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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Seminar 94/10

3:30 p.m., November 16, 1994

S. Fischer, Acting Chairman

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M.-A. Autheman	
J. Bergo	
	J. Guzmán-Calafell, Temporary
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	J. Shields
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C. Saito	A. G. Zoccali
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A. S. Shaalan	
	G. Y. Glazkov, Temporary
E. L. Waterman	
J. de Beaufort Wijnholds	
Zhang M.	Wei B.

J. W. Lang, Acting Secretary
S. W. Tenney, Assistant

Also Present

African Department: C. Brachet. Central Asia Department: L. E. Leruth. Fiscal Affairs Department: V. Tanzi, Director; M. Annunziata. Legal Department: R. B. Leckow. Monetary and Exchange Affairs Department: J. B. Zulu, Director; M. Guitián, Associate Director; V. Sundararajan, Deputy Director; W. E. Alexander, F. Caramazza, C. Enoch, K. M. Huh, R. B. Johnston, A. Kovanen, H. Mehran, D. A. Menchikov, L. Papi, P. J. Quirk, V. A. Sandoval, T. Yoshimura. Policy Development and Review Department: M. Allen, Deputy Director; H. M. Al-Atrash, P. Gajdeczka. Research Department: B. Turtelboom. Secretary's Department: A. Mountford. Southeast Asia and Pacific Department: M. R. Stone. Treasurer's Department: J. C. Berrigan. Office of the Managing Director: M. A. El-Erian. Advisors to Executive Directors: P. Cailleteau, A. Chang Fong, T. K. Gaspard, M. F. Melhem, S. O'Connor, M. Petrie, C. F. Pillath, J. R. Suárez. Assistants to Executive Directors: S. Al-Huseini, S. Arifin, P. I. Botoucharov, A. G. Cathcart, J. A. Costa, G. El-Masry, R. Ferrillo, H. Golriz, O. Himani, P. Jilek, B. M. Lvin, Ng C. S., V. Rigász, F. A. Schilthuis, G. Schlitzer, A. Sighvatsson, Wang Y., J. B. Wire.

1. INTERNATIONAL EXCHANGE AND PAYMENTS SYSTEM - ISSUES AND DEVELOPMENTS

The Executive Directors considered a staff paper on issues and developments in the international exchange and payments system (SM/94/202, 8/1/94; and Sup. 1, 8/12/94).

The staff representative from the Monetary and Exchange Affairs Department made the following statement:

> The staff paper for the current discussion surveys developments and issues in the exchange and payments system that cut across a broad range of the institution's functional and jurisdictional interests and purposes. These pertain especially to the areas of progress made in the acceptance of the obligations of Article VIII of the Fund's Articles of Agreement and currency convertibility that have been cited by the Managing Director as involving important policy objectives for the Fund in ensuring further progress in developing the international monetary system.
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> Issues that arise in the context of exchange system developments are summarized in Section VIII of SM/94/202 (8/1/94), under the relevant headings. As a further aid to help focus the discussion, this statement lays out possible priorities that might be given to these issues.
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> The issue of accelerating members' acceptance of the obligations under Article VIII is clearly a subject to which Directors may wish to give particular attention, as it is in the nature of unfinished business. Although recent experience with the establishment of full current and capital account convertibility have underlined the feasibility of full convertibility for a broader group of the Fund membership than had previously been expected, adoption of Article VIII status is of immediate relevance for an important share--one third to almost one half--of Fund members. In many cases, acceptance of the obligations under Article VIII is dependent on the lifting of exchange restrictions evidenced by external payments arrears--the elimination of which is, itself, a key objective of Fund-supported programs and technical assistance. One fourth of Fund member countries both have arrears and continue to avail themselves of the transitional arrangements under Article XIV. Directors may, therefore, wish to comment especially on the proposals to sustain the progress made over the past 18 months in promoting acceptance of Article VIII obligations.
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> The Board has on several occasions raised questions about the role of the Fund in the assessment of capital controls that are "necessary to regulate international capital movements" in accordance with Article VI, Section 3 of the Articles. The staff paper currently under consideration summarizes recent experience

since the last discussion of Fund jurisdiction over multiple currency practices applicable to capital transactions in 1985, and examines the possibility of setting terms of reference for an updated review of the broad aspects of capital convertibility, say, in early 1995. Such a review would involve in-depth analysis of the experiences with convertibility, and the Fund's role in this area in relation to that of other international and regional organizations, as well as that of its own jurisdiction under Article VIII.

General issues related to the role of exchange rate regimes in the international system were recently discussed by the Board (Seminar 94/8, 7/25/94), on the basis of a staff paper on improving the international monetary system (SM/94/170, 7/1/94). The staff paper currently under consideration documents developments in specific forms of regimes and the role of technical assistance in ensuring that markets are efficient and stable, within the regime chosen by the member in accordance with Article IV. Fund policies on the risks associated with nonmarket forward and multiple regimes are restated in the staff paper, and their confirmation by the Board is sought.

Regionalism and bilateralism in members' payments arrangements were last reviewed by the Board at EBM/82/123 (9/20/82), on the basis of a staff paper on review of bilateral payments arrangements, 1976-81 (SM/82/169, 8/17/82). The staff paper for the current discussion provides an update of developments and a summary of the Fund's current policies on the full multilateralism envisaged in Article I of the Articles. Directors may wish to consider the continued relevance of these policies, and provide views on any re-emphasis that may be required in light of the accession to Fund membership of previous members of the Council for Mutual Economic Assistance (CMEA) and the continuing payments regionalism elsewhere that is documented in the staff paper.

Another staff representative from the Monetary and Exchange Affairs Department made the following statement:

Updates of some of the main developments since the issuance of the staff paper on this subject are contained in SM/94/202 (8/1/94) and Supplement 1 (8/12/94), and BUFF/94/76 (8/1/94).

Since July 29, 1994, an additional four countries have accepted Article VIII status: Estonia on August 15, 1994 (EBD/94/150, 9/06/94); India on August 20, 1994 (EBD/94/156, 9/21/94); Paraguay on August 23, 1994 (EBD/94/159, 9/23/94); and Western Samoa on October 6, 1994 (EBD/94/117, 10/13/94).

These acceptances have brought the total number of members with Article VIII status to 97 as of November 14, 1994, representing 54 percent of the overall Fund membership. Seventy-three developing countries, or 47 percent of the members in this group, have accepted the obligations of Article VIII.

The number of acceptances received in the period August-November is consistent with the accelerated rate--of approximately one member per month--achieved since early 1993.

With the completion and issuance just prior to the 1994 Annual Meetings of the Annual Report on Exchange Arrangements and Exchange Restrictions, another year of comprehensive data on exchange controls has become available. Preliminary analysis of this data shows a continuation of the pattern described in SM/94/202. Of the 68 measures reported by Fund member countries in 1993 related to convertibility for invisible transactions, and not introduced for reasons of national security, 50 represented liberalizing actions--13 of the 18 tightening actions arose from a new exchange regime in the CFA franc zone. Similarly, of the 85 actions affecting the capital accounts of members in this period other than a few regulations introduced for prudential purposes, all but 8 were to permit greater freedom for capital transactions.

The staff intends to incorporate a summary of the updated information from the 1994 Annual Report on Exchange Arrangements and Exchange Restrictions in the version of the biennial review for publication.

Mr. Clark made the following statement:

The staff paper provides thorough and useful background information on the recent history of foreign exchange restrictions in member countries and on the Fund's powers and policies with respect to eliminating these controls. Although the staff paper also covers interesting issues associated with exchange rate regimes--particularly with respect to multiple currency practices--and with bilateralism and regionalism in cross-border payments, I will focus my comments on the issue of exchange rate restrictions.

We support the proposition that foreign exchange restrictions, which limit access to foreign exchange at a nondiscriminatory price in the spot or forward markets, are generally ineffective in limiting capital outflows and stabilizing foreign exchange markets. This proposition encompasses restrictions on foreign exchange payments for both current transactions and capital transactions. As the staff paper indicates, the distinction between foreign exchange payments associated with trade flows, as opposed to capital flows, is largely meaningless. International capital flows are vital to the development of world trade in goods and services, and payment flows from foreign currency transactions in all markets have implications for monetary and exchange rate policies. The staff's empirical analysis bears out this proposition, especially when the elimination of such controls are combined with the liberalization of the domestic financial sector, the adoption of a reasonably flexible exchange rate regime--at least one that minimizes misalignment prospects--and a program of sound macroeconomic policies and supportive structural reforms.

Suggestions that foreign exchange controls may be justified for prudential reasons--either national security or investor protection--have little merit, as other mechanisms are available that perform this function more effectively. For example, concerns about the risk of investing in foreign currency assets can be satisfied through disclosure requirements or portfolio restrictions that deal directly with the issue. Similarly, risks associated with forward exchange rate positions can be mitigated through capital and margin requirements or through position limits, rather than through restrictions on access to forward exchange markets.

For this reason, the implication in the staff paper that there are circumstances under which temporary approval of foreign exchange restrictions under Article VIII may be justified is worrisome. These justifiable conditions refer either to balance of payments problems or prudential risks. The staff analysis indicates that the former are better handled with appropriate stabilization and foreign exchange policies and the latter can be easily used to mask trade protectionism.

The increasing assertiveness of the staff in recent years in promoting the elimination of foreign exchange restrictions among developing countries, through its technical advice and program design, and in its efforts to encourage members to accept the obligations of Article VIII, has been valuable and successful. We presume that the staff has pursued this objective in its broadest sense, encompassing both current transactions and capital transactions, and encourage it to continue to do so. In this respect, we would suggest that the staff continue to interpret the provisions of Article I as directing members to avoid imposing foreign exchange restrictions on capital transactions to inhibit productive capital flows. Considering the difficulty involved in distinguishing between productive and nonproductive capital flows, it would be safest to recommend the elimination of all foreign exchange restrictions.

The consultative approach that the staff has adopted in encouraging members to accept the obligations of Article VIII and to eliminate foreign exchange restrictions on capital transactions is preferable to a more confrontational approach, even when the latter is within the jurisdiction of the Fund. From a practical viewpoint, persuasion and demonstration are generally more successful over the long term than compulsion. Nevertheless, the use of persuasion and demonstration should be increasingly persistent.

The staff explicitly states that, whatever the purpose of multiple exchange rates, they distort relative prices and the allocation of resources. Moreover, they typically provide special treatment for specific groups, permitting those groups to benefit from risk-free arbitrage opportunities that exist only as a consequence of exchange market inefficiencies. Accordingly, multiple exchange rate regimes promote special interest politics. Moreover, such regimes are costly to administer, particularly in comparison with less distortionary redistribution mechanisms. At previous reviews of these practices, the Board concluded that, because of their costs in terms of inefficiency and their distortionary effects, such practices are not conducive to medium-term balance of payments adjustment.

In light of these assertions and conclusions, it is puzzling that the staff finds any value in multiple exchange rate practices, even as a temporary device. If such a device is distortionary, it cannot be a valuable transitional tool for finding a new equilibrium level for an exchange rate. As it is now well accepted that misalignments under fixed exchange rate regimes are as prevalent as overshooting under more flexible exchange rate regimes, multiple exchange rates have no proven value as guarantors of exchange rate equilibrium. Moreover, by segmenting exchange markets, such practices will likely create disincentives for the development of interbank markets, and could add to the volatility of exchange rate movements.

The staff notes that the Fund's policies on the approval of such practices remain flexible. Under a consultative approach, such flexibility should not override the objective of eliminating such practices as quickly as possible.

Although the section of the staff paper on bilateralism and regionalism in cross-border payments is quite informative, it seems to raise more questions than answers. This would suggest that further work is needed on these topics. For example, is bilateralism linked to any particular exchange rate regime, such as a currency union, or a less rigid fixed exchange rate regime? If exchange rates are somewhat flexible, even with bilateral payment systems, would the absence of bilateralism reduce exchange rate volatility and increase the efficiency of foreign reserve management significantly?

With respect to regional payment arrangements, the pros and cons are outlined well, in theory at least. What has been the empirical experience with these arrangements? This is an important issue not only for developing countries, but also for industrial countries that are in the process of creating regional clearing houses for foreign exchange transactions in Europe and North America.

Mr. Wijnholds made the following statement:

One purpose of the Fund is to assist in the elimination of foreign exchange restrictions that hamper growth of world trade, and to establish multilateral systems of payments in respect of current transactions between countries. Therefore, the Fund should remain in the forefront of developments concerning advice and analysis on current and capital account convertibility, exchange rates and payments systems. The staff paper and statement on the Fund's role in these areas are, thus, very welcome and I generally agree with the staff's suggestions.

The theoretical arguments against foreign exchange restrictions seem compelling. Current account convertibility reduces distortions derived from foreign exchange rationing, opens up the domestic market to foreign competition, allocates domestic production to areas of comparative advantage, and improves access to capital inputs. Similarly, capital account convertibility allows foreign investments to support the economy and domestic capital to find its optimal ratio of risk to return.

When a credible adjustment effort is undertaken, the negative side effects of liberalizing foreign exchange will probably be no more than a temporary loss of output. However, if unsound policies are pursued, disturbing capital outflows can result. It can, nevertheless, be argued that capital outflows will result from unsound policies even when current and capital account restrictions are in place, through overinvoicing of imports or parallel market activities.

Considering the points I have just mentioned, I wish to support further progress in accelerating members' acceptance of Article VIII obligations and to support the measures that have recently been applied to do so. Moreover, the proposals for direct communication by Fund management to the authorities, and for formal representation noting that circumstances favor acceptance of Article VIII obligations, seem useful in this respect.

Countries that have not yet formally accepted Article VIII obligations, but do already more or less meet all of them, should be aware that accepting Article VIII will probably enhance the confidence that financial markets award to such countries.

The Fund's role in eliminating foreign exchange restrictions, as set out in its Articles, focuses on the current account. Following the changes in exchange rate arrangements since the end of the Bretton Woods system, the Fund has adapted somewhat flexibly to the new demands for more capital account convertibility. But it is useful to reassess the role and jurisdiction of the Fund in this field. I therefore look forward to a review on this topic in the near future. Anticipating this discussion, I wish to put forward a few considerations.

In general it can be expected that countries that pursue sound economic policies will abolish foreign exchange restrictions sooner or later, as this is in their own interest.

Prerequisites for early abolition of foreign exchange restrictions are confidence in the adjustment program and equilibrium in domestic demand and supply. Where these factors are absent, capital flight could result, threatening the adjustment program through large losses of reserves and/or severe depreciation. However, an early abolition of restrictions could accentuate the authorities' determination with respect to the adjustment process, hence, enhancing market confidence in the program.

Thus, different circumstances seem to merit different sequencing of currency convertibility. The larger the distortions and the smaller the market credibility, the more carefully currency convertibility should be undertaken. It would therefore appear to be appropriate that the Fund policy toward foreign exchange liberalization should not be too rigid and should be judged on a case-by-case basis. However, I agree that within such a policy, the bias should be toward removing the rigidities as soon as circumstances permit.

It remains to be seen whether a flexible approach is consistent with the inclusion in the Articles of a provision that would command the Fund to impose foreign exchange convertibility. The absence of such an article would not preclude the Fund from exerting influence in this field. The Articles do not include the enforcement of fiscal consolidation or of modest growth of net domestic assets either, although these are often performance criteria in Fund programs.

Concerning the choice of exchange rate regimes, it is important that member countries receive specific guidance from the Fund on which main factors to consider. The weight of Fund advice seems to have tilted from advocating floating exchange rates in the 1980s, following debt problems and overvalued exchange rates, to more pegged rates that impose more discipline on policy and are more transparent for the public. The latter regime, with the exchange rate as a nominal anchor, has proved to be successful in a number of instances. Therefore, more guidance by the staff to member countries on the underlying requirements of this regime--prudent macroeconomic policy and a peg level that is consistent with the fundamentals--can be useful.

I support the staff in its plea for countries to remove their multiple exchange rate regimes and in the risks it identifies concerning nonmarket forward regimes.

With respect to bilateral payments arrangements, it appears that their application is declining, when not taking into account the recent increase from the former socialist countries. To counter the remaining bilateral arrangements, I wish to support the broad conclusions reached at the previous review in September 1982. I support the staff's suggestion to identify restrictions in regional trading arrangements that are inconsistent with Article VIII and to encourage members to eliminate them.

Mr. Shaalan made the following statement:

I will comment on the issues for discussion set out in the last section of the staff paper and in the accompanying staff statement.

First, I agree that the procedures adopted in 1993 to encourage members to assume Article VIII obligations have been effective. Direct communications by management could generate further progress in this area, although it may be too soon to assume that the existing procedures have gone as far as they could. But, beyond the choice of the most appropriate channel for encouraging those members that have substantially liberalized their exchange systems to assume Article VIII obligations, the message itself is important. In particular, those members should be made aware that their retention of the transitional arrangements under Article XIV does not give them a license to introduce new restrictions, or to intensify existing ones.

Second, I would favor waiting another year or so before embarking on a campaign of formal representation under Article XIV. We should keep in mind that the existing procedures for encouraging members to, so to speak, upgrade their membership status have only recently been adopted and that their adoption came after a long period during which the Fund had not actively pursued this objective. Again, existing procedures have been quite effective. Let us give them some more time to produce results, before moving on to the next phase.

Third, I agree with previous speakers that it would be useful to focus on the issues underlying approval, or nonapproval, of restrictions during Board discussions. But, it is important to ensure that these discussions are based on a thorough coverage in the staff reports of the factors underlying staff judgments concerning the existence of restrictions in the first place.

Fourth, where the elimination of exchange restrictions evidenced by arrears is dependent on action by other members, I would favor not discouraging members whose exchange systems are otherwise free of restrictions on current international transactions from notifying the Fund of their wish to assume the obligations of Article VIII. The obligations under Article VIII are just that--obligations. But, in an environment of increasingly open trade and payments systems, assuming those obligations may well be seen, at least by some members, as a privilege--and one which should not be denied.

Fifth, greater publicity of the Fund's position on restrictions, in individual cases, could entail risks that cannot and should not be ignored. Such publicity could increase the likelihood of members being sued for the imposition--or the existence--of restrictions not approved by the Fund. It could be argued that this is not so bad after all, as it promotes the enforceability of contracts. That, it could do. But, it could also increase the likelihood of the Fund's being viewed as taking sides in contract disputes. Moreover, under the existing procedures for sharing staff reports with other institutions, all decisions are deleted prior to transmittal. It strikes me as quite extraordinary to move from such a scrupulous regard for confidentiality to having decisions of a sensitive nature released to the press.

Sixth, I do not have much enthusiasm for the possibility of extending the Fund's jurisdictional responsibilities to cover capital account transactions and multiple currency practices related to capital movements. The staff rightly points out that such an extension would be more in the nature of recognizing the practical reality. However, this raises a question as to whether the extension is so essential as to justify amending the Articles.

Mr. Mesaki made the following statement:

Article VIII, Section 2, which specifies members' obligations to avoid restrictions on current payments, has been a main component of the Articles from the beginning. As we can see from the description prior to the second amendment of the Articles, the transition clause--Article XIV--was introduced primarily because of the disorderly postwar conditions. Therefore, it is a fundamental pledge associated with Fund membership not to restrict payments and transfers for current international transactions and, if restrictions remain, to remove them as soon as possible. One of the Fund's most important assignments is to promote such developments.

From this viewpoint, the Fund is quite naturally expected to encourage members to accept Article VIII obligations. The relevant question here is how. One way is to press members more, emphasizing the obligations they assumed at the time of joining the Fund. Although I sympathize with this idea, caution is also required. Of course, the possibility of making representations stipulated in Article XIV, Section 3, should not be eliminated; however, I cannot agree with the frequent use of representations, which is against the Article itself. Nor can I agree with the application of Article XIV, Section 3 in a form such as a general declaration of conditions being favorable for general transition to Article VIII status, or in a mechanical form such as one based on the time outstanding under Article XIV status. It is not only difficult but also against the aim of Article XIV, Section 3 to examine in general terms whether conditions are favorable for the withdrawal of restrictions. Moreover, if restrictions are frequently reintroduced after transition to Article VIII status, the character of Article VIII status becomes vague, and careful prior examination is therefore required. In this connection, stricter assessment is warranted when the Fund examines approval of restrictions by Article VIII status members.

At least for the time being, it seems more appropriate to continue seeking the elimination of exchange restrictions, through consultations with the authorities. Consultations with countries that have a greater share in world trade are especially important. By graduating from Article XIV status, a member can expect to gain greater international confidence, and current transactions with the member will be promoted.

Turning to the issue of capital account convertibility, as the staff paper points out, international capital movements provide vital support to the multilateral trading system and play a critical role in economic development. Therefore, generally speaking, it is appropriate for the Fund to appeal to members to remove impediments to international capital movements, through various channels including Article IV consultations.

However, the idea of extending the Fund's jurisdictional responsibilities to include capital account convertibility requires additional examination from various viewpoints. For that purpose, I would like to have the staff's comments on the following points.

In the case of current transactions, the Fund's jurisdiction covers payments and transfers for current transactions, but not current transactions themselves, which are mainly covered by the jurisdiction of GATT. Note 1 in the staff paper creates the impression that the same applies to capital transactions; that is, the Fund's jurisdiction, if extended, will cover only foreign exchange transactions associated with capital transactions. Is my understanding correct? If so, what kind of image should we have concerning the relationship between capital account convertibility and capital transaction liberalization?

Citing a study by Sir Joseph Gold, the staff paper states that there is an established principle that the Fund examines capital movements in its exercise of surveillance over exchange rates. At Board meetings, Directors discuss, and sometimes criticize, individual members' policies on capital transactions from various viewpoints, including the effects of capital restrictions on the overall economy. I wonder in what respects the current procedure is inadequate.

In practice--whatever the theory may indicate--capital account liberalization is normally preceded by current account liberalization. At this stage, transition to Article VIII status, one of the main areas covered by the Fund's jurisdictional responsibilities, has been completed for only about half of the member countries. How should we evaluate the relationship between such a situation, and the extension of the Fund's jurisdictional responsibilities to capital account convertibility?

Although we naturally expect capital transactions to be liberalized over time, I wonder whether we can have a definite belief at this stage that, at least conceptually, full and immediate liberalization is justified a priori. I sympathize somewhat with Keynes, if he thought that at least some speculative capital flight was a matter for concern. I do not think the issue is as clear-cut as Mr. Clark states. In addition, we should keep in mind that, in reality, capital account liberalization proceeds only step by step. If restrictions remaining at a certain stage are subject to Fund approval, the effectiveness of such restrictions may be hampered, however justifiable they may be, because flexible adjustability to changing circumstances is an essence of capital control measures.

Concerning exchange rate regimes, the main conclusions of the 1984 and 1985 reviews on multiple exchange practices, and the review in 1988 on forward exchange rate regimes remain valid. I do not have any difficulties with the staff paper's description on bilateralism and regionalism in cross-border payments. The Fund is expected to continue paying due attention to the possible inconsistency of regional arrangements with Article VIII. I agree with the staff's view that advice on foreign exchange issues should be linked to other areas of technical assistance, including monetary operations, banking supervision, and payment systems.

Mrs. Cheong made the following statement:

The staff has done commendable work on analysis of the payments systems of member countries. However, in analyzing capital restrictions, the staff tends to treat rules affecting foreign ownership or restrictions to foreign participation as equivalent to restrictions on capital payments. Concurrently, the staff concedes that quantitative limits for goods and services are trade issues and in no way represent a payments restriction. This same principle should apply to restrictions on foreign ownership and other similar restrictions.

Countries with restrictions on foreign ownership can still have free payments systems, as payments systems are generally resident neutral. As a general rule, regulations on ownership do not affect the payments system, per se, although they may affect the volume of capital flows into, and out of a country. In fact, rules on ownership are already being treated as trade matters and are currently being negotiated as market access and national treatment commitments under the Uruguay Round agreements. The Fund should, therefore, distinguish rules of this nature when assessing the degree of liberalization of a member's payments regime.

The staff analysis of bilateral and regional payments arrangements in the context of Article VIII deserves some comments, but these could probably best be discussed when the staff paper on the review of such payments arrangements is circulated to Directors. However, at this juncture, suffice to say that the Fund, in determining whether an arrangement restricts payments, should pay due attention to the economic benefits of these arrangements in expanding world trade and economic growth. It would seem odd that bilateral payments arrangements can cause trade growth and yet restrict payment for the goods. The staff may wish to consider that there are many ways of making trade payments, paying due regard to practical problems, and not approach the issue in an entirely legalistic manner.

As to the proposals concerning the possibility of extending the Fund's jurisdictional responsibilities, like previous speakers, I doubt the usefulness of such an exercise. As the staff clearly pointed out, most countries, including developing countries, are already liberalizing their exchange control regimes. These would, over a relatively short period, cover most current and capital transactions. Most, if not all developing countries, and certainly those in my constituency, are committed to liberalizing payments systems as an effective way to promote investments and technology transfer, and to facilitate trade. However, such liberalization would be done in stages, more for prudent management, as liberalization is usually viewed as a one-way ticket. In many countries, few restrictions remain, and most of those that do concern mainly foreign participation in capital-related services. These are trade matters and should not be misconstrued as restrictions on payments. Extending the Fund's role, in a legal sense, to cover capital transactions as a means to achieve its broader objectives may therefore not be necessary. Even if the Fund were to expand its jurisdiction to cover capital transactions, as countries continue to deregulate, the Fund's jurisdictional efforts would again focus on a smaller range of exchange restrictions. It would seem that world economic development has been such that there is less for the Fund to do. Nevertheless, the Fund's role in this area need not diminish. It would be more useful for developing countries, and for the Fund, if it were to provide expert advice and guidance to countries on the direction of policy in general, and on the measurement of capital flows in particular. The latter would enable better and more detailed balance of payments analysis, and if more countries are able to collect, compile, and publish capital flow data on a more timely basis, it would assist the Fund in its analysis of the impact of such capital movements on macroeconomic stability.

Finally, a brief comment on the statement in the staff paper about the GATT overseeing the liberalization of capital transfers. The GATT Services Agreement deals only with issues of foreign participation in a member's services sector. In drafting the services agreement, countries agreed that removal of payments restrictions is not a trade issue, as these are generally taken for macroeconomic reasons and not intended to restrict services trade. However, it is recognized that, in making market access commitments, countries must ensure that payments arrangements do not nullify the commitments made. In other words, the GATT does not oversee the liberalization of capital transfers, only the market access restrictions. Of course, as a result of market access liberalization, the restriction on capital transfers may also be liberalized. The point is that, although the end result could be the same, the legal obligations for the GATT and, later, the World Trade Organization (WTO) members, are different from what is stated in the staff paper.

Mr. Schoenberg made the following statement:

The comprehensive and informative staff paper addresses one of the Fund's primary purposes: the elimination of foreign exchange restrictions. Undoubtedly, the Fund has done a very good job in carrying out its mandate to free individual countries from current account exchange rate controls, and we would encourage this institution to continue on that course.

In this context, I wonder whether the staff's observation on page 15, paragraph 2, namely, "that the liberalization of exchange systems that has accelerated since the mid-1980s has led to an improved environment for accepting the obligations of Article VIII in a number of countries" also refers to the liberalization of exchange rate systems. If there were a link between the liberalization of the exchange rate and the liberalization of foreign exchange transactions, then such a nexus should be taken into account if we discuss the desirability of more formalized exchange rate arrangements. The staff's comments would be welcome.

I would like to address two of the issues identified by the staff as important in the context of further developments of the exchange system. Before focusing on the question of Fund jurisdiction over capital account convertibility, let me first deal with some practical issues regarding possible ways to achieve further progress in the area of current account convertibility.

In particular, we would stress the staff's observation that the acceptance of Article VIII obligations is only sensible in cases where individual countries offer clear prospects for being in a position to fulfill their corresponding obligations.

Like other Directors, we would see some merits in direct communications from the Fund's management to authorities availing themselves of the transitional arrangements of Article XIV, communications that would emphasize the benefits of rapid transition to accept Article VIII obligations.

However, a procedure under which the Fund would exercise continuous pressure on qualifying members to give up their transitional arrangements under Article XIV would be more effective.

In principle, there should be also no objections to "a more general declaration of conditions"--preferably in the form of a decision by the Executive Board--with respect to the transition from Article XIV status to Article VIII status--by countries long overdue to take that step. We would, however, expect not too much effect of such a procedure in practice. More progress can probably rather be expected by way of an ongoing consultation process based, above all, on the required positive results of a country's adjustment policies. I agree here largely with Mr. Clark's view, namely, that persuasion and demonstration are likely to be more successful than compulsion.

With respect to the compatibility of restrictive exchange practices not approved by the Fund and the use of Fund resources, the Fund should use its additional leverage and insist on a timetable for elimination of the restrictions and accepting Article VIII obligations. Pressuring Article XIV member countries to accept Article VIII obligations, however, would only be sensible if the economic prerequisites in the countries concerned are in place. Greater publicity with respect to the Fund's position on exchange rate restrictions could also foster its objectives.

Let me now turn to the issue of capital account convertibility.

The staff has raised the fundamental question, whether the Fund's jurisdictional responsibilities should be extended to include payments, transfers, and multiple currency practices related to international capital movements including a corresponding amendment to the Articles of Agreement.

The staff's comments on that subject appear somewhat too strongly dictated by the regret that--given the worldwide progress toward current account convertibility--the Fund's continued focus on jurisdiction on current account transactions has led to its covering a diminishing share of total exchange transactions.

To the extent that the Fund has succeeded in carrying out its mandate thereby inevitably reducing the scope for further activity in this area, we should be rather happy with that outcome. The staff has, however, a valid point noting that the international monetary system is being more and more dominated by capital movements.

There are good reasons for looking more closely at the objective pros and cons of extending the Fund's jurisdiction to capital transactions.

In this context the question arises, for example, how many countries that do meet the requirements for accepting capital account convertibility have not moved yet into that direction. Another question would be how many of those "eligible" countries could be better convinced to assume capital convertibility status by creating a legal requirement as compared to steady behind-the-scenes encouragement by the Fund in the same way as the Fund lobbies member states to move from Article XIV to Article VIII status.

Then there is the question to what extent might the establishment of a legal obligation to move toward capital account convertibility have implications for the Fund's lending operations, for instance, by creating the obligation for the Fund to finance any perceived or actual balance of payments consequences of such a move. Many observers have made the point that the Fund's lending potential would have to increase dramatically in such a case because international capital flows are so large.

Finally, the question might arise precisely how the delineation of responsibilities between the Fund and other international organizations, such as the Organization for Economic Cooperation and Development (OECD) and the Bank for International Settlements (BIS), would appear if the Fund were to assume jurisdiction over capital account convertibility. Would such a step entail potential supervisory or prudential consequences? Which institution would be expected to define what national measures would constitute capital restrictions?

I have no ready answers to these questions. However, already this short list of issues appears to indicate the need for a thorough review of all the relevant aspects before drawing definite conclusions. Accordingly, my preference would be to ask the staff to prepare a paper analyzing in detail the principal costs and benefits of a move of the Fund into jurisdiction over capital account convertibility. Meanwhile, the Fund continues to have ample opportunity, in its existing framework, that is, in the context of its surveillance function and Article IV consultations, to convince member countries of the benefits of open capital markets.

Having said that, I would like to reiterate our long-standing conviction that no exchange restrictions, be it in the area of current account transactions or in the domain of capital movements, can provide sustainable solutions to balance of payments problems.

Countries that want to benefit from the obvious advantages of free capital movements have to accept a certain "impairment" of their economic policy sovereignty. Particularly, large abrupt change in capital flows can make economic policymaking more difficult. However, as it is impossible to differentiate between "good" and "bad" capital transactions, any attempts to foster the former and to bar the latter will fail. Moreover, earlier analysis undertaken by the staff indicates that most of the policy changes that have been forced by international capital markets seem to have been in the right direction.

Mr. Guzmán-Calafell made the following statement:

A number of encouraging trends have been observed in the international exchange and payments system over the past few years. The process of foreign exchange market liberalization has been finished in all but a few industrial countries. Simultaneously, a changing perception in developing countries as to the benefits of exchange controls, combined with the implementation of bold market-oriented economic reforms, has accelerated the elimination of restrictions on international payments and transfers in these nations. Despite the progress made, much still needs to be done and several concerns remain. As the staff paper is rather comprehensive, I will concentrate my comments on those aspects that are the most important.

Let me first consider the issue of Article VIII acceptance. The modest number of countries willing to abandon transitional status under Article XIV and to accept obligations under Article VIII is disappointing. Nevertheless, as explained in the staff paper, with the recent intensification of the staff's efforts the rate of Article VIII acceptance has increased substantially. The central issue is how to sustain, and even give an additional impetus to this trend; The best way to proceed is to continue along the path followed so far by the staff. If this approach has proved to work well in recent months, there does not seem to be a valid reason to change it.

In the case of those countries availing themselves for excessively long periods of provisions under Article XIV, Section 2, it would seem reasonable to reinforce such an approach via direct communication between the management and the corresponding authorities, as proposed in the staff paper. I agree with previous speakers that formal representations under Article XIV, Section 3, do not seem necessary at this stage. The most adequate route, for the time being, would seem to be to wait and see to what extent the approach adopted since early 1993 gains additional strength.

The question of Fund jurisdiction over exchange transactions and transfers related to international capital movements is a complex one, as evidenced by the last Board discussion on multiple--currency practices applicable to capital transactions. The empirical evidence shows that restrictions on capital movements have a number of efficiency costs. They are also very difficult to enforce, and eventually, economic agents find the way to circumvent them. In this context, I fully share the idea that eliminating controls on capital movements worldwide would have a substantial beneficial impact on the world economy. Nevertheless, whether Fund jurisdiction in this area is the best way to achieve such an objective is an issue that raises a number of doubts.

As the staff paper shows, the recent progress observed in the liberalization of capital accounts in developing countries is closely linked to the implementation of more adequate economic policies in these countries. One could argue, therefore, that the best the Fund could do to contribute to a more liberal environment for capital movements would be to strengthen its policy advice through Article IV consultations, Fund-supported adjustment programs, and in general, more efficient implementation of surveillance. In addition, some concern has been expressed in the past that the Fund's jurisdiction over capital movements would be effectively applied to only those member countries with Fund-supported economic programs, thereby making Fund surveillance less equitable.

A related topic is the interpretation of the approach to capital convertibility in the Articles. I have some difficulty in accepting the staff's position that, by seeking to eliminate foreign exchange restrictions which hamper the growth of world trade, Article I may have been intended to suggest that the restrictions to be eliminated were not only those that applied to current international transactions, but also those that inhibited the flow of productive capital. In view of the importance of the issue involved, I would expect to see support for this interpretation in Article VI, Section 3. Nevertheless, this Article does not refer to any categorization of international capital movements.

This does not mean that the Fund should be excluded from playing a role in the liberalization of capital movements in member countries. As explained in the staff paper, in exercising surveillance over exchange rates, the Fund is already empowered to discuss with member countries developments related to "restrictions on, or incentives for, the inflow or outflow of capital." In any case, given the central importance of the subject, I agree that further study of this issue is warranted.

The topics related to the Fund's advisory role in the area of exchange rate regimes are much less controversial. I agree with the staff that the Fund has an important role to play in supporting a country in selecting the regime best tailored to its needs. Fund technical assistance to deal with the operational aspects of these schemes is also of great value.

In conclusion, it is pleasing to note that the world economy faces a clear move away from multiple exchange rates. At present, countries with multiple exchange rate systems represent only about 4 percent of total trade. The number of multiple currency practices applied to capital transactions is even lower. This trend is reassuring, and I share the staff's position that those countries still applying these measures must be encouraged to remove them as soon as possible.

Mr. Jonáš made the following statement:

If the Fund is to continue playing the role assigned to it by the Articles of Agreement, the recent changes in the international exchange and payments system cannot go unanswered. I have several comments on the issues of current account convertibility, capital account convertibility, and bilateral and multilateral trade arrangements.

First, current account convertibility. The progress of the last two years in terms of members' acceptance of Article VIII obligations has indeed been impressive, and we are now approaching the major milestone of 100 countries with Article VIII status. The staff rightly sees this as demonstrating that current account liberalization is feasible for a still broader spectrum of the Fund's membership, but I am not sure whether the rate of new acceptances of Article VIII obligations can pushed much beyond its present pace. By and large, the countries that have not yet achieved Article VIII status are those where economic conditions and policies are less conducive to easy implementation of current account convertibility than in the case of the converts of recent months. I would be interesting in the staff's judgment about the prospects that the remaining 80 countries will accept Article VIII obligations.

In addition, there is a risk that countries may reimpose exchange restrictions that are not consistent with their obligations under Article VIII. In the past this risk has not been purely hypothetical: in fact, about one sixth of the developing countries which accepted obligations of Article VIII later reimposed some restrictions. This suggests that there is a trade-off between the number and the quality of countries' acceptance of Article VIII obligations. It is clearly undesirable to press for acceptance of Article VIII obligations more than is justified by a country's underlying macroeconomic and structural conditions and policies. It is possible to exaggerate the symbolic importance of the Article VIII status. Pressing for pro forma acceptance of the obligations is likely to increase the number of countries later reimposing some restrictions. I would prefer to see us encourage members to accept Article VIII obligations, while at the same time closely watching their general economic situations and policies and their balance of payments prospects, in order to avoid later de facto reversal of the current account liberalization.

On the issue of the Fund's involvement in capital account liberalization, I think that our success in increasing the number of countries which have more or less liberalized their current accounts requires us to broaden the Fund's jurisdiction to embrace international capital movements. If the Fund is to continue serving the purposes specified in its Articles, it cannot focus only on current international payments, which now represent a small and ever diminishing share of total exchange transactions. I therefore endorse the staff's idea for a detailed review of countries' experience with convertibility and the Fund's role in this area. Such a review will also be useful given the role foreseen for the WTO in overseeing the liberalization of capital transfers.

Finally, I have a comment on bilateral trade arrangements. Statistically, the arrival of the former centrally planned economies in the Fund might have been expected to slow or halt the trend toward a shrinking role for non-multilateral trade arrangements. But we must not overlook the exceptional circumstances under which various bilateral and barter arrangements have arisen in these countries. The Fund should encourage countries with such arrangements to replace them with multilateral arrangements as quickly as conditions permit. In addition, an in-depth review would be useful to for assessing the degree to which bilateral and regional payment arrangements involve discriminatory features. Since some of these restrictions are permitted to remain under the so-called transitional provisions of Article VIII, it would also be useful for the Fund to define more clearly the meaning of the term transitional.

Mr. Shields made the following statement:

Progress toward acceptance of Article VIII status, as the staff notes, was slow until the start of 1993. Since then, the staff has intensified its efforts and, as a result, the rate of Article VIII acceptance has rapidly increased. This is illustrated by Table 1 of SM/94/202, which shows that all but three of the Article XIV countries that are free of restrictions are CFA franc zone countries. Since circulation of the document, three non-CFA franc zone countries have accepted Article VIII status.

Consequently, I am not fully persuaded about the need for sharp acceleration in the rate of Article VIII acceptances. But there is still some work to be done to encourage countries to move to current account convertibility. Therefore, I see scope for a measured intensification of efforts.

Toward this end, the most benefit is to be gained from two suggestions made in the staff paper. The first is that the Board should take a decision, perhaps at the time of the Article IV consultation; and the second is that movement toward Article VIII status should be made a more prominent feature of Fund-supported programs. I could support either, or both, suggestions if other Directors agreed.

However, I am definitely not attracted by the suggestion of formal representations under Article XIV, Section 3. That section of the Articles says that such formal representation should only be made "in exceptional circumstances." It is not clear whether any countries fall into this category. The section further implies that this process could eventually lead to the initiation of compulsory withdrawal procedures. This is too heavy-handed an approach.

Turning to the issue of how long a country should remain in Article XIV status, I note that among Article XIV countries, ten were founder members of the Fund; and apart from the countries of the former Soviet Union and ten other countries, all have been members for over five years. This raises the question of what constitutes a transitional arrangement in Article XIV. It is regrettable that the staff paper does not adequately address the reasons for countries not proceeding to Article VIII status. I note that the freeing up of exchange regimes should ideally proceed, hand in hand, with greater trade liberalization. So, I cannot come to a view on the appropriate length of time to remain on Article XIV status.

As to the issues underlying approval or nonapproval of restrictions imposed by Article VIII countries, the rationale for their approval would be evidence of their transitory nature, their introduction as a response to a purely exogenous development, the existence of a timetable for their removal, and consideration on a case-by-case basis of their purpose, and the absence of any alternative way of dealing with the exogenous development.

I endorse present Fund policy that restrictive exchange measures are eliminated, as far as possible, before a member accepts Article VIII status. This is a sensible operational policy, requiring little interpretation. The policy described in SM/94/202 should also be continued. Similarly, I endorse the Fund's policy on acceptance of Article VIII status by members experiencing external payments arrears.

When considering exchange market reforms, we should think in terms of full liberalization, regardless of whether it is for capital or current account purposes. Any benefits from maintaining controls are outweighed by benefits from the better allocation of capital.

The present Articles do not clearly give Fund jurisdiction where capital account transactions are concerned; however, they were framed in a different era, and are perhaps not fully in tune with present day thinking. Nevertheless, I am persuaded that there is scope for increasing the Fund's involvement in this area. The U.K. Chancellor of the Exchequer touched on this theme in his address at the Annual Meetings in Madrid. He called on the Fund to "encourage members to remove their remaining exchange controls on capital flows." Further, it would also be useful for the Fund to quantify the economic benefits of free flows of capital when combined with free trade.

The staff paper suggests a formal review of the Fund's jurisdictional responsibilities in this area, perhaps stretching as far as proposals for amendments to the Articles. I understand that the staff paper on capital account convertibility, mentioned in the work program, could form the basis for such a review. In any case, I would strongly advocate such a review, provided we can agree on its terms of reference and are given an estimate of how much it would cost to undertake. I confess myself wary of considering yet another amendment of the Articles, but do not think we should rule it out at this stage. The Fund should cooperate with the OECD in carrying out the review.

We have already discussed the issue of exchange rate regimes at length in previous Board discussions, most recently last month. I have nothing to add to existing U.K. statements on the choice of fixed versus more flexible exchange rate regimes.

But with respect to multiple exchange rate systems, I see no need to revisit the conclusions of the 1984/85 review. Those conclusions were based on sound economic theory. There is no need to change them at this moment, and I confirm my support for them. Nevertheless, they were couched in terms of the medium-term balance of payments positions of members. As the staff paper notes, multiple currency systems have arisen as transitional systems, and as such may have played a useful purpose. So, in approving multiple exchange rate systems, we should pay careful attention to their purpose, to the existence of a timetable for their elimination, and in particular to the nonavailability of alternative means of transition.

Forward exchange markets have an important role to play in developed financial markets. Clearly, similar rules should apply to forward markets as apply to cash or spot markets. The Fund does not need to advocate such markets as a matter of policy; rather the focus should be on making sure there are no impediments to their development, and that the are no exchange rate restrictions once they are in place.

The key issue with respect to regionalism and bilateralism in cross-border payments is whether the accession of many formerly centrally planned economies to Fund membership necessitates a rethinking of the Fund's overall policies on regionalism and bilateralism. I see no case for a change in policies in this area. The regional developments should certainly be the subject of Board discussion, but should be addressed in the same way as all members--specifically, I support the review of intra-FSU payment systems. At the last Board discussion of this issue in 1982, there was concern that some members had bilateral payments arrangements with nonmembers, principally with countries that have now joined the Fund; the accession of such countries since 1982 has had the benefit of bringing bilateralism entirely within the family, so to speak.

On regionalism versus multilateralism, the principle of multilateralism in payments arrangements is a good one. The Fund should promote movement from regionalism toward multilateralism. I recognize the difficulty that the Fund, whose membership consists of individual countries, might have in exercising jurisdiction over regions. In view of the heavy work load of the staff and Directors, we need to pick and choose among the discretionary topics for discussion. For that reason, I see no need for an in-depth review of regional payment systems; we can consider individual regions on a case-by-case basis as is done already. I understand that a paper that might form the basis for such a review has already been written; I would be happy to see it circulated for information, but not for discussion.

Mr. Bergo made the following statement:

The staff paper describes of considerable progress, especially in recent years, toward current account convertibility, and somewhat more uneven progress toward capital account convertibility--but progress still. We welcome these developments, and we fully subscribe to the view that restrictions on foreign exchange convertibility, be it in the current or the capital account--the distinction between the two becoming increasingly irrelevant--hardly ever have the intended effects and that, to the degree they have any effect, they most often seriously distort the functioning of the economy.

In most cases, going for convertibility will not have important, longer-term negative effects. But it is certainly true, as the staff observes, that the most beneficial results come when convertibility goes hand in hand with the introduction of prudent macroeconomic policies and comprehensive structural reform.

In view of this, it is appropriate that the Fund pay increased attention to the promotion of foreign exchange convertibility, and take on greater responsibility in the surveillance of capital transactions. An important question is whether the Fund has the means, based on the current Articles, to aid the momentum of progress, and the extent to which the Fund currently utilizes these means, or whether an amendment of the Articles would be necessary for the Fund to achieve its main objective of overseeing a multilateral system that is free of exchange restrictions. I will focus my remarks on these issues.

As pointed out in the staff paper, the language in Article I, when read in conjunction with Article IV, Section 1, may be interpreted as applying also to restrictions that inhibit the flow of productive capital. From this, it can be argued that the Fund already has a mandate to promote capital account convertibility, albeit perhaps not a clear one, and one without specific means of enforcement. Nevertheless, there is substantial scope for strengthening the Fund's role within the framework of the current Articles, in surveillance activities and Article IV consultations. At the same time, I can understand the advantages of a more explicit mandate, and would not to rule out the possibility of explicitly giving the Fund jurisdiction over capital account convertibility, especially if this could be done in conjunction with other amendments of the Articles. However, more work will certainly be needed before we can proceed to that stage. Mr. Schoenberg rightly pointed to several issues that arise in this connection. Hence, I would welcome a review of the broad aspects of capital convertibility early next year, as mentioned in the staff statement.

While the Fund has played a very important role as the midwife of change toward current and capital account convertibility, the most important forces--economic and political--building the momentum for change toward full convertibility are at work largely outside the Fund's sphere of direct influence. It is important for the Fund to fully appreciate these forces and work with them.

Of particular importance is the general liberalization that has taken place in the regional context. The EU is an illuminating example. The principles of liberalization promoted within the EU have spilled far beyond its borders and have been the strongest force behind the general liberalization of the capital account among industrial countries in recent years. Regional cooperation could become an equally strong force of change in the rising countries of Asia and Latin America. Once economies have been liberalized on a regional basis the perceived advantages of maintaining restrictions toward the rest of the world will diminish.

This being said, we should not underestimate the Fund's role in maintaining and speeding up the momentum toward convertibility. The advice given by the Fund in the context of regular surveillance exercises, Fund programs, and technical assistance has played an extremely important role. Simply by assisting members with their programs of macroeconomic stabilization and structural reforms, particularly in adopting market-based monetary policy instruments, the Fund makes a most valuable contribution.

Concerning the unfinished business of Article VIII acceptance, the various ideas put forward in the staff paper to encourage this are certainly worth considering. However, for the Fund to put strong, open pressure on reluctant member countries might lead to confrontation, and might be counterproductive. The intensified procedures in force since 1993 have been positive, and their continuation might still be the best way forward. That is not to say that somewhat greater visibility of the Fund's efforts to promote Article VIII acceptance might not be worth considering in certain cases; but it may be worth stopping short of formal representation. There is also a good case for the Board to focus more on the issues underlying approval or nonapproval of restrictions. I have doubts, however, about the wisdom of establishing strict rules that disqualify countries with nonapproved exchange practices from the use of Fund resources. This might be an appropriate step at some point in the future, but at this stage there is the risk that the Fund might exclude itself from playing an important role in the stabilization of some major economies, stabilization that itself would be the most important ingredient of a realistic convertibility plan.

Mr. Newman made the following statement:

I will also try and be brief, since I agree with many previous speakers. I think we should be welcoming the trend toward greater current and capital account liberalization, because it reflects a growing recognition that price-based market determined systems are the most effective, efficient and equitable means of allocating resources and implementing our policy stance.

In that context, I think the Fund's greater assertiveness in encouraging countries to adopt Article VIII status is a desirable one, which is proving quite effective. Nevertheless, we have to recognize that about half the membership still have not moved to the Article VIII position, and it would be desirable if we could encourage them to do so. Like other Directors, however, I think my preference would be to do so through moral suasion rather than compunction. In that context, I would like the staff to possibly consider the use of a report card in the context of Article IV consultations in which we can applaud the steps that have been taken to liberalize in the current account area and the payments area, and simply note the additional steps that would be required to enable the country to adopt full Article VIII status, so they have a clear indication of both how far they have come and how far they must still go.

With respect to some of the other measures that need to be taken, the only concern I have is through the formalization of many of these measures, either through timetables or formal representations by the Managing Director, or even by the Executive Board, is the consequences of the country failing to live up to either the timetable or the representations. I would hate to be in a situation where we find ourselves with the emperor with no clothes, having made a call for a country to do so and the country saying, "Thank you very much, but not now." I do not think we want to get into the extreme position of denying programs necessarily or calling for even harsher measures, because I think those would be counterproductive.

At the same time, however, I think we need to be careful that we do not live in a vacuum. As some of the experiences during the Uruguay Round negotiations demonstrated, I think there was considerable concern in this Board that our colleagues in the Uruguay Round, in the WTO, may be going in a different direction than we think is appropriate to go in, and it is important that we try and move them, as well as ourselves, in the right direction of a more liberal environment rather than the less liberal environment, even when there are balance of payments problems.

With respect to capital account convertibility, I share the concerns expressed by Mr. Schoenberg about institutions, both domestic and international, that may try and create new missions because they have either been very successful or possibly unsuccessful in their other missions. Nevertheless, it seems to me that the staff does make a good case that greater reliance or greater recourse to capital account convertibility makes sense both practically and from a policy viewpoint. It seems to me that there are three issues that you need to look at as we move forward or not move forward in this area.

With respect to the financial implications of capital account convertibility, the founders of this institution wrote the Articles and provided for capital account restrictions for what they believed were legitimate concerns about the financial implications and the ability of the institution to deal with those implications, if you did not have the room for capital restrictions. Clearly, the world has changed a great deal in the 50-odd years since the original Articles were developed, and I was struck by the staff's analysis that in those cases where capital controls have been taken off, the effects have been beneficial. Nevertheless, we will be having a discussion of things like short-term facilities and other kinds of arrangements in a few weeks and maybe that would be a more appropriate place to look at that particular aspect of the issue.

The second aspect of the issue concerns the legal and the jurisdictional one. Here several speakers have raised relevant issues in that respect--Mr. Schoenberg, Mr. Mesaki and others--which indicates the clear need for a staff paper to look in greater depth at this issue and, therefore, I would support and encourage such a paper for our review sometime next year.

A third area, which has not been raised by anyone, concerns the Fund's role in monitoring capital flows. We have raised this issue in the context of various discussions on world economic market developments and the World Economic Outlook, in where there is a great deal of focus on the real side of the Fund's activities, but very little on the financial side. I recognize that capital flow information is generated from a multiplicity of sources and that our colleagues at the BIS and the OECD have made an attempt to try and develop the appropriate data and to monitor what is happening, but it seems to me that there are large gaps in this area and that the Fund might have a constructive role to play both in cooperating with others in developing the necessary data and in monitoring where capital flows are actually going and their implications for balance of payments and macroeconomic policies.

I have very little to say with about exchange rate regimes other than to support the staff's injunction that one size does not fit all and that a multiplicity of exchange regimes is desirable and probably unavoidable.

With respect to regional and bilateral payments arrangements, I find myself moving in the direction of Mr. Clark, but possibly not quite as far. I recognize that these are second-best solutions, but sometimes the second-best may be the only solution you have. The danger, of course, is whether or not the second-best prevents or slows your movement toward the first-best solution, which is clearly the multilateral system. So, while we develop these or use these as transitional mechanisms, I think we need to be very careful that they actually result in a transition to the first-best solution and not simply get accepted and sustained because they are convenient and available.

The Acting Chairman noted that the Work Bank published a quarterly report on capital flows, which contained data developed from its debt tables. If the Fund engaged in such work, it would need to take care not to duplicate the efforts of the World Bank.

Mr. Sarr made the following statement:

I welcome the recent progress made by Fund members--and among them, many developing countries in the context of their comprehensive stabilization programs--in removing restrictions on international exchange and payments. These countries have come to recognize that these restrictions have not been effective in reversing the balance of payment crises that confronted them, or in achieving their fundamental economic and development objectives. It is also noteworthy that even those developing countries that have not made sufficient progress in eliminating exchange and payment restrictions, have managed to eliminate the most severe forms of exchange and payments restrictions, and further liberalization measures are well under way.

In view of the rapid changes taking place in the financial market, it is appropriate for the Fund to explore ways to accelerate progress toward the elimination of the remaining restrictions and to ensure that its jurisdictional responsibilities of promoting international trade and payment systems free of restriction remain relevant.

The comprehensive and interesting staff papers provide a number of useful suggestions for addressing these issues, and I can endorse a number of them. I will comment briefly on some of the points raised in the staff paper in the order suggested in the staff's opening statement.

This chair considers that the procedures adopted recently by the Fund have been effective in easing exchange restrictions and have led to the recent progress in the acceptance of Article VIII status. We endorse the consultative approach envisaged, in particular through direct communications by Fund management to the authorities of countries, to encourage them to voluntarily accept the obligations of Article VIII.

We find useful the proposals to impress upon those countries availing themselves of the transitional arrangement under Article XIV, that the global environment is now more propitious for eliminating the remaining restrictions and for addressing the time frame of the transition period. However, we do not consider that it would be desirable to include the acceptance of Article VIII obligations as a condition for use of Fund resources. Technical assistance and a dialogue with member countries, within the framework of Article IV consultations, will be more useful in convincing member countries of the advantages of graduating to Article VIII status, which will only reinforce the sustainability and the credibility of these actions.

With respect to ad hoc restrictions, as evidenced by the presence of external payment arrears, the Fund will need to pay closer attention to the preventative aspects of these arrears. The present Fund procedures for dealing with these arrears are appropriate, but perhaps the role that creditor countries can also play in facilitating the timely elimination of such arrears needs to be addressed, in particular, for those bilateral creditors not participating in the Paris Club. These are areas where the membership will need to cooperate in order to achieve further progress.

The staff papers clearly note that there are a number of closely related issues in the area of capital account convertibility that have operational implications for the Fund. In addition, it is necessary to reassess whether, in the present circumstances, the Fund's jurisdictional responsibilities relating to international capital movements remain consistent with its broader objectives. We endorse the proposed broad review of the issues related to capital convertibility. I am sure that the lessons learned from the recent events surrounding the surge in capital flows and the issue of efficiency in the allocation of these resources, as well as prudential concerns, will be adequately reflected in the study.

With respect to the use of multiple exchange rate systems as a temporary policy tool prior to making a uniform exchange rate adjustment, this practice, although not perfect, plays an important role in determining the appropriate average exchange rate, and takes into account the special circumstances of members. We have no difficulties with the case-by-case approach to this issue and the criteria used for its approval or nonapproval. We encourage the Fund to continue to assist members in selecting an appropriate exchange regime, and in putting in place a risk-free, well-functioning exchange and payments system consistent with its mandate.

We agree with the staff that the Fund will need to exercise surveillance over evolving regional groupings. In view of the trade relations that existed among FSU countries and the substantial disruption of trade that recently took place, the Fund will need to be pragmatic in its approach to these countries, and continue advising them on the reforms needed to assist them in moving quickly to a multilateral trade system.

Extending his remarks, Mr. Sarr noted that the staff was investigating whether the measures recently introduced in the CFA franc countries constituted restrictions subject to Fund approval. He wondered whether the staff could comment on that question for the current discussion.

Mr. Zhang made the following statement:

I would like to thank the staff for preparing such a comprehensive paper for the Board. It is well documented and covers many complicated and delicate issues on the international exchange and payments system. My remarks will follow the order of issues presented in the staff paper.

On current account convertibility, the Fund's present procedures are still effective in the sense that they encourage member countries to adopt Article VIII obligations as early as the situation permits. The issue is how to accelerate the progress in achieving the Fund's objectives. We agree with the staff that direct communication between the Fund and the authorities is important; it is also necessary for the Fund to make clear to member countries the benefits of the rapid transition to Article VIII status.

However, there are always two sides to a coin; along with the benefits from early acceptance of Article VIII, there will also be risks. The degree of risk that a member country faces depends on its ability to steer policy in order to keep the economic fundamentals sound. Otherwise, imprudent and rapid acceptance of the obligations will expose member countries to undue risks, at a time when they are not expected to have recourse to new restrictions. In this connection, could the staff elaborate as to why about one sixth of the developing countries that have already accepted the Article VIII obligations, have reimposed exchange restrictions inconsistent with those very obligations.

Taking this into account, it would be appropriate for the Fund to emphasize both the benefits and risks to member countries when both sides are exploring the possibilities of moving toward acceptance of Article VIII status. In this process, efforts will also be needed to assess the ability of the member countries concerned to manage the risks or shocks arising from current account convertibility. Acceptance of Article VIII is not the purpose, but the means, of helping member countries better manage their domestic economies and further global economic integration.

For those members who have not yet adopted Article VIII status, some may need more time than others to reach that status. In this context, we share the view that there should not be a rigid time frame in defining the transition period. The period should be determined on a case-by-case basis, giving due consideration to each country's specific situation.

With respect to capital account convertibility, it might be early to consider whether controls on capital flows should fall under the Fund's jurisdiction, as many member countries are still not capable of coping with the adverse impact caused by sudden capital flows on a large scale. Moreover, as Mr. Kafka noted in commenting on the international monetary and financial system, there can be no question that controls over capital movements do not remain effective for any length of time. However, they can be helpful temporarily to protect a country from the impact of large capital movements. Further studies should be made to examine the impact of capital flows on overall macroeconomic management, and the prospective role of capital account liberalization as part of the structural reform. Before explicit conclusions can be reached, it would be improper for the Board to consider the Fund's jurisdiction over multiple currency practices as they relate to capital transfers. And before the Board has reached a fair judgment with respect to the impact of capital control on macroeconomic management, and to what role capital account decontrol can play in the future programs with members, it would not be circumspect to take up issues recommending amendments to the Articles.

The current practice of members choosing their own exchange regimes is effective. Of course, many defects exist in the practice. The Fund's assistance and advice is crucial in helping to improve the arrangements.

As to bilateral and multilateral payments arrangements, it is important, as recommended in the staff paper, to review the consistency of some regional developments with the multilateral objectives of the Fund, particularly in view of recent world economic developments.

Mr. Lanciotti made the following statement:

Recent developments in the international exchange and payments system have brought up a series of issues relating to their impact on macroeconomic policies, exchange rate stabilization, and the Fund's jurisdiction. I would like to comment on some of the issues proposed for discussion in the staff paper.

It is to be noted that in recent years the Fund has faced an increasing diversity of situations, especially among developing countries. In this new context, the adoption of a case-by-case approach is most effective, as acting according to general rules becomes an increasingly difficult task and may even reveal itself inappropriate. Accordingly, the Fund's assessment of restrictions on payments or transfers imposed by a member country should depend on an assessment of the country's initial conditions and final objectives, rather than on some dogmatic principles in favor of the free market.

There is a changing focus on the part of the Fund toward a medium-term perspective of conditionality, as discussed in a recent meeting (Seminar 94/9, 11/9/94). Most Directors welcomed this new attitude of the Fund, and I absolutely agree that a medium-term horizon is the most appropriate. Consistent with this view, the assessment of restrictions on payments or transfers should also be set in a medium-term perspective. Thus, we should pay more attention to the effects that external liberalization can have on a country's growth prospects, rather on its balance of payments in the short term.

I would like to address some issues in more detail.

As evidenced in the staff paper, the issue of current account convertibility now almost exclusively concerns the developing world. While practically all industrial countries have eliminated exchange restrictions on payments connected to current transactions, only a few developing countries have done so, notwithstanding a recent trend toward liberalization. Hence, only about one half of Fund members have thus far accepted the obligations of Article VIII, and some developing countries still maintain a transitional arrangement under Article XIV. Such a situation cannot be deemed satisfactory. Ensuring the convertibility of the current accounts is, in fact, one of the primary objectives of the Fund.

The staff has recently increased measures to encourage the acceptance of obligations under Article VIII. As the record of these measures is positive, the Fund should persevere even more convincingly in this new policy. However, some remarks are warranted.

As a general principle, the Fund should absolutely prevent situations in which a country accepts obligations under Article VIII and later reverts to exchange restrictions. In fact, preserving a stable and certain regulatory environment is of primary importance, especially from the point of view of private investors, and a move back to a restrictive regime may have a disorderly impact on the real sector of the economy. Thus, the Fund should continue to avoid, as it has done so far, the assumption of Article VIII obligations by countries with an uncertain balance of payments outlook.

As to those countries that apply for Fund financial support, the Fund-supported program should explicitly include a timetable for the elimination of the restrictions, to be set on a case-by-case basis. This would be especially appropriate for those countries that have maintained Article XIV status for an unduly long period of time.

For those countries that, on the contrary, do not have a Fund-supported program and have a positive macroeconomic and balance of payments outlook, the Fund should persevere in emphasizing, directly to their authorities, the benefits of a rapid transition to Article VIII status. I would suggest, also , that in order to further speed up this process, a timetable for the elimination of the existing restrictions be discussed during Article IV consultations with individual countries.

With respect to external payments arrears, the Fund should continue the practice of not approving a transition to Article VIII status unless a satisfactory program for their elimination is in place.

The staff paper demonstrates that the liberalization of capital accounts is nearly complete in the industrial countries. In the developing countries, there has been a clear shift toward liberalization. This shift can be explained in terms of an increasing awareness that capital controls are often imperfect complements of monetary control, can hardly be made effective, and the benefits from the liberalization overwhelm those from the restrictions.

However, recent experiences have taught us that developing countries differ widely in their structural problems and that capital liberalization should follow, rather than precede, macroeconomic adjustment. On the one hand, a number of countries have a relatively strong balance of payments and are likely to benefit from a rapid liberalization, in terms of higher capital inflows. The only problem in this case is how to guarantee the control of monetary policy by means of an appropriate sterilization of the inflow. On the other hand, some countries are facing structural problems in their balance of payments, for which the outcome of a rapid liberalization may be completely different. A more gradual approach might be more suitable to these countries' needs, and liberalization should proceed in step with macroeconomic adjustment and structural reforms.

The question arises whether the Fund's responsibilities with respect to the exchange rate system should be extended to include international capital movements. The issue is certainly important, as it would involve a potential extension of the Fund's role, which has a large number of implications for its legal and institutional framework. The question is not limited to analyzing whether or not capital liberalization is desirable per se, as the background paper seems to suggest; the answer seems obvious to everybody. A more difficult question is whether, and to what extent, the international economic environment has changed sufficiently to justify depriving members of the freedom to exercise the controls they deem necessary to regulate capital movements, without prior Fund approval. As it is very difficult to answer this question, the topic deserves further attention by the Board. I welcome the announcement that an updated review of capital convertibility may be held in early 1995.

The staff paper sets forth three main areas of concern for the Fund: exchange rate arrangements; restrictions on forward exchanges; and multiple exchange rates.

As to exchange rate arrangements, current developments show a trend toward more flexible regimes. I do not have much to add to what is contained in the staff paper. Every country should be left free to adopt the regime it deems most appropriate, while the Fund should exercise its surveillance and offer guidance to guarantee the efficiency and stability of foreign exchange markets.

As to the developments on forward exchanges, it is clear that the observed trend toward the removal of restrictions simply follows the trend toward capital convertibility. Given the speculative nature of some of the transactions occurring in these markets, it is perfectly understandable that some countries, especially those in the developing world with a weak balance of payments, may decide to maintain some restrictions. As I mentioned with respect to capital account transactions, the assessment of these restrictions depends on the initial conditions and economic objectives of the member country, and a more gradual transition toward liberalization may be appropriate in many cases.

With respect to multiple exchange rates, the staff paper does not clarify why--if these practices distort relative prices, the distribution of income and the allocation of resources--a large number of countries, amounting to one fourth of the Fund's membership, still maintain multiple exchange rates, albeit as a temporary device. This issue deserves further consideration; however, the Fund should exercise stricter surveillance on multiple exchange rates, to ensure their temporary nature.

Mr. Dlamini made the following statement:

I join other Directors in welcoming the current trend toward foreign exchange market liberalization, that has become increasingly evident in both the industrial and developing countries and has facilitated progress toward currency convertibility among the Fund's membership, particularly the industrial countries. Further progress in this direction, if complemented by the lifting of barriers on trade and capital flows, could enhance the existing efficiency gains in resource allocation and the expansion of the global economy. Indeed, this is an area in which members have an obligation to cooperate among themselves, and with the Fund, in fulfilling the mandate to ensure an efficient international monetary system that will promote growth in output and trade.

The Fund's intensified effort since 1993 to encourage the developing countries to accept Article VIII obligations is welcome and should be sustained. At the same time, we would advise that appropriate caution be exercised by the Fund in ascertaining whether a country meets the basic requirements for graduating to Article VIII status, as specified by the Articles. Among these preconditions are the achievement of an appropriate exchange rate, adequate international reserves, and sound macroeconomic policies, as well as the need to create an environment in which the economic agents have both strong incentives and the ability to respond to market prices.

The sustenance of strong adjustment efforts in these countries should facilitate the establishment of these conditions, and should create a foundation for a strong and diversified economy capable of withstanding the exogenous shocks to which these economies are presently susceptible. It is instructive that about one sixth of the relatively few developing countries that have so far accepted the obligations of Article VIII have reimposed exchange restrictions. The lesson seems to be that the decision to accept Article VIII obligations should not be based on a transitory improvement of the external sector position, especially if this results mainly from the compression of aggregate demand, especially imports.

The staff's proposed alternative approach of introducing a timetable for accepting Article VIII obligations in Fund-supported programs might give the impression that this is an end in itself, apart from the imposition of additional conditionalities that may serve no useful purpose. It would seem preferable to continue placing emphasis on strong adjustment, which is the responsibility of the authorities, and on adequate external assistance to help sustain the adjustment effort. The end result, it is hoped, would be an environment that favors a freer trade and payments regime that benefits the individual country, and the international community at large. Moreover, it is not even clear how this proposal will cover countries without Fund-supported programs.

In the light of the current global trend toward the liberalization of capital movements, and considering its impact on monetary and exchange rate policies of other member countries, the extension of the Fund's jurisdictional responsibilities to cover capital movement transactions could help to enhance the effectiveness of its overall surveillance activity. We encourage the staff to examine all the issues involved in this initiative, and to come up with appropriate recommendations for the Board's consideration. This is, however, likely to involve a long process that would include an amendment to the Articles. Meanwhile, the staff should use the existing channel of Article IV consultations to encourage members to move toward total elimination of controls on capital movements in the context of their adjustment efforts. Nevertheless, for some of the poor low-income developing countries implementing reform programs, emphasis on capital account liberalization should be sequenced relatively late in the reform process, after necessary institutional and policy reforms are already in place.

As to the issue of the evolving roles of exchange rate regimes, the trend toward a flexible exchange rate regime has been strong. Despite general concerns about the persistence of exchange rate volatility and misalignments, the present system seems to have made some efficiency gains, particularly in the industrial countries and the emerging economies of Asia and Latin America. However, in most of the reforming countries of sub-Saharan Africa that have adopted floating exchange rate regimes, mainly in the context of Fund-supported programs, the problem of exchange rate volatility has become more serious, rendering the inflation problem intractable, financial planning very difficult, and productive investments grossly inadequate.

The appropriateness of adopting a floating exchange regime in many of these countries, where the external sector position is highly vulnerable, would need to be re-evaluated, more so as the critically low reserve levels in these countries render the resort to market intervention by the central bank to moderate an extremely volatile situation unfeasible. However, the experience of relative financial and price stability in some countries with an exchange rate anchor seems to strengthen the argument for a fixed peg regime, preferably, to currency composite. Alternatively, a managed floating system that retains the present benefits of relative flexibility could be considered. We recognize, in particular, that regardless of the exchange regime adopted, the implementation of credible macroeconomic and structural policies is critical to the establishment of exchange rate stability. Nonetheless, we strongly urge the staff to revisit the issues on the choice of exchange rate regime in low-income developing countries.

The increase in the number of countries participating in regional payments arrangements seems to be somehow related to the current proliferation of regional trading blocs. It would, perhaps, be beneficial if the staff could examine, in a comprehensive manner, the reasons for this relationship and how to deal with any problems arising therefrom. One would expect that the coming into effect of the Uruguay Round agreement would have an impact on these regional arrangements and perhaps address some of the present concerns.

Mr. Saito made the following statement:

I welcome the integration of global financial markets in the industrial world and the acceleration of the freeing of exchange controls in developing countries, which were in all cases accompanied by the strengthening of the overall balance of payments, thus dispelling the fear of capital flight, which usually motivates exchange restrictions. I also welcome the role the Fund played, through effective surveillance and technical assistance, in bringing about all these positive changes.

The main conclusion to be derived from the current discussion is that the Fund's jurisdiction over payments and transfers related to international transactions should be broadened to include capital movements, not just those of goods and services. Full current account convertibility, in particular for nontrade-related transactions, is sometimes hindered by the presence of payments restrictions in the capital account, owing to the difficulty of effectively separating current account and capital account transactions.

At the same time, however, the benefits associated with the integration of global financial markets are clearly larger than the costs. International transfers of financial resources make possible the transfer of real resources that increase the efficiency and growth of the world economy. It is true that capital movements may impact on monetary and exchange rate policies in undesirable ways, particularly in the case of surges of capital inflows--which, incidentally, are primarily attracted by successful stabilization and transformation experiences, and not by increased domestic interest rates, as the staff paper seems to imply. It is important to keep in mind, however, the presence of counteracting mechanism both in the monetary and competitiveness areas, namely the increase in the demand for money associated with the stabilization, which offsets inflationary pressures, and the increase in productivity brought about by the process of structural transformation, which offsets the real appreciation of the exchange rate. In this respect, the staff paper, even though it clearly states that the balance of costs and benefits has shifted away from controls on capital movements, does not provide enough arguments to support that position. Not only are money demand and productivity considerations missed in the discussion, but also those related to the disciplining effects of capital movements. In any event, I share the staff's suggestion that a broad review of the Fund's jurisdiction over payments and transfers related to international capital movements is called for, including, if needed, the consideration of proposals for amendments to the Articles, so as to enable the Fund to exercise more effective surveillance aimed at ensuring worldwide prosperity. Having said this, I should mention that my Chilean authorities--although in full agreement with the benefits of open and liberalized markets--consider that short-term capital inflows of a likely speculative character should, and can, be effectively controlled.

As to the evolving roles of exchange rate regimes, the staff paper associates flexible exchange rate systems with freer foreign exchange markets. However, this relationship should not be interpreted as a necessary condition for the elimination of exchange rate restrictions, as some of the most liberal foreign exchange markets are found in countries with currency board arrangements.

As to bilateralism and regionalism in cross-border payments, I welcome the Fund's policy of encouraging members to terminate payments agreements that are inconsistent with Article VIII. I would caution, however, against an overly legalistic approach in assessing restrictions as, for example, with respect to the application of undue delay criteria, which may interfere with the successful practice of some regional payments clearing mechanisms that even predate Fund's guidelines.

The information provided by the staff paper on external payment arrears for my country seems to be outdated. Peru is listed as being responsible for the large increases in arrears during the 1991-92, notwithstanding the fact that, at that time, my country was successfully implementing a rights accumulation program, clearing arrears with international institutions, and reprogramming its debt with the Paris Club. I have other specific comments on references made in the staff paper to countries of my constituency, and I will contact the staff so that they may be taken into account before this document is released to the public.

It should be emphasized that, despite the virtual completion of the foreign exchange market liberalization in industrial countries, many controls still remain in the underlying transactions, such as restrictions on foreign direct and portfolio investment, which reduce the full efficiency benefits of liberalized markets.

Mr. Al-Jasser made the following statement:

The recent observance of the fiftieth anniversary of the Bretton Woods Conference makes this discussion both timely and appropriate. The issues raised in the staff paper cover the most fundamental objective of this institution, namely the promotion of a system of payments that is free of restrictions for current international payments.

The Fund has made important progress in the promotion of this basic mission. The progress achieved since 1993 has been particularly encouraging. There remains, however, an unfinished agenda; therefore, the need for sustained efforts to accelerate member acceptance of Article VIII obligations is imperative.

The number of countries that continue to avail themselves of the transitional arrangements under Article XIV for a prolonged period of time is sufficiently large to raise questions as to the meaning of transition in our Articles.

I agree with the staff's suggestion to accelerate further progress toward the achievement of the Fund's objectives under Articles I and VIII through communication to members that would emphasize the benefits of accepting Article VIII obligations. I would appreciate further elaboration from the staff on the relative merits, if any, of adopting decisions to encourage individual members to assume Article VIII status.

Moving to Article VIII status, however, does not always guarantee that measures inconsistent with the provisions of the Article will not arise. Indeed, there have been several instances in the past when members that have assumed Article VIII status introduced restrictions, or schemes, that gave rise to multiple currency practices. Few concrete actions were taken by the Fund when exchange rate restrictions were inconsistent with the Article.

Nevertheless, I would not agree that when members' practices are inconsistent with the Articles, greater publicity should be given to the issue through the issuance of a press release. This may give undue attention to what may be, at times, relatively minor issues. Instead, I would favor the inclusion of a list of practices not approved by the Fund in the Annual Report on Exchange Arrangements and Exchange Restrictions. If such an approach is considered insufficient, owing to the time lag between the Article IV consultation with a member and the publication of the staff report, we could notify the readership that the current status of the restrictions could be confirmed by contacting the External Relations Department. Had it not been for budgetary considerations, I would have suggested the issuance of a quarterly update.

Developments in the international monetary system since the founding of the Fund have been such that the Fund's jurisdiction covers a diminishing share of international payments. I therefore welcome the proposal for a study on capital account convertibility that could include a review of possibilities for an amendment of the Articles, in order to take into account this changing reality. As you well know, I raised this issue on a number of occasions. The questions raised by Mrs. Cheong and Mr. Clark in this respect deserve attention, and should be taken into account.

Capital controls are not effectively discouraged in the Articles and are viewed favorably under certain circumstances. However, developments in the international monetary system have made such provisions outdated. It is therefore important to examine our role in this area at an early date.

The need to thoroughly examine this issue is reinforced by the fact that, at present, no international organization has exclusive jurisdiction over this matter. The OECD codes cover only a part of the membership of this institution. At the same time, the General Agreement on Trade in Services allows member countries to make commitments to remove restrictions on certain capital movements in connection with the liberalization of trade in certain services.

Against this background, gaining explicit jurisdiction over payments for capital account purposes is a logical corollary of our basic mandate. Our mandate for exercising surveillance over members' exchange rates is, in fact, diluted if our involvement is constrained in an area that has strong implications for exchange rates. Moreover, to minimize possible friction and to ensure effective cooperation between the Fund and the WTO, it is important to ensure that there are no grey areas between the mandates of the two institutions.

Some members of the Board have expressed concern that an expansion of the Fund's mandate would translate into an intensification of conditionality. However, there should be no cause for alarm. I do not envisage the Fund's role in this area as a mirror image of that under Article VIII, with respect to current account convertibility, because that could have a number of other implications, including for financing. Rather, I see the Fund as a clearinghouse where the experiences of members can be distilled, and shared for the benefit of all. Moreover, I share the concerns expressed by Mr. Wijnholds. Indeed, broadening the Articles should not lead to commanding the Fund to impose capital account convertibility.

Ms. Arraes made the following statement:

I would like to emphasize the need to update the data on arrears in section III 1(c) of the staff paper, to include the most recent information available. We would prefer, however, that individual countries not be mentioned in the published version.

I will address the issues listed at the end of the document, beginning with those related to current account convertibility. The general trend toward liberalization of current account transactions can only be commended. It seems that the Fund has been effective in this area. The Fund should maintain the policy of asking countries that wish to accept Article VIII obligations to eliminate measures that require approval by the Fund, and also should ensure that these have a sustainable balance of payments position. The present procedure for accelerating the acceptance of Article VIII is appropriate, and we would not favor a formal representation by the Fund. The best approach would be persuasion and demonstration, as mentioned by Mr. Clark. The staff and management could make clear to those countries considered to be in a position to give up transitional arrangements what the restrictions were that they would have to eliminate, and possibly how to do it.

We favor the present flexible approach of not considering nonapproved restrictions as an impediment to the use of Fund resources. The present policy has worked well in the interest of the Fund and the countries involved. We certainly would not favor more publicity of exchange restrictions in the form of a press release. We already have the <u>Annual Report on Exchange Arrangements and Exchange Restrictions</u>.

As we have repeated many times, we do not favor an extension of the Fund's jurisdiction to approve capital account transactions. If at any time the Fund acquires that jurisdiction, it should be possible for a country to institute capital control measures without prior notice, and approval would have to be obtained a posteriori. It has been recognized by the Fund that fiscal policy is not as flexible as one would like it to be in dealing with capital inflows. Restriction on capital account transactions could help buy some time in the adjustment process.

I will refrain from making comments about exchange rate regimes, as this issue has been exhaustively discussed recently on the occasion of the fiftieth anniversary. However, the importance of Fund advice and technical assistance in this field can never be overemphasized.

As to the issues related to regionalism and bilateralism in cross border payments, we would favor the examination of regional payment arrangements. In fact, policy orientation by the Fund cannot be based on a paper from 1966 and a document from 1982. It might be useful to examine how trade in Latin America survived the disruption of payments caused by the debt crisis. Nevertheless, I would urge the staff to take into consideration the following points in the study.

Updated information should be used for the number of countries that have made the channeling of transactions through the Latin American Integration Association's (LAIA) system optional. Mandatory channeling of transactions might be considered a restriction, if the banking system experienced delays in transactions with the central banks. As this does not happen to the best of my knowledge, why not let both systems compete?

With respect to currency settlements between central banks and the banking system, it should be noted that, in Brazil, for instance, all transactions are settled in dollars, daily; the banks can then use the foreign currency freely, and the regional payments arrangement implies only a four-month line of credit between central banks.

As to the issue of how the extraordinary settlement of payments affects the average settlement period, when balances reach the limit of bilateral lines of credit between central banks, settlement is required within a four-month period. In addition, the effect of voluntary settlements could also be studied. As the interest rate charged is market related--prime rate--central banks prefer to settle debtor positions instead of keeping reserves in applications that would yield less.

With respect to the amount of payments channeled through LAIA's system, updated data--such as on the relation between payments and trade, and payments and reserves--should be provided on the importance of the system for the countries involved

My personal assessment is that the trend is toward liberalization of exchange systems in all countries of the region and that the LAIA payments arrangement will lose importance in the long run. Also, the Fund would lose precious time and resources trying to make 12 countries negotiate an agreement for reducing the settlement period.

Mr. Kannan made the following statement:

As I agree with the general thrust of the staff paper, I can limit my intervention for the current discussion.

As enshrined in its Articles, it is the Fund's responsibility to try to eliminate restrictions in the payment mechanism, so as to foster the growth of world trade and thus pave the way for establishing and strengthening a multilateral system of payments. This is further reinforced by the considerable divergence between output growth and volume of trade growth, which clearly indicates the significant role of exchange rates in the system. While current account convertibility exposes the domestic market to international competition, it simultaneously enhances the access to cheap capital.

But if we look at the recent surges in capital inflows, these flows were concentrated not only in a few countries, but mainly in those where the confidence of repatriation was amply available. This underlines the importance of liberalization measures. However, one can also observe that accepting Article VIII status is only a necessary condition, not a the sufficient condition, which has to emanate from sound macroeconomic policies in the member countries. In this context, I fully agree with Mr. Wijnholds that an early abolition of restrictions could strengthen the authorities' determination with respect to the adjustment process, hence, enhancing market confidence in the program.

As no economy will ever claim that the external environment is very favorable, this goal of making more members accept Article VIII status is to be pursued. Thus, accelerating further progress toward the achievement of the Fund's objectives under Article VIII, could be effectively implemented through Article IV consultations that provide a sound basis for the staff and the authorities to discuss the timetable for the rapid transition to accepting Article VIII obligations.

With respect to the transitional nature of Article XIV status, it would be better if the staff could prepare a paper listing how long the countries are in this transition period, and the contributing factors. This will help us in considerably in formulating our future course of action. However, in the case of members having approved or nonapproved restrictive exchange measures, the possibility of publicizing to a greater extent the Fund's position on these restrictions--for example, in the form of a press release--should be given another careful look.

Bilateral and regional payments arrangements in general go hand in hand with trade blocs or trade arrangements between the same group of members. Selectivity, which is the hallmark of such blocs, runs counter to free trade principles. It is worth examining how many members that have accepted Article VIII status are in such trade blocs, and how we are going to tackle this situation.

We must recognize that many developed economies took a considerable amount of time in moving toward capital account convertibility. As most of the developing countries are undertaking the necessary financial sector reform and strengthening the necessary institutional infrastructure, is it not better to wait longer before we move on this matter? This waiting period will help the member countries to consolidate the benefits of current account convertibility and will enable the Fund to bring more members under Article VIII status and to face institutional issues as mentioned by Mr. Schoenberg. Moreover, adequate progress in the external debt situation of developing countries is also an important issue.

Mr. Autheman made the following statement:

I have two brief comments on items 1 and 3 in the staff paper before turning to item 2. With respect to item 1, I agree with previous speakers that the best approach to encouraging countries to accept Article VIII is active persuasion, and I would insist on active persuasion. I do not find the other approaches described in this paper fruitful, for all of the reasons already expressed.

On item 3, although I agree with Mr. Newman that one size does not fit all, the staff paper shows that our store offers all the sizes needed. The relevant question in my mind is the question of proper attire: what is coat-and-tie when it comes to exchange rates? This question was touched upon by Mr. Schoenberg when he wondered what exchange rate system most conducive to exchanging liberalization. It was also is mentioned by Mr. Dlamini when he asked what exchange rate configuration is most conducive to low inflation. Now that our shop offers all sizes, we should work at the quality standard of our products.

With respect to capital account liberalization, I am not concerned that this institution may run out of business, but we should keep ourselves from running out of relevance. In 1944, it was probably relevant to consider agreeing that our final long-term objective would be current account convertibility. But we should be a little more ambitious and recognize that our long-term objective is complete liberalization. This does not mean that we should hurry to achieve this objective. We could be satisfied if, in 25 years, half the membership has achieved this situation, which would be twice as good as what we achieved in the last 50 years.

Capital account liberalization could provide an incentive for accelerating the move toward current account convertibility. Also, experience shows that current account convertibility calls for full convertibility at some stage. I would be ready to support an amendment of the Articles if, and when, there is an opportunity to amend the Articles. I do not see it as a matter of emergency, but if in five years we have an opportunity to amend the Articles, it would be appropriate to introduce this objective in our mandate.

An in-depth review, along the lines described by Mr. Wijnholds, Mr. Schoenberg, and Mr. Newman would be appropriate. However, such a review should not be restricted to the legal aspects, because the options are not limited to the choice between making legal obligations and taking a case-by-case approach. It could be relevant to consider guidelines in this area, providing the appropriate mix between a clear objective and the required flexibility in implementation.

We would need to address several concrete issues in such a review. For example, what would be the transitional arrangements consistent with current account liberalization objectives? I do not think that they would be the same as for current account convertibility. Should we consider restrictions to inflows in the same way as restrictions to outflows? Our own experience is that restrictions to outflows are damaging over a long period. Some restrictions to inflows may be useful if they are of a really transitional nature, such as the restrictions we discussed this morning. I did not hear many complaints against the restriction introduced by Brazil last month, because we all hoped that it would be of a transitional nature.

We need to elaborate a little more on our case, because countries need to be convinced. Among the issues that need to be addressed is the issue of proper sequencing of capital account liberalization. I read with interest a working paper by the staff, launching the proposal that a fast track would be the most appropriate. He cited the case of Venezuela, about which I have mixed feelings. We need to look at this carefully.

I am skeptical whether current account liberalization without a transitional arrangement can be successfully considered by countries that lack a robust balance of payments situation, which would generate a volume of foreign reserves likely to help them defend a range of parities deemed appropriate for their currency without relying on external support. Also, countries must dispose of a market of internationally competitive financial and nonfinancial domestic assets, failing which liberalization can lead either to capital flight or to uncontrolled appreciation of the exchange rate. I would support a wide-ranging review of all these issues.

Mr. Daïri made the following statement:

I welcome the recent progress in current account liberalization and consider it as the happy outcome of an appropriate approach that uses surveillance, program design, and technical assistance. This approach should be continued.

I agree with the staff on the need to move swiftly toward the capital account liberalization, but I agree with previous speakers that this will be more easily achieved in the context of consultation or Fund-supported programs--or the active persuasion referred to by Mr. Autheman--than through the rigid constraint of tightened Articles. Liberalization of the capital account should come naturally, as indicated by Mrs. Cheong, parallel with progress in financial reform and balance of payments viability. The move to capital account convertibility, would therefore follow the progressive pattern of the current account convertibility without putting undue constraints on the authorities. In fact, many countries, whether under Article VIII or not, have already taken substantial steps toward capital account liberalization. The staff should stress the need for additional liberalization measures in this area on a case-by-case basis and stand ready to support these countries in facing any unfavorable outcome of such liberalization.

Moreover, if any amendment of the Articles were to be considered in this matter, we would need to revisit the definition of exchange restrictions in order to deal with the limitations on financial or real assets ownership, and on capital movements that are used frequently both in industrial and developing countries.

The issue of multiple exchange practices applied within the context of exchange risk coverage should not be dealt with from a solely legal perspective, and whenever the Fund calls for removal of such practices, it should advise the countries on the most appropriate alternative.

I agree with previous speakers on the need for early preparation of a staff paper on bilateral and regional payments agreements.

Mr. Kaeser made the following statement:

At this stage of the discussion, and because most of the points I wanted to raise have been mentioned by previous speakers, I shall make only two remarks.

As the staff has pointed out, if Article XIV provides for transitional arrangements in current account convertibility, the ultimate goal of the Fund remains the universal acceptance of Article VIII obligations. Acceptance of Article VIII obligations should, therefore, be further encouraged. However, the process of acceptance should not be accelerated regardless of the costs and risks involved. I agree with the staff that the current policy should be pursued, in which members are not encouraged to assume Article VIII obligations while they maintain transitional restrictions, or while the likelihood is high that the restrictions will soon be reintroduced because the balance of payments equilibrium seems fragile. In other words, we should be ambitious but not overambitious, in this respect. According to the budgetary outlook in the medium term, the number of countries classified as program-intensive in fiscal year 1995 is some 112-116, that is two thirds, of the membership. I do not think that we should exert pressure on program-intensive countries to accept the obligations of Article VIII.

Determining what the necessary conditions are for the withdrawal of restrictions is not always a cut-and-dried matter. Defining the optimal amount of time that transitional arrangements should take, for example, is not easy. Not only do criteria need to be established, but also a case-by-case evaluation is necessary, taking into consideration both the ultimate goal of the Fund and the costs for the country concerned of speeding up adherence to Article VIII status.

With respect to arrears, which are a form of ad hoc restrictions, I support the current policy, that is, that a change of status should not be encouraged prior to the existence of a clear timetable for the elimination of arrears, and that this elimination take place in the near future.

With the conclusion of the GATT Uruguay Round and the start of discussions on a Multilateral Investment Agreement in the OECD, the time is ripe for a global assessment of payments and transfers related to international capital movements. The members of the OECD are bound by a code for the liberalization of capital transactions, but not all countries able to liberalize these transactions are members of this organization. Therefore, I support the idea of giving the Fund a specific mandate on this issue. Nevertheless, I take it for granted that current account convertibility should precede capital account convertibility, and the staff should take a closer look at what the concrete consequences of such an extension could be.

The Fund would be moving from the current situation, in which the staff provides comments--which are not binding--on capital movements in the course of exercising surveillance over exchange rates, to a new situation in which the Fund would formally take it upon itself to scrutinize capital movements.

The possible costs of such a change, notably possible moral hazard problems, should be identified. For example, such problems might arise if the Fund, by extending its jurisdiction, were to behave as a sort of lender of last resort. Considering the importance of this issue, we are against rushing into a decision, and we wonder if early 1995, as proposed, might be too soon to come to a final conclusion.

With respect to the issue of exchange rate regimes, it might be appropriate to pursue the case-by-case approach, even if, generally speaking, I would encourage all members to unify multiple exchange rates. It is important to keep in mind that macroeconomic imbalances in these countries exist, which lead them to resort to such multiple currency measures, and that these imbalances need to be addressed as well.

Concerning foreign exchange risk management, it would certainly be more efficient to allow forward markets to develop, rather than to cover these transactions with public funds. Members can contribute to this end by creating an economic environment favorable to the development as such markets. As a forward market will not fully develop so long as restrictions are in place, or their reintroduction is expected, this is one more argument for liberalizing and accepting Article VIII obligations.

Currently, a large number of countries are participating in regional cross-border payments arrangements. If elimination of restrictions characterized by bilateralism and, to a lesser extent, by regionalism, constitute the long-term goal, in the short term such arrangements could be vital for preventing the collapse of trade between commercial partners whose economies, for historical reasons, are highly interdependent. A review of bilateral and regional arrangements would be useful, in this context, it would be necessary to explore the options realistically open to the countries concerned, and to go beyond a simple enumeration of the negative effects of such arrangements.

Mr. Waterman said that he agreed with previous speakers that the Fund should encourage members to accept the obligations of Article VIII. While he also agreed with other speakers that it would be more appropriate to use persuasion than to use coercion, he would not object to the use of "active persuasion."

As the distinction between current and capital transactions had become increasingly blurred over recent years, it might be helpful to review the developments that had taken place since the Fund was established, Mr. Waterman stated. However, it would be important to distinguish between general restrictions on capital transactions and capital restrictions that resulted from other policies, such as restrictions on foreign investment or trade. The Fund should be very careful about getting involved in the latter type of restrictions, as they involved sensitive jurisdictional issues. In that respect, it was important to note that the effort to draw clear distinctions between the various types of capital restrictions could be difficult.

He was not generally in favor of capital controls, because Australia's fairly limited experience with them indicated that they were not very effective, Mr. Waterman commented. Nevertheless, given the scale and volatility of international capital movements and the difficulties encountered by a number of developing countries, he would not rule out their use completely.

Given the advantages and disadvantages associated with different types of exchange rate systems in various circumstances, it would not be appropriate for the Fund to try to force a particular model on all countries, Mr. Waterman said. However, it would be helpful to keep the experience of various countries under different exchange rate systems under review.

Mr. Glazkov commented that one of the most striking features of the current discussion was the dramatic change in attitude that had taken place throughout the world with respect to various types of external restrictions. When the Fund's Articles were first drafted, exchange and trade restrictions were seen as harmful not so much to the country implementing them as to that country's trade partners. At the present stage, countries were becoming increasingly aware of the direct national benefits to be derived from external liberalization. The transition being undertaken by a large number of formerly centrally planned economies toward more market-oriented systems was also a part of the current global reformation. That reformation had important implications for the issues under consideration.

He agreed with Mr. Evans and other speakers that persuasion and demonstration were preferable to compulsion in the effort to persuade countries to accept the obligations of Article VIII, Mr. Glazkov said. However, the task of accelerating further progress toward universal acceptance of Article VIII obligations should remain in focus. Toward that end, some of the proposals put forward by the staff--such as direct communications by Fund management to the authorities of member countries, emphasizing the benefits of rapid acceptance of Article VIII status and/or formal representations, under Article XIV, Section 3, to members that conditions were favorable for the withdrawal of certain restrictions--warranted further consideration.

In light of the increased importance of capital account convertibility since the Articles were drafted, he would favor considering ways to expand the Fund's mandate to cover issues related to convertibility, Mr. Glazkov stated.

However, the choice of exchange rate regime must remain the prerogative of individual countries, Mr. Glazkov said. The variety of complex issues involved in making that choice were of particular importance to the economies in transition that were undertaking macroeconomic stabilization programs. Therefore, the Fund should continue to offer members guidance on the main factors to be considered in establishing certain exchange rate regimes as well as the technical assistance needed to put in place stable and efficient foreign exchange markets.

The staff representative from the Monetary and Exchange Affairs Department said that the main purpose of the staff in preparing the paper currently under consideration was to keep the Board abreast of recent developments in the international exchange and payments system and to seek guidance from Directors on how to proceed in relations with individual member countries.

The Fund did not have a specific policy defining what constituted an appropriate period for countries to avail themselves of the "transitional" arrangements under Article XIV, the staff representative noted. Over the past two years, the staff had been making every effort to encourage individual countries to adopt the policies needed to allow them to eliminate external restrictions and accept the obligations of Article VIII. However, there had been no radical change in Fund policy; as in the past, countries were encouraged to accept Article VIII status only when appropriate policies were in place and their balance of payments position was sound.

Needless to say, acceptance of the obligations of Article VIII, in itself, could not be taken as a guarantee that a country would not experience future balance of payments difficulties, the staff representative continued. In such situations, the expectation, under Article VIII, was clearly that policies would be used to correct any imbalance in the balance of payments situation. However, cases had arisen in which countries had been either unable or unwilling to use policies effectively to correct such imbalances, and they had resorted to the reimposition of restrictions on payments and trade. In the light of that experience, the staff would not advocate pressing countries to move to accept Article VIII status until the underlying economic and policy conditions were supportive of such a move.

Against that background, the staff had submitted for consideration by the Board a variety of options for encouraging members to move to accept the obligations of Article VIII, the staff representative stated. In that context, the staff had attempted to present all possible options, ranging from gentle persuasion, or an analytical demonstration showing the costs associated with restrictions, to more rule-based approaches, such as formal communications, or even publicity. In so doing, the staff had not intended to indicate that it would favor a rule-based approach. On the contrary, the staff would favor the use of discretion, taking into account the specific circumstances of individual countries. However, in applying even a discretionary approach, the staff needed some rules or policies to guide its work.

The staff paper for the current discussion did not attempt to address all of the issues related to current account convertibility and the globalization of capital flows, the staff representative noted. Those issues would clearly need to be taken up in more detail in the context of a separate study on international capital flows. For the current discussion, the staff had merely tried to point out the dichotomy that existed between the code of conduct put forward at the time the Articles were written and current realities, in order to raise the question of whether consideration should be given to extending the Fund's mandate to cover issues related to international capital flows. Indeed, Article I and Article IV of the Fund's Articles seemed to provide a legal basis for doing so.

In line with the Fund's role in conducting surveillance over member countries' policies, the staff currently examined capital flows and practices affecting capital account transactions in the context of Article IV consultations with members, the staff representative continued. Nevertheless, the Fund's surveillance over capital account convertibility and liberalization could usefully be strengthened, if members agreed to grant the Fund jurisdiction over such matters. Such an agreement would provide the Board with a solid basis for discussions on issues related to capital account transactions and international capital flows, which could lead to the formulation of commonly accepted standards that could be applied in assessing the capital account practices of individual countries.

Having said that, however, it would remain to be seen how the development of such a common standard would affect underlying transactions, the staff representative went on. The analysis contained in the staff paper currently under consideration merely extrapolated the loose distinction that was traditionally made between foreign exchange market liberalization and underlying transactions. While experience clearly showed that freedom from exchange controls did not necessarily mean full freedom for international capital flows--given the controls and incentives that have remained on underlying transactions--it was difficult to make precise distinctions. It may be useful to consider that issue in more detail at a future discussion.

While the liberalization of foreign exchange markets had taken place within the context of an international system based on more flexible exchange rates, it would be difficult to conclude that that was the result of any cause-and-effect relationship, the staff representative considered. For example, in theory, there was no need to maintain any foreign exchange restrictions within a system of flexible exchange rates, but, in fact, restrictions remained. Also, there was, in theory, no need for reserves, but reserves were clearly being used.

Against that background, the accelerating trend toward liberalization of international payments and transfers was much broader than a mere lifting of exchange restrictions; it could be seen as a reflection of the way in which views on the role of government had evolved over time, the staff representative commented. At the time that the Bretton Woods system was put in place, governments were seen as having a predominant role in steering economies. As that view had changed, with governments playing a far more diminutive role in their economies, the use of restrictions had become far less frequent. That change had been accompanied by an increased reliance on market forces in the determination of how resources were allocated.

At present, no single international organization was charged with the task of overseeing international capital flows, the staff representative noted. The Fund clearly had a legitimate role to play in that area, as policies to ensure current account convertibility were at the heart of its main purposes. Indeed, it would be nearly impossible for the staff to examine the balance of payments outlook and exchange rate developments in a country without also examining the capital account. However, the staff was not proposing that the Fund should take on a new mandate in that area. Indeed, before taking any steps in that direction, it would be important to carefully consider both the advantages and disadvantages to be derived from extending the current work of the Fund with respect to capital account convertibility.

It should be noted that many of the questions related to capital transactions were very complex, the staff representative said. Although, as some Directors had indicated, it should be possible, in theory, to control short-term speculative capital flows, it was, in practice, very difficult to identify such flows. Moreover, even if short-term speculative capital flows could be identified as separate from other types of investment, it would be extremely difficult to design controls that would effectively regulate them without having an impact on other types of capital flows. The staff would attempt to examine that particular issue in the context of a future staff paper.

Also with respect to Fund jurisdiction over capital account transactions, some Directors, including Mr. Newman, had noted that the provisions of Article VIII could be seen to imply that the Fund should stand ready to provide support to members facing balance of payments difficulties arising from the capital account, the staff representative noted. Taking on such a role would clearly have financial implications for the Fund. Directors may also wish to take that issue up for careful consideration. Indeed, as Mr. Newman had indicated, certain aspects of that issue were likely to arise in the context of some forthcoming discussions on other related matters.

In preparing the staff paper currently under consideration, the staff had attempted to define a cut-off date for data on the incidence of external payments arrears that would remain reliable for most countries, the staff representative from the Monetary and Exchange Affairs Department stated. Every effort would be made to update the data contained in the staff paper on the basis of currently available information prior to its publication. As Ms. Arraes and other speakers had suggested, the inclusion of a listing of the countries concerned would not be as important in the published version of the staff paper as an indication of the amounts involved.

Another staff representative from the Monetary and Exchange Affairs Department recalled that the provision of technical assistance in the area of exchange arrangements had grown rapidly since the 1980s. In the 1980s, the Fund's technical assistance had focused primarily on making necessary exchange rate adjustments, establishing foreign exchange markets, and closing the gaps between parallel exchange rates and official exchange rates. Given the emphasis that was placed on parallel markets, the Fund staff naturally made estimates on the volume of transactions that flowed through the markets, and in so doing, it examined misinvoicing, errors and omissions, and the short-term capital components of the balance of payments. The staff found that, in most countries, the incidence of capital flight was sizable, despite the extensive exchange control systems that were in place. That realization led most staff missions to advocate movement toward current account convertibility in the context of floating exchange rate regimes. Of course, over time the magnitude of the problems related to capital flight had diminished, as evidenced by the reduced spread between parallel market exchange rates and official exchange rates in most countries. At the present stage, current account convertibility could be associated more frequently with pegged exchange rates than at the time of the debt crisis.

Accumulated experience with various types of controls gave rise also to increased awareness of the fact that exchange controls do not work, the staff representative said. Although there had been a number of cases of "backsliding"--in which exchange restrictions had been reimposed after a member had accepted the obligations under Article VIII--countries were moving away more generally from the use of exchange controls and putting in place more efficient policies.

Resort to the introduction of temporary restrictions in regimes that had previously been fully liberalized was a relatively new phenomenon, the staff representative stated. As to the case of Venezuela, it was important to note that the authorities were trying to resolve some very specific problems that were fairly unique to their economy, and there was still an open question about whether the use of capital restrictions, even on a temporary basis, would provide an adequate means to address the banking crisis. At the same time, however, recent developments in the European Union had led some countries to reintroduce exchange controls, indicating that the possibility of reintroducing such controls could become an increasingly important issue that should be examined carefully. In that connection, it would be useful to consider the questions pertaining to the reimposition of exchange controls in the context of the approval process for restrictions under Article VIII.

The Legal Department may wish to examine the possibility of including provisions related to the acceptance of the obligations of Article VIII in decisions pertaining to individual countries, the staff representative from the Monetary and Exchange Affairs Department commented. The inclusion of such provisions would seem to be consistent with the Fund's current practice, which was to advocate the removal of exchange restrictions in the context of decisions on individual countries.

Mr. Al-Jasser said that he was pleased to note that the staff was not suggesting that the Fund should take on a new mandate with respect to current account convertibility. Indeed, the Fund already had an implicit responsibility to look at capital transactions, and it fulfilled that responsibility in the context of its surveillance over member countries. As the staff had indicated, it would be very difficult to prepare accurate appraisals of members' policies with respect to their balance of payments and exchange rate systems without also examining capital account transactions. From that perspective, the current focus on issues related to the capital account could be seen as a product of the Fund's success in encouraging members to liberalize their economies.

As it would be extremely difficult for the Fund to fulfill its current responsibilities without paying close attention to capital flows among countries, it would be important for the Legal Department to take a forward-looking approach in preparing future papers on the relationship between the Fund and the WTO, Mr. Al-Jasser considered. There was a need to examine how an extension of the Fund's work with respect to capital transactions would fit within the already well-focused role of the Fund in the international monetary system. More important, as the Fund clearly had a role, under its Articles, to sanction the use of capital controls, there was probably a need to examine ways to address cases in which the use of such controls was not justified. That question would likely become increasingly important as developments in the international monetary system continued to unfold over the period ahead.

While no international organization currently had an exclusive mandate to oversee the international capital markets, the BIS was embarking on more work in that area, Mr. Al-Jasser noted. The OECD was also expanding its work on issues related to international capital flows, and the World Bank was expanding its efforts to collect statistical data on capital transactions. Therefore, it would be important for future staff papers to take a forward-looking approach in examining an appropriate future relationship between the Fund and other international organizations, in particular the WTO--with respect to international capital transactions--in order to avoid future problems, such as with respect to the possible duplication of efforts.

The Acting Chairman made the following concluding remarks:

> We have had a very wide-ranging and interesting seminar discussion on several issues that are at the core of our traditional responsibilities under the Fund's Articles. This is the first time that this biennial series of Fund publications has been the subject of a Board seminar, and a number of Directors commented on its relevance for guiding related discussions in Article IV consultations. Also, from their attendance and active participation, I suspect that Directors found this useful.
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> Directors generally welcomed the accelerated trend toward liberalization of members' exchange systems even though a number of Directors noted the large percentage of member countries that have not yet accepted Article VIII. Directors agreed, generally, that the procedures adopted in 1993 to accelerate progress toward current account convertibility, made explicit by members' acceptance of the obligations of Article VIII, had been successful. They endorsed the established policy that before assuming Article VIII status, members are expected to eliminate as

far as possible measures that require the approval of the Fund, and to satisfy themselves that they are not likely to need recourse to such measures in the foreseeable future.

Directors drew attention to the importance of Article VIII accession as a signal of members' commitment to an open policy stance. They agreed that the staff should continue to make intensive efforts to foster the acceptance of Article VIII obligations. Some Directors supported the view that representations by Fund management and/or the Executive Board to the authorities of countries availing themselves of the transitional arrangements of Article XIV might be beneficial. However, most Directors felt that active persuasion is better than formal representation and that the procedures instituted in 1993 remain appropriate.

Directors noted that several members continue to maintain exchange restrictions subject to Fund jurisdiction. They expressed particular concern about the increase in ad hoc restrictions on international payments and transfers evidenced by the increase in external payments arrears. They emphasized that efforts should continue to be made to reduce these arrears, which seriously compromise the system of international payments. Several Directors expressed concern that one sixth of the countries that had accepted the obligations of Article VIII had later reimposed controls, and they encouraged the staff to seek the early elimination of exchange restrictions or multiple currency practices by countries that had acted in this way.

When discussing issues relating to capital account convertibility, a number of Directors noted: the continued increase in the relative importance of capital account transactions in foreign exchange markets; the benefits that arise from the free movement of international capital; and the general ineffectiveness of controls in limiting capital flows, both inward and outward. Some Directors drew attention to the linkage between capital account convertibility and strong inflows of capital.

Some Directors expressed support for an extension of the Fund's jurisdictional responsibility in the area of capital account transactions, noting that we now live in a world that is very different from that faced by the Fund's founding fathers. They noted that, although the Fund does not have formal jurisdictional responsibilities over capital controls, the Fund's surveillance of members' exchange rate policies extends to capital account transactions. Other Directors were willing to contemplate the possibility of amending the Articles to make this jurisdiction more explicit. Some other Directors, however, expressed reluctance, noting that, in some circumstances, the use of capital controls could play a useful role in dealing with exchange rate pressures.

Directors noted the distortions that arise from multiple exchange rate regimes and welcomed members' reduced recourse to such regimes. However, some Directors noted that, in some cases, multiple currency practices had been used as a transitional measure to more liberal exchange rate regimes, albeit at the expense of consequent distortions. Directors, therefore, supported the continuation of the present approval policy for multiple currency practices, which calls for the unification of the exchange rate over a specific and appropriately brief period.

When discussing the increased incidence of bilateral and regional arrangements that accompanied the accession to membership by countries of the FSU, a number of Directors agreed that these arrangements may have a brief transitional role where multilateral payments instruments are poorly developed. Nonetheless, as such arrangements often give rise to exchange restrictions and multiple currency practices, many Directors supported a continuation of the Fund's existing policy. Accordingly, the elimination of bilateral payments arrangements inconsistent with Article VIII will normally be included as a performance criterion under upper credit tranche stand-by and extended arrangements of the Fund. Directors looked forward to the legal paper on jurisdictional issues relating to bilateral payments arrangements, and several Directors supported the view that the Fund should continue to keep under review regional payments arrangements and the use of countertrade arrangements.

From Directors' comments, it is clear that the issue of the Fund's potential role in monitoring capital account restrictions and encouraging capital account liberalization gives rise to a wide range of questions. Several Directors requested that the staff undertake a more detailed review of these issues for subsequent Board consideration. We shall seek to expand the April 1995 paper to address the issues that were raised. Some of these issues will also be addressed in the legal paper on Fund relations with the WTO.

LEO VAN HOUTVEN
Secretary