I. INTRODUCTION

Within the last two years, the Fund has given extensive consideration to the question of whether the liberalization of capital movements should be pursued through an amendment of its Articles of Agreement and, in particular, whether the Fund’s approval jurisdiction should be extended to capital movements. In this respect, a number of staff papers were presented to the Executive Board, examining the framework of a possible amendment and some of the more detailed related legal issues. In September 1998, the Interim Committee stated:

The Committee invites the Executive Board to complete its work on a proposed amendment of the Fund's Articles that would make the liberalization of capital movements one of the purposes of the Fund, and extend, as needed, the Fund's jurisdiction through the establishment of carefully-defined and consistently applied obligations regarding the liberalization of such movements. Safeguards and transitional arrangements are necessary for the success of this major endeavor. Flexible approval policies will have to be adopted. In both the preparation of an amendment to its Articles and in its implementation, the members' obligations under other international agreements will be respected. In pursuing this work, the Committee expects the IMF and other institutions to cooperate closely.¹

At the same time, the Asian crisis has broadened into a world crisis, and the Fund has been devoted to dealing with evolving events, as well as seeking to understand their implications² and taking steps towards a stronger international monetary system.³

Nonetheless, the new significance of international capital movements must be recognized. As put recently, "[T]he explosive growth of international financial transactions and international capital flows is one of the single most profound and far-reaching economic developments of the late twentieth and early twenty-first centuries."⁴ Accordingly, governments, international organizations, private market participants and informed observers must deal with the phenomenon. Several complex and fundamental issues need to be raised. Factually, what do capital movements involve? What policy responses at the national and international level are to be recommended? What legal structures and prescriptions are necessary? Finally, what form of international cooperation is appropriate?

The Fund will have a direct involvement in these matters. Even under the existing Articles and within its present functions, the Fund is intimately concerned with capital movements. In particular, the Fund already has the nominal responsibility for the oversight of the international monetary system (Article IV § 3(a)). In addition, the way in which countries deal


with capital movements has direct and profound implications for financial stability and economic growth, in both the national and world economies. The Fund's view remains, therefore, that capital liberalization contributes economic benefits, although the liberalization process must be carried forward in an orderly and properly sequenced way.

In this context, my comments relate to the Fund's legal structure, present and potential. First, I will summarize briefly the Fund's existing jurisdiction. Secondly, I will turn to possible changes that could be made in order to extend that jurisdiction to capital movements. Thirdly, I will comment briefly on some broader matters that are likely to condition the prospect for such an expanded Fund jurisdiction.

II. EXISTING JURISDICTION

There are two relevant aspects of existing Fund jurisdiction: (1) its regulatory or approval jurisdiction; and (2) its general involvement in capital movements. In various respects, the Articles distinguish between payments for current transactions and capital movements.

A. Regulatory Jurisdiction

Article I sets the tone. Underlying as a purpose of the Fund its assistance on the "establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions that hamper the growth of world trade." Thus, liberalization for current transactions is a designated purpose of the Fund. Liberalization of capital movements is not.

Under Article VIII § 2(a), members of the Fund submit to an obligation not to impose restrictions on payments and transfers for current international transactions without the approval of the Fund. At the same time, members may opt to maintain and adapt existing restrictions; in that event, only newly imposed restrictions require Fund approval (Article XIV § 2). An additional point is that the Fund's Articles include in the concept of current payments elements that might otherwise be treated as capital (Article XIX (d)). To that extent, the Fund's approval jurisdiction already extends to capital movements.

The Articles further accentuate the distinction between current and capital restrictions. Under Article VI, members may impose ("such controls as are necessary to regulate international capital movements.") as long as they do not restrict the making of payments and transfers for current international transactions (Article VI § 3). In addition, the Fund

5. See supra note 2.

6. The definition of "payments for current transactions" set out in Art. XXX(d) includes: (i) "payments of moderate amount for amortization of loans or for depreciation of direct investments;" (ii) "normal short-term banking and credit facilities;" and (iii) "moderate remittances for family living expenses."
may request members exercise capital controls to prevent a large or sustained outflow of capital that could make it necessary for them to turn to the Fund for financial assistance (Article VI § 1(a)).

The distinction between current and capital is maintained in other respects. First, the obligation to convert official balances held by other members is confined to balances derived from current transactions (Article VIII § 4). Secondly, the prohibition from engaging in multiple currency practices or discriminatory currency arrangements has been confined by interpretation to payments and transfers for current transactions (Article VIII § 3).

B. Capital Liberalization Under the Present Articles

While the Articles contain a distinction between current payments and capital movements in various significant respects, the Fund is nonetheless closely involved with capital movements in the performance of its several major functions. Accordingly, within the present Articles, the Fund has engaged in the pursuit of capital liberalization.

First, in the conduct of its surveillance function, the Fund is mandated to exercise firm surveillance over the exchange rate policies of members (Article IV § 3) and to oversee members’ obligations, articulated in Article IV § 1 (Article IV § 2). Of note, capital movements are part of the Article IV surveillance process; not only was the concept of capital introduced by the Second Amendment in 1978 (Article IV § 1), but it is specifically recognized in the principles and procedures for Surveillance over Exchange Rate Policies. In essence, however, the role of the Fund in surveillance is essentially analytical and recommendatory; the obligations of members under Article IV § 1 are essentially hortatory in nature, and the surveillance process consists essentially of the rendering of policy advice by the Fund to the member advice which the member may accept or reject.

The second major function of the Fund is the provision of financial assistance to members for balance of payments purposes. This use of Fund resources entails the imposition of conditionality, but the Fund’s power in this respect is not unlimited; conditionality needs to be consistent with the Fund’s Articles and must provide the Fund with sufficient safeguards to ensure that the Fund will be repaid (Article V § 3(a)). As already noted, capital liberalization is not a stated purpose of the Fund, and the Articles confer on the member the right to exercise capital controls.

In this regard, a distinction can be drawn between the imposition of capital controls and the removal of capital controls in Fund conditionality. For the former, the Fund has imposed controls on capital inflows as part of its conditionality, for example, by the inclusion of performance criteria establishing limits on public sector external borrowing. Such measures can be justified in light of Article VI § 1. The removal of capital controls in

Fund conditionality is harder to justify, in that it could be viewed as an unjustified circumvention of the right of members to control capital movements.

The third major function of the Fund consists of technical assistance, whereby the Fund, in response to a request by a member, is prepared to provide “financial and technical services” (Article V §2 (b)). In recent years, the ambit of this function has grown, extending, in particular, to exchange policy and the exchange system. Meanwhile, the possible constraint in Article V § 2(b) that the financial and technical services be “consistent with the purposes of the Fund,” has not been constraining, and advice has extended to issues of capital liberalization. Within the function of technical assistance, however, it is for the member to assess and to react to that advice as it decides.

C. Article VIII §2(b)

Article VIII § 2(b) imposes an obligation on members relating to the recognition of exchange control regulations of other members. Specifically, members have undertaken not to enforce in their territories exchange contracts involving the currency of any other member, if those contracts are contrary to the exchange controls of the other member that are consistent with the Fund’s Articles.

This provision has been a fertile source of legal commentary. National courts have diverged widely in their interpretations and applications of the provision. Some observers have suggested that a formal Fund interpretation would clarify matters, but such an interpretation has not been forthcoming.

With reference to the application of the provision to capital controls, the view could be taken that such measures would be included in the term “regulations maintained or imposed consistently with [the Articles].” Recently, however, the German courts held that Article VIII § 2(b) should reflect the scope of Article VIII § 2(a), and thus be restricted to exchange restrictions on current transactions. 8

III. OUTLINE OF PROPOSED AMENDMENT

As the existing jurisdiction of the Fund is the starting point for consideration of a possible amendment for capital movements, the analogy to the current provisions and practice is an appealing one. In summary, a general prohibition on restrictions on capital movements, the concept of approval of newly imposed restrictions in order to create consistency with the Fund’s Articles, and transitional provisions for existing restrictions. At this stage of the discussion of an amendment, a wide variety of approaches could be considered. This spectrum includes the following:

A. Amendment of the Fund's Purposes

The most basic form of an amendment would be to add the liberalization of capital movements as a purpose of the Fund in Article I, as endorsed by the April 1998 Interim Committee communique.

Under such an amendment, the orientation of the Fund's interest in capital liberalization would be emphasized. While lacking a general obligation on all members, the most direct effect would be to legitimate capital liberalization through the use of the Fund's conditionality, during the period of a Fund-supported program.

Several consequential changes might accompany an amendment of the Fund's purposes. First, to avoid an apparent contradiction, the express right of members to maintain controls under Article VI § 3 would presumably be eliminated (though this by itself would not prevent members from resorting to such controls as a manifestation of sovereignty). Secondly, in terms of Fund financing, the present restriction on the use of Fund financing for large or sustained capital outflows (Article VI §1) might be reconsidered though, in so doing, the capacity of the Fund to meet an increased demand for its financial assistance would have to be weighed. Thirdly, the preamble and obligations of Article IV §1 could be re-thought though the risks associated with re-visiting that provision, arrived at only after difficult negotiations, might argue against such an initiative.

B. Payments and Transfers for Capital Transactions

The current Article VIII § 2(a) provision on "payments and transfers for current international transactions" could be reflected, so that there would be a prohibition on restrictions for payments and transfers associated with capital transactions. The present provision is confined to outward payments and transfers only for capital movements. This could be extended to inward capital flows. (At the same time, the existing jurisdiction for current payments and transfers might be expanded similarly.)

C. Capital Transactions

The Fund's existing jurisdiction relates to restrictions on the making of payments and transfers for current international transactions, not to the underlying transactions themselves (with one limited exception, namely, short-term banking and credit facilities: Article XIX (d)). The reason for this limitation was well understood. There was to be another global international organization that would have jurisdiction over current account transactions, that is, the International Trade Organization (a complementarily put into effect by the GATT and continued by the WTO).

It can be argued, therefore, that a broader approach should be adopted in the case of capital movements, in that there is no existing universal international organization charged with liberalization of capital
transactions. In support of this view, it can be seen that, were the expanded jurisdiction to be limited to payments and transfers, the impact would be marginal, in that most capital restrictions are imposed upon the underlying transactions, not on the payments and transfers related to such transactions. In addition, it seems that other international organizations and agreements with competence over capital movements do not distinguish between underlying transactions and payments and transfers.

D. Concept of Restriction

On the assumption that the amendment would extend to underlying transactions, the concept of restriction will need to be defined or anticipated. Given that the Fund does not at the moment have jurisdiction over underlying transactions, there is no developed practice in the Fund at this point. Based on other experience, however, an operative principle could be developed to the effect that a restriction would consist of an official measure that treats international transactions less favorably than domestic transactions. Inevitably, this generality will need elucidation in practical situations; for example, while a national measure may formally treat domestic and international transactions in the same fashion, in the particular circumstances international transactions might in fact be treated less favorably.

E. Exceptions to Jurisdiction

Despite the general coverage of the possible amendment, specific types of capital transactions might be excluded, totally, in part, or subject to later inclusion by appropriate action. For example, an important question is whether inward direct investment (that is, direct investment made by non-residents with residents) should be excluded, and whether its inclusion could be considered at a later time.

An argument can be made for the exclusion from Fund jurisdiction of certain measures, such as inward direct investment, that are not directly linked to the Fund’s interest in balance of payments and macroeconomic management. An alternative, however, would be to exclude inward direct investment from Fund jurisdiction initially but provide that it could be activated later (in whole or in part, or with certain thresholds) by a special majority of the Board of Governors, and so put into effect without further amendment.

Members would need to be assured of their right to maintain existing restrictions. As with the present jurisdiction over current account payments, countries could expect to rely on transitional provisions to maintain and adapt restrictions without breaching the obligations of the Articles. A related question arises to what extent, and by what mechanisms, would a member be persuaded or pressured to adopt the full obligations of capital liberalization and thus terminate its reliance on transitional provisions?
F. Approval Policies

As with the current Articles, a member might be able to impose restrictions on capital movements in certain situations, for example, for restrictions introduced for balance of payments reasons, for prudential reasons, and for reasons of national security. Given national sensitivity on these matters, however, it is possible that members will require additional assurance before signing on to a proposed amendment in terms of detailed and relatively objective criteria to be stipulated in the Articles, rather than a general power of approval.

G. Article VIII § 2(b)

An amendment to expand the Fund’s jurisdiction in the interests of capital liberalization would raise the question of whether to put teeth into Article VIII § 2(b).

Views and possibilities differ, especially given the diversity of national interpretation of the existing provisions, on the one hand, and the greater impact of a strengthened provision on the enforcement of contractual arrangements, on the other hand. For instance, the provision could be retained in its present form, or even abolished.

A further possibility would be to amend Article VIII § 2(b) in order to provide a mechanism to facilitate orderly international debt reorganizations. Specifically, a new Article VIII § 2(b) could provide a means of imposing a stay on the enforcement of creditor claims during the time in which a member’s adjustment program is being supported by a Fund arrangement.

IV. SOME BROADER ISSUES

The choice of the scope and approach of an amendment to extend the Fund’s jurisdiction will be conditioned by a number of factors. Let me mention three of them.

A. Type of Obligation

In designing an amendment to expand the Fund’s jurisdiction, the type of obligation has to be considered.

First, a preliminary question is whether it would be better to specify the nature of the liberalization obligations or, alternatively, to confer the authority to establish such obligations on the Fund to be identified and activated at a later date. A number of treaties follow the latter approach. It rests, however, on the principle of unanimity for decisions (e.g., the OECD). In the Fund, however, that approach is not permissible; under the Articles neither the Board of Governors nor the Executive Board possesses the authority to establish obligations though they can interpret and enforce obligations.

Secondly, there is a pervasive question of the appropriate specificity of the new provisions. Notably, the existing Articles are often rendered in
terms of general principles and concepts. For example, the concept of exchange *restriction* in Article VIII § 2(a), while relatively general in its content, was left to be filled out by later decision and practice. Similarly, the Articles does not specify the policies or criteria to control the Fund’s approval of exchange measures subject to the Fund’s approval jurisdiction. For capital liberalization, however, given the sensitivity of members, there may be a bias towards a more detailed description of such determinative concepts, without which members might be unwilling to choose to support an amendment.

**B. Enforcement of Obligations**

Till now, the identification, invocation, application and enforcement of members’ obligations in the Fund take a different tack to that of some other organizations, such as the WTO. In the Fund, enforcement is not adversarial, as between members, and contains few formal and evidentiary procedures. Instead, they are based on the application of relatively objective criteria relating to the actual exchange measures and the practices of the governments. Significantly, also, the Articles do not envisage retaliatory action of members; rather, enforcement is for the Fund itself, by means of representation, peer pressure, conditionality, and sanctions. A relevant question arises, therefore, whether the extension of Fund jurisdiction to capital movements, given its nature and scope, would require a different system for enforcement.

**C. Conflicting Treaty Obligations**

The relationship between the amended Articles and other treaties that deal with capital movements is a further important matter for consideration. First, it could be expected that the extension of Fund jurisdiction would need to seek accommodation with other international organizations and treaty regimes dealing with capital liberalization. One way to achieve this end would be to provide specifically in the amendment that Fund jurisdiction would be subject to obligations in other treaties.

Secondly, to the extent that other treaties provide for a more favorable regime for foreign investments than the amended Articles, a question of discrimination among members would arise. In response, a “most favored nation” type of clause could be considered.

Thirdly, while in general a conflict of rights and obligations between different treaty regimes should be avoided, a solution would be for other treaty regimes to defer to the Fund’s specialized function of regulating and approving restrictions on capital movements, so that the Fund’s approval of restrictions would make them consistent with those other treaties. (See, in this regard, Articles 11 and 12 of the General Agreement on Trade in Services.)