

INTERNATIONAL MONETARY FUND

The Fund's Mandate—The Legal Framework

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I. INTRODUCTION

1. This paper is intended to accompany "[The Fund's Role and Mandate—An Overview](#)" (the "Mandate Overview Paper"). Taking into account the issues raised in the Mandate Overview Paper and, in particular, the potential areas for reform that it identifies, this paper provides a brief analysis of both the constraints and flexibility that exist under the existing legal framework. At the outset, it is useful to identify several aspects of this framework that are of particular relevance.

2. **Specialization.** While, at a certain level of abstraction, it may be said that all international organizations have been established to enhance human welfare, the assumption underlying the design of the post-war international architecture was that each organization would make its own distinct contribution to that objective; i.e., that it would be specialized. For the Fund, as with other international organizations, the nature of this specialization—the Fund's "mandate"—is anchored in its charter, the Articles of Agreement, which sets forth: (a) the specific powers granted to the Fund; and (b) the purposes for which the Fund's powers have been granted.

3. **Purposes.** The purposes set forth in Article I are largely unchanged from when the Fund was established in 1945 (see Box 1). Importantly, they are exhaustive rather than illustrative. Thus, since all of the enumerated purposes are of an economic nature, it has been understood that, unlike some other organizations, the Fund is precluded from using its powers for political objectives.¹ It should also be emphasized that the Fund's purposes do

¹ One of the few international financial institutions whose purposes include an explicitly political objective is the European Bank for Reconstruction and Development. [Article I of the Agreement Establishing the European Bank for Reconstruction and Development](#) provides that the purpose of the Bank shall be "to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and *applying the principles of multiparty democracy, pluralism and market economics*" (emphasis added).

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not, in and of themselves, confer powers on the Fund. Rather, and as is indicated in the final sentence of the text of Article I, they are intended to provide guidance as to how the powers set forth elsewhere in the Articles should be exercised.

Box 1. Article I of the Fund's Articles

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 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.

4. **Powers.** The powers conferred upon the Fund under the Articles can be divided into three categories: (a) *oversight powers*, relating primarily to the Fund's responsibility to monitor and promote the observance of members' obligations under the Articles; (b) the *power to provide financial assistance*; and (c) *advisory powers*. Consistent with the principles of national sovereignty and specialization noted above, the powers conferred upon

the Fund are generally limited to those explicitly identified in the Articles.² And while these powers are often expressed in general terms, the degree to which their interpretation can evolve is limited by the plain meaning of the text, as supplemented by the *travaux préparatoires* (legislative history).³ Fortunately, the drafters of the Articles also conferred upon the Fund “enabling authority” in key areas; i.e., the Articles grant the Fund the authority to adopt decisions of general applicability (referred to as “policies”) that are designed to provide more specific content to these powers and members’ obligations. Provided that they are consistent with the text of the Articles, these policies may adjust—and have been adjusted—over time to take into consideration changing circumstances. Accordingly, while the key parameters of the Fund’s mandate are established in the Articles of Agreement, it may be said that the operational content of the Fund’s mandate has been updated over time by Executive Board decision.

5. ***Promoting the Stability of the International Monetary System.*** While the powers conferred upon the Fund are diverse, the unifying theme that defines their scope and content is the promotion of the stability of the international monetary system—hence the name of the institution. As will be discussed in this paper, the international monetary system is *not* synonymous with the international financial system. Rather, it is comprised of, and limited to, those arrangements that directly control the balance of payments of members. In terms of its oversight powers, the Fund’s authority extends to the overall international monetary system (multilateral surveillance), as well as more specific aspects of the system that are to be scrutinized by the Fund on a member-by-member basis; e.g., exchange rates (through bilateral surveillance) and obligations on reserve policies (through Article VIII, Section 7). Regarding its financial powers, the Fund supports the stability of the international monetary system both at the member-specific level by making its general resources available to members to address their specific balance of payments problems, and at the aggregate level, by allocating SDRs to address a long term global need to supplement reserve assets.

6. It should be emphasized that the Articles specifically recognize that the Fund’s discharge of its responsibility regarding the stability of the external payments of its members requires it to be involved in analyzing, assessing and advising on domestic conditions and policies, including domestic *financial* conditions and policies. Importantly, however, the Fund’s authority in the domestic area is derivative; i.e., the basis of this authority is derived

² International organizations and courts have recognized and applied a doctrine of *implied* powers of international organizations under which an international organization may, in very limited circumstances, exercise certain powers despite the fact that they are not within the express provisions of the organization’s charter. The relevant international legal principles were examined by the Fund in the context of the Third Amendment of the Fund’s Articles.

³ See [Vienna Convention on the Law of Treaties, Articles 31-33](#), *United Nations Treaty Series*, vol. 1155, p. 331.

from the potential impact of domestic conditions and policies on the balance of payments of individual members and on the overall international monetary system.

7. The remainder of this paper analyses those specific elements of the legal framework that are relevant to the issues raised in the Mandate Overview Paper. In doing so, it draws upon both the text and legislative history of the relevant powers and purposes, and the interpretation that has been given to these provisions over the years by the decision-making organs of the Fund.

II. THE FUND'S OVERSIGHT AUTHORITY

A. Bilateral Surveillance under Article IV

The Existing Framework

8. *Obligations of Members.* While the par value system was abrogated at the time of the Second Amendment, Article IV continues to give primacy to exchange rates and exchange rate policies—the general obligation of members set forth in Article IV focusing primarily on the promotion of a “stable system of exchange rates” (see Box 2).⁴ The continued focus on exchange rates serves to explain why, at the time of the Second Amendment, it was not considered necessary to change the relevant purpose set forth in Article I; namely, “to promote exchange stability, to maintain orderly exchange arrangements and to avoid competitive exchange depreciation.” When the Fund was established, the promotion of exchange stability was understood as being closely related to another purpose set forth in Article I, that of “facilitating the expansion and balanced growth of international trade”. Since the competitive depreciations of the 1930s were viewed as playing a major role in the collapse of the international trading system, the architects of the Fund believed that the Fund should have adequate tools to limit this national impulse going forward.

9. Notwithstanding the above, an important element of the reforms introduced at the time of the Second Amendment was the explicit recognition that domestic policies, including financial sector policies, can have an important impact on the stability of the overall system of exchange rates and, accordingly, are a subject of international concern. To that end, Article IV establishes specific obligations for members not only with respect to the conduct of exchange rate policies (i.e., policies that are specifically designed to influence a member's exchange rate) but also domestic policies that can indirectly affect exchange rates.

⁴ See generally [Article IV of the Fund's Articles of Agreement—An Overview of the Legal Framework](#) (06/28/06).

**Box 2. Obligations of Members and
the Fund under Article IV**

Article IV - Obligations 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.

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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.

10. Importantly, however, the obligations regarding domestic policies, including financial sector policies, are limited in two important respects.⁵

- First, the relevant text reveals that these obligations (Article IV, Section 1(i) and (ii)) are of a “soft” nature: taking into account the fact that members retain great sovereignty in terms of the conduct of their domestic policies, they are only required to exercise “best efforts” in this area. In contrast, those obligations that relate to members’ external policies, including exchange rate policies (Article IV, Section 1 (iii) and (iv)), are of a “hard” nature—requiring the achievement of results rather than just the exercise of best efforts—reflecting the direct international impact of these policies.⁶
- Second, members’ obligations respecting domestic policies only require members to take action to promote their own domestic stability. As long as a member is implementing domestic policies in a manner that ensures such stability, it is under no obligation to change these policies, even if a change would further enhance the stability of the overall exchange rate system.⁷

11. ***Obligations of the Fund.*** The above distinction that exists with respect to members’ obligations respecting domestic and external policies is also reflected in the scope of the Fund’s overall responsibilities under Article IV. While Article IV imposes a general responsibility upon 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 designed to give guidance to members with respect to these policies. Finally, as a means of enabling the Fund to discharge these responsibilities, members are required to provide the information necessary to enable the Fund to exercise firm surveillance⁸ and, when requested by the Fund, to consult with the Fund regarding these policies.⁹

⁵ See [Bilateral Surveillance over Members’ Policies—2007 Decision](#) (adopted June 15, 2007) (hereinafter the “2007 Decision”).

⁶ [Article IV of the Fund’s Articles of Agreement—An Overview of the Legal Framework](#) (06/28/06), para. 28-39.

⁷ [Review of the 1977 Decision – Proposed Decision – Companion Paper](#) (05/22/07), para. 14.

⁸ While [Article IV, Section 3\(b\)](#) requires members to provide the Fund with the information it needs for this purpose, the Fund has relied upon the general reporting obligation set out in [Article VIII, Section 5](#) to require from members the information it needs for the conduct of surveillance.

⁹ The legal basis for Article IV consultations is (i) with respect to members’ exchange rate policies, the specific obligation to consult with the Fund under [Article IV, Section 3\(b\)](#), and (ii) with respect to members’ domestic

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12. **2007 Decision.** The 2007 Decision provides further guidance to both the Fund and its members regarding their mutual responsibilities under Article IV in a number of respects.

- First, in clarifying the scope of surveillance under Article IV, Section 1, the Decision 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.
- Second, with respect to members’ domestic policies, the Decision provides that members, in conduct of their domestic policies, will be considered by the Fund to be promoting external stability when they are promoting “domestic stability”. As noted above, this reflects the fact that, under the Articles, 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.¹⁰

Legal Implications of Reform

13. The legal implications of the possible reform initiatives identified in the Mandate Overview Paper with respect to bilateral surveillance vary, depending on the ambition of the reform. Specifically:

14. ***Oversight of Domestic Financial Sector Policies.*** The Mandate Overview Paper (para. 9) notes that, given the evolution of the capital markets, the above-described legal framework hampers the Fund’s capacity to conduct adequate oversight of the member’s domestic financial sector policies. Some of the identified constraints could be addressed through the adoption of decisions by the Executive Board. Specifically:

- In recognition of the important impact that domestic financial sector policies may have on the overall system of exchange rates, the Executive Board could decide that FSAPs will become a mandatory component of the Article IV consultation process for those members whose financial sector meets criteria established by the Executive Board.

policies, the obligation to collaborate with the Fund and other members under [Article IV, Section 1](#) to assure orderly exchange arrangements and to promote a stable system of exchange rates.

¹⁰ [2007 Decision](#), para. 6.

- The Mandate Overview Paper (para. 9) 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. Under the 2007 Decision, such spill-over effects may not be discussed in the context of surveillance because they are not transmitted through the balance of payments.¹¹ 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 through the member's own balance of payments.

15. However, an amendment of the 2007 Decision to address the second issue identified above would not resolve a more fundamental problem. As noted earlier, unless a member's domestic policies undermine domestic stability (for example, where they give rise to external instability, which the Mandate Overview Paper assumes would not be the case), the member is not required to change its domestic policies under Article IV even in order to further promote systemic stability. Accordingly, while these policies can be discussed in circumstances where a member is promoting domestic stability, including in the context of bilateral surveillance, they should not be the primary subject of bilateral surveillance of the member in question, given that surveillance is designed to assess members' observance of their obligations. As is noted in the Mandate Overview Paper (para. 9), however, these issues could be taken up in the context of multilateral surveillance, which is discussed below.

16. In order for the type of situation identified in paragraph 15 above to be made central to bilateral surveillance, it would be necessary to amend Article IV itself. 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.

17. ***Provision of Information.*** As noted above, Article IV, Section 3(b) gives the Fund the authority to require a member to provide the Fund with the information needed to conduct bilateral surveillance over exchange rate policies. However, the specific provision that the Fund has used to obtain information for surveillance (as well as for the information it

¹¹ Under the [2007 Decision](#), the scope of bilateral surveillance is largely determined by the concept of external stability which is defined as “a *balance of payments position* (emphasis added) that does not, and is not likely to give rise to, disruptive exchange rate movements” (para. 4).

needs for all of its other activities) is Article VIII, Section 5, which sets out several important limitations on the obligations of members to report information.¹² In particular, members are under no obligation to furnish information “in such detail that the affairs of individuals or corporations are disclosed.” Accordingly, the elimination of this exception would require an amendment of the Articles. At the same time, an amendment would not be required for the Fund to obtain such information through agreement with the relevant members as suggested in the Mandate Overview Paper (para. 12)—indeed, the Articles specially provide that the Fund may obtain “further information” (i.e., information that is not required to be provided under Articles) by “agreement with members.”

18. ***The Consultation Process.*** The Articles give the Fund broad latitude with respect to the design of the consultation process that enables it to discharge its surveillance responsibilities under Article IV. More specifically:

- As is suggested in the Mandate Overview paper (para. 13), it would be open for the Fund to determine that consultation discussions be thematic and cover several countries facing similar issues. Indeed, the consultation with Euro Area members is an example of the Fund engaging in a consultation process with a number of members in order to assess their compliance with their obligations under Article IV.¹³
- While the Articles do not establish a time frame within which members must consult with the Fund under Article IV, it is open for the Fund to adopt a decision establishing such limits (Mandate Overview Paper, para. 13). To date, the time frames that have been established by the Executive Board are in the form of “expectations” and allow members to deviate from them with no legal implications. However, the Executive Board has the authority to establish a framework whereby failure to meet the established time would provide the basis for a determination of a member’s breach of its obligations under the Articles of Agreement.

B. Multilateral Surveillance

19. Although it may be said that all of the Fund’s powers serve to safeguard the stability of the international monetary system, Article IV, Section 3(a) gives the Fund a specific mandate in this area, in that it provides that the Fund “shall oversee the international monetary system in order to ensure its effective operation.” This function, which provides the basis for the Fund’s multilateral surveillance, is related to the first purpose of the Fund set

¹² See: [Strengthening the Effectiveness of Article VIII, Section 5](#) (Decision No. 13183-(04/10), adopted January 30, 2004, as amended).

¹³ See [Modalities for Surveillance over Euro-area Policies in the Context of Article IV Consultations with Member Countries](#) (Decision No. 12899 (02/119), adopted December 4, 2002, as amended).

forth in Article I “to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.”

20. Although an important part of the Fund’s activities since the Second Amendment of the Fund’s Articles, multilateral surveillance has never been the subject of a comprehensive Executive Board decision that clarifies its scope. To the extent that the Executive Board wished to put such a decision in place (see Mandate Overview Paper, para. 8), three important questions would need to be addressed: (i) what is the “international monetary system” that the Fund is required to oversee; (ii) how can the Fund oversee the system “in order to ensure its effective operation”; and (iii) what are the obligations of members in the context of multilateral surveillance? Each is reviewed below.

21. ***The International Monetary System.*** References to the “international monetary system” were introduced into the Articles in the context of the Second Amendment. Although not defined in the Articles, the term was discussed 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.¹⁴ 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;
- 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.

22. Several important features of the concept of the international monetary system should be noted. First, and consistent with the Fund’s status as an inter-governmental organization, it deals entirely with official arrangements and rules in place among member countries, including the relevant provisions of the Fund’s Articles. Arrangements between private parties (e.g., banks) fall outside of its scope although, as discussed below, the design of official policy is necessarily informed by an analysis of private actions and incentives.

¹⁴ A study in the Fund’s 1965 *Annual Report* is of particular note.

Second, the concept deals solely with rules at the international rather than the domestic level. Accordingly, a member's domestic financial sector policies do not form part of the international monetary system. Third, and consistent with the two previous points, the international *monetary* system is different from the international *financial* system. The terms "monetary" and "financial" both appear in the Fund's Articles and, under the rules of interpretation, the use of different terms indicates that the drafters intended the terms to have different meanings.¹⁵ Importantly, the meaning of the term "monetary" (which normally refers to a means of payment) becomes clearer when read in conjunction with the term "international": "international monetary" matters are matters relating to a country's external payments— i.e., the balance of payments.

23. ***Scope and Modalities of Oversight.*** Notwithstanding the fact that the international monetary system has a relatively specific meaning, it is clear that, in the discharge of the Fund's responsibility to oversee "its effective operation," it is appropriate for the Fund to look at a broader set of issues. Indeed, just as domestic policies, including domestic financial sector policies, can have an important impact on the stable system of exchange rates (thereby making it relevant for bilateral surveillance), such policies can also have a similar impact on the effective operation of the international monetary system and, accordingly, are an important subject of multilateral surveillance. Similarly, while the international monetary system comprises official arrangements, the appropriate design of these arrangements necessarily requires an analysis and understanding of market conditions and the actions and incentives of private parties. This overall approach has been reflected in the Fund's practice in multilateral exercises such as the *World Economic Outlook* and the *Global Financial Stability Report*.

24. It is open for the Fund to determine the modalities of multilateral surveillance. Until now, the Fund has exercised this authority primarily through analyses and assessments such as the *World Economic Outlook*, the *Global Financial Stability Report* and the *Early Warning Exercise*. However, it is also possible for the Fund, in the context of multilateral surveillance, to engage in policy discussions with members (or a group of members) and to recommend that particular actions be taken. It should be noted that consultation discussions were the central feature of the multilateral consultation exercise that was conducted by the Fund in 2006/2007, an exercise that was also conducted pursuant to the Fund's multilateral surveillance authority.¹⁶

¹⁵ See, for example, [Article IV, Section 1\(i\) and \(ii\)](#). The relevant provisions are set out in Box 2.

¹⁶ See [Staff Report on the Multilateral Consultation on Global Imbalances with China, the Euro Area, Japan, Saudi Arabia, and the United States](#) (6/29/07).

25. ***Obligations of Members.*** Unlike the provisions of the Articles that provide the basis of the Fund’s 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 require members to adjust their policies). However, in terms of a member’s *procedural* obligations, the Fund may require members to consult with the Fund in those circumstances where the Fund concludes that such consultations are necessary in order for it to effectively discharge its oversight responsibilities. Relatedly, the Fund could require information to be provided to it for this purpose pursuant to Article VIII, Section 5, which—as noted earlier—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.

C. Reserve Policies of Members

26. In addition to conferring upon the Fund the general power of overseeing the international monetary system, the Articles establish obligations for members respecting their policies on reserve assets and give the Fund the responsibility of conducting surveillance over such policies (see Mandate Overview Paper, para. 23). The relevant provision is Article VIII, Section 7, which has never been relied upon. It reads as follows:

“[e]ach member undertakes to collaborate with the Fund and with other members in order to ensure that the policies of the member with respect to reserve assets shall be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system.”

This provision was incorporated into the Fund’s Articles in the context of the Second Amendment. It was one of several new provisions that were designed to reduce the role of gold and to strengthen the role of SDRs in the international monetary system.¹⁷

27. It would be open to the Fund to make use of Article VIII, Section 7 and to give greater content to the scope of members’ obligations under this provision. There are other examples under the Articles where members have been placed under an obligation to collaborate for certain purposes, while the precise content of that obligation has been left to the Fund to specify through Executive Board decision. The most prominent example of this approach relates to the obligation of members under Article IV, Section 1 to “collaborate

¹⁷ The provision’s rather vague language reflected a delicate compromise that was forged to address sensitivities related to the future role of currencies as reserve assets. See J. Gold, *Exchange Rates in International Law and Organization* (1988), page 198; J. Gold, *Interpretation: The IMF and International Law* (1996), page 529.

with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.”¹⁸

28. To the extent that the Fund were to give content to this provision, a number of questions would need to be addressed, both with respect to the role of the Fund and the obligations of members—and, in particular, with respect to the promotion of “better international surveillance of international liquidity.” Taking into account the legislative history of this provision, the following questions are of particular importance.

- First, who would conduct surveillance under Article VIII, Section 7? Although not explicit, it is reasonable to conclude that it would be the Fund who would perform this function. Having chosen the same term as is used in Article IV, it is reasonable to conclude that the drafters envisaged a process similar to surveillance under Article IV—that is, a process led and conducted by the Fund. Moreover, the Executive Board’s discussions on the drafting of Article VIII, Section 7 generally appear to have assumed that the Fund would play the leading role in implementing the provision.
- Second, what would such surveillance entail? The drafters of Article VIII, Section 7 rejected a reference to “international management of international liquidity” in favor of “surveillance.” As is the case with surveillance under Article IV, it is reasonable to conclude that the drafters envisaged an approach in which members retain responsibility over the conduct of their policies (in this case, policies on reserve assets) on the basis of guidance provided by the Fund through surveillance. Drawing on the Fund’s experience under Article IV, surveillance over a member’s reserve asset policies could consist of two elements: (i) the monitoring of the overall state of international liquidity; and (ii) the provision of guidance to members on the manner in which their policies are to be conducted, including through the adoption of policies for this purpose.
- Third, what would be required of members under Article VIII, Section 7? While the precise scope of members’ obligations under this provision would require further analysis, it would, at least, require members to consult with the Fund and to provide the Fund with the information it needs for the purposes of surveillance. As part of this obligation to consult, members could be required to discuss with the Fund the manner

¹⁸ The Fund has adopted principles for the guidance of members’ exchange rate policies that give content to this obligation. Such principles may take the form of “recommendations” whose observance by members will ensure their observance with the obligation to collaborate but whose nonobservance will not necessarily imply a breach of obligation.

in which their policies are directed towards the achievement of better international liquidity, and changes in policy that may be necessary for this purpose.

The Fund would also need to provide further guidance on the meaning of the obligation of members to collaborate towards the objective of making the SDR the principal reserve asset in the international monetary system. Two important features of this objective should be noted. First, making the SDR the principal reserve asset of the international monetary system is identified as an objective, but not necessarily as a result that has been—or is required to be—achieved. Second, as will be discussed further below, this objective does not, in and of itself, provide the basis for an allocation of SDRs.

D. Oversight of International Capital Movements

29. Under Article VIII, members may not, without the approval of the Fund, impose restrictions on the “making of payments and transfers for current international transactions.” The scope of this obligation—and the corresponding responsibility of the Fund to monitor and promote its observance—has not changed since the Fund was established in 1945. It reflects not only the priority that was placed on the promotion of international trade but also certain assumptions regarding the allocation of responsibilities among different international organizations. While other international fora (originally the GATT and subsequently the World Trade Organization) were charged with the liberalization of trade in goods and services, the Fund was required to ensure that members liberalized the payments and transfers associated with such trade.

30. Importantly, the Fund’s responsibility in this area excludes restrictions on capital movements; indeed, Article VI, Section 3 specifically recognizes that “members may exercise such controls as are necessary to regulate international capital movements.” This exclusion reflects the view—prevailing when the Fund was established—that speculative capital movements had contributed to the instability of the pre-war system and that extensive capital controls would be in place for the foreseeable future, with the future growth in the global economy being driven by trade flows. Since that time, however, international capital movements have come to play a critical role in the global economy. Indeed, given the recognition at the time of the Second Amendment that regulation of capital flows is an important element of the international monetary system, it is somewhat surprising that the Articles did not explicitly give the Fund a more robust role in this area.

31. While the critical role of capital movements in the global economy argues for a more active role for the Fund in overseeing members’ regulation of these movements, designing an appropriate approach is far more complex and nuanced than it was for current payments and transfers—given both the benefits and risks that arise from liberalization in this area. On the one hand, economic literature provides evidence that free capital movements help channel resources to their most productive uses, and increase economic growth and welfare. In particular, many emerging market economies that have liberalized their capital accounts have

benefited from higher levels of investment, more rapid development of their financial sectors, faster economic growth, and rising standards of living. Moreover, investors worldwide have benefited from opportunities for higher returns and portfolio diversification. On the other hand, recent crises demonstrate that capital flows can create risks to individual members and the system more generally. To the extent that members open up their capital account too soon—before they have achieved macroeconomic stability or put in place a well-regulated financial sector that can manage risks—such a policy can precipitate a severe balance of payments (or broader financial) crisis. Moreover, for countries that are experiencing a capital account crisis, the size of the capital outflows may outstrip the countries' ability to deal with the problem through a combination of financing and adjustment. In such cases, reliance on capital controls may be necessary for a temporary period. Finally, experience demonstrates that capital inflows may complicate macroeconomic management and that controls on such inflows, in certain circumstances, may need to be considered.

32. Although there is an important nexus between the regulation of international capital movements and balance of payments and macroeconomic stability, the existing international frameworks do little to take this relationship into account. Indeed, capital account liberalization often takes place in the context of bilateral and regional arrangements that give investor protection priority over financial stability. Given the fact that the Fund is charged with providing financing to address crises that may be caused by premature liberalization, it may be particularly appropriate for the Fund to play a central role in determining when liberalization supports—or undermines—stability of members and the overall system.

33. During the 1990s, the Fund spent considerable effort trying to design an amendment of the Articles that would give the Fund more explicit jurisdiction over capital movements. While the failure of this endeavor was due to more than one factor, there was a concern that the approach followed—where, similar to the approach applied to current payments, members would have the obligation to liberalize capital movements, subject to safeguards—placed excessive emphasis on the benefits of liberalization without full appreciation of the risks.

34. In establishing a future role for the Fund in this area, consideration could be given to at least two possible approaches. The first would follow the route envisaged in the 1990s: the Fund's Articles would be amended to establish obligations for members to liberalize capital movements, subject to broad safeguards that would allow both for the phased elimination of restrictions, and the imposition of new restrictions as a means of ensuring balance of payments and macroeconomic stability. This approach would give the Fund the central role in a multilateral and nondiscriminatory framework that would govern the regulation and liberalization of capital movements.

35. Under a second, less ambitious, approach, the Fund could play a more proactive role with respect to capital movements in the context of surveillance (see Mandate Overview Paper, para. 14). Depending on its design, this second approach would not require an

amendment of the Fund’s Articles. Specifically, it has been recognized that the right of members to regulate capital movements under Article VI is subject to some limitations. In particular, members must exercise their right to regulate capital movements in a manner that is consistent with their obligation to collaborate with the Fund and other members to promote a stable system of exchange rates. Indeed, this was recognized when the first decision on surveillance was adopted at the time of the Second Amendment.¹⁹ For this reason, it would be open for the Fund to establish policies (e.g., “recommendations”) pursuant to Article IV, Section 1 that provide guidance to members as to: (a) what conditions should be in place before a member liberalizes its capital account, and (b) when the imposition of controls on outflows or inflows may be an appropriate response to balance of payments or macroeconomic pressures. In the conduct of bilateral surveillance, the Fund would assess the extent to which members’ actions are consistent with these recommendations.²⁰ The Fund could also take up the systemic role of capital movements—and the impact of controls on such movements—in the context of multilateral surveillance.²¹

III. THE FUND’S AUTHORITY TO PROVIDE FINANCIAL ASSISTANCE

36. The Articles provide the Fund with three distinct areas of authority with respect to the provision of financial assistance: (a) the use of its general resources, (b) the allocation of SDRs and (c) the use of resources held in the Special Disbursement Account, which are derived from the sale of gold held by the Fund at the time of the Second Amendment. Many elements of the legal framework governing the Fund’s financial authority were reviewed comprehensively in the context of the recent reform of the Fund’s GRA financing facilities and the general allocation of SDRs.²² Accordingly, this section focuses primarily on legal issues arising from the discussion set forth in the Mandate Overview Paper.

¹⁹ The 1977 Surveillance Decision included, among the indicators that “might indicate the need for discussion” with a member “the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or overflow of capital.” See *Surveillance over Exchange Rate Policies* (Decision No. 5392-(77/63), adopted April 2, 1977), para. 2 (iii) (b). This provision was also included in the [2007 Surveillance Decision](#) (para. 15 (iii) (b)).

²⁰ However, this assessment of consistency would be for the purposes of policy discussions with members. The failure of a member to observe these policies would not, in itself, lead to a finding of breach of obligation.

²¹ Indeed, when the Fund initiated its discussion of an amendment of the Fund’s Articles to give the Fund greater jurisdiction over capital movements, it was initially proposed that the Fund rely on surveillance. However, this approach was ultimately rejected.

²² See [Conditionality in Fund-Supported Programs—Purposes, Modalities and Options for Reform](#) (1/29/09), [Review of Fund Facilities—Analytical Basis for Fund Lending and Reform Options](#) (2/6/09), [GRA Lending Toolkit and Conditionality—Reform Proposals](#) (3/13/09), [Allocation of Special Drawing Rights for the Ninth Basic Period—Draft Executive Board Decision and Report by the Managing Director to the Board of Governors](#) (7/16/09), and [Proposal for a General Allocation of SDRs](#) (6/9/09).

A. The Fund's General Resources

37. The Fund is required to make its general resources available to members to assist them in resolving their balance of payments problems in a manner that is consistent with the Articles and that establishes adequate safeguards for their temporary use. Taking into account the issues raised in the Mandate Overview Paper, several aspects of this responsibility merit emphasis.

38. **Balance of Payments Need.** Only members may use the Fund's general resources and, consistent with the conceptual framework that defines the Fund's oversight authority, a member may use the Fund's general resources only to the extent that it has a balance of payments need; i.e., a need arising from "its balance of payments or its reserve position or developments in its reserves." As is described in Box 3, this definition of balance of payments need, which was introduced at the time of the Second Amendment, was intended to be broad and has been sufficiently flexible to enable the Fund to provide financing in a variety of situations—for example, to a member of a currency union where the need in question arises from a budget.

39. **Conditionality.** With the exception of reserve tranche purchases, the Fund is precluded from making its general resources available in the absence of conditionality; i.e., in the absence of assurances that: (a) the resources will be used to resolve—rather than delay the resolution of—the member's balance of payments problem, and (b) the member will be in a position to repay the Fund in accordance with the relevant maturity schedule. These conditions, while distinct, are clearly related, in that the resolution of a member's balance of payments problem will enhance the capacity of the member to repay the Fund. The requirement of conditionality distinguishes a member's ability to use the Fund's general resources from its ability to use reserves, including SDRs, which are available to members for balance of payments purposes on an unconditional basis.

40. While the Articles require that the Fund's general resources be used on a conditional basis, they give the Fund considerable flexibility with respect to both the design and implementation of conditionality, as was recently demonstrated by the establishment of the FCL and its use of *ex ante* conditionality; i.e., where the necessary assurances are mainly obtained through the relevant member's policies implemented in the period preceding the approval of the arrangement, through reliance on qualification criteria that give confidence about future policy implementation.²³ The potential areas of reform of the Fund's GRA lending instruments identified in the Mandate Overview Paper (para. 15-19), while requiring amendments to existing policies, would be consistent with the conditionality requirements of

²³ As discussed in greater detail in [Conditionality in Fund-Supported Programs—Purposes, Modalities and Options for Reform](#) (1/29/09), *ex ante* conditionality was also used in the early years of the Fund.

the Articles to the extent that they continued to require some assessment of the adequacy of policies of the member to resolve an existing or potential balance of payments problem, and to ensure adequate safeguards for the use of the Fund's resources. With respect to the proposal to offer credit lines to qualifying members in the context of a systemic crisis, such an approach would be legally feasible and would be essentially procedural: there would be an actual Fund arrangement with a particular member only if—and to the extent that—the member were to accept the offer.

41. **Charges.** The Mandate Overview Paper (para. 16) discusses the possibility of differentiating charges on the basis of economic policies and fundamentals. Such differentiation would require an amendment of the Fund's Articles: under Article V, Section 8(d), the rate of charge arising from the Fund's holdings of members' currencies must be "uniform for all members." While this term has been understood as allowing for differentiation among facilities that address different balance of payments problems (e.g., previously, the Supplemental Reserve Facility had a special rate of charge), the requirement of uniformity would not permit differentiation within the same facility on the basis of members' economic policies and fundamentals.

Box 3. Conditions for Balance of Payments “Need” Under the Articles

Article V, Section 3(b)(ii) specifies that a member may use the Fund’s resources only if it represents that it has a need because of its balance of payments, or its reserve position or developments in its reserves. The meaning of these conditions, based on the text of the Articles and the relevant legislative history may be summarized as follows:

- A need because of a member’s *“balance of payments”* exists when the member has a BOP deficit according to accepted definitions of BOP, taking into account the distinction between “above the line” and “below the line” transactions.
- A need because of a member’s *“reserve position”* exists when the member has a gross reserves position that is relatively weak. This requires the exercise of judgment and is a country-specific analysis, as reserve adequacy depends on factors such as a country’s volume and variability of exports and imports, past behavior of reserves, seasonal factors, and the size of short-term liabilities. The Fund has considerable room for the exercise of judgment in determining need based on a member’s reserve position.
- A member’s need based on *“developments in its reserves”* may exist if there is an unfavorable development (e.g., an impending discharge of liabilities), even though the member does not have a BOP deficit or inadequate reserves. The legislative history shows that this concept was included in the Articles mainly to address concerns regarding the availability of Fund financing to reserve currency members, inter alia, in order to ensure that these members would not view their Fund positions as being less favorable than other reserve assets.

As these conditions of need are exclusive and alternative, the requirement of need will be satisfied if any one of them is met (e.g., where, notwithstanding a strong reserve position, a member has a deficit in its overall BOP). Moreover, it is not necessary for a BOP need to exist when a Fund arrangement is approved, as distinct from when a purchase is made, at which point a need is required. Accordingly, a Fund arrangement may be approved on a precautionary basis (i.e., on the basis of a prospective need).

As was discussed in a recent paper that analyzed the analytical framework for Fund lending, the balance of payments need requirement in the Articles is sufficiently flexible to enable the Fund to provide financing in a broad variety of situations. By way of example, the Fund has the authority to provide financing to members of a currency union for the following reasons. First, from the Fund’s perspective, members of a currency union still have their own balance of payments vis-a-vis other members, including other members of the currency union. Second, a balance of payments need of a currency union member can arise from the difficulties of the government financing its international debt obligations, even if these obligations are in the currency of the union and relate to the financing of the member’s budget deficit. What makes the servicing transaction “international”—and therefore relevant for balance of payments purposes—is the fact that it takes place between a resident and a non-resident.

42. *The Use of Collateral.* The Mandate Overview Paper (para. 19) discusses the possibility of the Fund receiving collateral from a member in the context of its lending activities. While this is possible under the Articles, it does not obviate the need for conditionality. Specifically, where a member requests an amount of the Fund’s general

resources that would result in the Fund's holdings of the member's currency exceeding 200 percent of quota, the Fund may require, as a condition for granting the request, that the member pledge collateral consisting of acceptable assets that, in the opinion of the Fund, are of sufficient value to protect the Fund's interests. While the existence of collateral may help the Fund to conclude that it has adequate assurances regarding repayment, it does not address—and cannot satisfy—the separate requirement that the Fund have assurances that the member's policies in place will enable it to actually resolve its balance of payments problems; i.e., the Fund is precluded from using collateral as a substitute for policies.

43. There may be situations—indeed there have been situations—where, although adequate policies exist, there continues to be a risk for the Fund given, for example, the amounts being disbursed. In these circumstances, collateral could provide an additional safeguard to mitigate against such risk. However, even in these circumstances, collateral has rarely been used, with the Fund preferring to rely on member policies as the basis for concluding that it will be repaid. This preference reflects, in part, the Fund's catalytic role. To the extent that the Fund relies on collateral when it provides financing, other lenders may conclude that the Fund has doubts regarding the adequacy of the member's policies and this may make them less willing to provide financing.

B. Allocation of SDRs

44. The Fund is authorized to allocate SDRs to members of the Fund that are also participants of the SDR Department. As mentioned in the Mandate Overview Paper (para. 28), the Articles prescribe very specific rules regarding the basis for—and the modalities of—such allocations. An SDR allocation may only be made if the Fund has made the determination that there is a long-term global need to supplement reserve assets—the objective of making the SDR the principal reserve asset does not, in and of itself, provide a basis for an allocation. Once a determination has been made that an allocation would be appropriate, the allocation must be made to all participants as a percentage of their quotas that is the same for all participants. Through the system of designation, and consistent with the reserve quality of the SDR, members have the right to use SDRs allocated to them to obtain freely usable currencies on an unconditional basis where they have a balance of payments need. They may also exchange them for currencies with other participants by agreement. SDRs may only be held by participants and other official entities that have been prescribed by the Fund. However, nothing precludes private parties from denominating their claims in SDRs, e.g., as a means of managing exchange rate risk.

C. SDA Resources

45. The Articles authorize the Fund to sell the gold held by it at the time of the Second Amendment and to place the profits of such sales in the Special Disbursement Account (SDA). Resources held in the SDA may be used, inter alia, for operations and transactions that are otherwise not specifically authorized by other provisions of the Articles but are

consistent with the Fund's purposes. One of the operations that is specifically identified in the relevant provision of the Articles is the provision of balance of payments assistance to developing members on special terms, which has provided the basis for the Fund's concessional financing, including under the PRGT, HIPC and the MDRI. Adoption of the new ex ante conditionality LIC instrument proposed in the Mandate Overview Paper (para. 21) would be pursuant to this authority. Further, and as is discussed in the Mandate Overview Paper (para. 20), it would be open for the Fund to use these resources for nonconcessional purposes, including to provide guarantees for the benefit of members.

IV. THE FUND'S ADVISORY AUTHORITY

46. At the time of the Second Amendment, the Fund was given the authority to perform, upon request, financial and technical services, provided that these services are consistent with the purposes of the Fund.²⁴ In contrast to the Fund's oversight authority, these powers are voluntary for both the member (they are only provided if requested) and for the Fund (the Fund is under no obligation to honor the request). Over the years, these advisory powers have been used extensively by the Fund both to complement and enhance its oversight and financial powers. For example, the FSAP, being voluntary, is a form of technical assistance that provides an important input into both the bilateral and multilateral surveillance process. (As noted earlier in the paper, however, it is also legally possible for the Executive Board to make it an obligation under bilateral surveillance.) The Fund's participation in the G-20 mutual assessment process is another example of technical assistance that will provide an important input into the Fund's surveillance activities. Moreover, the Fund's establishment and operation of trusts to provide concessional financing to low-income members is a financial service that, by administering donor resources, augments and leverages the SDA resources provided by the Fund for this purpose. Finally, the establishment of a substitution account to support the international monetary system, which was discussed extensively in the late 1970s, would also rely on the Fund's authority to provide financial services.

47. The Mandate Overview Paper sets out several proposals that could be implemented through the use of the Fund's advisory powers. In particular, the Fund could rely upon its advisory powers in establishing trust funds to guarantee new debt issuances of governments or government-sponsored vehicles (Mandate Overview Paper, para. 20). Moreover, it would be open for the Fund to provide technical assistance to a regional reserve pooling arrangement with respect to the design of the conditionality that would be applied in the event of the use of the pool's resources by a member of the pool.

²⁴ [Articles of Agreement, Article V, Section 2\(b\)](#).