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IMF Executive Board Reviews Multiple Currency Practices Policy and Considers Reforms

On February 1, 2019, the Executive Board of the International Monetary Fund (IMF) discussed a paper reviewing the Fund's policy on multiple currency practices (MCPs) and considered staff's initial proposals for reform. By limiting the circumstances in which Fund members may introduce and maintain multiple exchange rates, the MCP policy aims to promote orderly exchange arrangements and a stable system of exchange rates. As one of the original provisions of the Fund's Articles of Agreement, the prohibition of MCPs was part of a larger effort to eliminate restrictions on current international payments and transfers in the post-war era, as well as earlier distortive practices.

MCPs can arise from exchange transactions. An MCP occurs if action by a member's authorities results in an exchange transaction on the member's territory taking place at an exchange rate spread that does not reflect normal commercial realities. For spot transactions, the current policy establishes a uniform permissible spread of up to 2 percent for all countries; for non-spot transactions, the permissible spread is not quantified but it should not exceed the normal commercial costs and risks of the transaction vis-à-vis spot transactions. Over time, the purview of the policy has broadened to capture not only actions that give rise to actual exchange rate spreads in access of the permissible thresholds, but also those that have the potential to do so.

Under the current policy, Fund members are prohibited from engaging in MCPs, unless they are maintained under the transitional arrangements of Article XIV upon joining the Fund or are temporarily approved by the Fund's Executive Board. Such approval is for periods of 12 months and can be granted where the MCP is maintained for either balance of payments (BOP) or non-BOP reasons.

The last time the MCP policy was extensively reviewed was 1981, after the abandonment of fixed exchange rates under the par value system. Meanwhile, significant changes have occurred in foreign exchange markets, that provide an opportunity to review the policy: greater experience with flexible exchange rates, substantial deepening and standardization, development of hedging products, and substantial improvements in data availability. Several operational challenges have also arisen in the implementation of the policy.

To modernize the policy and better align it with other Fund policies, the paper discussed by the Board presented some initial considerations for reform. These considerations relate to what actions should be covered under the policy, how an MCP should be defined, and when MCPs should be approved. Staff will shortly, based on guidance received from the Executive Board, present a proposed new MCP policy to the Executive Board.

Executive Board Assessment[1]

Executive Directors welcomed the opportunity to review the policy on multiple currency practices (MCP). They noted that, since it was last reviewed in 1981, foreign exchange markets have undergone significant changes and some operational issues have arisen in the implementation of the policy. They agreed that these developments warrant a consideration of reforms to the MCP policy, with a view to maintaining its relevance, effectiveness, and traction with members.

Directors agreed that there remain economic and legal reasons to retain the MCP policy as a cornerstone of the Fund's legal and policy framework for exchange rates. They observed that MCPs can be distortionary, create unfair competitive advantage among countries, and hamper trade and investment. Directors noted that, while the existing MCP policy has served the Fund well, some important aspects of the policy have increasingly complicated its implementation in today's realities.

Directors broadly supported the majority of the reform proposals. As a general principle, they concurred that for the policy to be effective, it needs to be based on rules that reflect market realities in member countries, can be applied consistently across the Fund's membership, and are simple and easily understood by stakeholders. Directors also stressed that any revisions to the policy should seek to ensure that the Fund's legal and policy framework continues to facilitate the development of stable foreign exchange systems that are free of restrictions on payments and transfers for current international transactions. A number of Directors also attached importance to refocusing the MCP policy on measures that are deemed material. Overall, Directors considered that the core principle of the current policy—that official action should not cause unreasonable deviations in foreign exchange spreads compared to normal commercial costs and risks—remains appropriate.

Directors agreed that the scope of official action should be clarified to focus primarily on action that segments foreign exchange markets. They broadly concurred that certain practices

[1] An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

currently captured by the MCP policy should be excluded in the future, notably foreign exchange auctions that conform to best practice, illegal parallel markets, and the use of official exchange rates based on the market exchange rates of the previous day. A number of Directors stressed that removing illegal parallel markets from the MCP analysis should be complemented with reasonable efforts by country authorities to eliminate such markets and a stronger emphasis on exchange restrictions in Fund surveillance.

Directors endorsed the proposal to eliminate the practice of finding MCPs due to potentiality. They concurred that an MCP should only arise if official action resulted in an actual exchange rate spread on the member's territory exceeding the permissible margin. This would refocus the policy on economically more meaningful developments and promote a more constructive dialogue with the membership. In a similar vein, Directors supported excluding broken cross-rates, which have almost disappeared, from the remit of the policy.

Most Directors maintained the view that MCPs applying solely to the capital account are not considered a breach of obligation under Article VIII, Section 3 and are not subject to Fund approval. They saw merit in clarifying the specific linkages of the MCP policy and the Institutional View (IV) on the liberalization and management of capital flows as set out in the paper. In particular, they agreed that where MCPs also constitute capital flow management measures, they should be assessed under the IV. Such an assessment would, however, remain within the confines of policy advice without changing the rights and obligations of member countries under the Articles of Agreement. Some Directors were supportive of, or open to considering, the inclusion of MCPs on capital account transactions within the scope of the Fund's jurisdiction under Article VIII, Section 3, noting the materiality and distortionary effects of such MCPs.

With regard to the permissible spreads for spot transactions, Directors welcomed staff's proposal to replace the current fixed two-percent rule with a country-specific market-based norm that would apply uniformly across the membership. They noted that the range between the most depreciated and most appreciated exchange rates in the wholesale market on a given day would be an appropriate benchmark that is sensitive to the level of market development and market conditions in each member country. Most Directors also agreed that a two-percent tolerance margin around the mid-point of this range would help avoid capturing insignificant deviations from the market norm, although a few Directors would have preferred a higher margin. Directors also supported the proposal to treat non-spot transactions in an analogous manner, using the methodologies proposed by staff. In terms of implementation, most Directors supported retaining the notion that a single breach should constitute an MCP, while a number of Directors called for some flexibility based on materiality considerations.

Many Directors endorsed the proposal to remove the possibility of temporary approval of MCPs maintained for non-balance of payments (BOP) reasons, thereby more closely aligning the policies for approval of MCPs and exchange restrictions. Many other Directors considered that member countries should be allowed to maintain MCPs for non-BOP purposes in certain situations. A number of Directors saw merit in reviewing the policy on exchange restrictions in light of the proposed changes to the MCP policy, with a few Directors noting an opportunity to also revisit the Board decision on payment restrictions imposed for security reasons.

Directors considered the case for developing a formal remedial framework for unapproved MCPs. Most Directors favored preserving the current cooperative approach, under which the Fund, through its surveillance, program conditionality, and technical assistance, would encourage member countries to eliminate such measures. Some of these Directors saw scope for more transparent reporting in respect of unapproved MCPs. While a few Directors would be willing to consider a remedial framework for prolonged cases of MCPs, some others called for further analysis on the need for, and the modalities of, a remedial framework.

Going forward, Directors supported putting in place transitional arrangements to provide adequate time for member countries to adjust their policies, after which the revised MCP policy would become operational. Directors looked forward to further consultation and a formal proposal for reform that incorporates their views, followed by a guidance note for staff with implementation details. They would also welcome periodic reviews of the new MCP policy and its implementation in the future.