FINANCIAL STABILITY IN INTERNATIONAL LAW

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In the current interdependent global economic system, measures adopted nationally by governments to safeguard financial stability sometimes produce cross-border spillovers. A question arises as to how international economic law shall treat states' regulatory powers to tackle internal and external economic and financial threats. The goal of the research is to analyse (i) how international law distributes between different international subjects the social costs of global instability in the event of emergencies, and (ii) how regulatory powers are attributed in a situation of economic and financial interdependence. To do so, this article sets out a law and economics theory that conceptualises financial stability in international law as the result of a trade-off between three competing regulatory objectives: domestic stability, global stability, and financial integration. The way in which the interplay between these objectives is represented in law crucially influences the balance of rights and obligations in the formulation of national economic and financial policies, and the level of protection against economic threats. This article argues that current international law is largely inefficient because it structures the protection of financial stability as a matter of the individual rights of each state, rather than a social problem of the international community.

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The notion of financial stability has tended to elude any uniform conceptualisation, either in pure economic theory or in the law.[1] From an

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[1] See Garry J Schinasi, 'Defining Financial Stability' (Working Paper No 04/187, International Monetary Fund ('IMF'), 2004) 13–16 <https://www.imf.org/external/pubs/ft/wp/2004/wp04187.pdf> archived at <https://perma.cc/U843-VS78>; for a definition of monetary stability, see Rosa María Lastra, *Legal Foundations of International Monetary Stability* (Oxford University Press, 2006) 34–9.

economic point of view, it can be very simply described as the absence of crises or systemic risks. From a policy and legal perspective, however, the achievement of a stable economy is the culmination of a long and complex regulatory and political process that involves the formulation and implementation of different economic policies and the critical attribution of regulatory powers to different subjects at the domestic and international levels.[2] The pursuit of financial stability and economic efficiency has always ranked as one of the foremost policy objectives of any state. Monetary authorities set interest rates to encourage either investment or savings; fiscal authorities design tax policies to promote business and labour creation. During a crisis, financial authorities intervene in the market through 'lender of last resort' operations or bailout programs to maintain financial stability.

The fundamental role that financial, fiscal, and monetary stability play in domestic policy is reflected in international law in the fact that, with the notable exception of the European Union,[3] most of the policies that contribute to maintaining a stable economy have been historically largely *excluded* from international obligations. Monetary authorities can set the appropriate interest rates and control the level of liquidity in their economy without suffering any legal constraints,[4] and, to a lesser extent, they are free to manage their exchange rate policy.[5] Furthermore, in the context of finance, national supervisors are, in

[2] See Federico Lupo Pasini, 'Economic Stability and Economic Governance in the Euro Area: What the European Crisis Can Teach on the Limits of Economic Integration' (2013) 16 *Journal of International Economic Law* 211, 235–7.

[3] See Lastra, above n 1, chs 6, 12.

[4] Ernst Baltensperger and Thomas Cottier, 'The Role of International Law in Monetary Affairs' (2010) 13 *Journal of International Economic Law* 911, 912; More specifically on monetary sovereignty, see Lastra, above n 1, 5–32; Claus D Zimmermann, *A Contemporary Concept of Monetary Sovereignty* (Oxford University Press, 2013); Claus D Zimmermann, 'The Concept of Monetary Sovereignty Revisited' (2013) 24 *European Journal of International Law* 797; Tullio Treves, 'Monetary Sovereignty Today' in Mario Giovanoli (ed), *International Monetary Law: Issues For the New Millennium* (Oxford University Press, 2000); François Gianviti, 'Current Legal Aspects of Monetary Sovereignty' in IMF (ed), *Current Developments in Monetary and Financial Law* (IMF, 2005) vol 4.

[5] On exchange rate, see Claus D Zimmermann, 'Exchange Rate Misalignment and International Law' (2011) 105 *American Journal of International Law* 423.

principle, legally free to adopt or ignore international financial standards[6] and to choose when and how to intervene in the event of a local banking crisis.[7]

However, the increased pace of economic and financial integration and the closer interdependence among economies achieved in the last few decades has placed in the spotlight the global implications of economic sovereignty that were not visible long ago, and this deserves closer examination.[8] Recent events show that stability and instability are no longer purely domestic matters. For example, unsustainable macroeconomic and fiscal policies can transmit instability to neighbouring countries and cause losses to foreign investors;[9] the adoption of national solutions in response to the collapse of globally systemic important banks can easily spread systemic risk and financial contagion across national borders;[10] or the adoption of expansionary monetary policies that result in excessive liquidity in international markets can cause problems in other

6 International financial standards are not binding. However, some authors argue that as result of the institutional pressure from the IMF or World Bank and the market pressure from private investors, international financial standards have to be considered as de facto hard laws. On compliance with international financial standards, see Chris Brummer, 'How International Financial Law Works (and How It Doesn't)' (2011) 99 *Georgetown Law Journal* 257; Chris Brummer, 'Why Soft Law Dominates International Finance — and Not Trade' (2010) 13 *Journal of International Economic Law* 623, 638; Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (Cambridge University Press, 2012). A few authors go further, arguing that the adoption of financial standards as a result of the IMF conditionality does undermine national sovereignty. See Andreas F Lowenfeld, 'The International Monetary System and the Erosion of Sovereignty: Essay in Honor of Cynthia Lichtenstein' (2002) 25 *Boston College International & Comparative Law Review* 257; Robert P Delonis, 'International Financial Standards and Codes: Mandatory Regulation Without Representation' (2004) 36 *New York University Journal of International Law and Politics* 563.

7 Eva H G Hüpkes, *The Legal Aspects of Bank Insolvency: A Comparative Analysis of Western Europe, the United States and Canada* (Kluwer Law International, 2000); Thomas C Baxter Jr, Joyce M Hansen and Joseph H Sommer, 'Two Cheers for Territoriality: An Essay on International Bank Insolvency Law' (2004) 78 *American Bankruptcy Law Journal* 57, 73–6; Rosa Maria Lastra, 'Lender of Last Resort, an International Perspective' (1999) 48 *International and Comparative Law Quarterly* 340; Rosa M Lastra, 'Northern Rock, UK Bank Insolvency and Cross-Border Bank Insolvency' (2008) 9 *Journal of Banking Regulation* 165; Rosa María Lastra, 'Systemic Risk, SIFIs and Financial Stability' (2011) 6 *Capital Markets Law Journal* 197; Rosa María Lastra, 'Cross-Border Bank Insolvency: Legal Implications in the Case of Banks Operating in Different Jurisdictions in Latin America' (2003) 6 *Journal of International Economic Law* 79.

8 For a general overview of the problems of globalisation and international spillovers, see Ian Goldin and Mike Mariathasan, *The Butterfly Defect: How Globalization Creates Systemic Risks and What to Do about It* (Princeton University Press, 2014).

9 See Domingo Cavallo, 'Argentina and the IMF During the Two Bush Administrations' (2004) 7 *International Finance* 137; Padma Desai, *Financial Crisis, Contagion, and Containment: From Asia to Argentina* (Princeton University Press, 2003); Carlo Bastasin, *Saving Europe: How National Politics Nearly Destroyed the Euro* (Brookings Institution Press, 2012).

10 On the spillovers resulting from the insolvency of a cross-border bank, see Stjin Claessens et al, 'A Safer World Financial System: Improving the Resolution of Systemic Institutions' (Report No 12, International Center for Monetary and Banking Studies and Centre for Economic Policy Research, 2010); See also Richard Herring, 'The Challenge of Resolving Cross-Border Financial Institutions' (2014) 31 *Yale Journal on Regulation* 853.

countries.[11] Finally, sometimes during times of crisis the very protection of financial stability in one state might require the sacrifice of other states' rights under international law, such as by suspending the application of a treaty.

These examples illustrate that in an integrated financial system such as now exists, implementation of domestic fiscal, financial, or monetary policies in one state could very well produce negative repercussions in other states. Such realities pose fundamental questions for international law that have not yet been fully addressed. The present article has the objectives of filling a gap in the literature and conceptualising in a more coherent fashion the question of financial stability in international law in both its domestic and global dimensions. In doing so, this article will conduct a basic law and economics analysis of the various international norms dealing with financial stability.[12] In this regard, the concept of financial stability is intended in this article rather more broadly than in the classical financial literature, which conceptualises it as a phenomenon purely limited to the financial system: as the absence of systemic risks and inter-bank contagion. Rather, this article wants to look at financial instability as a more encompassing phenomenon, which encapsulates different and not strictly financial aspects, such as monetary or sovereign debt crises. For the same reason, when this article refers to financial integration, it refers to a situation of broader economic integration, which also encompasses free trade in goods and services, and capital mobility.

Two fundamental insights to help understand the law of financial stability will be offered. First, it will be suggested that the international law of financial stability should be conceptualised as a trade-off between three legal objectives: (i) domestic stability, (ii) global stability, and (iii) financial integration. The level of protection that international law accords to each of these directly affects the protection afforded to the other two.[13] Hence, the protection of financial stability should be analysed in terms of the regulatory power that international law attributes to states in achieving one of the objectives while sacrificing the others, as well as in the conflict between states' opposing goals. Secondly, it will be suggested that some of the consequences of the current regulatory framework

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[11] On quantitative easing, see Tommaso Mancini-Griffoli et al, 'Unconventional Monetary Policies — Recent Experience and Prospects — Background Paper' (Background Paper, IMF, 18 April 2013) <https://www.imf.org/external/np/pp/eng/2013/041813.pdf> archived at <https://perma.cc/82ME-GBEZ>; on the external impact of quantitative easing, see Marcel Fratzscher, Marco Lo Duca and Roland Straub, 'On the International Spillovers of US Quantitative Easing' (Working Paper No 1557, European Central Bank, June 2013) <http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1557.pdf> archived at <https://perma.cc/EJN3-44HJ>.

[12] On economic analysis of international law see, Jeffrey L Dunoff and Joel P Trachtman, 'Economic Analysis of International Law' (1999) 24 *Yale Journal of International Law* 1; Joel P Trachtman, *The Economic Structure of International Law* (Harvard University Press, 2008); Jack L Goldsmith and Eric A Posner, *The Limits of International Law* (Oxford University Press, 2005); Eric A Posner and Alan O Sykes, *Economic Foundations of International Law* (Harvard University Press, 2013).

[13] This theory was enunciated in the famous *Harvard Law Review* article by Guido Calabresi and A Douglas Melamed that developed, among others, the concept of the protection of legal entitlements. See Guido Calabresi and A Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089.

can be better understood by using the concept of externalities.[14] More specifically, this article will argue that sovereign control over its domestic financial stability produces externalities on partner countries. Accordingly, optimal protection of global financial stability should rely on the internalisation of such externalities by law.

The article will be divided into four parts. After the introduction, the first Part will conceptualise financial stability as a conflict between the three legal objectives and explain how the current international norms dealing with financial stability addresses conflicts and trade-offs between them. The second Part will discuss the concept of economic sovereignty and its relationship to the protection of global financial stability. It will analyse how sovereignty affects the interplay between the three objectives, and it will develop the concept of sovereignty as a negative externality. The third Part will discuss two possible solutions to the problem of externalities, namely the centralisation of financial governance into supranational authorities, and the adoption of a binding international law framework for financial stability.

I FINANCIAL STABILITY AND FINANCIAL INTEGRATION IN INTERNATIONAL LAW

In their famous essay, Guido Calabresi and Douglas Melamed state that the first issue that any legal system faces is to solve what they call 'the problem of "entitlement"'.[15] In any society, different groups of people have conflicting interests or goals that might sometimes collide. The role of the law, in regard to such conflicts, is to solve them by legitimising the pursuit of one objective and disfavouring the other. In the words of the two authors, the law shall decide which party will be 'entitled to prevail'.[16] The problem of entitlement is not unique to domestic law. In international law the same problem arises in all spheres of interstate interaction, from environmental regulation to the law of the sea.[17] Thus, the role of international law is to devise a regulatory framework that legitimises the pursuit of one interest over the others and allocates rights and obligations between states where conflicts occur.

The analysis of financial stability in international law fits particularly well within this interpretative framework. The high level of economic (especially financial) integration between states, coupled with the mechanisms of economic

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[14] On the concept of externality in law and economics, see Steven Shavell, *Foundations of Economic Analysis of Law* (Harvard University Press, 2004) ch 5; Carl J Dahlman, 'The Problem of Externality' (1979) 22 *Journal of Law and Economics* 141; Howard F Chang, 'Carrots, Sticks, and International Externalities' (1997) 17 *International Review of Law and Economics* 309.

[15] Calabresi and Melamed, above n 13, 1090.

[16] Ibid.

[17] For a comprehensive study on the subject in international law, see Joost Pauwelyn, *Optimal Protection of International Law: Navigating between European Absolutism and American Voluntarism* (Cambridge University Press, 2008). Note other authors that have applied the same methodology in international law: Jonathan Baert Wiener, 'Global Environmental Regulation: Instrument Choice in Legal Context' (1999) 108 *Yale Law Journal* 677; Warren F Schwartz and Alan O Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization' (2002) 31 *Journal of Legal Studies* S179; Richard Morrison, 'Efficient Breach of International Agreements' (1994) 23 *Denver Journal of International Law and Policy* 183.

policies, often leads to situations in which the pursuit of an objective by one state entails the sacrifice of another's objective. The first part of this section will introduce these objectives and briefly analyse if and how the law currently protects them as individual entitlements. The second part will then analyse how international law disciplines their trade-offs in the presence of a conflict.

A *The Three Objectives of the International Law of Financial Stability*

The question of financial stability in international law can be conceptualised as a trade-off between three broad and interrelated objectives: (i) the pursuit of financial integration, (ii) the protection of domestic stability, and (iii) the protection of global stability. The law protects them differently in different cases. Sometimes, they are protected as the entitlements of individual states, enshrined in binding international treaties or protected by customary international laws. In other cases, however, the pursuit of these objectives is not clearly addressed by the law. They are nothing more than broad policy goals not framed in legal terms and whose realisation relies only on voluntary cooperation. This section introduces them.

1 *Financial Integration*

The modern global economy relies on substantial economic interdependence.[18] The question of financial stability in international law is therefore linked to, and dependent on, the process of economic (and especially, financial)[19] integration. The relationship between financial integration and financial stability is most visible in two different circumstances. The first arises due to the role of monetary, trade and financial integration as a vehicle for cross-border contagion or spillovers.[20] Indeed, the same treaties that enable market integration also promote the reduction of those regulatory and administrative barriers that act as a natural safeguard against external instability. Secondly, in certain circumstances (for instance, during a balance of payments crisis),[21] the distressed country might decide to increase barriers — and thus suspend the application of economic treaties — to safeguard its domestic financial stability.[22]

The protection of financial integration is one of the three most important elements for the law of financial stability, and, more generally, one of the most

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18 See IMF, 'Understanding Financial Interconnectedness' (Report, IMF, 4 October 2010).

19 For literature on the relationship between financial integration and financial stability, see World Trade Organization, 'Financial Services: Background Note by the Secretariat' (Background Note No S/C/W/72, World Trade Organization, 2 December 1998).

20 See IMF, 'Global Financial Stability Report: Meeting New Challenges to Stability and Building a Safer System' (World Economic and Financial Surveys, IMF, April 2010); IMF, 'Global Financial Stability Report: Transition Challenges to Stability' (World Economic and Financial Surveys, IMF, October 2013); IMF, '2012 Spillover Report' (Report, IMF, 9 July 2012); Goldin and Mariathasan, above n 8, ch 2.

21 Shailendra J Anjaria, 'Balance of Payments and Related Issues in the Uruguay Round of Trade Negotiations' (1987) 1 *The World Bank Economic Review* 669; Isaiah Frank, 'Import Quotas, the Balance of Payments and the *GATT*' (1987) 10 *The World Economy* 307; Chantal Thomas, 'Balance-of-Payments Crises in the Developing World: Balancing Trade, Finance and Development in the New Economic Order' (2000) 15 *American University International Law Review* 1249.

22 Frieder Roessler, 'Selective Balance-of-Payments Adjustment Measures Affecting Trade: The Roles of the *GATT* and the IMF' (1975) 9 *Journal of World Trade Law* 622.

important objectives of international law. Over the last 60 years, most of the regulatory efforts of international economic lawyers and policymakers were directed at creating an international economic system in which factors of production could freely move across borders with minimum difficulty and with the highest level of protection.[23] From a legal viewpoint, such an integrated and liberalised economic system was achieved by the adoption of various treaties that enabled, among other things, the free movement of capital,[24] the cross-border establishment of international financial institutions, and free trade in goods and services. The process of financial integration is subject to a high degree of legalisation,[25] and it is structured through different international regulatory instruments. It is achieved by all those international norms that increase the scope of the market and provide the necessary conditions for financial institutions and investors to be treated fairly and equally. We can conceptualise the various norms that enable financial and economic integration or market expansion as legal entitlements.[26] Crucially, the objective of financial integration is structured by the protection of exporters' and investors' rights.[27] Traders and investors are granted a certain standard of treatment from partner countries in exchange for reciprocal treatment. Such norms comprise market access rights, non-discrimination rights, fair and equitable standards of treatment, non-expropriation rights, and free capital mobility. They are protected by a body of international agreements, comprising the World Trade Organization Agreements ('WTO Agreements'),[28] Free Trade Agreements, the Organisation for Economic Cooperation and Development ('OECD') Code of Liberalisation of Current Invisible Operations and the OECD Code of Liberalisation of Capital Movements,[29] as well as International Investment Agreements ('IIAs').

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23 Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Harvard University Press, 2007); Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton University Press, 2nd ed, 2008); Barry Eichengreen, *Global Imbalances and the Lessons of Bretton Woods* (MIT Press, 2007).

24 For a quick overview of the various regulatory instruments that promote free capital mobility, see Federico Lupo Pasini, 'Movement of Capital and Trade in Services: Distinguishing Myth from Reality Regarding the *GATS* and the Liberalization of the Capital Account' (2012) 15 *Journal of International Economic Law* 581 ('Movement of Capital and Trade in Services'); Federico Lupo Pasini, 'The International Regulatory Regime on Capital Flows' (Working Paper No 338, Asian Development Bank Institute, December 2011).

25 On the concept of legalisation, see Kenneth W Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance' (2000) 54 *International Organization* 421; Kal Raustiala, 'Form and Substance in International Agreements' (2005) 99 *American Journal of International Law* 581; Beth A Simmons, 'The Legalization of International Monetary Affairs' (2000) 54 *International Organization* 573.

26 See Pauwelyn, above n 17, 16–25.

27 On this point see, eg, Alan O Sykes, 'Protectionism as a "Safeguard": A Positive Analysis of the *GATT* "Escape Clause" with Normative Speculations' (1991) 58 *University of Chicago Law Review* 255, 274–8; Alan O Sykes, 'Public versus Private Enforcement of International Economic Law: Standing and Remedy' (2005) 34 *Journal of Legal Studies* 631 ('Public versus Private Enforcement'); Schwartz and Sykes, above n 17; Joel P Trachtman, 'International Law and Domestic Political Coalitions: The Grand Theory of Compliance with International Law' (2010) 11 *Chicago Journal of International Law* 127.

28 Here I refer to the *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995).

29 See OECD, *OECD Code of Liberalisation of Current Invisible Operations* (OECD, 2016); Organisation for Economic Cooperation and Development ('OECD'), *OECD Code of Liberalisation of Capital Movements* (OECD, 2016).

2 *Domestic Stability*

The second objective is the protection of domestic stability. In a broad sense it could be described as the protection of macroeconomic and financial sovereignty. However, from a closer perspective, this objective entails two distinct elements. The first is the sovereign *right to regulate.*[30] Accordingly, national governments ought to be free to decide independently their economic and financial policies and how to implement them. The second is the *right to protect* the economy during an economic emergency (for instance, a domestic economic crisis) or against an external threat originating from partner countries, as in the case of financial or monetary spillovers. This second goal might require either the suspension of those international treaties whose implementation is considered to endanger the stability of the national economy, or the reduction in the level of integration — for instance, through the adoption of capital controls.[31] As I will discuss later, domestic stability is probably the most protected among the three objectives. The power to devise and implement economic policies or maintain domestic stability is legally structured as a sovereign prerogative and has been largely excluded from any international obligations.[32]

3 *Global Stability*

The maintenance of global stability is the most elusive and least protected of the three objectives. The process of financial integration that took place during the last few decades expanded the scope of markets by reducing barriers to trade and investment, but at the same time, it created new channels for the transmission of instability across borders.[33] The peculiar integrated structure of finance is particularly prone to the risk of instability. Indeed, it is only necessary for one financial intermediary to fail, or a few unwise macroeconomic policies to be adopted, to spread contagion across the system. Economists define this phenomenon as 'systemic risk'.[34] When a country has an open financial system, which enables the free movement of capital or the establishment of cross-border

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30 For a good overview in international economic law, see Markus Wagner, 'Regulatory Space in International Trade Law and International Investment Law' (2014) 36 *University of Pennsylvania Journal of International Law* 1.

31 For a good overview of capital controls to control capital inflows, see IMF, 'Recent Experiences in Managing Capital Inflows — Cross-Cutting Themes and Possible Policy Framework' (Report, IMF, 14 February 2011) ('Recent Experiences in Managing Capital Inflows'); Lupo Pasini, 'The International Regulatory Regime on Capital Flows', above n 24; Annamaria Viterbo, *International Economic Law and Monetary Measures* (Edward Elgar, 2012) 150–289.

32 For instance, until the 1950s, in case of sovereign defaults the violation of a sovereign bond contract could not be enforced in any court outside the defaulting state. States were considered fully immune. The situation changed over the years. Nonetheless, even at present, bondholders do not have possibility to regain their losses, as most sovereign assets outside the national territory are still protected by immunity. See Mark Weidamaier, 'Sovereign Immunity and Sovereign Debt' [2014] 1 *University of Illinois Law Review* 67.

33 For an overview of the problem of international contagion, from an economic perspective, see Charles Wyplosz, 'International Financial Instability' in Inge Kaul, Isabelle Grunberg and Marc A Stern (eds), *Global Public Goods: International Cooperation in the 21st Century* (Oxford University Press, 1999) 152, 152–89.

34 A good overview of the very concept of systemic risk is provided in Steven L Schwarcz, 'Systemic Risk' (2008) 97 *Georgetown Law Journal* 193; Iman Anabtawi and Steven L Schwarcz, 'Regulating Systemic Risk: Towards an Analytical Framework' (2011) 86 *Notre Dame Law Review* 1349.

banks (in economic jargon, an open capital account), global instability can arise from different sources, such as cross-border banking crises, sovereign defaults, or spillovers originating from legitimate monetary policies.

Global stability is a relatively new concept in international law. The International Monetary Fund ('IMF') introduced it for the first time, albeit under a different name and focused only on monetary issues, in its *2007 Decision on Bilateral Surveillance over Members' Policies*.[35] The same concept was eventually reformulated and replaced by the *2012 IMF Decision on Bilateral and Multilateral Surveillance* ('*2012 Integrated Surveillance Decision*'),[36] which broadened the scope of the domestic policies under surveillance.[37] The *2012 Integrated Surveillance Decision* develops the concept of *systemic stability* which is to be most effectively achieved when *both* the balance of payments positions and domestic policies of the Member are stable.[38] According to IMF law, whenever one or both conditions are not present the Member's policies are likely to endanger the stability of other Members and, more generally, the monetary system. The IMF concept of systemic stability is, however, imprecise in terms of the broader analysis undertaken in this article. Indeed, it is inherently limited by the reference in art IV to the exchange rate system, which excludes all those domestic policies that, while producing global instability, do not impact the exchange rate. This article will refer to a broader notion of global stability defined as the absence of global systemic risk or negative cross-border spillovers in an integrated economic system. Global stability is, on that definition, the situation in which each state is not affected in its domestic stability by external spillovers from partner countries' monetary, financial, or fiscal policies.

B *Conflicts and Trade-Offs*

All three objectives described before ought to be promoted by law, as their achievement brings substantial social and economic benefits. However, they sometimes come into conflict, as the realisation of one goal by one state undermines the accomplishment of another goal by a different state. When such a situation arises, the law has to choose between them.

In the international law of financial stability there are two different conflicts. The first is between the protection of financial stability and the protection of financial integration. Depending on how the law protects each of these two

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35 The *2007 Decision on Bilateral Surveillance over Members' Policies* developed a concept of *external stability* to define the situation where a country's 'balance of payments position does not, and is not likely to, give rise to disruptive exchange rate movements'. IMF, 'IMF Executive Board Adopts New Decision on Bilateral Surveillance over Members' Policies' (Public Information Notice, PIN 07/69, 15 June 2007) <https://www.imf.org/external/np/sec/pn/2007/pn0769.htm#decision> archived at <https://perma.cc/3C3A-MQ6P>; see also Sean Hagan, 'Enhancing the IMF's Regulatory Authority' (2010) 13 *Journal of International Economic Law* 955.

36 *Bilateral and Multilateral Surveillance*, Decision No 15203-(12/72) (18 July 2012) ('*Integrated Surveillance Decision*').

37 According to the Fund, the concept of external stability is now being replaced with '"balance of payments stability" … to refer to an individual member's external accounts — not the stability of the overall system (the latter concept being covered by the term "systemic stability")': IMF, 'Modernizing the Legal Framework for Surveillance — An Integrated Surveillance Decision' (Report, IMF, 26 June 2012), 7.

38 *Integrated Surveillance Decision*, above n 36, [4], [7].

objectives and on how it structures their relationship, it will be established whether (i) a state might be able to protect its domestic stability thereby sacrificing partner states' entitlements to financial integration, or (ii) the protection of financial integration rights will require the sacrifice of domestic stability. The second conflict is between the protection of domestic stability and the protection of global stability. In the dynamics of the conflict, one state is exercising its sovereign right to regulate but, by doing so, it also produces cross-border spillovers that undermine the financial stability of the receiving country. The trade-off between those objectives is particularly difficult. In the words of Philip Bobbitt and Guido Calabresi, the law must make a 'tragic choice',[39] as the stability of one state *entails* the instability of another. It has to determine to what extent each objective deserves legal protection vis-à-vis the other and how such protection can be best attained. In general terms, the optimal protection of a legal entitlement is achieved when the attainment of one objective requires the lowest sacrifice of the others. In the mechanics of a conflict, the specific legal attributes conferred by law on each objective influences their legal interplay and determines their ultimate level of protection.[40] The next section will analyse it in detail.

1 *Domestic Stability versus Financial Integration in International Law*

Earlier we saw that international trade and investment laws provide states and investors with a set of rights which are meant to enable and support the process of financial integration. However, sometimes, in an attempt to protect domestic stability, a state violates or undermines one or more of its partner's entitlements to financial integration — for instance, their right to the free movement of capital or international trade in financial services. One specific example of this conflict is in the use of capital controls. States adopt controls for a variety of reasons, but mostly as a way to control monetary or financial stability,[41] which benefits the states adopting them while undermining partner countries' financial integration entitlements. Indeed, capital controls either prevent market access (if they are imposed on the inflow) or they prevent market exit (on the outflow). Yet both are rights protected by trade[42] or investment law.[43] A second example of financial stability measures that impinge on the right of financial integration in particular concerns the use of discriminatory measures in the context of a cross-border banking crisis. For instance, in the context of the recent financial crises in Europe and the United States, there were various cases of cross-border bank insolvencies or resolutions in which financial authorities sometimes favoured

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39 Philip Bobbitt and Guido Calabresi, *Tragic Choices* (Norton, 1978).

40 For a similar analysis in international law, see Pauwelyn, above n 17.

41 There is a wide literature on capital controls and capital account measure. See IMF, 'Recent Experiences in Managing Capital Inflows', above n 31.

42 Lupo Pasini, 'Movement of Capital and Trade in Services', above n 24.

43 See, Abba Kolo and Thomas Wälde, 'Economic Crises, Capital Transfer Restrictions and Investor Protection under Modern Investment Treaties' (2008) 3 *Capital Market Law Journal* 154; Abba Kolo, 'Transfer of Funds: The Interaction between the IMF *Articles of Agreement and Modern Investment Treaties* — a Comparative Law Perspective' in Stephan W Schill (ed), *International Investment Law And Comparative Public Law* (Oxford University Press, 2010) 345.

local creditors.[44] Similarly, in the context of international trade in goods, whenever a state suffers serious balance of payments problems, it can suspend partner countries' trading rights by imposing import restrictions.[45]

These examples demonstrate that the law solves the conflict between the two entitlements by giving preference to domestic stability. The conflict is resolved through legal mechanisms which invariably structure domestic stability as a sovereign right. The first of these legal mechanisms is the use of 'carve-outs'.[46] In treaties that deal with financial or monetary matters, or that promote capital flows, it is common to see clauses explicitly excluding domestic policies from the scope of application of the treaty. The most famous clause dealing with financial stability is art 2 of the *General Agreement on Trade in Services* ('*GATS*') *Annex on Financial Services*, most commonly known as the 'prudential carve-out'.[47] Another such clause is art 1(3)(b)–(c) of the *GATS* (elaborated in art 1(b) of the *GATS Annex on Financial Services*),[48] which excludes monetary and other macroeconomic policies from the ambit of application of the *GATS*. The role of carve-outs is to distribute and assign regulatory power on financial stability to home states thereby leaving full control over financial stability to these states. By doing so, these clauses allow each signatory to suspend the application of the treaty whenever it decides that observing the treaty provisions might reduce its discretion on domestic stability.

The second mechanism which characterises domestic stability as a sovereign right is the use of balance of payments clauses.[49] These provisions are present in different WTO Agreements such as the *General Agreement on Tariffs and Trade* ('*GATT*'), the *GATS*, the *Agreement on Government Procurement*, and the *Agreement on Trade-Related Investment Measures*, and in some IIAs. Although the specific procedural requirements of these clauses might differ slightly, overall these provisions tackle the same underlying problem: a low level of monetary reserves. Whenever a Member suffers from a balance of payments

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44 For a good overview of the legal problems affecting cross border bank resolution, see Rosa M Lastra (ed), *Cross-Border Bank Insolvency* (Oxford University Press, 2011).

45 Ugochukwu Chima Ukpabi, 'Juridical Substance or Myth over Balance-of-Payment: Developing Countries and the Role of the International Monetary Fund in the World Trade Organization' (2005) 26 *Michigan Journal of International Law* 701; Deborah E Siegel, 'Legal Aspects of the IMF/WTO Relationship: The Fund's *Articles of Agreement* and the WTO Agreements' (2002) 96 *American Journal of International Law* 561, 576–84.

46 There is a huge literature on financial stability clauses, mostly in WTO Law. The most representative contribution include the following: Lazaros E Panourgias, *Banking Regulation and World Trade Law:* GATS*, EU and 'Prudential' Institution Building* (Hart, 2006); Anne van Aaken and Jürgen Kurtz, 'Prudence or Discrimination? Emergency Measures, the Global Financial Crisis and International Economic Law' (2009) 12 *Journal of International Economic Law* 859; Mamiko Yokoi-Arai, '*GATS*' Prudential Carve Out in Financial Services and Its Relation with Prudential Regulation' (2008) 57 *International and Comparative Law Quarterly* 613; Bart De Meester, 'Testing European Prudential Conditions for Banking Mergers in the Light of Most Favoured Nation in the *GATS*' (2008) 11 *Journal of International Economic Law* 609; Thomas Cottier and Markus Krajewski, 'What Role for Non-Discrimination and Prudential Standards in International Financial Law?' (2010) 13 *Journal of International Economic Law* 817.

47 *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1B ('*GATS*') Annex on Financial Services, art 2.

48 *GATS*, 1867 UNTS 3, art 1(3)(b)–(c).

49 For an overview, see Viterbo, above n 31, 220, 225, 346, 353.

problem, and subject to the procedural conditions laid out in the WTO Agreements, it can adopt a set of measures that derogate from its WTO commitments. The system envisaged in the WTO allows the invoking party to restrict imports either through price-based measures or through the imposition of quantitative restrictions.[50]

The third group of provisions is emergency clauses.[51] Such provisions have a different scope of application to those discussed so far. Indeed, they apply only to those situations in which it is impossible for a state to perform its treaty obligations due to an unforeseeable emergency or a pressing need to protect the public interest. Such clauses can be roughly divided in two main groups. On the one hand, there are clauses protecting essential security interests that give the host state wide discretion to decide if the clause applies. On the other hand, there are emergency clauses that link the use of the clause to the rules of necessity in customary international law, thereby reducing the ability of host countries to ignore the treaty obligations.[52]

2 *Domestic Stability versus Global Stability in International Law*

The trade-off between domestic stability and global stability can be easily conceptualised as the conflict between the right to regulate enjoyed by one country and the protection of financial stability enjoyed by another. Such a conflict arises when monetary, fiscal, or financial policies in Country A produce negative spillovers in Country B or C.[53] Sometimes, instability is the involuntary effect of optimal domestic policies, while in other situations it is the result of government failure.[54] This conflict is a relatively new feature of international economic law and, arguably, a pressing problem for modern international monetary and financial law. The conflict arises from a fundamental asymmetry affecting the global financial system, whereby financial institutions and investors operate across borders, while the power to protect financial stability remains exclusively national. In this situation, national sovereignty over domestic stability is a double-edged sword. On the one hand, states need to retain enough

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50 *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995) annex 1A (‘*GATT*’) art XV(5); *GATS*, 1867 UNTS 3, art XII(1). For a good overview, see Ukpabi, above n 45.

51 Van Aaken and Kurtz, above n 46; Bart De Meester, ‘The Global Financial Crisis and Government Support for Banks: What Role for the *GATS*?’ (2010) 13 *Journal of International Economic Law* 27; William J Moon, ‘Essential Security Interests In International Investment Agreements’ (2012) 15 *Journal of International Economic Law* 481; Jürgen Kurtz, ‘Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis’ (2010) 59 *International and Comparative Law Quarterly* 325; William W Burke-White, ‘The Argentine Financial Crisis: State Liability under BITs and the Legitimacy of the ICSID System’ (2008) 3 *Asian Journal of WTO & International Health Law and Policy* 199; Giorgio Sacerdoti, ‘BIT Protections and Economic Crises: Limits to Their Coverage, the Impact of Multilateral Financial Regulation and the Defence of Necessity’ (2014) 28 *ICSID Review* 351; Robert D Sloane, ‘On the Use and Abuse of Necessity in the Law of State Responsibility’ (2012) 106 *American Journal of International Law* 447.

52 See, eg, *Treaty Between United States of America and the Argentine Republic concerning the Reciprocal Encouragement and Protection of Investment*, signed 14 November 1991, 31 ILM 124 (entered into force 20 October 1994) art XI.

53 See IMF, ‘Globalization, Financial Markets, and Fiscal Policy’ (Report, IMF, 16 November 2007) 26–30.

54 We will return on this issue in the last Part of the article.

regulatory policy space for economic policy to maintain an efficient domestic economy and achieve the preferred domestic policy objectives. But, on the other hand, the same domestic policies produce first-order spillovers on other countries that ultimately undermine global stability.

In this situation, international law is confronted with a choice between decreased sovereign discretion over the formulation and implementation of domestic economic policies on the one hand, and full sovereignty over domestic stability with lawful global spillovers, on the other hand. International law has chosen the first option: it protects domestic financial stability as a national sovereign prerogative at the expense of global stability. As long as a state is implementing a domestic stability policy within its sovereign discretion, and as long as it participates in the international economic system, it can lawfully produce negative cross-border spillovers.[55]

The only norms that explicitly protect global stability are in the IMF *Articles of Agreement* ('IMF *Articles*'), which do so through the concept of systemic stability.[56] This concept acknowledges that both sustainable and unsustainable domestic macroeconomic and financial policies have a direct effect on the stability of the international monetary system and might produce global spillovers. However, even in this case the level of protection accorded by IMF law is extremely limited. When instability arises from unstable domestic policies or an unstable balance of payments position,[57] the Fund may, in principle, intervene under its bilateral surveillance mandate and request the Member to modify the policies.[58] However, the reference to a stable system of exchange rates, contained in the chapeau of art IV(1) narrows the scope of protection to only those policies that actually impact on exchange rate instability.[59] Furthermore, the level of protection required to safeguard systemic stability given by art IV differs depending on whether the instability originates from balance of payment and exchange rate misalignments or from domestic policies. While the obligations that deal with exchange rate misalignment and balance of payments stability (contained in sub-ss iii and iv) are, in principle, 'hard' (or genuine) obligations,[60] the two obligations that deal with domestic policies (sub-

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55 For a more extensive explanation, see Federico Lupo-Pasini, *The Logic of Financial Nationalism: The Challenges of Cooperation and the Role of International Law* (Cambridge University Press, 2017) ('*The Logic of Financial Nationalism*'). In this book, I argue that protecting financial sovereignty and domestic interests more, in general, is inefficient in a situation of financial integration. In the book, I define this broad attitude as a 'logic of financial nationalism'. For a similar argument, see Eyal Benvenisti, 'Sovereigns as Trustees of Humanity: On the Accountability of States to Foreign Stakeholders' (2013) 107 *American Journal of International Law* 295.

56 *Integrated Surveillance Decision*, above n 36.

57 More specifically, '… a balance of payments position that does not, and is not likely to, give rise to disruptive exchange rate movements': Ibid 99.

58 *Articles of Agreement of the International Monetary Fund*, UNTS 2 (entered into force 27 December 1945) art IV, ss 1 and 3.

59 According to para 1 of s 1, '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': *Articles of Agreement of the International Monetary Fund*, UNTS 2 (entered into force 27 December 1945) art IV, s 1.

60 Whether they are hard obligations is, however, highly disputed. For an overview of the issue, see Zimmermann, above n 5, 427–37.

ss i and ii) were formulated specifically as 'soft' obligations.[61] Hence, they only require members to make their best efforts to achieve certain results.[62] Secondly, the current formulation of external stability does not tackle those spillovers that arise from stable domestic policies (such as excessive liquidity caused by expansionary monetary policies), which account for the large majority of spillovers. Although the *2012 Integrated Surveillance Decision* acknowledged that even a situation of domestic stability might produce cross-border spillovers, it nonetheless relegated the issue to multilateral surveillance. In essence, the IMF will only be able to discuss the matter with the Members, but will not have the right to advise on the appropriate policy actions, and there is no obligation on the Member in question to modify its policies.[63]

II THE 'PROBLEM OF SOVEREIGNTY' IN THE LAW OF FINANCIAL STABILITY

The analysis of the trade-offs between the three objectives presented above shows that the current law of financial stability is mostly focused on the protection of one objective: domestic stability. However, this safeguard of national interests comes at a high price — it sometimes sacrifices foreign traders and investors' rights, and it grants impunity to states to produce cross-border spillovers. Sovereignty is, in this context, the legal attribute that most clearly defines the current international law of financial stability.[64] The following Part addresses, from a law and economic perspective, whether the protection offered by sovereignty is efficient in a context of economic interdependence.

The protection of domestic stability as a sovereign right is a direct consequence of the political economy dynamics of monetary, financial, and fiscal policies. Domestic regulators are bound by a fiduciary duty to their citizens — the ultimate beneficiaries of domestic stability — that obliges national authorities to focus only on the safety and stability of the financial institutions and consumers located in the state territory.[65] From the point of view of domestic authorities, it is irrelevant whether the protection of domestic stability

61 Ibid 426.

62 Ross Leckow, 'Symposium: Developing the IMF, the World Bank and the Regional Development Banks: The Future of Law & Policy in Global Financial Institutions: The IMF and Crisis Prevention — The Legal Framework for Surveillance' (2007) 17 *Kansas Journal of Law and Public Policy* 285, 289.

63 See *Integrated Surveillance Decision*, above n 36, [9].

64 On the relationship between sovereignty and globalisation, see Benvenisti, above n 55; Joel P Trachtman, 'L'Etat, C'est Nous: Sovereignty, Economic Integration and Subsidiarity' (1992) 33 *Harvard Journal of International Law* 459; Anne-Marie Slaughter, 'Sovereignty and Power in a Networked World Order' (2004) 40 *Stanford Journal of International Law* 283; Saskia Sassen, *Losing Control?: Sovereignty in an Age of Globalization* (Columbia University Press, 1996); John H Jackson, 'Sovereignty-Modern: A New Approach to an Outdated Concept' (2003) 97 *American Journal of International Law* 782; John H Jackson, *Sovereignty, the WTO and Changing Fundamentals of International Law* (Cambridge University Press, 2006); Kal Raustiala, 'Rethinking the Sovereignty Debate in International Economic Law' (2003) 6 *Journal of International Economic Law* 841.

65 See Lupo-Pasini, *The Logic of Financial Nationalism*, above n 55; Chris Brummer, 'Territoriality as a Regulatory Technique: Notes from the Financial Crisis' (2010) 79 *University of Cincinnati Law Review* 499; Charles A E Goodhart and Rosa M Lastra, 'Border Problems' (2010) 13 *Journal of International Economic Law* 705.

undermines financial integration or produces spillovers in partner countries.[66] As long as domestic stability is achieved, national authorities fulfil their legal mandate. The principal-agent relationship will push national regulators to adopt non-cooperative policies that maximise national welfare with minimal cost (from a national perspective), while disregarding the economic and political costs or benefits for other nations. Hence, there is a high risk that the pursuit of an optimal level of domestic stability will probably result in a suboptimal level of global welfare.

We can conceptualise such effects as the externalities of sovereignty.[67] Externalities are economic jargon for the beneficial or negative effects on third parties arising out of the behaviour of agents that are not internalised by the agents. Third parties, therefore, either enjoy the beneficial effects of another party's behaviour without paying for them, or they suffer the costs of those behaviours without remedy.[68] Economic sovereignty produces both negative and positive externalities. An example of the positive externalities of domestic stability is the optimal protection of banking stability in a country with a systemically important banking system, or the protection of monetary stability in a reserve currency state. The beneficial effects of stability are enjoyed by all those states that share a common integrated financial system or that rely on the reserve currency, while none of them actively contribute to the implementation of stability policies.[69] This article, however, will deal only with the negative externalities of economic sovereignty, which is the most pressing issue. These can be classified as two main types. The first type is the reduction of the financial integration rights of partner countries. The second type is global instability. I will discuss them both in the next sections.

A *Externalities Affecting Financial Integration*

Externalities affecting financial integration can be succinctly described as the foregone gains suffered by foreign investors or traders due to the failure by home

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[66] There is a wide array of economic literature on the subject, especially in the context of cross-border banking: see David Andrew Singer, *Regulating Capital: Setting Standards for the International Financial System* (Cornell University Press, 2007); Katia D'Hulster, 'Cross Border Banking Supervision: Incentive Conflicts in Supervisory Information Sharing between Home and Host Supervisors' (Policy Research Working Paper No 5871, World Bank, November 2011).

[67] In law and economics, externalities have been usually associated with the concept of property. For a quick overview of the concept of externalities applied to international law see Posner and Sykes, above n 12, 17–20; See, eg, Joel P Trachtman, 'Externalities and Extraterritoriality: The Law and Economics of Prescriptive Jurisdiction' in Jagdeep S Bhandari and Alan O Sykes (eds), *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (Cambridge University Press, 1997); Dunoff and Trachtman, above n 12, 12–28; Trachtman, above n 12; Eric A Posner, 'International Law: A Welfarist Approach' (2006) 73 *University of Chicago Law Review* 487, 518–22; Goldsmith and Posner, above n 12, 45–78.

[68] The law and economic literature has often analysed the issue of externalities. For an overview, see Shavell, above n 14, ch 5.

[69] In this sense, economic stability is a global public good. On this issue, see Peter Drahos, 'The Regulation of Public Goods' (2004) 7 *Journal of International Economic Law* 321; Ernst-Ulrich Petersmann, 'International Economic Law, "Public Reason", and Multilevel Governance of Interdependent Public Goods' (2011) 14 *Journal of International Economic Law* 23; Gregory Shaffer, 'International Law and Global Public Goods in a Legal Pluralist World' (2012) 23 *European Journal of International Law* 669.

countries' authorities to comply with their trade or investment treaty obligations. The externalities arise when home countries choose to suspend the application of the agreement by invoking carve-outs, emergency clauses, and other legal mechanisms, in the pursuit of a domestic stability objective. By excusing non-compliance, the law operates a choice of value between domestic stability and financial integration that places the former above all else. For instance, banks wishing to access the host market are prevented from doing so. Foreign portfolio investors in local equity or foreign depositors with a local account are prevented from repatriating their capital. Investors in sovereign bonds suffer the equivalent of an expropriation. Crucially, only rarely does the law provide for compensatory adjustment mechanisms for partner countries.[70] Most of the time, the protection of domestic stability simply entails a net welfare loss for partner countries' exporters and investors which makes the current regulatory framework highly inefficient.

1 *Impossibilities*

To understand this argument it is first necessary to draw a parallel with the domestic law of contract.[71] The only occasion in which a party is excused from performing the contract without paying compensation (thus, producing a loss to the non-breaching party) is when it is impossible to perform the contract.[72] Such a situation falls under different legal headings, such as emergency or force majeure.[73] Impossibility clauses cannot be invoked when the breaching party is facing a better option than compliance. On the contrary, as the name suggests, impossibility clauses can be invoked only when one party is forced to breach the contract because it has no alternative. By not performing the contract, both the breaching party and the non-breaching party suffer a loss. The rationale of impossibility clauses satisfies the basic demand for fairness and equity. It is unfair that the cost of an unplanned and unexpected event, over which none of the parties had control, is assumed only by one of the parties. By not imposing the costs of the impossibility only on one party, the clause distributes the losses

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[70] The only example is expropriation in international investment law. Provided that the international investment treaty does not carve out domestic stability or it does not contain a necessity clause, and absent an invocation of force majeure by the host country, host authorities are relatively free to expropriate the foreign investment provided that they offer adequate compensations. See August Reinisch, 'Legality of Expropriations' in August Reinisch (ed), *Standards of Investment Protection* (Oxford University Press, 2008)

[71] See Posner and Sykes, above n 12, 24–6; Dunoff and Trachtman, above n 12, 28–36; Trachtman, above n 12, 119–50; Robert E Scott and Paul B Stephan, *The Limits of Leviathan: Contract Theory and the Enforcement of International Law* (Cambridge University Press, 2006). The parallel between treaties and contract was, however, rejected by some commentators: see Anthony A D'Amato, 'Treaties as a Source of General Rules of International Law' (1962) 3 *Harvard Journal of International Law Club Bulletin* 1; Marco Bronckers and Freya Baetens, 'Reconsidering Financial Remedies in WTO Dispute Settlement' (2013) 16 *Journal of International Economic Law* 281, 291–5.

[72] James Gordley, 'Impossibility and Changed and Unforeseen Circumstances' (2004) 52 *American Journal of Comparative Law* 513; Victor P Goldberg, 'Impossibility and Related Excuses' (1988) 144 *Journal of Institutional and Theoretical Economics* 100; Keith N Hylton, 'The Economics of Necessity' (2012) 41 *Journal of Legal Studies* 269; Omri Ben-Shahar and Eric A Posner, 'The Right to Withdraw in Contract Law' (2011) 40 *Journal of Legal Studies* 115.

[73] On force majeure, see Federica I Paddeu, 'A Genealogy of Force Majeure in International Law' (2012) 82 *British Yearbook of International Law* 381.

deriving from the impossibility equally between the parties. Had the breaching party been forced to pay compensation to the non-breaching party, the costs of the unexpected event would fall disproportionately to one side, with no gains for society as a whole. Thus, the use of impossibility clauses requires the presence of a fundamental element: the absence of any possibility to control the risk, and, of course, the absence of either contracting party's contribution in creating the event.

In the context of international law, for instance, art 25 of the *Responsibility of States for Internationally Wrongful Acts* ('*State Responsibility Articles*') compiled by the International Law Commission achieves precisely such objectives when it states that: 'necessity may not be invoked by a State as a ground for precluding wrongfulness if … the State has contributed to the situation of necessity'.[74] Furthermore, by denying the benefits of the impossibility when the state contributed to it, the law also encourages the efficient protection of the contract. Indeed, if the law excused the breaching party from paying damages or compensation even when it contributed to the event that caused the impossibility or if it could act in time to reduce its effects, the law would have the ultimate effect of discouraging parties from exerting an adequate level of control over their actions. It would transfer equally to both parties the losses of the breach while, in reality, only one of the parties was in the position of practical impossibility. The other one simply did not control it, or even may have contributed to it.

2 *The Inefficiency of the Current Law*

With the notable exception of expropriations in investment law, the current international law of financial stability largely treats the protection of domestic stability as if it originated from a pure impossibility to perform the treaty. However, only rarely the impossibility originates outside the sphere of control of the invoking party. That is, the law excuses non-compliance with treaty obligations without requiring the payment of compensation to partner countries, thereby sacrificing partner countries' treaty rights.[75]

The clearest example is, of course, the use of carve-outs. Whenever a WTO Member invokes art 2 of the *Annex on Financial Services*, or whenever a similar provision (for instance, to protect an essential security interest) is contained in an investment treaty, the invoking member is not only excused from performing the treaty, but crucially, it does not need to compensate the affected party. Similarly, the invocation of necessity, when justified under the treaty and customary international law, excuses the invoking state from paying compensation.[76] The

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[74] *Responsibility of States for Internationally Wrongful Acts*, UN GAOR, Supp No 10, UN Doc A/56/83 (3 August 2001) art 25(2)(b).

[75] For a similar argument see Alan O Sykes, 'Economic "Necessity" in International Law' (2015) 109 *American Journal of International Law* 296.

[76] The problematic use of necessity in customary international law is a perennial of international law. Truth be told, in the context of the Argentine crisis, the Argentine government invoked necessity to justify its domestic measures. The tribunal in *CSM v Argentina* dismissed Argentina's defence of its state of necessity. However, in a different arbitration over similar issue — *LG&E Energy Corp v Argentina* — the tribunal accepted Argentina's view. See Michael Waibel, 'Two Worlds of Necessity in ICSID Arbitration: *CMS* and *LG&E*' (2007) 20 *Leiden Journal of International Law* 637; Kurtz, above n 51.

same result is also achieved by the balance of payments clauses in international trade law, which entitle the invoking state to impose tariff increases or quantitative restrictions. In none of the three major WTO provisions on balance of payments (arts XII and XVIII of the *GATT*, and art XII of the *GATS*) is the invoking member required to provide compensatory adjustments the same way it does, for instance, in the context of the safeguard clause of art XIX of the *GATT*.

An efficient use of these clauses would demand the critical event to be completely outside the sphere of control of the parties, as suggested by art 25(2)(b) of the *State Responsibility Articles* in the context of the application of state of necessity.[77] However, only rarely are the necessary elements for the use of impossibility clauses present in the context of financial stability policies. A legitimate situation of impossibility would arise when an agriculture intensive economy experiences a bad harvest or an earthquake that reduces its export potential, thereby leading to a negative balance of payments position. In such a case the use of quantitative restrictions allowed by the *GATT* would be tolerated. The social costs of the earthquake would be placed on both the breaching and the non-breaching countries, as none of them had the possibility to control the natural event. Most of the time, however, when a domestic stability policy is implemented in reaction to a domestic situation, and it is invoked as giving rise to the impossibility of that state to perform its obligations under a treaty, the situation on which the invoking state relies is caused by negligence in the control of the risk by that state or is in fact a carefully calculated decision of non-compliance. We can think, for instance, of sovereign debt defaults or monetary crises. A recent example is the Icelandic banking crisis, which originated from the risky financial deregulatory process pursued by the Icelandic authorities.

In all these cases the non-complying state has the full control of its economic policies, while the non-breaching state has no possibility to intervene to prevent the situation of instability. By excusing compliance, the law transfers the social costs deriving from the breach of the treaty to the wrong side, and it discourages states from internalising the costs incurred by foreign investors or traders due to the non-application of the treaty. In the words of Robert Sloane, the law forgot that 'one state's safeguarded essential interest will often be another's seriously impaired essential interest'.[78]

To promote efficient control of the risk, the law should prohibit the application of the clause or require compensation whenever the invoking party has contributed to the situation of emergency. A good example is the non-application of the state of necessity principle in the context of the *CMS v Argentina* case.[79] The International Centre for Settlement of Investment Disputes ('ICSID') tribunal considered that the state of crisis that forced Argentina to adopt emergency measures was the result of negligent management of domestic policies by the Argentine government. Thus, it placed the burden of the crisis entirely on Argentina by demanding the payment of damages to the foreign investors.[80]

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77 See Sloane, above n 51.

78 Ibid 505 (emphasis altered).

79 *CMS Gas Transmission Co v Argentina (Award)* (ICSID Arbitral Tribunal, Case No ARB/01/8, 12 May 2005).

80 Waibel, above n 76; Kurtz, above n 51.

B *Externalities Affecting Global Stability*

Earlier we explained how the process of economic and financial integration increased the interconnectedness between financial systems, thereby enhancing the proclivity for contagion and spillovers. When receiving spillovers, partner countries have only two options. Both of them are Pareto suboptimal.[81] On the one hand, they can simply choose not to respond to the external threat. This situation is inefficient because it produces a zero-sum game in which the benefit of one state is offset by a welfare loss on partner countries. On the other hand, partner countries can choose to protect their own economy by exerting their sovereign right to protect their domestic stability. The arsenal of measures available to partner countries to safeguard their own domestic stability is nonetheless limited. Indeed, given the impossibility of preventing global instability by exercising extraterritorial jurisdiction, their only option is to raise a barrier against external instability and insulate the country from external threats. In this context, reducing or even cutting financial integration is the only lawful action partner countries can implement. This strategy of course entails fundamental welfare costs, as it sacrifices all the welfare benefits usually associated with a situation of integration.

There are two pertinent examples in this regard. First, the adoption of capital controls *on the inflow* of capital. Various commentators and some emerging market economies have recently pledged a more consistent use of capital controls to limit excessive global liquidity.[82] Such measures are completely legitimate under international trade and IMF law, if used to promote domestic stability.[83] Another example is the use of so-called ring-fencing techniques in the context of a cross-border banking crisis.[84] Ring-fencing essentially entails separating a cross-border bank's assets or profits in order to subject them to the local law. In the context of a cross-border banking crisis, ring-fencing would result in preventing the assets or profits of a branch or subsidiary from being repatriated or being subject to another state jurisdiction. The goal is to keep such assets local and handle them according to local law. Even in this case, the entitlement of a trader or investor to move its capital out is undermined.

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81 Pareto efficiency is achieved when the change renders a least one party better off, without making the other party worse off.

82 Olivier Jeanne, Arvind Subramanian and John Williamson, *Who Needs to Open the Capital Account?* (Peterson Institute for International Economics, 2012).

83 See Lupo Pasini, 'The International Regulatory Regime on Capital Flows', above n 24.

84 Katia D'Hulster and Inci Ötker-Robe, 'Ring-Fencing Cross-Border Banks: An Effective Supervisory Response?' (2015) 16 *Journal of Banking Regulation* 169; Alison Lui, 'Retail Ring-Fencing of Banks and Its Implications' (2012) 13 *Journal of Banking Regulation* 336.

1 *The* European Free Trade Area ('EFTA') Surveillance Authority v Iceland Dispute[85]

One useful example to highlight the inefficiency of current international law in protecting global stability comes from the 2014 *EFTA Surveillance Authority v Iceland case*.[86] This dispute, which situates itself in the context of the Icelandic Financial crisis of 2008–11 in the period preceding the creation of the European Banking Union, is one of very few cases concerning financial stability, and is particularly revealing of the attitude of international law in addressing financial stability. The dispute originates from the refusal of Iceland to cover the deposit insurance scheme for local depositors in branches of the Icelandic bank, Landsbanki, in the Netherlands and the United Kingdom.

According to EU law at the time,[87] in the European Economic Area ('EEA'), home states had the primary responsibility to supervise their national banks' foreign branches and to protect local depositors, even if located in another country.[88] Until recently, the home country control model was a fundamental pillar of EU financial law. It is now superseded by a dual structure in which Eurozone countries enjoy a single banking supervisor (the Single Supervisory Mechanism), while other EU and EEA states still operate through home-country models complemented by Colleges of Supervisors.[89] The home country control model that persists now in the EEA only for non-Eurozone countries entails, inter alia, a duty on each Member to set up a national deposit insurance fund that is capable of covering both national and foreign depositors of national banks. When the home bank went bankrupt at the outset of the 2008 Icelandic banking crisis, its operations abroad followed suit, leaving the local depositors in England and Netherlands exposed. Iceland refused to prop up the national deposit insurance fund (which also became insolvent) thereby forcing host country authorities in England and the Netherlands to intervene to protect local customers and, more generally, to maintain stability in their respective territories.

[85] For a commentary, see David G Mayes, 'Did Recent Experience of a Financial Crisis Help in Coping with the Current Financial Turmoil? The Case of the Nordic Countries' (2009) 47 *Journal of Common Market Studies* 997. The failure of Iceland to cover Icelandic banks' local depositors in England and Netherland was adjudicated by a European Free Trade Authority ('EFTA') Court in January 2013. For a good analysis of the case, see M Elvira Méndez-Pinedo, 'The Icesave Saga: Iceland Wins Battle before the EFTA Court' (2013) 1 *Michigan Journal of International Law Emerging Scholarship Project* 101; M Elvira Méndez-Pinedo, 'Iceland and the EU: Bitter Lessons after the Bank Collapse and the Icesave Dispute' (2013) 3 *Contemporary Legal and Economic Issues* 9.

[86] *EFTA Surveillance Authority v Iceland (Judgment)* (European Free Trade Authority Court, Case No E-16/11, 28 January 2013) ('*EFTA Surveillance Authority v Iceland*') <http://www.eftacourt.int/fileadmin/user_upload/Files/News/2013/16_11_Judgment.pdf> archived at <https://perma.cc/JL8U-HTW3>.

[87] Iceland is not part of the European Union. However, by being an EFTA member, it is entitled to be a part of the European Economic Area, an economic market between EU and EFTA members that entitles EFTA countries to participate in the EU single market. One of the conditions for participation is the adoption of almost all EU legislation related to the single market.

[88] *Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on Deposit-Guarantee Schemes* [1994] OJ L 135/5.

[89] For an overview of EU banking and financial services law, see Larisa Dragomir, *European Prudential Banking Regulation and Supervision: The Legal Dimension* (Routledge, 2010); Matthias Haentjens and Pierre De Gioia-Carabellese, *European Banking and Financial Law* (Routledge, 2015).

The major point of contention for the Court was whether Iceland could be forced to protect its foreign bank customers — as required by the home country control model — by standing behind the national deposit insurance fund. This was the claim of the EFTA Surveillance Authority and the EU Commission. The Court, however, accepted Iceland's view that extending its responsibility to include protection of foreign depositors when the depositor protection scheme is illiquid would jeopardise domestic financial stability. The economic rationale was that, by transferring the liabilities from the private sector to the state, a banking crisis would soon turn into a sovereign debt crisis.

The economic logic of the decision is inescapable.[90] However, it is highly questionable whether the Court achieved optimal protection of financial stability when allocating obligations (and commensurate rights) connected to the protection of depositors. The main question is, once again, whether a state should bear a duty to take into account the external effects of its policies. Iceland was sharing a common financial market with other EEA countries. Through the Single Passport, which provides mutual recognition of financial laws across the EEA,[91] Icelandic banks were automatically allowed to invest and offer services in other jurisdictions. Given the interconnectedness between its economy and partner countries — including the full removal of regulatory barriers for finance — Iceland should have had to take account of the external effects of its domestic stability policies. Instead, over the years it was able to promote a process of financial deregulation and adopt risky macroeconomic policies. When the crisis erupted the whole Icelandic banking sector became insolvent — including the deposit insurance fund and, of course, the Icelandic banks' foreign operations.[92] Iceland transmitted global instability but refused to intervene. When the Court accepted Iceland's view that backing the Icelandic deposit insurance fund would have turned a banking crisis into a sovereign debt crisis,[93] the court implicitly accepted the view that the protection of national interests ranks above global stability, and that partner countries should bear the burden of the resultant instability. This reasoning is particularly revealing of the general attitude of international law already described. It also evidences the same erroneous logic that has been raised by this paper: first, partner countries (the host regulator) are in a poor position to maintain stability and do not have the resources to supervise and regulate home country banks; secondly, by excusing home countries from compliance with supervisory duties, a massive moral hazard problem is produced, incentivising states to adopt inefficient policies.

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90 Indeed, both Spain and Ireland were on the verge of default when they intervened to bail out their own banks.

91 Paulina Dejmek, 'The EU Internal Market for Financial Services — A Look at the First Regulatory Responses to the Financial Crisis and a View to the Future' (2009) 15 *Columbia Journal of European Law* 455; Gérard Hertig, 'Imperfect Mutual Recognition for EC Financial Services' (1994) 14 *International Review of Law and Economics* 177; Pierre-Hugues Verdier, 'Mutual Recognition in International Finance' (2011) 52 *Harvard Journal of International Law* 55, 71, 82.

92 For an overview of the Icelandic crisis and its aftermath, see Annamaria Viterbo, 'Iceland's Capital Controls and the Constraints Imposed by the EEA Agreement' (2011) 6 *Capital Markets Law Journal* 214.

93 *EFTA Surveillance Authority v Iceland*, Case No E-16/11 [124], [180].

III LESS SOVEREIGNTY OR MORE INTERNATIONAL LAW?

The previous part demonstrates that the concept of sovereignty and the rules of international law are ill-equipped for dealing with the externalities of domestic policies, as they prohibit interference into the internal affairs of another state except in extreme circumstances. As Robert Keohane succinctly put it, 'the ability of governments to attain their objectives through individual action has been undermined by international political and economic interdependence'.[94] Achieving a higher degree of regulatory convergence is therefore the most pressing objective of international economic law. How can this objective be attained?

1 *A World Financial Government?*

One of the most common responses to the problems of economic globalisation is the creation of supranational authorities and a parallel reduction of national sovereignty.

Squaring sovereignty and economic integrations has never been easy. Commentators have mostly conceptualised the trade-offs as a choice of evil between these two objectives. In the context of cross-border banking supervision and resolution, Dirk Schoenmaker succinctly expressed the problem faced by partner countries in his so-called 'financial trilemma'.[95] He argued that it is impossible to simultaneously achieve national sovereignty over financial stability policies, an optimum level of global financial stability, and meaningful financial integration. He argues that states have to give up one of them, for instance by returning to a situation of reduced financial integration, or by centralising supervision into a single supranational authority. The same concept, however, can be also applied to other problems affecting financial integration. Indeed, if partner countries choose to maintain financial integration (by not imposing capital controls or ring-fencing) then they will necessarily suffer instability. On the contrary, if they decide to protect their domestic stability, the only way is to cut the transmission channels of contagion by suspending market access or non-discrimination rights for foreign firms, or by disabling international capital movements. Schoenmaker's Trilemma was extremely influential in the aftermath of the European Sovereign Debt Crisis, as it formed the intellectual basis for the creation of the European Banking Union, which replaced Eurozone countries' national supervisory and resolution authorities with two supranational banking authorities, the Single Supervisory Mechanism, and the Single Resolution Mechanism.[96]

Centralising economic and financial policies into supranational authorities, however, presents fundamental problems. First, it requires large amounts of resources and a very high level of institutional support, which makes it a possible strategy only for those countries that are already engaged in substantial economic

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94 Robert O Keohane, 'Sovereignty, Interdependence, and International Institutions' in Linda B Miller and Michael Joseph Smith (eds), *Ideas and Ideals: Essays on Politics in Honour of Stanley Hoffmann* (Westview Press, 1993) 92.

95 See Dirk Schoenmaker, *Governance of International Banking: The Financial Trilemma* (Oxford University Press, 2013).

96 See Giuseppe Boccuzzi, *The European Banking Union: Supervision and Resolution* (Palgrave Macmillan, 2016).

and institutional cooperation.[97] Secondly, to work effectively, it requires democratic political consensus. To understand why, it is useful to refer to Dani Rodrick's famous 'Political Trilemma of the World Economy'.[98] According to Rodrik's theory, it is impossible to square economic integration, national sovereignty, and democracy; only two of the three objectives can coexist simultaneously. The difficulty in squaring deep economic or financial integration with national sovereignty lies in the fact that, in order to be sustainable, deep economic integration requires democratic political support. This, however, can be achieved only if the decision over economic policies is transferred to the supranational level, which then presupposes the end of the nation state. We can see the importance of democratic support if we think that, despite the wide political support to the Banking Union, European authorities did not manage to convince Eurozone states to back the proposal for a Eurozone-wide deposit insurance fund.[99] A common deposit insurance fund for troubled banks implies fiscal solidarity between taxpayers of different countries, which might be called to contribute indirectly to save depositors of a foreign bank. Given the huge financial size that a Eurozone fund would imply, and considered that taxpayers vote in national elections, it was no surprise that European national governments did not reach an agreement on the establishment of the fund. For this to be possible, it would be necessary, as Rodrick suggests, that democratic institutions in support of economic policies be transferred from the national to the supranational level.[100]

2 *The Promise of Binding International Law*

Given the difficulties in creating supranational authorities, it is necessary to look for other options. One potential strategy to promote better coordination is to use international law to incentivise states to internalise the externalities of their actions.

The current law clearly falls short of these aspirations. The political economic foundation of trade and investment agreements is set on an exchange of concessions to open up markets. In exchange for participation in economic integration treaties it demands only the acceptance of mutual concessions on market access or standard of treatment.[101] But, generally, it does not require as a necessary condition the presence of minimal rules guaranteeing global stability.[102] For example, in international trade and investment agreements there is no explicit requirement subordinating market access or investment protection to the adoption of international financial standards set by the International Organization of Securities Commission or the Basel Committee on Banking

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[97] For a critique of 'centralisation', see Lupo-Pasini, above n 55, ch 7.

[98] Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (Norton, 2011).

[99] See Daniel Gros and Dirk Schoenmaker, 'European Deposit Insurance and Resolution in the Banking Union' (2014) 52 *Journal of Common Market Studies* 1.

[100] On the relevance of Rodrick's Trilemma in the context of the EU crisis, see Lupo Pasini, above n 2, 245–8.

[101] Here market access is intended in its broader meaning, comprising market access, non-discrimination, investment protection, capital mobility, etc.

[102] Verdier, above n 91, 66.

Supervision.[103] Undoubtedly, states are in principle free not to enter into agreements with countries that do not satisfy the minimum criteria for stability, or to demand supplementary conditions.[104] However, that is a voluntary decision whose adoption depends on the goals and negotiating powers of each party.[105] Similarly, in international investment treaties there is no provision that obliges host countries to limit their annual budget deficits or that imposes specific macroeconomic measures to minimise the risk of default. Quite the opposite: modern investment treaties 'carve-out' such policies from their scope.[106]

The separation between market access and domestic policies and the general exclusion of financial and macroeconomic policies from international legal scrutiny is a dangerous combination. The law created the 'road' for economic interdependence but without imposing the 'road traffic regulations' to ensure stability. States are free to set their own economic agenda, even if it will ultimately be unsustainable in the long term. They are relatively free to opt out from their obligations under trade or investment treaties, even when this causes external losses to foreign traders or investors. Or they can adopt domestic policies that, when producing spillovers, might undermine partner countries' domestic stability. By doing so, however, the law does not encourage them to take into account the external effect of their policies, and it thus fails to correctly price the costs of participating in an integrated economic system.

To address the shortcomings of international law, it is therefore necessary to force states to pay for the external effects of their policies. One possibility is to embed financial standards into trade agreements. In this regard, at the outset of the recent global financial and European sovereign debt crises, a few commentators suggested the signing of a 'New Concordat' which would be integrated into the *GATS*.[107] The same model could be extended to other agreements. For instance, bilateral investment treaties could refer to the IMF or the OECD Codes for the regulatory treatment accorded to portfolio investment, and perhaps also integrate into the agreement a mechanism that disciplines sovereign debt restructuring.[108]

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103 See Régis Bismuth, 'Financial Sector Regulation and Financial Services Liberalization at the Crossroads: The Relevance of International Standards in WTO Law' (2010) 44 *Journal of World Trade* 489.

104 For instance, art VII of the *GATS* and art 3(a) of the *GATS* Annex on Financial Services allow the use of recognition agreements: *GATS* 1867 UNTS 3 art VII; *GATS* 1867 UNTS 3 Annex on Financial Services, art 3(a).

105 It is arguably difficult to think of a developing country able to demand from its partners the adoption of codes of conducts for financial or fiscal policies or memorandum of understanding as a condition to access its market.

106 See Panourgias, above n 46.

107 Stijn Claessens et al, 'A Safer World Financial System: Improving the Resolution of Systemic Institutions' (Report No 12, International Center for Monetary and Banking Studies and Centre for Economic Policy Research, July 2010), 99–101; Eva Hüpkes, 'Rivalry in Resolution: How to Reconcile Local Responsibilities and Global Interests?' (2010) 7 *European Company and Financial Law Review* 216.

108 On an international sovereign debt restructuring mechanism, see Anne O Krueger, *A New Approach to Sovereign Debt Restructuring* (IMF, 2002); Varapat Chensavadijai et al, 'Proposed Features of a Sovereign Debt Restructuring Mechanism' (Report, IMF, 12 February 2003); IMF, 'Sovereign Debt Restructuring — Recent Developments and Implications for the Fund's Legal And Policy Framework' (Policy Paper, IMF, 26 April 2013).

Another possibility is to bypass WTO law, and move financial integration onto a different — perhaps, preferential — negotiating platform in which market access in financial services is subordinated to the adoption of a binding regulatory platform upon the violation of which market concessions will be suspended. The philosophy is similar to that of mutual recognition agreements, which are already used with regard to securities offering,[109] although it would entail a much wider economic bargain. For instance, I suggest the adoption of 'Regulatory Passports' for financial services, ie, binding agreements signed by home and host supervisory authorities that discipline both the market access and the regulatory/supervisory cooperation aspects of international finance.[110] One of the implications of this mechanism is the strategic use of discrimination as a regulatory tool. Members of a certain economic or financial agreement will retain the power to selectively discriminate over market access and standards of treatment concessions against those countries that do not offer adequate conditions of stability.

The goal of the abovementioned technique is simply to achieve a win-win situation whereby each state gives up part of its sovereignty in exchange for the benefits of financial integration and global stability. As such, this regulatory strategy is Pareto efficient, as it raises the level playing field of international finance without making any country worse off. By linking market access to the adoption of a binding regulatory framework (or a code of conduct) for financial stability, states wishing to be part of an integrated market are incentivised to factor the external dimension of their domestic policies into their decision-making process, and choose those that are likely to maximise domestic stability and global stability. At the same time the law achieves the fundamental objective of pricing correctly the costs and benefits associated with the participation in an integrated economic system. Experience demonstrates that exporting and foreign investment interests have proven to be extremely powerful in driving the behaviour of governments, often pushing towards the adoption of cooperative and global welfare enhancing approaches.[111] Since exporters and investors have a powerful voice in driving the international economic policies of their government, they will offer the political base necessary for the government to implement and lock in welfare enhancing structural reforms, thereby offsetting the lobby groups opposing structural reforms or profiting from a lax financial regulatory environment.[112]

IV CONCLUSION

The production of externalities from domestic policies is not unique to financial stability policy. Where there is economic integration, externalities are a common and unavoidable phenomenon in almost all areas of public policy.

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[109] Verdier, above n 91; Kalypso Nicolaidis and Gregory Shaffer, 'Transnational Mutual Recognition Regimes: Governance without Global Government' (2005) 68 *Law and Contemporary Problems* 263.

[110] Lupo-Pasini, above n 55, ch 9.

[111] The clearest example is in the context of international trade law. See Sykes, 'Public versus Private Enforcement', above n 27; Schwartz and Sykes, above n 17; Trachtman, above n 27; Verdier, above n 91.

[112] Verdier, above n 91.

Ultimately, almost every human action has an external dimension. Consequently, in an interdependent society, the objective of the law ought not to be the mere prohibition of actions having an external effect. This would simply reduce overall global welfare. On the contrary, the law should promote the internalisation of the social costs of harmful actions by the agents that engage in them and, in doing so, also the maximisation of overall welfare gains. In the context of financial stability, the law should therefore prevent abuses, reduce where necessary the excesses of unrestrained sovereignty, and devise a more acceptable balance between the three objectives in the interests of maximising global efficiency and stability.

In his illuminating treatise on financial crises, Charles Kindleberger noted that books and other publications on financial stability usually increase when crises occur.[113] The events that hit western economies in the last few years, from the financial meltdown of 2007–08 to the recent European macroeconomic crisis, gave rise to a surge in scholarship on financial and monetary policy and regulation. This article situates itself in this broad area of legal scholarship. However, it takes a step further from the pure technicalities of financial and monetary law, by looking at the broader picture of financial stability as a legal concept. This article is intended to fill a perceived gap in legal scholarship by conceptualising in a coherent fashion a general theory of financial stability in international law that could be used in the future to discuss any policy development in this field of law. To do so, this article articulated the concept of financial stability as a trade-off between three major objectives of international law. Their interplay determines their level of protection, and influences the balance of rights and obligations assigned by the law to each state. The article then tried to apply the theory to the various norms of financial stability situated across different areas of international economic law, from WTO to IMF, to cross-border bank resolution.

When analysing the proper role of the law in addressing stability and the sovereign powers necessary for its attainment, it is easy to fall into a moral trap and to justify any of the arguments based on abstract social values. This article has tried to avoid this trap, and rather chose to analyse stability from the pure logic of efficiency and stability. This was the article's only normative assumption. The article provided both a positive and a normative analysis of the applicable international law. It offered an overview of how international law operationalises the protection of the three objectives that make up the legal architecture of financial stability. It also offered a normative evaluation when it suggested switching from a protection of financial stability as a sovereign right to a protection of financial stability as a social problem of the international community.

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[113] In their book, Kindleberger and Aliber argue that books on financial crises are 'counter-cyclical': Charles P Kindleberger and Robert Z Aliber, *Manias, Panics and Crashes: A History of Financial Crises* (Palgrave Macmillan, 2005) 7.