new vehicle for domination.\(^5\)

International cooperation is good in that developed nations who influence the world economic development and the international financial environment profoundly will try and support the developing countries. They continue their efforts in terms of political systems, laws on human rights to promote continued development and to narrow disparities in a way that can profit the developing nations. The coordination of macro-economic rules takes full account of the interests and worries of all nations, especially the developing nations. Hard works are made to improve the effectiveness of multilateral observation designed to correct current external and economic disparities, endorse non-inflationary sustainable development.\(^6\) This is also to minimize real rates of interest and formulate exchange rates to be more stable and markets more reachable.\(^7\)

International economic cooperation ensures that new and additional economic resources are directed to developing nations. Effective modalities for positive access to, and relocation of, environmentally friendly technologies, especially developing nations, as well as on concessional and special terms, are examined. Multilateral economic institutions are in a position to react to the rising development requirements of developing nations. International economic cooperation provides enough resources to keep up long-term development, to assist structural improvement and to fund

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\(^7\) Supra note 9, p.21.
programs to ease the adverse social outcomes of adjustments for poor and susceptible groups\(^8\).

Regional financial integration is significant in increasing trade and venture in developing nations. Developing nations are able to strive to endorse economic incorporation and reinforce economic and practical co-operation among them. These attempts are encouraged and supported by the developed nations, as well as by the international institutions.

The main aim of international economic cooperation is to eliminate poverty and hunger, bigger equity in income circulation and the expansion of human resources. These were, and remain to be, the major challenges faced by many countries. The collective efforts of the international economic cooperation are much needed to guarantee that the swiftly altering realities end in a positive revolution in good turn of the economic development of all nations, especially the developing nations\(^9\).

However, there is a setback in the international economic cooperation. It has been associated with job losses, competitive weights and a deterioration of income allocation in developed and developing nations alike. Almost internationally, the lower records of the income allocation are most doubtful about the paybacks of international financial system incorporation, and these doubts are especially widespread in more unequal humanities. This calamity has highlighted suspicion of a world financial system that looks like to be the cause of much of our current dilemma\(^10\). There is rising bitterness that the extension of the past ten years majorly helped the wealthy, while the poor and the average classes are being forced to forfeit to deal with the aftermath of the binge. This is joined with related bitterness that authorities tend to privilege the concerns of international financial institutions and companies. There is an advancing famous observation that insulation will aid to support national efforts to deal with the crisis.


4.3 Economic cooperation and integration

The terms economic cooperation and economic integration are often used synonymously. But these two concepts are different. Regional economic cooperation is an evolutionary process consisting of several stages. Economic integration represents the most advanced or ultimate stage of economic cooperation. Economic integration is the unification of economic policies between different states through the partial or full abolition of tariff and non-tariff restrictions on trade taking place among them prior to their integration. This is meant in turn to lead to lower prices for distributors and consumers with the goal of increasing the combined economic productivity of the states.

4.4 Motivations for integration

The motivations for regional integration in both Europe and East Asia were initially similar in that they were both political in nature. In Europe, economic interdependence was thought to be the most effective means to promote the political cooperation that was highly desired in the region after World War II. Therefore, economic means would be used to achieve a political goal. The early catalysts for the formation of the European Community included Hitler and the fear of Germany, the United States and its aid under the Marshall Plan, and fear of the Soviet Union and its spread of communism. The Frenchman, Jean Monnet, first president of the European Coal and Steel Community (ECSC) and generally accepted principal architect of European unity, believed that unification would be best achieved through economic rather than military coordination. His proposal for a single high-level authority to supervise the development of the coal and steel industries in West Germany and in France led to reconciliation between those two countries, and this reconciliation was the basis for the European integration that followed.  

The motivation to form trading blocs may vary from region to region and from country to country. Nevertheless, as Shiells suggests, the following motivations seems to play a key role in the formation of trading blocs.

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1. To obtain economic benefits from achieving a more efficient production structure by exploiting economies of scale through spreading fixed costs over larger regional markets, increased economic growth from foreign direct investment, learning from experience etc.

2. To pursue non-economic objectives such as strengthening political ties and managing migration flows.

3. To ensure increased security of market access for smaller countries by forming regional trading blocs with larger countries.

4. To improve members’ bargaining strength in multilateral trade negotiations or to protest against the slow pace of trade negotiations.

5. To promote regional infant industries which cannot be viable without a protected regional market.

6. Finally, to prevent further damage to their trading strength due to further trade diversion from third countries.

Regional agreements frequently have political objectives and noneconomic dimensions, including national security, enhancement of bargaining power, and bolstering the credibility of reforms (economic and political). The attainment of such political objectives depends primarily on agreement design, as this determines the size and distribution of net economic impacts.14

The term economic integration has been interpreted in different ways. Some authors include social integration in this concept, other subsume different forms of international cooperation under this heading, and the argument has also been advanced that the mere existence of trade relations between independent national economies is a sign of economic integration. However, the term is commonly used to refer to the type of arrangement that removes artificial trade barriers, like tariffs and quantitative restrictions, between the integrating economies.16

The distinction between integration and cooperation is qualitative as well as quantitative. Whereas cooperation includes actions aimed at lessening discrimination,

15 Id p 109
the process of economic integration comprises measures that entail the suppression of some forms of discrimination. For example, international agreements on trade policies belong to the area of international cooperation, while the removal of trade barriers is an act of economic integration.

4.5 Types of integration

There are different degrees or levels of economic integration. The important forms of integration are outlined below:

(a) Free Trade Area
(b) Customs Union
(c) Common Market
(d) Economic Union
(e) Political Union

4.6 Pros and cons of economic integration

Broadly speaking, regional integration aims to improve economic outcomes for all participants involved, although in practice not all participants achieve the same degree of benefit. Oftentimes, economic integration is followed by political integration as well. For example, today's European Union is a product of the European Community, which itself was a product of the European Coal and Steel Community of 1954, a largely economic regime that eventually led to evolution towards political integration with the latter two.\(^{17}\)

In theory, regional integration is hailed as a way to maximize economic outcomes for all participants, but in practice some problems do arise. Some of these problems include, but are not limited to:

(i) Determining whether or not all participants have equal say in policies set by the regional institutions that oversee cooperation. Are there more powerful, core, states that have greater say in what outcomes obtain?

\(^{17}\) L.Luzzatti, New Freie PResse, Wien, (1907), pp.1-2.
(ii) Determining how to deal with economic disruptions and/or redistribution of resources. Economic problems might affect participants unequally, such that some states will be net recipients of some form of aid while others will be net lenders of aid. One might look at North Atlantic Treaty Organisation (NATO) as an example of a multi-state institution where one major participant— the United States— is the primary donor of aid while most other states within NATO are recipients of that aid (principally economic and military)\textsuperscript{18}.

On many levels, for example, the European Union is considered an independent, singular entity even though, of course, it consists of politically independent and sovereign units. Therefore, one must always keep in mind that, unlike an integrated "model" such as the United States, where the central authority is supreme by law, regional zones and institutions consist of participants who are not strictly bound by law. It is always a possibility that in the future a member will secede permanently. In this sense, one can view each state's participation as by treaty and not by law. Although most states do not easily relinquish the requirements set forth in a treaty, they can reject some or all of its requirements, therefore making it all the more difficult to attempt to impose, via some central authority, responsibility that is not desired by participants\textsuperscript{19}.

From an economic perspective, these regional trade agreements create more opportunities for countries to trade with one another by removing the barriers to trade and investment. Due to a reduction or removal of tariffs, cooperation results in cheaper prices for consumers in the bloc countries. Studies indicate that regional economic integration significantly contributes to the relatively high growth rates in the less-developed countries. Apparently, increase in trade volume creates employment opportunities and facilitates labour movement\textsuperscript{20}.

On the flipside, trade creation also leads to trade diversion. Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, weaker companies can be protected inadvertently with

\textsuperscript{18} GATT, Basic Instrument and Selected Documents, (1989), pp.27-29.
\textsuperscript{19} Economic World, (1921), p. 687.
the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc. Furthermore, with each new round of discussions and agreements within a regional bloc, nations may find that they have to give up more of their political and economic rights\textsuperscript{21}.

4.7 North American Free Trade Agreement

The North American Free Trade Agreement (NAFTA) is a comprehensive trade agreement that sets the rules of trade and investment between Canada, the United States, and Mexico. The objectives of the Agreement, which came into force on January 1, 1994, are to:

(a) eliminate barriers to trade in, and facilitate the cross-border movement of goods and services between the territories of the Parties;
(b) promote conditions of fair competition in the free trade area;
(c) Increase substantially investment opportunities in the territories of the Parties;
(d) Provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
(e) Create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
(f) Establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement\textsuperscript{22}.

Since the agreement entered into force, NAFTA has systematically eliminated most tariff and non-tariff barriers to free trade and investment between the three NAFTA countries. The agreement covers the following areas\textsuperscript{23}:

1. Market access - tariff and non-tariff barriers, rules of origin, governmental procurement.
2. Trade rules - safeguards, subsidies, countervailing and antidumping duties, health and safety standards.

\textsuperscript{21} Mason and Asher, (1981), pp. 546-47.
\textsuperscript{23} John Daniels and Lee H. Radebaugh, International Business, Pearson Education, New Delhi, (2003), p 87
3. Services – provides for the same safeguards for trade in services (consulting, engineering, software etc) that exist for trade in goods.

4. Investment – establishes investment rules governing minority interests, portfolio investment, real property and majority-owned or controlled investments from the NAFTA countries; in addition, NAFTA coverage extends to investments made by any company incorporated in a NAFTA country, regardless of country or origin.

5. Intellectual property – all three countries pledge to provide adequate and effective protection and enforcement of intellectual property rights, while ensuring that enforcement measures do not themselves become barriers to legitimate trade.

6. Dispute settlement – provides a dispute settlement process that will be followed instead of countries taking unilateral action against an offending party.

A very significant feature of the NAFTA is that, while most of the trade agreements have provisions only for the trade liberalization, it includes labour standards and environmental standards. The inclusion of labour standards resulted from the pressure of the labour lobby which feared that the U.S. and Canada would lose jobs to Mexico as a result of Mexico’s cheaper wages, poor working conditions and lax environmental enforcement. Similarly, the inclusion of the environmental standards resulted from the pressure of the environmental lobby which pushed for an upgrade of environmental standards in Mexico and strengthening of compliance.

4.8 South Asian Association for Regional Cooperation (SAARC)

The South Asian Association for Regional Cooperation (SAARC) involving seven countries, namely, India, Bangladesh, Pakistan, Nepal, Bhutan, Sri Lanka and Maldives, was formally launched in December 1985. These neighbors came together in act of faith. The birth of SAARC was a logical response to the problems facing the region.

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The fundamental goal of SAARC is to accelerate economic and social 
development through optimum utilization of their human and material resources. 
According to Article I of the Charter of SAARC, the objectives of the Association are 
as follows:-

1. To promote the welfare of the peoples of SOUTH ASIA and to improve their 
quality of life;
2. To accelerate economic growth, social progress and cultural development in 
the region and to provide all individuals the opportunity to live in dignity and 
and to realise their full potentials;
3. To promote and strengthen collective self-reliance among the countries of 
South Asia;
4. To contribute to mutual trust, understanding and appreciation of one another's 
problems;
5. To promote active collaboration and mutual assistance in the economic, social, 
cultural, technical and scientific fields;
6. To strengthen cooperation with other developing countries;
7. To strengthen cooperation among themselves in international forums on 
matters of common interests; and
8. To cooperate with international and regional organisations with similar aims 
and purposes.27

With about more than 1,200 million inhabitants, SAARC accounts for over 
one-fifth of the world population. The density of population in the SAARC 
countries, which have only about 3.3 per cent of the world’s land area, is very high, 
larly double when compared to the average density of the low income economies as 
a whole. A major share of the world’s poor lives in these countries.

4.9 SAARC Preferential Trading Arrangement (SAPTA)

The sixth SAARC Summit held in Colombo strongly mooted the idea of a 
SAARC Preferential Trading Arrangement (SAPTA) and the foreign ministers of all 
the member states signed the Agreement on 11 April 1953 during the seventh 
SAARC Summit in Dhaka. SAPTA became effective from 7 December 1995.

27 Article 1, SARC
The basic principles of SAPTA are as follows:-

1. Overall reciprocity and mutuality of advantages
2. Step-by-step negotiations and extension of preferential trade arrangement in stages
3. Inclusion of all types of products – raw, semi-processed and processed
4. Special and favourable treatment to Least Developed Countries (LDCs)

The special treatment of LDCs includes allowance of favourable percentage points, application of relaxed rules of origin, favourable terms for technical assistance, duty-free access, deeper tariff preferences, removal of non-tariff and para-tariff barriers, negotiation of long-term contracts to support sustainable exports and provision of special facilities with regard to shipping and documentation, preparation and establishment of industrial and agricultural projects, training facilities and support to export marketing etc, possibly linked to cooperative financing and buyback arrangements.\(^2^8\)

According to the county perspective exports on SAPTA, this preferential arrangement would benefit the SAARC countries due to the following reasons:

1. The countries can substantially reduce the transport cost because of geographical continuity among the members.
2. Capital goods produced within the region may be more compatible to the factor endowment of member states than those imported from developed countries.
3. The increasing competition among the member states would result in technical efficiency in existing industry as marginal firms might be forced to reduce their cost. Resources will be reallocated away from less efficient firms and monopolies protected by tariff wall will no longer be in a sheltered position.
4. As economic ties get stronger and countries become committed to common economic goals, political problems will gradually recede. When economic benefits gain significance, amicable environment may evolve for dissolving political problems.

5. Regional cooperation may also pave the way for regional banks or corporation which might be influential in promoting regional investment in larger projects\textsuperscript{29}.

4.10 South Asian Free Trade Area (SAFTA)

The basic principles underlying SAFTA are as under:

1. Overall reciprocity and mutuality of advantages so as to benefit equitably all Contracting States, taking into account their respective level of economic and industrial development, the pattern of their external trade, and trade and tariff policies and systems;

2. Negotiation of tariff reform step by step, improved and extended in successive stages through periodic reviews;

3. Recognition of the special needs of the Least Developed Contracting States and agreement on concrete preferential measures in their favour;

4. Inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms\textsuperscript{30}.

There is a view that what are needed are a customs union and not a free trade area because a free trade area has an important problem that goods from a non-member country may enter a member country and from there freely flow throughout the free trade area causing damage to the domestic industry/agriculture of some of the members\textsuperscript{31}.

4.11. Indo-Lanka Free Trade Agreement

The Indo-Lanka Free Trade Agreement (ILFTA) was the first bilateral trade agreement signed by both India and Sri Lanka. The agreement was entered signed in the backdrop of expanding economic ties between the two countries following liberalization of the Indian economy in the early 1990s. Whilst India had become one of Sri Lanka’s major import sources, exports to India remained low. With the deteriorating political relationship between India and Pakistan stalling of progress on the SAFTA, Sri Lanka and India were keen to forge ahead with a bilateral agreement

to cement the improving economic integration between the two countries\(^{32}\). The agreement was entered into on 28 December 1998.

The main objectives of the Free Trade Agreement, according to its preamble, are the following:

1. To promote through the expansion of trade the harmonious development of the economic relations between India and Sri Lanka.
2. To provide fair conditions of competition for trade between India and Sri Lanka.
3. In the implementation of this agreement both the countries would pay due regard to the principle of reciprocity.
4. To contribute, in this way, by the removal of barriers to trade to the harmonious development and expansion of world trade.

The agreement also provides for safeguard measures under which if any product, which is the subject of preferential treatment, is imported into the territory of a contracting party in such a manner or in such quantities as to cause or threaten to cause serious injury in the importing country to the agreement, the importing country with prior consultations except in critical circumstances suspend provisionally without discrimination the preferential treatment accorded under the agreement. The contracting parties are also free to apply their domestic legislations to restrict imports in cases where prices are influenced by unfair trade practices like subsidies or dumping\(^{33}\).

4.12 South-South cooperation

South-South cooperation is a term historically used by policymakers and academics to describe exchange of resources, technology and knowledge between developing countries, also known as countries of global south. It is a broad framework for collaboration among countries of the South in the political, economic, social, cultural, environmental and technical domains. Involving two or more developing countries, it can take place on a bilateral, regional, subregional or interregional basis. Developing countries share knowledge, skills, expertise and resources to meet their development goals through concerted efforts. Recent developments in South-South


cooperation have taken the form of increased volume of South-South trade, South-South flows of foreign direct investment, movements towards regional integration, technology transfers, sharing of solutions and experts, and other forms of exchanges \(^{34}\).

In 1978, the United Nations established the Unit for South–South Cooperation to promote South–South trade and collaboration within its agencies. However, the idea of South–South cooperation only started to influence the field of development in the late 1990s. South–South cooperation has been successful in decreasing dependence on the aid programs of developed countries and in creating a shift in the international balance of power \(^{35}\).

One of the key goals of the cooperation is to strengthen and improve economic ties. Some of the areas which these "southern" nations look forward to improving further include joint investment in energy and oil, and a common bank. This framework is now widely recognized as a key mechanism for the development agenda of countries in the South and is guided by mutual benefit between countries, respect for national sovereignty and ownership, establishment of partnership among equals, non-conditionality in cooperation and non-interference in domestic affairs. The underlying notion of this emerging framework is that South-South cooperation is not a substitute but rather a complement to North-South cooperation \(^{36}\).

### 4.13. Basic Elements of South-South Cooperation

South-South cooperation is initiated, organized and managed by developing countries themselves; often, Governments play a lead role, with active participation from public- and private-sector institutions, non-governmental organizations and individuals. It involves different and evolving forms, including the sharing of knowledge and experience, training, technology transfer, financial and monetary cooperation and in-kind contributions. South-South cooperation can include different sectors and be bilateral, multilateral, sub regional, regional or interregional in nature \(^{37}\).


4.14. Guiding Principles of South-South Cooperation

South-South cooperation is a manifestation of solidarity among peoples and countries of the South that contributes to their national well-being, their national and collective self-reliance and the attainment of internationally agreed development goals, including the Millennium Development Goals. The South-South cooperation agenda and South-South cooperation initiatives must be determined by the countries of the South, guided by the principles of respect for national sovereignty, national ownership and independence, equality, non-conditionality, non-interference in domestic affairs and mutual benefit.\textsuperscript{38}

4.15. Objectives of South-South Cooperation

The basic objectives of South-South cooperation are interdependent and mutually supportive and contribute to the broader objectives of international development cooperation. These objectives are to:

1. Foster the self-reliance of developing countries by enhancing their creative capacity to find solutions to their development problems in keeping with their own aspirations, values and special needs;
2. Promote and strengthen collective self-reliance among developing countries through the exchange of experiences; the pooling, sharing and use of their technical and other resources; and the development of their complementary capacities;
3. Strengthen the capacity of developing countries to identify and analyse together their main development issues and formulate the requisite strategies to address them;
4. Increase the quantity and enhance the quality of international development cooperation through the pooling of capacities to improve the effectiveness of the resources devoted to such cooperation;

While there has been some improvement in south-south trade during past decades, the southern countries to trade in large measure with northern countries. However, various scholars have argued that there is a greater potential for expanding south-south trade. The fact that southern products face growing difficulty in entering

\textsuperscript{38} Garelli, (1991),p.35.
northern markets makes it all the more essential that south-south trade should be expanded\textsuperscript{39}.

Frances Stewart examined the obstacles to north-south trade and she argued that the concentration of development of new products in the north left the south at a disadvantage. Such innovation had resulted in improved production efficiency and application of economies of scale in the north, and had contributed to increased income for northern consumers. However, products of northern origin which were aimed at high income consumers were not always marketable in the south, because there were fewer high income consumers\textsuperscript{40}.

Stewart mentioned four possible difficulties in the expansion of south-south trade. First, a switch to south-south trade may involve a switch to less efficient products and processes for some southern countries. Therefore, there would be inevitably short term losses for some of the southern countries. Second, the gains from the south-south trade will be distributed unequally, with the more advanced countries benefitting more than the less advanced countries, which would suffer the adverse effects of this reorientation\textsuperscript{41}.

Third, improvement in trade ties would have to be preceded by an increase in intra-south communications and transportation networks, to support the needs of the increased intra-trade. Finally, there would be a need for changes in income distribution in southern countries, to ensure that the benefits from the increased trade would benefit a large number of people\textsuperscript{42}.

On the whole, therefore, while the moves to promote south-south cooperation have involved much effort and produced many initiatives and schemes, the practical results have been very limited.

\textsuperscript{39} A Janssen, Les conventions monétaires, (1911), p.4.
\textsuperscript{41} Information in this section has been drawn mainly from South Commission, The Challenge to the South , (1992), P.87.
4.16. Association of Southeast Asian Nations (ASEAN)

As set out in the ASEAN Declaration, the aims and purposes of ASEAN are:

1. To accelerate the economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of Southeast Asian Nations;

2. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of the United Nations Charter;

3. To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;

4. To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;

5. To collaborate more effectively for the greater utilisation of their agriculture and industries, the expansion of their trade, including the study of the problems of international commodity trade, the improvement of their transportation and communications facilities and the raising of the living standards of their peoples;

6. To promote Southeast Asian studies; and

7. To maintain close and beneficial cooperation with existing international and regional organisations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.

In their relations with one another, the ASEAN Member States have adopted the following fundamental principles:

1. Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;

2. The right of every State to lead its national existence free from external interference, subversion or coercion;

3. Non-interference in the internal affairs of one another;

4. Settlement of differences or disputes by peaceful manner;
5. Renunciation of the threat or use of force; and
6. Effective cooperation among themselves.

4.17. Future of ASEAN

ASEAN was founded with a limited charter, even compared to many other regional organizations. The goal was to preserve long-term peace in Southeast Asia and, by unifying, to balance the roles that outside powers, including the United States, China, and Japan, played in Southeast Asia. Even though the Second Indochina War ended in 1975, the region remained mired in Indochina politics until the late 1980s, and ASEAN’s mission evolved only marginally from its original goal. ASEAN also made little effort to push for greater regional integration or trade liberalization. Despite China’s economic opening in the late 1970s, China did not have formal relations with many Southeast Asian states and was a minor trading partner for the majority of the countries in the region by the late 1980s. Most ASEAN states (with the exception of small, oil-rich Brunei, which was added as a member after the original five) were focused on building export-oriented manufacturing sectors that relied on low wages, Japanese capital, and open Western markets. This strategy was extremely successful, at least for a time: in the 1980s and early 1990s, Thailand regularly posted some of the highest growth rates of any country in the world.\(^{43}\)

4.18. European Union (EU)

The European Union is an economic and political union of 28 member states that are located primarily in Europe. The EU operates through a system of supranational independent institutions and intergovernmental negotiated decisions by the member states.\(^{44}\)

The EU traces its origins from the European Coal and Steel Community and the European Economic Community formed by the Inner Six countries, namely, Belgium, France, Federal Republic of Germany, Italy Luxembourg and Netherlands in 1958. In the intervening years the community and its successors have grown in size by the accession of new member states and in power by addition of policy areas to its

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\(^{44}\) Information for this section has been drawn considerably from B. Bhattacharya & Vijaya Kath, Regional Trade Agreement, (1996), p.87.
remit. The Maastricht Treaty established the European Union under its current name in 1993. The last major amendment to the constitutional basis of the EU, the Treaty of Lisbon, came into force in 2009.

4.19. International economic institutions

In order to understand our world today, we need to understand the principal international economic institutions that provide the foundation and structural support of the world economy. This does not mean that the day of the nation-state is over, nor that the institutions have become so successful that a brave new world of supranationalism is about to dawn. Rather, it means that the creative institutional experiments in international cooperation, born out of the ashes of World War II, have become so well established that there is a tendency to take them for granted. Having such institutions in place is a major asset for mankind in dealing with growing economic integration and increasingly pervasive interdependence with its inherent vulnerabilities.

There are three principal international economic institutions of a universal character: the International Monetary Fund (Fund), the International Bank for Reconstruction and Development (World Bank or Bank), and the General Agreement on Tariffs and Trade (GATT). All three originated in wartime planning for a better economic future, although the GATT was created later than the Fund and the Bank after the charter of the planned International Trade Organization (ITO) failed to enter into force. The planning took place against the background of the impoverishing economic policies of the 1930s, and in the context of ambitious planning that led to the establishment of the universal political institution, the United Nations. The history of these institutions is thus short by historical standards. The economic institutions are based on the recognition that in an interdependent world economy national and international prosperity are inseparable. As befitting the purposes of these institutions, they are of universal scope, with a growing membership reflecting the common interests among states, and hence the growth of community among them. They represent a potent force of attraction that has led to a diminishing number of non-members, a shrinking category that may be expected to disappear altogether.

The universal economic institutions coexist with international economic organizations of a regional or more limited character that are more or less patterned after them or have overlapping or related functions, such as the Organization for Economic Cooperation and Development (OECD) and the European Communities (EC)\(^{47}\).

The three principal institutions, the Fund, the World Bank, and the GATT, thus started out sharing the broad unity of purpose of promoting national and international prosperity. They were to do so with a historical division of work among them: the Fund was to promote a stable and open international monetary system, the World Bank economic growth through post-war reconstruction and development through productive investment, while the GATT would provide the framework for the establishment of an open international trading system. With the pursuit of prosperity being thus attended to, peace would be achieved through political cooperation institutionalized in the United Nations.\(^{48}\)

4.20. International Monetary Fund (IMF)

The International Monetary Fund (IMF), which was established on December 27, 1945 with 29 countries, is an organisation of countries that seeks to promote international monetary cooperation, facilitate the expansion of trade and thus to contribute towards increased employment and improved economic conditions in all the member countries. It was meant to govern and support the international monetary system in the postwar world and designed to prevent a repetition of the disorderly exchange-rate changes of the 1930s and provide its members with temporary financing when they encountered balance of payments problems\(^{49}\).

During the Great Depression of the 1930s, countries attempted to shore up their failing economies by sharply raising barriers to foreign trade, devaluing their currencies to compete against each other for export markets, and curtailing their citizens' freedom to hold foreign exchange\(^{50}\). These attempts proved to be self-defeating. World trade declined sharply, and employment and living standards


\(^{50}\) Lane, Timothy, “Tensions in the Role of the IMF and Directions for Reform”, (2005), pp.47-66.
plummeted in many countries. This breakdown in international monetary cooperation led the IMF’s founders to plan an institution charged with overseeing the international monetary system—the system of exchange rates and international payments that enables countries and their citizens to buy goods and services from each other. The new global entity would ensure exchange rate stability and encourage its member countries to eliminate exchange restrictions that hindered trade.\(^{51}\)

The IMF was conceived in July 1944, when representatives of 45 countries meeting in the town of Bretton Woods, New Hampshire, in the northeastern United States, agreed on a framework for international economic cooperation, to be established after the Second World War. They believed that such a framework was necessary to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression. The IMF came into formal existence in December 1945, when its first 29 member countries signed its Articles of Agreement. It began operations on March 1, 1947. Later that year, France became the first country to borrow from the IMF.\(^{52}\)

The IMF’s membership began to expand in the late 1950s and during the 1960s as many African countries became independent and applied for membership. But the Cold War limited the Fund’s membership, with most countries in the Soviet sphere of influence not joining.

With its near-global membership of 188 countries, the IMF is uniquely placed to help member governments take advantage of the opportunities and manage the challenges posed by globalization and economic development more generally. The IMF tracks global economic trends and performance, alerts its member countries when it sees problems on the horizon, provides a forum for policy dialogue, and passes on know-how to governments on how to tackle economic difficulties. The IMF provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.\(^{53}\)

\(^{53}\) Belgium, France, German, Great Britain, Italy and Japan.
Marked by massive movements of capital and abrupt shifts in comparative advantage, globalization affects countries’ policy choices in many areas, including labour, trade, and tax policies. Helping a country benefit from globalization, while avoiding potential downsides, is an important task for the IMF. The global economic crisis has highlighted just how interconnected countries have become in today’s world economy.

4.21. Purposes of IMF

The purposes of the IMF according to its Articles of Agreement are:

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution, which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

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

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

4.22. Membership

Any country may apply to become a member of the IMF. When a country applies for membership, the IMF’s Executive Board examines the application. If found suitable, the Executive Board gives its report to IMF’s Board of Governors.
After the Board of Governor clears the application, the country may join the IMF. However, before joining, the country should fulfil legal requirements, if any, of its own country. Every member has a different voting right. Likewise, every country has a different right to draw funds. This depends on many factors, including the member country’s first subscription to the IMF.

The IMF supports its membership by providing:

1. Policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
2. Research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
3. Loans to help countries overcome economic difficulties;
4. Concessional loans to help fight poverty in developing countries; and
5. Technical assistance and training to help countries improve the management of their economies.

4.23. Organization and Management

The IMF’s Articles of Agreement provide for a Board of Governors, an Executive Board, a Managing Director and a staff of international civil servants.

The Board of Governors is the highest decision making body of the IMF. It consists of one governor and one alternate for each member country. The governor, appointed by the member country, is usually the minister of finance or the central bank governor. While the Board of Governors has delegated most of its powers to the IMF’s Executive Board, it retains the right to approve quota increases, special drawing right (SDR) allocations, the admittance of new members, compulsory withdrawal of members, and amendments to the Articles of Agreement and By-Laws. It normally meets once a year.

The Executive Board is responsible for conducting the business of the IMF. It is composed of 24 directors, who are appointed or elected by member countries or groups of countries. The Managing Director serves as its chairman. Meeting several

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54 Peter B. Kenen, Reform of the International Monetary Fund, (1998), p.34.
times a week, the Board deals with a wide variety of policy, operational and administrative matters including surveillance of members’ exchange rate policies, provision of IMF financial assistance to member countries and discussion of systemic issues in the global economy. The Managing Director is assisted by a First Deputy Managing Director and three other Deputy Managing Directors. The Management team oversees the work of the staff and maintains high-level contacts with member governments, the media, non-governmental organizations, think tanks, and other institutions. Selected by the Executive Board, the Managing Director serves a five-year term and may be reelected to successive terms.\textsuperscript{57}

The IMF Board of Governors is advised by two ministerial committees, the International Monetary and Financial Committee (IMFC) and the Development Committee. The IMFC meets twice a year and discusses matters of common concern affecting the global economy and also advises the IMF on the direction of its work.

The Development Committee is a joint committee, tasked with advising the Boards of Governors of the IMF and the World Bank on issues related to economic development in emerging and developing countries. The committee has 24 members (usually ministers of finance or development). It represents the full membership of the IMF and the World Bank and mainly serves as a forum for building intergovernmental consensus on critical development issues.\textsuperscript{58}

\textbf{4.24. Accountability}

The IMF is accountable to its 188 member governments, and is also scrutinized by multiple stakeholders, from political leaders and officials to, the media, civil society, academia, and its own internal watchdog. The IMF, in turn, encourages its own members to be as open as possible about their economic policies to encourage their accountability and transparency. Official groups such as the Group of Twenty (G-20) and the Group of Eight (G-8) are also actively engaged in the work of the IMF.\textsuperscript{59}

The G-20 consists of the 20 leading and emerging economies of the world, and includes all G-8 countries plus Argentina, Australia, Brazil, China, India, Indonesia,

\textsuperscript{58} International Monetary Fund Annual Report, (1948), p. 21.
Korea, Mexico, Saudi Arabia, South Africa, and Turkey, as well as the European Union. The G-20 discusses and coordinates international financial stability and is a key player in shaping the work of the IMF. Its meetings usually take place twice a year at the level of heads of state and government, with several other ministerial-level meetings, including finance ministers and central bank governors, held a few times a year.

The G-8 finance ministers and central bank governors meet at least twice annually to monitor developments in the world economy and assess economic policies. The Managing Director of the IMF is usually invited to participate in those discussions. The G-8 functions as a forum for discussion of economic and financial issues among the major industrial countries Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States.\(^6^0\)

The IMF's work is scrutinized by the media, the academic community, and civil society organizations. IMF management and senior staff communicate with the media on a daily basis. The IMF’s work is reviewed on a regular basis by an internal watchdog, the Independent Evaluation Office (IEO), established in 2001. The IEO is fully independent from IMF management and operates at arm's length from the Executive Board, although the Board appoints its director.

The IEO's mission is to enhance the learning culture within the IMF, strengthen its external credibility, promote greater understanding of the work of the Fund, and support institutional governance and oversight. The IEO establishes its own work programme, selecting topics for review based on suggestions from stakeholders inside and outside the IMF. Its recommendations strongly influence the Fund's work.\(^6^1\)

The IMF also encourages its member countries to be as open as possible about their economic policies. Greater openness encourages public discussion of economic policy, enhances the accountability of policymakers, and facilitates the functioning of financial markets. To that effect, the IMF's Executive Board has adopted a transparency policy to encourage publication of member countries’ policies and data.


This policy designates the publication status of most categories of Board documents as "voluntary but presumed." This means that publication requires the member's explicit consent but is expected to take place within 30 days following the Board discussion.\(^62\)

However, the style of functioning of the IMF has come under close scrutiny by a number of experts. According to some experts, the IMF still operates on the erroneous assumption that its existing channels of accountability are sufficient. The IMF structure provides for two channels of accountability: the IMF’s Board of Executive Directors, and the Board of Governors. The Board of Executive Directors is not an adequate channel of accountability to those member states most affected by the IMF’s actions for two reasons.\(^63\) The first is that, as we have seen, most consumer member states are only indirectly represented on it. In fact, the link between each consumer member state and the Executive Director who represents it on the Executive Board has weakened as the number of countries each Executive Director represents has grown. Second, the Executive Directors from the key supplier member states dominate the Board.\(^64\)

The second reason is that IMF programs have become too numerous and complex for the Executive Directors to be able to exercise firm oversight over the staff. The Executive Directors representing the consumer states do not have sufficient staff or time in the day to adequately understand all the programmes in which the IMF is involved. Nor do they have the capacity to play an active role in making operational policy for the IMF and in dealing with the numerous organizational issues that the Board of any organization as complex as the IMF must address. The result is IMF staff and management are making decisions about IMF programs and are interpreting IMF policies without any substantive accountability to IMF consumer member states. For example, it is the management and staff who design the conditions attached to IMF financing for a country and who make the decision that the country has

\(^{62}\) Supra note 32, p.34.
\(^{64}\) The Changing Role of the IMF in Governance of Global Economy and its Consequences, Daniel D.Bradlow, Professor of Law and Director, International Legal Studies Programme, American University, Washington College of Law, in paper presented for the Annual Banking Law Update, Johannesburg
sufficiently complied with the multiple conditions attached to IMF financing to warrant asking the Board to release the next tranche of IMF funding.  

The Board of Governors is also not a sufficient channel of operational accountability even though each member state is represented on it. The Board, which only meets once a year, is the highest body in the organization and is not the appropriate body to deal with the operational issues that may arise in the relationship between the IMF and a consumer member state. Furthermore, even if the Governor from a consumer member state were willing to raise an operational issue in the Board of Governors, it is not clear that they would have adequate knowledge of the impact of the IMF’s policies and program in his/her country on its citizens. The reason for this is that many IMF consumer countries suffer from governance problems which mean that they are unlikely to have adequate channels of information about these impacts.

The problems in the existing channels of accountability have three important operational implications for the IMF. The first is that the IMF staff and management are effectively operating without any accountability. However, if the IMF staff is making policy in the member states, there is no obvious reason why they should be less accountable to those affected by the policies than the other participants in the policy-making process. In fact, it undermines the IMF staff and management’s credibility when they advocate accountability as an aspect of good governance in its member states but do not apply the principle to themselves. The second is that the IMF does not provide much guidance to the staff on how they should perform their responsibilities when they act in this policy-making capacity. For example, it does not clarify to whom they owe their primary responsibility, what obligations they owe to those affected by the policies, what factors they should consider in making decisions in this process etc. The lack of such guidance results in each staff member or mission team exercising great discretion in their policy-making activities in each member country. It also makes it hard to hold the staff accountable. In this regard it is important to note that, unlike the World Bank, the IMF does not have an operational

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manual that contains the detailed operational policies and procedures that its staff should follow in the conduct of their duties.68

Third, the IMF is performing its policy-making functions without establishing any formal mechanisms through which those non-state actors most affected by its actions can communicate directly with the IMF. In fact, the IMF is not unaware of this problem and it often engages in informal communications with these affected parties. However, this means that the IMF, in consultation with the government of the member state, is choosing with which non-state actors it communicates and is setting the terms for this communication69. A more formal procedure for communication with these non-state actors such as a requirement that all IMF missions hold a public hearing in the country they are visiting or an explicitly recognized right to make written submissions would ensure that many more in trusted non-state actors have a meaningful opportunity to communicate with the IMF. The IMF’s failure to establish such procedures contradicts the principles of participation and the need for transparent governance procedures that it advocates to its member states. It also suggests that the IMF is often making policy without having access to all the relevant information70.

Another aspect of the IMF’s lack of accountability is its continued adherence to the principle of uniformity. While it is important that international organizations treat all similarly situated member states equally, it is also important that it treat all member states fairly. Given the difference in the nature of the IMF’s relations with the industrialized and developing countries it is no longer adequate to contend that since all states participate in the same international monetary system they all should receive uniform treatment. In reality, as discussed above, some IMF consumer states do not have access to the financial markets that the G-7 utilizes. Furthermore, very few of the IMF consumer states are able to have any substantial input into the workings of the international monetary and financial systems or influence in its governance arrangements and institutions. This suggests that the uniformity principle has become a means of justifying unfair treatment for the developing countries. For example, it precludes the IMF from offering certain groups of member states disproportionately

69 Supra note. 85, p.54.
favourable access to its general resources or special considerations in its decision-making procedures\textsuperscript{71}.

4.25. Resources

The resources of the IMF come from two sources, namely, (i) subscription by members in the form of quotas and (ii) borrowings. Most resources for IMF loans are provided by member countries, primarily through their payment of quotas. Borrowing provides a temporary supplement to quota resources and has played a critical role in enabling the Fund to meet members’ needs for financial support during the global economic crisis\textsuperscript{72}.

4.26. The quota system

When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members that are broadly comparable in economic size and characteristics. The IMF uses a quota formula to guide the assessment of a member’s relative position. The current quota formula is a weighted average of GDP (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). Quotas are denominated in Special Drawing Rights, the IMF’s unit of account. The largest member of the IMF is the United States, with a current quota of SDR 42.1 billion (about $64 billion), and the smallest member is Tuvalu, with a current quota of SDR 1.8 million (about $2.7 million).

A member’s quota delineates basic aspects of its financial and organizational relationship with the IMF. A member’s quota subscription determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full upon joining the Fund: up to 25 percent must be paid in SDRs or widely accepted currencies (such as the U.S. dollar, the euro, the yen, or the pound sterling), while the rest is paid in the member’s own currency. The quota largely determines a member’s voting power in IMF decisions. Each IMF member’s votes are comprised of 250 basic votes plus one additional vote for each SDR 100,000 of quota. The amount of financing a member can obtain from the IMF (its access limit) is based on its quota. For example, under Stand-By and Extended Arrangements, a member can borrow up to 200 percent of its quota annually and


\textsuperscript{72} Supra note 87, p.34.
600 percent cumulatively. However, access may be higher in exceptional circumstances.

The IMF’s Board of Governors conducts general quota reviews at regular intervals (usually every five years). Any changes in quotas must be approved by an 85 percent majority of the total voting power, and a member’s quota cannot be changed without its consent.\footnote{IMF Press Release no 99/56 of 23 November 1999.}

The quota subscriptions of the member countries are the primary source of financial resources for the IMF. The Fund, however, is authorised under its Articles of Agreement to supplement its ordinary resources by borrowing. The Fund may seek the amount it needs in any currency and from any source ie., from official entities as well as from private sources. Two sources of supplementary financing now exist: the General Arrangements to Borrow (GAB), created in 1962 and the New Arrangements to Borrow (NAB) created in 1998.

Under the General Arrangements to Borrow, the IMF is able, under certain circumstances, to borrow specific amounts of currencies from 11 industrial countries or their central banks at marked-related rates. Under NAB, the Fund can avail credit facility from 25 members and institutions. The participants in NAB commit amounts based primarily on their relative economic strength.\footnote{“Meeting of the Governors of Central Banks Contributing to the Gold Pool: Communique” Federal Reserve Bulletin,(1968), p.254.}

On the occasion of the first reexamination of the Bretton Woods quota formula in the early 1960s, a multi-formula method was devised that included the choice of assigning differing weights for national income, on the one hand, and for current external payments and the variability of current receipts, on the other. With the flexibility that this provided, national income became a major weight in the formula for most industrial and other large countries, while current payments and variability of current receipts became important components for small open economies and for most developing countries. Since the early 1980s, the variables in the quota formula have included GNP, official reserves, current external payments and receipts, the variability of current receipts, and the ratio of current receipts to GNP.\footnote{Supra note 87, p.76.}
The IMF’s Articles of Agreement provide for general reviews of quotas at intervals of no more than five years. The key issues in these quinquennial reviews include (1) the size of the overall increase, which needs to be considered in the light of the medium-term outlook for the world economy and the role of the IMF in the financing of payments imbalances that may arise; and (2) the distribution of the overall increase between equiproportional increases for all members and selective increases for certain countries typically rapidly growing economies for whom the “actual quota” is seriously “out of line” with the “calculated quota.” The scope for selective increases is limited because an increase in the share of total quotas and, hence, in voting percentage for one member will automatically reduce the voting power of all other members. Most members and particularly the developing countries are anxious not to see their quota share in the total IMF decline and have tended to favour equiproportional increases in quotas.\footnote{G-24 Communique,(2000), p.87.}

Over the years, the equiproportional element has averaged about 70 percent of the overall quota increases. An important argument for selective increases in addition to the matter of equity that is associated with “outofliness” is the capacity of the candidates for such increases to provide liquidity to the IMF. This was a priority under the Seventh Review in 1978, when the quota share of the major oil-exporting countries was doubled at the expense of that of the industrial countries, that is, without infringing on the quota share of the other developing countries.\footnote{World Bank, The World Bank, (1983), p.45.} Total quotas have diminished rapidly in relation to the size of the world economy and world trade; actual quotas also have trailed increasingly behind calculated quotas. Among the reasons for these developments were (1) the growing access to world capital markets and the increased recourse to floating exchange rates, which have obviated the need for industrial countries to use the IMF’s resources; (2) the rapid dismantling of controls over international capital transactions in advanced and in emerging market economies, together with the expanding access to international capital markets by a growing number of countries; (3) the creation in the late 1980s of a special financing window, separate from the IMF’s quota resources, the Enhanced Structural Adjustment Facility (ESAF), now the Poverty Reduction and Growth Facility (PRGF), which strengthened the IMF’s ability to assist poor developing countries and
became the principal instrument for financial assistance at low cost and for longer terms to a group of about 80 IMF members\textsuperscript{78}.

Since the late 1970s, the quota share of the developing countries has averaged about 37.5 percent and their voting share around 40 percent. The difference is accounted for by the provision in the Articles of Agreement (Article XII, section 5) of 250 basic votes for each member in addition to one vote per SDR 100,000 of its quota. Until the mid-1970s, basic votes as a percentage of total votes remained above 10 percent; since then, however, successive general increases in quotas have reduced the share of basic votes to barely 2 percent in 2002. In the meantime, the number of developing countries in the total IMF membership has continued to grow.\textsuperscript{79}

The developing countries have, repeatedly, urged that a new quota formula, including such elements as population and a poverty index, be devised that would give them a larger voice in the IMF. Moreover, as the industrial countries have ceased using IMF resources, this has diminished the characteristic of the IMF as a “credit union” where members are at times lenders and become borrowers at other times and the rules of the credit union are set by all and for all. This development has affected the balance in the relationship between the two groups of members and as will be seen in Section IV it has accentuated the importance of decision making by consensus to protect the interests of the developing countries that are the minority shareholders\textsuperscript{80}.

4.27. Financing facilities

A country in severe financial trouble, unable to pay its international bills, poses potential problems for the stability of the international financial system, which the IMF was created to protect. Any member country, whether rich, middle-income, or poor, can turn to the IMF for financing if it has a balance of payments need—that is, if it cannot find sufficient financing on affordable terms in the capital markets to make its international payments and maintain a safe level of reserves.

IMF loans are meant to help member countries tackle balance of payments problems, stabilize their economies, and restore sustainable economic growth. This

\textsuperscript{78} IMF Survey, Reporting on Jeffrey Frankel’s Search for the “Missing Middle”. (2000) p.87.
The crisis resolution role is at the core of IMF lending. At the same time, the global financial crisis has highlighted the need for effective global financial safety nets to help countries cope with adverse shocks. A key objective of recent lending reforms has therefore been to complement the traditional crisis resolution role of the IMF with more effective tools for crisis prevention.\(^81\)

The IMF is not a development bank and, unlike the World Bank and other development agencies, it does not finance projects.\(^82\) IMF lending serves three main purposes. First, it can smooth adjustment to various shocks, helping a member country avoid disruptive economic adjustment or sovereign default, something that would be extremely costly, both for the country itself and possibly for other countries through economic and financial ripple effects (known as contagion). Second, IMF programs can help unlock other financing, acting as a catalyst for other lenders. This is because the program can serve as a signal that the country has adopted sound policies, reinforcing policy credibility and increasing investors' confidence. Third, IMF lending can help prevent crisis. The experience is clear: capital account crises typically inflict substantial costs on countries themselves and on other countries through contagion. The best way to deal with capital account problems is to nip them in the bud before they develop into a full-blown crisis.\(^83\)

The principal way in which the IMF makes its resources available to members is by selling to them the currencies of other members or SDRs in exchange for their own currencies. For example, if India needs US dollars to meet its balance of payments obligations, it may purchase the dollars from IMF by exchanging Rupees. Such transactions change the composition, but not the overall size of the Fund’s resources. A member to which the Fund sells currencies or SDRs is said to make ‘purchases’ (also referred to as ‘drawings’) from the Fund. The IMF levies charges on these drawings and requires that, within a specified time, members “repurchase” (or buy back) their own currency from the IMF with other members’ currencies or SDRs. The IMF lends in the following categories:

1. Stand-By Arrangement (SBA):

Under this arrangement, which is typically one to two years long but can be as long as three years, a country carries out a programme that it has designed in consultation with the IMF to resolve the balance of payments problems of a largely cyclical nature. The programme focuses on key macroeconomic policy measures and, to receive the financing, the member must meet performance criteria making its successful implementation of the programme. These criteria which allow both the member and the IMF to assess progress and may signal the need for further corrective policies – generally cover ceilings on government budget deficits, credit, and external debt, as well as targets for reserves. The country repays the money it has borrowed over 3 ¼ to 5 years.\(^{84}\)

SBA is the IMF’s workhorse lending instrument for emerging market countries. Rates are non-concessional, although they are almost always lower than what countries would pay to raise financing from private markets. The SBA was upgraded in 2009 to be more flexible and responsive to member countries’ needs. Borrowing limits were doubled with more funds available up front, and conditions were streamlined and simplified. The new framework also enables broader high-access borrowing on a precautionary basis\(^{85}\).

2. Flexible Credit Line (FCL)

The Flexible Credit Line is for countries with very strong fundamentals, policies, and track records of policy implementation\(^{86}\). It represents a significant shift in how the IMF delivers Fund financial assistance, particularly with recent enhancements, as it has no ongoing (ex post) conditions and no caps on the size of the credit line. The FCL is a renewable credit line, which at the country’s discretion could be for either 1-2 years, with a review of eligibility after the first year. There is the flexibility to either treat the credit line as precautionary or draw on it at any time after the FCL is approved. Once a country qualifies (according to pre-set criteria), it can tap all resources available under the credit line at any time, as disbursements would not be phased and conditioned on particular policies as with traditional IMF-supported

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\(^{86}\) Discussion on LPG model here is based on Biplab Dasgupta, (2009), p.93-95.
programs. This is justified by the very strong track records of countries that qualify to the FCL, which give confidence that their economic policies will remain strong or that corrective measures will be taken in the face of shocks\(^87\).

3. Precautionary and Liquidity Line (PLL)

The Precautionary and Liquidity Line (PLL) builds on the strengths and broadens the scope of the Precautionary Credit Line (PCL). The PLL provides financing to meet actual or potential balance of payments needs of countries with sound policies, and is intended to serve as insurance and help resolve crises. It combines a qualification process (similar to that for the FCL) with focused ex-post conditionality aimed at addressing vulnerabilities identified during qualification. Its qualification requirements signal the strength of qualifying countries’ fundamentals and policies, thus contributing to consolidation of market confidence in the country’s policy plans. The PLL is designed to provide liquidity to countries with sound policies under broad circumstances, including countries affected by regional or global economic and financial stress\(^88\).

4. Rapid Financing Instrument (RFI)

The Rapid Financing Instrument (RFI) provides rapid and low-access financial assistance to member countries facing an urgent balance of payments need, without the need for a full-fledged programme. It can provide support to meet a broad range of urgent needs, including those arising from commodity price shocks, natural disasters, post-conflict situations and emergencies resulting from fragility\(^89\).

5. Extended Fund Facility

The Extended Fund Facility is used to help countries address balance of payments difficulties related partly to structural problems that may take longer to correct than macroeconomic imbalances. A programme supported by an extended arrangement usually includes measures to improve the way markets and institutions function, such as tax and financial sector reforms, privatization of public enterprises\(^90\).

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\(^87\) Ruchir Sharma, “Don’t do something, just stand there”, the economic times, (1998), P.10


6. Trade Integration Mechanism

The Trade Integration Mechanism allows the IMF to provide loans under one of its facilities to a developing country whose balance of payments is suffering because of multilateral trade liberalization, either because its export earnings decline when it loses preferential access to certain markets or because prices for food imports go up when agricultural subsidies are eliminated\(^91\).

4.28. Lending to low-income countries

To help strengthen its support for low-income countries, the IMF revamped its concessional lending facilities to make them more flexible and meet increasing demand for financial assistance from countries in need. These changes became effective in January 2010. In September 2012, the Fund adopted a strategy to support concessional lending of about SDR 1¼ billion ($2.0 billion) a year on average over the longer term. This strategy is expected to be financed, in part, by the use of resources linked to gold sales. These reforms created a new architecture of facilities that is more flexible and tailored to the increasing diversity of low-income countries and their needs. As part of the reform package, the Board also approved a new concessional financing framework, and constituted Poverty Reduction and Growth Trust (PRGT)\(^92\).

Three types of loans were created under the new Poverty Reduction and Growth Trust as part of this broader reform: the Extended Credit Facility, the Rapid Credit Facility and the Standby Credit Facility.

(i) Extended Credit Facility (ECF) provides financial assistance to countries with protracted balance of payments problems. The ECF succeeds the Poverty Reduction and Growth Facility (PRGF) as the Fund’s main tool for providing medium-term support LICs, with higher levels of access, more concessional financing terms, more flexible program design features, as well as streamlined and more focused conditionality.

(ii) Rapid Credit Facility (RCF) provides rapid financial assistance with limited conditionality to low-income countries (LICs) facing an urgent balance of

\(^{92}\) Bordo, Michael D. “The International Monetary Fund: Its Present Role in Historical Perspective”, (2000) p. 77
payments need. The RCF streamlines the Fund’s emergency assistance, provides significantly higher levels of concessionality, can be used flexibly in a wide range of circumstances, and places greater emphasis on the country’s poverty reduction and growth objectives.

(iii) Standby Credit Facility (SCF) provides financial assistance to low-income countries (LICs) with short-term balance of payments needs. It provides support under a wide range of circumstances, allows for high access, carries a low interest rate, can be used on a precautionary basis, and places emphasis on countries’ poverty reduction and growth objectives. In addition to concessional loans, some low-income countries are also eligible for debts to be written off under two key initiatives. The Heavily Indebted Poor Countries Initiative, introduced in 1996 and enhanced in 1999, whereby creditors provide debt relief, in a coordinated manner, with a view to restoring debt sustainability; the Multilateral Debt Relief Initiative (MDRI) under which the IMF, the International Development Association (IDA) of the World Bank, and the African Development Fund (AfDF) cancel 100 percent of their debt claims on certain countries to help them advance toward the Millennium Development Goals.

4.29. Policy Support

Several low-income countries have made significant progress in recent years toward economic stability and no longer require IMF financial assistance. But many of these countries still seek the IMF’s advice, and the monitoring and endorsement of their economic policies that comes with it. To help these countries, the IMF has created a programme for policy support and signalling, called the Policy Support Instrument.

The Policy Support Instrument offers low-income countries that do not want or need Fund financial assistance a flexible tool that enables them to secure Fund advice and support without a borrowing arrangement. This non-financial instrument is a valuable complement to the IMF’s lending facilities under the Poverty Reduction and Growth Trust. The PSI helps countries design effective economic programmes.

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that deliver clear signals to donors, multilateral development banks, and markets of the Fund’s endorsement of the strength of a member's policies. The PSI is designed to promote a close policy dialogue between the IMF and a member country, normally through semi-annual Fund assessments of a member's economic and financial policies. This support from the IMF also delivers clear signals to donors, creditors, and the general public on the strength of a country’s policies. The facility is available to all PRGT-eligible countries with no current or prospective balance of payments need, that have broadly achieved and maintained a stable and sustainable macroeconomic position, consistent with strong and durable poverty reduction and growth, and that have institutions of sufficient quality to support continued good performance.

A PSI will be approved for one to four years, and may be extended up to a maximum period of five years. Successive PSIs may be requested as long as the country continues to qualify. The PSI cannot be used concurrently with the Extended Credit Facility (ECF). In contrast, the PSI can be used in conjunction with the Rapid Credit Facility (RCF) or Standby Credit Facility (SCF), if short-term financing needs arise, or with a precautionary SCF in periods of increased uncertainty or risk.

The PSI is designed to support country officials in achieving the objectives of their poverty reduction strategy. Countries have the flexibility to specify policy objectives and design reform strategies that are tailored to their own economic conditions. In general, policies aim to consolidate macroeconomic stability and push ahead with structural measures to boost growth and jobs. These included measures to improve public sector management, strengthen the financial sector, or build up social safety nets.

4.30. Gold in IMF

Gold played a central role in the international monetary system until the collapse of the Bretton Woods system of fixed exchange rates in 1973. Since then, the

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98 Supra note 65, p.65.
role of gold has been gradually reduced. But it is still an important asset in the reserve holdings of a number of countries, and the IMF remains one of the world’s largest official holders of gold. Consistent with the new income model for the Fund agreed in April 2008, strictly limited gold sales of 403.3 metric tonnes were used to establish an endowment. Resources linked to these gold sales have also been used to boost the IMF’s concessional lending capacity to eligible low-income countries (LICs).

The IMF held 90.5 million ounces (2,814.1 metric tonnes) of gold at designated depositories at mid-September 2013. The IMF’s total gold holdings are valued on its balance sheet at SDR 3.2 billion (about $4.8 billion) on the basis of historical cost. As of September 17, 2013, the IMF’s holdings amounted to $118.7 billion at current market prices.99

The IMF acquired its current gold holdings prior to the Second Amendment through four main types of transactions.

1. First, when the IMF was founded in 1944 it was decided that 25 percent of initial quota subscriptions and subsequent quota increases were to be paid in gold. This represents the largest source of the IMF’s gold.

2. Second, all payment charges (interest on member countries' use of IMF credit) were normally made in gold.

3. Third, a member wishing to acquire the currency of another member could do so by selling gold to the IMF. The major use of this provision was sales of gold to the IMF by South Africa in 1970–71.

4. Finally, member countries could use gold to repay the IMF for credit previously extended.

4.31. IMF’s legal framework for gold

The Second Amendment to the Articles of Agreement in April 1978 fundamentally changed the role of gold in the international monetary system by eliminating its use as the common denominator of the post-World War II exchange rate system and as the basis of the value of the Special Drawing Right. It also abolished the official price of gold and ended its obligatory use in transactions

between the IMF and its member countries. It furthermore required the IMF, when dealing in gold, to avoid managing the price of gold, or establishing a fixed price\textsuperscript{100}.

Following the Second Amendment, the Articles of Agreement limit the use of gold in the IMF’s operations and transactions. The IMF may sell gold outright on the basis of prevailing market prices, and may accept gold in the discharge of a member country's obligations (loan repayment) at an agreed price, based on market prices at the time of acceptance. Such transactions require Executive Board approval by an 85 percent majority of the total voting power. The IMF does not have the authority under its Articles to engage in any other gold transactions such as loans, leases, swaps, or use of gold as collateral nor does it have the authority to buy gold\textsuperscript{101}.

The Articles also provide for the restitution of the gold the Fund held on the date of the Second Amendment (April 1978) to those countries that were members of the Fund as of August 31, 1975. Restitution would involve the sale of gold to this group of members at the former official price of SDR 35 per ounce, with such sales made to those members who agree to buy it in proportion to their quotas on the date of the Second Amendment. A decision to restitute gold requires support from an 85 percent majority of the total voting power. The Articles do not provide for the restitution of gold acquired by the IMF after the date of the Second Amendment.

4.32. How and when the IMF has used gold in the past

Outflows of IMF gold occurred under the original Articles of Agreement through sales of gold for currency, and via payments of remuneration and interest. Since the Second Amendment of the Articles of Agreement, outflows of gold can only occur through outright sales. Key gold transactions included:

- **Sales for replenishment (1957–70).** The IMF sold gold on several occasions to replenish its holdings of currencies.
- **South African gold (1970–71).** The IMF sold gold to member countries in amounts roughly corresponding to those purchased from South Africa during this period.

\textsuperscript{101} Kahler, Miles. Leadership Selection in the Major Multinationals, (2001), p.87.
• **Investment in U.S. government securities (1956–72).** In order to generate income to offset operational deficits, some IMF gold was sold to the United States and the proceeds invested in U.S. government securities. Subsequently, a significant buildup of IMF reserves prompted the IMF to reacquire this gold from the U.S. government.

• **Auctions and "restitution" sales (1976–80).** The IMF sold approximately one-third (50 million ounces) of its then-existing gold holdings following an agreement by its member countries to reduce the role of gold in the international monetary system. Half of this amount was sold in restitution to member countries at the then-official price of SDR 35 per ounce; the other half was auctioned to the market to finance the Trust Fund, which supported concessional lending by the IMF to low-income countries.

• **Off-market transactions in gold (1999–2000).** In December 1999, the Executive Board authorized off-market transactions in gold of up to 14 million ounces to help finance the IMF’s participation in the Heavily Indebted Poor Countries Initiative. Between December 1999 and April 2000, separate but closely linked transactions involving a total of 12.9 million ounces of gold were carried out between the IMF and two members (Brazil and Mexico) that had financial obligations falling due to the IMF. In the first step, the IMF sold gold to the member at the prevailing market price and the profits were placed in a special account invested for the benefit of the HIPC Initiative. In the second step, the IMF immediately accepted back, at the same market price, the same amount of gold from the member in settlement of that member’s financial obligations. In the end, these transactions left the balance of the IMF’s holdings of physical gold unchanged\(^\text{102}\).

4.33. **Regulated gold sale**

On September 18, 2009, the Executive Board approved the sale of 403.3 metric tons of gold (12.97 million ounces), which amounted to one-eighth of the Fund’s total holdings of gold at that time. The gold authorized for sale was acquired after the Second Amendment of the IMF’s Articles of Agreement in April 1978 and thus not subject to restitution to IMF member countries, unlike gold the IMF acquired

before 1978. The modalities for the gold sales were consistent with the priority of
avoiding disruptions to the gold market.\textsuperscript{103}

This decision to sell gold was a key step in implementing the new income
model agreed in April 2008 to help put the IMF’s finances on a sound long-term
footing. A central component of the new income model was the establishment of an
endowment funded by the profits from the sale of a strictly limited portion of the
IMF’s gold, which the Fund had acquired after the Second Amendment of the
Articles.

In August 2009, the European Central Bank and other central banks
announced the renewal of their agreement (Central Bank Gold Agreement) on gold
sales, which are not to exceed 400 metric tonnes annually and 2,000 metric tonnes
over the five years starting on September 27, 2009. The announcement noted that
sales of 403 tonnes of gold by the IMF could be accommodated within these ceilings.
This ensured that gold sales by the Fund would not add to the announced volume of
sales from official sources.

The first phase in the Fund’s gold sales was exclusively off-market sales to
interested central banks and other official holders, which were conducted at market
prices at the time of the transactions. In October and November 2009, the Fund sold
212 metric tonnes of gold in separate off-market transactions to three central banks:
200 metric tonnes were sold to the Reserve Bank of India during October 19-30; 2
metric tonnes to the Bank of Mauritius and 10 metric tonnes to the Central Bank of
Sri Lanka in November.\textsuperscript{104}

In February 2010, the IMF announced the beginning of sales of gold on the
market. At that time, a total of 191.3 tons of gold remained to be sold. In order to
avoid disrupting the gold market, the on market sales were to be conducted in a
phased manner over time. This followed the approach adopted successfully by the
central banks participating in the Central Bank Gold Agreement. The start of on
market sales did not preclude further off-market gold sales directly to interested
central banks or other official holders. In September 2010, the Fund sold 10 metric

tonnes to the Bangladesh Bank, reducing the amount of gold to be placed on the market\textsuperscript{105}.

In December 2010 the IMF concluded the gold sales program with total sales of 403.3 metric tonnes of gold (12.97 million ounces), as authorized by the Executive Board\textsuperscript{106}. Total proceeds amounted to SDR 9.5 billion (about $14.4 billion), of which SDR 4.4 billion was used to establish an endowment as envisaged under the new income model\textsuperscript{107}.

In February 2012, the Executive Board approved a distribution of SDR 700 million in reserves from windfall gold sales profits (realized because of a higher gold price than the assumed price when the new income model was endorsed by the Executive Board), subject to assurances that at least 90 percent of the amount would be made available for the Poverty Reduction and Growth Trust (PRGT). This distribution, which became effective in October 2012, was part of a financing package endorsed by the Executive Board in July 2009 aimed at boosting the IMF’s lending capacity in 2009–14. In September 2012, the Executive Board approved the distribution of SDR 1.75 billion in reserves from the remaining windfall gold sales profit as part of a strategy to generate subsidy resources to ensure the longer-term sustainability of the PRGT. As with the earlier distribution, this will become effective once satisfactory assurances have been obtained that at least 90 percent of the amount to be distributed will be made available to boost the PRGT\textsuperscript{108}.

\textbf{4.34. Special Drawing Right}

The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. The SDR is neither a currency, nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members. Holders of SDRs can obtain these currencies in exchange for their SDRs in two ways: first, through the arrangement of voluntary exchanges between members; and second, by the IMF designating members with strong external positions to purchase SDRs from members with weak external

\begin{itemize}
\item \textsuperscript{105} Supra notes 76, p.433.
\item \textsuperscript{107} Laura, “Measuring Vulnerability: Capital Flows Volatility in the quota Formula”, (2005), P.33.
\item \textsuperscript{108} World Bank Annual Report, (1983), p. 121.
\end{itemize}
positions. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations\textsuperscript{109}. In addition to its role as a supplementary reserve asset, the SDR serves as the unit of account of the IMF and some other international organizations\textsuperscript{110}.

**4.35. SDR’s value**

The value of the SDR is based on a basket of key international currencies the euro, Japanese Yen, Pound Sterling, and U.S. Dollar. The basket composition is reviewed every five years by the Executive Board to ensure that it reflects the relative importance of currencies in the world’s trading and financial systems.

The SDR interest rate provides the basis for calculating the interest charged to members on regular (non concessional) IMF loans, the interest paid and charged to members on their SDR holdings, and the interest paid to members on a portion of their quota subscriptions. The SDR interest rate is determined weekly and is based on a weighted average of representative interest rates on short-term debt in the money markets of the SDR basket currencies\textsuperscript{111}.

**4.36. SDR allocations to IMF members**

Under its Articles of Agreement, the IMF may allocate SDRs to members in proportion to their IMF quotas, providing each member with a costless asset. However, if a member’s SDR holdings rise above its allocation, it earns interest on the excess; conversely, if it holds fewer SDRs than allocated, it pays interest on the shortfall. There are two kinds of allocations:

(i) **General allocations of SDRs.** General allocations have to be based on a long-term global need to supplement existing reserve assets. Decisions to allocate SDRs have been made three times: in 1970-72, for SDR 9.3 billion; in 1979–81, for SDR 12.1 billion; and in August 2009, for an amount of SDR 161.2 billion.

(ii) **Special allocations of SDRs.** A special one-time allocation of SDRs through the Fourth Amendment of the Articles of Agreement was implemented in September

2009. The purpose of this special allocation was to enable all members of the IMF to participate in the SDR system on an equitable basis and correct for the fact that countries that joined the Fund after 1981 more than one-fifth of the current IMF membership had never received an SDR allocation.

With the general SDR allocation of August 2009 and the special allocation of September 2009, the amount of SDRs increased from SDR 21.4 billion to SDR 204.1 billion (currently equivalent to about $317 billion).

4.37. Salient features of SDRs

The creation of SDR is essentially similar to the concept of credit creation which central banks undertake in their countries to supplement the resources of the banking system to meet the monetary requirements, that is, the liquidity need of the country. The SDRs scheme is an extension of the same principle.

The SDRs have been created under a Special Drawing Account (SDA) with the IMF. The resources of the new account, SDA, are created by an agreement amongst members as to the percentage of the existing resources (quotas) with the IMF to be formed into SDRs. With the introduction of the SDRs scheme, thus, the accounts of the IMF are divided into: (i) the General Account and (ii) the Special Drawing Account. The General Account deals with the ordinary transactions of the IMF relating to subscriptions, towards quotas, drawing purchases, payment of charges etc, the SDA conducts the SDR transactions. The value of the SDRs is fixed in gold. As per the existing scheme, the unit value of the SDRs is expressed in terms of gold equal to 0.888671 gram of fine gold for one U.S. dollar prior to August 1971. With effect from February 13, 1973, the SDR is equivalent to $1.2. The value of SDR being fixed, it has to be maintained by the member participants.

The arrangement, thus envisages a pure fiduciary reserve creation. It provides for regularly creating SDRs in the IMF which the member countries would accept as reserves and use for the settlement of international payments. The SDRs have been thus aptly described as “Paper Gold”. These paper gold reserves are expected to fill the gap of deficiency in international liquidity from a mere rise of 2.5 per cent in

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112 Supra note 87, p. 76.
world monetary reserve against the expansion in international trade at 8 per cent per annum. The SDRs themselves are not international money, but are just like coupons which can be exchanged for currencies required by the holder of SDRs for making international payments. The SDRs allocated to the Fund members are transferable assets under the designation issued by the IMF, subject to certain limits of holding. Thus, it is obligatory on the part of the participating countries to accept drawing rights from Fund members in exchange for the equal amount of convertible currency. This obligation, however, cannot exceed twice a country’s allocation\textsuperscript{114}. The use of SDRs would obviously imply a reduction in the reserves of the using country, while the other participating countries which are receiving drawing rights in international settlements would accumulate their SDR holdings.\textsuperscript{115}

4.38. Critical appraisal of SDRs scheme

The SDR scheme has been welcomed by many for the following merits.

1. The SDRs are a form of reserve assets which are suitable for incorporation into a country’s reserves. These are also a form of international credit creation on the analogy of domestic credit creation by the monetary authority. Moreover, the scheme envisages a pure fiduciary reserve creation, and, therefore, is quite flexible.

2. The scheme would permit the Fund to increase unconditionally the amount of world liquidity as per requirements, i.e., without depending upon the tenuous supply of monetary gold or increasing the obligation of the reserve currency countries. Drawings against SDRs would be unconditional in the sense that no change would be required to be made in the domestic economic policies (to restore balance of payments equilibrium) by the country using SDRs.

3. Another merit of SDRs is that unlike the present Ordinary Drawing Right in the IMF which gives rise to only to a temporary increase in international liquidity, the SDRs are intended to make a permanent addition to it.

However, the SDRs scheme in the form proposed and accepted by the world’s apex monetary authority, is subjected to many justifiable criticisms. Some of them are:

\textsuperscript{114} South Commission, \textit{The Challenge to the South}, (1992), p.27
1. The scheme is purely fiduciary in nature. Thus, there is all probability of distrust in the new reserve assets.

2. The scheme does not seek to cure the basic problems of international monetary relations such as the international movements of short-term funds arising out of disturbance in the international monetary equilibrium and the currency-gold switches. The scheme is helpless in the prevention of SDR-gold switches.

3. It has been observed that though SDR is a useful and flexible reserve instrument of international liquidity it cannot be used to finance persistent payment deficits without leading to a pervasive and massive international inflation.

4.39. Lending Conditionality

When a member country approaches the IMF for financing, it may be in or near a state of economic crisis, with its currency under attack in foreign exchange markets and its international reserves depleted, economic activity stagnant or falling, and a large number of firms and households going bankrupt. In difficult economic times, the IMF helps countries to protect the most vulnerable in a crisis.\textsuperscript{116}

The IMF aims to ensure that conditions linked to IMF loan disbursements are focused and adequately tailored to the varying strengths of members' policies and fundamentals. To this end, the IMF discusses with the country the economic policies that may be expected to address the problems most effectively. The IMF and the government agree on a programme of policies aimed at achieving specific, quantified goals in support of the overall objectives of the authorities' economic programme. For example, the country may commit to fiscal or foreign exchange reserve targets.\textsuperscript{117}

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Loans are typically disbursed in a number of instalments over the life of the programme, with each instalment conditional on targets being met. Programmes

\textsuperscript{116} Dervis, Kemal, ceren Ozer, \textit{A Better Globalization: Legitimacy, Government and Reform}, (2005), p.44.

typically last up to 3 years, depending on the nature of the country’s problems, but can be followed by another programme if needed. The government outlines the details of its economic programme in a "letter of intent" to the Managing Director of the IMF. Such letters may be revised if circumstances change\textsuperscript{118}.

For countries in crisis, IMF loans usually provide only a small portion of the resources needed to finance their balance of payments. But IMF loans also signal that a country's economic policies are on the right track, which reassures investors and the official community, helping countries find additional financing from other sources\textsuperscript{119}.

When a country borrows from the IMF, its government agrees to adjust its economic policies to overcome the problems that led it to seek financial aid from the international community. These loan conditions also serve to ensure that the country will be able to repay the Fund so that the resources can be made available to other members in need. In recent years, the IMF has streamlined conditionality in order to promote national ownership of strong and effective policies.

4.40. Designing effective programmes

Conditionality in its broad sense covers both the design of IMF-supported programmes, that is, the macroeconomic and structural policies and the specific tools used to monitor progress toward the goals outlined by the country in cooperation with the IMF. Conditionality helps countries solve balance of payments problems without resorting to measures that are harmful to national or international prosperity. At the same time, the measures are meant to safeguard IMF resources by ensuring that the country’s balance of payments will be strong enough to permit it to repay the loan. All conditionality under an IMF-supported programme must be “macro-critical, “that is, either critical to the achievement of macroeconomic programme goals or necessary for the implementation of specific provisions under the IMF’s Articles of Agreement\textsuperscript{120}.

The member country has primary responsibility for selecting, designing, and implementing the policies that will make the IMF-supported program successful. The program is described in a letter of intent which often has a memorandum of economic

\textsuperscript{119} De Gregorio, Jose, “An Independent and Accountable IMF, (1999), p.343
\textsuperscript{120} UNDP, Human Development Report, (1992), p. 75.
and financial policies attached to it). The programme’s objectives and policies depend on country circumstances. But the overarching goal is always to restore or maintain balance of payments viability and macroeconomic stability, while setting the stage for sustained, high-quality growth and, in low-income countries, for reducing poverty\textsuperscript{121}.

4.41. Compliance assessment

Most IMF financing features disbursements made in instalments that are linked to demonstrable policy actions. This aims to ensure progress in programme implementation and to reduce risks to the IMF. Programme reviews provide a framework for the IMF’s Executive Board to assess periodically whether the IMF-supported programme is on track and whether modifications are necessary for achieving the programme’s objectives. Reviews combine a backward-looking assessment (were the programme conditions met according to the agreed timetable?) with a forward-looking perspective (does the programme need to be modified in light of new developments?). Disbursements under an IMF-supported programme can take place only upon its approval, or completion of reviews, by the IMF Executive Board.

Programme approval or reviews are based on various policy commitments agreed with the country authorities. These can take different forms:

1. **Prior actions** are measures that a country agrees to take before the IMF’s Executive Board approves financing or completes a review. They ensure that the programme has the necessary foundation to succeed, or is put back on track following deviations from agreed policies. Examples include the elimination of price controls or formal approval of a budget consistent with the program’s fiscal framework.

2. **Quantitative performance criteria (QPCs)** are specific and measurable conditions that have to be met to complete a review. QPCs always relate to macroeconomic variables under the control of the authorities, such as monetary and credit aggregates, international reserves, fiscal balances, and external borrowing. For example, a programme might include a minimum level of net international reserves, a maximum level of central bank net domestic assets, or a maximum level of government borrowing.

\textsuperscript{121} Supra note 87, p.98.
3. **Indicative targets** are used to supplement QPCs for assessing progress. Sometimes they are also set when QPCs cannot because of data uncertainty about economic trends (e.g. for the later months of a programme). As uncertainty is reduced, these targets are normally turned into QPCs, with appropriate modifications.

4. **Structural benchmarks** are (often non-quantifiable) reform measures that are critical to achieve programme goals and are intended as markers to assess programme implementation during a review. They vary across programmes: examples are measures to improve financial sector operations, build up social safety nets, or strengthen public financial management. If a QPC is not met, the Executive Board may approve a formal waiver to enable a review to be completed, if it is satisfied that the programme will nonetheless be successfully implemented, either because the deviation was minor or temporary, or because the country authorities have taken or will take corrective actions. Structural benchmarks and indicative targets do not require waivers if they are not met but are assessed in the context of overall program performance. The IMF’s data base for Monitoring of Fund Arrangements (MONA), which is publicly available, covers all aspects of program conditionality.

4.42. **Evolving framework**

The IMF lending has always involved policy conditions. Until the early 1980s, IMF conditionality largely focused on macroeconomic policies. Subsequently, the complexity and scope of structural conditions increased, reflecting the IMF’s growing involvement in low-income and transition countries, where severe structural problems hampered economic stability and growth.

In recent years, the IMF has become more flexible in the way it engages with countries on issues related to structural reform of their economies. The guidelines on conditionality were revised in 2002 following an extensive review. In March 2009, the IMF further modernized its conditionality framework in the context of a comprehensive reform to strengthen its capacity to prevent and resolve crises. The revised operational guidance to staff stipulates that structural conditions should be

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focused and tailored to member countries’ different policies and economic starting points. Moreover, structural performance criteria requiring formal waivers were abolished, and structural reforms are covered by reviews of overall programme performance\textsuperscript{124}.

As part of the wide-ranging reforms of the IMF’s lending toolkit in 2009, a number of new facilities were introduced that rely heavily on ex-ante conditionality. This includes the Flexible Credit Line (FCL), which does not rely on traditional programme conditionality but on rigorous pre-qualification criteria (also referred to as “ex-ante” conditionality). In situations where a full-fledged economic programme is either not necessary or not feasible, the Fund can provide financial support to meet urgent balance of payments needs under the Rapid Financing Instrument (RFI) and Rapid Credit Facility (RCF). The Precautionary and Liquidity Line (PLL), introduced in 2011, combines elements of both ex-ante and ex-post conditionality\textsuperscript{125}.

On September 5, 2012, the IMF Executive Board discussed staff papers reviewing the guidelines on conditionality, as well as the design and effects of IMF-supported programs during the period 2002-September 2011 (with an emphasis on the recent years). The review highlights the Fund’s efforts to draw lessons from previous crises and provide better targeted and flexible lending. It finds that conditionality in programs is generally better tailored to individual country needs, more streamlined, and focused on core areas of Fund expertise. Programs have also adapted flexibly to changing economic circumstances, which has helped to achieve program objectives, and, at the same time, to safeguard social protection during crises (particularly in low-income countries)\textsuperscript{126}.

While the review found that the IMF’s conditionality guidelines were broadly appropriate, it highlights areas where further strengthening in implementation of underlying policies might be required, including as challenges remained especially in some recent high-debt crisis programs. These areas include: (i) keeping conditionality focused; (ii) enhancing risk diagnostics underpinning program design; (iii) considering macro-social issues in IMF-supported programs; (iv) enhancing program ownership and transparency; (v) leveraging economic surveillance to

\textsuperscript{126}Henning C. Randall. The Exchange Stabilization Fund, (1999), p.34.
increase contingency planning; and (vi) improving partnerships with other institutions.\textsuperscript{127}

4.43. Guidelines on conditionality

Conditions on the use of Fund resources are governed by the Fund’s Articles of Agreement and implementing decisions of the Executive Board. Conditionality, that is, program-related conditions intended to ensure that Fund resources are provided to members to assist them in resolving their balance of payments problems in a manner that is consistent with the Fund’s Articles and that establishes adequate safeguards for the temporary use of the Fund’s resources.

Conditionality is one element in a broad strategy for helping members strengthen their economic and financial policies. Through formal and informal consultations, multilateral surveillance including the World Economic Outlook and discussions of capital market developments, advice to members on the voluntary adoption of appropriate standards and codes, and the provision of technical assistance, the Fund encourages members to adopt sound economic and financial policies as a precaution against the emergence of balance of payments difficulties, or to take corrective measures at an early stage of the development of difficulties.\textsuperscript{128}

National ownership of sound economic and financial policies and an adequate administrative capacity are crucial for successful implementation of Fund-supported programmes. In responding to members’ requests to use Fund resources and in setting programme-related conditions, the Fund will be guided by the principle that the member has primary responsibility for the selection, design, and implementation of its economic and financial policies. The Fund will encourage members to seek to broaden and deepen the base of support for sound policies in order to enhance the likelihood of successful implementation.\textsuperscript{129}

In helping members to devise economic and financial programmes, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of

\textsuperscript{127} GATT, Activities in 1979, p.25.
payments problems and their administrative capacity to implement reforms. Conditionality and programme design will also reflect the member’s circumstances and the provisions of the facility under which the Fund’s financing is being provided. The causes of balance of payments difficulties and the emphasis to be given to various program goals may differ among members, and the appropriate financing, the specification and sequencing of policy adjustments, and the time required to correct the problem will reflect those and other differences in circumstances. The member’s past performance in implementing economic and financial policies will be taken into account as one factor affecting conditionality, with due consideration to changes in circumstances that would indicate a break with past performance\textsuperscript{130}.

The Fund will ensure consistency in the application of policies relating to the use of its resources with a view to maintaining the uniform treatment of members. A member’s request to use Fund resources will be approved only if the Fund is satisfied that the member’s program is consistent with the Fund’s provisions and policies and that it will be carried out, and in particular that the member is sufficiently committed to implement the program. The Managing Director will be guided by these principles in making recommendations to the Executive Board with respect to the approval of the use of Fund resources by members\textsuperscript{131}.

Fund-supported programmes should be directed primarily toward the following macroeconomic goals:

1. Solving the member’s balance of payments problem without recourse to measures destructive of national or international prosperity; and

Programme-related conditions governing the provision of Fund resources will be applied parsimoniously and will be consistent with the following principles:

(a) Conditions will be established only on the basis of those variables or measures that are reasonably within the member’s direct or indirect control and that are, generally, either (i) of critical importance for achieving the goals of the member’s

\textsuperscript{131} Dos Reis, Laura, “\textit{Measuring Vulnerability: Capital Flows Volatility in the Quota Formula},” (2005), p.34.
program or for monitoring the implementation of the program, or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. In general, all variables or measures that meet these criteria will be established as conditions.

(b) Conditions will normally consist of macroeconomic variables and structural measures that are within the Fund’s core areas of responsibility. Variables and measures that are outside the Fund’s core areas of responsibility may also be established as conditions but may require more detailed explanation of their critical importance. The Fund’s core areas of responsibility in this context comprise: macroeconomic stabilization; monetary, fiscal, and exchange rate policies, including the underlying institutional arrangements and closely related structural measures; and financial system issues related to the functioning of both domestic and international financial markets.

(c) Programme-related conditions may contemplate the member meeting particular targets or objectives (outcomes-based conditionality), or taking (or refraining from taking) particular actions (actions-based conditionality). The formulation of individual conditions will be based, in particular, upon the circumstances of the member.

The Fund is fully responsible for the establishment and monitoring of all conditions attached to the use of its resources. There will be no cross-conditionality, under which the use of the Fund’s resources would be directly subjected to the rules or decisions of other organizations. When establishing and monitoring conditions based on variables and measures that are not within its core areas of responsibility, the Fund will, to the fullest extent possible, draw on the advice of other multilateral institutions, particularly the World Bank. The application of a “lead agency” framework, such as between the Fund and the Bank, will be implemented flexibly to take account of the circumstances of members and the overlapping interests of the two institutions with respect to some aspects of members’ policies. The Fund’s policy advice, program design, and conditionality will, insofar as possible, be consistent and integrated with those of other international institutions within a coherent country-led
framework. The roles of each institution, including any relevant conditionality, will be stated clearly in Fund-related programme documents.\footnote{Guidelines on Conditionality, prepared by Legal and Policy Development and Review Departments, International Monetary Fund, (2002), p.876.}

4.44. Concerns on conditionality

The second line of criticisms of the IMF is concerned with the nature and appropriateness (both theoretical and political) of IMF conditionality. There are a number of criticisms in relation to this issue.

First of all, it is argued that the IMF has failed to distinguish between exogenous and endogenous factors contributing to the balance of payments deficits.\footnote{Dell, S., 'Stabilization: The Political Economy of Overkill,' World Economy, (1982), p. 600.} Critics point out that many developing countries, particularly the poorest ones, are often faced with balance of payments deficits caused by external factors outside their governments’ control (such as natural disasters like floods and droughts, and low international prices of primary products) rather than by internal factors (such as economic mismanagement). They thus suggest that IMF conditionality should be less severe where the causes of balance of payments problems are beyond the government's control. In response to this critique, both the IMF and its defenders take the view that what is important in determining the need for adjustment policies is not the issue of their causes, but whether the balance of payments problem is transitory and self-reversing. If it is transitory, then adjustment is not necessary. However, if not, adjustment policies are required, regardless of the causes of the payments deficit; otherwise the problem will re-emerge.\footnote{Nowzad, B., The IMF and its Critics, Essays in International Finance, (1981), p.87.} Furthermore, they argue that exogenous factors are not totally absent from the IMF’s consideration. They refer to the special facilities made available by the IMF such Contingency Financing Facility, which take into account exogenous causes of balance of payments problems.

Secondly, IMF conditionality is claimed to be inflexible. The monetarist framework adopted by the IMF in its policy analysis is, according to the critics, rigid: one simplistic solution applies to all countries, regardless of different circumstances they have encountered. Thus, the IMF’s policy programmes are often seen by the critics as a 'standard package' for all countries in all circumstances. The assertion is
rebutted by the defenders who claim that it is incorrect to say that IMF policy programmes are rigid. They point out that in practice the similarity of IMF programmes arises partly because the balance of payments problems in the developing countries share common elements, such as large budget deficits, monetary expansion and the lack of exchange and price adjustment, and partly because the IMF tends to focus on a limited number of broad macroeconomic variables.

Thirdly, relating to the above argument, a question has persistently been raised over the appropriateness of the IMF’s approach to the problems being faced by the developing countries. The critics assert that the IMF focuses on short-term balance of payments problems, and ignores long-term economic development. Its programmes have an adverse impact on development of the developing countries, and thus, the IMF has been labelled as an anti-developmental institution. According to the critics, IMF conditionality is said to be 'harsh' and the IMF has little interest in the negative socio-economic costs of its adjustment programmes, in particular on the poor and on income inequalities, and in their political consequences. This argument is often used to explain why countries have tried to avoid seeking financial assistance from the IMF\(^\text{135}\).

However, the defenders of the IMF argue that the ability and policies of the IMF are constrained by such factors as available limited resources and the role laid down in its Articles of Agreement of providing short-term financing. Moreover, it is not the role of the IMF to act like a development agency. In fact, the issue of development problems in the developing countries is the responsibility of the World Bank, its twin Bretton Woods sister\(^\text{136}\). The defenders point out that the IMF does not, nevertheless, completely ignore such an issue. Its special facilities, operations and promotion of international trade growth are said to have benefits to the developing countries. Such facilities as the EFF, the SAF and the ESAF are often quoted as beneficial to the developing countries due to the longer time over which resources are provided, and the longer repayment period than under the traditional SBA. In response to the criticism of harshness of IMF measures, the defenders argue that often


countries approach the IMF at the very late stage of its economic difficulties. In such situations, tough measures are then necessary in dealing with the severe problems\textsuperscript{137}.

With regard to the issue of social predicaments, the IMF's view is that it is not the responsibility of the IMF, but rather the domestic government to introduce measures to relieve the adverse social effects arising from the implementation of the IMF's adjustment programmes\textsuperscript{138}. However, recently there has been a joint IMF-World Bank effort to alleviate such adverse effects in countries which adopt their programmes. Furthermore, in linking their criticism of IMF conditionality to its lending, critics add that the amount of IMF financial assistance is small and even insufficient for the balance of payments needs of borrowing countries, in comparison to harsh conditions that they have to endure. Also the critics argue that the proportion of low and high conditionality lending provided by the IMF is inappropriate. By placing an increasing emphasis on high conditionality lending since the early 1980s, the IMF in effect pushes the borrowing countries into high-conditionality drawings. More importantly, the critics further argue that IMF conditionality is ineffective in helping indebted poor countries to reduce their debts, but rather increases them. Poor developing countries end up repaying more than the amount they have received from the IMF. Thus, the critics claim that IMF facilities cause the perverse transfer of resources from the poor developing countries to the IMF and thus contribute to the drain on the developing countries' scarce financial resources\textsuperscript{139}.

While the scope of IMF conditionality has expanded to include structural adjustment policies, the number of its objectives has at the same time seemingly enlarged. By the mid-1980s, economic growth had gained importance in IMP conditionality along with the balance of payments correction. According to the 1986 Annual Report of the IMP, in a review of IMP conditionality, the Executive Directors emphasised the need for a growth-oriented approach aimed at enhancing economic efficiency and competitiveness and increasing supply responses\textsuperscript{140}.

\textsuperscript{137} GATT, \textit{The Role of GATT in Relation to the trade and Development}.


\textsuperscript{140} International Monetary Fund, \textit{Annual Report of the Executive Board for the Financial Year}, (1986), p.98.
Over the years IMF conditionality has expanded its scope and extent not only from macroeconomic variables to structural adjustment measures, but its objectives have also increased in number to include economic growth, poverty alleviation and good governance in addition to its traditional objective of balance of payments correction. However, the increasing involvement of IMF conditionality in social and political issues and the growing number of IMF conditions would in turn have implications for the relationship between the IMF and its borrowing member countries in practice.\footnote{Laobooncharoen, Nontaporn, \textit{IMF conditionality: imposition or ownership?}, (2004), p.89.}

4.45. IMF and International Liquidity

A major function of the IMF is to provide international liquidity in accordance with the purpose of the Fund specified in the Articles of Agreement. International Liquidity refers to the generally accepted means of international payments available for the settlement of the international transactions. Thus, international liquidity encompasses the international reserves and the facilities for international borrowing for financing the balance of payments deficit. International reserves are defined to include official holdings of gold, foreign exchange, SDRs and reserve position in IMF.

The problem of international liquidity is associated with the problem of international payments. These payments arise in connection with international trade in goods and services and also in connection with capital movements between one country and another. Broadly speaking, the problem has two aspects: quantitative and qualitative. The qualitative aspect of the problem relates to the adequacy of international liquidity. The qualitative aspect of the problem pertains to the nature and composition of international reserves for liquidity\footnote{Venkitaramanan, S, \textit{Is IMF Illiterate in Economics?} The Hindu Business Line, (2000), p.87.}.

Part of the liquidity supplied by the IMF takes the form of reserve assets that can be used for balance of payments financing (unconditional liquidity) while part takes the form of credit to members that is generally subject to conditions (conditional liquidity).

Conditional liquidity is provided by the IMF under its various lending schemes. Most of the Fund’s credit extended under these arrangements require an
adjustment programme for the member that is intended to promote a sustainable external position. In addition, it is often the case that when the member obtains fund financing under agreed conditions, its access to international capital markets is enhanced. This catalytic role of the fund has become more important in the recent period when private lending institutions have been less willing to engage in international lending\textsuperscript{143}.

Unconditional liquidity is supplied through the allocations of SDRs and also in the form of reserve positions in the fund which are the claims corresponding to the resources that countries have made available to the fund. Member countries holding SDRs and reserve positions in the fund can use them to finance balance of payments deficits without having to enter into policy commitments with the fund\textsuperscript{144}.

\textbf{4.46. International cooperation and social development}

The world economy has transformed rapidly over the past six decades. The last two decades in particular have seen big changes, including the rapid economic emergence of countries like China and India. These developments have contributed to a renewed focus on South-South co-operation and underline the importance of increased international economic cooperation. The aim of all cooperation initiatives is to ensure clean and responsible behaviour in business and government in the interests of a fairer society. The integrity of businesses, markets and governments is central to the vitality and stability of economies. As the financial crisis demonstrated, banks are more than just intermediaries between companies and investors. Banks have an impact on the real economy and they have responsibilities to their clients, including ordinary savers. Similarly, companies have obligations to their shareholders, to employees and to the societies within which they operate. Governments have an obligation to provide fair and open treatment to citizens, companies and financial institutions alike\textsuperscript{145}.

Negotiating new rules for international business and finance will be complex and lengthy. It will call for international cooperation and commitment on the part of government officials and politicians, but also other stakeholders, including business

\textsuperscript{143} Supra note 56, p.543.
\textsuperscript{144} United Nations Organization, Conference on Trade and Employment, (1948), p.33.
and civil society. Improved consumer protection vis-à-vis banks and financial institutions, for example, will bolster confidence in financial markets. Working with governments and civil society, the international monetary agencies attempt to forge a fairer society in which citizens feel safe to pursue projects without fear that the system will let them down\textsuperscript{146}.

4.47. Conclusion

In conclusion, international cooperation is much significant in promoting human rights and improving the world’s peaceful coexistence. In the financial system part, it helps much in those economically stable and developed nations to provide support to the developing nations. It leads to improved international policies which guides developed and developing nations as well. This is where nations can then take benefit of the significant progresses in science and technology and the internalization of markets and competitions. It also has to look into environmentally friendly and sustainable economic development.

National public will more and more resist making national forfeits in order to respect international financial obligations. In the mean time, concerted interests who support international cooperation, such as the international economic and corporate subdivisions, have been destabilized by international economic weakness\textsuperscript{147}.

Given these changing global fundamentals, what are the implications for international cooperation and the global architecture?

First and foremost, despite the changing shape of global influence and even because of it the need for economic cooperation and collaboration between countries is vital. Today, the intricate networks of trade, finance, people, and confidence channels that link us all have created a world where a country's economic circumstances and policies don't simply affect itself. It's not necessary to cite examples in support of this as the years since the onset of the global financial crisis have brought this starkly into conventional wisdom, if it wasn't there previously.

In such a world, international cooperation is essential. It's important that countries identify commonality of interests, taking action to mitigate negative


spillovers and recognising the potential benefits of collective action to provide global public goods\textsuperscript{148}. Comparing the inter-war period with the post-World War II era, the lesson is that global growth and stability requires this co-ordination, and it's truer now than ever.

However, while the importance of international cooperation remains unquestioned, the changing backdrop is presenting challenges to the global architecture\textsuperscript{149}. The global architecture was set up under a Trans-Atlantic hegemony. As the hegemonic status has changed, the system has become strained, and the inability to adjust is resulting in growing fragmentation. The very use of the word "architecture"—implying a relatively fixed, well-designed, and uniformly accepted set of global institutions and conventions is, arguably, increasingly misleading.

One factor challenging the architecture is the simple fact that global power is shifting and dispersing. As power spreads across multiple centres and hubs, new institutions naturally spring up to represent them.

Also, what we're seeing is that these centres are themselves more heterogeneous groupings than previously. Asia is a case in point. The Asia-Pacific region represents an area of more divergent interests, values, cultures and histories than, for example, Europe or North America. This diversity can naturally engender multiple forums to reflect it.

A second factor challenging the global architecture is the faltering progress being made to reform the traditional global institutions. The emergence of multiple centres with stronger and more divergent voices is both a cause of, and a response to, this faltering progress. Common endorsement can no longer be achieved simply through shared interests and values of a small number of countries. Emerging powers are increasingly unwilling to accept outcomes from processes in which they have not been meaningful participants, and they do not necessarily share the core values and interests of the traditional players. But this faltering progress is also partly due to


hesitancy from the larger players to commit to taking the lead to make global cooperation successful\textsuperscript{150}.

International cooperation has become more complex. Monetary policy cooperation has become a hot topic again, but the focus has shifted from the potential benefits of coordinated policy action to the negative consequences of unconventional monetary policies (in particular quantitative easing (QE) in the United States and Abenomics in Japan\textsuperscript{2}), which have led some countries to argue that these are initiating currency wars. And the resurgence of interest in macroprudential policies as stabilization tools raises further complexities (both between different domestic policy agencies and in terms of international cooperation). Importantly, however, the instruments and processes for the unprecedentedly close international policy cooperation are still in place. In particular, the G20 process remains. This involves regular meetings at the leaders’ level focused on economic policies, and the linked creation of the G20 Framework for Strong, Sustainable and Balanced Growth at the Pittsburgh summit in 2009 and the associated Mutual Assessment Process (MAP). This has been overlaid upon a post-crisis jump in regional policy integration in a number of policy areas, most notably within Europe. But as the crisis has receded, so has the impetus for cooperation. There is a risk that the common purpose forged in the heat of economic chaos will wilt in more normal times. It is therefore particularly important to assess what the last five years tell us about why countries cooperate, what they should cooperate on, and how they should cooperate.

There are a number of definitions of cooperation and coordination, though there is general agreement that cooperation is ‘softer’ and less binding than coordination. Both cooperation and coordination imply that countries are prepared to adapt their own policy settings to take account of negative spillovers to other countries – and hence imply the need for active dialogue. In addition to issues of cooperation across countries and jurisdictions, there are also big questions about cooperation between the various arms of economic policy (and the responsible institutions) within a country\textsuperscript{151}. This is particularly relevant given the increasing

practice of making central banks independent of the fiscal authorities, and the growing importance of macro-prudential policies (which can have important interactions with monetary policy). Many of the same considerations apply to both national and international cooperation, such as whether institutions’ mandates allow them to take wider considerations into account. One conclusion we draw is that narrow and domestically oriented mandates make it much more difficult to talk about policy coordination – which generally implies some more binding commitments that are more difficult under narrowly defined mandates – and more fruitful to use the term policy cooperation.

Academic work on international economic policy cooperation has a long history. The theoretical literature suggests that cooperation can have benefits for all parties involved, under certain circumstances. But most empirical studies (which have focused mainly on monetary policy) estimate that the gains from cooperation are relatively small, and the appropriate forms of cooperation (and the level of gains) depend importantly on the policy regime in place, such as the exchange rate regime.

One strand of the literature suggests that under fixed exchange rates cooperation is not necessary to deliver optimal outcomes, provided that countries do not follow ‘beggar thy neighbour’ policies and that surplus countries are prepared to share the burden of adjustment in external imbalances. But the experience of recent years – both with de facto fixed exchange rate regimes, and within monetary unions – suggests that if these conditions are not met, policies focused on domestic objectives alone can be distinctly sub-optimal from an international perspective.

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