

INTERNATIONAL MONETARY FUND

**2011 Triennial Surveillance Review—Review of the 2007 Surveillance Decision and the
Broader Legal Framework for Surveillance**

Prepared by the Legal and the Strategy, Policy, and Review Departments

In Consultation with the Other Departments

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I. INTRODUCTION

1. **This paper reviews the 2007 Surveillance Decision and the broader legal framework for surveillance.**¹ While the [2007 Surveillance Decision on Bilateral Surveillance over Members' Policies](#) (thereafter, the 2007 Decision) requires the Fund to review the decision itself, this paper takes a broader view. It recognizes that the 2007 Decision cannot be assessed in isolation from the legal framework it derives from, i.e., the Articles of Agreement, and that a debate on the adequacy of this broader framework is also necessary. The paper therefore discusses the strengths and limitations of the current system as set out in both the Articles of Agreement (primarily, Article IV) and the 2007 Decision and explores options going forward.
2. **This review is informed by the findings of the 2011 Triennial Surveillance Review (TSR).**² Staff's findings in the TSR are that surveillance remains fragmented and needs to better recognize the central role of economic and financial interconnections across countries. The TSR also notes that surveillance should be more risk-based, and that the Fund should play a key role in the promotion of global macro-financial stability. At the same time, a number of issues have been left out of the scope of the 2011 TSR—e.g., the treatment of capital flows, reflecting the fact that conceptual work in this area is very much ongoing.
3. **This review builds on previous and ongoing discussions of the legal framework for surveillance.** It takes account of the difficulties encountered in the early implementation of the 2007 Decision, leading to a revision in the guidance to staff.³ It also builds on the 2010 review of the Fund's mandate, including the discussion of a possible multilateral surveillance decision.⁴ The review acknowledges ongoing debates on related matters within the institution (e.g., on capital flows), as well as outside.^{5,6} It is also informed by the recent Independent Evaluation Office assessment of surveillance in the run-up to the crisis.⁷

¹ A decision adopted in the context of the 2008 Triennial Surveillance Review, provided that the next review of the 2007 Decision on Bilateral Surveillance would be completed by September 26, 2011.

² See [2011 Triennial Surveillance Review—Overview Paper](#) and background documents.

³ [2007 Surveillance Decision—Revised Operational Guidance](#).

⁴ See in particular, [Modernizing the Surveillance Mandate and Modalities](#) and [Review of the Fund's Mandate—Follow Up on Modernizing Surveillance](#).

⁵ For outside views, see for instance [Palais Royal Initiative, Reform of the International Monetary System: a Cooperative Approach for the Twenty First Century](#) (Camdessus, Lamfalussy, Padoa-Schioppa and al., January 2011), and [Strengthening IMF Surveillance: A Comprehensive Proposal](#) (Truman, December 2010).

⁶ See [The Fund's Role Regarding Cross-Border Capital Flows, Recent Experiences Managing Capital Inflows—Cross-Cutting Themes and Possible Guidelines](#). In response to questions raised by some Executive Directors, the staff is also preparing a note on the issues relating to assessing members' reserves in the context of surveillance.

⁷ [IMF Performance in the Run-Up to the Financial and Economic Crisis: IMF Surveillance in 2004–07](#) (IEO, February 2011).

4. **The paper is organized as follows.** Section II summarizes the legal foundation for surveillance in the current system. Section III discusses deficiencies in the current system. Section IV lays out options for reform. Section V suggests issues for discussion.

II. EXISTING LEGAL FRAMEWORK FOR SURVEILLANCE⁸

5. **The legal basis for surveillance is set out in Article IV of the Fund’s Articles.** Article IV distinguishes between *Bilateral Surveillance* and *Multilateral Surveillance* and the decisions adopted by the Fund’s Executive Board maintain this distinction.

Bilateral Surveillance

6. **Article IV imposes obligations on members and the Fund that form the basis of bilateral surveillance.** Under Article IV, Section 1, members are subject to specific obligations with respect to the conduct of their economic policies. For its part, the Fund is required under Article IV, Section 3(a) to oversee the compliance of each member with these obligations. These provisions constitute the legal basis for bilateral surveillance. Importantly, and as is discussed below, the obligations of members and the Fund reflect the primacy that the existing Articles place on members’ exchange rate policies.

7. **Members’ substantive obligations are specified in Article IV, Section 1.** These obligations are set out against the background of a preamble that notes that 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, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability.” While the language of the preamble is broad in scope, focusing on the essential purpose of the international monetary system, the obligations of members are narrower. Specifically, Article IV, Section 1 provides that “each member shall undertake to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates”. This provision also sets forth more specific obligations (Article IV, Sections 1 (i)–(iv)) that are identified as being particularly important means of implementing this general obligation (Box 1).

⁸ For further discussion see: [The Fund’s Mandate—The Legal Framework](#), paragraph 10 and Box 4 (reproduced in Annex 1) and [Article IV of the Fund’s Articles of Agreement—An Overview of the Legal Framework](#).

**Box 1. Obligations of Members and the Fund under [Article IV](#)
Regarding Exchange Arrangements**

Section 1. General obligations of members

Recognizing that 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, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

- (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;
- (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;
- (iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
- (iv) follow exchange policies compatible with the undertakings under this Section.

.....
Section 3. Surveillance over exchange arrangements

(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.

(b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.

8. While these more specific obligations deal with both exchange rate policies and domestic policies, those relating to domestic policies are more limited in two respects:

- *They are of a "soft" nature.* Under Article IV, Sections 1 (i) and (ii), members' obligations relating to domestic policies, including financial sector policies, are limited to exercising "best efforts". In contrast, obligations relating to external policies, including exchange rate policies (Article IV, Sections 1 (iii) and (iv)) are of a "hard" nature, requiring the achievement of results rather than only the exercise of best efforts.

- *They only require members to take action to promote their own domestic stability.* As was discussed in the context of the review of the Fund’s mandate, while the obligations respecting external policies require a member to take into account the effect of these policies on other members, this is not the case with members’ domestic policy obligations: as long as a member is implementing domestic policies in a manner that ensures domestic stability, the member is under no obligation to change these policies, even if a change would further enhance the stability of the overall exchange rate system.⁹

9. **As is the case with the obligations of members, the obligations of the Fund give primacy to exchange rate policies over other policies.** The distinction between domestic and external policies that is made with respect to members’ obligations is also reflected in the scope of the Fund’s overall responsibilities under Article IV. While Article IV imposes a general obligation on the Fund to exercise oversight over *all* of a member’s obligations under Article IV, Section 1, it directs the Fund to give heightened scrutiny (“firm surveillance”) to members’ exchange rate policies. It also requires the Fund to adopt specific principles to guide members in the conduct of these policies. In contrast, no such principles are required with respect to domestic policies.

10. **This asymmetry of treatment between domestic and exchange rate policies originates from the Second Amendment.** The fact that, under the existing framework for bilateral surveillance, exchange rate policies are of primary—but not exclusive—concern reflects a balance that was struck between two competing considerations at the time of the Second Amendment of the Fund’s Articles in 1978. While the obligations of members under the original Articles only dealt with exchange rate policies, it was recognized that, with the abrogation of the fixed exchange rate system, domestic economic and financial policies would have an important impact on the stability of the overall system of exchange rates and, accordingly, should be a subject of members’ obligations under Article IV. At the same time, however, it was still understood that, notwithstanding their international impact, such policies were primarily a matter of domestic concern.¹⁰

11. **The scope of the 2007 Decision is necessarily defined by the scope of Article IV itself.**¹¹ However, within the framework of the Articles, the Decision provides important further guidance to both the Fund and its members regarding their mutual responsibilities under bilateral surveillance. In particular, the Decision:

⁹ See *The Fund’s Mandate—The Legal Framework*, paragraph 10.

¹⁰ See *Article IV of the Fund’s Articles of Agreement—An Overview of the Legal Framework*, page 2.

¹¹ [Bilateral Surveillance over Members’ Policies—Executive Board Decision](#), adopted June 15, 2007).

- Clarifies the *scope* of surveillance under Article IV, Section 1 and, in doing so, introduces the concept of “external stability.” External stability “refers to a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements.” The 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. Accordingly, the Fund, 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.
- Consistent with the constraints imposed by Article IV itself, provides that members, in conduct of their *domestic policies*, will be considered by the Fund to be promoting external stability when they are promoting their own “domestic stability”. However, and in contrast to the 1977 Surveillance Decision that focused exclusively on surveillance over exchange rates policies¹², the 2007 Decision also deals with surveillance over domestic policies and clarifies that fiscal, monetary and financial sector policies (both their macroeconomic aspects and macroeconomically relevant structural aspects) will always be the subject of the Fund’s bilateral surveillance.
- Lays out four *principles* for the guidance of members’ exchange rate policies under Article IV, Section 1—i.e., in a way that is consistent with the objective of promoting stability and avoiding manipulation—and *indicators* that may indicate the need for discussion with a member respecting these principles.¹³

Multilateral Surveillance

Article IV, Section 3(a), which requires the Fund to “oversee the international monetary system in order to ensure its effective operation”, forms the basis for multilateral surveillance. On the one hand, the coverage of this provision is far more comprehensive than that of bilateral surveillance. As discussed in *The Fund’s Mandate—The Legal Framework*,¹⁴ the “international monetary system” includes but is broader than the “system of exchange rates” that is the focus of attention under bilateral surveillance.¹⁵ Moreover, the set of issues that are relevant to ensuring the *effective operation* of the IMS is

¹² *Surveillance over Exchange Rate Policies*, adopted April 29, 1977. This was replaced by the 2007 Decision.

¹³ As noted, Article IV, Section 3(a) requires the Fund to adopt principles for the guidance of members’ exchange rate policies.

¹⁴ *The Fund’s Mandate—The Legal Framework*.

¹⁵ Specifically, it may be understood as consisting of four elements: (i) the rules governing exchange arrangements between countries and the rates at which foreign exchange is purchased and sold; (ii) the rules governing the making of payments and transfers for current international transactions between countries; (iii) the rules governing the regulation of international capital movements; and (iv) 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. See *The Fund’s Mandate—The Legal Framework*, page 10.

even broader than the IMS itself, including issues relevant to global economic and financial stability. On the other hand, the legal framework underlying multilateral surveillance is less robust than the framework for bilateral surveillance. In contrast to bilateral surveillance, the Articles do not identify any specific *substantive* obligations of members in connection with the Fund's mandate to oversee the international monetary system (i.e., obligations that may require members to adjust their policies). Furthermore, while the legal framework for bilateral surveillance has been extensively defined, including through the 2007 Decision, there is no comprehensive Board decision providing guidance on the *scope and modalities* of multilateral surveillance. Nonetheless, in terms of a member's *procedural* obligations, the Fund may require members to consult with it when the Fund concludes that such consultations are necessary in order for it to effectively discharge its oversight responsibilities.¹⁶

III. LIMITATIONS OF THE CURRENT FRAMEWORK

12. **A key issue is whether the above-described framework is the most conducive to the exercise of effective surveillance.** Fundamentally, the essence of the framework has not lost its relevance. And the breadth of the current Article IV has provided some flexibility to adapt surveillance over time in light of the significant changes that have taken place in the world economy since the Second Amendment of the Fund's Articles in 1978. However, these considerations do not guarantee that the framework is providing the most effective foundation for surveillance in practice. Key questions in this respect are: Does the framework adequately capture the economic reality, including the relevance of all policies in determining economic outcomes? Does it best support surveillance operations? And is it sufficiently balanced in its design to ensure adequate ownership by the membership and, thereby, give it the necessary legitimacy for effective surveillance? The remainder of this section explores what staff sees as a number of interrelated shortcomings that suggest room for reforms.

A. Unbalanced and Fragmented Surveillance

Exchange rate bias

13. **The economic framework underlying the legal construct has an exchange rate bias.** Exchange rate policies have a key role to play in promoting economic stability that should be acknowledged. But the framework for bilateral surveillance laid out in Article IV and the 2007 Decision insufficiently recognizes the role of other economic and financial

¹⁶ Relatedly, the Fund can require information to be provided to it for this purpose pursuant to Article VIII, Section 5, which provides that members must provide the Fund with such information as the Fund deems necessary for its activities. Under this provision, the Fund may, by Executive Board decision, require members (either all members or individual members) to provide information that it needs for multilateral surveillance.

policies and the overall interaction of all policies in determining economic outcomes. It also gives insufficient recognition to the full range of issues that ultimately influence the effectiveness of the IMS (Figures 1 and 2). Some of these issues lie at the core of members' obligations under Article IV. In particular, the framework for bilateral surveillance:

- (1) *Defines the scope of collaboration too narrowly.* By focusing on the collaboration of members with the Fund and among themselves “to assure orderly exchange arrangements and promote a stable system of exchange rates,” the general obligation of Article IV, Section 1 deemphasizes the broader objective of a well functioning IMS and, in particular, global economic and financial stability as conditions to achieve it. As observed in 2008–10, systemic crises may originate in, and spread primarily through, the financial system, with severe real consequences for the global economy but only limited impact on the system of exchange rates. The fact that, in establishing obligations for members, the legal framework for surveillance does not fully acknowledge this reality is a problem.
- (2) *Makes an artificial distinction between domestic and external policies.* As noted, in Article IV, as further clarified by the 2007 Decision, “exchange rate policies” are understood to directly affect external stability, while “domestic policies” only do so indirectly through the promotion of domestic stability. In reality, all policies contribute to a country's internal and external balances and may ultimately impact global stability and the functioning of the IMS. In that sense, what truly matters is the contribution to economic outcomes of the combined full range of policies, including fiscal, monetary, financial, structural, capital-account measures, exchange rate, and reserves policies. Moreover, the artificial distinction between domestic and external policies leads to operational difficulties in practice. For instance, in the early implementation of the 2007 Decision, it became clear that attributing a given outcome (e.g., external instability) to a specific policy (e.g., exchange rate policies) in isolation from the rest of the policy mix was very difficult. This point was recognized by the Fund when it revised the guidance to staff on the implementation of the 2007 Decision.¹⁷
- (3) *Establishes asymmetrical obligations.* By requiring members to take into account the external effects of their exchange rate policies but not their domestic policies, Article IV establishes a framework of obligations that is asymmetrical. Such an approach is not grounded in economic reality.

¹⁷ See *The 2007 Surveillance Decision—Revised Operational Guidance*, paragraph 8: “[the revisions] recognize the uncertainty involved in attributing outcomes to exchange rate policies as opposed to other policies, as a result of which cases where a member would be deemed to be in nonobservance of Principle D, in particular, are likely to be very rare.”

- (4) *Uses a difficult-to-assess concept of intent.* Even with exchange rate policies, there are problems with Article IV as the existing obligation respecting exchange rate manipulation requires an additional assessment of intent (e.g., manipulation is only problematic if it is used for the “purpose of” creating an unfair competitive advantage).

Figure 1. Schematic view of the conceptual framework underlying the current legal construct

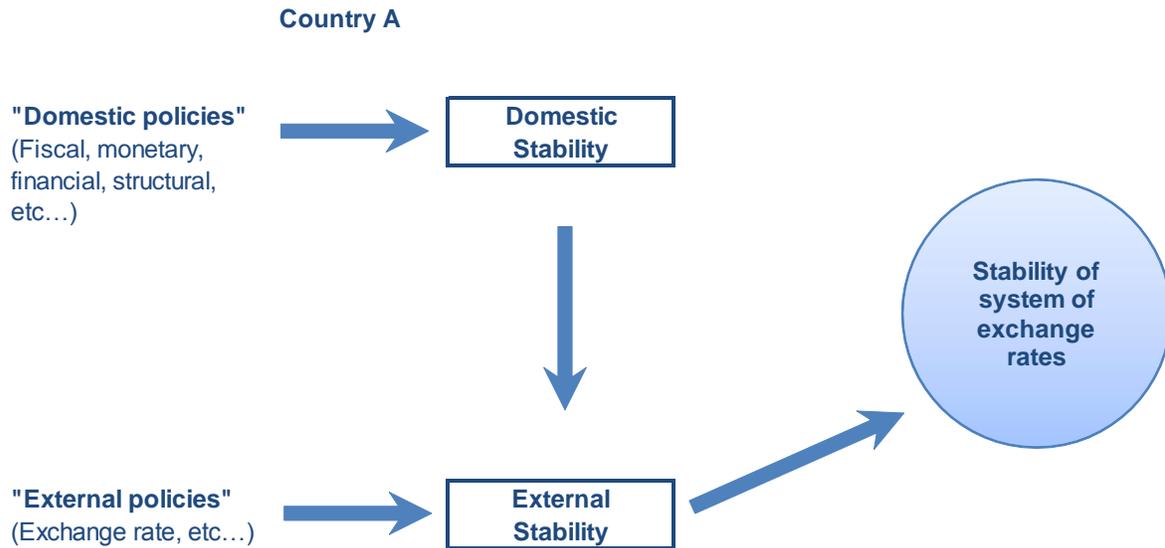
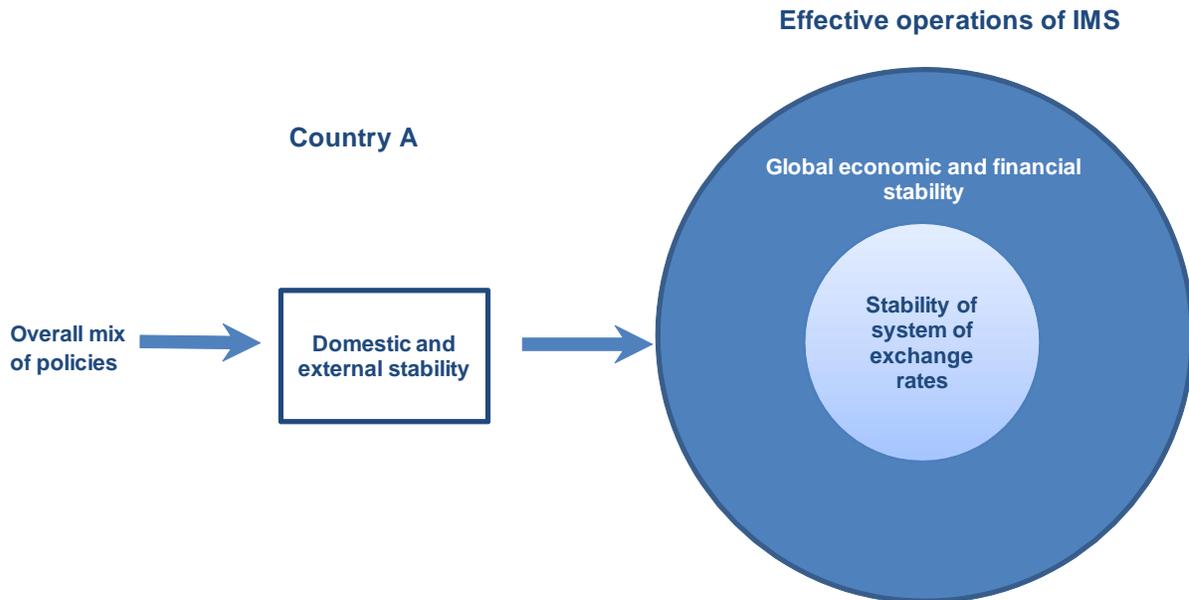


Figure 2. A revamped framework could better recognize the broader objective of surveillance and the interaction of the various policies



Insufficient integration

14. **The framework unduly segments the Fund’s surveillance activities.** Specifically, the current framework:

- (5) *Fails to integrate bilateral surveillance sufficiently with multilateral surveillance.* This is reflected in inadequate attention to inward and outward spillovers (see [2011 Triennial Surveillance Review—Overview Paper](#)) and a “partial equilibrium” bias in bilateral surveillance.¹⁸ As noted earlier, the perspective of bilateral surveillance on spillovers is limited in two important respects. First, under Article IV, where a member is conducting its domestic policies in a manner that promotes its own domestic stability, an examination of the spillover effects of such policies should not be the primary focus of surveillance. Second, under the 2007 Decision, bilateral surveillance permits the Fund to examine outward spillovers arising from a member’s policies only when they are transmitted through the member’s balance of payments, implicitly leaving outward spillovers transmitted through other channels outside of its scope.¹⁹
- (6) *Does not foster the integration of financial sector analysis into surveillance.* Significant operational effort has been made to improve the integration of financial sector analysis into overall surveillance activities, leading to some, but not enough progress (see *Overview Paper*). However, the role of the legal framework in promoting such integration also merits consideration. Because, under bilateral surveillance, the focus on the spillover effects of domestic policies is of a more limited nature, there is insufficient recognition of the role of financial sector policies in the promotion of global financial stability as a key element of an IMS operating effectively. More generally, it is also arguable that greater clarification of the role of the Fund in the promotion of global financial stability in the Articles or Board Decisions would also help foster more effective and better integrated financial sector surveillance.²⁰

B. Legitimacy Deficit

15. **In light of these concerns, it should not be surprising that the current legal framework suffers from insufficient ownership.** The exchange rate bias rooted in Article IV undermines the legitimacy of the Fund as some members who regard the focus on exchange rate policies—and surveillance itself—to be discriminatory against members with fixed exchange rate regimes. Such concerns mirror in many ways the concerns that were raised over the legitimacy of the Fund in the context of the debate over quota and voice reform. In particular, these concerns have:

¹⁸ See *Modernizing the Surveillance Mandate and Modalities*, paragraph 6.

¹⁹ For a more complete discussion of the legal framework governing the coverage of spillovers under bilateral surveillance, see *The Fund’s Mandate—The Legal Framework*, page 8.

²⁰ See [2011 TSR External Study—IMF and Global Financial Stability](#) (Palmer and Tok).

- (7) *Prompted calls to review the Articles.* In the context of the recent review of the Fund mandate, a number of Directors expressed their support for amending the Articles. Such calls reflect the recognition that only a limited rebalancing of the focus of surveillance can be achieved through Board decisions. There was also a desire to better signal the centrality of the Fund in the promotion of global financial stability, including through an explicit mention in Article I.
- (8) *Fueled opposition to the 2007 Decision.* The external consultants who interviewed country authorities for the TSR reported that “most authorities expressed unhappiness with the 2007 Surveillance Decision and felt it had narrowed the focus of surveillance too much towards the exchange rate.”²¹ Some mission chiefs have also expressed reservations with the framework reflected in the 2007 Decision, as illustrated by comments received in response to the TSR survey.²²

Members who question the fairness of the current system may be more likely to accept the legitimacy of the Fund’s advice if the legal framework were to give equal weight to all policies.

C. Other Debates

16. Other debates on legal issues that have a direct impact on the ability of the Fund to conduct effective surveillance are under way:

- (9) *As part of the discussion on how best to get traction for Fund advice, a deeper debate has opened up on the fundamental nature of the Fund (Box 2).* To some extent, this is a debate about where to position the Fund between two models: a purely cooperative institution based on dialogue and persuasion, and an institution charged with the strict enforcement (with the application of sanctions) of global rules governing the conduct of economic and financial policies. While Fund bilateral surveillance is about assessing members’ compliance with their policy obligations, the absence of any finding of breach of such obligations since the Second Amendment, as well as the difficulties encountered in seeking to apply labels in certain circumstances (e.g., fundamentally misaligned exchange rates in the framework of the 2007 Decision) reflects the heavy premium placed by the membership on the cooperative nature of the institution.²³
- (10) *Relatedly, another look is being given to the governance arrangements for surveillance.* When the existing surveillance framework was established as part of the Second

²¹ See [2011 Triennial Surveillance Review—External Report on Interview with Country Authorities](#) (Boorman and Ter-Minassian).

²² As an example, one mission chief commented that “the 2007 Decision doesn’t work as a surveillance framework neither in theory, nor practice and needs to go back to the (drawing) board.”

²³ When the guidance on the implementation of the 2007 Decision was revised in 2009 (see *The 2007 Surveillance Decision—Revised Operational Guidance*), it was recognized that the circumstances in which such labels would be applied would be very rare.

Amendment of the Fund's Articles (1978), provision was made in Schedule D for the establishment of a ministerial level "Council." This was motivated by the belief that involving political authority beyond the Executive Board would support a more effective exercise of the Fund's new surveillance authority. An open question is whether the activation of the Council would trigger a stronger commitment to the obligations under Article IV and help generate greater traction for Fund surveillance.

Box 2. Persuasion, Rules, Sanctions: How to Strengthen Traction?

The issue of the best model to help an international institution get traction on its advice and foster policy changes is a difficult one. In theory, one could envisage a continuum of models ranging from a purely cooperative to an exclusively sanction-based approach. Rules on the conduct of policies and guidelines on desirable results may play a role in all models, as a way to set expectations on what is expected from members. Conceptually, a number of questions arise in considering the possible models. These include, for instance: How firm should rules be? What is the role of outcome based indicators/threshold? What are the consequences for not following the rules or deviating from guidelines? Are sanctions designed in a way that sets effective incentives to encourage compliance? How much automaticity versus judgment is exercised in the enforcement of rules?

The Fund's approach to surveillance has mainly relied on dialogue and persuasion, within a framework that includes specific obligations and guidance on the conduct of policies. To date, while the Fund is required to oversee members' compliance with their obligations under Article IV, it has not relied upon the application of sanctions in order to enforce such compliance. Under the current Articles, a member in breach of its obligations may be denied the benefits of membership in a progressive manner: ineligibility to use Fund's resources, suspension of voting rights, and expulsion. In practice, no such sanction has ever been applied to members with respect to their substantive obligations under the present Article IV. In the recent past, efforts to use indicators and label members deviating from guidelines (e.g., having fundamentally misaligned exchange rates) were met with resistance.

What changes could be made to the Fund's current approach? The evolving experience with the G-20 MAP, including the move toward indicative guidelines and criteria based triggers for deeper analysis as part of a cooperative rule-based framework with more direct involvement of policy makers, is relevant to this question. Another possibility would be to explore enhancing compliance with the existing policy obligations by clarifying the framework to apply the sanctions envisaged in the Articles, but it is not obvious that the existing sanctions would actually be credible, in particular in the case of members of systemic importance, as it would probably not be in the international community's interest to exclude such members from the Fund. More broadly, the absence of any findings of breach of members' policy obligations in the Fund's history points to the difficulty of implementing such a framework.

The [Palais Royal Initiative](#) (2011) and [Truman](#) (2010) have suggested another approach to sanctions. They suggest amending the Articles to allow members to take "countermeasures" against a member in breach of its obligations (e.g., trade or exchange restrictions). These outside observers recognize that such sanctions may not need to be implemented if they are an effective deterrent. Any such framework would need to be designed with strong governance safeguards and focus only on the most egregious cases. It would represent a substantial shift from the Fund tradition of seeking to foster changes through multilateral cooperation.

- (11) *The issue of data gaps that may hamper effective surveillance has legal ramifications.* As a means of enabling the Fund to discharge its surveillance responsibilities, members are required to provide the Fund with the information it needs to conduct surveillance. However, even though there are circumstances where the Fund, to conduct surveillance effectively, needs access to data on individual institutions (for instance, on global systemically important financial institutions for the purpose of mapping out cross-country financial interconnectedness), Article VIII, Section 5 (b) effectively prohibits the Fund from requiring such information from members. Rather, the Fund must rely on the voluntary sharing of such information by the relevant members.²⁴
- (12) *There is an ongoing discussion about the appropriate role for the Fund on capital flows.* The Board has had the opportunity to discuss this issue in the context of the review of the Fund mandate, and subsequent papers.²⁵ As this discussion will continue in the context of planned follow up papers, this paper does not focus on this particular issue and possible legal consequences.
- (13) *The role of strengthened transparency in enhancing traction of Fund advice is being debated.* The Articles strictly limit the circumstances in which the Fund (i.e., the Executive Board) may publish its views on a member’s policies without the member’s consent. Specifically, under Article XII Section 8, the Fund may only unilaterally publish its views on a member’s monetary or economic conditions and developments when they “directly tend to produce a serious disequilibrium in the international balance of payments of members” and there is support by 70 percent of the total voting power. At issue is whether it would be beneficial if the Fund had greater freedom to publish its views on members’ economic and financial policies.

IV. OPTIONS GOING FORWARD

17. **This section discusses options to address the limitations of the current framework.** The options vary in ambition, ranging from amending the Articles of Agreement to revising Board decisions. They are not mutually exclusive. A possible course of action could be to launch reforms that are likely to take the most time to garner consensus and implement (Articles), while in the meantime pursuing changes that, although more limited, may be easier and faster to achieve (Decisions). Eventually, any significant amendment to the Articles would also need to be followed by (another) revision to the relevant Board Decisions to ensure that the legal framework as a whole remains internally consistent. Box 3 lays out the processes for adopting Board decisions and amending the Articles.

²⁴ See for instance [Financial Sector Surveillance and the Mandate of the Fund](#).

²⁵ See *The Fund’s Role Regarding Cross-Border Capital Flows, and Recent Experience in Managing Capital Inflows—Cross-Cutting Themes and Possible Policy Framework*.

A. Articles of Agreement

18. **The most comprehensive solution would be to amend the Articles.** The scope of any such reform can vary, depending on the precise nature of the amendment. The remainder of this section discusses the changes that could be considered.

Article IV

19. **Amending Article IV would help address many of the shortcomings at their root.** The amended Article IV could provide for an integrated framework for surveillance of global and country-level stability, while rebalancing the focus of surveillance to address the exchange rate bias, by revising the obligations of members to:

- Broaden their ultimate objective by focusing on the promotion of the stability of the IMS, as opposed to the stability of the system of exchange rates, thereby more accurately reflecting the range of issues that falls within the Fund’s mandate;
- Eliminate Article IV’s artificial distinction—and asymmetry—between domestic and external policies by establishing obligations that recognize the contributions of all policies to the stability of a member and, globally, to the effective operation of the IMS. Giving equal weight to all policies would go a long way towards addressing the perceived legitimacy deficit of the existing Article IV; and
- Eliminate the difficult-to-assess concept of intent.

20. **An important issue that would need to be considered in the process of amending Article IV is that of the “hierarchy” of obligations.** Specifically, the revised Articles would need to clarify the extent to which members, in the conduct of their policies, would be required to take into account not only their own stability but also the stability of the IMS. In most cases, a member promoting its own stability will also be promoting the stability of the system. But for members of systemic importance, there may be circumstances where promoting their own stability may not be sufficient or may even conflict with the promotion of systemic stability. While the primary obligation of a member in such circumstances could remain toward its own stability, the Articles could also explicitly require members to take into account, to the extent possible, the systemic implications of their policies. This would be consistent with the overall objective of an institution like the Fund to foster the best possible outcome for the international community.

21. **An illustrative starting point for discussion could build on the following elements.** An amendment to Article IV could establish a new general obligation for members to “collaborate with the Fund and other members to promote the stability of the IMS, including through the promotion of global economic and financial stability.” This general obligation would be supplemented by complementary obligations specifying that, in particular, “each member shall adopt economic and financial policies, including exchange

rate policies, that promote (i) a balance of payments position that does not, or is not likely to, give rise to disruptive adjustments, and (ii) sustainable economic growth and domestic price stability. In adopting such policies, members shall take into account their effect on the IMS in the conduct of their economic and financial policies.”

Box 3. Procedures for Revising/Adopting Board Decisions and Amending the Articles

Amending the Articles of Agreement

The procedure for adoption of amendments of the Articles of Agreement of the Fund is set forth in Article XXVIII of the Articles. Under this provision, a proposed amendment is communicated to the Chairman of the Board of Governors for consideration by the Board of Governors. If the proposed amendment is approved by the Board of Governors, the Fund asks all members whether they accept it. When three-fifths of the members having 85 percent of the total voting power have accepted the proposed amendment, the Fund would certify that fact by a formal communication to all members.^{1,2}

Under Article XXVIII(c), an amendment enters into force for each member, regardless of whether or not it has accepted the amendment, three months after the date of the Fund’s formal communication described above, unless a shorter period is specified.

Adopting/revising Board Decisions

Except in those cases where a special majority is specifically required in the Articles, decisions require a simple majority of the votes cast. The 2007 Surveillance Decision was adopted under Article IV, Section 3, by a majority of the votes cast. A similar majority would be required for adopting an integrated surveillance decision as described in this Board paper.³

¹ A limited number of amendments require acceptance by all members. See Article XXVIII(b). However, this would not be required for amendments to Article IV.

² It is noted in this regard that, under Article XXVI, Section 2(b) and Schedule L of the Articles, members whose voting rights have been suspended may not participate in the adoption of a proposed amendment of the Articles of Agreement or be counted in the total number of members for that purpose (except in the case of an amendment requiring acceptance by all members under Article XXVIII(b), or pertaining exclusively to the Special Drawing Rights Department). Also, their votes are not included in the calculation of the total voting power (except for purposes of the acceptance of a proposed amendment pertaining exclusively to the Special Drawing Rights Department).

³ In relation to Article IV, a special majority of 85 percent is only required for the introduction of par values (Article IV, section 4) and for making provision for general exchange arrangements (Article IV, section 2(c)).

22. **A revised Article IV could also reconsider the role of the Fund in the conduct of surveillance.** To the extent that the promotion of the effective operation of the IMS would become more squarely the basis for defining the obligations of both the Fund and its members, the scope and modalities of surveillance would need to be reconsidered. In that context, there would be a case to meld the currently separate bilateral and multilateral surveillance into a single function. In such a system, there would be a single concept of

surveillance in which the Fund would assess members' compliance with their obligations under Article IV and would determine the modalities for this purpose under the overarching objective of promoting the effective operation of the IMS.

Article I

23. **The purposes of the Fund under [Article I](#) could also be amended.** The provision of Article I that reflects the goals of surveillance (i.e., “to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation”) is an original provision of the Articles and does not fully reflect the changes to the system that were made at the time of the Second Amendment of the Fund’s Articles in the 1970s.²⁶ An amendment of Article I could ensure consistency with the revision of members’ obligations under Article IV. It could also signal the centrality of global financial stability to the effective operation of the IMS. An amended Article I could clarify that, for instance, a purpose of the Fund is the promotion of the stability of the IMS, including “through the promotion of global economic and financial stability”. This would help foster greater attention to financial sector surveillance and its integration with other surveillance activities.

Other Articles

24. **Other changes have been recently discussed and could be considered to strengthen surveillance.**

- [Article VIII, Section 5\(b\)](#), on the provision of information by members to the Fund, could be amended to give the Fund the power to require members to provide the Fund with information on individual corporations so as to allow better surveillance of financial stability risks through access to data on systemic financial institutions. While the adoption of such an approach may give rise to a number of legal and practical concerns from members (in particular, relating to the preservation of the confidentiality of such information and potential liabilities to the corporations in question in the event of disclosure), it would greatly facilitate the conduct of financial sector surveillance.
- The relationship between [Article VI](#) and Article IV may also be revisited as part of the broader debate on the role of the Fund regarding capital flows.²⁷
- [Article XII Section 8](#) which, as noted above, strictly limits the power of the Fund to unilaterally publish its views on a member’s policies, could be amended to broaden the power of the Fund to publish.

²⁶ *The Fund’s Mandate—The Legal Framework*, page 4.

²⁷ See, for instance, *The Role of the Fund Regarding Cross-Border Capital Flows*.

B. Integrated Surveillance Decision

25. **A more immediate, but less far reaching, solution would be to revise the framework that has been established through Board decision.** Such an approach could not change the underlying framework under Article IV—and, in particular, the scope of members’ obligations or the obligations of the Fund in the conduct of bilateral and multilateral surveillance—but it would involve replacing the existing surveillance decision with a new decision that would effectively integrate both bilateral and multilateral surveillance. This could be done in lieu of an amendment of the Articles or could be introduced while work on an amendment is ongoing.

26. **The most promising avenue would be the adoption of an integrated surveillance decision.** Such a decision would govern both bilateral and multilateral surveillance activities. It would be adopted within the confines of the existing Articles and would replace the 2007 Surveillance Decision. An integrated decision would not eliminate the conceptual distinction between bilateral and multilateral surveillance, but would help make progress in three important directions:

- *It would foster better integration of surveillance activities at all levels.* In their present form, Article IV consultations are an instrument of bilateral surveillance only. A significant operational consequence of an integrated decision would be to expand the scope of Article IV consultations so that they become also a vehicle for discussing issues relevant for the purpose of multilateral surveillance, including all cross-country spillovers irrespective of the policies they originate from or their channels of transmission.²⁸ Of course, other mechanisms for multilateral surveillance (e.g., the WEO and GFSR) could be retained.
- *It would clarify the scope, modalities and procedures for multilateral surveillance, thereby filling an important gap in the current framework.*²⁹ An integrated surveillance decision would clarify the expectations from the Fund and its members in the conduct of all surveillance activities, including multilateral, which is currently lacking. In this context, the new decision could clarify the whole range of issues that the Fund may need to examine in its assessment of the IMS, making clear in

²⁸ Under the current framework, Article IV consultations do not encompass multilateral surveillance but may cover certain issues that fall outside of the scope of bilateral surveillance—in particular, the retention of exchange restrictions subject to Articles VIII or XIV and the provision of “policy advice” as a form of technical assistance at the request of a member.

²⁹ See *Review of the Fund’s Mandate—Follow-up on Modernizing Surveillance* for a more in-depth discussion of the role a decision covering multilateral surveillance activities—be it stand-alone or integrated—could play.

particular that global and financial stability is a necessary condition to the effective operation of the IMS. The decision could set out guidance on the role of the Fund and its members, including their procedural obligations in this area. It could also provide a vehicle to foster greater data sharing with the Fund by encouraging members to enter in voluntary agreements for the sharing of firm-specific financial sector information, with due respect for the confidentiality of such data.

- *It would also go some way towards rebalancing the focus of bilateral surveillance and thereby address the legitimacy deficit, within the constraints of the current Articles.* The new decision could provide broader guidance on members' obligations related to their domestic policies. While the decision could not change the scope of members' obligations with respect to domestic policies (such a change could only be made through an amendment of the Articles), it could provide more comprehensive guidance to members on the manner in which they conduct these policies. At present, the 2007 Decision provides guidance to members on the conduct of their exchange rate policies but no similar guidance on the conduct of members' domestic economic and financial policies.³⁰ This would partly address the concerns over asymmetrical treatment of members with different exchange rate regimes. Finally, and perhaps most importantly for the perception of legitimacy, more comprehensive guidance with respect to the spillover effects of domestic policies (even when these policies do not undermine domestic stability) could be introduced pursuant to the Fund's authority to conduct multilateral surveillance.

V. ISSUES FOR DISCUSSION

27. **Directors may wish to focus the discussion on the following issues:**

- Do Directors agree that the current legal framework suffers from a number of deficiencies, and therefore insufficiently supports an effective implementation of surveillance? (Section III)
- Do Directors see merit in further considering amendments to the Articles? What are Directors views on the various changes that could be made to the respective Articles? (Section IV.A)
- Do Directors see merit in adopting an integrated decision covering both bilateral and multilateral surveillance? Is the direction indicated in Section IV.B for fleshing out such decision appropriate?

³⁰ As required under Article IV Section 3(b), the 2007 Decision sets out specific principles for the guidance of members' exchange rate policies but no equivalent principles for the guidance of domestic policies (a proposal to include such principles in the 2007 Surveillance Decision was rejected by the Executive Board at that time.) A new decision could set out principles covering the overall set of members' policies, including domestic policies.