EXPANDED MANDATE FOR THE IMF: GLOBAL FINANCIAL STABILITY
LEGAL IMPLICATIONS FOR THE ARTICLES OF AGREEMENT

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The International Monetary Fund (IMF), an institution that almost lost its meaning before the Great Recession of 2007-2010, came back to life in all its powers (and limitations). This paper explores how to keep the IMF relevant in the current international economic environment.

This paper will advocate an expanded mandate for the IMF in the area of global financial stability. This study affirms that the institution’s irrelevance before the Great Recession was due to the narrow mandate with respect to international monetary problems. Institutional reforms are being discussed in different forums, and this paper will propose certain reforms of


the International Monetary Fund (IMF) with regard to its mandate. Following economic theory, the IMF should be able to oversee not only the exchange rate developments of its members, but also developments in the financial sector, capital flows, and domestic macroeconomic policies. The question thus becomes: What are the legal implications if global financial stability is incorporated into the purposes of the IMF and the observance of that purpose becomes one of the obligations of its members under the Articles of Agreement?

I. INTRODUCTION

The 2007-2010 financial crisis was the first global financial crisis since the Great Depression.3 Its magnitude brought the global economy to the brink of collapse with a protracted economic downturn, high financial volatility and social instability.4 This was due to the voracious spillovers that propagated in several phases and through different channels.5

A confluence of factors contributed to the development of the crisis, some reminiscent of past turmoil and others surprisingly new.6 Four features are common to past crises: unsustainable asset price increases, credit booms that led to excessive debt

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5 Claessens, Dell’Ariccia, Igan and Laeven, supra note 3, at 11–13.
6 Id., at 4.
burdens, build-up of marginal loans and systemic risk,
and the failure of regulation and supervision to keep up
with and get ahead of the crisis when erupted.\(^7\) Four
new essential aspects played important roles, especially
in the transmission and amplification of the crisis: a)
the widespread use of complex and opaque financial
instruments, b) the increased interconnectedness among
financial markets, nationally and internationally, with
the U.S. at the core; c) the high degree of leverage of
financial institutions, and d) the central role of the
household sector.\(^8\)

All these complexities call (just like a déjà-vu
back to the 1998 Asian crisis) for a “new international
financial architecture” (if ever one existed, to quote Paul
Krugman).\(^9\) This Crisis is all about global, systemic
risk.\(^10\) In order to ascertain the dangers at a global
scale, close collaboration among international
institutions is mandatory. Such collaboration is
predicated on each of these institutions having a clear
and delineated mandate, which is not the case at this
point.

‘Connecting the dots’ across financial institutions,
markets and countries, understanding risks, and
bringing out solutions require working from a common
platform. The world needs a multilateral institution at
the center of the world economy to help anchor global
financial stability.

To be effective, the institution requires a
strong and respected voice, human and
financial resources appropriate to its mission
and it must be accountable to its members. It
must also work closely with other

\(^7\) Id., at 4–7.
\(^8\) Id., at 7–11.
\(^9\) For an example of a new approach to international financial ar-
chitecture in the wake of the 1998 Asian crisis, see generally BARRY
EICHENGREEN, TOWARD A NEW INTERNATIONAL FINANCIAL ARCHI-
\(^10\) See Claessens, Dell’Ariccia, Igan and Laeven, supra note 3, pas-
sim (identifying areas of systemic risk and the failure of institu-
tions to identify or contain that risk).
international organizations and standard
setters, and provide a focal point for
discussions on crisis management and the
macroeconomics of financial regulation.\textsuperscript{11}
The IMF is seen as being properly designed to be such
an institution,\textsuperscript{12} but the conditions described above
imply a different IMF than that we know today, one
with governance and a mandate with a multilateral
perspective.

II. PROBLEM STATEMENT

The IMF has overstepped its mandate in the past.
For example, was the IMF’s involvement in the Greek
crisis legally justified? There was no balance of
payments problem, but a budgetary one.\textsuperscript{13} Was IMF
entitled to be present in Indonesia back in 1998? There
was no current account problem, but a capital account
one.\textsuperscript{14} The legality of some of the IMF’s operations is
questionable. From an economic point of view though,
the IMF’s presence in one way or the other was needed,
be it for its seal of approval role or provider of financial
resources.\textsuperscript{15} Even I, a legal thinker, do not question the

\textsuperscript{11} COMM. ON IMF GOVERNANCE REFORM, FINAL REPORT, 3 (2009),
\textsuperscript{12} See id.
\textsuperscript{13} See Q&A: Greek Debt Crisis, BBC NEWS (last updated Nov. 10,
2011, 8:18 AM), http://www.bbc.co.uk/news/business-13798000 (ex-
plaining it was the excessive debts and deficits of Greece that
caus ed the crisis).
\textsuperscript{14} See IMF INDEP. EVALUATION OFFICE, THE IMF AND RECENT CAPITAL ACCOUNT CRISSES: INDONESIA, KOREA, BRAZIL 11–16 (2003),
\textsuperscript{15} See, e.g., Michael Bordo, Ashoka Mody, and Nienke Oome, KEEPING
CAPITAL FLOWING: THE ROLE OF THE IMF 7–9 (Int’l Monetary Fund
Housekeeping” Seal of Approval); IMF LENDING, INT’L MONETARY
FUND (Nov. 23, 2011),
necessity and desirability of the IMF’s involvement when a crisis somewhere in the world occurs, more so when it is a global systemic crisis like the one we are currently experiencing.

However, the outer real world and the legal world should converge if the rule of law is to remain the basis of this economic order. Hence, any legal thinker should start worrying about the limits of the present mandate of the IMF. Many worried in 1998 when the Asian crisis erupted, albeit all the discussions later faltered. Nevertheless, the debate came back to the table when the credit crunch erupted in 2007. This economic crisis has proved to catch everybody by surprise due to its intensity and especially the velocity of the propagation at global scale. There are many aspects that could be discussed when talking about the Great Recession, but only those aspects that underline the pertinence of the IMF and the necessity of expanding its mandate are relevant for the purpose of this paper.


16 E.g., EVA RIESENHUBER, THE INTERNATIONAL MONETARY FUND UNDER CONSTRAINT: LEGITIMACY OF ITS CRISIS MANAGEMENT 71–73 (2001) (“It seems that the gap between the Fund’s mandate by its Articles and the rapid development of the world financial system has become too big to be bridged by a wide interpretation of the Articles of Agreement.”); S. Stanley Katz, The Asian Crisis, the IMF and the Critics, 25 E. Econ. J. 421, 434–37 (1999) (“The question now is whether the Fund’s mandate and patched-up programs are adequate to cope with - and impact - today’s huge, seamless and fast-moving financial markets.”).

17 E.g., IMF Monetary and Capital Mkts. Dep’t and the Strategy, Policy, and Review Dep’t, Financial Sector Surveillance and the Mandate of the Fund, 6–7 (March 19, 2010), http://www.imf.org/external/np/pp/eng/2010/031910.pdf (“But these efforts are running up against the limitations of the current, bilateral-focused surveillance mandate and modalities.”).

18 See Claessens, Dell’Ariccia, Igan and Laeven, supra note 3, at 7–17.
Some relevant reports elaborating on the mandate of the IMF generally argue that the IMF lacks an explicit mandate to oversee global financial stability in all its dimensions – not only exchange rate developments, but also developments in the financial sector, capital flows and domestic macroeconomic policies.\textsuperscript{19} As demonstrated below, the limits are of a legal nature due to the constraints imposed by both Articles I and IV of the Articles of Agreement of the International Monetary Fund.\textsuperscript{20} Any legal discussion must be based on the analysis of these two provisions and the available means to overcome their limitations.


III. (GLOBAL) FINANCIAL STABILITY

III.1. DEFINITION AND MEASURES OF FINANCIAL STABILITY

Financial stability is not easy to define or measure because of the interconnection and interdependence of the different components of the financial system among themselves and with the real economy.\(^{21}\) It gets even more difficult when analyzing the transnational dimension of the system.\(^{22}\) Nevertheless, various central banks and other financial institutions have aimed to “capture conditions of financial stability through various indicators of financial system vulnerabilities.”\(^{23}\) The ongoing research attempts to develop a single aggregate measure that could indicate the degree of financial fragility or stress.\(^{24}\)

A stable financial system is characterized as stable for what it is not rather than for what it is: “absence of excessive volatility, stress or crises.”\(^{25}\) A broader definition is given by the ECB (2007). Financial stability can be defined as

“[A] condition in which the financial system — comprising financial intermediaries, markets and market infrastructure — is capable of withstanding shocks and the unraveling of financial imbalances, thereby mitigating the likelihood of disruptions in the financial intermediation process which are severe enough to significantly


\(^{22}\) Id.

\(^{23}\) Id.

\(^{24}\) Id.

\(^{25}\) Id. at 365-66.
impair the allocation of savings to profitable investment opportunities.”26

There are several measures commonly used in the literature to assess financial stability that focus on six main sectors: the real sector, the corporate sector, the household sector, the external sector, the financial sector and the financial markets.27 Each of these measures may signal certain problems, thus indicating risks and vulnerabilities. For example, the (real) exchange rate (external sector) measures the over-/undervaluation of a currency, which can trigger a crisis (capital outflows, massive inflows or loss of export competitiveness); monetary aggregates (financial sector) measure transactions, savings and credit and an excessive growth of any of these may signal inflationary pressures.28 These sectors and the interactions between them are the building blocks of a financial system.29 The central banks are using various composite indicators to analyze these interlinks.30 The complexity of the system is further increased “by the non-linearities that can affect the propagation of shocks and their transmission from one sector to another.”31 For example, the “links between monetary and financial stability, as monetary conditions will be affected by asset prices and vice versa.”32 Financial stability is assessed through the Financial Stability Reports (FSRs) of central banks around the world and some other international organizations.33

When talking about the global dimension of the financial system, the defining elements become cooperation, collaboration and coordination. In order to

26 Id. at 366.
27 See id. at 366-70.
28 See Gadanecz and Jayaram, supra note 21 at 368.
29 See id. at 370.
30 See id.
31 Id.
32 Id.
33 See id. at 372.
build a global financial stability framework, the
governments and the international organizations must
come together and agree on, firstly, the definition of a
global framework, and secondly, on the set of tools and objectives.

III.2. A NEW GLOBAL FINANCIAL STABILITY FRAMEWORK

“Global financial stability is a public good. A
global financial system requires global solutions.”34 The
 crisis provided plenty of “evidence that financial
stability cannot be ensured only by each country
keeping its domestic financial system in order.”35 No
doubt that is necessary but insufficient.36 Some policy
tools “have an impact beyond a country’s borders,
potentially contributing to instability in other
regions.”37 “[F]inancial distress in one part of the global
financial system [that] can be transmitted rapidly to
other parts due to the many financial and real
interlinkages.”38

There has been increasing progress, since the
crisis erupted, in the area of coordination of systemic
regulation.39 The national authorities reinforced their
commitment to joint and coordinated action on
macroeconomic policies and financial regulatory
reform.40 “Just as financial stability needs help from
monetary and fiscal policy at the national level,
international financial stability needs to be supported
by consistent policies at the global level.”41 Recognizing
this cross-border dimension highlights the need for

34 Hervé Hannoun, Deputy Gen. Manager, Bank for Int’l Settlements, To-
35 Id.
36 Id.
37 Id. at 7.
38 Id. at 25.
39 See id.
40 See id.
41 Hannoun, supra note 34.
more global cooperation among policymakers, as part of a global financial stability framework.

What is a new global financial stability framework? “Global” means comprehensive and worldwide.\(^{42}\) A global framework is “[c]omprehensive’ because such a framework requires contributions from prudential, monetary and fiscal policies, as well as market discipline. Each of these policy areas must incorporate financial stability concerns in the pursuit of its primary objective. Only the combination of these policies can achieve both price stability and financial stability. The framework must also be ‘worldwide’ because the global financial system itself is worldwide.”\(^{43}\)

\(^{42}\) Id. at 2.

\(^{43}\) Id.
The recent crisis revealed the cross-border dimension as the defining element of the financial system.\textsuperscript{44}

A (national) financial stability framework means tools and objectives. The global dimension of these objectives and tools is simply ignored.

**Table 1: Policy areas and contributions to global financial stability\textsuperscript{45}**

<table>
<thead>
<tr>
<th>Policy area</th>
<th>Primary objective</th>
<th>Financial stability objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prudential</td>
<td>Limit distress of individual financial institutions</td>
<td>Address systemic risk (cross section, over time)</td>
</tr>
<tr>
<td>Monetary</td>
<td>Stabilize prices</td>
<td>Lean against boom-bust cycles in credit and asset prices</td>
</tr>
<tr>
<td>Exchange rate</td>
<td>Stabilize exchange rate</td>
<td>Reduce capital flow volatility</td>
</tr>
<tr>
<td>Fiscal</td>
<td>Manage demand counter cyclically</td>
<td>Maintain fiscal buffers that allow a response to financial system stress</td>
</tr>
</tbody>
</table>

\textsuperscript{44} See id. \\
\textsuperscript{45} Id. at 6.
The table above “shows the various policy areas, their primary objectives, and the contribution they can make to financial stability as a secondary objective” (not necessarily yet incorporated as an objective for all policymakers).46 “For example, the objective of monetary policy is to stabili[z]e prices and that of prudential policies is to limit the distress of individual financial institutions.”47 “[P]rudential policies [though] are not enough to achieve financial stability and need to be supported by monetary policy.”48 If this view is accepted, then “the reaction function of the monetary authorities should not be narrowly understood as aiming at controlling inflation over the short run. Rather, it must also take account of credit growth and asset information, with the aim of promoting financial and macroeconomic stability over the medium term. In some circumstances, central banks may need to respond directly to this additional information, even if inflation deviates from its objective in the short run. This is because the trade-off between financial stability and monetary stability may be more apparent than real when the appropriate time horizon is considered. In the long run, the two goals are indeed likely to be complementary.”49

“Similarly, fiscal policy may be used to manage demand counter-cyclically, but it should also take into account the need to maintain fiscal buffers that allow a

46 Id.
47 Id.
48 Hannoun, supra note 34
49 Id. at 6–7.
response to financial system stress. This implies that government debt should be maintained at reasonably low levels in good times so that additional debt can be taken on in times of stress without unsettling financial markets.\textsuperscript{50}

The current legal framework makes the IMF the guardian of the international monetary system. Comparing the global financial system and the international monetary system will expose the narrowness of the IMF’s mandate in overseeing only the international monetary system and, furthermore, the impossibility of promoting —exchange stability if aspects of global financial stability are outside its mandate. In the interconnected world of fluctuating exchange rates depending on capital flows and mechanics of financial markets, focusing only on monetary aspects is a vital structural flaw of the major global supervisor, i.e. the International Monetary Fund.

IV. THE INTERNATIONAL MONETARY SYSTEM

In the beginning of the IMF’s life there was no awareness of a legal concept of an international monetary system, although the system as such definitely existed.\textsuperscript{51} There was no reference to it in the original Articles,\textsuperscript{52} but reference to the system was introduced in the Second Amendment.\textsuperscript{53} “Although not defined in the Articles, the term was discussed

\textsuperscript{50} Id. at 7.


\textsuperscript{52} See id.; see also Articles of Agreement of the International Monetary Fund, effective December 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39 [hereinafter Original IMF Articles of Agreement].

extensively in the Fund’s work on international monetary reform in the 1960s and early 1970s, including the work that led to the Second Amendment.”  

The expression was not introduced in Article I, however, even though that provision sets forth the purposes of the IMF. Reference should have been made in the introductory article if the concept was to appear in the body text of the treaty, as it does in Article IV Sections 1, 2 and 4, Article VIII Section 7, Article XXII, and Schedule D, paragraph 2(a).

The Articles have granted legal character on the concept of the international monetary system, but the Articles do not attempt to define it. In the absence of a definition, it cannot be said with assurance what the concept means for the purposes of the Articles until the Fund adopts an interpretation. If a problem of interpretation were to arise, the purposes of the Fund in Article I could not be ignored.

The IMF Legal Department explains its view of the organization’s objectives as such:

The relevant sources reveal that, while the objectives and benefits of a stable international monetary system are relatively broad, the elements of the system itself are rather specific, and consist of four elements:

- The rules governing exchange arrangements between countries and the rates at which foreign exchange is purchased and sold;

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56 See GOLD, supra note 51 at 26–28. See also IMF Articles of Agreement, supra note 55 art. IV, VIII, XXII, Schedule D.
57 GOLD, supra note 55, at 28.
• The rules governing the making of payments and transfers for current international transactions between countries;
• The rules governing the regulation of international capital movements; and
• The arrangements under which international reserves are held, including official arrangements through which countries have access to liquidity through purchases from the Fund or under official currency swap arrangements.  

IV.1. The IMF and the International Monetary System

Article I(i) – Purposes:
“To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems”

The first of the various purposes of the IMF establish that its area of interest is as broad as the international monetary system, including all monetary problems whatever they may be. “[T]he Fund’s function within that sphere is supervision of the management and adaptation of the system.” What is noticeable is that while the IMF is concerned with any monetary problems, it does not necessarily have regulatory authority over them, or have to find a solution binding on its members.

58 The Fund’s Mandate, supra note 54, at 10.
59 IMF Articles of Agreement, supra note 55, at Art. I(i).
60 Cf. GOLD, supra note 51, at 44 (“The focus of a fourth approach is on the problems to be resolved by the international monetary system. . . . These problems have been regarded sometimes as problems that an international monetary system must solve whatever its content may be[.]”).
61 GOLD, supra note 51, at 36.
62 See GOLD, supra note 51, at 36 (“The concern of the Fund with a problem of the international monetary system does not mean that the Fund has regula-
monetary law is not confined to the *corpus juris* of the Fund but includes the constitutive and other legal instruments of these other organizations and bodies” concerned with monetary problems, as well as relevant customary international law. Any monetary issue could be dealt with within another forum or bilaterally, as long as those other obligations remain fully compatible with the relevant Articles of the IMF Agreement.

To conclude, the international monetary system is comprised of the rules regulating the exchange rates, the payments and transfers for current international transactions, the international capital movements and the foreign reserves; all aspects related to the external policies of an economy. The IMF’s sphere of interest extends to all the international monetary problems concerning the international monetary system, which is a dynamic system. The international monetary law is not limited to the IMF’s law and the IMF’s regulatory authority does not cover all monetary problems. Global financial stability must become an objective of prudent monetary and fiscal policies. In order to build a global financial stability framework, the national authorities that pursue these policies must act in a coordinated manner at a global scale. The global financial system

tory authority under its Articles to advance a solution of the problem and to bind its members to accept the solution.”).

63 **GOLD, supra** note 51, at 38.

64 **GOLD, supra** note 51, at 36 (“If there is a gap in the Fund’s regulatory authority, members may fill it by action outside the Fund, provided that the way in which they fill it is not in conflict with the Articles.”).

65 See The Fund’s Mandate, *supra* note 54 at 10 (describing the elements of the International Monetary System).


67 See **GOLD, supra** note 51, at 36 (“The concern of the Fund with a problem of the international monetary system does not mean that the Fund has regulatory authority under its Articles to advance a solution of the problem and to bind its members to accept the solution.”).

68 Cf. The Fund’s Mandate, *supra* note 54, at 11 (noting the interplay between domestic financial sectors and the stability of the international monetary system).
is concerned not only with exchange rates and international capital movements, but also with domestic macroeconomic policies coordination and financial sector developments.\(^69\) These conclusions are relevant for the following discussion on incorporating global financial stability in the IMF’s Member States list of obligations. The main idea is to shift the focus from domestic stability to systemic stability, contrary to the status quo.

\section*{V. \textbf{Mandate of the International Monetary Fund and its Members' Obligations}}

Like any other international organization, the IMF’s mandate is founded in the Articles of Agreement, which sets forth the specific powers granted to the IMF and the purposes for which the IMF’s powers have been granted.\(^70\) The extension of the IMF’s mandate is directly proportional to the extension of its members’ obligations.\(^71\) The IMF’s mandate covers all the international monetary problems, but has regulatory authority only over the system of exchange rates and the international system of payments.\(^72\) (Article I). IMF members’ obligations also relate to the same elements of the international monetary system, with the distinction that their responsibilities concerning domestic policies are “soft,” while those concerning external policies are “hard.”\(^73\)

\begin{flushleft}
\(^{69}\) \textit{See} \textit{Summary of Issues and Reform Options, supra} note 19, at 20 (describing the shortcomings of the IMF’s surveillance powers with respect to these factors).

\(^{70}\) The Fund’s Mandate, \textit{supra} note 54, at 1.

\(^{71}\) \textit{See GOLD, supra} note 51, at 36 (“The obligations of members, including the obligations that subject members to the regulatory authority of the Fund, are those that members have accepted by subscribing to the Articles. New obligations can be created only by amendment of the Articles[.]”).

\(^{72}\) \textit{See IMF Articles of Agreement, supra} note 55, at art. I, IV, VIII; \textit{GOLD, supra} note 51 at 407–17.

\(^{73}\) \textit{See The Fund’s Mandate, supra} note 54, at 6 (describing soft obligations as those requiring “best efforts” and hard obligations as those requiring achievement of results).
\end{flushleft}
The IMF’s obligation of surveillance spreads over the entire international monetary system (multilateral surveillance), as well as over each member’s policies individually, with a particularly hard obligation to carry firm surveillance over the exchange rate policies of its members (bilateral surveillance).\textsuperscript{74}

V.1. Article I – Purposes of the Articles of Agreement of the IMF

The purposes are laid down in Article I and have remained unchanged since the IMF was established in 1945.\textsuperscript{75} They are exhaustive and do not, in and of themselves, confer powers on the Fund, but they are intended to provide guidance as to how the powers set forth elsewhere in the Articles should be exercised.\textsuperscript{76}

Table 2: Article I - Purposes

Article I: Purposes

The purposes of the International Monetary Fund are:

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

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

\textsuperscript{74} See id., at 3 (overviewing the surveillance capabilities of the IMF). See generally, IMF Articles of Agreement, supra note 55, at art. IV § 3.

\textsuperscript{75} The Fund’s Mandate, supra note 54, at 1.

\textsuperscript{76} Id. at 1–2.
members as primary objectives of economic policy.

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

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

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

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

The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article.77

All the powers granted to the IMF relate to problems in the balance of payments of its members.78 While the IMF’s purpose is to provide the platform for collaboration on monetary problems between its members,79

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77 IMF Articles of Agreement, supra note 55, at Art. I.
78 See IMF Articles of Agreement, supra note 55, at art. I(vi); The Fund’s Mandate, supra note 54, at 3.
79 See IMF Articles of Agreement, supra note 55, at art. I(i).
the granted power intended to achieve that purpose is the one enunciated in Article IV Section 3. That provision enables the IMF to oversee the management and adaptation of the international monetary system (multilateral surveillance) and to supervise the members’ obligation of collaboration to promote a stable system of exchange rates (bilateral surveillance). Article I(iii) and Article IV § 3 focus on the stability of the system of exchange rates. As such, for the IMF to exercise its powers all problems must relate to the balance of payments and every economic policy pursued by a member is considered in the view of its impact on the exchange rate.

V.2. Obligations of the Member States: Article IV, Section 1 of the IMF’s Articles of Agreement

The “essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services and capital among countries, and that sustains sound economic growth.” Additionally, a “principal objective” of the system “is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability.”

80 See id. at art. IV § 3.
81 Id. at art. IV. § 3(a).
82 Id. at art. I(iii), IV § 3.
83 See The Fund’s Mandate, supra note 54, at 3–4, (“[T]he Fund’s authority in the domestic area is derivative; i.e., the basis of this authority is derived from the potential impact of domestic conditions and policies on the balance of payments of individual members and on the overall international monetary system.”).
84 IMF Articles of Agreement, supra note 55, at art. IV § 1.
85 Id.
The purpose of the international monetary system is not the purpose of the IMF.\(^{86}\) The IMF has regulatory authority over some components of the system.\(^{87}\) Making the purpose of the IMF similar to that of the system would have meant a significant increase of jurisdiction, and the drafters wished to avoid such augmentation, even at the time of the Second Amendment.\(^{88}\) “The assumption underlying the preamble is that, to the extent that members observe their general obligations set forth in Article IV, Section 1, they will enhance the effective functioning of the international monetary system and, thereby, contribute to the realization of the broader economic benefits identified in this text.”\(^{89}\)

**The General Obligation to Collaborate**

“[E]ach member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.”\(^{90}\)

This represents members’ general obligation of collaboration. “The nature of the actions that members must take to satisfy the obligation of collaboration can only be determined in light of the objectives of this collaboration: to ‘promote orderly exchange arrangements and a stable system of exchange rates’.”\(^{91}\)

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\(^{87}\) See *supra* Part IV.1.

\(^{88}\) See Article IV Overview, *supra* note 86, at 8 (describing tensions which could result from impinging on members’ sovereignty by extending the IMF’s mandate).

\(^{89}\) *Id.* at 8.

\(^{90}\) IMF Articles of Agreement, *supra* note 55, at Art IV § 1 pmbl.

Similar to the purposes and the obligation of bilateral surveillance of the IMF, members’ obligation of collaboration is directly related to the stability of the system of exchange rates (systemic stability).

**The Specific Obligations**

Article IV Section 1 lays down four specific obligations of particular importance directly related to the general obligation of collaboration of members.

The first two provisions have as their object the domestic policies of member states. The wording of these provisions makes them particularly “soft” obligations, as a member state is required only to “endeavor to direct its economic and financial policies toward [growth and stability]” and to “seek to promote stability by fostering orderly underlying economic . . . conditions.” The weakness of the obligations is not surprising considering that the mentioned domestic policies to be pursued (economic and financial policies) are a matter of national sovereignty. Consequently, a member could not be required through Article IV consultations to change its domestic policies if presumed

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92 *See* The Fund’s Mandate, *supra* note 54, at 7 (describing the scope of surveillance as the promotion of “external stability,” as measured by balance of payments).
93 *See* The Fund’s Mandate, *supra* note 54, at 7 (describing the assumption that members’ promotion of their own stability will promote stability of the overall system); Article IV Overview, *supra* note 86, at 12 (citing 1969 IMF Articles of Agreement, *supra* note 91, at art. IV § 4(a) (comparing versions of the IMF Articles of Agreement).
94 Article IV Overview, *supra* note 86, at 13. The four obligations are (i) direction of domestic economic and financial policies, (ii) promotion of domestic economic stability, (iii) avoiding exchange rate manipulation, and (iv) adhering to exchange policies consistent with art. IV, § 1 in general. *See* IMF Articles of Agreement, *supra* note 55, at art. IV § 1.
95 *See* IMF Articles of Agreement, *supra* note 55, at art. IV §§ 1(i), 1(ii).
96 *Id.* at art IV § 1(i).
97 *Id.* at art. IV § 1(ii).
stable. The last two provisions, (iii) and (iv), refer to a member’s external policies, and therefore are formulated in “hard” language requiring actual results rather than mere efforts. The logic behind the wording of the article is that systemic stability is presumed achieved if domestic and external stability are achieved, and, even more, the stability of the system of exchange rates would be enhanced if appropriate economic policies are pursued.

V.3. Obligations of the Fund (Article IV Section 3) – Surveillance

At the very basic, Article IV § 3(a) represents the provision conferring to the IMF the power to conduct multilateral and bilateral surveillance.

The second paragraph raises the level of surveillance to “firm” as it is directly related to the “hard” obligations for members’ exchange rate policies. This provision “is perceived to undermine

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98 See The Fund’s Mandate, supra note 54, at 6 (“members’ obligations respecting domestic policies only require members to take action to promote their own domestic stability.”).
99 See Article IV Overview, supra note 86, at 15–17 (describing the obligations); The Fund’s Mandate, supra note 54, at 6 (same). Specifically, Article IV § 1(iii) requires member states to “avoid manipulating exchange rates” and Article IV § 1(iv) requires “following exchange policies compatible with . . . this Section.” IMF Articles of Agreement, supra note 55, at art. IV §§ 1(iii), 1(iv).
100 See Article IV Overview, supra note 86, at 14 (“[T]he assumption is that, by fostering orderly underlying economic conditions and a stable monetary system at the domestic level, members help ensure orderly exchange arrangements and a stable system of exchange rates.”); The Fund’s Mandate, supra note 54, at 7.
101 See IMF Articles of Agreement, supra note 55, at art. IV § 3(a) (“The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.”).
102 Id. at art. IV § 3(b) (“the Fund shall exercise firm surveillance over the exchange rate policies of members”).
103 Id. at art. IV §§ 1(iii), 1(iv). See also Article IV Overview, supra note 86, at 18 (describing IMF members’ obligations under art. IV regarding exchange rates).
evenhandedness, given the fact that ‘firm’ surveillance is only to be exercised over members’ exchange rate policies, implying that there is closer scrutiny of members with fixed or managed exchange rates," unlike those that let their currencies float.\textsuperscript{104}

V.4. June 2007 Decision on Bilateral Surveillance over Members’ Policies

The 2007 Decision\textsuperscript{105} provides further guidance to both the Fund and its members regarding their mutual responsibilities under Article IV in a number of respects.

The concept of “external stability” is introduced in order to clarify the scope of surveillance.\textsuperscript{106} External stability “refers to a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements.”\textsuperscript{107}

The 2007 Decision notes that Members promote the stability of the overall system of exchange rates (which it defines as “systemic stability”) by promoting their own external stability.\textsuperscript{108} Accordingly, the IMF, in its bilateral surveillance, will assess whether the Member’s policies are promoting external stability and will advise on policy adjustments necessary for this purpose.\textsuperscript{109}

Furthermore, the 2007 Decision provides that Members, in conduct of their domestic policies, will be considered by the IMF to be promoting external stability

\begin{itemize}
\item \textsuperscript{104} Summary of Issues and Reform Options, \textit{supra} note 19, at 20.
\item \textsuperscript{106} \textit{Id.} ¶ 4.
\item \textsuperscript{107} \textit{Id.}
\item \textsuperscript{108} \textit{Id.} ¶ 5.
\item \textsuperscript{109} \textit{Id.}
\end{itemize}
when they are promoting “domestic stability.” Consequently, a member that is in compliance with its domestic policy obligations may not be required to change its domestic policies to further enhance systemic stability.

VI. PROPOSAL

VI.1. Identified Problematic Provisions

Purposes

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

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110 Id. ¶ 6 (“In the conduct of their domestic economic and financial policies, members are considered by the Fund to be promoting external stability when they are promoting domestic stability. . . . The Fund in its surveillance will assess whether a member's domestic policies are directed toward the promotion of domestic stability. While the Fund will always examine whether a member's domestic policies are directed toward keeping the member's economy operating broadly at capacity, the Fund will examine whether domestic policies are directed toward fostering a high rate of potential growth only in those cases where such high potential growth significantly influences prospects for domestic, and thereby external, stability.”).

111 Id.

Article I (iii) “... to promote exchange stability...”

**Obligations of Members**

**Article IV, Section 1, Preamble: “... to promote a stable system of exchange rates.”**

**Article IV, Section 1, paragraph (i): “endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances.”**

**Article IV, Section 1, paragraph (ii): “seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions.”**

**Article IV, Section 3, paragraph (b): “... the Fund shall exercise firm surveillance over the exchange rate policies of members...”**

**VI.2. Overview**

Balance of payments (current account) is the quintessence representing the IMF; all its powers (supervisory, financial assistance, advisory) are exercised when there is a balance of payments problem.

The IMF is equipped with the mandate to monitor members’ obligations to promote “a stable system of exchange rates.” This limited mandate forces it to view macroeconomic developments through the prism of their impact on exchange rates (defined in the 2007 Decision as “external stability”). Due to this

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113 Id. art. I (iii).
114 Id. art. IV, § 1.
115 Id. art. IV, § 1(i).
116 Id. art. IV, § 1(ii).
117 Id. art. IV, § 3(b).
118 Id. art. IV, § 1.
narrow view, linkages via financial channels and capital flows are not properly assessed. For example, “the transmission of the current financial crisis from the United States did not, for instance, occur via a dollar collapse, as the Fund had feared, but rather through financial sector de-leveraging and massive capital reflows from emerging markets to US safety.” Accordingly, “the case is made to broaden the Fund’s surveillance mandate to give equal weight to macroeconomic and prudential policies and financial spillovers.”

A policy paper of the IMF, published in January 2010, notes that, “given the evolution of the capital markets, there may be circumstances where the domestic policies of members have important spill-over effects on the balance of payments position of other countries (i.e., they have an impact on systemic stability), even though they are not transmitted through the balance of payments of the member in question.” Such spill-over effects, under the 2007 Decision, “may not be discussed in the context of surveillance because they are not transmitted through the balance of payments.”

The Legal Department of the IMF proposed that the definition of external stability set forth in the 2007 Decision “could be revised to ensure that surveillance addresses circumstances where domestic policies impact the balance of payments of other countries, even where this effect is not transmitted though the member’s own

120 IMF, supra note 54, at Error! Bookmark not defined., ¶ 33.
121 Id.
123 IMF, supra note 54, at 8, ¶ 14.
124 Id.
balance of payments.” However, even if the definition of “external stability” would be revised, a more fundamental problem would still exist. As described above, due to the structure of Article IV Section 1, paragraphs (i) and (ii), unless a member’s domestic policies undermine domestic stability (for example, where they give rise to external instability), the member is not required to change its domestic policies under Article IV even in order to further promote systemic stability. The Legal Department of the IMF suggested that in order to change this situation, it would be necessary to amend Article IV itself. The Legal Department continued, noting:

Such an amendment could reconsider the primacy that is given to exchange rate policies over domestic policies and, in that context, expand members’ obligations relating to domestic policies in a manner that would require a member to adjust its domestic policies to support systemic stability—even if the domestic policies in question are not undermining the member’s own domestic stability. This would represent, however, a significant surrender of national sovereignty.

This study proposes a rebalancing of members’ obligations without a significant surrender of sovereignty. As already demonstrated earlier, the stability of either system, international monetary or global financial, cannot be ignored anymore. This could only be realized through coordination of fundamental domestic policies and proper balancing between domestic and systemic stability. Hence, members must collaborate with the IMF and each other to assure

125 Id.
126 Id. at 8, ¶ 15.
127 See supra Part VI.1 and 2.
128 IMF, supra note Error! Bookmark not defined., at 8, ¶ 16.
129 Id.
systemic monetary and financial stability (not only the stability of the system of exchange rates). Furthermore, with regard to the specific obligations of Article IV, members must pay due regard to the circumstances of the system, and not only to their own circumstances. The respective provisions need not be “hardened,” as soft law

can overcome deadlocks in the relations of states that result from economic or political differences among them when efforts at firmer solutions have been unavailing. . . . The soft law of these [international] organizations is the result not of a failure of will or technical skill on their part, but of the deep divisions among members. An organization, to succeed, cannot be too far in advance of the common will of its member[s].

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The stability of the international monetary system and the stability of the global financial system are complementary objectives to be pursued by states, private actors, international organizations and other bodies etc.

VI.3. Amendment

As “The Fund shall be guided in all its policies and decisions by the purposes set forth in this Article,” it is imperative that “global financial stability” becomes one of the IMF’s expressly stated purposes.

Purposes

To be deleted: Article I (vi): “In accordance with the above, to shorten the duration and lessen the degree of

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130 Gold, supra note 51, at 516.
131 IMF Articles of Agreement, supra note 54, art. I.
disequilibrium in the international balances of payments of members.”

Article I (iii) “to promote exchange stability” to be complemented by “to promote global financial stability.”

Obligations of Members

Art IV, Section 1, Preamble: “. . . to promote a stable system of exchange rates” must be complemented with the “promotion of a stable global financial system.”

Article IV, Section 1, paragraph (i): “endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances.” The last expression, “due regard to its circumstances,” to be replaced by “due regard to the circumstances of the global financial and international monetary system.”

Article IV, Section 1, paragraph (ii): “seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions.” The phrase “to promote stability” is to be replaced by “to promote global financial stability.” Furthermore, “to seek to promote international monetary stability by fostering a monetary system that does not tend to produce erratic disruptions” to replace “a monetary system that does not tend to produce erratic disruptions.”

132 Id. art. I (vi).
133 Id. art. I (iii).
134 The expression “exchange stability” is subject to further research if it should be replaced by “international monetary stability,” depending on the powers granted to the IMF with regard to international capital flows and reserve assets.
135 IMF Articles of Agreement, supra note 54, art. IV, § 1.
136 Id. art. IV, § 1(i).
137 Id. art. IV, § 1(ii).
Article IV, Section 3, paragraph (b): “. . . the Fund shall exercise firm surveillance over the exchange rate policies of members . . .” The term “firm surveillance” is to be exercised over all obligations of members.

VII. CONCLUSION

This study attempted demonstrated the narrowness of the current mandate of the International Monetary Fund that focuses only on the stability of the system of exchange rates in a world of massive international capital flows and gargantuan foreign reserves. The current crisis has placed in the spotlight the necessity of a stable global financial system that can only be achieved by coordination at the international level of governments and international organizations and other bodies. The IMF is the only international organization that has both the capacity and the expertise to oversee the financial systemic stability being pursued by its member states. This paper identified where the legal constraints lay and offers a modest proposal for amending those problematic provisions of the Articles of Agreement of the International Monetary Fund.

138 Id. art. IV, § 3(b).