Politics

Niklas Manhart

The Legalization of the International Monetary Fund: Exchange Rate Surveillance over China

Master's Thesis

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“There are three roads to madness: love, ambition and the study of money.”

- Adapted from Karl Marx

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Abbreviations

BIS	Bank for International Settlements
Board	IMF Executive Board
CGER	Consultative Group on Exchange Rate Issues
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board (formerly Financial Stability Forum, FSF)
IMF / Fund	International Monetary Fund
GATT	General Agreement on Tariffs and Trade
GFSR	Global Financial Stability Report
GMR	Global Monitoring Report
G-7	Group of Seven. Members: Canada, France, Germany, Italy, Japan, United Kingdom, United States of America
G-8	Group of Eight. Members: The G-7 plus Russia
G-20	Group of Twenty. Members: The G-8 plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, Republic of Korea, Turkey as well as the European Union
Group of 24	Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development. Members: Algeria, Argentina, Brazil, China, Colombia, Côte d'Ivoire, Democratic Republic of Congo, Egypt, Ethiopia, Gabon, Ghana, Guatemala, India, Iran, Lebanon, Mexico, Nigeria, Pakistan, Peru, Philippines, South Africa, Sri Lanka, Syria, Trinidad and Tobago, Venezuela
Group of Thirty	Private, nonprofit, international body composed of senior representatives of the private and public sectors and academia
IEO	Independent Evaluation Office of the IMF
IFA	International financial architecture
IL	International law
IMFC	International Monetary and Finance Committee
IR	International relations theory
MTS	Medium-Term Strategy
OECD	Organization for Economic Co-operation and Development (previously the Organization for European Economic Cooperation, OEEC)
PBC	People's Bank of China
PCIJ	Permanent Court of International Justice (predecessor of the International Court of Justice, ICJ)
PGMs	Principles for the Guidance of Members' Exchange Rate Policies
PIN	Public Information Notice
RMB	Chinese renminbi
ROSC	Reports on the Observance of Standards and Codes
SAFE	State Administration of Foreign Exchange
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Right
UFR	Use of Fund Resources
USCBC	US-China Business Council
USD	United States dollar
WEMD	Discussions of World Economic and Market Developments at the IMF Executive Board
WEO	World Economic Outlook
WEOD	World Economic Outlook Database
WTO	World Trade Organization

1. Introduction

In the last decade, allegations of currency manipulation have overshadowed the relationship between China and the United States (US). Washington argues that by artificially holding down the value of its currency, the renminbi, the Chinese manage to outpace their rivals in the race for the manufacturing title.[1] Owing to large reserve accumulations – a by-product of its heavy exchange rate management – Beijing is alleged to bring about global imbalances and financial instability.[2] In response, China blames the US for injecting excessive liquidity into the international monetary system – and for threatening the value of its vast dollar holdings.

Beyond the rhetorical mud-slinging, the dispute over the renminbi draws attention to an interesting phenomenon in world politics: the regulatory gap between money and trade. In the international monetary system, states threaten unilateral actions without addressing a supranational framework (Subacchi 2010: 1) – in contrast to the neighbouring area of trade where coordination is thriving. Just recently, China was embroiled in two disputes over trade practices. It accused the European Union (EU) of applying illegitimate tariffs on the import of metal fasteners (Wall Street Journal, 18 July 2011a); and it was incriminated for restricting exports of rare earths (China Daily, 22 July 2011). In both cases, legal settlement was reached with the help of the World Trade Organization (WTO). Considering that even Antigua managed to secure a legal victory against the US over its ban on online gambling (Reuters, 31 January 2008), the exchange of goods and services seems to be governed by firm legal rules – with a powerful institution to boot.

However, this distinction is not entirely accurate, as there is indeed an international body responsible for surveilling exchange rates: the International Monetary Fund (IMF or Fund). According to Art. IV of its Articles of Agreement, the Fund is tasked with overseeing both the international monetary system and the policies of all its members.[3] Yet in practice, the regulatory reach of the IMF is disputed: "Poor countries fear the Fund and choose to suppress its conclusions; middling countries quarrel with it; rich countries ignore it" (The Economist, 29 July 2010). The former Managing Director Dominique Strauss-Kahn conceded that if a country's policies were a threat to international stability, the Fund could "at best come up with a

[1] There is some confusion as to the correct denomination of the Chinese currency. *Renminbi* (RMB), the name used in this paper, is the formal term, referring to the legal tender. *Yuan* is the actual unit, used as the more colloquial expression (Wall Street Journal, 21 June 2010).

[2] The relevant legal and economic concepts used in this paper are explained in the Glossary, section 9.2.

[3] Unless otherwise stated, "Art." henceforth always refers to the Articles of Agreement of the IMF as per the Second Amendment of the Articles that took effect on 1 April 1978.

list of homework tasks, but not make them do the homework" (BBC World Debate, 8 October 2010). No country has ever been found in breach of its monetary obligations since Art. IV was ratified in 1978. As a result, "the focus of legislation concerning the international economy passed to the GATT and the WTO while most countries joined the IMF, which became essentially a foreign aid agency" (Lowenfeld 2010: 583). Shortly before the financial crisis in the late 2000s, Martin Wolf, a leading financial commentator argued that "if the International Monetary Fund did not exist, we would not re-invent it" (Financial Times, 21 February 2006).

Looking back, the Fund has not always appeared so powerless. A US representative warned in 1945 that joining the IMF would amount to "handing over to an international body the power to determine the destination, time, and use of our money [...] and abandoning, without receiving anything in return, a vital part of American bargaining power" (quoted by Gadbaw 2010: 557). In fact, the international community agreed to surrender considerable control over its exchange rates to the IMF between 1945 and 1971. But ever since the collapse of the Bretton Woods system and the Second Amendment, sovereign control over exchange rate policies returned to be "one of the most closely guarded national prerogatives" (Simmons 2000a: 573).[4] Attempts by the Fund to increase its clout over monetary affairs, such as the publication of a new decision on bilateral surveillance in 2007, proved futile in establishing further obligations. To this day, exchange rates are characterised by low levels of legal commitment.

Motivation

In recent years, currency manipulation has become an increasingly popular subject of research. There is, however, a distinct lack of explanations for the scarce efficacy of Fund supervision. In most cases, the reasoning is circular: there is no enforcement of Art. IV because the IMF has no power to enforce it. Accepting that "the vagueness [of Art. IV] is likely not the result of drafting error" (Mercurio/Leung 2009: 1299), the arguments put forth appear unsatisfactory. They range from historicisms like the observation that "in the 1970s, enforceable, 'hard' rules were not common" (Herrmann 2010: 51) to the simplistic claim that "every country wants to retain absolute freedom on the choice of its exchange rate regime" (Pattainak

[4] Changes to the constitutional charter of the IMF are called amendments. So far, they happened five times. On 28 July 1969, the First Amendment introduced a monetary reserve asset called the special drawing rights (SDRs). The Second Amendment which abolished the par value system became effective 1 April 1978. The Third Amendment of 11 November 1992 provided for the suspension of certain rights of members not fulfilling their obligations. The Fourth Amendment (10 August 2009) established a special one-time allocation of SDRs. The Fifth Amendment (18 February 2011) expanded the Fund's investment mandate. References to the "original Articles" in this paper are not confined to the original version (1945 to 1969), but include the First Amendment (1969 to 1978). "Articles" or "amended Articles" refers to the Articles after 1978. For the full references to all IMF documents used in this paper see the Bibliography.

2007: 300). Other critics blame the IMF's staff for showing "little inclination to get involved" (Chwieroth 2009: 53) and remaining "asleep at the wheel of its most fundamental responsibility" (Adams 2006: 135), culminating in ad-hominem arguments against the "failure" of the Fund's management and Managing Director (Mussa 2007: 123).[5]

In addition to their poor explanatory value, these arguments fall short of addressing the systemic reasons for the softness of bilateral surveillance. Since it appears that "high political costs" (Zimmermann 2010a: 55) have limited the degree to which states seek cooperation in monetary affairs, the central question is not why the Fund does not enforce its rules, but rather why it lacks the necessary punch. By incorporating international relations (IR) theory, this paper seeks to explore the motives behind the reluctance to relinquish authority over currency policies to a multilateral body.

Research question

Against the backdrop of the renminbi issue – "the elephant in the room" with respect to improper monetary conduct (Eichengreen 2007: 164) –, this paper retraces the unique trajectory of the international law (IL) on exchange rates – from the lawlessness of the gold standard to a highly regulated system under Bretton Woods and back to the obscure arrangement that has prevailed ever since the Second Amendment. Ultimately, it wants to answer the following question raised by Morris Goldstein:

> Through the rulings of adjudication panels in the World Trade Organisation and in contrast to what has happened on exchange rate issues, a body of international case law is unfolding – making it clearer what is and what is not internationally-acceptable trade policy on everything from bananas to steel to domestic tax systems. Why isn't a similar exercise going on for exchange rate policy (Goldstein 2005: 8)?

Key finding

To analyse the characteristics of bilateral exchange rate surveillance, this paper employs the concept of legalization[6] – a rational institutionalist approach for studying the "move to law" in world politics (Goldstein et al. 2000: 385). In short, it argues that international monetary stability is a public good which, as a collective action problem, provides strong incentives for cooperation. However, the analysis of the bilateral surveillance regime reveals that after the Second Amendment hard legalization no longer served the interests of the IMF membership,

[5] In analogy to a public firm, the Fund's three decision-making organs can be described as "the board of directors" (the Executive Board), "the shareholders" (the Board of Governors) and "the chairman of the board" (the Managing Director) (Lastra 2006: 376). A stylised view of IMF governance is contained in the Appendix 1 in section 9.1. More information can be found on the IMF website <http://www.imf.org/external/about.htm>. For an extensive treatment of IMF governance see Lamdany/Martinez-Diaz 2009.

[6] This paper is written in British English. However, the concept of "legalization" and the adjective "legalized" maintain their American spelling due to their formulation by American scholars.

while the costs of hard legal rules tipped the scale in favour of soft commitments. Specifically, the paper finds that exchange rates are subject to high uncertainty costs stemming from measurement difficulties, complexity, goal incongruence and subjectivity; as well as sovereignty costs due to reputational damage, distributional impact and loss of monetary power.

Structure

The argument is established over the next six sections:

- In the *second section*, this paper frames the debate on illegitimate currency practices in the historical perspective. It describes the conflicted relationship between monetary sovereignty and international cooperation – and how the IMF's ability to safeguard monetary stability has continuously eroded since the Second Amendment.
- The *third section* provides a stocktaking of the legal framework for exchange rate surveillance – illustrating the legal provisions established in 1978 to govern the members of the IMF in their currency policies and the reform of bilateral surveillance in 2007.
- The *fourth section* applies the concept of legalization to analyze the 2007 reform. Rooted in rational institutionalism, legalization argues that self-interested states will choose harder legal rules to solve collective action problems. By comparing the two bilateral surveillance regimes in terms of obligation, delegation and precision, this section finds that hardening the law on exchange rates has proved difficult. In particular, increasing the precision level appears an impediment to exchange rate surveillance.
- The *fifth section* substantiates the findings of the previous section by showing surveillance in practice with the "hard case" of China. Retracing the IMF's Art. IV consultations with Beijing before and after the 2007 reform, it illustrates the challenges involved in monitoring the exchange rate of a large economy.
- The *sixth section* explains the choice for the soft legalization of exchange rates. Facing a number of sovereignty costs and uncertainty costs, the international community decided against harder legal rules. The section concludes that hard rules are unlikely to characterise the international monetary system in the years to come.
- The *seventh* section explores the future of bilateral surveillance. By discussing the social constructivist perspective of the IMF and the Fund's track record as a setter of voluntary standards, it argues that instead of pursuing harder legalization the Fund should capitalise on its unique regulatory capabilities to overcome the stalemate in the supervision of monetary conduct.

This timeline shows the research framework:

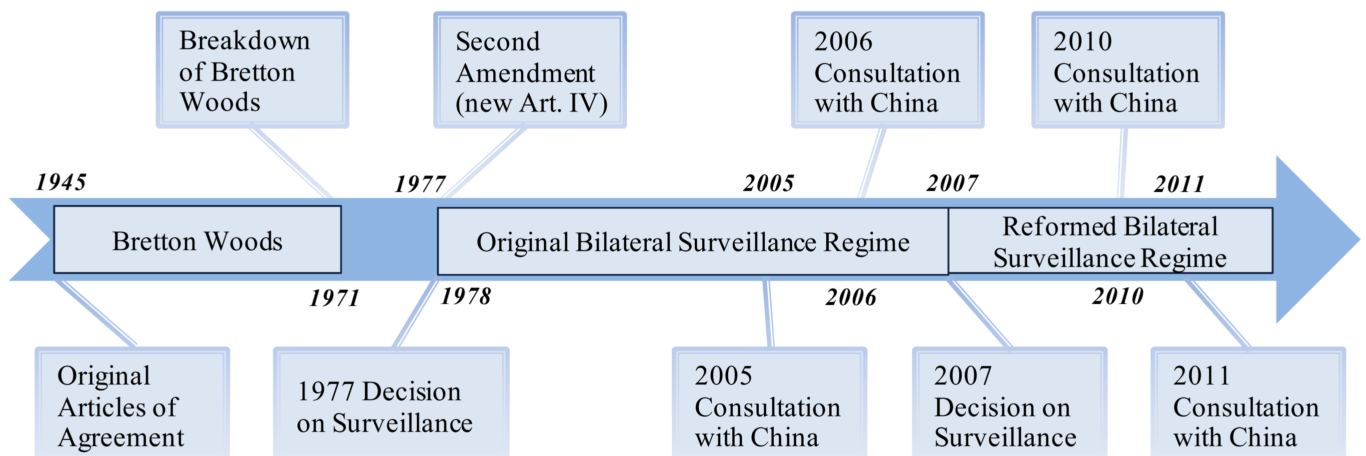

Figure 1: Timeline

Existing research

The different academic disciplines used in this paper offer a heterogeneous view in terms of existing literature. While there is an abundance of economic research on exchange rates, the same cannot be said for legal and political treatments. From the perspective of IL, "few books are available that deal with the legal framework underlying international monetary stability" (Thieffry 2008: 267).[7] Gilles Thieffry blames this scarcity on the fact that "when dealing with this topic, it is difficult to avoid economics and politics, two subjects many lawyers avoid" (Thieffry 2008: 267). Scholars of IR also long ignored the subject for two reasons: exchange rates were deemed "too technical and too remote from the concerns of either the mass public or special interests" and there was a "tedious predictability of currency values under the Bretton Woods system [which] lulled most scholars into inattention" (Broz/Frieden 2002: 317). This changed only with the numerous currency crises in the 1980s. Since the 1990s, international monetary relations have become "extremely prominent in practice" – not least due to the crisis in Southeast Asia and the creation of the euro (Broz/Frieden 2002: 318). However, most research on the international monetary system and the IMF focuses on issues of conditionality and legitimacy, while exchange rate surveillance of non-borrowing countries receives scant attention. Nevertheless, this paper seeks – in drawing from all disciplines – to shed some light on a fascinating and highly relevant subject.

[7] The most important treaties on the international law of money are Lowenfeld 2008, Lastra 2006 (focusing on the public aspect) and Proctor 2005 (focusing on the private aspect). The scholar of reference on the law of exchange rates is Joseph Gold, in particular Gold 1988. The best source for a history of the IMF are the Fund's own historians, such as Boughton 2001. The political economy of exchange rates is explored by Eichengreen 2008, Kirshner 1997 and Cohen 2010. For the issue of currency manipulation, the most pertinent articles are Herrmann 2010, Mercurio/Leung 2009 and Mussa 2007. Further references and reading suggestions are included in the relevant sections.

2. The role of law in monetary affairs

In the international monetary system – "the glue that binds national economies together" (Eichengreen 2008: 1) –, two legal principles collide. On the one hand states enjoy a high degree of sovereignty in their monetary policies.[8] Premier Wen Jiabao refers to China's "fundamental right to determine [its] own exchange rate" (quoted by Mussa 2007: 8). Even critics of China concede that maintaining a currency regime of its choice is a "legitimate matter of national sovereignty" (Goldstein 2005: 6). On the other, states are bound in their monetary policies by IL and the obligations it enjoins on them.

Even though the focus of this paper lies on the legal regime created in 1978, exchange rate surveillance needs to be appreciated in light of the demise of the highly legalized Bretton Woods system. This section shows how the evolution of the international monetary system heralded the revival of monetary sovereignty.

2.1 The principle of monetary sovereignty

Historically, control over money has long been considered essential to the notion of national sovereignty.[9] Monetary sovereignty goes back to the exclusive right of coinage enjoyed by central governments which put an end to the coexistence of different currencies in circulation (Baltensperger/Cottier 2010: 913). For symbolic and economic reasons, the emergence of national currencies was closely related to the formation of the nation state (Herrmann 2010: 38). Today, monetary affairs, next to taxation, amount to "one of the last and most solid bastions of national sovereignty" (Baltensperger/Cottier 2010: 912).[10] Even an ardent critic of state interference like Milton Friedman concedes that "there is probably no other area of economic activity with respect to which government intervention has been so uniformly accepted" (Friedman 1960: 8).

IL honours the fact that "the issue of a currency is an inherently national and sovereign act" (Proctor 2006: 1336). In a seminal ruling, the Permanent Court of International Justice stated in 1929 that "it is indeed a generally accepted principle that a State is entitled to regulate its

[8] In this section, sovereignty is defined in legal terms: "The right of a country to take decisions without the necessity for the consent of another country" (Gold 1988: 3). Note that definitions of sovereignty differ considerably between legal understandings and political or economic concepts. Critics denouncing the "waning of monetary sovereignty" (Treves 2000: 112) due to the influence of global capital markets refer to factual independence, not legal independence (Herrmann 2007: 5). Factual sovereignty costs will be explored in section 6.

[9] Lastra traces monetary sovereignty back to the writings of Machiavelli, Bodin and Hobbes (Lastra 2006: 6).

[10] The notable exception being the euro zone where 16 states have transferred their monetary rights to the European Central Bank. Lastra calls this "the most clear example of consensual limitation of monetary sovereignty" (Lastra 2006: 27).

own currency" (PCIJ 1929: 34). The currency to which a reference may be made in contracts is solely described by the law of the state, the "lex monetae" (Herrmann 2007: 3). This accords with domestic rulings which have confirmed that money, like tariffs and taxation, falls within the domestic jurisdiction of individual states – "a right to which other states cannot object" (Proctor 2005: 500).[11]

In practice, monetary sovereignty establishes three rights for the national legislator: to issue currency that is legal tender within its territory; to determine the value of that currency; and to regulate the use of any currency within its territory (Gianviti 2006: 4). These tasks are usually carried out by a central bank with the privilege of issuing national banknotes as well as creating and holding monetary reserves (Proctor 2005: 57). Importantly, the scope of monetary sovereignty is both internal, as regards the operation of national monetary policy, and external, as regards exchange arrangements vis-à-vis other currencies (Hermann 2010: 39).[12]

2.2 The need for cooperation in international monetary relations

Its domestic legislative remit notwithstanding, the exchange rate is an important price in the international economy. It expresses the relationship between the currencies of two countries and between its two economies – all goods, services and capital that move across national borders (Gold 1988: 1). Indeed, "for most countries, there is no single price which has such an important influence on both the financial world – in terms of asset values and rates of return, and on the real world – in terms of production, trade and employment" (Group of Thirty 1982: 10).

Like trade and investment, the two other dimensions of economic relations between states, monetary relations can take three shapes: cooperative, conflicting or non-existent. In the absence of isolationism, conflicts are unavoidable without cooperation (Lastra 2006: 346, footnote 2). It makes sense, therefore, that exchange rates should be subject to international agreement to avoid conflicts in the economic ties between states (Gold 1984: 1533).

[11] Such rulings include "The Emperor of Austria v. Day and Kossuth" by the English Court of Appeal in 1861 and "Juillard v. Greenmann" by the US Supreme Court in 1884 (Waibel 2010).

[12] As a legal concept, the notion of external monetary sovereignty is not without critics. The former IMF economist Michael Mussa calls it "nonsense" and "a logical absurdity" (Mussa 2007: 8). He argues that both nations must symmetrically possess the same sovereign right to set the exchange rate since it is a value between two currencies. However, Mussa confuses the "right" with the "manifestation" of the right (Mercurio/Leung 2009: 1269). The fact that a right of a nation conflicts with another's does not necessarily deprive both nations of their respective rights. The impossibility for both nations to achieve their respective desirable exchange rate is an insufficient limitation to negate the existence of the state's right to determine its currency.

In fact, international coordination of monetary policies has a long history (Baltensperger/Cottier 2010: 918). Central bank cooperation goes back to the 19th century (Lastra 2010: 345). And yet, the stability of the international monetary system until World War I "owed nothing to international legal agreements" (Simmons 2000a: 575).

Under the gold standard, countries linked their currencies to another and kept their reserves in gold or other currencies voluntarily.[13] Balance of payments adjustment occurred automatically, as long as countries played along to the "rules of the game" (Barnett/Finnemore 2004: 51). While the extent to which the central banks followed the rules is disputed, the "miracle of the gold standard somehow managed to successfully reconcile stable exchange rates with high capital mobility" (Eichengreen/Garcia 2006: 397). However, this monetary arrangement was plagued by high inflation and unemployment levels which put enormous strains on the domestic economies. When World War I broke out, the gold standard collapsed over night.

In the interwar period, the limits of informal monetary cooperation became apparent. The end of World War I heralded "monetary chaos" (Proctor 2006: 1336). Attempts to re-establish the gold standard failed (Lastra 2006: 349). As trade contracted sharply and unemployment surged, the major economies employed unilateral monetary devices to divert economic stress abroad: competitive devaluation, multiple exchange rates, trade restrictions, subsidies and controls of various kinds (Lowenfeld 2008: 598). By the end of World War II, the international community came to accept that "while a state must be able to control its own currency and has a vital interest in its external value, the exchange value of the currency can also significantly affect the interests of other members" (Proctor 2006: 1336).

In order to avoid competitive currency depreciation, there was a need for "consensual rules to guide the re-opening of national payments systems and an institutional mechanism to monitor those rules and encourage monetary cooperation" (Pauly 2006a: 1). The view prevailed that a "free-for-all" exchange rate system would allow large nations to exploit their power at the expense of smaller nations and that individual nations would pursue objectives not consistent with one another (Cooper 1975: 65). Never again were the monetary aberrations of the 1930s to be repeated. Rather, the states stood to gain reduced currency volatility, stability of domestic monetary conditions and the reduction of international trade conflicts (Broz/Frieden 2002: 337).

[13] The international gold standard was a monetary arrangement between roughly 1870 and 1914. Currencies were fixed in their value against gold and central banks vowed to exchange currency for a set parity (Lastra 2006: 348).

2.3 Limiting monetary sovereignty: the Articles of Agreement

The institutional answer to the need for monetary cooperation was the creation of the IMF. When the Articles of Agreement came into force in 1945, an international legal regime governed the monetary conduct of states for the first time (Lowenfeld 2008: 576).[14] Up to that point, there existed no multilateral treaty and virtually no customary international law in relation to exchange rates (Gold 1988: 2). Like activities on the sea and diplomatic relations among states, money became subject to the broader norms and principles of IL (Simmons 2000a: 578).

By joining the IMF's founding treaty, the members accepted its obligations and limited, to that extent, their monetary sovereignty. In exchange, they enjoyed the benefit of other members also limiting their sovereignty for the sake of international cooperation (Gianviti 2006: 3). Full monetary sovereignty now existed only in those countries that were not part of the IMF.[15] However, it must be noted that participation in the IMF remains voluntary. According to Art. XXVI:1, any member may withdraw from the Fund at any time. The rules of monetary conduct that arise from the Articles concern only the signatory states (Proctor 2005: 558) – and do not express universally binding duties.[16]

While their obligations appear modest today, the Articles of Agreement were a significant departure "in view of the jealousy with which states have traditionally guarded their monetary autonomy" (Pauly 1997: 11). And yet, although the authority over exchange rates granted to the Fund was "unprecedented" (Gold 1988: 48), its influence as a monetary institution today looks quite different from what the founders set out to create in 1945. The rise and fall of the IMF as a monetary institution helps to explain the softness that has characterised the law on exchange rates since the collapse of the Bretton Woods system.[17]

2.3.1 Unprecedented legality: 1945 to 1971

The Bretton Woods conference saw the creation of two major financial organisations. But unlike the World Bank, the IMF was not planned as a development agency (Leckow 2008:

[14] Other monetary "law-setters" include the World Bank and its affiliates, the Bank for International Settlements, the Paris Club, the Group of Ten, the Group of Seven and related groups. An overview in: Lowenfeld 2008: 749.

[15] The IMF currently has 187 members (as of June 2011). The member list is available online: <http://www.imf.org/external/np/sec/memdir/members.aspx>.

[16] "A treaty does not create either obligations or rights for a third State without its consent", Art. 34 of the Vienna Convention on the Law of Treaties, 1969.

[17] When did the Bretton Woods system end? *De facto*, the day US President Richard Nixon terminated the Gold parity in 1971. *De jure*, with the Second Amendment in 1978 (Lastra 2006: 29).

286). Against the backdrop of the Great Depression and its monetary woes, the Fund was designed to sustain a peaceful political order by fostering international trade and macroeconomic stability (Dodge 2006: 1). Its objective was "the maintenance of fixed, unitary, and non-discriminatory exchange rates that carried the endorsement of the international community as expressed in decisions of the IMF" (Gold 1984: 1536).

The par value system at the heart of the original Art. IV was an attempt to combine stability and elasticity – the advantages of a system of fixed exchange rates with that of flexible rates without the disadvantages of either (Rittberger/Zangl 2006: 160). While the value of their currencies was determined by market forces, the members agreed to maintain their currency at an agreed par value which was fixed but adaptable on request. To a degree, the system was self-enforcing. The Fund's role was to monitor the orderly adjustment of the balance of payments and to assist a member with temporary loans if it needed funds to finance necessary interventions.[18]

Moreover, the Articles restricted the movement of international capital flows to insulate the national capital markets. In 1945, it was understood that "sharp changes in capital flows were costly. Changes in capital flows can induce changes in trade flows. And to bring about large changes in trade flows often requires not only a reallocation of resources, but also in some cases sharp falls in national output" (King 2006: 4). Therefore, the convertibility requirement of the Articles foresaw only convertibility in the current account, while "the architects of Bretton Woods essentially took for granted the indefinite maintenance of capital controls" (Eichengreen/Garcia 2006: 397).

In practice, the system worked well only for a few years. It came fully into effect only when the European members achieved full convertibility around 1960. And even then, the system was only partially adhered to. Some members preferred to violate their obligations for their national benefit.[19] However, the members "never abandoned the idea that they remained bound by a legal duty to collaborate on exchange rate matters" (Pauly 2006a: 3).

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[18] Specifically, Art. IV of the original Articles established a parity of 1 USD = 0,888671 g of fine gold, while all other currencies were pegged to a certain amount of gold and, thereby, to the USD. From this par value, countries were allowed to deviate by up to 1 per cent up or down (Proctor 2006: 1337). According to Art. IV:5 of the original Articles, changes to the par of exchange were allowed only in case of "fundamental disequilibrium" – a term not defined on purpose, understood to mean a situation not correctable within the time for which resources of the Fund would be made available to members (Lowenfeld 2008: 623).

[19] When the IMF issued its last "Schedule of Par Values" on 15 March 1971, 83 of 117 members had established a par value in accordance to their obligations (Gold 1984: 1551). Among the developed members, only Canada – for many years – and Germany and the Netherlands – occasionally – were in breach of their obligations by letting their currencies float (Simmons 2000a: 579).

The greatest challenge to the par value system appeared in the late 1960s. With the increase in unregulated capital flows, governments lost their ability to maintain stable exchange rates (Rittberger/Zangl 2006: 161). Experience showed that to have sufficient bite, capital controls needed to be so tough that they harmed trade financing (Andrews/Willett 1997: 483). The fixed exchange-rate mechanism offered the markets a one-way speculative bet. The last of the fifteen changes in the par values of the members of the Organisation for European Economic Cooperation (OEEC) took place in 1961, as governments "consciously tried to avoid exchange-rate changes" (Schaefer 2006: 202).

The crumbling faith in the par value system showed that the balance of payments adjustment process was not working smoothly. In the face of enormous war costs and a deteriorating competitive position, the US lost its willingness to "run a large trade deficit to ensure liquidity in the international monetary system, to promise to convert foreign-held dollar reserves into gold and to pursue anti-inflationary policies to keep the exchange rate system stable" (Schaefer 2006: 201). On 15 August 1971, US President Richard Nixon terminated gold convertibility and decided to float the rate of the USD (Lowenfeld 2008: 625).

2.3.2 Reforming the Articles: 1971 to 1978

In 1971, the IMF, the US and the nervous leaders of Western Europe "tried to pick up the pieces and repair the system, each looking to the others to take the painful decisions of currency devaluation or revaluation" (Lowenfeld 1983: 388). The Smithsonian Agreement, established on 18 December 1971 and hailed by US President Nixon as "the most significant monetary agreement in the history of the world" (quoted in Lowenfeld 1983: 389), proved unsustainable in economic and legal terms. Described as a "par value system on life support" (Lowenfeld 2010: 582), a system of fixed exchange rates with wider margins no longer served the interests of the large economies. While the IMF was not finished – most of the original Agreement remained relevant –, its legal exchange rate regime appeared painfully obsolete.

However, many states wished to "return to legality" by amending the Articles of Agreement to reflect the reality of floating exchange rates (Lowenfeld 2008: 631). When the US took the lead in trying to restore international monetary legality, France favoured a return to fixed exchange rates under a rule-based system (Pauly 2006a: 10). By contrast, the US wished to create a flexible regime that would "foster adjustment through regular consultations but allow individual countries themselves to create the conditions for attaining domestic macroeconom-

ic objectives" (Lombardi/Woods 2007: 7). They regarded the markets as sufficient in size, strength and scope to determine exchange rates (Gold 1988: 7).

In the end, the US got its way. Nonetheless, it agreed on maintaining a "stable system of exchange rates" to appease France (Pauly 2006a: 12). At its first meeting ever in November 1975 in Rambouillet, the G-7 set the course for the formal amendment process of the Articles. Its declaration expressed the intention to "counter disorderly market conditions, or erratic fluctuations, in exchange rates" (G-7 1975: N. 11). The Second Amendment, now officially allowing the free choice of exchange arrangements, came into force on 1 April 1978.

2.3.3 Back to sovereignty: 1978 onwards

For the IMF, this was a mixed outcome. On the one hand, the international monetary system returned to legality after seven years of uncertainty. On the other, the Fund had little say in the new arrangement. Critics regarded the Second Amendment as an "adaptation of the legal regime to the actual state of affairs (in particular with regard to floating exchange rates) and not in any real sense a cure or even a prescription for a cure of the system's ills" (Lowenfeld 1983: 394).

In legal terms, the Second Amendment marked a radical change for the IMF. Though the Fund maintained its responsibility to provide international liquidity as well as technical assistance, it lost its importance in monetary affairs as authority shifted back to the members. The new Art. IV abolished the par value system, deprived gold of its former monetary role and established a system of floating currencies. Indeed, upon leaving the gold standard and fixed exchange rates, "there was very little left for a regulatory and legal approach to monetary affairs" (Baltensperger/Cottier 2010: 927). This prompted the economist Robert Triffin to call the amended Articles "more worthy of a slapstick comedy than of a solemn treaty defining a new international monetary system" (Triffin 1976: 45). International lawyers were uncertain what to make of the new rules. In a review of a book on the new legal arrangement (*Rules of the Game* by Kenneth Dam), Andreas Lowenfeld wondered

> what Professor Dam would come up with as rules of the international monetary game. I have been anxiously looking around for sources of black-letter law – for rules, in other words, as contrasted with factors, considerations, or illustrations. The game is still there, but the rules are more elusive than ever (Lowenfeld 1983: 380).

However, the members – bearing in mind the need for international cooperation – did not deprive the Fund completely of its responsibilities for the international monetary system. There was no intention to go back to the days of monetary anarchy. In a "remarkable acknowledge-

ment of the principle that exchange rates should be regulated by international law" (Gold 1988: 7), the members tasked the IMF with two new functions which, on paper, expanded its role as a monetary institution: overseeing the international monetary system in Art. IV:3(a) and monitoring national exchange rate policies by way of "firm surveillance" in Art. IV:3(b).

The new responsibilities put the Fund in a difficult situation. The members had taken back their sovereignty, and at the same time refused to provide the IMF with the necessary instruments to fulfil its new task. This "contradictory element" (Lombardi/Woods 2007: 7), not yet resolved by the IMF membership, characterises the vagueness of the IL on monetary conduct to this day. In a more positive reading, Louis Pauly interprets this development as a "continuing attempt by the Fund's most powerful member-states to find the golden mean [...] between binding monetary rules and unbridled national discretion"; the "normative quest" for cooperation, he claims, "survives unbroken since 1944" (Pauly 2006a: 1).

2.4 The IMF in today's international monetary system

After World War II, a powerful IMF seemed the right response to the turmoil of the interwar years. Since 1945, however, the environment the IMF was supposed to regulate changed markedly. Due to tectonic shifts in the international monetary system, the member no longer believed that a highly legalized IMF would serve their interests. Four developments in particular have challenged the IMF's ability to preserve monetary stability.

First, the prevalence of money with no inherent value (called fiat money). After Nixon had severed the link between currencies and a commodity, money lost its inherent value. The members were free to circulate money in the form of irredeemable debt obligations, thereby greatly increasing their national monetary autonomy (Steil 2007: 203). While instrumental for advancing growth and the flexibility of domestic monetary policy, this change paved the way for an increased volatility of the international monetary system.

Second, the dominance of the dollar. Contrary to what the abolition of an officially dollar-based system might suggest, "the demise of the Bretton Woods arrangements actually implied transition to a full dollar-based global economy, with the advantage that the United States had no commitments on gold convertibility" (Pattainak 2007: 316). Decades after the former French President Valéry Giscard d'Estaing denounced the "exorbitant privilege" the US had in providing the global reserve currency, the world turned to the dollar for stability and liquid-

ity.[20] In 2009, the USD was still used in 86 per cent of foreign exchange transactions and in 63 per cent of foreign reserves (McKinsey Global Institute 2009: 14). By contrast, the IMF's international reserve asset (called SDR) failed to find acceptance – which is unlikely to change in the upcoming multipolar reserve system (Eichengreen 2011b).

Third, the fragmentation of exchange arrangements. The end of the obligation to peg saw a variety of exchange regimes evolve. To enjoy the flexibility that comes with a floating exchange rate, most developed countries abandoned their pegs, whereas many developing economies continued to link their currency to the USD or currency baskets to maintain currency stability. The appearance of currency unions further hampered the IMF's task. As of 2009, the IMF members operate 29 hard pegs, 78 soft pegs, and 75 floating rates; in total, the IMF recognises nine different exchange arrangements (IMF Revised Classification 2009: 4).

Finally, the rise of financial markets. With the gradual opening up of the capital account, financial markets became larger and deeper, in many cases dwarfing official flows (Dodge 2006: 3). Between 1980 and 2007, cross-border capital flows grew at an annual rate of 13 per cent, from 0.4 to 10.9 trillion USD (McKinsey Global Institute 2011: 27). Countries could now finance large and long-lived current account deficits and surpluses through the markets without turning to the IMF (Mussa 2007: 37). The members lost their main incentive for listening to the Fund: where pegged exchange rates once served as the "main transmission belt for responsive policy actions, now-burgeoning international capital markets increasingly provided the actual stimulus for adjustment" (Pauly 2006a: 9). In addition, capital mobility undermined the efficiency of exchange rate management by eroding capital controls and increasing the cost of central bank interventions.

In combination, flexible exchange rates, independent monetary policies and easy borrowing from booming markets produced a "combustible mix" (Pauly 2009: 959) which limited the influence of the IMF. As more and more states enjoyed the fruits of monetary independence, the practice of bilateral surveillance bore little resemblance to the vision set out in the Second Amendment. Far from overseeing all members equally, the Fund's sway was restricted to countries it could impose its conditions on – which made the IMF's involvement highly contentious. After its alleged mishandling of a number of currency crises, many observers criti-

[20] The quote, often misattributed to Charles de Gaulle, was coined in the 1960s by d'Estaing who served as France's finance minister. The criticism found widespread public resonance after Robert Triffin identified the structural unsustainability of the dollar's role as an international reserve currency, the so-called Triffin Dilemma (Subacchi 2010: 4, footnote 9).

cised what was seen as an attempt to "strong-arm countries into conformity with dominant behavioural norms" (Pauly 1997: 10).[21]

As a result, the responsibility for the international monetary system slipped away from the Fund. Instead, the major economies took monetary affairs into their own hands. Domestically, they established new mechanisms for constraining monetary policy, such as independent central banks and inflation targets (Walter 2010a: 16). In the international realm, they set up new institutions like the G-7 to coordinate their monetary and exchange rate policies. Thereby, "monetary policy was effectively freed from indirect multilateral constraint" (Walter 2010a: 16). Although it was initially understood that the IMF would cooperate with the new institutions, a division of labour emerged. In agreements like the Plaza Accord in 1985 and the Louvre Accord in 1987, the major economies focused on the valuation of the dollar, while the IMF was reduced to a provider of information.[22] The responsibility to signal necessary balance of payments adjustments shifted from the IMF to cross-border financial markets.

At the turn of the century, this left the Fund in a dire state. While the IMF was forced to cut staff, developing countries started to amass large reserve holdings to insulate against its intervention. If not in "a deep slumber", the Fund appeared "drowsy" and its mandate "obscure" (King 2006: 3). In early 2008, the US was considering if the IMF was worth keeping, "with the weight point toward no" (Griesgraber 2009: 179). It took the impact of the global financial crisis to put the IMF back on the map as the G-20 endowed the Fund with a renewed mandate to oversee systemic stability (G-20 2008: N. 89). Nonetheless, macroeconomic policy coordination "remained both necessary in principle and elusive in practice" (Pauly 2009: 960).

To sum up, the Second Amendment reversed the high degree of legality of the Bretton Woods arrangement. However, the chaos of the interwar period had left its mark. The members still wanted the IMF to oversee their monetary conduct and the international monetary system – without endowing it with the necessary powers. This put the Fund in a conflicting position. It was still supposed to police its members, regardless of their economic conditions. But as the world's major economies had regained their monetary sovereignty, its effective mandate became unclear.

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[21] The most prominent critic of the IMF is Joseph Stiglitz, former chief economist of the World Bank, who accused the Fund of damaging crisis-hit countries through the relentless promotion of the "Washington Consensus" (fiscal discipline, privatization, etc.) (Stiglitz 2002). The IMF's former chief economist Kenneth Rogoff dismissed Stiglitz's accusations as "slander" (Rogoff 2002).

[22] The regard in which the G-7 held the IMF is symbolically demonstrated by the fact that the Managing Director had to leave the meeting of the finance ministers after giving a presentation about the state of the world economy (Lombardi/Woods 2007: 8).

3. Bilateral surveillance of exchange rate policies

The overall objective of the IMF – to promote international monetary and financial stability – never changed.[23] What did change, however, was the IMF's role after the breakdown of the Bretton Woods system. In total, the Articles establish three powers for the Fund:

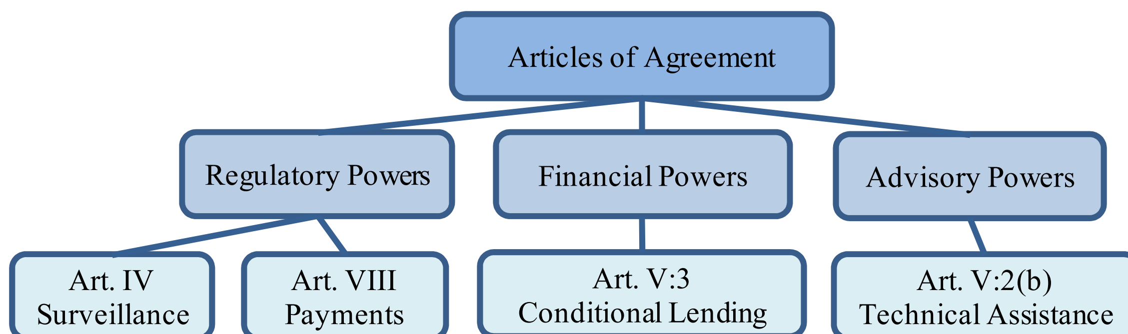

Figure 2: Powers of the Fund

In the first decades of its existence, the Fund performed primarily a regulatory function. Its tasks revolved more and more around its financial and advisory powers only after the Second Amendment in response to periods of instability triggered by the growth in private capital flows (Hagan 2010b: 41). However, the drastic transformation of the regulatory function did not affect the first regulatory power, the jurisdiction over international payments to make currencies convertible (Art. VIII), which remained unchanged. The novelty was the second regulatory power, surveillance, which replaced the par value system set out in the original Art. IV. Specifically, the new Art. IV provided the Fund with two instruments for overseeing domestic and international monetary affairs: bilateral and multilateral surveillance of exchange rate policies (Hagan 2010a: 957).

IMF surveillance has two principal goals (Boughton 2001: 136). The first is to "identify and discuss differences in interests and perspectives between the country and the international community". The second is to "examine economic developments and prospects objectively, abstracting as much as possible from political goals and constraints". To achieve these diverse objectives, the Fund produces a number of surveillance documents, ranging from the World Economic Outlook (WEO), a survey published twice a year about global economic developments, to Global Financial Stability Reports (GFSR), semi-annual assessments of global fi-

[23] In total, the Fund has six purposes listed in Art. I: (i) international monetary cooperation; (ii) expansion and balanced growth of international trade; (iii) exchange stability, orderly exchange arrangements and the avoidance of competitive exchange depreciation; (iv) the establishment of a multilateral system of payments; (v) making the general resources of the Fund temporarily available to the members; and (vi) lessen the degree of disequilibrium in the international balances of payments.

nancial markets. Like the Fund's more public functions of financial and technical assistance, they are almost all voluntary, although the Fund might link financial assistance to the fulfilment of specific objectives set out in a report. Figure 3 shows how the publications[24] vary in spatial focus, legal obligation and subject matter:

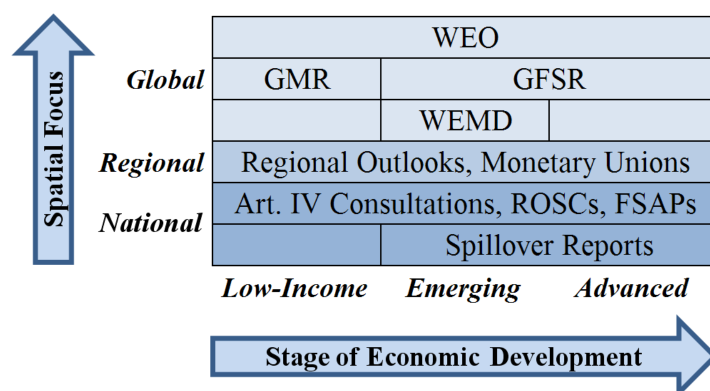

Figure 3: Surveillance Instruments

Only one vehicle of surveillance is mandatory across the entire membership: bilateral Art. IV consultations which differ considerably from other economic reports produced by private or public institutions due to their legal quality. Bilateral surveillance is a *jurisdictional* function that involves a degree of discretion on part of the Fund (Lastra 2006: 399).

Originally, Art. IV consultations were carried out during the Bretton Woods years to monitor progress on current account convertibility. Since the Second Amendment, they evolved into a full-fledged assessment of the macroeconomic policies of a member in light of his obligations stemming from the Articles. The function of Art. IV surveillance can best be explained with a metaphor in which Louis Pauly compares the supervision of global finance with the construction of a house:

> Constructively interacting national macroeconomic policies are the foundations, and a modicum of convergence in national regulatory standards is the plumbing. Central bankers, bank supervisors, securities regulators, and accounting standards boards have a large role to play in reinforcing the plumbing. All of their work is for nothing, however, if the central organs of government responsible for macroeconomic policy in an expanding array of powerful states move in distinctly different directions. Such a movement would crack the foundations of 'global' finance, and no superior exists to fix it (Pauly 1997: 142).

3.1 The original bilateral surveillance regime

To put bilateral surveillance into practice, the members agreed on a number of rules to guide both themselves in their policies and the Fund in its supervision. The resulting legal arrange-

[24] For an explanation of all IMF publications refer to <http://www.imf.org/external/pubs/pubs/per.htm>.

ment (what is referred to as the "bilateral surveillance regime" in this paper, see the overview in Appendix 2 in section 9.1) consists of three parts: the amended Art. IV called "Obligations Regarding Exchange Arrangements" which replaced the original Art. IV; a decision by the Executive Board which makes the provisions of Art. IV operable; and Art. XXVI which contains the theoretical enforcement mechanisms of the Fund.

This section takes a closer look at the original surveillance regime which governed Art. IV consultations between 1978 and 2007. While only descriptive in nature, it is necessary for the application of the legalization concept in section 4. For readability's sake, the legal quotes are kept to a minimum. The complete legal provisions are reprinted in section 9.3.

3.1.1 The amended Article IV

The amended Art. IV contains the principal obligations for both the members and Fund regarding exchange rates. It is the key provision in ensuring the stability of the global exchange rate system. Unless the Articles are amended again, it applies to all members, at all times, whatever their exchange arrangements may be (Gold 1988: 89). In order to achieve a "stable system of exchange rates", it sets out three objectives: a member should not resist an adjustment required by underlying conditions; its domestic policies should foster economic and financial stability; and it should avoid policies designed to interfere with the adjustment process or gain an unfair competitive advantage (IMF Legal Framework 2006: N. 3).

Most pertinent to the bilateral surveillance of exchange rates are three provisions: the free choice of exchange arrangement, Art. IV:2(b); general obligations of members, Art. IV:1; and surveillance over exchange arrangements, Art. IV:3. They are discussed in this order because a legitimate exchange arrangement (peg or float) is the precondition for legitimate exchange rate policies (the actual policy decisions).

a) Free Choice of Exchange Arrangement, Art. IV:2(b)

The main reason why the par value system collapsed was the desire of the major economies to regain freedom over their currency decisions. In consequence, the amended Art. IV concedes considerable autonomy to the members in regard to their exchange arrangement.[25] As per Art. IV:2(b) of the Articles, the only prohibited arrangement is a peg to gold, reflecting the intention of the Second Amendment to reduce the role of gold in the international monetary system

[25] Note that Art. IV:2 refers to "exchange rate arrangements" (meaning the broad classification or framework of the member's exchange system) whereas Art. IV:1 speaks of "exchange rate policies" (meaning the specific actions or inactions of members in the operation of their exchange arrangement). Unfortunately, Art. IV is not consistent in the use of its terminology. See the glossary for definitions and Gold 1988: 113.

(IMF Legal Framework 2006: N. 11). All other exchange rate systems established by IMF members are allowed, from choosing a foreign currency as legal tender to currency board arrangements and from fixed to floating exchange rates (Herrmann 2010: 40).

However, this freedom is not unlimited. Lowenfeld points out that Art. IV:2(b) does not mean no rule at all (Lowenfeld 2008: 634). Art. IV:2(b) cannot be read in isolation, it must be considered in light of the other provisions of the Articles, specifically the obligations imposed on the members by Art. IV:1. Therefore, a member's exchange arrangement is only permitted as long as it does not breach its other obligations under the Articles (IMF Legal Framework 2006: N. 13).[26]

b) Obligations of members, Art. IV:1

Establishing the obligations in regard to exchange rate policies, Art. IV:1 is considered the most complex of the Fund's provisions (IMF Legal Framework 2006: N. 16). It consists of three parts: the preamble and a general obligation as well as four specific obligations. Out of these, exchange rate manipulation deserves closer scrutiny.

aa) Preamble and general obligation

While containing no obligations, this section of Art. IV:1 provides a framework for the following, more specific obligations. By setting forth the "purpose" and "objective" of the international monetary system, the preamble identifies the broader economic benefits of Art. IV:1. The assumption is that adherence to its obligations enhances the functioning of the international monetary system (IMF Legal Framework 2006: N. 17). Importantly, the preamble speaks of the purposes of the international monetary system, not of the Fund. This reflects the shift in objective from achieving a stable exchange rate to achieving a stable exchange rate system. The function of the preamble is to assist the interpretation of the obligations regarding exchange rate arrangements (Mercurio/Leung 2009: 1271-1272).

The same applies to the general obligation to "collaborate" with the Fund. This provision stresses the collaborative nature of the surveillance relationship from the very beginning (IMF Further Considerations 2007: N. 29), whereas the degree of collaboration necessary to satisfy the general obligations remains vague (Mercurio/Leung 2009: 1273).

[26] A special case is the unilateral peg to another country's currency. As previously discussed, Michael Mussa claims that the issuing state should have the right to object to this kind of arrangement (Mussa 2007: 8). Charles Proctor argues that, Art. IV:2(b) notwithstanding, international law does not confirm this view. While Art. II:7 of the Charter of the United Nations enjoins states from intervening in the affairs of other states, a peg does not deprive the state intervened against of control over the matter in question. Therefore, a peg constitutes an *interference*, but not an *intervention* (Proctor 2005: 567-568).

bb) Specific obligations

The four specific obligations of Art. IV:1 differ considerably in scope and bindingness. In particular, each member shall

> (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
>
> (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
>
> (iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
>
> (iv) follow exchange policies compatible with the undertakings under this Section.

The obligations (i) and (ii) are positive in character. Formulated in soft terms, they are "more hortatory than peremptory" (Gold 1984: 1542), as opposed to the negative obligations in (iii) and (iv), arguably considered "hard obligations". This difference goes back to the Fund's juridical scope, which is greater in external policies than in domestic ones (Lastra 2010: 7). The formulation of the obligations was driven by the fact that "members should not have to give up a significant degree of sovereignty with respect to policies that, while they may have an international impact, are of domestic nature" (IMF Legal Framework 2006: N. 3).

The choice of verbs (*endeavour, seek to promote, fostering, follow*) illustrates the "labour pains" of the origins of this provision (Lastra 2010: 8). This is particularly the case with (i) and (ii). According to Edwards, "public statements of U.S. and French officials involved in the drafting of the new Art. IV indicate that neither in their preparatory work nor during the negotiations did they develop concrete examples of conduct that would be treated as violating subsections (i) and (ii)" (Edwards 1976: 737). Similarly confusing is obligation (iv). As the IMF recalls, at the time of its adoption there was uncertainty as to its meaning. There is no evidence whether "exchange policies" are broader than "exchange rate policies" and how this provision was to supplement the other obligations (IMF Legal Framework 2006: N. 35-37).

Hence, the bindingness of (i), (ii) and (iv) is disputed. Proctor asserts that "it is only necessary to read these provisions in order to realise that they do not create any obligations of a character which are meaningful in law" (Proctor 2005: 62). He considers the entire Art. IV:1 of very limited legal content, "aspirational, rather than legally enforceable" (Proctor 2006: 1338). Gold agrees that while technically binding obligations, the softness of (i) and (ii) makes it impossible to find that a violation of them has occurred (Gold 1988: 105).

cc) Exchange rate manipulation

The most specific and arguably most binding obligation is (iii). However, the concepts and definitions at its heart are highly problematic. What actions constitute currency "manipulation", the existence of which is itself called into question? A full discussion of these matters, particularly in economic terms, will be presented in relation to China's policies in section 5. For now, the focus lies on the legal problems that arise.

One of the main difficulties in defining manipulation is that intervention itself is common in the international monetary system. Semantically, "manipulation" means to manage or influence by exercise of one's abilities or skills (Edwards 1976: 743). It does not inherently carry a negative connotation. Whether it is good or bad depends on its objectives and effects. Since most countries manage their exchange arrangements to some degree, on the grounds of too broad a definition "virtually all countries could be considered to be 'manipulating' their exchange rates almost all of the time" (Mussa 2007: 13).

The clearest evidence of exchange rate manipulation is a "disproportionately large devaluation designed to secure a competitive advantage over neighbouring states with no broader objective in view" (Proctor 2005: 573) – such as Sweden's one-time devaluation of 16 percent in 1982 (Lowenfeld 2008: 635). Most examples, however, are not that clear-cut. When China maintained a stable exchange rate during the Asian crisis in 1997-8, its action was judged positively, as it had not sought to gain an unfair competitive advantage (Mercurio/Leung 2009: 1280). Five years later, similar policies sparked harsh criticism.

Ultimately, three questions must be answered (Gold 1988: 109): is an active behaviour on the part of the alleged manipulator required? Is a movement of the exchange rate necessary? And which role do the intentions of a country play?

In response to these difficulties, Art. IV:1(iii) divides manipulation into two elements. To establish a breach of its obligations, a member must fulfil an objective element ("manipulation") and a subjective element ("in order to" achieve one of two reprehensible goals) (Herrmann 2010: 41). Admittedly, this is not of much help, as "manipulation" and "unfair competitive advantage" still constitute nebulous terms. In addition, most of the problematic developments connected to exchange rates are the result of domestic policies, whereas Art. IV:1(iii) concerns external policies – and extending Art. IV:1(iii) to external policies would make (i) and (ii) superfluous (Gold 1988: 109).

The clarification of Art. IV:1(iii) by the IMF Legal Department is not helpful. There are, it says, “different ways” in which a member could manipulate its exchange rate – which “would not necessarily require that official intervention – whatever its form – result in the movement of the exchange rate” (IMF Legal Framework 2006: N. 34a). Bryan Mercurio and Celine Leung call this definition so broad it is “virtually unworkable” (Mercurio/Leung 2009: 1278).

c) Surveillance over exchange rate policies, Art. IV:3

Art. IV:3 is the legal basis for the Fund’s responsibility of surveilling the obligations of Art. IV:1. Surveillance is a “process of dialogue and persuasion centred on issues of external stability, covering exchange rate policies and relevant domestic policies” (IMF Further Considerations 2007: N. 2). It is intended to “help head off risks to international monetary and financial stability, alert the members to potential risks and vulnerabilities and advise them on needed policy adjustments” (IMF Surveillance Factsheet 2011: N. 1). In its structure, Art. IV:3 reflects the Fund’s dual oversight function – over the international system and individual member countries. Art. IV:3(a) is concerned with the international monetary system and establishes the basis for the Fund’s multilateral surveillance activities, albeit without bindingness. By contrast, Art. IV:3(b) lays the foundation for the bilateral surveillance of IMF members.

In principle, bilateral surveillance is a universal system of peer review and oversight (Lombardi/Woods 2008b: 2). According to Art. IV:3(b), all members must submit to surveillance, regardless of their exchange arrangement; they must all supply information and they must all enter into consultation with the Fund (Lowenfeld 2008: 637). These consultations, carried out at 12- to 18-month intervals, are at the core of the bilateral surveillance activity.[27] At the end of the consultation, the IMF mission produces a comprehensive report on the macroeconomic conditions, policies, and outlook of a member (Lavigne/Vasishtha 2009: 6). In their reports, IMF staff are expected to provide descriptions of the country’s exchange rate arrangement, an appraisal of its appropriateness with underlying policies and an assessment of the exchange rate level (Aylward 2007).

The schematic overview of the bilateral surveillance process in Appendix 3 in section 9.1 highlights three key takeaways:

- Art. IV consultations are bilateral – they are based on extended discussions with national policymakers whose views are given ample space in the published staff documents.

[27] Past Art. IV consultations can be accessed online: <http://www.imf.org/external/np/sec/aiv/indexc.htm>.

- There is no single Art. IV report by the IMF. Instead, various documents are produced by the staff and the Board which may reflect opposing views.
- Art. IV consultations work through a number of channels. There is direct contact with the national authorities, but also indirect effects on investors and the private sector – and other surveyed countries.

3.1.2 The 1977 Decision on exchange rate surveillance

In order to flesh out the provisions on bilateral surveillance, Art. IV:3(b) requires the Executive Board to draw up "principles" for bilateral surveillance. For this purpose, the 1977 Decision came into force with the Second Amendment on 1 April 1978 and served as the legal foundation for 30 years of IMF surveillance (Herrmann 2010: 42).[28]

To come to terms with the uncertainty of the new monetary system, principles had to be found to allow close surveillance irrespective of the members' exchange arrangements. This resulted in a "minimalist" approach to define surveillance that reflected the constraints faced at the time (IMF Preliminary Considerations 2006: N. 18).[29] Published shortly after the breakdown of the Bretton Woods system, the 1977 Decision focused exclusively on the surveillance over exchange policies (IMF PIN 07/69 2007).

The 1977 Decision contains two relevant provisions: general principles and principles for the guidance of members' exchange rate policies (PGMs) as well as principles for the guidance of the Fund (the "indicators").

a) General principles and PGMs

The general principles of the 1977 Decision posit that it is not necessarily comprehensive; subject to reconsideration in the light of experience and concerned directly only with Art. IV:3(b). The 1977 Decision then goes on to list the principles to which the members need to adhere to in their exchange rate policies, called PGMs in the parlance of the IMF.

Principle A simply repeats the provision of Art. IV:1(iii) against currency manipulation, as it was feared that any paraphrase might suggest more obligation than intended (Gold 1988:

[28] Regarded of high importance, the 1977 Decision was tentatively adopted before the Second Amendment on 29 April 1977 by the Executive Directors, subject to an approval at a later stage by the Interim Committee. It experienced some revisions, however only with respect to the procedures for surveillance. For the complete legislative history of the 1977 Decision see section 9.3.2 in the Appendix.

[29] Louis Pauly recalls the deep divisions that emerged on the design of the code of conduct that would make the amended Art. IV operative (Pauly 2006: 14). Three views came into conflict: the Fund pushed for a broad interpretation to revive the notion of prior consultation before exchange rate changes. Continental European members rejected consultations but called for the Fund to promote policy objectives and to take a view on the correctness of particular exchange rates. The US, Canada and the UK instead deferred to market forces and wanted the Fund to concentrate on the avoidance of manipulation. In the 1977 Decision, this view prevailed.

329). Principle B and C both deal with foreign exchange market intervention, which was understood to be the premier tool of exchange rate policy (Mussa 2007: 19). Principle B specifically addresses floaters, encouraging them to intervene for the stabilization of their exchange rate to avoid erratic exchange rate fluctuations. Of the three principles, this PGM has provoked the most debate and least agreement. It is formulated to avoid any implication of a "right" exchange rate (Gold 1983: 467). Principle C is again hortatory, urging the members to consider the impact of their interventions on other members.

From a legal point of view, the principles merely provide guidance. A member's neglect of a principle does not automatically constitute a breach of obligation – with the exception of Principle A which mirrors the obligation in Art. IV:1(iii) (Gold 1983: 455). For the other two principles, there is no evidence they ever actually constituted obligations (IMF Legal Framework 2006: N. 44).

b) Indicators

The third section of the 1977 Decision contains a number of developments that "might indicate the need for discussion with a member" if it pursues policies inconsistent with the obligations arising from Art. IV:1 (Lowenfeld 2008: 638). The purpose of these developments is to guide the Fund in its surveillance of exchange rate policies. Importantly, their interpretation is not intended to be mechanistic, but rather judgemental (Goldstein 2005: 3).[30] In other words, when indicators are triggered, it does not necessarily follow that a member is not observing a principle (IMF Further Considerations 2007: N. 53). Rather, it constitutes the first step to an enquiry by the IMF.

The indicators can be divided into two groups. The first four developments focus on *policies* that appear designed to engineer a misaligned exchange rate. The last two are concerned with *outcomes* suggesting the existence of exchange rate misalignment or balance of payment disequilibrium (IMF Further Considerations 2007: N. 55). However, Mussa finds it remarkable that they make explicit reference to the balance of payments only in the qualifying sense "for balance of payment purposes" in (ii), (iii a), (iii b) and (iv) and not at all in (v) and (vi). Similarly, there is only one reference to the exchange rate in (v) (Mussa 2007: 22).

Nevertheless, Lowenfeld regards the 1977 Decision as a significant expansion of the Fund's authority. The 1977 Decision, he argues, authorises the Managing Director to raise almost any

[30] This approach differs considerably from the original suggestion for the 1977 Decision by US representatives which foresaw "objective indicators" in the shape of "scattered changes to the level of a member's monetary reserves". These indicators would have created an obligation to adjust the balance of payments. However, the idea received little support from other governments (Gold 1984: 1533).

matter of the member's economic policy that has effect on its exchange rate or on the international economy (Lowenfeld 2008: 639).

In short, the original bilateral surveillance regime reflected the uncertainty of the years after Bretton Woods. Defended as political compromise, Art. IV is a "compound of obscure expressions" (Gold 1988: 112). While the 1977 Decision's scope appears sufficiently broad due to the indicators, its leverage is curtailed by the hesitant tone and the limited onus on the members. The only truly binding obligation – the avoidance of currency manipulation – is defined so vaguely it is basically impossible to enforce. But even though the legitimacy of the 1977 Decision as a basis for surveillance was called into question soon after its ratification, reform materialised only after 30 years.[31]

3.2 The reformed bilateral surveillance regime: the 2007 Decision

Reforming the rules for bilateral surveillance proved an arduous task. For two decades, reviews were restricted to minor and procedural provisions. While the G-8 called on the IMF to strengthen its monitoring role in 1999 (G-8 1999a), it took another six years until the then Managing Director Rodrigo De Rato launched his "Medium-Term Strategy" (MTS) to reform surveillance (Hagan 2010b: 41). The IMF lamented that the 1977 Decision "embodies only a small part of the best practices in surveillance", "discusses only as subset of members' policies covered by Art. IV" and "says virtually nothing about the role of the Fund in the conduct of surveillance" – which all in all led to a "striking gap" between its language and the reality of surveillance (IMF Further Considerations 2007: N. 3).

The IMF welcomed the adoption of the 2007 Decision on 15 June 2007 in boastful terms. The reform, it says, is the "culmination of a long and thorough effort to analyse gaps in the 1977 Decision, to distil the best practice of surveillance, and to crystallize a common vision of modern surveillance" (IMF PIN 07/69 2007). At first glance, this loftiness is surprising. The 2007 Decision resembles its lacklustre predecessor in many ways. Nonetheless, it contains some much-needed clarifications. First, the 2007 Decision introduces a new PGM for the avoidance of exchange rate policies resulting in external instability. The concept of exchange

[31] After 1978 the appropriateness of the 1977 Decision as a basis for surveillance was examined on a biennial basis. These reviews focused mostly on the implementation, rather than on a formal examination (IMF Preliminary Considerations 2006: N. 20). A number of bold reform proposals were not successful. In 1979, for instance, the US suggested that "any nation with exceptionally large payments imbalance – deficit or surplus" was to submit for IMF review how it proposes to deal with the imbalance (IMF Preliminary Considerations 2006: N. 10).

rate manipulation is then further explained and the indicators modernised, including "fundamental misalignment" of the exchange rate as a key trigger (US Treasury 2008: 2).

By way of domestic law analogy, the 1977 Decision can be regarded as the "constitutional framework" for surveillance, whereas the 2007 Decision ensures its effective implementation (Leckow 2008: 290).[32] In terms of structure, the 2007 Decision mirrors the 1977 version by including a preamble and principles for the guidance of the Fund; the PGMs and the indicators; and procedures and an annex to conclude it.

a) Preamble and principles for the guidance of the Fund

The preamble states the restrictions imposed on the 2007 Decision: no new obligations; due regard to domestic circumstances and flexibility; and a continued evolution of surveillance. The principles for the guidance of the Fund reiterate the limited scope of bilateral surveillance, restricting it to exchange rate policies pursuant to Art. IV:3(b). Contrary to the 1977 Decision, which focused exclusively on exchange rate policies, the scope for domestic surveillance is extended to monetary and fiscal policies (IMF 2007 Decision: N. 5).

b) Principles for the guidance of members

The PGMs A, B and C contain no surprises – they are the same as in the 1977 Decision, including Principle A which repeats the provision of in Art. IV:1(iii). Principle B and C continue to be included despite their limited usefulness. The new Principle D, stating that "a member should avoid exchange rate policies that result in external instability", is more interesting for its focus on outcomes. Rather than the motives brought forward by a member, it addresses policies that "result in external instability". According to the Fund, this is the case when "the balance of payments position is likely to give rise to disruptive adjustments in exchange rates" (IMF Companion Paper 2007: N. 2).

Yet, Principle D is not mandatory. The Fund cannot, on its basis, recommend different exchange rate policies (IMF Companion Paper 2007: N. 34). This is reflected by its formulation: like in Principle B and C, members "should" act, whereas Principle A establishes that they "shall" avoid exchange rate manipulation. But even in the case of Principle A the obligation is limited. When questions arise as to whether a member is implementing legitimate policies, the members are given the benefit of any reasonable doubt (IMF Proposal 2007: N. 13).

[32] Since its publication, the 2007 Decision was amended once. A Board decision in 2010 allowed for more flexible consultation scheduling through so-called "lapse of time" procedures: when there is no immediate urgency, the Executive Board discussions of Art. IV consultations can take longer than the regular period of three months (IMF Decision No. 14766 2010).

c) Indicators

Like in the 1977 Decision, there are a number of developments to indicate that a member's policies are not consistent with their obligations pursuant to Art. IV:1. Again, the IMF stresses they constitute a "filter", not an automatic trigger of non-observance (IMF Companion Paper 2007: N. 37). Of the six indicators of the 1977 Decision, (i), (iii) and (iv) remain unchanged.[33] The developments (ii), (v) and (vi) are modified to contain new concepts, whereas indicator (ii) now warns of unsustainable official or quasi-official borrowing. Indicator (v) is concerned with "fundamental exchange rate misalignment" and (vi) with "unsustainable current account deficits, or excessive and prolonged current account surpluses". In combination, the changes appear to give more edge to exchange rate surveillance.

However, "fundamental exchange rate misalignment" turned into a sticking point that threatened the functioning of the surveillance mechanism altogether. Members like China refused to collaborate with the Fund in the prospect of having their exchange rate labelled as "fundamentally misaligned". Therefore, management revised its guidelines in 2009 to eliminate the requirement of using specific terms such as "fundamental misalignment". It found that the attempt to apply exchange rate-related labels such as (v) proved an "impediment to the effective implementation of the Decision", weakening the candour of some assessments (IMF Revised Guidance 2009: N. 2).

d) Annex

Further guidance regarding the provisions on exchange rate manipulation in Principle A and, in turn, Art. IV:1(iii), is contained in the Annex to the 2007 Decision under N. 2:

> (a) "Manipulation" of the exchange rate is only carried out through policies that are targeted at – and actually affect – the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.
>
> (b) [...] a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.

In combination with the new indicators, these clarifications appear useful in making the legal framework of Art. IV:1(iii) workable. The two most problematic concepts, "manipulation" and "unfair advantage", are finally defined. Whereas the previous definition of the IMF Legal Department covered any intervention that might or might not affect the exchange rate, here

[33] For a detailed comparison of the indicators in the 1977 Decision and the 2007 Decision see: IMF Companion Paper 2007: N. 37 onwards.

manipulation requires policies “targeted” at the level of the exchange rate. The case of the rate not moving in accordance with fundamentals is also explicitly included in (a). The “unfair competitive advantage” is only pursued if the member is trying to “increase net exports”. While substantiating the subjective element of manipulation – the explicit intention by the member to prevent adjustment or gain an unfair advantage – remains difficult, there is now more clarity as to what constitutes objective manipulation.

3.3 Formal sanctioning powers

The third part of the bilateral surveillance regime are the Fund’s formal sanctioning powers – which are asymmetric in practice. According to Art. XXVI:2, the Fund has three sanctions at its disposal: (a) a declaration of ineligibility to use its resources, (b) a suspension of voting rights and (c) a request to withdraw from the IMF. Option (a) is unlikely to scare countries in possession of large currency reserves such as China. Options (b) and (c) fall flat for a number of reasons. The voting threshold is very high with 70 and 85 percent of the IMF’s membership. In addition, formal sanctions run counter to the Fund’s consensual way of solving conflicts. There is no history of these measures ever being employed against violators of Art. IV:1, and the 2007 Decision makes no hint that sanctions will ever enter the surveillance process (Staiger/Sykes 2008: 28).[34] As a result, the IMF is neither equipped with an effective mechanism for solving disputes between members, nor with hard sanctioning powers (Herrmann 2010: 45). While the Fund can instil fear in a country in need, it has in fact little leverage over its major members.

That is not to say that the IMF’s influence is restricted to its sanctioning powers. Some scholars argue that international institutions exert their power through normative channels. The permanent monitoring of its members gives the Fund “many subtle possibilities, via policy advice and recommendations, combined with peer pressure, to motivate a member to change a contested policy without even having to proceed to an official finding of breach with regard to that member” (Zimmermann 2010a: 22-23). The potential of soft law is further discussed in section 7.[35] For now, it must be acknowledged that the Fund has little leverage by way of hard sanctioning powers. But as will be argued in the next section, the traditional hard law versus soft law dichotomy fails to grasp the evolution of the bilateral surveillance regime after 2007.

[34] The only recorded expulsion from the Fund was Czechoslovakia in 1954 (Lastra 2006: 376).

[35] As a legal concept, soft law was popularised by Ignaz Seidl-Hohenveldern in 1979 (Gold 1983: 443). Note that some scholars question the use of the term *soft law* on the grounds that the norms and normative instruments it describes are not intended to be legally binding and thus not law at all (Bilder 2000: 65).

4. The legalization of bilateral surveillance

For international lawyers, the demise of the Bretton Woods system marked the end of hard law in monetary relations. Due to its lack of enforceable rules of conduct, the legal monetary regime after 1978 was simply considered soft law.[36] The problem with this categorization is that soft law comes in various guises, ranging from simple statements of goodwill to detailed, law-like frameworks that merely suffer from difficult enforcement. In Mario Giovanoli's view, "there is no black and white distinction to be made between 'soft law' and 'hard law', but rather a gradation" (Giovanoli 2000: 73). Grouping all non-binding agreements in the same category does not do justice to the individual levels of delegation, obligation and precision soft law arrangements may display.

Since the 2007 Decision established no new obligations, the bilateral surveillance framework before and after 2007 appears identical by applying the hard/soft law dyad. To assess the effect of the 2007 reform, legalization proves more effective. It reveals that the 2007 Decision made the surveillance process operational for the first time. However, it also shows that higher precision can lead to difficulties in issue-areas with high uncertainty costs involved.

To investigate the legalization of exchange rate surveillance, this section introduces the theoretical concept first: why do states choose legalization, and how can it be measured? The concept is then applied broadly to monetary affairs, and specifically to both surveillance regimes.

4.1 The concept of legalization

Legalization reflects the increasing importance of legal and quasi-legal rules for international institutions. It is defined as "a particular form of institutionalization characterised by three components: obligation, precision, and delegation" (Abbott et al. 2000: 401).[37] The components are a particular set of characteristics institutions may or may not possess. *Obligation* means that the behaviour of states becomes subject to scrutiny under the rules, procedures and discourse of IL. *Precision* means that rules unambiguously define the conduct they require, authorise, or proscribe. *Delegation* means that third parties have been granted authority to

[36] The first proponent of a "sliding scale of hardness or softness of all [international] norms" was Michael Reisman (Reisman 1988: 375). The concept of legalization employed in this paper was conceptualized in 2000 by Kenneth W. Abbott, Robert O. Keohane, Andrew Moravcsik, Anne-Marie Slaughter and Duncan Snidal in the special issue 54 of *International Organization*.

[37] Legalization is not to be confused with *judicialization*, a subtype of legalization defined by a high degree of delegation. Judicialized institutions typically have dispute-settlement bodies and highly judicialized adjudication mechanisms (Goldstein et al. 2000: 390 and Zangl 2010). For numerous examples of legalized institutions see the typology in the Appendix 4 in section 9.1.

implement, interpret, and apply the rules; to resolve disputes; and to make further rules (Abbott et al. 2000: 401).

As a specific form of institutionalization, legalization "represents the decision in different issue-areas to impose legal constraints on governments" (Goldstein et al. 2000: 386). The degree to which institutions possess the three characteristics determines their type of legalized institution. These types "encompass a multidimensional continuum", ranging from the ideal type where all properties are maximized through multiple forms with different combinations to the complete absence of legalization (Abbott et al. 2000: 401). The best example of an increase in legalization is the transition of the GATT to the WTO.[38]

4.1.1 Why legalization?

Rather than a coherent theory, legalization is a descriptive concept (Goldstein et al. 2000: 399). Moving away from a narrow view of law requiring enforcement by a coercive sovereign – the definition of hard law –, it is helpful in understanding nuanced changes to the rules set by international institutions (Abbott et al. 2000: 402). By combining perspectives from political scientists and international legal scholars, it provides a framework for the examination of legalized institutions beyond the high-profile international tribunals traditionally studied in this context (Goldstein 2000: 387). Ultimately, legalization tries to explain why states voluntarily agree to constrain their sovereignty by submitting to international rules.

Institutionalism and collective action problems

As a rational institutionalist concept, legalization shares a number of realist assumptions. Utility-maximizing, self-interested states are the central actors (Abbott 2006: 13), collectively forming an anarchical system with no coercive entity.[39] However, states do not only pursue security or power interests. Rather, under the condition of interdependence – characterised by asymmetrical costs of mutual dependence – they seek international cooperation through institutions to solve contracting dilemmas (Keohane 1984, summarised in Jönsson/Tallberg 2008:

[38] The WTO is the "paradigmatic institution cited as evidence for such institutional evolutionary dynamics" (Brummer 2010: 626). Created in 1948 to promote free trade through reductions of formal tariffs, the GATT was characterised by low delegation, political bargaining and a lack of enforcement mechanisms. Over time it evolved to include deeper commitments by its signatories. This culminated in the transition to the WTO in 1995, a "true international organization with a distinct legal personality" (Brummer 2010: 626). From a legal perspective, the WTO is considered a "member-driven, rule-oriented, unitary, comprehensive and nearly universal system where the obligations run horizontally from members to other members, decisions are made by consensus, and obligations are interpreted and enforced through a dispute settlement mechanism with a highly developed juridical function having the power to determine violations and authorize sanctions" (Gadbaw 2010: 563).

[39] For a general introduction to institutionalist theory see Jönsson/Tallberg 2008 and Shepsle 2006. For a brief introduction to the IR paradigms see Abbott 2006.

5).[40] Without cooperation, they "find themselves unable to reach a Pareto-optimal solution, despite a certain degree of convergence of interests between them" (Keohane 1984: 68).[41]

These so-called collective action problems were popularised by Mancur Olson in 1965. Olson found a mismatch between individual incentives and collective interests (Hardin 2003). He argued that the provision of public goods – which are non-excludable and non-rival[42] – is difficult because individual contributions are "both personally costly and often only trivially important in achieving a group goal, especially in large groups" (paraphrased by Shepsle 2006: 31). Therefore, "rational, self-interested individuals will not act to achieve their common or group interests" (Olson 1965: 2). Instead, they are tempted to free-ride – reaping the benefits without contributing themselves (Hardin 2003).

A possible solution for collective action problems requires the presence of a dominating actor to enforce cooperation. The notion of "hegemonic stability" as an alternative to international cooperation in economic affairs was suggested in the 1970s by political economists like Robert Gilpin and Charles Kindleberger (references in Kirshner 2003). However, the late blossoming of the GATT in spite of dwindling US influence suggests that the dominance of a single power "may contribute to order in world politics, [...] but it is not a sufficient condition and there is little reason to believe that it is necessary" (Keohane 1984: 46). Also regarding the monetary area, "this fable is quite murky", as the role of the US in the Bretton Woods system has demonstrated that a single state at the centre of the international monetary system is a source of instability (Kirshner 2003: 649). In addition, the US has repeatedly failed to get its way in the creation of new IMF rules – despite the popular claim that the Fund is simply a tool of US foreign policy. Therefore, it makes sense to discard hegemonic influence as the sole catalyst of cooperation.

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[40] International institutions are defined as "explicit arrangements, negotiated among international actors, that prescribe, proscribe, and/or authorize behaviour" (Koremenos/Lipson/Snidal 2001: 762). A study on the rational design of international institutions is Koremenos/Lipson/Snidal 2001.

[41] A Pareto-improving allocation produces some winners and no losers. Originally, the principle of Pareto-optimality stated that "if all individuals refrained from doing A, every individual as a member of the community would derive a certain advantage. But now if all individuals less one continue refraining from doing A, the community loss is very slight, whereas the one individual doing A makes a personal gain far greater than the loss that he incurs as a member of the community" (Vilfredo Pareto 1935, quoted in Hardin 2003). For a broader account of collective action problems and free-riding – including its game-theory assumptions – see Hardin 2003.

[42] Public goods are "commodities for which the cost of extending the service to an additional person is zero and for which it is impossible or expensive to exclude individuals from enjoying" (non-rivalry and non-excludability) (Nordhaus 2005: 3). The theory of public goods was popularised by Paul Samuelson in 1954 (Samuelson 1954).

By stressing the importance of formal institutions, rational institutionalism also goes beyond traditional regime theory which focused on cooperation under anarchy, not institutions, as the dependent variable (Koremenos/Lipson/Snidal 2001: 764). Instead of looking broadly at principles, norms, rules and decision-making procedures (Krasner 1983 and Keohane 1984), it emphasises the importance of formal international institutions to overcome contracting dilemmas through selective benefits, leadership and repetition (Shepsle 2006: 10). International organizations such as the IMF are of particular interest as they provide stronger centralization and independence than looser institutional arrangements (Abbott/Snidal 1998: 4).

How does IL fit into the picture? In the rational institutionalist view, it is "instrumental for states to realize common interests" (Andrew Guzman in Zangl 2010: 5). After evolving from a descriptive "law of coexistence" into "a law of cooperation" (Brütsch/Lehmkuhl 2007: 15), IL turned into the vehicle through which multilateral cooperation is carried out. It sets the boundaries for acceptable behaviour and sanctions opportunistic behaviour. As a result, the effectiveness of cooperation "depends above all on the legal infrastructure within which substantive legal norms are embedded" (Zangl 2010: 5) – of which legalization is a possible quantification.[43] Figure 4 shows the relationship between the international system, IL and legalization:

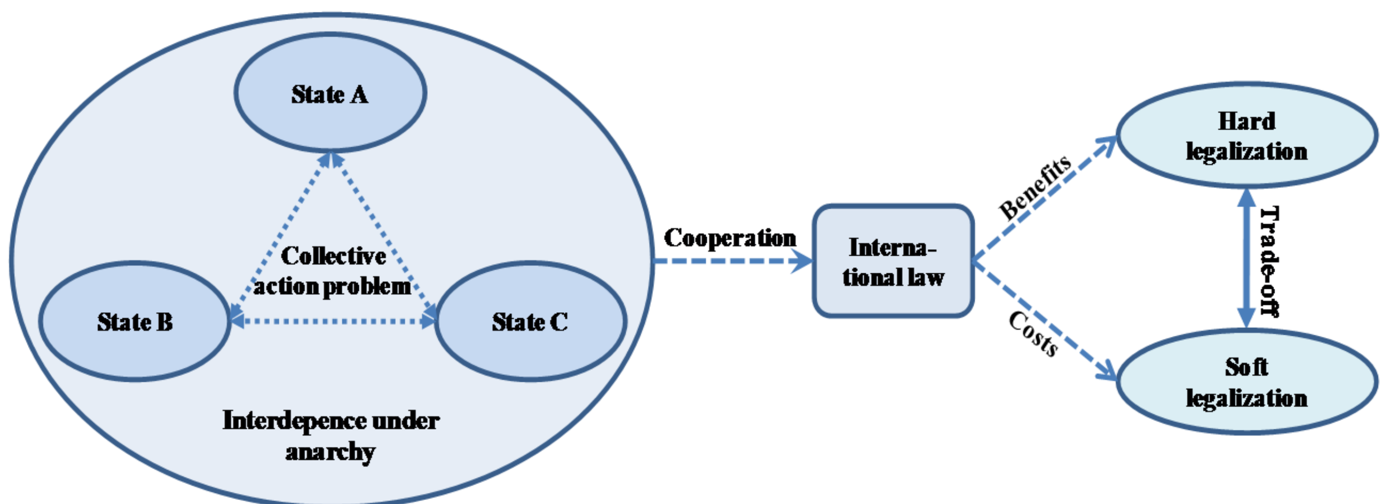

Figure 4: The Process of Legalization

[43] In a rambling critique, Martha Finnemore and Stephen Toope criticise the concept of legalization for "appropriating the general term legalization for only a few features of the law" – a process more aptly called "bureaucratization" (Finnemore/Toope 2001: 744). They lament that legalization "fails to include underlying social practice", overlooking the "larger context of roles law might play". In their view, it fails to incorporate customary international law, to define the characteristics of law and to treat law as a process (Finnemore/Toope 2001: 745). In response, the original authors argue that Finnemore and Toope fall short of providing an alternative concept (Goldstein et al. 2002). For another norm-based critique of legalization see Brütsch/Lehmkuhl 2007: 9-32. A different take on legalization beyond state preferences, inter- and transnational "constitutionalization", is developed by Zangl/Zürn 2004.

Benefits of legalization

Under international anarchy, states have difficulties in credibly committing themselves to future behaviour – an impediment to welfare-enhancing cooperation (Abbott/Snidal 2000: 426). Based on these assumptions, it follows that states choose legalization primarily for two reasons: *credible commitments* and *reducing transaction costs*. Commitment is crucial “when one party to an agreement must carry out its side of the bargain [...] in reliance on future performance by others” (Abbott/Snidal 2000: 426). Legalization fosters mutual assurance through the “precision of individual commitments, coherence between individual commitments and broader legal principles, and accepted modes of legal discourse” (Abbott/Snidal 2000: 426). Opportunistic behaviour is limited by raising the reputational costs of reneging (Simmons 2000b: 819). In addition, legalization allows the reduction of transaction costs for negotiating contracts and solving contractual disputes (Jönsson/Tallberg 2008: 5). As international institutions bring about subsequent transactions, provisions must be continuously “interpreted, applied to specific fact situations, and elaborated to resolve ambiguities and address new and related issues” (Abbott/Snidal 2000: 430).

Costs of legalization

Legalization, however, has no inherent value. In the attempt to limit auto-interpretation, reduce transaction costs and increase enforceability, states write detailed agreements which create problems: “[legalization] may be wasteful, forcing states to plan for highly unlikely events; it may be counterproductive, introducing opaque and inconsistent provisions; it may lead to undesirable rigidity; and it may prevent agreement altogether” (Abbott/Snidal 2000: 433). States face the trade-off between the costs and the benefits of hard legal commitment, determined by a range of issue-specific factors. John Maynard Keynes recognised as early as 1942 that “perhaps the most difficult question is how much to decide by rule and how much to leave to discretion” (quoted in Lastra 2006: 345).

In particular, states need to take into account *sovereignty costs* – “outcomes inferior to those that might be obtained in the absence of legalization and constraints that legalization imposes on policymaking autonomy” (Kahler 2000: 663-4). Sovereignty costs arise when states are no longer able to follow their national prerogatives (Brummer 2010: 631). They can range from “simple differences in outcome on particular issues, to loss of authority over decision making in an issue-area, to more fundamental encroachments on state sovereignty” (Abbott/Snidal 2000: 436). In addition to material sovereignty costs, they can also arise for psychological or symbolic reasons (Abbott 1998: 62).

States may also confront *uncertainty costs* when "underlying problems may not be well understood, so states cannot anticipate all possible consequences of a legalized arrangement" (Abbott/Snidal 2000: 441). At first glance, this might seem counterintuitive, as legalization is a way to overcome coordination problems. However, the prospect of future gains is restricted to the case of *risk* – when actors cannot predict an outcome, but know the probability of possible outcomes (Abbott/Snidal 2000: 442). Legalization is less desirable when circumstances are fundamentally *uncertain* regarding the problem itself, the necessary commitment, the domestic opposition or the compliance of other actors (Abbott/Snidal 2004: 62). Therefore, hard legal arrangements as a commitment device may imply that "future changes in policy will be more costly" (Kahler 2000: 664).

4.1.2 Measuring legalization

Legalization can be measured thanks to the three dimensions central to the concept.[44] To assess them, the authors provide a set of indicators, ranging from a low to a high degree of the particular characteristic (all references in section 4.1.2: Abbott et al. 2000: 409-418):

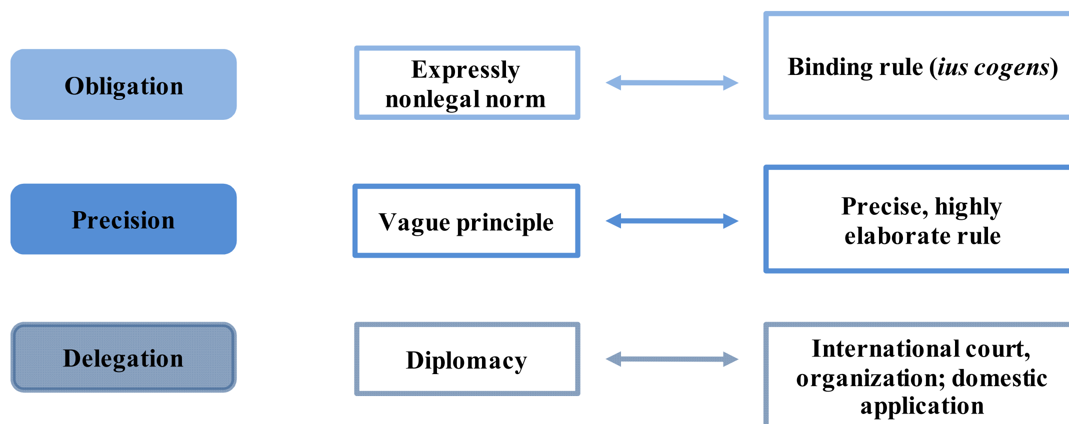

Figure 5: Attributes of Legalization

Obligation

Legal rules and commitments impose binding obligations on states and other actors. They are subject to various defences or exceptions, and not to be disregarded as preferences change. Breach of a legal obligation is understood to create legal responsibility, which does not require a showing of intent on the part of specific state organs. Only states injured by a breach have the right to complain. When an injury is established, "legal responsibility entails an obligation to make reparation". Under high obligation, "discussion of issues purely in terms of

[44] The authors discuss a fourth characteristic: *compliance* or *enforcement*. However, this factor is omitted from the definition in order do to test "whether different levels of legalization lead to different levels of compliance" (Abbott 1998: 59). In his definition of legalization, Kern Alexander retains the fourth attribute in the form of *sanctions* (Alexander 2000: 2), which can be subsumed under *obligation* for the purposes of this paper.

power is no longer legitimate". Legally binding agreements allow states to "assert legal claims, engage in legal discourse, invoke legal procedures, and resort to legal remedies". Under non-binding instruments, they may "make normative claims, engage in normative discourse, and resort to political remedies". Weak legal obligations are expressed by hortatory commitments.

Precision

A precise rule "specifies clearly and unambiguously what is expected of a state or other actor". It narrows the scope for reasonable interpretation. Precision implies that rules are non-contradictory, creating a framework within which "case-by-case interpretation can be coherently carried out". Precision ranges from "rule-like" ("the speed-limit is x km per hour") to "standard-like" ("drive carefully"). High precision of the rules means that decisions are made ex ante, whereas generic instructions call for interpretation in court. When provisions are too general, "one cannot meaningfully assess compliance, casting doubt on their legal force".

Delegation

Delegation is "the extent to which states and other actors delegate authority to designated third parties to implement agreements". Third-party dispute settlement mechanisms can be authorised to interpret rules or to make new rules. In their most highly-legalized form, parties agree on binding to third-party decisions. They are least legalized when the process involves political bargaining. Intermediate arrangements include mechanisms to facilitate agreement. Therefore, delegation is not confined to dispute resolution – it helps to "elaborate imprecise legal norms, implement agreed rules, and facilitate enforcement". In addition, states may delegate the task of monitoring state behaviour and the dissemination of information on rule observance, "creating implicit sanctions for states that wish to be seen as trustworthy members of an international community".

4.2 The legalization of monetary affairs

Currency stability, like well-functioning systems of law, public order or public finance and taxation, can be regarded as a global public good problem (Baltensperger/Cottier 2010: 911). This is illustrated by Michel Camdessus, the former Managing Director of the IMF:

> It is essentially the same system for everyone. If it works well, all countries have the opportunity to benefit; if it works badly, all are likely to suffer. And, as is so frequently true for public goods, not many people care for, and even fewer are prepared to pay for, its improvement even if many comment about it. [...] Exchange rates always, to some extent, involve issues of international public goods as an exchange rate is the relative price of two national monies and is affected by the corresponding national monetary policies (Camdessus 1999).

As a result, exchange rates are characterised by a collective action problem called the *welfare dilemma*. When there is no central authority to guide monetary policy, states may try to increase their share of the economic pie by devaluing their currency (Rittberger/Zangl 2006: 145). If all or most states employ beggar-thy-neighbour policies, some may achieve a short-term success. In the long term, the shares will remain equal but the overall pie will shrink. Both the international community and the individual state are worse off than would have been the case with effective international cooperation.[45]

The theory suggests that states should seek legalization to ensure monetary cooperation. However, it appears that IR scholars have shown neglect towards the legalization of monetary affairs. In their typology of legalized institutions (Appendix 4 in section 9.1, originally Abbott et al. 2000: 406), the authors of the special issue of *International Organization* omit the IMF. In the introduction to the same issue, the Articles get only a brief (and flawed) mention.[46] While studies on the legalization of diverse issue-areas such as the internet, international sports and organic agriculture have been published, the legalization of the IMF has been largely ignored.[47]

In all likelihood, this is attributable to the unusual trajectory of the legal obligations on exchange rates. While the path of IL is usually geared towards harder legalization, monetary affairs took the opposite turn. Instead of displaying increasing legalization like other institutions such as the WTO, "exchange-rate commitments under the IMF failed to return to the levels of obligation and precision they had displayed three decades ago" (Kahler 2000: 661).

However, total neglect is not justified. While the developments outlined in section 2 made it impossible to sustain a system of fixed exchange rates – thereby raising the costs of a highly legalized exchange system –, the end of the Bretton Woods system never amounted to the end of law in monetary affairs. In spite of the scant attention it receives, the IL on monetary conduct is far from defunct. Most provisions of the original Articles remain legally binding until today, for instance the prohibition of restrictions on current payment, of multiple currencies and of discriminatory currency practices (Waibel 2010).

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[45] An application of this cooperation dilemma to the "tariff warfare" in the area of trade in Cooper 1975: 65.

[46] To support the claim that Art. IV is hortatory, the article takes into account only Art. IV:1(i) and Art. IV:1(ii) (the soft obligations), without even mentioning Art. IV:1(iii) (Abbott et al. 2000: 412).

[47] The studies on the internet (by Volker Leib) and international sports (by Dirk Lehmkuhl) in Zangl/Zürn 2004; on organic agriculture (by William D. Coleman and Austina J. Reed) in Brütsch/Lehmkul 2007.

And even in the case of exchange rates, the international community has shown continued interest in keeping monetary practices in the realm of legality after the breakdown of the par value system. Therefore, law has continued to permeate the international monetary system. Whenever reform of the legal monetary regime is at stake, the IMF's members attempt to exert their influence. This is testified by the hard bargaining before the Second Amendment and the 2007 Decision. It appears that despite a lack of hard obligations, the "normative quest" (Pauly 2006a: 1) for legal cooperation in monetary affairs is unbroken. In a world where markets guide national economic policymaking and without a consensus on exchange rate arrangements, "multilateral economic surveillance was more, not less, necessary" (Pauly 2006a: 16).

The importance of legalization in monetary affairs has been examined by Beth Simmons in the only study on the subject. She looked at the role of legal rules in encouraging members to comply with Art. VIII by keeping their current account free from restrictions. Art. VIII, one of the two regulatory powers of the Fund, is a voluntary obligation which mandates that national authorities make foreign exchange available to pay for imports or external interest payments (Simmons 2000b: 820).

Simmons found that states, when faced with the *welfare dilemma*, relied on the capacity of the IMF to solve their collective action problem. This shift to legalization after World War II was "an effort to lend credibility to various monetary policy commitments that were shattered after World War I" (Simmons 2000a: 583). International legal commitment served as a "signalling device that governments use to convince of a serious intent to eschew the proscribed behaviour" (Simmons 2000c: 324). The IMF's members could reduce uncertainty about the behaviour of other countries, making cooperation possible. Simmons finds that legalization "helps governments make credible policy commitments to market actors" in order to avoid "reputational costs associated with reneging on a legal obligation" (Simmons 2000a: 574).

Even though Simmons only studies the obligation to keep the current account free from restriction pursuant to Art. VIII, her study is helpful for the purposes of this paper as it suggests that, even after the end of Bretton Woods, legalization provided a solution to contracting problems in monetary affairs. Nonetheless, it appears that exchange rate surveillance has not displayed a similar tendency. By comparing the legalization of the two bilateral surveillance regimes, the following section shows how the publication of the 2007 Decision failed to establish highly legalized rules for monitoring exchange rate policies.

4.3 The legalization of the original bilateral surveillance regime

a) Obligation

After the breakdown of the Bretton Woods system, the major economies were reluctant to let the IMF interfere in their monetary sovereignty. To safeguard flexibility, they agreed on a low level of obligation for the rules for bilateral surveillance. But at the same time, the rules were not characterised by a total absence of obligation or even an explicit negation of intent to be legally bound. After all, there was a general agreement that the IMF should retain some responsibilities.

The members tried to convey their desire for limited legality by employing soft obligations, not soft law, in Art. IV:1. Gianviti notes that soft obligations like Art. IV:1(i) and (ii) do not require the achievement of a particular objective, but only a reasonable effort. In contrast, soft law means there is no obligation at all (Gianviti 2002: 46). In addition, two adjectives in Art. IV:3(b) were chosen to compensate for the softness of Art. IV: "firm" and "specific" (Gold 1988: 322). The scope of the Articles is broad – covering all members regardless of their exchange arrangement or their participation in monetary unions. At least in theory, the Articles did provide the Fund with some instruments for responding to a breach of its obligations.

In practice, however, the bilateral surveillance regime never attained a level of unconditional obligation: Art. IV:2(b) grants the members almost unlimited freedom of choice in their exchange rate arrangement; the domestic obligations stemming from Art. IV:1(i) and Art. IV:1(ii) are hortatory at best; and even the bindingness of the external obligations in Art. IV:1(iii) and Art. IV:1(iv) is limited, despite the IMF's claim that they are of "hard" nature (IMF Legal Framework 2006: N. 3). *De facto*, Art. IV:1 has been transformed into a soft law provision (Gianviti 2002: 47).

The 1977 Decision did not include any additional obligations. Principle A simply repeated the provision of Art. IV:1(iii), while the Principles B and C were of particularly weak nature. The indicators were carefully worded in order to avoid the impression of automatic consequences. Moreover, the Decision covered only external policies, whereas Art. IV:1 is an attempt to bind the members in both their domestic and their external policies.

And even in the case of manipulation, obligation is confined by the necessity to rely on the member's stated intentions – while giving him the benefit of doubt. As a result, the Fund never found a member in breach of his obligations under Art. IV:1. The closest it came to sanctioning a member was the devaluation of the Swedish krona in 1982. Lowenfeld recalls this

episode which perfectly exemplifies the limited obligation of Art. IV:1 (Lowenfeld 2008: 635).

On 8 October 1982, Sweden announced a devaluation of the krona of 16 per cent intended to improve conditions for Swedish industry. Other Nordic countries complained publicly and to the IMF that Sweden was seeking an unfair advantage because its devaluation far exceeded what would have been necessary to restore its competitiveness. In response, the Executive Board met within a week to consider Sweden's actions. Thereafter, the Managing Director met with Swedish officials to discuss the matter.[48] However, no formal decision or sanction followed, although "it was generally understood within the Fund and the international financial community that Sweden had acted contrary to Art. IV:1(iii)" (Lowenfeld 2008: 636). As the Fund's historian observes, "wielding a club is not always compatible with being part of a club" (Boughton 2001: 42).

b) Delegation

During the Bretton Woods years, the Fund was responsible for setting the exchange rates of its members – corresponding to a high level of delegation. After the Second Amendment, this responsibility reverted back to the members who were now merely required to notify the IMF of changes to their exchange arrangements, without having to seek the Fund's approval. Stripped of its main delegated right, the Executive Board's sway over surplus countries was significantly reduced. The Board could only interpret the Articles, but it was banned from creating any new obligations (Gold 1988: 323). Despite its large and permanent staff, the Fund remains an intergovernmental body where decision-making reflects political bargaining. Important documents such as the 1977 Decision are negotiated "by a small group of members outside the Executive Board" (IMF Legal Framework 2006: N. 6).

And yet, the Fund continued to enjoy a number of legal responsibilities in monitoring the international monetary system and the behaviour of its members. Consultations on domestic issues expanded and covered more and more ground – such as labour policies (Gianviti 2002: 48). Pauly argues that, in a way, "such an approach actually extended the legal jurisdiction of the Fund" because Art. IV consultations were now mandatory and reached beyond exchange rate policies (Pauly 2006a: 16). Uniquely for an international financial institution, the Fund now fulfilled a number of roles at the same time – prosecutor, judge and jury – "with no form

[48] The 1977 Decision also established special consultations as a vehicle for the Managing Director to initiate and conduct on a confidential basis a discussion of observance of the principles with a member (IEO 2007: 47). The procedure has been applied twice by the IMF - with Sweden and with South Korea in 1987 – but neither made it to the point of consideration by the Executive Board (Mussa 2007: 40).

of appeal for members to a third-party tribunal outside the institution" (Leckow 2008: 293). This concentration of responsibilities, however, suggests a higher degree of delegation than is actually the case. A closer look at the Art. IV process reveals how the Fund's independence was curtailed by the members.

At first glance, the Art. IV mechanism might look like an influential vehicle for unilaterally surveilling national monetary policies – with an investigation by the IMF mission on the ground and a summing-up by the Managing Director at the end. This impression is underpinned by the fact that the IMF staff might issue a statement about its mission before submitting its view to the – intergovernmental and therefore less outspoken – Executive Board.

And yet, surveillance takes place in the form of *consultations.* As a legal matter, it is "the consideration by the Executive Board of the staff report and any comments or responses from the member that constitutes [its] heart" (Mussa 2007: 39). In other words, the Art. IV consultations are not unilateral assessments by the IMF's economists, but rather the result of a negotiation process. The title "conclusions" for the final report was chosen because it sounded less like an assertion of authority (Gold 1983: 464). "Conclusions" also differ from "decisions" because the Board does not adopt them explicitly, but rather endorses implicitly the summing-up by the Managing Director (Gold 1983: 465). In order to promote consensus within the Board, dissenting opinions of individual Directors are not incorporated separately. Instead, they are grouped by qualifiers such as "a few" or "some".[49]

But delegation is restricted even further: the conclusions of Art. IV reports are only published if the country consents to do so (Lastra 2010: 8). In the early years of surveillance, it was taken for granted that the process was secret (Boughton 2001: 101). Over time, the release of staff reports became more frequent. But while publication of the Art. IV consultations is now "voluntary but presumed", the member enjoys the right to delete "market sensitive information" and may decline publication altogether (US Treasury 2008: 4). As a result, the Art. IV process remains of consensual nature, indicating a low level of delegation.

Among the various responsibilities delegated to an international institution, dispute-settlement is of particular interest. Can members make a legal claim against each other? In the case of the WTO, the rights and obligations flow horizontally (between the members). The Articles, however, only establish duties of vertical nature (Zimmermann 2010a: 21-22). The obligation

[49] The procedure is explained in: IMF Qualifiers 2010.

to refrain from currency manipulation is owed to the Fund, but not to other members, which reduces the scope for third-party discretion on part of the IMF.

This view is not shared by Charles Proctor who argues that "in the absence of some clear provision to the contrary, the conclusion of a treaty should involve a reciprocity of rights and obligations among all parties" (Proctor 2006: 1345). To be sure, the Articles do contain a number of references to the community of its members; and the general obligation of Art. IV:1 calls on the members to collaborate with each other. Following Proctor's view, the US would be allowed to call on the IMF to apply retaliatory measures against a member in possible breach of its obligations.

However, Proctor's view that members can invoke the IMF's judgement is disputed by Zimmermann who points out that there are no IMF-internal dispute settlement procedures (Zimmermann 2010a: 23). In fact, the Articles do not foresee any way for members to protest against another member's behaviour. It is the responsibility of the Managing Director to bring instances of breach of obligation to the attention of the Board (Zimmermann 2010a: 22).

The vertical nature of the Articles has not stopped members from formally and informally attempting to bring reprehensible conduct by other members to the Fund's attention. When Sweden, as mentioned above, unilaterally devalued the krona in 1982, the other Nordic countries appealed for the Fund to engage in discussions with Sweden. A bill against currency misalignment introduced in the US Senate in 2007 foresaw that after 180 days of failure to eliminate the misalignment, the Treasury could "request" the IMF to engage in consultations with the designated country (Pattainak 2007: 301). This suggests that delegation might be higher than the rules indicate, although realistically only issues "raised by economically powerful members will most likely receive particular attention" (Staiger/Sykes 2008: 27).

c) Precision

Ideally, IMF law "must be formulated with sufficient precision to give members clear guidance and to enable the Fund to determine with as little difficulty as possible that members are or are not observing the principles" (Gold 1988: 322). In practice, it provides little clarification both to the Fund and its members due to its ambiguity. Yet, this was not a new phenomenon in terms of IMF rules. The original Articles were famously vague in defining the "fundamental disequilibrium" that would allow a change in the exchange rate. As Lowenfeld argues, this does not necessarily constitute a shortcoming, any more than did "the failure to define

'due process' or 'unreasonable searches' in the American Constitution" (Lowenfeld 1983: 385). One Executive Director who authored the text of the Second Amendment recalls that

> precision and purity of language – obviously desirable goals – were most difficult to achieve when a compromise was involved. That some terms were vague was of course a matter of some importance, as it was experience gained by their use that would give them precise meanings. The [proposed] text had evolved over many hours of negotiation, and [I] would be reluctant to see any changes made (IMF Legal Framework 2006: N. 6).

As the Director points out, precision is not a quality in itself. It may prevent evolution of the legal regime, particularly when the consequences of the rules are as unclear as after the breakdown of Bretton Woods. The IMF argues that "the [1977] Decision – with its lack of specificity – has allowed surveillance to be used flexibly, and to adapt to changing circumstances". However, it is possible to read too much into this quality, as the Fund does by claiming that "the longevity of the [1977] Decision proves its enduring value" (IMF Preliminary Considerations 2006: N. 21).

Rather, the level of precision was so low that it was almost impossible to determine whether a member complied with its obligations. Francois Gianviti notes that in some countries "had it been part of their national legislation, Art. IV might have failed to pass the constitutional requirement of sufficient predictability of result and uniform treatment" (Gianviti 2002: 33). The meaning of certain provisions was simply obscure at the time of their creation. Take Art. IV:1(iii): it is not clear how a member is supposed to manipulate the international monetary system – and no further guidance is provided by the Fund (IMF Companion Paper 2007: N. 28). Manipulation itself is highly problematic. According to the IMF's legal department, manipulation "would not necessarily require that official intervention – whatever its form – result in the movement of the exchange rate" (IMF Legal Department 2006, N. 15). Joseph Gold concludes that Art. IV:1 is a futile attempt to phrase in exact terms the great uncertainty surrounding the new monetary system (Gold 1988: 112).

4.4 The legalization of the reformed bilateral surveillance regime

a) Obligation

That the 2007 Decision would not establish new obligations was to be expected. The Executive Board is endowed with little political capital. It is not allowed to expand the legal obligations of Art. IV under the guise of adopting specific principles (Edwards 1976: 754). In addition, there was an explicit request by the developing and emerging economies to refrain from

any new obligations in the 2007 Decision. Therefore, the Executive Board shied away from a compliance-based approach to surveillance (IMF Further Considerations 2007: N.10).

The low level of obligation was expressed by a number of provisions. For a start, the 2007 Decision still allowed members to refuse the publication of the Art. IV reports. Instead, it emphasised that surveillance is a process of dialogue and persuasion. In comparison to an earlier staff version of the 2007 Decision, additional "safeguards" were included by the Directors in Paragraph 13 of the final version to stress that members are presumed to be implementing policies consistent with the principles (IMF Supplement 2007: N. 6). This led to phrasing the PGMs as *recommendations*, adopted by the Fund pursuant to the (soft) general obligation of Art. IV:1, rather than to creating new *obligations* in the vein of the specific principles of Art. IV:1(i) to (iv).

The difference between the two becomes apparent in the case of non-observance: an infraction of an *obligation* amounts to a direct breach of the Articles. Not following *recommendations*, however, does not give rise to a breach of obligation in itself. Rather, it takes several steps to find that a member infringed the general obligation. First, the Fund would be required to find that observance of the conduct is obligatory for all members. The members would then be given reasonable time to refrain from the conduct. Only subsequently could the Executive Board rule against the member (IMF Further Considerations 2007: N. 50). Not least due to this caveat, the old and new guidelines do not differ materially in their obligation level (Mussa 2007: 64).

This fact has not been changed by the new PGM which was an attempt to strengthen the IMF's resolve by making the *result* of an action by the member, as opposed to the *intent*, subject to surveillance for the first time. Even so, Principle D remains a soft obligation. The burden of proof is still on the Fund – granting the member the benefit of reasonable doubt.

b) Delegation

On paper, the 2007 Decision increased the level of delegation by extending the scope of surveillance to a variety of domestic issues while the 1977 Decision covered only exchange rate policies. The practical importance of this modification is, however, rather limited since surveillance had covered other economic policies for some time now. All other innovations that the Fund has introduced in its surveillance process over the last decade – such as the monitoring of standards and multilateral consultations with large economies – remained outside the realm of bilateral surveillance. Only recently have there been attempts to include novelties

such as assessments of systemically important financial institutions in the Art. IV process (FSAPs, see section 7). On the whole, there was no attempt to delegate additional responsibilities to the Fund in the 2007 Decision.

c) Precision

In comparison to obligation and delegation, precision is the area in which the 2007 Decision marked the most significant changes. The IMF praised the "greater clarity and specificity" of the new rules, allegedly resulting in "quality, evenhandedness, and effectiveness" of surveillance (IMF PIN 07/69 2007). That said, the 2007 Decision does indeed set clearer expectations for the practice of surveillance. By stating that "manipulation" is carried out through policies "targeted" at the exchange rate and that the purpose of such misalignment is to "increase net exports" in the Annex N. 2, key concepts of Art. IV:1(iii) such as "manipulation" and "unfair advantage" are clarified in a way that allows its implementation. In addition, the new indicators for surveillance better reflect the realities of current monetary practice.

However, the 2007 Decision also highlights the problems of greater precision. The only attempt to sharpen the IMF's bite has proved catastrophic for the surveillance process as the contentious "fundamental misalignment" label was not accepted by the Executive Board in any Art. IV report. Such "fear of labelling" delayed several consultations, most notably with China. This was criticised by the US which accused the IMF of "not tackling potentially harmful exchange rate practices and shying away from the necessary and essential task of making judgments about 'fundamental misalignment'" (US Treasury 2008: 2). But instead of following the advice of "speaking out forcefully and publicly about harmful country exchange rate practices" (US Treasury 2008: 2), the IMF removed the "fundamental misalignment" label in order to conclude its review of China's monetary policy.

4.5 Interim conclusion: low legalization level despite 2007 Decision

Overall, the bilateral surveillance regime between 1978 and 2007 displays low levels of obligation, precision and delegation. The implicit hope that this kind of legalization would hone the surveillance process over the years did not come to fruition. In relying on a minimalist definition of its principles for surveillance, the IMF had originally anticipated that, "as it accumulated experience in performing its function of firm surveillance, an expanding code of specific principles would be formulated" (Gold 1984: 1552). It became clear as early as 1984 that "the three specific principles announced originally by the IMF, in language as imprecise as the Articles, have not been sharpened or augmented" (Gold 1984: 1552). The evolution of

the bilateral regime until 2007 was restricted to procedural changes "to compensate for [its] imprecision" (Gold 1988: 328). Over the course of three decades, the bilateral surveillance regime "remained virtually unchanged even as the practice of surveillance evolved and a disconnect developed between the [1977] Decision and the best practice of surveillance" (IMF PIN 07/69 2007).

As a result, IMF surveillance proved highly ineffective – in particular regarding non-borrowing countries. As a former Executive Director from the US said in 1993, "we, as an institution, have failed in our task of industrial country surveillance. We have to do a better job [...] of warning our authorities about the errors of their ways" (Thomas C. Dawson, quoted in Boughton 2001: 135).[50] Owing to "political sensitivities and concerns not to destabilize market activity", the examination of exchange rates disappeared from the IMF's sight (Boughton 2001: 137). Consequently, "the number of consultations [since the Second Amendment] has probably reached something between forty and fifty thousand", but "in none of these consultations has the Executive Board ever concluded that a member was out of compliance with its obligations regarding its exchange rate policies" (Mussa 2007: 40).

For reform being thirty years in the making, the 2007 Decision changed surprisingly little in the way the Fund does surveillance. Increases in precision are contrasted with little obligation and delegation. There are, however, some notable changes. Exchange rate analysis, neglected in Art. IV consultations for years, returned to the core of the IMF's daily work (US Treasury 2008: 2). The concept of currency manipulation was clarified and external stability incorporated in the surveillance principles. In a benign reading, this can be interpreted as a sign of life on part of the Fund:

> The legal framework [of bilateral surveillance] constitutes an effective instrument of institutional reform. In redesigning the framework for surveillance, enormous attention was paid to the scope of members' obligations and the Fund's responsibilities under Article IV to ensure that whatever is put in place is firmly grounded in the Articles of Agreement" (Leckow 2008: 292).

Yet, despite refining its toolset for surveillance, "the Fund is essentially left as powerless as before in ensuring full compliance with the existing multilateral code of monetary conduct" when a member seeks an unfair trade advantage in breach of Art. IV:1(iii) (Zimmermann 2010a: 26). The 2007 Decision has not helped in highlighting the value of legal rules on monetary conduct. Illegitimate policies need to be undertaken with the clear intent to cause eco-

[50] A detailed account of the IMF surveillance of the US, Japan, Germany, France and the UK between 1978 and 2001 is found in Boughton 2001.

nomic harm to other members, which "makes it practically impossible for the IMF to find a member in breach of this provision" (Zimmermann 2010a: 55).

Critics lament that the published Art. IV reports continue to be only "negotiated documents", similar to the myriads of country reports produced by other private and public agencies (Pattainak 2007: 302). According to Mussa, the changes should not make a difference: "nothing in the 1977 Decision conflicts with the emphasis suggested by the 2007 Decision" (Mussa 2007: 16). Apparently, bilateral surveillance has evolved into a cooperative and consultative process. Rather than an exercise in "firm surveillance", the annual Art. IV consultations now consist of a comprehensive report on countries' macroeconomic conditions, policies and outlook (Lavigne/Vasishtha 2009: 6).

In short, it appears that establishing more legalized rules regarding exchange rate policies has proved difficult. The comparison of the bilateral surveillance regimes shows that the 2007 Decision is neither a "landmark step" (IMF Survey Magazine 2007) nor a "keystone of the effort to upgrade the foundations of the IMF's bilateral surveillance" (IMF PIN 07/69 2007). Although the theoretical case for the provision of exchange rate stability through cooperation is strong, bilateral surveillance scores rather low in terms of legalization despite the 2007 Decision. The low levels of obligation and delegation – and the decrease in precision in 2009 – indicate that exchange rates are an issue area characterised by high sovereignty and uncertainty costs. As Figure 6 shows, the exchange rate commitments of the Bretton Woods years were abandoned for good while legalization returned to a low to intermediate level after the 1978 reform:

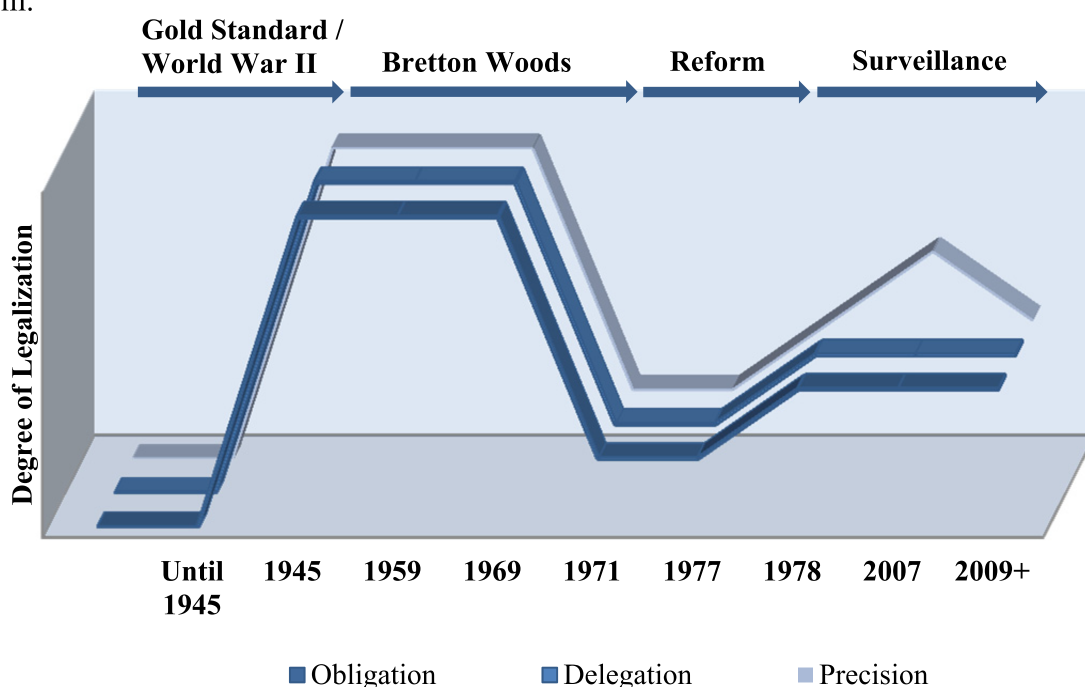

Figure 6: The Legalization of Exchange Rate Commitments

5. Exchange rate surveillance in practice: the case of China

The theoretical finding of the previous section is that the 2007 Decision failed to increase the legalization of the bilateral surveillance framework. Before exploring the reasons for the soft rules on bilateral surveillance in section 6, it is necessary to substantiate this finding by analyzing the practice of surveillance before and after the 2007 reform. The thorny issue of currency manipulation shows the limits of enforcing binding legal rules on the exchange rate of a large economy.

5.1 The controversy over China's exchange rate policies

Allegations of deplorable monetary conduct have become a global phenomenon, with China being far from the only culprit. Many countries were affected in one way or another by the recent debate on "currency wars".[51] States like Brazil and Japan took action to devalue their currencies, whereas others like Canada and Australia saw steep rises in their exchange rates. Against this background, it might appear unfair to single out China over its currency policies. However, no other case causes such controversy.[52]

Unusual for exchange rate policies, China's alleged exchange rate manipulation sparked heated debate in political circles and the media. The sheer scale and persistence of its monetary interventions makes China the *hard case*, justifying closer scrutiny. What is more, it is widely accepted that the 2007 Decision was a direct response to China's unwillingness to let the renminbi appreciate. No other country appears as guilty as China of maintaining an undervalued exchange rate to boost exports and to improve its competitive position. There are calls for the IMF to denounce Beijing as a currency "manipulator" pursuant to Art. IV:1(iii). But before looking at the IMF surveillance of China in detail, it is necessary to delve into the economics of the Chinese exchange rate.

5.1.1 The evolution of the renminbi regime since 1978

Over the years, China has employed several different exchange arrangements. Until 1978, the Chinese administration prevented the international use of the renminbi with a strict policy of exchange restrictions and controls as part of its tightly regulated economy (Herrmann 2010:

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[51] The term "currency wars" was popularised by the Brazilian Finance Minister Guido Mantega who complained in September 2010 about the monetary policies of Japan, China and the US which, he alleged, were aimed at devaluing their respective currencies with "weapons" like capital controls, interventions and quantitative easing (printing money to buy bonds) to the detriment of emerging markets (The Economist, 04 October 2010).

[52] For an overview of the literature on the renminbi issue see Herrmann 2010: 33, footnote 10. Also: Burdekin 2008 and Morrison/Labonte 2011.

32). A commentator observed in 1975 that "China, of great importance in the arena of national security and military strategy, is inconsequential in the international monetary arena because it is so withdrawn from the world economy in its national economic policies" (Cooper 1975: 94). This changed around 1978 with the market reforms of Deng Xiaoping and the liberalization of the Chinese exchange regime. In 1986, China established a dual exchange rate system with both a fixed rate (for exporters) and a market rate (for the inner China market) that lasted for eight years (Mercurio/Leung 2009: 1261).

The dual system was unified in 1994 when China started to use a policy of managed floating. From 1995 to 2005, the exchange rate to the USD was in fact fixed at 8.25 RMB to 1 USD – even amid the woes of Asia's financial crisis in the later 1990s when most neighbouring countries abandoned their peg to the USD. Despite slight fluctuations in the early days of the peg, "the permitted range of fluctuation was, in practice, quite limited and the effective bands were tightened over time as the People's Bank of China (PBC) intervened more and more in order to minimize volatility" (Burdekin 2008: 18). When China formally ended the peg in July 2005, the renminbi had appreciated only by 2.1 per cent. Figure 7 shows the impressive resilience of the RMB in comparison to other Asian currencies:[53]

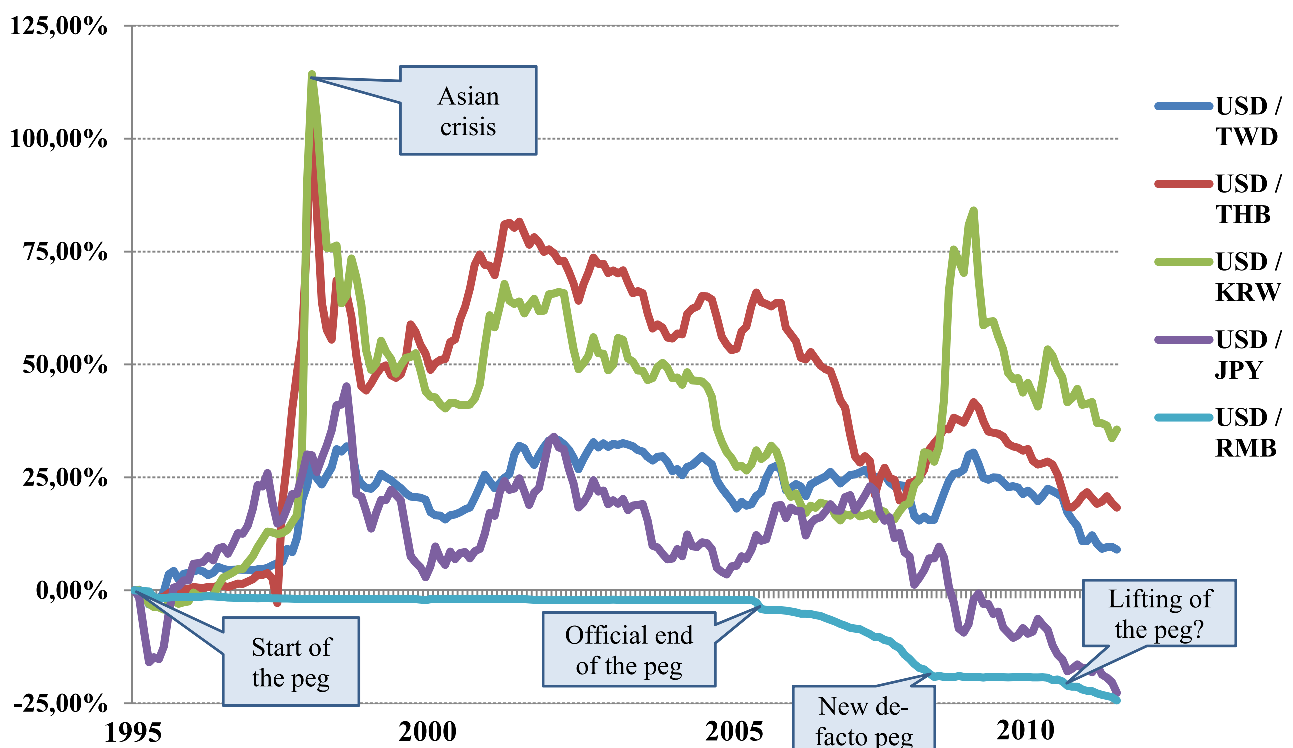

Figure 7: Asian Exchange Rates Against the USD

[53] Figure 7 covers the period from January 1995 until September 2011, changes of the monthly bid rates in per cent. The currencies: Chinese renminbi, Japanese yen, Korean won, Thai bhat and Taiwan dollar. Further economic statistics for China are contained in the Appendix 5 in section 9.1. The Appendix 6 in section 9.1 includes a number of comparative indicators for China and its Asian neighbours.

The official termination of the peg in 2005 was followed, at least according to official sources, by a peg to an undisclosed basket of currencies in order to gradually appreciate the RMB rate. However, Jeffrey Frankel's examination of the *de facto* development of the RMB-USD rate shows that China continued to peg to the USD until 2006 (Frankel 2010a: 44). Frankel further finds that China relaxed its grip on the RMB until 2008, allowing a gradual appreciation of around 20 per cent, but only to establish a new peg to the USD when its export-oriented economy was hit by the crisis. Far from a "self-initiated, gradual and controllable process" (PBC 2010b), the movement of the RMB was in fact always heavily managed.

In June 2010, the PBC announced to lift the peg to the USD and increase the flexibility of the RMB rate (PBC 2010a). The RMB was now allowed to rise by 0.5 per cent each trading day in China's foreign exchange market. However, appreciation remained gradual. While there was a nominal appreciation of 5.24 per cent against the USD until June 2011 (Xinhua, 20 June 2011) – and of 9 per cent in real terms due to higher inflation than in the US (US Treasury 2011: 3) – the RMB has actually fallen against a basket of currencies of its main trading partners (Financial Times, 12 July 2011).

In the coming years, China is expected to follow the path of gradual appreciation to curb inflationary pressure, avoid overheating as well as achieving internal and external balance (Frankel 2010a). The Economist Intelligence Unit reckons that until 2015 the RMB will appreciate by 3.8 per cent a year (EIU 2011: 9) – an estimate which Chinese authorities seem to confirm. According to the State Administration of Foreign Exchange, the priority going forward will be "steadily promoting the reform for RMB exchange rate formation mechanisms [...] to establish a managed floating exchange rate regime based on market supply and demand" (SAFE 2010). Yet experience shows that such statements must be taken with caution.

5.1.2 Instruments and intentions for managing the renminbi rate

There is strong evidence that China has tailored the renminbi regime to its economic necessities since 1995. In doing so, it is noteworthy how China managed to prevent RMB appreciation despite growing spectacularly for over a decade; conventional economic wisdom says that attempts to uphold an undervalued exchange rate through long periods of growth are frustrated by domestic inflation or upward pressures on the exchange rate. Most developed economies refrain from heavy exchange rate management in favour of floating rates. Two questions arise: which instruments has China employed to control the RMB rate, and what are its intentions?

The short answer to the first question is that China employs "a combination of sterilized intervention and barriers to capital mobility [...] to maintain a relatively weak exchange rate without engendering domestic inflation" (Reinert/Rajan 2009: 489). Since this mechanism is at the core of the criticism levelled against China, it deserves further explanation.

Influencing the nominal exchange rate is the first step of China's management of the RMB rate. As the exchange rate is a price which is set by supply and demand in the market, China makes use of monetary measures (called interventions) by its central bank in order to control the market rate of its currency. Whenever the value of the RMB is rising above its target range, the PBC will increase the RMB supply by purchasing holdings of foreign currency, thereby decreasing the RMB's value (Mercurio/Leung 2009: 1262). In addition, interventions influence the rate by signalling future policies regarding the desired range of the exchange rate (Fischer 2008: 378) – the Swiss franc made a leap of 9 per cent within one trading day after the authorities announced a peg to the euro (The Economist, 06 September 2011).

The clearest evidence of China's interventions are the massive reserves it has acquired through foreign exchanges purchases in combination with its persistent surplus. The US Treasury reckons that China held reserves worth 3000 billion USD in April 2011 (US Treasury 2011a: 14). To put this number into perspective: it is equivalent to 52 per cent of China's GDP, it is three times higher than any other nation's reserves and it amounts to more than 2300 USD per Chinese citizen. The bulk of its holdings – more than a third – are held in US treasuries, 1152 billion USD in April 2011 (US Treasury 2011b). Figure 8 shows how the steep rise in China's foreign exchange reserves was acquired by investing a large annual share of its GDP. As Beijing stepped up its exchange rate engineering to counter the global downturn, the interventions proved dearer and dearer.

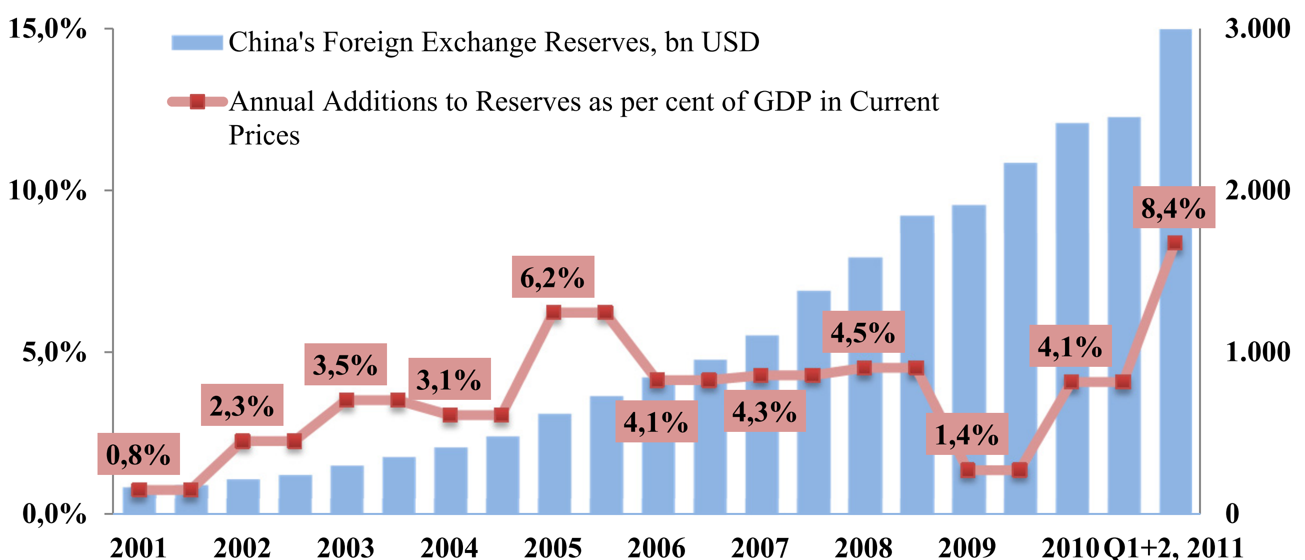

Figure 8: China's Foreign Exchange Reserves

However, the PBC's attempts to influence the RMB rate through interventions in the foreign exchange market would be futile in the face of excessive capital mobility. This has two reasons. The first is the diminishing efficacy of interventions due to increasing capital flows. As the account of the late Bretton Woods years has shown, flows of financial assets across borders can frustrate the adjustment of the exchange rate because the channels for intervention are harder to influence (Fischer 2008: 378). The second is the threat of speculative bets against the currency. When governments try to defend an exchange parity, speculators can sell short (sell borrowed currency) in order to profit from an eventual appreciation (Burdekin 2008: 20). After the UK was forced to leave the European Exchange Rate Mechanism on "Black Wednesday" in 1992, it had spent billions of pounds in order to maintain a stable rate (Willet 2002: 10). Beyond a willingness to intervene on a large scale, policymakers need therefore to resist integration into the global capital markets to have a sustained effect on the exchange rate (Fischer 2008: 378).

To avoid such negative externalities, China has also put in place tight capital controls. Although Beijing has made the RMB fully convertible under the current account in 1996 in accordance with Art. VIII, it continues to "tighten the regulations on RMB inflow by strengthening the supervision of the underlying transactions", subjecting exchange inflow to approval by its regulatory authorities (Mercurio/Leung 2009: 1263). Zimmermann explains why interventions in combination with capital controls have the effect of deflecting upward pressure on the RMB rate:

> The capital and the current account are in surplus, which implies that the supply of foreign exchange in China's domestic market is increasing at the same time that the use of (and thus the demand for) foreign exchange is strongly constrained by government regulation. Without regulation, the excess supply of foreign exchange would lead to an increase in the value of the RMB. Such a shift would occur as a result of Chinese market participants converting foreign exchange holdings into RMB. Faced with an ever-growing foreign exchange surplus (demand for RMB!), China uses massive capital controls and a central bank persistently buying foreign exchange in order to absorb existing supply of foreign exchange (Zimmermann 2010a: 10).

The strategy outlined above is, however, not the full extent of China's exchange rate policies. By using interventions and capital controls, China only influences the nominal RMB rate (the number of RMB units that can purchase a USD, CNB 2011), which in itself is not contentious. In fact, "governments have intervened in foreign exchange markets for decades. In any system of fixed exchange rates, the price of a currency in terms of other currencies set by the government may prove inconsistent with the market valuation of the currency" (Staiger/Sykes 2008: 2). Such a "reasonable ratio" for "prudent levels of reserves", Mussa reckons, amounts to about three months of imports (Mussa 2007: 66).

There is a simple reason why influencing the nominal exchange rate is mostly unproblematic: changes in the nominal rate do not necessarily influence the demand for exports. This goes back to a phenomenon identified by David Hume in 1752, the "price-specie-flow mechanism" (Hume [1752] 1987). Translated into modern terminology, it states that "countries with balance of payments surpluses experience inflows of specie that expand their domestic money supplies, thereby inducing domestic inflation, appreciation of the real exchange rate, and a reduction in the balance of payments surplus" (Mussa 2007: 70). This means that in the long run, foreign exchange interventions will be offset by domestic inflation. The prices for imported goods and services rise as businesses and workers try to boost prices and wages to compensate for the increase of the money base (Boughton 2001: 85). Such an increase in domestic prices may blunt any price advantage produced by a low exchange rate.

For that reason, policymakers need to control the *real* exchange rate (the nominal rate multiplied by the purchasing power factor) to secure trade effects (Zimmermann 2010a: 9). Put simply, China needs to undo the effect of the interventions on its domestic money supply to avoid rising prices. This is achieved through *sterilization* (the reduction of the money supply) which prevents that foreign exchange interventions bring about a domestic monetary condition change (Reinert/Rajan 2009: 489). In China's case, sterilization is achieved by issuing bonds and raising reserve requirements for banks (Financial Times, 12 July 2011).

The success of these measures is striking. As the figures 9 and 10 show, China has consistently managed to produce both high growth rates and a surplus in traded goods – even during the global downturn. In theory, this would suggest a high domestic inflation rate. And yet, China's consumer prices have only increased by an annual average of 1.6 per cent between 1997 and 2006 (Appendix 7 in section 9.1, IMF WEOD 2011) – even below the usually desired target of 2 per cent. Accounting for the price hike caused by the global financial crisis still gives a modest average of 2.8 per cent between 1997 and 2011.

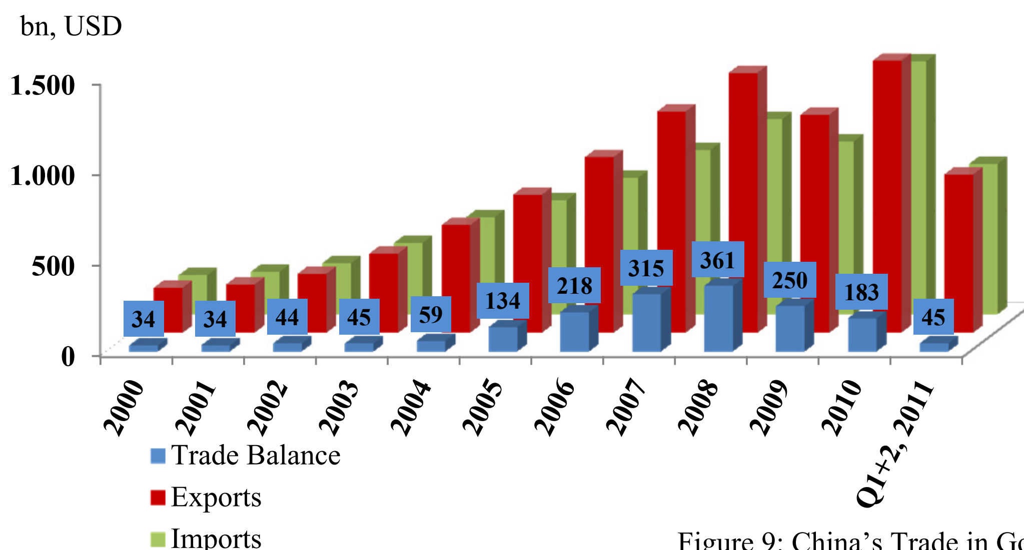

Figure 9: China's Trade in Goods

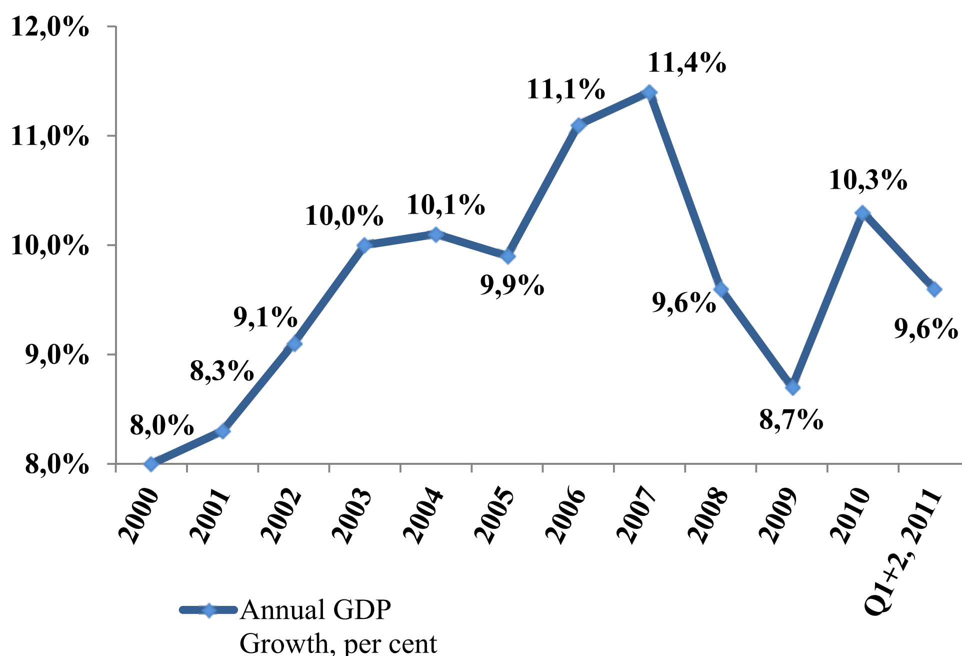

Figure 10: China's GDP Growth

The data suggest that by using sterilization operations and capital controls, China "chokes off the normal mechanism of adjustment of the real exchange rate through domestic price inflation" (Mussa 2007: 70). Without the PBC's exchange rate policies, "the massive capital inflow and the record trade surplus could not persist at the same time, neither theoretically nor practically" (Herrmann 2010: 33). This leads to the second question raised in this section – the motives behind China's policies.

In all likelihood, China keeps its exchange rate out of line with economic fundamentals to curb the prices of its exports, thereby boosting its manufacturing sector. Admittedly, there are critics who deny that a lower exchange rate amounts to a direct subsidy of trade. Zimmermann cautions that "it is extremely difficult to determine to what extent shifts in trade flows have been caused by a specific real exchange rate as simple correlations say little about actual causation" (Zimmermann 2010a: 10). However, even without an exact determination of causation, the link between exports and exchange rate seems straight-forward. A study by the McKinsey Global Institute found a negative correlation of 0.87 between the real USD rate and total US exports between 2000 and 2009, suggesting a high degree of causality (McKinsey Global Institute 2009: 22). Tradable goods are characterised by cross-price elasticity as demand in country A fluctuates with the price in country B. By reducing the comparative price for its exports, China artificially increases their demand (Zimmermann 2010a: 7).

The downsides of China's exchange rate policies demonstrate the importance that Beijing attaches to the competitiveness of its exporting industries. First of all, opportunity costs: the

accumulation of foreign reserves generates far smaller profits than more productive investments (Cohen 2008: 23). Second, risk: China invests a large share of its GDP in foreign securities, the value of which depends on factors outside its reach. Every new round of quantitative easing (printing money to buy bonds) by the Federal Reserve is a threat to the value of its dollar holdings. Third, a lack of monetary flexibility: at the moment, the ability of the PBC to fight inflationary pressure is curtailed by the rigidity of China's exchange rate policies. And finally, the risk of a grudging middle-class which faces high prices on imported goods.

Why does China then hold on to its export-led development strategy? Most importantly, to "ensure controlled liberalization of the economy at a rate that delivers sufficient economic growth to absorb millions of labour force entrants, migrants and laid-off workers" (Dobson/Masson 2009: 14). In the absence of a developed social welfare system, employment is a promising way to reduce poverty and prevent civil unrest. According to recent estimates, the export sector has been responsible for 30 per cent of China's recent employment growth (Dooley/Folkerts-Landau/Garber 2007: 107).[54] Clearly, there are strong incentives for China to maintain a lower exchange rate than suggested by the economic fundamentals. But the implications of these policies are highly contentious.

5.1.3 Critics and advocates of the Chinese exchange policies

The view that the RMB is undervalued is widely shared and has been on the agenda of international institutions for years (Herrmann 2010: 33).[55] The G-7 has called for "more flexibility in exchange rates" in 2005 and specifically for appreciation of the RMB in 2006 (G-7 2005 and G-7 2006). Among China's critics, the US is by far the most vocal. American policymakers already urged for an appreciation and liberalization of the Japanese yen in 1984 and of the Korean won in 1993 (Frankel 2006: 2).[56] The term *manipulation* entered the debate in 1988 when the Omnibus Trade & Competitiveness Act mandated the Treasury to report to Congress on a biannual basis whether a trading partner was manipulating its currency (US Treas-

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[54] According to the following calculation: "Exports generate 10 per cent of value added in GDP. The export sector grows twice as fast as the rest of the economy. So 25 per cent of all growth is from the export sector. Because of a lower capital-labor ratio than in the rest of the economy, the export sector accounts for about 30 percent of employment growth" (Dooley/Folkerts-Landau/Garber 2007: 107, footnote 3).

[55] For a critical overview of the RMB debate see Bouveret 2006: 3.

[56] China is far from the only Asian country involved in the heavy management of its exchange rate. In the aftermath of the crisis in the late 1990s, foreign exchange interventions were regarded both as a way to promote exports and as insulation against the IMF. Brunei and Hong Kong established currency boards with a rigid peg to the USD. Korea and the Philippines claimed independent floats, but in fact actively controlled their exchange rates. Several other economies managed their currencies out of "fear of floating". Even Japan and Taiwan, which opted for a float, intervened heavily in favour of their currencies in the last decade (Cohen 2008: 30-31).

ury 1988: Section 3004:b).[57] The first countries found "guilty" of manipulation by the Treasury were Korea and Taiwan, with Singapore and Hong Kong "getting off with a warning" (Frankel 2010a: 5). China was mentioned first in the early 1990s and named as a manipulator five times between 1992 and 1994 (Morrison/Labonte 2011: 8).[58] However, since 1994 no Treasury report has used this label again (Zimmermann 2010b: 3).

Over the last decade, the cautious stance by the Treasury diverged increasingly from the combative attitude of Congress. Starting in 2003, pressure mounted on the Treasury to denounce China as a manipulator. Since then, numerous bills proposed to impose tariffs on all Chinese goods in the absence of substantial revaluation by China (Frankel 2010a: 15). Despite serious concerns over its compatibility with WTO or IMF law, unilateral legislative action by Congress looms over the debate to this day (Zimmermann 2010b: 5). In the previous (111th) Congress, a bipartisan bill targeting currency manipulation managed to pass the vote in the House of Representatives with a margin of 348 to 79 (Financial Times, 29 September 2010). While the bill never made it to Senate consideration, it reflected growing frustration among US policymakers with China. In the new (112th) Congress, the sabre-rattling continues: some senators are already drumming up support for a new currency bill when they reconvene in September 2011 (Wall Street Journal, 15 June 2011).

The US administration is siding with the Treasury in refraining from threatening gestures. Barack Obama has not repeated his accusations of October 2008 when he, as President Elect, stated that China's trade surplus is "directly related to its manipulation of its currency's value" (Reuters, 30 October 2008). He is, however, opposed by the economists from the Peterson Institute of International Economics. Its founder, C. Fred Bergsten, alleged in a testimony in the Senate that "the conclusions by both the Treasury and the IMF are patently incorrect" (Bergsten 2004: 4) and that the IMF is "violating its own rules" by not denouncing China with more force (Bergsten 2004: 5). When the exchange rate gets out of line, the critics argue, "it distorts resource allocation within the country as well as the pattern of international trade among countries" (Goldstein 2005: 3). It is criticised that the Chinese government is using sterilised interventions to prevent effective balance of payments adjustment (Mussa 2007: 74-

[57] An account of the legislative initiatives in the US against currency manipulators is provided by Herrmann 2010: 36 and Zimmermann 2010b.

[58] Remember that China maintained its peg only since 1995. The practices denounced between 1992 and 1994 were not undervaluation, but rather dual exchange rate systems, restrictions on imports, and lack of access to foreign exchange by importers (Morrison/Labonte 2011: 8).

75). Excessive accumulation of reserves is said to cause financial instability.[59] While the US has "begged, pleaded, and threatened China to change its disruptive currency practices", the Peterson economists accuse China of reaping the benefits of cheap exports by straining US employment (Gagnon/Hufbauer 2011). Their belligerent tones are backed by star economist Paul Krugman, a self-proclaimed liberal, who requested the US government to "take a stand" on the RMB if "sweet reason won't work" (New York Times, 15 March 2010).

Some congressmen employ an even stronger rhetoric. The Republican Mike Rogers lamented that the Chinese "cheat to steal our jobs" while his party colleague Dana Rohrabacher attacked China's "clique of gangsters" that is doing "great damage to the people of the US" (Financial Times, 29 September 2010). US workers' representatives strike a similar chord. According to the president of the United Steelworkers Union, China uses "steroids" to boost its exports by employing a "predatory economic practice" and "feeding its economy by killing and devouring American manufacturing jobs" (Gerard 2010).

However, such inflammatory rhetoric cannot conceal that the verdict on China is far from unanimous. While there is consensus that China should increase domestic consumption, numerous commentators regard its currency practices as perfectly legitimate. Gregory Chin identifies three counter-explanations to the "neo-mercantilist" view that China hoards reserves to manipulate its currency: encouraging foreign investment, minimizing currency volatility and maintaining investor confidence (Chin 2010: 699). This is backed by Chinese officials who argue that their policies are not meant to favour exports, but rather to improve stability (Morrison/Labonte 2011: 1).[60] In turn, China points the finger at the US for creating excessive liquidity via its loose monetary policies, thereby driving inflationary pressure in its direction. An accumulation of large reserves, China claims, is inevitable with its large trade surplus. In addition, China is concerned about flows of "hot money" – defined as "international short

[59] US critics including Ben Bernanke, chairman of the Federal Reserve, have repeatedly blamed global imbalances and cheap money from China for causing the global financial crisis (New York Times, 19 October 2009). This view is refuted by the proponents of the "Bretton Woods 2" concept, Michael Dooley, David Folkerts-Landau and Peter Garber, who blame domestic factors. They regard the Chinese exchange policies as "the backbone of a successful industrialization or development strategy" and as sustainable for a few more decades (Dooley/Folkerts-Landau/Garber 2007: 107).

[60] It should be noted that among Chinese policymakers there is disagreement over the right currency strategy going forward. On one side, the PBC and its chairman Zhou regard excessive rigidity of the RMB as a constraint on their ability to curb inflation and bank lending. On the other, the Commerce Ministry and the commission which defines long-term economic strategy see the RMB as a tool "to maximise export employment" (The Economist, 08 April 2010). However, central bank independence is limited in China. The PBC's monetary policy committee is "still technically no more than an advisory committee and, as it stands, incorporates several government officials, including the deputy Minister of Finance" (Burdekin 2008: 80). On monetary governance within China see also Walter 2010: 22.

term speculative arbitrage" (SAFE 2010) – into the country by investors who seek profits in light of an imminent appreciation, hence sparking inflation fears (Burdekin 2008: 12).

The benign view is backed by a number of economists. For Barry Eichengreen, the "tried and tested development strategy" of restraining domestic consumption and maintaining a low real exchange rate has been "beneficial for years" in promoting high-value manufacturing (Eichengreen 2010a: 11). Joseph Stiglitz argues that revaluation of the RMB would not influence the US trade deficit due to a shift of production to Bangladesh and Cambodia – countries less willing than China to finance the US deficit (Stiglitz 2007 and also Frankel 2006: 3). He is echoed by Robert Mundell who says that RMB appreciation "wouldn't help resolve global current account imbalances, but would devastate China, causing drastic deflation, impoverishing the rural sector, and cutting its growth rate by as much as half" (Mundell 2006: 6). Critics, it is argued, ignore the benefits to US firms and consumers produced by cheap goods and credit, and to US enterprises manufacturing cheaply in China (Mercurio/Leung 2009: 1258).

Indeed, a report by the US-China Business Council shows that while China made up 43 per cent of the US trade deficit in 2010 – up from 19 per cent in 2000 –, the correlation to the exchange rate is not flawless (USCBC 2011: 10). The report also cites a thought provoking figure: the US exports to China grew by 468 per cent since 2000 – despite the alleged disadvantage of an overvalued USD (USCBC 2011: 8). Figure 11 pinpoints some irregularities in the neo-mercantilist argument:

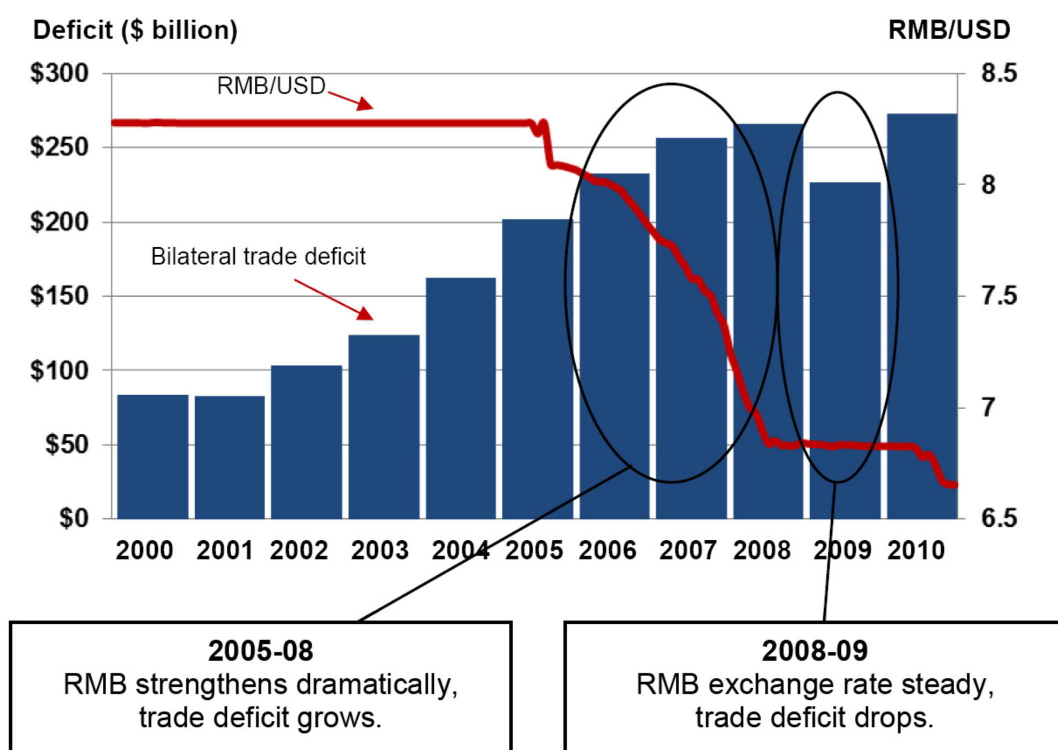

Figure 11: US-China Economic Relationship

In short, there is no denying that both the critics and the advocates of China's exchange policies have strong arguments in their favour. The exchange rate of the RMB is clearly below the level in line with its fundamentals. At the same time, China has every reason to support its development with appropriate monetary policies. After all, in terms of GDP per capita the US still outmatches China twelve times (USCBC 2011: 12).

The responsibility of IL in this dispute cannot be to rule on the economical soundness of China's development strategy. Rather, the Fund must restrict itself to its purpose – safeguarding international stability – by surveilling if China is living up to its obligations stemming from the Articles, in particular regarding exchange rate manipulation. The degree to which the IMF has fulfilled this responsibility is the subject of the next section.

5.2 IMF surveillance of the Chinese exchange rate policies

The Fund is tasked with evaluating China's compliance with the obligations of Art. IV:1 on a yearly basis in the form of Art. IV consultations. Section 4 found that the IMF has better tools at its disposal on the grounds of the 2007 Decision, but is still ill-equipped to give a candid assessment of dubious currency practices by a large economy.

This section explores bilateral surveillance of the member with the clearest indications of currency manipulation. The legal issues at the heart of the surveillance of China must be discussed first. Is there an outright breach of the obligations of Art. IV:1? This helps to clarify if the IMF has a reason, or even a duty, to speak out on the renminbi issue.

5.2.1 Is China in breach of the Articles?

To recall: there are two regulatory powers enjoined on the Fund: Art. IV and Art. VIII. In the case of China, compatibility with Art. VIII is given since 1996 (Mercurio/Leung 2009: 1284), whereas observance of Art. IV is highly problematic. Following the logic of Art. IV, the answer requires three steps. First, the legality of the *exchange rate arrangement* in the light of Art. IV:2 needs to be assessed. Next, the *exchange rate policies* must be judged against the criteria of Art. IV:1(iii), which entails both an *objective element* and a *subjective element*.

a) Exchange rate arrangement

The first step is unproblematic. As shown in section 3.1.1, Art. IV:2(b) covers a broad range of exchange arrangements, including pegs. While "the world's short recent history of floating exchange rates among fiat currencies has affected popular thinking about what is eternally

normal and proper in the economic system" (Steil 2007: 203), there is no legal basis to the claim that "one of the fundamental tenets of free trade is that currencies should float" (Wall Street Journal, 25 September 2006). The fact that China is preventing market forces from determining its currency can therefore not be held against it. However, the continuation of the arrangement must be compatible with the obligations of Art. IV:1 (Proctor 2006: 1344). If the exchange rate is used to promote exports, it may give rise to a breach of Art. IV:1(iii).

b) Exchange rate policies: the objective element

The second step is the objective element of currency manipulation of Art. IV:1(iii). On the basis of the 2007 Decision, "it is clear that China's exchange rate policy fulfils at least some of the 'developments' indicating the need for discussion (in particular (i), (ii) and (vi)" (Herrmann 2010: 44). This seems a fair assessment. China has indeed displayed "protracted large-scale intervention in one direction in the exchange market" (i), "excessive and prolonged official or quasi-official accumulation of foreign assets" (ii) and "large and prolonged current account deficits or surpluses" (vi). In addition, the provisions of the Annex to the 2007 Decision also appears to hold true. The RMB's "strikingly stable exchange rate following the adoption of a currency peg also makes it difficult to contend that China's exchange regime does not affect the exchange rate level" (Mercurio/Leung 2009: 1278). Hence, it can be safely maintained that the objective element of currency manipulation is fulfilled.

c) Exchange rate policies: the subjective element

However, it is more difficult, if not impossible, to prove the subjective element of Art. IV:1(iii). As reports by the US Treasury and the Fund have repeatedly underlined, it is not sufficient that China's exchange rate policies have the effect of creating an unfair competitive advantage or preventing a balance of payment adjustment. It must be shown that "those were the objectives which China had in mind and intended to achieve through the implementation of its policy" (Proctor 2006: 1343).

The legal argument brought forward in China's favour is that a pegging arrangement has numerous advantages unrelated to unfair competitive advantages, including "the certainty which it offers to investors and those doing business with the country concerned" (Proctor 2006: 1343). China was facing huge problems when it initiated its current monetary strategy: mass migration to the cities, rural unemployment, low standards of living and great poverty in some areas. Pegging the currency is a conventional way to achieve long-time stability if effectively

managed, and thereby conducive to the objective of Art. IV:1 to “promote a stable system of exchange rates”. Despite its recent economic boom, China still faces “unfinished banking reform, overcapacity in the industrial sector and enterprises generally inexperienced in dealing with big currency fluctuations” (China Daily, 17 April 2007). The stability argument is underlined by the fact that China maintained a peg since 1995, but tensions began to surface only in 2003 with its growing trade surplus (Proctor 2006: 1334).

In fact, the Chinese policy of maintaining stability despite a worsening of its competitive position against its neighbours was “widely praised” during the 1997 crisis (Proctor 2006: 1335). Moreover, the crisis in 2008 showed that countries with large reserves were less susceptible to economic shocks (The Economist, 4 November 2010). Foreign exchange reserves provided “self-insurance during the global liquidity crisis” (Frankel 2009: 14). While it is true that the Chinese export sector enjoys governmental privileges, the exchange rate is arguably only part of a wider set of subsidies like cheap credit for businesses or regulative benefits. For instance, China employs so-called “financial repression”: “controls on the investment of Chinese citizens that allow it to funnel capital into Chinese businesses” (Miller 2010).[61]

The critics of China claim that its exchange rate policies have the precise intention of securing an unfair advantage over its economic rivals. The lack of flexibility in the exchange rate since 1995 and the vertiginous rise in reserves since 2003 are regarded as evidence that China’s strategy is “manipulation by any standard and needs to be called that and acted upon” (Fred Bergsten in US House of Representatives 2007: 42). In this view, employment objectives are no justification, as all countries share similar concerns, or as Goldstein polemically phrases it, “should one additional worker hired in the export industry of China count more than one in Bangladesh or one in Egypt?” (Goldstein 2005: 7). For some critics, China’s admission that the exchange rate has the purpose of stimulating domestic employment is a confession of guilt in violation of Art. IV:1(iii) (Mussa 2007: 75).

However, these arguments do not substantiate the subjective element of Art. IV:1(iii). Justified as they may be on economic or political grounds, they do not stack up against the high

[61] Considering that competitive devaluation may amount to a trade subsidy, the powerful dispute settlement mechanism of the WTO is a tempting alternative to the IMF for dealing with currency misalignment. However, there is a clear division of labour between the two bodies. Art. XV:2 of the GATT provides that problems concerning monetary reserves, balances of payments or foreign exchange arrangements fall into the domain of the Fund. In addition, the IMF and the WTO adopted an agreement on cooperation in 1996 which in paragraph 8 repeated the Fund’s responsibility for exchange rates (IMF-WTO Agreement 2006). The potential of the WTO in determining currency manipulation and the collaboration between IMF and WTO is explored in Zimmermann 2010a, Mercurio/Leung 2009 and Staiger/Sykes 2008.

threshold of Art. IV:1(iii). The IMF has repeatedly stressed that a member enjoys the benefit of reasonable doubt and that Art IV:3(b) demands due regard for domestic policy choices.

In the light of the impossibility to denounce China as a manipulator on the grounds of Art. IV:1(iii), the IMF has two options. One is to bend the rules in order to get tough with China, as Fred Bergsten demands: “The fact that it’s not manipulating does not take it off the hook for needing to participate in the adjustment process and accept a substantial rise in the value of its currency” (Bergsten in US House of Representatives 2007: 42). Yet it appears highly unlikely that a clear finding of exchange rate manipulation may be reached by the Fund (Herrmann 2010: 44). The second and more reasonable option is to expect a candid assessment of the RMB’s undervaluation without resorting to explicit labels – after all, three indicators of the 2007 Decision are met, clearly suggesting policies in possible breach of Art. IV:1(iii).

5.2.2 Art. IV consultations with China prior to the 2007 Decision

a) 2001-2005

Ever since China initiated its policy of mass reserve accumulation in the early 2000s in combination with its rigid exchange rate, there have been calls for the IMF to improve its surveillance over Beijing. However, a report by the Independent Evaluation Office of the Fund (IEO) found that coverage of exchange rate issues of China in that period was “inadequate”. In the case of China “substantive engagement with the authorities was lacking on the specifics of exchange rate regime options identified by IMF staff” (IEO 2007: 14). Surprisingly, the 2004 consultation, the first one ever published, went as far as saying that “it is difficult to find persuasive evidence that the renminbi is undervalued” (IMF 2004 Consultation: 12). In addition, “some traditional indicators of exchange rate misalignment were not brought to bear on the issue through 2005, clouding the overall assessment of renminbi levels” (IEO 2007: 21).

This criticism is echoed by Mussa, who claims that in its surveillance of China before 2006, the Fund speaks “only vaguely about the desirability of ‘greater flexibility’” (Mussa 2007: 4). In response to this criticism, the IMF staff argued that all reports between 2001 and 2006 contained at least a short discussion of exchange rate issues (IEO 2007: 125).

A look at the 2005 consultation confirms Mussa’s contention: there is no proper assessment of China’s exchange regime; the arguments appear weak and the language bland. There is no attempt to quantify the possible misalignment of the RMB rate. To be precise, there is not a single piece of data to back up the arguments. In its neutrality, the report only refers to a pre-

ferred increase in *flexibility* (which could mean depreciation). The only hint to undervaluation fails to mention any developments in the economic fundamentals except "continued strengthening of the external balance" (IMF 2005 Consultation: 14). Even the arguments in favour of flexibility appear weak. For instance, it is argued that greater flexibility would help avoid "disruptions to the domestic economy" because "currency risk management instruments are underdeveloped" (IMF 2005 Consultation: 14). This is an odd finding, considering that the instruments to manage the RMB are quite sophisticated and the fixed exchange regime was instrumental in stabilizing the Chinese economy over a long period of time. In fact, the major disruption to the domestic economy happened in 2008 after China relaxed its peg for a few years and exporters took a hit.

Overall, the lack of analytical depth is striking. By stating that a further delay in changing the regime would "compromise the PBC's ability to conduct monetary policy" and that "investment decisions across the economy would also continue to be distorted, with resources allocated to projects in the traded goods sector" (IMF 2005 Consultation: 15), the staff merely states the obvious: the Chinese administration chooses stability over flexibility and exports over domestic consumption. But there is no proper assessment of the implications of these choices. And most important in regard to bilateral surveillance – there is no indication that the obligations of Art. IV played a part in the 2005 consultation.

b) 2006

From the outset, the 2006 consultation makes a better impression. The IMF staff itself regards it as particularly thorough in discussing all relevant exchange rate issues (IEO 2007: 125), citing the 2006 consultation with China as an example of good practice in exchange rate surveillance. The report is said to contain "extensive coverage of key exchange rate issues, including the exchange rate regime, the level of the exchange rate, and the implications of China's exchange rate policies for other countries" (IMF Getting it Right 2007).

To be sure, the 2006 report does display an increased focus on exchange rate issues. The consultation acknowledges that the promise of more flexibility of the previous year had not come into fruition. It states that "movement in the renminbi's real value over a considerable period of time has not been in line with most fundamental factors" (IMF 2006 Consultation 2006: 17). The IMF staff goes on to cite the massive reserve accumulation (from 219 billion USD in 2001 to 930 billion USD in 2006) and the growing current account surplus (1.3 per cent in 2001 to 7.2 per cent in 2005) as evidence of "undervaluation" of the RMB rate, something it failed to do in the previous editions.

But from this point on, the report again fails to quantify the extent of the RMB's misalignment. Instead, it gives ample room to the outlandish view by the Chinese authorities that "supply and demand conditions in the foreign exchange market were one factor accounting for the stability of the rate" (IMF 2006 Consultation 2006: 17). This pattern is repeated when the staff stresses the need "to utilize more fully the flexibility provided by the current exchange rate system to allow greater movement in the renminbi-dollar rate" and, for the first time, "further significant appreciation of the currency in nominal effective terms" (IMF 2006 Consultation: 18), only to shy away from its judgement on the next page by emphasizing that "exchange rate flexibility, not just appreciation, is what is needed for China's economy going forward" (IMF 2006 Consultation: 18), as if further *depreciation* was really a viable option.

Not least due to the additional caveat that "the direct contribution of an appreciation in China's exchange rate to reducing global imbalances might not be large" (IMF 2006 Consultation: 20), it becomes clear that the quantitative increase in exchange rate coverage did not correspond to a marked increase in candour. As in 2005, there is no apparent engagement on the issue of Art. IV:1. Nevertheless, the 2006 consultation caused some animosity between Beijing and Washington. Expressing the authorities' view, the official media outlet China Daily called the "meddling" by the IMF "disturbing" (China Daily, 17 April 2007).

5.2.3 Art. IV consultations with China after the 2007 Decision

a) 2007 - 2009

The reforms of 2007 did change the tone of the consultations with China, but not in the way the Fund or American critics might have hoped for. Rather than being able to exercise firm surveillance, the IMF was confronted with China's reluctance to engage in the surveillance process altogether. This standstill had two reasons. First, mounting pressure on the Fund to speak out against China which had returned to its monetary ways of mass reserve accumulation and a rigid exchange rate after the muted increase in flexibility in 2005. Second, the adoption of the 2007 Decision with its new indicators for currency manipulation. The bone of contention appeared to be development (v), "fundamental exchange rate misalignment". At least, this is what the account by the IEO suggests:

> The adoption of the 2007 Bilateral Surveillance Decision reinforced the perception of political pressures to address exchange rate issues. With China's exchange rate now potentially subject to being called "fundamentally misaligned", the 2007 Article IV consultation was not completed. Furthermore, while a staff report was written for the 2008 Article IV consultation, it did not go to the Board for discussion, reflecting the ongoing tensions over the implementation of the Decision. It was not until 2009 that a Board discussion took place for an Article IV con-

> sultation. This was a particularly critical period during which the Article IV process was effectively suspended for one of the world's most systemically-important economies (IEO 2010: 21).

As it turns out, China did not refuse to collaborate with the Fund entirely. The opening line of the (unpublished) 2008 staff report reveals that discussions indeed took place from May 2007 to June 2008 (IEO 2010: 21, footnote 27). However, China made use of its right to suppress the publication of any documents about the consultation.[62]

This move drew unprecedented attention to the often neglected Art. IV process. Critics from the US in particular saw it as an admission of guilt on part of China. A bipartisan group of US Senators released a statement claiming that "China's efforts to suppress the report show it has something to hide" (Schumer 2010). Considering how little credit the IMF sometimes receives for its Art. IV reports, the Senators' description of the report as a "smoking gun on currency manipulation" must have been flattering.

Nonetheless, the IMF reacted to the standstill by revising its guidelines for surveillance in 2009. In the words of Nigel Chalk, the IMF's mission chief for China, "the use of labels was proving an impediment to effective implementation of the decision" (IMF 2009 Transcript). But despite this revision, it was not until July 2010 that China felt confident about the release of its Art. IV report.

b) 2010

The differences between the 2010 consultation and previous editions are evident at first glance. The section on exchange rates is shorter (one instead of three pages in 2005 and 2006), and it includes statistical findings. In terms of content, it focuses on a single issue: why the staff believes that the RMB is "substantially below the level consistent with medium-term fundamentals" (IMF 2010 Consultation: 19). The arguments put forth are:

- The accumulation of international reserves continues to be rapid;
- The level of the real exchange rate is close to the level of the late 1990s even though, in the interim, China has had significantly higher productivity growth than its trading partners;
- China's current account is set to return to a position of sizeable surplus in the coming years.[63]

In these observations, the report appears sound. However, it raises the question why the IMF was so late on its call, as these precise developments had been widely denounced since the early 2000s. But then again, the candour of the 2010 consultation was limited by a number of

[62] Other countries who choose to suppress the release of their Art. IV reports include Guyana, Saudi Arabia and Myanmar (The Economist, 29 July 2010). In total, 88 per cent of reports are published (BBC, 29 July 2010).

[63] China had experienced a temporary reduction of the current account surplus prior to the consultation.

factors. To begin with, there was disagreement on the issue of undervaluation between the staff and the Executive Directors. The Public Information Notice (PIN) published after the discussion in the Board strikes a more conciliatory chord than the staff report:

> Several Directors agreed that the exchange rate is undervalued. However, a number of others [6 to 9 Directors] disagreed with the staff's assessment of the level of the exchange rate, noting that it is based on uncertain forecasts of the current account surplus. Many Directors [10 to 15 Directors] stressed that, over time, a stronger renminbi would help facilitate a shift from exports and investment to private consumption as the principal driver of economic growth (IMF PIN 10/100 2010).

In addition, media reports indicate that the tenor of the report was toned down before publication. Apparently, the draft version of the 2010 consultation contained a staff estimate of the RMB's undervaluation – putting it between 5 per cent and 27 per cent. However, this passage was omitted from the released document (BBC, 29 July 2010).

Lastly, the document follows the convention of the previous editions to grant abundant space to the arguments of the national authorities. For instance, the large reserve accumulation is attributed by China to the global expansion of liquidity. The lack in exchange rate flexibility is countered with the argument that "real exchange rate had been very flexible over the past decade" (IMF 2010 Consultation: 19). The fact that the Chinese arguments are again followed by the views of the Fund creates the impression of an endless to and fro – an effect contrary to the idea of discretionary surveillance.[64] As a result of these three caveats, Chinese media could call the 2010 consultation "softened", "conciliatory", and in *agreement* "with the country's approach to let the RMB appreciate in a gradual manner" (China Daily, 29 July 2010).

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[64] This "we-said, they-said" quality of the report was perfectly captured by the Economist, which turned the 2010 consultation into a "Socratic dialogue" (The Economist, 29 July 2010):

IMF: China's exchange rate remains "substantially" undervalued.
China: How do you know?
IMF: Because your dollar reserves are rising rapidly.
China: That's because the Americans are printing them so fast.
IMF: But your real exchange rate has barely strengthened since the late 1990s, despite all the progress you've made since then.
China: That is an arbitrary date. The rate is up by more than 50% since 1994 and by 22% since 2005.
IMF: You are quite right that comparison to any one point in time could be deceptive.
China: Yes.
IMF: But your surplus will be sizeable in the coming years. Look at our models!
China: We refute this view. Our surplus will keep falling in the next few months then level off. Equilibrium is at hand. The future will be different from the past. Your models are like shadows on the wall of a cave.
IMF: Can you lend us some money?
China: Would 50 billion USD do it?

[The dialogue alludes to the fact that the IMF, in a favourable turn of events, signed a 50 billion USD purchase agreement (the first ever) with China in September 2009, only months prior to the 2010 consultation (IMF Press Release 09/923 2009)].

c) 2011

Despite its critical undertone, the 2010 consultation seems to have appeased China. Reports by the IMF indicate that the 2011 consultation has been concluded on 9 June 2011 without any problems (IMF Press Release 11/225 2011). In terms of content, the 2011 report marks an improvement in a number of respects. Importantly, it finds “little reason to change the assessment made during the 2010 edition” (IMF 2011 Consultation: 18). Reserve accumulation was larger than expected and the exchange rate still “substantially undervalued” despite the 2010 reform – in fact, high inflation led to a real depreciation against the USD since 2010. The dissenting view of the authorities is clearly set apart from the staff view. Significantly, the staff has ventured to quantify the misalignment of the RMB for the first time. Using all three equilibrium methods at its disposal, it finds an undervaluation of 3, 17 and 23 per cent, respectively (IMF 2011 Consultation: 18, footnote 1). Faster appreciation, it concludes, would help China to achieve the rebalancing goals set out in its 12th Five-Year Plan.[65]

However, what might appear to be the first candid assessment of China in the history of surveillance is again washed out by the Executive Board. In the PIN, the Directors find that “China’s economy remains on a solid footing, propelled by vigorous domestic and external demand” and that “a major disruption in China’s so-far-steady growth would have material adverse consequences for the rest of the world” (IMF PIN 11/94 2011). The consequences of such an ambivalent message on part of the Fund are apparent by the reaction of the Chinese media. Headlines like “IMF lauds global role played by [China’s] economy” (Xinhua, 22 June 2011) and “China continues to be ‘bright spot’ in global economy” (Xinhua, 21 June 2011) indicate that the critical views of the staff, hidden in a footnote, got lost along the way.

Moreover, the candour of the 2011 consultation was dampened by the publication of an accompanying “spillover report”. Instead of providing a lucid assessment of the external threats stemming from China’s exchange policies, the report found that “currency revaluation alone yields only limited benefits to the rest of the world” (IMF Spillover Report 2011: 14). While it is true that “positive spillovers hinge more on other reforms to rebalance domestic demand” (IMF Spillover Report 2011: 14), the overall effect of the 2011 consultation was unintended: the Chinese authorities could, like in 2010, easily spin the report into an endorsement of their policies.

[65] Adopted on 14 March 2011, the 12th Five-Year Plan sets out China’s economic targets for the period from 2011 to 2015. It emphasises sustainable growth, the reduction of wealth disparities and boosting domestic consumption (Xinhua, 15 March 2011).

5.3 Interim conclusion: China and the challenges of firm surveillance

The consultations with China in 2005 and 2006 confirm the view that candid exchange rate surveillance of surplus economies was not possible on the basis of the original bilateral surveillance regime. The aspiration that an effective surveillance practice would evolve over time had not materialised. Rather, it seems that until 2007 the gloomy prediction of an early commentator came true:

> Because of the powers reserved to the states, the use of general language in the article, and the necessity in any case for a full exploration of the economic and historical context before attempting to give answers to questions that will arise in the future, the Fund faces a major challenge in breathing life into the words of the new Article IV. The Fund and its members cannot allow the words of the article to become *mere pious statements that are disregarded in practice* (Edwards 1976: 769, the author's emphasis).

Shortly before the 2007 Decision, the IMF staff bluntly described the reality of Art. IV consultations: "The Fund has thus chosen a modus operandi for surveillance that relies more on shaded appraisals than on statements of compliance or noncompliance. [...] Issues of potential breach of obligations almost never arise" (IMF Preliminary Considerations 2006: N. 26). This was echoed by the IEO which had examined the bilateral surveillance of 30 countries between 1999 and 2005. In fulfilling its responsibilities, "the IMF was simply not as effective as it needs to be" (IEO 2007: 3). Specifically, the IEO lamented a lack of clarity over the IMF's role which endangered its moral authority (IEO 2007: 7). Policymakers from large emerging economies called surveillance "a missed opportunity" (IEO 2007: 9). Five out of 30 reports contained little or no exchange rate analysis – for all the six years covered (IEO 2007: 21).

The 2005 consultation with China is a case in point. Despite strong evidence for reprehensible behaviour on part of China, there is no assessment of the exchange rate regime, an almost meaningless language and barely any analysis. That is not to say that China should have been called out as a currency manipulator. As shown, the concept of manipulation is highly problematic. Yet the total lack of engagement on the issue of misalignment is striking. While the indicators do not trigger an automatic breach of Art. IV:1, they can signal that a member's monetary policies are out of line with its obligations and deserve closer scrutiny.

By contrast, the 2006 consultation fares better. Its analysis is more thorough, reflecting the possibilities of hands-on dialogue with national policymakers – an exposure available to few institutions. However, it also demonstrates that exercising firm surveillance is not effective in a consensual framework. Mussa is right in claiming that the consultations until 2007 "clearly do not convey to the Chinese authorities any notion that the Fund's Executive Board has serious and urgent concerns about China's exchange rate policy" (Mussa 2007: 115).

Things changed markedly with the 2007 reform when the IMF signalled for the first time that the RMB might be denounced as "fundamentally misaligned". While it cannot be determined with hindsight if this increase in firmness was caused by the new rules or by growing frustration among the IMF staff, it seems that the candour of bilateral surveillance has improved with the publication of the 2007 Decision. In 2009, Robert Lavigne and Garima Vasishtha compared a sample of 24 Art. IV reports before and after the 2007 Decision. They found that their overall quality had improved, in particular in their "focus on external stability" and in the "quality of exchange rate analysis" (Lavigne/Vasishtha 2009: 1).

The recent surveillance of China, however, also reveals the limits of legalized currency obligations: the 2010 consultation "provides a perfect illustration of the great difficulty to come up with a precise and reliable assessment of the degree to which an exchange rate might be under- or overvalued" (Zimmermann 2010a: 10-11). Facing opposition from the host country, the staff report again failed to call out an apparent – at least regarding the objective element – breach of Art. IV:1(iii). Instead, the analysis is presented in a form typical for Art. IV consultations: a "laundry list of warnings, with no prioritization" (IEO 2010: 23).

In response to such criticisms, the deputy director of the IMF's Asia Department argues that "the public record on IMF work is really just the tip of the iceberg. A significant part is done out of the public eye" (Dunaway 2008: 336). Apparently, the IMF has been pressing China for an increase in exchange rate flexibility since 1999 (Dunaway 2008: 337) – not very successfully, it should be added, considering the immovability of the RMB rate in the last decade. Serious doubts arise as to the value of the Fund's informal pressure on country authorities. As a senior IMF staff member admits, hard-hitting surveillance of the largest shareholders "does not exist...you cannot speak truth to authorities...you're owned by these governments" (IEO 2010: 30).

On a positive note for the Fund, the surveillance of China shows that the Art. IV process is still of importance, even to large economies. Art. IV consultations are not the "mere routine zero-value exercises" some critics make them out to be (Pattainak 2007: 300). China could have simply ignored the release of the consultations from 2007 to 2009. Instead, it suppressed their publication and made sure that its views found their way into them. However, the attempt to increase the degree of legalization, albeit only with respect to precision, must be deemed a failure. The theoretical case for cooperation in the face of collective action problems lacks confirmation in the monetary area. It appears that hard rules do not provide a viable solution to the cooperation problem in exchange rate surveillance.

6. The choice for soft legalization in exchange rate surveillance

The Fund's credo that "there is broad agreement on what constitutes best practice surveillance" is wishful thinking (IMF Further Considerations 2007: N. 2). In reality, the best way to do surveillance is quite controversial. Despite a clear incentive for cooperation, the legal rules on exchange rate policies never returned to the level of legalization of the Bretton Woods era. Cautious attempts to increase their obligation, delegation or precision were rejected by members resolved to retain their monetary sovereignty.

According to the concept of legalization, states choose hard legal arrangements to increase the credibility of their commitment and to reduce transaction costs. However, these advantages may be outweighed by uncertainty costs and sovereignty costs. The ongoing reluctance by the IMF membership to submit to hard legal obligations regarding exchange rate policies suggests that it estimates these downsides larger than the benefits of cooperation. While the causality of the individual factors identified in this section cannot be measured, in combination they provide an explanation why exchange rate surveillance is an issue-area still characterised by soft legal obligations.

6.1 Uncertainty costs

No multilateral agreement can anticipate every contingency (Abbott/Snidal 2000: 433). Yet when uncertainty is too high, legalization can have adverse consequences and therefore fail to produce the desired benefits of cooperation. The failure to increase the precision of the bilateral surveillance regime in 2007 suggests that uncertainty considerations play a significant role in explaining the reluctance to harder legalization regarding exchange rates. In particular, this section argues that legal currency commitments are characterised by measurement difficulties, complexity, goal incongruence and subjectivity.

6.1.1 Measurement difficulties

One of the reasons why it is difficult to agree on hard legal agreements in the realm of exchange rate surveillance is that measuring "correct" exchange levels is hard, if not impossible. Faced with this challenge, some US critics seem to employ the approach of Supreme Court Justice Potter Stewart who in 1964, asked for a definition of pornography, famously said: "I know it when I see it". In a proposed currency bill, the US Senators Charles Schumer and Lindsey Graham set the undervaluation of the RMB at an arbitrary 27.5 per cent by simply taking a median of some estimates (Herrmann 2010: 40). Trade unionist Leo Gerard boldly

claims that "the discount for Chinese products sold in America is as much as 40 per cent" (Gerard 2010). Yet, "the awkward truth is that it is almost impossible to be sure when a currency is misaligned, let alone by how much" (The Economist, 21 July 2007). There is no economic definition of "undervaluation". Without plunging too deep into the technicalities of exchange rate measurement, it is useful to highlight some of the flaws of the two methods commonly employed to measure misalignment: purchasing-power parity (PPP) and equilibrium approaches.[66]

The oldest method is PPP – the idea that a currency should buy the same amount in every country, which in the long run, through the actions of importers and exporters, would induce prices to be equalised by exchange rates across countries (Suranovic 2010: 30-1).[67] The problem with this method is that prices are not only influenced by tradable factors. Impediments to PPP can also include transportation costs and trade restrictions, costs of non-tradable inputs, the impossibility of perfect information and the behaviour of other market participants (Suranovic 2010: 30-4). Price differences may be caused by cheaper labour, rent and electricity (Burdekin 2008: 27). Moreover, the estimates yielded by PPP depend on the particular index used to compare price levels (Boughton 2001: 81). While still popular for illustrative purposes, the PPP approach is too flawed and static for the purpose of exact measurement.

More commonly used are equilibrium exchange rates – which "refer to the exchange rate that is consistent with a given set of fundamentals over the medium to long term" (IEO 2007: 53).[68] Equilibrium rates are problematic for a number of reasons, including that "many different factors on both the trade side and the financial side influence a country's trade imbalance besides just the exchange rate" (Suranovic 2010: 30-6). The two most important equilibrium methods are models based on internal and external balance and on the estimation of a reduced-form equilibrium real exchange rate regression (IEO 2007: 53). Out of these, the fundamental equilibrium exchange rate (FEER), employed by the Peterson Institute in its esti-

[66] Nobel laureate Paul Krugman suggests a third, rather unorthodox approach in the vein of Justice Stewart: "We know that the renminbi is grossly undervalued, not through questionable estimates that can be endlessly debated, but on a PPE (proof of the pudding is in the eating) basis: the current value of the renminbi is consistent with massive artificial capital export, and that's that" (New York Times, 16 March 2010).

[67] A crude version of this approach is the Economist's Big Mac Index. The latest edition (July 2011) suggests a modest undervaluation of the RMB against the USD of 7 per cent in trade weighted-terms. Available online: <http://www.economist.com/markets/Bigmac/Index.cfm>.

[68] Equilibrium rates were first defined by Ragnar Nurkse in 1945 as "the rate that would produce equilibrium in the balance of payments but without wholesale unemployment at home or abroad, undue restrictions on trade, or special incentives to incoming or outgoing capital flows" (in Goldstein 2006: 315). For a general survey of equilibrium methods see Siregar 2011.

mates of RMB undervaluation, can serve as an illustration of the difficulties in calculating equilibrium rates.

FEER hinges on the idea that there is an exchange rate consistent with current-account balance and internal balance (full employment with low inflation). As it is difficult to identify the level of potential output, it assumes that "the adjustment process assures internal balance when external balance is achieved" (IEO 2007: 53). However, FEER has a number of flaws. To begin with, "a large current-account surplus does not necessarily prove that a currency is unfairly cheap" (The Economist, 21 July 2007). It may simply "reflect countries' different savings and investment rates". Second, it is increasingly difficult "to define the sustainable level of a current account in a world of mobile capital" (The Economist, 21 July 2007). FEER removes speculative capital flows from the medium-term capital account (IEO 2007: 53). But most importantly, FEER assumes that China is at internal balance (Bouveret 2006: 1), whereas in reality China, with its crumbling state enterprises and large rural population, is far from balanced internally. As a result, Pattainak considers FEER only of "academic value" and claims that since its introduction in 1983, "no real progress has been made in operationalizing the concept in the sphere of policymaking" (Pattainak 2007: 319).

The consequence of this methodological uncertainty is that estimates of currency undervaluation vary greatly. The Treasury admits that "there is no absolutely precise way to calculate equilibrium exchange rates" (US Treasury 2008: 5) and that the results are "very sensitive to various modelling assumptions" (Treasury official Mark Sobel in US House of Representatives 2007: 102). A working paper by the IMF found that estimates of RMB misalignment range from 49 per cent undervaluation to a small *overvaluation* (Dunaway/Li 2005: 3). In a more recent study, the estimated misalignment varied between 50 and 12.8 per cent (Cheung/Chinn/Fujii 2010: 87). Practitioners adapt to this uncertainty by employing a range of calculations – the investment bank Morgan Stanley uses an index made up of "no fewer than 13 models to value currencies" (The Economist, 21 July 2007).

The IMF itself acknowledges that there are "considerable uncertainties surrounding exchange rate misalignment estimates" (IMF Further Considerations 2007: N. 37). To overcome this, the Fund strives "to stay at the forefront of research on exchange rates". On average, it issues "over 30 working papers a year on exchange rate-related issues" (Aylward 2007). However, its calculations are troubled by the fact that there exists no "agreed benchmark" on what constitutes an unfair exchange rate – neither Art. IV nor the legislative history provide explicit guidance on what the benchmark should be (IMF Companion Paper 2007: N. 30). In an at-

tempt to improve its work on exchange rate calculations, the IMF established the Consultative Group on Exchange Rates (CGER) in 2006. The CGER came up with three methodologies based on equilibrium approaches that were included in Art. IV consultations (IMF Press Release 06/266 2006).[69] All three would treat as "unfair" deviations from the equilibrium level (IMF Companion Paper 2007: N. 5). Reasons for deviating exchange rates may include exchange rate policies, market imperfections, or unsustainable domestic policies (IMF Companion Paper 2007: N. 6).

And yet, all three methods are far from satisfactory. An internal review of the new approach in 2008 found "widespread dissatisfaction with the Fund's exchange rate analysis, including wariness of the quantitative techniques used by staff" (IMF 2008 Review: N. 30). Too often, it claims, "assessments are presented as a 'black box' without adequate documentation of underlying assumptions made by staff". This is the case with China's 2011 consultation where the quantifications are presented almost timidly in a footnote without further explanations.

The question is how to deal with these challenges. The choice is between two options: trying harder or accepting the impossibility of exact quantifications of exchange rates. The IEO is in favour of the former. It claims that "to improve assessments of the exchange rate level, the IMF should be at the forefront of developing the needed analytic framework. The genuine difficulty in doing this is no excuse for not making more progress" (IEO 2007: 37). Mussa also argues that considerable margins of error in Fund surveillance are not a serious problem because "the objective is, or at least should be, to identify cases where exchange rates are substantially misaligned" (Mussa 2007: 25).

Brazil's Finance Minister Guido Mantega recently urged the IMF to create such a "manipulation index" to support actions through the WTO (Reuters, 28 October 2010). But there are serious doubts if the costs and difficulties involved would justify such an approach. In 2009, the IMF mission to China refrained from making a quantitative assessment: "Given the current global climate it [was] very difficult to put any particular point estimate on how large undervaluation is" (IMF 2009 Transcript).[70] Ultimately, the attempt to achieve excessive precision seems counterproductive.[71] As Eichengreen notes, "it would probably be too delicate a

[69] The three methods are called the macro-balance approach, the external sustainability approach and the effective exchange rate approach. For further explanations see IMF CGER Methodology 2006.

[70] While the staff report of the 2009 consultation was not published on China's request, the Fund did hold a telephone conference regarding the findings of the IMF mission (IMF 2009 Transcript).

[71] Expressing a minority view, Pattainak goes a step further in suggesting that the IMF should disregard exchange rate *levels* altogether and instead focus on managing exchange rate *volatility* (Pattainak 2007: 303).

task for the fund to attempt to act as an exchange rate 'umpire' – to announce by exactly how much exchange rates were overvalued or undervalued and to declare some as seriously misaligned" (Eichengreen 2010b). In particular, "computing and publishing a single set of reference rates would give the process a spurious sense of precision and undermine its credibility" (Eichengreen 2007: 165). In a similar vein, Frankel suggests to "retire the language of 'manipulation'" in order not to "cheapen the language appropriate to WTO rules" (Frankel 2010: 29). By withdrawing the use of the term "fundamental misalignment" in 2009, the Fund has taken the first step in this direction.

6.1.2 Complexity

A related cause of uncertainty is the complex nature of monetary policies. Beyond the technical question as to what constitutes a "correct" exchange rate, the relation between economic policies and the exchange rate is not sufficiently explored. The IMF itself reckons that "since policies work together to produce outcomes, attribution of outcomes to exchange rate policies will typically be difficult, and, consequently, cases where such attribution can be made beyond any reasonable doubt are expected to be very rare" (IMF Revised Guidance 2009: Appendix, Q. 1).

a) Domestic factors

As the section on the RMB has shown, influencing an exchange rate requires an intricate domestic policy mixture – and there is no guarantee of success, as the efforts by the Japanese central bank to influence the rate of the yen have repeatedly demonstrated. It is simple for policymakers to impose a tariff on a particular product. In contrast, the exchange rate can only be a target of monetary policy (US Treasury 2008: 5), not a result in the instrumental sense. Consequently, "exchange-rate policies are inherently difficult to separate from monetary policies more generally" because "interest rates, inflation rates, and exchange rates are in practice intimately related" with a "range of other policies" also having an impact on all of these variables (Pauly 1997: 39).

The factors that influence the exchange regime include, among others, "whether an economy is relatively closed or open to trade and financial flows, the extent of pass-through from exchange rate changes to domestic inflation, the flexibility of labour and other factor markets, the concentration of trade" as well as "the sophistication, credibility, and quality of a country's institutions" (US Treasury 2008: 5). This was echoed by the 2008 review of surveillance which found that "uncertainty is particularly great when it comes to attributing outcomes to

exchange rate policies or other policies, since it is always the policy mix that matters" (IMF Revised Guidance 2009: N. 3).

It appears that the evolution of the surveillance regime since 1977 has not kept pace with the complexity of these domestic factors. Originally, the 1977 Decision focused only on exchange rates because that was all that the members could agree on in the amended Art. IV:1. Over time, this restriction prevented effective surveillance. Therefore, a broader range of economic policies became subject to Art. IV consultations, but without an expansion of the Fund's legal powers, as the new Principle D in the 2007 Decision testifies. For comprehensively monitoring all policies related to exchange rates, the Fund's mandate would have to be increased significantly, which is an unlikely prospect.

b) External factors

In addition to the uncertainty regarding the effect of domestic policies, the dependence on external developments also plays an important role. As the exchange rate reflects conditions in other countries as well, there is an "inherent ambiguity" in regulating domestic policies in regard to the (external) exchange rate (Boughton 2001: 160). This can be illustrated with the case of Brazil. With the end of the global recession in 2009, excessive liquidity in the US in combination with a commodity boom attracted large capital flows to prospering emerging economies. Brazil saw its currency rise by 38 per cent against the dollar within two years due to this inflationary pressure (The Economist, 13 January 2011). It was forced to intervene by installing capital controls and buying dollars to prevent overheating of its economy and a continued deterioration of its competitive position.

Another example is Switzerland. Recently, Swiss exporters grew increasingly frustrated by the continuous appreciation of the franc – 8 per cent against the euro and 15 per cent against the dollar in 2011 alone, as "investors have sought safety from the debt problems of both the euro zone and the US" (Wall Street Journal, 18 July 2011b). To maintain its country's competitiveness, the Swiss National Bank took a bold step. It effectively ended Switzerland's monetary independence by committing to "unlimited purchases" of reserves to achieve a peg to the euro (The Economist, 06 September 2011) – a decision with potentially damaging consequences such as speculative bets against the franc as well as inflationary fears.

Such "spillover effects" contribute to the difficulty in surveilling exchange rate policies. As Jonathan Kirshner explains, punishing the producers of macroeconomic "bads" (such as exchange rate policies) is problematic: "If injured states punish the producers of the negative

spillovers, then those policies will be perceived as costly and curtailed. But while states can be discriminatory in their trade policies, the international economic effects of macroeconomic policies are almost inherently uniform" (Kirshner 2003: 649). By this logic, the benefits of multilateral collaboration to regulate damaging spillovers are offset by the likeliness of incurring undesired costs.

This difficulty translates into the rules on exchange rates. The Articles do not specify any substantive external policy obligation that Members must adhere to following the Fund's responsibility to "oversee the international monetary system" in Art. IV:3(a) (Hagan 2010a: 964). There is no decision on multilateral surveillance comparable to the 2007 Decision on bilateral surveillance that fleshes out Art. IV:3(b). Attempts to examine cross-country spillovers in the traditional Art. IV process have not been successful so far (Lavigne/Vasishtha 2009: 1). Surveillance of the US during the subprime mortgage boom "said little about the potential implications of the country's policies for the stability of the international financial system" (Eichengreen 2010b).

This has two reasons. First, that "the current legal framework for bilateral surveillance requires the Fund to examine outward spillovers arising from a member's policies only when they are transmitted through the member's balance of payments". Second, that "each member is required to promote systemic stability only by promoting its own domestic stability" (IMF Modernizing Surveillance 2010: N. 6). In other words, on the grounds of the current framework the Fund can only act against policies that undermine the member's *external* stability (defined as "the avoidance of disruptive exchange rate movements", IMF Further Considerations 2007: N. 13). This has the paradoxical effect that the Chinese policies, which are the reason for the spillovers in the first place, actually serve to shield China from criticism by stabilizing the exchange rate and thus avoiding disruptions to it.

Attempts to overcome problem of external spillovers by adopting voluntary multilateral consultations with China, the Euro area, Japan, Saudi Arabia and the US in 2006-2007 had little impact because the participating countries refused to commit to any new policy measures (Schinasi/Truman 2010: 3). The multilateral consultations resulted in an "appearance of consensus but little action, at which point the process was overtaken by events" (Eichengreen 2011a: 5). Anne Krueger, former deputy Managing Director of the IMF, reckons that policymakers with domestic mandates, like central banks, are not going to take external spillovers into account unless when they feed back into domestic developments like inflation (quoted in

The Economist, 9 October 2010). Therefore, it is unlikely that legal rules are capable of limiting the detrimental external effects of exchange rate policies.

6.1.3 Goal incongruence

But even if measuring misalignment and attributing the effect of domestic and external factors was improved, agreement on an "optimal national exchange rate policy" would remain a challenge (Broz/Frieden 2002: 319). In the international monetary system, the policy goals of states tend to be incongruent. As a result, "insufficient consonance of interests between different regulatory players" prevents legalized arrangements (Brummer 2010: 635).

The comparison with trade is again illustrative. As Ernst Baltensperger and Thomas Cottier note, regulating trade through IL is "difficult enough" (Balternsperger/Cottier 2010: 924). In Bretton Woods, the proposed International Trade Organization could not be agreed on. The Uruguay Round for transitioning to the WTO was almost ten years in the making, while the current Doha Round came to deadlock. But at least there is broad agreement among participants on the advantage of free trade (Balternsperger/Cottier 2010: 924). For many centuries, states have agreed on trade agreements – either for favoured-nation treatments or preferential arrangements (Lowenfeld 2008: 598).

This is quite different in the realm of money. Each of the numerous options at the disposal of currency makers (pegging or floating, a strong or weak level of the currency, with a myriad of intermediate solutions) comes with a political price. A strong currency boosts domestic consumption whereas a weak currency benefits exporters. Pegging gives stability by reducing uncertainty and lowering transaction costs, while floating allows macroeconomic flexibility and reduces the sensitivity to external shocks (Cohen 2008: 27). States at different stages of development may come to different conclusions when waging the trade-off between the costs and benefits of particular exchange regimes (Broz/Frieden 2002: 319) – depending on factors such as "their size and openness, the flexibility of their domestic labour markets, and the patterns of shocks that they face" (Willet 2002: 11).[72] These divisions can even extend inside the state authorities – such as between those who favour growth or containing inflation (Walter 2010a: 22). Overall, governments are on their own – "there is no generally accepted economic

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[72] In an early study on the subject, Cooper discussed the criteria for choosing between 39 different monetary regimes (differing in the role of exchange rates in balance of payments adjustment, of the reserve asset and of capital convertibility). He finds that "a clear-cut cost-benefit analysis" of this issue is not possible due to the uncertainties involved (Cooper 1975: 91). Today, two literatures have emerged on exchange rate regime choice: economics focuses on factors such as openness, country size and labour mobility, whereas IR includes determinations of power and interest. For an overview see Leblang 1999: 601.

model that determines whether it is better for a country to float, fix, or manage its exchange rate or how to relate exchange rate policy unambiguously to one or more of several macroeconomic goals" (Boughton 2001: 74).

To make things worse, goals cannot only deviate, but also run contrary to each other. Take growth and stability, for instance. The IMF regards growth as an important means to promote external stability "through its effects on sustainability and on long-term developments in macroeconomic policies" (IMF Further Considerations 2007: N. 24). But at the same time, excessive growth creates inflationary pressures that destabilise the domestic and international economy. As the Director of the IMF's Legal Department concedes, "there is an emerging recognition that there may be cases where a member's domestic policies, while being completely supportive of domestic stability, may nevertheless give rise to systemic instability" (Hagan 2010a: 963).

Some may point at the high degree of legalization in the euro zone to demonstrate that agreement over exchange rate outcomes is less problematic than stated so far. However, Europe needs to be regarded as an exception in the international monetary system. Lawrence Broz and Jeffry Frieden have identified five factors stimulating cooperation on exchange rate issues, and it appears that Europe ticks many boxes: a shared interest in currency stability; linkage to other policy areas; an institutionalised nature of interstate cooperation to work out differences associated with greater cooperation; a small number of states willing to take the lead and bear adjustment costs; and favourable environmental economic conditions (Broz/Frieden 2002: 338-9). Taken as a whole, the euro members still display a strong reluctance to external interference. Until the recent sovereign debt crisis, the EU never allowed the IMF to intervene in internal macroeconomic policy discussions (Mussa 2007: 2). Moreover, cooperation is far from perfect. The Stability and Growth Pact, a stringent monetary and fiscal agreement between the members of the euro zone, was repeatedly breached by Germany and France and relaxed in 2005 at their behest.

6.1.4 Subjectivity

A major uncertainty in regulating monetary conduct through legal obligations is its subjectivity: the importance of intentions over results. As the episode of Brazil has shown, no monetary tool can be discarded on principle. Employed carefully, interventions and capital controls can prove instrumental in stabilizing an economy. The Directors stressed that the obligations of Art. IV:1 "should not be construed as stigmatizing the use of these legitimate policy options

per se or removing them from the toolkit of members" (IMF PIN 07/69 2007). In fact, the Fund has advised countries often enough "to devalue the currency and thereby to restore the international competitiveness of the country's export industries" when domestic inflation was rising excessively (Boughton 2001: 84). As the disputed case of China – and the sympathetic reaction to the recent attempt by the Swiss to safeguard the competitiveness of their industry – make clear, there is a thin line between legitimate and reprehensible policies.

In the case of the WTO, the dispute settlement panel "will only be interested in examining the existence of an objective adverse effect created by a clearly identifiable governmental measure" (Zimmermann 2010a: 24). The intention behind particular policy measures is irrelevant. In contrast, the IMF repeatedly emphasised that a clear intent to pursue specific policies in breach of Fund obligations must be demonstrated and that members always enjoy the benefit of the doubt. Regardless of the success of its measures, a member must display the intention to engage in beggar-thy-neighbour policies. Zimmermann therefore characterises Art. IV:1 as an "obligation of conduct", as opposed to the "obligation of result" of the WTO (Zimmermann 2010a: 924).

Mussa tries to get around this problem by claiming that the "intent" requirement in Art. IV:1(iii) only refers to the specific obligation (iii) and not to the general obligation of Art. IV:1 to "ensure the effective functioning of the international monetary system" (Mussa 2007: 14). A member, he claims, "could not deflect a request by the Fund for policy action [...] with the assertion that its policies were not intended – and could not be proved to be intended – to disrupt the effective functioning of the international monetary system" (Mussa 2007: 14). However, he fails to mention that the general obligation has no legal value, it is hortatory at best. Attempts to give bilateral surveillance the character of an "obligation of result", such as the introduction of Principle D in the 2007 Decision, were always met with fierce opposition by the IMF membership and are therefore unlikely to succeed.

The case for subjectivity is so strong that even the ardent critics of China in the US face difficulties in pinpointing its wrongdoings. A report in 2005 by the Government Accountability Office (an investigative arm of Congress) stated that in order for Treasury to reach a positive determination of currency manipulation, finding "a material global current account surplus and a significant bilateral trade surplus with the US" is not sufficient without demonstrating intent (quoted in Morrison/Labonte 2011: 8).

The best illustration of the difficulties in determining malign currency practices is provided by a debate in Congress on the renminbi between Sander Levin, the combative chairman of the Subcommittee on Trade, and Mark Sobel, the Treasury official responsible for external exchange rate relations. At this point of their exchange, Levin is increasingly irritated by Sobel's attempts to shirk shaming China:

> But why can't you say – why can't you simply acknowledge that it provides them an unfair competitive advantage in international trade? Essentially, what you do is to look for reasons not to name them. All my suggestion is the time has come for us to be straightforward with each other and with the American people. There may be other reasons that you don't want to name China. As long as you kind of dance around it, you're going to cause disillusionment (US House of Representatives 2007: 113).

The congressmen go on to press Sobel whether the Treasury is about to declare China a manipulator in its next report. As he dodges their questions again, the pugnacious Republican Paul Ryan chimes in:

> We're on the same team. We're trying to give the President and you folks who are sitting here the tools that you need to get tough with China and to have some real teeth in some laws that you can go and use when you're negotiating. You said yourself, talk, talk, talk. This isn't about bashing China – this is about good people in the United States of America losing their jobs that pay a lot of money and contribute to the tax base of communities, leaving because of an unfair trade practice and an intentional, in my mind, *currency manipulation or misalignment or whatever the technical terms we need to use* (US House of Representatives 2007: 116, the author's emphasis).

Ryan's frustration is a testimony to the problems of determining unseemly monetary conduct. And when the concept is stripped of economic and legal reasoning, political motives lay bare. Jeffrey Frankel has indeed demonstrated that accusations of currency manipulation on the part of the US are more likely when certain domestic variables apply (such as unemployment in election years) rather than legitimate economic concerns (Frankel 2010a: 10).

6.2 Sovereignty costs

In the view of legalization, states relinquish control over functions traditionally performed domestically when cooperation yields better results. Accordingly, states show little disposition to abide by international rules when the surrender of sovereignty leads to outcomes regarded as disadvantageous. In addition to uncertainty, costs may be caused by an encroachment on national sovereignty (Abbott/Snidal 2000: 436). Such sovereignty costs may arise for "psychological or symbolical reasons, or they may have a material basis where by supranational decisions could be detrimental to national interests" (Alexander 2000: 12).

In these days, the importance of sovereignty in currency matters is not intuitive. After all, many economies – including the US – do not pursue an active currency policy through measures aimed directly at the exchange rate. However, even when monetary decisions are delegated to an independent central bank, the responsibility for the domestic currency rarely shifts outside national borders. States especially fear reputational damage, a distributive impact as well as a loss in monetary power.

6.2.1 Reputational damage

Morris Goldstein wonders why external criticism is considered particularly detrimental regarding exchange rate policy – leading the accused states to "lose face", harden their position and delay reform (Goldstein 2006: 326). The answer is that monetary sovereignty has an importance for national policymakers that goes beyond economic reasoning. In Britain, opposition to the euro is instrumental in drumming up electoral support. Many Germans still resent giving up the d-mark. In Asia, the meddling of the IMF during the crisis of the 1990s is remembered with animosity. Money, Cohen argues, "has long played a key symbolic role for governments, useful – like flags, anthems, and postage stamps – as a means to cultivate a unique sense of national identity" (Cohen 2003: 5). Famously, Mundell once said that "great powers have great currencies" (Mundell 1993: 10).

While Mundell was referring to a strong, and not an artificially low exchange rate, bowing to external pressure in regard to the national currency can still be fatal. According to Mussa, "changing an exchange rate that is pegged [...] is almost always seen as a defeat for the government officials involved" (Mussa 2007: 76). Accordingly, policymakers have shown great reluctance to allow outside interference ever since the end of the par value system. When the idea of "objective indicators" to trigger sanctions by the Fund was suggested in the 1970s, the British Prime Minister Margaret Thatcher said that "no one is going to tell me how to run economic policy". A spokesperson for the US Treasury echoed that "we wouldn't want to have the IMF order us around ...either" (both quoted in Gold 1983: 477). The political implication of exchange rate choice is straightforward: "Politicians may use [...] monetary policy to engineer greater support before elections" (Broz/Frieden 2006: 593). Therefore, "policymakers cannot risk having their hands tied when it comes to domestic monetary policy" (Leblang 1999: 604).

Rare attempts to challenge the domestic sovereignty over money were nipped in the bud. In 1976, Friedrich Hayek suggested "de-nationalizing" currencies by allowing for private, com-

peting currencies (Hayek 1976, summarised in Reinert/Rajan 2009: 244). His reasoning was that a currency monopoly, like any monopoly, leads to inefficiencies and abuse. However, his ideas found no resonance beyond academic circles as national currencies turned out to be too important a symbol.

In the area of trade, reputational repercussions pose less of a problem. When the WTO finds a member in breach of its obligations, it can negotiate compensations or grant a member the right to retaliate with trade sanctions. While such a ruling may have a negative impact on a member's reputation, the effect seems limited in scope and time. In contrast, the IMF's judgements on currency policies appear more controversial politically as well as more market-sensitive.

It makes sense that this feeling is even more pronounced in China, where a traditional diffidence in multilateral action is paired with new-found economic vanity. And indeed, China still displays great reluctance to allow external interference in currency matters. Not only has it resisted public shaming in Art. IV reports, it even tried to prevent a discussion of its exchange rates altogether. At the 2010 G-20 Summit in Toronto, a statement welcoming China's announced shift to flexibility was expected, but dropped from the final declaration upon Chinese request (Reuters, 27 June 2010). The final version carefully stated that "emerging surplus economies will undertake reforms tailored to country circumstances" to "enhance exchange rate flexibility to reflect underlying economic fundamentals" (G-20 2010, N. 12).

Concerning the renminbi, China shows an attitude similar to human rights questions – it hardens its stance in the face of external criticism. In 2005, an unyielding Premier Wen Jiabao claimed that China regards "reform of the exchange rate of RMB an issue of sovereignty, and will never yield to any external pressure to change it" (Xinhua, 17 May 2005). This is why Frankel warns that "demands that China stop intervening in the foreign exchange market to keep the renminbi fixed against the dollar could be counterproductive" (Frankel 2009: 14).

6.2.2 Distributional impact

According to rational institutionalists, states commit to hard rules in the prospect of Pareto-efficient outcomes which create no losers. When it comes to surrender control over the domestic currency, however, states may fear a distributional impact. While the effective ability of state authorities to manage their exchange rate is hampered by externalities it often has no control over – such as vast foreign exchange markets and the securitization of currencies

(Sono/Kanda 2010: 510) –, a commitment to a particular exchange rate goal can nevertheless turn costly, both politically and economically.

This is not the case when things go well – and public interest in currency matters is limited. However, "precisely because the public does not perceive much stake in the international monetary system, it will not be willing to make many sacrifices to preserve it once its dictates conflict sharply with the requirements of domestic economic policy" (Cooper 1975: 92). After its futile attempt to preserve the fixed rate of the British pound in 1992, the Tories lost their lead in the polls until Prime Minister John Major was ousted from office (BBC, 9 February 2005).

The benefits of monetary cooperation – such as stability and lower transactions costs – may be felt only in the long run, whereas the domestic impact of fulfilling monetary obligations is often immediate – and painful. Currency commitments may involve domestic measures such as "austerity budgets, deflationary monetary policy, costly and compulsory intervention in exchange markets, and a number of other initiatives such governments would otherwise not undertake" (Kirshner 2003: 649). Importantly, this applies both to maintaining and to changing an exchange rate. Fixed exchange rate commitments are agonizing since they offer speculators one-way speculative bets with minimum risk that force governments to raise interest rates to "astronomical levels" (Willett 2002: 9). But change in the exchange rate is also "always a price change that hurts somebody" – the government "is blamed by those who feel the hurt and gets little credit from those who are benefited" (Mussa 2007: 76).

China witnessed this development during the financial crisis in 2008 when its labour-intensive manufacturing sector faced rising costs due to higher inflation, slowing demand and the effect of RMB appreciation. Realizing that its hold to power is "likely to remain secure so long as it can continue to develop China's economy and create jobs" (Miller 2010), the Communist Party responded to complaints from exporters, who saw their sales plummeting, by re-installing its traditional peg to the USD (Frankel 2010b: 53).[73] A number of government bodies promoted the view that "job creation was essential for social stability" (Walter 2009: 17).

However, the desire to deflect distributional impact from exchange rate commitment is not uniform across the IMF's membership. Given the recent rise in capital mobility, most developed countries favour monetary and fiscal autonomy via independent central banks and infla-

[73] Regional party politics play a big role. Qu explains how in China the leaders of the export-heavy provinces on the East coast are promoted to the central government based on the economic success they achieve in their office (Qu 2010: 23).

tion targeting.[74] In contrast, many emerging and developing countries prefer exchange rate targeting – which “puts them at greater risk of falling foul of existing global rules and norms” (Walter 2009: 9). The divide in the run-up to the 2007 Decision demonstrates how fears of an asymmetrical distributional impact hamper legalization efforts.

On one side, the US strongly supported revising exchange rate surveillance. According to Frankel, “the US Treasury in early 2006 passed the Chinese renminbi hot potato on to the IMF” (Frankel 2007: 12). As Pattainak argues, “giving an institution like the IMF a greater voice on a member country’s exchange rate policy appeared more convenient to the US than attempting international coordination through Plaza or Louvre type agreements” (Pattainak 2007: 315). He quotes former Treasury Secretary Larry Summers in viewing the IMF as “among the most effective and cost efficient means available to advance US priorities worldwide” (Pattainak 2007: 317).

On the other, the Group of 24 emerging and developing countries expressed concern that “expanding the principles for the guidance of members in the Decision would blur the distinction between surveillance over exchange rate policies and over domestic policies” (Group of 24 2007: N. 10). They feared it would give the IMF more leverage over their countries, while leaving untouched the Fund’s inability to influence major economies (IEO 2008: 22-23). A common perception emerged that “the multilateral regime is itself asymmetric and flawed” (Walter 2009: 21). Therefore, the Group of 24 expressed three requests in regard to any revision of the 1977 Decision: no new obligations, due regard to country circumstances and flexibility (Group of 24 2007: N. 10).

Thirty years earlier, the Fund could have passed the Decision in disregard of these conditions. This time, however, the Executive Board tried to appease the Group of 24. Instead of simply adopting the 2007 Decision with a majority of votes cast by the industrialised countries, it made changes to the draft Decision to achieve a broader consensus (Leckow 2008: 293). Nevertheless, a number of members expressed their reservation over the 2007 Decision, including India, Brazil and Argentina (Lavigne/Schembri 2009: 1). China in particular was highly critical. In its view, the Fund should concentrate on helping to achieve external stability and strengthen its surveillance over members issuing major reserve currencies. Exchange rate adjustment, the Governor of the PBC Zhou Xiaochuan argued, is not “the ultimate and only policy instrument in resolving external imbalances” (Zhou 2006).

[74] In the G-20, only China and Saudi Arabia operate a clear exchange rate target (Walter 2009: 25).

6.2.3 Loss of monetary power

A third sovereignty cost associated with the legalization of currency policies is a loss in monetary power, a concept that, according to Benjamin Cohen, comprises two separate dimensions. The one with a realist leaning is *influence* – "letting others have your way" (Cohen 2010: 5). In this sense, currency policies can be employed coercively – through the practice of currency manipulation, the exploitation of monetary dependence and the exercise of systemic disruption (Kirshner 1997: 8).[75] However, such practices have lost their relevance today. More pertinent is the second dimension of monetary power – *autonomy*, the ability to act without external constraint (Cohen 2010: 5). In his study of two "follower states", Canada and Austria, Pauly shows how monetary statecraft produces institutional and policy buffers to limit "the power of their lead partners to deflect on to them the transitional costs of bilateral adjustment" (Pauly 2006b: 205). Many emerging economies employed reserve accumulation to shield from adjustment pressures in response to the financial crises in the 1990s – and to their controversial handling by the Fund (Chin 2010: 694).[76]

This motivation is particularly strong in China where the "management of the currency reserves is part of national economic security and defence calculations, a broader regime of national reserves alongside grain, energy and material" (Chin 2010: 699). Reminiscent of the command-and-control planning of its communist past, China seeks "reserve adequacy" by securing a supply of national reserves to protect the country's economic security (Chin 2010: 700). For this insurance policy, China puts up with interest rates on US debt which are far lower than what more productive investments might yield (Cohen 2008: 23).

Judging by the recent financial crisis, it appears that emerging economies have been successful in deflecting economic shocks through monetary insulation. While the relationship between reserves and stability is nonlinear (the benefits diminish with the size of financing requirements), research shows that reserves helped soften the impact of the crisis on emerging economies (Eichengreen 2010a: 2). As long as fragile economies face pressures through the balance of payments, they will resist international commitments that might lessen their monetary autonomy by pursuing "the strongest self insurance possible" (Pattainak 2007: 318) – limiting the IMF's ability to encourage behaviour as long as they are "willing to bear the cost of sterilizing the associated capital inflows" (Eichengreen 2007: 165).

[75] In this case, "manipulation" is not understood as an artificially misaligned domestic currency, but rather as the targeting of a foreign currency (for instance by forcing a devaluation).

[76] Crises such as in South America in the early 1980s (Mexico, Brazil and Argentina), Southeast Asia 1997-8 and Russia 1998 (for a detailed account see Lowenfeld 2008 and Boughton 2001).

6.3 Interim conclusion: the softness of the law on exchange rates

Owing to high uncertainty costs and sovereignty costs, harder legalization of exchange rate surveillance has not happened so far, and is unlikely to happen in future. The optimistic estimate by Baltensperger and Cottier that "the experience of dispute resolution under WTO law should encourage the development of appropriate mechanisms within the IMF" to make currency valuations justiciable and suitable for legal dispute settlement, "obliging members to work towards a solution based upon mandatory fact-finding by the Fund" (Baltensperger/Cottier 2010: 936), seems unrealistic. From a normative point of view, it may be the case that the governance of the international financial system "needs a higher degree of legalization than today" (Allegret/Dulbecco 2003: 20). Realistically, soft legalization must be accepted as the regulatory vehicle of choice in monetary affairs.

But then again, legalization is not a teleological concept, and soft law not a second-best solution on the way to firm legalization.[77] The arrangements on exchange rates show that the trajectory of law can take the opposite turn. When circumstances force a retreat from hard law, soft law may be the only alternative (Gold 1983: 444). To cope with the costs of hard legal rules, actors sometimes deliberately choose soft legalization as a "superior institutional arrangement" (Abbott/Snidal 2000: 423). In the case of the IMF, soft rules provide a "compromise with scepticism" (Gold 1983: 460), a "rational adaptation to uncertainty" (Abbott/Snidal 2000: 444). By avoiding formal legality, states can reap the benefits of a coordinated legal response without excessively curtailing future behaviour. This resonates with recent scholarship in the area of international financial law. In this area, soft law "departs from traditional notions of informality" and is in fact "harder than its soft-law quality suggests", in particular when distributional implications are involved (Brummer 2010: 624).

The rules on trade serve again as a useful illustration – but this time for the adverse effects of firm legal rules. As Cynthia Lichtenstein argues, "concern is mounting over whether hardening up [trade] law [...] results in fact in remediation of the consequences for the international trading system of deviant behaviour or results only in what might be described as American style litigious game playing" (Lichtenstein 2000: 357). Firm rules may pose new barriers instead of facilitating trade and investment. With its rigid timetables, the ability of the Appellate Body to rewrite law and the imposition of hard sanctions, the WTO seems prone to litigation, rather than negotiation (Lichtenstein 2000: 358) – a possible downside of hard legalization.

[77] Although soft law may well lead to hard rules in the long run, for instance in the case of the Convention on Prior Informed Consent for pesticides and chemicals established in 1989. For a discussion of soft law as a pathway to harder legalization see Abbott/Snidal 2004.

7. The future of exchange rate surveillance

The findings of this paper do not bode well for a more robust IMF surveillance. The idea that the IMF "could prescribe conduct under amended Art. IV did not prove viable, if [...] it was ever seriously considered" (Lowenfeld 2010: 585). Going forward, it is unlikely that hard legalization – rules and coercion – will play a larger role in the bilateral surveillance of exchange rates. The "old" IMF, which "operated autonomously from other international institutions", in a "mutually reinforcing relationship with the power of the American state", "priding itself on its formal rule-governed deployment of financial resources" (Porter 2007: 3), seems unqualified to fight imbalances and foster monetary cooperation.

What does this mean for the future of bilateral surveillance? In a pessimistic reading, the IMF is again standing on the sidelines of global finance: "All the Fund staff can convey now is an opinion on a country's exchange rate policy that carries no more of an opprobrium than anybody else's opinion" (Goldstein 2010: 5). There is, however, a different approach which suggests that legitimacy and expertise, rather than delegation and obligation, explain why states listen to the Fund (Finnemore/Barnett 2004: 67).

The social constructivist perspective discussed in this section does not contradict the concept of legalization. Rather, it complements the state-centric view by giving a fuller account of the Fund's role in the global economy. Additional insight into the potential of surveillance despite low levels of legalization is provided by the experience of the IMF as a setter of voluntary standards.

7.1 Learning from the Fund: a constructivist perspective

7.1.1 Theory

The rational institutionalist perception of the IMF is instrumental. States weigh a self-interested trade-off between costs and benefits of legalized rules which help to overcome co-operation problems. In case of excessive costs, states endow the institution with limited power by turning to soft law. As a result, the IMF's authority is a function of its delegated powers. By contrast, social constructivists bestow a greater influence on institutions as actors in the international system. In their view, institutions actively influence states through shared ideas, norms and beliefs (Momani 2006: 253). International organizations are not considered vehicles for the promotion of national interests, but rather regarded as possible "agents of policy change" that "teach" states how to conform to international standards. International organiza-

tions "shape social reality" by creating, moulding and sanctioning knowledge (Barnett/Finnemore 2004: 31).

Some scholars argue that this is precisely how the Fund should be viewed – "less dependent on oversight and monitoring, and linked to persuasion and joint-problem solving" (Kahler 1992: 126). According to Miles Kahler, a "technocratic alignment" exists between the economists at the Fund and the national policymakers they interact with (Kahler 1992: 126). These specialists, he claims, may lead national authorities to "learn" from the Fund (Kahler 1992: 127). Similarly, Martha Finnemore and Michael Barnett claim that the IMF has now become actively involved in members' domestic economies in ways "rejected by its founders" who designed the Fund to ensure that decision-making power resides firmly with the members (Finnemore/Barnett 2004: 45 and 48). They attribute this shift in agency to the Fund's ability to set agenda through its independent staff (Finnemore/Barnett 2004: 50). In sum, "the IMF's intellectual apparatus contains a logic that has led it to expand its involvement in domestic political economies" (Finnemore/Barnett 2004: 63).

Domenico Lombardi and Ngaire Woods have applied this approach to bilateral surveillance. They suggest that surveillance "creates collaborative processes in which views are exchanged and officials learn from one another" (Lombardi/Woods 2007: 29). Art. IV consultations bring "IMF officials into direct engagement with governments, creating a forum within which learning may occur" (Lombardi/Woods 2008a: 718). Due to the public nature of IMF oversight, this effect is strengthened by peer review – an "influence on a government to adopt certain policy standards in order to avoid the stigma that its peers would place on it for deviating from socially- or internationally-accepted norms" (Lombardi/Woods 2008a: 713).

In his appeal for a renewed surveillance mandate, the Governor of the Bank of England Mervyn King noted that such a view resonates with the ideological foundations of the Fund: "With countries naturally reluctant to cede any control over their own monetary and fiscal policies [...] the IMF will have as instruments only the powers of analysis, persuasion, and, in Keynes' own favourite words, 'ruthless truth-telling'" (King 2006: 9). There is, however, no certitude to the constructivist argument that surveillance produces learning. As King duly adds, "the phrase [ruthless truth-telling] does not conjure up many memories of the many international meetings I have attended" (King 2006: 9). The common perception is that Art. IV reports are "regularly relegated to the 'duly noted' bin. Governments receive them, file them away, and go back to doing exactly what they were doing before" (Eichengreen 2010b). Therefore, the influence of Art. IV consultations on surplus economies needs verification.

7.1.2 Reality

In 2006, Bessma Momani investigated the interaction between the authorities of a non-borrowing country (Canada) and bilateral surveillance. Acknowledging that measuring "learning" is difficult as policy changes may be dictated by unrelated factors – such as the evolution of the natural policy cycle, hegemonic pressure or distributional coalitions, Momani determined the extent to which Canada's Department of Finance officials and staff utilise Art. IV policy advice (Momani 2006: 255). She finds that between 1999 and 2005 the Canadian staff thought the Fund "very competent, knowledgeable about Canada and technically skilled" (Momani 2006: 261). The expertise was enhanced by the Fund's access to cross-comparative research and data from other countries. However, the respondents overwhelmingly denied using Art. IV consultations to support their policy decisions. The Fund's advice was deemed "less policy relevant and less politically feasible" than country reports by the Organisation for Economic Co-operation and Development (OECD) (Momani 2006: 262).

A similar study was carried out by Lombardi and Woods on behalf of the IMF to assess the effectiveness of surveillance. Using internal IMF reviews and own research, they establish that the creation of "shared knowledge" must be a two-way process – which is not the common perception during Art. IV consultations. In this respect, OECD reports are again cited as best-practice (Lombardi/Woods 2008a: 723). While surveillance seems to affect competition among peers, the authors see no influence on countries' substantive policies (Lombardi/Woods 2008a: 732). They conclude that Art. IV has some, albeit limited, traction. Overall, they observe "little evidence that surveillance leads to learning, as the Board and the membership exhibit little ownership of the results" (Lombardi/Woods 2008a: 733).

The Independent Evaluation Office of the IMF confirms the findings by Momani and Lombardi/Woods. In a survey among authorities of the major advanced economies in 2007, 32 per cent considered the IMF contribution on exchange rate decisions as "marginal" and 50 per cent as having "no impact" (IEO 2007: 11). In 2010, a study on the performance of bilateral surveillance in the run-up to the crisis established that policy recommendations are often obvious and lack specificity about how to implement them. Most authorities wonder how to respond to "wide-ranging lists of risks, listed with no sense of probabilities or urgency" (IEO 2010: 22-23). The contributions by the Board are "fairly generic reiterations of the staff report months after the mission team's concluding statement" (IEO 2010: 22-23). The Art. IV process is described as a "detrimental environment" for learning, plagued by political constraints and frequent "turf battles" within the staff (IEO 2010: 30).

7.1.3 The potential of Article IV consultations

These findings indicate that the influence of the Art. IV process on large economies is still limited. There is, however, no reason to discard the constructivist argument prematurely. For all its eulogies, the IMF is still "uniquely placed" to serve as a global monetary authority (Lastra 2010: 4). Tony Porter argues that the Fund, thanks to its "powerful capacity for generating economic analysis, and its capacity to lend" is "uniquely capable of generating a very asymmetrical but relatively effective order" (Porter 2007: 21).

The geographic reach of the Fund should not be underestimated. In 2005, it covered about 95 per cent of the globe (185 countries), almost as much as the United Nations (193 countries) – and far more than Citibank, the most globally engaged private institution, which is active in about 100 countries (Boughton 2005: 3). In comparison to other financial institutions, the IMF has "the clearest legal mandate, the largest professional staff, and significant financial resources under its own day-to-day control" (Pauly 1997: 8).

Next to its staff and mandate, the Fund also has promising regulatory instruments at its disposal – starting from the Art. IV process which constitutes a "comparative advantage" for the provision of impartial analysis (Helleiner/Momani 2007: 24). Although the function of signalling policy changes has shifted away from the Fund, Eichengreen argues that there are "compelling counterarguments" to the idea that "markets and national officials know better, rendering the IMF's data gathering, data dissemination and policy-analysis-and-advice functions redundant" (Eichengreen 2007: 162). Stanley Fisher, the current head of Israel's central bank, says that "for many countries, the IMF's Article IV report is the most thorough and professional evaluation of the country's economy and economic policies" (Fischer 2008: 381). In the same survey in 2007 that showed the IMF's marginal influence on large economies, 61 per cent of emerging economies called its contribution to their major exchange rate decisions "instrumental" (IEO 2007: 11).

The potential of bilateral surveillance is underpinned by recent developments in the regulation of international finance. Porter identifies three fundamental changes: "from hierarchies and formal rules to more pluralistic arrangements", "from the deployment of material resources to the mastery of knowledge and communication" and "from hegemony to multilateralism and democracy" (Porter 2007: 3). By capitalizing on these shifts in financial regulation, the Fund could significantly increase the leverage of bilateral surveillance over non-borrowing countries – if its draws the right lessons from its latest regulatory history.

7.2 Lessons learned? The IMF as a standard-setter

7.2.1 Standards in the international financial architecture

The constructivist argument is not lost on the IMF, which has long stressed that persuasion and learning are instrumental for its work. By emphasizing the use of voluntary global standards, Jacqueline Best argues, the Fund leaders have framed the recent reform of the IMF's regulatory apparatus as a "norm-building strategy" to combine power and knowledge (Best 2010: 3). More than a choice, this seems a necessity. Not only are the IMF's financing facilities now bypassed by most states; the Fund also faces fierce competition in the provision of economic information.

Back in 1945, the IMF was the only source of rules and analysis on monetary issues. Today, a large number of public and private bodies has emerged for the regulation and supervision of the international financial system. This framework is called the international financial architecture (IFA) (Giovanoli 2010: 4).[78] As the overview in Appendix 8, section 9.1, shows, the IFA comprises a broad range of actors, from formal organizations to informal groupings, as well as private-sector associations and market practices (Porter 2007: 2). Its evolution was primarily driven by crises: the creation of the Basel Committee in the 1970s followed the uncontrolled expansion of financial markets. The emergence of the Financial Stability Board (FSB) was established after the Asian crisis in the late 1990s to coordinate the regulatory response to financial instability.[79]

In the IFA, only few rules are "embodied in proper instruments of international law" such as the Articles of the IMF (Giovanoli 2000: 71). The majority of its rules and guidelines are not of a legally binding nature. Instead, most sources of international financial law are "informal, intergovernmental institutions [...] for the global regulatory community" (Brummer 2010: 627). Standards in particular have become the primary channel of regulation in the IFA.[80]

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[78] The term was coined by Barry Eichengreen in 1998, although Eichengreen today objects to its use because "architecture" conveys unity and coherence, whereas in fact many arrangements evolved as "unintended consequences of past actions" like the post-Bretton Woods exchange rate system which is more "the product of the inability of policy makers to agree than the result of any conscious decision" (Eichengreen 2011a: 1).

[79] The FSB was created as the Financial Stability Forum (FSF). Its website lists the main "principles" of the IFA: <http://www.financialstabilityboard.org/cos/wssb.htm>. In total, the twelve standards cover accounting, auditing, anti-money laundering and countering the financing of terrorism, banking supervision, corporate governance, data dissemination, fiscal transparency, insolvency and creditor rights, insurance supervision, monetary and financial policy transparency, payment systems, and securities regulation (Lastra 2010: 10).

[80] The classic example for financial standards is the Basle I standard on minimal capital requirements for banks. Created in 1988 as the Basle Accord by the Basle Committee for Banking Supervision under the auspices of the BIS, Basle I was adopted in many countries and became one of the most important rules in the global financial sphere. For a study of the legalization of the Basle I standard see Alexander 2000.

Defined as “best-practice rules for national regulators and market participants” (Kerwer 2005: 614), they do not possess traditional legal character. However, they are often voluntarily adopted and implemented by national authorities (Giovanoli 2000: 72).

Similar to other forms of international rules, standards represent a trade-off. They may lack democratic legitimacy and a precise legal basis. The absence of any binding character is a possible deficit in their implementation and enforcement (Giovanoli 2000: 80). Their regulation is usually “not well coordinated” and their effectiveness “not guaranteed” (Kerwer 2005: 615). But in spite of these limitations, standards offer unique advantages in the way they address the costs of hard legalization identified in this paper.

Uncertainty is managed through flexibility – states are able to see the impact of rules in practice before committing (Brummer 2010: 633). Sovereignty costs are taken into account through easier negotiations and “the need to justify the standards in accordance with technical criteria developed in the standard-setting institution” (Porter 2007: 19). When standards are produced by formal international organizations, “enforcement is already taken into consideration during the negotiations” (Kerwer 2005: 626). Despite a lack of formal obligation, they can motivate compliance, either voluntarily – “wherever the expertise they embody is deemed to be relevant” (Kerwer 2005: 616) – or with strong encouragement by the international community through “peer pressure, public monitoring and possibly market discipline” (IEO 2008: 19). International regulation of this kind is “bolstered by reputational, market, and institutional mechanisms that have been largely overlooked” (Brummer 2011: 262). This suggests that the incorporation of standards could strengthen the leverage of surveillance.

7.2.2 The track record on IMF standards

The potential of voluntary standards to surmount regulatory deadlock has not gone unnoticed by the Fund. Together with the World Bank – the other financial institution whose founding document constitutes hard law – the IMF has been increasingly involved in the creation and assessment of international financial standards in the last fifteen years.

In 1996, the Fund established the Special Data Dissemination Standard (SDDS) for guiding members in their provision of data to the public when they seek access to international capital markets (Lombardi/Woods 2008a: 724). The SDDS is not mandatory, but facilitates access to private capital. It was supplemented in 1997 with the General Data Dissemination Standard (GDDS) which helps countries develop statistical capacity (Lombardi/Woods 2008: 724). In his studies of SDDS adoption in East Asia, Andrew Walter found that peer pressure indeed

led many countries to sign up, but far fewer to actually comply with the implemented standards. This, he argues, has three reasons. First, assumptions about the strength of the IMF and the World Bank to promote compliance are too optimistic as compliance remains largely a domestic matter. Second, that domestic politics favours "mock compliance" – feigning compliance while limiting its impact. Finally, that non-compliance is sometimes the best option (Walter 2007: 33). As a result, only 36 per cent of the IMF membership complied with the SDDS in 2007, as opposed to 99 per cent for the Basle I standard (Walter 2010b: 98).

In the aftermath of the crisis in Asia, the IMF then started the "standards and codes" initiative with the World Bank. To complement the traditional Art. IV surveillance on macroeconomic policies with the supervision of the institutional environment (Lombardi/Woods 2007: 11), the initiative started monitoring the observance of the twelve international standards identified by the FSB as most relevant. However, this process was integrated with the Art. IV process only recently (IMF Revised Guidance 2010: N. 45). Its instruments – the Financial Sector Assessment Programme (FSAP) which results in the publication of a Report on Observance of Standards and Codes (ROSC) – are still voluntary, as they are mostly performed as technical assistance (Lastra 2010: 10).

The verdict on the IMF standards initiative is mixed. On a positive note, a review by the IMF found that "the initiative scores fairly high in terms of its overall worth although less in terms of some specific benefits". However, it is "not seen as having yet had a commensurate impact on actual reform implementation". The IMF attributes this fact to the "difficulty in integrating standard assessments and surveillance" – in particular in identifying macroeconomic findings (IMF Standards and Codes Effectiveness 2005: 5-6).

Moreover, the initiative was challenged by developing states since most standards were based on the practices of Western economies (Best 2010: 3). In spite of IMF efforts to "represent the standards and codes initiative as universal and necessary, emerging and developing countries recognise the political costs of the policy and have been resisting them" (Best 2010: 22). The emerging and developing nations, worried about additional asymmetrical burdens (IEO 2008: 20), therefore long rejected calls by the G-8 to "develop a system for surveillance of implementation of the codes and standards built on the Art. IV process" (G-8 1999b: N. 21c).

This shows that standards are not exempt from the costs associated with traditional forms of legalization. Chris Brummer notes that the standard initiative was only successful through its conditionality requirements, but had "no effect on (generally wealthy) countries that are not

recipients of IMF and World Bank assistance" (Brummer 2011: 310). In spite of their recent popularity, standards offer no easy way out for the IMF – "any global standard or institution, even one of a technical nature, also has distributional implications" (Mosley 2003: 335).

7.3 The characteristics of effective surveillance

Bilateral surveillance can take many forms. At worst, it can serve as an "information-gathering exercise with little impact on policy" or as an "instrument for powerful members to impose their preferences on borrowers"; at best, as a "catalyst for peer and market pressure" and as a "forum for learning and dialogue" (Lombardi/Woods 2007: 12-13).

Experience shows that regardless of the particular vehicle of regulation, interest politics must be taken into account with respect to Fund involvement. To be persuasive, surveillance needs to be "tailored to the needs of member states, offer strong cross-comparative analysis, and fit the political and policy constraints of member states' governments" (Momani 2006: 266). However, informality appears equally counter-productive. The IMF cautions that too consensual a modus operandi, "while effective in many ways", also carries the risk of losing sight of the commitments of Art. IV by tempting both the members and the Fund to "treat surveillance rather like technical assistance" and "shy away from delivering tough messages" (IMF Preliminary Considerations 2006: N. 27). By combining the views discussed in this paper, this section tentatively singles out the characteristics of effective bilateral surveillance

Independence

The consultations with China have shown that political constraints compromise the value of surveillance. At the moment, the IMF has little incentive to shame its shareholders (Allegret/Dulbecco 2003: 13). This issue arises because the intergovernmental, politically responsible Board is charged with voting on the conclusions of Art. IV consultations, whereas in the FSB, for instance, the views of independent central bankers have greater influence (Schinasi/Truman 2010: 39).

In response, Kahler suggests the creation of an autonomous unit within the IMF to ensure an independent audit, albeit on the grounds of benchmarks agreed upon with national authorities (Kahler 2006: 262). Lavigne agrees that only by keeping the Board "at arm's length from staff in the supervision of surveillance, the IMF would truly have a mandate to operate independently that could shield it from political pressures" (Lavigne 2009: 43). In addition, the current format of Art. IV reports seems a stumbling block for candid surveillance. According to a staff member who worked on a large country, "it was hard to give difficult messages to

the authorities even if the team had the analysis [...] the concluding meetings were really just negotiation sessions on language" (IEO 2010: 30). Therefore, the authorities' views need to be set apart to prevent a superfluous dilution of the Fund's message.

Avoidance of stigmatization

Attempts to quantify exchange rate misalignments are fraught with political and statistical dynamite. Their inclusion diverts attention away from legitimate claims by the Fund and forces the member into antagonism. Mundell is right in not wanting surveillance "to become a code for giving the IMF power to determine exchange rates" (Mundell 2006: 5). Rather than calculating equilibrium rates, the IMF should "focus on the direction and speed of real exchange rate adjustment and on the extent to which policies are permitting the real exchange to adjust" (Lavigne/Schembri 2009: 10).

Eichengreen suggests that the Fund should "settle for offering a range of assessments", in order to move toward publishing "more forceful, umpire-like decisions" only if this proved successful (Eichengreen 2010b). Stigmatizing labels such as "manipulation" prevent candid surveillance and should be discarded. Recent guidelines for Art. IV indicate that staff should focus on assessing broad consistency with equilibrium (IMF Revised Guidance 2010: N. 28).

Transparency

A strong case can be made for automatic disclosure of surveillance reports as an additional insulation from member influence (Kahler 2006: 267). As the IMF acknowledges, "communicating well and candidly with all relevant audiences is key to effective surveillance" (IMF Revised Guidance 2010: N. 50). The current secrecy of the Art. IV process represents a serious inhibition to its effectiveness (Allegret/Dulbecco 2003: 13). With non-borrowing members, the only power of the Fund is its voice. Without systematic publication of its findings, it stands little chance to be heard.

In a survey among IMF staff, the lack of transparency and publication of documents was identified as the main impediment to the candid treatment of exchange rate issues (IEO 2007: 92). If forced publication is off the table, the staff should at least follow the recommendation "not to share draft staff reports with country authorities" and not to "negotiate" documents (IMF Revised Guidance 2010: 53).

At the same time, the Fund needs to focus its external communications. The 35 different publications it currently produces risk drowning out any relevant messages.[81] As Layna Mosley

[81] A list of all IMF publications can be found online: <https://www.imf.org/external/cntpst/selectbyseries.aspx>.

emphasises, actors only embrace standards that are "well known and that provide simple summary assessments" (Mosley 2003: 352). Lately, this notion seems to find acceptance among the Directors who "cautioned against a proliferation of new surveillance documents and the duplication with other reports" (IMF PIN 10/128).

Practical usefulness

Many Art. IV consultations suffer from limited practical usefulness for policymakers. While almost all reports suggest "fiscal consolidation", few documents speak to issues that matter to national authorities – as opposed to the OECD (Momani 2006: 265). As one anonymous policymaker said, "interactions on the Art. IV often feel like just any other meeting I have with all those international institutions, too formulaic" (IEO 2010: 22-23). Due to its large membership and regular surveillance missions, the Fund has access to a wealth of cross-comparative information which it is still making limited use of – like in the run-up to the global financial crisis, as a study by the IEO found (IEO 2010: 28).

The IMF could greatly improve the usefulness of its Art. IV reports by offering "practical examples of policy implementation in other member states" (Momani 2006: 266). A recent reform of the Fund's operational guidance suggests that the examination of "how [underlying drivers of critical balance of payments flows] might be influenced by developments in specific other countries" will be bolstered (IMF Revised Guidance 2010: 25). For instance, the Fund could initiate "multilateral dialogue among countries facing similar issues" (IMF PIN 10/128).

Legitimacy

For the purposes of this paper, the Fund's legitimacy played a minor role and has therefore largely been omitted. Yet, in terms of voluntary acceptance, legitimacy must be mentioned as a central tenet of all proposals for IMF reform. While the Fund has gone to great lengths to improve its disastrous image, many emerging and developing countries – including China – maintain vivid memories of its "share of debacles in the past decades in attempts to salvage economies plagued by financial crises" (China Daily, 17 April 2007).

The necessary steps have been discussed at length, from reducing the influence of European countries which still enjoy a disproportionate share of power to moving recruiting practices away from the current focus on Anglo-American economists (Griesgraber 2009, and for a study by the IEO: Lamdany/Martinez-Diaz 2009). A first, long overdue step was undertaken in December 2010 when some quota shares were shifted to emerging and developing countries – making China the 3rd largest member in terms of voting power (IMF Quotas 2011).

8. Concluding remarks

This paper has shown that a legislative body comparable to the law on trade has not evolved in exchange rate policies due to the major sovereignty and uncertainty costs involved. The bilateral surveillance regime demonstrates that the trajectory of IL is not always geared towards harder legalization. When states associate international cooperation with an excessive restriction of domestic policy options, they forgo the benefits of legalised rules in favour of soft arrangements that better suit their needs. As a consequence, the rules on bilateral surveillance are still characterised by low delegation, obligation and precision despite ongoing reform efforts.

If the IMF is regarded solely as an instrument of interested-based cooperation, its future role in the supervision of monetary conduct is likely to remain limited. With European leaders trying to stave off the collapse of the euro zone and the US, its economy in shambles, facing a crucial presidential election in 2013, a leap in legalization seems far-fetched. Meanwhile, the economic powerhouses of emerging Asia show little disposition toward regional integration – let alone grand multilateral agreements that might hold back their relentless growth.

However, this paper also suggests that the value of bilateral surveillance should not be easily dismissed. In a market-based monetary system, reputation and impartial analysis will always carry authority. Therefore, social constructivist approaches ascribe the potential of greater agency to the IMF – if certain conditions are met. The increased use of voluntary standards as a substitute for further legalization seems a sensible approach. And yet, the first experiences with the integration of standards in the Art. IV process have been sobering.

The Fund must proceed with caution to avoid repeating the mistakes which have so greatly dampened the effectiveness of Art. IV consultations in the past. In any case, efforts to improve bilateral surveillance are under way. Looking ahead to a review of bilateral surveillance due no later than October 2011, the new Managing Director Christine Lagarde has already signalled willingness to overhaul the surveillance regime:

> If there are things that the Fund has been doing for many years, [...] I will say, if it is not useful, if it is not providing value, then let's drop it, and let us focus our immense resources and massive capital power, brain, on what is going to be useful for the members (IMF Press Conference 2011).

In future, the need for exchange rate surveillance is unlikely to diminish. While the international monetary system was not at the heart of the recent financial crisis, it remains the place "where tensions from globalization – and the conflict between domestic policy goals and in-

ternational obligations – tend to coalesce" (Subacchi 2010: 1). Even China, the strongest critic of the 2007 Decision, never rejected the *idea* of bilateral surveillance. Its resistance to Art. IV surveillance was motivated by timing, rather than principle (Walter 2009: 13).

Recent developments indicate that the Fund's potential as a financial authority is clear to policymakers. Setting out the agenda for France's presidency of the G-20, President Nicolas Sarkozy said that the IMF should "spell out criteria for objectively measuring global financial and trade imbalances to make sure G-20 members share a common assessment of problems" (Wall Street Journal, 25 January 2011). It remains to be seen if such an approach can breathe new life into the obligations of Art. IV.

Regardless of the IMF's fate, the ailing economies of the West will continue to look with envy at China, which is poised to overtake the US as the world's largest economy between 2014 and 2016 (Yang 2011). The anger over the RMB is likely to subside long before the IMF agrees on a meaningful intervention. A number of pointers indicate that further appreciation is imminent. The new-found confidence of the Chinese middle-class with its hunger for cheaper imports and higher wages will play a bigger part in balancing Beijing's exchange rate policies than any sabre-rattling on part of Congress. Export-led growth faces an uncertain future thanks to dwindling demand in the developed world which accounts for 40 per cent of China's exports (Roach 2011). Most important, the faltering US economy looks less and less like a safe haven for China's riches.

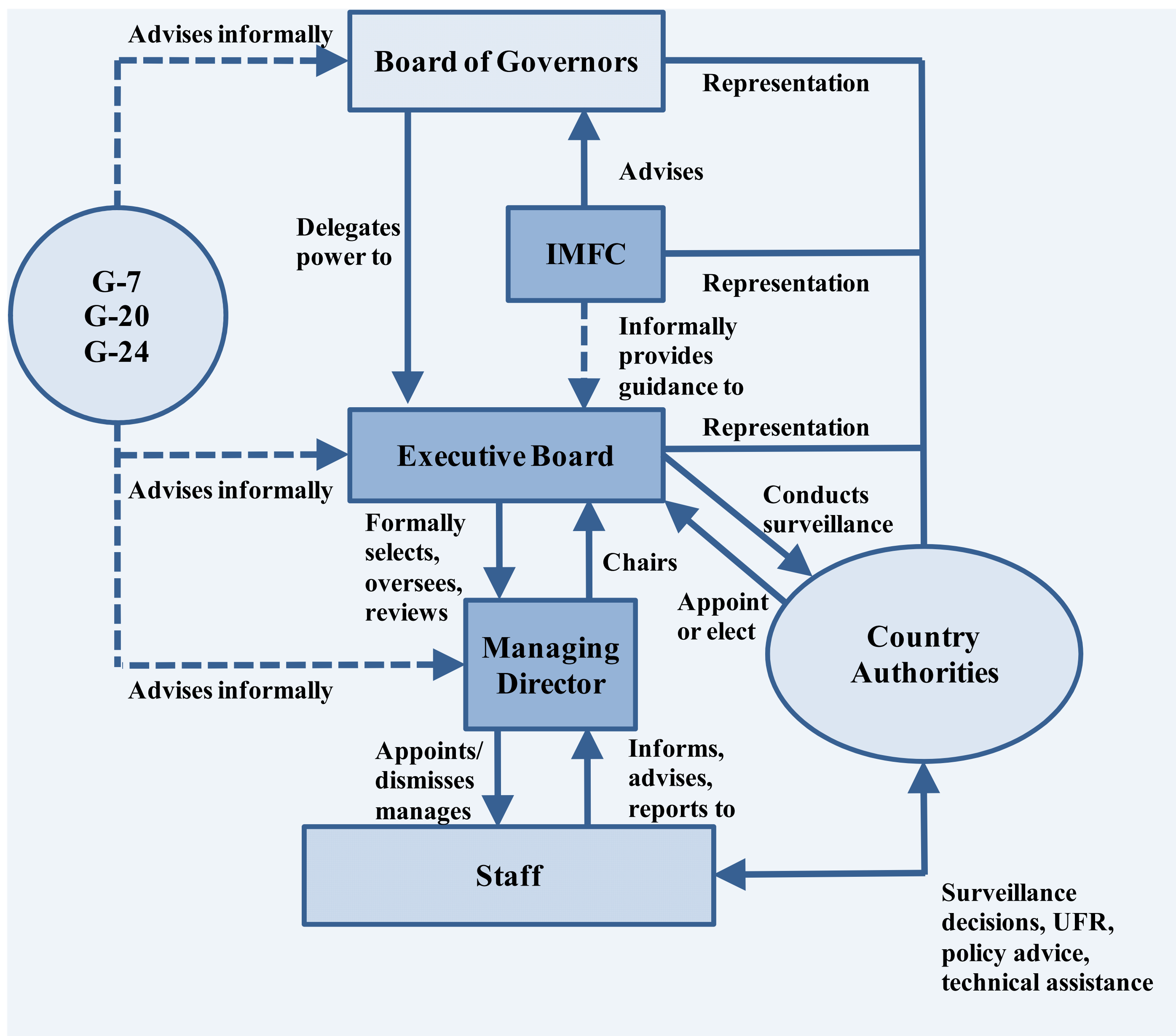
In addition, China is pursuing a strategy of gradual currency internationalization. By making the renminbi increasingly available as a currency of settlement and payment in the region, China seeks to eliminate exchange rate risks for its exporters, boost regional trade and replace the risky USD as the world's reserve currency (Yongding 2011). While this will undermine the effectiveness of managing the RMB rate through capital controls, there is no guarantee that internationalization will automatically entail appreciation (The Economist, 19 August 2011).

After maintaining a careful exchange rate policy for almost 20 years, the Chinese authorities are unlikely to take rash decisions on the way forward. How long appreciation will take is open to question. As Li Ruogu, the former Deputy Governor of the PBC once said:

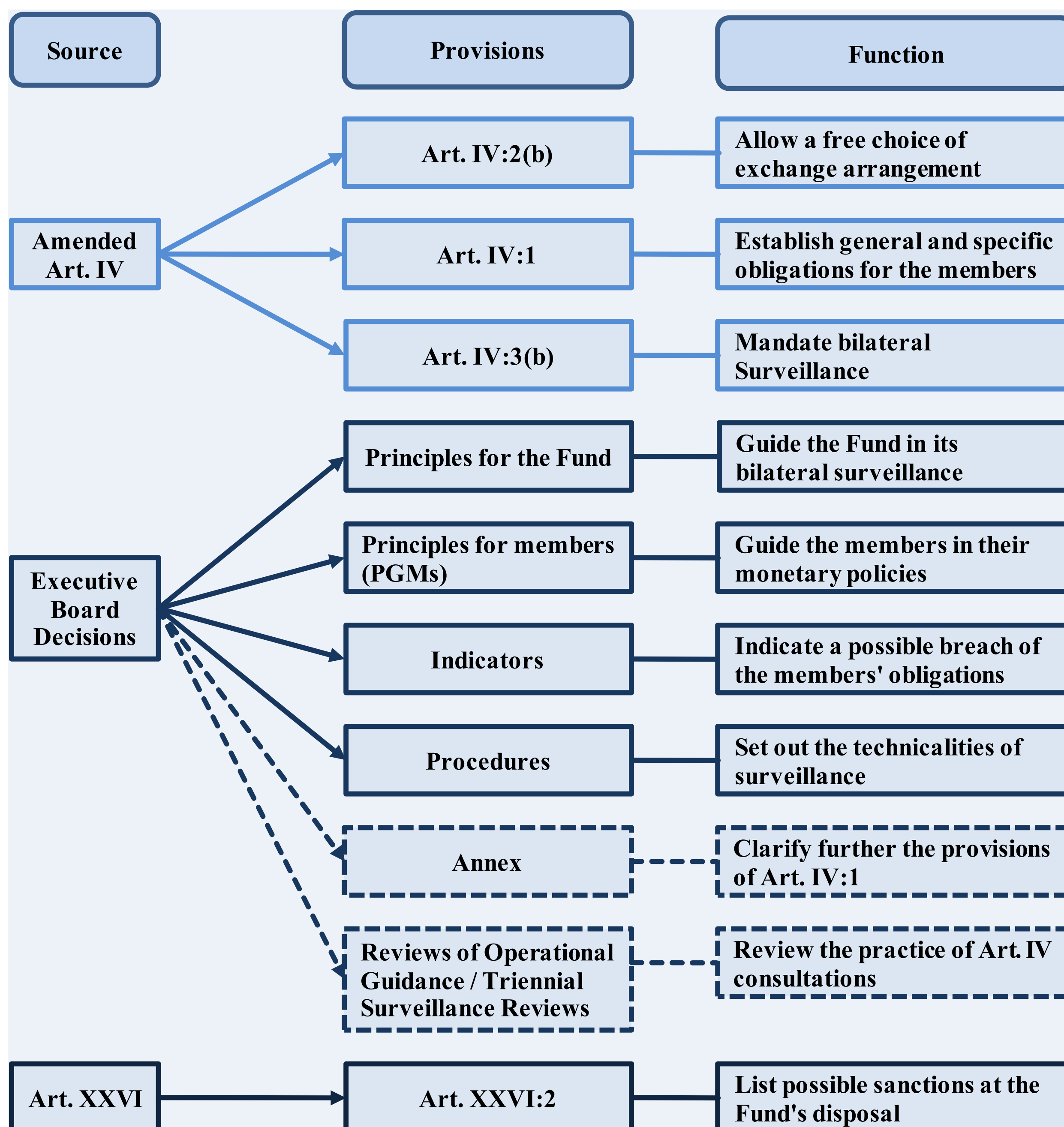
> I have listened to both sides of this debate. Here is what I think. I think those who call for a fixed exchange rate are right in the short run. And those who call for a floating exchange rate are right in the long run. How long is the short run, you ask? You must understand that China is 8000 years old. So when I say short run, it could be 100 years (paraphrased by Frankel 2010a).

9.1 Additional Figures

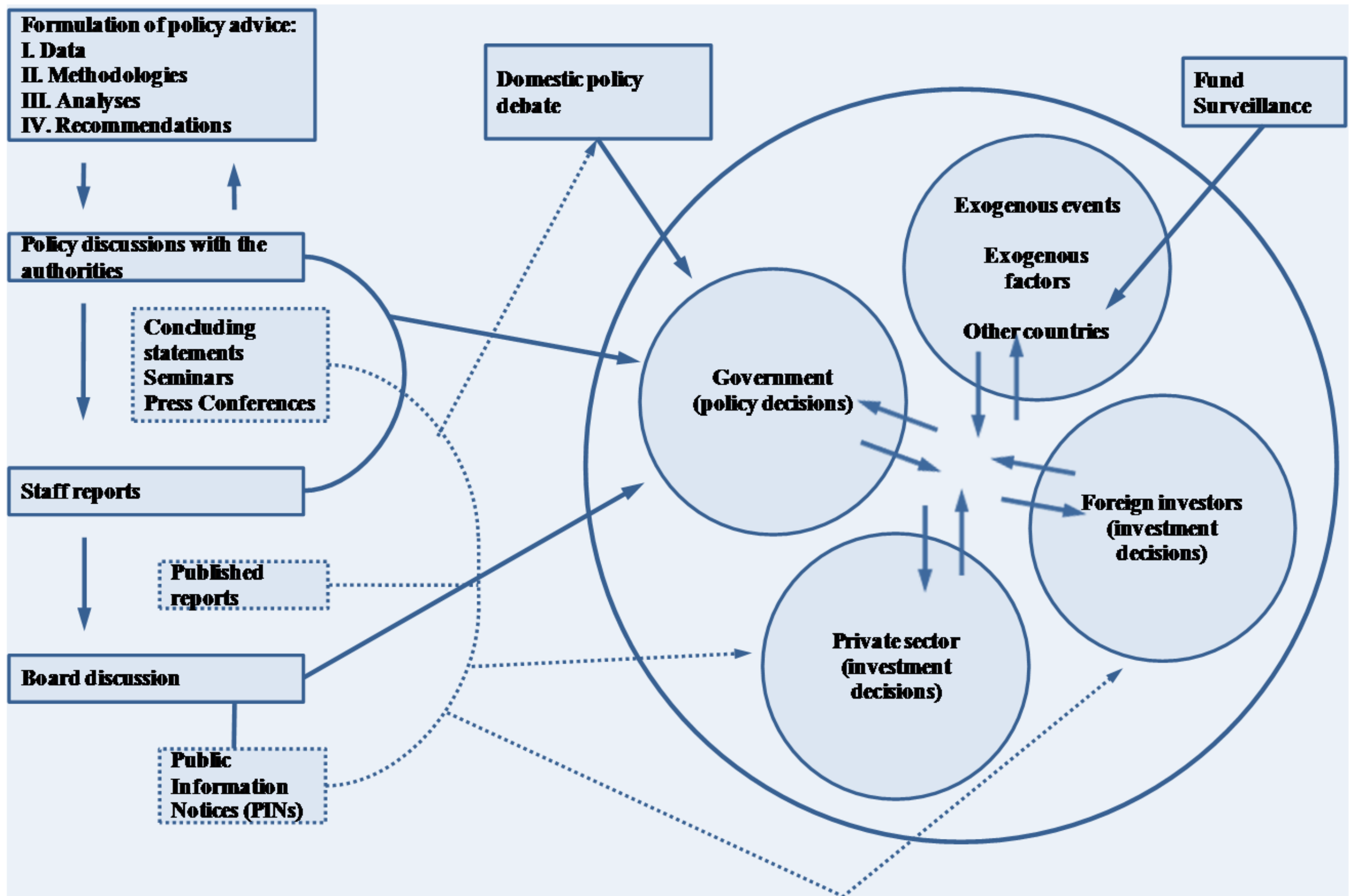
Appendix 1: IMF Governance



Appendix 2: The Bilateral Surveillance Regime



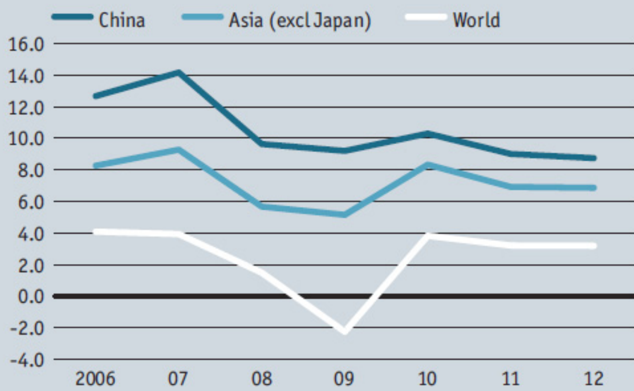
Appendix 3: The Art. IV Process

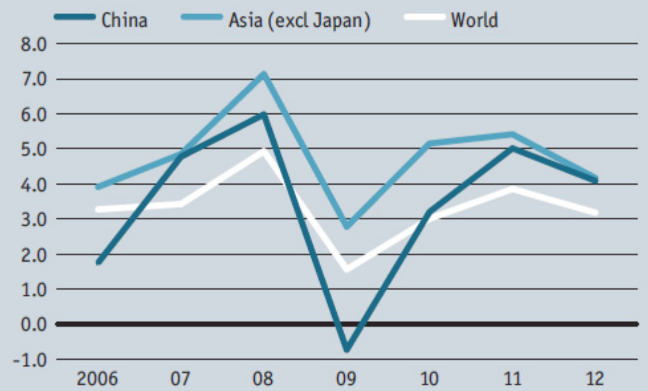


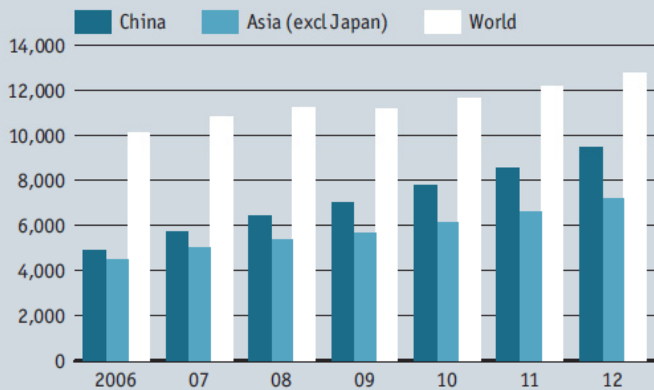
Appendix 4: Forms of international legalization

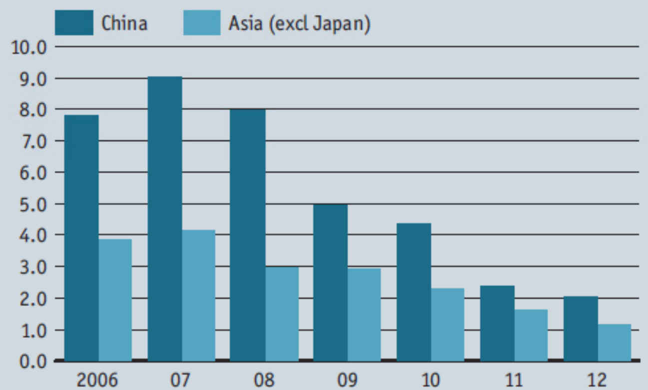
Type	Obligation	Precision	Delegation	Examples
Ideal Type: Hard Law				
I	High	High	High	EC; WTO-TRIPs; European rights convention; International Criminal Court
II	High	Low	High	EEC Antitrust, Art. 85-6; WTO-national treatment
III	High	High	Low	US-Soviet arms control treaties; Montreal Protocol
IV	Low	High	High (moderate)	UN Committee on Sustainable Development (Agenda 21)
V	High	Low	Low	Vienna Ozone Convention; European Framework Convention on National Minorities
VI	Low	Low	High (moderate)	UN specialised agencies; World Bank; OSCE High Commissioner on National Minorities
VII	Low	High	Low	Helsinki Final Act; Nonbinding Forest Principles; technical standards
VIII	Low	Low	Low	Group of 7; spheres of influence; balance of power
Ideal Type: Anarchy				

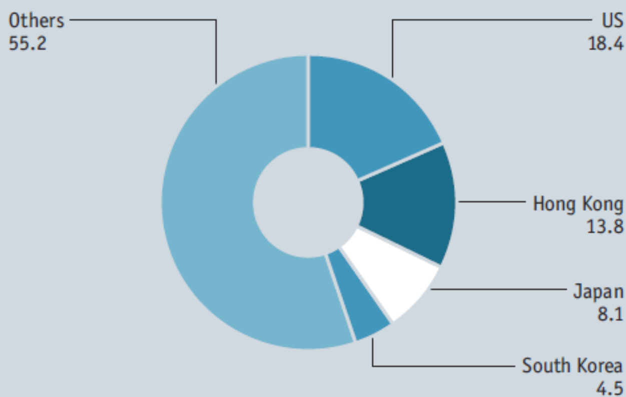
Appendix 5: China Annual Trend Charts

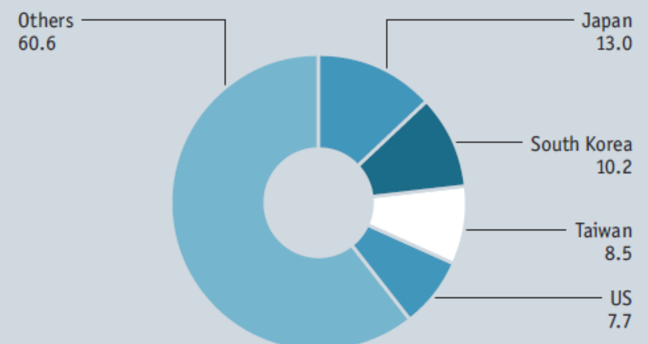




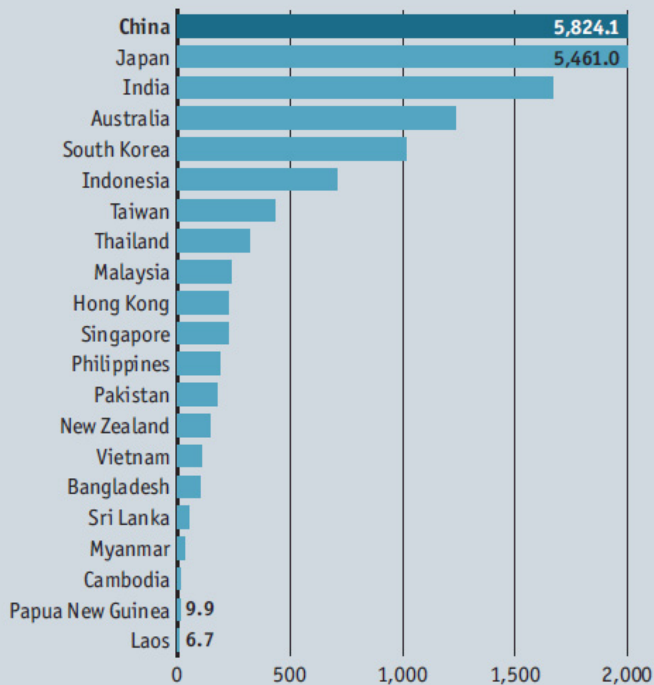


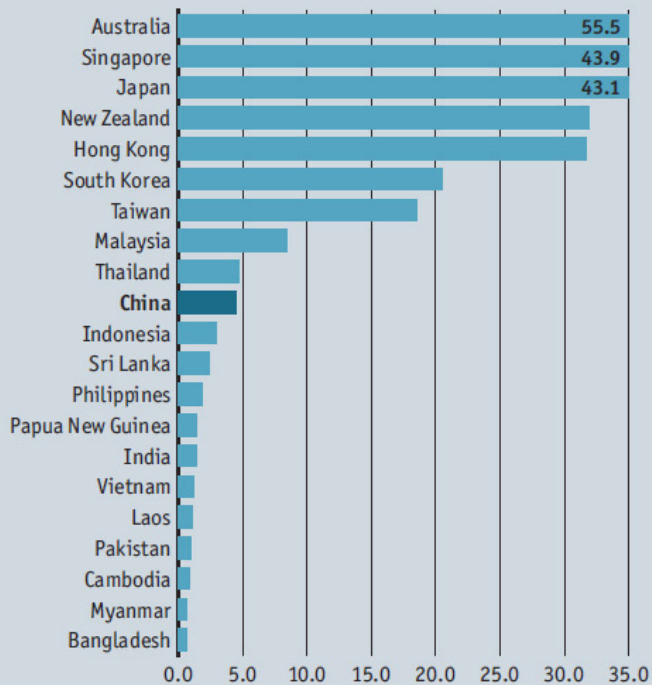


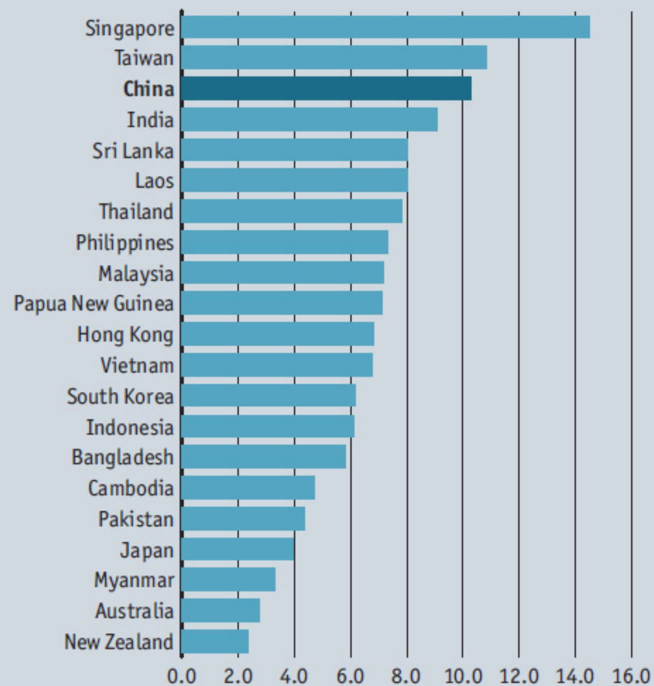


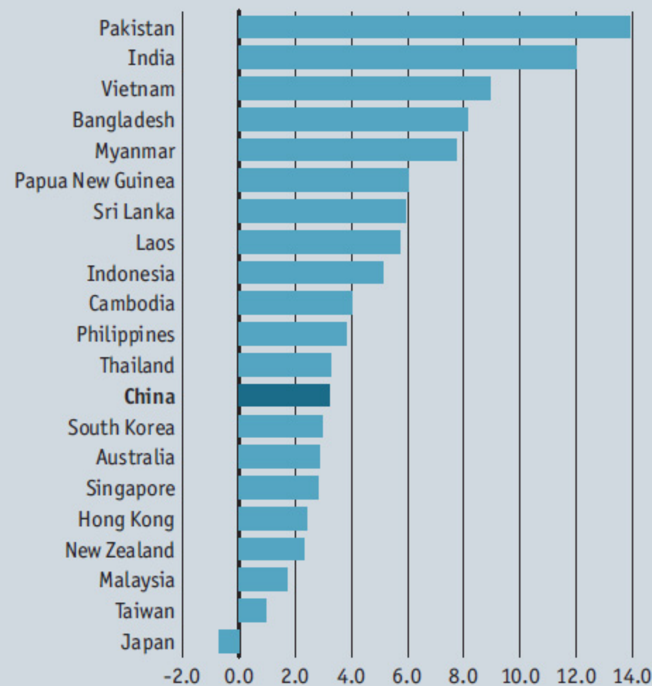


Appendix 6: China Comparative Indicators

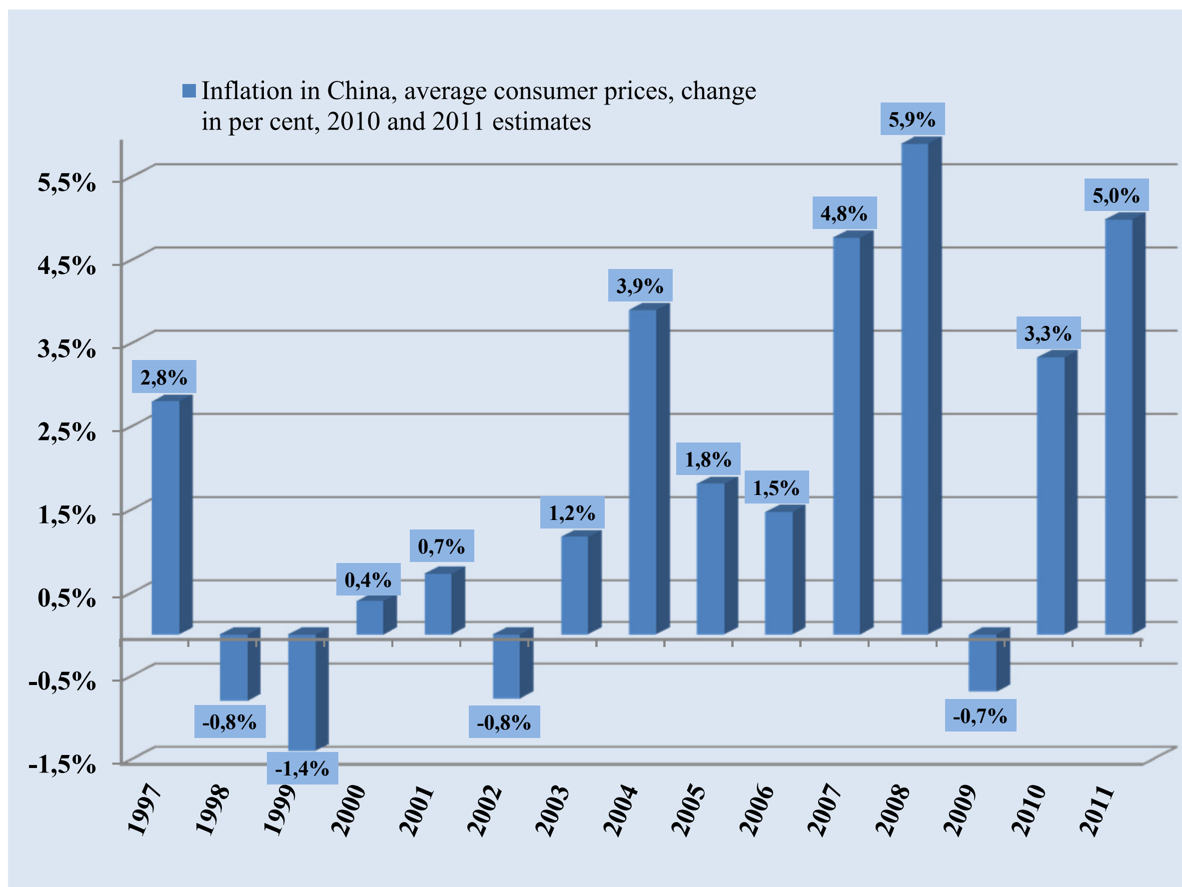




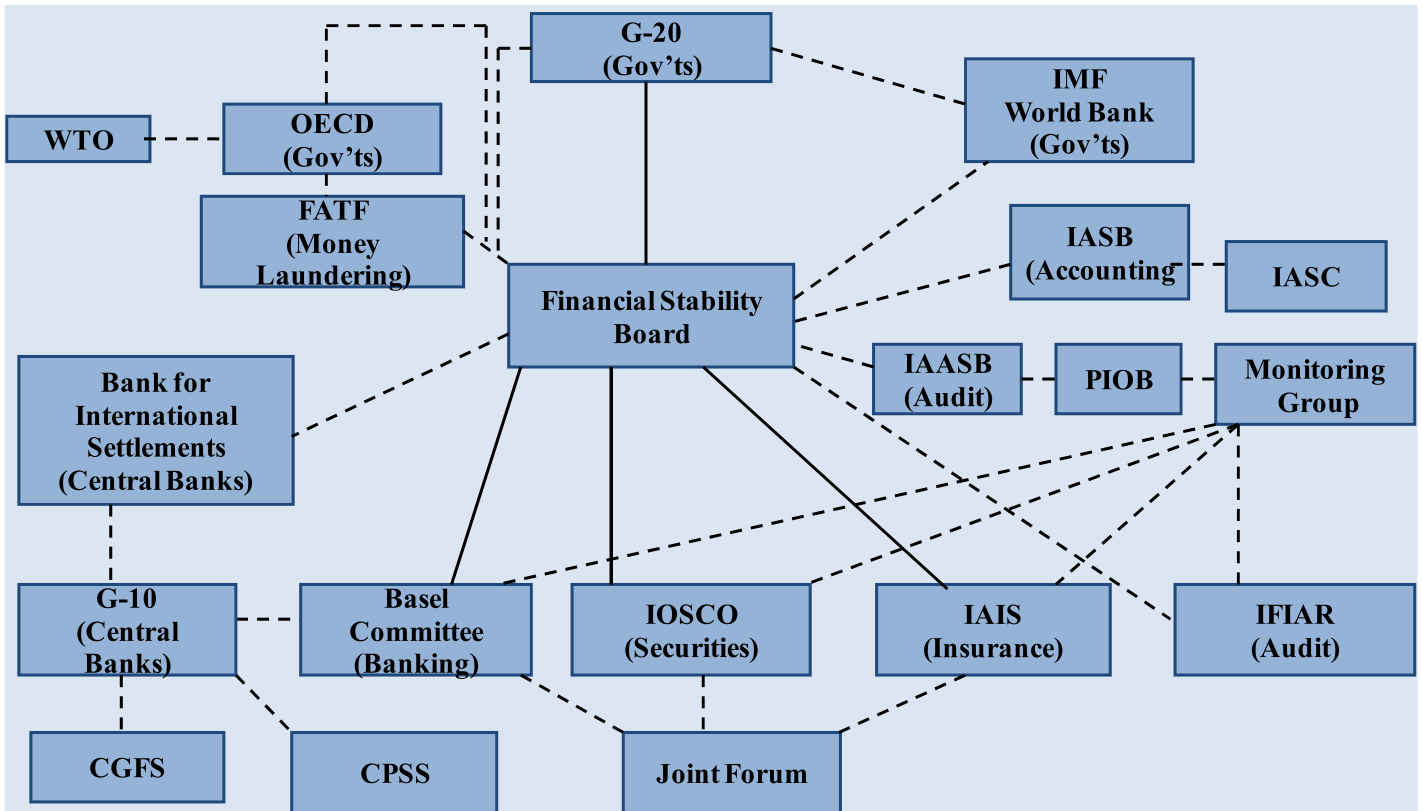




Appendix 7: China Consumer Price Inflation



Appendix 8: The International Financial Architecture



(Further information on all the members of the IFA can be found on the FSB's website: <http://www.financialstabilityboard.org/members/links.htm>.)

9.2 Glossary of key concepts

Concept	**Definition**
Adjustment Mechanism	The changes in prices and quantities by which market forces eliminate balance of payments deficits and surpluses (Eichengreen 2008: 233).
Article IV Consultation	A regular, usually annual, comprehensive discussion between the IMF staff and representatives of individual member countries concerning the member's economic and financial policies. The basis for these discussions is in Article IV of the IMF Articles of Agreement (as amended, effective 1978) which direct the Fund to exercise firm surveillance over each member's exchange rate policies (IMF Glossary 2006).
Balance of Payments	A statement summarizing the economic transactions between the residents of a country and nonresidents during a specific period, usually a year. The balance of payments includes transactions in goods, services, income, transfers and financial assets and liabilities. Generally, the balance of payments is divided into two major components: the current account and the capital and financial account (IMF Glossary 2006).
Balance of Payments Equilibrium	A condition in which a current account surplus or deficit is equal to capital outflow or inflow, defined in some way as normal or sustainable, without undue resort to restrictions on current international transactions or on payments and transfers for them or to incentives for inflows or outflows of capital, and without excessive unemployment (Gold 1988: 35).
Beggar-thy-neighbour Policies	An exchange rate devaluation by one country that, by compressing its demand for imports, leaves its trading partners worse off, also known as competitive devaluation (Eichengreen 2008: 233).
Capital Account	A standard component of the balance of payments accounts, usually a shortened term for the capital and financial account, which refers to (i) capital transfers and acquisition/disposal of non-produced, nonfinancial assets and (ii) financial assets and liabilities (IMF Glossary 2006).
Capital Controls	Regulations limiting the ability of firms or households to convert domestic currency into foreign exchange. Controls on capital-account transactions prevent residents from converting domestic currency into foreign exchange for purposes of foreign investment. Controls on current-account transactions limit the ability of residents to convert domestic currency into foreign exchange in order to import merchandise (Eichengreen 2008: 234).
Convertibility	The ability of a currency to be freely transformed into foreign exchange. Current account convertibility applies when the purpose of such transformation is to acquire foreign goods or services activities. Capital account convertibility is used when the purpose is the acquisition of foreign assets, such as foreign stocks and bonds activities that are typically recorded in the capital account (Reinert/Rajan 2009: 224).
Cross-Price Elasticity	The extent to which changes in the price of an imported good affect demand for the domestic competing good (Reinert/Rajan 2009: 891).

Current Account	The record of all transactions in the balance of payments covering the exports and imports of goods and services, payments of income, and current transfers between residents of a country and nonresidents (IMF Glossary 2006).
Equilibrium Exchange Rate	An exchange rate consistent with a given set of fundamentals over the medium to long term. Employed to measure the misalignment of an exchange rate with an underlying measure of equilibrium (IEO 2007: 53 and Reinert/Rajan 2009: 346).
Exchange Rate	The price at which one currency can be exchanged for another. Also referred to as the bilateral exchange rate. Monetary systems may be related to each other by two means of measurement, the (nominal) par of exchange and the (real) rate of exchange (US Treasury 2011: 27 and Proctor 2005a: 469).
Exchange Rate Arrangement	The overall method that a member uses to determine the value of its currency against other currencies, ranging from floating to pegged. A broad classification or framework of a member's exchange system (IMF Legal Framework 2006: N. 4 and Gold 1988: 113).
Exchange Rate Policies	Actions or inactions of members in the operation of their exchange arrangements, and more specifically not only intervention policies but also other external policies and certain domestic policies that are specifically pursued for balance of payments purposes (IMF Further Considerations 2007: N. 13).
Exorbitant Privilege	The greater macroeconomic space accorded to a country issuing a major reserve currency (especially the United States) by virtue of the greater liquidity of its markets, ability to borrow in its own currency abroad at lower cost, as well as the seigniorage earned from issuing an internationally used currency (IMF Glossary 2006).
External Balance	Some combination of exchange rate stability and an appropriate and sustainable balance on current transactions in goods and services (Boughton 2001: 138).
External Stability	A balance of payments position that does not, and is not likely to, give rise to unnecessary disruptive exchange rate movements (IMF Further Considerations 2007: N. 13).
Fiat Money	Money that is intrinsically worthless and is not backed by an asset or a commodity at the central bank (Reinert/Rajan 2009: 813).
Floating (Flexible) Exchange Rate	A regime under which the foreign exchange rate of a currency is fully determined by the market with intervention from the government or central bank being used sparingly (US Treasury 2011: 27).
Fundamental Equilibrium Exchange Rate (FEER)	An exchange rate at which both the internal and external balance are satisfied, where the internal balance is high employment and low inflation and the external balance is characterised as the sustainable desired net flow of resources between countries when they are in internal balance (Reinert/Rajan 2009: 347).
Foreign Exchange	Any type of financial instrument that is used to make payments between countries is considered foreign exchange. Examples of foreign exchange assets include foreign currency notes, deposits held in foreign banks, debt obligations of foreign governments and foreign banks, monetary gold, and SDRs (IMF Glossary 2006).

Global Imbalances	Large and unsustainable mismatches in crucial macroeconomic variables in major countries or areas of the world economy, including the unsustainable trade deficit of the US, excessive savings of China and Japan and dismal poverty in the world's poorest countries (Reinert/Rajan 2009: 536)
Gold Standard	A monetary system in which the value of money is defined in terms of a given quantity of gold. Voluntarily adhered to between 1880 and World War I (Reinert/Rajan 2009: 561).
Inflation	A sustained increase in the general price level, often measured by an index of consumer prices. The rate of inflation is the percentage change in the price level in a given period. (IMF Glossary 2006).
Internal Balance	The achievement of the maximum growth of output and the highest employment level consistent with (reasonable) price stability (Boughton 2001: 137).
International Financial Architecture	The collective governance arrangements at the global level for safeguarding the effective functioning (or the stability) of the global financial system (Schinasi/Truman 2010: 3).
International Financial System	The international (global) monetary system with its official understandings, agreements, conventions, and institutions as well as the private and official processes, institutions, and conventions associated with private financial activities (Schinasi/Truman 2010: 3).
International Monetary System	The rules governing the relations of countries through their balance of payments and the monetary authorities that manage them (Schinasi/Truman 2010: 3).
International Reserves	Foreign assets held by the central bank that can be used to finance the balance of payments and for intervention in the exchange market. Foreign assets consist of gold, special drawing rights, and foreign currency (most of which are held in short-term government securities). The latter are used for intervention in the foreign exchange markets (US Treasury 2011: 28).
Intervention	The purchase or sale of a country's currency in the foreign exchange market by a government entity (typically central bank) in order to influence its exchange rate. Interventions may be sterilized or unsterilized (US Treasury 2011: 25-26).
Managed Float	A regime under which a country establishes no predetermined path for the exchange rate but the central bank frequently intervenes to influence the movement of the exchange rate against a particularly currency or group of currencies (US Treasury 2011: 28).
Nominal Exchange Rate	The number of units of the domestic currency that can purchase a unit of a given foreign currency. A decrease in this variable is termed nominal appreciation of the currency. An increase in this variable is termed nominal depreciation of the currency (CNB 2011).
Par of Exchange	The equation between two money units, each based on a fixed (usually metallic) standard - fixed by treaty under the Bretton Woods system (Proctor 2005a: 470).
Par Value System	An exchange rate system where members are obligated to declare a par value (a "peg") for their national money and to intervene in currency markets to limit exchange rate fluctuations within maximum margins (a "band") one per cent above or below parity (Cohen 2001).

Pegged (Fixed) Exchange Rate	A regime under which a country maintains a fixed rate of exchange between its currency and another currency or a basket of currencies. Typically the exchange rate is allowed to move within a narrow predetermined (although not always announced) band. Pegs are maintained through a variety of measures including capital controls and intervention (US Treasury 2011: 28).
Purchasing Power Parity (PPP)	A theory which relates changes in the nominal exchange rate between two countries' currencies to changes in the countries' price levels. The PPP theory predicts that an increase in a currency's domestic purchasing power will be associated with a proportional currency appreciation, and that a decrease will be associated with a proportional currency depreciation (IMF Glossary 2006).
Real Exchange Rate	The exchange rate that takes into account the difference in rates of domestic inflation between the two countries (usually consumer price inflation), which also impact the relative prices of their goods (US Treasury 2011: 13).
Reserve Currency	A foreign currency held by central banks or monetary authorities for the purpose of exchange intervention (to influence the exchange rate of the national currency) and the settlement of intergovernmental claims (debts). A reserve currency is also used in the pricing of goods, services, and assets entering international trade and finance (Reinert/Rajan 2009: 968).
Soft Law	Rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain (indirect) legal effects, and that are aimed at and may produce practical effects (Schaefer 2006: 195).
Spillovers	Phenomena in which a change in one country leads to a change in in another country (Reinert/Rajan 2009: 1029).
Stable System of Exchange Rates	A system in which exchange rates are permitted to reflect underlying conditions – even if this results in exchange rate fluctuation and where unnecessary disruptive exchange rate movements are avoided by the pursuit of appropriate domestic policies (IMF Further Considerations 2007: N. 24).
Sterilized Intervention	Intervention in which the central bank sells domestic currency increases the domestic money supply, in essence expansionary monetary policy. To neutralize the effect of the intervention on the money supply the central bank will sell domestic government securities, taking an equivalent amount of domestic currency out of circulation (US Treasury 2011: 28).
Surveillance	The jurisdictional appraisal of a country's macro-economic and structural policies and performance from an international standpoint (Lastra 2010: 514).
Triffin Dilemma	A prediction by the US economist Robert Triffin that internal contradictions would bring an end to the Bretton Woods system. Triffin recognized the failure of gold supplies to keep pace with the requirements of an expanding international trading system for adequate reserves and liquidity and the asymmetric adjustment mechanism that led to a predominance of restrictive domestic policies and a tendency toward global recession (Reinert/Rajan 2009: 1141).

9.3 Reprints of the legal provisions on bilateral surveillance

9. 3.1 The amended Article IV

Art. IV:1, Art. IV:2 and Art. IV:3 of the Articles of Agreement, adopted at the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, 22 July 1944; entered into force 27 December 1945; amended effective 28 July 1969, 1 April 1978, 11 November 1992, 10 August 2009, and 18 February 2011; available online: <http://www.imf.org/external/pubs/ft/aa/in-dex.htm>.

Article IV: Obligations Regarding Exchange Arrangements

Section 1. General obligations of members

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavour to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

(iv) follow exchange policies compatible with the undertakings under this Section.

Section 2. General exchange arrangements

(a) Each member shall notify the Fund, within thirty days after the date of the second amendment of this Agreement, of the exchange arrangements it intends to apply in fulfilment of its obligations under Section 1 of this Article, and shall notify the Fund promptly of any changes in its exchange arrangements.

(b) Under an international monetary system of the kind prevailing on January 1, 1976, exchange arrangements may include

(i) the maintenance by a member of a value for its currency in terms of the special drawing right or another denominator, other than gold, selected by the member, or

(ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, or

(iii) other exchange arrangements of a member's choice.

(c) To accord with the development of the international monetary system, the Fund, by an

eighty-five percent majority of the total voting power, may make provision for general exchange arrangements without limiting the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund and the obligations under Section 1 of this Article.

Section 3. Surveillance over exchange arrangements

(a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.

(b) In order to fulfil its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.

9.3.2 The 1977 Decision

Executive Board Decision No. 5392-(77/63), adopted 29 April 1977; repealed by Executive Board Decision No. 13919-(07/51), 15 June 2007; reprinted from: Selected Decisions and Selected Documents of the International Monetary Fund, 31st Issue, Washington, 31 December 2006; available online <http://www.imf.org/external/pubs/ft/sd/2006/31stissue.pdf>.

Surveillance Over Exchange Rate Policies

1. The Executive Board has discussed the implementation of Article IV of the proposed Second Amendment of the Articles of Agreement and has approved the attached document entitled "Surveillance over Exchange Rate Policies." The Fund shall act in accordance with this document when the Second Amendment becomes effective.

   In the period before that date the Fund shall continue to conduct consultations in accordance with present procedures and decisions.

2. The Fund shall review the document entitled "Surveillance over Exchange Rate Policies" at intervals of three years and at such other times as consideration of it is placed on the agenda of the Executive Board.

General Principles

Article IV, Section 3(a) provides that "The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each mem-

ber with its obligations under Section 1 of this Article." Article IV, Section 3(b) provides that in order to fulfill its functions under 3(a) The Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." Article IV, Section 3(b) also provides that "The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members." In addition, Article IV, Section 3(b) requires that "each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies."

The principles and procedures set out below, which apply to all members whatever their exchange arrangements and whatever their balance of payments position, are adopted by the Fund in order to perform its functions under Section 3(b). They are not necessarily comprehensive and are subject to reconsideration in the light of experience. They do not deal directly with the Fund's responsibilities referred to in Section 3(a), although it is recognized that there is a close relationship between domestic and international economic policies. This relationship is emphasized in Article IV which includes the following provision: "Recognizing … that a principal objective [of the international monetary system] is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates."

Principles for the Guidance of Members' Exchange Rate Policies

A. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

B. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterised inter alia by disruptive short-term movements in the exchange value of its currency.

C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

Principles of Fund Surveillance over Exchange Rate Policies

1. The surveillance of exchange rate policies shall be adapted to the needs of international adjustment as they develop. The functioning of the international adjustment process shall be kept under review by the Executive Board and Interim Committee and the assessment of its operation shall be taken into account in the implementation of the principles set forth below.
2. In its surveillance of the observance by members of the principles set forth above, the Fund shall consider the following developments as among those which might indicate the need for discussion with a member:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) an unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term official or quasi official lending, for balance of payments purposes;

(iii)

(a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or

(b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for balance of payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements;

(vi) unsustainable flows of private capital.

3. The Fund's appraisal of a member's exchange rate policies shall be based on an evaluation of the developments in the member's balance of payments, including the size and sustainability of capital flows, against the background of its reserve position and its external indebtedness. This appraisal shall be made within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member, and shall recognize that domestic as well as external policies can contribute to timely adjustment of the balance of payments. The appraisal shall take into account the extent to which the policies of the member, including its exchange rate policies, serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment.

9.3.3 The 2007 Decision

Executive Board Decision No. 13919-(07/51), adopted 15 June 2007, as amended by Executive-Board Decision No. 14766-(10/115), 29 November 2010, available online: <http://www.imf.org/external/pubs/ft/sd/index.asp?decision=13919-%2807/51%29>.

Bilateral Surveillance over Members' Policies

1. This Decision provides guidance to the Fund in its oversight over members' policies pursuant to Article IV, Sections 3 (a) and (b), and guidance to members in the conduct of their exchange rate policies pursuant to Article IV, Section 3 (b). It does not deal directly with the Fund's responsibility to oversee the international monetary system in order to ensure its effective operation, referred to in Article IV, Section 3 (a).

2. Part I of this Decision sets out the scope and modalities of the Fund's oversight of members' obligations under Article IV, Section 1, including the Fund's exercise of firm surveillance over the exchange rate policies of members (such oversight of members' obligations is herein-

after referred to as "bilateral surveillance"). Part II establishes principles for the guidance of members in the conduct of their exchange rate policies as required under Article IV, Section 3 (b); it also identifies certain developments which, in the Fund's assessment of a member's observance of the principles, would require thorough review and might indicate the need for discussion with the member. Part III sets out procedures for surveillance.

3. Fund surveillance over members' policies shall be adapted to the needs of the international monetary and financial system as they develop. The principles and procedures set out in this Decision, which apply to all members irrespective of their exchange arrangements and balance of payments positions, are not necessarily comprehensive and are subject to reconsideration by the Fund in the light of experience.

Part II - Principles for the Guidance of Members' Policies Under Article IV, Section 1

14. Principle A sets forth the obligation contained in Article IV, Section 1(iii); further guidance on its meaning is provided in the Annex to this Decision. Principles B through D constitute recommendations rather than obligations of members. A determination by the Fund that a member is not following one of these recommendations would not create a presumption that that member is in breach of its obligations under Article IV, Section 1.

A. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

B. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterised inter alia by disruptive short-term movements in the exchange rate of its currency.

C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

D. A member should avoid exchange rate policies that result in external instability.

15. In its surveillance of the observance by members of the Principles set forth above, the Fund shall consider the following developments as among those which would require thorough review and might indicate the need for discussion with a member:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) fundamental exchange rate misalignment;

(vi) large and prolonged current account deficits or surpluses; and

(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows.

ANNEX

Article IV, Section 1(iii) and Principle A

1. Article IV, Section 1 (iii) of the Fund's Articles provides that members shall "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." The language of this provision is repeated in Principle A contained in Part II of this Decision. The text set forth below is designed to provide further guidance regarding the meaning of this provision.
2. A member would only be acting inconsistently with Article IV, Section 1(iii) if the Fund determined both that: (a) the member was manipulating its exchange rate or the international monetary system and (b) such manipulation was being carried out for one of the two purposes specifically identified in Article IV, Section 1(iii).

   (a) "Manipulation" of the exchange rate is only carried out through policies that are targeted at – and actually affect – the level of an exchange rate. Moreover, manipulation may cause the exchange rate to move or may prevent such movement.

   (b) A member that is manipulating its exchange rate would only be acting inconsistently with Article IV, Section 1(iii) if the Fund were to determine that such manipulation was being undertaken "in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." In that regard, a member will only be considered to be manipulating exchange rates in order to gain an unfair competitive advantage over other members if the Fund determines both that: (A) the member is engaged in these policies for the purpose of securing fundamental exchange rate misalignment in the form of an undervalued exchange rate and (B) the purpose of securing such misalignment is to increase net exports.
3. It is the responsibility of the Fund to make an objective assessment of whether a member is observing its obligations under Article IV, Section 1 (iii), based on all available evidence, including consultation with the member concerned. Any representation made by the member regarding the purpose of its policies will be given the benefit of any reasonable doubt.

Sources of figures

Figure	Title	Source
Figure 1	*Timeline*	Author's own
Figure 2	*Powers of the Fund*	Adapted from Hagan 2010a
Figure 3	*Surveillance Instruments*	Adapted from Lombardi/Woods 2007: 10
Figure 4	*The Process of Legalization*	Author's own
Figure 5	*Attributes of Legalization*	Adapted from Abbott et al. 2000: 404
Figure 6	*The Legalization of Exchange Rate Commitments*	Author's own
Figure 7	*Asian Exchange Rates Against the USD*	OANDA.com, <http://www.oanda.com>
Figure 8	*China's Foreign Exchange Reserves*	*Reserve Levels January 2001 to June 2010*: SAFE 2011, <http://www.safe.gov.cn/model_safe_en/> *Reserve Levels Q1, 2011*: US Treasury 2011b *GDP in Current Prices*: IMF WEOD 2011, <http://www.imf.org/external/ns/cs.aspx?id=28>
Figure 9	*China's Trade in Goods*	*2001 to 2009*: IMF WEOD 2011, <http://www.imf.org/external/ns/cs.aspx?id=28> *2010 and 2011*: China's Ministry of Commerce, <http://english.mofcom.gov.cn/statistic/statistic.html>
Figure 10	*China's GDP Growth*	*2001 to 2009:* Chinability.com, <http://www.chinability.com/GDP.htm> *2010 and 2011:* National Bureau of Statistics of China, <http://www.stats.gov.cn/>
Figure 11	*US-China Economic Relationship*	Taken from USCBC 2011: 10
Appendix 1	*IMF Governance*	Adapted from Lamdany/Martinez-Diaz 2009: 5
Appendix 2	*Bilateral Surveillance Regime*	Author's own
Appendix 3	*The Art. IV Process*	Adapted from Momani 2006: 252
Appendix 4	*Forms of International Legalization*	Adapted from Abbott et al. 2000: 406
Appendix 5	*China Annual Trend Charts*	Taken from EIU 2011: 22
Appendix 6	*China Comparative Indicators*	Taken from EIU 2011: 25
Appendix 7	*China Consumer Price Inflation*	IMF WEOD 2011 <http://www.imf.org/external/ns/cs.aspx?id=28>
Appendix 8	*The International Financial Architecture*	Adapted from Davies 2008: 12

Bibliography

IMF documents

The IMF produces 35 different types of publications. To increase clarity, all IMF documents have been referenced with a shortened title and the year of publication. All IMF sources can be obtained at <http://www.imf.org>. The amended Art. IV, the 1977 Decision and the 2007 Decision are reprinted in section 9.3.

Year	Date	Short Reference	Full Title
1945	27.12.1945	*Original Articles*	Articles of Agreement of the International Monetary Fund
1977	29.04.1977	*1977 Decision*	Surveillance Over Exchange Rate Policies – Executive Board Decision No. 5392–(77/63)
1978	01.04.1978	*Amended Articles*	Second Amendment of the Articles of Agreement of the International Monetary Fund
1996	09.12.1996	*IMF–WTO Agreement*	Agreement Between the International Monetary Fund and the World Trade Organization
2004	06.07.2004	*2004 Consultation*	People's Republic of China: 2006 Article IV Consultation – Country Report No. 04/351
2005	01.07.2005	*Standards and Codes Effectiveness*	The Standards and Codes Initiative – Is It Effective? And How Can It Be Improved?
2005	08.07.2005	*2005 Consultation*	People's Republic of China: 2005 Article IV Consultation – Country Report No. 05/411
2006	28.06.2006	*Legal Framework*	Article IV of the Fund's Articles of Agreement – An Overview of the Legal Framework
2006	28.06.2006	*Preliminary Considerations*	Review of the 1977 Decision – Preliminary Considerations
2006	31.10.2006	*Glossary*	Glossary of Selected Financial Terms – Terms and Definitions
2006	31.07.2006	*2006 Consultation*	People's Republic of China: 2006 Article IV Consultation – Country Report No. 06/394
2006	08.11.2006	*CGER Methodology*	Methodology for CGER Exchange Rate Assessments
2006	29.11.2006	*Press Release 06/266*	IMF Strengthening Framework for Exchange Rate Surveillance
2007	14.02.2007	*Further Considerations*	Review of the 1977 Decision – Further Considerations, and Summing Up of the Board Meeting
2007	23.04.2007	*Survey*	IMF Survey Vol. 36 N. 7
2007	22.05.2007	*Proposal*	Review of the 1977 Decision – Proposal for a New Decision
2007	22.05.2007	*Companion Paper*	Review of the 1977 Decision – Proposal for a New Decision – Companion Paper
2007	13.06.2007	*Supplement*	Review of the 1977 Decision – Proposal for a New Decision – Supplement
2007	15.06.2007	*2007 Decision*	Bilateral Surveillance over Members' Policies – Executive Board Decision No. 13919–(07/51)

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2007	21.07.2007	*Survey Online*	Surveillance Guidelines – Landmark Framework for IMF Surveillance
2008	02.09.2008	*2008 Review*	2008 Triennial Surveillance Review – Overview Paper
2008	08.10.2008	*Press Release 08/238*	IMF Executive Board Adopts Surveillance Priorities for 2008–2011– Press Release No. 08/238
2008	11.10.2008	*PIN 08/133*	IMF Executive Board Reviews the Fund's Surveillance – PIN No. 08/133
2009	20.06.2009	*2009 Transcript*	Transcript of a Press Tele–conference Call with International Monetary Fund Officials on China's 2009 Article IV Consultation
2009	22.06.2009	*Revised Guidance*	The 2007 Surveillance Decision – Revised Operational Guidance
2009	02.09.2009	*Press Release 09/293*	IMF Signs US$50 Billion Note Purchase Agreement with China – Press Release No.09/293
2009	21.09.2009	*Revised Classification*	Revised System for the Classification of Exchange Rate Arrangements – Working Paper 09/211
2010	26.03.2010	*Modernizing Surveillance*	Modernizing the Surveillance Mandate and Modalities
2010	27.07.2010	*PIN 10/100*	IMF Executive Board Concludes 2010 Article IV Consultation with China – PIN No. 10/100
2010	29.07.2010	*2010 Consultation*	People’s Republic of China: 2010 Article IV Consultation – Country Report No. 10/238
2010	09.09.2010	*PIN 10/128*	IMF Executive Board Discusses Follow–Up to Modernizing the Fund’s Surveillance Mandate and Modalities
2010	27.09.2010	*Press Release 10/357*	Expanding Surveillance to Require Mandatory Financial Stability Assessments of Countries with Systemically Important Financial Sectors
2010	28.10.2010	*Qualifiers*	Qualifiers Used in Summings Up of Executive Board Meetings
2010	29.11.2010	*Decision No. 14766*	Lapse of Time Procedures for Article IV Consultations – Executive Board Decision No. 14766–(10/115)
2010	22.12.2010	*Revised Guidance 2010*	Bilateral Surveillance Guidance Note
2011	01.03.2011	*Surveillance Factsheet*	Factsheet: IMF Surveillance – The 2007 Decision on Bilateral Surveillance
2011	03.03.2011	*Quotas*	Factsheet: IMF Quotas
2011	04.2011	*WEOD*	World Economic Outlook Database
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2011	21.06.2011	*Spillover Report*	People's Republic of China – Spillover Report for the 2011 Article IV Consultation and Selected Issues
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