The Multilateral System of Payments
Keynes, Convertibility, and the International Monetary Fund's Articles of Agreement

By Joseph Gold

International Monetary Fund
Washington, D.C.
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Prefatory Note

This Occasional Paper has been written by the former General Counsel and Director of the Legal Department of the International Monetary Fund, who is now Senior Consultant. The views expressed are those of the author and are not necessarily those of the Fund.
Introduction

Volume 26 of the Collected Writings of John Maynard Keynes records for the first time a strange episode in the development of the International Monetary Fund.¹ It is of interest for a number of reasons. The problem that gave rise to the episode was a fundamental one, and it was discussed with great sophistication.² The Fund’s solution of the problem has become the main mechanism for realizing the purpose of the Fund that seeks a multilateral system of payments and transfers in respect of current international transactions among members and the elimination of foreign exchange restrictions that hamper the growth of world trade. The heart of the problem was the reconciliation of two provisions. These provisions remain in the Articles, without any modification that is relevant to the problem, notwithstanding two broad amendments of the Articles. Finally, to add to the interest of the affair, one of the two provisions became the subject of a compromise in the negotiation of the Second Amendment that has its own bizarre aspect.

The final plenary session of the Bretton Woods Conference was held on July 22, 1944, and Keynes left by car for Ottawa, arriving on July 26, 1944. D. H. Robertson, of the U.K. Treasury and later Professor of Political Economy at Cambridge University, sent him a note dated July 31, 1944 that raised the problem for the first time. The role of Dennis Robertson in the negotiation and drafting of the original Articles is well known, but the tribute to him, and to Edward M. Bernstein of the U.S. Treasury, in Volume 26 deserves quotation not only because both had so active a part in trying to resolve the problem once it had come to the surface but also because of the sharp difference of opinion that developed between Keynes and Robertson. The passage appears in a letter dated July 22, 1944 to Sir Richard Hopkins, Permanent Secretary of the U.K. Treasury, in which Keynes reports with incandescent praise on the contribution of members of the delegation that he had led:

Everyone in our team has played together splendidly. If anyone is picked out I think it would have to be Dennis, whose help has been absolutely indispensable. He alone had the intellectual subtlety and patience of mind and tenacity of character to grasp and hold on to all details and fight them through Bernstein (who adores Dennis), so that I, frequently occupied otherwise, could feel completely happy about the situation.³

The Problem Discovered

The two provisions of the original Articles that have been referred to read as follows:

Article VIII, Section 2(a)

“Avoidance of restrictions on current payments.— (a) Subject to the provisions of Article VII, Section 3(a), and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.”

Article VIII, Section 4

“Convertibility of foreign held balances.—(a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents (i) that the balances to be bought have been recently acquired as a result of current transactions; or (ii) that their conversion is needed for making payments for current transactions. The buying member shall have the option to pay either in the currency of the member making the request or in gold. (b) The obligation in (a) above shall not apply (i) when the convertibility of the balances has been restricted consistently with Section 2 of this Article, or Article VI, Section 3; or (ii) when the balances have accumulated as a result of transactions effected before the removal by a member of restrictions maintained or imposed under Article XIV, Section 2; or

² The main features of the discussion are summarized in Part I of this pamphlet with such interstitial comments on them as are useful for the purposes of exposition. All references to provisions are to provisions of the original Articles except when explicit reference is made to the First or Second Amendment.
Robertson described part of the problem that he was raising as the elucidation of the convertibility obligations that members of the Fund would assume under Article VIII after the close of the transitional period. This formulation was too narrow for two reasons, with the consequence that the difficulty that Robertson saw was even broader than he assumed. First, the Articles did not define a transitional period in which members could avail themselves of transitional arrangements. A member availed itself of these arrangements under Article XIV until it gave them up. The transitional arrangements were not limited to the three years from the date of the beginning of financial operations (March 1, 1947), after which the Fund reported on the restrictions still in force under the arrangements, or to the five years from the same date, after which the Fund consulted members still retaining such restrictions. Both periods were thought by some observers to constitute the transitional period, but this view was not held by the Fund. Moreover, Keynes had resisted any interpretation that limited the freedom of the United Kingdom to decide when it would give up the transitional arrangements.

The second reason why the formulation was too narrow was that the obligation of members under Article VIII, Section 2(a) could affect them before they ceased to avail themselves of the transitional arrangements. This result followed from Article VIII, Section 1, which imposed on all members the obligations set forth in Article VIII, whether or not they were availing themselves of the transitional arrangements. The effect of Article VIII, Section 2, however, was to authorize restrictions if they were authorized by the transitional arrangements of Article XIV, Section 2. If they were not authorized by Article XIV, Section 2, for example, because they were to be "introduced" by a member, and were not "adapted," the member was subject to Article VIII, Section 2(a) in respect of the restrictions it proposed to introduce and was required to obtain the approval of the Fund for these restrictions.

As restrictions authorized by Article XIV, Section 2 receded, the scope of Article VIII, Section 2(a) expanded, because the word "introduced" was understood to embrace the reintroduction of former restrictions. Furthermore, it was deduced from the text of Article XIV, Section 2 that the restrictions a member was authorized to maintain or adapt were restrictions for balance of payments purposes. If restrictions were maintained or adapted for other reasons, the member had to seek the Fund's approval for them.

Article VIII, Section 4, in contrast to Article VIII, Section 2, did not apply to a member before it gave the Fund notice under Article XIV, Section 3 that it was ceasing to avail itself of the transitional arrangements and was undertaking to perform the obligations set out in Article VIII, Sections 2, 3, and 4. Article VIII, Section 4 contained a saving clause that immunized a member from even the partial application to it of the provision until the member gave the notice. Article VIII, Section 4(b)(ii) provided that the obligation of a member to convert balances of its currency held by the monetary authorities of other members did not apply to balances accumulated as a result of transactions effected before the removal of restrictions maintained or imposed under Article XIV, Section 2. This clause was understood to refer to all balances accumulated by the holder before the issuer of the currency gave notice that it was going to perform the obligations of Article VIII, Sections 2, 3, and 4. The issuer was not required to convert balances that had resulted from payments and transfers before the notice even though they had been unrestricted when made.

Robertson saw Article VIII, Section 2(a) as the proviso that expressed "the main and over-riding obligation." It was the proviso, he wrote, under which the United States and Canada, for example, received the assurance that the proceeds of exports by their residents to the United Kingdom could be remitted to the country of origin whether the exports had been invoiced in sterling or in the exporter's currency. Proceeding with the analysis of the proviso, Robertson made three points:

1. Although the Fund could approve restrictions under Article VIII, Section 2(a), the exercise of this power did not depend on whether or not the member had exhausted its rights to use the Fund's resources.

2. The right of an exporter to transfer the proceeds of a recent current international transaction was not dependent on the purpose for which he wished to make the transfer. In particular, he was not limited to transfers for the purpose of making payments for current international transactions.

3. An exporter when transferring the proceeds of his...
recent export was assured of receiving only his national currency.

Robertson then made three points on Article VIII, Section 4, which he found both narrower and wider than Article VIII, Section 2(a):

1. The right to demand conversion under Article VIII, Section 4 was confined to members (i.e., monetary authorities).

2. The obligation to convert was in abeyance when a member had exhausted, "temporarily or permanently," its right to use the Fund's resources.

3. The obligation of conversion was not confined to the proceeds of recent current international transactions but extended to other balances if conversion was needed for making payments for current international transactions.

Robertson was skeptical about the benefits that Article VIII, Section 4(a)(ii) seemed to accord to a member that might want to obtain the conversion of balances that had not resulted from recent current international transactions ("old" or "capital" balances) because the member wished to make payments for current international transactions. Once again, he made three points:

1. The obligation of a member to convert old balances of its currency would not apply if the member had restricted them as capital under Article VI, Section 3.8

2. A member might be unable to use the Fund's resources for the purpose of converting balances even though the member had not exhausted its rights of recourse to the Fund. The Fund might regard a proposed use for this purpose as "a large . . . outflow of capital,"9 for which a member was not entitled to make a net use of the Fund's resources.

3. A member that sought conversion under Article VIII, Section 4(a)(i) or (ii) might not achieve its objective. If, for example, India wished to convert sterling balances into U.S. dollars, it would find that it was entitled to receive only rupees under the provision. Robertson appears to have overlooked, or at least did not mention, the fact that if the United Kingdom purchased the rupees from the Fund, the United Kingdom exhausted part of its right to purchase currencies, including U.S. dollars, from the Fund, while the right of India to make purchases in U.S. dollars, if needed, would be increased pro tanto, provided that India was not disabled from making purchases for some reason pertinent to its own relations with the Fund. In effect, therefore, sterling balances could be converted through the Fund into U.S. dollars if the conditions of all relevant provisions were satisfied.

Robertson was skeptical also about the value to a member of its exemption from the obligation to convert balances of its currency under Article VIII, Section 4(a)(i) when it was unable to use the Fund's resources, because the obligation of conversion was implicit in what he regarded as the master-obligation of Article VIII, Section 2(a) and not in the supplementary obligation of Article VIII, Section 4. The obligation of a member under the former provision was not subject to the qualification in the latter provision that the member was able to use the Fund's resources. Here Robertson arrived at the heart of the problem that agitated Keynes so profoundly. Was the United Kingdom bound to ensure the conversion of sterling under Article VIII, Section 2(a) even though it could not use the Fund's resources for this purpose and even though it was not bound to convert balances of its currency under Article VIII, Section 4?

It should not be overlooked that monetary authorities were not excluded from the benefit of convertibility under Article VIII, Section 2(a) because Article VIII, Section 4 provided a special form of convertibility for them. The point is made because there are so many references in the debate to the position of private persons under Article VIII, Section 2(a).

**Keynes v. Robertson**

Keynes replied from Ottawa, in a letter dated August 9, 1944, that he had enjoyed Robertson's note because it gave him an excuse "to divert the mind to something interesting away from the barren fields and waste lands of financial diplomacy,"10 but he argued that Robertson had misinterpreted the provisions on one fundamental matter. Article VIII, Section 2(a), Keynes insisted vehemently, did not create an obligation of convertibility.11 He asked Robertson where in that provision he found an obligation to convert balances into the currency of the holder but not into other currencies. The implication of the question is that as the text did not make this distinction, Robertson was forced logically into the unreasonable position of having to conclude that a member must see that the holder of the proceeds of a recent current transaction could transfer them into any currency of his choice.

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7 Ibid., p. 115.
8 See Article VIII, Section 4(b)(i).
9 Article VI, Section 1.

10 Keynes, Collected Writings, Vol. 26, p. 117.
11 Note, however, the following sentence in the Explanatory Notes by United Kingdom Experts on the Proposals for an International Monetary Fund in Joint Statement by Experts on the Establishment of an International Monetary Fund (Cmd. 6519, April 1944): "Clauses III(5) and IX(3) provide that a member's obligation to maintain free convertibility of its currency applies only to transactions of a current account nature" (published in The International Monetary Fund, 1945–1965: Twenty Years of International Monetary Cooperation, Vol. 3 (Washington, 1969), p. 130; hereinafter referred to as History, 1945–65). The clauses referred to were the progenitors of Article VIII, Section 2(a) and Article VIII, Section 4. The British experts, therefore, did regard Article VIII, Section 2(a) as a provision that created an obligation of convertibility.
Keynes' view of Article VIII, Section 2(a) was that it required a member not to interfere with conversion but that it did not require the member to provide convertibility. A nonresident holder of sterling received in a recent current transaction was to be free to dispose of it, either to his central bank or to another private person, for another currency, within the margins for exchange transactions, but the issuer of the currency was not obliged to provide him with the currency that he wanted. In other words, all that the private holder was entitled to expect was that the United Kingdom would not block his sterling balance. Keynes held that only Article VIII, Section 4 dealt with convertibility. On Robertson’s view, argued Keynes, a central bank would be bound in all circumstances to intervene continuously in its market to support its exchanges with all other members. Such an obligation would render unnecessary, and make nonsense of, the elaborate provisions of Article VIII, Section 4. A nonresident holder of a sterling balance, Keynes argued, could dispose of it as of right against the British Exchange Control only through the kind offices of his own central bank, which was entitled, but not obliged, to buy the balance from him for the currency that he wanted. The United Kingdom could maintain a free exchange market open to dealings by private persons, with market support of all currencies, but it was not compelled to do so. A member’s only obligation of convertibility was to buy its currency from another central bank, subject to the qualifications of Article VIII, Section 4.

A strange element in Keynes' presentation of his case is the influence on it of the involvement of private persons. His conclusion was that in relation to them the only obligations of a member were to refrain from interfering with their current transactions and to prohibit exchange transactions by them outside the legal margins for exchange rates under the Articles. His conclusion seems to have been affected by the thought that at least the first part of the conclusion gave rights to private persons against members. These rights were exceptional, and therefore to be construed narrowly, because all other rights and obligations under the Articles were between members or between members and the Fund. The Articles, however, create no rights for private persons against members. All rights and obligations are between members and the Fund, and perhaps between members. It is a breach of obligation toward the Fund, and perhaps other members, if a member fails to perform an obligation that affects private persons.

Another strange element in Keynes' argument is his view that only Article VIII, Section 4 created an obligation of convertibility. Nobody recalled that there was a definition of the holdings of a convertible currency, and therefore of convertibility, in the original Articles. Article XIX (d) defined a member’s holdings of convertible currencies as “its holdings of the currencies of other members which are not availing themselves of the transitional arrangements under Article XIV, Section 2, together with its holdings of the currencies of such non-members as the Fund may from time to time specify.” Under Article XIV, Section 3 a member that was not availing itself of the transitional arrangements was a member that had not notified the Fund that it was “prepared to accept the obligations of Article VIII, Sections 2, 3, and 4.” The obligations of all three provisions, therefore, including Article VIII, Section 2(a), were obligations of convertibility.

In a letter to Robertson dated August 14, 1944, Keynes made explicit the assumption on which his analysis was based. The Americans, he wrote, were always somewhat confused about whether they wanted central banks to support the private markets in exchanges or whether they wished to concentrate transactions in the hands of central banks. He considered the former view as “mere conservatism” 12 that cut across the philosophy of the Fund. Only the latter view made sense of the general structure of the Fund.

In his rejoinder of August 29, 1944, Robertson recalled some of the history of the two provisions at Bretton Woods, implying that it supported his version of them. He wrote that when they were put cheek by jowl after having been drafted separately, it seemed that the relation between them needed further consideration. The U.S. delegation proposed to insert a sentence into Article VIII, Section 4 to make it clear that nothing in that provision limited Article VIII, Section 2(a). Robertson opposed this move, and the U.K. delegation proposed instead to qualify the obligation of members under Article VIII, Section 2(a) by making it subject not only to Article VII, Section 3(b) (the scarce currency clause) and Article XIV, Section 2 (the transitional arrangements) but also to Article VIII, Section 4.

One must assume that the British proposal was a reference to Article VIII, Section 4(b)(v). That is to say, under the proposal, a member would be bound to observe the obligation under Article VIII, Section 2(a) only if it was entitled to use the Fund’s resources. The controversy was complicated, wrote Robertson, by Louis Rasminsky's attack on Article VIII, Section 4(b)(v), which Rasminsky would have deleted.

It can be assumed that the United States and Canada had no interest in Article VIII, Section 4. The United States was not interested because it was not proposing to centralize all exchange transactions and because normally its traders received payments in U.S. dollars. Canada was not interested in the provision because its traders were likely to receive payments in U.S. dollars and Canada

12 Keynes, Collected Writings, Vol. 26, p. 123.
would be content to retain them in its reserves without demanding conversion. These two countries saw advantages, therefore, in the broadest possible convertibility.

Robertson recalled that Keynes resisted the deletion of Article VIII, Section 4(b)(v). The U.S. and Canadian delegates then withdrew their proposals for modifying Article VIII, Section 4 and concentrated on demanding that Article VIII, Section 2(a) should not be qualified by a reference to Article VIII, Section 4(b)(v). Keynes accepted this proposed compromise, when put to him by Robertson through Sir Wilfrid Eady of the U.K. Treasury, and "I then felt—apparently wrongly—that the whole position was as clear and as satisfactory to everybody as it could be made, having regard to the fact that we had to keep to the Joint Statement as a basis and were not free to rewrite the whole thing from the start in the most lucid possible manner." 13

Robertson may have agreed to delete the reference to Article VIII, Section 4(b)(v) from Article VIII, Section 2(a) because the reference might have been taken to imply that if a member was able to use the Fund’s resources under Article VIII, Section 4(b)(v), it would be bound to provide convertibility under Article VIII, Section 2(a) for both categories of transactions in Article VIII, Section 4(a). Such an obligation would broaden Article VIII, Section 2(a) beyond its intended effect because the provision would then apply not only to balances recently acquired as the result of current international transactions but also to other balances if the holder wanted them converted in order to make payments for current international transactions.

The analytical portion of Robertson’s rejoinder summarizes in one brief paragraph the reason why he found it impossible to share Keynes’ narrow view of Article VIII, Section 2(a). If a member proposed, "as I have always understood that we propose," 14 to monopolize exchange dealings, an American exporter receiving sterling for his export could not go into a free market in London to buy U.S. dollars with his sterling. 15 The government monopoly constituted a restriction on the making of payments and transfers for current international transactions contrary to Article VIII, Section 2(a), unless the member operated its monopoly so as not to hinder the making of such payments and transfers. In short, the Exchange Control had to provide dollars to an American who wished to make transfers and to a resident who wished to make payments. The Articles allowed members to choose their system of exchange management, but the same freedom for remitting proceeds must prevail between members whether both centralized their exchange dealings, or neither centralized them, or one centralized them and the other did not.

For the first time in this debate, "payments" by residents and the availability of foreign exchange for their current transactions was mentioned. Up to this stage, the debate had been conducted as if it related only to "transfers" of their receipts by nonresidents.

The Debate Enlarged

On September 17, 1944 Keynes circulated within the U.K. Treasury and to members of the U.K. Bretton Woods delegation a note on the controversy and on two problems of the interpretation of further provisions that had been raised by other commentators. He reiterated his interpretation of the two provisions of Article VIII but confessed that he was disturbed by the fact that Robertson held a different view. If Robertson was correct, wrote Keynes, the Chancellor of the Exchequer would not be justified in commenting the proposed Articles to the House of Commons.

In explaining his views, Keynes seemed to reject any suggestion that Article VIII, Section 2(a) obliges a member to interpose no restrictions on payments by residents to nonresidents. Apparently, he considered "payments" to refer only to payments by nonresidents. The United Kingdom, for example, would be bound not to impede payments in sterling by a nonresident with the proceeds of recent current international transactions.

Keynes hammered away at the conclusion, admitted by Robertson, that, according to his view, Article VIII, Section 2(a) would render the safeguard of Article VIII, Section 4(b) nugatory. Keynes had always attached primary importance to this safeguard. He did not see how, without it, any member could safely sign the Articles, because it would then be undertaking to maintain convertibility without the means to do so.

Keynes did not hide his annoyance. He refers to "Professor Robertson (who was the British Delegate representing us on the Committee which dealt with this clause)." 16 Keynes wrote that he had not become aware of the difference of opinion until the Conference was over. He thought that the matter should be reconsidered. He suggested that,

13 Ibid., pp. 124–25.
14 Ibid., p. 126.
15 Robertson argued that Keynes’ view would give the American exporter to the United Kingdom less favorable treatment after the convertibility of sterling than he already enjoyed, even during wartime, a result that Robertson thought "inconceivable" (Keynes, Collected Writings, Vol. 26, p. 126). Keynes replied (p. 136) that the existing facility was granted subject to "a system of discriminatory import licensing" that enabled British authorities to prevent Americans from obtaining sterling. This system, he held, would not be permissible once sterling became convertible, so that Robertson was supporting a much more onerous obligation. This reply is not consistent with Keynes’ conviction that the Articles did not apply to import licensing, but perhaps he was thinking of the "discriminatory currency arrangements" that were prohibited by Article VIII, Section 3.
16 Ibid., p. 137.
if his interpretation was open to reasonable doubt, he should write personally to H.D. White to see how the Americans understood the provisions. If Keynes' interpretation was held to be correct, the text could be left unchanged, but it might be advisable to put the interpretation on record.

W.E. Beckett, the legal adviser of the British delegation at Bretton Woods, and G.L.F. Bolton of the Bank of England replied to the note and supported Keynes. James E. Meade, who was then Economic Assistant in the U.K. Cabinet Office, questioned Keynes' logic. Keynes decided to bring the "textual doubts" to the attention of the Chancellor of the Exchequer. Keynes transmitted (on September 20, 1944) some relevant documents to T. Padmore, the Chancellor's Private Secretary, and drew his special attention to Beckett's opinion. Keynes requested authority to discuss the matter with White, in the first instance orally. Keynes would suggest drafting changes and would rely on Beckett's advice that the Bretton Woods Secretariat had been given authority to correct textual errors. Keynes continued to think that, if Robertson's interpretation was correct, the Articles as drafted were unacceptable. Keynes had two meetings with the Chancellor and was instructed to approach White and Bernstein on his forthcoming visit to Washington.

The Americans Enter the Debate

Keynes put two problems to White in a letter dated October 6, 1944. One was the result of an objection by the American economist Paul Einzig that if a member prohibited exchange transactions outside the margins for exchange rates permitted by the Articles, this measure would be a restriction under Article VIII, Section 2(a). The provision, according to Einzig, required the member to support all parities in the exchange market by what is now called intervention, with the result that a member would have an unlimited obligation to acquire weak currencies. Keynes thought that there had been a slip in drafting, which could be eliminated by adding to the end of Article VIII, Section 2(a) such words as "within the range permitted under Article IV, Section 3."

The second problem, wrote Keynes, was more serious. He set forth his views on convertibility under the two provisions of Article VIII, dismissing the phrase "making of payments and transfers" as a piece of jargon taken over from British exchange control regulations, in which it related to internal transactions only. He disclosed, however, that, on another interpretation, his conclusions were thought to be "unduly simpliste." He described the alternative interpretation as one according to which a monopoly of exchange transactions, which would be necessary for an effective control of capital transactions, would be a restriction within the meaning of Article VIII, Section 2(a), unless "perhaps" the authorities stood ready, in relation to current transactions, to provide all comers with any desired currency at exchange rates within the prescribed range, "though even then it is not clear on a strict reading that the monopoly would be in order." The paradoxical result would be a heavier burden of convertibility on members that had a monopoly of exchange transactions than had to be borne by other members under Article VIII, Section 4(b)(v).

Keynes noted that it would be possible to avoid the heavier burden that he described by what he regarded as a clumsy and inconvenient device. All exchange transactions could pass through the exchange control and licenses would be granted for all requests relating to current transactions that would authorize the applicant to go into the exchange market and take his chances of finding a partner.

If it was agreed that the dilemma was unintended and the result of inadvertent drafting because of the unavoidable haste with which the proceedings of the Conference had been conducted, Article VIII, Section 2(a) could be made to read as follows:

No member shall, without the approval of the Fund, impose restrictions on the making of internal payments and transfers arising out of current international transactions, or on foreign exchange transactions which are inconsistent with or frustrate the obligation of convertibility of foreign held balances under VIII(4) below.

Keynes proposed that the changes in Article VIII, Section 2(a) could be made under the authority conferred by the Conference on the Secretariat to correct errors in the text. It is hardly likely, however, that any such authority was intended to go beyond the correction of obvious editorial errors. The new text as drafted by Keynes was not so modest a correction.

On December 29, 1944, Keynes wrote a memorandum in which he reported on his discussions with American officials and complained that he had not received a written reply. "... American autographs are very rare." Keynes reported that White had agreed with him that Einzig's interpretation was wrong, and that the prohibition of "black market" transactions was not a restriction under Article VIII, Section 2(a).

On the problem of the relationship between the two provisions, Bernstein and Ansel F. Luxford, chief legal adviser of the U.S. delegation at the Conference, strongly supported "the interpretation sprung on us (or, at any rate, on me) after our return by Professor Robertson." White,

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17 Ibid., p. 144.
18 Ibid.
19 Ibid., p. 145.
20 Ibid., p. 146.
21 Ibid., p. 148.
who also, according to Keynes, had not had his attention drawn to the problem at Bretton Woods, attached little importance to the problem, which shocked Bernstein. Keynes reported that White would readily have compromised on the problem during the Conference, but, in view of the opposition of Bernstein and Luxford, White could not agree to interpret Article VIII, Section 2(a) as Keynes was proposing. White saw no procedure that was available for modifying the text. Keynes emphasized to White the political difficulties in the United Kingdom of defending Bernstein’s interpretation, and he, Keynes, could not conscientiously advise the Chancellor to defend its merits in the House of Commons.

In the memorandum of December 29, 1944, Keynes took up the question whether the problem was of small practical importance. Even if White were right, the matter would still be of great doctrinal importance and would affect the internal consistency of the Articles. Keynes saw these aspects of the problem as issues of the retention of freedom by a member, that is to say, as political issues. If exchange difficulties developed for a member, it could either deprecate its currency or it could limit the convertibility of its currency. The United Kingdom had taken great pains to ensure that its freedom to change the par value of sterling would not be unduly fettered. Keynes did not elaborate this point, but he was referring to various elements in the provisions on par values, including the “Catto clause” as he called it in attributing its origin to Lord Catto, the Governor of the Bank of England. The provision that gave effect to this clause was Article IV, Section 6, under which a member could make an “unauthorized change” of par value—a change notwithstanding the objection of the Fund—without being in violation of the Articles, although it forfeited its right to use the Fund’s resources.

Keynes thought that the United Kingdom had taken equal pains to retain discretion in an emergency to limit convertibility. He saw the assurance of this discretion in the qualifications of Article VIII, Section 4(a) that were included in Article VIII, Section 4(b). Section 4(b)(v) in particular gave a member discretion to decide how far it would draw down its gold reserves after it had exhausted or been deprived of its right to use the Fund’s resources, without having to obtain the consent of the Fund. “I argued that there were reasons of politics and war which made it both reasonable and essential that we ourselves should retain the discretion to decide at what point we should call a halt to the further depletion of our gold reserves.”

The interpretation of Article VIII, Section 2(a) that he opposed would cancel this discretion as a result of the inadvertent omission of a reference in it to Article VIII, Section 4(b)(v) that would have supplied the necessary qualification.

Keynes could not dismiss the problem as unimportant in practice because, if the United Kingdom were to run into difficulties, it was much more likely to want to limit the convertibility of sterling than to devalue the currency. He reverted to the task the Chancellor would face in explaining to the House of Commons that “the apparent let-out under VIII 4(b) is a pure deception, because our representatives at Bretton Woods had not been wide enough awake to notice that the necessary cross-reference to this in VIII 2(a) had been omitted.”

The next topics that Keynes considered were intention and the technique of legal interpretation. On intention, his comment shows an insight into the difficulty that international lawyers have in handling this concept, particularly in the interpretation of multilateral treaties. Keynes dismissed intention as unimportant, because it could involve no more than four or five persons at most. The problem, he wrote, was never raised in a main Committee of the Conference, and nine out of ten delegates would be as innocent of knowledge of the matter as were he and White. Keynes was relying on his own intention, however, as major support for his thesis.

Legal interpretation, therefore, became all the more important, wrote Keynes. He made two points. First, the language of Article VIII, Section 2(a) did not impose a positive obligation on members to provide any foreign exchange required for current international transactions. At most, the provision forbade interference with certain means of obtaining foreign exchange. He admitted, however, that the centralization of foreign exchange transactions would be a restriction. He countered the impact of this admission by arguing that a system of exchange control could be devised easily that would fall short of free convertibility but would not violate Article VIII, Section 2(a). He may have been referring to the control of all exchange transactions and the channeling of those involving current transactions to the exchange markets. If this is a true understanding of his argument, he was really conceding the correctness of Robertson’s view, although Keynes concluded his legal argument by holding that the provision could not be interpreted in this way.

His second legal point was that, on the American interpretation, Article VIII, Section 2(a) and Article VIII, Section 4(b)(v) were in conflict, and in such circumstances he supposed that lawyers would give the benefit of the doubt to an interpretation that avoided the contradiction.

23 Keynes, Collected Writings, Vol. 26, p. 150.
24 Ibid., p. 151.
Once Keynes was willing to admit that the centralization of foreign exchange transactions was a restriction, he could have sought the arbitrament of the purposes of Article I in order to reconcile within the context of the Articles the provisions that he found contradictory. The original Articles provided that the Fund was to be guided in all its decisions by the purposes of the Fund as set forth in Article I. The fourth purpose was the one most directly involved. It was drafted in broad language:

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.

The language is not only broad; it may also be repetitive. It encompasses both a multilateral system of payments and the elimination of foreign exchange restrictions that hamper the growth of world trade. These restrictions would interfere with a multilateral system of payments in respect of current transactions, but perhaps the restrictions were mentioned in order to emphasize disapprobation of bilateralism as an impediment to trade.

Keynes reported that Bernstein did not agree that there was a contradiction between Sections 2(a) and 4(a) of Article VIII. Section 4(a) covered two categories of transactions—those numbered (i) and (ii) in it—while Article VIII, Section 2(a) covered only category (ii). Keynes doubted whether this analysis was correct. It seems, however, that he had misunderstood the argument. Article VIII, Section 2(a), in dealing with transfers, refers to category (i) as defined in Article VIII, Section 4(a), i.e., balances recently acquired as the result of current transactions, and not to category (ii). Article VIII, Section 2(a) imposes no obligation on members to avoid restrictions on transfers of other balances because the conversion of them is sought for the purpose of making payments for current international transactions. Keynes argued that even if Bernstein was correct, the issue of contradiction would still arise in connection with one category of transactions.25

Keynes appended to his memorandum a new redraft of Article VIII, Section 2(a), which had been prepared by E. Rowe-Dutton of the U.K. Treasury and C.F. Cobbold, Deputy Governor of the Bank of England:

Subject to the provisions of Article VII, Section 3(b), Article XIV Section 2 no member shall, without the approval of the Fund, impose restrictions which

(i) prevent the making of payments in its own currency by persons in its territory to persons outside its territory in respect of current transactions, or

(ii) prevent the transfer of currency paid to persons outside its territory in accordance with (i) immediately above to the central bank or other fiscal agent operating in the territory of such persons.26

This text was intended to limit a member’s obligation on payments to payments made in its own currency, so that no obligation would arise to permit payments in foreign currency or to provide foreign currency. It was intended also to limit a member’s obligation on transfers to transfers of the member’s currency by a nonresident to its monetary authorities, so that again there would be no obligation to permit the currency to be exchanged for foreign currency or to provide foreign currency for this purpose. The only obligation of the member would be to convert its currency in the hands, and at the request, of the foreign monetary authorities, in accordance with Article VIII, Section 4, if they obtained the currency.

Keynes agreed that the redraft was a considerable improvement on his own effort and he would prefer to have it adopted, but he thought that the change in language was too radical to give it any chance of acceptance. He had sought a minimum change in language in order that it could be accepted as a "'mere interpretation."27 To accomplish this objective, the opening words of Article VIII, Section 2(a) could be made to read:

Subject to the provisions of Article VII Section 3(b) and Article XIV Section 2, or except in the conditions of Article VIII 4(b)(iii) or (v). . . .28

The "'except" clause could be even shorter:

"Except in the conditions of Article VIII 4(b). . . ."29

The memorandum of December 29, 1944 was concluded with a proposal that the Chancellor should write a letter to Mr. Morgenthau, Secretary of the U.S. Treasury, setting forth the history, analysis, and solution of the problem in accordance with Keynes’ views.

The Chancellor held a meeting in which the memorandum of December 29, 1944 was discussed. It was agreed that Keynes should prepare the draft of a letter, and that the United Kingdom should consider either a new conference to clear up the matters in issue or a redraft of the provisions before accepting the obligations of Article VIII, Sections 2, 3, and 4. In short, there would be no attempt to obtain an immediate revision of the Articles. Keynes prepared the draft of a letter, in vigorous lan-

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25 Keynes continues: "'Mr. White defended the practical effect by arguing that we could always dodge Mr. Bernstein's intention by import controls. There is something in this; but such controls in peace-time would fall a good deal short of covering all types of current transactions as defined in XIX(i)'" (ibid., p. 152).

26 The authors of this text proposed also an accompanying redraft of Article VI, Section 3 (ibid., p. 155).

27 Ibid., p. 153.

28 The purpose of this reference was to make Article VIII, Section 2(a) subject, with the other qualifications, to the full list of qualifications in Article VIII, Section 4(b).

guage, that proposed an understanding between the U.S. and U.K. Governments to solve the problem, in accordance with British views, at an appropriate time.

**Keynes v. Robertson: Round Two**

Keynes sent copies of his memorandum of December 29, 1944 and the draft letter to Robertson, who had returned to Cambridge University and was now Professor of Political Economy. Robertson wrote in January 1945 that if he received documents, he would have to comment on them freely. Robertson began by averring that the deletion of the reference to Article VIII, Section 4(b)(v) from Article VIII, Section 2(a) had not been a last-minute slip in drafting, but had been made with Keynes’ assent. The Americans and Canadians would deny that the draft was inadvertent. Moreover, Robertson had explained the relationship between the two provisions, in the sense that Keynes now rejected, in a meeting of Commission I, one of the major bodies of the Conference.

Robertson drew attention to an inconsistency in Keynes’ position. On the one hand, he accepted the conclusion that the centralization of foreign exchange transactions would be a restriction under Article VIII, Section 2(a), which implied a return to free exchange markets. On the other hand, his approval of the redraft by Rowe-Dutton and Cobbold meant that he was forcing all members to centralize foreign exchange transactions if they wanted to have the benefit of Article VIII, Section 4(a) in order to see that their exporters received their own currencies. For example, the United States would have to instruct its exporters to the United Kingdom to invoice their exports in sterling and to France in francs, and so on, and, in addition, would have to instruct the Federal Reserve to stand ready to buy all these currencies from the exporters. Yet it had been affirmed that the Articles would not affect the practices and the procedures of traders and bankers. Robertson did not think that the United States would accept the consequences of the version prepared by Rowe-Dutton and Cobbold.

Robertson wrote a further letter to Keynes on February 12, 1945, in which he put the view that the Bernstein-Robertson version was not only necessary to make the system work but also was particularly beneficial for the United Kingdom. British exports were invoiced in sterling to a wide range of countries, which therefore held sterling balances, while the United Kingdom did not hold balances of their currencies. Article VIII, Section 4(a) would be of little benefit to the United Kingdom as a means of obtaining payments for its exports if that provision was the only convertibility obligation and if Article VIII, Section 2(a) did not impose an obligation to ensure that in some way private traders were paid for their exports. It would be open to “Brazil,” a name chosen as a symbol for all other members, to refuse to make sterling available to its importers, even though it held large amounts of the currency. “Brazil” would be able to represent that British exporters should invoice in cruzeiros and that the Bank of England should buy the cruzeiro balances and present them for conversion under Article VIII, Section 4(a).

Robertson admitted that if Article VIII, Section 2(a) created a separate convertibility obligation, the question remained whether it should be subject to the same qualification as in Article VIII, Section 4(b)(v). This qualification also could be a two-edged weapon. “Brazil” could exhaust its right to use the Fund’s resources and then, even though it had ample sterling reserves, it could impose exchange restrictions as freely as it wished. On the basis of Robertson’s view of Article VIII, Section 2(a), “Brazil” would still be bound by the obligation of that provision, although the United Kingdom would be able to invoke Article VIII, Section 4(b)(v) against “Brazil” if the United Kingdom ran into difficulty. The result was unsymmetrical and apparently unfair, but unfair in favor of the United Kingdom, and defensible because the United Kingdom was a reserve currency country and would be strengthened in that role.

Keynes replied (February 14, 1945) that there was great force in Robertson’s argument. There would be advantage in understanding Article VIII, Section 2(a) as Robertson did, but it was not possible to read the text in that way. Keynes thought that Robertson’s real point was that Article VIII, Section 4(a) was inadequately drafted because “Brazil” should be compelled to release sterling to its importers if it held sterling balances. That revision would be compatible with the philosophy of having all obligations run between members and not between private persons and members. Robertson’s response (February 17, 1945) on this last point was that all obligations should be expressed as running between members or between members and the Fund, but he refrained from pointing out that his interpretation of Article VIII, Section 2(a) was compatible with that objective. He made the further point that if a member was to be compelled to release convertible currencies to its importers, as Keynes suggested, it would be difficult not to treat gold in the same way, because both were included in the definition of “monetary reserves” in the Articles.

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30 For example: “Do you not share my feeling that, in the case of a document prepared so hastily as the Final Act yet so difficult to amend, it would be a bad and dangerous precedent to seek by subtle interpretation to impose any obligation which did not appear, clearly and unambiguously, on the face of the document, or which had not been understood or accepted by those who signed it?” (ibid., p. 158).

31 A “paper on which one can’t comment is like a tick under the skin!” (ibid., p. 159).
Other British Commentators

Keynes sent copies of his draft letter to others. Eady, in a letter of January 24, 1945, expressed his agreement with Keynes on the two provisions, but he doubted the wisdom of an approach to Morgenthau because the response would probably be unhelpful to Keynes' position and would embarrass the Chancellor in his presentation to the House of Commons of the case for the Fund. The response might stress the importance of convertibility and of the maintenance of it once it was undertaken. The obligation should not be lightly suspended by a reserve currency country or by other members. The Fund had flexible authority to grant waivers so as to permit a member to go on using the Fund's resources in support of convertibility. A member should not be able to depart from the obligation of convertibility without consulting the Fund because the member had used the Fund's resources to the full. It could be assumed that in a proper case the Fund would grant approval of departures from the obligation of convertibility. Moreover, a member was not bound to put its reserves in danger before requesting the Fund to approve temporary, partial, or conditional restrictions. The responsibilities of the Fund and the member in such a situation were not essentially different from those that existed when changes in par values were being considered.

Eady thought that such a reply would be plausible and even meritorious if one could be "dead certain" about the management of the Fund. A misgiving about management could scarcely be made public, but he thought that the problem should be put on the record with Morgenthau and cleared up before the Fund came into being. For Eady as well, therefore, the essential problem was a political one.

Eady wrote a second letter the next day in which he discussed the disappearance of the reference in Article VIII, Section 2(a) to Article VIII, Section 4(b)(v), although the mystery seemed insoluble. He was sensitive about the matter because he had been the channel of communication between Keynes and Robertson on the controversial aspect of the drafting.

In the opinion (January 17, 1945) of L.C. Robbins, who had been a member of the U.K. delegation at Bretton Woods, it was desirable that a country should have the right to impose restrictions without requiring the approval of the Fund once it ceased to be able to use the Fund's resources, but it was not essential. The United Kingdom was more likely to impose import restrictions than exchange restrictions if balance of payments difficulties arose, and this safeguard would be sufficient because the Articles did not apply to import restrictions. He was doubtful about the wisdom of putting the problem on public record while the creation of the Fund was in doubt, but he was willing to inform the United States privately that clarification would be necessary after the Fund was in being.

Keynes' reply to Robbins (January 19, 1945) doubted the advisability of defending the Articles by reference to import restrictions, because that argument could give support to the contention, which had been advanced, that the monetary agreement and the contemplated trade agreement should be taken up together.

U.K.-U.S. Correspondence

Keynes revised the original draft of his letter, which, dated February 1, 1945, went forward under the signature of Sir John Anderson, the Chancellor, to Morgenthau. The substantive paragraph was as follows:

The essential point is this. The obligation under VIII 4(a) lapses under VIII 4(b)(v) if the member has exhausted his facilities with the Fund. In such circumstances, therefore, he resumes his discretion how far and for how long he shall continue to exhaust his ultimate gold reserves by maintaining _de facto_ convertibility. I shall be expected to explain whether this is in any way undone by VIII 2(a), with the result that, in the above circumstances, the discretion is given to the Fund, instead of to the member, to decide up to what point the member shall be required to deplete his gold reserves (which represent a country's iron ration for many purposes, including war) before resuming liberty of action. I do not see how I could advise either the Cabinet or Parliament to be content with a lesser safeguard in this respect than that which appears to be given by VIII 4(b). Nor is it likely, if I gave such advice, that it would be accepted. Furthermore, the critics of the Fund, who I am sorry to say are none too friendly, would be given an opportunity to claim that it was a regrettable deception of public opinion to allow what appears to be a clear safeguard in one sub-section to be taken away by what is a far from clear, and indeed dubious, interpretation of another sub-section of the same clause.

The letter was discussed between British and American officials. On June 8, 1945, Morgenthau sent the following reply to the Chancellor:

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32 A member could use the Fund's resources without using its own reserves, but the effect of the repurchase provisions of the original Articles (Article V, Section 7) was that at the end of the Fund's financial year the member would have to put itself into the same position as if it had made an equal use of both the Fund's resources and its own reserves. This obligation was abated, however, to the extent that a member's reserves would be reduced below an amount equal to its quota.


34 Robbins recalled the sentence in paragraph 38 of the Proposals for an International Clearing Union in which it was said that "In any case, it should be laid down that members of the Union would not allow or suffer among themselves any restrictions on the disposal of receipts arising out of current trade or 'invisible income'" (*History, 1945–65*, Vol. 3, p. 33).

My dear Sir John,

This is in reply to your letter of February 1, 1945, inquiring about a possible inconsistency between Section 2(a) and Section 4(b) of Article VIII of the Fund.

I can see no inconsistency whatever in these sections. Article VIII Section 2 is designed to assure people engaged in international business that no member of the Fund will prevent their being paid for the goods they export and for other current obligations. The section states, subject to specified qualifications, that "no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions". With this provision international business can proceed without the restrictions that would result from the imposition of exchange controls on current transactions.

The exceptions to the general principle of Section 2 are enumerated very clearly and in unmistakable terms. If a currency should be declared scarce, a member may impose restrictions in accordance with Article VII, Section 3(b); and any country covered by the transitional arrangements may during the transitional period maintain and adapt to changing circumstances wartime restrictions on payments and transfers for current international transactions. No other exceptions to the general principle of Section 2 are specified because, I believe, no other exceptions were intended.

Section 4 of Article VIII deals with a different problem. Under this section each member (or its central bank) is obligated to buy balances of its currency held by another member (or its central bank) if the balances have been recently acquired as a result of current transactions or the conversion of these balances is needed for making payments for current transactions. There then follow the conditions under which the obligation does not apply, all of the exceptions being specifically listed.

In our view Section 2 and Section 4 have different obligations to meet different problems. Section 2 is concerned to see that an exporter is assured of payment for his exports in his own currency. Under Section 4, the exporter no longer owns the foreign currency, for it has been acquired by his central bank. Under Section 2, the currency represents the accruing proceeds of current trade and is being presently acquired or will be acquired in the near future by a private trader. Under Section 4, the currency balances have already been acquired by a central bank, and they may represent balances resulting from recently completed transactions or even balances long accumulated from past transactions.

The financial obligations contemplated by the two sections are of a different order. By their nature, the sums involved in Section 2 are moderate in amount; the sums involved in Section 4 may be enormous in amount, for they can include the accumulated balances of years. As a practical matter, a country can be asked not to restrict payments and transfers to traders for current transactions. On the other hand, the burden of converting large accumulated balances held by foreign central banks may be too great for a country when it cannot secure the help of the Fund.

These are the reasons why restrictions on current payments may not be imposed without the consent of the Fund except in the two cases specified in Section 2, although the convertibility of balances held by foreign central banks can be restricted when a country no longer has access to the Fund and under the other conditions specified in Section 4.

As you are aware the distinction between these sections of Article VIII do not become significant until the end of the transitional period and may not be of consequence then.

We have explained these points in greater detail some time ago in conversations with Mr. Brand and Mr. Opie.

Sincerely yours,

H. MORGENTHAU JR. 36

The penultimate paragraph was correct in the sense, explained earlier in this paper, that a member did not have to perform the obligation of Article VIII, Section 4 until it had undertaken to perform the obligations of Article VIII, Sections 2, 3, and 4. It was true, therefore, that the distinction between Sections 2(a) and 4 of Article VIII could not become "significant" for a member while it was still availing itself of the transitional arrangements under Article XIV. It has been explained, however, that a member might have to observe the sweeping obligation under Article VIII, Section 2(a) even though it was availing itself of the transitional arrangements. Keynes' main concern was the interpretation of Article VIII, Section 2(a), because he was content with the limited scope of Article VIII, Section 4.

Keynes commented to Eady at once (June 21, 1945) that everything turned on the meaning of Article VIII, Section 2(a), and in particular on the meaning of the words "impose restrictions." But he was content, if the United Kingdom was released from the obligation to convert under Article VIII, Section 4, to rely on import restrictions as a defense against Article VIII, Section 2(a). On this point, it must be noted, however, that payments for current transactions were defined by Article XIX(i) much more extensively than payments due in connection with foreign trade.

Keynes proposed that, if a reply was wanted, the substantive part of it could be drafted along the following lines:

It all depends on the interpretation given to the words "no member shall make restrictions on the making of payments and transfers for current international transactions". Our interpretation is that these words forbid a member to impose legal restrictions which would prevent a holder of its currency from spending it to pay for goods or to buy any foreign currency, provided the price of the foreign currency is within the permitted range and the currency he offers in exchange represents the accruing proceeds of current trade. Section 2 does not mean, in our view (to give a concrete example), that the U.S. monetary authority is under an obligation to buy for dollars any foreign currency arising out of a current transaction which may be offered to it or to provide in return for dollars any foreign currency which a trader may desire to

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36 Ibid., pp. 183-84.
cover a current transaction. In our view the obligation of the U.S. monetary authority to provide foreign currencies arises solely out of Section 4.37

No reply was sent.

Reservations to the Articles have never been accepted. An alternative technique in the early days of the Fund was a member’s request for an authoritative interpretation of the Articles when it considered that the Articles were unclear on a crucial issue. The United States requested an authoritative interpretation on the proper use of the Fund’s resources,38 and the United Kingdom on an aspect of fundamental disequilibrium.39 The United Kingdom did not request an interpretation that would give effect to Keynes’ view of the convertibility provisions. It is probable that a request was not made because the interpretation would have been opposed by the United States.

The Issues Narrowed

Is it possible to distill the differences between the Americans and Robertson on the one side and Keynes and his supporters on the other side? It is submitted that the differences that remained at the end of the internal British debate and the U.K-U.S. debate can be narrowed down to one and possibly two.

1. It seems clear that one remaining difference was whether a member that elected to centralize all foreign exchange transactions was obliged by Article VIII, Section 2(a) to provide foreign currency in return for balances of its own currency earned in recent current international transactions. Keynes held that there was no such obligation, whether or not the member was able to use the Fund’s resources for the purpose of converting its currency for the benefit of other members under Article VIII, Section 4. He might have been willing, on the analogy of Article VIII, Section 4, to accept the obligation by amendment, if a member was able to use the Fund’s resources. Robertson and the Americans held that there was such an obligation if a member centralized all foreign exchange transactions. All parties agreed that there was no obligation on a member to provide foreign exchange if the member permitted exchange markets to which all could have recourse. The absence of such an obligation did not release a member from ensuring that exchange transactions in its territories took place only at exchange rates within margins consistent with the Articles. Keynes thought that it would be sufficient for a member to perform this obligation by declaring exchange transactions outside the margins to be illegal, but Robertson was skeptical about the sufficiency of this measure. If the obligation could not be performed in this way, the member might have to support its currency in its exchange market with reserves.

2. Most of the debate centered on the conversion by nonresidents of the proceeds of recent current international transactions. Little discussion was devoted to

(a) the use of the proceeds of a recent current international transaction by a nonresident to make payments in that currency for other current international transactions instead of transferring the proceeds; or

(b) the ability of a resident to obtain foreign currency in return for his own currency so that he could make payments for current international transactions. All parties probably agreed that a member must not interfere with (a).

On (b), the letter from Morgenthau was silent. Probably, all parties would have agreed that a member had no obligation under Article VIII, Section 2(a) to provide the foreign exchange if the member had not centralized all foreign exchange transactions, but again the member would have to observe its obligation with respect to exchange rates. Robertson held that if a member centralized all foreign exchange transactions, it was obliged to provide its residents with the foreign exchange they needed for making payments for current international transactions. Keynes, it seems, would deny that such an obligation could be spelled out of Article VIII, Section 2(a).

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37 Ibid., p. 185.
38 Selected Decisions of the International Monetary Fund and Selected Documents, Eighth Issue (Washington, 1976), p. 35. (Hereinafter referred to as Selected Decisions, 8th.)
39 Ibid., p. 30.
II  The Practice of the Fund

Freedom for Transfers

It will be seen that the practice of the Fund has been consistent with Robertson's and the U.S. Treasury's position in the controversy and with the analysis that Eady assumed would be forthcoming from the U.S. Treasury and would be, in his opinion, both plausible and meritorious.

The Fund's approach to a systematic consideration of the convertibility provisions of the Articles was a slow one. For some years, the Fund tended to concentrate on the question whether particular practices were restrictions on the making of payments and transfers for current international transactions and on whether the practices were desirable or undesirable. In 1951 the Fund began to discuss "restrictions on the making of payments and transfers for current international transactions" as a concept. This general question had to be faced because the Fund was required, three years after it began financial operations on March 1, 1947, to initiate the practice of annual reports on the restrictions still in force under the transitional arrangements of Article XIV, Section 2. After a further two years, the Fund was required to hold annual consultations with members retaining any restrictions inconsistent with Article VIII, Sections 2, 3, and 4. Moreover, it was necessary for the Fund to distinguish between these restrictions and import restrictions under the jurisdiction of the General Agreement on Tariffs and Trade (GATT), with respect to which the Fund had certain advisory functions. Nevertheless, the general question was not resolved for a number of years, and other questions relating to convertibility were not raised, because of the freedom that members enjoyed under the transitional arrangements and because the staff had explained to the Executive Board the guidelines that it was following in consultations under Article XIV. The Executive Board was able to conclude tacitly that the guidelines were reasonable without having to endorse them formally. The Fund has often been cautious in arriving at decisions on its regulatory jurisdiction.

By the time that it became more urgent to settle outstanding questions of convertibility, the policy of members and the Fund had developed in favor of the liberalization of exchange markets. The assumption that foreign exchange transactions would continue permanently or indefinitely to be centralized by means of exchange control, which assumption Keynes had shared, was no longer entertained, at least by industrial countries and other members in their currency areas.

Two major developments occurred that led the Fund to come to at least some conclusions on the meaning of the convertibility provisions. The first development was the institution, on December 27, 1958, of "external convertibility" by 10 European members. This step was followed shortly afterward by similar action on the part of 5 more European members, and by 15 other members, most of which were associated in a monetary area with one or other of the European members. All these countries permitted current earnings of their currencies by nonresidents to be exchanged for foreign currencies at rates of exchange within the margins around parities as defined by the Articles. Although the new convertibility was given the generic title of "external" or "nonresident convertibility," wide differences existed among the members that were engaging in it. Variations existed, for example, because of differences in the definition of nonresidents and because bilateral payments arrangements with other countries continued in force. Many of the practices that members still followed were deemed to be restrictions under Article VIII, Section 2(a). Moreover, all but one member continued to refrain from conceding similar freedom to residents to make payments to nonresidents. External convertibility, therefore, was not as broad as the convertibility that is undertaken when a member performs the obligations of Article VIII, Sections 2, 3, and 4.

External convertibility was associated closely with a policy of greater freedom for commercial banks to deal in the exchange markets in convertible or externally convertible currencies. The members that permitted this greater freedom had concluded that there should be greater flexibility in the margins within which exchange rates could move, so that members would have wider discretion in the choice of the exchange rates at which they would intervene in the markets. In other words, members, by

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II • THE PRACTICE OF THE FUND

instituting external convertibility, chose to take more of the impact of that development on exchange rates and less on their reserves than would have been the effect of confining all exchange rates to the margins specified in the Articles.

Those margins were 1 per cent on each side of the parity between the two currencies exchanged in a transaction. The margins were prescribed for all exchange transactions involving a member's currency and the currencies of all other members and not for transactions involving a member's currency and its intervention currency only. Many members wished to apply margins of \( \frac{3}{4} \) of 1 per cent for these latter transactions and to allow transactions involving their own and other convertible or externally convertible currencies to be determined by arbitrage through the exchange markets. The effect of such a practice, however, would be that the margins for exchange transactions between the currencies of two members that used the same intervention currency would be the cumulation of the margin of each on the intervention currency. If the exchange rate in the market for each currency against the intervention currency was at the maximum distance of \( \frac{3}{4} \) of 1 per cent from parity, the margin in transactions between the two currencies would be 1½ per cent from parity.

The Fund concluded that two sets of margins of this kind could be considered a multiple currency practice and that it could approve them under Article VIII, Section 3 if approval was justifiable. The Fund also concluded that the extension of arbitrage through well-organized exchange markets would help members to achieve the convertibility of Article VIII. On July 24, 1959, the Fund took the following decision:

The Fund does not object to exchange rates which are within 2 per cent of parity for spot exchange transactions between a member's currency and the currencies of other members taking place within the member's territories, whenever such rates result from the maintenance of margins of no more than 1 per cent from parity for a convertible, including externally convertible, currency.

The decision, which had no time limit and therefore did not confer a merely temporary approval, shows how far the Fund was willing to go in support of the determination of members to institute or enlarge free exchange markets.

The second major development was the undertaking of ten European members to perform the obligations of Article VIII, Sections 2, 3, and 4, with effect from February 15, 1961. This development had been foreseen for some time, and in order to prepare the way for it, the staff submitted two papers to the Executive Board, of which one, dated November 12, 1959, was entitled Legal Aspects of Article VIII and Article XIV and the other, dated February 16, 1960, was entitled Policy and Procedural Aspects of Article VIII and Article XIV.

Neither paper dealt with the issue that gave Keynes such concern, and it was not mentioned by any Executive Director either in the discussion of the two papers by the Executive Board or in the earlier and inconclusive efforts to clarify Article VIII, Section 2(a) that began in 1951. There was tacit acceptance of the proposition that if a member centralized exchange transactions, it must provide the foreign currency that would enable a nonresident to transfer the proceeds of recent current international transactions without undue delay, and that if the member failed to do so, it would be imposing a restriction that required the approval of the Fund under Article VIII, Section 2(a). Centralization itself has never been considered a restriction, so that in this respect the Fund's view has differed from the apparent admission by Keynes that it was a restriction. According to the Fund's view, centralization becomes a restriction only if nonresidents are unable to make timely transfers. In the practice of the Fund, the view has never been advanced that there is no restriction in these circumstances because a member is unable to use the Fund's resources either for the purpose of Article VIII, Section 4 or for any other purpose.

Notwithstanding Keynes' surprise when Robertson explained the effect of centralization under Article VIII, Section 2(a), an explanation was given during the Bretton Woods Conference, as Robertson recalled. The minutes of a meeting of Commission I on July 13, 1944 contain this passage:

A question was raised whether the wording . . . should be interpreted to prohibit exchange control if exchange was always made available for current account transactions. After discussion from the floor, the Chairman ruled that the wording would not exclude exchange controls but would be applicable if there were restrictions contrary to the provisions of the Fund.

An informal and unpublished record of the same meeting contains the verbatim record of the discussion on which the passage quoted above is based:

NEW ZEALAND: If, then, a country in some form or another entirely controlled its foreign exchange and inside its own rules made full provision for every current transaction that is carried out, that could be carried out under normal trade, then at that point that country would not be in any way restricting the availability of exchange for current transactions and would be quite inside of the provisions of this agreement.

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42 Article IV, Section 3.
43 Selected Decisions, 8th, p. 13.

DR. WHITE: That would be my understanding.

NEW ZEALAND: And providing all the exchange for current transactions.

DR. WHITE: That would be my understanding, Mr. Chairman [of the New Zealand delegation]. But is there any one who feels that a different interpretation is in any way warranted by any phraseology in this document? Does anyone disagree with the interpretation of the Chair? (After a pause) If not, then we will accept that as the interpretation.

A further colloquy between a member of the Indian delegation and Robertson, as reported in the same record, is relevant:

MR. SHROFF: I should like an interpretation from the U.K. Delegation as to how this provision will affect foreign trade transactions between member countries who are ordinarily accustomed to carry on their foreign trade in terms of sterling . . .

UNITED KINGDOM: . . . My understanding is that sterling acquired as the result of current transactions would be really convertible either into rupees or into any other currency. That, of course, applies only to sterling which at the time is being currently acquired as the result of current transactions.

The distinction made in these passages is between exchange controls and restrictions. Exchange controls as such do not require approval under Article VIII, Section 2(a), but restrictions are subject to approval. In these passages, the explanation is given that there is no restriction subject to Article VIII, Section 2(a) if a member that controls all exchange transactions invariably provides the foreign exchange that enables nonresidents to transfer the proceeds of recent current international transactions. But there is also no restriction if a member that controls all exchange transactions always permits nonresidents to go into the exchange market in order to transfer these proceeds. This practice is not an abuse if there is a market, although Keynes thought that it would be.

Keynes may have thought that the necessary foreign exchange would not be available in the exchange market even though it was allowed to operate freely for current international transactions. In those circumstances, the member’s situation would be similar to the one in which it centralized exchange transactions but could not provide the necessary foreign exchange. The member would be in balance of payments difficulties and would have to consider a change in its policies and the use of the Fund’s resources. It could also consider the temporary imposition of restrictions with the approval of the Fund. The Fund has not decided that, if a member permits a free exchange market but the market is not adequate to enable nonresidents to make transfers, the member must obtain the Fund’s approval on the ground that the member is imposing a restriction.

Under the original Articles, if that situation were to arise, the likelihood, as Robertson pointed out, was that exchange rates would move outside the margins around parity that were consistent with the Articles. The member would have been unable to perform its exchange rate obligations in the par value system without intervening in its exchange market in order to provide it with the necessary foreign exchange. If the member lacked sufficient reserves for intervention on the scale that was called for by the circumstances, the member would have had to consider a change in policies, including a change in the par value of its currency, use of the Fund’s resources, and temporary restrictions.

The theory on which nonresidents must be permitted to make transfers under Article VIII, Section 2(a) is that this freedom will assist in the establishment of a multilateral system of payments and transfers in respect of current transactions between members and in the elimination of foreign exchange restrictions that hamper the growth of world trade. If an exporter who is resident in country A earns a balance of the currency of member B in a transaction with an importer who is resident in country B, the exporter, by transferring the balance into his own currency, can obtain the currency of member C. He can then pay for an import from a resident in country C. Once he has transferred the proceeds into his own currency, it is the obligation of member B not to deny him the ability to obtain currency C with his own currency.

If the exporter does not make his transfer promptly, member B may conclude that he has made an investment, so that the proceeds have become capital that is then subject to control by member B under Article VI, Section 3. If the exporter keeps some proceeds as working balances for business purposes in member B, they should not be regarded as capital, because they are likely to be turned over constantly in the course of business.

The example involving members A, B, and C refers to the exporter’s ability to transfer proceeds into his own currency. The 1959 memorandum concludes that this ability must be the minimum meaning that is to be attributed to Article VIII, Section 2(a) but the memorandum also raised the question whether the provision could have a broader meaning. The language of Article VIII, Section 2(a) does not confine transfers to exchanges in which the exporter obtains his own currency. The unqualified language, it has been seen, bothered Keynes. If it was necessary for the exporter to get any currency that he wanted, the burden on the monetary authorities of the importer, member B in the example, would be unreasonable if they were centralizing all exchange transactions. They would not be holding the currencies of many members in their reserves. The answer, however, would have to be that their obligation to permit transfers could be deemed to be satisfied if they provided a convertible currency with which the exporter could obtain the currency that he wanted. Indeed, it is likely that this practice
would be deemed to be compliance with Article VIII, Section 2(a) even if the mandatory transfers under that provision were understood to be transfers into the exporter's own currency.

The memorandum pointed out, however, that there was something of an anomaly in holding that resident importers must be able to get any currency they needed for making payments while limiting exporters to transfers into their own currency. If the importer in country B could pay the exporter in country A in the currency of member C, but paid instead in currency B, why should the exporter be unable to obtain currency C with currency B? The memorandum leaned in favor of holding that the currencies of payment and of transfer were coextensive. It cited the passage quoted above from the informal record of the Bretton Woods Conference in which Robertson informed Shroff that India would be able to get "rupees or any other currency" for the proceeds of recent current international transactions.

The force of this remark is dubious, however, because it has been seen that Robertson, in the debate with Keynes, understood transfers to mean transfers into the exporter's own currency. This meaning seems to have been intended by the United States and the United Kingdom when they submitted the following joint draft to the Bretton Woods Conference:

No member shall impose restrictions on the transfer into the currency of another member of the proceeds of current transactions with that member, . . . unless authorized under this Agreement, or approved by the Fund. 45

The language of Article VIII, Section 4(a) refers to conversion of balances of a member's currency held by the monetary authorities of another member into the holder's currency. This language is not relevant to the determination of the currency of transfers under Article VIII, Section 2(a). The reason is that Article VIII, Section 4 is designed to ensure that the conversion can be carried out with the use of the Fund's resources. The technique consists of what is in effect an assignment of drawing rights from the issuing member to the holding member. This assignment can be made only if the issuing member purchases the holding member's currency from the Fund. A member could make purchases from the Fund if they did not increase the Fund's holdings of its currency above 200 per cent of its quota, although the Fund could waive that limit. If a member increased the Fund's holdings of its currency by the purchase of another member's currency, the Fund's holdings of that other member's currency were reduced by an equivalent amount. This technique had nothing to do with Article VIII, Section 2(a), in which no reference is made to the use of the Fund's resources. It must be noted, however, that although the holding member receives its own currency under Article VIII, Section 4(a), the increase in its drawing rights opens up the possibility of purchasing a range of currencies from the Fund when it has a need to use the Fund's resources.

The Fund has never decided the question of the currency or currencies of transfer under Article VIII, Section 2(a), because the question has never been posed as a practical problem.

**Freedom for Payments**

Keynes concentrated on the freedom that should be available for transfers by nonresidents of the proceeds of recent current international transactions. At one time during the debate, he ran payments and transfers together as if they were a single category. They are, however, distinct categories, and Article VIII, Section 2(a) was designed to ensure freedom for both. If a nonresident payee receives the proceeds of a recent current international transaction in the payor's currency, and the nonresident wishes not to transfer the proceeds but to use them to pay for another such transaction, the member issuing the currency is bound not to restrict the payment. The language of the provision is broad enough to apply if the second transaction is with a resident of the issuing member country or with a resident of any other member country.

In dealing with freedom for payments, Article VIII, Section 2(a) is more important in its application to a member's residents. A member is bound by the provision not to restrict its residents in the use of their own currency to make payments for current international transactions or in their acquisition of another currency to make payments of this kind. If a member centralizes exchange transactions, the analysis that applies to transfers applies to payments also. That is to say, the member is required to provide the necessary foreign exchange or else be subject to the finding that it is imposing a restriction. A major difference between external convertibility and the convertibility obligations under Article VIII, Sections 2, 3, and 4 is the requirement that residents must not be restricted when they wish to make payments for current international transactions.

Article VIII, Section 2(a) prohibits restrictions on the "making" of payments and transfers. The 1959 memorandum concluded that the prohibition implicit in the word "making" is laid on the member whose residents are making payments for current international transactions and not on the member whose residents are receiving the payments. The memorandum drew the further conclusion

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that Article VIII, Section 2(a) does not prevent a member from prescribing the currencies that its residents must receive in current international transactions. This conclusion was compatible with the intention that the original Articles would not interfere with the normal practice of conducting international transactions in no more than a limited number of currencies.  

The theory on which prescribing the currencies of receipt is not considered a restriction under Article VIII, Section 2(a) is that this practice, when combined with the obligation of members whose residents are making the payments, will not have an inhibiting effect. The reason is that a member whose residents are making the payments must not interfere with the ability of its residents to obtain the currency prescribed by the member whose residents are receiving the payments.

The 1959 memorandum noted a qualification of the power to prescribe the currencies of receipt. If that power were exercised in a manner that was not evenhanded in relation to other members, the practice might constitute a discriminatory currency arrangement. Members must forbear from resorting to these arrangements unless they obtain the approval of the Fund. Approval has not been readily forthcoming since the days of the movement to external convertibility.

The prescription of the currency of receipt became relevant in the later stages of the debate between Keynes and Robertson. If Article VIII, Section 4(b)(v) qualified Article VIII, Section 2(a), “Brazil” would be able to refuse sterling to its importers for making payments to British exporters on the ground that “Brazil” was not entitled to use the Fund’s resources. “Brazil” would be able to prescribe that its importers must make payments in cruzeiros, and it would then be able to shelter behind Article VIII, Section 4(b)(v) if the Bank of England presented the cruzeiros for conversion. In such circumstances, the United Kingdom would not be imposing a restriction under Article VIII, Section 2(a) if it responded to “Brazil” by prescribing sterling as the currency of receipt by its exporters, but “Brazil” would be imposing a restriction, according to Robertson’s view, if it then refused to provide sterling to its importers. Robertson did not quite make this argument toward the end of the debate. He could also have relied on this argument in response to Keynes’ assertion that Article VIII, Section 2(a) was inadequately drafted because “Brazil” should be required to provide its importers with sterling if it held sterling balances. The debate became confused with the fallacy that Robertson’s position involved obligations between monetary authorities and private persons.

### Restrictions

#### General

The main problem in the debate between Keynes and Robertson has never been mentioned in the practice of the Fund, but the debate did involve some consideration of the question whether the centralization of exchange transactions could be a restriction under Article VIII, Section 2(a). The meaning of the word “restriction” in its broadest significance, as distinguished from the varieties of practice that might be considered restrictions, was a major preoccupation of the Executive Board in its discussion in 1960 of the two staff memoranda. This subject had been the main topic of the inconclusive discussion of Article VIII, Section 2(a) during the preceding decade. One reason why the earlier discussions had not led to a conclusion was the view of some members that all restrictions imposed for balance of payments reasons were covered by Article VIII, Section 2(a), while other members rejected this view because it would encompass trade restrictions that fell within the jurisdiction of the GATT. These members relied on the argument of legal neatness, but their opposition was reinforced by some legal differences between the Fund and the GATT. Weighted voting power does not prevail in the GATT while it does in the Fund, and advance approval of the Fund is required for the imposition of restrictions under Article VIII, Section 2(a) in contrast to the procedures of the GATT on trade restrictions.

The 1959 memorandum examined three main approaches to the meaning of the word “restriction.” One approach had been based on effect. Any governmental interference or impediment that had the effect of reducing the freedom of persons to make payments or transfers for current international transactions was a restriction. A second approach had been based on purpose. A governmental measure was a restriction if the government imposed it for the protection of its balance of payments. The memorandum rejected both approaches, because they would have embraced restrictions on trade. It has been seen how important it was for Keynes to clarify that the Fund did not have jurisdiction to approve restrictions on trade. There was abundant evidence before, during, and after the Bretton Woods Conference that separate international monetary and trade organizations were contemplated with jurisdiction that to the maximum extent would not be overlapping, although it would be a function of each organization to see that its members’ practices within its field did not frustrate the objectives of the other organization. Furthermore, the second approach would often require the investigation of subjective motivations. The Fund might be unable to ascertain them, but even if it could they might turn out to be mixed. Finally, the Fund had already decided that Article VIII, Section 2(a) applied to exchange restrictions whatever might be the motive

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46 Ibid., p. 461.
47 Selected Decisions, 8th, p. 138.
with which they were imposed. In particular, the provision applied to restrictions even if the motivation of the government imposing them was the preservation of national or international security.

The rejection of these approaches narrowed the choice to the third approach, which was the form in which, or the technique by which, governmental authorities interfere with payments and transfers for current international transactions. A restriction can be either a formal governmental measure or an informal governmental procedure. A formal measure is one that is formulated as an interference applied directly to the financial aspect of current international transactions, whether by prohibiting, limiting, or unduly delaying financial performance. An informal procedure is not the result of a formal measure of this kind but the procedure is administered as if there were such a measure. In either case, there is no restriction unless there is actual interference. Therefore, a law or regulation under which interference is possible is not a restriction unless interference occurs in the administration of the law or regulation. If, for example, a license is required for all payments and transfers but is always granted without undue delay, there is no restriction. Interference can take the form of prohibiting, limiting, or unduly delaying entry into financial commitments for current international transactions or the discharge of financial commitments once they have been entered into.

The 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.

There were three reasons why the formulation was expressed as a "guiding principle." First, a compromise was necessary with those members that had favored one or the other of the rejected approaches. These members no longer resisted the third approach, but they wanted to avoid a firm interpretation that would preclude the possibility of future reconsideration of the solution if it proved to be unworkable or otherwise undesirable. Second, the formulation included usages, such as "direct" or "as such," that could provoke controversy because of their imprecision. Third, a formulation was desirable that made room for as much freedom as possible in evaluating the facts when there was doubt about the classification of a measure.

The guiding principle is that the technical character of a measure of interference determines whether it is a restriction on payments and transfers or on trade or other transactions. Often, the determination is made by isolating the discretion that governmental authorities are exercising. If, for example, their discretion is to grant or withhold licenses to import, with foreign exchange made available if a license is granted, the restriction will be held to be on importation. If the discretion is to grant or withhold licenses to use or obtain foreign exchange, with permission to import following automatically on the grant of an exchange license, the restriction will be deemed to be on payments and transfers and subject to Article VIII, Section 2(a). The circumstances may show, however, that a restrictive measure imposes a concurrent restriction on both trade (or other transactions) and payments and transfers. The problem of classification may arise, however, in circumstances far more intricate than those posited here and may call, therefore, for a more sophisticated inquiry. Even when a measure is clearly applied to payments and transfers, the inquiry to determine whether it is restrictive in effect as well as in form may be an intricate one.

The main problems in the operation of Article VIII, Section 2(a) since the Executive Board's discussions in 1960 have been, as in the period before the discussions, whether particular measures were restrictions that fell within the scope of the guiding principle. The spread of convertibility under Article VIII, Sections 2, 3, and 4 and the elimination of restrictions even by members that are still availing themselves of Article XIV, so that they too are largely or even wholly subject to Article VIII, Section 2(a), is one explanation of this phenomenon. The other problems discussed in the 1959 memorandum have rarely arisen or have not arisen at all because international trade and payments are conducted now in convertible currencies, so that it has become unnecessary in most instances to apply policies based on distinctions among the currencies involved in trade and payments. This explanation does not imply that there has been a constantly diminishing interference with international economic activity. On the contrary, an increase in protectionism has been a cause for concern, but the protectionism has taken the form, for the most part, of interference with trade rather than interference with payments and transfers.

The "guiding principle" remains in operation and has not been the subject of any attempt to reformulate it more precisely on the basis of experience. The volume of experience on which the Fund can draw in applying Article VIII, Section 2(a) has not been reduced by any change in the provisions of the Articles comparable to the change that has occurred in connection with multiple currency practices under Article VIII, Section 3. The abrogation of the former par value provisions by the Second Amend-

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48 Ibid., pp. 133–34.

ment has had a profound effect on the concept of multiple currency practices. The distinction drawn here between restrictions on payments and transfers for current international transactions and multiple currency practices must not obscure the fact that a practice may be both a multiple currency practice and a restriction of this kind.

Three caveats must be observed in connection with the concept of restrictions under Article VIII, Section 2(a). First, the Fund performs certain advisory functions for the GATT in connection with restrictive trade measures. Second, "the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions" may be of concern to the Fund under its surveillance of the exchange rate policies of members. A third caveat, connected with the use of the Fund's resources, will be mentioned later.

Capital and current transactions

Article VIII, Section 2(a) requires members to avoid restrictions on payments and transfers for current international transactions, but Article VI, Section 3 authorizes members to impose controls on capital transfers. The latter provision, which has not been modified by the Second Amendment, except in punctuation, is as follows:

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, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2.

The 1959 memorandum examined the question whether the words following "but" meant that if controls were applied to balances as capital, the holders were to be able nevertheless to use the balances to make payments for current international transactions. The memorandum held that this was not the correct understanding of the provision, and that a contrary view would make the effective control of capital movements impossible. The provision meant that if capital controls are imposed on certain balances, the controls must be administered in such a way that other balances are not restricted for use in current transactions and that transfers of the proceeds of recent current transactions are not subjected to undue delay.

The language referring to the undue delay of transfers in settlement of commitments gave some discomfort. If this language is intended to proscribe undue delay in permitting transfers of the proceeds of recent current transactions, that practice is proscribed by the earlier reference in the provision to restrictions. If the word "transfers" means what it means in Article VIII, Section 2(a), it is not felicitous to describe them as made in "settlement of commitments," because commitments are settled by payments before transfers can occur. Nevertheless, the conclusion that the purpose of the words is to prevent undue delay in permitting transfers of the proceeds of recent current international transactions is supported by a draft advanced at Atlantic City of the provision that became Article VI, Section 3:

No member country may control international capital movements in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments arising from such transactions, except as provided in Article VI, Section 2 and Article X, Section 1.

It is not clear why the words "arising from such transactions" were deleted, but perhaps it was thought that "transfers" made them unnecessary in a context that refers to payments for current transactions. These obscurities of Article VI, Section 3 have not been the subject of debate since the memorandum was written. The definition of payments for current transactions has been substantially the same under all three versions of the Articles. It now reads as follows:

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;

51 It is not possible to conclude that "transfers" is a term of art under the Articles as a whole and refers only to the proceeds of recent current international transactions. The word is used in Article VI for movements of capital also.

52 Another explanation of the language is possible but it is subject to the objection that the language would have to be regarded as a vestige of the time before Article XIX(i) of the original Articles (Article XXX(d) of the present Articles) was drafted. Some of the payments listed in the provision as payments for current transactions would be regarded by economists as capital transfers. Some of these payments were included, therefore, in earlier drafts of Article VI, Section 3 and Article VIII, Section 2(a). Early drafts at Atlantic City read as follows:

"Subject to VI and X, 2, below, a member country may not use its control of capital movements to restrict payments arising out of current transactions in goods and services or to delay unduly transfers of earnings, interest and amortization."

"Not to impose restrictions on payments arising out of current transactions in goods and services or to delay unduly transfers of earnings, interest, and amortization, except as provided in X, 2, or to engage in any discriminatory currency arrangements or multiple currency practices without the approval of the Fund."

The first of these two drafts was replaced by the one quoted in the text, in which the references to particular types of transfers were deleted, probably because a definition of payments for current transactions had been drafted by then.
(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.53

The 1959 memorandum discussed the question whether the clause “which are not for the purpose of transferring capital” applies even to the four listed classes of payments or whether payments falling into any one of these classes are deemed unassailably to be payments for current transactions. On this latter view, the clause would be the general criterion according to which further classes could be established under the “without limitation” clause. The other interpretation would permit investigation of the motives of a resident engaging in what would be prima facie a current transaction to see whether he was really seeking to establish a capital position abroad. The memorandum leaned in favor of this interpretation, but it may be an unrealistic one in practice.

This issue of interpretation has not arisen in the Fund’s activities. There have been a number of problems, however, of the meaning of some of the other parts of the definition of payments for current transactions or of the application of the definition to certain circumstances.

Arrears

It has been seen that undue delay by a member in permitting payments or transfers for current international transactions may be a restriction under Article VIII, Section 2(a). Payments arrears have been the subject of the only general decision on the effect of Article VIII, Section 2(a) since the decision of June 1, 1960. The decision on payments arrears adopted on October 26, 1970 is reproduced in Appendix B.

The decision clarifies the fact that undue delay in the availability or use of exchange for current international transactions resulting from governmental action may be a restriction not only when it is formalized, for example, by the establishment of waiting periods for exchange, but also when the practice is informal or followed on some but not all occasions. This attitude is typical of the pragmatic view that the Fund takes when examining particular measures or practices in order to decide whether they are restrictive.

According to the decision, the practical test for deciding whether there is a restriction when payments arrears exist is whether there has been a substantial delay beyond the time usually required for ascertaining the bona fides of applications for exchange or the time that can be regarded as normal for the administrative processing of applications. The Fund does not apply rigid rules in following this approach. The circumstances, including the institutional arrangements, of a member are taken into account.

The decision of October 26, 1970 illustrates a feature of the Fund’s activities that goes beyond the scope of this paper but that has to be noted in connection with it. This feature is the third caveat mentioned earlier. The Fund’s policies on the use of its resources are designed to support the establishment of a multilateral system of payments in respect of current transactions between members and the elimination of foreign exchange restrictions that hamper the growth of world trade. The policies are not confined to the promotion of this one purpose but extend to the promotion of all the purposes of the Fund. Stand-by and extended arrangements, therefore, may have as one of their objectives the elimination of payments arrears even if the arrears relate to capital transactions and do not constitute restrictions under Article VIII, Section 2(a). Similarly, the arrangements may be directed toward the elimination or avoidance of restrictions on trade or on other current account transactions even though the restrictions are not subject to the approval of the Fund under Article VIII, Section 2(a).54

The Fund remains concerned about the damaging effects of arrears, and continues to help members to eliminate and avoid arrears. The 1970 decision remains in force but it has been augmented by the lessons of much experience. The Fund’s activities in connection with the rescheduling of debt are part of this experience.55

Relation Between Official and Market Convertibility

The 1959 memorandum examined the relation between Article VIII, Section 2(a) and Article VIII, Section 4, but approached this inquiry from the direction opposite to the one taken by Keynes. The problem was not to determine whether Article VIII, Section 4 qualified Article VIII, Section 2(a), or, in other words, whether the obligation of market convertibility had to be performed only when the obligation of official convertibility was effective. Instead, the problem considered in the memorandum was whether the Fund could approve limitations on official convertibility under Article VIII, Section 4 that were unrelated to restrictions on market convertibility approved by the Fund under Article VIII, Section 2(a).

It was clear that if the convertibility of balances of a member’s currency had been restricted with the approval

53 Article XIX(i) of original Articles; Article XXX(d) of present Articles.
of the Fund under Article VIII, Section 2(a), or if movement of the balances had been restricted as capital under Article VI, Section 3, the member had no obligation to convert the balances under Article VIII, Section 4. The obligation of official convertibility was a supplement to the obligation of market convertibility because there might be no exchange market, or an inadequate exchange market, for the exchange of currencies accumulated by a member under its requirement of the surrender of some or all exchange. If, however, the market convertibility of balances of a member's currency was limited by restrictions approved under Article VIII, Section 2(a), the official holders who accumulated these balances under their exchange surrender requirements should not be able to get them converted by the member issuing the currency. The same rationale applied to balances restricted as capital under Article VI, Section 3. Members that obtained these balances should not be able to get them converted by representing under Article VIII, Section 4(a)(ii) that conversion was needed for making payments for current transactions. If members could get the official conversion of these two classes of balances, they would be able to undermine the protection that had been the objective of the restrictions imposed by the issuer of the currency with the approval of the Fund or under the authority of the Articles.

The supplementary character of the obligation of official convertibility helped in resolving the problem whether the Fund could approve a limitation of the obligation to convert balances that were not restricted under Article VI, Section 3 or Article VIII, Section 2(a). The memorandum concluded that if a member was entitled to use the Fund's resources, it was required to convert unrestricted balances in accordance with Article VIII, Section 4. No power of the Fund to authorize limitation of the obligation of official convertibility was mentioned in Article VIII, Section 4. One reason for the absence of this power was that the obligation had to be performed only if the obligor was entitled to use the Fund's resources. This analysis avoided the anomaly that a member entitled to use the Fund's resources could request approval of not using the resources.

The Fund was never called upon to answer the question definitively. Nor was it required to answer many other questions that arose on the text of Article VIII, Section 4. An important one, for example, was the meaning of the word "entitled" in Article VIII, Section 4(b)(v). Under that part of the provision, a member was not required to perform the obligation of official convertibility when "for any reason" it was "not entitled to buy currencies of other members from the Fund for its own currency." Under Article V, Section 3(a) of the original Articles, a member was "entitled" to buy the currency of another member from the Fund in exchange for its own currency subject to four conditions. One of the conditions was that the proposed purchase would not increase the Fund's holdings of the member's currency by more than 25 per cent of quota during the period of 12 months ending on the date of the purchase and would not increase the Fund's total holdings above 200 per cent of quota. The Fund had authority, however, to waive either or both of these limits.

The question, therefore, was whether a member was bound to perform the obligation of official convertibility if its use of the Fund's resources would increase the Fund's holdings of its currency beyond the limits in the condition under Article V, Section 3(a), because the member had obtained a waiver or might obtain a waiver if it applied for one. Keynes attached overwhelming importance to Article VIII, Section 4(b)(v), but in his references to it there was no discussion of this problem. There is evidence, however, that Article VIII, Section 4(b)(v) is carefully drafted to reflect the intention that a waiver, or at least the possibility of a waiver, does not expand the obligation beyond the limits.

The 1959 memorandum reached this conclusion. It did not receive total support in the 1960 discussions in the Executive Board because some members accumulating U.S. dollars in their reserves favored an extensive interpretation of the obligation, and because waivers had become commonplace in the Fund's approval of stand-by arrangements. At Bretton Woods, however, it had been assumed that waivers would not be routine. Stand-by arrangements, of course, were not foreseen by the Conference.

The Second Amendment retains the word "entitled" in the provision corresponding to the former Article V, Section 3(a). The limit of 25 per cent of quota has been deleted, but a provision on waivers has been retained.

The detailed discussion of official convertibility under Article VIII, Section 4 was necessary in 1959 in order to encourage a widespread willingness to undertake the obligations of convertibility. Members wanted to know with some precision what they were undertaking. Within the Fund there was no conviction that Article VIII, Section 4 would be part of the foundation on which future convertibility would rest. The 1959 memorandum noted that in the circumstances that had developed already, in which the markets were the main machinery for the growing multilateral system, Article VIII, Section 4 was likely to have less practical importance than had been assumed originally. Another forecast then ventured was that the right to control capital transfers, which the Articles assured to members, was likely to be relied on much less vigorously than had been supposed. It seemed that the

56 Gold tranche purchases were additional to this amount (Article V, Section 3(a)(iv)).
57 The word "entitled" appeared also in Article VI, Section 2.
58 Article V, Section 4.
59 Article V, Section 3(b). See also Article V, Section 3(d) and Article VI, Section 2 of the Second Amendment.
60 Article V, Section 3(b)(iii).
61 Article V, Section 4.
body of legal provisions was not wholly compatible with the spirit of the times.

Official Convertibility and the Fund’s Resources

Additional repurchase obligation

A study of official convertibility under the Articles, including its present manifestation, is incomplete without some account of a peculiar provision of the original Articles. The provision was Article V, Section 7(b)(ii), which was often referred to as creating an additional repurchase obligation. The origin of the provision was the determination, made clear at Bretton Woods, that the Articles were not intended to interfere with customary practices on the currencies in which current international transactions are conducted. It will be recalled, moreover, that the prescription of the currency of receipt is not a restriction and is not subject to the need for approval by the Fund under Article VIII, Section 2(a).

As a result, some of the experts at Bretton Woods foresaw that some currencies would be of negligible or no usefulness to the Fund. For example, the trade of Patria with Terra might be invoiced in sterling. If Terra was in payments difficulties, it might wish to purchase sterling from the Fund but not Patria’s currency. The burden of this financing would fall on the United Kingdom’s currency subscription to the Fund, while Patria’s currency subscription would remain dormant. Moreover, if Patria accumulated sterling balances in its reserves, it would probably retain them and not present them to the United Kingdom for conversion under Article VIII, Section 4. The United Kingdom would not be called upon for official convertibility and would not have an opportunity to purchase Patria’s currency from the Fund with which to convert Patria’s holdings of sterling. Patria’s obligation of official convertibility under Article VIII, Section 4 would not be a corrective that would activate Patria’s currency subscription.

The solution was a repurchase obligation for Patria, in addition to the basic repurchase obligations of all members, to repurchase its currency from the Fund to the extent that its reserves had increased because of its receipt of sterling in trade with Terra. The provision was impaired, however, by two flaws. The first was that Patria’s obligation was to repurchase the Fund’s holdings of its currency only to the extent that they exceeded 75 per cent of quota. This percentage represented the normal currency subscription, below which repurchase could not be carried under the Articles. The Fund would be likely to hold Patria’s currency above this percentage only if Patria had made a net use of the Fund’s resources, but if Patria was accumulating sterling in its reserves it was probably in surplus and had no need—and indeed no entitlement—to use the Fund’s resources. On this hypothesis, the additional repurchase obligation was ineffective. Robertson drew this failure to the attention of Keynes, feared that there was no constitutional way of rewriting the provision, but hoped that a remedy could be found by the Executive Board at its first meeting.

This hope, even if entertained and prolonged beyond the first meeting, was frustrated by the second flaw. The Fund was unable to arrive at a practicable code of conventions for applying the provision even when the Fund held a member’s currency in excess of 75 per cent of quota. Article V, Section 7(b)(ii) remained dormant and joined Article VIII, Section 4 in its resting place. This fate was not unreasonable in view of the fact that an objective of the former provision was to cure a deficiency in the latter. During the discussion of the First Amendment, a proposal was made to delete Article V, Section 7(b)(ii) from the Articles, but the proposal was resisted, successfully, by a few members. They feared that some members would receive an undeserved benefit if the provision was abrogated. They thought also that abrogation would be considered an endorsement of the special status of reserve currencies because abrogation might suggest that the official holders of reserve currencies would never be interested in getting the conversion of their holdings. It will be seen that a similar attitude is responsible for the survival, on paper, of Article VIII, Section 4 under the Second Amendment.

Diversified use of currencies

Starting in 1958, the Fund followed a policy of encouraging the use of an increasing number of currencies in its transactions. This policy was facilitated first by the spread of external convertibility and then by the acceptance of convertibility under Article VIII, Sections 2, 3, and 4. In due course, the policy was formulated in a decision of July 20, 1962. Members purchasing some currencies under the policy wished to exchange them for the currencies they held in their reserves. Some of the currencies purchased from the Fund could be exchanged in the market for the currencies that were wanted without disturbing the market. For other currencies that were purchased, cooperative practices were worked out between the central banks of the purchasing and the issuing

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62 Procs. and Docs., pp. 461-63.
63 Keynes, Collected Writings, Vol. 26, p. 125.
64 Selected Decisions, 8th, pp. 56-62.
members. On no occasion was a conversion carried out under Article VIII, Section 4.

The limelight was focused on that provision, however, in efforts to increase even further the number of currencies that the Fund would be able to sell. To make these sales possible, the conversion of the currencies into the reserve currencies of the purchasing members was necessary. Some members that were in a sufficiently strong balance of payments and reserve position to justify sales of their currencies by the Fund were reluctant nevertheless to enter into collaborative arrangements for converting any balances of their currencies that might be sold by the Fund. Under the original Articles, remuneration was not paid on a "creditor" position in the Fund. Therefore, a member received no compensation for the interest that it would cease to earn on the currency it provided in exchange for balances of its own currency purchased from the Fund. Even after remuneration became payable under the First Amendment, it might be payable at a rate less than the rate of interest forgone. These were reasons why some members were unwilling to facilitate sales of their currencies by the Fund.

However reluctant a member might be to see its currency sold by the Fund, the member could not veto a sale. Was the member obliged to convert under Article VIII, Section 4 balances of its currency in the hands of the purchasing member? There was doubt that conversion could be required under the provision, but it was pointless to reach a conclusion on the question because conversion under the provision by a member unwilling to see its currency sold could have the effect of nullifying a transaction with the Fund. If the Fund sold Patria's currency to Terra, and Patria was obliged to convert the balance because of Article VIII, Section 4, Patria could purchase an equivalent amount of Terra's currency from the Fund. Patria then would recapture the balance sold by the Fund in the first transaction. Moreover, the effect of the two transactions would be to restore both members to their status quo in relation to the amount of use they could make of the Fund's resources. The situation was unsatisfactory and resented by many members that collaborated in making their currencies useful in the Fund's activities, but the problem was not solved until the Second Amendment.
Compromise on Official Convertibility

Before the Second Amendment, the definition of a convertible currency under the Articles was, in effect, the currency of a member that had informed the Fund of its willingness to perform the obligations set forth in Article VIII, Sections 2, 3, and 4. The definition was an artificial one, which means that it had peculiar characteristics even after allowance is made for the fact that it was intended only for certain purposes of the Fund. Convertibility as a concept can be said to consist of three elements: use, exchangeability, and exchange value. Under the Articles, once a member gave notice that it was willing to perform the obligations of Article VIII, Sections 2, 3, and 4, there was no retreat to the transitional arrangements of Article XIV, and this is still the legal position. One consequence before the Second Amendment was that a member’s currency remained convertible for the purposes of the Articles even though the Fund approved restrictions by the member on the making of payments and transfers for current international transactions. In short, the use and exchangeability of a convertible currency could be limited but the label of convertibility was not detached.

It must not be thought that because a currency remained convertible, balances of it purchased from the Fund could be used or exchanged notwithstanding these restrictions. On the contrary, balances to which the restrictions applied were not freed from them because the balances were sold by the Fund. Continuing convertibility meant in such circumstances that the Fund would go on accepting the currency in repurchase and would go on treating it as convertible in computations for the purpose of applying certain provisions of the Articles.

As for assured value, a member’s currency would not lose its legal character as convertible for the purposes of the Articles even if the Fund approved multiple currency practices under Article VIII, Section 3 or even if the member allowed its currency to float in violation of the member’s obligations under the par value provisions. Nevertheless, one view of Article VIII, Section 4 was that it was a prop of the par value structure. According to this view, the provision was intended to give members the assurance that if they obtained balances of the currencies of other members as the result of intervention, the official conversion of those balances could be obtained under Article VIII, Section 4. On this hypothesis, Article VIII, Section 4 should have been deleted from the Second Amendment.

The United States was willing to see the Articles modified in this way. In support of this position, it pointed out that no transaction had ever been carried out by reference to the provision. The system that had developed was one in which the currencies that had important roles in international trade and payments were U.S. dollars or convertible into U.S. dollars through the markets, while dollars accumulated by members could be converted into gold because of the free purchase and sale of gold that the United States engaged in with the monetary authorities of other members in accordance with Article IV, Section 4(b). Market convertibility under Article VIII, Section 2(a) and not the official convertibility of Article VIII, Section 4 had been a mainstay of the real system. Under this system, if members accumulated U.S. dollars or other reserve currencies, it was not because they centralized exchange transactions but because they intervened in the markets in support of par values. If members lost reserves, it was again the result of intervention and not official convertibility under Article VIII, Section 4. Intervention in the markets was made necessary by the exchange rate obligations in conditions of market convertibility under Article VIII, Section 2(a), as Robertson had foreseen.

The U.S. position was influenced less by the systematic relationship of Article VIII, Section 4 to the par value system than by its determination to avoid any impression that it might be willing in future to resume an obligation of official convertibility in any form. The United States had shaken itself free from all forms of official convertibility.

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Compromise on Official Convertibility

by the President’s announcement of August 15, 1971, and it had no intention of encouraging the belief that it might engage in the same or similar practices in the future.

The abrogation of Article VIII, Section 4 was resisted by some members. They hoped for the evolution of an international monetary system with more satisfactory exchange arrangements and with symmetrical rights and obligations for all members. They did not expect that Article VIII, Section 4, with its limitations and obscurities, would be the instrument for achieving symmetry, but they hoped for some form of settlement with the use of reserves by reserve currency countries, and in particular the United States, if balances of these currencies were accumulated by other members. These ideas had been discussed exhaustively in the then recent past by the ad hoc Committee of the Board of Governors on Reform of the International Monetary System and Related Issues (the Committee of Twenty). The members that hoped for an evolution along these lines faced a dilemma: they could not sensibly insist on the retention of the provision (Article IV, Section 4(b)) under which the United States had undertaken the practice of the free purchase and sale of gold, and there was no prospect of reaching agreement on a provision that required “asset settlement” by reserve currency countries. Facing this dilemma, members entrenched themselves behind Article VIII, Section 4 and refused to see it abrogated in the absence of some substitute provision, because bare abrogation might suggest that they were reconciled to no evolution of the international monetary system or to an evolution not in accord with their preferences.

Attempts were made to find a compromise. One suggestion was that Article VIII, Section 4 might be replaced by a provision under which the Fund would have the power to approve, at some appropriate date, arrangements for the treatment of balances. Another suggestion was that Article VIII, Section 4 might be made dependent on the restoration of a par value system under Article IV, Section 4 and Schedule C of the Second Amendment or on a decision to make Article VIII, Section 4 effective in circumstances not defined in advance. Another proposal was that members would be deemed to be performing the obligations of Article VIII, Sections 2, 3, and 4 if they were issuers of a “freely usable currency” as defined by the Second Amendment or a currency that could be converted into a freely usable currency, and if, in addition, they imposed no restrictions, whether approved or unapproved by the Fund, on the making of payments and transfers for current international transactions.  

None of these or other proposed compromises was acceptable. In the end, the solution was the retention of Article VIII, Section 4, with the revision of the second sentence of Section 4(a) so that it now reads as follows:

The buying member shall have the option to pay either in special drawing rights, subject to Article XIX, Section 4, or in the currency of the member making the request.

The retention of Article VIII, Section 4, with this one amendment, was explained in the Report of the Executive Directors to the Board of Governors on the Proposed Second Amendment in the following passage, which was drawn largely from Pamphlet No. 14 (The Fund’s Concepts of Convertibility):

Convertibility Under Article VIII

14. Article VIII, Section 2(a) constitutes what has become the basic convertibility provision of the Articles of Agreement. The mechanism of convertibility under this provision is available to all parties, whether private or governmental, and under it holders of currency balances recently acquired as a result of current transactions must be allowed to transfer those balances through the exchange markets.

15. The basic convertibility mechanism of Article VIII, Section 2(a) was supplemented, in the original Articles, by another form of convertibility under Article VIII, Section 4 to which the monetary authorities of members, and only those authorities, could have recourse. This supplemental mechanism for monetary authorities was provided for by the drafters of the original Articles on the basis of certain assumptions about the character and operation of the monetary system after 1944, which has, however, developed in other directions. They assumed, for example, that conversions through the market might be moderate, but that governments might centralize all foreign exchange receipts, with the result that official balances might be enormous and conversion impossible without the use of the Fund’s resources.

16. The obligation of members to convert under Article VIII, Section 4 is a closely defined obligation and subject to certain conditions. One important condition is that the balances presented for conversion have been recently acquired as a result of current transactions, or that conversion of the balances is needed for making payments for current transactions. Another important condition is that the member asked to convert must be entitled to use the Fund’s resources. The theory of Section 4 is convertibility of official balances through the mechanism of the Fund, and a member is under no obligation to convert official balances of its currency, whether through the use of the Fund’s resources or with other assets, unless it can purchase from the Fund the currency of the member requesting conversion.

17. The world has not developed along the lines expected by the drafters of Article VIII, Section 4, and the convertibility mechanism envisaged in that provision has never been applied. Section 2(a) of Article VIII, and not Section 4, has provided the mechanism for conversion, and the Fund has supported this form of convertibility with its resources.


70 Article XXX(1).

71 For a more detailed account, see Gold, Use, Conversion, and Exchange, pp. 26-32.
18. The second amendment has been agreed on the understanding that the situation as described above will continue to prevail, so that no obligation will be applied for a member so long as exchange markets for the currency held normally serve this function. Members are, of course, free to agree to convert balances of their currency held by other members, as they have done on occasions in the past, or can, by agreement, transfer special drawing rights to other members for this purpose. It has been considered unnecessary, therefore, to attempt to modify the provision at this time, taking into account the fact that circumstances similar to those that the drafters of the original Articles had in mind might possibly emerge, thus justifying more reliance on the provisions of Article VIII, Section 4. Any study of a possible future modification of the provision could be undertaken more usefully in the light of developments in connection with exchange arrangements under Article IV.\textsuperscript{72}

The main message in this extract is that the obligation under Article VIII, Section 4 is not to be applied as long as market convertibility is maintained. If circumstances were to change and market convertibility ceased to be as widespread and effective as it was at the date when the Report was written, so that there might be a need for official convertibility, Article VIII, Section 4 could be reconsidered in the light of the new circumstances.

Freely Usable Currencies: Official Exchanges

The compromise as described above was accompanied by the deletion from the Articles of the definition of convertible currencies and all mention of convertibility or conversion except in Article VIII, Section 4. These changes have been accompanied by the disappearance from the financial activities of the Fund of the distinction between the currencies of members that have undertaken to perform the obligations of Article VIII, Sections 2, 3, and 4 and the currencies of those members that have not yet taken this step. A new vocabulary has been coined in which the “exchange” of currencies is prominent. The former Article V, Section 7(b)(ii) has been abrogated together with all other formulas on repurchase.

A new concept has been introduced into the Articles by the Second Amendment: “freely usable currencies.” They are defined as follows:

A freely usable currency means a member’s currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets.\textsuperscript{73}

The Fund has decided that the U.S. dollar, pound sterling, deutsche mark, French franc, and Japanese yen are freely usable currencies, but this list may be changed by deletion or addition if the Fund decides that circumstances warrant changes in it.

Freely usable currencies have an essential role in enabling the Fund to use all currencies in the transactions it conducts through the General Resources Account. If the Fund sells a freely usable currency, it is assumed that the purchasing member, if it wishes, can exchange the currency in the market without affecting the exchange rate. The issuer of a freely usable currency sold by the Fund can require a purchaser that wishes to exchange it to engage in an official exchange. In that exchange, the issuer must provide a freely usable currency selected by the purchaser at a rate of exchange that is governed by the Articles. If the Fund sells a currency that it has not deemed to be freely usable, the issuer must exchange it, on the prompt request of the purchaser. The exchange is made in return for a freely usable currency selected by the issuer of the currency sold, and at the exchange rate that is required by the Articles. The issuer and purchaser may agree, however, on another procedure for an exchange.

The obligations as described above are confined to balances purchased from the Fund in contrast to the balances that are the subject of official convertibility under Article VIII, Section 4. Market convertibility under Article VIII, Section 2(a), however, relates to balances without limiting them to those that originate in transactions with the Fund.

Official Redemption

The Report on the Proposed Second Amendment notes that members are free to agree to convert balances of their currencies held by other members, without invoking Article VIII, Section 4, or can agree to use special drawing rights (SDRs) for this purpose. The Second Amendment contains a provision that recognizes the redemption of balances with resources drawn from the Fund. Under Article V, Section 3(a), a member may purchase currency from the Fund to help the purchaser solve its balance of payments or reserve problem. The currencies that the member may purchase are determined by the Fund in accordance with its policies on the selection of currencies suitable for sale because of the balance of payments and reserve position of the issuers and developments in the exchange markets, as well as the desirability of promoting over time balanced positions in the Fund among members.\textsuperscript{74}

\textsuperscript{72} Proposed Second Amendment to the Articles of Agreement of the International Monetary Fund: A Report by the Executive Directors to the Board of Governors (Washington, 1976), Part II, Chap. C, pp. 17–18.

\textsuperscript{73} Article XXX(f). See Gold, Use, Conversion, and Exchange, pp. 55–92.

\textsuperscript{74} Article V, Section 3(a) and (d); and Rule O-10, in International Monetary Fund, By-Laws, Rules and Regulations, Thirty-Seventh Issue (Washington, January 1, 1981), p. 57.
ing to purchase the currency of another member because the purchasing member wishes to redeem an equivalent amount of its own currency offered by the other member, the purchasing member is entitled to purchase the currency of the holder unless the Fund has given notice that its holdings of the currency have become scarce. Under this provision, if the two members agree on the redemption, the purchasing member is entitled to purchase the currency of the holder from the Fund even though at that time the Fund would not sell the currency in other transactions. Neither member is bound by the Articles to enter into such an agreement. The provision was inspired by the transactions with the Fund that had been entered into by members that had to make settlements under the "snake" arrangements.

The First Amendment provided for the official redemption of balances of a currency with SDRs. In the negotiation of the First Amendment, the United States protested that the right of a member holding SDRs to obtain currencies for them from transferees of SDRs designated by the Fund, when the member needed currencies because of its balance of payments position or because of developments in its reserves, was of no use to the United States. The United States did not support the U.S. dollar with other currencies. When the United States was in difficulties, pressure on the dollar might produce requests for the conversion of dollar balances with gold. The United States was interested, therefore, in a provision under which it would be able to redeem dollar balances with SDRs and not gold. The United States was unable to negotiate a right to redeem with SDRs any dollar balances that were offered to it, but it did succeed in obtaining a provision under which SDRs could be used if the United States and the holder of the balances agreed on this form of redemption. The provision was written in terms of any member whose currency was offered for redemption and not in terms of the United States alone. This special provision has been submerged in a broader provision of the Second Amendment under which members may agree on the exchange of SDRs for currency, and under which the currency may be that of the transferor of the SDRs or some other currency.

75 Article V, Section 3(d).
76 Gold, Use, Conversion, and Exchange, pp. 36–38.
77 Article XXV, Section 2(b)(i) of the First Amendment.
78 Article XIX, Section 2(b) of the Second Amendment. Gold, Use, Conversion, and Exchange, pp. 41–45.
IV Keynes’ Questionnaire on Convertibility

Keynes attached to his letter of February 6, 1945 to White an Annex consisting of five questions. Not all of them were answered specifically by Morgenthau’s letter of June 8, 1945 to Anderson. An attempt is made below to provide detailed answers to these questions in accordance with the Articles and the Fund’s practice before and after the Second Amendment.

Q. “(1) What obligation, if any, does VIII 2(a) impose on a member in your view? Could you furnish us with a paraphrase of this sub-section which clearly bears the desired interpretation and is held by you to be its legal equivalent?”

A. Whether or not a member centralizes all or some exchange transactions, the effect of Article VIII, Section 2(a) is that:
(i) residents must not be subjected to restrictions that prohibit, limit, or unduly delay payments they wish to make for current international transactions in the currency, whether their own or another, in which payments are to be made;
(ii) nonresidents must not be subjected to restrictions that prohibit, limit, or unduly delay
(a) payments for current international transactions with balances that are the proceeds of recent current international transactions, or
(b) transfers of the proceeds of recent current international transactions.

The guiding principle in ascertaining whether a measure or a practice is a restriction on payments and transfers for current international transactions is whether it involves a direct governmental limitation on the availability or use of exchange as such.

This answer applied before the Second Amendment and continues to apply under the Second Amendment.

Q. “(2) VIII 4(a) imposes an obligation of convertibility into any currency, whether the national currency of the applicant or not? If the obligation is not thus unlimited, by what words in the text is it limited?”

A. The obligation is limited to the applicant’s currency, but if the Fund’s resources are used for the conversion the applicant would obtain an equivalent right to purchase other currencies from the Fund.

Since the Second Amendment, members are expected not to invoke Article VIII, Section 4(a).

(Did Keynes intend to raise this question in relation to Article VIII, Section 2(a) and not Article VIII, Section 4(a)?)

Q. “(3) Does VIII 4(a) impose an obligation of convertibility into any currency, whether the national currency of the applicant or not? If the obligation is not thus unlimited, by what words in the text is it limited?”

A. The obligation is limited to the applicant’s currency, but if the Fund’s resources are used for the conversion the applicant would obtain an equivalent right to purchase other currencies from the Fund.

Since the Second Amendment, members are expected not to invoke Article VIII, Section 4(a).

(Did Keynes intend to raise this question in relation to Article VIII, Section 2(a) and not Article VIII, Section 4(a)?)

Q. “(4) VIII 4(b) expressly relieves a member of certain obligations in certain contingencies. Is it held that VIII 2(a) re-imposes obligations which VIII 4(b) has expressly removed? If so, is there not a direct inconsistency between the two sub-sections?”

A. Article VIII, Section 2(a) is the primary obligation of members that is intended to achieve a multilateral system of payments in respect of current transactions among members and the elimination of foreign exchange restrictions that hamper the growth of world trade. Article VIII,

79 Keynes, Collected Writings, Vol. 26, p. 182.

80 For a detailed discussion, see the U.S. Treasury’s “Questions and Answers on the International Monetary Fund (June 10, 1945),” Questions 33 and 34 (reproduced in History, 1945–65, Vol. 3, pp. 175–81).
Section 4 was intended to be a supplementary obligation if a member's currency was accumulated by other members. Article VIII, Section 2(a) qualifies Article VIII, Section 4 and not the reverse. If a member finds difficulty in performing its obligation under Article VIII, Section 2(a), it can request the Fund to approve restrictions and, if the Fund approves, the member's obligation is modified under Article VIII, Section 4, but there are other measures, which are more compatible with the purposes of the Fund, for dealing with the difficulty of observing Article VIII, Section 2(a). There is no inconsistency between the two provisions when they are viewed in this way.

Since the Second Amendment, members are expected not to invoke Article VIII, Section 4(a).

Q. “(5) If a member declares exchange transactions illegal except within a permitted range but has no exchange control, is it free from any obligation under VIII 2(a)?”

A. A member had exchange rate obligations as well as the obligation under Article VIII, Section 2(a). A member could choose whatever measures it considered appropriate for performing its exchange rate obligations, provided that the measures were consistent with the Articles and were effective.

The question is based on provisions that related to the par value system but are no longer in effect under the Second Amendment.
Appendix A

Article VIII and Article XIV

There has been in recent years a substantial improvement in the balance of payments and the reserve positions of a number of Fund members which has led to important and widespread moves to the external convertibility of many currencies. Most international transactions are now carried on with convertible currencies, and many countries have progressed far with the removal of restrictions on payments. In consequence of these developments, it seems likely that a number of members of the Fund either have reached or are nearing a position in which they can consider the feasibility of formally accepting the obligations of Article VIII, Sections 2, 3, and 4. Previous decisions taken by the Fund, such as those on multiple currency practices, bilateral arrangements, discriminatory restrictions maintained for balance of payments purposes, and payments restrictions for security reasons, indicate the Fund's attitude on these matters. The present decision has been adopted as an additional guide to members in pursuance of the purposes of the Fund as set forth in Article I of the Articles of Agreement.

1. Article VIII provides in Sections 2 and 3 that members shall not impose or engage in certain measures, namely restrictions on the making of payments and transfers for current international transactions, discriminatory currency arrangements, or multiple currency practices, without the approval of the Fund. The 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. Members in doubt as to whether any of their measures do or do not fall under Article VIII may wish to consult the Fund thereon.

2. In accordance with Article XIV, Section 3, members may at any time notify the Fund that they accept the obligations of Article VIII, Sections 2, 3, and 4, and no longer avail themselves of the transitional provisions of Article XIV. Before members give notice that they are accepting the obligations of Article VIII, Sections 2, 3, and 4, it would be desirable that, as far as possible, they eliminate measures which would require the approval of the Fund, and that they satisfy themselves that they are not likely to need recourse to such measures in the foreseeable future. If members, for balance of payments reasons, propose to maintain or introduce measures which require approval under Article VIII, the Fund will grant approval only where it is satisfied that the measures are necessary and that their use will be temporary while the member is seeking to eliminate the need for them. As regards measures requiring approval under Article VIII and maintained or introduced for nonbalance of payments reasons, the Fund believes that the use of exchange systems for nonbalance of payments reasons should be avoided to the greatest possible extent, and is prepared to consider with members the ways and means of achieving the elimination of such measures as soon as possible. Members having measures needing approval under Article VIII should find it useful to consult with the Fund before accepting the obligations of Article VIII, Sections 2, 3, and 4.

3. If members at any time maintain measures which are subject to Sections 2 and 3 of Article VIII, they shall consult with the Fund with respect to the further maintenance of such measures. Consultations with the Fund under Article VIII are not otherwise required or mandatory. However, the Fund is able to provide technical facilities and advice, and to this end, or as a means of exchanging views on monetary and financial developments, there is great merit in periodic discussions between the Fund and its members even though no questions arise involving action under Article VIII. Such discussions would be planned between the Fund and the member, including agreement on place and timing, and would ordinarily take place at intervals of about one year.

4. Fund members which are contracting parties to the GATT and which impose import restrictions for balance of payments reasons will facilitate the work of the Fund by continuing to send information concerning such restrictions to the Fund. This will enable the Fund and the member to join in an examination of the balance of payments situation in order to assist the Fund in its collaboration with the GATT. The Fund, by agreement with members which are not contracting parties to the GATT and which impose import restrictions for balance of payments reasons, will seek to obtain information relating to such restrictions.

Decision No. 1034-(60/27)
June 1, 1960
Appendix B

Payments Arrears

The Executive Board has reviewed the Fund's policy with respect to payments arrears. The Fund shall be guided by the approach in the conclusions set forth [below].

Decision No. 3153-(70/95)
October 26, 1970

Conclusions

1. Undue delays in the availability or use of exchange for current international transactions that result from a government's limitation give rise to payments arrears and are payments restrictions under Article VIII, Section 2(a), and Article XIV, Section 2. The limitation may be formalized, as for instance compulsory waiting periods for exchange, or informal or ad hoc.

2. The need for the Fund to define its policy on payments arrears is emphasized by the fact that restrictions resulting in payments arrears arising from informal or ad hoc measures do particular harm to a country's international financial relationships because of the uncertainty they generate. This uncertainty is particularly harmful to the smooth functioning of the international payments system and has pronounced adverse effects on the creditworthiness of the debtor country which may extend beyond the period of the existence of the restrictions.

3. In the light of these considerations it is believed that the Fund should aim in consultation reports at a more systematic treatment of restrictions on payments and transfers for current international transactions that produce payments arrears. In all cases where payments arrears 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, the payments arrears should be treated in the consultation papers as evidence of a payments restriction requiring approval in Article VIII or Article XIV consultation decisions.

The staff, in the consultation discussions, will have to establish whether payments arrears exist by ascertaining whether there has been a substantial delay beyond that usually required for ascertaining the bona fides of exchange applications or the time that can be regarded as normally required for the administrative processing of applications for exchange. If payments arrears exist and approval of the restriction giving rise to them is requested by the member, the member should be expected to submit a satisfactory program for their elimination. Approval if given should be only for a temporary period and generally with a fixed terminal date. Because of the difficulty in surveillance, approval should be wherever feasible in terms of the level of arrears outstanding. The program for the elimination of the payments arrears should provide for a maximum permissible delay to which a payment or transfer could be subjected, together with a phased reduction in the outstanding level.

4. Fund financial assistance to members having payments arrears should be granted on the basis of performance criteria or policies with respect to the treatment of arrears similar to the criteria or policies described in the preceding paragraph for the approval of the payments restrictions. In general, the understandings should provide for the elimination of the payments arrears within the period of the stand-by arrangement. Such understandings should be based on the concept of a given level of payments arrears and should be reflected in the performance criteria included in stand-by arrangements in the higher credit tranches. To support the policies designed to deal with arrears the letter of intent should include a statement that there would be no imposition of new restrictions or increase in the level of delayed payments. Where Fund financial assistance is being provided, but only through the first credit tranche, the adoption of a viable program directed toward the elimination of the payments arrears should be an important factor in considering whether the country was making reasonable efforts to redress its international financial situation.
Occasional Papers of the International Monetary Fund

1. International Capital Markets: Recent Developments and Short-Term Prospects, by a Staff Team Headed by R. C. Williams, Exchange and Trade Relations Department. 1980.


3. External Indebtedness of Developing Countries, by a Staff Team Headed by Bahram Nowzad and Richard C. Williams. 1981.

