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# An "Interesting" Provision Concerning Exchange Rate Arrangements

This article is inspired by a comment made by Joseph Gold in December 1975. On December 15 of that year, he, as General Counsel of the International Monetary Fund, and Jacques J. Polak, as Economic Counselor, briefed the IMF Executive Board on a meeting held three days earlier of the Deputies of the Group of Ten in Paris. At the G-10 Paris meeting, the French and United States representatives had presented their long-awaited agreed text of a new article IV on exchange rate arrangements to be incorporated into the amended Articles of Agreement of the International Monetary Fund. During the briefing of the IMF Executive Board, Mr. Gold referred to one provision in the proposed article IV as "the interesting Section 2(c)."[1]

## I. Background

As many readers are aware, the text of article IV was the product of intense negotiations in the fall of 1975 (some seventeen meetings over three months) between Edwin H. Yeo III, then U.S. Under Secretary of the Treasury, and Jacques de Larosière, then Director of the Treasury of France.[2] While both France and the United States desired greater stability in the exchange markets, they differed about preferred exchange arrangements. The United States was determined to assure that the U.S. dollar would never again, in law or in fact, be the center hub in a system of fixed (even if "adjustable") exchange rates (that is, the currency against which other IMF members would set official values of their currencies) as had been the case in the former Bretton Woods

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1. Minutes of IMF Executive Board Meeting of Dec. 15, 1975, IMF Doc. EBM/75/196 (1975) at 3, *reprinted in* 2 Documents Relating to the Second Amendment of the Articles of Agreement of the International Monetary Fund 2004, 2006 (1980) [hereinafter Documents].

2. *See generally* 2 M. De Vries, The International Monetary Fund, 1972–1978: Cooperation on Trial 736–62 (1985); R. Edwards, International Monetary Collaboration 502–07 (1985).

par value system.[3] The United States wished to preserve a role for the play of supply and demand in exchange markets to determine the exchange rates between the U.S. dollar and the currencies issued by its major trading partners.

France, at the opposite pole, was determined that the international monetary system move toward a regime of stable but adjustable exchange rates, even if it was not possible to put such a regime into place promptly.[4] The draft text of article IV that resulted from the negotiations emphasized the shared desire for a more stable exchange system, and it compromised the differences. The U.S.-French draft, with some modifications, was incorporated into the Second Amendment to the Articles of Agreement of the IMF as the new article IV entitled "Obligations Regarding Exchange Arrangements."[5] The Second Amendment became effective on April 1, 1978.[6]

Section 1 of article IV states a number of general obligations to which all members of the International Monetary Fund are committed at all times. Among these obligations is the fundamental one: "each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates."

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3. For a description of the Bretton Woods par value system of exchange rates and its ultimate collapse in the period 1971–73, see R. EDWARDS, *supra* note 2, at 491–501 and citations therein; J. GOLD, EXCHANGE RATES IN INTERNATIONAL LAW AND ORGANIZATION 27–74 (1988) [hereinafter EXCHANGE RATES].

4. *See supra* note 2. Drafts of art. IV presented by France, by the United States, and by the IMF staff to the IMF Executive Board in the Spring of 1975. 3 M. DE VRIES, *supra* note 2, at 287–300; 1 DOCUMENTS, *supra* note 1, at 471–78, 668–81, 765–80, 841–46, 870–73, 945–50.

5. Agreement between France and the United States on art. IV was announced at the Economic Summit Conference at the Château de Rambouillet in France in November 1975. The draft text was presented to a meeting of the Deputies of the Group of Ten in Paris on December 11–12, 1975. During the following week, Joseph Gold, working with representatives of France and the United States, made revisions in the draft. *See* M. DE VRIES, *supra* note 2, at 748–49; Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INT'L L. [A.J.I.L.] 443, 452–56 (1983) [hereinafter Gold, *Strengthening*], *reprinted in* 2 J. GOLD, LEGAL AND INSTITUTIONAL ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS 515, 528–33 (1984) [hereinafter ESSAYS]. Hereinafter Gold, *Strengthening*, is cited to both the original version in A.J.I.L. and the reprinted version in ESSAYS. *See also* EXCHANGE RATES, *supra* note 3, at 89–94, 118–19, 200–02, 215, 317–20.

The revised text was then presented to the IMF's Executive Board. IMF Doc. DAA/74/24 (1975), *reprinted in* 1 DOCUMENTS, *supra* note 1, at 1644–51. The Executive Board approved it with some further modifications on December 23, 1975. It was submitted to the IMF's Interim Committee at its meeting in Kingston, Jamaica, in January 1976. Thereafter, the Second Amendment, incorporating the new art. IV, was approved by the IMF's Board of Governors for submission to the member countries for acceptance.

6. The Second Amendment substituted a complete new text of articles and schedules for the former text. The text of the Articles of Agreement of the International Monetary Fund, as amended effective April 1, 1978 [hereinafter IMF Articles of Agreement], appears at 29 U.S.T. 2204, T.I.A.S. No. 8937. For the original articles, adopted June 22, 1944, entered into force Dec. 27, 1945, see 60 Stat. 1401, T.I.A.S. No. 1501, 2 U.N.T.S. 39. For the First Amendment, effective July 28, 1969, see 20 U.S.T. 2775, T.I.A.S. No. 6748, 726 U.N.T.S. 266.

Sir Joseph Gold has described section 1 as stating "soft" law.[7] This author has argued elsewhere that, despite the generality of the language used, section 1 imposes significant legal obligations.[8]

Section 3 of article IV grants authority to the IMF, indeed imposes a duty upon it, to oversee the international monetary system and the compliance of each member country with its section 1 obligations. The Fund has a duty to engage in firm surveillance over the exchange rate policies of members and to adopt principles for the guidance of all members concerning exchange rate policies.[9] So far only one decision stating guiding principles has been adopted and it is phrased at a high level of generality.[10]

## II. A Close Look at Section 2(c)

Section 2 of article IV is entitled "General Exchange Arrangements." Subsection (b) of that section describes arrangements that were acceptable during the period when the Second Amendment was being brought into force:

> Under an international monetary system of the kind prevailing on January 1, 1976, exchange arrangements may include (i) the maintenance by a member of a value for its currency in terms of the special drawing right or another denominator, other than gold, selected by the member, or (ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, or (iii) other exchange arrangements of a member's choice.[11]

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7. *See* Gold, *Strengthening, supra* note 5, A.J.I.L. at 452–54, ESSAYS at 527–30; *see also* EXCHANGE RATES, *supra* note 3, at 89–112.

8. Edwards, *The Currency Exchange Rate Provisions of the Proposed Amended Articles of Agreement of the International Monetary Fund,* 70 AM. J. INT'L L. 722, 734–46, 757–59 (1976); R. EDWARDS, *supra* note 2, at 507–21, 566–68, 605–07.

9. *See* R. EDWARDS, *supra* note 2, at 519–21, 558–68; EXCHANGE RATES, *supra* note 3, at 317–52.

10. IMF Executive Board Decision No. 5392 (77/63) (Apr. 29, 1977, effective Apr. 1, 1978) [hereinafter Executive Board Decision no. 5392]; 1977 IMF ANN. REP. 107–09; SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND AND SELECTED DOCUMENTS 9–14 (13th issue 1987). For discussion, see R. EDWARDS, *supra* note 2, at 519–21; EXCHANGE RATES, *supra* note 3, at 387–93; Gold, *Strengthening, supra* note 5, A.J.I.L. at 465–73, ESSAYS at 545–54.

Section 3(b) of art. IV states that the principles adopted shall be "for the guidance of *all* members" (emphasis added) and shall be consistent with the right of members to choose their own exchange arrangements that are consistent with the purposes of the fund and with the obligations of sec. 1.

11. IMF Articles of Agreement, *supra* note 6, art. IV, sec. 2(b).

The text of sec. 2(b) in the U.S.-French draft of art. IV submitted to the Deputies of the Group of Ten in Paris in early December 1975, before its revision by the working group chaired by Joseph Gold, read as follows:

> Under the present functioning of the system such arrangements may include maintenance by a member of a value for its currency in terms of the special drawing right or other denominator, other than gold, selected by the member; may include maintenance by a group of members of mechanisms under which each member of such group maintains the value of its currency in relation to other members of such group; and may include other exchange arrangements of a member's choice. Gold, *Strengthening, supra* note 5, A.J.I.L. at 455, ESSAYS at 530.

While section 2(b) has been called "codified anarchy,"[12] it was not intended to be a permanent regime. It uses a specific date for reference. Use of the date, January 1, 1976, avoided the necessity to describe or define the then-functioning international monetary system. More importantly, in this author's view, the use of a time reference highlights the expectation of future change and evolution in the international monetary system.

Section 4 of article IV of the IMF Agreement authorizes the Fund to institute the par value system provided for in schedule C to the Agreement. The system would have a common denominator in relation to which member countries would express par values for their currencies. Exchange rates would be maintained on the basis of those values. Overall, the system is similar to but more flexible than the par value system of the former Articles of Agreement.[13] In order to institute the par value system, the Fund must determine, by an 85 percent weighted majority vote,[14] that "international economic conditions permit the introduction of a widespread system of exchange arrangements based on stable but adjustable par values."[15] Section 4 is loaded with factors that the Fund is to consider in making the determination:

> The Fund shall make the determination on the basis of the underlying stability of the world economy, and for this purpose shall take into account price movements and rates of expansion in the economies of members. The determination shall be made in light of the evolution of the international monetary system, with particular reference to sources of liquidity, and, in order to ensure the effective operation of a system of par values, to arrangements under which both members in surplus and members in deficit in their balances of payments take prompt, effective, and symmetrical action to achieve adjustment, as well as to arrangements for intervention and the treatment of imbalances.[16]

It should be apparent from the text quoted above, that the list of factors is long enough and contains enough troublesome considerations, so that section 4 is unlikely to be invoked without a great deal of preparatory work. Schedule C may well stand more as an example of one possible future stable-rate system than as a regime that is actually to be applied.

If the Fund is going to have a role in harmonizing and unifying exchange rate arrangements, the vehicle is unlikely to be section 4 of article IV. This leads to consideration of the "interesting" section 2(c). The section in the original U.S.-French draft read: "The Fund may by an 85 percent majority of the total voting power modify as appropriate the general exchange arrangements established under this Article."[17]

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12. Kenen, *Techniques to Control International Reserves*, in THE NEW INTERNATIONAL MONETARY SYSTEM 202, 208 (R. Mundell & J. Polak eds. 1977).

13. *See generally* EXCHANGE RATES, *supra* note 3, at 195–224.

14. Voting in the IMF is explained in R. EDWARDS, *supra* note 2, at 32–35.

15. IMF Articles of Agreement, *supra* note 6, art. IV, sec. 4.

16. *Id.*

17. EXCHANGE RATES, *supra* note 3, at 118; Gold, *Strengthening*, *supra* note 5, A.J.I.L. at 454–55, ESSAYS at 530.

This provision, had it been adopted without change, would have enabled the Executive Board of the IMF, if the voting majority were mustered, to legislate exchange arrangements binding on all members. Joseph Gold, as General Counsel of the IMF, found the idea of enabling the Fund to develop new general exchange arrangements, that would replace the loosely defined arrangements in section 2(b), to be attractive. He was, however, troubled by the idea of giving the Executive Board power to impose new and unknown obligations on member countries without the necessity for approval of the particular exchange commitments by national legislatures in those countries that require such approval for a country to undertake major new international obligations, especially if there is also an impact in domestic law.[18]

A working group, consisting of Mr. Gold and representatives of France and the United States, changed the language quoted above.[19] The revised text, with a minor change,[20] became the final version. Section 2(c) reads:

> To accord with the development of the international monetary system, the Fund, by an eighty-five percent majority of the total voting power,[21] may make provision for general exchange arrangements without limiting the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund and the obligations under Section 1 of this Article.[22]

The above language, which is the language now in article IV, provides important enabling powers to the Fund, but the Fund's actions under the revised section 2(c) do not have the compelling force of the original U.S.-French draft. The requirement of an 85 percent majority vote in the original draft is nevertheless retained. The *Report* of the Executive Directors to the Board of Governors on the Second Amendment devotes only two sentences to section 2(c):

> Section 2(c) enables the Fund, by an eighty-five percent majority of the total voting power, to recommend general exchange arrangements that accord with the development of the [international monetary] system. This action of the Fund, however, could not limit in any way the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund and the obligations of members under section 1.[23]

Although the quotation above uses the word "recommend," that word does not appear anywhere in the text of section 2. Section 2(c) enables the Fund to

18. Gold, *Strengthening, supra* note 5, A.J.I.L. at 454–55, Essays at 530–31.

19. For background on the drafting of sec. 2(c), see Gold, *Strengthening, supra* note 5, A.J.I.L. at 454–55, Essays at 530–31.

20. For the revised draft text of art. IV (including sec. 2(c)) submitted to the IMF Executive Board on December 19, 1975, see IMF Doc. DAA/75/24 (1975), *reprinted in* 1 Documents, *supra* note 1, at 1644–51. The final words in the draft of art. IV, sec. 2(c), "under Article IV, Section 1," were edited to read "under Section 1 of this Article" in the final version.

21. *See supra* note 14.

22. IMF Articles of Agreement, *supra* note 6, art. IV, sec. 2(c). For discussions of the purposes of the Fund and the legal character of the obligations of art. IV, sec. 1, to which reference is made in sec. 2(c), see R. Edwards, *supra* note 2, at 11–12, 507–31, 566–68; *see also supra* note 7.

23. Exec. Dir. of the Bd. of Governors of the IMF, Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund: A Report by the Executive Directors to the Board of Governors pt. II, sec. C, para. 4 (1976); 1976 Proceedings, IMF, Supp. at 14.

"make provision for" general exchange arrangements. This phrase is not synonymous with "recommend" and implies a more active and creative role for the Fund. If the Fund makes provision for general exchange arrangements that include, for example, stable exchange rates based on central rates with the SDR as the common denominator, and the vast majority of members participate in that system, the type of alternate arrangement (for example, a floating rate arrangement) that a nonparticipating member will be able in fact to choose for itself, consistent with its section 1 obligations, may be limited. The collaboration obligation of section 1, if it is to mean anything in the context of section 2(c), would require that the floating arrangement harmonize with the general stable-rate exchange arrangements.[24]

Having examined the character of the Fund's authority under section 2(c), the next step is to consider what the phrase "general exchange arrangements" encompasses. "General Exchange Arrangements" is the title of section 2 in which the subsection being discussed appears. Thus, the "codified anarchy"[25] of section 2(b), quoted earlier,[26] applicable to "an international monetary system of the kind prevailing on January 1, 1976," should be understood as "general exchange arrangements." These particular arrangements are about as loose a set of "general exchange arrangements" as one can imagine.

At the other extreme would be arrangements involving a shared world monetary instrument, issued by a central institution like the IMF, that would operate not only at the international level but penetrate into national economies. This monetary instrument would be the standard of value and principal means of payment used in official transactions. It would also be the standard of value in private international and domestic transactions, and instruments modeled on it could be the means of payment in those transactions. It would supplant at least some of the functions of national currencies. It is conceivable that the ECU could evolve into this dominant role in its regional sphere.[27] Evolution of the SDR into such an instrument is more problematic.[28]

24. An IMF member that chooses exchange arrangements for itself that differ from those provided for in a Fund decision under sec. 2(c), would appear to enjoy no greater freedom than a member that decides not to establish a par value for its currency after sch. C is applied. The same substantive test for compatibility of alternate arrangements is used in art. IV, sec. 2(c), and in sch. C, para. 3: consistency with the purposes of the Fund and with obligations under art. IV, sec. 1. Consultations of the Fund with the "nonparticipant" under sec. 3 of art. IV can be as wide-ranging and intensive as those contemplated in sch. C, para. 3.

25. *See supra* note 12 and accompanying text.

26. *See supra* note 11 and accompanying text.

27. *See* Committee for the Study of Economic and Monetary Union [chaired by Jacques Delors], Report on Economic and Monetary Union in the European Community ¶ ¶ 45–49 (Apr. 12, 1989); *see also* R. Edwards, *supra* note 2, at 342–45; IMF, The Role of the SDR in the International Monetary System 29–41 (IMF Occasional Paper No. 51, 1987) [hereinafter Role of SDR].

28. See R. Cooper, The International Monetary System: Essays in World Economics 239–78 (1987); R. Edwards, supra note 2, at 635–42; J. Polak, Thoughts on an International Monetary System Based Fully on the SDR (IMF Pamphlet Series No. 28, 1979); Kenen, *The Use of the SDR*

The par value system of schedule C in the IMF's Articles of Agreement goes nowhere near as far as a common currency system. It is, however, about as tight a set of arrangements as one can realistically imagine being instituted in a world of many nation states of great economic and social diversity. While the par value arrangements of schedule C are keyed to the Fund's making a "determination" under article IV, section 4, that is loaded with considerations,[29] section 2(c) can be used to provide for arrangements similar to those of schedule C that embody a concept of "central rates," rather than par values, without a comparable formal determination being required.[30] Central rates could be expressed in terms of a common denominator (such as the SDR) with rates in currency exchange transactions to be maintained on the basis of them.[31]

When one compares the extremely loose general exchange arrangements provided for in section 2(b) with a harmonized central rate system similar to the par value system of schedule C, it becomes apparent that the scope for potential application of section 2(c) is very wide indeed. Joseph Gold has said that section 2(c) encompasses "all kinds of possibilities."[32] As in other creative endeavors, it may clear the mind to "brainstorm." IMF Executive Directors did just that in two meetings two days before Christmas 1975. Ideas for potential future use of section 2(c) included:

(a) Arrangements that contemplate that authorities in each participating country will establish and announce "target zones" for exchange rates in those cases where authorities decide not to make commitments to stable rates.[33]

(b) Arrangements that include defined narrow margins of fluctuation around central rates for those countries participating, without necessarily adopting a common

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*to Supplement or Substitute for Other Means of Finance*, in INTERNATIONAL MONEY AND CREDIT: THE POLICY ROLES 327 (G. von Furstenberg ed. 1983); Speech by W. Martin, "Toward a World Central Bank?" (Per Jacobsson Lecture 1970).

29. *See supra* text accompanying notes 14–16. The IMF cannot under sec. 2(c) put into place an exchange rate system in which members are expected to establish "par values" for their currencies. *See* Minutes of IMF Executive Board Meeting of Dec. 23, 1975, IMF Doc. EBM/75/207 (1975) at 7, 9, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2120, 2126, 2128.

30. Joseph Gold mentioned the possibility of using art. IV, sec. 2(c), to provide for general exchange arrangements embodying central rates when the IMF Executive Board discussed sec. 2(c) when it was still in draft. *See* Minutes of IMF Executive Board Meeting of Dec. 23, 1975, IMF Doc. EBM/75/206 (1975) at 14–15, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2103, 2116–17; *see also* EXCHANGE RATES, *supra* note 3, at 120.

31. In actual operation central rate and par value systems might be very similar, the main difference being terminology, not economics. The Fund, if it provided for "central rate" arrangements, would have more flexibility in modifying, terminating, or moving beyond those arrangements compared to its more limited ability to modify or terminate sch. C's par value arrangements.

32. Minutes of IMF Executive Board Meeting of Dec. 23, 1975, IMF Doc. EBM/75/206 (1975) at 16, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2103, 2118.

33. *See* comments of Pieter Lieftinck (Netherlands), IMF Doc. EBM/75/206 (1975) at 15, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2103, 2117. The IMF can give advice on target zones without the necessity of a decision under sec. 2(c). EXCHANGE RATES, *supra* note 3, at 454–55. *See generally infra* notes 53, 54 and accompanying text.

denominator (much as subsections (i) and (ii) of section 2(b) admit the coexistence of multiple denominators).[34]

(c) Arrangements that prepare the groundwork for a possible later decision, to be made under section 4, to put into place the par value system of schedule C. An example would be arrangements that include provisions concerning intervention and settlement.[35]

(d) Central rate arrangements that are essentially equivalent to the par value arrangements of schedule C. Each participating country would state a central rate for its currency against a common denominator (perhaps the SDR). The arrangements would include defined margins of permitted fluctuation and formal procedures to be followed when a participating country proposes to change a central rate.[36]

(e) If and when schedule C is in operation, section 2(c) could be used to harmonize the par value system of schedule C with the exchange arrangements of countries that choose not to establish par values for their currencies or, after establishing par values, cease to maintain them.[37]

(f) If the par value system of schedule C is bypassed, arrangements might in the future go beyond the conception of that system and be more highly integrated.[38]

## III. Thoughts on a First Use of Section 2(c)

The time has come for the International Monetary Fund to use the enabling power in section 2(c) of article IV to provide for general exchange arrangements to replace those provided for in section 2(b). The objective of a first decision should not be to define a perfect set of general arrangements. The objective, in light of the evolution of the international monetary system since 1976, should simply be to provide a good taxonomy of exchange arrangements that at the present time and in the immediate future are consistent with section 1 of article IV.

The need for a section 2(c) decision is apparent when one sees how unhelpful section 2(b) is at the present time. Section 2(b) sets forth three classes of permitted exchange arrangements, the last category being "other exchange arrangements of a member's choice."[39] The original expectation was that this last category would be used by a few countries, like the United States, Canada, Japan, and the United Kingdom with active exchange markets, that choose to "float" the rates of their currencies. In fact, some forty-four IMF members have at the present time chosen "more flexible" exchange arrangements (independent floating, managed floating, or frequent rate adjustments) that do not fit into either of the first two categories listed in section 2(b) and can only be accommodated

34. *See* comments of Emilio Sacerdoti (Italy), IMF Doc. EBM/75/207 (1975) at 5, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2120, 2124.

35. *See* comments of Eckard Pieske (Fed. Rep. Germany), IMF Doc. EBM/75/206 (1975) at 16, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2103, 2118; and IMF Doc. EBM/75/207 (1975) at 10, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2120, 2129.

36. *See supra* notes 30 and 31 and accompanying text.

37. *See* comments of Eckard Pieske (Fed. Rep. Germany) and Joseph Gold, IMF Doc. EBM/75/207 (1975) at 4–5, 10, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2120, 2123–24, 2129.

38. *See* comments of Byanti Kharmawan (Indonesia), IMF Doc. EBM/75/207 (1975) at 8–9, *reprinted in* 2 DOCUMENTS, *supra* note 1, at 2120, 2127–28.

39. *See supra* text accompanying note 11.

under the residual "other exchange arrangements" category.[40] One should probably also add some thirty-nine countries that currently "peg" the exchange rates of their currencies to the U.S. dollar.[41] These arrangements are unilateral and not cooperative and thus do not fit section 2(b)(ii) ("cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members").[42] The result is that the exchange arrangements of more IMF members are in the residual category than in the other two categories combined.

The authority of section 2(c) should be used to define an entirely new set of categories of exchange arrangements— categories that fit the development of the international monetary system. The section 2(c) decision should provide each IMF member with a choice among a small number of types of exchange arrangements adequate to accommodate the reasonable needs of virtually all members. The residual "other exchange arrangements" category should not be part of the section 2(c) decision.[43]

Fresh thinking will be necessary as definitions are worked out of exchange arrangements appropriate to the development of the international monetary system, even if the intent is more to describe than prescribe. Relevant policy and operational criteria should be used in the definitions. Obviously, economic factors must be taken into account. The author is not an economist and will make only a few general observations from a legal perspective.

Exchange arrangements that are fundamentally different should not be lumped together because their economic consequences appear similar. The IMF Staff's present classification scheme for its published tables displaying exchange arrangements is clearly deficient.[44] The Staff's categories, in their "first cut," use as the criterion whether the member does or does not use a pegged exchange rate for its currency with margins of fluctuation of ± 4.5 percent or less from the pegged rate. Each of the two principal categories is ultimately divided into five subcategories.[45] The author submits that the most important distinction for policy purposes is whether a country's exchange arrangement is governmentally administered or is market based, which does not figure at all in the IMF's ten-category scheme.

The majority of IMF member countries require their residents to surrender foreign exchange obtained from export and other transactions to the monetary

40. *See* the "Exchange Rate Arrangements as of March 31, 1988" table in 1988 IMF ANN. REP. 87.

41. *Id.*

42. If "another denominator" in sec. 2(b)(i) is interpreted to include the U.S. dollar, then these pegged arrangements could be said to fall into that category. *See* R. EDWARDS, *supra* note 2, at 523. Sir Joseph Gold places them in the residual "other exchange arrangements" category. EXCHANGE RATES, *supra* note 3, at 116.

43. Under sec. 2(c), members have the explicit right to choose exchange arrangements of their choice, consistent with the purposes of the Fund and their obligations under art. IV, sec. 1, and do not need to be reminded of that right.

44. *See supra* note 40.

45. The categories are as follows:

authorities.[46] In many of these countries, the central bank is a monopoly supplier of foreign exchange and provides foreign currency to commercial banks for only authorized payments. The country's government or central bank decrees the prices (exchange rates) at which commercial banks buy and sell foreign currencies in transactions with their customers.[47] Such an exchange rate arrangement might be described as an "administered exchange arrangement."

At the opposite pole from such an administered arrangement is a market-oriented arrangement. The United States, United Kingdom, and Canada have paradigm forms of such an arrangement. The United States, for example, has virtually no exchange controls except for military security purposes and for the tracing of funds in unlawful drug transactions. Commercial banks are allowed to buy and sell foreign currencies, to extend credit in foreign currencies, and to deal freely with residents and nonresidents. The government does not prescribe exchange rates. Exchange rates are determined primarily by demand and supply conditions in the exchange market. United States' policies on official intervention in the market have varied during the last dozen years.[48] Given the size of the exchange market for the dollar, market interventions by U.S. authorities have been relatively infrequent and usually relatively small in size. For example, during the entire year of 1986, U.S. monetary authorities did not intervene at all.[49]

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PEGGED RATE ARRANGEMENT
- *Pegged to Single Currency*
  - U.S. Dollar
  - French Franc
  - Other Currency
- *Pegged to Currency Composite*
  - SDR
  - Other Currency Composite

FLEXIBLE RATE ARRANGEMENT
- *Limited Flexibility*
  - Arrangement of Bahrain, Qatar, Saudi Arabia, and United Arab Emirates
  - European Monetary System
- *More Flexibility*
  - Rate Adjusted According to set of Indicators
  - Other Managed Floating
  - Independent Floating

46. Currency surrender requirements are essential to an administered exchange arrangement but are not necessarily inconsistent with market-oriented arrangements. About 80 percent of the IMF's members had currency surrender requirements at the end of 1987. *See* 1988 IMF ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS 544–49. Currency surrender requirements are described in R. EDWARDS, *supra* note 2, at 383–86.

47. R. EDWARDS, *supra* note 2, at 386–89.

48. *See generally id.* at 532–35; Y. FUNABASHI, MANAGING THE DOLLAR: FROM THE PLAZA TO THE LOUVRE (1988).

49. BD. OF GOVERNORS OF FED. RESERVE SYS., 73D ANN. REP. 31 (1986). U.S. authorities have on a few occasions intervened heavily, or indicated their intention to do so, in order to move an exchange rate in a direction judged more appropriate. This happened in November 1978. *See* R. EDWARDS, *supra* note 2, at 533–34.

The use of market-oriented exchange rate arrangements is not limited to a small group of highly industrialized countries. During the 1980s a number of developing countries changed from administered exchange arrangements to market-oriented arrangements while retaining currency surrender requirements.[50]

There are subvarieties of governmentally administered and market-oriented exchange arrangements for which a section 2(c) decision must make provision. For example, in a number of countries in which foreign exchange is not centralized, monetary authorities publish rate ranges (usually in the form of an "official" rate of some type with defined margins on either side of it), and markets are allowed relatively free play within the published margins. The central bank will intervene as a buyer or seller of last resort at the margins and may also intervene at other times to keep market rates within the margins. When market rates press against margins for more than a temporary period, official rates may be changed to accommodate the market movement; in addition, or as an alternative, various financial and economic policy actions may be adopted (such as changes in credit terms, interest rates, and exchange controls) in order to encourage market rates to approximate more closely the official rate.

A market-based system that uses official rates and relatively insignificant exchange controls and a system in which the government has a monopoly power over foreign exchange and promulgates governmentally decreed rates may each produce stable exchange rates. The roles of the monetary authorities in the two types of systems are, however, so different that the two systems should be kept separated in a section 2(c) decision.

A taxonomy of exchange arrangements should take account of the role of capital controls in different arrangements. Nominal rate stability is easier to achieve when capital controls are employed. Liberalization of capital movements, however, may have benefits that outweigh stability of nominal exchange rates.[51] The Deputies of the Group of Ten in a report in June 1985 stated: "The Deputies agree that controls on international capital flows do not offer a desirable or effective means of achieving greater exchange rate stability . . . . [F]ree capital movements are beneficial to the expansion of trade and to efficient resource allocation."[52]

50. *See* P. Quirk, B. Christensen, K. Huh & T. Sasaki, Floating Exchange Rates in Developing Countries: Experience with Auction and Interbank Markets (IMF Occasional Paper No. 53, 1987).

51. The members of the IMF in art. IV, sec. 1, recognize that an essential purpose of the international monetary system is to provide a framework that facilitates the movement of capital. The IMF's principal decision on surveillance of exchange rate policies states that an IMF member's "introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital" may indicate the need for special discussion with the member. Executive Board Decision No. 5392, *supra* note 10. *See generally* R. Edwards, *supra* note 2, at 449–60, 551–54.

52. Report of the Deputies of the Group of Ten: The Functioning of the International Monetary System para. 25 (June 1985), *reprinted in* 14 IMF Survey (Supp. on Group of 10 Deputies' Report, July 1985); A. Crockett & M. Goldstein, Strengthening the International Monetary System: Exchange Rates, Surveillance, and Objective Indicators 44 (IMF Occasional Paper No. 50, 1987).

There may be a temptation when formulating a section 2(c) decision to try to move the United States and the countries issuing currencies that are most actively traded against the dollar (German mark, Japanese yen, Canadian dollar, U.K. pound sterling) in the direction of establishing and announcing, following periodic consultation, what are called "target zones" for exchange rates of the dollar against actively traded currencies. "Target zones" are ranges within which the authorities intend to maintain or direct exchange rates but without undertaking any formal commitment to do so.[53] While it is appropriate for provisions in a section 2(c) decision concerning market-based exchange arrangements to include arrangements that use target zones, the decision should also accommodate market-based systems that give a wide play to market forces and do not involve commitments to either stable rates or target zones.[54]

A decision that provides for general exchange arrangements under section 2(c), which requires an 85 percent majority of the Fund's total voting power, can be supplemented by Fund decisions under article IV, sections 2(a) and 3, requiring only a simple majority of voting power, relating to notification of exchange arrangements and Fund surveillance over exchange rate policies. For example, and this is intended here only as an example, the Fund might request members to submit official forecasts of exchange rate ranges. This would be a step short from recommending that member countries establish target zones for the rates of their currencies.

To facilitate uniformity of presentation and analysis of forecasted rates, each IMF member might be requested to forecast rates for its currency in relation to the SDR or one of the five national currencies that compose the "basket" in terms of which the SDR is currently valued (French franc, German mark, Japanese yen, U.K. pound sterling, and U.S. dollar).[55] The issuers of the five

53. The concept of "target zones" and official attitudes toward them are discussed in A. Crockett & M. Goldstein, *supra* note 52, at 12–15; Exchange Rates, *supra* note 3, at 393–405, 447–59; J. Williamson, The Exchange Rate System 62–78 (1983). *See also* paras. 32 and 103 of Group of Ten report of June 1985, *supra* note 52; and paras. 5 and 66–67 of Group of Twenty-four report of Aug. 1985, *reprinted in* 14 IMF Survey (Supp. on Group of 24 Deputies' Report, Sept. 1985), and in A. Crockett & M. Goldstein, *supra* note 52, at 60.

54. The finance ministers and central bank governors of the Group of Five (France, Federal Republic of Germany, Japan, United Kingdom, and United States) and the Group of Seven (Group of Five plus Canada and Italy) have agreed from time to time on desired ranges of rates among their currencies and have intervened in the market accordingly. *See* communiqués issued following meeting of Group of Five at the Plaza Hotel, New York, Sept. 22, 1985, and following meeting of Group of Five plus Canada at the Louvre, Paris, Feb. 22, 1987. 14 IMF Survey 296, 297 (1985); 16 IMF Survey 73, 75 (1987). No communiqué was issued after the Group of Seven meeting in Washington, Feb. 3, 1989. N.Y.Times, Feb. 4, 1989, at 18, col. 1.

Exchange market intervention is a monetary policy tool that U.S. authorities have preferred to use sparingly. Favored instruments operate primarily on the domestic money supply and interest rates. They affect exchange rates, but they are not designed for the fine tuning of them.

55. The IMF's basic SDR valuation decision is Executive Board Decision No. 6631 (80/145) G/S (1980), 1981 IMF Ann. Rep. 142–43; Selected Decisions, *supra* note 10, at 324–25. The most

currencies (the Group of Five) would be requested to forecast the rate ranges of their currencies against the SDR.[56] The forecasts might be submitted, say, quarterly and relate to the next six months. After the Fund gains experience in using the rolling forecasts as a surveillance tool, it could decide whether the forecasts (or papers based on them) should be published. Experience might also lead the IMF to consider how it might endow the SDR with an improved capability to be a denominator for exchange rate purposes.[57] At the present time it does not function well in that role.[58]

As experience is gained in forecasting future exchange rate ranges, authorities may find it possible to sharpen their estimates and to improve their ability to gauge the pace of rate movements in varying circumstances. The exercise may also give a new dimension to the examination of underlying economic and financial conditions and policies.

Economic forecasting is part of sound governmental planning. There is no reason to exclude exchange rates from that process. Consultation (and perhaps publicity) in the official forecasting of exchange rates should promote stability in the total exchange rate system. Rate predictability and rate stability are not necessarily the same. The proposal made here opts for rate predictability and system stability over nominal rate stability.

## IV. Conclusion

Section 2(c) of article IV of the Articles of Agreement enables the International Monetary Fund to be creative as future exchange rate systems are contemplated. Unlike schedule C and section 4 of article IV, there are no preconditions to its use. Section 2(c) permits the Fund to take one step at a time

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recent adjustment of weights of the five currencies was made effective Jan. 1, 1986. Executive Board Decision No. 8160 (85/186) G/S (1985); 1986 IMF ANN. REP. 102–03; SELECTED DECISIONS, *supra* note 10, at 326.

56. Consultations among the issuers of the five currencies would be necessary if the forecasts are to be mutually consistent. Since the SDR is issued by the IMF and is its unit of account, the IMF's Managing Director should participate in the consultations among the Group of Five as they harmonize forecasted rates against the SDR. A graph showing rates of the five currencies in relation to the SDR during the 12-year period 1974–1985 appears in ROLE OF SDR, *supra* note 27, at 55.

Monetary authorities of the countries participating in the European Monetary System, who already consult frequently, would have to harmonize their communications to the Fund. Since two EMS currencies (French franc and German mark) are included in the SDR "basket," no internal changes in the EMS system would be required. *See generally* Guitian, *The European Monetary System: A Balance Between Rules and Discretion*, in POLICY COORDINATION IN THE EUROPEAN MONETARY SYSTEM 3 (IMF Occasional Paper No. 61, 1988); Russo & Tullio, *Monetary Policy Coordination Within the European Monetary System: Is There a Rule?*, in POLICY COORDINATION IN THE EUROPEAN MONETARY SYSTEM, *supra*.

57. *See generally* ROLE OF SDR, *supra* note 27.

58. As of March 31, 1988, only seven IMF member countries pegged the exchange rates of their currencies to the SDR. These seven countries did not have active exchange markets. 1988 IMF ANN. REP. 87.

or to make changes by leaps toward a better exchange rate system. It also permits the Fund to take steps "backward" or to change direction when that seems wise.

The time has come for scholars and officials to propose and debate how and when the "interesting" section 2(c) should be used to improve the arrangements under which currencies are exchanged and valued. Improved exchange arrangements should facilitate international transactions in goods, services, and capital. They should create a framework that permits public and private decision-makers to take a longer-term perspective when making economic decisions. Fundamental purposes for which the International Monetary Fund was established are at stake.[59]

59. *See* IMF Articles of Agreement, *supra* note 6, art. I(ii), art. IV, sec. 1.