Treasury Department
Division of Monetary Research

Date Aug. 23, 1944

To: Mr. Luxford

From: Mr. Ness

I attach hereto two copies each of the commentaries on the Sections in Articles IV, V, VI and VII. Together with the material covering Articles VIII and XIV, which I sent you yesterday, this completes the portion assigned to us.

Treasury Department
Division of Monetary Research

Date Aug. 22, 1944

To: Mr. Luxford

From: Mr. Ness

I attach hereto the copies of the Articles with which Mr. Mikesell was charged. I have the remaining work in draft, but I am editing some of it as it is being typed up to supply you with the extra copies you need. It will be coming along shortly.

Fixing Initial Par Values

Each member shall communicate to the Fund not later than thirty days after the effective date of this Agreement, the par value for its currency based on the *de facto* rates of exchange prevailing for its currency sixty days prior to the effective date of the Agreement. The par value so communicated shall be the par value of the member's currency for the purposes of the Fund unless the member signifies within a period of ninety days from the effective date of this Agreement that it regards such par value as unsatisfactory. In the case of a member whose territory has been occupied by the enemy, this period of ninety days may be extended by the Fund if the member so requests. When a member signifies that the par value of a currency initially communicated to the Fund is unsatisfactory, the Fund and the member shall, during a period to be determined by the Fund in the light of all relevant circumstances, agree upon a suitable par value for the currency concerned. If the Fund and the member do not agree within such period so determined, the member shall be deemed to have withdrawn from the Fund as of the date of the termination of such period.

A member communicating to the Fund a par value for its currency shall at the same time communicate a value, in terms of its own currency, for each subordinate currency, where such exists, in territories under its jurisdiction. From the values so communicated the Fund shall compute the par value of each such subordinate currency. The provisions of the preceding paragraph shall apply separately to the principal and subordinate currencies in the event that the member signified within the stated period that the par value of any one of them is unsatisfactory.

The Fund shall begin exchange transactions at such date as it may determine after par values have been established for the currencies of members having sixty percent of the aggregate quotas fixed in Article II, Section 2, but in no event until one-hundred fifty days after the effective date of this Agreement. No exchange transactions shall be undertaken by the Fund until the par value communicated by the member is satisfactory to the Fund.

TREASURY DEPARTMENT

INTER OFFICE COMMUNICATION

DATE 8/25/44

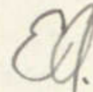
TO Mr. Luxford

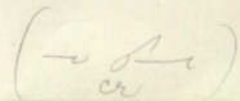
FROM E. Arnold

Attached is the remainder of my work on Article VIII. Added to what I left in your office this morning, this material will complete the draft on that Article. Also attached are the marked-up copies of the comments by Mikesell on which my work is based. I hope that you have a clean copy but it seemed unwise to destroy these in case you do not.

When I called Mikesell about a couple of problems that were bothering me, he indicated some concern lest, in my ignorance of economics, I omitted or misstated significant points contained in his material. I expressed the view that undoubtedly the work done by the Legal Division would be presented to Monetary Research for clearance, but to further remove any question of my having made unfortunate changes I am sending a carbon copy of my work to Mikesell.

Attachments





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8/21/44

ARTICLE VIII.

<u>General Obligations of Members</u>

Sec. 1 — <u>Introduction</u>

Sec. 2 — <u>Avoidance of restrictions on current payments</u>

(a) No member shall, without the approval of the Fund, impose restrictions on payments arising out of the current international transactions made by residents in that country to residents of foreign countries or their agents. This obligation applies to payments in both the currency of the persons making the payments and the currency of the persons receiving payment. Thus, if an American exporter ships goods to Great Britain, Britain may not place restrictions on payments by the importer to the exporter or his bank whether the payments are made in pounds or in dollars.

Restrictions may not be placed on the transfer of payments arising out of current international transactions. This means that funds received by an exporter or his agent in another country may be sold to importers or others having payments to make in that country without restriction. For example, if an American exporter receives pounds in payment for his exports to Great Britain, these pounds may not be blocked but must be free for use in paying for exports from Great Britain or for meeting other sterling obligations.

The obligation not to place restrictions on the making of payments and transfers for current international transactions also implies that those having payments to make abroad will be able to secure foreign exchange freely and that foreigners receiving payments in local currency will be able to sell such local currency for their own currency. This obligation does not mean that foreign balances arising out of current transactions may be used to

purchase the currencies of third countries, since this would be a capital transaction and not one related to a payment arising out of a current transaction between the two countries in question. Nor does this obligation apply to capital transactions between the two countries not related to the making of payments on current international account.

In the event that the currency of a member country is declared scarce, other members are permitted to restrict payments made in that scarce currency in accordance with Article VII, Section 3b. Member countries would still be obligated not to restrict payments and transfers in their own currencies and with respect to all other currencies not declared scarce.

Where countries have maintained restrictions on the making of payments and transfers for current international transactions during the war period, or in the case of occupied countries which find it necessary to introduce such restrictions on liberation, these restrictions may be retained during the transitional period in accordance with the provisions of Article XIV, Section 2.

(b) Many countries will find it necessary to maintain restrictions on capital movements and restrictions on current international payments during the transitional period. Such restrictions are difficult to enforce without the cooperation of other members, and it is therefore provided that transactions in the currency of a member country which are contrary to the exchange control regulations, maintained or imposed by that member, shall be unenforceable in the territories of all members. Thus, if Great Britain is imposing restrictions on capital transfers outside the sterling area and an American owner of securities sells sterling balances derived from the sale of such securities to an American importer for use in making a payment

in Great Britain, such a transaction would be held invalid in American courts. (See lawyers on this point.) This does not mean that the U.S. would have to police its exchange markets to prevent such transactions, but we would not recognize their validity when they occurred.

In addition, this Section provides that members may, by mutual accord, cooperate with one another in making their exchange regulations more effective provided such regulations are consistent with the provisions of the Fund Agreement. Such cooperation will probably take the form of the exchange of information on transactions in the currencies of other members.

Sec. 3 — Avoidance of discriminatory practices

No member country or its fiscal agent is permitted to engage in discriminatory currency arrangements or multiple currency practices except as authorized under this agreement or approved by the Fund. By preventing discriminatory currency arrangements is meant that a member country or its central bank may not say to the importers of that country, or to others having payments to make abroad, that they may acquire foreign exchange only for trade with certain countries or for importing certain products from a particular country and not from others.

By multiple currency practices is meant the practice of employing currencies with different values in terms of foreign currencies. Thus a member country may not declare that certain balances held in that country will have a value in terms of foreign currencies lower than that of other balances presently held or balances acquired in the future. Nor may a member country declare that balances held in that country have one foreign exchange value for certain purposes and a different foreign exchange value

for other purposes. The purpose of prohibiting multiple currency practices is to avoid the use of a familiar unfair trade practice popularized by Germany in the 1930's. Germany authorized the liquidation of certain mark balances held by foreigners at sharply reduced rates in terms of other currencies. These marks were sold at a discount to tourists in order to encourage travel in Germany. Germany sold other marks at rates below the official par value of the mark to South American importers who were permitted to use them to buy certain commodities, thus giving German exporters a competitive advantage in trade with these countries. Certain Latin American countries have employed multiple exchange rates largely as a means of obtaining revenue from those engaged in foreign trade. Thus Venezuela requires the American oil companies to buy the pesos they need at substantially higher prices than is paid for dollars sold to the exchange authorities by Venezuelan coffee exporters. These countries will need time to revise their revenue systems before they can abolish the use of multiple currency rates, and it is provided that they shall consult with the Fund as to the progressive removal of such practices. These practices may also be temporarily retained in accordance with the provisions of Article XIV, Section 2, on transitional arrangements. It is also possible that the Fund may approve the retention of certain multiple currency practices which, in the judgment of the Fund, are not discriminatory and do not interfere with trade.

Sec. 4 — Convertibility of foreign-held balances

(a) Although Section 2a provides that member countries may place no restrictions on the making of payments and transfers for current international

transactions, it was considered desirable to strengthen this provision with a positive obligation on the part of each member country to buy balances of its currency held by another member country at the request of the latter. The buying member has the option to pay either in the currency of the member making the request or in gold.

The obligation of member countries to buy their own currencies applies only in two cases: (1) If the balances to be purchased have been recently acquired as a result of current international transactions; or (2) If their conversion is needed for making payments for current international transactions.

In the first case the balances must have been recently acquired in payment for merchandise exported to that country or for interest or other current obligations, and the obligation to purchase these balances for gold or the currency of the country selling the balances is simply a means of enabling exporters and others receiving payments in the currency of that country to be paid in their own currency. In the second case, the balances need not be currency acquired, but it must be established that their conversion is needed for settling a balance either with that country or with a third country. If, for example, the U.S. has peso balances in Venezuela and we have a payment to make in Venezuela which that country states must be made in dollars, we could require Venezuela to buy the pesos from us with dollars or with gold. But this obligation does not depend in every case upon our having to make dollar payments to Venezuela. If we have an adverse balance of payments with the rest of the world, we could also require Venezuela to buy the pesos with gold or dollars. If we

receive gold we could use this gold to settle our unfavorable balance with the rest of the world. If, on the other hand, Venezuela pays in dollars she would be taking pressure off the dollar in world markets by increasing the demand for dollars; or if Venezuela obtained the dollars from the Fund the reduction in the Fund's dollar holdings would increase our ability to buy the foreign exchange we need from the Fund to settle our adverse balance with the rest of the world.

This Section has sometimes been called the multilateral clearing provision. It will be recalled that a member country, say Great Britain, is not obligated to permit another member, say France, to sell pounds in its market for dollars. France can sell pounds in London for francs but Britain may, if she chooses, prohibit France from selling pounds for dollars to settle France's balance with the U.S. Yet the obligation of England to provide francs for pounds has much the same result as if Great Britain had permitted France to buy dollars in her market to settle a current balance with the U.S. The reason for this is as follows: If Great Britain buys the francs in her market the value of the pound in terms of francs will be depressed to the point where Britain will find it necessary to go to the Fund for francs. The reduction of the Fund's holdings of francs will increase France's ability to purchase dollars from the Fund with francs. Furthermore, in the event that the Fund's holdings of francs are reduced below France's quota, France can purchase an amount of dollars up to the point where the Fund's holdings of francs are equal to its quota without incurring any penalty charge.

(b) There are certain conditions under which the obligation

discussed in (a) above does not apply. These conditions may be stated as follows:

(1) It does not apply in cases where restrictions on the convertibility of balances are permitted under Section 2 of this Article and in cases consistent with the right of members to control capital transfers in accordance with Article VI, Section 3. For example, if a member country finds it necessary to impose restrictions on capital movements, the balances accumulated by foreigners as a result of sales of shares or tangible property would not be subject to the convertibility requirement of this Section.

(2) Balances which have accumulated before the removal of restrictions maintained or imposed by member countries during the transitional period in accordance with Article XIV, Section 2, are exempt from the convertibility obligation. For example, Great Britain would not need to purchase with gold or dollars sterling balances acquired by Americans before Great Britain removes her war-time restrictions on foreign exchange transactions.

(3) Any balances which have been acquired by another member country contrary to the exchange regulations of the member which is asked to buy from need not be purchased. For example, if a resident of a member country imposing restrictions on capital transactions sells balances constituting the proceeds of the sale of capital assets to the resident of another member country, the member country whose currency is sold need not purchase that currency from the other member.

(4) When the currency of the member requesting the purchase has been declared scarce under Article VII, Section 3a, this obligation no longer applies. (For explanation, see the discussion under Article VII, Section 3a.)

(5) When a member country which is requested to purchase its own currency is not entitled to buy the currencies of other members of the Fund for its own currency, the specific obligations of this Section do not apply. This is not to be interpreted to mean that a member country does not have the obligation to maintain convertibility of its currency even though it is not entitled to purchase foreign exchange from the Fund. It is still subject to the requirement of Section 2 of this Article not to impose restrictions on making payments or transfers arising out of current international transactions, while at the same time not permitting its exchange rate to fall beyond the prescribed range from parity. In the event that a member country is unable to meet its obligation to convert its currency and cannot use the resources of the Fund, it will either have to make arrangements for temporary modification of its obligations with the consent of the Fund, or be subject to suspension for failure to meet its obligations.

Sec. 5 — Furnishing of information

Sec. 6 — Consultation between members regarding existing international agreements

A number of our commercial treaties which have been entered into in the past have included prohibitions against restrictions on transactions in

foreign currencies which, under special or temporary circumstances, are permitted under the Fund Agreement. Member countries which are parties to such agreements agree to consult with one another for the purpose of reconciling any conflicts between the provisions of the Fund Agreement and other agreements to which they may be a party.

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ARTICLE XIV.

Transitional Period

Sec. 1 -- Introduction

Member countries must not seek to finance their foreign exchange requirements for relief or reconstruction through the Fund. Foreign exchange needed for such purposes must be provided from their own resources or by agencies such as UNRRA in the case of relief, or the International Bank for Reconstruction and Development in the case of reconstruction. It should also be made clear that the payment of foreign indebtedness arising out of the war cannot be financed by the Fund. This means specifically that Great Britain cannot use the Fund to finance the liquidation of her large short-term indebtedness which has accumulated during the war. Since the Fund is designed to handle only normal fluctuations in the balance of payments positions of member countries, such as those which accompany seasonal and cyclical fluctuations, the Fund's resources are not sufficient to finance the liquidation of past indebtedness.

Sec. 2 -- Exchange Restrictions

In the post-war transitional period many member countries will have an enormous need for foreign exchange to rebuild their war-devastated territories, to replace worn-out capital equipment, and to replenish their stocks of raw materials and consumer goods. Some of the necessary foreign exchange will be supplied from the gold and foreign exchange resources of the country itself and some from international agencies created for this purpose. But in a country where free enterprise prevails the demand for foreign exchange in the immediate post-war period will be far greater than the supply, at least until the export industries of these

countries are reconstructed so that they can produce an adequate supply of foreign exchange. If, therefore, these member countries were required to abolish all exchange restrictions and to permit the free purchase of foreign currencies during the transitional period, anything approximating a balanced international position for these countries would be impossible. Moreover, any attempt to require these countries to permit free exchange dealings in foreign currencies during this period would place an enormous strain on the resources of the Fund.

Another exchange problem created by the war is the existence of large, abnormal balances. This problem exists chiefly for Great Britain, but to a lesser extent in other countries as well. There have been built up in Great Britain large sterling balances as a result of British expenditures in sterling area countries. Sterling balances which have been built up before Britain assumes the obligations provided in Article VIII, Sections 2, 3 and 4, are not subject to these obligations. So far as Britain's obligations to the Fund are concerned, the balances accumulated during the war may be blocked for any purpose so long as Britain chooses to keep them blocked. But as soon as Britain notifies the Fund that she intends to meet her obligations under Article VIII, Sections 2, 3 and 4, future accumulations of sterling balances are subject to these provisions. Britain may find it necessary to continue to increase her short-term indebtedness for a time after the end of the war and after the beginning of the Fund's operations. Therefore, Britain cannot announce that she is ready to assume the above-mentioned obligations until she is sure that she can remove the restrictions on the use of sterling balances accumulated in the future and still maintain a balanced position.

For the reasons stated above member countries are permitted to maintain and adopt to changing circumstances restrictions on payments and transfers for current international transactions during the transitional period. Countries whose territories have been occupied by the enemy are permitted to introduce restrictions where necessary. Member countries who adopt or retain exchange restrictions agree to abolish or modify these restrictions as soon as they believe they are able to maintain a balanced position without having to make undue use of the resources of the Fund. Countries should be able to abolish exchange restrictions when their internal economies have been reconstructed and their export trade restored.

Member countries availing themselves of the privilege of retaining or imposing exchange restrictions during the transitional period under this Section must have continuous regard for the purposes of the Fund. This means that they may not retain or impose restrictions merely to gain a competitive advantage and may retain or impose only those restrictions which are necessary to maintain a balanced position without making undue use of the Fund's resources.

Section 3 — Notification to the Fund

Before a member country becomes eligible to buy currency from the Fund it must notify the Fund whether it intends to avail itself of the transitional arrangements provided for in Section 2 or whether it is prepared to accept the following obligations: (1) Not to impose restrictions on the making of payments and transfers for current international transactions; (2) to avoid discriminatory and multiple currency practices; and (3) to convert its foreign-held balances, in accordance with the provisions of

Article VIII, Sections 2, 3 and 4. If the member country elects to avail itself of the transitional arrangements, it must notify the Fund as soon thereafter as it is prepared to accept the above-mentioned obligations.

The obligations referred to in Section 2 of this Article are confined to those mentioned above as provided for in Article VIII, Sections 2, 3 and 4. All other obligations of the Fund Agreement, including those relating to exchange rates as provided for in Article IV, must be assumed by member countries in the transitional period. Some conflict with the obligation to maintain exchange rates within the prescribed range may occur if a member country elects to maintain multiple exchange rates in the transitional period as a means of maintaining a balanced position. If multiple exchange rates are employed it would appear that one rate should be selected with the approval of the Fund as the par value of the currency and the member country should be asked gradually to reduce the spread between the rates. In no case should members be permitted to vary the rates for the purpose of gaining a temporary trade advantage nor should they be permitted to increase the spread between the rates.

Sec. 4 — Action by the Fund Relating to Restrictions

Three years after the date on which the Fund's operations begin and in each year thereafter, the Fund shall report on the restrictions still in force under Section 2 of this Article. Presumably in making this report the Fund will investigate the need for the retention of such restrictions as may be in force.

It is presumed by the Fund Agreement that except in special circumstances most countries will be able to withdraw their exchange restrictions which are inconsistent with the Article VIII, Sections 2, 3 and 4, within five

years after the operations of the Fund begin. Hence the Fund Agreement provides that five years after the date on which its operations begin and in each year thereafter, any member which still retains any of the above-mentioned restrictions must consult with the Fund as to their further retention.

If at any time the Fund believes that conditions are favorable for the withdrawal of any particular restriction or for the general abandonment of restrictions, it may request the member country to withdraw the restrictions which the Fund believes are no longer necessary or desirable. After the member has had time to reply, the Fund may declare a member ineligible to use the resources of the Fund if the member still persists in maintaining the restrictions.

IV, 1, a: Expression of Par Values

The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944. The significant words in the section are "a common denominator" which indicate that the relative values of member currencies are derived from the relations of each of them to gold, as was also the case under the gold standard. Denoting par values in terms of the United States dollar of the weight and fineness of July 1, 1944, has the first effect of specifying directly the relative value of the currency so defined to the dollar, but it also relates a currency to gold, inasmuch as the dollar was then equal to one thirty-fifth of a fine troy ounce. This portion of the provision was designed to meet the needs of those countries which for several reasons preferred to denominate their currencies in some unit other than gold.

IV, Section 1, b: Expressions of Par Values

The Fund will keep its accounts and make all computations relating to member currencies on the basis of their par values. The Fund will thus measure the resources available to members, as well as the obligations of members to the Fund and other members, in terms of par values.

IV, 2: Gold Purchases Based on Par Values

In view of the fact that a country may alter the value of its currency in terms of gold by buying and selling gold at varying prices, the Fund, in order to maintain the stability of the par values which have been established, must be in a position to specify the spread about parity which will be permitted in the gold transactions between member countries and to make certain that transactions will not take place outside that range.

HJB/8/22/44

Article IV - Par Values of Currencies

Section 3 - Foreign Exchange Dealings Based on Parity

The rate of exchange among various countries may be expected to fluctuate somewhat with the movement of trade or the payment of international services. Under the Agreement definite limits are set to the range of fluctuation. In the case of spot transactions, the limit is set at 1 percent above or below parity. This range is approximately equivalent to the range established by the gold points under the old gold standard. The gold points varied, of course, between two countries, depending upon the distance between them and the cost of shipping gold. For example, between New York and London the variation above and below par was less than one-half of one percent. The 1 percent variation permitted by the Fund Agreement is intended to serve approximately the same purpose as the gold points. If the exchange rate on the open market does not reach the upper limit there is little occasion for the member country to apply to the Fund. There would be no potential drain on gold reserves and no difficulty in obtaining the desired foreign exchange. When the exchange reaches this point it may be necessary for the member country to apply to the Fund to secure the foreign currency.

Spot exchange transactions usually include cables and sight bills as opposed to the forward transactions in which there is no bill which can be collected or discounted at the moment but where there is merely a promise to deliver future exchange. In the Fund Agreement the 1 percent permissible variation applies to sight bills and cables. In the case of time bills a further allowance must be made for the effect of interest

rates on the discount. Thus, if interest rates should again go to 8 percent on bills, a 90-day bill would be sold at 2 percent under the price of a sight bill, so that a time bill might be sold at a lower rate than the 1 percent margin. The Fund by regulation will no doubt take the interest factor into consideration in establishing the permissible variations from parity.

In the case of transactions other than spot, the Fund is permitted to establish a variation from parity exceeding the 1 percent margin for spot exchange. This variation must be determined by the Fund in the light of the conditions of financial markets and probably will vary somewhat with the currency involved. Forward or futures transactions have frequently been used as a means of speculating in the future course of a currency. By selling short, the exchange rate on a particular currency would be depressed in anticipation of future declines in the spot rate. While short sales have a legitimate function in arbitrage and hedging of exchange operations, there is no doubt that they can contribute to currency instability in initiating movements in exchange rates which are excessive in view of the probable conditions of trade and the respective demands of the countries for each others' currency. In the postwar period the dangers of such speculative movements will be particularly great, since the parity established for the currencies will be tentative while the conditions of world trade will be subject to serious change in the years immediately following the war. Under these circumstances forward transactions at rates above or below the reasonable variations from parity might make the work of the International Monetary Fund extremely difficult. They might initiate movements in a currency which would depress it so far as to make the demand upon the Fund's resources greater than the Fund's ability to

supply currency.

Accordingly, the members are required to maintain exchange rates between their own currency and foreign currencies, where all parties are members of the Fund, within the established parities. So far as its own currency is concerned, a member may limit the possible variation by buying or selling gold at the parity price or near it. For a country without gold, other measures must be taken such as rendering unenforcable exchange contracts made at rates beyond the permissible limits or other control of the exchanges to prevent excessive variation.

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8/22/44

IV, 4, a: Obligations Regarding Exchange Stability

This provision is a general statement of the fundamental obligation of member countries to collaborate with the Fund for the purposes for which it was established. In accepting it, members are committed to promoting stable exchanges and their specific obligations in this connection are enumerated in later provisions. They also agree to maintain orderly exchange arrangements by, for example, refraining from the multiple currency practices of the 1930's whereby differing rates were applied to different transactions, depending on the country making the purchase, the source of the funds used in payment, and other special conditions.

The final phrase in this provision requires that members refrain from indulging in competitive currency depreciation, one of the most objectionable international trade practices in the pre-war years. It was employed by some nations in an attempt to pull themselves out of the depression by increasing their exports at the expense of their neighbors. Other countries were forced to follow suit. Since an advantage could be obtained only so long as the other trading nations maintained the value of their exchanges, no country could benefit in the long run. The results were an increase in the economic distress of the world at large, a decrease in the volume of world trade, and continuing depression in the countries depreciating their currencies.

IV, 4, b: Obligations Regarding Exchange Stability

This provision implements the general obligation specified in the preceding paragraph (IV, 4, a). It provides that not only shall the par values of currencies be expressed in terms of gold but that the member country shall undertake to maintain that value by permitting transactions between its currency and member currencies only within the spread about par values prescribed in the case of spot transactions and the range about parity permitted by the Fund on other transactions. Members thus accept the obligation not to permit within their territories any de facto depreciation or appreciation of their currencies, and for this purpose, member countries are required to adopt appropriate measures consistent with this Agreement.

The second sentence of this paragraph provides that a nation such as the United States, which freely buys and sells gold at the established rate for the settlement of international transactions, is thereby carrying out its responsibility under this provision. The United States is thus relieved of any obligation to take special measures to maintain the value of other member currencies within its market.

IV, 5, a: Changes in Par values

Provision (a) is a very important element in the flexibility of exchange rates permitted by the Fund. The countries participating at Bretton woods recognized that it would be inappropriate and impossible to attempt to maintain a rigid exchange rate structure in the post-war world. On the contrary, what is desired is an orderly pattern of exchange relationships in which changes needed to correct fundamental disequilibrium are permitted.

It will be difficult to estimate in advance just what pattern of trade relationships will prevail in the post-war period, to what extent countries will recapture their prewar markets, and the schedule of exchange rates which will be most appropriate for the years which follow. The economic position of the various countries will also change over a period of years and pressures may be expected to develop on different currencies. The Fund will be in a position to lend support to currencies when the pressures are of a temporary character, but it is also recognized that changes in exchange rates may occasionally be necessary.

A country, however, undertakes to propose a change in the par value of its currency only when required to correct a fundamental disequilibrium in its balance of payments which will continue unless corrected in this way. It is also under obligation to prove to the

Fund, in the cases when the Fund's approval is needed, that the change has not been proposed merely to gain a competitive advantage. Through this provision, the Fund is also in a position to refuse its approval of a proposed change if it is not convinced that the alterations in par values will be conducive to improved trade relationships as a whole. Currency depreciation will be limited to those cases where, as happened after the last war, currencies appeared to have been overvalued in terms of the whole exchange rate pattern.

IV, 5, b: Changes in Par Values

The changes in par values envisaged by the Fund will be made on a much more orderly and responsible basis than has been the case in the past. The maintenance of an orderly pattern of exchange rates will be facilitated by the important requirement that changes in par values may be made by member governments only after consultation with the Fund. Although the Agreement provides for certain situations when a member may take action without the Fund's approval, under no circumstance may a par value be changed without adequate prior consideration.

This requirement stems from recognition of the fact that all countries are concerned with and affected by the changes in par values made by any single nation. An opportunity is provided, therefore, for reasoned discussion and consideration of the problem by all. Sovereignty and the right to unilateral action are still maintained, but the world community of interest will also be considered. A country will retain its right to take unilateral action to depreciate its currency, but it must come before a Board of Directors consisting of competent, experienced men who represent the other countries' interests in the matter.

Provision (b) also contains the basic protection of the sovereign power of a country over the foreign exchange value of its currency, for a change in the par value of a currency may never be made except

on the proposal of the member country. No change in the par value of the dollar could, for example, be made without our own request. In effect, a member cooperating fully with the Fund would be surrendering no more sovereignty than a country voluntarily surrenders when it adopts the gold standard. A limited right to unilateral action is retained by all members and the ultimate right to unilateral action through withdrawal exists as it does with all agreements entered into for the mutual advantage of the participants.

IV, Section 5, c: Changes in Par Values

Provision (c) designates the conditions under which changes in the par value of their currencies may be made by member countries.

Recognizing the extreme uncertainty of the immediate post-war years and the difficulties involved in the initial determination of appropriate par values, member countries have been given the right to make a change equal to 10 percent of their par values as initially established in Agreement with the Fund. This change does not require the approval of the Fund but it may be undertaken only after consultation with it.

This permissible change is not an unequivocal right of a member to a 10 percent alteration of its par value at any time without the consent of the Fund. If a country makes a 5 percent change in its initial par value with the Fund's approval, it may then only make an additional 5 percent alteration without the Fund's approval. If a member should make a 10 percent change in its initial par value, it has no further rights under provision c (i). Furthermore, both plus and minus changes are to be counted. If a country depreciates its par value by 5 percent and then decides to return to its original position, it will have used up its full right to the 10 percent modification. No member may fluctuate back and forth within the range of 10 percent. The freedom of action thus granted, although an important safeguard to a country, will apply only within strict limits.

For all other proposed changes in par values a member country must obtain the consent of the Fund. However, for alterations which would fall within a further 10 percent of initial par values, the Fund must notify the country concerned of its approval or opposition within 72 hours, if the member so requests. The advantage , in addition to the benefits of quick action, to the member requesting such a change may seem to be that it forces the Fund to give the member the benefit of any doubt incapable of resolution within the limited time available for investigation. It is to be expected, however, that the Fund would have followed very carefully the economic developments leading to a country's request for a modification in its par value, and that the need for a quick reply would not impose any hardship on the Fund or lead to hasty investigation.

For all requests for changes which, together with all previous changes, would exceed 20 percent of the initial par value, the concurrence of the Fund must be obtained, but the Fund may take a longer period of time to make its decision.

IV, 5, d: Changes in Par Values

The only changes in the pattern of exchange rates which are significant are those which affect the trade relationships prevailing among member countries. Therefore, uniform changes in the par values of the currencies of all members, which leave all such relationships unaltered, shall not be taken into account in determining whether a proposed change falls within the several categories discussed in the consideration of the previous subsection.

IV, 5, e: Changes in Par Values

A member may change the par value of its currency without the concurrence of the Fund if the change does not affect the international transactions of member countries. This provision has been designed to meet the needs of a country in which, by reason of state trading, the Government has complete control over prices and over the quantities of goods which will be bought or sold abroad. The values of its imports and exports are determined not by the exchange rate but by the overall economic program of the country. The exchange rate is thus largely a matter of internal bookkeeping which does not affect international trade relationships. The par value of its currency will have only a formal significance and any change in that value will leave its foreign exchange transactions unaffected.

It should be noted, however, that in making such changes member countries are not relieved of their obligation to consult with the Fund, and it will be within the power of the Fund to decide whether the proposed change will in effect leave unaltered the exchange transactions of the country concerned.

IV, 5, f: Changes in Par Values

The Fund shall concur in a proposed change in the par value of a member currency if it is satisfied that the change is necessary to correct a fundamental disequilibrium. It is recognized that there will be occasions when changes in exchange rates are both appropriate and desirable, as for example when, because of changing conditions or an incorrect original evaluation, a member's currency is significantly under or over valued. At such times a change in par values will correct a serious maladjustment which exposes the balance of payments of the country concerned to dangerous pressures, pressures which if not removed would threaten or make impossible the country's continued observation of its obligations to the Fund and to the other members.

It should be noted that the burden of proof is upon the country proposing the alternation. However, if the Fund is so satisfied, it shall not object to a proposed change because of the domestic social or political policies of the member. It is extremely important that such an international organization as the Fund, with the power seriously to influence both the external and internal conditions of member countries, should be entirely free of any political bias. Its decisions must be made on the basis of the purely economic factors involved and in the best long-run interests of the particular member proposing the change and of the other members of the Fund.

IV, 6: Effect of Unauthorized Changes

Every change in the par value of a member currency must have been preceded by consultation between the Fund and the country making the change. If the change has been made despite the objections of the Fund, in such cases where the change exceeds 10 percent of the initial par value and where, therefore, the Fund is entitled to object, the member shall be ineligible to use the resources of the Fund unless the Fund otherwise determines. No infringement on the sovereign power of the individual or its freedom to act is entailed, but if a member fails to abide by the rules of the Agreement, it shall be denied access to the resources of the Fund established by that Agreement.

If, after the expiration of a reasonable period, the difference between the Fund and the member is not settled to the satisfaction of the Fund, the member may be required to withdraw. In such a case of compulsory withdrawal from the Fund, the decision by the Board of Governors must be carried by a majority of the governors representing a majority of the total voting power.

Each country, therefore, retains the final word over changes in the par value of its currency and the right to unilateral action. However, a member may act in a fashion inimical to the welfare of the other members or fail to fulfil its obligation to maintain a reasonable degree of exchange stability only at the cost of withdrawing from the agreement.

IV, 7: Uniform Change in Par Values

The Fund may make uniform proportionate changes in the par values of the currencies of all members. Such a change would involve, if uniformly accepted, no alteration in the exchange rate between any two currencies; it would involve instead a change in the price of gold. Such a decision must have the approval of a majority of the total voting power, including the votes of every member having at least 10 percent of the total quotas. The three countries who would thus be required to acquiesce before such a change could be made are: the United States, the United Kingdom, and the U.S.S.R.

Any member may, however, prevent the proposed change in the par value of its currency by informing the Fund, within 72 hours of the Fund's action, that it does not wish to have its currency included in such action. The freedom of each member to determine the par value of its currency is thus fully protected. The requirement that notice must be given to the Fund within the short time specified has been imposed because it is recognized that such a change will be proposed in a period of unsettled conditions, which will be intensified by protracted doubts as to whether or not particular currencies are to be included.

IV, 8, a; Maintenance of Gold Value of the Fund's Assets

The gold value of the Fund's assets shall be maintained not withstanding changes in the par or foreign exchange value of the currency of any member. The purpose of this provision is to protect the Fund against any loss on its holdings of local currency which would result from a depreciation in a rate of exchange. Member countries will always be assured, therefore, of the value of their subscription to the Fund. Although the currency assets of the Fund will change from time to time, the foreign exchange value of these assets will remain the same.

IV, 8, b: Maintenance of Gold Value of Funds Assets

Whenever the par value of a member's currency is reduced or its foreign exchange value has depreciated to a significant extent, the member shall pay to the Fund an amount of its own currency sufficient to compensate for the reduction in the gold value of its currency held by the Fund.

The provision covers both a de jure and a de facto depreciation of currencies. Nevertheless, not every temporary movement in the rate of exchange below the prescribed range shall be regarded as a significant depreciation within the meaning of this provision. It is recognized that a temporary or abnormal depreciation may take place in the exchange rate for a currency. This can occur in unusual circumstances if the member country cannot promptly supply spot foreign exchange out of its current holdings or out of resources it may acquire from the Fund. Even where a member country is prepared to export gold for the purpose of acquiring additional foreign exchange, the rate of exchange could temporarily fall below the prescribed range because time may elapse before an export of gold can be converted into spot exchange.

Such temporary depreciations have been excluded from this provision by the words "to a significant extent". Only if a member country should be unable or unwilling to maintain the exchange rates for its

currency within the range prescribed by the Fund and should allow a depreciation of its currency which is both material and persistent to occur will the Fund require that the country deliver sufficient local currency to make good the de facto depreciation.

It should be noted that the Fund is given the power to determine at what point the foreign exchange value of a member's currency has depreciated "to a significant extent" and therefore at what point the obligation of this provision may be invoked.

IV, 8, c: Maintenance of Gold Value of the Fund's Assets

Whenever the par value of a member's currency is increased, the Fund shall return to such member an amount of its currency equal to the increase in the gold value of its currency held by the Fund. It should be noted that the Fund is obligated to return to the member country the increase of value resulting from a de jure appreciation of its currency but that the obligation does not apply to a de facto increase in the foreign exchange value of a currency.

There is a twofold explanation of this latter exclusion. A member's currency would appreciate in value only at a time when there was a great demand for the currency of that country, in which case the Fund's holdings of such currency would undoubtedly be inadequate to supply the demand. For the Fund to give up a part of its supply of such currency would probably make the situation more difficult. Furthermore, there is no reason why a member country should benefit as a result of having failed to maintain the foreign exchange value of its currency within the range prescribed by the Fund.

IV, 8, d: Maintenance of the Gold Value of the Fund's Assets

The obligation of a member country to maintain the gold value of the Fund's holdings of its currency shall apply to a uniform proportionate change in the par values of the currencies of all members, unless at the time of such a change the Fund shall decide otherwise. The effect of requiring members to compensate the Fund for the loss in gold value resulting from a uniform change in par values would be to increase the capital of the Bank through an increase in its currency assets. The Fund is thus given the power to decide whether or not such an increase in the capital of the institution shall occur.

IV, 9: Separate Currencies Within a Member's Territories

When a government accepts this Agreement, it does so both on its own behalf and with respect to all its colonies and territories. Similarly, when a member establishes, in agreement with the Fund, the initial par value for its metropolitan territory, it will also communicate to the Fund a value for each separate currency which exists in any of its colonies or territories. The foreign exchange value of the currencies of politically subordinate areas, furthermore, are generally maintained in a very close and stable relationship to the currency of the home country. The Fund will, therefore, consider that a member proposing a change in the par value of its currency is also proposing a corresponding change in the separate currencies of its territories. Each country, however, has complete liberty to specify that the proposed change relates only to its metropolitan currency or only to one or more of the currencies under its jurisdiction.

VII, 1: General Scarcity of a Currency

If the Fund finds that a general scarcity of a particular currency is developing, it may so inform the members and may issue a report setting forth the causes of the scarcity and containing recommendations designed to bring it to an end. The Fund has a responsibility at such a time because the growing scarcity of a currency would threaten the disruption of trade relationships. The Fund will be in an excellent position to examine carefully the situation giving rise to the scarcity and to call to attention the techniques which may be used to correct the existing disequilibrium.

The specific recommendations made in the Fund's report would depend on the complex of factors responsible for the scarcity and would focus both on the country whose currency is in a short supply and on the countries demanding the currency in question. It might recommend, for example, efforts to increase imports in the country with the favorable balance of payments or measures to expand the volume of its foreign investment, if those would be appropriate in the given situation. In general, the Fund would give careful consideration to the internal conditions of the countries involved and would endeavor to make those suggestions which would lead to a further expansion rather than to the restriction of international trade. Should the Fund decide, however, that a decrease would be desirable in the purchases of other countries from the nation whose currency is scarce, or that an appreciation of the par value of the scarce

currency was needed, these recommendations would be included in the report.

In getting the countries concerned to act upon its suggestions, the Fund would have the powerful support of world public opinion. The country whose currency was becoming scarce would be safeguarded by the requirement that a representative of the country whose currency is involved shall participate in the preparation of the report.

It should be noted that the Fund is not obligated to issue a report.

VII, 2: Measures to Replenish the Fund's Holdings of Scarce Currencies

Where the Fund finds that a general scarcity of a member's currency is developing the Fund will undoubtedly attempt to replenish its holdings of a member's currency. It may do so by arranging to borrow the scarce currency from the government or central bank of the country concerned or from any other source within or outside the territories of the member concerned. No member, however, is under any obligation to lend its currency to the Fund or to permit the Fund to borrow from its nationals or outside its markets. Any loans made to the Fund by a member country will be made entirely at the discretion of the member country, providing of course, that the Fund desires to borrow.

The Fund may also increase its supply of a scarce currency by using its gold resources to purchase the currency desired from the member country. In this case member countries have an obligation to sell their currencies to the Fund for gold. This provision, however, is merely an explicit statement of a practice which has been customary in international transactions. Countries on the gold standard had voluntarily assumed this obligation, and countries, in recent years, which were not on the gold standard have generally been desirous of replenishing or expanding their gold supplies.

This provision is another of those in the Fund Agreement which strengthens the role of gold in international transactions.

VII, 3, a: Scarcity of the Fund's Holdings

The report of the Fund on the developing scarcity in a member currency, and the action taken upon the Fund's recommendations by the countries concerned, may suffice to alleviate the threatened scarcity, and the activities of the Fund in increasing its supply of the currency involved will aid in maintaining a supply sufficient to meet the needs of member countries. If, however, it becomes evident to the Fund that the demand for a member currency seriously threatens its ability to supply that currency, the Fund shall formally declare the currency scarce. It may do so whether or not it has previously issued a report on the problem.

After a currency has been declared scarce, the Fund shall apportion among the member countries its present supply of the currency and any further supply it may obtain. The Fund shall not apportion the currency on the basis of an equal or proportionate share to each country but will take into consideration the relative needs of the various members. The currency being thus allocated on the basis of need, member countries will have an incentive to alleviate the scarcity by employing their own resources of gold or of the currency in demand.

In determining the basis of its apportionment of the scarce currency, the Fund will also pay due regard to the general international economic situation and any other pertinent considerations. For example,

the rapidity with which the Fund can afford to relieve the scarcity by distributing its present supply in part will be determined by way in which world trade and investment are expected to develop in the following years.

Whether or not the Fund has previously issued a report on the approaching scarcity, it is under an obligation to do so at the time it formally declares that a currency is scarce.

VII, 3, b and c: Scarcity of the Fund's Holdings

When a currency is declared scarce by the Fund, members will be able to obtain it from the Fund only in limited quantities. They will, therefore, be forced to control the use of such currency by their nationals. For this reason, the formal declaration by the Fund that a currency is scarce shall operate as an authorization to any member to impose limitation on the freedom of exchange operations in the scarce currency.

In determining the manner in which a country shall ration its supply of the scarce currency among its importers and other users of foreign exchange, the member shall have complete jurisdiction. However, nothing in the declaration of scarcity relieves members of their obligation to permit exchange transactions in member currencies within their territories only within the prescribed range of parity. They may not, therefore, auction the currency to the highest bidder.

The Agreement stipulates, furthermore, that the limitations imposed on dealings in the scarce currency shall be no more restrictive than is necessary to limit the demand to the supply held by or accruing to the member, and the restrictions must be relaxed and removed as rapidly as conditions permit. The authorization to impose such restrictions expires as soon as the Fund formally declares the currency in question no longer scarce.

VII, 4: Administration of Restrictions

In exercising the power to allocate their limited resources of a scarce currency governments may impose considerable hardship on the country whose currency is being rationed. The member whose currency has been declared scarce will of necessity suffer a decrease in its total volume of exports. It may, however, be convinced either that its exports are being restricted unduly or that it is being discriminated against in particular areas or products. Under such circumstances, members are required to give sympathetic consideration to any representations made by the country whose currency has been declared scarce.

VII, 5: Effect of Other International Agreements on Restrictions

It is possible that the authorization to impose restrictions on exchange transactions may conflict with the provisions of commercial treaties entered into before this Agreement. Some trade agreements, for example, contain a provision which states that the nationals of the United States shall be accorded as favorable treatment in the administration of exchange restrictions as is accorded the nationals of any third country. If the dollar should be declared scarce, however, a member would by the terms of the Fund Agreement be permitted to impose restrictions specifically upon dollar transactions and thus deny to trade in that currency treatment as favorable as that accorded trade in other currencies. A conflict between agreements might therefore arise. To meet this difficulty, a provision has been included which states that members agree not to invoke the obligations of any engagements entered into with other members prior to this Agreement in such a manner as will prevent the operation of the provisions relating to scarce currencies.

ARTICLE IV PAR VALUES OF CURRENCY

Section 1(a). Expression of par values.

This section provides for a "common denominator" in which the currencies of all members can be expressed. Countries are given the option of using as a "common denominator" gold or the United States dollar of the weight and fineness in effect on July 1, 1944. Since the United States dollar referred to has a specific gold weight, it makes little difference which common denominator is used. The alternative provision was included merely to meet the needs of certain countries which preferred to express the par value of their currencies in United States dollars.

Section 1(b). Expression of par values.

The Fund will keep its accounts and make all computations relating to member currencies on the basis of their par values. Thus, in determining the price one country will pay for the currency of a member which it purchases from the Fund, the Fund need only refer to the relative par values of the currencies of the two members.

ARTICLE IV PAR VALUES OF CURRENCY

Section 2. Gold purchases based on par values.

In order to maintain the stability of par values and hence the stability of exchange rates, the Fund prescribes a margin above and below par value for each member's currency and no transaction between members may deviate from par beyond the prescribed margin.

However, in dealing with non-members a certain flexibility is permitted. This is helpful to members and tends to strengthen their position, vis a vis, non-members who are free of any restrictions in dealing with gold. No member is permitted to buy gold at a price above par value or to sell gold at a price below par value, except within the prescribed margin.

It will be noted that there is no prohibition against selling gold above par and similarly there is no prohibition against purchasing gold below par. This obviously has no affect upon transactions between members since where the purchaser is not affected the seller would be and conversely where the seller is not affected the purchaser would be. However, with respect to non-members it permits the member to sell or buy gold at other than par value so long as the transaction is profitable to that member in relation to par value. Thus, if France, a member, were dealing with Argentina, a non-member, it could sell Argentina gold at a price above par value. Also, it could purchase gold from Argentina at a price below par value. In each case the member country is making a profit in relation to par value and the non-member can deal with the member at values which deviate from par only if it is willing to take a loss.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 3. Foreign exchange dealings based on parity.

This section deals with the permissible deviation which may take place in the exchange rates for transactions involving two member currencies. In the case of spot exchange transactions the limit is set at one per cent above or below parity. The one per cent variation is intended to serve approximately the same purpose as that served by the gold points under the old gold standard.

With respect to transactions other than spot, i.e., forward transactions, the Fund is permitted to establish a variation from parity in excess of one per cent. Actually, the amount in excess of one per cent does not represent a real deviation from parity. It represents, rather, the amount of interest which is earned from the time of the original transaction until the time that the obligation matures. Every future transaction appears to be a spot transaction as of the maturity date. Manifestly, considered as a spot transaction, the variation from parity would be greater than one per cent.

However, if a transaction is separated into its component parts it will become clear that the variation from parity is made up of two elements: the permissible variation of one per cent with regard to spot transactions and an additional amount which does not represent a variation in parity rates at all but is merely taking into account the fact that payment for the currency purchased was made subsequent to the date of the purchase, and interest accrued on the obligation.

In other words, this section has a twofold purpose:

1) It fixes within a range of one per cent the permissible variation in exchange transactions between member countries; and

2) It places within the discretion of the Fund appropriate interest rates that may be charged on future transactions in foreign currency dealings between member countries.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 4(a). Obligations regarding exchange stability.

Under this section, Article I (iii) is translated from a mere statement of purpose to an obligation which each member undertakes to perform. Moreover, having placed it in terms of an obligation the Fund is not without sanctions to enforce the faithful performance of such obligation. Other sections treat, in ddail, with the nature and the varying degree of severity of such sanctions.

In addition, each member undertakes to maintain orderly exchange arrangements with other members. This provision would prevent the recurrence of multiple currency practices under which countries employed different rates depending upon the nature of the transaction, the country with which the transaction was made, the source of the funds used in payment, etc.

Finally, under this section, each member undertakes to avoid competitive exchange alterations. It is hardly necessary to dwell at length on the harmful effects that such depreciations have upon world trade. Any attempt to gain a competitive advantage by currency depreciation and thus obtain a larger proportion of world trade at the expense of other countries almost invariably results in a retalitory depreciation by the country or countries adversely affected. In the long run the policy of "beggar your neighbor" impoverishes both countries.

Section 4(b). Obligations regarding exchange stability.

This section is the enforcement device for effectuating the provisions of section 3. Section 3 specified the permissible variation in spot exchange transactions and stated that the Fund would fix a reasonable further variation with respect to transactions other than spot transactions. Under this section each member agrees to take appropriate measures to prohibit within its territories any exchange transactions between its currency and the currencies of other members which are outside the variations prescribed under section 3. This means that each member is agreeing that it will prevent not only a de facto depreciation in its own currency, but that it will maintain the parity of member currencies.

However, there is one important exception to the requirement that appropriate measures be taken to prohibit exchange transactions in the territories of a member which are outside the prescribed variation; and that exception is in favor of those members whose monetary authorities freely buy and sell gold in conformity with section 2 above. Such countries will be deemed to be fulfilling their undertakings under this section.

This means that the United States, which freely buys and sells gold at the established rate for the settlement of international transactions, is thereby discharging its responsibility under section 4, and it is thus relieved of any obligation to take special measures to maintain the value of other member currencies within its market.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 5(a). Changes in par values.

Provision (a) of section 5 strikes the keynote for the whole section. It provides expressly that a member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium. It provides implicitly the corollary proposition that the Fund in considering such a proposal will object to the change unless, in fact, such change is necessary to correct a fundamental disequilibrium.

Section 5 has a number of deterrents aimed at checking changes in par values. The first of these is fund in subdivision (a) which restricts the number of reasons for which a country may seek a change in the par value of its currency to the one permissible reason, namely, to correct a fundamental disequilibrium.

Section 5(b). Changes in par values.

In provision (b) there is a second deterrent. Before the member may make any proposal to change the par value of its currency, it must first consult with the Fund. The importance of consultation as a restraint on undesirable unilateral action can hardly be over emphasized. When a country's currency is subjected to severe pressure the temptation to resort to the easy solution of depreciation may be quite strong. However, in consulting with the Fund and in attempting to demonstrate the necessity for making the proposed change, it may, and probably will, in most cases, appear that the disequilibrium, although severe, is merely temporary or that the disequilibrium, although not temporary, is not fundamental but is due to or aggravated by internal conditions which could be remedied by the member itself or by other factors which may require outside assistance. There are so many possible causes contributing to what may seem to be a permanent disequilibrium that it may be extremely difficult to show that a particular state of disequilibrium is fundamental.

Of course, where a member's currency is found to be actually over valued in terms of the whole exchange rate pattern such member should be not only permitted but encouraged to devalue in order to bring its currency in harmony with the realities of the situation. Failure to devalue under such circumstances would result in a sustained pressure on the currency of the member which would cause that member continually to seek access to the Fund in order to obtain necessary foreign exchange.

The essence of this provision is that it makes consultation a necessary prerequisite to the right of any member to propose a change in the par value of its currency.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 5 (c). Changes in par values.

This provision is the third step in the mechanics established under section 5 for changing the par value of a member's currency. Assuming that a member, in accordance with provision (a), believed that the proposed change was necessary to correct a fundamental disequilibrium and assuming that such member, in accordance with provision (b), consulted with the Fund with respect to the propriety of changing the par value of its currency, then the member would be entitled to propose to the Fund the desired change in the par value of its currency.

Having been presented with such a proposal, the Fund will be guided by subdivision (c) with respect to the factors it should consider and the action it should take in connection with the member's proposal.

The first general factor the Fund is directed to consider is whether the member is one which has already altered the initial par value of its currency under Article XX, section 4. If it has altered the initial par value of its currency, then presumably the new par value represents one which both the member and the Fund believed was appropriate to the economy of the member and one that could be maintained by that member. It seems manifest that the Fund under such circumstances would closely scrutinize any proposal by a member for a further change in the par value of its currency.

The second factor to be considered by the Fund is the total amount of change that a member has already made in the initial par value of its currency. If the proposed change, together with all previous changes, whether increases or decreases, does not exceed 10 per cent of the initial par value, the Fund is directed to raise no objection. It should be noted that the member proposing the change is not in any event relieved of its obligations under (a) and (b) above (i.e., that there be prior consultation with the Fund and that the proposal should be made only for the purpose of correcting a fundamental disequilibrium).

It should be emphasized that this provision does not give a 10 per cent play in the changes that a member may make in the initial par value of its currency. In other words, a member, the initial par value of whose currency was 100, would not, under this provision, be permitted to fluctuate the value of its currency between 90 and 110. It would be permitted only to make one or more changes which, when added together, did not exceed a cumulative change of more than 10 per cent. For example, a member could, under this provision, increase the par value of its currency from 100 to 103 and then increase it again from 103 to 106. At that point the member would be permitted to increase the value a further 4 per cent or to decrease it 4 per cent. Having used either option, the member would have exhausted its privilege of making a 10 per cent change without objection from the Fund.

With respect to any proposed further change, in addition to the 10 per cent referred to above, the Fund is free to exercise its own discretion in determining whether or not to object to the proposed change. The only limitation placed upon the free exercise of this discretion is a time limitation in making its decision known. In cases where the proposed change, including all previous changes, whether increases or decreases, does not exceed 20 per cent of the initial par value, the time limitation is to the effect that the Fund make known its decision within 72 hours. In other words, if a member has availed itself of the privilege of changing the par value of its currency 10 per cent and it subsequently proposes to change the value of its currency a further 10 per cent, the member, upon proposing such a change is entitled to know the Fund's decision within 72 hours.

Section 5(d). Changes in par values.

For the purposes of the Fund, only changes in the pattern of exchange rates are significant, because such changes affect the trade relationships prevailing among members. Therefore, uniform changes in the par values of the currencies of all members, which leave all such relationships unaltered, shall not be taken into account in determining whether a proposed change falls within the categories of cases discussed in provision (c).

Section 5 (e). Changes in par values.

Provision (e) permits a member to change the par value of its currency without the concurrence of the Fund if the change does not affect the international transactions of members of the Fund. The Fund is not properly concerned with the workings of the purely internal economy of members. Thus, if because of various other factors a change in par value would not affect the international transactions of members, there is no necessity for obtaining the concurrence of the Fund.

It should be emphasized, however, that in making such a change, a member country is not relieved of its obligation to consult with the Fund and it will be within the power of the Fund to decide whether the proposed change will in fact leave unaffected that member's international transactions with other members.

Section 5(f). Changes in par values.

In connection with provision (a) it was mentioned that it was implicit in that provision that the Fund would object to any proposed

change unless such change were necessary to correct a fundamental disequilibrium. Provision (f) supplements and completes the thought in provision (a).

If a member believes that a change is necessary to correct a fundamental disequilibrium and proposes such a change under provision (a) and if the Fund is satisfied that the member is correct in its belief, the Fund must grant its approval to the proposed change. In particular, this provision prohibits the Fund from taking into consideration such extraneous factors as the domestic, social or political policies of the member proposing the change. This prohibition is one of the many safeguards designed to prevent the Fund from becoming involved in and from interferring, in any way, with the internal policies of any member.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 6. Effect of unauthorized changes.

In section 5 above, the Fund was given authority to object to the proposal of any member to change the par value of its currency. This section provides specific sanctions to put teeth into those objections. If a member changes the par value of its currency despite the objections of the Fund, such a member may be dealt with quite severely and effectively under the powers granted in this section.

To begin with, the offending member immediately becomes ineligible to use the resources of the Fund, unless the Fund otherwise determines; and thereafter, if it fails to iron out its differences with the Fund within a reasonable time, it is subject to the drastic penalty of compulsory withdrawal.

ARTICLE IV PAR VALUES OF CURRENCIES

Section 7. Uniform changes in par values.

The Fund may make uniform proportionate changes in the par values of the currencies of all members. In order to do so, there must be approval by the majority of the total voting power, and such majority must include every member which has 10 per cent or more of the total of the quotas. Under this formula, a uniform change could not take place without the approval of the United States.

For the protection of the smaller countries, it is provided that any member can prevent the proposed change from applying to the par value of its currency by informing the Fund within 72 hours that it does not wish the par value of its currency to be changed.

IV, 1, a: Expression of Par Values

The par value of the currency of each member shall be expressed in terms of gold as a common denominator or in terms of the United States dollar of the weight and fineness in effect on July 1, 1944. The significant words in the section are "a common denominator" which indicate that the relative values of member currencies are derived from the relations of each of them to gold, as was also the case under the gold standard. Denoting par values in terms of the United States dollar of the weight and fineness of July 1, 1944, has the first effect of specifying directly the relative value of the currency so defined to the dollar, but it also relates a currency to gold, inasmuch as the dollar was then equal to one thirty-fifth of a fine troy ounce. This portion of the provision was designed to meet the needs of those countries which for several reasons preferred to denominate their currencies in some unit other than gold.

IV, Section 1, b: Expressions of Par Values

The Fund will keep its accounts and make all computations relating to member currencies on the basis of their par values. The Fund will thus measure the resources available to members, as well as the obligations of members to the Fund and other members, in terms of par values.

IV, 2: Gold Purchases Based on Par Values

In view of the fact that a country may alter the value of its currency in terms of gold by buying and selling gold at varying prices, the Fund, in order to maintain the stability of the par values which have been established, must be in a position to specify the spread about parity which will be permitted in the gold transactions between member countries and to make certain that transactions will not take place outside that range.

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Article IV - Par Values of Currencies

Section 3 - Foreign Exchange Dealings Based on Parity

The rate of exchange among various countries may be expected to fluctuate somewhat with the movement of trade or the payment of international services. Under the Agreement definite limits are set to the range of fluctuation. In the case of spot transactions, the limit is set at 1 percent above or below parity. This range is approximately equivalent to the range established by the gold points under the old gold standard. The gold points varied, of course, between two countries, depending upon the distance between them and the cost of shipping gold. For example, between New York and London the variation above and below par was less than one-half of one percent. The 1 percent variation permitted by the Fund Agreement is intended to serve approximately the same purpose as the gold points. If the exchange rate on the open market does not reach the upper limit there is little occasion for the member country to apply to the Fund. There would be no potential drain on gold reserves and no difficulty in obtaining the desired foreign exchange. When the exchange reaches this point it may be necessary for the member country to apply to the Fund to secure the foreign currency.

Spot exchange transactions usually include cables and sight bills as opposed to the forward transactions in which there is no bill which can be collected or discounted at the moment but where there is merely a promise to deliver future exchange. In the Fund Agreement the 1 percent permissible variation applies to sight bills and cables. In the case of time bills a further allowance must be made for the effect of interest

rates on the discount. Thus, if interest rates should again go to 8 percent on bills, a 90-day bill would be sold at 2 percent under the price of a sight bill, so that a time bill might be sold at a lower rate than the 1 percent margin. The Fund by regulation will no doubt take the interest factor into consideration in establishing the permissible variations from parity.

In the case of transactions other than spot, the Fund is permitted to establish a variation from parity exceeding the 1 percent margin for spot exchange. This variation must be determined by the Fund in the light of the conditions of financial markets and probably will vary somewhat with the currency involved. Forward or futures transactions have frequently been used as a means of speculating in the future course of a currency. By selling short, the exchange rate on a particular currency would be depressed in anticipation of future declines in the spot rate. While short sales have a legitimate function in arbitrage and hedging of exchange operations, there is no doubt that they can contribute to currency instability in initiating movements in exchange rates which are excessive in view of the probable conditions of trade and the respective demands of the countries for each others' currency. In the postwar period the dangers of such speculative movements will be particularly great, since the parity established for the currencies will be tentative while the conditions of world trade will be subject to serious change in the years immediately following the war. Under these circumstances forward transactions at rates above or below the reasonable variations from parity might make the work of the International Monetary Fund extremely difficult. They might initiate movements in a currency which would depress it so far as to make the demand upon the Fund's resources greater than the Fund's ability to

supply currency.

Accordingly, the members are required to maintain exchange rates between their own currency and foreign currencies, where all parties are members of the Fund, within the established parities. So far as its own currency is concerned, a member may limit the possible variation by buying or selling gold at the parity price or near it. For a country without gold, other measures must be taken such as rendering unenforceable exchange contracts made at rates beyond the permissible limits or other control of the exchanges to prevent excessive variation.

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IV, 4, a: Obligations Regarding Exchange Stability

This provision is a general statement of the fundamental obligation of member countries to collaborate with the Fund for the purposes for which it was established. In accepting it, members are committed to promoting stable exchanges and their specific obligations in this connection are enumerated in later provisions. They also agree to maintain orderly exchange arrangements by, for example, refraining from the multiple currency practices of the 1930's whereby differing rates were applied to different transactions, depending on the country making the purchase, the source of the funds used in payment, and other special conditions.

The final phrase in this provision requires that members refrain from indulging in competitive currency depreciation, one of the most objectionable international trade practices in the pre-war years. It was employed by some nations in an attempt to pull themselves out of the depression by increasing their exports at the expense of their neighbors. Other countries were forced to follow suit. Since an advantage could be obtained only so long as the other trading nations maintained the value of their exchanges, no country could benefit in the long run. The results were an increase in the economic distress of the world at large, a decrease in the volume of world trade, and continuing depression in the countries depreciating their currencies.

IV, 4, b: Obligations Regarding Exchange Stability

This provision implements the general obligation specified in the preceding paragraph (IV, 4, a). It provides that not only shall the par values of currencies be expressed in terms of gold but that the member country shall undertake to maintain that value by permitting transactions between its currency and member currencies only within the spread about par values prescribed in the case of spot transactions and the range about parity permitted by the Fund on other transactions. Members thus accept the obligation not to permit within their territories any de facto depreciation or appreciation of their currencies, and for this purpose, member countries are required to adopt appropriate measures consistent with this Agreement.

The second sentence of this paragraph provides that a nation such as the United States, which freely buys and sells gold at the established rate for the settlement of international transactions, is thereby carrying out its responsibility under this provision. The United States is thus relieved of any obligation to take special measures to maintain the value of other member currencies within its market.

IV, 5, a: Changes in Par Values

Provision (a) is a very important element in the flexibility of exchange rates permitted by the Fund. The countries participating at Bretton Woods recognized that it would be inappropriate and impossible to attempt to maintain a rigid exchange rate structure in the post-war world. On the contrary, what is desired is an orderly pattern of exchange relationships in which changes needed to correct fundamental disequilibrium are permitted.

It will be difficult to estimate in advance just what pattern of trade relationships will prevail in the post-war period, to what extent countries will recapture their prewar markets, and the schedule of exchange rates which will be most appropriate for the years which follow. The economic position of the various countries will also change over a period of years and pressures may be expected to develop on different currencies. The Fund will be in a position to lend support to currencies when the pressures are of a temporary character, but it is also recognized that changes in exchange rates may occasionally be necessary.

A country, however, undertakes to propose a change in the par value of its currency only when required to correct a fundamental disequilibrium in its balance of payments which will continue unless corrected in this way. It is also under obligation to prove to the

Fund, in the cases when the Fund's approval is needed, that the change has not been proposed merely to gain a competitive advantage. Through this provision, the Fund is also in a position to refuse its approval of a proposed change if it is not convinced that the alterations in par values will be conducive to improved trade relationships as a whole. Currency depreciation will be limited to those cases where, as happened after the last war, currencies appeared to have been over-valued in terms of the whole exchange rate pattern.

IV, 5, b: Changes in Par Values

The changes in par values envisaged by the Fund will be made on a much more orderly and responsible basis than has been the case in the past. The maintenance of an orderly pattern of exchange rates will be facilitated by the important requirement that changes in par values may be made by member governments only after consultation with the Fund. Although the Agreement provides for certain situations when a member may take action without the Fund's approval, under no circumstance may a par value be changed without adequate prior consideration.

This requirement stems from recognition of the fact that all countries are concerned with and affected by the changes in par values made by any single nation. An opportunity is provided, therefore, for reasoned discussion and consideration of the problem by all. Sovereignty and the right to unilateral action are still maintained, but the world community of interest will also be considered. A country will retain its right to take unilateral action to depreciate its currency, but it must come before a Board of Directors consisting of competent, experienced men who represent the other countries' interests in the matter.

Provision (b) also contains the basic protection of the sovereign power of a country over the foreign exchange value of its currency, for a change in the par value of a currency may never be made except

on the proposal of the member country. No change in the par value of the dollar could, for example, be made without our own request. In effect, a member cooperating fully with the Fund would be surrendering no more sovereignty than a country voluntarily surrenders when it adopts the gold standard. A limited right to unilateral action is retained by all members and the ultimate right to unilateral action through withdrawal exists as it does with all agreements entered into for the mutual advantage of the participants.

IV, Section 5, c: Changes in Par Values

Provision (c) designates the conditions under which changes in the par value of their currencies may be made by member countries.

Recognizing the extreme uncertainty of the immediate post-war years and the difficulties involved in the initial determination of appropriate par values, member countries have been given the right to make a change equal to 10 percent of their par values as initially established in Agreement with the Fund. This change does not require the approval of the Fund but it may be undertaken only after consultation with it.

This permissible change is not an unequivocal right of a member to a 10 percent alteration of its par value at any time without the consent of the Fund. If a country makes a 5 percent change in its initial par value with the Fund's approval, it may then only make an additional 5 percent alteration without the Fund's approval. If a member should make a 10 percent change in its initial par value, it has no further rights under provision c (i). Furthermore, both plus and minus changes are to be counted. If a country depreciates its par value by 5 percent and then decides to return to its original position, it will have used up its full right to the 10 percent modification. No member may fluctuate back and forth within the range of 10 percent. The freedom of action thus granted, although an important safeguard to a country, will apply only within strict limits.

For all other proposed changes in par values a member country must obtain the consent of the Fund. However, for alterations which would fall within a further 10 percent of initial par values, the Fund must notify the country concerned of its approval or opposition within 72 hours, if the member so requests. The advantage , in addition to the benefits of quick action, to the member requesting such a change may seem to be that it forces the Fund to give the member the benefit of any doubt incapable of resolution within the limited time available for investigation. It is to be expected, however, that the Fund would have followed very carefully the economic developments leading to a country's request for a modification in its par value, and that the need for a quick reply would not impose any hardship on the Fund or lead to hasty investigation.

For all requests for changes which, together with all previous changes, would exceed 20 percent of the initial par value, the concurrence of the Fund must be obtained, but the Fund may take a longer period of time to make its decision.

IV, 5, d: Changes in Par Values

The only changes in the pattern of exchange rates which are significant are those which affect the trade relationships prevailing among member countries. Therefore, uniform changes in the par values of the currencies of all members, which leave all such relationships unaltered, shall not be taken into account in determining whether a proposed change falls within the several categories discussed in the consideration of the previous subsection.

IV, 5, e: Changes in Par Values

A member may change the par value of its currency without the concurrence of the Fund if the change does not affect the international transactions of member countries. This provision has been designed to meet the needs of a country in which, by reason of state trading, the Government has complete control over prices and over the quantities of goods which will be bought or sold abroad. The values of its imports and exports are determined not by the exchange rate but by the overall economic program of the country. The exchange rate is thus largely a matter of internal bookkeeping which does not affect international trade relationships. The par value of its currency will have only a formal significance and any change in that value will leave its foreign exchange transactions unaffected.

It should be noted, however, that in making such changes member countries are not relieved of their obligation to consult with the Fund, and it will be within the power of the Fund to decide whether the proposed change will in effect leave unaltered the exchange transactions of the country concerned.

IV, 5, f: Changes in Par Values

The Fund shall concur in a proposed change in the par value of a member currency if it is satisfied that the change is necessary to correct a fundamental disequilibrium. It is recognized that there will be occasions when changes in exchange rates are both appropriate and desirable, as for example when, because of changing conditions or an incorrect original evaluation, a member's currency is significantly under or over valued. At such times a change in par values will correct a serious maladjustment which exposes the balance of payments of the country concerned to dangerous pressures, pressures which if not removed would threaten or make impossible the country's continued observation of its obligations to the Fund and to the other members.

It should be noted that the burden of proof is upon the country proposing the alteration. However, if the Fund is so satisfied, it shall not object to a proposed change because of the domestic social or political policies of the member. It is extremely important that such an international organization as the Fund, with the power seriously to influence both the external and internal conditions of member countries, should be entirely free of any political bias. Its decisions must be made on the basis of the purely economic factors involved and in the best long-run interests of the particular member proposing the change and of the other members of the Fund.

IV, 6: Effect of Unauthorized Changes

Every change in the par value of a member currency must have been preceded by consultation between the Fund and the country making the change. If the change has been made despite the objections of the Fund, in such cases where the change exceeds 10 percent of the initial par value and where, therefore, the Fund is entitled to object, the member shall be ineligible to use the resources of the Fund unless the Fund otherwise determines. No infringement on the sovereign power of the individual or its freedom to act is entailed, but if a member fails to abide by the rules of the Agreement, it shall be denied access to the resources of the Fund established by that Agreement.

If, after the expiration of a reasonable period, the difference between the Fund and the member is not settled to the satisfaction of the Fund, the member may be required to withdraw. In such a case of compulsory withdrawal from the Fund, the decision by the Board of Governors must be carried by a majority of the governors representing a majority of the total voting power.

Each country, therefore, retains the final word over changes in the par value of its currency and the right to unilateral action. However, a member may act in a fashion inimical to the welfare of the other members or fail to fulfil its obligation to maintain a reasonable degree of exchange stability only at the cost of withdrawing from the agreement.

IV, 7: Uniform Change in Par Values

The Fund may make uniform proportionate changes in the par values of the currencies of all members. Such a change would involve, if uniformly accepted, no alteration in the exchange rate between any two currencies; it would involve instead a change in the price of gold. Such a decision must have the approval of a majority of the total voting power, including the votes of every member having at least 10 percent of the total quotas. The three countries who would thus be required to acquiesce before such a change could be made are: the United States, the United Kingdom, and the U.S.S.R.

Any member may, however, prevent the proposed change in the par value of its currency by informing the Fund, within 72 hours of the Fund's action, that it does not wish to have its currency included in such action. The freedom of each member to determine the par value of its currency is thus fully protected. The requirement that notice must be given to the Fund within the short time specified has been imposed because it is recognized that such a change will be proposed in a period of unsettled conditions, which will be intensified by protracted doubts as to whether or not particular currencies are to be included.

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Article VI - Capital Transfers

Section 1 - Use of the Fund's Resources for Capital Transfer

The International Monetary Fund is intended to secure stability in international exchange rates. It is not intended as a device for capital expansion or for other purposes not related to the current movement of international trade and services. In the past, capital movements have frequently been a disrupting factor in the exchange situation. Thus, if a large capital export takes place from one country to another its effect is to increase the rate of exchange on the country receiving the capital. If the rate is high enough, gold may be attracted or in view of the present distribution of gold and the limitations upon the transfer of gold, exchange instability might result. In the 1930's the exchange situation was further complicated by the movement of so-called "hot money", funds in the form of short-term or demand deposits moving from one country to another, either because of the possibility of earning interest or speculative profits in the country to which the flow was directed, or to avoid conditions existing in the country from which the capital flowed. Regardless of the motivation of the short-term capital movement its effect was undoubtedly to depress the rate of exchange on the countries losing capital and to raise the rate of exchange and increase the gold and other reserves of the countries receiving capital.

It is not the purpose of the Fund to limit capital movements as such. The Fund's interest in capital movements arises merely from their possible contribution to exchange in/stability or to the possibility that the Fund's

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resources might be used by some members to make capital investments abroad which really are made by other countries providing the Fund's resources. It is, therefore, provided that a member may not make net use of the Fund's resources "to meet a large or sustained outflow of capital". In case the Fund judges that such a capital movement is in process it may request a member to exercise control over its exchange to prevent this movement if the country involved is a net purchaser of exchange from the Fund. Failure to act with appropriate control devices may result in the suspension of the members privilege of purchasing foreign currencies from the Fund.

It is recognized that the definition of a capital transaction in international exchange is extremely difficult. The Agreement (Article XIX, (i)) defines current transactions for the purposes of the Agreement as payments due in connection with trade or services including banking and credit facilities, interest and dividends, moderate amortization and depreciation, and moderate remittances for family living expenses. This list is, however, not inclusive, and does not preclude the acceptance of other types of transactions as current, and the Fund may, after consultation with the members concerned, adopt appropriate definitions by regulation.

The Fund Agreement does not seek to prevent capital movements which are met out of a member's own resources. If it uses its gold or foreign exchange to make capital investments abroad, there can be no objection on the part of the Fund, provided that the result is not to use the Fund's resources for these purposes. Such capital movements, however, must be in accordance with the purposes of the Fund, by which may be understood, that they do not contribute toward exchange instability. Capital move-

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ments from countries with a net active balance of payments undoubtedly contribute a great deal to the stability of exchange by increasing the demand for the exchange of countries with passive balances and reducing the credit surplus of the creditor countries.

The Fund, moreover, does not propose to prohibit the use of its resources for small capital transactions incidental to the ordinary course of trade, banking, and other business. For wxample, an exporter to dispose of his goods in a foreign country may in practice find it necessary to finance the purchase by the importer. There will be no net drain on the exchange resources in this instance because within a relatively short period repayment will be made and so reverse the movement of exchange. This may apply also to the case of equipment sales where the period of payment would probably be somewhat longer. In the ordinary financing of trade when time bills are received in payment there will be offsetting transactions which might be regarded as capital movement. Similarly, when an insurance company pays claims, the payment might also be regarded as a capital transaction. These payments would be relatively small in comparison to the total of transactions and in any case would be incidental to the normal course of current trade. It is possible that, as a matter of fact, small capital transactions will prove beneficial to the Fund's assets since the currency bought from the Fund may often be one for which there is little demand while the currency paid into the Fund, that is, from the capital-exporting country, may actually be a desirable asset for the Fund to hold.

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In any event, the attempt to control exchanges is costly and inconveneint. It may also be contrary to the preference of the country involved. Furthermore, the control of exchange has so often been used to obtain unfair trade advantages that the Fund will require the imposition of exchange controls to prevent capital transfers only when these capital transfers involve a serious drain on the Fund in the case of a flight of capital or large investments abroad by countries with an unfavorable balance of payments situation. It may be noticed that this Agreement leaves the determination of when a capital outflow is large or sustained to the discretion of the Fund. What would be a large transfer for one country would be insignificant for others and, accordingly, the Fund will have to consider each case on its individual merits.

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Article VI - Capital Transfers

Section 2 - Special Provisions for Capital Transfers

Some member countries will have little occasion to use the resources of the Fund because their balance of payments on current account will generally be favorable as a consequence of foreign demand for their products or services. If these countries export capital by using the Fund's resources for capital transfers, they actually will contribute to the stability of the Fund and exchange rates of the capital-importing countries. When they buy a currency from the Fund with their own currency, the Fund will have among its assets a larger amount of a currency in greater demand and a smaller amount of currency in relatively smaller demand. This would be desirable for the Fund. Therefore the Agreement provides that a country whose currency has been held by the Fund for at least six months in an amount less than 3/4 of its quota, may use the resources of the Fund for any purpose, including capital transfers, unless the country has been declared ineligible for other reasons. The amount of currency bought from the Fund for capital transfers, however, may not be so great as to increase the Fund's holdings of the currency of a country buying exchange to 75 percent of its quota, nor of reducing the Fund's holdings of the currency bought below 75 percent of the quota of the member concerned. In this way countries whose currencies are in relatively great demand may replenish the Fund's stock of their currency without, at the same time, contributing to the scarcity of other currencies.

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Article VI - Capital Transactions

Section 3 - Controls of Capital Transfers

The Fund Agreement authorizes the members to impose such controls of exchange as may be necessary to regulate international capital movements, but the members may not use these controls for purposes which will restrict payment on current transactions or which will put difficulties in the way of later transfers of funds needed to settle current obligations. This clause of the Agreement, however, may not be construed so as to prevent a country from exercising control over the use by its nationals of a currency declared scarce by the Fund. In the case of a scarce currency, the Fund must ration its own supply of the currency, and after the formal declaration required, the members may also impose restrictions on free exchange which have the effect of rationing the scarce currency. Moreover, under Article XIV, Section 2, a country may retain exchange restrictions adopted prior to the war if it makes use of the privileges of the transitional period. Such restrictions may be applied to current international transactions, though the members agree to withdraw such restrictions as soon as it is possible to do so without unduly disturbing their exchanges or restricting their ability to balance their payments without excessive recourse to the Fund.

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Article V - Transactions with the Fund

Section 1 - Agencies Dealing with the Fund

The Fund is an agency for monetary cooperation among the member countries. It is not intended to replace the private exchange market. In its operations the Fund is to transact its business entirely with governmental agencies or central banks, which operate in the public interest even though they may not be owned directly by the government. By limiting the Fund's operations to dealings with the member countries through their Treasuries (or Finance Ministries), central banks, stabilization funds or other fiscal agencies, the Fund is prevented from acting in a country contrary to the wishes of its government. It cannot operate directly in the private exchange market and so possibly, of its own accord, interfere with the monetary policies of the members.

By confining its operations to governmental or quasi-governmental institutions, the Fund may avoid any charge of favoritism to particular private corporations. Its transactions may assume very large proportions and the commissions which private banks or exchange dealers could make would be considerable. It, therefore, seems preferable to deal only with non profit making institutions.

In view of the differences in the organization of the governments and financial markets of the member countries, the Fund must be able to deal with the various agencies charged with the operations with which the Fund is concerned. Since its operations will consist largely of the purchase and sale of gold and currencies, the Fund must be able to deal with the authority holding the gold reserves. This may be the Treasury, as in the U.S., or the stabilization fund, as with the British Exchange Equalization Account, or the central banks, as in most countries. The reserves may be

divided among various agencies so that the Fund may deal with several of them. Moreover, the Fund's holdings of national currencies are to be kept as deposits in the central bank or other fiscal agencies where the country does not have a central bank. The Fund, therefore, will deal with the central bank and the Treasury or Finance Ministry in most cases.

The member countries, in accepting the Agreement, assume certain obligations regarding exchange rates, exchange controls and other regulatory activities which affect the stability of exchange rates. The enforcement of the national regulations is entrusted generally by the member to its central bank or to its Treasury or Finance Ministry. It is desirable, therefore, that the Fund should be in direct contact with the organization which administers these regulations. This is particularly important since under some conditions, sanctions may be imposed to prevent the misuse of the Fund's assets. These sanctions will take the form of limitation or suspension of currency sales to the member, and will be applied to the public agency and not to the private exchange market.

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Article V - Transactions with the Fund

Section 2 - Limitations on the Fund's Operations

The Agreement defines precisely the scope of operations on the part of the Fund. Considering that the assets of the Fund will be approximately $8.8 billion, it is necessary to specify what should be done with this money. If the Fund were not limited, these funds might be used for investment or otherwise contrary to the purpose of the Agreement, which envisages mainly the assurance of stability in exchange rates as a device for encouraging stability and growth of international trade. While the member countries agree to certain limitations upon their exchange policies and activities, they may need the assistance of the Fund to maintain the stability of these exchange rates. The basic operation of the Fund, therefore, will be to supply the members with currencies which are needed to balance their payments without seriously disrupting exchange rates.

The Fund will not, of its own accord, take active steps to stabilise a particular exchange rate, and it will not buy and sell exchange in the markets of the members. It will come to the assistance of a country only when the member applies to it for the purchase of some foreign currency or currencies needed to settle its balance of payments. The traders and bankers of the member countries will carry on their exchange transactions in the ordinary way. Only when they are unable to obtain needed exchange will the central bank or treasury go to the Fund to purchase the foreign currency, by offering gold or its own currency. By supplying the desired currency the Fund will be able to tide the member over periods of exchange stringency which otherwise might induce devaluation in the attempt to secure equilibrium in the balance of payments. By providing a dependable source of exchange for a member requiring it, the Fund will contribute to

the maintenance of the stability of the exchange rates of the other members. The member, however, does not secure this exchange without cost, since the Fund will charge 3/4 of 1 percent of the amount of currency secured, while the member must pay the Fund an additional charge on its holdings of member currencies above the quota.

It should be noted also that the Fund will supply currency only as long as the members adhere to the provisions of the Fund Agreement. If they violate its terms or tend to use the Fund's resources contrary to the purposes of the Fund, the Fund has the right under Section 5 to limit their use of the Fund or even to declare the country ineligible to secure any currencies through the Fund. In more serious cases the member may be compelled to withdraw.

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Article V - Transactions with the Fund

Section 3 - Conditions Governing Use of the Fund's Resources

(a) A member may buy the currency of another member from the Fund provided that four conditions are met.

1. The member may obtain the currency only for purposes which are consistent with the provisions of the Agreement. In practice this means that the currency must generally be used to meet balances on current transactions, which are defined to include payments for goods and services and normal short-term banking operations, payments of interest and dividends, payments of moderate amounts for amortization of loans or depreciation of direct investment and moderate remittances for family living expenses (Article XIX, (i)). In general, under Article VI, Section 1, the member may not use the Fund's resources to meet a large or sustained outflow of capital. Relatively small capital transactions required for the expansion of exports or the ordinary course of trade, banking, or business, may be financed through the Fund. A special exception to the provision against the use of the Fund's resources for capital transactions is provided for the case of countries whose currencies have been in relatively short supply in the Fund, that is, where the Fund's holdings of its currency have been below 75 percent of the quota for a period of six months or more. Such a country may purchase the currencies of other countries with its own currency for any purpose including capital transfers. In short, the purpose of this section is to assure resources for current transactions but where a country's currency has been in relatively great demand its purchase of other country's currency with its own money would not only not weaken the Fund, but would also enable other countries to balance their payments more easily.

2. When a currency is declared scarce under Article VII, Section 3, the request of any one country must, of course, be subject to the Fund's decision in equitably apportioning the scarce currency among its members.

3. The Fund Agreement imposes two quantitative limitations upon the amount of foreign currencies which a member may purchase by offering its own currency. The Fund's holdings of any one currency may not exceed 200 percent of the country's quota. Consequently, the limitation on net purchase of currency by a country is equivalent to the amount of its quota plus the amount of gold subscription. For example, if a country has a quota of $100 million and it has paid $20 million in gold, the Fund would not hold 200 percent of its quota in local currency, that is, the equivalent of $200 million, until the country had purchased $120 million of foreign currencies from the Fund. Since its gold contribution was 20 percent, only the amount of its quota may be secured from the Fund's resources.

The second limitation is on the rate at which the member country may purchase currencies. In any twelve-month period the member may not purchase foreign currencies in an amount which would increase the Fund's holdings of its own currency by more than 25 percent of the quota. While the Fund may make special exceptions, there is a general exception provided for the case of currencies which the Fund has held in an amount less than 75 percent of the quota. These currencies will be those in great demand. Accordingly, the members whose currencies have been in demand are permitted to purchase in a twelve-month period more than 25 percent of their quotas in other currencies provided that the Fund's total holdings do not exceed 100 percent of the quota in that period.

4. A country may not purchase currencies from the Fund in case it has been declared ineligible to use the resources of the Fund. It may become ineligible under several clauses of the Agreement. If it uses resources of the Fund contrary to the purposes of the Fund, the Fund, after presenting a report and giving reasonable time for reply, may (under Article V, Section 5) declare the country ineligible. The same penalty may be applied if the member changes its par value despite the objection of the Fund (Article IV, Section 6) or if it neglects to exercise appropriate control over capital movements when requested to do so by the Fund (Article VI, Section 1). Ineligibility to use the Fund's resources may also result from the member's failure to fulfill any of its obligations under other sections of the Agreement (Article XV, Section 2) including the obligation to remove restrictions on exchange inconsistent with the purposes of the Fund (Article XIV, Section 4).

(b) Ordinarily members will not be permitted to acquire foreign currency from the Fund to hold against forward exchange transactions. The purpose of this clause is to prevent the use of the Fund's resources for speculative purposes, which often contribute to exchange instability. Speculative profits could be made at any time when the anticipated market price of a currency exceeded the Fund's selling price and charges. While private speculation and arbitrage operations are not prohibited by the Fund agreement, the member governments may not use the Fund's resources for these purposes. They also may not use the Fund to cover short sales.

It is recognized that there are proper non-speculative uses of the forward exchange market, for example where a bank or an exporter receives bills payable at a future date. Cases may arise where it is desirable to permit the member to cover such transactions by use of the Fund's resources. This might occur in the case of crop movements or other transactions of large amount which might require anticipation of exchange needs at a future time. The Fund at its discretion may permit the sale of currency to cover such transactions and thus avoid the risk of exchange fluctuations.

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Article V - Transactions with the Fund

Section 4 - Waiver of Conditions

The requirements of Section 3 are intended to apply generally but it must be recognized that there are unforeseen contingencies which might make their strict application undesirable in that instability of exchange might result. The Fund, therefore, is permitted to waive these requirements especially for countries which have not made large or continuous use of the Fund as a means of securing foreign currency. A country may suddenly find itself in serious exchange difficulties as the result, say, of a crop failure, a change in the prices of exported goods, a sudden shift in the world demand for its products and unusual circumstances such as natural disasters. It would be unreasonable for the Fund to refuse to provide currency under such circumstances if it may anticipate that the demand for foreign currencies will be of relatively short duration. Countries dependent upon the export of crops may have unusual seasonal requirements for exchange and the Fund may take such special conditions into consideration.

Furthermore, there may be occasions where a country is willing to pledge collateral to the Fund to secure currency. This collateral may take the form of gold, silver, securities or other assets acceptable to the Fund. The member may be willing to pledge part of its gold reserves or offer marketable securities as collateral if it expects that its need for the currency will be relatively short or when the sale of its gold or securities might have undesirable repercussions on its own monetary system. The Fund may be more willing to sell currency beyond the usual limits if it receives adequate collateral to protect it against loss, than if it received merely the currency offered.

Whenever the Fund waives the ordinary conditions for the sale of currency it has complete discretion to set the terms for the transaction. It must, however, sell on terms which protect the interests of the Fund so that the collateral offered must be adequate, or if the conditions are waived without collateral, the Fund must be reasonably sure that the country applying will be able to repurchase its own currency in due time.

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Article V - Transactions with the Fund

Section 5 - Ineligibility to Use the Fund's Resources

The Fund may apply sanctions to members which violate the Agreement or use the Fund's resources contrary to the agreed purposes. For example, if a country regularly appeals to the Fund to purchase other countries' currencies and these purchases continue over a period of time, it would be an indication that its exchange position is in fundamental disequilibrium. Since the Fund is not intended to provide resources to enable countries to secure an excess of imports over a long period of time, the member is supposed to take measures to correct its disequilibrium by increasing its exports, reducing its imports or perhaps increasing the productivity of its economy by capital improvement. The country's net purchases of exchange may also be the result of an inappropriate fiscal policy.

Whenever the Fund concludes that a member is using the Fund's resources contrary to the purposes of the Agreement, it may present a report to the member explaining its position and making recommendations for a change. When this report is presented the Fund is permitted to limit the amount which that country may secure from the Fund. If the member, after reasonable notice, does not give a satisfactory reply to the Fund or neglects to present any explanation, the Fund may continue the limitation and after additional notice may declare the country ineligible to use the resources. In this way the Fund will be protected against the possibility of some of the members relying continually on the Fund for the correction of their balance of payments rather than taking more fundamental measures for correction.

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Article V - Transactions with the Fund

Section 6 - Purchase of Currency from the Fund for Gold

If a member desires to use its gold to purchase foreign currency it is expected to do so by purchasing it from the Fund provided that it can do so with equal advantage. This section will provide the Fund with a source of renewing its gold reserves and so strengthen the Fund and increase its ability to acquire any desired currency. That is, when a member sells gold to the Fund for the currency of Country A, the Fund may use this gold to secure additional supplies of A's currency or, if desirable, the Fund may use the gold to acquire B's currency, which it may need in larger amount. The principle involved here is roughly analogous to the concentration of gold reserves in the central bank. It will prevent the dispersion of gold reserves beyond the needs of various countries and will enable the Fund to operate more efficiently.

It is not intended by this provision to limit the market for gold or to compel the members to sell their gold to a single buyer. Hence, if the member can sell its gold more advantageously to a member country or its nationals than it can to the Fund, it is permitted to do so. The "equal advantage" will be largely a matter of costs since the Fund will impose a uniform handling charge on transactions in gold. It is possible that gold transactions can take place with private persons or with the central banks or treasuries of other countries at lower cost than with the Fund. This will not be prevented by the Agreement. In some cases there may be other factors entering into the situation such as the convenience of transportation or the ease with which gold can be secured or the speed with which transfers can be made by earmarking or otherwise.

This provision of the Agreement also does not apply to newly-mined gold produced in a member country. This gold is free of any restriction and may be disposed of in any market without restriction by the Fund. Gold mining countries are likely to treat gold as an ordinary export and dispose of their gold through recognized channels. If they were required to sell their gold to the Fund, they might in practice be deprived of the advantages accruing to other countries in buying foreign currencies with their own national currency.

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Article V - Transactions with the Fund

Section 7 - Repurchase by a Member of its Currency Held by the Fund

(a) A member country has an incentive to repurchase its currency from the Fund since it pays a charge on the Fund's holdings of its currency in excess of the quota. It may voluntarily repurchase its currency by selling gold to the Fund, and when gold is offered, the Fund is required to accept it in payment.

(b) This section is intended to prevent the use of the Fund's resources by a member to a greater extent than it is willing to use its own monetary reserves to settle its balance of payments. Member countries are, therefore, required, under specified conditions, annually to repurchase part of their currencies held by the Fund. In making payment under this clause, the member must offer gold and convertible currencies. For the purposes of the Fund, a currency is convertible whenever a member country has accepted the conditions of Article VIII, Sections 2, 3, and 4, and has not availed itself of the privileges of the transitional period under Article XIV, Section 2. In practice this means that a currency will be regarded as convertible if the member imposes no restrictions on payments and transfers for current international transactions, if it does not engage in discriminatory currency practices and if it permits the free conversion of balances acquired as the result of current transactions or which are needed for making payment for current transactions.

When a member's monetary reserves are larger than its quota and have increased in the course of a year more than the Fund's holdings of its currency have decreased, the member is required to repurchase its currency to an amount equal in value to one-half of the net increase in the Fund's

holdings of its currency plus one-half of the net increase in the member's monetary reserves. In making the payment under these circumstances the member must use one-half of the increase in each type of reserve, that is, it must use one-half of its gold acquisition and one-half of the increase in each of the convertible currencies. The balance of the repurchase from the Fund must be paid for by using the reserves in proportion to the amounts held by the country. To illustrate, let it be assumed that the country's quota is $100 million and that the Fund's holdings of its currency have increased $20 million while its own monetary reserves have increased $40 million. The member would, therefore, be required to repurchase half of the increase in the Fund's holdings, that is, $10 million, plus one-half of the increase in its monetary reserves, or $20 million. If the member has increased its reserves by $10 million of gold and $10 million of each of the convertible currencies, A, B, and C, it would pay the Fund $5 million in gold and $5 million of each of the convertible currencies acquired. The remaining payment must be divided between gold and convertible currencies in the proportions in which they are then held by the member. (Cf. Schedule B, p. 42)

It is also possible for a member to make a disproportionate use of the Fund's resources if its monetary reserves have decreased in the course of a year, but by an amount less than the increase in the Fund's holdings of its currency. In that case the member is required to repurchase one-half of the increase in its currency held by the Fund less one-half of the decrease in its own monetary reserves. For example, if a country's quota is $100 million and its monetary reserves have decreased from $150 million to $130 million, while the Fund's holdings have increased $30 million, the amount of currency repurchased must be equal to $15 million minus $10 million.

In this case the member in buying back $5 million of its own currency must use gold and convertible currencies in the proportion in which they are held in its monetary reserves.

It would also be possible for a country to use the Fund's resources to build up balances in the currencies of other members which are not needed for the ordinary purposes of trade but which may be held for future use, for speculation, or for capital investment. That is, country A might insist in its trade with country B, that B pay in C's currency, and A, therefore, accumulates a balance of C's currency. Then if, after the repurchase as described in the preceding paragraph is completed, it appears that the member's holdings of the other member's currency have increased as the result of such transactions it must use the excess of the foreign currency to repurchase its own currency from the Fund.

The requirement of repurchasing currency is subject to three qualifications. If a member's monetary reserves are smaller than its quota, it is not required to repurchase its currency. Secondly, if the Fund's holdings of its currency are less than 75 percent of its quota, it is not required to repurchase. In this case repurchase would further reduce the Fund's holdings of the currency and so make it more difficult for other countries to obtain it. Whenever the Fund's holdings are below 75 percent of the quota, it indicates that this currency is in demand by other countries, and is a desirable asset in the Fund. In making payments to the Fund in the repurchase of currency, the member may not use any currency which the Fund has in excess of 3/4 of the quota, nor may the amount paid to the Fund be such as to increase the Fund's holdings of any currency bey@nd this 3/4 limit. If the country has built up its reserve by acquiring convertible

currencies which the Fund holds in excess of 75 percent of the quota, it must pay a larger proportion in currencies held by the Fund in smaller amount. Similarly if its payment were to increase the Fund's holding beyond this limit, the currency involved may be used only to the limit and the balance of the payment made in proportionally larger amounts of the currencies held by the Fund in amounts under three-fourths of the quota. Finally, if a non-member currency is regarded as convertible by the Fund, a member's holdings of it are included in the amount determining repurchase. But non-member currencies may not be offered to the Fund in repurchase, so that the proportions of convertible member currencies used in payment must be increased.

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Article V - Transactions with the Fund

Section 8 - Charges

The Fund, whenever it sells one member's currency to another, will charge the buyer a service charge of 3/4 of 1 percent. Under the Agreement, the maximum permissible variation of spot exchange rates is 1 percent from parity. Consequently in purchasing a currency from the Fund the member may obtain it at 1/4 of 1 percent less than the possible maximum price on the open market. In addition to this, however, the member must pay a charge to the Fund on the Fund's holdings of its own currency. The Fund is also permitted to increase this service charge to 1 percent or reduce it to not less than 1/2 percent at its discretion.

The charges mentioned above are payable on each purchase of currency and are applied to the amount of foreign currency purchased. In addition, however, each member must pay a charge to the Fund on the average daily balance of its own currency held by the Fund in excess of the quota. These charges are graduated with the amount of excess currency held and also with the period of time for which the currency is held by the Fund. If the purchase of currency is under 25 percent, no charge is made for the Fund's holdings of currency in excess of the quota for the first three months. For the balance of the first year, the rate is 1/2 percent per annum and for each subsequent year that the Fund holds this currency the charge increases by 1/2 percent. On the second 25 percent of currency held by the Fund the charge will be 1 percent for the first year and an additional 1/2 percent for each subsequent year. The charge increases by 1/2 percent for each 25 percent of the quota and for each additional year. The schedule of charges is shown in the table.

Charges Levied by the Fund on Holdings of Member Currencies in Excess of Quotas

Currency holdings in excess of quotas	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year	7th Year	8th Year	9th Year	10th Year
0 - 25 percent	1/2[a]	1	1-1/2	2	2-1/2	3	3-1/3	4	4-1/4	5
25 - 50%	1	1-1/2	2	2-1/2	3	3-1/2	4	4-1/4	5	-
50 - 75%	1-1/2	2	2-1/2	3	3-1/2	4	4-1/2	5	-	-
75 - 100%	2	2-1/2	3	3-1/2	4	4-1/2	5	-	-	-
100- 125%[b]	2-1/2	3	3-1/2	4	4-1/2	5	-	-	-	-

a/ For holdings less than 25 percent in excess of the quota there is no charge for the first three months.

b/ Holdings may exceed 200 percent of the quota only by special waiver by the Fund. When the requirement is waived the schedule of charges increases by 1/2 percent in each bracket.

There is a limit, however, to the amount of a given country's currency which the Fund can hold and it is desirable to have adjustments made as quickly as possible so as to reduce the Fund's excess holdings. A period of 3 to 4 years should normally be adequate to retire the Fund's holdings since in that period of time the member may make the needed adjustments in its balance of payments position. The Agreement, therefore, provides that whenever the rate on a portion of the currency reaches 4 percent, say, that a 25 percent purchase is held by the Fund for 7 years, or a 75 percent holding is on the books for 5 years, the Fund is to make an arrangement with the country concerned to reduce its holdings of the currency. While the charges on any bracket are permitted to rise to 5 percent, if the country does not reach an agreement with the Fund at that time, the Fund may increase the charge at its discretion.

The schedule of charges may be changed only by a 3/4 majority of the voting power.

Moreover, the payment of these charges to the Fund must be in gold unless the member's monetary reserves are less than 1/2 of its quota. In that event, it pays in gold a proportion equal to the ratio of its monetary reserves to 1/2 of its quota, and the balance may be paid in its own currency. This provision is intended to avoid taking a large percentage of the gold holdings of any country if its gold holdings are too small to be adequate in view of its trade and its monetary requirements.

These provisions for charges for the currency held by the Fund are intended primarily as a means of discouraging too great reliance on the Fund's resources for foreign exchange rather than for the member to adopt policies which will secure equilibrium in its balance of payments. Incidentally, the charges will provide revenue for the Fund to pay its cost of operation and possibly to yield a small return to those countries whose currencies are in use by the Fund and by other member countries. It should be noticed that the countries whose currencies are in demand will have a cost in providing them. Their shares of the quota must be paid in currency payable on demand and in most instances this will mean raising the funds by borrowing in the market. If they receive no return on their contribution their situation would not be equitable in comparison to other countries whose currencies are held in excessive amounts by the Fund and which are permitted to pay their shares in a non-interest-bearing demand note.

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MINIMUM CHARGES PAYABLE BY A COUNTRY ON FUND'S HOLDINGS OF ITS CURRENCY IN EXCESS OF ITS QUOTA

If after the Fund's holdings of a member's currency have reached the member's quota, the member draws in each year its permitted maximum (25%) on the first day of each of four years, the Fund's holdings rising to 200% of the member's quota, the charges payable on the whole excess are uniform in each year, as follows:

I. Summary

1st year - 3/8%
2nd year - 1 1/8%
3rd year - 1 5/8%
4th year - 2 1/8%
5th year - 2 5/8%

II. Breakdown by Years

Excess over Quota	Minimum Percentage Charge per Annum
First year	
1st 25%	3/8
Second year	
1st 25%	1 1/8
2nd 25%	1 1/8
Third year	
1st 25%	1 5/8
2nd 25%	1 5/8
3rd 25%	1 5/8
Fourth year	
1st 25%	2 1/8
2nd 25%	2 1/8
3rd 25%	2 1/8
4th 25%	2 1/8
Fifth year	
1st 25%	2 5/8
2nd 25%	2 5/8
3rd 25%	2 5/8
4th 25%	2 5/8

A good deal of agreement has been achieved.

Articles

1. Purposes and policies
2. Subscription to the Fund
   (except for quotas)
3. Transactions with the Fund
   substantially agreed except certain technical points on gold transactions
4. Par values, initial agreed
5. Capital transactions agreed
6. Scarce currencies (not yet considered)
7. Management of the Fund
   substantially agreed. Some aspects of voting still to be decided
8. Withdrawal and settlement
   Not yet considered
9. Undertakings of member countries
   Certain technical points in connection with gold transactions
10. Transitional
    Not yet considered
11. Amendments
    Agreed
12. Interpretation
    Agreed, except certain technical definitions.
13. Not yet considered
14. Not yet considered

Substitutes for Alternatives A and B - Article III, Section 12, Page 15

The Fund shall have at all times the right to communicate its views informally to any member on any matter arising under this Agreement. The Fund may, by a two-thirds majority, publish a report to that member with regard to its monetary or economic conditions and developments which directly tend to produce a serious disequilibrium in the international balance of payments of members. If the member has not among the Executive Directors a Director appointed by it, the provisions of Article VII, Sec. _____ apply. The Fund shall not publish a report which would involve changes in the fundamental structure of the economic organization of members.