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**Statement by the Managing Director
on the Liberalization of Capital Movements
Under an Amendment of the Articles**

In Hong Kong last September, the Interim Committee issued a Statement on the Liberalization of Capital Movements Under an Amendment of the Articles (attached) inviting the Executive Board to complete its work on a proposed amendment of the Fund's Articles that would make the liberalization of capital movements one of the purposes of the Fund and extend, as needed, the Fund's jurisdiction through the establishment of carefully defined and consistently applied obligations regarding the liberalization of such movements. In its Communiqué, the Interim Committee requested the Executive Board to accord high priority to this work.

In light of the Interim Committee's request, it is important that we continue to make progress in our work on the amendment. I would note that many of the participants in our seminar on capital account liberalization also pointed to an amendment of the Articles as the most effective means of promoting the orderly liberalization of capital movements consistent with the Fund's central role in the international monetary system.

With this in mind, I have attached to this statement a draft outline of the proposed Fifth Amendment of the Fund's Articles.

With respect to the three sections of the draft outline, the following may be noted:

1. **Purposes.** The outline proposes specific language for Article I to include the liberalization of capital movements in the Fund's purposes. The proposed language attempts to reflect the importance of capital in the international economy and the Fund's role in the orderly liberalization of international capital movements.
2. **Jurisdiction.** The outline does not propose specific language for Article VI or other provisions of the Articles but sets forth the key principles that would guide the drafting of the relevant amendments. These principles are intended to reflect Executive Board deliberations to date, and it is recognized that additional principles may need to be added as discussions continue. For example, the Executive Board has not yet discussed in detail the treatment of subnational measures and regional groupings.

It is also recognized that there are a number of aspects of the principles contained in the outline that will require further elaboration or where agreement is still very preliminary. This is particularly true in the case of the treatment of restrictions on inward direct investment: the proposed "two-step" approach has only been discussed on an informal basis and, moreover, there are a number of important outstanding questions regarding how the concept of "restrictions on inward direct investment" will be defined. Further elaboration is also necessary with respect to a number of other issues relating to the scope of the Fund's jurisdiction, including the treatment of implicit discrimination.

3. **Other Aspects.** The principles are confined to those matters where preliminary agreement appears to have been reached. As has been noted in the past, there are a number of other issues that are related to--but are not a necessary part of--an expansion of the Fund's jurisdiction. For instance, the question has been raised whether the rules on settlement of *disputes and remedies under the Articles should be amended*. An additional issue is the future of Article VIII, Section 2(b), which has been, and will continue to be, discussed separately in the context of the Fund's policy on arrears to private creditors.

Proposed Fifth Amendment—Outline

Purposes

The text of the Fund's purposes set out in Article I (ii) and (iv) would be revised to read as follows (modifications are indicated):

- "(ii) To facilitate the expansion and balanced growth of **both international trade in goods and services and international capital movements**, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."
- "(iv) To assist in the establishment of a multilateral system of payments in respect of current **and capital** transactions between members, and in the elimination of foreign exchange restrictions ~~which hamper the growth of world trade~~, and in **the orderly liberalization of international capital movements.**"

Jurisdiction

1. The amendment will establish the general rule that members are prohibited from imposing restrictions on international capital movements without Fund approval.

2. The amendment would also set forth *specific exceptions to the general rule*. These exceptions would be as follows:

(a) Similar to the transitional provisions that exist under the present Articles, members would be able to "maintain and adapt to changing circumstances" restrictions that are in place at the time the amendment enters into force or, for future members, at the time of membership.

(b) Members would have the right to impose restrictions on inward direct investment. However, the amendment would give the Board of Governors the authority to decide, by an eighty five percent majority of the total voting power, to extend Fund jurisdiction over some or all of these restrictions at a later date. The procedures for defining the different categories of inward direct investment would be set forth in the text of the amendment itself.

3. With respect to *the meaning of the general rule*, the text of the amendment or the commentary would provide the following:

- (a) "capital movements" would include (i) capital transactions and (ii) the making and receipt of payments and transfers for such transactions;

- (b) for the purpose of determining when a capital transaction is “international”, the Fund would rely on (i) the residence of the parties and (ii) the location of the asset; and
 - (c) an official measure would be a “restriction” on a capital transaction if it discriminates between domestic and international transactions, i.e., if it treats international transactions less favorably than domestic transactions and such less favorable treatment is not justified by relevant circumstances. With respect to restrictions on the making of payments and transfers for capital transactions, the Fund would be guided by the principles that it has developed under its existing jurisdiction over payments and transfers for current transactions.
4. Although the features of the Fund’s approval policies would not be set forth in the text *of the amendment itself, it is expected that, by the time the amendment becomes effective, the Board would have agreed upon these features.*

Other Aspects

1. The Fund would retain the right to request the imposition of restrictions on capital movements in order to avoid an excessive use of its resources.
2. Consistency of a restriction with the Articles (e.g., after Fund approval of the restriction) would not exempt a member from its obligations under other (existing or future) treaties.

**Statement of the Interim Committee on the Liberalization of
Capital Movements Under an Amendment of the Articles**

1. It is time to add a new chapter to the Bretton Woods agreement. Private capital flows have become much more important to the international monetary system, and an increasingly open and liberal system has proved to be highly beneficial to the world economy. By facilitating the flow of savings to their most productive uses, capital movements increase investment, growth, and prosperity. Provided it is introduced in an orderly manner, and backed both by adequate national policies and a solid multilateral system for surveillance and financial support, the liberalization of capital flows is an essential element of an efficient international monetary system in this age of globalization. The IMF's central role in the international monetary system, and its near universal membership, make it uniquely placed to help this process. The Committee sees the Fund's proposed new mandate as bold in its vision, but cautious in implementation.
2. International capital flows are highly sensitive, inter alia, to the stability of the international monetary system, the quality of macroeconomic policies, and the soundness of domestic financial systems. The recent turmoil in financial markets has demonstrated again the importance of underpinning liberalization with a broad range of structural measures, especially in the monetary and financial sector, and within the framework of a solid mix of macroeconomic and exchange rate policies. Particular importance will need to be attached to establishing an environment conducive to the efficient utilization of capital and to building sound financial systems solid enough to cope with fluctuations in capital flows. This phased but comprehensive approach will tailor capital account liberalization to the circumstances of individual countries, thereby maximizing the chances of success, not only for each country but also for the international monetary system.
3. These efforts should lead to the establishment of a multilateral and nondiscriminatory system to promote the liberalization of capital movements. The Fund will have the task of assisting in the establishment of such a system and stands ready to support members' efforts in this regard. Its role is also key to the adoption of policies that would facilitate properly sequenced liberalization and reduce the likelihood of financial and balance of payments crises.
4. In light of the foregoing, the Committee invites the Executive Board to complete its work on a proposed amendment of the Fund's Articles that would make the liberalization of capital movements one of the purposes of the Fund, and extend, as needed, the Fund's jurisdiction through the establishment of carefully-defined and consistently applied obligations regarding the liberalization of such movements. Safeguards and transitional arrangements are necessary for the success of this major endeavor. Flexible approval policies will have to be adopted. In both the preparation of an amendment to its Articles and in its implementation, the members' obligations under other international agreements will be

respected. In pursuing this work, the Committee expects the IMF and other institutions to cooperate closely.

5. Sound liberalization and expanded access to capital markets should reduce the frequency of recourse to Fund resources and other exceptional financing. Nevertheless, the Committee recognizes that, in some circumstances, there could be a large need for financing from the Fund and other sources. The Fund will continue to play a critical role in helping to mobilize financial support for members' adjustment programs. In such endeavors, the Fund will continue its central catalytic role while minimizing moral hazard.

6. In view of the importance of moving decisively towards this new worldwide regime of liberalized capital movements, and welcoming the very broad consensus of the membership on these basic guidelines, the Committee invites the Executive Board to give a high priority to the completion of the required amendment of the Fund's Articles of Agreement.