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Minutes of Executive Board Meeting 84/61

10:00 a.m., April 19, 1984

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	G. E. L. Nguyen, Temporary
A. Donoso	
	D. C. Templeman, Temporary
	M. Z. M. Qureshi, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	
R. K. Joyce	
A. Kafka	
	G. Grosche
G. Lovato	
	C. J. Batliwalla, Temporary
	J. E. Suraisry
	A. A. Scholten, Temporary
A. R. G. Prowse	
G. Salehkhou	
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	
	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

African Department: J. B. Zulu, Director. Asian Department: D. C. L. Nellor. European Department: G. A. Mackenzie. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; G. Begashaw, J. O. Bonvicini, M. Guitian, T. Hatayama, K. M. Huh, A. K. Mitchell, P. J. Quirk, N. E. Weerasinghe, E. J. Zervoudakis. Legal Department: J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; P. Wickham. Bureau of Statistics: S. H. Hahn. Advisors to Executive Directors: A. A. Agah, H. A. Arias, S. El-Khouri, S. M. Hassan, Y. Okubo, I. R. Panday, D. I. S. Shaw. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, I. Angeloni, R. L. Bernardo, M. B. Chatah, Chen J., I. Fridriksson, D. Hammann, H. Kobayashi, E. Landis, G. W. K. Pickering, E. Portas, J. Reddy, D. J. Robinson, Shao Z., S. Sornyanyontr.

1. EXPERIENCE WITH MULTIPLE EXCHANGE RATE REGIMES - REVIEW

The Executive Directors continued from the previous meeting (EBM/84/60, 4/18/84) their consideration of the staff paper reviewing experience with multiple exchange rate regimes (SM/84/64, 3/19/84; and Cor. 1, 3/28/84). They also had before them a paper providing background information on the same subject (SM/84/65, 3/20/84; Cor. 1, 3/22/84; and Cor. 2, 4/4/84).

Mr. Feito said that the subject under consideration was a sensitive area of Fund policy and advice. Assessments of and policy recommendations on multiple exchange rates were delicate because of their political and social implications. It was also an area where economic analysis alone had not provided straightforward or unqualified policy prescriptions, and where empirical analysis had failed to reconcile conclusively competing hypotheses.

He agreed with the staff that economic reasoning did not justify the persistent maintenance of multiple exchange rate systems, Mr. Feito confirmed. There was little doubt that the use of multiple exchange rates as a permanent crutch was discredited by both economic analysis and broad historical experience, and perhaps because of that, there was an inclination to deplore the resort to multiple exchange rates without due regard to either the circumstances in which they were implemented or to their duration. There seemed to be a tendency to deprecate multiple exchange rate practices and to treat them as a forbidden instrument of economic policy. Those attitudes might be appropriate insofar as they were confined to the permanent use of multiple exchange rate devices.

That having been said, there were arguments in favor of the temporary use of multiple exchange rate practices in certain circumstances, based on a balanced judgment, Mr. Feito noted. The staff had admitted somewhat reluctantly that important social and political, but not economic, considerations might argue for the transitional use of multiple rate systems. But the staff went on to state that there was a tendency for such systems to become long-lasting features of the economy, implying that proposals to implement or maintain those systems should be regarded with suspicion irrespective of the soundness of the arguments in their favor. In any event, the staff stated that the budget--not the exchange system--should be the tool to achieve the objectives sought through multiple rates. Those assertions called for a number of qualifications.

First, Mr. Feito continued, if the proposition that multiple exchange rate devices tended to become long-lasting features of the economy was correct, he could agree with Mr. Kafka's comments at the previous meeting that it would certainly be easier to condemn multiple exchange rates, regardless of the arguments adduced for their maintenance or implementation. However, the existence of such a tendency could not be supported by the evidence put forward in the staff papers. Section III of SM/84/65 stated that for the 93 countries that had used multiple currency practices over the past 13 years, the average duration was 5 years, which did not validate the view that multiple exchange rates tended to become a long-lasting feature of the economy, but rather bore out their temporary nature. In addition, the number of members--37--that had ceased maintaining multiple practices altogether during the period had been almost three times greater than the number of members--13--that had maintained such practices continuously since 1970. Of the 37 members that had ceased maintaining multiple exchange rates, only 5 had reverted to them at a later date, indicating the exceptional character and temporary nature that most members attributed to multiple exchange rate practices.

The average 5-year life of multiple exchange rates was associated with a relatively even distribution of the duration periods, but there were 20 members that had used them for only 2-3 years, Mr. Feito observed. The fact that some members had maintained such practices continuously since 1970 could not be adduced against their temporary nature without considering the circumstances of each member and whether or not those practices had been simplified over those years. In sum, it did not seem correct to infer from the evidence put forward by the staff that "there is a tendency for such systems to become long-lasting features in the economy," especially considering the special circumstances of the world economy during the reference period--which, for the developing countries, closely resembled the postwar period for the industrial countries in Europe. It should be recalled that it had taken considerably more than 10 years for those countries to eliminate multiple exchange rate practices.

The cavalier treatment of data by the staff to discern trends in the duration of multiple exchange rate practices cast doubts on the staff's use of empirical evidence to highlight other issues surrounding multiple exchange rates, Mr. Feito remarked. Incidentally, there were differences between the figures on page 9 of SM/84/64 and the data reported on page 5 and in Table 2 of SM/84/65. More generally, he cautioned against the unqualified use of data by the staff to support any a priori concept. He agreed with Mr. Prowse's comment at the previous meeting that whether or not one agreed with the staff would have to be based on faith, rather than on empirical evidence. He also shared Mr. Kafka's skepticism regarding the staff's presentation of other characteristics of multiple exchange rates.

Second, Mr. Feito went on, with regard to the reasons for which multiple exchange rate systems might be advocated, the staff had cited a number of cases that warranted the use of multiple rates as a second-best policy when the optimum policy, which would involve direct exchange rate action, was not feasible. However, a multiple exchange system might be considered the best policy to defend an exchange rate regime as distinct from a specific exchange rate value, for example, when a group of countries had pegged their currencies to, say, the dollar. In Central American countries whose economies were closely intertwined with the U.S. economy, the fixed exchange rate relationship had proved to be not only an effective price-setting mechanism but also an essential factor in the achievement of the highest rates of real income growth among Latin American countries. However, in the presence of unprecedented falls in the terms of trade and growing external imbalances, those countries were faced with the choice of changing the nominal parity of their currencies, undergoing a deflationary process, or a combination of both in order to have a real exchange rate that was consistent with the lowered terms of trade.

Leaving aside the fact that neither deflation nor nominal variations of the exchange rate would restore external balance in the face of capital flows that were less responsive to economic factors than in the past, Mr. Feito said, in such circumstances a country was faced with the dilemma of having either to deflate the economy excessively or to abandon an exchange rate regime that had provided the framework for economic policy over many decades and had proved to be extremely successful in most respects. It could be argued that a once-for-all devaluation was not tantamount to a change in the exchange rate regime. However, the expectation and the reaction of economic agents to a change in the exchange rate might be unpredictable; and there was no economic rationale for expecting the new situation to be any better or more stable.

Some countries had therefore opted to use separate exchange markets, Mr. Feito continued, channeling some uses of foreign exchange through a parallel market operating at a floating rate. If a fixed exchange rate regime was optimal for those countries, and if there were indications that their current economic difficulties were temporary--for instance, as a result of current world interest rate levels and an unsustainable exchange rate for the dollar--then the first-best argument would be for a multiple exchange rate practice. Of course, that practice would be viable only if any disparities in costs and purchasing power between those countries and the rest of the world were corrected and if the other assumptions he had mentioned were met. It was noteworthy that excessive attention to the correction of short-term problems might lead to the elimination of those parts of the institutional framework that had been instrumental in fostering a long-run path of stability and growth. Adequately managed multiple exchange rates might be a better remedy in those cases than direct exchange rate action.

There remained the question of whether the budget, rather than the exchange rate system, might not be a more appropriate instrument when a case for multiple exchange rates could be made, Mr. Feito said. A distinction must be drawn between multiple exchange practices that were intended to affect some long-term features of the economy--its sectoral composition or the distribution of income among the factors of production--and multiple exchange rates that were a temporary instrument of short-run macroeconomic management. The long-term objectives would be better sought through the budgetary process and would not warrant the introduction of multiple exchange rates, provided that those objectives were intended to have a permanent effect on the country's economic system, Mr. Feito stated.

However, as indicated by the staff, most multiple exchange rate systems did not fall in that long-term category but were implemented to cope mainly with temporary disturbances affecting the external balance, Mr. Feito continued. In those circumstances, it was not clear that the budget was a better instrument than the exchange system. Admittedly, the distributive consequences of multiple currency practices could be measured more easily through the budgetary process. There was the risk, however, that a scheme of taxes and subsidies would be difficult to abolish once the temporary forces that had led to its introduction had subsided. Moreover, subsidies tended to be overstated while taxes tended to be understated, thereby leading to graver and costlier distortions than those associated with multiple exchange rates. In such circumstances, the exchange rate system would be a better expedient for dealing with temporary objectives than the budgetary process.

Referring to the staff's treatment of multiple rate practices that were introduced to mitigate the adverse impact on wealth of the increased local currency cost of servicing external debt, Mr. Feito observed that additional analysis and empirical evidence were needed. He wondered what had been the basis for the staff's assertion that the case for such subsidization of the impact of a devaluation on debt service payments was often overstated. The issue was delicate and deserved more attention; he encouraged the staff to analyze fully the issues, both legal and economic, involved in preferential exchange rates for foreign debt servicing.

There was a need for continued flexibility, Mr. Feito remarked, and the fears and warnings of the staff throughout the paper might be overstated. It was easily ignored that the alternative to multiple exchange rates, when the need arose, was not direct exchange rate action but quantitative restrictions. The second-best rationale for multiple exchange rates was that they entailed lower costs in terms of the efficient allocation of resources, and that they were much less likely to lead to corruption and retaliatory measures than quantitative restrictions. A proliferation of quantitative controls, and not more market-related exchange rates, would be the end result of a lack of flexibility in judging the advisability of multiple exchange rate practices during the current turbulent period for the world economy. In sum, the points presented in the concluding section of SM/84/64 would have to be reformulated if they were to represent the consensus of the Board on the advantages and limitations of multiple exchange rates and to reflect a more flexible approach to the subject. In particular, he joined Mr. Kafka in urging that the second paragraph on page 26 be modified, because temporary approval of multiple exchange rate practices was not tantamount to their elimination after a very short period of time.

It was not auspicious at present for the Board to re-examine the question of appropriate action to be taken by the Fund under Article VIII with respect to multiple exchange rates applicable to capital transactions, Mr. Feito concluded.

Mr. Mtei observed that many compelling reasons had necessitated the adoption of multiple exchange rate regimes, and that some of them had been cited by the staff. The basic goal, however, had been to ameliorate the strains on the economy that had emerged as a result of a weak balance of payments position or of certain policy actions implemented as part of the adjustment process. For instance, the redistribution of income resulting from a large devaluation, which was common to many adjustment programs, had social and political ramifications that policymakers found difficult to ignore. The use of multiple exchange rate regimes had been one of the practical means through which some policymakers had tried to balance the imperative of sound adjustment policies against the imperative of keeping the social and political fabric of a nation from falling apart. In recognition of such dilemmas, Fund policies on multiple exchange rates and the implementation of surveillance in recent years had been marked by flexibility with respect to both the range of the rates and the period for which they were to be maintained. The staff paper seemed to be an effort to reverse that flexibility, an approach that he found difficult to justify, given the seriousness of the external payments difficulties currently facing many member countries. Such action could only give ammunition to the growing number of critics who said that Fund policies were becoming unduly restrictive: policies that were not giving sufficient weight to the practical constraints of the world in which policymakers had to live, and in which second-best solutions, with all their theoretical imperfections, sometimes made the most sense.

He had no quarrel with the basic principle set out in the staff paper that the maintenance of multiple exchange rate systems entailed costs in terms of efficient resource allocation, Mr. Mtei remarked. However, one also had to bear in mind that a country might be faced with even more difficult problems in the absence of the room for maneuver that the implementation of a multiple exchange rate regime afforded. Therefore, the choice of criteria to be used in determining the severity of the costs of a particular exchange rate regime was not absolute but relative to the feasibility of other alternatives. Even when only economic factors were considered, as in the case of the general comparison in Section III of SM/84/65 of the evolution of selected economic indicators in countries with and without multiple exchange rate regimes, it was difficult to postulate any causal effect. That result alone should caution the Board against making hard and fast rules that applied to all countries at all times. If there was no substantial evidence that the flexible approach of the Fund had been inimical to the smooth functioning of the international monetary system, there was no reason why it should not be continued.

The staff had expressed concern about the lengthy application of multiple currency practices by some member countries, Mr. Mtei noted. While multiple exchange rate regimes should not be accepted as a permanent aspect of members' exchange arrangements, the decision of the Fund to grant or extend its approval of them should take into consideration the nature of the country's balance of payments disequilibria, the external economic and financial environment, and the feasibility of alternative measures. The increased resort to multiple exchange rates by developing countries in recent years might be seen as a reaction to the unfavorable external circumstances facing those countries. It was to be hoped that as the world economic recovery proceeded, many of those countries would move away from such practices.

The implications of multiple exchange rate regimes for world trade and resource allocation should not be overemphasized, Mr. Mtei stated. Instead, attention should be directed to the more immediate problems of exchange rate volatility, protectionism, and high interest rates that currently dominated the international economic and financial scene. Those problems imposed more serious costs on the world economy than multiple exchange rates operated by some developing countries. He noted with concern the staff's recommendation that removal of multiple rate practices should be a standard criterion in programs supported by the use of Fund resources. Such a move, if accepted, would only increase the asymmetry in the Fund's surveillance over members' exchange rate policies and compound the inequities of the system that had been borne by deficit countries using Fund resources, which were largely developing countries. It was unfortunate that the tendency to tighten conditionality continued to arise in different forms. It was more disturbing that there appeared to be no justification for such a rigid formulation of the implementation of Fund policies on multiple exchange rates. The flexible and pragmatic policies adopted by the Fund in 1981 had worked satisfactorily and there was no convincing reason to take a rigid position without considering the prevailing circumstances. The present case-by-case approach should be continued.

Finally, Mr. Mtei said that he did not support an interpretation of the Articles or a proposition that would result in the Fund being overly involved in regulating members' efforts to control capital flows, even if the members chose to use a dual exchange rate system to regulate such flows.

Mr. Tvedt remarked that the staff papers provided a good review of multiple currency practices and explained clearly the arguments for and against such practices. Undoubtedly, the continued high incidence of multiple currency practices in recent years could, to a large extent, be attributed to the protracted world recession. Consequently, as the world economy recovered, he hoped that the incidence of multiple currency practices would decline.

His chair shared the staff's views on multiple currency practices, Mr. Tvedt continued; they were an undesirable economic policy tool and often proved to be most burdensome for the country itself. He therefore strongly supported the efforts of the Fund to reduce members' reliance on such arrangements. Still, he recognized that in certain circumstances political reasons might make it difficult to eliminate multiple currency practices. The Fund had demonstrated commendable flexibility in that area, but the advantages of a unified exchange rate system were so overriding that every effort should be made to eliminate multiple exchange rate practices where they existed, perhaps through greater use of firm timetables for their gradual but speedy elimination.

The issue of multiple exchange rates and capital flows was once again addressed in the staff papers, Mr. Tvedt noted, and the suggestion had been made that the Fund's jurisdiction with regard to multiple currency practices should be applied to capital transactions. That issue needed to be assessed carefully and perhaps separately. He continued to have some reservations on the matter, but would be willing to consider it again, based on a separate staff paper. With regard to multiple exchange rate practices for non-balance of payments reasons, the Board's view in 1981 had been to urge members to avoid such practices; he continued to subscribe to that view.

Mr. Qureshi commented that the principle of flexibility in the implementation of Fund policy on multiple exchange rates and other multiple currency practices, as contained in the guidelines established in 1981, continued to be appropriate and had been correctly reaffirmed in the staff paper. However, in noting that the incidence of such practices had increased since 1981, the staff seemed to imply that the application of flexibility might need to be tightened somewhat. In his opinion, any general tightening of policy implementation in that area would not be appropriate; individual cases should continue to be assessed in an undogmatic fashion on the basis of their relative merits.

A flexible implementation of Fund policy on multiple currency practices had permitted appreciable progress to be made over time in reducing members' resort to such practices, Mr. Qureshi continued. The increased incidence of those practices in recent years should be seen against the background of the special circumstances experienced by developing countries over a period that had been marked by severe external financial difficulties and a highly unfavorable external environment. In any event, the increase had been marginal and did not show a rising trend. In addition, a simple intertemporal comparison of the proportion of members adopting multiple currency practices, as shown in Table 1 of SM/84/64, was subject to several weaknesses arising from differences in the scope and characteristics of such practices, and was therefore susceptible to more than one interpretation.

The need for a flexible and pragmatic approach to multiple currency practices, including multiple exchange rates, arose from various considerations, Mr. Qureshi remarked. Basically, such practices were adopted for, and prompted by, a variety of reasons, and could differ greatly in their domestic and external impact. In some cases, the adoption of multiple rates reflected a need for a more gradual pace of adjustment or an accommodation of certain social or political considerations, such as the distribution of income. In other cases, however, a more positive argument could be made for multiple exchange rates, even from the narrower criterion of efficiency of resource allocation; multiple rates were sometimes resorted to as a price-related alternative to direct quantitative restrictions, or as a means of allowing market forces to play a greater role.

In yet other cases, Mr. Qureshi continued, a multiple rate arrangement could contribute to improved allocative efficiency by offsetting implicit or effective multiple exchange rates that might already exist in an economy--most likely to the disadvantage of exports--arising from the differential impact on the various sectors of commercial policy, the tax system, and other structural imperfections. In such circumstances, the removal of the explicit multiple rate arrangement without a corresponding reform of the features in the system that produced implicit multiple exchange rates might not necessarily be desirable. Accordingly, where the adoption of multiple rates was induced by such underlying imperfections of a structural nature, there would be an argument for approving the practice for periods that were long enough to permit necessary adjustments to be made to tackle those imperfections. Approval for longer periods could also be considered in situations where multiple currency practices were designed for non-balance of payments purposes, such as raising public revenues, and where their effects were largely domestic and did not impede balance of payments adjustment. Since recourse to those practices in such cases was generally made because alternative policy options were perceived to be limited, technical assistance from the Fund in the identification and development of alternative policy tools would be useful.

The need for flexibility in the implementation of Fund policy on multiple currency practices also derived from the consideration that the case for such practices could differ greatly for different types of economies, Mr. Qureshi observed. Thus, special considerations were involved in dealing with multiple rates in centrally planned economies. An argument for multiple rates could also be presented for countries with dualistic economic structures, for example, economies with a dominant natural resource export sector but also significant productive activity or potential in manufacturing. Of course, the same effect could be achieved through a system of taxes and subsidies, but those alternatives might not be available, or be considered feasible, in some cases for a period of time.

With regard to the length of time over which the elimination of multiple currency practices could be sought, Mr. Qureshi said that the staff had made a case for explicit plans for their elimination over a relatively short period. Admittedly, the approval of such practices was granted only on a temporary basis. However, temporariness could be consistent with different time spans, depending on the nature of the case. The period allowed for the elimination of those practices should, inter alia, be related to the time it took to address the conditions that led to their adoption and on the basis of which approval had been granted in the first instance, rather than be based on some a priori notion as to the permissible absolute length of the period. Therefore, it would be neither possible nor desirable to specify at the outset in all cases of multiple currency practices a clear timetable for their elimination; the matter should be approached pragmatically, on a case-by-case basis.

An estimate had been provided in the paper of the average duration of multiple currency practices during 1970-83, Mr. Qureshi commented. It would also be useful to know how that statistic had behaved over time, and whether the global average hid significant differences in the average duration of multiple currency practices of major and minor scope.

Mr. Salehkhou said that he agreed with the report's main conclusion that the present guidelines and practices, which had generally been implemented with the required flexibility, remained appropriate and should be continued. In many instances, recourse to multiple exchange rate regimes had been instrumental in the implementation of a strong adjustment effort and far-reaching policies. To a large extent, the regimes had helped cushion the severe effect that a substantial exchange rate adjustment might have on economies where the exchange rate was rarely used as an active instrument of economic policy and where so many structural distortions were built into the system that only a cautious and gradual approach could bring about progress. For example, in Ghana the use of a dual exchange rate regime, together with a complex scheme of bonuses and surcharges, had enabled the Ghanaian authorities to desensitize the depreciation issue and had provided them with a valuable respite before the adjustment and unification of the exchange rates had actually taken place.

In recent years there seemed to have been a growing trend in developing countries to introduce multiple exchange rate practices in conjunction with increasing balance of payments and international reserves difficulties, Mr. Salehkhou commented. Although such a trend did not constitute a surge in the number of countries resorting to multiple regimes, it reflected many developing countries' uneasy approach to exchange rate adjustment and its role in stabilization programs. The beneficial impact of large devaluations on exports was not usually evident and seemed to be a medium-term or long-term process, while the effects on inflation, standards of living, and various sectors of the economy were immediate. Thus it was only natural for the countries concerned to try to ease some of those effects through, inter alia, recourse to multiple exchange rate regimes. However, such practices should not be allowed to delay excessively actual adjustments.

In discussing the outcome of multiple rate systems, Mr. Salehkhou continued, the staff appropriately referred to the tendency of those systems to become a long-lasting aspect of members' exchange arrangements and to introduce even more distortions into the economy through the misallocation of resources, and to the high economic costs involved. However, the effect of multiple rates could only be appraised in the light of the appropriateness of the reasons for resorting to them and, in particular, of their role in smoothing the impact of overall adjustment policies. As in the case of subsidies, the Fund should allow some exceptions to doctrine, particularly when there was no clear-cut argument to the contrary, and when the subsidies were aimed at reducing the social costs of adjustment policies and strengthening public support for their continuation.

With regard to the implementation of Fund policies, and in particular of Fund-supported adjustment programs, the provision for a timetable for adjustment and the unification of exchange rate systems remained appropriate, Mr. Salehkhou observed. However, to help achieve such adjustment, those programs should allow for an improvement in the external account as well as for a sufficient buildup in members' international reserves to sustain the exchange rate reform and its initial pressures on the capital account.

On other aspects of Fund surveillance, there was clearly a need for more uniformity of treatment and evenhandedness in dealing with multiple exchange rate regimes in member countries, regardless of their status as users or nonusers of the Fund's resources, Mr. Salehkhou remarked. He shared Mr. Kafka's comments at the previous Board meeting about the asymmetry of such treatment and the helplessness of users of Fund resources.

The Fund should continue to be very flexible in its approach to multiple regimes maintained for other than balance of payments reasons, Mr. Salehkhou concluded, in particular when the possible effects on external adjustment were minor and when the regimes were not discriminatory and did not harm the interests of other members.

Mr. Zhang commented that the staff paper correctly stated that the long-run costs of multiple exchange rate regimes in terms of resource allocation were difficult to evaluate, especially because of their pervasiveness in all types of economic decisions. With respect to the short-term effects, the paper stated that it was by no means obvious that the external payments position had in fact been balanced at a lower domestic price level or inflation rate than would have been obtained by a once-for-all exchange rate adjustment or by a depreciation under a unified floating rate. Those statements implied that evidence of the effects of multiple exchange rate regimes was not conclusive.

Although the review cautiously stated that it did not attempt to establish a particular cause/effect relationship between the evolution of basic economic indicators and the existence of multiple exchange rates, Mr. Zhang said, it nevertheless concluded that the evidence did not suggest that the performance of members with multiple exchange rates was strong in general nor that it fared well relative to other countries' performance. That conclusion disregarded entirely the impact of general economic conditions on various countries that were quite independent of the effect of the exchange rate system. It was clear that the countries that had resorted to multiple exchange rates had faced particularly adverse conditions. Moreover, such comparisons did not provide answers to the question of whether the economic, social, and political consequences of government policies might not have been worse in the absence of multiple exchange rates, either direct or through taxes and subsidies.

In developing countries, multiple exchange rate regimes were introduced to alleviate difficulties arising, to a large extent, from structural imbalances and rigidities, as well as from the impact of fluctuations in the world economy, Mr. Zhang commented. Any attempt to reduce their scope or to effect their complete elimination had to take into consideration the changes in the underlying causes of their initial introduction, as well as the social and political implications of their removal. That was in line with the flexible and pragmatic approach adopted by the Fund with respect to the speed of the elimination of multiple exchange rate regimes.

In centrally planned economies, Mr. Zhang continued, multiple coefficients for the conversion of foreign into domestic prices had an institutional character. They were employed as one of the means to direct foreign trade in conformity with the objectives of the central plan. With regard to references in the staff paper to China, he pointed out that the internal settlement price system had been introduced to simplify the administration of foreign trade within the planned economy and to make it more efficient. The present temporary system had had no harmful effects on other countries and was compatible with the purposes of the Fund.

Some of the statements in Section V of SM/84/64--Summary and Conclusions--could not be accepted without qualification, Mr. Zhang stated. The statement on page 25 that "experience shows that multiple rate systems are costly in terms of efficiency in resource allocation...they are burdensome to administer, and they have not proven conducive to medium-term balance of payments adjustment" was much stronger and more definite than warranted by the information contained in the preceding sections. Depending upon the individual country's experience, that statement might not be true. The Fund should undertake a concrete analysis of a concrete situation. The statement in the fifth paragraph on that page also called for certain reservations. It acknowledged that the strength of important social and political considerations at particular times advocated maintaining a certain relationship between the prices of imported and exported goods or sought particular income distribution effects to be attained by means of the multiple exchange rates. But it also suggested that those objectives were better sought through a budgetary process so that the cost could be weighed openly rather than through an opaque subsidy/tax scheme typical of multiple currency practices.

If such a budgetary process entailed a global tax policy, then it was not capable of dealing with the existing sectoral disequilibria, Mr. Zhang commented. Furthermore, in many developing countries the deficiencies of the global tax system were so great that they had often forced the government to rely upon customs duties, indirect taxation, or multiple rates. It was therefore doubtful whether the elimination of multiple exchange rate systems or subsidy/tax schemes could achieve the objective without fundamental structural changes and the establishment of a more adequate fiscal system--a time-consuming process that could only be achieved gradually under conditions of an improving economic situation in a country.

In general terms, the present policy, which was formulated in the 1981 reviews of multiple currency practices and of surveillance, continued to be valid, Mr. Zhang said. Temporary approval for such practices should continue to be granted, but the approval should not be used to obtain a country's agreement to an early or definite timetable for the elimination of multiple exchange rate regimes. Experience showed that there were cases when a country's multiple exchange rate system had to be maintained for extended periods.

It was not clear which practices were in a strict sense outside the Fund's jurisdiction but had economic consequences similar to those subject to its jurisdiction, Mr. Zhang commented. With regard to multiple exchange rates applied to capital transactions, the present practice of not including such cases in the surveillance exercise should be maintained.

Mr. Suraisry said that he welcomed the opportunity to review the recent experience with multiple exchange rate regimes. The Fund had played an important role in reducing and in some cases eliminating multiple exchange rate practices in the past. That role was fully in line with the Articles of Agreement and consistent with the Fund's purposes. The Fund's surveillance over multiple exchange rate practices should therefore be continued, particularly at the present time when the Fund was encouraging members to remove all the impediments to sustained and balanced growth in the world economy. It was disappointing, although perhaps understandable in the light of the world economic difficulties of the past few years, that there had been an increase in multiple exchange rate practices since 1980. As the staff had pointed out, they often led to distortions and inefficiencies and were often ineffective in promoting adjustment. It was therefore important for members to avoid reliance on multiple exchange rates as much as possible. Unfortunately, however, multiple exchange rates might be unavoidable in some cases. They could be a temporary bridge to a more lasting solution if they were accompanied by comprehensive adjustment measures. It was therefore appropriate for the Fund to approve multiple exchange rates in certain cases, provided they were temporary and set the stage for early adjustment in the future.

Against that background, Mr. Suraisry continued, the Fund should maintain its present policy of discouraging members from resorting to multiple exchange rate practices. Through Article IV consultations, members should be urged to phase out and eliminate such practices whenever possible. The Fund should help members to draw up a specific timetable for removing multiple exchange rates, both in the context of the approval procedures under Article VIII and in programs involving the use of Fund resources. At the same time, the Fund should retain its flexibility, which was essential since members' circumstances varied considerably. It might not always be possible for members to move as quickly as the Fund would wish, but it was important that they move steadily in the right direction.

The present policy with regard to multiple currency practices maintained for reasons other than balance of payments remained appropriate, Mr. Suraisry stated. Regarding the practices that lay outside the Fund's jurisdiction, he sympathized with the staff's recommendation. However, he agreed with Mr. Kakfa that to extend the Fund's jurisdiction into such a sensitive area could create unnecessary friction between the Fund and some of its members.

Finally, on the Fund's jurisdiction over multiple exchange rates that applied to capital transactions, Mr. Suraisry considered that it was a complex issue that should be studied further. It would be useful to know more about the legal background and about the effects of those practices on the adjustment process in the countries concerned as well as in other countries.

Mr. Donoso commented that the policies with respect to the treatment of multiple exchange rates should not be changed. The Fund should maintain its reluctance to approve schemes involving multiple rates as a permanent feature of economic policies in member countries, but it should also be flexible in accepting multiple rates on a temporary basis if doing so would facilitate the application of fundamental policy corrections in the context of a program.

It had been stated that exchange rate policies intended to be of a transitory nature had proved difficult to modify during the years since the review of the policies on multiple exchange rates in 1981, Mr. Donoso stated. He did not share the view stated in the paper that, without concrete plans for the elimination of multiple exchange rates formulated as performance criteria, or without specific dates for their simplification and removal in the programs, multiple rates would become permanent. First, the evidence was not conclusive, and second, since 1981 the economic situation of developing countries had worsened. Multiple exchange rates did not tend automatically to become difficult to eliminate; rather, the worsening economic situation had, in many cases during the past year, made their removal inappropriate at the originally scheduled date.

The unification of multiple exchange rates could be achieved more easily than the elimination of a specific subsidy or tax, Mr. Donoso observed. Excessive pressure to unify exchange rates, when the need to preserve real incomes or the solvency of companies was urgent, might result in permanent subsidies with a higher cost for the country.

He agreed with the staff's analysis of the costs of multiple exchange rates, Mr. Donoso said. But the costs of speeding up the unification of rates could be even higher if it was made possible by the introduction of subsidies and taxes that might appear justified in a difficult economic situation but that would be much more difficult to remove in the future. He could not conclude that present policies were not working properly, based on the evidence presented, especially the evidence of the past three years. As long as extraordinary difficulties remained, it would be necessary to judge in each case whether the alternatives to multiple exchange rates were preferable or even more costly. The authorities of the member countries, as well as the staff, should have as much flexibility as possible to make that judgment.

Along with other Directors, Mr. Donoso said, he found that, as formulated at present, the items suggested for consideration by the Board could not constitute a basis for the future application of policies. The need for a flexible application of present policies should be stressed along with a clear indication of the operational content of that procedure.

Miss Batliwalla stated that her chair held the view that Fund policy on multiple exchange rates, characterized in the past by flexibility and a case-by-case approach, should be continued. That approach had served the members well and there was little supportive evidence in the staff paper for adopting a stricter stance. The staff's own assessment was that over time significant progress had been made in members' reliance on multiple currency practices and that the record of the past few years had not established a definite upward trend in the number of members using multiple rates. The more recent upward trend was clearly attributable to the severe balance of payments pressures and special circumstances of a group of developing countries.

The staff had not made a convincing case for tightening existing guidelines on multiple currency practices, Miss Batliwalla continued. For instance, there was not sufficient evidence in the paper to show that multiple currency practices once introduced acquired a permanent character; in an overwhelming number of cases the average duration of those practices was five years. Such a time frame for their removal was not unreasonable. She therefore agreed with Mr. Kafka and Mr. Feito that more research needed to be done in that area and that more scientific arguments for further tightening were required.

Experience indicated that multiple currency practices had not proliferated indiscriminately, Miss Batliwalla remarked; therefore there was no need to elevate the issue by including their early elimination in every program, a performance criterion the nonobservance of which could affect members' drawing rights. Such a rigid time-bound approach could be counterproductive to the overall adjustment effort. Most programs had review clauses or an understanding in that area, and there was a general commitment to the simplification of the exchange system. If the Fund's surveillance exercises were unable to come to grips with the wider issues of instability and wide fluctuations in exchange rates, her chair did not see a strong case for tightening surveillance in respect of small increases or deviations in multiple currency practices. That procedure could heighten the asymmetry in the treatment of users and nonusers of Fund resources. Her authorities, therefore, continued to favor the present pragmatic and flexible approach.

Mr. Tshishimbi noted that, according to the staff report, there had been no substantial increase in the number of multiple exchange rate systems in the world since the 1981 review of the Fund's surveillance over members' exchange rate policies. The slight increase at the end of 1983 reflected the prevalence and severity of balance of payments difficulties, particularly among developing countries. With the world economy recovering at present, the incidence of multiple exchange rate systems should subside.

The Fund had generally adopted a flexible and pragmatic approach, guided by the consideration that multiple exchange rate systems should be eliminated at the earliest possible time, Mr. Tshishimbi remarked. In the course of its exercise of surveillance, the Fund had also, on a temporary basis, approved multiple exchange rates in the context of either Article IV consultations or negotiations on the use of Fund resources. The basis for approval had always been a clear indication that the multiple exchange rates were needed as a transitional step toward the implementation of policies that could produce more lasting effects on the country's balance of payments. The approach followed by the Fund to date had served its intended purpose, and there was no reason to modify it. He shared the conclusions of the staff report. In particular, the elimination of the multiple exchange rate systems could, in many cases, contribute to a better allocation of resources among sectors and among industries, as well as to the reduction of administrative costs, eventually leading to an improvement in the balance of payments. However, he shared the views expressed at the previous meeting by Mr. Prowse on the comparison of selected economic indicators in countries that had used the multiple exchange rate systems with those in countries that had not. It was not certain that countries using multiple exchange rates had not performed well for that reason alone, or because they had been in trouble before resorting to multiple currency restrictions.

The Board should examine appropriate actions to be taken by the Fund under Article VIII with regard to multiple exchange rates applicable to capital transactions, Mr. Tshishimbi remarked. He also believed that multiple currency practices for reasons other than balance of payments difficulties had been rare in recent years, and therefore the current practices in that regard should continue.

The staff had cited several member countries, including his own, where a second market exchange rate had served as an indicator of an appropriate level of an equilibrium exchange rate, Mr. Tshishimbi noted. There was no suggestion that such an indicator had provided a justification for the adoption of a multiple exchange rate. An additional market had already been in place and had been used to channel specific operations that the government wished to encourage or discourage, or an existing clandestine market had been formalized. In any case, a parallel market would not indicate an equilibrium exchange rate for a number of reasons, not least of which was the limited size of such a market relative to overall transactions. In most instances, a parallel market rate overstated the spread between the parallel and the official rates, because it generally embodied a premium designed to cover the risks involved in the transactions carried out through the parallel market.

On multiple exchange rates approved by the Fund that persisted beyond the period for which they had been originally envisaged, Mr. Tshishimbi continued, the staff had stated that the rates had become a device for postponement of much needed adjustment or had been added to the other restrictive measures taken by the authorities to deal with balance of payments problems and foreign exchange shortages. In its search for improvement, the staff had suggested that concrete plans for the elimination of such multiple exchange rates should be formulated, for instance, as performance criteria in the implementation of the adjustment programs supported by the use of Fund resources. Besides the asymmetry involved in that action that had been noted by other Directors, he was not convinced that such a formulation would be helpful or even necessary. Each case should continue to be treated on its own merits. For example, a situation in which the protracted use of an inappropriate exchange rate would require a sizable uniform adjustment could not be treated in the same way as the situation requiring only a marginal adjustment. The distributional effects involved in the first case might not be easily predicted for inclusion in the performance criterion. In some cases, as Mr. Mtei had noted, the social costs of an unduly accelerated speed of adjustment might be too high. Therefore, the Fund should retain the maximum flexibility at its disposal and not adopt unduly rigid formulas.

Mr. Templeman stated that he agreed with the staff's conclusions regarding the negative consequences of multiple exchange rate regimes on resource allocation and medium-term balance of payments adjustment. That conclusion was not based on any theoretical view, but on practical experience in the Board in reviewing their operation in specific cases. While multiple exchange rates might appear easier to administer and might seem to require less formal legislation than other measures, they generally were extremely cumbersome and complex and often had unintended but nevertheless harmful effects, as many Directors had already noted. One consequence of a multiple exchange rate regime that deserved more emphasis was its contribution to a perception that a country was engaging in unfair trade practices. Thus, countries with multiple exchange rates ran the risk of provoking justifiable retaliatory trade measures.

Although the policy enunciated in the 1981 review of surveillance over multiple currency practices provided for some flexibility, Mr. Templeman continued, the experience of the past few years indicated that such flexibility should be exercised with great care. While some countries had effectively utilized a multiple exchange rate regime during a transition to a market-determined rate, too many other countries during the past few years had allowed a multiple rate regime to contribute to their problems. The surveillance decision allowing the establishment of multiple exchange rates as a second-best approach should not signal an easing on the Fund's part of the objective of using the exchange rate policy as an important tool in balance of payments adjustment. The decision did not require the Fund to be dogmatically "flexible." Indeed, the presumption against multiple currency practices should remain, and any flexibility that was permitted should be fully justified.

In situations where the use of temporary multiple exchange rate regimes was justified, given the alternatives, a firm understanding with regard to their removal should be sought, Mr. Templeman said. Otherwise, such regimes could become a crutch that allowed a country to avoid the policy and institutional changes that would make resort to such stopgap methods no longer necessary. In the context of Fund programs, the Fund should specifically include as performance criteria the unification of the multiple rates by a specific date or a review of the exchange rate policy during the program. In cases where a multiple rate was adopted, complementary adjustment policies in other areas would probably have to be stronger and be taken sooner, as the exchange rate was not being allowed to play its full adjustment role.

In the context of approval procedures under Article VIII and the general exercise of surveillance under Article IV, in too many cases there had been a tendency for the staff to consider a measure temporary in several consecutive Article IV reviews, Mr. Templeman commented. As his chair had noted in 1981, the staff should seek to avoid the classification of a measure as temporary unless there was adequate reason to conclude that progress was being made toward its elimination. To help the staff and the Board assess the extent to which a multiple rate was temporary, his chair recommended that the staff obtain a government's specific plans regarding the elimination of its multiple currency practices during the regular Article IV consultation. The staff would then report those plans to the Board along with the description of a member's exchange system and would include specific recommendations to the Board for approval or non-approval of the practice. The progress members had made toward eventual unification of the exchange system should be reviewed during subsequent Article IV consultations, and future Board approval of those practices should be granted in the light of the progress members were making.

He agreed with the 1981 decision regarding adoption of multiple currency practices for non-balance of payments reasons, Mr. Templeman said. In such cases, the staff should be explicit in describing the reasons and should continue to press for alternative policies. He also agreed with the staff's view that, if a subsidy could be justified, the subsidization of debt repayments through the exchange system was not the most effective method. It would be far better for the government to establish direct subsidies. Finally, in view of the increasing importance of capital movements, and to strengthen the exercise of surveillance over exchange rate policies, it was desirable for the Board to monitor constantly the question of appropriate action to be taken by the Fund under Article VIII and Article IV with respect to multiple exchange rates applicable to capital transactions.

Mr. Ismael stated that he was in general agreement with the staff analysis and conclusions. Table 1 (SM/84/64) indicated that considerable progress had been made over the years in reducing the prevalence of multiple currency practices--in 1955, 62 percent of the Fund membership had maintained multiple currency practices while in 1983 that figure had declined to 31 percent. However, those figures concealed an important change that had taken place: an increase in the use of other instruments, such as tariffs, subsidies, and quantitative restrictions, to achieve those objectives for which multiple currency practices were often introduced. He invited the staff to comment on the extent to which the reduced use of multiple currency practices could be explained by preferences among member countries for other instruments to provide similar incentives and disincentives.

The staff had drawn a distinction between multiple currency practices introduced for balance of payments reasons and those introduced for non-balance of payments reasons, Mr. Ismael commented, and had suggested that the Fund should be less tolerant of the latter. The different motives for the introduction of multiple currency practices were of doubtful significance; it was the impact of those practices that was important. For example, exchange restrictions on imports might be motivated by the desire to protect domestic industry, but often they also had a positive effect on the balance of payments insofar as imports were reduced; the converse was also true. A country that introduced multiple currency practices to conserve foreign exchange simultaneously afforded increased protection to domestic industry. As a result, income distribution and other variables were affected. Because multiple currency practices were multifaceted in their impact, it was important that the Fund's attitude toward individual cases of multiple currency practices should be influenced not by the motivation for their introduction, but by their impact on resource allocation and world trade.

With respect to multiple exchange rates applicable to capital transactions, Mr. Ismael commented that his chair preferred to keep open the option of members to restrict capital movements in times of emergency. Large capital movements could have a serious destabilizing impact on the money supply and exchange rates of member countries, and it was therefore important that members should have the instrument of multiple exchange rates available to deal with that situation.

As to centrally planned economies, where imports, exports, and prices were determined in the context of the plan, the Fund should adopt an attitude of flexibility and understanding, Mr. Ismael observed. In the absence of such an approach, difficulties could arise in Fund relations with centrally planned economies. He encouraged the staff, in its negotiations with countries that faced social and political difficulties in introducing large adjustments in their exchange rates, not to shy away from accepting multiple exchange rates if it facilitated Fund assistance to those countries.

The conclusion of the Executive Board discussion on the role of exchange rates in less developed countries made it clear that the Fund could not be too dogmatic on exchange rate matters insofar as they related to developing countries, Mr. Ismael observed. In many countries where the authorities had strong feelings about exchange rate matters, multiple exchange rates could be accepted as a transitional arrangement with a timetable for their gradual elimination included in the Fund program.

In a few countries, multiple currency practices had been adopted to ease the debt service costs arising from large devaluations, Mr. Ismael commented. The aim had been to protect businesses with large external liabilities from bankruptcy and defaults. The staff had argued that there was no merit in that approach, but prima facie, given the size of exchange rate changes in the countries concerned, some form of financial support to businesses with large external liabilities was justified to avoid large-scale bankruptcies. There was not enough evidence or experience to support the conclusion that multiple rate practices to assist businesses with external debt service were counterproductive. With regard to the staff statement that "the policy of urging members to use means other than the exchange system to attain the objectives sought by multiple currency practices remains appropriate," each case should be examined on its own merits, taking particular account of the available administrative machinery in the country concerned. For example, a country could levy an export surcharge on a commodity for revenue purposes. Because of administrative convenience, that surcharge might be collected by the banking system when foreign exchange was received, rather than by the customs department at the point of export. That procedure amounted to a multiple currency practice, as defined by the Fund, which should take a more generous view. Therefore, he could not agree with the staff that means other than the exchange system should always be used to attain the objectives sought by multiple currency practices.

Mr. Prowse commented on the extraordinary level of agreement among the various groups in the Board, with perhaps only one member favoring the inclusion of multiple exchange rates applicable to capital transactions under the Fund's jurisdiction. The perceptive interventions presented on the topic had not contained any convincing theoretical or empirical argument against the extension of the Fund's jurisdiction to capital transactions under either of the relevant Articles, and several speakers had indicated their willingness to consider the matter further, with Mr. Tvedt proposing a separate paper on the subject.

The staff had argued that in the past eight years there had been a remarkable growth in volume, mobility, and flexibility of capital flows, Mr. Prowse recalled. To exclude them from consideration was to attempt to improperly confine external adjustment to the current account. He supported the proposal for a further paper and, in the light of the widespread expressions of interest, Board consideration of the matter during the year. The proposed paper should cover the legal aspects, because the Board would have to decide whether to incorporate those arrangements on the capital account, and should include the theoretical and analytical aspects, as well as empirical evidence.

Mr. Templeman endorsed Mr. Prowse's suggestion; such a paper would be very informative.

Mr. Suraisry proposed that the paper on Article VIII jurisdiction should describe the impact of practices on the adjustment process both in countries implementing them and in others.

The Director of the Exchange and Trade Relations Department thanked Executive Directors for their comments, which would prove extremely useful in providing guidance to the staff on the application of the policy with regard to multiple exchange rate regimes. He agreed with Mr. Ismael's point on the general problems arising from protectionism, which was one reason why the staff had presented the topic to the Board. The tendency to use some multiple currency practices was related to the issue of protectionism, and the Fund should exercise what jurisdiction it had to indicate its serious concern with the repercussions of multiple exchange rate policies; in that respect, Fund policy paralleled that of the GATT. Although differences of opinion had been expressed as to the degree of flexibility that should be exercised, the Board had endorsed the Fund's view that multiple currency restrictions should be temporary and properly supervised. In his view, the correctness of the policy of avoiding multiple currency practices to the extent practicable had also been generally accepted.

He assured Executive Directors that the staff was not systematically against the use of multiple rates, the Director continued. It should be apparent from the programs put before the Board that there were occasions when the staff had even suggested using multiple rates when it had found other avenues politically blocked. Frequently the staff had found black markets developing, and exchange controls prevailing; it preferred open recognition of a dual market situation and a return, therefore, to more uniform pricing mechanisms than heretofore. In that sense the need for flexibility was acknowledged.

The staff had emphasized that it should be quite clear that multiple currency practices were transitional, the Director continued, while promoting the correct implementation of adjustment. But perhaps some Directors had felt that the staff had been too rigid in its opposition to multiple currency practices. Although the analysis had perhaps been less than complete, the staff had drawn on its broad experience in dealing with those practices, and many of its statements were derived from that experience rather than from the tables. However, cases of both poor performance and improved performance had been subject to the same statistical inadequacies. Although not conclusive, some of the statistical elements fitted a general pattern, which had been accepted by the Board.

On the question of asymmetry, or the degree to which the staff used the occasion of a stand-by arrangement to force the implementation of measures that were not taken by other countries, the Director stressed that the staff paid particular attention in stand-by arrangements to multiple currency practices primarily to ensure that the medium-term problems were being dealt with and that the multiple currency practice was a transitional device. In order to receive assurance that the balance of payments situation was recovering sufficiently and that the Fund had reasonable prospects of the revolving use of its resources, the staff had to ensure that the policies in place would promote that recovery. For that reason the staff focused on the prompt phasing out of the measures in order to provide a solid and satisfactory base for the desired investment, growth, and balance of payments recovery.

Most measures with respect to multiple exchange rates applicable to capital transactions were within the Fund's jurisdiction, the Director of the Exchange and Trade Relations Department commented. For example, short-term capital movements in the form of banking and normal amortization were classified in the Articles of Agreement as current transactions for the purposes of the Fund, and most multiple exchange rates were subject to Fund approval. The issue was therefore not as critical for the Fund as perceived, but the staff regarded it as an important principle and would welcome further research on that topic.

The staff representative from the Exchange and Trade Relations Department, replying to questions by Mr. Kafka and Mr. Qureshi on the data on the duration of multiple exchange rate regimes, said that the average duration would be reduced from 5 years to approximately 4.5 years if the 15 countries that had maintained the regimes continuously were excluded. As suggested by Mr. Qureshi, there might well have been changes in the average duration over that 13-year period. A detailed analysis might indicate that the increase in incidence of multiple exchange rate regimes since the mid-1970s had resulted statistically in a shortening of the duration over the latter part of the period. Of course, the staff did not know how much longer present regimes would be maintained, and that was part of the reason for the present discussion.

With regard to the incidence of major and minor practices over the period, the staff representative continued, it had been difficult to characterize practices unambiguously as complex or simple, but the staff had presented in the background paper (page 4 of SM/84/65) an analysis of that aspect. In general, in the 1970s the overall complexity of multiple exchange rate regimes had not changed markedly. However, looking at the period since 1980, the staff had noticed a significant change toward dual and three-tier exchange regime arrangements. The coverage of those arrangements had generally been wider and had had a greater impact on the economies than some of the specific taxes and subsidies that had been employed in the 1970s. Therefore, on balance, there had been some increase in complexity, as defined in the paper, since 1980.

The use of parallel markets as indicators of an appropriate exchange rate had been queried by Mr. Tshishimbi, the staff representative remarked. The staff had tried to avoid any impression that an illegal rate should be used as an unqualified indicator of an equilibrium level, and had stated that "such a market-determined exchange rate is not always representative of an 'equilibrium' level for a variety of reasons." Illegal market rates could differ widely from official rates; some were three to ten times the official rate. When incentives of that magnitude existed, a number of people would be unwilling to surrender at the official market rate, and illegal markets were sizable in many economies relative to overall economic activity. Therefore, it was not the market's thinness that was likely to cause problems for its use as an indicator. However, even in the event of liberalization, there would always be some degree of discount in the illegal market because of the widespread maintenance of exchange controls on capital.

On the substitution of other practices for a multiple currency practice, the staff representative from the Exchange and Trade Relations Department noted that a survey in a recent Annual Report on Exchange

Arrangements and Exchange Restrictions of all restrictive practices, including multiple currency practices, revealed that since the mid-1960s there had been a downward trend in the practices subject to Fund jurisdiction. Of course, that view had to be qualified because of the usual difficulties in measuring the complexity of those arrangements. In the same period, particularly in recent years, there had been an increase in the number of multiple currency practices, both outside and perhaps, more recently, within the Fund's jurisdiction. But again the question of causation arose; it was difficult to judge whether the Fund had been responsible in any way.

The Deputy General Counsel informed Executive Directors that the staff would prepare a paper presenting more details and reviewing past material on the topic under consideration. He recalled that Mr. Clark had asked how Article VI, Section 3, which provided that the member might regulate capital movements, affected one's view of Article VIII, Section 3, on Fund jurisdiction over multiple currency practices. A consideration of that important issue also had to include the impact of the provisions of Article IV that deal with the general obligations of members with respect to exchange rates. Further, Article I, item (iii) stated that the purposes of the Fund were not only to maintain a multilateral system of payments for current transactions but also to promote exchange stability, orderly exchange arrangements, and the avoidance of competitive devaluations. The need to take account of all of those provisions had been a major concern at the time of the interpretation in 1956 to the effect that Article VI, Section 3 permitted a member to discriminate in the application of exchange arrangements that controlled capital movements. But at the same time the Committee on Interpretation had recognized that the issue with respect to the reconciliation of all of those provisions to multiple currency practices was a much more complex problem and was therefore put aside.

In the 1959 paper entitled "The Legal Aspects of Article VIII and Article XIV," the staff had argued that there was Fund jurisdiction, but no resolution was reached at that time, the Deputy General Counsel continued. In 1979, following the Second Amendment changing the provisions of Article IV, the staff had reviewed the issue. While the new Article IV did not continue the par value system, and thus the argument that the use of multiple currency practices might undermine the par value vanished, the new Article recognized that one of the purposes of the international monetary system was to facilitate not only the exchange of goods and services, but the movement of capital as well. In that context, members undertook to maintain exchange rates consistent with all the purposes in the new Article IV and not to manipulate exchange rates to their own advantage. The paper being prepared by the staff would review all those factors.

The question had been raised by Mr. Polak, the Deputy General Counsel recalled, of the impact outside the Fund of approval or nonapproval with respect to a member's multiple currency practice. He assumed Mr. Polak's question was what would be the effect, under Article VIII, Section 2(b), if a multiple exchange rate used in an exchange contract had not been approved by the Fund. Article VIII, Section 2(b) provided that exchange contracts that involved the currency of a member and were inconsistent with the exchange control regulations of the member, maintained consistently with its obligations under the Articles, would not be enforceable in the territories of other members. The use of an unapproved rate in an exchange contract could have that effect outside the territory of the member. He added a caveat in that the courts of a country usually looked to the local valuation of currencies when establishing the value of a currency for the purpose of a judgment.

The Acting Chairman said that, with regard to the exercise of jurisdiction by the Fund under Article VIII, the staff had always taken the view that the Fund had that jurisdiction. The Board had neither endorsed nor rejected that view.

Mr. Kafka remarked that his calculations indicated that the average duration of the maintenance of restrictions, including those with continuous multiple rates, was over six years; therefore the average for those that did not maintain them continuously was four and a half years. If the average duration for the entire group was five years, then the average duration for those not maintaining them continuously must be less than four years.

More important, Mr. Kafka continued, the Director of the Exchange and Trade Relations Department, commenting on the matter of asymmetry, had said that the reason the Fund insisted on the early removal of multiple rates as a performance clause in financial arrangements with members was to protect the integrity of the adjustment process. That explanation seemed appropriate when multiple rates were imposed for balance of payments reasons, but was hardly relevant when referring to another type of multiple rate, for example, an exchange tax used instead of an import duty or export tax on a particular product.

The Director of the Exchange and Trade Relations Department explained that in the context of financial arrangements, the staff believed the main consideration to be the need to ensure a sustained recovery of the balance of payments. The staff reviewed exchange measures in accordance with the Board's policy on temporary approval and monitored them to guarantee that they did not impede the recovery of investment, growth, and the balance of payments.

The degree to which the staff had stressed that multiple currency practices would have to be eliminated in the life of an arrangement had been applied pragmatically, the Director said. For example, Brazil's export tax on coffee, which gave rise to a multiple currency practice subject to Fund jurisdiction, had been in effect for many years. The staff had not considered the elimination of the practice entailed by the tax essential because its existence responded primarily to fiscal, nonbalance of payments reasons. However, other considerations could arise and the staff would view its eventual replacement from a pragmatic standpoint. The main issue for consideration by the Fund hinged on the process of balance of payments improvement; the staff would continue to use its judgment on that basis, as mandated by the Board.

Mr. Kafka observed that there was no regulation, either formulated by the Executive Board or in the Articles of Agreement, that prevented the Fund from granting temporary approval on repeated occasions and without necessarily linking the withdrawal of that approval to the maintenance of a financial arrangement, particularly when the practice did not affect the balance of payments.

The Acting Chairman then made the following summing up:

> During the present discussions concern was expressed by some Executive Directors regarding the greater resort to multiple rates in recent years by member countries, particularly in the developing world. A number of Directors held the view that there had been particular circumstances in which reliance on multiple exchange rates had provided members with a reasonable second-best--or even a first-best, a few Directors maintained--solution and with the respite necessary to formulate and adopt adjustment measures, or had enabled members to allow market forces to play a more prominent role in their economies. These Directors took issue with the staff's contention that multiple currency practices tended to become lasting features of economic policy.
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> Many Directors, however, had focused more on those cases in which resort to multiple exchange rates had retarded the adoption of the required policy actions and had thereby hindered the progress of the medium-term adjustment process. A number of Directors were satisfied that economic analysis and the experience of the Executive Board in reviewing specific examples when dealing with Fund programs and Article IV consultations adequately supports the conclusion that multiple exchange rates are economically disadvantageous and should be avoided. Other Directors, however, considered that neither analysis nor empirical studies are sufficiently conclusive to justify a rigid or even necessarily uniform position on the part of the Fund. Thus, in general, Directors remained of the view that Fund policies in the area of multiple exchange rates should remain flexible, pragmatic, and responsive on a case-by-case basis to each particular country's circumstances.
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> Within this general approach, Directors drew attention to the costs involved in the administration of multiple exchange markets and to their distorting effects on the allocation of resources. Attention was also drawn to the danger of multiple rates leading to countervailing trade measures elsewhere. Directors for the most part supported the staff's recommendation regarding Fund approval of multiple exchange rates. Perhaps the most important judgment to be made when deciding on such approval related to the temporary character of multiple exchange rate systems. The preponderance of view was that such approval should be based, among other things, on the existence of a well-conceived plan--which the staff could appropriately help to formulate--designed to bring

about the unification of exchange rates over a specific and appropriately brief period of time. The development of such plans and the search for firm commitments to eliminate multiple rates should be expected from members undertaking adjustment programs supported by the use of Fund resources. In this context, the normal course of action would be for the Fund to approve multiple exchange rates introduced or maintained by members undergoing an adjustment effort supported by a stand-by or extended arrangement. In cases where no arrangement entailing the use of Fund resources was in effect, approval of multiple exchange rates would be granted when there were firm assurances of their temporary nature, based on measures and conditions considered likely to ensure their elimination. In such cases, a strengthening of follow-up procedures was suggested. Still, a number of Directors considered that there was an inherent asymmetry in the treatment of cases that involved use of resources and those that did not and they believed that the Fund should try to avoid making undue use of its leverage in the former cases.

Directors noted the points made in the paper concerning the use of devices which, although strictly speaking do not constitute multiple currency practices, had virtually the same economic effects. There was broad support for the staff's conclusion that resort to such devices was appropriately subject to the exercise of the Fund's surveillance under Article IV, which encompassed issues that went beyond those subject to the approval jurisdiction of the Fund in a narrow sense.

With regard to multiple rates adopted for non-balance of payments reasons, a number of Directors similarly espoused a pragmatic case-by-case approach with appropriate flexibility, while maintaining the policy of urging members to use means other than the exchange system to reach their objectives.

Finally, Directors expressed views on the staff's comments regarding multiple exchange rates applied solely to capital transactions. While some Directors considered that there were no grounds for changing the existing approach to the matter, others felt that the Executive Board should consider the question and resolve the issue. I believe that the sense of the meeting was that the Board should re-examine the issue of the Fund's jurisdiction under Article VIII, Section 3 over multiple currency practices applicable solely to capital transactions. For this re-examination the staff will prepare a paper that will review the past considerations of this issue and present its further views. Until the re-examination has been completed, the present procedure on this type of multiple currency practice will continue to be followed.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/60 (4/18/84) and EBM/84/61 (4/19/84).

2. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAP/84/79 (4/17/84) is approved.

APPROVED: September 27, 1984

LEO VAN HOUTVEN
Secretary