THE IMF MANDATE ON CAPITAL CONTROLS: LEGAL ANALYSIS OF THE ARTICLE IV BYROAD AND OF THE INSTITUTIONAL VIEW OF 2012

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TABLE OF CONTENTS

ABSTRACT

Capital controls and other Capital Flow Management Measures ('CFMs') have once again become a fiercely debated and controversial topic in international financial law. The Asian Financial Crisis (1997) and subsequent crises spurred policy makers to understand that while largescale cross-border capital flows can bring enormous benefits, they can also generate extreme financial instability. In turn, and after being condemned for years by the International Monetary Fund, CFMs have once again become part of the suite of respectable governmental measures used to combat instability and systemic integrity. More recently, the IMF has in certain instances mandated the use of CFMs as part of their financial assistance and rescue packages. However, while the Fund—charged with securing the stability of the international monetary system—had little practical choice but to

change its position on the use of CFMs, the question posed in this article is whether the IMF actually had the legal authority to do so. Although the Fund, as the prevailing international financial authority, is the logical choice to house efforts to promote stability and international coordination of matters pertaining to capital flows, its operational mandate as historically defined under the Articles of Agreement never anticipated the growing importance of modern capital flows, and therefore remains largely silent on the matter. This article contributes to the debate on the IMF mandate and capital controls by legally analyzing how the Fund has operated and achieved the expansion of its mandate before concluding that the Fund's expansion was achieved through a 'byroad' but nevertheless is within its operational mandate.

I. INTRODUCTION

Capital controls and other Capital Flow Management Measures ('CFMs') have recently become a fiercely debated and controversial topic. Such measures were largely unpopular and out-of-favor during the 1990s as the idea of market liberalization became the dominant ethos in international institutions and global governance.[1] However, the foundation of this approach was shaken following the Asian Financial Crisis (1997) and in subsequent crises, as policy makers and commentators began to understand that while largescale cross-border capital flows can bring enormous benefits they could also generate extreme financial instability. For this reason, CFMs have increasingly become in vogue as a means to limit the risks posed by the free flow of cross-border capital.

In some respects, the term "CFMs" is simply a less offensive and more obscure way to refer to "capital controls." The International Monetary Fund ('IMF' or 'the Fund'), for instance, now refers to CFMs in a broad manner which encompasses but is not limited to capital controls,[2] but to many the concept of CFMs remains undefined and largely impalpable.[3] Regardless of terminology, the IMF's ideological position favoring the complete liberalization of capital accounts has slowly evolved into an embrace of CFMs. This institutional shift became

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[1] IMF, *The IMF's Approach to Capital Account Liberalization*, Evaluation Report, at 24–29 (Apr. 2005). Financial flow liberalization was perceived as a positive contribution to economic growth, economic development and capacity-building throughout the 1990s. *Id.* *See also* JOAN EDELMAN SPERO & JEFFREY A. HART, THE POLITICS OF INTERNATIONAL ECONOMIC RELATIONS 223–27 (6th ed. 2003).

[2] IMF, *Liberalizing Capital Flows and Managing Outflows*, Policy Paper, at 6 (Mar. 2012).

[3] For this reason, it is currently extremely difficult to establish what type of measures and policies could fall under the scope of CFMs, as well as to determine how these measures and policies should operate in practice.

complete in 2012, when the Fund announced its new "integrated approach" to liberalization.[4] This approach shifted traditional IMF antagonism towards capital controls to a preference for temporary or longer-term use of "measures that are specifically designed to limit capital flows" and finds that "[i]n certain circumstances, [CFMs] can be useful."[5] With this statement, CFMs not only became part of the suite of respectable measures governments *may* use in order to combat instability and systemic integrity, but also in certain instances something which governments *must* use in order to receive assistance from the IMF.

While the lack of overarching regulatory framework over the international financial system is well known and indeed has proven to be problematic,[6] the question now is whether the IMF has taken it upon itself to fill the lacunae. If so, a related question is whether the IMF has the authority under its mandate to do so.

As the international body tasked with securing the stability of the international monetary system, the reality is that the IMF had little choice but to take a stand on the use of CFMs. CFMs were taken throughout the 1990s and early 2000s by a host of countries—including Brazil, Chile, Thailand, Malaysia, or Taiwan—to mitigate financial difficulties after policymakers and commentators around the world realized that full financial liberalization would increasingly have unwanted effects.[7] More recently, following the Global Financial Crisis of 2008, they have been used in countries such as Iceland, Brazil, Argentina, Cyprus, India, Indonesia, and South Korea.[8] In early 2016, the idea that China might set up capital controls to compensate for massive capital outflows throughout 2015 has been suggested by some neighbor's Central Bankers—without being discarded by the IMF's Director Christine Lagarde—before being officially rejected by China.[9]

The complication, however, is that the Fund's operational mandate—as historically defined under the Articles of Agreement—never anticipated the

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[4] IMF, *The Liberalization and Management of Capital Flows: An Institutional View*, Policy Paper, ¶ 21–22 (Nov. 2012).

[5] *Id.* ¶ 31.

[6] *E.g.*, John Williamson et al., *International Rules for Capital Controls*, VOX (Jun. 11, 2002), http://voxeu.org/article/international-rules-capital-controls (discussing the view of some authors, "currently, the international regime is permissive about the use of capital controls [and] countries can use them or not as they wish."). *See also* IMF, *The Fund's Role Regarding Cross-Border Capital Flows*, Policy Paper, at 22 (Nov. 2010).

[7] *See, e.g.*, Joseph E. Stiglitz, *Capital Market Liberalization, Economic Growth, and Instability*, 28 WORLD DEVELOPMENT 1075–86 (2000) (discussing ideological shifts regarding financial liberalization); Richard N. Watanabe, *Foreign Exchange and Capital Movement Controls in Taiwan,* 16 UCLA PAC. BASIN L. J. 1, 9, 17, (1997). In the case of Taiwan, for instance, foreign exchange and capital movement controls were employed during a rapid economic growth period to preserve domestic savings, restrict foreign ownership in specific sectors and reduce instability risks generated by capital inflows. *Id.* at 2.

[8] Philip J. MacFarlane, *The IMF's Reassessment of Capital Controls After the 2008 Financial Crisis: Heresy or Orthodoxy?*, 19 UCLA J. INT'L L. & FOREIGN AFF. 167, 169 (2015).

[9] Antoine P. Martin, *China, Capital Controls, Lagarde and Kuroda*, THE ASIA PAC. CIRCLE (Feb. 11, 2016), https://www.asiapacificcircle.org/single-post/2016/02/11/China-Capital-Controls-Lagarde-and-Kuroda.

growing importance of modern capital flows and therefore remains largely silent on the matter. Of course, the continuous reduction of regulatory barriers orchestrated by the Fund has increased financial inflows to both advanced economies and emerging markets.[10] However, these have also increased capital volatility[11] (i.e. a "stop and go" cycle of fund allocations and reallocations facilitated by the fall of regulatory barriers) and, in time, have begun to represent serious policy challenges by increasing spillovers and conveying financial and policy shocks alike across borders.[12] That being the case, a strict reading of the Articles would suggest that the Fund has no authority over capital movements.[13] Nonetheless, as the prevailing international financial authority, the Fund appears to be the logical choice to house efforts to promote stability and international coordination of matters pertaining to capital flows and, in fact, its surveillance operations have been largely developed over time.[14]

Although not long ago the IMF Board cautiously considered whether it was premature to change the Fund's mandate in the absence of further analysis and practical experience,[15] the IMF's authority has indeed expanded over time. A shift took place, beginning with the materialization of a mandate to oversee the development of stable exchange rate policies in the late 1990s, and the development in the late-2000s of a multilateral surveillance and coordination role, which monitors the "needs of the international monetary and financial system as they develop."[16] Simply put, the Fund nowadays plays an increasingly important role in following and assisting governments, which experience wildly fluctuating inward and outward capital flows. Moreover, as this article will analyze in detail, it is also clear that the Fund's mandate and legal authority towards the subject matter have evolved over time through various back door entrances and bypasses to encompass capital movements.

The literature on the relationship between the IMF and the regulation of cross-border capital flows is voluminous, but mostly consists of a non-legal authorship and perspective. In particular, the literature is filled with economic and empirically focused research conducted by IMF staffers and academic economists as well as contributions by authors with a political or international relations approach to capital flow monitoring.[17] As Gochoco and Rhee note, however, the

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10 *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 1.

11 IMF, *Pursuing Equitable and Balanced Growth*, Annual Report 2011, at 9 (Sep. 2011).

12 *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶¶ 3, 7.

13 *See* OLIVIER JEANNE ET AL., WHO NEEDS TO OPEN THE CAPITAL ACCOUNT? 109–10 (2012).

14 *See infra* Section III.

15 IMF, *Executive Board Discusses the Fund's Role' Regarding Cross-Border Capital Flows*, Public Information Notice No. 11/1 (Jan. 5, 2011); *See also* IMF, *IMF Executive Board Discusses Recent Experiences in Managing Capital Inflows*, Public Information Notice No. 11/42 (Apr. 5, 2011).

16 *See infra* Section III.B.

17 *See, e.g.*, Maria Socorro Gochoco-Bautista & Changyong Rhee, *Capital Controls: A Pragmatic Proposal* (Asian Dev. Bank, Working Paper No. 337, 2013), https://www.adb.org/sites/default/files/publication/30196/ewp-337.pdf; Manuela Moschella*, The Institutional*

economic debate has thus far been largely "paternalistic," or, focusing on "whether capital controls are beneficial and effective in securing financial stability against volatile capital flows without raising funding costs for recipient countries."[18] In contrast, regulatory issues surrounding the trend have remained unconsidered. In fact, although a few commentators have made some suggestions as to the necessity to set up a regulatory framework on cross-border capital management,[19] Siegel considers that, in the main, the word "framework," in relation to CFMs, has only been used for "convenience" without giving any legal authority to the Fund.[20] In this regard, Feibelman has concluded, "the scope of the Fund's jurisdiction over its members' policies regarding capital movements is unclear."[21]

This article contributes to the debate on the IMF mandate over capital controls through a legal approach, which considers *how* the Fund has operated and achieved its mandate shift. Understanding the shifting nature of the IMF's mandate is important, yet largely ignored in the legal literature and misunderstood in the economic literature. The article makes two primary arguments. First, while there is a consensus in the literature that the evolution of the Fund's mandate flows directly from a political decision to get involved rather than from an express mandate to do so, we argue that the Fund has derived the expansion of its mandate to operate from the very wording of the Articles of Agreement. In this regard, while Section II shows that the Articles create a gap in the Fund's legal mandate, Section III will argue that the IMF followed an "act now, apologize later" approach. This approach established what we identify as an "Article IV byroad," which allowed the Fund to interpret its constitutive instrument to escape the distinction historically made between "capital movements" and "current international transactions" and therefore remain in line with the evolution and development of the world economy. Second, we argue that the Fund's so-called Institutional View of 2012 was not a radical break from tradition, but rather a formalization and crystallization of the ideas and direction it has pursued since, at the earliest, 2008. Thus, in our view, the Institutional View of 2012 does not create any new rights nor does it change the Fund's legal mandate.

The ground-breaking instruments—if any—would be the following ones: The 1977 Decision on Surveillance over Exchange Rate Policies first demonstrated a willingness of the Fund's lawyers and strategists to shift mandates beyond those explicitly written in the Articles. The 2007 Decision, which furthered the 1977 mandate of the Fund, as well as its related 2006 legal and policy paper. And the

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Roots of Incremental Ideational Change: The IMF and Capital Controls After the Global Financial Crisis, 17 BRITISH J. OF POL. & INT'L REL. 442 (2015).

18 Gochoco-Bautista & Rhee, *supra* note 17, at 2.

19 *See, e.g.*, ANNA-MARIA VITERBO, INTERNATIONAL ECONOMIC LAW AND MONETARY MEASURES: LIMITATIONS TO STATES' SOVEREIGNTY AND DISPUTE SETTLEMENT 115 (2012); JEANNE ET AL., *supra* note 13, at 13; Gochoco-Bautista & Rhee, *supra* note 17, at 2.

20 Deborah E. Siegel, *Capital Account Restrictions, Trade Agreements, and the IMF*, *in* CAPITAL ACCOUNT REGULATIONS AND THE TRADING SYSTEM: A COMPATIBILITY REVIEW 67, 72 (2013).

21 Adam Feibelman, *The IMF and Regulation of Cross-Border Capital Flows*, 15 CHI. J. INT'L L. 409, 414 (2015).

Integrated Surveillance Decision of July 2012 which seemingly cemented the Fund's "act now, apologize later" approach to capital flow management and legally allowed the Fund to move on and operate in new, clear, official, and formalized terms.

II. MANDATE UNDER THE FUND'S ARTICLES OF AGREEMENT

The IMF's Articles of Agreements are the important starting point when assessing the Fund's mandate under international law. In the Articles of Agreement, it is apparent that the mandate of the IMF is conditioned by a historical distinction between "current international transactions," which fall under the Fund's authority, and "capital movements," which fall under the member states' competence.[22] In modern times, however, the concept of "current international transactions" as provided in the IMF mandate, has not been restricted to payments and transfers for goods and services; it now extends to capital transactions at large.[23] The Articles, nonetheless, remain silent and do not even consider the Fund's authority towards capital flow management methods.[24] The remainder of this Section provides an analysis of the Articles of Agreement, discusses the so-called asymmetry between capital movements and current transactions, and considers the implications for the Fund's mandate.

A. Reading the Articles of Agreement: Capital Movements vs. Current International Transactions

The difficulty in establishing the Fund's authority to oversee capital policymaking, CFMs, and capital controls stems from the fact that while the Articles of Agreement provide the Fund with a large coordination role they split capital movement policy supervision between the IMF and its member states.

In the main, the Fund has a wide role in stability coordination and facilitation. According to Article I, the purposes of the IMF are *inter alia*, to (i) promote international monetary cooperation, (ii) facilitate the expansion and balanced growth of international trade, and (iii) promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.[25]

At the same time, the Articles are opaque when it comes to assessing the Fund's competence to coordinate policy and monitor cross-border capital flows. For instance, while Section 3 of Article VI ensures that the regulation of cross-

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[22] *See infra* Section II.A.

[23] Deborah E. Siegel, *Using Free Trade Agreements to Control Capital Account Restrictions: Summary of Remarks on the Relationship to the Mandate of the IMF*, 10 ILSA J. INT'L & COMP. L. 297, 299 (2004).

[24] *See The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, at 23–25 (discussing the difficulty to define "capital controls").

[25] Articles of Agreement of the IMF, 60 Stat. 1401, 2 U.N.T.S. 39.

border capital movements remains a state prerogative and makes it clear that the "Members may exercise such controls as are necessary to regulate international *capital movements*."[26] Section 2(a) of Article VIII limits the ability of the states to *fully* control capital movements by providing that "no member shall, *without the approval of the Fund*, impose restrictions on the making of payments and transfers for *current international transactions*"[27] or unduly delay transfers of funds in settlement of commitments (which also fall under the scope of current transactions).[28] Furthermore, Section 1 of Article IV imposes an obligation on members "to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates."

In other words, the Articles of Agreement create a difference between "capital movements" and "current international transactions" which some commentators have described as a capital movement vs current transactions asymmetry.[29] Under this asymmetry, therefore the members are subjected to IMF guidance on exchange matters and can only manage capital movements as long as they do not interfere with 'current transactions'—i.e. capital flows merely corresponding to payments and transfers. *A contrario*, this means that the Fund has full authority over monetary and exchange arrangement policies—while states have an obligation to cooperate—but the IMF in theory has no legal authority over cross-border capital movements unless these can be considered as "current transactions." The IMF's supervision role in regards to exchange arrangements, however, has long been the starting point of the Fund's shift in mandate towards capital movement supervision.

B. Explaining the Asymmetry

In order to proceed, one must understand the differences between capital movements and current transactions as provided under Articles VI and VIII of the Articles of Agreement. Distinguishing between the two concepts requires recourse to the IMF's institutional history.

Simply put, capital movements and current transactions have historically been considered as distinct elements because the Bretton Woods negotiations placed no emphasis on the liberalization of trade exchange or on financial facilitation. Such issues were not a major concern to the international community at that time,[30] because the participating countries were focusing on recovery and self-preservation following the Second World War.[31]

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26 Articles of Agreement of the IMF, 60 Stat. 1401, 2 U.N.T.S. 39 (emphasis added).
27 *Id.* (emphasis added).
28 *Id.* art VI.
29 *See* Feibelman, *supra* note 21, at 430 (defining the term Asymmetry).
30 *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 22.
31 Antoine Martin & Bryan Mercurio, *The IMF and its Shifting Mandate Towards Capital Movements and Capital Controls: A Legal Perspective*, 44 L. ISSUES OF ECON. INTEGRATION 211, 44, n.3 (2017) (discussing this historical perspective).

The timing of Bretton Woods was important, and for our purposes, directly led to the opaque distinction between capital movements and current transactions for at least two reasons. First, it must be remembered that post-Great Depression and post-war period governments viewed liberalised trade far differently than we do today—simply stated, fairly high levels of tariff and other trade barriers were viewed as necessary to strengthen domestic industry and to re-establish, build and protect nascent markets.[32] At the same time, the prevailing sentiment was that unrestricted capital movements favored speculative trading which could negatively affect upon exchange rate stability and the notion of "capital movements" was thus largely understood in a protectionist way, far from the modern perception that liberalism is about removing barriers and intervention.[33] Accordingly, the regulation of "capital movements" was left under state control so that nations could ensure the preservation and support of domestic development efforts.[34]

Second, the views of the influential British economist John Maynard Keynes were gaining favor, and many believed that government interventionism was critical to the establishment of a stable international monetary landscape capable of facilitating growth; this was the system, which could offer a solution to curb or even avoid market failures.[35] As a result, the IMF was created in parallel to the International Bank for Reconstruction (the World Bank) with the purpose of allowing the big players to monitor common efforts towards currency stability and prevent the competitive monetary devaluations, which were blamed for worsening economic conditions in the 1920s that culminated with the Great Depression.[36] As such, the IMF was granted authority to ensure that cross-border "current transactions"—i.e. the financial transactions allowing for the realization of international trade exchanges—remained stable and under control; but, the idea of improving the countries' *current account* through capital movements facilitation (i.e. establishing a balance between the goods exchanged across borders) and the suggestion that free trade was key to development emerged much later.[37]

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32 *See, e.g.*, SPERO & HART, *supra* note 1, at 2–3, 15 (discussing Bretton Woods); *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, at 18 (discussing Bretton Woods); *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, at 17 (discussing Bretton Woods).

33 *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, at 17.

34 *Id.*

35 Joseph E. Stiglitz, *The World Bank at the Millennium*, 109 ECON. J. 577, 578 (1999). *See also* Gochoco-Bautista & Rhee, *supra* note 17, at 6.

36 Martin & Mercurio, *supra* note 31.

37 *Id.* Interpretations diverge as to what 'current transactions' actually encompassed at the time. Some IMF documents for instance conclude that the term then comprised international payments and transfers. *See, e.g.*, *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6 at 18; Stiglitz, *supra* note 35, at 577. Alternative sources, in contrast, clearly reject the idea that payment and transfers were ever included in the Fund's mandate. *See e.g.*, *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, at 17; MacFarlane, *supra* note 8, at 176–79. *See also* Feibelman, *supra* note 21, at 440–41 (discussing the existence of an agreed repartition of roles between international organizations acting in the various trade and financial fields).

C. Consequences of a Restrictive Mandate in a Changing World

The distinction between capital movements and current transactions has severely impacted the day-to-day operations of the IMF for many decades, if only because the monetary and financial landscape has changed tremendously since the Fund's creation and because the Fund's mandate on paper was never in line with those fundamental changes in international business relations.

On one hand, the immense liberalization of international trade which has occurred primarily as a result of the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), has led to a tremendous rise in the level of goods traded. This in turn has increased the need to realize cross-border transactions as well as the need to rely on more efficient financial services on a cross-border basis. In particular, the opening of more financial markets and the expansion of the commodities trade have transformed international finance into a self-standing activity capable of propping up or destroying the global economy irrespective of palpable trade. On the other hand, the IMF had no legal authority to get involved in establishing a framework for the liberalization or regulation of financial flows and services. Therefore, all financial liberalization efforts only materialized as part of WTO negotiations through the GATS Annex on Financial Services during the Uruguay Round between 1995 and 1997,[38] as well as through bilateral Free Trade Agreements. The Fund, because of the asymmetry, was expected to overlook monetary and exchange rate stability factors as well as international financial stability at large.[39] Over time, in other words, international business developments have progressively given a new meaning to the concept of "current transactions," which has *de facto* been merged with the once very distinct concept of "capital movements."[40] Simultaneously, increasingly facilitated financial services and capital flows have been hardly regulated or controlled by an international mechanism or institution.

Yet, while a common idea during the heyday of the "Washington Consensus" era of the 1990s was that financial flows had a propensity to improve standards of living—especially considering that a large number of developing economies had lost access to capital markets funding due to successive economic crises[41]—recent developments including the 1997 financial crisis in Asia and the

[38] *See* World Trade Organization, *Overview of the 1995 and 1997 Negotiations on Financial Services*, https://www.wto.org/english/tratop_e/serv_e/finance_e/finance_fiback_e.htm (last visited Sept. 20, 2017).

[39] *See* Daniel D. Bradlow, *Rapidly Changing Functions and Slowly Evolving Structures: The Troubling Case of the IMF*, 94 AM. SOC'Y INT'L L. PROC. 152, 153 (2000).

[40] *See* MacFarlane, *supra* note 8, at 179 (showing the difference between both concepts).

[41] *See e.g.*, *Id*. at 183-184; SPERO & HART *supra* note 1, at 223–227. Multiple scholars discuss the theory of "surplus" flows. *See e.g.*, Daniela Gabor, *Paradigm Shift? A Critique of the IMF's New Approach to Capital Controls*, 4 (Dep't of Acct. Econ. And Fin. Bristol Bus. School, U. of the W. of Eng., Bristol, Working Paper No. 1109, 2011); Gochoco-

2000 South American crisis led many to rethink financial liberalization. Given the recognition of the inherent volatility and instability of large cross-border capital flows, financial liberalism now appears as a danger by countries increasingly facing sudden unforeseen outflows of capital that have severe negative effects on currency value and economic stability. Accordingly, the idea that such flows had to be managed has begun to gain traction in governmental and academic communities.[42]

However, the case for capital controls has not been entirely proven, just as the economic literature previously failed to demonstrate a robust correlation between capital account liberalization and growth.[43] That being said, some evidence documents the negative "push and pull" aspects of financial flows.[44] For example, Neely notes that "large international capital inflows, especially short-term foreign borrowing, can exacerbate these perverse incentives and pose a real danger to banking systems."[45]Gabor concludes that capital flows have replaced trade as the "major conduit for the transmission of global shocks," and further finds that because "large capital flows trigger excessive currency interventions . . . the global financial crisis forcefully highlighted the importance of developing mechanisms to curb the effects of large and volatile capital inflows on growth and financial stability in developing countries."[46]

As a result, commentators and states alike have reconsidered the very idea of applying CFMs to ensure the stability of domestic and global economies and their protection against uncontrollable capital movements. Facing a severe devaluation of the Ringgit, Malaysia imposed capital controls in 1998 that**,** amongst other things**,** banned transfers between domestic and foreign accounts and prevented investment repatriation in order to deter short-term capital outflows while

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Bautista & Rhee, *supra* note 17; MacFarlane, *supra* note 8, at 188; Christopher J. Neely, *An Introduction to Capital Controls*, FED. RES. BANK ST. LOUIS. REV. 13, 15 (Nov/Dec. 1999); Moschella, *supra* note 17, at 449; Feibelman, *supra* note 21, at 432. *But see* INDEP. EVALUATION OFFICE OF THE INT'L MONETARY FUND, THE IMF'S APPROACH TO CAPITAL ACCOUNT LIBERALIZATION: REVISITING THE 2005 IEO EVALUATION, 10 (2015) (giving a counter argument emphasizing a lack of consensus as to the benefits of liberalization) [hereinafter REVISITING THE 2005 IEO EVALUATION].

[42] *See* Feibelman, *supra* note 21, at 431 (discussing pre-crisis period beliefs); Gabor, *supra* note 41, at 2, 5, 9 (discussing pre-crisis period beliefs); Moschella, *supra* note 17, at 451 (discussing pre-crisis period beliefs).

[43] REVISITING THE 2005 IEO EVALUATION, *supra* note 41, ¶ 10. *See also* Kevin P. Gallagher & Jose Antonio Ocampo, *IMF's New View on Capital Controls*, XLVIII ECON. & POL. WEEKLY 10, 11 (2013) (referring to IMF economists concluding in 2012 that "the international community should not seek to promote totally free trade in assets—even over the long run—because . . . free capital mobility seems to have little benefit in terms of long-run growth").

[44] IMF, *Exchange Arrangements and Exchange Restrictions*, Annual Report 2014, at 60 (2014).

[45] Neely, *supra* note 41, at 20.

[46] Gabor, *supra* note 411, at 6. Multiple scholars have posed the idea that necessity to permit the rapid closure of positions in response to changing conditions creates an inherent "destabilizing potential" because it increases exposure to global liquidity shocks. *See Id;* MacFarlane, *supra* note 8, at 172; Feibelman, *supra* note 21, at 412–13, 434.

preserving long-term investments.[47] The measures have been described as having prevented Malaysia's suffering to the same extent as Thailand and Indonesia during the Asian Financial Crisis.[48] For this reason, several countries imposed similar controls during the Global Financial Crisis, some of which remain in effect. Brazil for instance established numerous CFMs between 2008 and 2012 to control a currency, which had appreciated by fifty percent since 2004 because of successful reforms, aimed at attracting foreign investors.[49] The thrust of those CFMs was the prevention of excessive *inflows* with the goal of stabilizing the exchange rate, thus preventing an overvaluation, which would have made the economy less competitive, and reduced inflation generated by rising prices.[50] More widely reported are the controls put in place by Iceland in 2008 with the IMF's approval after staff concluded that temporary controls were necessary to prevent rapid currency depreciation.[51] More recently, some outsiders questioned whether China should institute controls on outwards transactions the country suffered significant, accelerated financial outflows resulting from large and unexpected currency devaluation; the causes of such devaluation ostensibly were the fall of the Shanghai Index in 2015 and a decrease in the country's expected GDP.[52]

Hence, despite the original mandate of the Articles of Agreement being largely restrictive, the IMF has been diligent in following worldwide capital flow development and even contributed to guiding various countries in designing and implementing CFMs. Rather than choosing inaction until its formal explicit authorization, the IMF took it upon itself to expand its mission to promote a stable system of exchange rates and to include policies affecting capital movements. The IMF did this for two reasons: first, capital movements have an impact on domestic and global exchange stability; and second, global capital flows overall constitute an essential component of the international monetary system.[53]

III. ACT NOW, APOLOGIZE LATER

Whereas this shift is widely documented in the economic and political literature, the process relied upon to operate this shift has however been left largely unconsidered by legal commentators. In practice, the Fund has set up what we call

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47 Neely, *supra* note 41, at 22 (discussing the issue that the move has been criticised for replacing reforms instead of buying time for reform).

48 Ethan Kaplan & Dani Rodrik, *Did the Malaysian Capital Controls Work?* (Harv. U., John F. Kennedy School of Gov't Faculty Research Working Paper Series, Working Paper No. 01-008, 2001), http://www.financialpolicy.org/financedev/rodrikmalaysia.pdf.

49 *See* Laura Alfaro et al., *The Real Effects of Capital Controls: Financial Constraints, Exporters, and Firm Investment* 5–8 (Harv. Bus. School, Working Paper No. 15-016, 2014).

50 *Id.* (giving an extensive analysis).

51 *See* MacFarlane, *supra* note 8, at 192–93.

52 Martin, *supra* note 9; Gabriel Wildau, *China Economy Fears Ease after Capital Inflows Boost*, FINANCIAL TIMES (July 14, 2015), https://www.ft.com/content/057d9cd6-29fe-11e5-8613-e7aedbb7bdb7.

53 Feibelman, *supra* note 21, at 431.

an 'Act now, apologize later' approach through a creative interpretation of its constitutive instrument to develop an 'Article IV byroad' allowing it to take a progressive *de facto* and active role in overlooking capital movement matters as part of its exchange arrangement authority.

A. The Article IV Byroad

Through its staffers, the IMF has over time attempted to address the "asymmetry" and gain a broader authority over capital movements.

The most significant of these occurred through the 1977 Decision on Surveillance over Exchange Rate Policies (also known as the 'Hong Kong Declaration'), which formed the second amendments of the IMF Articles of Agreement.[54] By the end of the 1970s, the international community had already made significant efforts to remove restrictions on current transactions—such as payments and transfers—while cross-border capital flows had increased in parallel to the growth of international trade. The Hong Kong Declaration completed the shift from the *par value* system to floating exchange rates.[55] In doing so, the Fund significantly increased its scope of action towards financial flows by introducing the idea that its exchange stability prerogatives had to be considered more broadly because the isolated and unilateral controls operated by states over cross-border capitals impact global exchange stability. More precisely, while Article VI had merely prevented members from manipulating exchange rates to prevent unfair adjustments, the revised Article IV broadened the Fund's role by transforming its competence from a stable exchange rate into a general authority to oversee the stability of the exchange system itself.[56] The 1977 Decision, in other words, more fully integrated the Fund into the process of assisting members to conduct currency policy adjustments in response to capital movement surges.[57] Commenting on the integration, Siegel states:

> [T]he revised Article IV recognized that the overall functioning of the international monetary system was impacted by a growth in international capital movements and liberalization of controls by some members. It imposed obligations on both the IMF and members – the IMF has responsibility to oversee the international monetary system and the members are required to adhere to the surveillance obligations relating to a stable system of exchange rates.[58]

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[54] IMF, *IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies*, Public Information Notice No. 07/69 (June 2007).

[55] *See e.g.*, MacFarlane, *supra* note 8, at 182, 189 (providing a background discussion).

[56] *See supra* Section II.B.

[57] *IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies*, *supra* note 54.

[58] Siegel, *supra* note 20, at 70.

The Fund's efforts to gain competence over capital movements continued into the 1990s, when a proposal for another amendment offered a vocabulary shortcut—the elimination of the remaining difference in treatment between capital movements and current account transactions—based on the general recognition of the systemic benefits flowing from trade and capital account liberalization. Indeed, while at the time free capital flows were generally perceived as making a positive contribution to the global economy,[59] the IMF suggested the creation of a broad legal obligation for members to progressively liberalize policies and regulations on both trade and capital movements.[60] This move towards a simplification of the system ultimately failed, however, as members refused to surrender sovereignty over capital policymaking because they feared that a complete prohibition of capital controls would eventually lead to financial crises.[61] Members, nonetheless, continued liberalizing capital markets on a unilateral basis and, over time, the Fund eventually succeeded in increasing its influence on capital control policymaking—ironically, as a result of the negative effects created by liberalization. Flowing from the sudden withdrawal of large capital inflows, in particular, the 1997 Asian Financial Crisis helped persuade Members that capital account liberalization should be organized, sequenced, and integrated progressively as part of parallel economic reform programs, integrated with suitable macroeconomic policies (exchange rate included), and after ensuring that measures were taken to strengthen financial institutions and markets—the IMF's so-called "integrated approach."[62]

B. The Role of the 1977 and 2007 Decisions on Surveillance over Exchange Rate Policies

Having clarified the process the IMF follows to expand its scope of application, we now consider how the Fund operated from a legal point of view.

As already mentioned, the 1977 Decision played an essential role in establishing the Fund's indirect authority over the monetary system at large and over the capital movements. In addition, the 1977 Decision also created a precedent, which the IMF has built upon when broadening its competence under the 2007 decision and discussing the validity of the capital movements mandate formulated through the 2012 Institutional View.

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59 *See supra*, note 1.

60 *See The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 4 ("This could take the form of an obligation to ultimately liberalize capital movements, subject to safeguards and routine exclusion of prudential measures. Alternatively, and more neutrally, one might consider an amendment calling on members to collaborate with the Fund and others to ensure that capital movements are consistent with international monetary stability."); Feibelman, *supra* note 21, at 431; MacFarlane, *supra* note 8, at 188. These sources provide further detail on the surrounding conditions.

61 MacFarlane, *supra* note 8, at 189–190.

62 REVISITING THE 2005 IEO EVALUATION, *supra* note 41, ¶ 10 (explaining the "Integrating Approach").

Though hardly mentioned in the literature, a 2006 document prepared by the Fund's Legal Department in consultation with the Fund's Policy Development and Review Department provides critical insights as to its mandate legal adaptation strategy—that we call the "Article IV byroad." [63] Focusing on Article IV (as revised with the 1977 Decision), the Legal and Policy Development Departments paved the way to its 2007 replacement instrument by formulating careful and precise reasoning.

First, the Departments recollected that although an essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services *and* capital, the latter had merely been considered "economic benefits" but were never part of the Fund's purposes *per se* because such a shift "would have been understood as a significant expansion of the Fund's mandate" in contradiction with Article VI(3). [64] Having recalled that capital movements never fell under the IMF's strictly legal jurisdiction, the 2006 document nonetheless placed strong emphasis on the obligation of members to collaborate with the Fund on exchange arrangement matters and described this obligation as the logical means to expand the IMF's scope of action.[65] In fact, the Legal and Policy Departments used the members' obligation to collaborate on exchange stability as the cornerstone of the constitutional re-interpretation. The document essentially emphasised that, in practice, the Fund had always "made considerable use" of the cooperation obligation to limit exchange rates' instability and competitive depreciation policies—even though the strict exchange policymaking fell out of its scope of application until the Amendment was adopted in 1977 to ensure the stability of the economic and financial system itself.[66] Hence, given the Fund's 'new' (1977) systemic mandate, the document thus argued that the cooperative approach was still key to ensuring exchange stability at large and added that in fact, it had always been intended that the Fund's overall mission would change over time to adapt to new circumstances in the political economy:

> 22. [F]ollowing a similar approach, the Fund could rely on the collaboration undertaking set forth in the present Article IV, Section 1 as a basis for either requiring or recommending that members take—or refrain from taking those actions that, while not included in any of the specific obligations listed in Article IV, Section 1, are considered by the Fund to be necessary in light of changing circumstances to assure orderly exchange arrangements and to promote a stable system of exchange rates
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> 27. [A]lthough the legislative history is silent on the question, it must be assumed that, notwithstanding the continuity of

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[63] IMF, *Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework*, Policy Paper (June 2006).

[64] *Id.* ¶ 8.

[65] *Id.* ¶ 16-28. *See also*, Articles of Agreement of the IMF, *supra* note 25, art. 4 § 1.

[66] *Article IV of the Fund's Articles of Agreement, An Overview of the Legal Framework*, *supra* note 63, ¶ 20–22, 25.

> language, *it was intended that the underlying meaning of this objective would change in a manner that takes into account the change made to the other objective of the obligation to collaborate* (i.e., the change from "exchange stability" to a "stable system of exchange rates", and the broad freedom given to members to put in place exchange arrangements of their choice). As noted above, even where the exchange arrangement actually includes a specified exchange rate, the right of the member to select this component would be constrained by its obligations regarding a stable system of exchange rates.[67]

Second, the Legal and Policy Development Departments relied on the vagueness of the Articles to further support the idea that a broader approach to exchange matters was needed. Noting that Article IV Section 1(ii) requires each member to "seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions," the Departments argued that (i) "efforts in the Executive Board to insert the word 'exchange' before 'stability' were rejected" and (ii) that "it [was] not clear whether the phrase 'erratic disruptions' only refer to disruptions in exchange rates or whether it has a broader meaning."[68] Simply stated, the Departments have *ex post* offered a creative interpretation of the Articles in order to justify a mandate expansion.

Third, the Departments argue that a broader mandate was required because "there are different ways in which a member could potentially 'manipulate' exchange rates within the meaning of Article IV [such as] excessive intervention in the exchange markets or through the imposition of capital controls."[69] IMF lawyers and policy strategists, in other words, established a practical relationship between capital controls and exchange stability by emphasising that:

> [M]ost importantly, the Articles specifically confer upon members the right to exercise controls on capital movements. However, it has been understood that a member may not impose capital controls if such controls are used to manipulate the member's exchange rate in order to prevent balance of payments adjustment or to gain an unfair competitive advantage over other members.[70]

A contrario, therefore, the Fund's increasing authority towards the stability of the exchange system logically conferred competence to overlook members' capital policies. In a footnote, furthermore, the Departments recalled that the Executive Board discussions relating to the 1977 Decision "clarified that the

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[67] *Article IV of the Fund's Articles of Agreement, An Overview of the Legal Framework*, *supra* note 63, ¶ 20–22, 25.
[68] *Id.* ¶ 31.
[69] *Id.* ¶ 34(a).
[70] *Id.* ¶ 15.

imposition of capital controls or the capital flows that could occur in the absence of such controls could be legally used as an indicator justifying a need for discussion between the Fund and the member of the appropriateness of the member's exchange policies."[71]

Overall, the Legal and Policy Development Departments concluded by suggesting that the Fund's competence to ensure the stability of the exchange system could evolve by using members' general obligation to collaborate to promote a stable system of exchange rates. This is a means to reach gray areas of the system as stated in paragraph 39 of Article IV in the International Monetary Fund's Articles of Agreement:

> 39. [I]f the Fund wishes to provide further guidance to members as to those exchange rate obligations under Article IV, Section 1 that go beyond the obligation to avoid exchange rate manipulation, it may rely directly on the general obligation to collaborate to promote a stable system of exchange rates. As is discussed earlier, and consistent with the approach that was adopted prior to the adoption of the Second Amendment, the Fund could call on members to pursue such exchange rate policies that it views as being necessary to achieve the objective of achieving a stable system of exchange rates.

Although it established various connections between capital controls and exchange arrangements, the 2006 analysis by the Legal and Policy Development Departments only drew conclusions as to the Fund's mandate evolution in relation to exchange arrangements and merely invited the Fund to extend its competence—i.e. provide further guidance—over exchange system stability at large because of the expanding nature of the concept, including towards capital controls. However, it did not elaborate on future shifts occurring in relation to capital movements.

Thus, while the existing system under the 1977 Decision was lagging, the 2006 document followed by the related 2007 Decision[72] *both* increased the Fund's authority to pursue its legal coordination mandate, "including the Fund's exercise of firm surveillance over the exchange rate policies of members"[73]—by taking a 'multilateral and medium-term perspective' towards exchange rates policymaking. This was so exchange rate manipulation and disruptive capital movements motivated by exchange rate benefits resulting in "external instability" could be limited.[74] The 2007 Decision, in particular, furthered the mandate shift by making clear that the Fund's future surveillance mandate "shall be adapted to the needs of the international monetary and financial system as they develop" and shall focus on

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71 *Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework*, *supra* note 63, at 7 n.10.

72 IMF, *IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies*, Public Information Notice No. 07/69 (June 2017).

73 *Id*.

74 *Id*. *See also The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 25.

the members' policies that "can significantly influence present or prospective external stability" whether in the context of exchange rate, monetary, fiscal or financial sector policies at large.[75] The instrument, it should be added, went even further by adding that the Fund would gain authority over Union policymaking.[76] It also gave the Fund the authority to authorize members to take on capital flow management policies in certain conditions: "A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterized *inter alia* by disruptive short-term movements in the exchange rate of its currency."[77]

Clearly, these documents are important because they show that the Fund's Legal and Policy Department has never been afraid of suggesting recourse to *de facto* mandate expansion based on a progressive interpretation of the mandate in light of a changing global political economy. Somewhat surprisingly, the legal impact of the 2007 Decision is hardly ever mentioned in the literature despite being described by the Executive Board as an "important starting point" or "keystone" in the efforts to modernize the foundations of the IMF's surveillance function and, in so doing, crystalizing thirty years of good practices in light of the current globalization trend.[78]

IV. THE CONTRIBUTION OF THE 2012 'INSTITUTIONAL VIEW' IN TERMS OF LEGAL MANDATE

Leaving aside the direct and indirect attempts to amend the Articles of Agreement and increase the Fund's authority over capital accounts described in the above subsections, the Fund cemented its authority over CFMs in 2012 through its "Institutional View." While the IMF's 2012 position on capital account issues has been characterized in the literature as a radical departure from its own orthodoxy,[79] this view is somewhat exaggerated for two important reasons. First, IMF staff papers had for some years indicated the coming positional shift; in fact, the IMF approach to its dealings with countries suffering during the Global Financial Crisis reflected the changing stance on the use of capital controls. Second, and as a corollary, while the Institutional View crystallized the shifting view on the use of capital controls, it is nothing but the culmination of a slow and steady movement within the Fund, marked essentially by the "integrated approach" and the elaboration of the "Article IV byroad." Simply stated, the "Institutional View" had no influence or legal effect on the Fund's expanding mandate.

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75 *IMF Executive Board Adopts New Decision on Bilateral Surveillance Over Members' Policies*, *supra* note 72.

76 *Id.*

77 *Id.*

78 *Id.* (stating the Fund's surveillance function is "the activity whereby the IMF monitors the economic and financial policies of its member countries in the interest of international monetary stability.").

79 *See* Feibelman, *supra* note 21, at 415 (discussing the Institutional View being described as a "newly defined approach").

A. Forging and Institutionalizing the View

While the IMF has internally debated capital account liberalization and controls, especially since the 1980s within the IMF's Executive Board,[80] it is only recently that the Executive Board's views and doctrinal position on cross-border capital controls have rapidly shifted.[81]

As previously noted, the Fund has shifted away from the traditional idea that liberalization is a one-size-fits-all recipe to economic progress. For at least the last few decades, and most prominently in the 1990s, the IMF followed the 'Washington Consensus' model of neoliberalism which eschewed capital controls in both its doctrine and dealings with borrowing nations. As such, and in line with IMF advice, most capital control measures disappeared during the 1990s to allow financial flows to circulate. Following heavy criticism of its advice given during the Asian Financial Crisis, the Fund has slowly and cautiously come to endorse the view that some controls may be warranted in certain circumstances for the sake of domestic, regional and international stability. The Fund's current view is outlined in a number of reports published between 2010-2012 detailed below, including a 2010 report prepared by the Strategy, Policy, and Review Department and the Legal Department, which stated:

> No presumption is made here that capital account liberalization is a goal in itself in all cases, but rather that a broader range of tools and advice, contemplating both the elimination and imposition of controls, may be more appropriate for domestic and systemic stability. It is recognized that international capital flows are only a type of financial flow—the type that crosses borders—and that the overall approach must fit in a broader vision of macro-prudential regulation and supervision.[82]

Of course, it took until late 2012 for the IMF's official position on capital account issues to be released, which means that while the Fund's staff had in practice shifted its views towards capital controls in its post-Global Financial Crisis advice it could not rely on standardized guidelines to offer policymakers with consistent advice.[83] The lack of consistent advice did not go undiscovered. In fact, as early as 2005, the Fund's Independent Evaluation Office (IEO) noted some issues involved with a lack of coherence in IMF advice. The IEO recommended that the Executive Board formally clarify the scope of IMF surveillance on capital account issues, provide clear guidance to staff on the official position, and focus on the

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80 *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, ¶ 20.

81 *See Pursuing Equitable and Balanced Growth*, *supra* note 11, at 26 (providing another summary of the Executive Board's work on capital controls).

82 *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 5.

83 *See The IMF's Approach to Capital Account Liberalization*, *supra* note 1, ¶ 2 (discussing inconsistencies).

"push factors behind international capital flows and how to minimize the volatility of capital movements."[84] Similarly, while discussing the 2007 Decision on Bilateral Surveillance, the Fund's Annual Report for 2008 suggested that temporary capital controls could be used as financial and monetary stabilization methods.[85] During the Global Financial Crisis (and in a clear reaction to the then recent financial crisis in South America which showed similar trends as seen during the 1997–1998 Asian financial crisis and 1998–1999 Russian and Brazilian crises[86]), the Fund's International Monetary and Financial Committee (IMFC) called on the IMF to "cover the full range of macroeconomic and financial policies that bear on global stability."[87] Thus reiterating the Fund's authority to oversee capital movements at large.

While these reports sent strong signals on the evolving direction of the IMF, the real change occurred in 2010 in the wake of the Global Financial Crisis, when the Fund concluded that "with liquidity being withdrawn as part of policy exits, new financial stability risks ha[d] surfaced."[88] Until this time, traditional thought on the issues was that the significant capital flows to Asia and Latin America stemming from improving governance and outlook, abundant liquidities, and low interest rates in advanced economies, were a boon to the emerging world.[89] The Fund, however, formulated concerns that, despite limited evidence at the time, excessive flows could generate speculative bubbles and currency bubbles while the global financial sector linkages could spread financial vulnerabilities created by "push and pull factors" (such as sudden stops in inflows followed by sudden outflows generated by future monetary and liquidity tightening policies) across economies.[90] In another cautionary note, the second Global Financial Stability Report published in October 2010 not only supported the use of macroeconomic policies and prudential regulations to deal with surges in temporary inflows, but also directly referenced the changing position of the Fund when it added that "[w]hen these [other] measures are not sufficient . . . capital controls may have a role in complementing the policy toolkit."[91]

In November 2010, the aforementioned report prepared by the Strategy, Policy, and Review Department and the Legal Department comprehensively addressed the issues by providing background on the Fund's historical and prospective roles, emphasizing staff difficulties in advising members due to a

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84 *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, at Executive Summary.

85 IMF, *Making the Global Economy Work for All*, Annual Report 2008, at 22–23 (Apr. 2008).

86 *See* JEANNE ET AL, *supra* note 13, at 9.

87 Press Release, IMF, Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, IMF Press Release No. 09/347 (Oct. 4, 2009).

88 IMF, *Meeting New Challenges to Stability and Building a Safer System*, Global Financial Stability Report, at 3 (Apr. 2010).

89 *Id.*

90 *Id.* at 29.

91 *Id.* at 135.

general lack of regulatory good practices guide in relation to cross-border capital movements, and calling for an official position on the matter. The document, furthermore, suggested that consideration be given to amending the Articles of Agreement,[92] and vigorously called on the Fund to take a strong leadership position in contrast to its status quo of doing things, which, in the drafters' words, were "not tenable" anymore.[93] In response, the Fund's Executive Board responded in early 2011 by admitting that while capital liberalization efforts had generated "substantial benefits by facilitating efficient resource allocation across countries," liberalization had also generated a growing volatility in worldwide cash flows, which had played a "key role" in the recent worldwide crisis.[94]

Around the same time, the International Monetary and Financial Committee of the IMF's Board of Governors sent its strongest signal of a pending change in official direction when it called for a "comprehensive and balanced approach for the management of capital flows."[95] The Fund's ideological evolution came in response to calls emanating from various actors in the international sphere, who increasingly demanded the flexibility to use capital controls and similar measures to manage the capital flows and markets. At the same time, these actors sought clarity from the Fund in light of its recent inconsistent practice. On a political level, the shift responded to a plea formulated into a G20 communiqué dated October 2010, which requested that the IMF "further work on macro-prudential policy frameworks, including tools to help mitigate the impact of excessive capital flows," and also committed "advanced economies, including those with reserve currencies, [to now] be vigilant against excess volatility and disorderly movements in exchange rates."[96] Having described the G20 declaration as a "hard-won consensus on broad principles"[97] and admitting that currency management and capital controls could constitute "legitimate policy choices,"[98] the Executive Board lamented the lack of "universal rules of the road" governing cross-border financial

[92] *See The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 4 § V ("In the longer term, to provide a more complete framework to address the complex issues related to international capital flows, consideration could be given to amending the Articles of Agreement. This could take the form of an obligation to ultimately liberalize capital movements . . . Alternatively, and more neutrally, one might consider an amendment calling on members to collaborate with the Fund and others to ensure that capital movements are consistent with international monetary stability.").

[93] *Id.* ¶ 3 ("In the aftermath of the global crisis, and especially now with resurgent capital flows requiring a considered policy response, it is not tenable for the Fund to remain on the sidelines of a debate so central to global economic stability.").

[94] *IMF Executive Board Discusses the Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 125.

[95] Press Release, IMF, Communiqué of the Twenty-Fourth Meeting of the IMFC: Collective Action for Global Recovery, IMF Press Release No. 11/348 (Sept. 24, 2011) https://goo.gl/z5BYOY.

[96] G20, *Communiqué Meeting of Finance Ministers and Central Bank Governors* ¶ 4 (Oct. 10, 2010), http://www.g20.utoronto.ca/2010/g20finance101023.pdf.

[97] *The Liberalization and Management of Capital Flows: an Institutional View*, *supra* note 4, ¶ 7.

[98] Gabor, *supra* note 41, at 4.

flows and reconsidered the Fund's mandate to oversee international monetary stability in relation to capital movements.

This reconsideration directly led to three main ideas. First, the Board found it necessary to formulate a coherent institutional view and guidelines for reducing vulnerabilities and reinforcing the Fund's surveillance role in relation to capital accounts and capital flows: "a more pro-active and systematic role for the Fund with respect to global capital flows seems desirable."[99] Second, the Board called for expanded bilateral and multilateral efforts towards policy surveillance to avoid potential spill-overs. Third, the Board considered whether the IMF's Articles could be amended to provide for a "more complete and consistent legal framework for addressing issues related to capital flows" and insisted on the necessity to improve policy advice while leaving sufficient room for "country-specific circumstances" (i.e. to take into account the various liberalization levels from one country to another).[100]

From an institutional perspective, the key element to the Fund's shift and expansion of mandate is the surveillance function. Simply stated, the recent Global Financial Crisis (if not those before it) highlighted the fact that national policies related to capital flow management could have large multilateral effects. Since "a breakdown in the domestic stability of a large country [could] spill over into stress in other countries and even to the global system as a whole," the IMF believes all economies could equally bear risks flowing from volatile cross-border capital flows. In particular, the conclusion of a 2011 IMF note found that because domestic policymakers could "not fully appreciate the multilateral transmission of their policies," the Fund now had an important bilateral and multilateral surveillance and supervision role to play. This role includes cross-border flow and global liquidity monitoring, stability and spillover controlling, policy coordination and dialogue promotion, and efficient advising, among other duties.[101]

These movements led to the majority of the IMF Board of Directors welcoming in April 2011 a framework proposition which then appeared as a "first-round articulation of the Fund's institutional views on responses to manage capital inflows," with a view to assimilating the framework into the Fund's surveillance mandate in the future.[102] A year later, in March 2012, the IMF released a final key document aimed at providing the Fund with an "up-to-date and operational framework for policy advice on liberalizing capital flows and on the management of capital outflows" which proposed an "integrated approach" to capital flow liberalization.[103] According to this "integrated approach":

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99 *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶ 4 § IV.

100 *Executive Board Discusses the Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 15. Referring to *The Fund's Role Regarding Cross-Border Capital Flows*, *supra* note 6, ¶¶ 4, 47.

101 IMF, *IMF Executive Board Discusses the Multilateral Aspects of Policies Affecting Capital Flows*, Public Information Notice No. 11/143 (Nov. 29, 2011).

102 *Id.*; *IMF Executive Board Discusses Recent Experiences in Managing Capital Inflows*, *supra* note 15.

103 *Liberalizing Capital Flows and Managing Outflows*, *supra* note 2, ¶ 3.

> (i) Capital flows must be considered "within the broader context of macroeconomic and financial system stability," (ii) while respecting that 'the appropriate degree of liberalization can differ across countries, based on country specific conditions including the level of financial sector and institutional development', (iii) so that the 'economy and financial sector can handle the resulting flows without undue risk', (iv) especially when keeping in mind the 'broad linkage between domestic and cross-border financial liberalization'.[104]

The document, in particular, crystalized discussion held within the IMF's Executive Board in July 2001 in relation to conditionality in IMF funding and called for a more "integrated" and cautious approach to liberalization.[105] The document also acknowledged that CFMs may "need to be temporarily reimposed under certain conditions without compromising the overall process of liberalization," while also noting that the "reimposition of CFM on outflows" could be "useful mainly in crisis or near crisis conditions, but only as a supplement to more fundamental policy adjustment."[106]

In November 2012, seven years after the IEO discussed the necessity of an official position on capital controls,[107] the IMF's shift in policymaking and incursion into the financial sector was complete with the publication of the Fund's so-called "Institutional View" on the liberalization and management of capital flows. The Institutional View synthesizes the conclusions of the previous IMF policy and position papers and thus reiterates the various points stated previously. Of note, is the call for greater liberalization (as opposed to an objective of full capital account liberalization). The Institutional View recognizes that increasing capital flows represents a global policy challenge, even though they may be beneficial when certain conditions are met. Such conditions are low inflation, large foreign reserves, composition of external flows including a relatively large share of FDI and equity flows, financial development reflected in growing financial market depth and enhanced regulation and supervision, institutional quality and governance deemed by investors to be improving, and increased trade openness.[108] Increasing capital flows can also have disruptive and unexpected effects on economies. In other words, the Institutional View makes it clear that one size does not fit all, suggests that CFMs ought to be part of the "toolkit" depending on specific circumstances and policy objectives (i.e. "if capital flows pose risks to a member

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[104] *Liberalizing Capital Flows and Managing Outflows*, *supra* note 2, ¶¶ 21–22.

[105] *Id.* ¶ 21; *The IMF's Approach to Capital Account Liberalization*, *supra* note 1, at 55.

[106] *Liberalizing Capital Flows and Managing Outflows*, *supra* note 2, ¶ 4.

[107] *The IMF's Approach to Capital Account Liberalization: Revisiting the 2005 IEO Evaluation*, *supra* note 41, ¶ 35.

[108] *The Liberalization and Management of Capital Flows: An Institutional View*, *supra* note 4, ¶ 20.

state's macroeconomic or financial system's stability"),[109] and observes that while designed to be temporary and part of larger efforts, CFMs maintained on a long-term basis ought not to be precluded.[110]

B. Legally Entrenching the View: The Integrated Surveillance Decision of July 2012

However, while some describe the 2012 "Institutional View" as ground-breaking and the "first and only systematic effort to manage global capital flows" characteristic of a new "post-crisis mandate,"[111] the importance given to this document can be questioned. In our view, the more relevant instrument in terms of mandate and legal evolution is largely forgotten in the literature.

The discussion above makes clear that the Institutional View merely "crystalized" an approach that had been developing for a long time (while at the same time validating what some countries had been doing already).[112] For this reason, the Institutional View has been described by some as bringing about an "incremental . . . ideational change" in policymaking[113] and as a "consolidated" and "final cumulative paper . . . based on a series of interim papers"[114] or a "formalization of communiqués."[115] The IMF itself, in fact, introduced the publication of the Institutional View from March 2012 with a document described as the "fourth in a series of Board papers developing a comprehensive Fund view on capital flows and the policies that affect them" and which predicted that the "next step" would be in the form of a "subsequent paper, responding to the call by the International Monetary and Financial Committee (IMFC), integrat(ing) all of the elements covered in the series of papers thus far into a comprehensive, flexible, and balanced, approach for the management of capital flows, drawing on country experiences."[116]

In our view, the legal value of the Institutional View is overstated because, as a clarifying document, it has no impact on the Fund's mandate to oversee capital movement issues. The strategic move described in the Institutional View, in fact, was formalized as part of the 1977 and 2007 Decisions, through the 2006 note by the IMF's Legal and Policy Development Departments. More importantly, it was

109 *The Liberalization and Management of Capital Flows: An Institutional View*, *supra* note 4, ¶ 18; *Exchange Arrangements and Exchange Restrictions*, *supra* note 44, at 63 (introducing the opportunity to apply CFMs to outward flows).

110 *The Liberalization and Management of Capital Flows: An Institutional View*, *supra* note 4.

111 Feibelman, *supra* note 21, at 438, 449; Gallagher & Ocampo *supra* note 43, at 10–11.

112 Siegel, *supra* note 20, at 72.

113 *Contra* Moschella *supra* note 17, at 443–44, 451.

114 Siegel, *supra* note 20, at 72.

115 Gochoco-Bautista & Rhee, *supra* note 17, at 8.

116 *Liberalizing Capital Flows and Managing Outflows*, *supra* note 2, at Executive Summary.

formalized through the Fund's Integrated Surveillance Decision of July 2012 in which the Board, considering "the need to promote global economic and financial stability to ensure the effective operation of the International Monetary System," took the decision that the Fund's assessments and policy advice would now have to "incorporate relevant aspects of the global and regional economic and financial environment" while ensuring that the institution's legal mandate would evolve accordingly.[117] In legal terms, accordingly, the Integrated Surveillance Decision is far more important than the Institutional View in regards to the Fund's policymaking shift because it is the main and only tool capable of transforming the Fund's legal mandate.

In contrast with the Institutional View, the Integrated Surveillance Decision has been adopted by a majority of the Executive Board. Under Article XII Section 3 of the Articles, the Executive Board is responsible for conducting the business of the Fund, and as such has the decision-making power required to undertake and formalize such a mandate evolution. Thus, while the Institutional View reflects a policy evolution, the Integrated Decision is one of the instruments that decided, officialized and authorized a mandate evolution in affirmative and authoritative terms.

Interestingly, the Integrated Surveillance Decision relies on the "Article IV byroad" approach explained earlier in this article. Clearly, the Decision does not relate to Article VI and does not grant the Fund a clear Article VI competence to deal with capital movements. The Decision, instead, relies on the increasingly interconnectedness between exchange policymaking, current transactions and capital movements to extend the Fund's jurisdiction over Article IV monetary matters over capital movements. As a reminder, Article IV creates an obligation on members to foster "economic and financial conditions and a monetary system that does not tend to produce erratic disruptions" and to refrain from manipulating the exchange rate. The Decision expressly extends the Fund's surveillance role "beyond" Article IV and "encourages members to consider the effects of their policies on the effective operation of the international monetary system,"[118] but does so through the Fund's indirect role in relation to capital flows. The relevant paragraphs read:

> 6. [A]ccordingly, exchange rate policies will always be the subject of the Fund's bilateral surveillance with respect to each member, *as will monetary, fiscal, and financial sector policies* (both their macroeconomic aspects and macroeconomically relevant structural aspects).
> 10. The international monetary system includes, in particular: (a) the rules governing exchange arrangements between countries and the rates at which foreign exchange is purchased and sold; (b) the rules governing the making of payments and transfers for

[117] IMF, *Modernizing the Legal Framework for Surveillance-An Integrated Surveillance Decision: Revised Proposed Decision*, Policy Paper, at 2 (July 2012).
[118] *Id.* ¶ 2.

current international transactions between countries; (c) *the arrangements respecting the regulation of international capital movements*; and (d) 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.

11. The international monetary system is considered to be operating effectively when the areas it governs do not exhibit symptoms of malfunction such as, for example, persistent significant current account imbalances, an unstable system of exchange rates including foreign exchange rate misalignment, *volatile capital flows*, the excessive build up or depletion of reserves, or imbalances arising from excessive or insufficient global liquidity.

12. Therefore, in its multilateral surveillance, the Fund will focus on issues that may affect the effective operation of the international monetary system, including (a) global economic and financial developments and the outlook for the global economy, including risks to global economic and financial stability, and (b) the spillovers arising from policies of individual members that may significantly influence the effective operation of the international monetary system, for example by undermining global economic and financial stability. The policies of members that may be relevant for this purpose include exchange rate, monetary, fiscal, and financial sector policies and policies respecting capital flows.[119]

Hence, although the 2012 Decision did not create new obligations for the members,[120] it confirmed the 2007 Decision by reaffirming that "[f]und surveillance over members" policies and over the international monetary system shall be adapted to the needs of the international monetary and financial system as they develop.[121] The Fund's mandate, in other words, did not change as a result of the 2012 Institutional View, but rather shifted because the Directors took the decision to further "elucidate the place of capital account issues in bilateral and multilateral surveillance" [122] and used their decision-making authority to officialize the evolution in clear legal terms through the 1977, 2007, and 2012 Decisions. In our opinion, these are the ground-breaking instruments in the Fund's shifting mandate. [123] In contrast, the Institutional View provides no legal authority,

119 *Modernizing the Legal Framework for Surveillance-An Integrated Surveillance Decision: Revised Proposed Decision*, *supra* note 117, ¶ 2 (emphasis added).

120 *Id.* pmbl.

121 *Id.* ¶ 3.

122 REVISITING THE 2005 IEO EVALUATION, *supra* note 41, at Executive Summary.

123 *See Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework*, *supra* note 63 (emphasizing that this also deserves a mention as it provided the views of the Fund's lawyers and strategists on the matter).

competence, or jurisdiction to the Fund but merely provides an informative status update of the IMF position on the issue of capital controls.

V. CONCLUDING REMARKS

Many questions have been formulated as to what role the IMF should play in relation to CFMs. To date, most of the literature provides an economic or political perspective on the issue. This article fills the gap by providing a legal approach on the Fund's mandate; instead of asking whether the institution should have engaged in CFM policymaking, the chapter evaluates *how* the process actually took place. More specifically, while the existing literature explains the economic and political motivations behind the IMF's newly formulated "integrated approach to financial liberalization," this manuscript has (1) discussed the legal mandate of the Fund as provided under its Articles of Agreement; and (2) established how the Fund progressively relied on what we called an "Article VI bypass" approach to evolve as an institution and expand its mandate despite the absence of any amendments to its constitutive instrument. We have three main conclusions.

First and unsurprisingly, the currently increasing powers employed by the Fund in relation to capital movements do not form part of its original mandate. Indeed, the Fund's evolution and expansion in mandate occurred through a number of instruments such as the 1977 and 2007 Decision, the 2006 Legal and Policy Note, and finally the Integrated Surveillance Decision of 2012. These documents, coupled with creative interpretations of text where required, (1) provided the Fund with sufficient authority to oversee the stability of the exchange system (rather than to ensure the stability of exchange rates); (2) demonstrated that IMF lawyers and strategists have never been afraid of moving beyond explicit mandates and restrictions; and (3) gave the Fund authority to allow members to take measures to regulate capital flows. Thus, the Fund's evolution and expansion of its mandate derives not solely from its Institutional View, but in fact, it derives from earlier creative, patient, and progressive interpretations that, while having no legal grounding as far as the Articles of Agreement are concerned, became the dominant position.

The second, related conclusion is that while the 2012 Institutional View is largely described as a new policy orientation, it merely makes explicit in an official way the claims and suggestions formulated over the years by the various actors. From a legal perspective, the Institutional View has no impact on the Fund's evolution or expansion of mandate.

Third, the "act now, apologize later" move orchestrated by the IMF to increase its authority over capital movements should not be demonized or dismantled. Quite simply, such a move has been necessary in the absence of alternative solutions. In this regard, the IMF's position has merely responded to a need formulated by a changing reality of the role of trade and finance in the world economy. This shift is best exemplified by the Legal and Policy Development Departments, which engaged in a process of creatively interpreting constitutive documents and of moving forward despite the apparent gaps in the explicit mandate.

Moreover, the extension by the IMF of its authority towards capital movements has significant precedent[124] since the Fund already increased its mandate in the past to adapt to the rejection of the *par value* system and expended its authority from an exchange rate stability role into a broader exchange system stability supervision mission.

Considering that countries have the IMF's blessing to make use of CFMs in certain circumstances, the next step will be for the IMF to establish the global rules of the game to control capital in a sound and sustainable manner.

[124] *See* Gallagher & Ocampo, *supra* note 43, at 10–11.