

**FOR  
AGENDA**

SM/03/166

May 5, 2003

To: Members of the Executive Board

From: The Secretary

Subject: **Strengthening the Effectiveness of Article VIII, Section 5**

Attached for consideration by the Executive Directors is a paper on strengthening the effectiveness of Article VIII, Section 5, which will be brought to the agenda for discussion on a **date to be announced**. Issues for discussion appear on pages 32 and 33.

If the Board meeting produces broad support for the staff proposals, the staff envisages returning to the Board with proposed decisions. As the Board's consideration of this matter is expected to conclude at a later date, the staff does not propose the publication of this paper.

Questions may be referred to Mr. Fetherston (ext. 38761) and Mr. T. Lane (ext. 37668) in PDR, and Mr. Leckow (ext. 34799) and Ms. Mouysset (ext. 38210) in LEG.

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INTERNATIONAL MONETARY FUND

**Strengthening the Effectiveness of Article VIII, Section 5**

Prepared by the Policy Development and Review and Legal Departments  
In consultation with STA and other departments

Approved by Timothy Geithner and François Gianviti

May 2, 2003

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## EXECUTIVE SUMMARY

The Fund relies primarily on voluntary cooperation of members to ensure the provision of information needed for its activities. Such cooperation takes place in the context of a legal framework, of which Article VIII, Section 5 is a central pillar. Article VIII, Section 5 requires members to provide certain information to the Fund. Remedies and sanctions are available to the Fund in the relatively rare cases involving reporting problems that are not amenable to resolution through cooperative approaches. In the context of the Fund's broad effort to strengthen its framework for dealing with misreporting, the Executive Board asked the staff to develop proposals for strengthening the effectiveness of the Article. This paper responds to that request.

There are a number of issues that need to be addressed in strengthening the effectiveness of Article VIII, Section 5. First, key categories of fiscal and monetary information are not included in the list of information members are required to report to the Fund under Article VIII, Section 5, limiting the Fund's ability to respond to some recent cases in which the authorities were found to have provided inaccurate information. Second, it is important to review how the Fund applies Article VIII, Section 5, particularly in the context of use of Fund resources, to avoid a proliferation of nuisance cases. Third, the sanctions specified under Article XXVI for a breach of obligation are relatively severe, contributing to reticence in their application.

The principal proposals are as follows:

- The paper proposes expanding the coverage of Article VIII, Section 5 to bring it more closely into line with the Fund's data needs, notably to include key fiscal and financial information, based on the existing framework for data provision to the Fund. Specifically, it proposes including in the list of data members are required to report under Article VIII, Section 5 an additional list of information which is based on the core statistical indicators now routinely presented in all Article IV reports, with some additional detail and related information needed on a timely basis for effective surveillance.
- The paper also proposes to modify the application of Article VIII, Section 5 in the context of performance criteria established under Fund financial arrangements in the General Resources Account. The application of the Article will be limited to situations in which a purchase was made on the basis of the information provided by the member, or the information was reported to the Board in the context of a review which was subsequently completed or a decision of the Board to grant a waiver for the non-observance of a performance criterion. Moreover, Article VIII, Section 5 would only apply where a member reports that a performance criterion was met when in fact it was not, or where a member reports that a performance criterion was breached by a particular margin and it is subsequently discovered that the margin of non-observance was greater than originally reported.

- The paper proposes a new framework of procedures to be followed and remedies to be applied in cases in which a member is in breach of Article VIII, Section 5. The paper proposes greater reliance upon more flexible remedies, short of a declaration of ineligibility to use Fund resources, in case of a breach of obligation; these could include a statement of concern to the member followed by a declaration of censure.

The obligation to provide information under Article VIII, Section 5 is subject to the member's capacity to provide the information. The paper stresses that any finding of a breach of this obligation should follow only after an assessment of the consistency of any data revision with understandings reached between Fund staff and the member on the member's statistical practices and of the member's capacity to report the information. These assessments will continue to involve an element of judgment on the basis of accepted statistical practice and experience, with the member being given the benefit of any doubt.

It is proposed that, following the adoption of Executive Board decisions, the expanded list of information members would be required to report would come into effect only after a transition period of one or two years. The framework for remedial action, which applies also to the existing scope of Article VIII, Section 5, would become available for use immediately after approval by the Executive Board.

## I. INTRODUCTION

1. To discharge its mandate effectively, the Fund needs accurate, timely, and comprehensive information, which it obtains primarily through the voluntary cooperation of its members. While these cooperative arrangements have generally served the Fund well, there have been a number of cases in which problems in data reporting—misreporting, delayed reporting, and nonreporting of information—have nonetheless arisen.<sup>1 2</sup> Incomplete or inaccurate information can detract from the quality of the advice the Fund gives to a member and undermine the Fund's ability to respond to a developing crisis before it is too late. It is desirable that the Fund continue to rely mainly on cooperation and dialogue in preventing such problems and addressing them when they arise; but such episodes point to a need to strengthen the effectiveness of Article VIII, Section 5 in the few cases where cooperative approaches prove insufficient.

2. While misreporting associated with the use of Fund resources has, until recently, been the focus of the Fund's attention in this area,<sup>3</sup> there is now a growing awareness that the provision of inadequate information can significantly impede the Fund in the exercise of surveillance and especially in its role in crisis prevention. Directors have consequently recognized the need to strengthen the reporting of information under Article VIII, Section 5 of the Articles of Agreement (Box 2) in the context of all Fund activities subject to the Articles.<sup>4</sup>

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<sup>1</sup> In the remainder of the paper, the term "misreporting" includes the provision of inaccurate information and the failure or refusal of the authorities to provide complete information in a timely manner.

<sup>2</sup> The delays in reporting essential information in some countries (reserves and other data in Mexico during 1994 and Thailand and Korea in 1997) hampered the Fund's efforts to detect emerging vulnerabilities and prevent financial crises. In some countries, the nonprovision of critical information continues to be a problem (Box 1).

<sup>3</sup> The two sets of Misreporting Guidelines, applicable to the Fund's general resources and the PRGF, were revised in 2000. See: EBS/00/12, EBS/00/13, and BUFF/00/48; and EBS/00/121, including Supplements 1 and 2, and BUFF/00/129. The legal framework governing misreporting in the context of assistance delivered under the HIPC initiative was strengthened in March 2002. See: EBS/02/18; EBS/02/36, including Supplement 1, and BUFF 02/50 (March 28, 2002).

<sup>4</sup> See: *Summing Up by the Acting Chairman, Strengthening Safeguards on the Use of Fund Resources and Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations* (EBM/00/32, 3/23/00).

### Box 1. Recent Cases Involving Article VIII, Section 5

This Box reviews several cases involving information-reporting problems in recent years. These incidents underscore the desirability of expanding the coverage of the provisions of Article VIII, Section 5. They also point to the role of this Article as a complement to the misreporting guidelines in program contexts in which those guidelines were not applicable.

#### **Reporting of Inaccurate Information**

In Jordan (1996-98), misreporting of fiscal and national income data occurred in the context of Fund arrangements. The misreporting guidelines did not apply either because these variables were not specified as PCs or because of technical reasons. The misreporting of national income was viewed by management as a breach of obligation under the Articles, but the misreporting of fiscal data was not, as Article VIII, Section 5 does not require provision of fiscal information. Pakistan (1998-99) misreported information on its fiscal deficit; as the deficit was specified as a PC, both the misreporting guidelines and Article VIII, Section 5 applied.

Russia (1996-98) and Ukraine (1996-98) also involved application of Article VIII, Section 5 to variables reported as PCs. In both cases the Fund relied on this Article as the two year limitation period then in effect under the misreporting guidelines had expired. Russia breached its obligation under Article VIII, Section 5 in 1996 when it misreported information on its external reserves. Ukraine breached its obligation on several occasions during 1996-98 when it misstated reserves, NDA and credit to government.

It emerged in early 2000 that Egypt's budget deficit for 1998/99 had been significantly underreported, and sizeable discrepancies between the debt and financing data for 1997/98 and earlier years also came to light. The 1998/99 episode did not constitute misreporting, as there was no Fund arrangement at that time and Article VIII, Section 5 does not apply to fiscal data. The discrepancies for earlier years are still being resolved; should this lead to upward revisions of the deficit, misreporting issues could arise (as the deficit was monitored as a PC under Fund arrangements then in effect). The misreporting guidelines would not apply (due to the statute of limitations), but Article VIII, Section 5 would.

Thailand (2000) was found on the basis of corrected information to have breached a PC on the non-accumulation of new external debt by a small amount. This error was not covered under the Misreporting Guidelines as no purchase had been effected, but it did constitute a breach of obligation under Article VIII, Section 5. As the noncompliance was small and the error had no impact on economic developments or performance under the program, Directors did not call for remedial action.

#### **Failure to Report Information**

The authorities of Turkmenistan drastically reduced the flow of basic macroeconomic data provided to the Fund for surveillance purposes in 2000-01. This affected both information specified under Article VIII, Section 5 and other core information required for effective surveillance. Staff brought these information-reporting problems to the attention of the Executive Board as a possible breach of Article VIII, Section 5 after the steps of the graduated approach to data provision had been followed. After the Board set a deadline for the provision of the missing information, the Turkmen authorities in June 2002 provided the outstanding information required under Article VIII, Section 5, and the staff informed the Board of this on June 17, 2002.

In Brunei Darussalam, the authorities have been reluctant to provide the Fund information on their IIP—a crucial input in assessments of the strength of the balance of payments and fiscal positions, and one of the variables explicitly mentioned in Article VIII, Section 5. The Fund, its management, and staff followed the steps envisioned in the graduated approach to data provision. As these data have not been provided to date, Directors repeatedly urged Brunei to improve its cooperation in providing key information required under the Articles of Agreement. Provision of IIP data was also an issue in the latest consultation discussions with Singapore, Qatar, Kuwait, and United Arab Emirates. However, Singapore now disseminates an IIP statement that is in conformity with the requirements of the SDDS. Information on the IIP of Kuwait and United Arab Emirates was provided by their Executive Directors during the respective Board discussions.



Box 2. Article VIII, Section 5. *Furnishing of information*

(a) The Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on the following matters:

- (i) official holdings at home and abroad of (1) gold, (2) foreign exchange;
- (ii) holdings at home and abroad by banking and financial agencies, other than official agencies, of (1) gold, (2) foreign exchange;
- (iii) production of gold;
- (iv) gold exports and imports according to countries of destination and origin;
- (v) total exports and imports of merchandise, in terms of local currency values, according to countries of destination and origin;
- (vi) international balance of payments, including (1) trade in goods and services, (2) gold transactions, (3) known capital transactions, and (4) other items;
- (vii) international investment position, i.e., investments within the territories of the member owned abroad and investments abroad owned by persons in its territories so far as it is possible to furnish this information;
- (viii) national income;
- (ix) price indices, i.e., indices of commodity prices in wholesale and retail markets and of export and import prices;
- (x) buying and selling rates for foreign currencies;
- (xi) exchange controls, i.e., a comprehensive statement of exchange controls in effect at the time of assuming membership in the Fund and details of subsequent changes as they occur; and
- (xii) where official clearing arrangements exist, details of amounts awaiting clearance in respect of commercial and financial transactions, and of the length of time during which such arrears have been outstanding.

(b) In requesting information the Fund shall take into consideration the varying ability of members to furnish the data requested. Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed. Members undertake, however, to furnish the desired information in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimates.

(c) The Fund may arrange to obtain further information by agreement with members. It shall act as a center for the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies designed to assist members in developing policies which further the purposes of the Fund.

3. Article VIII, Section 5 applies to the provision of information in connection with all of the Fund's activities under the Articles, including Fund financial assistance in the General Resources Account (GRA) and Fund surveillance.<sup>5</sup> This Article empowers the Fund to require members to "furnish it with such information as it deems necessary for its activities." In addition, it specifies a list of data that members are required to report to the Fund as "the minimum necessary for the effective discharge of the Fund's duties." Failure by a member to provide the information required under Article VIII, Section 5 may result in the Fund finding the member in breach of obligation and in the application of the sanctions specified in Article XXVI (as described in Section IV below).

4. While Article VIII, Section 5 is already being applied by the Fund (including in cases where certain required information has not been provided—see Box 1) there are a number of ways in which its effectiveness could be enhanced. The coverage of the data that members are specifically required to report to the Fund in the list set out in Article VIII, Section 5, is, from a contemporary perspective, incomplete. In particular, it includes only part of the core information set that the Board has indicated is the absolute minimum needed for effective surveillance.<sup>6</sup> Key fiscal and monetary information (such as the budget deficit, monetary aggregates, and interest rates) are not included in the list. The significance of this omission was highlighted by some recent cases in which the authorities provided the Fund incorrect information on these issues without breaching their obligation under Article VIII, Section 5, due to the limited scope of that list of information.<sup>7</sup>

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<sup>5</sup> Article VIII, Section 5 does not apply to the provision of information that is required for the purposes of Fund financial assistance under the PRGF or the HIPC Initiative. See *Misreporting of Information in the context of Fund Surveillance and Fund Financial Assistance- Present Legal Framework* (EBS/00/13, 2/2/00), page 18: "The provision of information under a PRGF arrangement does not fall within the scope of Article VIII, Section 5. PRGF resources are held in an administered account and the obligations of a member using such resources are not governed by the Fund's Articles (Article V, Section 2 (b)). The obligations of a member using PRGF resources are governed exclusively by the terms of the PRGF Trust Instrument, which are incorporated by an explicit reference into the terms of each PRGF arrangement. Accordingly, the Fund, under a PRGF arrangement, cannot require a member to provide the Fund with information for the purposes of Article VIII, Section 5, and the failure of a member to provide information for the purposes of a PRGF arrangement cannot give rise to the application of sanctions under Article XXVI, Section 2, as it is not a breach of obligation under the Articles of Agreement."

<sup>6</sup>See *Summing Up by the Chairman—Strengthening Fund Surveillance—Provision of Statistical Data by Members* (EBM/95/32, 4/3/95).

<sup>7</sup> As discussed in Box 1, this was the case in Jordan (1996-98).

5. The paper also proposes modifications in the use of Article VIII, Section 5 in the context of performance criteria established under Fund arrangements in the GRA with a view to avoiding nuisance cases. Currently, a member may be found in breach of obligation in situations where it provides revised information but that information does not affect the assessment that a performance criterion was observed or where the program was off track for other reasons. It is proposed to limit the application of the Article to situations in which a purchase was made on the basis of the information provided by the member, or the information was reported to the Board in the context of a review which was subsequently completed or a decision of the Board to grant a waiver for the non-observance of a performance criterion. Moreover, Article VIII, Section 5 would only apply where a member reports that a performance criterion was met when in fact it was not, or where a member reports that a performance criterion was breached by a particular margin and it is subsequently discovered that the margin of non-observance was greater than originally reported.

6. The sanctions available to the Fund may, in some cases, be disproportionate to the gravity of a breach of obligation arising from misreporting (Box 3). The severity of the sanctions specified under Article XXVI has contributed to reticence in their application, since the Fund has, in practice, felt that that they would, in most cases, constitute an unduly harsh response. To deal with situations in which the sanctions of Article XXVI are deemed too draconian, it is desirable to rely upon remedies that are less severe.

7. This paper first reviews the basic features of members' obligations under Article VIII, Section 5 before examining the manner in which the effectiveness of those obligations could be enhanced. The paper then presents a framework for remedial action that could be applied to address cases in which members breach their obligations in the event that cooperative approaches are unsuccessful in rectifying the situation. It ends with an outline of issues for discussion.<sup>8</sup>

8. It should be noted that Article IV, Section 3 (b) of the Fund's Articles requires members to "provide the Fund with the information necessary" for surveillance. While this provision and Article VIII, Section 5 both establish obligations for members to provide the Fund with information for the purposes of surveillance, the Fund has not relied upon

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<sup>8</sup> While many of the proposals set out in the paper focus on the provision of information in the context of surveillance, the paper is not limited exclusively to the reporting of information in this context. Information that members provide in the context of surveillance may be used for other purposes—for example, in determining whether to extend financial assistance to a member. Specific proposals regarding the reporting of information under a Fund arrangement are set out in Section IIB. Moreover, the remedial framework proposed in Section B would apply to all cases of misreporting under Article VIII, Section 5, regardless of the context.

Box 3. Article XXVI, Section 2. *Compulsory withdrawal*

(a) If a member fails to fulfill any of its obligations under this Agreement, the Fund may declare the member ineligible to use the general resources of the Fund. Nothing in this Section shall be deemed to limit the provisions of Article V, Section 5 or Article VI, Section 1.

(b) If, after the expiration of a reasonable period following a declaration of ineligibility under (a) above, the member persists in its failure to fulfill any of its obligations under this Agreement, the Fund may, by a 70 percent majority of the total voting power, suspend the voting rights of the member. During the period of the suspension, the provisions of Schedule L shall apply. The Fund may, by a 70 percent majority of the total voting power, terminate the suspension at any time.

(c) If, after the expiration of a reasonable period following a decision of suspension under (b) above, the member persists in its failure to fulfill any of its obligations under this Agreement, that member may be required to withdraw from membership in the Fund by a decision of the Board of Governors carried by a majority of the Governors having 85 percent of the total voting power.

(d) Regulations shall be adopted to ensure that before action is taken against any member under (a), (b), or (c) above, the member shall be informed in reasonable time of the complaint against it and given an adequate opportunity for stating its case, both orally and in writing.

Article IV, Section 3 (b) for this purpose.<sup>9</sup> Rather, the Fund has obtained the information necessary for surveillance by relying upon the voluntary cooperation of members and the list of information that all members are required to provide under Article VIII, Section 5. It is not proposed that the Fund change existing practice with respect to Article IV, Section 3(b) and, accordingly, this paper does not discuss further members' obligations under this provision.

9. This paper does not contemplate any changes to the cooperative approach of graduated contacts by staff, management and the Executive Director concerned to deal with cases in which members are reluctant to provide information needed for effective surveillance.<sup>10, 11</sup> Moreover, it does not propose any changes in the area of the Fund's work on data dissemination, under which members' decisions to subscribe to the SDDS or

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<sup>9</sup> See EBS/00/13, page 9.

<sup>10</sup> See *Summing Up—Strengthening Fund Surveillance-Provision of Statistical Data by Members* (SUR/95/34, 6/7/1995).

<sup>11</sup> See: *Data Provision to the Fund for Surveillance Purposes* (SM/02/126, 4/26/02 and Correction 1, 7/11/02); and *Summing Up by the Acting Chair, Data Provision to the Fund for Surveillance Purposes* (SUR/02/054, 5/16/02).

participate in the GDDS will continue to be based on a voluntary approach, as reaffirmed by the Board on several occasions.

10. More generally, as noted above, it is envisaged that, within the legal framework of its Articles of Agreement, the Fund will continue to rely primarily on the cooperation of members—supported by technical assistance where needed to build up statistical capacity—to obtain the information it needs. The aim of strengthening the provision of information under Article VIII, Section 5 as discussed here is to provide the Fund with more effective tools to address those cases of misreporting that arise, while preserving the Fund’s cooperative strategy for data-reporting problems. The specific proposals presented in the paper will give the Fund greater flexibility in dealing with the relatively rare cases of breach of obligation under the Articles, while broadening the list of information to be provided to the Fund. The proposals are calibrated to avoid unnecessarily burdening the vast majority of the membership for whom the cooperative approach works well. Their main objective is to permit the Fund to exercise its functions more effectively by enhancing its ability to react to egregious cases of misreporting and by strengthening incentives for cooperation.

## **II. MEMBERS’ OBLIGATIONS UNDER ARTICLE VIII, SECTION 5**

11. This section (a) examines the framework of obligations under Article VIII, Section 5, and (b) discusses the manner in which the provision of information under Article VIII, Section 5 could be strengthened.

### **A. The Present Framework under Article VIII, Section 5**

12. Article VIII, Section 5 of the Fund’s Articles requires members to report to the Fund the information the Fund “deems necessary for its activities.” As noted above, this obligation is not limited to a particular activity of the Fund. Rather, it is general in nature and applies to all of the Fund’s activities under the Articles, including surveillance and the use of Fund resources.

### **Types of Information Required under Article VIII, Section 5**

13. Under Article VIII, Section 5, members are required to provide two different types of information: (i) information that is specifically listed in the provision; and (ii) other information that is required by the Fund.

14. Article VIII, Section 5 specifically lists certain categories of information that members are required to provide to the Fund “as the minimum necessary for the effective discharge of the Fund’s duties.” Members have an obligation to provide this information without the need for the Fund to request it. The Fund may not, without an amendment of the

Articles, eliminate any of the categories listed in Article VIII, Section 5 or exempt members from the provision of such data.<sup>12</sup>

15. Article VIII, Section 5 also permits the Fund to require members to provide it with other information that it “deems necessary” for its activities, including surveillance and Fund financial assistance. It is the Executive Board (rather than the staff or management) that may require members to provide information for this purpose. The information must be required in a decision of the Fund which may be general (i.e., applying to all members or a group of members) or country-specific in nature; any such decision may be changed by the Board at any time.<sup>13</sup> The decision may be related to a particular activity of the Fund, and this has been the case in the provision of financial assistance. Thus, a decision such as stand-by or extended arrangement which identifies conditions (e.g., performance criteria) for access to Fund resources requires the accuracy of any information reported by the member on such conditions. The Fund has never adopted a country-specific decision requiring the provision of particular information in the context of surveillance.<sup>14</sup>

### **Periodicity of Reporting under Article VIII, Section 5**

16. Timely provision of information is essential for the effective conduct of surveillance and other activities of the Fund. How frequently must members provide information under Article VIII, Section 5? Neither the Articles nor any Board decision have specified any periodicity for the reporting of the categories of information specified under Article VIII,

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<sup>12</sup> The Executive Board has no authority to eliminate categories or exempt members. This conclusion follows because the Articles of Agreement themselves identify each category of information listed in the provision as the “minimum necessary for the effective discharge of the Fund’s duties.”

<sup>13</sup> The Board could exempt a member from the obligation to provide information required under Article VIII, Section 5 (other than items specified in Article VIII, Section 5) if the requirement was set out in a country-specific decision but not in a decision of general applicability.

<sup>14</sup> In the context of surveillance, the Fund has generally not declared members to be in breach of Article VIII, Section 5 and has not pursued legal approaches to such cases. To date, Czechoslovakia is the only example where such a finding was made outside of the context of Fund financial assistance. Following the resolution of the Board of Governors of September 28, 1954, Czechoslovakia was required to withdraw from the Fund on December 31, 1954. In addition, facing a possible finding of breach of obligation and declaration of ineligibility to use Fund resources, Cuba withdrew from the Fund on April 2, 1964. See J. Keith Horsefield, *The International Monetary Fund 1945-1965, Volume I: Chronicle*. Washington, DC: International Monetary Fund, 1969, pp. 359-364 and pp. 548-550.

Section 5. Therefore, the obligation is continuous in nature. More specifically, members are under an obligation to compile the information on a regular basis in as up-to-date a form as possible, and to provide the Fund with such information whenever it becomes available (however, see the discussion of “capacity” below).

### **Limitations upon Members’ Obligations—Capacity**

17. The obligation to provide information under Article VIII, Section 5 is not absolute. The Fund is required to “take into consideration the varying ability of members to furnish the data requested” (Article VIII, Section 5 (b)). A member that fails to provide the Fund with accurate information will not be found in breach of its obligation under Article VIII, Section 5 if the Fund is satisfied that the member was unable to provide the information. In assessing a member’s capacity, the Fund examines a broad range of factors;<sup>15</sup> in this process, the member needs to demonstrate that it does not have the necessary capacity.<sup>16</sup> In addition to this general capacity-based limitation that applies to the provision of all information under Article VIII, Section 5, there is a second more specific capacity-based limitation in Article VIII, Section 5 that only applies to the production of information on the International Investment Position (IIP) (i.e., Article VIII, Section 5(a)(vii)); thus, Article VIII, Section 5 (a)(vii) requires members to provide information on the IIP “so far as it is possible to furnish this information.”

18. A member’s incapacity will not excuse it indefinitely from its obligation to provide particular information. Article VIII, Section 5(b) requires members to provide information “in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimates.” Thus, members are obligated to improve their statistical reporting systems over time and their capacity to provide information will generally be expected to gradually improve. Where capacity is an issue, steps taken to strengthen capacity would be taken into account in making a judgment as to whether a member is in breach of its obligation.

19. As a specific example of how capacity is to be assessed, it is useful to examine the obligation to provide IIP data. Particularly in light of capital account liberalization and the rapid growth of cross-border private capital flows, compilation of comprehensive IIP data is a challenging task: largely reflecting these technical difficulties, in April 2003 less than half the membership (83 countries) reported this information to the Fund for publication. Three

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<sup>15</sup> See: *Misreporting of Information in the Context of Fund Surveillance and Fund Financial Assistance—Present Legal Framework* (EBS/00/13, 2/2/00), page 7.

<sup>16</sup> The member will normally have greater difficulty demonstrating an incapacity to provide information that is needed to verify observance of a PC under a Fund arrangement. In proposing that particular variables be established as PCs, Fund staff normally seeks to ensure that the member has the ability to provide, in an accurate and timely manner, the information necessary to assess observance.

quarters of these countries reported what might be considered comprehensive data; the remainder provided only partial data.<sup>17</sup> At the same time, the increasing focus on crisis prevention and resolution and work on analysis of balance sheet positions suggests that IIP data (in particular, for the sovereign and monetary authorities) are becoming increasingly critical for the Fund's activities.<sup>18</sup> While it is recognized that compilation of comprehensive IIP data covering both the public and private sectors is technically challenging, the presumption that all countries have the capacity to report data that at least include the IIP of the sovereign and monetary authorities appears reasonable.<sup>19</sup>

## **B. Strengthening the Provision of Information Under Article VIII, Section 5**

20. There are two ways in which it is proposed that the framework for the provision of information under Article VIII, Section 5 be strengthened: (1) by expanding the range of information to be required of members; and (2) by clarifying the circumstances in which the discovery of inaccuracies in information supplied by a member would give rise to a breach of obligation under Article VIII, Section 5.

### **Expanding the range of information to be provided**

21. A principal weakness of Article VIII, Section 5 in its present form is that the information specifically listed in the provision reflects the economic priorities and concerns of 1944 which, in many ways, differ from those that are prevalent today. It thus includes some elements (such as gold production) that are now of limited relevance and excludes other items that are now very important. In particular, the list does not contemplate members providing the Fund with monetary information or information on their fiscal position. This has given rise to difficulties in several cases of misreporting involving fiscal information (Box 1).

22. The Fund could address this difficulty by expanding the list of information it deems necessary for its activities and that would be required of members under Article VIII, Section 5. The Executive Board could adopt decisions requiring all members to provide information additional to that specifically listed in Article VIII, Section 5. As noted, the Fund has, in the past, adopted decisions requiring members using Fund resources to ensure the accuracy of additional information reported for the purposes of Article VIII, Section 5—that is, for monitoring PCs under Fund arrangements. The approach presently under consideration

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<sup>17</sup> See *Development of International Investment Position Statistics* (SM/02/263, 8/15/02, and Supplement 1, 10/10/02).

<sup>18</sup> This is recognized by the status accorded to IIP data as a prescribed category in the SDDS.

<sup>19</sup> The obligation to report information under Article VIII, Section 5 is subject to the qualification that members are not under any obligation “to furnish information in such detail that the affairs of individuals or corporations are disclosed.”



for expanding the range of information required of members would differ, in particular, in that it would apply to all Fund members (i.e., not only those using Fund resources). Secondly, the information would be required of members principally for the purposes of surveillance.

23. The deletion from Article VIII, Section 5 of data items explicitly specified in the provision but no longer critical for the Fund's activities could only be done by an amendment of the Articles of Agreement. Staff does not propose seeking an amendment of the Articles for this purpose.

24. In expanding the list of information to be provided by members under Article VIII, Section 5, there are at least three different approaches which the Fund could take: (a) a "uniform" approach; (b) a "case-by-case" approach; and (c) a "hybrid" approach.

25. Under a *uniform approach*, the Board could adopt a single decision of general applicability identifying additional categories of information that all countries would be required to provide to the Fund; this approach would ensure uniformity of treatment but could prevent the Fund from taking into account the specific circumstances of individual members, except insofar as their capacity to provide information is taken into account in determining whether a breach of obligation has arisen.

26. Under a *case-by-case approach*, the Board could take a decision for each individual member, identifying the additional categories of information that the member would be required to provide the Fund; this approach would take into account the individual characteristics of each member but would make it more difficult to ensure uniformity of treatment. It could also prove unwieldy by requiring the Executive Board to adopt and review more than 180 country-specific decisions.

27. Incorporating elements of both previous options, a third or *hybrid approach* could entail the Board adopting (i) a general decision identifying certain categories of information to be provided by all members and (ii) as appropriate, individual country-specific decisions setting out additional information to be required. Under the hybrid approach, the Board would adopt a general decision applicable to all members but would adopt an individual decision for a member only if warranted by the specific circumstances of the member—for instance, in cases in which there was a history of reporting problems or for members facing a looming crisis. This approach would avoid placing an undue burden on the staff resources of the Fund and the membership while, at the same time, providing the Fund with the flexibility to legally require additional information when warranted.<sup>20</sup> This approach would appear to be the most workable option and is, therefore, recommended.

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<sup>20</sup> A more expansive variant of the hybrid approach would supplement a general Board decision with country-specific decisions for *all* the Fund's members. Such an approach would prove unnecessary and unworkable and is not recommended. Yet another approach

(continued)

28. Several questions would need to be addressed before this approach could be made operational. The Fund would have to specify the categories of information that would form part of the general list to be required of all members. While data needs will undoubtedly continue to evolve, a useful starting point for expanding the information to be required of members is the set of core statistical indicators that the Board has identified as the absolute minimum which all members should report to the Fund on a timely basis and which is now routinely presented in Article IV staff reports as a basis for tracking the timeliness, periodicity, and other aspects of data reporting.<sup>21</sup> This information is, as a practical matter, already provided by a large proportion of the membership for the purposes of surveillance.<sup>22</sup>

29. The core indicators are: (i) exchange rates; (ii) international reserves;<sup>23</sup> (iii) reserve or base money; (iv) broad money; (v) interest rates; (vi) consumer price index; (vii) exports/imports; (viii) external current account balance; (ix) overall government balance; (x) GDP or GNP; (xi) the central bank balance sheet; and (xii) external debt and debt service. One of these indicators (item (i)), is already listed in Article VIII, Section 5 and, accordingly, is already required under this provision. Likewise, many, but not all, of the items listed in Article VIII, Section 5 are either also included in, or in some instances related to, the core list of indicators for surveillance. For example, the Article requires the reporting

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would be to group countries according to levels of development, access to markets or other characteristics. As a mandatory requirement, this approach would pose several difficulties: distinctions drawn between different groups would inevitably involve elements of arbitrariness and may lose their relevance over time.

<sup>21</sup> See *Summing Up—Data Provision to the Fund for Surveillance Purposes* (SUR/02/54, 5/16/02) and *Data Provision to the Fund for Surveillance Purposes* (SM/02/126, 4/26/02), Annex V. See also *Summing Up—Strengthening Fund Surveillance—Provision of Statistical Data by Members*, (SUR/95/34, 6/7/1995).

<sup>22</sup> It should be noted that there are some country-specific differences with respect to some of the more detailed aspects of the definitions adopted in reporting the data.

<sup>23</sup> Following generally accepted statistical definitions, international reserves are “external assets that are readily available and controlled by the monetary authorities for direct financing of payments imbalances, for indirectly regulating the magnitudes of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes.” See *Balance of Payments Manual, 5<sup>th</sup> Edition (BPM5)*, paragraph 424. The BPM5 lists among reserve assets these instruments: foreign exchange, monetary gold, special drawing rights (SDRs), reserve position in the Fund, and certain other claims. On the basis of this definition, assets redeemable in nonconvertible foreign currencies cannot be reserve assets. See *International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template* (Washington, DC: International Monetary Fund, 2001), paragraphs 64-74.

of holdings of gold and foreign exchange, which is related to but distinct from the concept of reserve assets (which is one of the core indicators for surveillance).<sup>24</sup> Moreover, the list of information contained in Article VIII, Section 5 does not include reserve-related liabilities, despite the importance of accurate information on any liabilities against international reserves (including derivative positions) as well as any pledged assets.<sup>25</sup>

30. The staff proposes that the Board adopt a decision for the purposes of Article VIII, Section 5, requiring members to provide the Fund with an expanded set of information needed for surveillance (Box 4). The proposed list is based on the core statistical indicators, but specifies some additional detail and related information needed for effective surveillance, including the assessment of vulnerabilities. In particular, the proposed list includes not only the overall government balance (as in the core statistical indicators), but also government revenues, expenditure, debt, and financial assets. Similarly, whereas the core indicators include the central bank balance sheet, base money, and broad money, the proposed required list also includes the consolidated balance sheet of the banking system. The general capacity-based limitation on members' obligations under Article VIII, Section 5 would apply to the information required under the proposed decision; hence, members would not be in breach of Article VIII, Section 5 for their failure to report information that they are unable to provide.<sup>26</sup>

31. Following this approach, the indicators covered by such a decision would be: (i) reserve or base money; (ii) broad money; (iii) interest rates (both market- and officially-determined rates on loans, deposits and government debt);<sup>27</sup> (iv) for the general government and its subsectors: revenue, expenditure, balance and composition of its financing,<sup>28</sup> and the

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<sup>24</sup> The complete list of categories in the core list for surveillance that are closely related to categories that are listed in Article VIII, Section 5 comprises: (i) international reserves (related to holdings of gold and foreign exchange); (ii) GDP or GNP (related to national income); (iii) CPI (related to indices of commodity prices in retail markets); (iv) external current account balance (which forms part of the international balance of payments); and (v) exports/imports (which include total exports and imports of merchandise).

<sup>25</sup> See *Summing Up by the Acting Chairman—Second Review of the Special Data Dissemination Standard—Further Considerations* (BUFF/99/40, 3/23/99).

<sup>26</sup> Under Article VIII, Section 5, members have the obligation to report whatever information that is required and that they are able to provide.

<sup>27</sup> Understandings on the information to be provided (see paragraph 37) would be expected to cover, where available, discount rates, money market rates, treasury bill, note and bond rates, deposit rates, and lending rates.

<sup>28</sup> The general government includes the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

**Box 4. Additional Information Required Under Proposal to  
Strengthen the Effectiveness of Article VIII, Section 5**

In addition to the variables explicitly listed in Article VIII, Section 5 (see Box 2), staff propose to make additional information a reporting requirement under the provision. This revised list depends heavily on the core list of indicators for surveillance.

- (i) reserve or base money
- (ii) broad money
- (iii) interest rates
- (iv) overall general government revenue, expenditure, general government balance and composition of its financing; and public and guaranteed debt
- (v) the central bank balance sheet
- (vi) external current account balance
- (vii) international reserves and reserve liabilities
- (viii) GDP/GNP
- (ix) CPI
- (x) External debt and debt service
- (xi) consolidated balance sheet of the banking system
- (xii) domestic and external public financial assets

stock of public and publicly-guaranteed debt (including its residency, currency and maturity composition);<sup>29</sup> (v) the central bank balance sheet; (vi) the external current account balance; (vii) international reserves, together with reserve liabilities and identifying any reserve assets which are pledged or otherwise encumbered, as well as derivative positions; (viii) exports/imports (ix) CPI; (x) GDP or GNP, (xi) the country's external debt and debt service (actual and scheduled);<sup>30</sup> (xii) the consolidated balance sheet of the banking system; and (xiii) domestic and external public financial assets.<sup>31</sup>

32. While it is inherently difficult to know where to draw the line between mandatory requirements and voluntary data provision,<sup>32</sup> in specifying the former, priority has been given

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<sup>29</sup> The public sector comprises the general government and public enterprises.

<sup>30</sup> The country's external debt and debt service would comprise the debt and debt service of both the public and private sectors.

<sup>31</sup> The currency coverage of external public financial assets would be the same as that underlying the calculation of international reserves. See footnote 23.

<sup>32</sup> Broader lists have been established in the context of the Fund's voluntary data standards initiatives. A list of 16 indicators was presented in the context of the discussions of Data Standards (July 1995). See *Standards for the Provision of Economic and Financial Data to the Public* (SM/95/175, 7/17/1995). A list of 17 data categories reflecting the coverage of the GDDS was presented in August 2000. See *Data Dimension of the GDDS, Data Categories* (continued)

to data that are readily available to the membership and are critical to the Fund.<sup>33</sup> Expanding the list in this manner would address the need for accurate, comprehensive, and timely data on international reserves and the public finances required to assess countries' external, fiscal, and financial sector vulnerabilities.<sup>34</sup> Augmenting the list of data members are required to report under Article VIII, Section 5 in this way will help prevent a repetition of the Fund's experience with misreporting and members' unwillingness to furnish it with key information during crises. Such a list would need to be periodically reviewed to ensure that it continues to satisfy the Fund's needs.

33. As noted earlier, it is not proposed that any items be deleted from the present categories of information specified in Article VIII, Section 5, since this would require an amendment to the Articles. If the proposed decision were adopted, members would continue to have a legal obligation to provide all of the items currently listed in the Article, including those items that do not appear on the core surveillance list.

34. An alternative to expanding the list of information members are *required* to report under Article VIII, Section 5 would be to continue to obtain additional information on a purely voluntary basis. This has been the Fund's approach to date, in particular in obtaining the information on the indicators for surveillance that are not required under Article VIII, Section 5. The Fund could make use of a core list of information for surveillance that includes the additional data described in paragraph 31, while continuing to rely on voluntary cooperation to ensure that the information is reported. Any failure to report the requested information would then be addressed using the cooperative procedures available under the 1995 graduated approach. In the event of misreporting of such information, the member would not be in breach of obligation and the Fund would rely on moral suasion and, to the extent that deficiencies in statistical systems were at fault, the provision of technical

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*and Indicators, Amendments to the Special Data Dissemination Standard and the General Data Dissemination System* (SM/00/195, 8/21/2000). Finally, a list of 18 data categories reflecting the coverage of the SDDS was presented in August 2000. See *Data Dimension of the SDDS, Amendments to the Special Data Dissemination Standard and the General Data Dissemination Standard* (SM/00/195, 8/21/2000).

<sup>33</sup> SDDS requirements for the provision of data on international reserves and foreign currency liquidity and external debt were established as benchmarks for the membership as a whole in June 2000. Accordingly, the core statistical indicators that members are to report, International Reserves and External Debt, were modified in May 2002.

<sup>34</sup> See *Summing Up—Data Provision to the Fund for Surveillance Purposes* (BUFF/00/93, 7/10/00).

assistance.<sup>35</sup> If such a voluntary approach were pursued, the provision of the requested information over an appropriate period (such as two years) could be reviewed in connection with the Fund's periodic data provision review. The Board could decide at that time whether to proceed to expand the coverage of Article VIII, Section 5.

35. Such an approach would have both advantages and disadvantages. In substance, it would maintain the status quo, since both the information on the list of core indicators and the additional information proposed above is in most cases being provided by the authorities on a voluntary basis. As such, it would have the advantage of alleviating possible concerns over the extension of members' legal obligations. But it would defer, possibly by another two to three years, the broadening of the coverage of Article VIII, Section 5 requested by the Board in March 2000. In the staff's view, the proposed broadening of the legal requirements at this time is appropriate, as it would bring the information-reporting obligations of the Fund's membership more closely into line with the realities of the Fund's activities. While in most cases there is no need to invoke members' legal obligations, as the authorities willingly provide much more information than is legally required, these obligations are an important protection for the institution in egregious cases.

36. While neither Article VIII, Section 5 nor the 1995 paper on core data provision (SM/95/59) provides detailed definitions of the information to be reported to the Fund, the basic concepts are generally understood.<sup>36</sup> Within the parameters of such basic concepts, Fund staff typically discuss with the authorities the detailed specifications of the information being reported and arrive at common understandings, with a view to ensuring its adequacy for the intended purposes. (This is the case both for information required under Article VIII, Section 5 and for other information, including those on the list of core indicators, that members provide voluntarily.) It is proposed that, in future, this approach continue to be followed under Article VIII, Section 5 both for information that is listed in the provision and for additional information that will be required in Board decisions as contemplated in paragraph 31 above. Data provision should also be guided by the general principles regarding the quality of the information being reported, as presented in the staff guidance note for the 1995 paper—specifically on its coverage, methodological soundness, and intersectoral consistency.<sup>37</sup>

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<sup>35</sup> Of course, the member would be in breach of obligation if it misreported information that was otherwise required under Article VIII, Section 5—for example, because the relevant category of information is listed in Article VIII, Section 5.

<sup>36</sup> When information is required in a Fund arrangement for the purposes of assessing observance of a PC, it is normally subject to a detailed definition.

<sup>37</sup> Three criteria for assessing data quality are listed in the staff guidance note for the 1995 paper: (i) coverage of both institutions and transactions should be as comprehensive as possible, and gaps in coverage should be identified and their impact on data assessed. Gaps

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## **Data Revisions and Misreporting under Article VIII, Section 5**

37. A further issue concerns the manner in which the Fund would distinguish misreporting from bona fide data revisions. Normal statistical practice for all members, regardless of their level of economic development or statistical sophistication, may entail revisions to reported information that are legitimate and desirable. These revisions occur for a variety of reasons. First, as countries develop statistical capacity, they may enrich their dissemination practices by compiling and releasing preliminary as well as final data. In many series there may be substantial data revisions, even over an extended period.<sup>38</sup> Reports based on preliminary data are useful, despite being based on less than complete or appropriate source data, as they balance the need for coverage and accuracy with the need for timely information. Second, data may be revised following a switch from one understood and acceptable statistical methodology to another, in many cases following Fund staff recommendations.<sup>39</sup> Clearly, well understood and documented revisions, whatever their motivation or magnitude, are a normal and welcome element in data dissemination and should not give rise to a breach of Article VIII, Section 5. In addressing this particular issue, it would not be feasible for the Fund to prescribe a single reporting standard for information required under Article VIII, Section 5, as no such standard has yet been universally agreed upon and adopted.<sup>40</sup> In the absence of such standards, the next-best approach would be to

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in coverage that substantially affect the accuracy and reliability of the data should be filled in the short run by estimates developed jointly by staff and the authorities, on the expectation that reliable reporting on missing institutions and transactions will be developed as soon as possible; (ii) data should be methodologically sound, that is, they should conform to the extent possible to international standards with regard to analytical framework, identification of sectors, and classification of transactions and balances; and (iii) data should be intersectorally consistent; this is critical for an understanding of the relationships among policy variables and forecasting the impact of policy measures on target variables. Subsequently, the Board has encouraged the staff to continue working on data quality (see *Summing Up* by the Acting Chairman—Progress Report on the Provision of Information to the Fund for Surveillance, SUR/97/132, 12/11/1997). The Data Quality Assessment Framework (DQAF) was endorsed by the Board for use in data ROSCs in June 2001 (see *Fourth Review of the Fund's Data Standards' Initiatives*, SM/01/..., July 2, 2001). Work is currently under way to produce a new guidance note.

<sup>38</sup> For instance, fiscal data in many countries are routinely revised according to a pre-determined schedule.

<sup>39</sup> One example is the switch from Laspeyres to chain weighting in calculating the CPI.

<sup>40</sup> For instance, conforming with the new standards for the compilation and reporting of fiscal data set forth in the *GFSM 2001* requires extensive investment by members, and technical assistance by the Fund to help members with low statistical capacity. In some cases,

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rely on understandings between the member and staff on the accounting and statistical practices they use in compiling the information they report to the Fund and a revisions policy governing, among other things, the basis on which preliminary data may subsequently be revised. With such pre-specification, a country would not be at risk of being found in breach of obligation to the extent that it revised data in line with agreed revisions policy or made recognized improvements in methodology in relation to previously announced reporting practices they had been understood to be following—for example, changes in sampling, coverage, or reporting basis.<sup>41</sup>

38. There are limits, however, to the extent to which such specification of methodology and revisions policy would be practicable. For many types of data, including national accounts, balance of payments, and some fiscal data, the derivation of aggregate numbers typically involves numerous steps, with elements of sampling and estimation of some sub-components. A complete specification of how the data are derived and the circumstances and timetable under which they may be revised would be very cumbersome, and in many cases, it may not even be possible to formulate a revisions policy in a manner that is explicit in all respects, as some revisions may take place for reasons that are not foreseeable. It is also essential to recognize that there is a tradeoff between the timeliness and accuracy of data, and that improvements in methodology often have “teething problems” which lead to temporary inaccuracies. Assessing whether a country has breached its obligations under Article VIII, Section 5 must therefore involve an element of judgment based on best statistical practice and experience and with the benefit of any doubt given to the member country.

39. At the same time, some element of pre-specification of statistical practice is useful, both in clarifying the nature of the information being provided and in reducing the degree of uncertainty with regard to whether the member country is fulfilling its obligations.<sup>42</sup> In the context of surveillance, there would need to be informal understandings between the authorities and Fund staff on statistical methodology and revisions policy.<sup>43</sup> Data provision and revisions in line with these understandings would generally be considered in compliance

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however, the definition contained in a PC may contemplate the use of a particular accounting technique.

<sup>41</sup> As under existing procedures, no breach of obligation would be regarded as having occurred when the information being revised consists of estimates made by Fund staff.

<sup>42</sup> In the data modules of the Reports on the Observance of Standards and Codes (ROSCs), countries are assessed as to whether they have a pre-specified revisions policy as one of the elements of data serviceability.

<sup>43</sup> In practice, such informal understandings are already in place with respect to information that is already required and reported under Article VIII, Section 5 or with respect to many statistical indicators that are not currently subject to Article VIII, Section 5.



with Article VIII, Section 5, whereas judgment would be required in assessing the implications of other data revisions, taking into account, inter alia, accepted statistical practices. In the context of use of Fund resources, the relationship is more formal, given the use of the information in monitoring program implementation, as well as the fact that the information is more often drawn from accounts that are considered final. In this context, the technical memorandum of understanding (TMU) provides a vehicle for specification of the information that will be reported and, to the extent that it is subject to revision, the circumstances and timetable under which such revisions may occur. A TMU should provide such information on methodology and revision practices in as much detail as is practicable.

### **Application of Article VIII, Section 5 in the context of use of Fund resources**

40. This section identifies additional issues arising from the application of Article VIII, Section 5 to the reporting of information necessary to assess the observance of a performance criterion under a Fund arrangement in the General Resources Account. It proposes that, to avoid possible “nuisance” cases, Article VIII, Section 5 be applied only in the situations where there is potential harm to the Fund from misuse of its resources or damage to its reputation described below.

41. As explained above, performance criteria under Fund arrangements in the General Resources Account are Board decisions. For the purposes of Article VIII, Section 5, such performance criteria have been interpreted as requiring the accurate reporting of the information necessary to assess observance. Hence, the provision of inaccurate information on a performance criterion has been regarded as a breach of obligation under Article VIII, Section 5.<sup>44</sup> However, as observance of a performance criterion is only necessary as a condition for the use of Fund resources, members have not been found in breach of their obligations under Article VIII, Section 5 for failing to provide information related to a performance criterion, because in that case they could not have had access to Fund resources.

42. In practice, three groups of cases of misreporting may arise. First, a member that provides inaccurate information that leads the Fund to mistakenly believe a performance criterion has been met (when in fact it was not) and, on that basis, makes the related purchase may be found to be in breach of Article VIII, Section 5; the purchase is also regarded as a noncomplying purchase under the Misreporting Guidelines. Article VIII, Section 5 will also apply where a member reports that a performance criterion was breached by a particular margin, a waiver is granted and the purchase made, and it is subsequently discovered that the extent of nonobservance was actually greater than was reported by the member; to the extent that the Board granted the waiver on the condition that the information provided by the

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<sup>44</sup> The obligation to provide information on performance criteria, however, is subject to the two general qualifications of Article VIII, Section 5 regarding the provision of information on the affairs of individuals or corporations and the need to take into account the member’s capacity to provide the information.

member on performance under the relevant performance criterion is accurate, the Misreporting Guidelines will also apply. With respect to this first group of cases, no change in the present approach is proposed.

43. Second, a member that provides inaccurate information on a performance criterion could be found to be in breach of Article VIII, Section 5 even if it appears that the member, on the basis of the revised information, has met the performance criterion.<sup>45</sup> Instead of strengthening the provision of information to the Fund, the application of Article VIII, Section 5 in this case may prove counterproductive. As the member has actually met the performance criterion, there has been no misuse of Fund resources and the application of sanctions would only be an incentive for not correcting the information provided to the Fund. It is, therefore, proposed that this second group of cases not be subject to the application of Article VIII, Section 5.

44. Third, a member may be found in breach of its obligation under Article VIII, Section 5 for providing inaccurate information on a performance criterion in situations where no purchase was requested. For instance, in the case involving a review under the Stand-By arrangement for Thailand (EBS/00/112), it was decided that the misreporting of information relating to the performance criterion on short-term borrowing resulted in a breach of obligation, even though no purchase was made on the basis of the incorrect information.

45. For this third group of cases, it is proposed that Article VIII, Section 5 only apply if the information was reported to the Board in the context of (i) a review which the Board subsequently completed, or (ii) a decision of the Board to grant a waiver for the nonobservance of a performance criterion (including such decisions taken outside of a Board review). Two types of misreporting would be covered in these circumstances: first, where a member reports that a performance criterion was met and it is subsequently discovered that the performance criterion was not observed; and second, where a member reports that a performance criterion was breached by a particular margin, and it is subsequently discovered that the margin of nonobservance was even greater than reported.<sup>46</sup> Although no misuse of Fund resources takes place in such cases, the potential for damage to the Fund's reputation is high—where, for example, the Fund, having completed the review and/or granted the waiver, reports to external creditors that the member's program is on track and the creditors provide assistance to the member.

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<sup>45</sup> In the staff report relating to Ukraine (EBS/00/177), paragraph 12, it is noted that: "First, a member that misreports information may be found in breach of its obligation under Article VIII, Section 5 even if the misreporting does not affect the observance of a performance criterion."

<sup>46</sup> Under this approach, the case of Thailand discussed above would be covered under Article VIII, Section 5.

46. It is possible that a member that did not wish to request a purchase, the completion of a review or a waiver would have concerns that reporting information to the Fund on performance under its Fund-supported program might result in a breach of Article VIII, Section 5 in the event that the information turned out to be inaccurate. In this situation it is open to the member to provide the Fund with such information subject to an express clarification that the information is not to be used for the purposes of assessing the observance of performance criteria or Board decisions on access to Fund resources. Under such a clarification, the member would not be subject to the application of Article VIII, Section 5 if the information proved to be incorrect. The member would need to withdraw this clarification before the information could be used in connection with a request to purchase, completion of a review, or a waiver under the arrangement.

47. The proposed approach with respect to performance criteria would be without prejudice to the application of Article VIII, Section 5 when the information to be provided is specifically listed in or is otherwise required under the provision.

### **III. A FRAMEWORK FOR REMEDIAL ACTION**

48. This section examines (a) the sanctions and remedies potentially available to the Fund to address a breach of obligation under Article VIII, Section 5, and (b) proposes a procedural framework for their application.

#### **A. Remedies and Sanctions in Cases of Misreporting**

49. The misreporting of information required under Article VIII, Section 5 can give rise to a breach of obligation under the Articles and can lead to the imposition of sanctions. Article XXVI provides for three sanctions that are to be imposed for a breach of obligation in sequential steps of escalating severity: (i) a declaration of ineligibility to use the general resources of the Fund; (ii) the suspension of voting rights; and (iii) compulsory withdrawal. Whenever a member is found to be in breach of Article VIII, Section 5, it is open to the Fund to impose these sanctions.<sup>47</sup> There has been one instance in which a member has been found to be in breach of obligation of Article VIII, Section 5 outside of the context of Fund financial assistance—the case of Czechoslovakia, where the member was required to withdraw from the Fund. Since 1999, management has reported five cases to the Board in which a member was in breach of obligation of Article VIII, Section 5 in the context of Fund financial assistance (i.e., Jordan, Pakistan, Russia, Ukraine, and Thailand). Although sanctions were not imposed in any of these cases, the authorities did adopt remedial measures.

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<sup>47</sup> Under Article XXVI, the Executive Board has the authority to declare a member ineligible or to suspend its voting rights; it is, however, up to the Board of Governors to require a member to withdraw membership in the Fund.

50. The Fund's *Rules and Regulations* specify certain procedures to be followed when a member is believed to be in breach of an obligation under the Articles. In accordance with Rule K-1, the Managing Director is required to report to the Executive Board any case in which it appears to him that a member is not fulfilling its obligations under the Articles. Based on the report of the Managing Director, it is the responsibility of the Executive Board to make the determination whether a member has breached its obligations. The decision finding a member in breach of obligation can be published by the Fund.

51. After finding a member in breach of obligation, the Executive Board can decide to impose the first sanction under Article XXVI.<sup>48</sup> Before a sanction may be imposed, a complaint must be issued.<sup>49</sup> There is no legal obligation on the part of the Executive Board to impose the sanctions under Article XXVI. Instead of imposing formal sanctions under Article XXVI, the Board can call upon the member to remedy the situation that gave rise to the misreporting. Such remedies are taken by the member voluntarily and may include, for instance, the commitment to improve statistical reporting systems or reserve management practices.

52. The imposition of sanctions under Article XXVI may not always provide the most appropriate response to cases of misreporting. The sanctions contemplated under Article XXVI may be disproportionate to the breach of obligation. For example, a declaration of ineligibility does not appear appropriate for a case of minor misreporting, or a case of misreporting by a member that has not requested access to Fund resources. Moreover, the imposition of a sanction may not, in itself, help to resolve the problems that gave rise to misreporting.

53. The voluntary adoption by the member of remedial measures to address the causes of the misreporting can be an effective alternative to the imposition of sanctions under Article XXVI. Remedies can be tailored to address the root causes of misreporting—for example, the institutional weaknesses that gave rise to the misreporting. In addition, remedies can be tailored to the gravity of the breach of Article VIII, Section 5. The willingness of the member to address voluntarily the causes of misreporting may provide the Board with the assurance that the imposition of sanctions in a particular case is not necessary.

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<sup>48</sup> Rule K-2, however, provides that, “whenever the Executive Board is authorized by the Articles to declare a member ineligible to use the general resources of the Fund it may refrain from making the declaration and indicate the circumstances under which, and the extent to which, the member may make use of the general resources.”

<sup>49</sup> A complaint may be issued by the Executive Board, an Executive Director, or the Managing Director. For a more complete discussion of the procedural issues associated with the issuance of a complaint, see *Compulsory Withdrawal from the Fund—Legal Aspects* (EBS/97/19, 2/10/97).

54. In addition to the adoption of remedies and the imposition of sanctions, misreporting may give rise to other consequences under the Articles—in particular, when it involves the refusal of a member to provide the Fund with information that is required under Article VIII, Section 5. The refusal of a member to report such information may lead the Fund to delay the completion of its Article IV consultation with the member if this information is deemed to be necessary for effective surveillance. However, a delay in the completion of an Article IV consultation is not a form of remedy or sanction and cannot be used to punish a member; in this regard, the Fund is under a legal obligation to exercise firm surveillance over the exchange rate policies of members. The Fund could only delay the completion of a consultation if the member's refusal to report were to prevent the Fund from conducting effective surveillance over the member's policies. Faced with inadequate data, management may be forced to postpone the date for Board discussion of the Article IV consultation with the member. Management would inform the Executive Board of the postponement.<sup>50</sup> The delay in the completion of the consultation and the reasons for it could be made public.

### **B. Framework for Remedial Measures and Sanctions**

55. In the past, the Fund has largely addressed instances of a breach of Article VIII, Section 5 on a case-by-case basis. Moving forward, there is merit to putting in place a more complete procedural framework (i.e., similar to the Fund's strategy for addressing cases in which members are in arrears to the Fund) that would specify in greater detail *ex ante* (1) the procedures to be followed in addressing a breach of obligation under Article VIII, Section 5, (2) the remedies that members could be called upon to voluntarily adopt, and (3) the circumstances in which sanctions available under the Articles would be applied. The main purpose of such a framework would be to provide clearer guidance and to ensure uniformity of treatment among members.

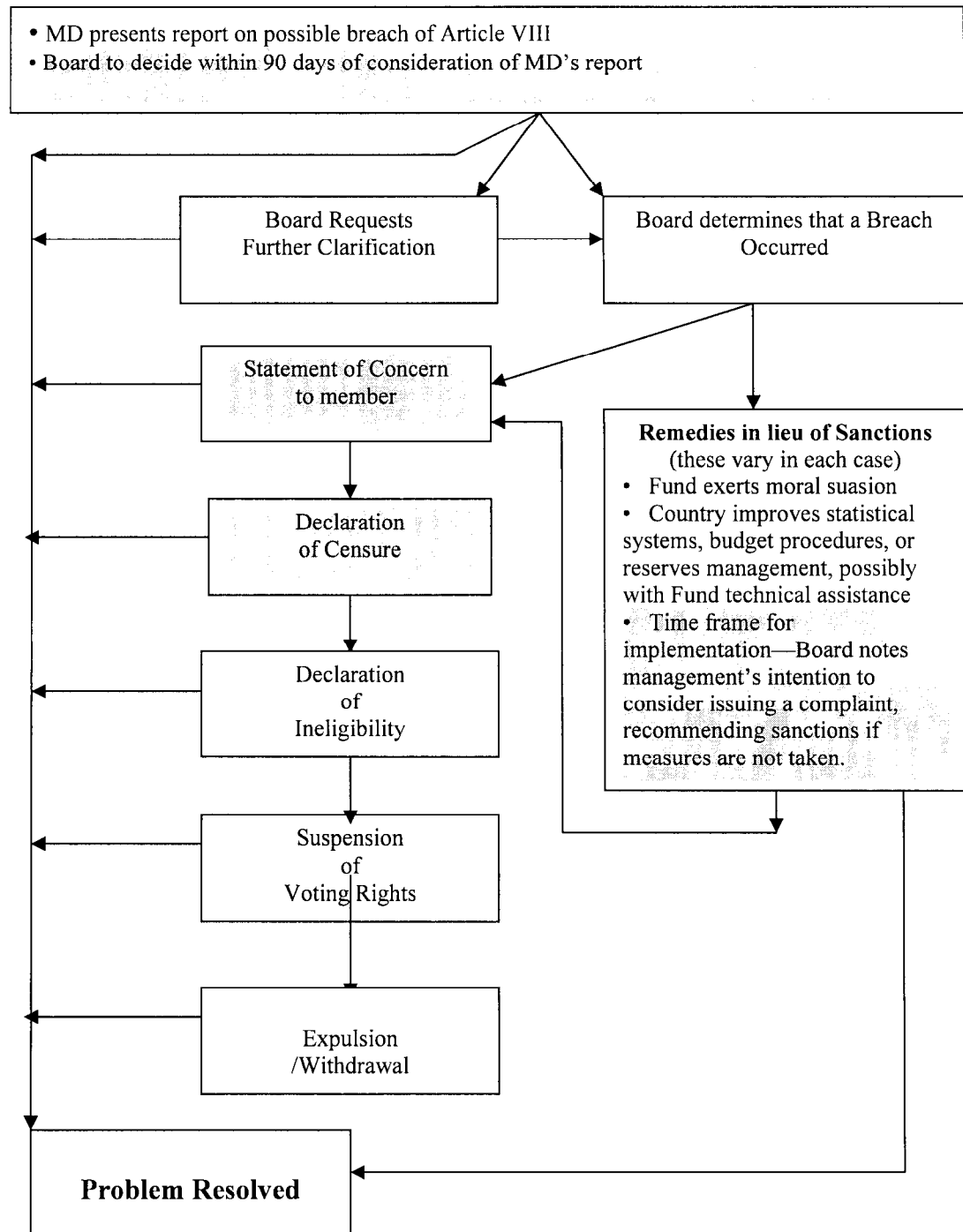
#### **Procedures for Addressing Breaches of Obligation**

56. The framework (Chart 1) could specify in greater detail the procedures the Fund would follow in addressing a breach of obligation under Article VIII, Section 5 arising from a failure to provide information or from the reporting of inaccurate information. In handling cases involving a failure by a member to report information, the framework would be activated only after events have moved beyond the graduated voluntary approach put in place by the Board in 1995. In seeking to obtain the necessary information from a member that has failed to report, the Fund would make use of direct staff and management contacts with the authorities, assistance from the Executive Director concerned, and Executive Board

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<sup>50</sup> If management were to delay completion of the consultation in this situation, the Executive Director representing the member could also present the views of the authorities; in these circumstances it would ultimately be for the Board to decide whether the consultation should be delayed.

**Chart 1: Proposed Framework for Remedial Action under Article VIII, Section 5<sup>51</sup>**



<sup>51</sup> Shaded elements indicate new proposals.

involvement either at the time of the Article IV consultation or in informal country matters sessions. In addition, a public statement could be issued by management detailing the member's failure to provide the Fund with essential information. The prospect of such a statement could serve as an instrument of moral suasion.

57. The graduated approach, as articulated by the Board in 1995, only applies to cases in which a member has failed to provide information—not to cases in which a member has reported incorrect information. In cases in which the member has provided incorrect information, management normally engages in informal discussions with the authorities and the Board before determining whether the member may be in breach of obligation under Article VIII, Section 5 and issuing a report to the Board. A report by the Managing Director to the Executive Board on a breach of Article VIII, Section 5 is usually preceded by informal consultations between management and Directors. If Fund staff encounters problems in the collection of data for surveillance purposes, the Managing Director would normally bring the matter to the attention of the Board at an informal meeting on country matters.

58. Once the Managing Director has reached the conclusion that the relevant member is in breach of its obligation under Article VIII, Section 5 (because of the failure to report or inaccurate reporting), a report to the Executive Board must be issued under Rule K-1. The new framework could specify the steps the Fund would take after the Managing Director issued the report.<sup>52 53</sup> Under the framework, the Executive Board would decide, within a pre-determined timeframe, whether the member had breached its obligation. More specifically, the new framework could establish a timeframe within which the Board would either (i) confirm the Managing Director's conclusion by making a finding of a breach of obligation, (ii) require factual clarification, or (iii) decide that no breach of obligation has occurred. A timeframe of 90 days is proposed.<sup>54</sup>

### **Remedies and Sanctions**

59. For those cases in which the Board has found the member to be in breach of Article VIII, Section 5 and believes that the adoption of remedial measures would be appropriate, the framework could specify a standard set of remedial measures that members

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<sup>52</sup> At each stage of the strengthened approach, informal contacts by staff, management, and the Board would, in addition to the steps contemplated below, be used to seek to ensure compliance with members' obligations under Article VIII, Section 5.

<sup>53</sup> Cases involving a noncomplying purchase in the GRA would also be subject to the procedures set out in the Guidelines on Misreporting. The Managing Director's Report on the noncomplying purchase required under the Misreporting Guidelines could be issued at the same time as the report under Rule K-1.

<sup>54</sup> If factual clarification is required, the Board would need to specify a deadline for such clarification.

would normally be asked to undertake voluntarily, and for the establishment of a timetable for the implementation of such measures. The Executive Board could refrain from imposing the sanctions under the Articles if, in its view, remedial measures to address the misreporting (in particular, improvements in the member's statistical systems, budget procedures or reserve management practices) would be more appropriate. A statement of intention by the member to take remedial action could be supported by technical assistance from the Fund. The Board's decision finding the member in breach of obligation would set a timeframe for the implementation of the remedial measures, and note management's intention to consider issuing a complaint and recommending the imposition of sanctions in case the member did not take the remedial measures within the specified period.

60. If a member were to fail to take remedial action within the designated time frame, management could consider recommending the imposition of sanctions under the Articles. However, management could recommend that the Board, before resorting to the sanctions specified in Article XXVI, make use of an intermediate step—a “declaration of censure.” A declaration of censure would take the form of a Board decision censuring the member for its breach of obligation and its failure to take remedial action; in the declaration, the Board could note management's intention to consider recommending the imposition of sanctions under Article XXVI if the member failed to cooperate by a deadline set by the Executive Board. The declaration would be made public, and could be particularly effective with respect to members that do not intend to use Fund resources in the near future and for which a declaration of ineligibility would have limited impact. It is envisaged that before issuing the declaration, the Fund would issue a statement to the member (that would be published) setting out its concerns, giving the member the opportunity to rectify the situation, and/or make representations to the Fund.

61. If the member failed to comply by the deadline stipulated in the declaration of censure, the Fund could resort to the sanctions specified under Article XXVI.<sup>55</sup> The sanctions under Article XXVI, i.e., the declaration of ineligibility to use Fund resources, the suspension of voting rights and, ultimately, compulsory withdrawal, are designed to be applied step by step. The new framework could clarify that the Fund, after issuing a declaration of censure, would normally, within a pre-announced timeframe, proceed to a declaration of ineligibility to use Fund resources, the suspension of voting rights, and, ultimately, compulsory withdrawal if the member persists in its breach of obligation under Article VIII, Section 5.

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<sup>55</sup> Procedurally, the imposition of sanctions under Article XXVI requires the filing of a complaint. The procedures could specify that, within a pre-announced time frame, the Managing Director would issue a complaint recommending the imposition of sanctions. A separate Board decision will be required to impose sanctions.



## **Publication**

62. It is proposed that all Board decisions under this framework be published, including decisions finding a member in breach of obligation, noting the intention of members to adopt remedial measures, statements of concern, or issuing a declaration of censure and imposing sanctions under Article XXVI. Moreover, management would make public any decision to delay the completion of an Article IV consultation when the failure of a member to provide information required under Article VIII, Section 5 impeded the effective conduct of surveillance.

## **Resource Implications and Transition Period**

63. The proposals made in this paper aim chiefly to strengthen the effectiveness of Article VIII, Section 5 and to put into place a more complete procedural framework through which to respond to a breach of obligation. As such, these proposals are unlikely to have resource implications either for the current year or the medium-term estimates. Neither the addition of categories to the data members are required to provide under Article VIII, Section 5 nor the delineation of procedures under Article VIII, Section 5 should represent additional work for the staff. Most members already voluntarily provide the Fund with the information that they are capable of providing, including items required under Article VIII, Section 5. Where capacity constraints do not permit members to provide appropriate statistical information, including items required under Article VIII, Section 5, staff is already working closely with the membership to improve capacity, including through the provision of technical assistance from the Fund, although it is possible that the proposals in this paper would give rise to an increase in demand for such assistance, which would then need to be prioritized against various competing demands in the absence of additional resources.<sup>56</sup>

64. Directors may wish to consider the possible need for a transition period before the proposed expansion of the set of information members are required to provide comes into effect. Given that most members are already voluntarily providing most or all of the additional information that they would be required to provide under the proposed decisions, a lengthy transition period is not likely to be needed. But the fact that the proposed decisions would give legal force to the provision of such information would argue that members be allowed some period to come into compliance. Since members' obligations under Article VIII, Section 5 would continue to be subject to members' capacity to provide the information, a transition period would not need to be sufficiently long to permit all members to rectify any deficiencies in such capacity. The staff thus suggests that Directors may wish to consider whether to establish such a period (perhaps of one year) from the approval of the proposed decisions before the expanded reporting obligations come into effect. The transition

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<sup>56</sup> Staff will identify in country reports instances where technical assistance is needed to facilitate the compilation and reporting of required data with adequate periodicity and timeliness.

period would only apply to the additional information that will be required by Board decision. During the transition period, members will remain under an obligation to report information that is already required under Article VIII, Section 5. The framework for remedial action, which applies also to the existing coverage of Article VIII, Section 5, would become available for use immediately after approval by the Executive Board.

#### **IV. ISSUES FOR DISCUSSION**

65. Directors' views are sought on the staff's approach to strengthening the provision of information under Article VIII, Section 5 and to making more active use of the legal procedures available to the Fund in problem cases.

- Do Directors agree to adopt a general decision to implement this approach that will be applicable to all members, and could be supplemented by decisions applicable to individual members in particular cases as needed?
- Directors may wish to comment on the appropriate scope of an expanded list of data which members are required to report under Article VIII, Section 5. Do Directors agree that the list should be expanded to include the core statistical indicators and other fiscal and financial information as detailed in paragraph 31, or would they prefer the expanded list to include only the core statistical indicators?
- Instead of making the expanded list of information a reporting obligation under Article VIII, Section 5 as proposed by staff, would Directors instead favor reliance upon a voluntary system of reporting this additional information, compliance with which over a two-year period would be evaluated as part of the subsequent periodic review of data provision to the Fund?
- Do Directors agree that assessments of members' capacity to report required information, the adequacy of the information provided, and the implications of data revisions must continue to involve an element of judgment, on the basis of best statistical practice and experience, with the benefit of any doubt being given to the member?
- Directors' views are sought on the proposed modifications in the application of Article VIII, Section 5, in the context of performance criteria established under Fund arrangements in the General Resources Account. Are Directors in favor of limiting the application of this Article to situations in which a purchase was made on the basis of the information provided by the member, or the information was reported to the Board in the context of a review which was subsequently completed or a decision of the Board to grant a waiver for the non-observance of a performance criteria? Are they, in addition, in favor of limiting its application to situations where a member reports that a performance criterion was met when in fact it was not, or where a member reports that a performance criterion was breached by a particular margin and

it is subsequently discovered that the margin of non-observance was greater than originally reported?

- Directors may wish to comment on the proposals regarding the Fund's remedies for breach of Article VIII, Section 5. In particular, is a declaration of censure an appropriate remedy before imposing the sanctions envisaged under Article XXVI?
- Do Directors agree with the proposed 90-day maximum period between the issuance of the Managing Director's report on a possible breach of obligation and a Board decision?
- Directors may wish to consider whether to establish a transition period before the proposed expansion of the list of required information would take effect. Do Directors agree that the appropriate length of such a period should be one year from the Board's adoption of a decision, or do they consider a longer transition period of, say, two years, to be more appropriate?
- Do Directors agree that relevant information on all Board decisions regarding breaches of Article VIII, Section 5 should be made public?