

The role of the IMF as a global financial authority

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Introduction

The financial crisis has taught us many lessons. One of them is that financial institutions are only global in good times, they retrench to national frontiers when things turn sour. However, this state of affairs has to change if financial institutions and markets can credibly claim to be global. This suggests that international solutions are needed for international problems. In this context, I contend that the International Monetary Fund, the institution at the centre of the international monetary and financial system, is best placed to adopt a role as a ‘global sheriff’ (echoing the words of George Soros in the 2010 Davos meeting) with regard to international financial stability.

This paper focuses on the surveillance function, leaving aside other functions that should also be coordinated at the international level, such as dispute settlement and rule-making (regulation).

The case for a global financial authority

The challenges that the international monetary and financial system faces in the XXIst century are very different from the challenges the Bretton Woods institutions – the International Monetary Fund and the World Bank – confronted when they started operations in Washington DC in 1946.¹

The worldwide change from fixed to floating exchange rates, following the collapse of the par value regime, also signified a more profound change in the nature of the IMF. The shift in emphasis from being primarily an international monetary institution focusing on issues such as exchange rate stability and convertibility, to becoming an international financial institution with a broader array of responsibilities, encompassing not only monetary issues, but also other financial issues, such as the regulation and supervision of banking and capital markets, financial reform, debt restructuring and others. The global financial crisis 2007-2009 (with its peak in 2008) gives support to the case for a global financial authority.

The IMF is not only the international monetary institution *par excellence*; the IMF is also at the centre of the international financial system.

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¹ For an extensive analysis of the law of the IMF, its history and the challenges faced by the institution, see Chapters 12-14 of *Legal Foundations of International Monetary Stability*, Lastra (Oxford: Oxford University Press, 2006). This paper draws on chapter 13 and 14 of this book.

At a national level, it has become now widely accepted that regulation and supervision are different functions (albeit interrelated)²; such distinction is now also made at the European level and it should be made at the international level. A further distinction is now also made between macro and micro supervision. According to the House of Lords Report on the Future of EU Supervision and Regulation,³ 'macro-prudential supervision is the analysis of trends and imbalances in the financial system and the detection of systemic risks that these trends may pose to financial institutions and the economy. The focus of macro-prudential supervision is the safety of the financial and economic system as a whole, the prevention of systemic risk. Micro-prudential supervision is the day-to-day supervision of individual financial institutions. The focus of micro-prudential supervision is the safety and soundness of individual institutions as well as consumer protection'. A common trend in response to the crisis is to give the central bank responsibility for macro-prudential supervision.

An analogy can be made between the role of the central bank at the national level and the role of the IMF at the international level. A central bank is typically entrusted by national law to maintain monetary stability in the domestic jurisdiction. The IMF is the international institution entrusted by an international treaty (the IMF Articles of Agreement) to promote stability in the international monetary order. The evolution of national central banks in recent years is characterized by the increasing importance and attention given to the goal of financial stability, as part of the mandate of the central bank (with or without supervisory responsibilities). By analogy, the interpretation of the mandate of the IMF (according to the broad enumeration of goals in Article I of the Articles of Agreement, reproduce below) has been expanded over the years and the pursuit of international financial stability has become an important objective in the international financial architecture.⁴

The legal basis

The International Monetary Fund is the institution best placed to assume the role of global financial authority. In my opinion, a creative interpretation of Article I and Article IV of the IMF Articles of Agreement provides the legal basis for the Fund to expand its surveillance role into issues of financial stability.

In terms of the official interpretation of the Articles of Agreement, the Board of Governors at its first meeting in 1946 made a broad delegation of powers to the Executive Board, in accordance with the possibility foreseen in Article XII, Section 2(b). According to the current text of Section 15 of the IMF's By-Laws: 'The Executive Board is authorised by the Board of Governors to exercise all the powers of

² See Lastra, chapter 2 of *Central Banking and Banking Regulation* (London, FMG, 1996) for a distinction between supervision and regulation.

³ See <<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldcom/106/106i.pdf>>

⁴ Lord Eatwell and Lancey Taylor have proposed the creation of a World Financial Authority in their book *Global Finance at Risk: the Case for International Regulation* (Wiley, 2008). See also *Global Governance of Financial Systems. The International Regulation of Systemic Risk* by Kern Alexander, Rahul Dhumale and John Eatwell, published by Oxford University Press, 2005, and 'International Regulation and Supervision of Financial Markets After the Crisis' by Christoph Ohler in C. Herrman and J.P. Terhechte (eds), *European Yearbook of International Law 2010*, Springer-Verlag, Berlin, Heidelberg, 2010, pp. 3-29.

the Board of Governors, except for those conferred directly by the Articles of Agreement on the Board of Governors'. The Executive Board does indeed have the power of interpretation, though this power has to be exercised consistent with general principles of interpretation, including those set forth in the Vienna Convention on the Law of Treaties.⁵

The objectives of the IMF, which are to guide all its policies and decisions, are defined in Article I of its Articles of Agreement:

- (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 productive resources of all members as primary objectives of economic policy.
- (iii) To promote exchange rate stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- (iv) To assist in the establishment of 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 Fund's resources available to them under adequate safeguards, thus providing them with the 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. smoothly functioning payment systems, promotion of international monetary cooperation.

This broad enumeration of goals has allowed the institution to survive over the years, adjusting and readjusting its role in response to diverse economic circumstances. The reference in Article I (i) to international monetary problems can be construed nowadays as a reference to international monetary and financial problems. The same can be said about the reference in Article I (vi) to the promotion of international monetary cooperation, which can be construed as a reference to international monetary and financial cooperation.

The process of international financial standard setting (the growth of soft law) is a key feature of the evolving 'international financial architecture'. The IMF is not the only international financial standard-setter, nor is it currently the most relevant one. This regulatory function is shared by a number of formal international organizations, informal groupings and *fora* of an international character (with the Basel Committee on Banking Supervision and other Committees that have grown under the auspices of the Bank for International Settlements, playing a significant role), professional associations and other entities. However, the IMF is uniquely placed to monitor the compliance with standards through its function of surveillance and through its

⁵ See http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf, in particular Articles 31 and 32 (Section 3, 'Interpretation of Treaties').

assessment of the health of the financial sector (via the Financial Sector Assessment Program, FASP, and the Reports on the Observance of Standards and Codes, ROSCs) and to provide countries with the incentive to observe those standards through the design of conditionality. [A sheriff does not make rules, but enforces and makes sure individuals comply with the rules. By analogy, a global sheriff is not expected necessarily to make the rules, but to monitor countries' observance with such rules].

The IMF is the only institution (other than the Bank for International Settlements⁶) that has international legitimacy, an array of functions (surveillance, conditional financial assistance and technical assistance), appropriate financial resources and staffing to assume the role of global financial authority. Other informal international standard setters, such as the Financial Stability Board,⁷ the Basel Committee on Banking Supervision or IOSCO, can continue with their rule-making role, but only the Fund can effectively contribute to the enforcement of those standards through its surveillance function. The IMF can play a role similar to that played by the Financial Action Task Force (FATF) with regard to AML/CFT (anti-money laundering/countering the financing of terrorism) standards. In the same way as the FATF seeks partnership with the IMF, World Bank, FATF regional bodies, national financial intelligence units (FIUs) and even the financial industry itself⁸ to verify the observance of AML/CFT standards and to ensure that every country in the world is assessed using the same methodology, the IMF can also seek to further develop partnerships with other national, regional and international bodies to ensure adequate implementation of adequate standards for supervision, regulation and resolution of financial institutions.

Of course, from a legal perspective, the IMF is not expected to supervise institutions. Indeed the supervisory function it should exercise is 'surveillance of financial sector policies', i.e., super-vision of how country comply with standards, and what type of procedures and tools they have in place for resolution, supervision, regulation and others. Surveillance, is therefore key to the understanding of the role of the IMF in the XXIst century.

The main functions performed by the IMF in relation to its members are surveillance (Article IV of the IMF Articles of Agreement), financial assistance (Article V, Section 3) and technical assistance (Article V Section 2 (b)). The Fund uses surveillance, financial assistance and technical assistance as instruments to accomplish its objectives or purposes as defined in Article I. From the point of view of the member states, they constitute the main 'services' that the Fund provides to them. From the Fund's perspective, its powers can be broken down into three categories: (i) regulatory (jurisdiction), comprising Article VIII Section 2 and Article IV; (ii) financial (Article V, Section 3), and (iii) advisory (technical assistance, Article V Section 2(b)).

⁶ See chapters 12 and 14, above note 1.

⁷ For a brief summary of the functions of the FSB and the functions of the IMF see chapter 8 of the House of Lords' Report, above note 3.

⁸ See James Fries, 'Global Markets and Global Vulnerabilities: Fighting Transnational Crime Through Financial Intelligence', prepared remarks for the MOCOMILA meeting in Salamanca on 25 April 2008, available at <http://www.mocomila.org/meetings/2008-freis.pdf>

The authority of the IMF to perform specific services for members that are not mentioned in the Articles but are sufficiently related to the purposes of the institution is made explicit by the Second Amendment, Article V Section 2(b). While surveillance applies to all members, conditional financial assistance and technical assistance only apply to the members that request such assistance. The mandatory nature of surveillance contrasts with the voluntary nature of technical assistance.⁹

Surveillance

The legal basis of surveillance is Article IV, Sections 1 and 3, as amended. Article IV Section 1 imposes a set of obligations upon members, further explained below. To make these obligations effective, the Fund is granted powers to oversee, to monitor the compliance of each member with these obligations.

Article IV Section 3 (a) confers upon the IMF a clear role in this regard:

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.

Article IV Section 3(b) further states:

[T]he 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.

The principles of surveillance were set out in further detail in a 1977 decision¹⁰ which was replaced by a new Decision of 2007.¹¹ The Decision of 15 June 2007 crystallizes a common of the best practice of surveillance, and covers exchange rate policies and also relevant domestic economic and financial policies. External stability in this Decision of 2007 encompasses both the current account and the capital account of the balance of payments, consistent with the members obligations under Article IV.

In my opinion, a new Decision would be helpful to clarify the extent to which financial stability and financial policies contribute to the notion of ‘external stability’. This could also be the basis for the IMF to embrace more formally its role of global sheriff for financial stability.

⁹ From the Fund’s point of view, surveillance is the key function. From the member countries’ point of view, financial assistance is the key. Countries in need (of balance of payments support) subject themselves to conditionality, surveillance and technical assistance as the price that must be exacted to obtain financial support. Members are not always keen to tighten their belts or the belts of their citizens to obtain the resources they need to address balance of payments difficulties, but they are well aware that non-observance of their financial obligations with the Fund will lead them into further trouble.

¹⁰ See Decision of the Executive Board No. 5392-(77/63) of 29 April 1977 as amended. This decision implemented the new Article IV of the IMF Articles of Agreement, which at the time was still in the process of being ratified (The Second Amendment was approved in April 1976 and became effective in April 1978).

¹¹ See Decision of the Executive Board of 15 June 2007, on Bilateral Surveillance of Member Policies, available at <http://www.imf.org/external/np/sec/pn/2007/pn0769.htm#decision>

In the words of the late Manuel Guitián, ‘The IMF is primarily a surveillance institution’,¹² in charge of the oversight of an international financial code of conduct. This code of conduct is a set of obligations that members must comply with according to the Articles of Agreement. The domain of surveillance has extended beyond macro-economic policies to encompass financial sector and structural issues.

Surveillance is a jurisdictional function, which has traditionally focused on the assessment of the exchange arrangements, the exchange rate and the balance of payments,¹³ and which today focuses upon a wide range of economic policies, encompassing not only exchange rate, monetary and fiscal policies, but also financial sector issues, structural issues and institutional developments.¹⁴ Surveillance entails a judgement on the part of the Fund, and as with any judgement, a degree of discretion is always involved. In the case of surveillance, the exercise of this ‘judgement’ is particularly complex, because of the interconnectedness between domestic and foreign economic policy, the interdependence amongst countries and the political and social consequences of some sensitive economic decisions.

Following the abandonment of the par value regime, the Second Amendment places the function of surveillance at the centre of the Fund’s operations, at the core of the international monetary system. From being a virtually self-enforcing arrangement subject to strict rules, surveillance now becomes a function in which judgment is of the essence. Surveillance is no longer a rules-based regime but a ‘discretion based regime’.¹⁵

The obligations of IMF members with regard to surveillance are spelt out in Article IV, Section 1 of the IMF Articles of Agreement reads as follows:

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;

¹² See Manuel Guitián, ‘The Unique Nature of the Responsibilities of the International Monetary Fund’, IMF Pamphlet Series No. 46, Washington DC, 1992, 9.

¹³ *ibid* 11. ‘The focus of obligation on the part of members centers on the point and the terms of intersection of their national economies with each other – that is the balance of payments, the exchange rate and the exchange regime’.

¹⁴ See <http://www.imf.org/external/np/exr/facts/surv.htm> See also Wolfgang Bergthaler and Wouter Wossu, ‘Recent Legal Developments in the International Monetary Fund’, in C. Herrmann and J.P. Terhechte (eds), *European Yearbook of International Economic Law*, Springer-Verlag, Berlin, Heidelberg, 2010, pp. 391-404.

¹⁵ See also Manuel Guitián, ‘The IMF as a Monetary Institution: The Challenge Ahead’, *Finance and Development*, September 1991, 38.

- (ii) Seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not 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 of this Section.

Article IV Section 1 imposes obligations upon its members that are both positive and negative in character. The positive obligations are the ones described in Article IV, Section 1 (i), (ii) and (iv). The negative obligation is the one described in Article IV Section 1(iii), which is written in rather forceful terms: ‘avoid manipulating exchange rates’.

The first two obligations of Article IV Section 1 - (i) and (ii) - are formulated in soft terms. As Proctor points out, ‘an obligation to co-operate with a view to achieving a particular objective, does not impose an obligation to achieve that objective.’¹⁶ Gianviti considers that these first two obligations - (i) and (ii) – are ‘soft obligations’, as opposed to the obligations in (iii) and (iv), which are ‘hard obligations’, even though the language of Section 1 (iv) is rather generic.¹⁷ While the obligations in Section 1(iii) and (iv) relate to external policies, where the Fund has greater jurisdiction, the obligations in Section 1 (i) and (ii) relate to domestic policies, where members have greater sovereignty.

The members are obliged to co-operate with the Fund by supplying all the information necessary to allow the Fund to perform effective bilateral surveillance, according to Article IV Section 3(b). The obligation to furnish information to the Fund ‘as it deems necessary for its activities’, is also recognised in Article VIII, Section 5.

Despite the emphasis that Article IV places upon exchange rate policies, in recent years, the practice of surveillance has given greater emphasis to domestic policies (the ‘soft obligations’ of Article IV, Section 1(i) and (ii)), than to exchange rate policies (the ‘hard obligations’ of Article IV, Section 1 (iii) and (iv)).

Since Article IV imposes obligations upon members, sanctions can be applied in the case of breach of these obligations. However, ‘there has not been a single instance in which sanctions have been applied or a report has been made for breach of obligation under Article IV. This *de facto* transformation of Article IV Section 1 into a ‘soft law

¹⁶ See Charles Proctor, *Mann on the Legal Aspect of Money*, 6th edition (Oxford: Oxford University Press), Proctor, 562.

¹⁷ See François Gianviti, ‘Evolving Role and Challenges for the International Monetary Fund’, ‘Evolving Role and Challenges for the International Monetary Fund’ in Mads Andenas and Joseph Norton (eds) *International Monetary and Financial Law Upon Entering the New Millenium. A Tribute to Sir Joseph and Ruth Gold* (London: The British Institute of International and Comparative Law, 2002), p. 46. He defines a ‘soft obligation as an obligation that does not require the achievement of a particular objective or even the exercise of best efforts or due diligence, but only a reasonable effort in light of all relevant circumstances. In contrast, soft law means that there is no obligation at all’.

provision’ is reflected in the description of Article IV consultation with members as ‘policy advice’ (...) or ‘policy dialogue’.¹⁸

Gianviti discusses the nature of the obligation of members under Article IV and the ambiguities in Article IV, Sections 1 and 3. The focus of the obligation relates to exchange rate policies; other policies (such as trade and investment policies) do not constitute ‘an obligation under Article IV’ even if they are an important element to assess exchange rate policies. However, he acknowledges that the practice of surveillance is expanding beyond the actual obligations of Article IV through the conduct of Article IV consultations. He warns against an undue extension in this practice: if surveillance is perceived more as a form of peer pressure than as compliance with obligations specified in the Articles of Agreement, this may lead to a dilution of its objectives.

The language of Article IV Section 1 reflects the ‘labour pains’ of the origins of this provision, which came to replace the legal certitude and simplicity of the original par value regime. The choice of verbs (endeavour, seek to promote, fostering, follow), the introduction of a preamble, and what I would describe as a ‘hesitant tone’ in the new mandate, suggest that the drafters of the provision were unsure about the direction that the new regime would follow and did not want to preclude an eventual return to the regime that they had just abandoned.

Types of surveillance

The Fund mainly carries out surveillance through its so-called ‘Article IV consultations’ with each individual member country.

In accordance with Article IV of the IMF Articles of Agreement, IMF staff hold annual bilateral meetings with officials from the member country. When an ‘Article IV consultation’ takes place, a Fund staff team (called an IMF ‘mission’) visits the country to collect information about macroeconomic policies (fiscal, monetary and exchange rate), the soundness of the financial system, and other relevant issues such as social, labour, and environmental policies as well as institutional developments. Following the review of these policies, the Fund team holds discussions with the authorities regarding the effectiveness of their economic policies as well as prospective changes for the domestic economy and the member’s balance of payments positions. At the conclusion of these discussions, and prior to the preparation of the staff’s report to the Executive Board, the IMF mission often provides the authorities with a statement of its preliminary findings. Once the IMF’s Executive Board has discussed the staff report, they forward a summary of the discussion to the country’s government. The conclusions of the report are only published if the country consents to do so. However, with the increase transparency of the IMF and its work in recent years, the summary of the Executive Board discussions for many Article IV consultations are published in Public Information Notices (PINs), which are available in the IMF website.

The evolving nature of the practice of surveillance has been made possible thanks to the ample room of interpretation granted to the Fund in the exercise of surveillance.

¹⁸ *ibid* 47.

Every two years, the IMF reviews the principles and procedures that guide its surveillance.

In addition to this ‘bilateral surveillance’, there is also ‘multilateral surveillance’, with the publication by the Fund of a World Economic Outlook Report and a Global Financial Stability Report twice a year. Another form of surveillance is ‘regional surveillance’, under which the IMF examines developments in regional areas, such as the European Union and the euro area.

The purpose of surveillance is to evaluate the appropriateness of a country’s existing policies and at the same time to encourage the country to adopt new policies that enhance the smooth functioning of the international monetary system. IMF surveillance integrates the bilateral aspects of analysing the policies of individual countries with the multilateral aspects of examining the consequences of these policies for the operation of the system as a whole.

From macro-surveillance to micro-surveillance

IMF surveillance has evolved significantly over the last decades, with the increased attention to financial sector issues and policies being the main development in recent years. While surveillance in the past was typically focused on the jurisdiction over the exchange arrangements of members and macro-economic policies, surveillance nowadays also takes into account other issues, often involving the workings of the private sector (‘micro’ issues), such as good governance (both political and corporate governance), legal and institutional reform, bank restructuring, financial reform, etc.

Surveillance of national policies becomes more complex when countries embark in programs of trade and financial liberalization. The opening up of the economy raises important challenges and sets into motion a process of regulatory reform. In the 1970s the emphasis of surveillance was on the traditional macro-economic policies such as exchange rate, monetary and fiscal policies. In the 1980s, structural policies became more relevant, particularly in the aftermath of the debt crisis. At the beginning of the 1990s, the transition from centrally planned to market economies in countries in Eastern Europe and the former Soviet Union moved surveillance in the direction of further structural reforms, with emphasis on legal and institutional reform. In the late 1990s the financial crises in South East Asia, Russia and other emerging economies, suggested that financial reform and financial law reform should be the object of IMF surveillance. Following the crisis 2007-2009 the IMF should adopt a key role in the strengthening of banking and financial systems, in the prevention of future crises and in the development of appropriate tools and frameworks for the resolution of crises, on a cross-border basis. This broad scope of economic situations and policies has facilitated the evolution of surveillance over the years, being the most interesting development in the last two decades the emphasis given to financial stability and financial sector policies.

There is a widespread recognition in the aftermath of the crisis that surveillance must be strengthened to increase the Fund’s ability to detect incipient financial tensions and vulnerabilities in international capital markets. The Fund has access to information about vulnerabilities in each country and therefore is in a unique position via the exercise of its functions (in particular surveillance and technical assistance) to

monitor that Members have adequate supervision, regulation and resolution procedures and tools. If we need a global institution that can safeguard international financial stability, the Fund is best suited to undertake such role.

The need to provide effective surveillance of the financial system (a need which became pressing following the crises in the late 1990s), gave rise to the Financial System Stability Assessments (FSSAs), which the Fund carries out as part of the Financial Sector Assessment Program (FSAP), a joint IMF-World Bank initiative which was introduced in May 1999.¹⁹ In an FSSA, IMF staff address issues of relevance to the function of surveillance, including risks to macro-economic stability stemming from the financial sector and the capacity of the sector to absorb macro-economic shocks.

In addition to the FSSAs, a key component of the FSAP are the Reports on Observance of Standards and Codes (ROSCs) which summarise the extent to which countries observe certain internationally recognized standards and codes.²⁰ The IMF has recognised twelve areas and associated standards as useful for the operational work of the Fund and the World Bank. These comprise accounting, auditing, anti-money laundering and countering the financing of terrorism (AMF/CFT), banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and financial policy transparency, payment systems, and securities regulation.

ROSCs provide a focus to surveillance, and also facilitate performance accountability. ROSCs also provide a direction to programs of technical assistance by identifying the areas which the country must aim to improve or strengthen.²¹ Finally, ROSCs highlight the close relationship between conditionality and surveillance, and contribute to clarifying the obligations inherent in the international code of conduct, which the IMF oversees.

While FSAPs and ROSCs inform Fund surveillance, they have, as a legal matter, been performed so far as technical assistance. Such activities have been voluntary for both the member and the Fund.²² This should however change now, and these activities should be formally part of surveillance, i.e., an obligation for Members. Such change would not require amendment to the IMF Articles of Agreement.

In terms of crisis prevention, I have advocated before²³ that the IMF could take a step forward in its assessment of the stability and soundness of countries' financial systems (an assessment which has been greatly improved via the FSAP program and ROSCs) through the development of an internal rating system for countries' banking

¹⁹ See 'Financial Sector Assessment Program (FSAP)' at www.imf.org/external/np/fsap/fsap.asp. See also IMF Executive Board Review of the Experience with the Financial Sector Assessment Program, 6 April 2005 (PIN No. 05/47) at www.imf.org/external/np/sec/pn/2005/pn0547.htm. The reports prepared by the World Bank under the FSAP are called Financial Sector Assessments (FSAs).

²⁰ See 'Reports on Observance of Standard and Codes' at www.imf.org/external/np/rosc/rosc.asp

²¹ Gianviti, 'Evolving Role and Challenges for the International Monetary Fund', op cit at p. 49.

²² Ibid. According to Gianviti, ROSCs 'bridge the gap between technical assistance and surveillance'. The FSAP reports and ROSCs, 'feed into surveillance, i.e., provide material which deepens the Fund's understandings of the member's circumstances'.

²³ See Chapter 14 of *Legal Foundations of International Monetary Stability*, above note 1.

and financial systems akin to the CAMEL system in the USA.²⁴ CAMEL ratings are composite ratings that take into account capital adequacy, asset quality, management competence, earnings and liquidity. CAMEL ratings are unpublished as opposed to the ratings prepared and published by private rating agencies. CAMEL ratings are a supervisory technique, which can act as an instrument of ‘crisis prevention’ by helping identify problems early on (effective supervision needs to be based upon the best possible information). The information (about banks) in the USA is provided to the authorities through on-site examinations and reporting requirements. Supervisors have the duty of alerting or warning institutions perceived to be in trouble, prompting in some cases early corrective action or restructuring.

These proposed IMF ratings could also be composite ratings with regard to the safety and soundness of a country’s banking and financial system and could be based upon the results of Article IV consultations, FSAP reports, FSSAs and ROSCs, and upon the data compiled by members in accordance with the Special Data Dissemination Standard or SDDS and the General Data Dissemination System or GDDS.²⁵ These ratings could help identify vulnerabilities (a function that is already performed to some extent by ROSCs and through the practice of surveillance) and, therefore, act as an instrument of ‘crisis prevention’.²⁶

The question of publication (on a voluntary basis) of these proposed IMF composite ratings is debatable. According to Article XII, Section 8, which governs the communication of views to members, the Fund may - by a seventy percent majority of the total voting power - decided to publish a report regarding its monetary or economic conditions and developments which directly tend to produce ‘a serious disequilibrium in the international balance of payments of members’. The IMF would need to balance the incentives for members to remain open and candid in their relations with the Fund with the need to provide valuable information to investors. Since there is no collateral in international sovereign lending (conditionality serves a substitute for collateral), the decision to support a troubled country or a country which appears to be heading for trouble needs to be based upon the best possible

²⁴ In the US, following criticism of the General Accounting Office regarding the existent of divergent approaches and bearing in mind that the determination of the soundness of a financial institution is not an ‘exact science’, the federal regulatory agencies adopted the Uniform Financial Institutions Rating System in 1978-79. For banks the rating system is commonly known as the CAMEL system.

²⁵ See <http://www.imf.org/external/np/exr/facts/data.htm>. The need for data dissemination standards has been highlighted by financial crises in which information deficiencies played a role. The standards for data dissemination consist of two tiers. The first is the SDDS which was established in 1996 to guide countries that have access, or might seek access, to the international capital markets. The second tier, the GDDS was established in 1997 to help countries provide more reliable data. It is open to all IMF members. Importantly, the GDDS is focused on improving statistical systems, whereas the SDDS focuses on commitments to data dissemination standards in countries that already meet high data quality standards. Both are voluntary, but once a country subscribes to the SDDS, observance of the standard is mandatory. Countries also agree to post information about their data dissemination practices on the IMF’s external website on an electronic bulletin board known as the Dissemination Standards Bulletin Board, DSSB. Further, they must establish an Internet site containing the actual data, called a National Summary Data Page (NSDP), to which the DSBB is linked.

²⁶ Article VIII Section 5 imposes an obligation upon members with regard to the reporting of information to the Fund. However, the requirements of Article VIII Section 5(b), which place member ‘under no obligation to furnish information in such detail about the affairs of individuals or corporations’ would certainly be a hurdle to surpass, since countries would only provide this information on a voluntary basis. Another legal requirement to take into account is Article XII Section 8.

information. The IMF can provide credible and reliable information on the health of the borrower country's economic and financial institution.

As mentioned above, one can draw an analogy between the work that the Fund could undertake to certify and monitor that countries have adequate financial regulation, supervision and resolution standards and the work of the Financial Action Task Force with regard to AML/CFT standards.

Arminio Fraga, former Central Bank Governor of Brazil, suggested a different proposal. He wrote in 1996 that, the IMF should act as 'the permanent auditor of countries, which should voluntarily submit themselves to examination in order to lower their borrowing costs. Annual Article IV consultations could be supplemented by quarterly reviews that would enhance the credibility of the data released under the IMF's recent initiative [he refers to the Special Data Dissemination Standard] and thus help to reduce the costs of adjustment programs'.²⁷

Any degree of protection justifies regulation and supervision, nationally and internationally. The greater the expected protection, the more justifiable regulation and supervision becomes. It then follows that any degree of international protection justifies strengthening international banking rules and enhancing surveillance of domestic bank supervisory and regulatory policies. In fact, this increased surveillance and enhanced transparency in banking and financial matters is needed to preserve international financial stability. Greater and closer surveillance over financial systems and the quality and adequacy of their supervision, regulation and resolution frameworks should be an essential component of an Article IV consultation. The FSAP program was a step forward in the Fund's efforts to gather appropriate information to assess the stability and soundness of the financial systems of member countries. This program should now become an obligation for members.

Conclusion

In this paper, I have argued that the IMF is the institution best placed to assume the role of global financial authority. The instruments that the Fund has at its disposal in the pursuit of the objectives granted to it by the IMF Articles of Agreement – in particular with regard to surveillance – make the institution particularly suitable to become a 'global sheriff' for financial stability.

In my opinion, a creative interpretation of Article I and Article IV of the IMF Articles of Agreement provides the legal basis for the Fund to expand its surveillance role into issues of financial stability.²⁸ The reference in Article I (i) to international monetary problems can be construed nowadays as a reference to international monetary and financial problems. The same can be said about the reference in Article I (vi) to the

²⁷ See Arminio Fraga, 'Crisis Prevention and Management: Lessons from Mexico' in Peter Kenen (ed), 'From Halifax to Lyons: What Has Been Done About Crisis Management', *Essays in International Finance* No. 200, Princeton University, October 1996, 54-55.

²⁸ The alternative route of an amendment to the IMF Articles of Agreement is likely to be a lengthy and convoluted process, since it needs to be approved by the Board of Governors and it becomes effective when it has been ratified by three-fifths of the members, having eighty-five percent of the total voting power (and with the US holding 17% of the voting power – effectively a veto power - it may be subject to the whims of the US Congress).

promotion of international monetary cooperation, as well as to the role granted to the IMF according to Article IV Section 3 (a) to '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'.²⁹ Furthermore, IMF members according to Article IV Section 1 (ii) shall 'seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not produce erratic disruptions'.

This paper focused on the surveillance function of the IMF. I have not discussed in great detail here the need for international financial regulation (rule-making) nor have I discussed other functions that should also be coordinated at the international level, such as dispute settlement.

²⁹ Financial stability as a concept is a relatively modern one, since other concepts were used in the past to describe this objective; the term macro-prudential supervision is even more contemporary.