

## ARTICLE IV

### Exchange Arrangements

#### NOTIFICATION OF EXCHANGE ARRANGEMENTS UNDER ARTICLE IV, SECTION 2

1.\* .....

2. The procedures set forth in Section IV of SM/77/277 [attached] are approved, and members shall be guided by the considerations in Section IV with respect to the prompt notification of any changes in their exchange arrangements.

3.\* .....

*Decision No. 5712-(78/41)*

*March 23, 1978*

#### *Attachment*

#### Section IV of SM/77/277

#### IV. Issues Connected with Subsequent Notification

Once the procedures for initial notification have been clarified, only a few issues remain to be dealt with in respect of subsequent notifications. One of these is the question of what would constitute a change in an exchange arrangement requiring notification. Clearly, any official action involving the adoption of a different type of arrangement would require notification. Furthermore, in cases where a member pegs its currency, it would be appropriate to notify the Fund of all changes in the peg; this would include not only every change in the central point around which a member was maintaining margins, but also those involving a change in the composition of a composite, other than one occurring from a redistribution of currency weights on the basis of newly available trade or payments data.

For members with flexible exchange arrangements, it is more

\*Not included in this volume.

difficult to specify changes which will require notification to the Fund. For members classified as fixing the rate according to a set of indicators, it would seem an appropriate rule that they communicate to the Fund details of any discrete exchange rate changes that are not consistent with the changes produced by the set of indicators. It would also be expected, if the suggested approach outlined earlier in this paper is accepted, that all members maintaining flexible exchange arrangements be asked to notify the Fund whenever the authorities have taken a significant decision affecting such arrangements. This would involve, as a minimum, notification of such decisions whenever public policy statements have been issued. In addition, in any instance in which the Managing Director considered that a significant change had occurred in a member's exchange policy (including intervention arrangements), and no notification has been received from that member, he would consult with the member to request information on the background to such developments. If considered appropriate, a formal notification of the change would be sought from the member.

Members would be expected to inform the Fund of all actions involving exchange taxes and subsidies. Indeed, under Article VIII, Section 3, members will continue to be required to request prior Fund approval of any multiple currency practices that may be involved in such actions.

Upon receipt of notification of a change in exchange arrangements from a member the staff would circulate it to the Executive Board. If the Board wishes, it could continue to be the normal practice that whenever a change is significant, its communication to the Board would be followed promptly by a staff paper describing the context of the change in policy and giving the staff's assessment.

#### SURVEILLANCE OVER EXCHANGE RATE POLICIES

1. The Executive Board has discussed the implementation of Article IV of the proposed Second Amendment of the Articles of

Agreement and has approved the attached document entitled "Surveillance over Exchange Rate Policies." The Fund shall act in accordance with this document when the Second Amendment becomes effective. In the period before that date the Fund shall continue to conduct consultations in accordance with present procedures and decisions.

2. The Fund shall review the document entitled "Surveillance over Exchange Rate Policies" at intervals of two years and at such other times as consideration of it is placed on the agenda of the Executive Board.

*Decision No. 5392-(77/63)*

*April 29, 1977*

### Surveillance over Exchange Rate Policies

#### *General Principles*

Article IV, Section 3(a) provides that "The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article." Article IV, Section 3(b) provides that in order to fulfill its functions under 3(a), "the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies." Article IV, Section 3(b) also provides that "The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members." In addition, Article IV, Section 3(b)

requires that "Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies."

The principles and procedures set out below, which apply to all members whatever their exchange arrangements and whatever their balance of payments position, are adopted by the Fund in order to perform its functions under Section 3(b). They are not necessarily comprehensive and are subject to reconsideration in the light of experience. They do not deal directly with the Fund's responsibilities referred to in Section 3(a), although it is recognized that there is a close relationship between domestic and international economic policies. This relationship is emphasized in Article IV which includes the following provision: "Recognizing . . . that a principal objective [of the international monetary system] is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates."

*Principles for the Guidance of Member's Exchange Rate Policies*

A. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

B. A member should intervene in the exchange market if necessary to counter disorderly conditions which may be characterized inter alia by disruptive short-term movements in the exchange value of its currency.

C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

*Principles of Fund Surveillance over Exchange Rate Policies*

1. The surveillance of exchange rate policies shall be adapted to the needs of international adjustment as they develop. The functioning of the international adjustment process shall be kept under review by the Executive Board and Interim Committee and the assessment of its operation shall be taken into account in the implementation of the principles set forth below.

2. In its surveillance of the observance by members of the principles set forth above, the Fund shall consider the following developments as among those which might indicate the need for discussion with a member:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) an unsustainable level of official or quasi-official borrowing, or excessive and prolonged short-term official or quasi-official lending, for balance of payments purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or

(b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for balance of payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows; and

(v) behavior of the exchange rate that appears to be unrelated to underlying economic and financial conditions including factors affecting competitiveness and long-term capital movements.

3. The Fund's appraisal of a member's exchange rate policies shall be based on an evaluation of the developments in the

member's balance of payments against the background of its reserve position and its external indebtedness. This appraisal shall be made within the framework of a comprehensive analysis of the general economic situation and economic policy strategy of the member, and shall recognize that domestic as well as external policies can contribute to timely adjustment of the balance of payments. The appraisal shall take into account the extent to which the policies of the member, including its exchange rate policies, serve the objectives of the continuing development of the orderly underlying conditions that are necessary for financial stability, the promotion of sustained sound economic growth, and reasonable levels of employment.

*Procedures for Surveillance*

I. Each member shall notify the Fund in appropriate detail within thirty days after the Second Amendment becomes effective of the exchange arrangements it intends to apply in fulfillment of its obligations under Article IV, Section 1. Each member shall also notify the Fund promptly of any changes in its exchange arrangements.

II. Members shall consult with the Fund regularly under Article IV. The consultations under Article IV shall comprehend the regular consultations under Articles VIII and XIV. In principle such consultations shall take place annually, and shall include consideration of the observance by members of the principles set forth above as well as of a member's obligations under Article IV, Section 1. Not later than three months after the termination of discussions between the member and the staff, the Executive Board shall reach conclusions and thereby complete the consultation under Article IV.

III. Broad developments in exchange rates will be reviewed periodically by the Executive Board, inter alia in discussions of the international adjustment process within the framework of the World Economic Outlook. The Fund will continue to conduct special consultations in preparing for these discussions.

IV. The Managing Director shall maintain close contact with members in connection with their exchange arrangements and exchange policies, and will be prepared to discuss on the initiative of a member important changes that it contemplates in its exchange arrangements or its exchange rate policies.

V. If, in the interval between Article IV consultations, the Managing Director, taking into account any views that may have been expressed by other members, considers that a member's exchange rate policies may not be in accord with the exchange rate principles, he shall raise the matter informally and confidentially with the member, and shall conclude promptly whether there is a question of the observance of the principles. If he concludes that there is such a question, he shall initiate and conduct on a confidential basis a discussion with the member under Article IV, Section 3(b). As soon as possible after the completion of such a discussion, and in any event not later than four months after its initiation, the Managing Director shall report to the Executive Board on the results of the discussion. If, however, the Managing Director is satisfied that the principles are being observed, he shall informally advise all Executive Directors, and the staff shall report on the discussion in the context of the next Article IV consultation; but the Managing Director shall not place the matter on the agenda of the Executive Board unless the member requests that this procedure be followed.

VI. The Executive Directors shall review annually the general implementation of the Fund's surveillance over members' exchange rate policies.

#### SURVEILLANCE: PROCEDURES

1. *Review.* The Executive Board has reviewed the procedures relating to the Fund's surveillance over members' exchange rate policies. These procedures, and the procedures for regular consultations under Article IV, will be reviewed again by the Executive Board in December 1979. The Executive Board will

review the document "Surveillance over Exchange Rate Policies" at an appropriate time not later than April 1, 1980, as provided for in paragraph 2 of Decision No. 5392-(77/63), adopted April 29, 1977. . . .

2.\* . . . . .

3. *Supplemental surveillance procedure.* . . . Whenever the Managing Director considers that a modification in a member's exchange arrangements or exchange rate policies or the behavior of the exchange rate of its currency may be important or may have important effects on other members, whatever the member's exchange arrangement may be, he shall initiate informally and confidentially a discussion with the member before the next regular discussion under Article IV. If he considers after this prior discussion that the matter is of importance, he shall initiate and conduct an ad hoc consultation with the member and shall report to the Executive Board, or informally advise the Executive Directors, on the consultation as promptly as the circumstances permit after conclusion of the consultation. This procedure will supplement the proceedings in Executive Board Decision No. 5392-(77/63), adopted April 29, 1977.

*Decision No. 6026-(79/13)*

*January 22, 1979*

#### SURVEILLANCE OVER EXCHANGE RATE POLICIES: REVIEW

The Executive Board has reviewed the document "Surveillance over Exchange Rate Policies" as provided in paragraph 2 of the Executive Board Decision No. 5392-(77/63), adopted April 29, 1977, and will review it again at an appropriate time not later than April 1, 1986.

*Decision No. 7645-(84/40)*

*March 12, 1984*

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\*Not included in this volume.



The Executive Board has reviewed the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as required by paragraph 2 of that decision. The next review of the document shall be conducted not later than April 1, 1988.

*Decision No. 8248-(86/60)*

*April 1, 1986*

#### IMPLEMENTATION OF PROCEDURES FOR SURVEILLANCE: REVIEW

The Executive Board has reviewed the procedures relating to the general implementation of the Fund's surveillance over members' exchange rate policies, as required by paragraph VI of *Procedures for Surveillance* in the document "Surveillance over Exchange Rate Policies" referred to in Decision No. 7645-(84/40), including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/84/44, in the light of the Managing Director's summing up, until the next annual review, which shall be conducted not later than April 1, 1985.

*Decision No. 7646-(84/40)*

*March 12, 1984*

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The Executive Board has reviewed the general implementation of the Fund's surveillance over members' exchange rate policies, as required by paragraph VI of *Procedures for Surveillance* attached to Decision No. 5392-(77/63), adopted April 29, 1977, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/85/65, in the light of the Managing Director's summing up, until the next

annual review, which shall be conducted not later than April 1, 1986.

*Decision No. 7939-(85/49)*

*March 25, 1985*

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The Executive Board has reviewed the general implementation of the Fund's surveillance over members' exchange rate policies, as required by Paragraph VI of Procedures for Surveillance contained in the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, including the procedures for the conduct of consultations under Article IV, which consultations shall comprehend the consultations under Article VIII and Article XIV, and approves the continuation of the procedures as described in SM/86/4, in the light of the Managing Director's summing up, until the next review, which shall be conducted not later than April 1, 1987.

*Decision No. 8249-(86/60)*

*April 1, 1986*

**SURVEILLANCE: PROCEDURES—IMPLEMENTATION OF THREE-MONTH PERIOD**

The Executive Board approves the proposed method of applying the three-month rule for implementing the procedures for surveillance, set forth in EBD/83/161 [below].

*Decision No. 7427-(83/83)*

*June 8, 1983*

*Attachment*

**EBD/83/161**

The document entitled "Surveillance over Exchange Rate Policies," attached to Decision No. 5392-(77/63), includes

certain Procedures for surveillance. Of these, Procedure II states that "Not later than three months after the termination of discussions between the member and the staff, the Executive Board shall reach conclusions and thereby complete the consultation under Article IV." This three-month period begins from the last day of discussions between the authorities and the staff mission and it is counted off on a calendar basis. Accordingly, the first Board day (*viz.*, Monday, Wednesday, or Friday) upon the completion of the three-month period is regarded as the deadline for Executive Board discussion. Sometimes Executive Board consideration and completion of the Article IV consultation are delayed beyond the three-month deadline (see SM/83/43, 3/1/83, pp. 29–30), and in such cases, Board approval is usually sought on a lapse-of-time basis for an extension of the period. The procedure is administered flexibly in the sense that if Board discussion is scheduled just one or two Board days after the deadline, the three-month waiver paper seeking Board approval is not necessarily circulated.

However, there are certain periods during the year when Board meetings would normally be avoided for the convenience of Executive Directors. For example, in 1983 Board meetings were not scheduled in the weeks of February 7–11 and April 25–29 because of Interim and Development Committee meetings, respectively. For the same reason, Board meetings are not likely to be scheduled during August 8–19, 1983 because of the informal Board recess and during approximately September 16–30 because of the Annual Meetings and ancillary meetings, including caucus meetings. It would be appropriate and convenient to recognize these recurrent and normal gaps in the Board's schedule when applying the three-month rule. Accordingly, if a three-month deadline falls in a period such as one of those mentioned above when a Board meeting would normally not be scheduled, the Friday of the week immediately following such a period would be regarded as the applicable deadline for the purposes of the rule. . . .

ENHANCED SURVEILLANCE: PROCEDURES FOR TRANSMITTAL OF  
STAFF REPORTS

When the Executive Board has approved a request by a member for consultations under the Fund's policy on enhanced surveillance, the annual and midyear consultation reports prepared by the Fund staff in accordance with that policy in respect of the member may be transmitted by the member to creditor banks and other creditor financial institutions party to the arrangements specified by the member in the request for consultations, on the understanding that the recipients of the reports have assured the member that the reports will not be used for any purpose other than those of the arrangements specified in the member's request to the Fund and will be kept confidential; and that the reports shall not be transmitted by the member earlier than two weeks after their circulation to members of the Executive Board.

*Decision No. 8222-(86/45)*

*March 12, 1986*

*The Chairman's Summing Up of the Discussion  
of the Role of the Fund in Assisting Members with  
Commercial Banks and Official Creditors*

*Executive Board Meeting 85/132—September 4, 1985*

*General Remarks*

The procedures relating to enhanced surveillance that have been discussed by Directors were developed in response to the need to help members make progress toward addressing their debt problems and improving their relations with their creditors in an orderly manner and in a broader framework.

It was noted by many Directors that by adapting some of its policies, the Fund had played a central role in helping to limit the disruptions associated with the debt crisis and in promoting a normalization of debtor/creditor relations. Most Directors, how-

ever, observed that the practice of enhanced surveillance that had developed involved some risks. Some Directors stressed the risk of a possible weakening of Fund conditionality. Others feared that the Fund might tend to become too deeply and too specifically involved in relations with the commercial banks, and that generalized reliance on the Fund's judgment by the international community could affect the Fund's credibility and interfere with the normal functioning of the markets, which should rely eventually on the banks' own assessments. In other words, enhanced surveillance in the view of most Directors should not become a substitute for stand-by and extended arrangements and should not "crowd out" or "dilute" the Fund's normal procedures and transform the institution into a kind of universal credit-rating agency. In that vein, a majority of Directors, while recognizing the usefulness of the practices that have evolved, considered that enhanced surveillance should be used on a limited basis under the guidance and control of the Executive Board, essentially to help promote MYRAs (multiyear rescheduling arrangements), although all MYRAs might not be associated with enhanced surveillance.

### *Criteria and Procedures*

#### *a. Criteria for the adoption of enhanced surveillance*

While several Directors insisted on the need for flexibility and on the importance of avoiding too rigid criteria, most Directors felt that enhanced surveillance could be undertaken when the four following conditions are met:

First, at the request of a member country, who must initiate the procedures;

Second, in cases where a good record of adjustment has been shown;

Third, in cases in which a MYRA is needed to normalize market relations and to facilitate the return to voluntary or spontaneous financing;

Fourth, in cases where the member is in a position to present an adequate quantified policy program in the framework of consultations with the Fund staff, which are part of the procedure of enhanced surveillance.

*b. Length of the Fund's involvement*

Directors thought that, on the whole, the early cases of enhanced surveillance had covered rather too long periods. They felt that in the future the Fund should try to limit the procedure to about the consolidation period of a MYRA. I would suggest that we should retain some flexibility and remain open to the possibility of extending enhanced surveillance a little beyond the consolidation period. If the Fund were to cut off enhanced surveillance at the end of the consolidation period, the communication of reports to the banks would be halted at a delicate time in the normalization of relations between the country and its creditors; i.e., at the time when the country will need more voluntary financing to meet external payments falling due. While we should try to limit enhanced surveillance as much as possible to the consolidation period, there might be occasions when an extension of enhanced surveillance into the period after consolidation may be necessary and warranted.

*c. Trigger mechanisms*

A number of Directors feared that staff involvement in the design and the negotiation of trigger mechanisms between the commercial banks and the member country risked diluting the banks' responsibility in the monitoring process under MYRAs and risked engaging the Fund in providing on/off signals to the banks. Most Directors felt that the staff should not negotiate or take responsibility for designing and assessing trigger mechanisms. But, if the member wished, the Fund staff would not refuse to give its views on the purely technical merits or drawbacks of such mechanisms. It is important to emphasize that the Fund should take no active part in the negotiation of the design of these trigger mechanisms.

*d. Contents and distribution of staff reports*

Directors stressed the need to ensure that staff reports to be issued to creditor banks under the policy of enhanced surveillance continue to provide full and frank assessments of the policies and economic prospects of member countries. While a number of Directors were of the view that staff reports should be made available to creditor banks under the enhanced surveillance procedures only after the Executive Board had met to discuss the reports, most Directors agreed that countries would be authorized to release these staff reports to their creditor banks not earlier than two weeks after their issuance to the Executive Board. The majority of Directors were of the view that authorization to release staff reports should be provided by a general decision pertaining to all cases for which enhanced surveillance is agreed rather than by an individual decision in each case. The reports to be released to creditor banks would reflect only the staff's views and would not contain any references to the discussions and views of the Executive Board. No amendments to the staff report other than the deletion of references to Board discussions would be made.

*e. Involvement of the Executive Board*

I understand that the procedure would be as follows: First, request by a member for enhanced surveillance; second, management assesses the case in accordance with the policies agreed by the Executive Board today and determines whether to submit the request for the endorsement of the Board. In cases where the criteria raise delicate problems of interpretation, management would continue to consult informally with Executive Directors at the earliest opportunity.

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*g. Review of the policy on enhanced surveillance*

A number of Directors suggested that in view of the need to assess changing circumstances and the possible effects of the procedures for enhanced surveillance on the Fund and its policies, the Board should engage in a periodic review of the policy of enhanced surveillance, with an initial review to be held in about one year.