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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 76/42

10:00 a.m., March 15, 1976

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
J. Amuzegar	C. P. Caranicas
P. Åsbrink	J. H. Kjaer
S. Y. Cross	T. Leddy
J. de Groote	H. G. Schneider
N. Deif	M. Finaish
B. J. Drabble	D. Lynch
R. Gavaldá	S. Sevilla
S. Jagannathan	
A. Kafka	W. Temple-Seminario
K. Kawaguchi	M. Wakatsuki
	Sein Maung
P. Lieftinck	
H. R. Monday	J. B. Zulu
	E. O. de Toledo
	E. Sacerdoti, Temporary
E. Pieske	G. Laske
	P. J. Bull
	G. Heyden Q., Temporary
J. H. Wahl	J. Foglizzo
R. J. Whitelaw	
A. W. Yaméogo	S. Nana-Sinkam

R. V. Anderson, Acting Secretary
B. J. Owen, Assistant

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Also Present

African Department: M. Touré, Director; L. Dini, Deputy Director; C. L. Merwin, Deputy Director; R. J. Bhatia, E. L. Bornemann, P. Boxall, P. J. Duran, R. Pownall, M. Russo. European Department: A. Pfeifer, Deputy Director; R. N. Brown, T. Gudac, E. Krall, A. Mohammed, B. C. Stuart. Exchange and Trade Relations Department: E. Sturc, Director; D. K. Palmer, Deputy Director; M. Dakolias, G. G. Johnson, T. Sweeney. Legal Department: J. Gold, General Counsel and Director; G. P. Nicoletopoulos, Deputy General Counsel; P. R. Lachman, J. K. Oh, S. A. Silard. Middle Eastern Department: S. A. Gerakis. Research Department: J. J. Polak, Economic Counsellor and Director. Treasurer's Department: W. O. Habermeier, Treasurer; D. S. Cutler, D. Williams, G. Wittich. Western Hemisphere Department: S. T. Beza. Bureau of Language Services: J. S. Haszard, Director. Information Office: H. Hartmann. Advisors to Executive Directors: C. Bouchard, J. K. E. Cole, A. Malek, F. K. Hussein. Technical Assistants to Executive Directors: V. Amiel, S. Arancibia, E. Avillez, C. J. Batliwalla, M. Berger, D. Berthet, I. M. Cobbold, A. Doizé, B. Goos, R. Khonsary, H. Kuroda, C. Lohmann, A. G. Morris, K. Nakayama, A. B. Nymark, M. Pietinen, S. B. Satyal, S. P. Upasani, A. van Dorssen, L. F. Vílches, P. Zimmer.

1. APPROVAL OF MINUTES

The draft minutes of Meeting 75/179 were approved.

2. EXCHANGE MARKETS - CURRENT SITUATION

Mr. Wahl said that because his authorities believed in firm surveillance by the Fund, he wished to inform the Executive Directors, ahead of the official notification, that the French Government had decided for the time being to withdraw the French franc from the EEC narrow margins agreement. The decision had been taken because of speculation, mainly in favor of the deutsche mark, which had started at the beginning of March after developments in London affecting the pound sterling. Those developments had led to a general disturbance on exchange markets and large balances had been transferred from sterling into the supposedly strong currencies in the EEC snake. As a result, the deutsche mark had been at the top of the spread and the French franc at the bottom. The Bank of France had therefore borne almost the entire burden of the interventions under the EEC narrow margins agreement. The magnitude of those interventions was clear from the decline in official reserves during the movements in January and February. The loss then had been rather more than F 6 billion, and the present crisis had been more expensive still. The French Government had considered it unwise to risk allowing official reserves to decline at such a rate. It had therefore proposed an EEC solution and had asked for a meeting in Brussels of the finance ministers and central bank governors of countries with currencies associated with the snake arrangement. The meeting had taken place the previous day and the French Minister of Economy and Finance had proposed changes in the technicalities of the narrow margins agreement, relating to the intervention rules and to the conditions for intervening. However, with the exception of the Government of the Federal Republic of Germany, the other governments represented had not responded favorably to the solution proposed by the French authorities. Therefore, the only course left was for the French Government to suspend for the time being the participation of the French franc in the narrow margins agreement of the EEC. Minister Fourcade had stated that that did not mean that the French franc was to float wildly.

The Acting Chairman added that Article VIII consultation discussions with France had been completed recently, along with the by now traditional special consultation, so that the staff would be in a position to prepare background material on the decision fairly shortly.

Mr. Lieftinck also informed the Executive Board that he had received a cable that morning from his authorities reading: "In accordance with an agreement reached with their Benelux partners the Dutch authorities hereby notify the Fund that effective March 15 they will maintain a maximum margin of 2.25 per cent instead of the previous 1.5 per cent for rates in

exchange transactions in the official market between the Dutch guilder and the Belgian and Luxembourg franc."

Mr. de Groote added that he had received a similar cable from his authorities. There was no longer much justification for the Benelux countries to maintain a separate arrangement, since they were almost alone with their main trading partner, Germany, in the EEC narrow margins agreement. There had been some pressure on exchange rates in the Belgian market that morning, but the losses had been much smaller than expected. On the other hand, measures had been taken immediately; interest rates had been increased, liquidity measures had been taken to make it difficult for banks and enterprises to finance speculation on leads and lags, and government measures in the fiscal field were expected shortly.

The Executive Directors took note of the statements by Mr. Wahl, Mr. Lieftinck, and Mr. de Groote.

3. ZAIRE - EXCHANGE SYSTEM

The Executive Directors considered a staff paper on the exchange system of Zaïre (EBS/76/127, 3/12/76). They also had before them a staff paper on a request by the Government of Zaïre for a stand-by arrangement (EBS/76/129, 3/13/76).

Mr. Yaméogo stated that the staff paper accurately described the decision of his Zaïrian authorities to depreciate the zaïre and to link it to the SDR instead of to the U.S. dollar. As agreed between the Zaïrian authorities and the staff, comprehensive economic and financial measures intended to redress the internal and external problems of the economy would be presented to the Executive Board shortly. He hoped that the exchange rate move would be accepted as a first step toward improving the situation, which had begun to deteriorate in 1972.

Mr. de Groote welcomed the authorities' action. The measures were in the right direction and he hoped that they would be part of an overall program, which would be necessary to improve the economic situation of the country.

Mr. Cross echoed the view that the exchange rate move was a welcome and certainly important part of the more comprehensive program that was needed to restore the desired stability to the Zaïrian economy.

Mr. Wahl joined others in approving the measures taken by the Zaïrian authorities.

Mr. Monday agreed that the action taken by Zaïre was a step in the right direction. He looked forward to discussing at a later date the proposed supplementary measures.

The Acting Chairman remarked that, as indicated in the staff paper recently issued on the request by Zaïre for a stand-by arrangement (EBS/76/129, 3/13/76), the exchange rate move was the first, and essential, part of a comprehensive stabilization effort being undertaken by the Zaïrian authorities in cooperation with the Fund.

The Executive Directors then turned to the proposed decision, which they approved.

The decision was:

1. The Zaïrian authorities have communicated to the Fund a rate of Z 1 equals SDR 1 to take effect as a central rate on March 12, 1976. They also intend to continue to avail themselves of the wider margins under Decision No. 3463-(71/126), adopted December 18, 1971, as amended by Decision No. 4083-(73/104), adopted November 7, 1973.

2. The Fund notes the central rate communicated by the Zaïrian authorities and their intention to maintain the rate for the zaïre in terms of the special drawing right as defined in Rule O-3(a) and to continue to avail themselves of wider margins.

Decision No. 4983-(76/42), adopted
March 15, 1976

4. SPAIN - EXCHANGE SYSTEM

The Executive Directors considered a supplementary staff paper on the exchange system of Spain, prepared on the basis of additional information received since February 12, 1976 (EBS/76/57, 2/12/76; and Sup. 1, 3/8/76).

Mr. de Toledo observed that the supplementary paper contained all the facts needed to explain fully the reasons for the move by the Spanish authorities to depreciate the peseta on February 9, 1976.

Mr. Bull said that the material provided by the staff showed that the action of the Spanish authorities had been fully justified. He had noted in particular the statement in the staff appraisal that "in the absence of the depreciation, a significant reduction in the current account deficit could have been achieved only by the adoption of more restrictive financial policies. However, in view of the unprecedentedly low level of capacity utilization and the underlying political situation, such a policy was clearly untenable." Those lines also reflected his understanding of the situation in which the Spanish authorities had found themselves in deciding whether or not to change the value of the peseta. They had taken the right decision, and they had the support of his authorities. The repercussions of the Spanish exchange rate move on the currency speculation taking place

in Europe during the early months of 1976, including the likelihood of some undesirable effects on the French franc as well as on the pound sterling, had been unavoidable in the prevailing circumstances.

Mr. Pieske remarked that it was clear from the staff paper that there had been substantial balance of payments justification for the devaluation. Contrary to the experience of most other industrial countries, both Spain's trade balance and its current account balance had deteriorated further in 1975, the total deterioration since 1973 being larger than would have been accounted for by the added cost of oil imports. Also, the Spanish authorities had been justified in taking action to avoid the risk of capital outflows that might have been prompted by a major decline in reserves, a risk that seemed to be higher than usual in Spain's present circumstances. Finally, it would not have been appropriate to attempt to improve the current account by more restrictive domestic policies at present.

To sum up, Mr. Pieske said that since there seemed to be good reasons for devaluing the peseta, and since he had heard no complaint that it would give Spanish industry an unfair advantage, he was prepared to give the authorities the benefit of the doubt and support the proposed decision.

Mr. Temple-Seminario observed that the staff had quantified the facts in its recent supplementary paper, and he could accept the proposed decision without the slightest difficulty.

Mr. Drabble recalled that the Spanish authorities had pursued a cautious foreign exchange policy. A number of countries in a similar position had, like Spain, engaged in a sizable amount of official borrowing to cover a large current account deficit. In those circumstances, however, there was considerable question about a country's freedom of maneuver since a certain level of reserves was ultimately needed to ensure continued access to financial markets.

It was stated on page 2 of Supplement 1, Mr. Drabble continued, that the Spanish representatives considered that an exchange rate adjustment would have been inappropriate earlier, while external demand remained depressed and domestic wage and price pressures were still high. It was then stated that, by early 1976, both those factors had been reduced in significance. Although he understood the remark on external demand, his impression was that there was continuing labor unrest, and that active wage negotiations were in progress. Therefore, he asked the staff whether they felt that by and large the major wage settlements had been agreed, and that there was thus less risk of an exchange rate move further complicating wage negotiations.

Mr. Wahl agreed with Mr. Bull's view that the decision of the Spanish authorities had added to the difficulties of the exchange markets, but that they had been justified in taking their decision.

Mr. Lieftinck said that he had no difficulty in going along with the proposed decision on the Spanish exchange system. The Executive Board had before it that day two proposed decisions with respect to currency adjustments, and in both cases, a devaluation had been justified. Nevertheless, in trying to pass judgment on such steps, it was the duty of the Executive Directors both to consider whether there was sufficient justification for a devaluation and to be attentive to the degree of the devaluation. Surveillance definitely meant consideration of whether or not a move was a competitive devaluation. Neither the staff paper on Zaïre, which had made a 45 per cent devaluation of its currency--for which there was ample justification and an urgent need--nor the staff paper on Spain, where the depreciation needed had been far less, justified the magnitude of the depreciations. Generally speaking, the staff should check the criteria for the magnitude of upward or downward exchange rate adjustments.

Mr. Whitelaw believed that the supplementary staff paper had been helpful in explaining the rather sudden decision by the Spanish authorities in February. Table 1 on the balance of payments showed that the change in the current account deficit could almost entirely be accounted for by the increase in the cost of oil imports. The 1973 current account had been in surplus by SDR 461 million; in 1974, it had shown a deficit of SDR 2,709 million, SDR 2 million of which was due to the cost of oil imports. The same was true in 1975. Also, it appeared that in 1974/75 Spain had been financing those deficits largely by short-term borrowing. Such borrowing could not continue indefinitely. In retrospect, the Spanish authorities probably deserved credit for their wisdom in acting quickly because they had forestalled any pressure on the peseta and protected their reserves. The exchange rate move could be seen as part of an adjustment process that, over the space of three years, had begun to look inevitable.

On a more general point, Mr. Whitelaw continued, his chair had consistently over the last one or two years spoken in favor of flexibility in exchange rates. That philosophy was not met, however, if exchange rates were moved in situations where it was not apparent that they should be. Perhaps the Executive Board should devote some time to the background to the more recent movements in exchange rates, which left the impression of a lack of control over exchange rates in general, with flows of funds of a short-term character in both directions. In looking at exchange rate movements in the future, the Executive Board ought not to be happy if it felt that a country could not engage in compensatory financing to offset flows against a currency that were not justified and not sought by the country concerned. The European bodies concerned with such problems might already be discussing the matter, both in the EEC and elsewhere. But the Fund rarely tackled such issues, except in writing the Annual Report.

Mr. Cross agreed that there appeared to have been justification for the move by the Spanish authorities, given the large trade and balance of

payments deficit they faced. It was difficult to assess the proper magnitude of exchange rate movements. At a previous discussion (EBM/76/17, 2/13/76) there had been some suggestion that an alternative might have been to allow the rate to float under the impact of market forces to determine the appropriate amount of the depreciation. However, the Spanish move was adequately justified in the supplementary paper. He hoped that the domestic measures normally associated with such a move would be in evidence shortly.

The Deputy Director of the European Department, in reply to Mr. Drabble, explained that, according to the figures, the increase in prices and wages had been smaller in the past few months than for some time previously. However, the staff had asked the Spanish authorities whether, as Mr. Drabble had suggested, it was the right time to make such a move, since there was some labor unrest and the problem of inflation had by no means been solved. The view of the Spanish authorities was that, although the move would increase prices further, its timing was appropriate as they were confident that wage developments could be kept within reasonable limits.

In response to Mr. Lieftinck, the Deputy Director said that, although the staff paper did not expressly state that the magnitude of the depreciation was justified, it was the opinion of the staff that it was within a reasonable range. Exact calculations, of course, were hard to make. It was also relevant in that connection that, for reasons explained in the paper, the authorities had chosen to fix a new level for the rate rather than leaving it to the market. Thus, they had been forced to choose a percentage for the depreciation that would convince the market, and 10 per cent had apparently done so.

The Economic Counsellor, in response to Mr. Whitelaw's general comments, noted that in the case of both Spain and France, initial discussions of rate changes could not be based on firmly established statistical bases. The Executive Board had now received a fuller justification for the Spanish move, and it would shortly have an opportunity to consider changes in the exchange rate for the French franc.

Apart from the discussion of individual exchange rate changes, the Economic Counsellor observed, the whole issue was dealt with not only in the Annual Report but more extensively in the world economic outlook discussions. That might be the best framework within which to look at exchange rates against the underlying payments situations of members and relative movements in prices.

The Executive Directors then turned to the proposed decision, which they approved.

The decision was:

The Fund notes the exchange rate action taken by the Spanish authorities as described in EBS/76/57 and Supplement 1. The Fund will remain in consultation with the Spanish authorities and in this regard the Managing Director will take appropriate initiatives.

Decision No. 4984-(76/42), adopted
March 15, 1976

5. AMENDMENT - DRAFT REPORT TO BOARD OF GOVERNORS, AND RESIDUAL ISSUES - FREELY USABLE CURRENCIES

The Executive Directors resumed from the previous meeting (EBM/76/41, 3/12/76) their page-by-page consideration of the second draft of the report to the Board of Governors on the second amendment of the Articles of Agreement (DAA/76/5, Rev. 1, 3/1/76; Sup. 1, 3/5/76; and Sup. 2, 3/10/76), together with a supplement to the comprehensive draft amendment containing drafts of provisions on freely usable currencies (DAA/76/9, Sup. 1, 3/5/76).

The General Counsel, in reply to a question by Mr. Cross, confirmed that the use in the report of the term "general resources" in some contexts and the term "General Resources Account" in others was determined solely by stylistic considerations. The expressions should be read interchangeably.

In response to a suggestion by Mr. Kafka, the General Counsel proposed an editorial change in the antepenultimate sentence of page 18 of the draft report to make a distinction between the Trust Fund and the Subsidy Account, which were not both related to the oil facility.

Mr. Foglizzo wondered whether, in view of a recent explanation by the General Counsel, it would not be useful to introduce a sentence along the following lines: "Any decision taken under Article V, Section 2(b) would be a decision of the full Board and a decision taken by a simple majority."

The Acting Chairman agreed that there was no reason not to state the correct position.

Mr. Laske asked whether it was necessary to keep the short sentence in the right hand margin, which was proposed to add to paragraph 10 on page 23 of the draft report. It might limit the Fund's flexibility in future.

The General Counsel recalled that the additional language in paragraph 10 had been inserted as a result of the conclusions reached in the first reading of the draft report.

Mr. Cross expressed his preference for keeping the sentence. The question had been discussed, and it had been decided not to be too specific about the use of particular types of collateral in the future, although the Fund had not used collateral in the past.

The Acting Chairman remarked that the additional language was both a statement of fact as to past practice and an expression of the expectation that it would not be changed. In earlier years, when collateral arrangements had been discussed, the Executive Board had indicated that collateral was in no way a substitute for conditionality.

The General Counsel agreed that that was a basic consideration. But collateral posed an irreconcilable dilemma because, to be effective, foreclosure had to be contemplated, and if that was considered inadvisable, there was no point in having collateral at all.

Mr. Bull said that he supported Mr. Cross' view. To reopen the discussion would lead to many difficulties.

Mr. Laske commented that he could accept the sentence if there were strong objections to its deletion.

Mr. Whitelaw remarked that it did not seem logical to refer in the additional language to the expectation that the Fund's past practice of not requiring collateral would remain unchanged, and then to explain in two sentences the type of collateral the Fund would accept. Perhaps those two sentences should be deleted.

The General Counsel observed that the main legal substance of the last two sentences was in the reference to special drawing rights. Nowhere else was there an explanation of the implicit power--in the reference to "acceptable assets"-- to accept SDRs as collateral. A more logical order might be to place the additional language at the end of the paragraph.

The Executive Directors accepted the General Counsel's suggestion.

The General Counsel explained that DAA/76/5, Revision 1, Supplement 2, contained substitute paragraphs for paragraph 11 on page 23. Paragraphs 12 and 13 on page 24 would thus have to be renumbered.

Mr. Foglizzo noted the reference in paragraph 12 to Article XIX, Section 7(a). He asked whether the use of Section 7(b), namely, the possibility for the Fund to authorize members to use other exchange rates than the one referred to in Section 7(a), had been precluded. Also, there seemed to be an obligation for a member purchasing a nonfreely usable currency with the intention of exchanging it for another currency at the time of the purchase to make the exchange through the issuer of the currency purchased. He asked whether there would be a procedure to help

the purchasing member enter into an agreement with the issuer, and whether it would be centralized in the Fund.

The General Counsel responded that the reference in paragraph 12 and in Article V, Section 3(e) to Article XIX, Section 7(a) was not a direct application of the provision of Section 7(a), nor did it include a reference to Section 7(b). Article XIX, Section 7(a) applied to transactions in SDRs, and Section 7(b) was a derogation of that provision. The reference to Article XIX, Section 7(a) in Article V, Section 3(e) had been made in order to establish a formula for finding the exchange rate to apply in the transaction. The equal value principle was not being applied in a direct sense, but an attempt was being made to apply what might be called a cross rate, based on Section 7(a).

All of the steps contemplated by the provisions of Article V, Section 3(e) would be under the administration of the Fund and would normally be carried out simultaneously, the General Counsel considered. Therefore, a procedure would be established to assist the purchaser of a nonfreely usable currency to go to the issuer for an exchange.

Mr. Foglizzo then referred to the text of Article V, Section 3(e)(ii) and asked for an explanation of the meaning of the words "obtained in exchange." For instance, did it require the issuer of a currency being received in exchange to collaborate in the market exchange?

The General Counsel replied that Article V, Section 3(e) was a general provision. The collaboration clause would apply both to the issuer of a freely usable currency and the issuer of a currency that was not freely usable. The issuer of the currency being received in exchange in the first and second instance would be expected to collaborate, whether the exchange was made in the market or at the official level.

Mr. Foglizzo inquired whether the reference in paragraph 13 of the report to the requirement for collaboration with the Fund and other members implied the establishment of policies by the Fund or whether it was an expression of hope.

The General Counsel responded that the collaboration clause did not mean there were fixed obligations. Paragraph 13 attempted to explain that the clause was not a disguised substitute for explicit obligations, but nevertheless it had meaning. He doubted whether it called for the adoption of policies by the Fund. Rather, it would be made effective by the establishment of procedures by the Fund to facilitate collaboration between the issuers of currencies.

The Acting Chairman remarked that since there was no detailed legal obligation, it was hard to define in advance in precise terms what collaboration meant, except attempting to be helpful.

Mr. Foglizzo observed that throughout the scheme, there was a general provision that, if a member purchased the currency of any member, that member was entitled to request the conversion of its currency--whether or not it was freely usable--officially and bilaterally with the purchasing member. He asked whether the obligation applied only to currencies directly purchased from the Fund, in the first exchange, or whether it applied to a currency that the purchasing member obtained, and did not want, as a result of two or three exchanges of currency.

The General Counsel explained that if the currency purchased from the Fund was not freely usable, either the issuer or the purchaser could require an official exchange. For any other procedure to apply, the two parties would have to reach an agreement. If the currency purchased from the Fund was a freely usable currency, only the issuer could insist on an official exchange. One more exchange was covered by the collaboration clause, namely, the exchange of the first currency received by the purchaser for a second currency. After that, the purchaser would exhaust his remedies at the official level, although he would be able to go into the market.

The Acting Chairman added that the possibility of informal collaboration leading to further official conversions would still remain.

Mr. Sacerdoti considered that it would have been preferable to discuss the principles underlying Article V, Section 3(e), before embarking on a detailed examination of the text. Nevertheless, the General Counsel, in responding to Mr. Foglizzo, had singled out an interesting detail on which he sought clarification. If he understood the draft provisions correctly, a member purchasing from the Fund the freely usable currency of another member was not at liberty to ask for a particular freely usable currency but must be satisfied with the one it received. That procedure, which had already been discussed at length, seemed reasonable. But the issuer of the freely usable currency that was purchased by the member had a privilege that the purchaser did not have. The issuer could ask the purchaser, if it converted the freely usable currency, to convert it through the issuer if the issuer so decided. It seemed to him to be an asymmetrical rule, and he sought clarification of both the rationale and the necessity for it.

The General Counsel explained that the draft provision represented an amalgam of logic and of pragmatic considerations. As a matter of logic, Mr. Sacerdoti's understanding was correct. Of course, there was always the possibility of relying on the obligation to collaborate under Article V, Section 3(e)(ii).

The Acting Chairman commented that if the currency purchased from the Fund in the first instance was a freely usable currency, the issuer of that currency could exercise the option of requiring official conversion, in which case the conversion would take place at the equal value rate. If the issuer chose not to exercise its option, collaboration under

Article V, Section 3(e)(ii) was required, as in other circumstances, to "enable such balances of its currency to be exchanged, at the time of purchase, for the freely usable currencies of other members."

Mr. Bull stated that, on the assumption that the pound sterling was judged to be a currency qualifying under Article XXX(f) as a freely usable currency, the Bank of England would be prepared to collaborate with the issuers of other currencies that qualified in order to make satisfactory and firm reciprocal arrangements for ensuring that members wishing to receive the freely usable currency of their choice would be able to do so at rates of exchange equivalent to a rate based on Article XIX, Section 7(a).

Mr. Drabble remarked that his authorities were satisfied in substance with the draft provisions on freely usable currencies. However, as a matter of presentation, the term "freely usable currency" was in fact being used to denote a currency that was not freely usable per se but met certain other criteria. For instance, it was conceivable that a currency might be widely used in settlements with other countries in its trading bloc but not meet the conventional definition of being, in fact, "freely usable." On the other hand, the currencies of certain Fund members might be freely usable in the sense that no restrictions whatsoever were placed on their use by nonresidents, either for investments in the markets or for exchange in the market for other currencies, and yet they might fail to meet the specified criteria. He wondered whether, both in Article XXX(f) and in paragraph 14 of the draft report (DAA/76/5, Rev. 1, Sup. 2) the intention was not to refer to a currency that was both freely usable and widely used.

The General Counsel replied that the definitions in Article XXX were for the purpose of applying the provisions of the Articles of Agreement. As to the term itself, for reasons that were known an effort had been made to avoid the word "convertible" in all contexts of the Articles except where convertibility was unavoidably the topic. It was possible that the criteria of Article XXX(f) could be interpreted extensively to encompass a number of currencies. The elasticity of those criteria over time could not be predicted. It had to be recognized that Article XXX(f) involved a determination of a policy character, just as the definition of "currency convertible in fact" did in the present Articles. The definition of a freely usable currency would be a standard that could be, but need not necessarily be, applied to every currency that might seem to fit the terminology.

Mr. Drabble added that he did not object to the use of the definition for the Fund's purposes, although the wording opened the way for broader criteria than normally understood by the term "free usability." He would suggest amendments to the text at an appropriate point.

The Acting Chairman noted that there was much to be said for a relatively short list of freely usable currencies that were widely used so that the

probability of departure from equal value in connection with exchanges related to Fund transactions would not be great.

Mr. Kawaguchi observed that his acceptance of the provisions would depend on whether or not the Japanese yen would in practice be considered a freely usable currency. Also, he understood that the concept of "freely usable currency" was narrower than the previous notion of "currency convertible in fact," but to what degree was not clear.

The General Counsel remarked that there were three currencies convertible in fact under the present Articles, excluding balances of other currencies deemed to be convertible in fact. In comparing "freely usable currency" with "currency convertible in fact," a striking difference was the absence under the amended Articles of the interconvertibility obligation that was implied in the concept "currency convertible in fact." It was interesting to note that Mr. Bull had in fact given assurance that, if the pound sterling were on the new list of freely usable currencies, there would be virtually no difference with respect to sterling. In a sense, it seemed impossible and perhaps improper to begin to establish lists of currencies that would meet the test of "freely usable" until the time came to apply the provisions of the amended Articles. Paragraph 14 of the draft report (DAA/76/5, Rev. 1, Sup. 2) indicated that there would be consultation with any member that the Fund thought should be placed on the list or removed from it. The practice under the present Articles was for the Fund and the members concerned to reach an understanding if the issuer of a currency wished to be on the list. But there was a reservation mentioned in paragraph 14. The Fund must in the end make the decision, otherwise there might be no freely usable currency and the scheme would be inoperable.

Mr. Kawaguchi reiterated that unless the language of Article XXX(f) could be interpreted to mean that the Japanese yen would be included on the list of freely usable currencies, his authorities would seek a modification of the definition. The Japanese yen was after all widely traded in the principal exchange markets, but not necessarily in all. Strict criteria were unnecessary and might thwart the purpose of smooth Fund operations. Too narrow an interpretation of the definition of a freely usable currency would mean that only the U.S. dollar would be listed. In present circumstances, the pound sterling would be excluded. Yet the purpose of the international monetary reform was to make as many currencies as possible freely usable. There was no point in leaving a gold standard for a gold exchange standard, and then moving to a dollar standard. The standard should be a market currency standard.

Mr. Drabble said that in order to meet his earlier point that the two criteria of Article XXX(f) went in a sense beyond what might be narrowly defined as "freely usable," the language might be changed to read:

"A freely usable currency means a currency that the Fund determines is also (i) in fact widely used by other members...and (ii) widely traded... ."

The Acting Chairman observed that the implication of adding the word "also" was that there was a third criterion, namely, that the member imposed no restrictions on the use of its currency.

The General Counsel added that if the implication was total freedom from restrictions at all times, the operation of the provision would be hampered. There were probably residual restrictions on the use of most currencies, if only on capital transfers. Even if the currencies that the Fund might contemplate putting on the list of freely usable currencies when the amended Articles took effect were subject at that time to no restrictions, the imposition of a minor restriction in the future would mean the removal of the currency from the list. Moreover, it was not clear whether the intention was to refer to restrictions on capital or current transactions.

Mr. Drabble said that he would be satisfied, in view of the difficulties mentioned, if it could be made clear in the report to the Governors that the term "freely usable currency" was relevant only to the purposes of the Articles.

Mr. Kafka said that if, as he understood it, the phrase "by other members" in Article XXX(f)(i) meant members other than the issuer, presumably that could be so stated. Also, it was not the "other members" who made the payments for international transactions; the other members sold the currency in their market in order to enable their residents to make payments. Perhaps that should also be mentioned.

The General Counsel commented that there was an economy in language if the word "other" could be used. Mr. Kafka's point could be taken care of by modifying Article XXX(f) to read "a freely usable currency of a member means... ." The inclusion of a reference to "residents" would cause difficulty because it would seem to exclude monetary authorities, which were not necessarily covered by the phrase. Throughout the Articles, the word "member" was used to embrace "residents."

The Acting Chairman wondered whether the words "by other members" were necessary.

The General Counsel remarked that the phrase could perhaps be omitted if it was clear that the provision would not be subject to the misunderstanding that it comprehended use by the issuer only. The word "widely" might be sufficient to carry the proper connotation.

Mr. Foglizzo wondered whether the reference in Article XXX(f)(ii) to "all the principal exchange markets" should not be modified to read "most of the principal exchange markets," or similar less exclusive language. For instance, the yen was not officially quoted on the Paris exchange market, nor was the French franc widely traded in Tokyo.

Mr. Drabble agreed with Mr. Foglizzo that the word "all" suggested that there was a finite number of principal exchange markets. The matter would still be left open for determination if it was stated that the currency was "widely traded in the principal exchange markets."

The General Counsel said that the use of the words "widely" and "all" was intended to be cumulative, and thus to have a restrictive effect.

Mr. Bull considered that there was a delicate balance between the language of Article XXX(f) and the text of Article V, Section 3(e)(iv). The purchase of a freely usable currency of another member under Article V, Section 3(e)(iv) was to be restrictively treated; the exchange was to be made with the other member only at the request of that member and for a freely usable currency selected by the other members. The definition of currencies deemed to be freely usable was broadened to the extent that the monetary authorities of the countries concerned agreed to collaborate among themselves to make arrangements under Section 3(e)(ii). He had already indicated the willingness of the Bank of England to collaborate with others in order to widen that provision. But unless there was to be a fairly wide range of countries prepared to collaborate with one another, the restrictive character of Section 3(e)(iv) would not need to be widened. If the definition of freely usable currency in Article XXX(f) was broadened, then the countries whose currencies were subject to the provisions of Section 3(e)(iv) would probably have to be prepared to give up the right to choose the currency they were to provide as well as the right to insist that the transaction be made in its market. The delicate balance between the tightness of the definition in Article XXX(f) and the provisions of Article V, Section 3(e)(iv) made it difficult to alter either provision.

Mr. Amuzegar observed that whether or not Article XXX(f) referred to "all" or "the" principal exchange markets, the Fund would still have to define what it considered a "principal" exchange market. It would therefore seem necessary to draw up lists of exchange markets as well as lists of freely usable currencies.

The General Counsel explained that, as he had previously mentioned, it would be necessary to draw up new By-Laws, Rules and Regulations, and Decisions of the Fund. The list in question would be covered under one of those categories. He recalled that there had been a series of Fund decisions on balances of currencies convertible in fact. It seemed inadvisable to anticipate the content of the list so far ahead of the date of the effectiveness of the second amendment.

Mr. Lieftinck said that he was generally satisfied with the proposed text of Article XXX(f). However, he wondered what would happen if a clearly recognized principal exchange market was temporarily closed.

The Acting Chairman remarked that the rule of reason would have to apply. The temporary closing of a market would not exclude its being a principal exchange market.

Mr. Kjaer considered that if the definition in Article XXX(f) was widened or the present draft language interpreted to include a fairly large number of currencies, the purchasing members should have more protection than was presently provided in draft Article V, Section 3(e)(iv). For example, if a country drew on the Fund and was provided with Mexican pesos--which were not on the list of freely usable currencies--but wanted U.S. dollars, the Mexican authorities would be entitled to provide Canadian dollars and the Canadian authorities to provide Japanese yen. The purchasing member would then have to sell the yen; it would of course be able to sell them in the market but would not be entitled to a particular conversion or to collaboration from the Japanese authorities. At the minimum, the purchasing member should be entitled to request conversion under the equal value principle into another usable currency, possibly again at the choice of the member issuing that usable currency, namely, the Japanese authorities in the hypothetical example he had cited. The purchasing member would then at least have a chance of obtaining the currency it really wanted under the equal value principle.

The Acting Chairman recalled that the purchasing member at the third stage of the exchanges could not be prevented from cooperating with other members even though it had no further entitlement under the Articles to collaboration. The issue raised by Mr. Kjaer was a matter of policy.

Mr. Sacerdoti said that he saw no reason for giving the issuer of a freely usable currency the double privilege contained in Article V, Section 3(e)(iv). The first privilege was the entitlement to request the purchaser to make the exchange through the issuer, and the second was that the exchange should be made for a freely usable currency selected by "the other member," which he interpreted to mean, again, the issuer of the freely usable currency. He could accept the first privilege to allow the issuer to tell the purchaser to exchange an unwanted currency for another currency through the issuer. But he failed to understand why that privilege should be strengthened by giving the issuer the right to state that it would not provide its currency but would give the purchaser a third currency. After all, the issuer was not under any obligation once it had given the purchaser a freely usable currency. If the issuer was anxious to avoid the sale of its own freely usable currency on other exchange markets by the purchaser, it might be better off if its currency was not on the list; then it would be bound to satisfy the request of the purchaser for a currency of its choice.

The General Counsel confirmed Mr. Sacerdoti's interpretation of the provisions of Article V, Section 3(e)(iv). The other member referred to was the issuer of the currency. A matter of principle and not of drafting was involved. Section 3(e) was based on the principle of giving the issuer the choice of currency to the maximum extent so as not to burden it unduly with the need to find the currency, the situation that would result if the purchaser had the choice in all circumstances. The assumption was that the issuer would provide the freely usable currency it held in its reserves.

Mr. Lieftinck commented that the principle was clearly stated in paragraph 11 of the draft report, where it was mentioned that Article V, Section 3(e) was a provision "intended to ensure that a member purchasing another member's currency from the Fund will be able to use it, directly or indirectly, to meet its balance of payments need," "reflecting the consensus that the ability of the Fund to use all its general resources for the benefit of members should be based on a clear legal foundation." If there was disagreement on the stated objective, the text of Article V, Section 3(e) would have to be changed. Otherwise, the present provisions were appropriately drafted.

Mr. Foglizzo said that he could go along with the text of Article V, Section 3(e)(iv) if the consensus was that it should not be changed, although he agreed with Mr. Sacerdoti that there seemed to be a conflict between the denomination of a currency as freely usable and the fact that a purchasing member could not receive the freely usable currency of its choice because it would be subject to the wishes of the issuer of the freely usable currency it received from the Fund in the first instance.

Mr. Cross observed that it should be borne in mind that Section 3(e) followed Section 3(d), which provided that if a member had a need for a particular currency, it could receive that currency unless it had been declared scarce by the Fund.

Mr. Deif asked whether the declaration of a currency as scarce meant that Article V, Section 3(e)(iv) would not apply.

The General Counsel noted that there had never been a declaration of scarcity and it seemed safe to assume that there would not be. The substance of Section 3(d), to which Mr. Cross had referred, was that in certain circumstances, if a particular currency was required, it could be purchased from the Fund without the need to fit into the stipulations of the currency budget. Article V, Section 3(d) was limited in its scope. It was the redemption provision that allowed a member to purchase the currency of another member if that member was offering the currency of the first member for redemption by it.

Mr. Bull said that as he read Article V, Section 3(e)(iv), on the assumption that the issuer of the freely usable currency first purchased did not exercise its right to request the conversion to take place in its market, the purchaser could obtain the freely usable currency of its choice by following the proper collaboration procedures with the issuer of the currency of its choice, against the currency it received in the first instance.

Mr. Foglizzo remarked that it was not clear from the language of Section 3(e)(iv) that the words "at the request of that member" applied only to the exchange with "the other member"--the issuer of the currency--or whether it was of more general application. The words used in Article V, Section 7(j)(iv) were "if requested by the other member." Perhaps the language of the two provisions should be identical.

Mr. Kjaer wondered whether Article V, Section 3(e)(iv) could not read: "a member purchasing, directly or indirectly, from the Fund the freely usable currency... ." If a member country sought the privilege of having its currency defined as a freely usable currency under Article XXX, the minimum obligation it should accept was to ensure that the chain of conversions would not stop, to the disadvantage of the purchaser. The drawing member should be entitled to the equal value principle beyond the first step. It would be better if the drawing member could also select the second freely usable currency, but since that privilege was being reserved for the issuer, the purchasing member should at least be able to dispose of any currency that it received against its will under the equal value principle.

The amount of protection would be moderate, Mr. Kjaer agreed in response to a remark by the Acting Chairman.

The General Counsel observed that Mr. Kjaer's objective could not be met by amending Section 3(e)(iv) to include the words "directly or indirectly," because there were no indirect purchases from the Fund. Also, if the principle advocated by Mr. Kjaer was accepted, further redrafting in the provision would be necessary.

Mr. Laske commented that he had some understanding for the concerns expressed by Mr. Foglizzo, Mr. Kjaer, and Mr. Sacerdoti with respect to Section 3(e)(iv), although he believed that the Fund and its members would rely on the basic procedure set forth in Section 3(e)(ii) for conversion through the process of collaboration. Section 3(e)(iv) was a "safety valve" for use in the unlikely event of the collaboration process not working properly. A member issuing a freely usable currency would only resort to a request under Section 3(e)(iv) in a situation of extreme difficulty. In his view, the practical operation of the provision under the amended Articles would not involve much change from what was presently done.

Mr. Sacerdoti stated that he could agree with Mr. Laske that Section 3(e)(iv) would probably not create a problem in practice. Nevertheless, the safeguard it offered might lead to strange results. In theory, it was possible for a purchasing member to obtain a freely usable currency and, after a subsequent series of conversions, under the provisions of Section 3(e)(iv), end up with the freely usable currency it had first drawn and did not want to keep. Without a further explanation of the rationale for Section 3(e)(iv), he was not convinced that it was necessary and could not accept it.

Mr. Laske agreed that it was not likely in practice that the conversions would turn the full circle described by Mr. Sacerdoti. He was concerned more with the right of an issuing member to ask the purchasing member, if the purchaser was likely to make a conversion in a way that would be harmful to the interests of the issuer, that the issuing member should be able to make the conversion itself. Of course, the issuer was then under the obligation to make the conversion at equal value. Erratic fluctuations on exchange markets raised the possibility of a conversion by a purchasing member taking place, unknown to the issuer of the freely usable currency and at a moment of grave consequence for it. Thus, the operation and the intent of the entire system would be safeguarded if the issuing member had the right to claim in those circumstances that it should carry out the conversion itself.

Mr. Sacerdoti said that he could accept the interpretation given by Mr. Laske of Section 3(e)(iv), but he would not like to give the issuer of the freely usable currency the option of selecting the other freely usable currency to be offered to the purchasing member. He would like the second sentence of Section 3(e)(iv) to read "the exchange shall be made at the rate of exchange referred to in (i) above," without any reference to the selection of a freely usable currency by the issuing member.

Mr. Laske observed that the intention of the provision as it was presently drafted was to take care of the practical consideration that a member could not be asked to provide a currency that it did not hold. Other language had been used in Article V, Section 7(j)(iv), covering practically identical operations, to provide for agreement to be reached between the two members, but the identity of the operations was only a superficial one. His interpretation of Section 3(e)(iv) was, similarly, that there would have to be discussions if the purchasing member wanted a particular currency that it had not been able to receive under Article V, Section 3(d).

Mr. Sacerdoti considered that it was not a matter of the purchasing member asking for a currency that the issuer did not have. The purchasing member would receive a freely usable currency that it must be satisfied with but the issuer could then insist on making the conversion itself, and giving the purchasing member a currency that it did not want.

Mr. Amuzegar agreed with Mr. Sacerdoti that the issuer should not be given two rights. If the issuer did not have the currency wanted by the purchasing member, it should either let the conversion take place freely in any market, or if it wanted to exercise its right and request the purchasing member to carry out the conversion in the issuer's market to avoid detrimental effects, then the issuer should provide the particular currency sought. Otherwise, the issuer should give up the right to ask for the conversion to take place in its own market.

The General Counsel wondered whether there was real detriment to the purchaser inasmuch as the purchaser received equal value. The purchasing member's entry into the market would simply be postponed by one exchange. It would immediately enter the market and end up with the currency it sought in the third exchange, after having received equal value.

In response to Mr. Sacerdoti's proposal to amend the last sentence of Section 3(e)(iv) in line with Section 7(j)(iv), the General Counsel noted that the objective sought could only be achieved if there was a reference to the selection of the freely usable currency by the "purchasing" member instead of a reference to the "other" member.

The Acting Chairman added that the provision would be ambiguous without a clear reference to the member selecting the currency.

Mr. Bull said that he could also go along with bringing the wording of Article V, Section 3(e)(iv) into line with Section 7(j)(iv). However, Mr. Sacerdoti's wishes could probably only be fulfilled under the collaboration clause of Section 3(e)(ii). For that reason, his authorities considered that it would be most useful if the central banks of countries whose currencies were deemed to be freely usable for the purpose of the provision would undertake, under the collaboration clause but without having an obligation to do so in the Articles, to provide those currencies--under the equal value principle--that other countries wanted to hold in their reserves or to use in making payments. Of course, it was a matter that could be considered later when the provision was implemented under the amended Articles.

Mr. Cross believed there was also a question of what right a drawing country had when it obtained the currency of a country that issued a non-freely usable currency. Moving in the direction suggested by Mr. Sacerdoti might disturb the equal value provision in that respect. The issuer of a non-freely usable currency had an obligation under Section 3(e)(i) to provide a freely usable currency of its choice, but not to provide any of a number of currencies that the drawing country might want. Care should be taken to avoid setting up artificial incentives for drawing members to try to obtain one currency rather than another.

Mr. Laske said that he agreed completely with Mr. Cross that both the issuer of a nonfreely usable currency and the issuer of a freely usable currency had the same rights and obligations. Both could select the freely usable currency they wished to provide to the purchaser. Again, the prime consideration was that monetary authorities could not be asked to give a currency they did not hold. As for Article V, Section 7(j)(iv), with respect to repurchase operations, slightly different language was used for the same reason, namely, that the repurchasing member wishing to obtain a freely usable currency specified by the Fund could not be asked to provide a currency it did not have. Monetary authorities could not be expected to submit to the inconvenience of receiving in exchange for their own currency another currency for which they had no use and which they did not customarily hold in their reserves. As Mr. Bull had stated, the construction of all the provisions under discussion was carefully balanced.

The General Counsel drew attention to the need to take account of another consideration. If the issuer of a freely usable currency was required to acquire another freely usable currency that it did not hold, it would have to supply it to the purchaser at equal value under the terms of the provisions. But the issuer had no means under the Articles of getting the other freely usable currency at an equal value rate. The issuer therefore would have to obtain the currency at a nonguaranteed rate and provide it at a guaranteed rate.

Mr. Sacerdoti, responding to Mr. Cross' remarks, agreed that it was appropriate for the issuer of a nonfreely usable currency not to be compelled to provide a particular usable currency and not to be under the obligation to exchange the freely usable currency it provided for another. Also, he had no objection to placing an obligation on the issuer of a freely usable currency to convert it at equal value. His remarks had been directed to the right of the issuer of the freely usable currency to prevent the member receiving it from exchanging it in the market; instead of informing the purchasing member that it would officially convert its freely usable currency for the purchasing member, the issuer could state that it would provide another freely usable currency that the purchaser might not want. The General Counsel had observed that the conversion would take place at the rate of exchange referred to in Section 3(e)(i), and that the detriment to the purchaser in going to the market with one freely usable currency rather than another to obtain a third usable currency might not be great. Yet, as Mr. Laske had said, there might be times when it would be to the advantage of a purchasing member to go into the market with one particular freely usable currency rather than with another. The rationale for the provision was thus becoming clearer.

Mr. Kjaer said that he could agree that it might not be so detrimental to the purchaser, if it ended up with a particular freely usable currency and had no right to request further conversion under the equal value principle, provided that the list of freely usable currencies was restricted to very few currencies.

Mr. Kawaguchi asked what the position was with respect to the language of Article XXX(f). He could agree that determination of the list of freely usable currencies should await the implementation of the amended Articles, but he stressed the need for allowing as much flexibility as possible in the interpretation of the provision to cover all future contingencies. If the intention was to retain the word "all" in subparagraph (ii), he would have to reserve his position.

The Acting Chairman remarked that there was still a difference of view on the wording of Article XXX(f)(ii).

Mr. Kafka suggested a reference to "all relevant exchange markets."

Mr. Bull wondered whether Mr. Kawaguchi could not rely on a flexible interpretation of the provisions when they were implemented rather than changing the language at the present stage. He was not certain that the deletion of the word "all" made any substantive difference. To disturb the balance more radically would create considerable problems.

Mr. de Groote asked whether Mr. Kawaguchi would be satisfied with saying "widely traded in principal exchange markets."

Mr. Lieftinck said that he had no objection to the present text, which might, however, be improved if it read "widely traded in the international exchange market."

Mr. Monday remarked that he too could have accepted the present text. Although he could go along with the deletion of the word "all" in subparagraph (ii), he could not accept the deletion of the two words "all the," because that would make the meaning of the provision too vague.

Mr. Amuzegar agreed with Mr. Monday that both words could not be eliminated. However, the word "all" was unnecessary if the Fund was to determine which were the principal exchange markets.

Mr. Kjaer wondered whether the word "all" could be deleted if all candidates for inclusion on the list made a statement similar to that of Mr. Bull with respect to mutual arrangements between members on the list.

Mr. Sacerdoti considered that too long a list of freely usable currencies would be inadvisable, but a list limited to only one currency would be unacceptable. Either the retention or the deletion of the word "all" might lead to a very restrictive list of the principal exchange markets. On balance, he would prefer the deletion of the word "all," unless that would add to the risk of too long a list; he was inclined to think that it would tend on the contrary to restrict it to only one currency.

Mr. Laske believed that it would make little difference whether the word "all" was kept or not. His preference was for not changing the text. The test would come when the Fund had to decide on the principal exchange markets. If the word "all" was not kept, the tendency at that time might be to decide on a wider list of freely usable currencies than if the word was retained, even though there might be a desire to make the list as short as possible.

Mr. Deif stated that his preference would be for the deletion of the word "all."

Mr. Foglizzo considered that if the deletion was not widely supported, the word "all" should be kept in subparagraph (ii).

Mr. Heyden, Mr. Kafka, Mr. Sein Maung, and Mr. Whitelaw said that they would be willing to support the deletion of the word "all."

Mr. Nana-Sinkam agreed fully with Mr. Laske that when the definition of a principal exchange market came up for discussion, many countries would be candidates. It was open to question whether all their currencies would be widely traded and used in the exchange markets on the Fund's list. Since in the last analysis it was up to the Fund to define the principal exchange markets, it could always use its discretion to limit the list. On those grounds, he was in favor of deleting the word "all."

Mr. Drabble expressed a slight preference for the deletion of the word "all," partly for the reason mentioned by Mr. Nana-Sinkam that it might be useful to give the Fund more discretion to define the principal exchange markets for the purpose of the provision. The use of a word like "all" might imply another standard. That was why he had remarked earlier in the discussion that the word "all" left the impression that there was a finite list of markets, as determined by the volume of exchange passing through a particular market. There might well be reasons for the Fund not wishing to base its definition on such a standard.

The Acting Chairman concluded that there was a consensus in favor of deleting the word "all," without any intention of prejudging the extent to which the list would be opened up, because the provision would have to be interpreted and the word "the" would remain.

The Executive Directors accepted the deletion of the word "all" in Article XXX(f)(ii).

The meeting adjourned until the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Directors without meeting in the period between EBM/76/41 (3/12/76) and EBM/76/42 (3/15/76).

6. ARAB REPUBLIC OF EGYPT - TECHNICAL ASSISTANCE

In response to a request from the Government of the Arab Republic of Egypt for technical assistance, the Executive Board approves the proposal set forth in EBD/76/47 (3/8/76).

Adopted March 12, 1976

7. SWAZILAND - TECHNICAL ASSISTANCE

In response to a request from the Government of the Kingdom of Swaziland for technical assistance, the Executive Board approves the proposal set forth in EBD/76/48 (3/8/76).

Adopted March 12, 1976

8. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/76/53 (3/11/76) is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 76/100, July 9, 1976

H. JOHANNES WITTEVEEN
Chairman

ROGER V. ANDERSON
Acting Secretary