The International Monetary Fund and Current Account Convertibility[1]

I. Introduction

The experience of the pre-World War II years had shown that, together with trade restrictions, exchange restrictions had a great damaging effect in the development and growth of world trade and thus, on global prosperity. Exchange restrictions and competitive exchange depreciations had led away from the system of multilateralism and automatism of the theoretical gold standard and had contributed greatly to international friction.

It became a common practice for many countries in the 1930s to establish different rates of exchange for different commodities to stimulate their exports by making them cheaper in foreign markets while at the same time making the import of similar or other goods expensive in the domestic market and hence uncompetitive. It was also rather common for countries to conclude bilateral trade and payments agreements through which increased imports were exchanged for increased exports. These agreements usually contemplated fixed rates of exchange below the official rates and provided that the balances originated in the payments for the exports would be used to pay for imports from the other partner country, thus creating a fragmented international trade and payments system. Other mechanisms frequently used involved the direct rationing of foreign exchange by making it only available for payments of goods or commodities declared essential or with priority, while others would be met only if there was a surplus of exchange.

With this in mind, and in order to avoid the problems that had arisen in the intervening period between the two wars, due in great part to the lack of international cooperation on monetary matters, the International Monetary Fund was created, inter alia:

- "to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems";

- "to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciations"; and

- "to assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade."[2]

For the achievement of these purposes, members of the Fund assumed a series of obligations and the Fund was provided with some powers and also with resources that could be made temporarily available to members to provide them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

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[2] Article I(i), (iii) and (iv) of the Fund's Articles of Agreement.

I will not talk about the obligations established under Article IV of the Fund's Articles of Agreement by the Second Amendment following the demise of the par value system, but about the obligations undertaken by members in order to establish a system of unrestricted payments and transfers for current international transactions.

II. Exchange Controls

To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions, which, as mentioned above, is one of the Fund's purposes, members assumed some specific obligations and the Fund was given some specific powers.

For instance, all exchange control regulations of a member must be communicated to the Fund (Article VIII, Section 5(a)(xi)). In addition, some exchange controls may not be imposed by a member without prior Fund approval.

A distinction is made under the Fund's Articles between exchange restrictions and other exchange control measures, which are a broader concept. A verification procedure for payments by residents debtors to non-resident creditors, or for the purchase of foreign currency by residents going abroad, is part of a country's exchange controls, but is not a restriction. If, however, the full amount requested for the payment or the purchase cannot be obtained because of a regulation imposing a ceiling, or because of an administrative decision

denying the application, there is a restriction. Similarly, if the verification procedure imposes undue delays, there is a restriction.

A second distinction is made between restrictions affecting capital movements and restrictions affecting current transactions. Restrictions on international capital movements can be imposed by a member without the Fund's approval (Article VI, Section 3). These restrictions can be selective: the member may impose restrictions on capital transfers to one member or several members (for instance, within the European Union).

A. Definition and Conceptual Issues Regarding Exchange Restrictions and Multiple Currency Practices

1. The concept of exchange restrictions

Under Article VIII, Section 2(a), a member may not impose restrictions on the making of payments and transfers for current international transactions without the (prior) approval of the Fund.

a. Scope

As already mentioned, the concept of exchange restriction is narrower than the concept of exchange control and has a limited scope. While exchange control regulations encompass all regulations pertaining to the acquisition, holding or use of foreign exchange, or to the use

of domestic or foreign currency in international payments or transfers as such, exchange restrictions are limited to exchange measures that affect "the making of payments and transfers for current international transactions."

First, Article VIII, Section 2(a) only applies to payments and transfers for international transactions, i.e., transactions between residents of different countries; it does not apply to domestic transactions, i.e., transactions between residents of the same country.

Second, Article VIII, Section 2(a) imposes on Fund members an obligation toward their own residents. Members must allow, or not impede, their residents purchasing goods or services from nonresidents, or engaging in other current international transactions, to acquire and use the needed foreign exchange to make payment in settlement of those transactions. A member must not unduly delay, limit, or prevent any of its residents from obtaining the foreign currency that they need for making payments to nonresidents in settlement of current international transactions.

Third, Article VIII, Section 2(a) also imposes an obligation on Fund members toward nonresidents. Nonresidents that have recently acquired balances of the country's currency as a result of current international transactions must be permitted to transfer, or must not be impeded from transferring those balances (i.e., to convert them into a currency of their choice; usually a freely usable currency and transfer such currency abroad). The country of issue may not restrict the nonresident's choice to sell or transfer the currency as long as the transfers do not represent international capital movements.

Fourth, Article VIII, Section 2(a) is directed only to payments and transfers for current as opposed to capital international transactions. Restrictions on capital movements can be imposed by a member without the Fund's approval. Article VI, Section 3 provides that:

> "Members may exercise such controls as are necessary to regulate international capital movements but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments...."

The meaning of "payments for current transactions" can be found in Article XXX(d):

> "Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:
> (1) all payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
> (2) payments due as interest on loans and as net income from other investments;
> (3) payments of moderate amount for amortization of loans or for depreciation of direct investments; and
> (4) moderate remittances for family living expenses.

The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions."

The definition in the Fund's Articles of current transactions is very broad and encompasses various types of transactions. It does not always square with the use of the words "current" and "capital" by economists or balance of payments statisticians. For example, economists sometimes treat amortization of loans and depreciation of direct investment as capital items whereas the Articles treat "payments of moderate amount for amortization of loans or for depreciation of direct investments" as current.

Fifth, Article VIII, Section 2(a) applies to payments and transfers for transactions, not to the transactions themselves. Thus, it does not preclude a member from prohibiting certain imports or other transactions. If, for example, a country prohibits the import of certain luxury items and includes a provision in its exchange control laws prohibiting the use of foreign exchange to pay for prohibited imports, that would not be a restrictive measure within the scope of Article VIII, Section 2(a). Also, a law or regulation that prohibits banks from selling foreign exchange for payments for prohibited imports would not be inconsistent with Article VIII, Section 2(a).

Trade restrictions in the form of quantitative limitations on imports by a member would also not constitute exchange restrictions though they would have the effect of limiting the overall quantity of payments to nonresidents. Such restrictions do not become exchange restrictions within the meaning of Article VIII, Section 2(a) even if they are imposed for the purpose of

conserving foreign exchange. Exchange restrictions are only those measures that interfere with payments and transfers for current international transactions where the underlying transactions are not restricted.

The only situation in which the Fund has so far equated a restriction on the transaction with a restriction on payments and transfers is that of "normal short term banking and credit facilities". In the view of the Fund, since these facilities are so intimately connected with the financing of payments for current international transactions, such as trade, a restriction limiting the availability of these facilities if they existed, amounts to a restriction on payments and thus such measures are subject to Fund approval under Article VIII, Section 2(a).

Sixth, Article VIII, Section 2(a) is only directed to the making as opposed to the receipt of payments and transfers. The obligation is on the Fund member whose traders are on the paying side as distinguished from the member whose traders are on the receiving side. Thus, a member may determine the currencies in which its traders must receive payments, and, for example, require that they be paid in a certain specific foreign currency to the exclusion of all others. A member may also impose a surrender or a repatriation requirement on the foreign currencies that its residents acquire in the course of engaging in international transactions.

Seventh, Article VIII, Section 2(a) is directed at restrictions that are imposed by a member; that is, by the government or a governmental agency of the member, such as the central bank. Exchange restrictions that do not result from governmental acts are not subject

to the Fund's jurisdiction because the members of the Fund are not responsible for them. Thus, for instance, the nonpayment of a debt by an insolvent debtor, or a debtor whose assets have been attached by judicial order at the request of a creditor, or a debtor that simply decides for whatever reason, or for no reason at all, not to pay a current obligation to a nonresident, would not be an exchange restriction.

The imposition of a restriction by a member may take the form of a law or regulation, but a restriction may also arise from the administrative practice of a member even in the absence of an express regulation. Thus, administrative practices which result in undue delays in the availability or use of foreign exchange for the making of payments and transfers for current international transactions are regarded by the Fund as restrictions within the meaning of Article VIII, Section 2(a).

b. The Fund's criterion for determining the existence of a restriction

In order to clarify the meaning of Article VIII, Section 2(a), the Executive Board of the Fund has decided that:

"[t]he guiding principle in ascertaining whether a measure is a restriction on payments and transfers for current transactions under Article VIII, Section 2, is whether it involves a direct governmental limitation on the availability or use of exchange as such." (Decision No. 1034-(60/27), adopted June 1, 1960).

This test involves an examination of all aspects of the exchange measure in question; namely the text of the relevant regulation and its implementation. The application of this test has made it clear that certain types of exchange measures imposed by Fund members, that could be viewed by traders as restrictive, do not constitute exchange restrictions within the meaning of Article VIII because they do not constitute a limitation on the use or availability of foreign exchange for the making of payments and transfers. For example, a government may insist that payments and/or transfers be made by a particular means of payment or through particular channels without creating restrictions. Thus, when a Fund member prohibited the use by its residents of credit cards abroad, the measure was not considered restrictive by the Fund because other means of payment, such as banknotes and travelers' checks were available. Registration or licensing used to monitor, rather than to restrict payments, also fall into the above category. Verification requirements such as a requirement to submit documentary evidence that a payment is bona fide also do not constitute exchange restrictions, unless the process results in undue delays.

It should finally be noted that the above-mentioned test applies irrespective of the motivation of the restriction. Thus, exchange restrictions that are imposed, not for balance of payments reasons, but for security reasons are nevertheless inconsistent with the obligations of members under the Fund's Articles, unless they are approved by the Fund.

2. The concept of multiple currency practice

Under Article VIII, Section 3, Fund members are prohibited from engaging in any discriminatory arrangement or multiple currency practices without the approval of the Fund. That provision leaves to the Fund to define what a multiple currency practice is. The Fund's policy on multiple currency practices is set out in Decision No. 6790-(81/43) of March 20, 1981.[4] According to this policy, "[a]ction by a member or its fiscal agencies that of itself gives rise to a spread of more than 2 percent between buying and selling rates for spot exchange transactions between the member's currency and any other member's currency would be considered a multiple currency practice and would require the prior approval of the Fund."

It must be said from the outset that this policy has been interpreted to apply to any system of multiple rates where an official action is involved, even if they are not giving rise to differences of more than 2 percent at the time they are introduced if there is no mechanism in place that will prevent such spread from arising. This is basically because: first, under the Fund's Articles, members are required to seek the prior approval of the Fund; that is, seek approval before introducing measures inconsistent with their undertakings under them, and second, the jurisdiction of the Fund is limited to the approval of measures that are inconsistent with those provisions.

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[4] See Selected Decisions, Twenty-First Issue, (1996), p. 398.

The policy on multiple currency practices is based on a set of basic principles that are essential for determining the existence of a multiple currency practice. Thus, for a multiple currency practice to exist, it should at least be established that there is:

(a) an official action by a member or one its fiscal agencies, which could take the form of an exchange control measure but it could also consist of any form of governmental influence, guidance, or direction. Official action could emanate from any part of the member's government, and particularly its various entities with responsibilities on financial or exchange matters;

(b) the official action must be directly related to an exchange transaction. An exchange transaction is defined as the "exchange of one currency for another" or the "purchase and sale of one currency in return for another," the term currency being understood as means of payment; and

(c) it must give rise to a multiplicity of effective rates.

"Multiplicity" refers to the existence of more than one effective rate of exchange. Multiple rates are to be found in differences between a buying and a selling rate, between buying rates or between selling rates that could result in spreads of more than two percent.

"Effective rate" means the "imputed rate of exchange resulting from all of the pecuniary elements of the exchange transactions" and it includes "certain costs or subsidies that may be

so closely connected with exchange transactions that they must be considered part of the effective rate" if these costs or subsidies are imposed by the authorities.

In order to determine whether charges or subsidies resulting from governmental action are part of the effective rate, it is necessary to determine whether they are directly related to exchange transactions. This determination depends on the facts of each case, but it is necessary to consider the nature of the measure, its effects, and the procedures followed for applying it.

Multiple currency practices are also generally considered to be exchange restrictions because, in most cases, they affect the making of payments for current international transactions, and are, therefore, subject to Fund approval under Article VIII, Section 2(a) and 3.[1] For example, multiple currency practices arising from the existence of an officially managed exchange guarantee scheme for the benefit only of certain categories of traders constitutes a limitation on access to a preferential rate of exchange for those traders that may not benefit from that rate.

[1] For instance, a multiple currency practice arising from a more favorable rate on sales of certain foreign exchange receipts would not give rise to an exchange restriction under Article VIII, Section 2(a), since the latter only apply to the making of payments and transfers for current international transactions and not to receipts of such payments.

B. Types of Exchange Measures Giving Rise to Exchange Restrictions or Multiple Currency Practices: An Overview of Fund Practice

Set forth below are examples of exchange measures that have been found by the Fund, under certain circumstances, to give rise to exchange restrictions or multiple currency practices, or both, and are subject to Fund approval under Article VIII.

1. Exchange measures that give rise to exchange restrictions

a. Restrictions on certain invisible transactions

The imposition by a member of limits on the provision of foreign exchange for payments for certain current international transactions, e.g., in the form of basic allocations for tourist or business travel abroad, education, family living expenses, payment of insurance premiums, constitute a limitation on the availability of foreign exchange for current international payments, and, therefore, a restriction subject to Fund approval under Article VIII, Section 2(a).

A restriction also arises if there are no basic allowances for certain transactions and the authorities approve requests for foreign exchange for those transactions on a discretionary basis.

However, if the limits are only indicative (i.e., if banks are authorized to automatically provide foreign exchange for all transactions within the limits and the authorities approve all requests for foreign exchange transactions beyond the limits upon establishing their bona fide character, or for transactions for which there are no basic allocations once their bona fide character are established) and the public is made aware of such a policy, there is no restriction.

That the public is made aware of the latter (through some system of publicity) is important; otherwise the mere existence of limits will have a "chilling" effect and thus be restrictive in fact.

b. Restrictions on the transferability of investment income by nonresidents

Members may not restrict the right of nonresidents to convert and transfer proceeds of current international transactions. Thus, any limits on remittances of profits, dividends, interest (investment income), whether stipulated in terms of time (e.g., repatriation of investment income would not be allowed for a certain number of years after the commencement of production), or amount (repatriation limited to a certain percentage of the profits made), or a combination of both, would be contrary to Article VIII, Section 2(a). For instance, a dividend balancing requirement under which certain companies were not allowed, for a certain period of time following the commencement of production, to transfer to their nonresident investors dividends in excess of the amount of the foreign exchange earnings of the companies from exports, would be inconsistent with Article VIII, Section 2(a).

c. Foreign exchange budget allocation

If a foreign exchange budget is used to determine the availability of foreign exchange for authorized imports rather than to determine the amount of imports that will be permitted during a particular period of time (e.g., a year), it could give rise to an exchange restriction. That would, for example, be the case if, by means of an exchange budget, a member determines the amount of foreign exchange to be available under each heading of national expenditure for imports of goods and services. That would also be the case if a member establishes a foreign exchange budget in the form of exchange quotas for certain categories of importers. These measures constitute exchange restrictions because they have as a necessary consequence that the availability or use of exchange will be confined to the allocation and there will be no authorization to use exchange beyond the particular allocation.

d. External payments arrears

Undue delays in the availability or use of foreign exchange for current international transactions that result from a governmental limitation also give rise to payments arrears and are payments restrictions under Article VIII, Section 2(a) and Article XIV, Section of the Fund's Articles. [5] Thus, although external payments arrears are not themselves a breach of

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[5]The treatment of payments arrears by the Fund is found in Decision No. 3153-(70/95) of October 26, 1970. See Selected Decisions, Twenty-Third Issue, (1998), pp. 462-463.

obligations under the Fund's Articles, their existence may be the manifestation of an underlying exchange restriction. In that case, the arrears are said to "evidence" a restriction.

External payments arrears evidence a restriction on the making of payments or transfers for current international transactions where the arrears are owed by private entities or public entities which do not form part of the budgetary process of the government, and arise from a governmental limitation on, or interference with, the availability of foreign exchange at the time a payment for a current international transaction falls due, or with the timely transfer of the proceeds of such transactions. They do not evidence restrictions when they are owed by the government itself or by entities which form part of the budgetary process of the government; in these cases, they are treated as government defaults. The rationale for this position is that a government could not be properly regarded as imposing an exchange restriction on itself. External payments arrears do not evidence exchange restrictions when they have arisen because the debtor either lacks the domestic resources necessary to purchase the foreign exchange or refuses to make the payments as they fall due.

Although government defaults are not regarded by the Fund as exchange restrictions, an exchange restriction may still arise if a government, rather than not paying its debt to its foreign creditors, agrees to pay them on accounts in its own territory but then blocks the transfer of the balances from these accounts. This would not be a case of nonpayment but one of official limitation on transfers after payment was made. This would be an official limitation on the making of transfers for current international transactions, and, therefore, a restriction contrary to Article VIII, Section 2(a).

An exchange restriction evidenced by external payments arrears may be eliminated by: (i) removing the limitation on, or interference with, payments and, thereby, allow the clearance of the arrears by the debtors; or (ii) through the conclusion of rescheduling agreements between the government or the debtors themselves and the creditors. It is worth mentioning that arrears owed to Paris Club creditors are not, for purposes of Article VIII, legally rescheduled through the signature of a Paris Club Agreed Minute but only upon the conclusion of all the bilateral rescheduling agreements with creditors.

e. Import licensing procedures

Import licensing procedures may involve both trade and payments aspects and, thus, may raise the question of when they give rise to exchange restrictions. If no import license is required but an exchange license is needed to make payments for imports and such license is not automatically granted, there is an exchange restriction. Conversely, if an import license is issued subject to the discretion of the authorities, but as a consequence of the import license, foreign exchange is then automatically made available and payment permitted, then there is no exchange restriction. If an import license is freely granted but its presentation does not mean that foreign exchange will be made available for payment, this would be an exchange restriction. A combined import and exchange license is involved when both the exchange and trade aspects of current transactions are covered by a single authorization. If the measure does not regulate exclusively either the exchange or the trade side of the transaction and is issued on a discretionary basis, it must be regarded as both an exchange restriction and a trade restriction.

f. "Own fund" systems

Under many of these systems, importers are required to use their own foreign exchange earnings to pay for certain imports and are generally granted import licenses on that condition. Such schemes have generally not been regarded as giving rise to exchange restrictions, unless it is established that importers that are granted import licenses would not be provided access to foreign exchange should they become unable to pay because of insufficient "own funds." The restriction arises because the authorities would be limiting the availability of foreign exchange to make payments for imports that have been authorized.

2. Exchange measures that give rise to multiple currency practices

a. Different rates for different transactions

A typical multiple currency practice may take the form of the setting by the Central Bank of different exchange rates applying to different categories of transactions (e.g., official transactions, commercial transactions, tourist transactions, etc.) which result in spreads of more than two percent between these rates.

b. Exchange taxes

A tax or subsidy payable on exchange transactions, or on the purchase or sale of a foreign currency, may be related enough to the exchange of currencies to be considered part of the effective exchange rate and, therefore, give rise to a multiple currency practice. If a tax is withheld from all payments to all nonresidents, it has been considered to be an application of the income tax, but if the liability for the tax is incurred only if the amount is to be remitted abroad (for instance, if the tax is collected at the time the exchange is purchased to make the payment), the tax has been considered as part of the effective exchange rate and, thus, as giving rise to a multiple currency practice.

c. Exchange guarantees

Exchange guarantees provided by a member of its fiscal agencies to cover exchange risks are analyzed as a provision by the member of subsidized exchange rate. Under many of these systems, compensation for exchange losses is not part of the nominal exchange rate applied to the purchase of foreign exchange by the beneficiary of the guarantee, but it is part of the effective exchange rate as defined by the Fund because the benefit of the coverage of exchange risk flows directly from exchange losses which are assumed by the guarantor with no or inadequate compensation of the risk involved and, thus, from the exchange transaction in which these losses are realized.

A system for covering exchange risks managed by a member or its fiscal agencies does not give rise to a multiple currency practice if it is self-financed, i.e., if the premia paid by the beneficiaries of the system are sufficient to cover the exchange risks. In such a case, the

system is unlikely to need official subsidies to meet its liabilities. The self-financing character of the system is evaluated in advance, i.e., when the system is set up and the liabilities are incurred (and not when compensation is paid). It is then that it must be determined whether a multiple currency practice exists. However, regular assessments need to take place so as to ensure that the system remains self-financed over time so that a multiple currency would not arise.

d. Broken cross rates

Broken cross rates are a type of multiple currency practice that arise from "[a]ction by a member or its fiscal agencies which results in midpoint spot exchange rates of other members currencies against its own currency in a relationship which differs by more than 1 percent from the midpoint spot exchange rates for these currencies in their principal markets. If the differentials of more than 1 percent in these cross rates persist for more than a week, the resulting multiple currency practice would be subject to Fund approval under Article VIII." [6]

Let us consider Country X which establishes fixed rates of exchange between its currency C and say, the U.S. dollar and the French franc: C= 1$
and C= 2FF. The cross rate between the dollar and the French franc in Country X in this example would be that 1 dollar equals 2 French francs. If this implicit rate of exchange

[6] Decision No. 6790-(81/43) of March 20, 1981. See Selected Decisions, Twenty-First Issue, (1996), p. 399.

between the U.S. dollar and the French franc deviates for more than a week by more than 1 percent from the rates between these two currencies in their principal markets (Paris and New York), this would be regarded as giving rise to a multiple currency practice subject to Fund approval, unless there is a mechanism in place to ensure that such deviations would last for less than a week.

e. Dual or multiple exchange markets

If the authorities establish separate exchange markets and the coexistence of these markets results in spreads of more than two percent between the rates in the different markets, or such a spread may arise at any time due to the lack of a mechanism to avoid spreads of more than two percent, then, a multiple currency practice subject to Fund approval arise if current transactions are to take place in both markets. However, if one of the markets is only relegated to capital transactions, the existence of the measure will be identified but it will not be characterized as a multiple currency practice requiring the approval of the Fund; a majority of the Fund's Executive Directors representing a majority of the total voting power in the Fund, considering that members are free to impose capital restrictions in accordance with Article VI, Section 3, have not been persuaded by the position of the staff that multiple currency practices on capital transactions are also subject to the obligation of Article VIII, Section 3.

A multiple currency practice would also arise if the authorities, having established an official market, were to allow the existence of a free market without establishing any mechanism to

ensure that spreads of more than two percent would not arise between the rates in these markets, and if not all current transactions have access to the official market.

3. Exchange measures that may give rise to restrictions and multiple currency practices

a. Bilateral payments arrangements (BPAs)

Historically, bilateral payments arrangements have taken a variety of forms, and each arrangement must be examined closely to determine whether or not it contains features that would be subject to Fund approval under Article VIII, Sections 2(a) or 3. BPAs may give rise to restrictions on transfers as well as multiple currency practices.

Restrictions on transfers. An exchange restriction arises whenever a member restricts the right of a nonresident to transfer abroad balances of currency which the nonresident has recently acquired as a result of current international transactions. This is the case where the nonresident in question is another member of the Fund or its central bank. Under most BPAs, partner banks accumulate balances of currency as residents of the partner countries make payments for current international transactions through the arrangement and amounts are credited or debited from the accounts of the partner banks. In many cases, a partner bank will not be permitted to freely convert and transfer the net credit balance which it holds against another partner bank, but this amount will only be available for payments between the parties. Settlement of a credit balance will only take place upon the expiration of the

period of settlement specified in the arrangement. The Fund has determined that these official arrangements give rise to exchange restrictions under Article VIII, Section 2(a) if balances are not settled, at a minimum, every three months because such balances would otherwise be unavailable to make payments and transfers for current international transactions.

Multiple currency practices. Bilateral payments arrangements may also give rise to multiple currency practices when the arrangements make use of "special" exchange rates. For the spreads between these rates and other rates in a member's territory to be taken into account, they need to be connected to actual exchange transactions. Exchange transactions under a bilateral payments arrangement may be identified at the level of the residents making use of the arrangement (when an importer pays its central bank in his local currency and in turn the exporter receives payments in his local currency from his central bank) and at the level of the partner banks (which may be at the time of crediting of the account between partner banks and/or at the time of settlement of official balances between partner banks).

Thus, a multiple currency practice will arise from a bilateral payments arrangement which provides that exchange transactions under the arrangement will be conducted at "special" exchange rates, which differ by more than two percent from those prevailing in the markets.

A bilateral payments arrangement would also give rise to a multiple currency practice if it specifies rates which are consistent with market rates at the commencement of the

arrangement's operation but does not provide for such rates to be subsequently adjusted during the arrangement's operation to ensure that they will not, at any time, differ by more than two percent from the rates prevailing in the market.

b. Foreign exchange auctions

Foreign exchange auction systems have often been found to give rise to exchange restrictions and to multiple currency practices. The typical restrictive feature of these systems is that the authorities limit the volume of foreign exchange made available to residents for the making of payments and transfers for current international transactions.

Thus, an exchange restriction will arise where the auction is the sole source of foreign exchange and the amount of foreign exchange made available at auctions is insufficient to meet the demand for foreign exchange to make current payments. If the authorities allocate foreign exchange outside the auction for certain payments while the exchange made available at the auction is insufficient to meet the demand, an exchange restriction would also arise.

If the allocation of foreign exchange outside the auction is made at a different exchange rate than the auction rate and the two rates may differ by more than two percent, the system gives rise to a multiple currency practice, unless there is a mechanism in place that prevents such spreads from arising. An official Dutch auction system also gives rise to multiple currency practices if the rates at which successful bidders are sold foreign exchange at the same auction could differ by more than two percent.

c. Import deposit requirements

Advance import deposit requirements and cash margin requirements for letters of credit inherently give rise to exchange restrictions, because the basic feature of such schemes, namely that the payor is required to block resources for a period of time as a condition for making a payment for a current international transaction, constitutes a direct limitation on payments for imports. No exchange restriction would be involved if the advance deposit or cash margin applied only to one means of payment (e.g., payment by check) while other normal means of payments for imports were available and remained unrestricted. No exchange restriction would arise if the deposit were a condition for the issuance of an import license, rather than a condition for the payment of the import (unless, of course, having the import license is a pre-condition to making payments in their connection).

Another case is the imposition of a deposit requirement on tourist exchange requests. Such a measure has been found to be restrictive because it imposes a significant precondition (and usually an added cost) on the availability of foreign exchange, and amounts to a governmental limitation on the availability of foreign exchange.

If the government requires an import deposit to be made before a letter of credit is opened or foreign exchange purchased, the measure is directly connected with the exchange transaction and the cost is considered to be part of the effective exchange rate. Thus, import deposit requirements have been found to give rise to multiple currency practices when the

rate of interest, if any, paid on the deposits was lower than the prevailing market interest rate. The absence of interest or the existence of an interest below the market rate is analyzed as an additional cost of the exchange transaction.

III. Legal Effects of Approval and Nonapproval of Exchange Restrictions by the Fund

1. General considerations

Pursuant to Article VIII, Section 2(a), the requirement of approval by the Fund does not apply to exchange restrictions maintained by a member in accordance with Article XIV, Section 2. Article XIV, Section 2 authorizes a member to maintain and adapt to changing circumstances the exchange restrictions that were already in effect when it became a member of the Fund but does not allow it to impose new restrictions. Thus, the benefits deriving to a member from the transitional arrangements are: (i) the right to maintain and adapt, without requiring the approval of the Fund, the restrictions in effect on the date it became a member; and (ii) the restrictions so maintained or adapted, are in accordance with the member's obligations under the Articles. The criterion applied to determine whether the modification of an Article XIV restriction is an adaptation under Article XIV or an imposition under Article VIII is whether the modification restricts an activity that was previously unrestricted (in which case it would be an imposition) or whether it merely affects the level of the restriction (in which case it would be an adaptation). The criterion is, therefore, whether the change in the restriction is one of degree or one of nature.

Approval is normally granted by the Fund by a formal decision, provided that the Fund is satisfied that the restrictions are imposed for balance of payments reasons and are not discriminatory, that their use will be temporary while the member is seeking to eliminate the need for them. The Fund follows, however, a different procedure for the approval of restrictions imposed for security reasons. In this connection, Decision No. 144-(52/51), adopted August 14, 1952 provides that restrictions notified to the Fund pursuant to that decision are approved for purposes of Article VIII, Section 2(a), unless the Fund informs the member within 30 days after receiving the notice that it is not satisfied that such restrictions are imposed solely to preserve national or international security.

2. Effects of Fund approval on the relations between the Fund and the member imposing the restrictions

Because Article VIII, Section 2 (a) prohibits the imposition of exchange restrictions without the Fund's approval, exchange restrictions that are not approved by the Fund are inconsistent with the Articles and approved restrictions are consistent with the Articles.

The main consequence of nonapproval of exchange restrictions by the Fund is that the member is in breach of an obligation assumed by it under the Articles, and the Fund may, under the Articles, take certain actions regarding that member. Such actions include the issuance of a report by the Managing Director to the Executive Board or a complaint by the Managing Director or other members that a member is not complying with its obligations regarding exchange controls, discriminatory currency arrangements, or multiple currency

practices; a declaration of ineligibility to use the general resources of the Fund which causes the suspension of the member's entitlement to use the Fund's general resources; a suspension of the member's voting and related rights, which may be followed by the compulsory withdrawal of the member from the Fund.

It should be noted that the Fund may authorize the use of its general resources by a member imposing or maintaining exchange restrictions, even when they are imposed without the approval of the Fund. However, it may also adopt policies on the use of its general resources, or decisions on individual requests for purchases, denying, or limiting access to its general resources to members imposing exchange restrictions that the Fund is not prepared to approve, or maintaining restrictions that are inconsistent with its purposes. In addition, when examining a member's request for use of its general resources, the Fund must examine the member's exchange restrictions (existing or contemplated), taking into account the purpose, under the Articles, of avoidance or elimination of exchange restrictions.

3. Recognition of Exchange control regulations by foreign courts under the Fund's Articles

Article VIII, Section 2(b) imposes an obligation on member countries with respect to exchange control regulations of other member countries:

> "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or

imposed consistently with this Agreement shall be unenforceable in the territories of any member."

The meaning of this provision has been partially clarified by a Decision of the Fund (Decision No. 446-4, 10 June, 1949). Four points of this decision are particularly important:

- Article VIII, Section 2(b), applies even when the exchange control regulations are not part of the *lex contractus*; it does not give competence to the *lex monetae* (the law of the member whose currency is involved) as *lex contractus*; the provision is not a rule of conflict, but a substantive rule of private international law;

- public policy (*ordre public)* cannot be invoked against the recognition of another member's exchange control regulations if they are consistent with the Fund's Articles;

- unenforceability means that the performance of the contract cannot be decreed, and damages for non-performance cannot be awarded, by the judicial or administrative authorities of other member countries, but that the contract may remain valid, and there is no prohibition on voluntary performance by the parties; from the reference to the authorities of other member countries, it follows that the authorities of the member enacting the regulation, as well as international and arbitral tribunals, are not subject to this provision;

- the Fund stand ready to advise whether a particular exchange control regulation is consistent with the Articles.

The applicability of Article VIII, Section 2(b) is predicated on the consistency with the Articles of the exchange control regulations that have been infringed by the contract. For those regulations that consist of restrictions on payments and transfers for current international transactions, consistency requires that they be maintained under Article XIV, Section 2 or approved by the Fund under Article VIII, Section 2(a). Thus, when the Fund approves a member's exchange restrictions under Article VIII, Section 2(a), a necessary effect is the application of Article VIII, Section 2(b) to exchange contracts involving the member's currency that are contrary to these restrictions. Capital restrictions that do not restrict payments for current transactions or do not unduly delay transfers of funds in settlement of commitments, are consistent with the Articles and thus covered by the provision.

Article VIII, Section 2(b) raises complex issues of interpretation of its main concepts, that are briefly explained below:

The concept of "exchange contract" has been interpreted differently by the courts of Fund members. There are at least three different interpretations: (i) a broad interpretation (followed by French and German courts) is that exchange contracts are any contracts that affect a country's exchange reserves; (ii) a narrow interpretation (followed by U.K. and U.S. courts) confines exchange contracts to contracts for the exchange of the currency of a country against the currency of another; (iii) and an intermediate interpretation (proposed by the Fund staff) defines an exchange contract as a contract providing either for payment or transfer of

exchange, or for an international payment or transfer (i.e., a payment between a resident and a nonresident, or a transfer of funds from one country to another).

"Exchange control regulations" are defined by the Fund staff as regulations pertaining to the acquisition, holding or use of foreign exchange as such, or to the use of domestic or foreign currency in international payments or transfers as such.

The meaning of "involving the currency" depends on the interpretation given to the terms "exchange contract." For those who define it as a contract for the exchange of currencies, a member's currency is involved if it is one of the currencies that are exchanged. In contrast, for those who view exchange contracts as contracts affecting the member's exchange resources, the phrase "exchange contracts which involve the currency of any member" refers to contracts affecting a member's balance of payments or exchange resources. This interpretation raises the question of the appropriate criterion to be used to determine when a member's balance of payments is affected. The position of the Fund staff is that a member's currency is involved by a contract when either the performance of the contract is to be made from assets located in the member's territory, or a resident of the member is a party to the contract.

The date as of which the conditions of: (i) involvement of a member's currency by a contract, (ii) contrariness of the contract to a member's exchange control regulations, and (iii) consistency of the regulations with the Fund's Articles must be assessed, is, in the view of the Fund's staff, the date on which performance of the contract is sought.

The sanction of "unenforceability" prescribed in Article VIII, Section 2(b) means that the judicial and administrative authorities of members should not lend their assistance to any party seeking performance of exchange contracts of the type described in this provision, or seeking damages for the non-performance of the same.

As already mentioned, one of the conditions for the applicability of Article VIII, Section 2(b) is that the exchange control regulations to which the contract is contrary be maintained or imposed consistently with the Articles. It follows that when a member imposes exchange restrictions that, while subject to the approval of the Fund, are not approved, other members are under no obligation to give any effect to these restrictions. Moreover, since the Fund' s Articles of Agreement recognizes the right of members to impose capital restrictions, such restrictions, if maintained by members, are consistent with the Fund's Articles unless they also limit current payments. However, more recently, the German highest court has concluded that only exchange measures subject to the Fund's approval jurisdiction, or maintained by members in accordance with the transitional provisions of Article XIV, are covered by the provisions of Article VIII, Section 2(b). The main basis for its conclusion is the title of Article VIII, Section 2 which reads: *Avoidance of restriction on current payments.*