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Research On a Comparative Analysis of Treaty-based Versus Soft-law Approaches to International Financial Stability

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ABSTRACT

International financial stability is an important determinant of strong and stable global growth. International financial stability is primarily a condition where the systems that an economy relies upon to price, allocate, and manage financial risks function effectively and hence support global economic performance. To achieve and maintain this stability, treaty-based and soft law have a significant role in the international financial stability. [1] The objective of this article is to explore the advantages and disadvantages of both treaty-based and soft-law frameworks in the context of international financial stability and analyze the potential implications that each can have in shaping the future regulatory environment of global finance. Finally, although various evidence is presented to illustrate the advantages of based-treaties, this article still demonstrates soft law is increasingly aligned with the future direction of global governance and international cooperation due to flexibility, efficiency and progressiveness.

KEYWORDS

Soft-law; Comparative Analysis; International Financial Stability

1 Treaty-based approaches

The definition of treaty-based approaches is a legally binding agreement that governs relations between sovereign states, such as finance of international relations in a treaty setting.[2] This mechanism is formally structured and imposes clear, enforceable obligations on participating states from legal certainty and framework.

1.1 Advantages

First and foremost, the provisions of multilateral treaties of international economic law, notably those of multilateral trade and monetary agreements, are essentially designed to achieve the reconciliation of national incentives with global public goods and to safeguard against capture risk.[3] For example, the International Monetary Fund (IMF) constructs IMF-Quotas mechanism, which means each member country of IMF is assigned a quota on relative size in the world economy, in order to provide emergency and developmental assistance to member countries facing financial crisis.[4] This support is conditioned upon the implementation of economic reform with countries that need it, which aims to solve balances of payments problems problems without resorting to measures that harm national or international prosperity. As an illustration, IMF have approved an agreement which provided approximately US$6 billion to Pakistan in 2019, which aims to help to reduce public debt and rebuild officer reserves due to large fiscal deficits and misaligned economic policies.

Additionally, treaties-based can enhance enforcement to ensure compliance by states through dispute resolution systems. Multilateral agreements typically incorporate dispute resolution mechanisms, ensuring accountability and providing tools for enforcing compliance, including sanctions against member states for violations. . For instance, the institutional structures of bodies such as the World Trade Organization (WTO) and IMF are described as member-driven, unified in rules, comprehensive in scope, and nearly universal in participation. [5] The case of United States - Subsidies Upland Cotton illustrates Brazil declared agricultural subsidies in U.S. distorted global cotton trade, violating WTO rules and requested consultations with the United States regarding prohibited and actionable subsidies provided to U. S. producers, users and exporters of upland cotton. Ultimately, WTO ruled that U.S. should reform its subsidy programme and pay Brazil US$300 million a year in compensation. For another example, the Excessive Deficit Procedure (EDP) ruled a clause which demonstrated European Union (EU) member states must maintain budget deficits below 3% of Gross Domestic Product (GDP) and government debt are not exceeding 60% of GDP in the 1992 Maastricht Treaty.[6] From 2009 to 2010, Greece announced a fiscal deficit of 12.7% of GDP and a government debt of 120% , serious exceeding the EDP's prescribed fiscal deficit ratio. The EDP strongly requested that Greece make a detailed stability programme and that Greece's domestic economic structural reforms, including austerity measures and public sector layoffs, were significantly demanded by EDP. However, Greece failed to meet these bailout conditions in 2012-2015, leading to repeated withholding of funds. In conclusion, the case of U. S. and Greece state how treaty-based can effectively enhance enforcement through powerful dispute resolution systems. Institutions like EU and WTO utilize structured legal frameworks, policies and financial penalties to ensure adherence to agreed standards. This approach not only avoid violations but significantly contribute to the sustainability of financial development.

Lastly, treaties-based establish explicit legal duties and structured frameworks for member states, contributing to stability, and predictability in global financial interactions. These regulations enable nations, financial institutions, and markets to better foresee legal outcomes thus diminishing uncertainty and facilitating improved economic decision-making. Effective global regulation can prevent domestic regulatory authorities from being influenced or dominated by protectionist interests. For instance, the article 127 of chapter 2 of the Treaty on the Functioning of the European Union (TFEU) rules the primary purpose of the European Central Bank (ECB) is to maintain market price stability and to support the Community's economic policies in order to achieve an efficient allocation of resources and to promote cooperation and mutual development.[7] This legislation illustrates treaty-based provides a legally binding mandate for ECB, which has positive effects on common development and synergies in the EU.[8]

1.2 Disadvantages

While this system demonstrates considerable stability, it increasingly reveals limitations in adaptability for the ongoing evolution and advancement of the global economic and financial market. Due to the inherent rigidity of treaty-based mechanisms, member states often find themselves incapable of swiftly modifying regulations to respond effectively to volatile conditions in financial markets. In 2010, the IMF undertook a series of reforms, including increasing the voting power of emerging countries like China, in order that the distribution of quota shares among IMF member countries would be consistent with their contribution to sustainable growth in the world economy. However, there are still lingering disagreements over the quota formula, and the reforms were not adopted until 2016, because the United States was reluctant to vote on the reforms due to holding 16.5% of the total voting power and being preoccupied with domestic affairs.[9] In addition, in 2012, the Obama administration in the U.S. nominated Jim Yong Kim to be the new president of the World Bank. Obama's nomination of Kim, which essentially guaranteed his election, drew the ire of emerging powers when the United States did not consider the Nigerian candidate, Ngozi Okonjo-Iweala, who was widely regarded as more qualified. The credibility and influence of the IMF has declined in many emerging countries, especially developing countries.

Additionally, the procedures involved in drafting, revising, endorsing, and ratifying treaties typically require extensive periods of negotiation and consultation. For instance, the United Nations Convention on the Law of the Sea (UNCLOS) is a milestone in the development of the modern law of the sea , which was adopted by the international community in 1973 at the Third United Nations Conference on the Law of the Sea on 30 April 1982 after nine years of negotiation and consultation.[10] UNCLOS, although it had received the support of a large number of countries at the time of its adoption, took 12 years to enter into force from the moment it was opened for signature to the time of its entry into force. Although UNCLOS provides an opportunity for the international community to actively participate in ocean governance, the slowness of the treaty-based process has undeniably affected the efficiency of governance to a certain extent.

Furthermore, treaties-based may lead to suffer challenges from the changes of legal policies and strategic deployment in states. For example, based on Thomas Pringle v Government of Ireland and Others, Thomas Pringle, an anti-austerity Independent MP in Ireland, argued that the establishment of ESM was unlawful, as it exceeded the European Union's exclusive jurisdiction over monetary policy and extended beyond the competencies defined. In other words, treaties can be controversial among sovereign states, reducing their effectiveness and influence. As the cyclical nature of the capital market has brought to the fore the disadvantages of economic globalization, the game of great power relations has led some countries to try to avoid the negative externalities of globalization by withdrawing from treaties. [11] Another example is the UK's departure from EU and its withdrawal from EU treaties, which has seriously affected treaty-based and triggered a series of adverse reactions.

2 Soft-law approaches

Specifically, soft law encompasses international instruments, guidelines, declarations, principles, or codes of conduct which, although lacking legal authority, exert normative influence by guiding international governance frameworks. Specifically, soft law encompasses international instruments, guidelines, declarations, principles, or codes of conduct which, although lacking legal authority, exert normative influence by guiding international governance frameworks.

2.1 Advantages

First, the growing prominence of soft law can be attributed to the fact that implementing norms created by private institutions generally results in reduced compliance costs and enhanced regulatory flexibility. By comparing treaty-based, soft law does not have a lengthy process and can adapt quickly and efficiently to the rapidly changing capital markets. According to Article 288 of TFEU, recommendations and opinions are non-legally binding behaviors that do not have the force of law but are negotiated and voted on in accordance with due process and have far-reaching implications. Recommendations and opinions are non-legally binding behaviors that, although they have no legal effect, are negotiated and voted on according to appropriate procedures and have far-reaching implications. These soft law mechanisms promote coordination rather than mandatory harmonization, avoiding confrontation between member states, while at the same time providing policy guidance. In 1944, IMF governance was designed for the benefit of the original core of like-minded member countries, which imposed strict limits on change as the membership expanded. It can be argued that soft law facilitates broader capacity-building, as its flexible nature within financial markets streamlines coordination efforts while concurrently guiding the establishment of cross-border standards. In light of this, soft law provides a more flexible and cost-effective framework for global financial governance than the rigidity inherent in treaty-based. Under article 288 of the Treaty on the Functioning of the European Union - allows for timely policy coordination without triggering legal confrontation. While the original design of institutions such as IMF reflected the interests of a small number of founding countries and has since struggled to adapt to institutional evolution, soft law mechanisms have proved to be more inclusive and adaptable. By facilitating the progressive development of norms, fostering cooperation and reducing compliance burdens, soft law plays a crucial role in building regulatory capacity and setting flexible cross-border standards, which makes it increasingly indispensable in the governance of a dynamic and interconnected global marketplace.

Furthermore, soft law developed by members of a particular community often demonstrates greater efficiency because they directly address practical needs, reflect technological developments, and allow flexibility to adapt the legal framework to changing circumstances. The ESG report refers to a document that demonstrates a company's performance and practices in different areas, which are environmental, social governance areas. Based on ESG reporting from 2005 to 2023, the number of enterprises voluntarily participating in ESG assessment has increased from approximately 10% to 80% and shows obviously continuous promoting. This demonstrates that companies that preform well on ESG criteria are often regarded as more sustainable and responsible, contributing to increasing investors and consumers prefer companies with strong ESG records, even if ESG reporting is a voluntary form of soft law. This ESG report clearly illustrates how soft law initiatives such as sustainability guidelines can drive a steady increase in corporate transparency even without treaty-based enforcement. To sum up, the growing number of companies voluntarily joining the ESG assessment report illustrates that while soft law is not legally binding, international financial markets and consumer acceptance invariably drive its development and international recognition, rather than relying on a treaty-based push. On the one hand, ESG report reflects the broader potential of soft law to shape corporate behaviour and promote responsible governance in an increasingly complex and dynamic global economy. On the other hand, ESG report also reflects the broader potential of soft law to shape corporate behaviour and promote responsible governance in an increasingly complex and dynamic global economy.

2.2 Disadvantages

To begin with, the most notable disadvantage of soft law is that it is not legally binding and is observed by the contracting member countries on a voluntary basis. The statute of the Basel Committee explicitly states that its decisions are not legally binding or enforceable, and that it relies on voluntary implementation by States. This shows that individual countries will seek to avoid harm according to legal and economic needs, which undermines the principle of uniformity of soft law as a law. As an illustration, the United States is selective and purposive in the implementation of Basel III, the Federal Reserve only applies Basel III to large international banks, while small and medium-sized banks with assets of less than \$250 billion apply a 'simplified standardized approach' rather than a 'simplified standardized approach' to Basel III. The Federal Reserve applies Basel III only to large international banks and applies a 'simplified standardized approach' rather than the full Basel Accord to small and medium-sized banks with assets less than \$250 billion. One of the key reasons is that Basel encourages banks to use the internal ratings-based approach (IRB) to assess credit risk, but its expensive regulatory costs and complex internal risk models are difficult for many small and medium-sized banks in the United States to afford. The Federal Reserve said that there is an exemption threshold for small and medium-sized banks, and that setting up IRBs would put enormous pressure on these banks. Another example is that China has also not adopted the IRB system on a wide scale, and it is still the large banks such as Industrial and Commercial Bank of China and China Construction Bank that have adopted the system.[12] And if China's small and medium-sized banks were to fully implement Basel, it would create the most central issue in the financial industry, which is to build a comprehensive risk management system. This is not something that can be achieved overnight and cannot be expected to be reached by buying an IT system, especially since it is difficult to change and reform in a short period of time. According to the Capital Management Measures for Commercial Banks (for Trial Implementation) issued by the China Banking and Insurance

Regulatory Commission (CBIRC) in 2012, the CBIRC introduced the Basel Accord capital adequacy ratio, capital leverage ratio and systemically important additional capital, but gave banks at all levels a hierarchical classification according to risk sensitivity, implemented differentiated supervision, and made clear arrangements for a transition period for commercial banks to enable them to better fulfil the standards. China has made a lot of local adjustments during the application of Basel and retains some adoption rights, but the government has absolute dominance over how Basel is applied. In light of this, while soft law such as the Basel Accords provided flexible and adaptable international regulatory standards, their non-binding nature seriously undermined their harmonization and effectiveness. The voluntary nature of compliance allows countries to selectively implement provisions based on domestic legal and economic factors. As the United States and China have shown, national regulators often adapt the Basel framework to local institutional capacity and regulatory priorities. While such localization can enhance feasibility, it also fragmented the global regulatory landscape and weakened the intent of soft law harmonization, which may lead to not ensure consistent and comprehensive compliance across jurisdictions.

3 The development and application of soft law mechanisms in the future

This essay argues that an effective approach to maintaining international financial stability that is widely used globally is soft law. Although soft law lacks legal enforcement, it can still play a significant role through other enforcement mechanisms, such as peer review, the International Monetary Fund's Financial Sector Assessment Programme (IMF FSAP) and market pressures.

Firstly, peer review is a very important mechanism in soft law, which refers to the process by which countries or regions assess each other's performance or compliance in terms of adherence to agreed standards, which are agreed but not legally enforceable. For example, since the 1980s , many states resisted the criminalization of money-laundering for fear of interference with legitimate business transactions and the division of labour. To address these concerns, the Organization for Economic Cooperation (OECD) established the Financial Action Task Force (FATF) in 1989, comprised of financial experts. The FATF applies a system of peer review to guide behaviour and is flexible enough to adapt to national differences, so that there is an expectation that breaches of the guidelines will be politically costly. The Task Force legitimizes the participation of international actors and relevant domestic bureaucracies and Non-Governmental Organizations (NGOs) in national decision-making. Some of the principles of their international law agree to a large extent with those contained in the peer review. As this example demonstrates, soft law has a tangible impact by expanding the range of institutions available to review behaviour, and States have consistently responded positively to the recommendations of their peers and adopted regulatory improvements to safeguard their international reputations.

According to some data of the compliance rates of soft law and treaty-based in global governance, the average compliance rate of treaty-based is higher than that of soft law, for example in the field of corporate codes of conduct. Treaty-based is about 80%, while soft law is about 70%. While hard law typically leads to higher rates of governance, soft law still achieves moderate to large compliance rates. This supports the argument that soft law is effective even in the absence of legally enforceable and binding laws. Although treaty-based has legal effect and a certain degree of enforcement, with the continuous development of economic globalization and cross-border trade, the increasing integration of international financial markets, and the soundness of the international financial rapid response mechanism, soft law will be more applicable to the future of international financial stability. As an illustration, the greatest progress of soft law is that the G20 becomes a promoter of the reform of global financial governance, and plays a significant role in coordinating the positions of all parties, integrating the relevant institutions and reshaping the rules of governance.[13] Furthermore, soft law is consistent with the ‘territoriality principle’ common to international law, which allows states to apply soft law in accordance with the politics, economy and culture of the region.[14]

4 Conclusion

To sum up, despite the theoretical attraction of a treaty-based approach due to its legally binding nature, the practical realities of financial markets strongly favour the adoption of a soft law approach to international financial stability due to flexibility, adaptability and the ability to respond quickly to crises. Providing soft law system can offer substantial benefits, these efforts still face significant challenges in balancing their flexibility with accountability mechanisms. With financial risks becoming more transnational and complex, the relevance of soft law will only grow.

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