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The IMF's Approach to Promoting Good Governance and Combating Corruption — A Guide

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The IMF places great emphasis on good governance when providing policy advice, financial support, and technical assistance to its 184 member countries. It promotes good governance by helping countries ensure the rule of law, improve the efficiency and accountability of their public sectors, and tackle corruption. In so doing, the IMF limits itself to economic aspects of governance that could have a significant macroeconomic impact. The IMF also has strong measures in place to ensure the integrity of its own organization.

This guide, which is presented in a question and answer format, is intended to help the reader locate information about the IMF's work on governance and corruption. Comments are welcome and should be sent to publicaffairs@imf.org.

How are governance and corruption related?

The term *governance*, as generally used, encompasses all aspects of the way a country, corporation, or other entity is governed. It includes the economic-policy interactions that fall within the mandate and expertise of the IMF. Relevant questions with regard to those policies are: their effectiveness; their transparency, and thus the accountability of policy makers; and the extent to which they meet internationally accepted standards and good practices. *Corruption* is a narrower concept than governance. It is often defined as the abuse of public authority or trust for private benefit. The two concepts are closely linked. Where there is poor governance, there are greater incentives and more scope for corruption. Thus, the promotion of good governance helps combat corruption. It complements efforts that target corruption more directly, such as raising public awareness and strengthening the enforcement of anti-corruption legislation. There is also a reverse link: corruption undermines governance to the extent that it distorts policy decisions and their implementation.

Why does the IMF care so much about good governance?

The IMF's operations and its relations with member states have always been concerned with good governance. But in 1996, the policy-making committee of its Board of Governors added an explicit mandate. In its *Declaration on Partnership for Sustainable Global Growth,* the Interim Committee stressed, among other things, the importance of "promoting good governance in all its aspects, including by ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption, as essential elements of a framework within which economies can prosper. "

An overview of corruption around the world shows that many of its most commonly cited causes and consequences are economic in nature. It is natural that these are covered by the IMF in its relations with its member countries. As for causes, corruption thrives in the presence of: excessive government regulation and intervention in the economy; substantial exchange and trade restrictions; and complex tax laws requiring frequent contacts between tax payers and inspectors. Corruption is further favored by lax spending controls, and when the government provides goods, services and resources at below-market prices (for example foreign exchange, credit, public utilities and housing, access to education and health facilities, and access to public land). There is potential for corruption when officials take decisions that are potentially costly to private individuals or companies (for instance, tax incentives, zoning laws, timber rights and rights to extract mineral resources, investment permits, privatizations, and monopoly rights over exports and imports or domestic activities). Factors that contribute indirectly to corruption include: the quality and remuneration of the civil service, the effectiveness of deterrents, and the example set by the country's leadership.

There is no doubt that corruption can have a major negative impact on economic performance. Corruption can reduce investment and economic growth. It diverts public resources to private gains, and away from needed public spending on education and health. It tends to compress operation and maintenance expenditures, while boosting beyond levels that are socially desirable public investment and defense spending, both highly amenable to corruption. Finally, by reducing tax revenue, corruption can complicate macroeconomic management, and since it tends to do so in a regressive way, it can accentuate income inequality.

Where is the IMF's policy on good governance described?

In 1997, the IMF's Executive Board adopted a guidance note that sought to promote greater attention to governance issues, by the IMF staff, management and Executive Board alike (*Good Governance-The IMF's Role*). In February 2001, the IMF Executive Board evaluated the experience with the guidance note (*Executive Board Reviews IMF's Experience in Governance Issues-Public Information Notice*) on the basis of a staff paper (*Review of the Fund's Experience in Governance Issues*) that described the evolution of the Fund's role in governance since 1997. At the conclusion of its discussion, the Executive Board supported this evolution, stressing that prevention should be the centerpiece of the IMF's governance strategy.

What are the limitations to the IMF's role in promoting good governance?

The 1997 Guidance Note *Good Governance-The IMF's Role* describes how the IMF, given its mandate and expertise, is best placed to contribute to good governance (including the avoidance of corrupt practices) through its policy advice and technical assistance in two spheres, namely:

· *improving the management of public resources* through reforms covering public sector institutions (e.g., the treasury, central bank, public enterprises, civil service, and the official statistics function), including administrative procedures (e.g., expenditure control, budget management, and revenue collection); and

· *supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to efficient private sector activities* (e.g., price systems, exchange and trade regimes, and banking systems and their related regulations).

The 1997 Guidance Note describes the broad role for the IMF in governance, but also indicates the boundaries to that role. The most important one is that the IMF should get involved in governance issues only when they have a significant current or potential impact on macroeconomic performance. The IMF must also limit itself to the economic aspects of those issues, since those are within its mandate and expertise.

Finally, IMF staff are encouraged to collaborate closely with other multilateral institutions with complementary areas of expertise, in particular the World Bank. World Bank staff has accumulated much practical experience with good governance and anti-corruption measures and compiled databases for measuring governance performance. This work is presented on the World Bank's public website, by both the governance and public sector reform network and the World Bank Institute.

In what directions is the IMF's role in governance expanding?

Since 1997, the IMF's role in promoting good governance has expanded considerably. The main initiative has been to encourage transparency and accountability in economic policies through the development and promotion of internationally recognized standards, and codes of good practices in data dissemination; fiscal, monetary and financial policy transparency; and banking, insurance and securities regulation and supervision, and payment system oversight. The Fund also introduced minimum standards for the control, accounting, reporting and auditing systems of the central banks of countries to which it lends, this in order to safeguard the use of Fund resources. In its work, the IMF increasingly emphasizes the need for adequate systems for tracking public expenditure on poverty reduction; while important for all poor countries, this is particularly so for the group of heavily indebted poor countries (HIPCs) receiving debt relief. Finally, the IMF is intensifying its involvement in international anti-money laundering and combating the financing of terrorism. These efforts are aimed at ensuring the integrity of countries' financial systems. In addition, countering money laundering supports the international anti-corruption drive. It makes it more difficult to hide bribes in bank accounts abroad thereby reducing the rewards which in turn should discourage the solliciting or accepting bribes.

How does the IMF incorporate its concerns about governance into its policy advice?

The IMF provides policy advice to all its member countries, and when pertinent this advice covers governance issues. This is part of the IMF's surveillance function. At the individual country level, the principal form of surveillance is the Article IV Consultation. The staff's diagnosis of the economic problems the country is facing and its appraisal of policies are presented to the IMF's Executive Board in a staff report. Close to two-thirds of countries are now (year ending April 2002) agreeing to the publication of those Article IV Staff Reports on the IMF's public website. For about 90 percent of countries, *Public Information Notices* (PINs) are issued following the discussion of the staff report in the Executive Board. These contain a brief economic background on the country plus a summary of the Executive Board discussion. By searching the PINs for the key words "governance" or "corruption", the reader can find concrete examples of how the IMF incorporates advice on these issues into its policy advice. In 2002, roughly one-third of Article IV PINs have contained such explicit references. But even if there are no such explicit references, the discussion may have addressed governance issues.

IMF staff has been asked by the Executive Board to pay special attention to the two-sided nature of international corruption. When carrying out surveillance of industrial countries, the IMF staff follows in particular the implementation of the OECD's 1997 *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. Under this Convention—effective since 1999—all OECD member countries have made the bribery of a *foreign* public official by a domestic individual or company a crime under their laws, and are committed to prosecute instances that come to the attention of their law enforcement agencies.

How does the IMF incorporate governance concerns when it

extends financial support?

A concern for good governance also influences the way the IMF discharges its lending function. The IMF lends to countries experiencing balance-of-payments problems to support policies designed to resolve the problems and restore conditions for sustainable economic growth. Unlike development banks, the IMF does not lend for specific projects. Some of these policy measures are considered critical to the success of the program become formal conditions for the disbursements of the IMF loans. Measures to improve governance or redress corruption have increasingly become part of this conditionality, as described in a 1998 article in the IMF's publication *Finance and Development*.

Country authorities describe the objectives and policy programs for which they seek financial support from the Fund in a Letter of Intent (LOI) with an attached Memorandum of Economic and Financial Policies. Together with other country policy intentions documents, these LOIs are posted on the IMF's website. Searching the texts of these LOIs/MEFPs for the key words "governance" or "corruption" will produce many concrete examples of how governance is incorporated in IMF-supported programs and, more narrowly, in the program conditions. Many of these country-intention documents contain such explicit references.

Even when the LOIs do not refer explicitly to governance, the programs in question may still address governance-related issues. Examples can be found in Annex II of the staff paper that served as the background for the IMF Executive Board's governance review in March 2001 (see *Review of the Fund's Experience in Governance Issues, March 28, 2001*). The examples cover program involvement during 1997-99 in five areas of public resource management: (i) financial discipline in state-owned enterprises (SOEs) in Bulgaria and Indonesia; (ii) revenue administration in Bolivia and Cameroon; (iii) expenditure management in Azerbaijan and Côte d'Ivoire; (iv) instances of corruption in Cambodia and Kenya; and (v) state monopolies in Mali and Indonesia.

How does the IMF promote good governance through its technical assistance?

Alongside surveillance and lending, technical assistance is the third major activity of the Fund, and it is a crucial part of the IMF's efforts to promote good governance. The purposes of IMF technical assistance are to strengthen member countries' implementing capacity, and to assist in the design of appropriate policies (see *Technical Assistance--A Factsheet*). Assistance in building capacity—such as strengthening tax and customs administrations, and improving budgeting and public expenditure management-has a direct bearing on good governance. Increasingly, countries call on IMF technical assistance to help them implement the IMF's codes on transparency in fiscal, and in monetary and financial policies (see sections below), and with meeting donor requirements for the tracking of poverty spending (for an overview of areas of technical assistance by department, see the Annex of *Policy Statement on IMF Technical Assistance, April 1, 2001*).

As part of its technical assistance effort, the IMF has issued *Guidelines for Foreign Exchange Reserve Management* and *Guidelines for Public Debt Management*, the latter one co-authored by the World Bank. The IMF's technical assistance departments, as well as the World Bank's Treasury Department, assist with their implementation. Since both activities involve large amounts of public funds, the sections in these guidelines dealing with accountability, assurances of integrity and internal governance are most relevant to the cause of limiting the scope for corruption.

A government activity well known to be susceptible to corruption is customs administration. IMF technical assistance experts in this area have therefore devised practical measures that authorities can adopt to promote integrity in customs administration, as described in a paper presented to the 1997 International Anti-Corruption Conference (IACC). Another paper at the same conference presented an IMF staff's perspective of corruption in tax administration more broadly.

Country-specific technical assistance reports are submitted confidentially to the authorities that requested them. But IMF staff regularly distills the lessons learned while providing assistance to a wide range of countries. The results are often published in the form of *Occasional Papers* or books (see the IMF's Publications for a list).

What are the findings of the IMF's research on governance and corruption?

Governance and corruption issues feature regularly in research-oriented publications by IMF staff. Because of its adverse impact on economic performance, corruption can threaten the success of IMF-supported programs. A summary prepared in 2000 describes how IMF research has highlighted the effects of corruption on economic efficiency, equity and growth, while also providing insights into its origins, effects and possible remedies. More recent IMF research can be found by searching the IMF's public website for titles of publications containing the words "governance" or "corruption." Often this research draws on experience accumulated in the course of country work. Ongoing research projects can also be searched for relevant keywords.

A special paper series called *Economic Issues* (EI) presents IMF research in a brief and popular format. The following issues deal specifically with governance:

Why Worry About Corruption? (EI No. 6; Feb. 1997) analyzes possible causes and consequences of corruption, and explains how it discourages investment, limits economic growth, and alters the composition of government spending, often to the detriment of growth.

Roads to Nowhere: How Corruption in Public Investment Hurts Growth (EI No. 12; March 1998) explains how public investment projects are particularly susceptible to corruption and examines the economic implications.

Improving Governance and Fighting Corruption in Baltic and CIS Countries (EI No. 21, July 24, 2000) describes, based on IMF experience with transition economies, the forms poor governance and corruption can take, why it is economically costly, and what the IMF can do about it.

An overview of corruption can be found in *Corruption Around the World: Causes, Consequences, Scope, and Cures* (IMF Staff Papers, December 1998).

How does IMF Management make the case for good governance?

Public speeches by management and senior staff are one way in which evolving policies in the IMF are articulated. A content search of those speeches shows that a great many of them cover the issue of *governance or corruption*, indicating the importance IMF Management attaches to these issues. Of particular interest are a speech by the Managing Director to Transparency International on *The IMF and Good Governance*, with special reference to the Asian crisis, and another one on *Capacity Building, Governance and Economic Reform in Africa*. The Director of the IMF's African Department spoke on *governance in the macroeconomic area* to a symposium on the New Partnership on Africa's Development (NEPAD).

How do the IMF's transparency codes help in the fight against corruption?

Greater transparency and accountability may be expected to improve the quality of economic decision—making and strengthen the international financial system. At the same time, these are dimensions of good governance that are critically important to any anti-corruption strategy. The IMF endorses and actively promotes internationally recognized codes and standards in the policy areas within its mandate. It has itself developed two policy transparency codes, one on fiscal policy and another on monetary and financial policies. In addition, the IMF has developed a standard for economic and financial data, the Special Data Dissemination Standard (SDDS). This is intended for countries who access international capital markets, and most of them subscribe to it. Countries for whom the SDDS is currently too ambitious can adhere to a developmental framework for strengthening their data dissemination practices, the General Data Dissemination System (GDDS). The IMF encourages countries to work towards compliance with these codes and standards, realizing full well that for many countries this will require considerable efforts and time-consuming institution building.

At the request of countries, and in collaboration with the authorities, IMF staff will prepare reports on compliance with these transparency codes and the SDDS. These are bundled, together with reports by World Bank staff on other financial and economic codes and standards, in the so called *Reports on Observance of Standards and Codes (ROSCs)*.

How does the IMF promote good governance through transparency in fiscal policy?

Particularly pertinent to the promotion of good governance and the prevention of public sector corruption is the IMF's *Code of Good Practices on Fiscal Transparency*. The primary purpose of the code is to develop the capacity in domestic institutions—legislature, auditor general, financial markets, press—as well as among the public and non-governmental organizations, to hold their governments accountable for fiscal policy and fiscal management.

A paper presented to the 1999 International Anti-Corruption Conference described why the IMF's fiscal transparency code is a potentially powerful anti-corruption tool. While all provisions of the fiscal transparency code promote good governance, a few of them deserve to be highlighted because they do so very directly. These include the provisions that insist on: a clear demarcation between the government, on the one hand, and the rest of the public sector and economy, on the other (par. 1.1); a legal or regulatory basis for all budgetary and extra budgetary activities, and all taxes, duties and fees (par. 1.2); ethical standards for public servants (par. 1.2.3); gross reporting of all revenue and expenditure transactions (par. 3.2); proper accounting systems (par. 4.1.2); standardized procedures for procurement and employment (par. 3.3.2); and internal and external audit procedures (par. 4.2).

The code is accompanied by a *Manual on Fiscal Transparency*. Drawing on transparency practices around the world, this can serve as a good source of inspiration and reference for policy makers seeking to implement the code.

Progress with implementing the fiscal transparency code was reported in a paper presented at the 2001 International Anti-

Corruption Conference.

What does the IMF do to promote transparency in monetary and financial policies?

Governance problems may arise when central banks and bank regulators and supervisors interact with commercial banks and other financial institutions. The IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration on Principles* is particularly aimed at promoting good governance in this area. Its primary purpose is to develop the capacity of domestic institutions—legislature, auditor general, financial markets, press—as well as the public and non-governmental organizations, to hold their monetary and financial authorities accountable for monetary policy and management, and the supervision of and any interventions in financial institutions. As such, the code can be a useful tool in preventing corruption.

While all the provisions of the monetary and financial transparency code promote good governance, a few of them are more directly relevant to corruption. Of central banks, the code requires public disclosure of: information on emergency financial support and foreign exchange reserve assets, liabilities and commitments (par. 3.2.); properly audited financial statements, including information on accounting policies and any qualifications, and internal governance procedures (par. 4.2); and information on expenses and revenues (par. 4.3). It also calls for the ready availability to the public of the texts of regulations issued (for instance, on foreign exchange controls) (par. 3.4), and for a code of conduct for staff (par. 4.4).

A separate section of the monetary and financial policies transparency code deals with financial agencies, especially those involved in the supervision and restructuring of banks. It requires of them the same level of public disclosure and internal governance as required of central banks. Other provisions with a special relevance to corruption are those requiring openness on the procedures for appointment, terms of office and removal of senior staff (par. 5.1.4); periodic public reporting on major developments and of aggregate data and balance sheet information (paragraphs 7.1. 7.2 and 7.3);

and political accountability (par. 8.1).

The monetary and financial transparency code is accompanied by a *Supporting Document*. Drawing on transparency practices around the world, this is a good source of inspiration and reference for central banks and financial agencies seeking to implement the code.

Does the IMF deal with corporate governance?

The term "corporate governance" refers to the rules, regulations, practices and institutions governing the relations between the owners—i.e., the shareholders in case of a corporation—and the managers of an enterprise. It deals with how the managers can be made to run the enterprise in the best interest of the owners, and possibly other "stakeholders". Thus, corporate governance is quite distinct from the political and economic governance of states (or lower level governments).

Clearly, good corporate governance is of the utmost importance to the smooth functioning of a country's business and financial sectors. The collaboration between the IMF and the World Bank on international standards for economic and financial systems has therefore been extended to corporate governance. The World Bank has developed a template that is being used for country assessment of corporate governance (see *Reports on the Observance of Standards and Codes (ROSCs)* and the link on that page to ROSCs produced by the World Bank).

The IMF, jointly with the World Bank, has also developed the *Financial Sector Assessment Program (FSAP)*. The detailed assessments of observance of relevant financial sector standards and codes, reported in the ROSCs, are a key component of the FSAP. FSAP's aim is to promote the soundness of financial systems in member countries by ensuring that their financial sector regulation stimulates good corporate governance in financial institutions.

What does the IMF do to ensure good governance in-house?

Just as it promotes good governance among its members, the IMF also makes sure good governance prevails inside its organization. The centerpiece of its efforts to ensure ethical conduct and prevent corruption among its staff is its *Code of Conduct for Staff*. The implementation of this code is bolstered by extensive financial disclosure requirements for senior staff, and sanctions. The code outlines in one document the guidelines for staff conduct, which are prescribed in various Fund rules and regulations. It also provides guidance on how to exercise good judgment in ethical matters, and it includes practical examples to illustrate how the rules can be applied. There is a separate but similar *Code of Conduct for Members of the Executive Board* who are appointed or elected by their national authorities and are not IMF staff. They are also covered by the same financial disclosure requirements as senior IMF staff. The position of Ethics Officer has been established to provide the services of an impartial person to inquire into alleged violations of the IMF's internal rules and regulations and *Code of Conduct for Staff*.

The foundation on which the IMF conducts its procurement activities as well as the expectations it has of its current and potential suppliers are described in an *IMF Procurement Guide for Suppliers*.

The IMF's financial statements are prepared according to International Accounting Standards (IAS), and they are audited in accordance with the International Standards on Auditing (ISA). A description of accounting principles and auditing procedures can be found in *Financial Organization and Operations of the IMF*. A Summary of Significant Accounting Policies and the statement from the external auditor can be found in the Financial Statements appendix to the *Annual Report*.

The IMF's website contains much information on the IMF's overall governance structure, such as: membership, quotas and voting structure; Governors, Executive Directors, and Management; and Articles of Agreements, and by-laws. A comprehensive description is also contained in the publication *Governance of the IMF, Decision Making, Institutional Oversight, Transparency, and Accountability*, which also includes a case study of IMF governance during the 1994/95 Mexican currency crisis.

A recent addition to the IMF's governance structure is the *Independent Evaluation Office (IEO)*. By reporting directly to the IMF's Executive Board, independently of IMF management, on issues related to the IMF's effectiveness, it supports the Board in discharging its institutional governance and oversight responsibilities. Public accountability is also served by the IMF's Transparency Policy which has opened most IMF activities to public scrutiny, including its reports on the economies of a majority of its member countries, its lending activities, and many of its policy deliberations.