

April 18, 1997

**Summing Up by the Chairman
Capital Account Convertibility and a Possible Amendment of the Articles
Executive Board Meeting 97/38
April 15, 1997**

Executive Directors welcomed the further discussion on the basis of the staff paper on capital account convertibility and the considerations underlying a possible amendment of the Fund's Articles. Directors agreed that this summing up would be transmitted to the forthcoming meeting of the Interim Committee in accordance with the request made at its September 1996 meeting.

Directors agreed that an open and liberal system of capital movements was beneficial to the world economy. At the same time, they recognized the need to ensure that capital account liberalization was approached in an orderly and sustainable manner. They emphasized the importance of ensuring that the Fund was able to discharge effectively its mandate of overseeing an international monetary system increasingly dominated by capital flows. Given its mandate and its universal membership, Directors agreed that the Fund should play a central role in promoting capital account liberalization, and fostering the smooth operation of international capital markets. The Fund should also be prepared to advise its members in determining how the removal of restrictions should be sequenced with the necessary supporting structural and macroeconomic reforms. The Fund was also well placed to determine when the temporary imposition of controls could provide an appropriate means of addressing surges in capital inflows and outflows.

Accordingly, most Directors supported an amendment of the Fund's Articles to include the liberalization of capital movements in the mandate of the Fund, and supported an extension of the Fund's jurisdiction to capital movements which would allow for flexibility in implementation through transitional provisions and approval policies. Directors underscored the importance of ensuring adequate coordination with other international organizations.

With respect to the scope of jurisdiction, many Directors favored extending the Fund's jurisdiction to capital movements in a comprehensive manner, covering capital transactions and payments in both inward and outward directions. On inward direct investment, a number of Directors agreed that such transactions should be excluded from the scope of the Fund's jurisdiction on the grounds that they are normally restricted for reasons other than macroeconomic and balance of payments management. However, it was generally recognized that both inward and outward payments and transfers associated with inward direct investment should be included within the Fund's jurisdiction. It was acknowledged that further

consideration would have to be given to the definition of inward direct investment transactions under an amendment. Several Directors also pointed to the need to clearly define the scope of the Fund's jurisdiction with respect to other international organizations and agreements. Directors agreed that an extension of the Fund's jurisdiction over capital movements would require the development of approval policies to enable members to impose temporary restrictions on both capital inflows and outflows. In light of the potential volatility and size of capital movements and, accordingly, the need for members in some circumstances to impose such restrictions on an emergency basis, Directors generally supported greater flexibility in approving temporary restrictions than under the policy presently applied to payments and transfers for current international transactions. Specifically, most Directors supported a procedure which would allow for restrictions introduced to address emergency situations to be approved on a lapse of time basis for a limited period. However, the need for follow-up by the Fund regarding the need for adjustments in underlying policies was also pointed out. Directors agreed that there would be a need for the nontemporary approval of restrictions imposed for national security and prudential reasons similar to the existing procedures for restrictions imposed for national and international security reasons.

Directors agreed that an extension of jurisdiction over capital movements would need to provide for transitional arrangements to ensure that liberalization was sequenced with structural measures, particularly in the monetary and financial sectors, and that the pace of liberalization took into consideration the particular circumstances of individual countries. However, it was recognized that the transitional provisions should be clearly defined and not be used by members as a way of unnecessarily delaying capital account liberalization. In that regard, it was noted that the Fund had been successful in assisting members to accept the obligations of Article VIII under its existing jurisdiction through annual consultations, surveillance, and technical assistance, and that such mechanisms would also serve as the primary means by which the Fund would assist members to ensure that capital liberalization was neither premature nor unduly delayed. Many Directors also emphasized the need to avoid backsliding after liberalization.

Views differed on the effect of capital account liberalization on the demand for Fund financing. While some Directors argued that capital liberalization would likely reduce such demand, others noted that the size and volatility of capital flows could increase the need for financing. A number of Directors underscored the need to avoid the moral hazard that could be associated with Fund financing of capital outflows and considered it desirable to retain some form of limitation on the Fund's financing of large and sustained capital outflows. However, some other Directors recommended the removal of that limitation. Those are issues to be revisited at the next stage of discussion. Directors also looked forward to an early discussion of the Fund's policy on external payment arrears to private creditors. Following the guidance by the Interim Committee, we will consider the next steps ahead of the September Interim Committee meeting.