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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/23

10:00 a.m., February 13, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
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	J. E. Suraisry
	E. M. Taha, Temporary
	G. Ortiz
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
N. Wicks	T. A. Clark
	N. Coumbis
Zhang Z.	

L. Van Houtven, Secretary
B. J. Owen, Assistant

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Also Present

European Department: P. Dhonte. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; J. T. Boorman, K. M. Huh, P. J. Quirk, E. Sidgwick. External Relations Department: L. F. Hamilton. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; R. C. Effros, Ph. Lachman, A. O. Liuksila. Middle Eastern Department: M. A. El-Erian. Research Department: R. R. Rhomberg, Deputy Director. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Western Hemisphere Department: S. T. Beza, Associate Director. Bureau of Statistics: J. B. McLenaghan. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: H. A. Arias, G. R. Castellanos, K. A. Hansen, G. W. K. Pickering, T. Sirivedhin, D. C. Templeman, N. Toé, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, W.-R. Bengs, M. B. Chatah, J. J. Dreizzen, G. Ercel, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, M. Lundsager, K. Murakami, J. Reddy, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, E. L. Walker, B. D. White.

1. MULTIPLE CURRENCY PRACTICES APPLICABLE SOLELY TO CAPITAL TRANSACTIONS

The Executive Directors considered a staff paper on multiple currency practices applicable solely to capital transactions (SM/85/19, 1/16/85), which had been prepared following the Executive Board's review of experience with multiple exchange rate regimes (SM/84/64, 3/19/84; Cor. 1, 3/28/84; SM/84/65, 3/20/84; Cor. 1, 3/22/84; Cor. 2, 4/4/84; EBM/84/60, 4/18/84, and EBM/84/61, 4/19/84).

Mr. Grosche observed that capital transactions had become the predominant factor determining exchange rates. The erratic behavior of the capital transactions was of growing concern to governments, whose desire understandably was to insulate the domestic economy from the influence of destabilizing capital movements. However, the use of multiple currency practices was not only costly in terms of the efficiency of resource allocation and difficult to administer--as the Executive Board had concluded when it reviewed the issue in 1984--but ineffective in shielding the economy from adverse capital movements. Germany's experience with the bardepot had not been encouraging.

Therefore, it was more than appropriate for the Fund to assess experience with multiple currency practices in fulfilling its general purpose of promoting orderly exchange arrangements, Mr. Grosche continued. Article IV consultations provided the right opportunity for the Fund to exercise surveillance in developed and developing countries alike. Both groups of countries could do more to liberalize capital markets and to simultaneously create the economic conditions enabling them to operate smoothly. While his authorities shared the Fund's doubts about the usefulness of multiple currency practices, they believed that their application in connection with capital movements should not be completely ruled out. The huge amounts of capital that could be mobilized on short notice in the present day world posed an imminent and real threat to member countries' financial and economic stability. In an emergency, multiple practices could provide members with an additional tool, enabling them to act quickly by introducing measures to fend off large destabilizing flows.

Nevertheless, his authorities were not fully convinced that the Fund's jurisdiction encompassed all multiple currency practices, Mr. Grosche continued. In their view, the relevant Articles of Agreement could be interpreted differently. In the beginning, the intention had been to liberalize current transactions but to allow member countries to retain a considerable degree of freedom to control capital transactions, a principle that had been respected in the Second Amendment of the Articles. For that reason, he could not easily accept the staff's argument that Article VIII, Section 3 should override Article VI, Section 3. On the contrary, multiple currency practices were an authorized instrument for controlling capital transactions, in accordance with Article VI, Section 3, and under the provision for exceptions in Article VIII.

He also had difficulty endorsing the staff's argument that the present principles for surveillance over exchange rate policies, applied under Article IV, created a convincing legal basis for establishing the Fund's jurisdiction over capital transactions, Mr. Grosche added. The obligation of members "...to assure orderly exchange arrangements and to promote a stable system of exchange rates" could very well necessitate the immediate introduction of multiple currency practices on a temporary basis in order to counter massive speculative capital flows.

To conclude, Mr. Grosche stated that his authorities would continue to examine in depth the legal aspects of the issue, which was a fundamental one. More effective surveillance of members' exchange rate policies might well reduce the need for emergency action in the form of multiple currency practices. Moreover, the Fund should evaluate carefully the question whether broader jurisdiction over multiple currency practices could in fact promote its surveillance function. Finally, future staff papers on the issue should make it clear that Fund jurisdiction would not require prior approval of multiple currency practices applicable to capital transactions introduced by countries not having arrangements with the Fund.

Mr. de Groote stated that the exchange system of the Belgium-Luxembourg Economic Union (BLEU), which had existed since 1950, did not fall within the purview of the staff paper. The BLEU free exchange market was not solely for capital transactions. Current transactions passing through the free market were subject to the Fund's jurisdiction, in full agreement with his authorities, when the divergence between the official and the free rates was substantial and durable. The object of the Fund's jurisdiction was not the existence as such of a regime allowing for occasional divergences between rates but rather the actual existence of such divergences inasmuch as they could be regarded as significant. A divergence lasting for some time of more than 2 percent had traditionally been considered significant; recently, however, that figure had had to be regarded as a broad indication rather than as a strict criterion. On the basis of that long-standing interpretation, relations between Belgium and Luxembourg and the Fund had evolved over time in a way regarded as satisfactory by all parties involved, including the Executive Board. There could be no other explanation for the submission of the dual exchange market to the Fund's jurisdiction during the Article IV consultations in 1983--a year when there had been so-called significant divergences between the rates--but not during the Article IV consultation in 1984, a year when there had been no such divergences.

In commenting on the legal case presented in the staff paper, Mr. de Groote continued, his first objective was to maintain uniformity of treatment for multiple currency practices that applied to capital transactions, or simultaneously to capital and current transactions. His second aim was to maintain good relations between the Fund and its members that succeeded in applying, in practice, liberal payments systems for capital transactions.

The staff presentation in SM/85/19 was somewhat contrived, Mr. de Groote considered. An attempt was made to extend the Fund's jurisdiction to multiple exchange practices, yet it was recognized that the use of discriminatory currency arrangements to control capital movements did not fall within the Fund's legal province. Rather paradoxically, considering the role of the Fund in promoting payments liberalization, the staff tried to subject to Fund jurisdiction practices relying on market mechanisms, leaving restrictions of an administrative and bureaucratic nature for more generous treatment. Such an approach seemed to disregard completely the purpose of the dual exchange rate regimes in the countries mentioned in the staff paper. If his understanding was correct, those countries had introduced special markets for capital transactions in order to dispense with the need for restrictions on capital movements in certain circumstances. The staff's approach also showed little consideration for the satisfactory treatment by the Executive Board of such cases, which had all been explained in due time in staff reports for Article IV consultations without reference to the jurisdiction of the Fund.

He had raised questions on several occasions about the French devise titre market and about the system that had prevailed in the United Kingdom until 1979, which had been fully answered by the Executive Directors for France and the United Kingdom, as well as by the staff, Mr. de Groote recalled. Neither the relations of those countries with other members nor the functioning of their own internal payments systems had shown any negative effects from those regimes.

The same provisions should govern multiple currency practices applicable solely to capital transactions and those applied jointly to capital and current transactions--as in the BLEU system--even if the Fund's jurisdiction extended to them, an eventuality that he did not accept, Mr. de Groote went on. It should be recognized that it was not the regime but the effective divergence between the rates that could be subjected to the Fund's jurisdiction. Therefore, he had difficulty with the staff's proposal, as described on page 14 of SM/85/19, for recommending temporary approval of a dual rate system as an alternative to quantitative controls on capital, as well as with paragraph 2 of the conclusions to the staff memorandum. Paragraph 2 should be amended to read: "In the event that a significant divergence between the rates occurs and the practices are nondiscriminatory, the staff appraisal would...." Countries maintaining such regimes should not submit them to the Fund's jurisdiction on the grounds that they would be temporary; only occasional divergences between the effective rates could be temporary, again based on the assumption, which he rejected, that the Fund's authority to approve such transactions could be established.

No explanation was given in the staff paper for the partial examination of the issue by the Executive Board's Committee on Interpretations in 1956, Mr. de Groote noted. In leaving aside its consideration of whether multiple currency practices solely designed to control capital movements would require the approval of the Fund under Article VIII, Section 3, the Committee had referred to the question as being of a somewhat complex nature. It might have been preferable to ask the Committee on Interpretations to resume its examination of the problem, in the light of the Second Amendment of the Articles, rather than to force an interpretation on the Executive Board on the occasion of the present discussion.

Mr. Suraisry noted that the complex issue before the Executive Board had existed since the Fund's establishment without as yet having been resolved conclusively. The two broad aspects of the issue were the legal question of the Fund's jurisdiction over the operational effects of multiple currency practices applicable solely to capital transactions and the operational effects of those practices.

The staff made a good legal case for bringing such multiple currency practices formally within the Fund's jurisdiction, Mr. Suraisry continued. Such a move could be seen as an extension of the Fund's existing procedures. Such practices should be covered as part of the Fund's surveillance activities. However, before taking a definite position, he had asked whether the staff's proposal represented merely a tidying-up exercise, or whether the Fund's jurisdiction was being extended more fundamentally. All the implications would have to be made absolutely clear, particularly as the Fund would be relying on the cooperation of members in exercising its new jurisdiction.

There had been very few cases of multiple currency practices applying exclusively to capital transactions, Mr. Suraisry went on. Even so, such practices had differed widely in their application. While such multiple currency practices could have negative economic implications, they might also at times, as a temporary measure, help members to adjust.

Therefore, the Fund's approach should be comprehensive, thorough, and flexible, Mr. Suraisry considered. Multiple currency practices applicable solely to capital transactions should be taken into account in the Fund's regular Article IV consultations, but he was not convinced that it was necessary at present to introduce formal procedures for approving or not approving those practices. As an alternative, in relevant cases, the staff could perhaps include in its reports for Article IV consultations a thorough assessment of the causes and effects of such practices, both for the member and for other members. Those assessments could be included in the staff appraisals; in that way, the Fund would be addressing the issue effectively without having to formally approve or not approve the practices. Such an approach would demonstrate the Fund's concern to members about multiple currency practices, and it would also give members the opportunity, where appropriate, to move gradually toward eliminating such restrictions. With experience, the Fund might then be in a better position to assess the need for moving toward the more formal approach recommended by the staff at some time in the future.

In sum, Mr. Suraisry said, he preferred a more flexible operational approach to that proposed by the staff. He would also reserve his position on the legal issue until he had heard the staff's response to his question and the views of other Directors.

Mr. Jaafar noted that the staff had argued strongly that Article VIII, Section 3 applied equally to capital transactions and to current international transactions. Although he understood the staff's motivation and rationale, he was not convinced that the Articles of Agreement subjected capital transactions to the Fund's jurisdiction. To attempt to prove that, they had been stretching the interpretation of the Articles too far; moreover, the staff's interpretation might not be correct, as he read the Articles.

Insofar as the economic rationale for including capital transactions within the Fund's jurisdiction was concerned, Mr. Jaafar continued, the Fund was operating in an imperfect world where there were all sorts of restrictions and impediments to the flow of production. Taxes, subsidies, and protectionism could have the same economic impact as multiple currency practices. Furthermore, there was lack of empirical evidence proving that multiple currency practices applied to capital transactions were always harmful. Indeed, in some cases, the imposition of multiple currency practices could even improve the allocation of resources.

In certain circumstances, multiple currency practices might have to be kept in place for a long time, Mr. Jaafar commented. First, such practices were common in centrally planned economies and would probably continue to be so; bringing them within the Fund's jurisdiction might not have a positive impact. Second, multiple currency practices could prove effective in neutralizing the destabilizing impact of large capital flows that might influence the exchange rate and the money supply in a different direction than desired by a member country. Countries in that predicament would find it useful to respond quickly by introducing multiple currency practices. Third, in some countries that had had to undertake large devaluations, multiple currency practices applying to capital transactions might be a useful means of averting business bankruptcies on a large scale. A number of countries already applied multiple currency practices with that objective in mind.

Just as the Fund's surveillance operated inequitably between countries with Fund-supported programs and those without them, the brunt of the Fund's jurisdiction over multiple currency practices with respect to capital transactions would fall largely on those member countries having Fund arrangements, Mr. Jaafar considered. If the staff recommendations were adopted, they might well find their way into performance criteria. At the same time, countries without Fund arrangements, including several industrial countries that applied multiple currency practices, would escape the Fund's jurisdiction, thereby making the Fund's surveillance even less equitable.

Finally, because only a few countries had multiple currency practices applicable solely to capital transactions, there was no compelling reason for the Executive Board to make any change in the existing interpretation of and practices under Article VIII, Section 3, Mr. Jaafar concluded. He would therefore prefer to maintain the status quo.

Mr. Fujino stated that it remained his chair's view that the Fund should discourage its members from adopting or maintaining multiple currency practices because they were costly in terms of efficiency in resource allocation as well as being difficult to administer. Such practices also tended to be maintained over an extended period and thus had the negative effect of delaying necessary adjustment. At the same time, however, his chair had always emphasized that the Fund's policy should be pragmatic and responsive to each country's particular circumstances, since the use of multiple currency practices might at times be unavoidable as a temporary device.

Against that background, and after carefully studying the staff paper, he had certain reservations about extending the Fund's jurisdiction under Article VIII, Section 3, to cover multiple currency practices applicable solely to capital transactions, Mr. Fujino commented. First, the legal issue of the relationship between Article VIII, Section 3, and Article VI, Section 3, was complex and difficult. The rather technical, legal arguments in SM/85/19--on pages 5-6 in particular--left unanswered the important question of whether multiple currency practices applicable exclusively to capital transactions did in fact call for Fund approval; those practices could be regarded as one form of control over international capital movements that members were allowed to introduce under Article VI, Section 3. In the present state of international capital markets, there was always a risk that large one-way capital flows would destabilize an economy or more particularly the exchange rate. Members should be prepared to respond quickly to such flows with the necessary emergency measures. According to his understanding, that was the rationale underlying Article VI, Section 3, which should therefore be interpreted cautiously.

His second reservation, Mr. Fujino continued, concerned the need that would remain, even if the Board were to accept the staff's conclusions, to make a clear distinction between multiple currency practices applicable solely to capital transactions that required Fund approval under Article VIII, Section 3, and controls to regulate capital movements that members were authorized to introduce under Article VI, Section 3. In addition to outright multiple currency schemes, many variants were possible, including tax or deposit systems. That general question had not yet been fully examined.

Third, according to the staff paper, and as many other Directors had mentioned, relatively few member countries had maintained multiple currency practices solely applicable to capital transactions, Mr. Fujino remarked. Thus, the Fund had not had enough experience to make recommendations.

Based on those observations, it was premature for the Executive Board to accept the position that multiple currency practices applying exclusively to capital transactions were subject to Article VIII, Section 3, as suggested by the staff in its conclusions, Mr. Fujino said. However, the appropriateness of such practices should continue to be examined carefully and assessed by the Fund as part of its surveillance exercise.

Finally, Mr. Fujino stated, Japan remained firmly committed to liberalizing transactions in the international capital market. His authorities were doing their utmost to live up to their commitment by enlarging access to the market and by providing wider facilities for the use of the Japanese currency.

Mr. de Maulde commented that his appreciation of conciseness was second to none, but in SM/85/19, the staff's extraordinarily short paper, attempting to deal in full with the complex, fundamental issue of multiple currency practices for capital transactions, had not accomplished its objectives.

The three questions that had to be answered were legal, economic, and procedural, Mr. de Maulde observed. First, did the Fund have legal jurisdiction over arrangements related to capital transfers? Second, were such arrangements systematically detrimental to the maintenance and/or restoration of current account balances, or could they be helpful in certain circumstances? Third, were the Fund's existing surveillance procedures and practices under Article IV not an adequate and workable way of providing sufficient knowledge of such arrangements and for giving members advice on the subject?

The procedural question had been dealt with fully by Mr. de Groote and Mr. Fujino, Mr. de Maulde observed. On the economic question, he recommended to the attention of Executive Directors the lectures given by Mr. de Vries, former Alternate Executive Director, at Johns Hopkins University, on the "Policies and Responsibilities of the IMF - Back to Basics." Mr. de Vries had explained convincingly why the control of capital movements had been included as one of the most fundamental tools of the Bretton Woods Agreement for maintaining external equilibrium. He would go one step further and cite the current international monetary situation--characterized by huge disequilibria in balances of payments and huge misalignments of exchange rates--as reason to question a system under which capital transactions had become totally unregulated, while at the same time more and more obstacles were being put in the way of current transactions. As the Managing Director had argued convincingly in his recent speech on the rise of protectionism and its relationship to the debt crisis, 1/ the phenomenon of protectionism was not unrelated to the laissez-faire attitude that had prevailed vis-à-vis capital movements, which were accounting for a larger and larger share of exchange market transactions. He regretted that the staff had failed to discuss that fundamental issue in its paper.

On the legal question, he agreed with Mr. Grosche's views, Mr. de Maulde concluded. The selective treatment by the staff of the Articles of Agreement, one provision of which had been simply ignored in the staff paper, did not reinforce the credibility of the Legal Department.

1/ Remarks delivered by the Managing Director at a symposium organized by the Federation of Swedish Industries, Stockholm, Sweden, February 6, 1985.

The Executive Board had adopted a decision in 1969 under which it could submit, if any Executive Director so requested, a legal question to the Committee on Interpretations. He formally requested that the Committee resume its review of the Fund's jurisdiction over multiple currency practices, in full confidence that it would provide the clear, reasonable, and unbiased legal analysis that had been missing from the staff paper.

Mr. Coumbis stated that his chair had doubts about the legal approach taken by the staff to the question of multiple currency practices applied to capital flows. The economic consequences of dual exchange rates on capital transactions should be considered alongside the Fund's jurisdiction. Therefore, the primary issue was whether or not multiple currency practices were consistent with the fundamental objectives of the Fund as spelled out in Article I.

It was thus unfortunate that only a few isolated remarks on the issues he had mentioned had been included in Section III of SM/85/19, Mr. Coumbis continued. Moreover, the staff took for granted the view that multiple currency practices generated distortions--negative from the point of view of net economic welfare--whether or not they were applied to current or capital transactions. The validity of that view had recently been the subject of debate by both economists and policymakers, and to the best of his knowledge, without any consensus having been reached. He would also be interested to know how that staff view could be reconciled with the thesis emerging explicitly from the analysis in a study by the Research Department, 1/ according to which the role of taxes and restrictions on capital flows in improving the viability of a floating exchange rate system remained an open question. He was not expressing an opinion on the issue but simply endorsing the more open-minded approach taken by the staff in that study, and during the Executive Board seminars on the subject of exchange rates (Seminars 84/1 and 84/2, January 30, 1984).

If the conclusions in SM/85/19 were supported unreservedly, an initiative undertaken to reduce frictions in payments systems would most likely have the opposite effect, Mr. Coumbis stated. According to Article VI, a country could impose outright controls on capital movements. Therefore, if the Fund did not permit a member to maintain a dual exchange rate system, that member would have a clear incentive to adopt more rigid forms of control over capital flows under Article VI.

For those reasons, his chair could not support the proposals formulated by the staff in the conclusions to SM/85/19, Mr. Coumbis stated. Moreover, no formal decision was proposed, and it was unclear whether the Board was being asked to accept or reject the content of those conclusions in their entirety.

The data in Table 1 on exchange rate spreads under multiple currency systems did not provide, at least for Italy, an updated estimate of those

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1/ The Exchange Rate System: Lessons of the Past and Options for the Future (Occasional Paper No. 30, July 1984).

spreads because the effects of the significant changes in regulations introduced at the end of 1984 had not been shown, Mr. Coumbis observed. Neither had those changes been mentioned in the staff paper.

Despite his reservations about the approach proposed in the staff paper, he was in favor of studying further the possibility of extending the Fund's jurisdiction over capital flows, Mr. Coumbis concluded. A liberal approach could offer substantial benefits in many cases, both because the distinction between current and capital transactions could not be drawn in practice and because the enlarged scope for diversification in private sector portfolios could provide an incentive for savings. The economic issues involved should be investigated in greater detail in a separate staff paper. In addition, the Executive Board should discuss the options for extending the Fund's interests and jurisdiction, giving careful consideration to the institutional aspects of the current international monetary setting and the implications for the degree of restrictiveness of exchange rate systems in the relevant countries.

Mr. Kafka remarked that although experience showed that multiple rates were far from satisfactory, he joined other Directors in disagreeing with the staff recommendation to affirm the Fund's jurisdiction over multiple currency practices applying solely to capital transactions. However, he had no objection to those practices being discussed during Article IV consultations.

He had been puzzled to find the matter suddenly assume major importance, the Fund having lived happily with multiple exchange rates applicable to capital transactions for 40 years, Mr. Kafka continued. The legal arguments advanced for affirming that the Fund had jurisdiction over such practices had been shown by Mr. Grosche to be utterly unconvincing. Only the briefest reference had been made to the economic justification, by reference to the most conventional wisdom in economics, to the effect that anything except lump sum taxes must interfere with the proper allocation of resources.

Although he had on several recent occasions sensed a need for the Committee on Interpretations to be brought back to life, he did not think that the Committee should resume its consideration of the Fund's jurisdiction over multiple currency practices. If members' resort to multiple rates were to be restricted, they would no doubt introduce far more restrictive measures. Finally, he asked why the U.S. interest equalization tax had not been cited in the staff paper as a multiple rate practice.

Mr. Dallara recalled that his chair had outlined its views on multiple currency practices in some detail during the Executive Board's discussion in April of experience with multiple currency exchange rate regimes and their adverse impact on economic adjustment (EBM/84/60 and EBM/84/61, 4/18/84 and 4/19/84). The main economic arguments adduced by the staff at the time against the use of such practices relating to current transactions also applied to practices involving solely capital transactions.

The staff had argued that multiple currency practices did not provide an effective shield against the impact of capital movements and that the spread between multiple rates tended to diverge, sometimes so greatly as to call into question the appropriateness of the principal exchange rate and thus of its broad relevance in the context of the overall economic position and prospects of the member country. Not only did members generally fail to achieve the desired results from multiple currency practices--as a number of Directors had already reaffirmed--but they frequently were led thereby to avoid or postpone the more fundamental policy and institutional changes that might be needed to bring about the economic adjustment that would in turn promote a rational and efficient allocation of resources, thereby enhancing the prospects for economic growth and further adjustment.

Indeed, multiple currency practices designed solely to affect capital movements dealt basically with the symptoms of whatever problem existed, when what was needed was an economic environment in which capital would stay at home, Mr. Dallara went on. Traditionally, the Fund's interest in members' exchange rates had been at the heart of its activities, under both the par value system and the flexible rate system embodied under the Second Amendment. Article IV as revised provided the Fund with a mandate to exercise firm surveillance over the exchange rate policies of its members in order to assist them in their efforts to collaborate with the Fund and with other members to assure orderly exchange arrangements and promote a stable system of exchange rates. By definition, multiple currency practices directly affected exchange rates. For many years, the Fund had of course had clear jurisdiction over multiple currency practices relating to current transactions, to which it had consistently directed its attention in its surveillance exercise. In recent years, as a number of Directors had pointed out, the growth of capital movements had increasingly affected exchange rate developments. That trend highlighted the need for the Fund to review such developments more closely through its surveillance procedures. As part of its effort to strengthen surveillance, it would be logical for the Fund to use those procedures to cover multiple currency practices applicable to both current and capital transactions, which affected exchange rates and economic adjustment alike. Uniformity of treatment among Fund members would be simultaneously furthered.

His chair had been somewhat uncertain during the Executive Board's review of multiple exchange rate regimes in April about the Fund's legal jurisdiction over multiple currency practices applicable solely to capital transactions, Mr. Dallara stated, because the legal case had not been developed in detail in the staff papers prepared for that discussion. The legal issues had since been explored thoroughly and convincingly in SM/85/19. Moreover, the staff had taken a consistent position over the years. While he understood Mr. Kafka's puzzlement about the need to deal with the issue after so many years, he nevertheless shared the interest shown by other Directors in obtaining a clear-cut interpretation of the Articles by the Executive Board as to whether the Fund had jurisdiction over multiple currency practices applicable solely to capital transactions. If the Board accepted the staff's legal opinion, which he understood had been less seriously questioned than the economics of the issue, it would have the duty of exercising the jurisdiction emanating from the legal analysis.

A decision to invoke the provisions of Article VIII, Section 3 to apply that jurisdiction would not raise any conflict with the general application of Article VI, Section 3, which related to direct capital controls, as other Directors had implied, Mr. Dallara considered. He saw no such direct relationship, nor did he believe that a member would be prohibited in any way from imposing multiple currency practices with regard to capital transactions, as the conclusions to Section IV of the staff paper made clear. The question was rather whether or not the Fund could legally approve such practices. His authorities believed that it would be important, should the Executive Board support the approach outlined in the staff paper, for the facts to be established carefully in staff reports for Article IV consultations with the individual member concerned; the impact of such multiple currency practices should be assessed and appropriate recommendations made. The staff would have to take whatever steps necessary to ensure that any temporary approval of such multiple currency practices during the course of an adjustment program should not be misunderstood or misinterpreted outside the Fund, including in the courts. To conclude, he supported the staff recommendations.

Mr. Alfidja noted that the issue under consideration was complex, raising as it did the question of interpretation of whether Article VIII, Section 3 took precedence over Article VI, Section 3. The difficulty of answering that question perhaps explained why the Fund had refrained from taking a firm decision on the issue. The Fund's existing position had been appropriate so far, and it should not be changed unless new developments warranted a departure from it. Furthermore, the various legal aspects of multiple currency practices applicable solely to capital transactions, which had been well described in the staff paper, were not inimical to the Fund's current position. Under the circumstances, he had difficulty endorsing the staff conclusions. He could support Mr. de Groote's suggestion to remit the question to the Committee on Interpretations.

Mr. Lindå observed that the staff proposal to expand the Fund's jurisdiction over multiple currency practices to include capital transactions implied an important change in principle. The legal analysis in the staff paper was clear, but the practical consequences of a change in the current interpretation of the Articles were not made with equal clarity. In addition, the difficulty of interpretation involved certain risks when it came to identifying various measures to control capital movements. Potential problems could arise, inter alia, with respect to the equal treatment of countries. Against that background, his chair saw a need for additional analysis.

If a decision were adopted, it would have to demarcate with precision the Fund's jurisdiction, Mr. Lindå noted. Moreover, it would be important to spell out clearly that any such decision would apply solely to multiple currency practices as such and hence would have no implications with respect to the control of capital transactions that were regulated separately by Article VI, Section 3. Furthermore, if a decision was taken to extend the Fund's jurisdiction along the lines suggested by the staff, future recommendations by the Fund with respect to multiple currency practices applicable to capital transactions should be based on considerations applying to the individual member and, therefore, be formulated on a case-by-case basis.

In concluding, Mr. Lindå remarked that his chair was not opposing in principle the proposed expansion of the Fund's jurisdiction but, in seeking a more complete justification before taking a final decision, could support the proposal by Mr. de Groote and Mr. de Maulde that the Committee on Interpretations should be asked to consider the question further.

Mr. Sengupta said that although the staff had summarized the present status of both the legal and economic considerations relating to multiple currency practices applicable solely to capital transactions, a few aspects of the question required further elucidation before a definite judgment could be formed on the Fund's assumption of jurisdiction in that respect.

The Committee on Interpretations of the Executive Board had taken the matter up for consideration as early as 1956 but had not reached a view with respect to the Fund's jurisdiction, stating only that it proposed to keep that aspect of multiple currency practices relating to capital transactions under consideration, Mr. Sengupta continued. Executive Board Decision No. 541-(56/39), adopted July 25, 1956, stated that members were free to adopt a policy of regulating capital movements; neither that nor any other decision or Article of the Fund's Agreement specifically debarred members from introducing multiple currency practices applicable solely to capital transactions. That view was strengthened by the wish of the Committee on Interpretations not to pronounce judgment on the issue but to keep it open for further consideration. The Executive Board had had a further major opportunity to clarify the issue when it had submitted its recommendations relating to the Second Amendment of the Articles to the Board of Governors. At that time, following a thoroughgoing examination of the Articles and the extensive changes incorporated under the Second Amendment, neither the Executive Board nor the Board of Governors of the Fund had apparently wished to incorporate a specific provision in the Articles covering multiple currency practices relating to capital transactions, nor had the matter even been mentioned in the Commentary to the Second Amendment. The lengthy argumentations of the Legal Department had some merit, but against the backdrop of the hesitation on the part of the Executive Board and of the Board of Governors to state clearly a preference for the assumption of jurisdiction by the Fund over multiple currency practices solely applicable to capital transactions, he wondered whether the Executive Board should hasten to change the existing practices by adopting a decision to that effect at the present juncture.

While it could be argued on a theoretical plane that multiple rate systems would be costly in terms of efficiency in resource allocation between sectors and products and that they were cumbersome to implement, it was not obvious that the logic of uniform exchange rates did not allow differential treatment between current and capital transactions, Mr. Sengupta observed. It was also a matter for argument whether, in a regime of floating exchange rates, a different rate for particular transactions really undermined the stability of the system. Article VI, Section 3, which allowed for controls over capital movements, recognized the need for treating capital transactions and current transactions differently. If that was true of the developed countries, it was even more true of developing countries, where a $1 capital transaction had an altogether different economic value from a $1 current transaction.

In practice, Mr. Sengupta remarked, the Fund had shown flexibility in refraining, in its consideration of multiple currency practices relating to capital movements, from making recommendations for their approval. The staff paper indicated that very few countries were using multiple rates solely for capital transactions, although it made no attempt to quantify the impact on the world economy or on the effectiveness of the Fund's surveillance of the practices applied by those countries. Such analysis would have enabled the Board to form an opinion whether, in spite of the historical background, it was imperative for the Fund to take an immediate decision. To his mind, that did not appear to be the case.

In sum, it was open to doubt whether the Fund could, through a decision of the Executive Board, assume jurisdiction over multiple currency practices solely applicable to capital transactions at the present stage. He suggested that the matter be left for consideration at a more appropriate time in the future.

Mr. Leonard mentioned that over the past few years, there had been a number of developments of consequence for Fund surveillance of members' exchange rate policies and the adjustment process. Of significance among them had been greater resort to multiple rates. It was thus right that the Fund and the Executive Board should take a second look at the issue under discussion, which had arisen once more during the lengthy review in April 1984 of multiple exchange rate regimes.

The view of his chair was that Fund policy relating to multiple exchange rates had correctly been flexible, pragmatic, and responsive on a case-by-case basis to each member's particular circumstances and that it should remain so in future, Mr. Leonard continued. In addition, it was of value to sustain and strengthen the surveillance function of the Fund, a position his chair had taken on a wide range of Fund policies. A logical extension of that approach was that the Fund should exert its jurisdiction over multiple currency practices.

In SM/85/19, the staff had made a convincing case on both legal and economic grounds for the Fund to have jurisdiction over multiple currency practices applicable solely to capital transactions, Mr. Leonard considered.

The staff had established that the limitations contained in Article VI, Section 3, could not be viewed in isolation but must be seen and applied in accordance with the purposes and provisions of the Articles of Agreement. When those broader considerations were taken into account, the provisions of Article VI, Section 3, could not be regarded as removed from the jurisdiction of the Fund's multiple currency practices relating to capital transactions.

The original drafters of the Articles of Agreement had probably not been preoccupied with transactions in the capital account, Mr. Leonard commented, because at the time capital flows had been considered secondary to trade flows in the current account. For that reason, the founding fathers would no doubt not have considered it necessary to stress the Fund's competence in respect of the capital account. By contrast, the experience of the past decade suggested that capital flows could, by themselves, exert tremendous pressures on exchange rates and more broadly on economic and financial conditions. The Fund could not turn a blind eye to that important development; if it chose not to exercise jurisdiction, he wondered who would coordinate policies with respect to capital flows and their impact or whether the outcome would be left to happenstance.

The staff paper contained a useful summary of instances of the application of multiple currency practices, Mr. Leonard said. Furthermore, in the papers discussed in seminar in April 1984, the Board had been given an ample account of the negative economic impact of such practices in general. Admittedly, the experience of the Fund membership with multiple currency practices applicable solely to capital transactions was limited, but it should not be concluded for that reason that the consequences of those practices were insignificant.

In sum, Mr. Leonard said that he agreed with the staff that the Fund had jurisdiction over multiple exchange rate practices for capital transactions. He considered it appropriate that such practices should be subject to the same evaluation that the Fund already used for multiple currency practices relating to current transactions. At the same time, the Fund's approach to all cases of current or capital transactions should be flexible, an important factor in the decision adopted being the likely temporariness of the need for such practices and the reasons for their imposition.

Mr. Ortiz observed that the staff paper focused on refuting the argument that the Fund's jurisdiction over multiple currency practices did not apply to capital transactions because that would limit the member's right under Article VI, Section 3 to exercise the controls it deemed necessary over international capital flows. The staff had mentioned that the controls referred to in Article VI could not be understood to mean the use of exchange rates; to fall within the purview of Article VI, those controls would have to be interpreted as quantitative as opposed to price restrictions. He wished to note an apparent inconsistency arising from that interpretation, illustrating it with an example that followed the reasoning of Mr. de Groote. A country might maintain a freely convertible exchange rate system, under which no controls were imposed on either current or capital account transactions. If that country then explicitly prohibited its residents from purchasing foreign securities or holding any deposits in foreign currency, the member country need not consult the Fund when it imposed such restrictions because it would be exercising its right to restrict capital movements as contemplated in Article VI, Section 3. If subsequently the authorities decided to allow nationals to purchase foreign assets but established a different exchange rate solely for those transactions, such a dual exchange rate system would be viewed as a multiple currency system, subject to Fund approval under Article VIII, Section 3. Yet the replacement of a quantitative restriction, or outright prohibition, by free access to the foreign exchange market--albeit at a different price--in order to meet residents' preferences for portfolio diversification, would be considered by many as a move toward the liberalization of the exchange market, and thus within the spirit of Article IV, Section 1.

He also remained unconvinced by the economic arguments advanced in the staff paper, Mr. Ortiz stated. The general conclusion drawn from the Executive Board's review of multiple exchange rate regimes in April 1984--quoted on page 11 of SM/85/19--should be read in the context of the analysis in SM/84/64 of multiple currency practices applied to current transactions, the analysis of those practices having been the main subject of that earliet paper. In fact, the issue of multiple currency practices applied solely to capital transactions had not been explicitly analyzed either from a theoretical or empirical viewpoint in SM/84/64. It could always be argued, in theory, that the imposition of restrictions in some markets or in certain segments of a market would have repercussions on the functioning of other markets. Therefore, it was difficult to contest the assertion that restrictions on the capital account would affect the current account. However, in many instances a strong case could be made for the establishment of a dual exchange rate system and in particular for separating current and capital account transactions. In addition to the usual argument that such a division helped to cushion destabilizing short-term capital flows, the marked instability of exchange rates of major currencies since the advent of generalized floating had prompted many analysts to recommend the establishment of controls on capital account, or of dual exchange rate systems, to reduce the degree of overshooting of exchange rates. Even in a world of well-functioning markets, which presupposed, for instance, the absence of controls and the existence of rational expectations, overshooting of the exchange rate would occur if, for instance, the pace of the adjustment of the rate or the value of assets in markets differed, or if political risks existed.

The empirical evidence cited in SM/85/19 did not reveal a marked malfunctioning of multiple exchange rate systems applicable exclusively to capital transactions in any of the instances in which those systems had been used, Mr. Ortiz observed. His conclusion was that not much would be gained if the Fund formally affirmed its jurisdiction over multiple currency practices applying to capital transactions.

Mr. Wijnholds recalled that at EBM/84/60, Mr. Polak had asked for a re-examination of the issue of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions because he considered it "intellectually uncomfortable for the Fund implicitly to abandon its jurisdiction in that respect." He therefore welcomed the present discussion. Before taking up the issues in the staff paper, he wished to explain that Mr. de Vries, in the lectures to which Mr. de Maulde had referred, had indeed made the point that capital controls might still have a useful role to play in the present-day world. However, as he understood Mr. de Vries' position, he would probably feel that the Fund had jurisdiction over the specific issue of multiple currency practices applicable solely to capital transactions.

The legal aspects of multiple currency practices raised complex issues on which there was a long history of discussion, Mr. Wijnholds noted. While he considered the staff paper to be convincing with respect to the legal aspects and while he supported the economic arguments put forward, the paper seemed somewhat vague and perhaps insufficiently flexible in dealing with the procedural question of implementation. Although Article VIII, Section 3 did not make it unambiguously clear that the Fund had jurisdiction over multiple currency practices applicable solely to capital transactions, it would be in the spirit of the Articles of Agreement to conclude that it had jurisdiction. The economic arguments for including such practices under the Fund's surveillance were also compelling. Not only could multiple currency practices relating to capital movements lead to prolonged avoidance of pressure on the main exchange rate, as the staff had rightly pointed out, but they could also contribute to the delay of necessary adjustment in countries' policies in general. Formal confirmation of the Fund's jurisdiction would therefore be advisable.

Because Fund surveillance over exchange rate policies had practical consequences, Mr. Wijnholds went on, the implementation of jurisdiction over the multiple currency practices applicable solely to capital movements should be an important element in the Board's consideration. Conceivably, the authorities in some countries that were generally in favor of freedom of capital movements were taking a cautious--perhaps too cautious--view. Because of the uncertainty about how the staff envisaged dealing in practice with multiple currency practices relating solely to capital transactions, it would be useful to clarify a number of issues. First and foremost, would prior approval by the Fund be required when members introduced such practices? Paragraph 1 of Section II of SM/85/19 suggested that that was the staff view. In Section IV on conclusions, the staff had indicated in paragraph 2 that if the practices were maintained on a temporary basis and for balance of payments reasons, the staff appraisal in the report for the Article IV consultation would continue to include a recommendation for their approval. Although that statement might sound reassuring, it would probably not allay the fears of those countries that had difficulty accepting the Fund's jurisdiction over multiple currency practices relating to capital transactions, as the present discussion had proved.

In order to resolve the issue, he suggested that the staff should reconsider the way in which the Fund's jurisdiction would be implemented, paying particular attention to whether or not prior approval was a reasonable requirement in the circumstances, Mr. Wijnholds stated. Another issue to be considered was whether there was a case for treating those practices applicable solely to capital transactions somewhat differently from other multiple currency practices. A further issue was whether it could be said that multiple currency practices affecting capital transactions were a more efficient, or less onerous, means of influencing capital flows than other forms of capital control. Would a strict approach to multiple currency practices not induce countries to prefer more extensive use of other capital controls? His final question concerned the most generous approval policy that would remain compatible with the Fund's overall objectives. Unless those questions could be clarified, the Executive Board risked reaching a conclusion based more on misgivings about the possible inflexible implementation of the Fund's jurisdiction over the practices in question than on a genuinely negative attitude to the issue of the Fund's jurisdiction per se.

Mr. Romuáldez stated that it remained the view of his chair that multiple currency practices applicable to capital transactions should come under the Fund's jurisdiction. He agreed with the broad thrust of the economic arguments put forward by the staff in SM/84/64 and as summarized in Section III of SM/85/19. There was thus no need for him to go over that ground again other than perhaps to make the point that while multiple currency practices applicable to capital transactions might have a temporary role to play in certain circumstances, there was little justification for keeping them as permanent or long-term arrangements. The question for him was not one of jurisdiction but whether the Articles as currently written made provision for such jurisdiction. In that respect, a central issue was the interpretation of the word "control" in Article VI, Section 3. The staff argued that controls over capital flows permitted under Article VI could not be interpreted to include separate or dual exchange rates for capital transactions, and thus that Section 3 of that Article did not limit the scope of Section 3 of Article VIII in relation to capital transactions. He could go along with the staff view.

The legal considerations presented on page 5, Article VIII, Section 3--read in conjunction with Section 2(a)--clearly envisaged some circumstances in which multiple currency practices applicable to capital transactions would not be in accordance with the requirements of that Article, Mr. Romuáldez remarked. Therefore, it was difficult to understand how multiple currency practices applicable to capital transactions could be interpreted as a control in terms of Article VI, Section 3, because such an interpretation would, in terms of the "except as authorized under this agreement" wording in Article VIII, Section 3, take such practices outside of the scope of Article VIII, Section 3, contrary to what was envisaged of that Article.

He agreed fully with Mr. Dallara and Mr. Wijnholds that the problems that had arisen during the present discussion pertained not so much to the question of whether or not the Fund had jurisdiction as to certain difficulties arising out of its implementation, Mr. Romuáldez continued. It was important to bear that distinction in mind if an already complex issue was not to be further complicated. For instance, he was uncertain whether differential exchange rates for capital transactions would run afoul of Article VIII, Section 3 in all cases. He had in mind the wording of Decision No. 6790-(81/43), adopted March 20, 1981, which referred, in defining when an exchange rate spread constituted a multiple currency practice, to "action by a member or its fiscal agencies that of itself gives rise to a spread of more than 2 percent...." The key words were "that of itself," which incidentally had been omitted from the paraphrasing of paragraph 1.a.i on page 7 of SM/85/19. If, as that decision suggested, a multiple exchange rate practice for the purposes of Article VIII jurisdiction required direct exchange rate action on the part of the member, then it was not clear to him whether multiple exchange rates arising as an indirect consequence of restrictions on capital transactions, as authorized under Article VI, Section 3, would fall within the scope of Article VIII, Section 3. For instance, the capital controls maintained by the United Kingdom from 1947 to 1979, and by France since 1981, as described in SM/85/19, had given rise to multiple exchange rates in the sense that foreign securities in the domestic secondary market had been priced at a premium over the exchange rate adjusted foreign price. Yet he was not sure that such action by a member to restrict purchases and sales of foreign securities by residents constituted a multiple currency practice. Rather, the multiple exchange rate would seem to be "a by-product of capital controls operated through the banking system on the securities market," to cite the staff's view, in SM/84/64, of the French devise titre market.

A parallel question had been raised by his chair in 1979, when the Executive Board had taken up the issue of whether central bank dealing spreads, which of themselves were within 2 percent, but which resulted in commercial bank spreads of more than 2 percent, would constitute a multiple currency practice subject to Article VIII, Section 3, Mr. Romuáldez recalled. From the minutes of the Executive Board's discussion on that point (EBM/79/164 and EBM/79/165, 10/26/79), there appeared to be no hard and fast rule that could be applied in such cases, as reflected in Decision No. 6790-(81/43), which provided that "when difficulties are encountered in the interpretation and application of these criteria..." [the criteria for determining when an exchange rate spread constituted a multiple currency practice] "...in specific cases, particularly concerning the nature of official actions, the staff will present the relevant information to the Executive Board for its determination." He asked the staff whether it envisaged similar difficulties in deciding whether the exchange rate differentials resulting from certain capital controls constituted a multiple exchange rate practice, and if so, whether it was intended that difficult cases would similarly be brought to the Executive Board for determination.

He could perhaps best sum up his position by referring to the three practical consequences of the proposed affirmation of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions, listed in the conclusions to SM/85/19, Mr. Romuâldez remarked. He had no problem with paragraph 1, proposing a strengthening of the analysis in staff reports for Article IV consultations of multiple currency practices applying to capital transactions. Article IV, and Decision No. 5392-(77/63), on surveillance over exchange rate policies, clearly authorized that practice. The Fund had general jurisdiction over multiple currency practices applying to capital transactions and hence the legal authority either to approve or disapprove such practices. However, he was concerned about the criteria to be used in determining whether a different exchange rate for capital transactions, or for a subset of capital transactions, would constitute a multiple currency practice, although the standard performance criterion in stand-by and extended arrangements should cover the practices. However, he would appreciate clarification of the criteria to be used in assessing whether multiple or dual exchange rates would constitute a multiple currency practice.

In conclusion, he associated himself with Mr. Leonard's reminder that in exercising its jurisdiction, the Fund must, as in the past, do so with flexibility.

Mr. Wicks stated that capital flows had played an increasingly dominant role in determining exchange rates over the past 20 years or so. For that reason, and regardless of the question of jurisdiction, he believed that the Fund had a legitimate interest, and indeed an important duty, to scrutinize the capital controls applied by individual countries. Therefore, he would like a full description of capital account controls and developments to be included routinely in staff reports for Article IV consultations, together with some analysis of their effects.

The staff's legal arguments in SM/85/19 were helpful, but certain implications of the staff proposal needed to be more fully discussed, Mr. Wicks remarked. For instance, if he understood the legal position, the Articles of Agreement gave the Fund jurisdiction only over multiple currency practices applied to capital transactions, and not--contrary to the position with respect to current account transactions--over exchange restrictions or discriminatory currency arrangements. If his interpretation was correct, it would be paradoxical and even counterproductive if the extension of the Fund's jurisdiction to cover multiple currency practices on capital transactions encouraged members to replace capital controls with other types of control that were outside the Fund's jurisdiction and that might be even less desirable.

On the procedural points that had already been raised during the discussion, it would be most interesting to have the staff's views on the most practical way of implementing the approach it had suggested for the Board's consideration, Mr. Wicks said. For instance, if a country in considerable exchange rate and balance of payments difficulties wanted to introduce a control of the type under discussion on capital movements, would the member have to ask for formal approval of the Executive Board, based on a staff paper, before it could implement the control? More specifically, would the approval be prior to the announcement of the measures by the authorities concerned? He foresaw some difficulties with any such procedure for prior approval.

Mr. Alhaimus remarked that the staff paper and the discussion so far in the Executive Board had made him even less certain of how to interpret the Article in question. Given the diversity of views, it might be preferable, as Mr. de Groote and other Directors had suggested, to ask the Committee on Interpretations to take up the matter again and present its recommendations to the Executive Board. Nevertheless, because the issue had not so far been demonstrated to have such material significance--apart from the legal aspects--he was more inclined to support the conclusion reached by the Committee on Interpretations almost 30 years previously--namely, to keep the problem under consideration.

Mr. Mtei commented that he had not been entirely convinced of the validity of the legal position as stated in the staff paper. He also doubted the view that multiple currency practices relating to capital transactions, particularly those maintained by developing countries, had no real economic value. Therefore, he supported the suggestion that the Committee on Interpretations might usefully review the complex issue. In the meantime, the status quo should be maintained.

Mr. Salehkhou stated that he had not been convinced by the staff's arguments relating to the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions and that he would have reservations about the Executive Board affirming such jurisdiction. Since the Fund's establishment, the staff had argued consistently for the extension of its jurisdiction with respect to the surveillance of exchange rate regimes to that type of practice, whereas the Executive Board had repeatedly refrained from assuming such power for the simple reason that the issue was much more complex and controversial than had been recognized in SM/85/19. That complexity had been acknowledged as early as 1956 by the Committee on Interpretations, which had been unable to take a decision one way or the other on the matter. The points at issue had evolved little since the Committee's examination, and the staff paper under discussion, in which earlier staff memoranda were extensively quoted, did not develop any new arguments for changing the status quo at the present time. Moreover, since the issue had been referred to the Committee on Interpretations, it would seem unusual for the Executive Board to consider taking a decision without having a formal opinion from the Committee.

On the legal aspects, the staff had concentrated its analysis on the relationship between Article VI, Section 3, which clearly authorized controls aimed, when necessary, at the regulation of capital movements, and Article VIII, Section 3, which provided that members should avoid multiple currency practices "except as authorized under this Agreement or approved by the Fund," Mr. Salehkhou went on. Furthermore, the staff considered the general and broad language repeatedly used in the Articles and in other official Fund documents in referring to multiple currency practices as evidence that both current and capital transactions were subject to Fund jurisdiction. However, that assumption hardly seemed acceptable in the face of the long-standing controversy on the issue and in view of the clear language used with respect to capital movements in Article VI, Section 3. A more reasonable assumption, in his opinion, was that the maintenance under the Second Amendment of broad language in dealing with current and capital transactions reflected rather the unsettled nature of the issue and the desire to maintain the status quo.

The economic grounds for the proposed change appeared to be even less justified, Mr. Salehkhou considered. On the one hand, despite a significant expansion of capital movements, members' recourse to multiple exchange rates for capital transactions had remained marginal. On the other hand, although the staff had repeated its view that multiple currency practices introduced distortions because they affected resource allocation negatively--quoting to that effect from the earlier paper on experience with multiple exchange regimes (SM/84/64)--the arguments developed by a number of Executive Directors qualifying that analysis had not been mentioned in SM/85/19. As the Acting Chairman had said in his summing up of the Board's review of experience with multiple exchange rate regimes, for a number of Directors, "multiple exchange rates had provided members with a reasonable second-best--or even best, a few Directors maintained--solution and with the respite necessary to formulate and adopt adjustment measures...." That aspect of multiple exchange rate regimes should not be ignored and justified the Fund's traditionally flexible approach.

Finally, the staff had argued that an extension of the Fund's jurisdiction to cover multiple currency practices on capital transactions would ensure greater policy consistency in the implementation of surveillance, Mr. Salehkhou noted. However, given the inherent asymmetry of the Fund's surveillance procedures, which for obvious reasons had been effective only for those members using Fund resources, the proposed extension could reasonably be regarded as another attempt to tighten further Fund conditionality, continuing the trend observed in recent years. The result could well be more rigidity in Fund-supported adjustment programs, which in time might become increasingly burdened by matters of relatively minor importance.

Mr. Zhang said that he could not accept the staff's recommendations.

Mr. Nebbia remarked that the number of occasions on which the important issue of the Fund's jurisdiction over multiple currency practices applied to capital transactions had been discussed, without the Executive Board having reached definitive conclusion, reflected its complexity in terms of the interpretation and scope of various Articles of Agreement. The different views expressed during the present discussion had confirmed the complexity of the issue. For instance, Article VIII, Section 3, called for the avoidance of discriminatory currency practices, whereas Article VI, Section--stated clearly that "members may exercise such controls as are necessary to regulate international capital movement...."

The staff had presented a good case for the Fund's exercise of jurisdiction over all multiple currency practices, including those applicable solely to capital transactions, based on a legal interpretation of the Articles and on some economic considerations, Mr. Nebbia commented. However, he did not share the staff's legal view, and he did not intend to review the strictly legal interpretations of the relevant Articles, on which the staff had based its case, because that was a matter for the Committee on Interpretations. Rather, his own position took into account the economic implications of the Articles. First, in the past 40 years, only a few countries had introduced multiple rates as a means of controlling capital movements, most for temporary periods. Therefore, he saw no real need for significant involvement by the Fund in such matters, at least not at the present stage. Second, it was a fact that the financial resources that could be mobilized in the current world situation at short notice could burden the economic stability of a country. Member countries should have the right to use whatever mechanism would allow them to respond to such threats. Third, multiple currency practices applied to capital transactions affected current account transactions in the same way as other controls that countries had the right to apply. Thus, there were no clear economic grounds for treating the tools available to a country needing to exercise discriminatory control of capital movements under Article VI, Section 3.

Neither the legal nor the economic case for jurisdiction by the Fund over multiple currency practices applicable to capital transactions had been sufficiently established to enable him to endorse the staff's conclusions in SM/85/19, Mr. Nebbia stated.

Mr. de Groote noted that because the idea of convening the Committee on Interpretations had not received much support--and had indeed raised more problems than it solved--he would propose an alternative procedure that would reflect the two basic conclusions of the discussion. First, it had been generally agreed that countries should provide information to the Fund on their multiple currency practices, in line with the procedure followed in the past by those countries mentioned in the staff paper as having applied such practices. Second, there had been a broad consensus doubting the possibility of legally recognizing the Fund's jurisdiction over multiple currency practices applicable to capital transactions at the present stage. In order to reconcile those two opinions of the Executive Board, paragraph 1 of the conclusions in SM/85/19 could be abbreviated along the following lines: "specific information and analysis normally accorded to exchange restrictions and multiple currency practices with members would also be provided for the practices under consideration." It would also be necessary to introduce that paragraph in a way that did not indicate strongly the staff view, which had not been shared by the Executive Board, that the Fund had jurisdiction. In addition, the practices under consideration would have to be defined as multiple currency practices applicable solely to capital transactions. A decision amended as he had suggested could provide a practical solution to the problem.

Ms. Bush considered that many Directors had expressed some support for the economic arguments in favor of the Fund reviewing multiple currency practices as they related to capital transaction. It was also clear, as Mr. de Groote had mentioned, that much doubt had been expressed about the Fund's legal jurisdiction over such practices. Mr. de Groote's reformulation of paragraph 1 of the staff conclusions might satisfy most members of the Board.

Mr. de Maulde said that he could accept Mr. de Groote's amendments as a reasonable solution. He would also be prepared to withdraw his formal request for the matter to be referred to the Committee on Interpretations. The wording of the conclusions would have to be clarified to specify that the Executive Board had not agreed, as the staff had requested, to affirm the jurisdiction of the Fund over multiple currency practices applicable solely to capital transactions. It would also have to be stated clearly that the specific information and analysis would be related to the Fund's normal surveillance under Article IV. The two words describing that information and analysis as being "normally accorded" to exchange restrictions and multiple currency practices would have to be deleted to enable him to accept paragraph 1 as amended.

Mr. Wicks sought confirmation that the drafting suggestions put forward did not imply that the Executive Board was taking a decision on the issue of the Fund's jurisdiction. As he had interpreted Mr. de Groote's proposal, the Executive Board would be putting the matter into abeyance for the time being while additional information of a practical nature was being gathered.

Mr. de Groote confirmed Mr. Wicks' understanding of his suggestion.

Mr. de Maulde remarked that he would understand the Executive Board as having refused to affirm the jurisdiction of the Fund, instead of stating that that jurisdiction existed.

Mr. Wicks responded that he would prefer a much more neutral formulation. The issue was an evolving one, and before a final decision was taken, it would be necessary to have the staff's answers to the many questions raised during the discussion.

Ms. Bush remarked that as she understood the position, the Executive Board had not affirmed the Fund's legal jurisdiction, which remained an open question.

Mr. Kafka commented that by his count, Directors representing only about 40 percent of the voting power had been prepared to affirm the Fund's jurisdiction.

The Chairman remarked that he would sum up the sense of the meeting on that point following the present discussion. The view of the Executive Board might of course change in the future.

Mr. Sengupta asked whether there was any reason why multiple currency practices relating to capital transactions could not be discussed during Article IV consultations. He recognized that Mr. de Groote had suggested deleting, at the end of paragraph 1 of the conclusions, the phrase "as a basis for the exercise of jurisdiction," but he wondered why it was necessary to refer specifically to Article IV consultations in that paragraph.

Mr. Grosche considered that the issue of the Fund's jurisdiction had not been settled, although he hoped that a conclusion could be reached in the near future after further discussion. He could go along with Mr. de Groote's proposed amendments of paragraph 1 of the conclusions in SM/85/19, based on Mr. Wicks' interpretation of that position.

Mr. Leonard observed that the matter clearly had to be regarded as an ongoing one. In the meantime, he would not wish to see any derogation from the present position of the Fund as interpreted by the Executive Board.

Mr. Wijnholds remarked that because there might still be some movement in countries' positions, he hoped that a final view on the matter of jurisdiction would not be taken at the present meeting.

The Chairman said that it was the Executive Board's prerogative to reopen any matter.

Mr. Ortiz remarked that he could not agree with Mr. de Maulde that a statement to the effect that the majority of Executive Directors did not want to affirm the Fund's jurisdiction meant that the issue was closed to further discussion.

The Director of the Legal Department recalled that the issue under discussion had been brought before the Executive Board, in the form in which it had been presented in SM/85/19, in response to the sense of the meeting, as summed up by the Acting Chairman, at EBM/84/61 (4/19/84). As noted in the opening paragraph of SM/85/19, the Executive Board had wished to have a more thorough examination of the issue of the Fund's jurisdiction under Article VIII, Section 3, over multiple currency practices applicable solely to capital transactions. The staff had responded to the Executive Board's request for a review of past considerations of the issue and for any further views that the staff might have. No attempt had been made to repeat the entire contents of previous staff papers on the issue, nor had the staff dealt with all the economic and other practical aspects that had been covered in other staff papers and examined by the Executive Board on previous occasions.

The legal position explained in SM/85/19 reflected a view that had been held consistently by the staff throughout the history of the Fund, the Director noted. That view had not been questioned until the Executive Board had asked its Committee on Interpretations to examine the legal principles of the Articles regarding exchange practices, including problems connected with maintenance of the multiple rates, in 1956. Even then, the Executive Board had accepted the view of the Committee that the question was complex and that it could not at that time reach a conclusion. However, the Committee confirmed that the Fund did have jurisdiction with respect to exchange rates that involved not only capital movements but current transactions, which could be taken to imply that it had not excluded the possibility that the Fund had jurisdiction with respect to rates applicable solely to capital transactions.

The basic principle of the Articles had always been that the international monetary system should be based on unitary exchange rates, and that principle continued to apply even after the Second Amendment of the Articles, which put an end to par values. The Executive Directors had devoted their attention at that time to making it clear that members had the right to adopt the exchange arrangements of their choice, including floating rates. As had been pointed out in the Commentary to the Second Amendment, there was no thought given at that time to the introduction of an exception from the principle of unitary exchange rates.

Acceptance of the view that the Fund had jurisdiction over multiple rates for capital transactions would not in any way restrict the right of members to apply other "capital controls," the Director of the Legal Department noted. The Fund had acquired considerable experience and jurisprudence over the years relating to distinctions between capital controls that involved restrictions and capital controls that involved multiple rates. It was frequently necessary to determine whether a particular practice with respect to current transactions was a restriction or whether it involved a multiple rate, and it would be no more difficult to make that determination with respect to capital transactions. Even if the Fund's jurisdiction over multiple currency practices applying solely to capital transactions were to be affirmed, the right of members to apply capital controls through quantitative means would be preserved; there would be no discriminatory treatment of members as some Executive Directors had implied.

Procedurally, the Articles of Agreement required a member to obtain the approval of the Fund before introducing multiple rates for current transactions, the Director of the Legal Department explained. Although it should be noted that the Fund had over time become reconciled to accepting notification from the member at as early a date as possible, if the member found it difficult in the circumstances to notify the Fund formally before it introduced a multiple rate. The same procedure would apply to multiple rates for capital transactions, and presumably, the same understanding of the prior approval concept would be acceptable with respect to rates applying to capital transactions.

The Fund had always been flexible in granting temporary approval of multiple rates, the Director added. If approval was granted for a period of some length, provision had to be made for a review before a specified date because such rates were exceptional and could not be maintained indefinitely, especially if they were harmful to the member or to other members.

Reference had been made to Decision No. 6790-(81/43), which provided guidelines to the Fund in carrying out its policy on multiple currency practices, the Director of the Legal Department noted. That decision was meant to apply to all multiple rates, irrespective of whether they were for current or capital transactions, based on the staff's long-standing view that the Fund had jurisdiction over multiple rates for capital transfers. Under the terms of that decision, the Executive Board would be consulted if difficulties were encountered in the interpretation and application of the criteria considered in specific cases of official action that caused exchange rate spreads and cross-rate quotations to differ unreasonably from those that arose from normal commercial costs and risks of exchange transactions.

The practical consequences enumerated in the conclusions to SM/85/19 were not necessarily linked to acceptance of the view that the Fund had jurisdiction with respect to multiple rate capital transactions, the Director of the Legal Department stated. For the most part, those practical consequences were the results of the procedures and practices for surveillance and also of the rules of the Fund under which members were required to report in detail all exchange controls and other aspects of their exchange rate systems to the Fund. To the extent that those particular practical consequences called for somewhat more detailed examination of the practices in question, the new procedures could be introduced by the Executive Board, whether or not it took the view that the Fund had jurisdiction with respect to multiple rates over capital transactions.

The Director of the Exchange and Trade Relations Department recalled that the staff had been requested, by several Executive Directors, to examine the issue of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions. Despite the misgivings expressed during the discussion, that request had seemed appropriate to the staff. The issue had remained unresolved for 40 years. Meanwhile, capital movements had become much more important. During the past four decades, the Fund had developed procedures for exercising surveillance, in which members had reasonable confidence. Likewise, the staff had managed to work out a flexible technique for applying the difficult concept of prior approval of multiple currency practices under which a member gave a complete description to the staff of the measures it was taking, thereby permitting the Executive Board to make a judgment based on a full review.

The fact that the probable outcome of the meeting would not be an affirmation of the Fund's jurisdiction would not necessarily be regarded by the staff as operationally detrimental, the Director noted. The staff had always regarded the issue as one of the Fund's legal jurisdiction, based on an interpretation of the Articles, and it had deemed it appropriate to accede to the request that it seek confirmation of its logical and long-standing position. The issues of policy had therefore not been dealt with as fully in SM/85/19.

In exercising jurisdiction, it was always necessary to be precise, the Director remarked, and precision entailed establishing a dividing line with the risk of distortion if that line was crossed by some members. The Fund had minimized that risk, in developing its surveillance procedures, by reviewing virtually any practice as part of the normal consultation procedure, including questions that were not strictly within the Fund's jurisdiction, such as trade matters and even aspects of monetary and fiscal policy.

The exchange equalization tax introduced by the United States had been examined thoroughly by the staff, the Director of the Exchange and Trade Relations Department stated. Such practices always raised difficult issues, but the staff had had no doubt that that tax did not affect exchange transactions and was thus not a multiple currency practice within the Fund's jurisdiction that had to be brought before the Executive Board.

The staff intended to maintain the Fund's traditional, flexible attitude, the Director commented. The majority of the measures being introduced at present to restrict capital transactions--for the most part by developing countries--also affected current transactions. A flexible attitude was therefore essential. The fact that not many multiple currency practices applicable solely to capital transactions had been used by member countries could also be viewed as a reason for bringing them within the scope of the Fund's jurisdiction, with the approval of the Executive Board, in order simply to settle an issue that had been left unresolved for so long. A more important issue was the considerable interest that most capital recipients must surely have in establishing or extending the Fund's jurisdiction, rather than reducing it, even though the increasing freedom of capital movements had made it possible so far for countries in need of capital inflows to rest assured of receiving them. It was unfortunate that concern over the way in which the Fund exercised surveillance or applied conditionality should in any sense weaken support for the Fund's jurisdiction. Those issues were quite separate from the jurisdictional issue; stand-by arrangements included provisions on trade and on other matters over which the Fund had no direct jurisdiction, for good and sufficient policy reasons that should not affect judgments about the rather limited problem of multiple currency practices applicable solely to capital transactions. While the current procedure relating to those practices would be maintained, it was nevertheless important to keep the issue open and for the Fund not to be seen as moving away from playing a role in respect of multiple currency practices relating to capital movements at a time when the international community expected it to assert its role.

Mr. Kafka remarked that it was unlikely that the international community was expecting a momentous decision by the Fund on the issue under discussion. Furthermore, he would be very interested to know on what grounds the U.S. equalization tax had been considered not to have any effect on exchange transactions and thus not to be a multiple currency practice, especially as several other instances of similar practices had been mentioned in the staff paper.

The Director of the Exchange and Trade Relations Department replied that the exchange equalization tax had obviously had effects on the exchange market, in much the same way as interest rates did. The issue examined by the staff at the time had been whether the equalization tax was a measure implemented through the exchange system; after careful consideration, the staff had decided that there was no basis for holding that the tax was not such a measure.

The Director of the Legal Department noted that many measures could of course have an effect on exchange transactions, including various actions that were not applied through the exchange system, such as income taxes or trade measures. In determining whether or not a practice was a multiple rate, the Fund had always applied the same test, namely, whether the practice was carried out through the exchange system. As he understood it, the U.S. exchange equalization measure had imposed a tax on the instrument used; it had not been applied through the exchange system.

Mr. Kafka recalled that Brazil had once been obliged by the Fund to eliminate a supplementary income tax on the remittance of profits because it supposedly gave rise to a multiple rate. He would be grateful for an explanation of the difference between the U.S. and the Brazilian measures, apart from the fact that one applied to outgoing and the other to incoming payments.

The Director of the Exchange and Trade Relations Department responded that as he recalled the situation, the Brazilian income tax had been levied at the time of the exchange transaction, thereby establishing a linkage that had not been established in the case of the U.S. equalization tax. He would confirm that understanding following the meeting.

Mr. Sengupta said that his understanding of past discussions of the issue was that a deliberate decision had been taken not to make a clear pronouncement on the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions because the logic of the unitary exchange rate, if it was carried too far, led to problems if at the same time some transactions were subject to control. As Mr. Ortiz had observed, if a country had a freely floating, unified exchange rate without control over current transactions but controls over capital transactions, the market would determine a different rate for capital transactions. If the Fund expected the member to eliminate such effective multiple exchange rates, it would have to ask it to remove capital controls. The theoretical problem was whether different exchange rates for different types of transactions had a greater impact on the stability of the system, a problem that had not been resolved in practice. The issue of the Fund's jurisdiction had not been raised because the need for controlling capital transactions had been recognized in the Articles.

The Director of the Exchange and Trade Relations Department responded that most dual exchange rate markets fitted the description given by Mr. Sengupta. If there were some restrictions on the movement of capital through the official market, capital movements were allowed to take place in another market, and the rates would diverge. Current transactions took place in nearly all such markets, in the form of interest, commissions, or royalties, for instance, so that the multiple rate fell within the Fund's jurisdiction and was dealt with straightforwardly as such. The measures restricting capital movements were of less concern to the staff than the reasons for their introduction, which might involve interest rates that were out of line. The staff in fact accepted the existence of such dual markets and had on occasions encouraged their introduction as part of a movement toward liberalization. However, the staff was not in favor of rates diverging for an extended period of time; in the longer run, the divergence led to distortions between the transactions carried out at the different rates. Those problems had been dealt with in the earlier staff paper on experience with multiple exchange regimes (SM/84/64, 3/19/84; and Cor. 1, 3/28/84). He could provide Mr. Sengupta with additional, more precise information later.

The Director of the Legal Department recalled that the situation described by Mr. Sengupta had been discussed in a staff paper issued in 1979 on the operational aspects of multiple currency practices under the Second Amendment (SM/79/161, 6/13/79). The Executive Board had subsequently pursued its review of the Fund's policy with respect to multiple currency practices in 1981 (EBM/81/35 and EBM/81/36, 3/6/81; SM/81/34, 2/5/81). The decision adopted on March 20, 1981--Decision No. 6790-(81/43)--recognized the difficulty in certain circumstances of deciding whether a particular rate was the result of an official action by the member. For instance, if a member exercised its right to apply quantitative capital controls that resulted in dual exchange rates, it could be said that those rates were a consequence of the member's actions. In accordance with that decision, the staff would bring the matter to the Executive Board whenever the interpretation or application of the criteria mentioned in the decision warranted it.

More generally, the Executive Board had not focused in its discussion on multiple currency practices under the Second Amendment on the Fund's jurisdiction with respect to capital rates because it accepted the principle of unitary exchange rates as the basis of the system, the Director of the Legal Department repeated. It could not be said that the Executive Board had deliberately decided not to endorse the Fund's jurisdiction.

Mr. de Groote asked for confirmation of his understanding that the Fund's jurisdiction with respect to the dual exchange system of the Belgian Luxembourg Economic Union extended not to the existence of the regime as such but to the fact that the rates occasionally diverged significantly. It was important to establish that principle, because Article IV consultations with Belgium and Luxembourg had been conducted on that basis for many years.

The Director of the Legal Department confirmed Mr. de Groote's understanding. If the exchange regime introduced by Belgium and Luxembourg did not result in a spread of more than 2 percent, the Fund would not claim jurisdiction, and it would thus not require the member to submit its exchange system to the Fund for approval. Because the dual rate system resulted from time to time in a spread of more than 2 percent, it did have to be submitted to the Fund for approval. However, both current and capital transactions were effected through Belgium's dual market, so that the question of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions did not arise.

Mr. de Groote, referring to the statement by the staff that the Fund had become reconciled to not having prior consultations with members when they introduced multiple exchange rate regimes, asked why it was necessary to submit to the Fund's jurisdiction multiple currency practices on which the Fund and the member exchanged information and that was analyzed on the occasion of Article IV consultations. There would be no point in affirming such jurisdiction unless the Fund was in fact seeking a priori rather than a posteriori approval.

The Director of the Legal Department replied that he had not stated that the Fund did not expect members to consult; the issue had been the need for prior approval. Under the Articles, a member would be expected to obtain prior approval of the Fund; in practice, that had often proved difficult, and the Fund had developed a procedure under which members were expected to consult the Fund as soon as possible and, if necessary, to request approval, which was granted as shortly after the introduction of the practice as was feasible. As was the case with respect to exchange restrictions, it was important that such practices should be considered by the Fund as soon as possible, in order to respect the principle of the Fund's jurisdiction with respect to such practices.

Mr. Coumbis stated that his chair was not ready to take a decision on whether or not the Fund had jurisdiction over multiple currency practices applicable solely to capital transactions until further information had been provided by the staff.

Mr. Taha remarked that in light of the remarks by the Director of the Exchange and Trade Relations Department, the legal aspects did not represent a major departure from existing Fund practices; it was perhaps important to emphasize the operational aspects of the issue under discussion.

The Chairman made the following summing up:

> As I understand it, there was not in today's discussion a majority in support of the proposal that the Board formally endorse the staff's legal position that multiple currency practices applying exclusively to capital transactions are subject to Article VIII, Section 3 of the Articles of Agreement in the same way as multiple currency practices applying to payments and transfers for current international transactions. Nine Directors, representing some 32 percent of the voting power, considered that they could not at this time go along with the staff's interpretation. Eight Directors, representing about 30 percent of the voting power, were not convinced by the staff interpretation,

but were open to a re-examination of the legal aspects of the issue. Five Directors, representing almost 39 percent of the voting power, indicated that they could accept the staff's legal interpretation. Thus, the staff's legal position has not received the necessary support. I have concluded therefore that the Executive Board has not yet taken a view on the question of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions and that the matter remains open for further consideration. Suggestions have been made to refer the question to the Committee on Interpretations. Under the terms of reference of that Committee, any Executive Director may request that a legal question be sent to the Committee by the Executive Board. It is my understanding, at the end of this meeting, that no such request is now being made, although several Executive Directors noted that they might wish to consider their option to do so in the future.

On the operational aspects of the Fund's jurisdiction over multiple currency practices applicable solely to capital transactions, the Board expressed wide interest in the way in which such practices as well as restrictions on capital movements would be treated. As I understand the sense of the meeting, Directors considered, first, that members should continue to provide the Fund with specific and full information on capital controls and multiple currency practices applicable solely to capital transactions; and second, that a full analysis of such practices and an assessment of their economic consequences should continue to be provided, in the framework of the Fund's surveillance activities by the staff in reports for Article IV consultations.

The Executive Directors concluded for the time being their consideration of the staff paper on multiple currency practices applicable solely to capital transactions.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/22 (2/11/85) and EBM/85/23 (2/13/85).

2. COMOROS - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1984 consultation with the Comoros to not later than February 25, 1985. (EBD/85/46, 2/7/85)

Decision No. 7905-(85/23), adopted
February 11, 1985

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/85/36 (2/8/85) is approved.

APPROVED: November 19, 1985

LEO VAN HOUTVEN
Secretary