

November 13, 1974

To: Members of the Executive Board

From: The Secretary

Subject: Draft Amendments on Use of the Fund's Resources - Revision
and Commentary

Attached for consideration by the Executive Directors is a redraft of the amendments on the use of the Fund's resources, together with a commentary by the staff.

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This subject will be brought to the agenda for discussion on a date to be announced.

INTERNATIONAL MONETARY FUND

Draft Amendments on Use of the Fund's Resources--
Revision and Commentary

Prepared by the Legal Department

(In consultation with the Research, Treasurer's,
and Exchange and Trade Relations Departments)

Approved by Joseph Gold

November 12, 1974

The following redraft of amendments on the use of the Fund's resources and commentary have been prepared in the light of the discussion by the Executive Directors at EBM/74/107-108 (9/4/74). The redraft does not incorporate certain ideas on new arrangements for financial assistance through the Fund, e.g., in connection with segregated resources or separate facilities. These ideas will be examined in a separate memorandum.

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I. Redrafted Provisions

Article V

Section 2. Limitation on the Fund's operations

Except as otherwise provided in this Agreement, operations on the account of the Fund shall be limited to transactions for the purpose of supplying a member, on the initiative of such member, with the currency of another member or special drawing rights in exchange for gold or for the currency of the member desiring to make the purchase.

Section 3. Conditions governing use of the Fund's resources

(a) ~~A member's use of the resources of the Fund shall be in accordance with the purposes of the Fund.~~ The Fund shall adopt policies on the use of its resources, including policies on stand-by arrangements, that will assist members to solve their balance of payments problems in a manner consistent with the purposes of the Fund and the provisions of this Agreement and that will establish adequate safeguards for the temporary use of its resources. ~~A member~~ Members shall not be entitled without the permission of the Fund to use the Fund's resources to acquire currency to hold against forward exchange transactions.^{1/}

(b) A member shall be entitled to ~~buy~~ purchase the ~~currency~~ currencies of ~~another~~ other ~~members~~ members from the Fund in exchange for its own currency subject to the following conditions:

(1) A ~~The~~ member's use of the resources of the Fund ~~shall~~ would be in accordance with the purposes of the Fund,^{2/} the provisions of this Agreement, and the policies adopted under them;

^{1/} This provision has been transferred, in modified form, from the present subsections (b) and (c). The first sentence of the present subsection (c) has been included, in modified form, as condition (1) in draft subsection (b).

^{2/} This provision has been transferred, in modified form, from the present subsection (c).

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(ii) ~~The member desiring-to-purchase-the-currency~~
 represents that it ~~is-presently-needed-for-making-in~~
~~that-currency~~ has a need to make the purchase because of

Draft A

developments in its balance of payments which-are
~~consistent-with-the-provisions-of-this-Agreement;~~

Draft B

its balance of payments situation or developments
in its reserves ~~payments-which-are-consistent-with~~
~~the-provisions-of-this-Agreement;~~

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Draft C

its present and prospective balance of payments and
reserve position ~~payments-which-are-consistent-with~~
~~the-provisions-of-this-Agreement;~~

(iii) ~~The-Fund-has-not-given-notice-under-Article-VII,~~
~~Section-3,-that-its-holdings-of-the-currency-desired-have~~
~~become-scarcer.~~^{3/} The proposed purchase would be a gold
 tranche purchase, or would not cause the Fund's holdings

^{3/} This sentence in the present subsection (a)(ii) has been transferred, in modified form, to draft subsection (d).

~~of the purchasing member's currency to increase by more than twenty-five percent of its quota during the period of twelve months ending on the date of the purchase or~~
to exceed two hundred percent of its quota;

(iv) The Fund has not previously declared under Section 5 of this Article, Article IV, Section 6, Article VI, Section 1, or Article XV, Section 2(a), that the member desiring to purchase is ineligible to use the resources of the Fund.

(c) A representation by a member under ~~(a)~~ (b) above shall be examined by the Fund to determine whether the proposed purchase would be consistent with the purposes of the Fund, the provisions of this Agreement, and ~~with~~ the policies adopted under them, with the exception that proposed gold tranche purchases shall not be subject to challenge.

(d) The Fund shall adopt policies on the currencies to be sold that take into account the present and prospective balance of payments and reserve positions of members, and the desirability of promoting over time a balanced distribution of reserve positions in the Fund, provided that if a member represents that it needs to purchase the currency of another member in order to obtain an equivalent amount of its own currency held by that other member, it shall be entitled to purchase the currency of that member unless the Fund has given notice under Article VII, Section 3, that its holdings of the currency have become scarce.

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(e) A member's currency that is purchased from the Fund shall be converted by the member at the time of the purchase if conversion is requested by the purchasing member. Conversion shall be made with a currency convertible in fact on the basis of the rates at which the Fund would sell the currencies involved or with such other currency and at such other rates consistent with the provisions of this Agreement as may be agreed between the members.

II. Commentary

1. Article V, Section 2 would be amended to include in this general provision a reference to the Fund's authority to sell special drawing rights to members. As the Fund is already authorized to sell special drawing rights under Article XXV, Section 7(f), no change in substance would be involved.

2. Draft Section 3 has been restructured so as to follow a more logical order. The present subsection (c), except for the first sentence, becomes draft subsection (a), because it requires the Fund to adopt policies on the use of its resources. The present subsection (b), which deals with purchases in relation to forward exchange contracts, has been incorporated in draft subsection (a). The present subsection (a), which deals with a member's entitlement to make purchases, becomes draft subsection (b), in part because one condition to which the entitlement is subject is consistency with the policies of the Fund adopted by the Fund under draft subsection (a). The present subsection (d) becomes draft subsection (c) and deals with the duty of the Fund to examine requests to determine their consistency with the Fund's policies as well as with the purposes of the Fund and the provisions of the Articles.

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3. Subsections (a), (b), and (c) of draft Section 3 should include the same concepts because they deal, in turn, with the duty of the Fund to have policies, the entitlement of members to make purchases in accordance with those policies, and the duty of the Fund to make sure that requests are in accordance with the policies. Therefore, the language of all three subsections requires consistency, for both the Fund and members, with the purposes of the Fund, the provisions of the Articles, and the policies adopted by the Fund under the provisions.

4. Draft Section 3(a) would include a reference to the Fund's policies on stand-by arrangements. This reference would be desirable in order to lay the foundation for the introduction of a reference to charges for stand-by arrangements in Article V, Section 8 that would be necessary in order to make the Fund's implied power to levy such charges an express power and to make them subject to the same rules as other charges. Under present practice, the rules are not the same, because charges for stand-by arrangements are payable in U.S. dollars as an alternative to gold or special drawing rights pursuant to paragraph 5(b) of Decision No. 270-(53/95), December 23, 1953 (Selected Decisions, pp. 28-31, 30), and paragraph 3 of Decision No. 2901-(69/122) G/S, December 18, 1969 (Selected Decisions, p. 13⁰), to the extent that they are not payable in a member's currency as specified by Article V, Section 8(f), whereas for other charges members have no option to pay in U.S. dollars.^{1/} Moreover, policies on stand-by arrangements have acquired such an importance among the Fund's policies on the use of its resources that it would be desirable to make this change if only as a matter of presentation. The amendment would not

^{1/} See DAA/74/3, Sup. 1 (to be issued) for draft amendments of Article V, Section 8 that would terminate this distinction.

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affect the Fund's power to adapt its policies on stand-by arrangements. It need not be expected that policies would be frozen in their present form because of the amendment.

5. The amendment of Article V, Section 3(b) has been considered in order to see whether it would be desirable to give members an entitlement to use the resources of the Fund for holding against forward exchange transactions. Under current practice members make purchases under Section 3(a) to restore foreign exchange holdings to a needed level, whether these holdings have been depleted as a result of spot or forward exchange transactions. This practice, and the availability of stand-by arrangements from the Fund to cover forward exchange commitments, may explain the absence of specific requests for permission under Section 3(b) for the purchase of currency. A right to purchase that would enable a member to hold and even invest resources purchased from the Fund pending the maturity of forward exchange contracts would seem to be difficult to justify. Therefore, draft subsection (b) does not extend the entitlement of members to purchases for the purpose of holding against forward exchange transactions. The present text of subsection (b) has been incorporated in draft subsection (a) with the substitution of "members" for "a member" in order to convey the idea that the Fund may adopt policies under it which would give permission that would entitle members to make purchases for this purpose. Requests by members would be subject to the other provisions of Section 3.

6. Article V, Section 3(a)(1) would be amended as shown in draft Section 3(b) to give effect to two main purposes. The first purpose would be to make it possible for a member to request a purchase without specifying a particular currency. Under the present practice of widespread convertibility through the exchange markets, a member (except the member issuing the main intervention currency, and possibly some other members for special reasons) can be said to need any currency that can be converted in this way. Therefore, the phrase "in that currency" has a different meaning from the one that was normally assumed when the Articles were drafted. The present language may be misleading for that reason.

7. The currencies sold by the Fund would be selected by it in accordance with policies on the use of currencies, which it would have to adopt pursuant to draft Section 3(d). Under existing practice, which is based on Decision No. 1371-(62/36), adopted July 20, 1962 (Selected Decisions, pp. 36-42), a currency budget is prepared in accordance with the policy set forth in that Decision and following consultation with members issuing the currencies that might be used in purchases. Prior to the submission of requests to purchase, members consult with the Managing Director regarding the currencies to be purchased, and the Managing Director provides advice pursuant to the currency budget. Draft Article V, Section 3(d) would give currency budgets a legal status similar to designation plans. If, however, a member represented that it needed the currency of another member in order to redeem balances of its own currency held by that other member, the purchasing member would be entitled

to purchase the holder's currency unless the Fund had given notice under Article VII, Section 3, that its holdings of the currency had become scarce. This entitlement, which is patterned on Article XXV, Section 2(b)(i),^{2/} would take account of the position of members issuing currencies that are held by other members in their reserves.

8. The second purpose referred to in paragraph 4 above would be to simplify the language of Article V, Section 3(a) and bring it into conformity with established policies and practices of the Fund. Drafts A, B, and C represent different approaches to simplification, but the intention is to have a formulation that would not alter present policies and practices. Under any of the formulations the same criterion of need would continue to apply to both gold tranche and credit tranche purchases,^{3/} and a member would still have to represent, that is, declare,^{4/} that it had a need to make the purchase. It could use the resources purchased from the Fund, however, without having to make payments with them. For example, a member would continue to be able to restore its foreign exchange holdings if it had drawn them down in connection with intervention in the exchange market or as the result of direct monetary settlements. In addition, as at present, a request to use the Fund's resources by a member in deficit would not be challenged solely because its reserve position was strong.

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9. The feasibility has been considered of giving members that are participants in the Special Drawing Account an entitlement to purchase special drawing rights under draft Article V, Section 3(b). At present,

^{2/} Article XXV, Section 2(b)(i) provides:

"A participant, in agreement with another participant, may use its special drawing rights ...

to obtain an equivalent amount of its own currency held by the other participant; ..."

^{3/} The question arises, however, whether different criteria should apply to the two categories of purchase.

^{4/} See Decision No. 284-4, adopted March 10, 1948, in Selected Decisions, pp. 20-21. Even though the word "declares" could be used in the draft to carry the same meaning as the word "represents", namely, that the member's statement would be examined and could be challenged by the Fund (see Article V, Section 3(d)), the retention of the word "represents" has the advantages of familiarity and experience with its interpretation.

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they do not have an entitlement, but by virtue of Article XXV, Section 7(f) the Fund may agree to sell special drawing rights to a participant in the Special Drawing Account. Relatively little use has been made of this power so far. The difficulty with an entitlement is that it might impair the Fund's liquidity by reducing the Fund's holdings of an asset with which it can replenish its holdings of any currency that it may need for its operations. Moreover, the Fund might not hold a sufficient amount of special drawing rights to satisfy all demands if members were entitled to purchase them. If there were to be an entitlement, the Fund would need to be authorized to limit it, for example, in relation to availabilities and possibly priorities.

10. Article V, Section 3(a)(iii) would be amended to delete the limitation of 25 per cent of quota during any period of 12 months. This provision was envisaged as a safeguard against improvident use of the Fund's resources. The power of the Fund to challenge a representation of need by a member (see n. 4, above), and the development of policies on the use of the Fund's resources, however, have made this provision unnecessary as a safeguard. The established practice of granting routine waivers of the amount has made an anomaly of the provision. There seemed to be little support in the earlier discussions of the Executive Directors for deleting the limit of 200 per cent or raising it.

11. Draft Article V, Section 3(d) would be a new provision. The policies that the Fund would have to adopt under this provision would take into account, first, the present and prospective balance of payments and reserve positions of members and, second, the desirability of promoting over time a balanced distribution of reserve positions in the Fund.^{5/} Balanced distribution has been understood in the Fund's practice so far as one that can be determined by a quantitative relationship, that is a ratio, between a member's gold tranche, plus its loan claims on the Fund, to reserves as defined by the Fund for this purpose. It seems desirable, in the interest of flexibility of policy, to avoid a detailed definition of this concept by inclusion of a formula in the Articles. The mandate to "take into account" these factors does not foreclose the Fund from taking into account other factors as well if they appear relevant at any time, such as the liquidity of the Fund, or even from giving preponderant weight to such other factors.

12. Draft Article V, Section 3(e) would establish an obligation of conversion for the issuer of the currency sold by the Fund as a consequence of draft Section 3(b). The amendment would be an important one that would contribute to the usability of all currencies in transactions. The issuer would have to convert the currency at the request of the purchasing member

^{5/} The concept of a balanced distribution of reserve positions in the Fund is symmetrical with the general principle of designation in Article XXV, Section 5(a)(i) that speaks of a "balanced distribution of holdings of special drawing rights" among participants in the Special Drawing Account.

into currency convertible in fact at the time of the purchase or shortly thereafter. This obligation would be applicable only if the purchasing member made a formal request for conversion prior to the purchase. The purchasing member would not have to make a request for conversion, and would be able to retain the currency sold by the Fund or use it in accordance with the other provisions of the Articles.

13. Conversion pursuant to the obligation in draft Article V, Section 3(e) would be made on the basis of the rates at which the Fund would sell the currencies involved at the time of the conversion. The reason for having a mandatory standard in contrast to normal market or central banking conversions is that the particular currencies to be converted would have been obtained by purchasing members not as a matter of their choice but pursuant to the Fund's policies. The standard of exchange rates in the Fund's transactions would be an equitable one in all conditions, including the present conditions of general floating and wider margins. Notwithstanding the provisions of draft subsection (e) the purchasing member and the issuer of the currency purchased may agree that conversion shall be made with a currency other than a currency convertible in fact and at an agreed rate of exchange provided that it is consistent with the Articles.

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14. All decisions under the amended provisions discussed in this memorandum would be taken by the Executive Directors under the general delegation of power to them by Section 15 of the By-Laws of the Board of Governors. These decisions would be within the scope of the criterion of the "general operations of the Fund" in Article XII, Section 3(a). The Council would be authorized under draft Article XII, Section 2(c) (DAA/74/1, Supplement 1, August 6, 1974) to take decisions if that were necessary "to enable the Council to fulfill its functions." It is unlikely that any of the decisions discussed in this memorandum would be covered by this criterion.

15. Draft Article V, Section 7(c) and (d), which appeared in DAA/74/4, will be considered in DAA/74/2, Supplement 2 (to be issued), in order to have a unified presentation of the repurchase provisions.