

November 8, 1974

To: Members of the Executive Board

From: The Secretary

Subject: Draft Amendments: Exchange Rates and Legalization of Floating

Attached for consideration by the Executive Directors are revised versions of the texts of DAA/74/5, together with a commentary on these draft amendments.

194

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

Corrected: 11/11/74

INTERNATIONAL MONETARY FUND

Draft Amendments: Exchange Rates and Legalization of Floating

Prepared by the Legal Department

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

Approved by Joseph Gold

November 4, 1974

Part I - Revised Draft Amendments

The draft amendments set forth below are revised versions of the texts in DAA/74/5 that have been prepared in the light of the discussions of the earlier versions by the Executive Directors.

Article IV

Section 4 3. Obligations regarding exchange stability

195

~~The maximum and the minimum rates for exchange transactions between the currencies of members taking place within their territories shall not differ from parity~~

~~(1) in the case of spot exchange transactions, by more than one percent; and~~

~~(11) in the case of other exchange transactions, by a margin which exceeds the margin for spot exchange transactions by more than the Fund considers reasonable.~~

(a) Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations policies.

(b) Subject to Section 4, each member undertakes through appropriate measures consistent with this Agreement, to permit within its territories exchange transactions between its currency and the currencies of other

Corrected: 11/11/74

~~members only within the limits prescribed under Section 3 of this Article~~  
at rates in accordance with (c) or (d) below. A member whose monetary  
 authorities, for the settlement of international transactions, in fact  
 freely buy and sell gold within the limits prescribed by the Fund under  
 Section 2 of this Article shall be deemed to be fulfilling this undertaking.

(c) The maximum and the minimum rates for exchange transactions  
between the currencies of members taking place within their territories  
shall not differ from parity

(1) in the case of spot exchange transactions, by more than  
[ ] percent or by such other margin or margins as the  
Fund may adopt [by a      percent majority of the total  
voting power], and

(ii) in the case of other exchange transactions, by a margin  
which exceeds the margin or margins for spot exchange trans-  
actions by more than the Fund considers reasonable.

The Fund may prescribe conditions to be observed by members in  
connection with margins adopted by the Fund under (i) above.

(d)

#### Alternative 1

Notwithstanding (c) above, a member may permit exchange trans-  
actions outside the limits prescribed by or under (c) above in such  
[exceptional] [particular] situations, for such periods, and subject to  
such conditions as the Fund may determine [by a      percent majority of the  
total voting power].

- 3 -

Alternative 2

Notwithstanding (c) above, [in particular situations specified by the Fund] a member may permit exchange transactions outside the limits prescribed by or under (c) above provided that it acts consistently with [guidelines] [policies] established by the Fund for the management of exchange rates.

Section 4. Foreign exchange dealings during interim periodAlternative 1

The Fund shall decide [by a     percent majority of the total voting power] when Section 3(b), (c), and (d) shall begin to apply. In the period before these provisions apply, the Executive Directors may adopt rules on the subject matter of the provisions.

197Alternative 2

Section 3(b), (c), and (d) shall not apply for a period of [three] years, provided that the Fund, by a majority of the total voting power, may extend or terminate this period at any time. During this period, the Executive Directors may adopt rules on the subject matter of the provisions.

## Article XVI

## Emergency Provisions

Section 1. Temporary suspension

(a) In the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund, the Council or the Executive Directors by unanimous-vote a four-fifths majority of the total voting power may suspend for a period of not more than one hundred ~~twenty-days~~ year the operation of any of the following provisions:

- 4 -

(i) Article IV, Sections 3 ~~and 4~~(b), (c), and (d)

(ii) Article V, Sections 2, 3, 7, 8(a) and (f)

(iii) Article VI, Section 2

(iv) Article XI, Section 1

~~(b) Simultaneously with any decision to suspend the operation of any of the foregoing provisions, the Executive Directors shall call a meeting of the Board of Governors for the earliest practicable date.~~

(b) A suspension of the operation of a provision under (a) above may not be extended beyond one year except by the Board of Governors which, by a four-fifths majority of the total voting power, may extend a suspension for an additional period of not more than [two] years if it finds that the emergency or unforeseen circumstances referred to in (a) above continue to exist.

~~(c) The Executive Directors may not extend any suspension beyond one hundred twenty days. Such suspension may be extended, however, for an additional period of not more than two hundred forty days, if the Board of Governors by a four-fifths majority of the total voting power so decides but it may not be further extended except by amendment of this Agreement pursuant to Article XVII.~~

(c) The Executive Directors may, by a majority of the total voting power, terminate such suspension at any time.

(d) The Fund may adopt rules with respect to the subject matter of a provision during the period in which its operation is suspended.

- 5 -

## Article XXIX

## Suspension of Transactions in Special Drawing Rights

Section 1. Emergency provisions

In the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund with respect to the Special Drawing Account, the Council or the Executive Directors, by ~~unanimous-vote~~ a four-fifths majority of the total voting power, may suspend for a period of not more than one ~~hundred-twenty-days~~ year the operation of any of the provisions relating to operations and transactions in special drawing rights, and the provisions of Article XVI, Section 1(b), (c), and (d) shall then apply.

## Part II. Commentary

### Introduction

1. The revised draft amendments set forth in Part I of this memorandum are based on DAA/74/5, of July 17, 1974, and the comments made by executive directors at ERM/74/109 and ERM/74/110. These draft amendments relate to the following four subjects:

- (a) wider margins for exchange transactions (Article IV, Section 3)),
- (b) the legalization of floating (Article IV, Section 3(d)),
- (c) the introduction of a transitional exchange regime in the interim period (Article IV, Section 4), and
- (d) the temporary suspension of the operation of certain provisions of the Articles (Articles XVI and XXIX).

2. These draft amendments do not purport to deal with the question of the adjustment process or the question of gold. Therefore, they do not involve Section 1, Section 2, or the second sentence of Section 4(b) of Article IV. These provisions, as well as other provisions of the Articles, will have to be reexamined when agreement is reached on the subject of gold.

3. Under the draft amendments the provisions of Section 3 and 4 of Article IV are rearranged in order to emphasize the central function in the code of conduct contained in the Articles of the obligation of members under the present Article IV, Section 4(a), which corresponds to one of the purposes of the Fund (Article I(iii)). In addition, the rearrangement would make it clear that members could act consistently with the objective of exchange stability either through the maintenance of effective par values or through the adoption of floating rates in particular situations and the observance of adequate safeguards, such as guidelines established by the Fund.

4. Under the draft amendments Article IV, Section 4(a) of the present Articles would become Article IV, Section 3(a) and would differ from it only in one respect: the word "policies" would be substituted for the word "alterations." This change is intended to make the obligation under the provision applicable with respect to all competitive exchange policies and not simply competitive changes in exchange rates. As a result of the modified language the Fund would be able to decide that a member was failing to observe its obligations with respect to competitive practices even though that failure took the form of inaction. Under the present text of Article IV, Section 4(a), the Fund would be able to decide that a member that does not change the rate of exchange for its currency was failing to perform its obligations under the provision only if the Fund concluded that the member was failing "to promote exchange stability" or "to maintain orderly exchange arrangements".

- 7 -

5. The change in the language discussed in paragraph 4 above would not affect the position of members under Article IV, Section 5(b). Under that provision, a change in the par value of a member's currency may be made only on the proposal of the member. The substitution of "policies" for "alterations" in the present text of Article IV, Section 4(a) would not enable the Fund to propose a specific new par value or, of course, to put a new par value into effect in the absence of a proposal by the member.

6. Section 3(b) of amended Article IV is the same as the present Section 4(b) of Article IV except for two changes that are the consequence of the insertion in the Article of two new provisions: one providing for a transitional exchange regime in the interim period (Section 4) and another authorizing floating rates in certain circumstances (Section 3(d)).

#### Wider Margins

7. Under Section 3(c) of the draft amendment, which is intended to take the place of the present Section 3, a margin for spot exchange transactions would be included in the Articles. This margin could be 1, 2 1/4, or 4 1/2 per cent on either side of parity, or any other margin that might be agreed upon for insertion in the Articles. These margins would be maximum margins, and members would not be prevented from maintaining narrower margins. Under the draft provision the Fund would be able to establish a different margin, which might be either wider or narrower than the one included in the provision, for all spot transactions or different margins for different categories of transactions. For instance, if the margin prescribed in the provision were 2 1/4 per cent for all spot transactions, the Fund could decide to widen it to 4 1/2 per cent for all such transactions, or to 4 1/2 per cent for spot transactions in the currencies of members participating in a multi-currency intervention system and to, say, 5 1/2 per cent for spot transactions between these currencies and other currencies. The decision of the Fund would be taken by either the Executive Directors or the Council, unless it were decided that only the Council should have this power. A decision would be taken by a majority of the votes cast unless some majority of the total voting power were required.

8. When establishing new margins under the text in Part I, the Fund would have the power to attach such conditions as it deemed appropriate, and members would have to observe the conditions when employing the margins. These conditions could include, for example, rules that would prohibit excessively wide spreads between a buying and a selling rate or excessive differences among buying rates or among selling rates for categories of transactions or currencies. The Fund would not be authorized to exercise control over similar practices by members within the margins prescribed in the Articles, because the authority to impose conditions would be exercised only in connection with changes in the margins. It would be desirable, however, for the Fund to have authority to prevent such practices even within the margins



prescribed in the Articles because they are likely to be wider than the narrow margins of the present Article IV, Section 3. Moreover, it would be logical for the Fund to have this authority because new margins prescribed by the Fund under the draft of Section 3(c)(i) might be narrower than the margins included in the amended Articles, but the Fund would be able to attach conditions to the narrower margins. The Fund could be given the proposed authority by an amendment of Article VIII, Section 3, which would make it clear that the Fund's jurisdiction with regard to multiple currency practices and discriminatory currency arrangements was applicable within any margins that might be in force. Under this amendment the first sentence of Article VIII, Section 3, would read as follows:

"No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1, to engage in, any discriminatory currency arrangements or multiple currency practices, whether within or outside the margins prescribed by Article IV, Section 3(c), except as authorized under this Agreement or approved by the Fund."

9. Article IV, Section 3(d) of the draft amendments would authorize the adoption of floating by members. This practice is not permitted by the present provisions of the Articles, under which members must ensure that all rates for exchange transactions in their territories take place within the margins set forth in the Articles. The Fund has authority to permit deviations from this obligation only by approving multiple currency practices (Article VIII, Section 3). In short, the Fund has no authority to permit unitary floating rates for the currencies of members, but would have that authority under the draft amendments.

10. Section 3(d) is drafted in two versions. Under the first of these versions, floating would be viewed as an exception to the rule of effective par values and would be permitted, under a general or ad hoc approval, only as a temporary measure and subject to conditions intended to ensure a return to an exchange system based on an effective par value. Under the second version, members would be free to let their currencies float without having to obtain the approval of the Fund and for as long as they desired, provided that they acted consistently with guidelines adopted by the Fund. The second version could take one of two forms. Under one, the situations in which members would be entitled to allow their currencies to float, subject to the observance of guidelines, would be defined by the Fund. Under the other form of the second version, the entitlement of members would be general and not confined to defined situations. Under either form of the second version, floating would be treated as one of the ways in which a member could choose to carry out its obligations with regard to exchange stability. The other way would be maintenance of an effective par value, i.e., the maintenance of rates within legal margins from parity.

- 9 -

11. In view of the treatment of floating under the draft amendment, only members with floating rates maintained inconsistently with draft Article IV, Section 3(d) would be failing to observe their obligations under the Articles. These members would be subject to Article XV, Section 2, under which the Fund would be able, as a first step, to declare them ineligible to use the Fund's resources.

12. The treatment of unauthorized floating as explained in paragraph 11 above would differ from the consequences of an unauthorized change in par value. Under the present text of Article IV, Section 6 a member that changes the par value of its currency despite the objection of the Fund in circumstances in which the Fund is entitled to object is not treated as violating its obligations and is not subject to Article XV, Section 2(a). This legal distinction was made as a compromise when the Articles were drafted with those who wished to maintain as much authority as possible over the values of their currencies. Nevertheless, the price for an unauthorized change of par value is that a member making it is automatically ineligible to use the Fund's resources. It is doubtful that, under amendments of the kind that are contemplated, unauthorized floating should be a violation of the Articles if unauthorized changes in par value are not. It would be difficult, furthermore, to justify the differences in treatment with respect to ineligibility. The most logical course would be to delete Article IV, Section 6, which in any event is obscure and reflects an outmoded compromise.

13. Under the present Articles, a member that has once established a par value for its currency continues to have that par value until a new par value is established. A par value is not abrogated under the Articles because a member allows its currency to float. One consequence of this legal position is that a member is clearly subject to the provisions of Article IV, Section 5 on changes in par values when it wishes to establish a new par value. Another consequence is that a member is not required to obtain the concurrence of the Fund if it makes its par value effective once again after a period of floating, even if the Fund were to regard the par value as inappropriate. It has been suggested that, at least in certain circumstances of floating, a member should be able to treat the par value for its currency as abrogated under the Articles. A member has been able to do this hitherto but only for the purposes of its domestic law. The suggestion involves complications, and it is proposed to examine them in a separate memorandum.

#### Exchange Regime in Interim Period

14. The draft provisions regarding wider margins and floating rates are intended to deal with the longer-term and are not adequate to deal with the realities of the present situation. A new provision, Section 4 of Article IV, would provide for a transitional period during which the basic provisions with regard to margins and exchange rates would not apply. During this period the Fund would be able, on the basis of

this provision, to adopt rules putting into effect present arrangements with regard to central rates, wider margins, guidelines for floating, currencies pegged to an intervention currency within narrow margins, or other arrangements compatible with the objective of exchange stability and good order. The provision appears in two versions. Under one version the transitional regime would be in effect for a period specified in the provision, although this period could be shortened or extended by a decision of the Fund. Under the other version the regime would be of indefinite duration but the Fund would be able to put an end to it at any time by a decision making the provisions of Section 3(b), (c), and (d) applicable as of a specified date. The decision under either version would be taken by the Executive Directors or the Council, unless it were provided that only the latter should be empowered. Again, it would be necessary to determine what majority should be required for the decision.

#### Suspension of the Operation of Certain Provisions

204 15. Article XVI, Section 1 permits the Fund to suspend the operation of certain provisions of the Articles listed in that section for a period not exceeding 360 days, "in the event of an emergency or the development of unforeseen circumstances threatening the operations of the Fund." The Executive Directors, by unanimous vote, may decide on a suspension for a maximum period of 120 days, but the period of the suspension may be extended for an additional period of not more than 240 days only by a decision of the Board of Governors taken by a four-fifths majority of the total voting power. At the time of the initial decision to suspend, the Executive Directors must call a meeting of the Board of Governors "for the earliest practicable date."

16. Article XVI, Section 1 has not been used to cope with the widespread floating of currencies in present circumstances, partly because of the formidable obstacle of the requirement of unanimity, but also because it was assumed that floating might continue to be widespread after the maximum period of suspension of one year had elapsed. The draft amendments of Article XVI, Section 1 and Article XXIX, Section 1 are intended to make these provisions more readily usable in the future in circumstances of widespread floating, or in other situations in which suspension would enable the Fund and its members to deal more adequately with the problems they faced. It is not proposed to deal with the present situation under Article XVI, but instead to establish a transitional regime under Section 4, because it is not known how long the present situation may last and because it can hardly be described at this time as an unforeseen circumstance.

17. The references to the Council in the draft amendments of Articles XVI, and XXIX are intended to permit it to carry out its mandate to "deal with sudden disturbances that might threaten the international monetary system." The new majority of 80 per cent for decisions on suspension would make it easier to exercise the power. In view of these functions of the Council and the expectation that that organ of the Fund would normally hold meetings several times a year, it was felt that Article XVI, Section 1(b) served no important purpose and for that reason it has been deleted.

- 11 -

18. The list of provisions in Article XVI, Section 1 that may be subject to a decision on suspension of operation is the same as in the present Articles except in one minor respect: the references in (i) have been changed as a consequence of the rearrangement of and changes in the provisions of Article IV, Sections 3 and 4. There seems to be no need to expand the list of provisions that should be subject to suspension under Article XVI.

19. The period of the initial suspension has been extended from 120 days to one year, and the extensions have been changed from a maximum of 240 days to a maximum of [two] years. The reasons for these changes are that experience has shown that emergencies or unforeseen circumstances may last longer than the present maximum period of one year and that the process of amendment needed for corrective action may take longer than one year. An initial suspension could not be prolonged beyond one year by either the Council or the Executive Directors or by the two organs acting consecutively.

20. Article XVI, Section 1(d) would give express authority to the Fund to adopt substitute rules on the subject matter of a provision while its operation is suspended. The Fund has an implied power under the present provisions (see SM/73/181 (7/23/73)), but it would be advisable to take the opportunity to make the power express.

21. The insertion of the words "operations and transactions" in Section 1 of Article XXIX is intended to make the intention of the provision explicit, i.e., that the suspension applies only in respect of provisions that deal with operations and transactions in special drawing rights and not all provisions that relate to special drawing rights. As in the case of a suspension under draft Article XVI, Section 1, the Council as well as the Executive Directors would have the power to decide on a suspension under draft Article XXIX.