The IMF and Regulation of Cross-Border Capital Flows

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Abstract

This Article examines the International Monetary Fund’s recent efforts to play an assertive regulatory role with regard to global capital flows. There is a growing consensus among scholars and policymakers that states must carefully manage capital flows and coordinate their policies for doing so, and that direct capital controls are a useful part of their policy toolkit in extreme circumstances. After many years of evolution in this direction, the Fund has become a leading proponent of this consensus, and it now views helping its members manage capital movements to be a prominent part of its post-crisis mandate. This effort has become one of the centerpieces of the Fund’s bilateral and multilateral surveillance and its participation in international financial regulation. The Fund has embraced this role against a backdrop of a web of uncoordinated international trade and investment agreements that commit states to liberalize their capital account policies. There is currently no other multilateral framework designed to systematically manage global capital flows. For the foreseeable future, the Fund is in a unique position to play a productive role in helping states craft consistent approaches to capital flows and in promoting international coordination of these policies. It faces significant challenges in the effort, however, including its members’ potentially conflicting obligations under trade and investment treaties, uncertainty about its jurisdiction over capital flows, and pervasive limitations of the consultative mode of its surveillance. Thus, the Fund’s ambition to help its members manage capital flows will be an important test of its post-crisis mandate to promote global stability.

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I. INTRODUCTION

Over the last two decades, and especially since the recent global economic and financial crisis, the International Monetary Fund has increasingly asserted its role in the emerging framework for international financial regulation. This role is generally underestimated and mischaracterized in the legal literature. The Fund is charged with ensuring the stability of the international monetary system and with enforcing its members’ obligations under international monetary law. Initially, the Fund did not construe this mandate as requiring extensive engagement with its members’ financial sectors. As financial crises since the 1990s have made clear, however, stability of domestic and international financial systems is integral to monetary and economic stability. As a result, promoting financial stability has become a central focus of the Fund’s regulatory activity.

This increased focus on financial stability has in turn led to a significant evolution in the Fund’s efforts to influence its members’ policies regarding cross-border capital flows. Thus, the Fund’s efforts to help manage global capital flows provide an important illustration of the institution’s post-crisis mission and its potential role in international financial regulation.

Cross-border capital flows are the connective tissue of the international financial system and, in recent decades, they have become an enormous part of the global economy. The expansion of cross-border capital flows has coincided with the liberalization of domestic rules in advanced economies and many emerging economies, often pursuant to international agreements regarding foreign investment. The recent global financial crisis dramatically illustrated, however, that there are costs and potential pitfalls associated with the increasing volume of capital flows. Heavy capital inflows can fuel asset value bubbles and
exchange rate appreciation, overwhelm regulatory and supervisory capacity, and make an economy vulnerable to capital flow reversals. Capital outflows can create downward pressure on asset values and the exchange rate and can deplete foreign reserves. Most troubling, inability to control rapid outflows can imperil domestic financial systems and exacerbate or spur an acute financial crisis with likely spillover effects. Thus, there is a growing consensus that cross-border capital flows need to be more carefully managed at both the domestic and international levels. As Annamaria Viterbo notes, the "dynamics" of capital movements "are central both to international monetary stability and global financial stability."6

Yet managing capital flows and global liquidity is a profoundly difficult endeavor. Historically, states have utilized a wide variety of policies to affect the ability or inclination of both foreign investors and domestic residents to make cross-border investments.7 These include direct limitations on transfers of financial assets, taxes on cross-border financial transactions, capital exit levies, limits on the domestic use of foreign currency or on nonresidents' access to local currency, domestic bank deposit requirements, restrictions on deposit withdrawals, and differential exchange rate regimes for cross-border transactions.8 Some countries have maintained controls throughout the modern era and have effectively avoided fully integrating with the international financial system.9 Others have liberalized and then imposed controls in response to particular circumstances. Prominent examples of the latter include Chile's

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6 Viterbo, supra note 4, at 196.
7 See IMF, The Fund's Role Regarding Cross-Border Capital Flows, supra note 4, at 25 ("The term 'capital controls' is used broadly and sometimes loosely to cover a very broad range of official measures affecting international capital movements. While typically applied to limits on the rights of residents or nonresidents to enter into underlying capital transactions (for example, limits on the external debt of residents), they can also apply to the payments and transfers associated with these transactions.").
8 See Scott & Gelpern, supra note 4, at 575; Kevin P. Gallagher & Yuan Tian, Regulating Capital Flows in Emerging Markets: The IMF and the Global Financial Crisis, at 7 (Global Econ. Governance Initiative, Working Paper No. 5, May 2014); see also Olivier Jeanne et al., Who Needs to Open the Capital Account? 4–5 (Peterson Inst. For Intl. Econ. 2012) (discussing the variety of “species of capital controls”); M. Ayhan Kose et al., Financial Globalization: A Reappraisal, at 70–73 (Int'l Monetary Fund, Working Paper No. 06/189, Aug. 2006) (setting forth a taxonomy of capital flow management measures); Eswar S. Prasad & Raghuram G. Rajan, A Pragmatic Approach to Capital Account Liberalization, 22 J. Econ. Persp. 149, 163 (2008) ("The measures that countries have put in place to control capital flows come in various flavors. For example, controls can be imposed on inflows or outflows; on different types of flows (like foreign direct investment, portfolio equity, or portfolio debt); flows of different maturities; and flows into specific sectors.").
controls on inflows in the early 1990s, Malaysia’s controls on outflows in the late 1990s, and Iceland’s dramatic controls on outflows during the most recent crisis. More recently, numerous countries have adopted policies to limit capital inflows in response to expansionary post-crisis policies in large economies. Scholars and policymakers continue to debate the efficacy and effects of these policies. Furthermore, there is growing concern that some countries may be employing controls to limit appreciation of their currencies and thereby gain a competitive advantage for domestic exporters.

Adding complexity to the task of managing capital flows, the relevant policies that affect capital movements are not limited to those that directly regulate cross-border financial transactions. They include a wider range of policies that impact global investment patterns and allocation of global liquidity, especially domestic monetary and exchange rate policies. The external effects of domestic policies designed to manage capital flows in or out of an economy are often unanticipated or broader than intended. Policies that cause outward capital flows generally create inflows elsewhere and vice versa. They can also indirectly impact similarly situated countries by raising concerns among market participants that those other countries will adopt similar policies. Thus, managing cross-border capital flows requires international, multilateral coordination across a broad range of policies, some of which impact capital flows only indirectly.

The existing legal framework affecting capital flows is not designed for the purpose of managing flows, and it is ill-suited to the task. Most of that framework is a decentralized and overlapping patchwork of bilateral, regional, and multilateral agreements. These agreements are primarily designed to promote international trade and investment, and they generally commit states to

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10 At that time, Chile imposed significant reserve deposit requirements for portfolio investments to stem surging capital inflows. See SCOTT & GELPERN [19th ed.], supra note 4, at 1275.


12 During the recent crisis, Iceland broadly prohibited conversion of krona assets to foreign currency. See IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 33, 36.

13 See, for example, Gallagher & Tian, supra note 8, at 3–4 & fig.1 (noting the large capital inflows to emerging markets since the global crisis).

14 See, for example, discussion infra notes 63–67 and accompanying text.

15 See discussion infra notes 79–81 and accompanying text.

16 See discussion infra notes 63–64 and accompanying text.
remove obstacles to cross-border capital movements. They allow for widely varying degrees of flexibility for managing capital inflows and outflows to preserve or restore financial stability. Perhaps most concerning, the variety of obligations regarding capital movements pursuant to these international agreements may impede broader international coordination of national policies affecting global capital flows.

Against this background, the International Monetary Fund has expanded its efforts to influence its members’ policymaking affecting capital flows and to facilitate international coordination in this context. Although the scope of the Fund’s jurisdiction over its members’ policies regarding capital movements is unclear, those policies have become an increasingly important focus of the Fund’s regulatory mandate as global capital flows began to play a more dynamic role in the burgeoning international financial system in recent decades. In the wake of the global financial crisis, the Fund began to take a more assertive posture in consulting with its members about their capital flow management policies and in conducting broader surveillance of their policies affecting global capital flows.

In 2012, Fund staff proposed an “institutional view” of its members’ “liberalization and management of capital flows.” Building on previous staff positions and advice to members over the years, this view generally embraces liberalization of capital flows when carefully sequenced with development of the financial sector and other institutions. Perhaps more significantly, it emphasizes the need for its members to manage cross-border capital flows through macro-prudential policies and, in some circumstances, more targeted controls. The Fund has also undertaken the task of facilitating multilateral coordination of its members’ domestic policies that affect global capital flows. It has recently reconceptualized its surveillance mandate to encompass more comprehensive multilateral surveillance of the international monetary system, focusing in particular on the spillover effects of its members’ domestic policies. The potential role of cross-border capital flows in causing or transmitting financial instability is a primary focus of this newly redesigned multilateral surveillance.

Currently, the Fund’s engagement in this area represents the only multilateral effort or framework designed to systematically manage global capital flows. The Fund’s effort to help its members manage global capital flows is

17 See discussion infra notes 189–221 and accompanying text.
18 See discussion infra notes 110–125 and accompanying text.
20 See discussion infra notes 167–174 and accompanying text.
therefore a notable example of the potential impact of its regulatory role in the international financial system. As with other aspects of the Fund’s surveillance, especially its expanding financial surveillance, however, it remains to be seen whether the Fund’s newly articulated approach to capital movements will in fact enable it to have a more meaningful impact on its members’ policies. As other commentators have observed, the Fund’s newly articulated institutional view is cast in general terms and leaves domestic policymakers to grapple with significant uncertainty and ambiguity.\textsuperscript{21} Those policymakers must navigate potentially conflicting obligations under other trade and investment agreements, and the scope of the Fund’s legal mandate over members’ policies regarding capital flows is uncertain. Thus, the Fund’s project to improve international coordination of the management of global capital flows will inevitably prove to be an important test of its post-crisis surveillance function, especially its newly articulated mandate to conduct multilateral surveillance.

To be clear, this Article does not aim to assess the substantive merits of the Fund’s efforts or its actual impact on members’ regulation of capital flows or on their financial policies more generally. Instead, it describes how the Fund’s newly defined approach to its members’ policies regarding capital flows represents the only systematic attempt to regulate and coordinate global capital flows at the international level. In so doing, it aims to illustrate how the Fund’s engagement with capital flows reflects the institution’s ambition to play a meaningful role in international financial regulation. Section II describes the emerging consensus concerning the need for cross-border capital flow management. Section III addresses the Fund’s jurisdiction over capital movements, its evolving view of the policies its members should adopt to effectively manage capital flows, and its efforts to influence and help coordinate those policies. Section IV describes a number of practical challenges to these efforts, including potential tensions with the large web of international trade and investment agreements that touch upon capital flows, analytical complexity, and general limitations of the Fund’s modes of bilateral and multilateral surveillance.

II. REASSESSING CROSS-BORDER CAPITAL FLOWS

The recent global financial crisis accelerated a shift in the prevailing views among domestic and international policymakers regarding cross-border capital flows. This Section describes an emerging consensus regarding capital flows, which favors a cautious approach to liberalizing the regulatory treatment of such flows and reflects a growing receptiveness to managing them. This emerging consensus acknowledges that managing capital flows involves a broad range of

\textsuperscript{21} See discussion infra notes 236–240 and accompanying text.
domestic policies, including some not traditionally understood as capital controls, and that it often requires multilateral coordination of these policies.

A. New Caution

In the decades leading up to the recent crisis, domestic and international policymakers had generally converged on a commitment to the goal of liberalizing the regulatory treatment of cross-border capital flows\(^2\) by limiting or removing restrictions on capital movements.\(^2\) Until the modern era, limits on cross-border capital movements were pervasive;\(^2\) they had been “enshrined in the international financial architecture” after World War II.\(^2\) The trend toward liberalization began in the 1960s,\(^2\) reflecting optimism about the potential benefits and effects of mobile capital. Removing obstacles to cross-border movement of capital can, in theory, promote efficient allocation of financial resources\(^2\) and international pooling of financial risk.\(^2\) Foreign investment is

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23 See IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 6 (“In its broadest sense, [liberalization of capital flows] means the elimination of measures that could hamper international capital flows.”); Prasad & Rajan, supra note 8, at 165 (describing various approaches to liberalizing treatment of capital flows); see also Michael Waibel, BIT by BIT: The Silent Liberalisation of the Capital Account, in INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY – ESSAYS IN HONOUR OF CHRISTOPH SCHREUER 1, 2–3 (Christina Binder et al. eds., 2009) (describing capital account convertibility).

24 For a discussion of policies that states have used to control capital flows, see infra notes 50–58 and accompanying text.

25 Moschella, supra note 22, at 1. See VITERBO, supra note 4, at 39 (explaining why liberalization of capital flows was not addressed in the Bretton Woods framework).

26 See VITERBO, supra note 4, at 182.

27 See Gochoco-Bautista & Rhee, supra note 22, at 1 (“Standard theory regards capital controls as barriers to free capital mobility which prevent capital-scarce countries from borrowing at lower rates to finance investment and current consumption. This inter-temporal consumption smoothing is welfare-enhancing and efficient, since it allows countries with insufficient capital to use the excess capital of other countries.”); Charles Engel, Capital Controls: What Have We Learned?, Bank of Int’l Settlements Papers No. 68, at 24 (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2206275 (“International flows will, in an ideal world, move capital to its most productive use.”); Jonathan D. Ostry et al., Capital Inflows: The Role of Controls, at 4, IMF Staff Note no. 10/04 (Feb. 19, 2010) (noting that capital mobility can “allow countries with limited savings to attract financing for productive investment projects.”); see
widely believed to fuel economic growth in recipient countries. Participation by international investors may promote the development of domestic financial sectors and related regulations in recipient markets. It may also reduce opportunities for corruption and cronyism. This optimism aside, empirical research to date on the benefits of liberalizing the regulatory treatment of capital movements has proved inconclusive. For example, it remains unclear how much increasing capital inflows actually help fuel economic growth in low-income countries.

Although the benefits of capital flows are difficult to measure, their potential costs and hazards are increasingly discernible. The recent crisis saw “significant surges and sudden stops in cross-border capital flows” and, subsequently, renewed flows as advanced economies pursued expansive monetary policies. This experience has underscored aspects of cross-border

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29. Ostry et al., supra note 27, at 4 (noting that capital mobility can “foster the diversification of investment risk”).

30. See, for example, IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 15 (“In many countries, FDI has helped to boost investment, employment, and growth.”).

31. See Engel, supra note 27, at 24 (“International investors might impose more market discipline on local economies, driving out inefficient firms in favor of better organized and managed companies. International inflows might [also] spur development of local capital markets.”); Prasad & Rajan, supra note 8, at 150 (“The debate is refocusing on a different set of benefits, primarily the indirect or ‘collateral’ benefits that accrue to a country’s governance and institutions when it opens up to cross-border capital flows.”); Ostry et al., supra note 27, at 4 (noting that capital mobility can “contribute to the development of financial markets”).

32. See, for example, IMFs The Funds Role Regarding Cross-Border Capital Flows, supra note 4, at 21 (“Neither the benefits of liberalization nor the costs and effectiveness of capital controls are well-established in the empirical research.”).

33. See, for example, Prasad & Rajan, supra note 8, at 149 (“Cross-country regressions suggest little connection from foreign capital inflows to more rapid economic growth for such countries.”).

34. Gallagher & Tian, supra note 8, at 3–4 fig.1.

35. See Gallagher & Tian, supra note 8, at 4.
capital flows that were underappreciated in the years leading to the crisis, especially their potentially destabilizing effects.

Capital inflows, for example, can fuel credit booms and asset bubbles by increasing the availability of credit and can contribute to exchange rate appreciation. A rising exchange rate can "undermine the competitiveness of the tradable sector, thereby jeopardizing exports and growth." More dramatically, booms and bubbles can overwhelm a jurisdiction's capacity for supervision of its financial sector. In many of the countries that experienced acute financial crises in recent years, "prudential regulation and supervision in these recipient countries had not kept up with the challenges posed by growing inflows."

Inflows, especially those with short-term maturities, can thereby increase vulnerability to instability in the financial sector. Most of the financial, banking, and debt crises in recent decades have followed periods of credit booms fueled by external investment and capital. The Asian financial crisis of the late 1990s dramatically followed this pattern, proving to be a turning point in scholars' and policymakers' views on capital movements. During the recent global financial crisis, emerging economies with "pre-crisis inflow surges suffered larger output losses ... [Those] with greater restrictions on capital inflows (especially on debt liabilities) fared better." As a result, there is a newly heightened appreciation among scholars and policymakers that there are "market development and institutional" preconditions for effective liberalization of

36 See Ostry et al., supra note 27, at 9 (describing various types of inflows and their relative "riskiness"); Gochoco-Bautista & Rhee, supra note 22, at 1 ("[N]ew perspectives on the role of capital controls are now emerging in the aftermath of the global financial crisis.").


38 Moschella, supra note 22, at 7-8.

39 See infra notes 44-45, 161-166 and accompanying text (discussing the need for institutional capacity before financial liberalization).

40 IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 14 ("The growth experience of 48 [emerging market economies] since the onset of the crisis suggests that de facto measures of openness (primarily bank-intermediated flows) were significant predictors of growth declines, as were banks' pre-crisis leverage and credit growth.").

41 See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 19 ("[T]he belief held by many that the Asian crisis ... had its roots in premature capital account liberalization.").

42 See infra notes 131-137 and accompanying text.

capital movements, as well as a growing skepticism that full liberalization is a universally appropriate goal.

The crisis has also underscored concerns about the destabilizing effects of capital outflows. Rapid capital outflows can significantly exacerbate deteriorating financial and economic conditions and impede crisis resolution. They can cause or exacerbate collapsing currency values, deplete reserves, and precipitate credit freezes, which can quickly bleed into the real economy. The recent crisis also illustrated how cross-border capital movements can amplify the external effects of domestic financial crises, threaten global stability, and serve as “the principal conduit for the transmission of global shocks.”

Domestic policymakers around the globe have employed various policies designed to stem capital outflows throughout the modern era, especially in periods of financial crisis. Such policies have included direct prohibition of repatriation of capital, waiting periods for repatriation, and exit levies. Given the disruptions in capital flows during the crisis and concerns about surging inflows in emerging economies thereafter, scholars and policymakers are now

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44 See Gochoco-Bautista & Rhee, supra note 22, at 6 (“There is some agreement in the literature that a certain minimum threshold level of financial market development and institutional infrastructure have to be met before the gains from financial liberalization can be realized.”). See Prasad & Rajan, supra note 8, at 166 (“[N]ot all countries are ready for capital account liberalization—typically the more developed the country, the readier it is.”).

45 See, for example, JEANNE ET AL., supra note 8, at 112–14 (“[T]he free international mobility of capital should not be considered the ideal toward which all countries [in the] world should aspire.”); IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 17 (“[R]ecent research suggests that there is no certainty that full liberalization is an appropriate objective for all countries at all times, and that a more cautious approach to liberalization is warranted.”); VITERBO, supra note 4, at 191 (discussing the potential costs of liberalizing capital flows).

46 See Moschella, supra note 22, at 8 (noting that during the initial phase of the recent crisis, emerging markets had to deal with surging capital outflows).

47 Engel, supra note 27, at 23 (noting “exchange rate externalities” imposed by individual borrowers and lenders when they retrench); Forbes & Warnock, supra note 37, at 4 (noting that “sudden stops [in capital flows] are correlated with currency depreciations, slower growth, and higher interest rates”).

48 See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 3 (“[W]ith international asset positions now dwarfing output, global portfolio allocations and reallocations have profound effects on the world economy.”).

49 Id. at 3.

50 See VITERBO, supra note 4, at 157 (noting pervasive outflow controls during the 1930s, in Latin America during 1980s, in Malaysia, Thailand, and Russia during 1990s, and in Iceland in 2008).

51 See id.

52 See JEANNE ET AL., supra note 8, at 13 (noting a “new tide of capital flows from advanced to developing and emerging-market economies” since the crisis); Moschella, supra note 22, at 8 (observing that, after 2009, “the easing of monetary conditions in the advanced economies pushed capital flows” toward emerging markets).
increasingly receptive to policies designed to control or manage both capital outflows and inflows.53 Policies to control inflows are increasingly understood as tools for preventing54 as well as resolving crises.55 Historically, such policies have included taxation of inflows, limitations on non-residents' access to domestic bank accounts, residence requirements for domestic investment, and restrictions on residents' foreign borrowing.56 They generally aim to "[r]educe the volume of capital flows . . . [and] [a]lter the composition of capital flows (towards longer maturity flows),"57 which may reduce pressure on the exchange rate and give

53 See, for example, SCOTT & GELPERN, supra note 4, at 577 ("The policy consensus on capital controls has shifted palpably in the aftermath of the global financial crisis. The IMF, its major shareholders, and prominent policy officials previously on record as opposing capital controls, have expressed cautious support for controls as a temporary measure to counter global liquidity pressures, disorderly exchange rate movements and financial instability."); see also Kristin Forbes et al., Buble Thy Neighbor: Portfolio Effects and Externalities from Capital Controls, at 1 (Nat'l Bureau of Econ. Research, Working Paper No. 18052, May 2012), available at http://www.nber.org/papers/w18052 ("Some economists and policymakers have recently become more supportive of controls on capital inflows, particularly if they are aimed at limiting the appreciation of overvalued currencies and reducing financial fragilities resulting from large and volatile capital flows."); Gochoco-Bautista & Rhee, supra note 22, at 1 ("Indeed, past aversion to capital controls has seemingly been replaced with a new appreciation of its contribution to economic policy as a tool for financial stability."); Moschella, supra note 22, at 2 ("While in the 1990s the predominant view was that capital controls should not belong to the policy toolkit that countries can use to manage capital inflows, [they] are now regarded as useful instruments."); VITERBO, supra note 4, at 191–92 (discussing the trend toward a more favorable view of capital controls).

54 See De Paoli & Lipinska, supra note 28, at 1 ("Capital controls can be—and often are—used as a tool to manage exchange rate fluctuations."); SCOTT & GELPERN, supra note 4, at 575 (noting the use of capital controls "to counter the financial and economic impact of foreign exchange markets"); PALAIS-ROYAL INITIATIVE, REFORM OF THE INTERNATIONAL MONETARY SYSTEM: A COOPERATIVE APPROACH FOR THE TWENTY FIRST CENTURY 11 (2011), available at http://global-currencies.org/smi/gb/telechat/news/Rapport_Camdessus-integral.pdf ("Further consideration should be given to measures, such as capital controls and broader macro-prudential measures that might effectively allow countries to protect their economies from the negative effects of large and volatile capital flows."). But cf. Engel, supra note 27, at 24 (noting that "controlled exchange rates might be more misaligned than uncontrolled exchange rates"); VITERBO, supra note 4, at 156.

55 See, for example, JEANNE ET AL., supra note 8, at 21 ("Optimal prudential controls correct distortions that lead economic agents to take too much risk when there is a boom in capital inflows."); Sean Hagan, United Nations Conference on Trade & Dev. [UNCTAD], Transfer of Funds, at 45, UNCTAD Doc. UNCTAD/ITE/ITF/20 (Dec. 1, 2000) ("[T]here are circumstances in which [capital] outflows . . . outstrip both the adjustment capacity of the member and the amount of financing that can be provided. . . . In such cases, a country may have no choice but to impose restrictions as a component of its overall adjustment programme."); VITERBO, supra note 4, at 156.

56 See VITERBO, supra note 4, at 157.

domestic policymakers more room for monetary policy. They may also aim to manage the allocation of those flows within the financial sector. In the decade or so before the crisis, a growing number of countries had adopted such policies, and they have become increasingly common in the years since the crisis.

Although there is increasing agreement that domestic economies need to manage capital inflows and outflows, policymakers face challenges in identifying precisely when and how to do so. Thus, as one writer puts it, “the debate on how to manage potentially destabilising capital inflows is once again at the centre of public and scholarly attention.”

Research to date on the effect of capital controls and capital flow management measures remains inconclusive and difficult to analyze. The literature on the topic broadly indicates that such policies can have a modest impact on the volume of capital flows and a greater impact on the composition of those flows. This research leaves significant uncertainty about the extent to which capital flow management measures can be an effective way to protect or insulate an economy from financial or economic

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58 See id.

59 See VITERBO, supra note 4, at 155. Controls may be “country-specific” and sometimes essentially permanent. Id. They may be imposed through direct regulation of transactions or through indirect market-based mechanisms, like taxes. See id. at 158–59.

60 See JEANNE ET AL., supra note 8, at 13; VITERBO, supra note 4, at 156 (noting policies in Brazil, Colombia, Malaysia, and Thailand in the 1990s and similar policies in Iceland, South Korea, and Taiwan in the years immediately preceding the global crisis).

61 See VITERBO, supra note 4, at 191 (noting policies in Iceland, Ukraine, Brazil, Peru, Indonesia, South Korea, Thailand, Russia, and Argentina); JEANNE ET AL., supra note 8, at 13–19 (discussing policies adopted by Brazil, Taiwan, Korea, Thailand, and Indonesia in the wake of the crisis).

62 Moschella, supra note 22, at 8.

63 See SCOTT & GELPERN, supra note 4, at 576, 1179–83 (discussing the literature on this question and the cases of Chile and Malaysia); Gochoco-Bautista & Rhee, supra note 22, at 4–6 (discussing “mixed” evidence of the effectiveness of controls adopted by states in the 1990s).

64 See Engel, supra note 27, at 25 (“It is appropriate again to emphasize the limitations of the empirical studies on the effectiveness of capital controls.”); Ostry et al., supra note 27, at 5 (“It is difficult to get the data to speak loudly on the issue.”).

65 See Ostry et al., supra note 27, at 11–12; see also Engel, supra note 27, at 22 (“The empirical literature tends to find that capital controls have weak effects on capital flows.”); Forbes et al., supra note 53, at 1 (discussing research “showing that taxes on capital inflows can improve a country’s welfare by reducing negative feedback effects due to capital flow volatility or by adjusting the terms-of-trade to shift consumption across periods”).

66 See Engel, supra note 27, at 25 (“There is evidence that controls can tilt the composition of flows.”); Ostry et al., supra note 27, at 5 (“The evidence appears to be stronger for capital controls to have an effect on the composition of inflows than on the aggregate volume.”).
volatility. To make matters more complicated, the toolkit for affecting cross-border capital flows includes numerous instruments, including some that are not primarily understood as capital flow management measures. Most notably, prudential macroeconomic measures such as monetary and exchange rate policies can have determinative impacts on the direction and volume of global capital flows.

Furthermore, there are reasons to be concerned that capital flow management policies might have deleterious or distortive effects within the economy that employs them. In attempting to manage capital flows, a country may negatively impact the availability or cost of external credit to itself and its residents. Under some circumstances, such policies may also cause residents to remove capital from the economy. It is also possible that domestic policymakers will rely on attempts to manage capital flows as a substitute for, or in order to delay, macroeconomic or structural policy adjustments needed to weather financial or economic shocks.

See, for example, Mahvash S. Qureshi et al., Managing Capital Inflows: The Role of Capital Controls and Prudential Policies, at 14 (Nat'l Bureau of Econ. Research, Working Paper No. 17363, Aug. 2011), available at http://www.nber.org/papers/w17363 ("Our findings suggest that capital controls and various prudential policies can help reduce the riskiness of external liability structures and the extent of risky foreign-currency lending in the economy."); Forbes & Warnock, supra note 37, at 4 ("We find no evidence that capital controls insulate an economy against capital flow waves."); IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 34 ("It appears that for controls on outflows to have a chance at being effective, they need to be supported by coherent macroeconomic policies."); see also Prasad & Rajan, supra note 8, at 166 ("The surge in overall international capital flows, and the increasing sophistication of international investors, has made it harder to shape financial flows into or out of a country."); Vitribo, supra note 4, at n.119 (discussing the ongoing debate over controls and liberalization).

See, for example, Jonathan D. Ostry et al., Managing Capital Inflows: What Tools to Use?, at 4, IMF Staff Note no. 11/06, (Apr. 5, 2011) (discussing "how the macro and financial-stability rationales for capital controls fit together; how prudential and capital control measures should be deployed against various risks that inflow surges may bring; and specifically, how capital controls should be designed to best meet the goals of efficiency and effectiveness"); Jeanne et al., supra note 8, at 2 ("It is desirable to negotiate an international agreement about which controls are appropriate and which are not.").

See, for example, Ostry et al., supra note 27, at 4 ("The tools [for managing capital inflows] include fiscal policy, monetary policy, exchange rate policy, foreign exchange market intervention, domestic prudential regulation, and capital controls."); id. at 6–8 (elaborating upon these policy tools).

See Qureshi et al., supra note 67, at 15; Hagan, supra note 55, at 44.

See Hagan, supra note 55, at 44.

See id.
B. Multilateral Dimensions

The recent crisis also illustrated that many of the determinants and effects of capital flows in and out of an economy are external. Cross-border capital flows are, by definition, international in nature: any movement of capital across a border involves at least two countries. Increases in linkages between domestic financial systems have made it easier for global capital to move among and between economies in response to fast-changing economic or regulatory environments. Circumstances and policies affecting capital flows in and out of one nation can directly and swiftly affect the movement of capital in and out of numerous other nations.

For example, monetary policy in a systemically significant economy can affect the global supply of credit; it can also impact the direction of capital flows, effectively reallocating global liquidity. Stimulative monetary policy in the U.S. and elsewhere has “provided an environment of cheap credit available for

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73 See Ostry et al., supra note 27, at 10–11 (noting that widespread use of controls could impede exchange rate adjustments needed to correct global imbalances and, potentially, “redirect flows to countries less able to absorb them”); Gochoco-Bautista & Rhee, supra note 22, at 2 (“Unlike the cases prior to the global financial crisis, the debates are not simply about weighing trade-offs and effectiveness of capital controls in managing the risks to financial stability associated with large and volatile capital flows. Instead, they have become part of the hot button political issues of ‘currency wars’ and ‘currency manipulation.’”); see also IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 21 (“Greater attention needs to be paid to the multilateral effects of policies, including liberalization of capital flows and changes in prudential measures. Capital flow policies could have substantial multilateral effects, although the direction and size of such effects is difficult to predict.”); Jeanne et al., supra note 8, at 4 (“Capital account policies (including the accumulation of reserves) can be used to achieve exactly the same trade effects as tariffs on imports and subsidies for exports. Thus, any conflict about international trade has a natural tendency to spill over to capital flows, and vice versa.”); id. at 33–36 (noting the multilateral effects of an individual state’s controls on inflows).

74 See Gochoco-Bautista & Rhee, supra note 22, at 2 (noting that domestic policies designed to manage capital movements can cause disruptive flows elsewhere); see also IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 17 (“Policy and economic developments in other countries can significantly exacerbate the volatility of capital flows in any given country. Large, internationally active, complex financial groups . . . contribute to the rapid transmission of external and sector-specific shocks to the wider financial system.”); Pardee Center Task Force Report, Capital Account Regulations and the Trading System: A Compatibility Review, at 2 (Mar. 2013), available at http://www.bu.edu/pardee/files/2013/02/Pardee-CARS-and-Trade-TF-March2013-copy.pdf (pardee-task-force (“It may be necessary for nations to cooperate on ‘both ends’ of capital flows in order to regulate cross-border finance in an efficient manner.”).

75 See Gochoco-Bautista & Rhee, supra note 22, at 1 (“Many emerging economies openly introduced capital controls to mitigate the risks associated with volatile and large financial inflows from the unconventional monetary expansion in advanced economies.”). But see Forbes & Warnock, supra note 37, at 1 (finding no support for “the widespread presumption that changes in global liquidity or interest rates in a major economy, such as the United States, are important factors driving surges in capital flows [independent of any effect on global risk and growth]”).
overseas reinvestment,” resulting in significant and potentially destabilizing inflows of capital to many emerging market economies.⁷⁶ Such externalities can cause or exacerbate misallocation of global liquidity or otherwise undermine global stability, especially if risks are shifted to economies that have relatively less capacity for managing capital flows.⁷⁷

Domestic policies adopted to manage capital movements may also distort firm-level international investment decisions.⁷⁸ They can also have broader financial and economic effects on other states through exchange rates.⁷⁹ They may be employed, for example, to effectively limit appreciation of a currency’s exchange rate, benefitting the domestic exporting sector.⁸⁰ This is particularly important against the backdrop of growing concerns that some emerging market economies may be attempting to manipulate their exchange rates, perhaps in violation of formal commitments.⁸¹

In some circumstances, policies to control capital flows can produce contagion effects.⁸² If one state in or near financial distress imposes limits on capital outflows, investors in other states that are in a comparable situation may begin to fear that the second state will adopt similar limits and react accordingly.

⁷⁶ Gochoco-Bautista & Rhee, supra note 22, at 1 (noting also that “since the onset of the global financial crisis, capital inflows—mostly portfolio flows—to emerging markets have been large and volatile”).
⁷⁷ See, for example, De Paoli & Lipinska, supra note 28, at 2 (“[I]f capital controls are set in an uncoordinated fashion, they can have damaging implications for global risk-sharing and welfare. Ultimately, when countries simultaneously and independently engage in such interventions in the international flow of capital, not only global but individual welfare is adversely affected.”); Forbes et al., supra note 53, at 7 (finding that capital controls established in Brazil affect portfolio investments not only in that country, but also in other countries in the region); Forbes et al., supra, note 53, at 5 (“This renewed support for capital controls has also assumed that capital controls in one country do not generate significant externalities on other countries. Our analysis shows, however, that this may not be true.”).
⁷⁸ See Prasad & Rajan, supra note 8, at 164.
⁷⁹ See, for example, Ostry et al., supra note 68, at 9 (“[T]he risk that controls are being imposed for beggar-thy-neighbor reasons is genuine.”).
⁸⁰ See JEANNE ET AL., supra note 8, at 21, 37–39.
⁸¹ See Moschella, supra note 22, at 8; see also VITERBO, supra note 4, at 289–315 (discussing tensions related to exchange rates resulting from “global imbalances and undervalued currencies” and efforts to address exchange rate manipulation caused by capital account policies or otherwise). “Many countries—including Brazil, China, and India—are reported to have engaged in exchange market intervention and enacted capital controls to contrast currency appreciation.” Id. at 315. See IMF, Bilateral Surveillance over Members’ Policies Executive Board Decision, ¶ 15 (June 2007), available at https://www.imf.org/external/np/sec/prn/2007/prn0769.htm#decision (noting that restrictions on capital flows can be employed to effectively manipulate exchange rates).
⁸² See, for example, Forbes et al., supra note 53, at 5.
removing their investment from the second state, perhaps precipitating or exacerbating a crisis there.\textsuperscript{83}

C. Summary

In the wake of the recent global crisis, there is heightened appreciation of the need to manage cross-border capital flows and a new recognition that doing so involves a wide array of domestic policies. Policymakers increasingly need sound guidance on prudent approaches to liberalizing their capital accounts while ensuring flexibility to manage flows in ways that preserve financial and economic stability.\textsuperscript{84} Furthermore, managing capital flows in one national or regional economy may require adjustments and interventions elsewhere in the world. This requires a meaningful degree of international coordination and cooperation,\textsuperscript{85} the absence of which recently "contribute[d] to global instability."\textsuperscript{86}

III. THE FUND’S EVOLVING ROLE

Currently, there is no comprehensive multilateral framework for regulating and coordinating domestic policies to manage capital flows.\textsuperscript{87} Instead, as the

\textsuperscript{83} See Hagan, supra note 55, at 44 ("[I]nvestors may perceive [the imposition of capital controls] as a signal that other countries may also rely on controls as a means of dealing with difficulties and, as a result, the controls may have ‘contagion’ effects.").

\textsuperscript{84} See, for example, JEANNE ET AL., supra note 8, at 3 ("[I]t would be desirable for a code of good practices concerning capital account policies to be developed under the auspices of the IMF."); PALAIS-ROYAL INITIATIVE, supra note 54, at 11 ("The development of internationally agreed guidelines in this area, covering both issues of disruptive inflows and outflows would be useful.").

\textsuperscript{85} See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 7 ("The case for collective action to address these challenges and thus preserve and extend the benefits of capital flows is strong."); see also JEANNE ET AL., supra note 8, at 3 ("[U]nder some circumstances, unconstrained national actions can be collectively damaging."); Forbes et al., supra note 53, at 5 (advocating “international coordination or oversight of the use of capital controls to avoid a ‘bubble thy neighbor’ effect which could lead to retaliation across countries and reduce global welfare”); Forbes & Warnock, supra note 37, at 6 (proposing “an important role for global institutions and cross-country cooperation in reducing capital flow volatility”); Gochoco-Bautista & Rhee, supra note 22, at 2 ("The need to establish multilaterally-consistent rules will become more imperative since capital flows will continue to be a primary conduit for the transmission of global shocks in the future.").

\textsuperscript{86} VITERBO, supra note 4, at 196.

\textsuperscript{87} See VITERBO, supra note 4, at 88 ("This notwithstanding, consensus on the need of a genuine multilateral regime for investment protection remains a distant prospect."); id. at 89 (discussing the failed OECD Multilateral Agreement on Investment); PALAIS-ROYAL INITIATIVE, supra note 54, at 4 ("There is no unified global governance structure to help ensure that major economic and financial policy decisions made nationally, including exchange rate policies, are mutually consistent and contribute to global stability."); IMF, The Fund’s Role Regarding Cross-Border Capital
following Section describes, those domestic policies are subject to an array of bilateral, regional, and multilateral trade and investment agreements that reflect a significant degree of heterogeneity and inconsistency. 88 And those agreements are, for the most part, only secondarily or incidentally concerned with cross-border capital flows. 89 Against this backdrop, the Fund has increasingly asserted a role in regulating its members’ efforts to manage capital flows and in influencing the multilateral determinants of those flows. This Section describes the Fund’s general mandate, the scope of its jurisdiction over capital movements, and its evolving approach to engaging with members about their policies regarding cross-border capital flows.

A. Scope of Authority

1. Generally.

The Fund was created in the wake of the Second World War to address monetary and exchange rate instability, which had exacerbated conditions leading to that conflict. 90 It became one of the “pillars” of the international economic legal framework, along with the World Bank and the General Agreement on Tariffs and Trade (GATT). 91 As set forth in its Articles of Agreement, the Fund was designed to promote stable economic growth and expansion of international trade among its members by, among other things, promoting cooperation in monetary affairs and exchange rate stability. 92

Initially, the Fund’s Articles committed its members to a fixed exchange rate regime enforced by the Fund. In the 1970s that regime collapsed, and the Fund’s Articles were amended to broadly require that its members “collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.” 93 Each member of the Fund now

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88 See infra Section III.A.
89 See Ostry et al., Managing Capital Inflows, supra note 68, at 19 (observing that these obligations can constrain prudential policies regarding capital movements).
91 See VITERBO, supra note 4, at 56.
93 Id. art. IV, § 1.
Regulation of Cross-Border Capital Flows

commits, among other things, to “(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth . . . with due regard to its circumstances; [and] (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions.”

The Fund is charged with overseeing “the compliance of each member” with these obligations pursuant to its bilateral surveillance with each member, which it has historically conducted through an annual consultation process. The Fund’s Executive Board has interpreted “a stable system of exchange rates” to mean “systemic stability,” and it has determined that “[s]ystemic stability is most effectively achieved by each member adopting policies that promote its own balance of payments stability and domestic stability.” In recent decades, and especially since the most recent crisis, the Fund and its members have increasingly recognized financial stability as a necessary component of domestic and external stability. As a result, surveillance of members’ financial policies has become a central focus of the Fund’s bilateral surveillance of its members’ compliance with their obligations under the Articles.

The Fund is also charged with “oversee[ing] the international monetary system in order to ensure its effective operation,” which provides the jurisdictional basis for its multilateral surveillance. Whereas the Fund conducts bilateral surveillance to enforce its members’ compliance with their obligations under the Fund’s Articles, the distinct aim of multilateral surveillance is to address threats to global stability that do not arise from its members’ domestic instability, but rather from the external or systemic effects of its members’ domestic policies. The Fund’s Executive Board has expressly found that

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94 Id. Furthermore, members are obligated to provide the Fund with information necessary for it to execute its responsibilities. Id. art. VIII, § 5.
95 Id. art. IV, § 3(a).
98 Id. at 6. See id. (“In the conduct of their domestic economic and financial policies, members are considered by the Fund to be promoting balance of payments stability when they are promoting domestic stability. . . . The Fund in its surveillance will assess whether a member’s domestic policies are directed toward the promotion of domestic stability.”); see also Viterbo, supra note 4, at 69.
99 See generally Feibelman, supra note 1.
100 IMF Articles of Agreement, supra note 92, art. IV, § 3(a).
members have no formal obligations under the Articles to avoid such policies. Instead, the Fund’s multilateral surveillance aims to encourage and influence its members to promote external stability through their domestic policies.

Until recently, the scope of the Fund’s multilateral surveillance was rather limited, comprised primarily of its periodic Global Financial Stability Report and World Economic Outlook reports. The recent global economic and financial crisis generated a significant amount of internal and external assessment of why the Fund had failed to help its members avoid default and why the crisis had proved difficult to contain. One product of this assessment was significant expansion of the scope of the Fund’s multilateral surveillance. In 2012, the Fund’s Executive Board adopted a new Decision on surveillance that embraces a robust mandate for multilateral surveillance and aims to closely integrate it with its ongoing practice of bilateral surveillance.

In rearticulating its mandate to oversee the international monetary system, the Fund’s Executive Board noted that “symptoms of malfunction” in the system include, among other things, “volatile capital flows, the excessive build up or depletion of reserves, [and] imbalances arising from excessive or insufficient global liquidity.” It identified “exchange rate, monetary, fiscal, and financial sector policies and policies respecting capital flows” as particularly relevant to its multilateral surveillance. The Fund’s multilateral surveillance will

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102 See id. at 7.
103 See to the Fund’s Executive Board:
In the context of multilateral surveillance, the Fund may not and will not require a member to change its policies in the interests of the effective operation of the international monetary system. It may, however, discuss the impact of members’ policies on the effective operation of the international monetary system and may suggest alternative policies that, while promoting the member’s own stability, better promote the effective operation of the international monetary system.

Id.

104 See Feibelman, supra note 90, at 126.
105 See Independent Evaluation Office [IEO], IMF Performance in the Run-Up to Financial and Economic Crisis: IMF Surveillance in 2004-07, at vii, IEO Evaluation Report (2011) (“Warning member countries about risks to the global economy and the buildup of vulnerabilities in their own economies is arguably the most important purpose of IMF surveillance. This IEO evaluation found that the IMF fell short in delivering on this key objective in the run-up to the financial and economic crisis.”); PALAIS-ROYALE INITIATIVE, supra note 54, at 7 (noting the need to improve both the substance and the impact of the Fund’s surveillance in the wake of the crisis).
106 See generally IMF, Integrated Surveillance Decision, supra note 97; see also Feibelman, supra note 90, 124–33 (describing the process leading up to this development and the new mandate for multilateral surveillance).
108 Id. at 8.
also focus on global economic trends and, especially, on potential “spillovers arising from policies of individual members that may . . . undermine[e] global economic and financial stability.”

2. Regarding capital movements.

Despite the Fund’s mandate to oversee the international monetary system and enforce its members’ obligations to promote domestic stability, the scope of its jurisdiction to engage with its members regarding their treatment of capital flows is somewhat unclear. As a starting point, states’ sovereignty over their monetary affairs pursuant to public international law generally includes “[t]he power to adopt exchange restrictions and capital controls.” States ceded a significant degree of their monetary sovereignty pursuant to the Fund’s Articles, but they retained much of it as well. The Articles expressly and significantly limit states’ power to interfere with “current payments.” Article VIII provides that “no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.” Yet Article VI leaves to members much greater power to restrict capital movements, expressly allowing them to “exercise such controls as are necessary to regulate international capital movements.” This provision reflects that, at the time of the Fund’s founding, it was generally assumed that member states would exercise control over capital flows within and across their borders. Thus, the
Fund’s Articles create what one prominent writer describes as an asymmetry between obligations regarding current payments and the lack of similar obligations regarding cross-border capital flows.  

Notwithstanding this general asymmetry between the treatment of current payments and that of capital movements, the Articles do effectively limit members’ ability to restrict capital flows to some extent. For example, the prohibition of restrictions on current payments under Article VIII covers payments or transfers of investment income. Thus, taken together, Articles VIII and VI prohibit restrictions on outward capital flows that represent profits of investment income (that is, current payments), but do not preclude restrictions on repatriation of capital. Members are also prohibited from using Fund resources “to meet a large or sustained outflow of capital,” so the Fund may “require that a member impose controls on capital movements in order to prevent such use” if a member is receiving financial support from the Fund. Finally, the Fund’s Articles prohibit members from utilizing capital controls as a strategy for manipulating their exchange rates to gain competitive advantage. 

Most notably, the Fund has determined that its members’ obligations under the Articles “to promote a stable system of exchange rates” extends to policies affecting capital movements. In other words, the Fund has jurisdiction over

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116 See VITERBO, supra note 4, at 180 (“[T]he IMF structure is based on the dichotomy between current payments and capital movements.”).

117 See Hagan, supra note 55, at 10 (“[W]hile the obligations established under the Fund’s Articles serve to liberalize investment flows in a number of important respects, it is not an international investment agreement as such.”).

118 “[A]pplying the definition of ‘current payments’ contained in the Articles, while the authorities would be precluded from establishing a special exchange rate for the repatriation of profits, they would be free to impose a special rate for the repatriation of the original capital or capital appreciation.” Hagan, supra note 55, at 15. See id. at 14 (“[L]imitations on the ability of a resident or non-resident, as the case may be, to purchase foreign exchange for the purpose of making the payments or transfers in question constitute a restriction.”).

119 See VITERBO, supra note 4, at 163 (noting that the prohibition of restrictions on payments does not apply to regulation of “inward investment related payments and transfers”) (emphasis in original).

120 IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 7. See VITERBO, supra note 4, at 168–69 (discussing the “[o]bligation to maintain a unified exchange rate system under Art. VII, Section 3”).

121 See VITERBO, supra note 4, at 184.

122 IMF Articles of Agreement, supra note 92, art. IV, § 1. Members’ freedom to regulate capital movements “is not unlimited . . . with one such limitation being that members cannot exercise their right to regulate international capital movements in a manner that would be inconsistent with their obligations under Article IV.” IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 6–7.
those policies to the extent that they implicate domestic or global stability.\textsuperscript{123} Furthermore, because global capital flows are "an important element of the international monetary system,"\textsuperscript{124} the Fund has jurisdiction to consult with its members about their capital account policies in the course of its multilateral surveillance.

Nonetheless, the Articles were undoubtedly designed to limit to some significant extent the Fund's jurisdiction over its members' policies regarding capital movements. Reflecting this, the Fund's staff sought, unsuccessfully, in the 1990s to amend its Articles to expressly extend its jurisdiction to capital movements. The amendment under consideration at the time "would have imposed upon members a general obligation to gradually liberalize their capital account transactions, subject to certain safeguard provisions"\textsuperscript{125} and would have authorized the Fund to enforce that obligation.

B. The Fund's Approaches to Capital Flows

1. Pre-crisis.

The fact that the Fund's Articles reserve members' freedom to "exercise such controls as are necessary to regulate international capital movements"\textsuperscript{126} reflects the view of the Fund's architects that such controls can be beneficial under some circumstances.\textsuperscript{127} In the years between the amendments to the Fund's Articles in the 1970s and the financial crises of the late 1990s, however, the Fund increasingly embraced and helped to advance a consensus that liberalization of capital movements was a key component to promoting

\textsuperscript{123} See IMF, \textit{Liberalizing Capital Flows and Managing Outflows}, supra note 9, at 7 ("[T]he Fund focuses on capital flow issues both as an integral part of bilateral surveillance and in the context of its responsibility to oversee the international monetary system (that is, multilateral surveillance.").

\textsuperscript{124} VITERBO, supra note 4, at 183–84 (discussing the Fund's 1977 Decision on the newly amended Article IV, which acknowledged that capital flows may be a topic of concern in Fund surveillance, and noting that capital flows were generally included in Article IV consultations thereafter).

\textsuperscript{125} Id. at 187. See id. at 186–89 (discussing the effort to amend articles during the 1990s); see also IMF, \textit{The Fund's Role Regarding Cross-Border Capital Flows}, supra note 4, at 4 (discussing efforts to amend the Fund's Articles in 1997 to give the Fund clear jurisdiction over capital movements); id. at 19 (noting that the proposed amendment would have required liberalization but provided safety valves—transitional rules and temporary restrictions of huge outflows); id. at 19–20 ("[T]his reform effort [of the 1990s] did not come to fruition, largely due to the reluctance of key members to cede sovereignty in this important area, coupled with the belief held by many that the Asian crisis ... had its roots in premature capital account liberalization.").

\textsuperscript{126} See sources cited supra notes 113–114 and accompanying text.

\textsuperscript{127} See discussion supra note 115 and accompanying text.
economic growth and development. During this period, the Fund generally encouraged members to remove existing restrictions on capital flows and discouraged the use of capital controls to address financial or economic instability. It was toward the end of that period that the Fund sought to amend its Articles to expand its jurisdiction over capital movements.

During the financial crises of the 1990s, however, as the potentially destabilizing effects of capital flows became clearer, the Fund grew more cautious about capital account liberalization. During this period, the Fund staff developed an approach that generally favored liberalization of capital flows in tandem with other institutional reforms, especially improvements in the regulation and supervision of the financial sector. It occasionally approved the use of controls by members obtaining financial support from the Fund.

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128 See Gochoco-Bautista & Rhee, supra note 22, at 1 (noting that in the mid-1990s the Fund "had been on the verge of amending Article VIII to include capital account convertibility"); id. at 7 ("The bias for financial liberalization and against the use of capital controls was increasingly the norm from the 1980s up to the Asian financial crisis, as the IMF placed emphasis on the benefits to developing countries from greater capital mobility, with less attention on the attendant risks of cross-border capital flows."); see also Prasad & Rajan, supra note 8, at 149 (noting the abandoned effort to amend the Fund's Articles in the 1990s, which would have made "liberalization of capital movements one of the purposes of the IMF"); VITERBO, supra note 4, at 189-90 (noting that the Fund had been strongly in favor of liberalization in the 1990s).

129 See Gallagher & Tian, supra note 8, at 2 ("It has been well established that the International Monetary Fund, . . . though no longer wholly opposed, was generally skeptical for the regulation of cross-border financial flows from the 1980s to the run up to the global financial crisis."). "During this era, the IMF excluded the use of controls from its list of appropriate capital flow management policies," based on concerns that they are ineffective, "an obstacle to necessary macroeconomic adjustments," and can cause "negative spill-over and contagion effects." Moschella, supra note 22, at 8; see also id. at 12 (discussing the Fund's negative view of Chile's controls on capital, which it deemed "incompatible with the still-desirable goal of capital account liberalization").

130 See discussion supra note 125 and accompanying text.

131 See JEANNE ET AL., supra note 8, at 47 ("After the onset of the Asian financial crisis, the IMF's approach to capital flows took a more nuanced turn."); Gochoco-Bautista & Rhee, supra note 22, at 1 (noting that the Fund's experience with the Asian financial crisis contributed to the end of efforts to amend the Fund's Articles); VITERBO, supra note 4, at 190 (discussing the Fund's "more cautious approach to capital account liberalization" after the crises of the 1990s).

132 See JEANNE ET AL., supra note 8, at 47 ("Effective capital account liberalization was [thereafter] a question of proper sequencing."); IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 16 ("Staff advice has tended to rely to a large extent on the so-called 'integrated approach' to liberalization, which received considerable support at an informal Board seminar in 2001, but was never formally adopted as the Fund's policy framework."); VITERBO, supra note 4, at 190 (noting that the Fund embraced a structured approach to liberalization during this period).

133 See Moschella, supra note 22, at 12 (noting that, during this period, the Fund was still skeptical about controls on outflows, but increasingly embraced controls inflows); VITERBO, supra note 4, at 184 ("[T]he IMF has often supported members' economic programmes that included controls on capital inflows . . . and on capital outflows.").
2005, the Fund’s Independent Evaluation Office released an important report on the Fund’s approach to capital account liberalization and capital flows during the period between 1994 and 2004. The report confirmed the Fund’s shift toward a more cautious approach to liberalization after the crises of the 1990s. It also observed that, although “the IMF staff was in principle opposed” to the use of capital controls, the Fund’s staff “became much more accommodating of the use of capital controls over time, albeit as a temporary, second-best instrument.” The report raised concerns, however, that the Fund’s overall approach to capital account policies and capital flows was ad hoc and sometimes inconsistent, and it called for a clarification of the Fund’s approach at the institutional level.

A 2007 Executive Board Decision broadly rearticulated and clarified the Fund’s approach to bilateral surveillance and focused more heavily on capital flows than the 1977 Decision it replaced. The 2007 Decision noted that the Fund’s surveillance of members’ policies “will always include an evaluation of the developments in the member’s balance of payments, including the size and sustainability of capital flows.” And it identified capital management policies designed to impact balance of payments as “developments . . . which would require thorough review and might indicate the need for discussion with a member.” Although the framework for surveillance articulated in the 2007 Decision was eclipsed by the global financial crisis, which began to unfold in that year, the Integrated Surveillance Decision that soon replaced it also focused expressly on capital flows.

2. Post-crisis.

The recent global crisis was a transformative event for the Fund in various ways, most notably with regard to its mandate for multilateral surveillance.
discussed above. By highlighting the potential of capital flows to be a source of both domestic and systemic instability, the crisis also led to a significant shift in the Fund's approach to capital movements. Among other things, the crisis largely confirmed growing concerns within the Fund and elsewhere about the liberalization of policies affecting capital movements. As discussed above, it also revealed the complex interplay of policies affecting capital movements, highlighting their multilateral dimension.

Furthermore, the crisis underscored the lack of any comprehensive international, multilateral framework for governing and coordinating domestic policies regarding cross-border capital movements. As a Fund staff paper noted:

Various parts of the membership are taking divergent approaches to surging capital inflows—among other things, currency intervention, taxes, reserve requirements, and prudential measures. The appropriateness of these responses, both for the member itself and for the wider global good (e.g., they may only divert flows to other countries or exacerbate other imbalances), have not been fully evaluated. Yet doing so is nearly impossible in the absence of an institutional line and consistent framework.

It concluded: ‘‘[i]n 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.’’ The Fund was also encouraged by its members in the G-20 as well as other commentators to play a more central regulatory role in addressing capital movements.

143 See discussion supra notes 106–109 and accompanying text.
144 See VITERBO, supra note 4, at 8–10 (noting that the Palais-Royal report, supra note 54, identified “four sources of instability under the current international monetary system”: global imbalances, capital flows, exchange rate fluctuations, and reserve accumulation).
145 See Moschella, supra note 22, at 2 (“Since the burst of the global financial crisis in 2007, the Fund has significantly revised its previous policy stance on [controls].”)
146 See sources cited supra notes 44–45 and accompanying text; see also JEANNE ET AL., supra note 8, at 48–49 (noting the Fund’s heightening concern about capital flows and openness to capital controls in the wake of the recent crisis).
147 See discussion supra notes 63–64 and accompanying text.
148 See supra Section II.B.
150 Id. at 3. See also Gallagher & Tian, supra note 8, at 4 (proposing that policymakers at the Fund were motivated to shift the institutional position on capital controls “in hopes that it would revive interest in the IMF, given that global regard for the institution had waned significantly”).
151 See, for example, IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 4 (“The IMFC and the G-20 have called for work by the Fund on the management of capital flows, in connection with ongoing efforts to improve the functioning of the international monetary system.”); see also JEANNE ET AL., supra note 8, at 2 (“[T]he [IMF] was asked by its shareholders to address the question of whether there is a need for globally agreed ‘rules of the road’ for
To some extent, the recent shift in the Fund’s approach occurred ad hoc, as a product of its efforts to help restore and preserve stability in the wake of the global financial crisis. As the crisis unfolded, it increased its focus on capital flows in its bilateral and multilateral surveillance of its members’ policies. Perhaps most notably, Fund programs in Iceland, Central and Eastern Europe, and Cyprus included controls on outward flows. In the aftermath of the crisis, the Fund also supported controls on inward flows in some emerging economies.

During this period, the Fund’s staff prepared a series of papers on capital managing capital flows.”); Statement by the United States Secretary of the Treasury Timothy Geithner in the Twenty-Third Meeting of the International Monetary Fund and Financial Committee (Apr. 16, 2011), available at http://www.imf.org/external/spring/2011/imfc/statement/eng/usa.pdf (encouraging the Fund to strengthen its surveillance of capital flows); Palaí-Roaíale Alhmtiative, supra note 54, at 11 (“The IMF should establish a more complete analytic framework on capital flows, both in capital exporting and importing countries, in light of the experience gained over the last two decades that have been characterised by large and volatile capital flows.”).

See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 21 (“Controls on capital outflows have been included in economic programs supported by the Fund in capital account crises where large outflows have threatened to overwhelm emergency financing (including under Fund arrangements) and deplete international reserves.”). Further, “[t]he prominent role of the Fund in the implementation of the derogation provisions reflects the fact that the Fund is charged with both assisting countries in the design of programmes that address balance of payments problems and providing the financial assistance that is necessary to support these programmes. . . . [W]hen a country faces a balance of payments crisis there is a very close relationship between issues relating to the need for restrictions, the degree of economic adjustment and the amount of external financing.”

See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 24–34 (discussing enhanced Fund surveillance of policies affecting capital flows after the crisis); Gochoco-Bautista & Rhee, supra note 22, at 7 (“[T]he IMF should take into account the experience gained over the last two decades that have been characterised by large and volatile capital flows.”). See also IMF, Factsheet: Vulnerability Indicators, available at http://www.imf.org/external/np/exr/facts/vul.htm (noting that the Fund has begun to give greater attention to capital flows as a “vulnerability indicator” for its members).

See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 22 (“Most surprising to many was the IMF’s strong support of the use of capital controls on outflows in Iceland as part of that country’s post crisis stand-by-agreement.”); Moschella, supra note 22, at 2.

See also discussion supra notes 183-85 and accompanying text.

flows “to equip the Fund with an up-to-date and operational framework for policy advice on liberalizing capital flows and on the management of capital outflows” and “to inform policy discussions with and advice to Fund members.” In this process, the Fund’s staff amplified its views on the need for careful, integrated liberalization of policies affecting capital inflows, and fully embraced the idea that capital management measures can be crucial tools for crisis containment “without compromising the overall process of liberalization.” The Fund’s staff also acknowledged that policies designed to manage capital movements are potentially discordant with the existing terrain of bilateral and regional trade and investment agreements.

The efforts within the Fund to improve its surveillance of capital flows culminated in an “institutional view” articulated by the Fund’s staff and subsequently endorsed by its Executive Board. Not surprisingly, it embraces and expands upon the Fund’s “integrated approach” to liberalization, which ties certain institutional developments to particular types of capital flows and proposes a sequence for liberalizing the various types of flows. States are more likely to experience benefits of liberalizing capital flows if they “have achieved certain levels of financial and institutional development” and if liberalization is

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157 IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 1; id. at 7 (noting that the discussion in the paper is “not intended to provide guidance on the scope of members’ obligations under Article IV”).

158 See IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 20 (describing the “[c]urrent surveillance practice”); see also IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 26-33 (discussing the potential benefits of liberalization to China and India in particular).

159 IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 1. See id. at 5 (“[T]he temporary reimposition of [capital flow management measures] on capital outflows can be useful mainly in crisis or near crisis conditions but only as a supplement to other policies in response to large outflows typically associated with crises.”); id. at 35 (“Once a country has substantially liberalized capital flows, a certain degree of capital outflow volatility is normal, and does not in and of itself call for the use of [management measures].”).

160 See IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 8 (“[T]hese agreements in many cases do not provide ... proper sequencing of liberalization.”); IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 24 (“The existing configuration of agreements presents particular challenges for the Fund, including through its role in providing financing to address capital account crises (e.g., these may be triggered by premature liberalization.”). The potential application of trade and investment treaties to capital flow management measures is discussed infra Section IV.A.

161 IMF, An Institutional View, supra note 19. See Gochoco-Bautista & Rhee, supra note 22, at 7. The new view was “incorporated into a Staff Guidance note in 2013 and [is] intended to guide official IMF policy advice on the matter.” Gallagher & Tian, supra note 8, at 4.

162 IMF, An Institutional View, supra note 19, at 14.

163 See id.
accompanied by "sound fiscal, monetary, and exchange rate policies."\(^{164}\)
Similarly, the risks of liberalization are greater if states have not achieved a basic level of development, especially with regard to financial regulation and supervision.\(^{165}\) In particular, the Fund's view proposes that members liberalize inflows of foreign direct investment before liberalizing related outflows or other longer-term flows or attempting to develop capital markets.\(^{166}\)

The more notable aspect of the Fund's new institutional view on capital flows is its unequivocal assertion of the need to manage them and its embrace of a broad range of capital flow management measures, ranging from general macro-prudential policies (like monetary policy) to aggressive controls on outflows.\(^{167}\) It envisions that to manage capital inflows and outflows, its member states should under most circumstances rely on general prudential measures, especially monetary, fiscal, and exchange rate policies,\(^{168}\) which can impact the volume and direction of capital flows.\(^{169}\)

The Fund's view expressly recognizes, however, that states may sometimes need to resort to more aggressive measures to manage capital flows. Given the continued skepticism at the Fund and elsewhere that controls can significantly impact the volume of flows,\(^{170}\) however, the Fund's new approach embraces aggressive capital controls "only as a last resort policy tool."\(^{171}\) They may be necessary, for example, if there is not sufficient "room" for general prudential measures, if those measures would take too much time, or if flows threaten systemic instability.\(^{172}\) According to the Fund's new institutional view, if such measures are necessary, they should be limited, non-discriminatory, and temporary,\(^{173}\) and they should generally be accompanied by macroeconomic policies designed to address "fundamental causes of the crisis."\(^{174}\)

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\(^{164}\) Id. at 12.

\(^{165}\) See id.

\(^{166}\) See id.

\(^{167}\) See id. at 16–29.

\(^{168}\) See id. at 17–18 (proposing policies that could respond to surging inflows, including "lowering interest rates," "fiscal tightening," and "allowing the currency to strengthen"); id. at 25 (noting that "macroeconomic, structural, and financial policies" should be the first line of defense against capital outflows).

\(^{169}\) See discussion supra note 65 and infra notes 173–174 and accompanying text.

\(^{170}\) See Moschella, supra note 22, at 9.

\(^{171}\) Id. at 10.

\(^{172}\) See IMF, An Institutional View, supra note 19, at 18.

\(^{173}\) See id. at 20.

\(^{174}\) Id. at 26. See id. at 19 (asserting that aggressive capital flow management measures should not substitute for necessary adjustment in macroeconomic policies).
Finally, in addition to providing these guidelines for its members’ capital flow management policies, the Fund’s institutional view acknowledges the multilateral factors affecting global capital flows and asserts its authority to try to influence its members’ policies. Among other things, the Fund aims to identify and contain spillovers from an individual members’ domestic economy to help coordinate the policies of source and recipient states, and to promote more consistency among the various international agreements affecting states’ policies regarding capital flows. As discussed below, these efforts will be a core and challenging component of the Fund’s multilateral surveillance.

Although there had been ambivalence and episodic support within the Fund for attempts to manage capital flows over recent decades, the new institutional view represents a clear shift from the institution’s pre-crisis official position. Manuela Moschella considers the Fund’s evolving approach to capital flows as a case study of “ideational change” among policymakers. According to her, the Fund’s “incremental” change in response to crisis has been slower than the literature would predict, due in part to the constraints of the Fund’s legal framework, including uncertainty about the scope of its jurisdiction over capital flows.

In any event, Kevin Gallagher and Yuan Tian have shown that the Fund has not simply articulated a new institutional view but has changed its regulatory behavior as well. Since the crisis, the Fund has voiced considerably more support for capital controls in its surveillance of members’ policies, especially

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175 See id. at 30 (noting the Fund’s responsibility to ensure the stability of the international monetary system and the threat that volatile capital flows pose to that system).
176 See id. at 32; see also id. at 29 (discussing contagion as a potential spillover effect).
177 See id. at 28; id. at 16 (noting “push and pull factors” affecting capital flows).
178 See id. at 33.
179 “[T]he current ideational stance within the Fund presents broad continuities with past policy ideas.” Moschella, supra note 22, at 10–11 (discussing gradualists at the Fund with regard to capital flows since the early 1980s).
180 See generally id.; see also Gallagher & Tian, supra note 8, at 2–4 (discussing the literature on the crisis and “the shift of discourse at the IMF [about capital controls]”).
181 See Moschella, supra note 22, at 2–3 (arguing that “ideational change [at the Fund regarding capital controls] was slower and more incremental than most of the literature claims it to be even after a major shock”).
182 See id. at 12–13 (arguing that the IMF Articles of Agreement provide flexibility for, as well as constrain, the Fund’s evolving approach to capital controls).
183 See Gallagher & Tian, supra note 8, at 20–23; see also Joseph P. Joyce & Ilan Noy, The IMF and Liberalization of Capital Flows, 16 REV. INT’L ECON. 413 (2008) (examining the correlation between Fund programs and capital account liberalization); Rathin Roy & Raquel Almeida Ramos, IMF Article IV Reports: An Analysis of Policy Recommendations (Int’l Policy Center of Inclusive Growth,
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where their economies have become vulnerable to economic or financial crises. Their research also shows that the Fund is less supportive of liberalization when members have significant current account deficits. As one writer puts it, "[f]or an organisation that has historically opposed capital controls, even trying in the mid-1990s to amend its Articles of Agreement to allow it to promote capital account liberalization, the current position is puzzling and deserves scholarly attention."

In sum, the Fund’s newly articulated institutional view aims to be a road map for its members’ domestic policies regarding capital flows. It marks an incremental but noteworthy shift in the institution’s approach to liberalizing capital flows, part of a new, somewhat more cautious and nuanced approach to liberalization in general, as well as a more dramatic shift toward embracing direct capital controls as a potential policy tool. Furthermore, the Fund’s new view should be viewed as a significant assertion of its jurisdiction to help manage global capital flows pursuant to its mandate to ensure the stable functioning of the international monetary system. In this regard, the Fund’s evolving engagement with its members regarding capital movements reflects its ambition to play a more assertive regulatory role in the international financial system more generally.

IV. CHALLENGES

The Fund faces a number of challenges as it attempts to play a more assertive role in regulating and coordinating its members’ policies regarding capital flows. These include “perceived ambiguity in its Articles, divergent attitudes among members, and the legacy of a failed attempt to confront the financial crisis.”


See Gallagher & Tian, supra note 8, at 28 (“We can conclude from the regression results that the financial crisis has a significant influence on the IMF’s decision about level of support for capital controls... [A]s the economy becomes more vulnerable, the level of support for capital controls increases.”). Mention of controls in Article IV reports is “significantly correlated with the domestic banking-sector credit”—as credit in that sector grows, controls are more likely to be mentioned, presumably reflecting greater vulnerability. Id. at 26.

See id. at 26.

Moschella, supra note 22, at 10-11 (describing three phases of “ideational change” at the Fund concerning capital controls). “In summary, before the global financial crisis burst, there existed [within the Fund] strategic and well-positioned advocates endowed with alternative ideas.” Id. at 12.

Although the current Fund’s rethink on controls is timid in light of the empirical evidence collected as the result of the latest crisis, it certainly signals that the IMF is reevaluating its assumptions about the costs and benefits of liberalisation. This leads the Fund into potentially uncharted territories.” Id. at 15.
issue in the late 1990s.”188 This section explores, in particular, potential tensions with other international legal regimes, concerns about the substance of the Fund’s new approach to capital flows, and ongoing challenges for the Fund in improving the traction of its surveillance and related activities.

A. Coordinating Legal Domains

Although nations vary widely in their openness to foreign trade and investment,189 most have increasingly liberalized their policies on trade and investment in recent decades, often pursuant to international agreements. Taken together, these agreements reflect a heterogeneous approach to capital flows.190 As discussed below, the Fund’s new institutional approach to capital flows and the growing academic consensus it reflects are in tension with some of these other legal regimes. As Viterbo notes, some of the policies that the Fund and other commentators believe should be available to policymakers for managing capital flows “may be limited by the obligations contained in previously undertaken trade and investment treaties.”191

Most international agreements touching upon capital movements have been designed to remove or limit regulatory actions that might impede the free flow of capital across borders. The Code of Liberalization of Capital Movements (the “Code”),192 promulgated by the Organization for Economic Co-operation and Development (OECD),193 is the most significant of these. It is a formal

188 IMF, The Fund’s Role Regarding Cross-Border Capital Flows, supra note 4, at 3. Reevaluation of capital controls within the Fund was “hotly contested,” with the “BRICS countries leading an efforts [sic] to grant the most policy space possible for emerging markets to regulate capital flows.” Gallagher & Tian, supra note 8, at 4.

189 See VITERBO, supra note 4, at 239 (describing four models of relative openness to investment).

190 See Broomfield, supra note 87, at 1 (noting “the different approaches taken by various international organizations and many international investment agreements”); Hagan, supra note 55, at 1-2 (noting the variety of provisions in international agreements affecting capital flows); VITERBO, supra note 4, at 88 (noting the lack of “inter-treaty coherence” and potentially conflicting obligations in agreements related to capital flows).

191 VITERBO, supra note 4, at 281. Viterbo discusses this tension as an example of “norm conflict.” Id. at 41-47.


193 The OECD was formed by European states in the wake of the Second World War to implement the Marshall Plan. See History, OECD, http://www.oecd.org/about/history/ (last visited Feb. 18, 2014). It has since expanded to 34 members, including the U.S., Canada, and Japan, and a few large emerging economies such as Mexico, Turkey, and South Korea. See Members and partners, OECD, http://www.oecd.org/about/membersandpartners/ (last visited Feb. 18, 2014). Its mission, broadly defined, is to help its members and other governments identify and adopt policies that promote economic development and social welfare. See Hagan, supra note 55, at 18, (“Under the OECD Convention, OECD members are required to ‘pursue their efforts to reduce
agreement among its members with the general goal of "eliminating exchange and capital controls." Pursuant to the Code, OECD members have agreed to "progressively abolish between one another ... restrictions on movements of capital to the extent necessary for economic co-operation." In particular, members commit to "grant any authorisation required for the conclusion or execution of transactions and transfers specified" under the Code. These include direct investments, liquidation of direct investments, certain real estate transactions, and the issuance, sales, and purchases of securities and collective investment securities. The Code provides that other transactions, generally those with shorter maturities, can be restricted.

The Code allows a member to temporarily derogate from its commitment to liberalize capital movements "[i]f its economic and financial situation justifies such a course," if adherence would "result in serious economic and financial disturbance," or "[i]f the overall balance of payments of a Member develops adversely at a rate and in circumstances ... which it considers serious." Such

or abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalisation of capital movements." (quoting Convention on the Organization for Economic Cooperation and Development, art. 2(d), Dec. 14, 1960, 12 U.S.T. 1728). To that end, the OECD adopts decisions, recommendations, standards, and models on various topics of regulatory concern; in some cases, the OECD facilitates international agreements among its members.

OECD, Forty Years' Experience with the OECD Code of Liberalisation of Capital Movements, supra note 27, at 3.


OECD Code, supra note 192, art. 2(a).

OECD Code, supra note 192, annex A; Hagan, supra note 55, at 19-20 (noting that the provisions cover the transfer of proceeds from liquidating investments as well as from investment income); see also id. at 19 ("[T]he investment liberalization obligations of the Capital Movements Code extend not only to the ability of non-residents to make investments in a host country, but also to the ability of a country's residents to make investments abroad."); id. at 23 (noting that the Code "covers both underlying transactions and associated transfers" and that "[t]he coverage of underlying transactions is particularly necessary in the case of inflows, where restrictions are normally imposed at that level").

See OECD Code, supra note 192, art. 2(b)(iv) (referring to "List B" transactions); Hagan, supra note 55, at 22 ("The generous treatment of these transactions is attributable to their volatility and, accordingly, their potentially adverse impact on the macroeconomic and balance-of-payments stability of OECD members.").

OECD Code, supra note 192, arts. 7(a)-(c). See IMF, Liberalising Capital Flows and Managing Outflows, supra note 9, at 8 (noting that prudential restrictions can be introduced under the Code).
derogations require notice to the OECD Council and are subject to review but not prior approval.\(^\text{200}\) It is also possible that, under some circumstances, principles of public international law may support derogation from obligations under the Code.\(^\text{201}\)

Members of the European Union (EU) have also agreed to dramatically liberalize the treatment of capital movements within the EU. In 1958, the Treaty of Rome provided that “the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.”\(^\text{202}\) In 1993, the Maastricht Treaty established the free movement of capital as one of the fundamental freedoms of the EU,\(^\text{203}\) prohibiting members from restricting capital movements among themselves or between members and non-member states.\(^\text{204}\) Like the OECD, these treaties allow EU members to take some restrictive measures to address acute crises or balance-of-payments difficulties, but these exceptions are not allowed to members in the Euro zone.\(^\text{205}\)

Many nations have also made formal international commitments regarding capital flows through bilateral or regional investment treaties.\(^\text{206}\) These treaties

Furthermore, “[n]othing in this Code shall be regarded as altering the obligations undertaken [pursuant to] the Articles of Agreement of the [IMF] or other existing multilateral international agreements.” OECD Code, \textit{supra} note 192, art. 4. See Broomfield, \textit{ supra} note 87, at 2 (discussing the deference of GATT and NAFTA to Fund assessment of members' restrictions on capital movements).

\(^\text{200}\) See Hagan, \textit{ supra} note 55, at 22 (“[T]he OECD Codes provide that a member may take the initiative to introduce restrictions for balance of payments reasons, but that they must be promptly notified to the OECD, where they are examined.”).

\(^\text{201}\) See \textit{VITERBO}, \textit{ supra} note 4, at 260–71 (discussing the possibility that doctrines of public international law would allow for derogation in the absence of an expressly agreed safeguard); \textit{see also} \textit{id.} at 195 (noting that the European Court of Justice has ruled that European Union members’ investment treaties must allow for prudential controls).


\(^\text{203}\) \textit{See id.} art. 63; Waibel, \textit{ supra} note 23, at 12.

\(^\text{204}\) \textit{See IMF, Liberalizing Capital Flows and Managing Outflows, supra} note 9, at 6 (noting that members of the European Union, not all of which are within the Eurozone, have agreed to “generally prohibit[] all restrictions on the movement of capital”).

\(^\text{205}\) \textit{See} TFEU, \textit{ supra} note 202, arts. 66, 143, 144; \textit{see also} IMF, \textit{Liberalizing Capital Flows and Managing Outflows, supra} note 9, at 8 (“EU members outside of the euro area may additionally resort to restrictions on capital movements when faced with balance of payments difficulties under certain circumstances.”).

\(^\text{206}\) \textit{See generally} Broomfield, \textit{ supra} note 87 (noting provisions of international investment treaties that limit restrictions on cross-border capital movements); \textit{see also} Hagan, \textit{ supra} note 55, at 28–38 (discussing the design and scope of provisions in international investment treaties that limit restrictions on cross-border capital movements); \textit{VITERBO}, \textit{ supra} note 4, at 84–89 (describing
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are directed at protecting foreign investors in host countries. Because the movement of capital across national borders and jurisdictional lines is a sine qua non of international investment, these agreements generally include commitments to avoid restrictions on inward investments and related transfers.

Until recently, most international investment treaties, especially bilateral treaties, did not allow for derogation from these commitments to address balance-of-payments difficulties or financial crises. It appears that such treaties increasingly do allow for derogation; some allow for derogation to address acute balance-of-payments problems, others allow it to resolve financial instability, and still others allow it for either reason. But some agreements still do not include

different types of international investment agreements and noting that there are over 2,500 such agreements in force).

207 See Hagan, supra note 55, at 28 (“Investment protection is one of the central objectives (and, in some cases, the only objective) of bilateral and regional investment agreements... [T]hese agreements normally require a host country to liberalize the full range of investments made by the treaty party’s investors.”).

208 See, for example, Waibel, supra note 23, at 2 (“The growth of international investment depends on capital accounts that are at least partly open... [The transferability of financial assets] is an essential ingredient for the proper operation of investments.”); see also sources cited supra note 2 and accompanying text.

209 See, for example, Hagan, supra note 55, at 1 (“By establishing a host country’s obligation to permit the payment, conversion and repatriation of amounts relating to an investment, a transfer provision ensures that, at the end of the day, a foreign investor will be able to enjoy the financial benefits of a successful investment.”); Waibel, supra note 23, at 2 (arguing that free transfer clauses in international investment treaties “[h]ave led to a patchwork liberalization of the capital account”); VITERBO, supra note 4, at 86–87 (noting that free transfer provisions “are contained in all [investment treaties]” but “differ greatly in scope”), 239–45 (discussing the difficulty in defining the scope of “investments” covered by such agreements); IMF, Liberalizing Capital Flows and Managing Outflows, supra note 9, at 8; Hagan, supra note 55, at 28 (“[T]hese agreements serve to liberalize inward, but not outward, investments, in contrast to the OECD Codes, which liberalize both.”).

210 See, for example, Broomfield, supra note 87, at 1 (“[I]nternational investment agreements, and especially bilateral investment treaties (BITs)—crafted primarily to protect investors—typically do not allow for the imposition of restrictions on capital outflows associated with foreign investments for balance-of-payments reasons.”); Waibel, supra note 23, at 19 (noting that “many multilateral treaties” include balance-of-payments safeguards while “only a minority” of bilateral investment treaties do so); Hagan, supra note 55, at 37 (“The general absence of temporary balance of payments derogation provisions [in investment treaties] may be attributable to the general perception that these agreements are generally designed to protect [foreign direct investment]. Since this type of investment is generally not volatile, signatories may therefore not view temporary balance of payments derogation as being a necessary safeguard.”).

211 See, for example, Pardee Center Task Force Report, supra note 74, at 3 (noting that BITs generally include exceptions for balance of payments problems or financial crises, but not for both); VITERBO, supra note 4, at 131–42 (noting prudential carve-outs for financial regulation in most trade and investment treaties), 249–73 (discussing and surveying safeguards clauses).
express exceptions of any kind. Significantly, the U.S. generally refuses to include such derogation provisions in its bilateral investment treaties.

Finally, multilateral trade agreements include some provisions related to cross-border capital movements. The General Agreement on Trade in Services (GATS), for example, enables signatories to make commitments to liberalize regulation of their financial services sectors and “covers capital transfers related to trade in financial services.” The treaty provides that “members must refrain from imposing restrictions on international payments and transfers associated with the current and capital transactions that are covered by the specific commitments” under the agreement. The North American Free Trade Agreement (NAFTA) also covers trade in financial services (and, thus, some cross-border investments), and it limits the restrictions that signatories can place on related transfers. NAFTA and GATS both expressly allow for derogation from these obligations to address balance-of-payments problems. Like the

See VITERBO, supra note 4, at 88; Pardee Center Task Force Report, supra note 74, at 7 (noting that many bilateral investment treaties “do not have a balance of payments safeguard and/or a prudential carve out” and criticizing many of the provisions that exist).


See Pardee Center Task Force Report, supra note 74, at 2 ("[N]egotiations at the WTO, for financial services, take a ‘positive list’ approach whereby nations get to choose which sectors to liberalize and even put limitations or conditions on such liberalization. Indeed, Chile liberalized trade in cross-border financial services but reserved the right to deploy [capital flow management measures] when monetary authorities saw it as necessary.")

See generally General Agreement on Trade in Services, art. II, ¶ 2, Annex on Financial Services, Second Annex on Financial Services, Apr. 15, 1994, 1869 U.N.T.S. 283 [hereinafter GATS]; Ostry et al., Managing Capital Inflows, supra note 68, at 20 (noting that signatories of GATS “incurred obligations to remove restrictions on capital flows if they have made commitments in the financial services sector”).

Pardee Center Task Force Report, supra note 74, at 6. See GATS, supra note 215, art. XI.

GATS, supra note 215, art. XI. See Hagan, supra note 55, at 25; VITERBO, supra note 4, at 216.


See Hagan, supra note 55, at 37; see also Broomfield, supra note 87, at 2 n.2 (noting that NAFTA includes a free transfer provision).

See GATS, supra note 215, art. XII; NAFTA, supra note 218, arts. 140(1), 2104; Broomfield, supra note 87, at 2 n.2 (noting that NAFTA allows for derogation from its free transfer obligation to address balance-of-payments difficulties); Hagan, supra note 55, at 26 (describing the derogation allowed from restrictions on capital movement under GATS and noting that GATS defers to the Fund’s treatment of restrictions on current payments), 37 (describing the derogation from liberalization allowed under NAFTA); Ostry et al., Managing Capital Inflows, supra note 68, at 20
other provisions discussed above, the derogation provisions under both NAFTA and GATS are complex and consequently leave much room for uncertainty about when they might apply.\(^2\)\(^2\) It is not clear, for example, whether the derogation allowed under GATS applies to inflows as well as outflows.\(^2\)\(^2\)\(^2\)

In sum, there is a significant number of international agreements that create a variety of obligations for states regarding their treatment of capital flows. The scope and content of these obligations are complicated, and some are potentially conflicting. Most of these obligations are designed to facilitate trade and investment, not to manage capital flows, and many of them constrain policymakers from taking actions that might aid them in managing capital flows. Although the trend in recent years has been for greater safeguards in international agreements providing for liberalization, there is still a wide range of approaches in this regard, many of which may not adequately balance the goals of liberalization and stability.\(^2\)\(^2\)\(^3\) States may reasonably hesitate to adopt beneficial capital flow restrictions at pivotal moments due to concerns about ex post disputes or litigation over those restrictions pursuant to a trade or investment agreement.\(^2\)\(^2\)\(^4\) Investment treaties may give rise to greater concern in this regard because they allow private investors to bring challenges,\(^2\)\(^2\)\(^5\) unlike trade agreements, which only allow other states to do so.\(^2\)\(^2\)\(^6\)

\(^2\)\(^2\)\(^1\) See Pardee Center Task Force Report, supra note 74, at 5–6 (noting that the balance of payments exception under GATS is qualified by a “necessity test” and may prove cumbersome); Hagan, supra note 55, at 37 (noting that the derogation provision under NAFTA “is relatively elaborate”).

\(^2\)\(^2\)\(^2\) See Pardee Center Task Force Report, supra note 74, at 4 (“It may be that the GATS balance of payments safeguard does not adequately guarantee that nations can use measures to regulate both the inflow and outflow of capital because there is no reference to derogations to maintain ‘financial stability.’”); Hagan, supra note 55, at 27 (“It is unclear from the text of Article XII whether a derogation is also intended to apply to restrictions on capital inflows.”).

\(^2\)\(^2\)\(^3\) See VITERBO, supra note 4, at 197 (“The long-term objective of capital account liberalization should be coupled with adequate IEL safeguards.”).

\(^2\)\(^2\)\(^4\) See, for example, Broomfeld, supra note 87, at 2 (noting that “the existence of a balance-of-payments crisis can be subjective” and that “[a] country may be threatened with lawsuits even if it believes capital controls are needed to respond to a clear balance-of-payments dilemma”).

\(^2\)\(^2\)\(^5\) See VITERBO, supra note 4, at 87 (“Certainly, the most distinctive feature of international investment agreements is that they provide for the settlement of disputes between investors and the host country.”).

\(^2\)\(^2\)\(^6\) See Pardee Center Task Force Report, supra note 74, at 8 (“Finally the Task Force expressed serious concern about the use of ‘investor-state dispute resolution’ in cases pertaining to investment treaties. WTO disputes are settled ‘state-to-state’ and therefore nation-states can
Perhaps most troubling, these bilateral, regional, and multilateral agreements do not provide tools for addressing the external effects of domestic policies regarding cross-border capital flows, especially spillovers or contagion. They do not amount to an institutional mechanism for active international coordination or for a global, systematic, or multilateral approach to capital flows. As noted above, this has led to various calls for a distinct legal regime to provide guidelines and coordination of domestic policies regarding capital movements. Thus far, this has proved to be an insurmountable challenge. The OECD members made a prominent yet unsuccessful attempt in the late 1990s to adopt a Multilateral Agreement on Investment. That agreement included guidelines on liberalizing capital management policies as well as an express safeguard provision for derogation to preserve financial and economic stability. Thus, if it had been adopted, that agreement would have at least represented a systematic approach to promoting and regulating global capital flows.

The lack of an independent framework for regulating capital flows underscores the potential benefit of the Fund’s role in providing regulatory guidance in the course of its bilateral surveillance and international coordination through its multilateral surveillance. It is well situated, and appears to have the authority, to develop a consistent approach to balancing liberalization of capital movements with safeguards to preserve stability and help its members limit negative externalities of their domestic policies.

That said, there is significant potential conflict between the Fund’s institutional view of the need to manage capital movements and the obligations under many existing trade and investment treaties pushing more aggressively towards liberalization. To the extent that potential conflicts in formal

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227 See IMF, *The Fund's Role Regarding Cross-Border Capital Flows*, supra note 4, at 21 (“[T]he patchwork . . . for the regulation of international capital movements is generally not optimal for international monetary system stability or for a multilateral approach.”).

228 See discussion supra notes 85–86 and accompanying text.

229 See *VITERBO*, supra note 4, at 139.

230 See id.

231 See id. at 197–98 (noting, for example, that Iceland may have breached its obligations under the European Economic Area agreement by imposing controls in 2008 pursuant to its IMF lending program); see also *Broomfield*, supra note 87, at 3 (“Currently, it is possible that a country in crisis will have to face two potentially conflicting international obligations: an IMF recommendation to employ capital controls, and [international investment agreements] that allow investors to sue if controls are imposed.”); sources cited supra note 164 and accompanying text; see 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 INT’L LAW STUDENT ASSOC. J. INT’L & COMP. L. 297, 301
obligations arise, it is not entirely clear that the Fund’s authority to enforce members’ obligations under its Articles would govern. Unless and until that proposition is established, a state may be put in a situation of uncertainty about its potential liability for actions that the Fund determines are necessary to satisfy the state’s obligations under the Fund’s Articles. In any event, this potential conflict can be resolved in the absence of a comprehensive regime through express provisions in the relevant agreements clarifying the order or relationship of obligations.\textsuperscript{232} This is the approach taken in GATS/WTO\textsuperscript{233} and some international investment treaties,\textsuperscript{234} which include provisions ensuring that obligations and exceptions to obligations are consistent with those pursuant to the Fund’s Articles.

B. Other Challenges for the Fund

In light of the growing consensus on the need for managing global capital flows, scholars and policymakers have generally welcomed the Fund’s newly articulated approach and guidelines regarding capital flows.\textsuperscript{235} However, numerous commentators believe that the Fund’s new approach falls short of what is necessary to provide sufficiently clear and predictable guidance to its members regarding capital flow management.\textsuperscript{236} Some writers have observed that the Fund’s position does not concretely clarify when a country has reached “the undoubtedly difficult-to-define institutional threshold for gaining the benefits of capital account liberalization.”\textsuperscript{237} Similarly, others have suggested that if the Fund cannot provide sufficiently clear guidance in particular circumstances, its new embrace of capital flow management may be both under and overaggressive;

\textsuperscript{232} See Broomfield, \textit{supra} note 87, at 3; Viterbo, \textit{supra} note 4, at 197–98.

\textsuperscript{233} See \textit{Viterbo}, \textit{supra} note 4, at 205–08, 222–32 (discussing formal deference to the Fund’s determinations by WTO bodies).

\textsuperscript{234} See \textit{id.} at 255–60 (discussing clauses with substantive links to IMF framework in NAFTA, the agreement creating the ASEAN Free Trade Area, and the proposed OECD Multilateral Agreement on Investment, 198 (noting, however, that most bilateral and regional investment agreements do not link to the IMF in this way).

\textsuperscript{235} See Gochoco-Bautista & Rhee, \textit{supra} note 22, at 8 (discussing the reaction to the Fund’s newly articulated approach).

\textsuperscript{236} See, for example, \textit{id.} at 2 (“The new framework is also complicated, intentionally vague, and difficult to implement given the absence of explicit guidelines. For example, it is ambiguous as to what constitutes an ‘exhaustive’ use of macroeconomic policy space.”).

\textsuperscript{237} Prasad & Rajan, \textit{supra} note 8, at 150. See Moschella, \textit{supra} note 22, at 10 (calling the Fund’s new approach hesitant and incoherent).
some members may feel too free to adopt controls while others may delay too long in employing them. The Fund's new view does not, for example, aim to provide specific guidance on design questions regarding what transfers to target with which kinds of restrictions under what circumstances. Without drawing brighter conceptual lines, the Fund can only increase clarity through consistent application and advice in its surveillance, conditional lending, and technical assistance.

Assuming that the Fund can succeed in articulating clear and consistent substantive guidance and advice for its members regarding capital flows, it also faces the challenge of increasing the impact of its views. This is part of a more general challenge the Fund faces in gaining greater traction for its attempts to influence its members' policies in the course of bilateral and multilateral surveillance. In fact, these challenges may be related: if the substance of the Fund's advice is concrete and credible, it may be more likely to gain traction. It is also possible, however, that there are limits to the impact of the Fund's surveillance that stem from its legal framework and the complicated basis of its jurisdiction over capital flows.

Reflecting both concerns, some writers have advocated that the Fund create and/or enforce a more formal rule-based framework for managing capital flows and policing manipulative behavior through capital account policies. Such an approach would likely provide a greater degree of international management and coordination of capital flows than the status quo, even with more aggressive Fund surveillance of capital account policies. It would represent

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238 See Gochoco-Bautista & Rhee, supra note 22, at 2 (“Without establishing more explicit rules on the implementation of capital controls, there exist potential risks arising from their unilateral and unbridled use.”).

239 See id. at 14 (“The preconditions under the IMF framework... preclude the use of capital controls except as a measure of last resort, but by which time, perhaps the use of capital controls may be moot.”).

240 See Hagan, supra note 55, at 46–47 (“The question of whether restrictions should differentiate between certain types of transfers raises a number of complex issues.”).

241 Increasing the traction of its surveillance and advice is a general and, arguably, defining challenge for the Fund. See generally Feibelman, supra note 90.


243 See supra Section III.A.2.

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a significant incursion into sovereign power, however, and would at least require amending the Fund’s Articles to unequivocally extend the Fund’s jurisdiction to capital movements.\footnote{245} As the previous effort to amend the Fund’s Articles to extend Fund jurisdiction to capital movements and the fate of the OECD’s Multilateral Agreement on Investment reflect, ambitious international lawmaking in this area will face an uphill battle.

The Fund’s surveillance of its members’ policies regarding capital flows therefore represents the first and only systematic effort to manage global capital flows. It represents the first time that any regulatory actor has attempted to both understand and influence the full range of factors affecting global capital flows, and so it faces regulatory challenges that have not previously been tackled. As an initial matter, for example, the analytical task of understanding the dynamics of global capital flows is daunting. It requires an appreciation of the determinants flowing from individual states as well as those that arise from multilateral factors, including the accumulation and interaction of those state-level phenomena.

To that end, since the crisis, the Fund has supplemented the core components of its pre-existing multilateral surveillance, World Economic Outlook and Global Financial Stability Report,\footnote{246} with spillover reports\footnote{247} and, more recently, a Pilot External Sector Report.\footnote{248} Both of these new initiatives focus heavily on the role and impact of global capital flows on the domestic stability of the Fund’s members and the stability of the international monetary system.\footnote{249}

Assuming the Fund can develop credible analytical expertise with regard to managing global capital flows, it will still face the challenge of influencing members to take into account the external and multilateral effects of their capital account policies. In some circumstances, it may be possible to convince

\footnote{245} See JEANNE ET AL., supra note 8, at 112–14; see also PALAIS-ROYALE INITIATIVE, supra note 54, at 11 (“Use of capital controls, subject to IMF surveillance under an amended Article VI, may be warranted as an option to prevent disorderly exchange rate movements or financial instability.”).


\footnote{249} See id. at 6 (“This report is structured to provide first an overview of developments in key external sector dimensions—current accounts, capital flows, intervention policies, and trade policies—and then provide an assessment of the external sector positions of the larger economies including what needs to be done to close remaining imbalances.”); IMF, 2013 Spillover Report—Analytical Underpinnings and Other Background supra note 247, at 6 (emphasizing “policy uncertainty” in the United States and in Europe, which might “raise global risk aversion, resulting in sharp corrections in financial markets and capital outflows from emerging markets”).
members that these external effects feed back to them through the global economy or systemic instability. But in many cases, members will likely resist fully weighing the global effects of their policies; in such cases, it may prove difficult to influence members to adjust their policies for the sake of systemic stability. The Fund’s leverage in such circumstances is arguably limited by the fact that its formal authority over multilateral aspects of global capital flows is significantly narrower than its jurisdiction over its members’ policies that threaten their domestic stability. As noted above, the Fund has determined that its members do not have an independent obligation under the Fund’s Articles to endeavor to promote global stability. If members fail to respond to the Fund’s multilateral surveillance of their policies regarding capital flows, however, this may provide good reason to consider the possibility of ensuring that the Fund’s members do have a more general obligation to promote global stability under the Fund’s Articles.

Grappling with such analytical and enforcement concerns will inevitably be a central component of the broader challenge that the Fund faces in fulfilling its new mandate to promote global stability through multilateral surveillance. Helping its members manage capital flows will thus provide an early and crucial opportunity to develop the scope and the modes of this function. Given the importance of this new mandate and the centrality of capital flows in the international monetary system, the Fund’s efforts to help its members liberalize and manage capital flows represents an important test of its ability to have a meaningful impact on policies that it deems central to its regulatory functions.

V. CONCLUSION

There is a growing consensus among scholars and policymakers that states must carefully manage capital flows and coordinate their policies for doing so and that direct capital controls are a useful part of their policy toolkit in extreme circumstances. After many years of evolution in this direction, the Fund has become a leading proponent of this consensus and has adopted managing global capital movements as a prominent part of its post-crisis mandate. It has done so against a backdrop of a web of uncoordinated international trade and investment agreements that commit states to liberalize their capital account policies.

Currently, the Fund is the only entity charged with the regulatory responsibility for managing global capital flows, the connective tissue of the international financial system. Its efforts in this regard represent the only comprehensive multilateral framework designed to help states manage those flows. For the foreseeable future, then, the Fund is in a unique position to play a

250 See discussion supra notes 102–103 and accompanying text.
productive role in helping states craft consistent approaches to managing capital flows and in promoting international coordination of these policies. In any event, this effort has become a centerpiece of the Fund’s new integrated approach to bilateral and multilateral surveillance. It is also one of the most important—very possibly the most important—component of its participation in international financial regulation. Helping manage global capital flows will thus be a defining aspect of the Fund’s regulatory role in coming years and test of post-crisis mandate to promote global stability.