

INTERNATIONAL MONETARY FUND

Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework

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I. Introduction

1. This paper provides an overview of the legal framework of Article IV of the Fund's Articles of Agreement. It is designed to assist the Executive Board in its consideration of the steps that could be taken to provide members with more specific guidance as to their obligations under Article IV.

2. *The present version of Article IV was incorporated into the Articles by the Second Amendment of the Articles of Agreement in 1978.* It established a new code of conduct for exchange arrangements in the wake of the collapse of the par value system. Under the original par value system, a member's choice as to how it valued its currency against the currency of other members was very limited: the value had to be expressed in terms of gold, either directly or through the U.S. dollar. A member's ability to modify the value of its currency against this common denominator was also limited: beyond a specified limit, a member that changed the par value of its currency without the concurrence of the Fund became ineligible to use the Fund's resources, and the Fund would concur only if it was satisfied that the change was necessary to correct a "fundamental disequilibrium". An important purpose of Fund financial assistance was to enable members to maintain the par value of their currencies in circumstances where they were subject to balance of payments pressures.

3. *By legalizing a member's freedom to choose whatever exchange arrangement it wished—including floating—the Second Amendment represented a complete departure from the par value system, which had been the central feature of the Articles.* While the provisions of the present Article IV continue to reflect the view that a country's exchange rate policies are a matter of international concern, the approach taken is of a fundamentally different nature. The rationale underlying the obligations of members set forth in the present Article IV, Section 1 may be summarized as follows.

- ***First, there is a recognition that a member should not resist an adjustment to its exchange rate if such an adjustment is needed in response to underlying conditions.*** There was a concern that the par value system had created rigidity without stability, with members failing to adjust—or delaying adjustment—even in circumstances of fundamental disequilibrium. This rigidity was perceived as having hampered the balance of payments adjustment of many members and the achievement of the sustainable equilibrium of the overall system. The assumption underpinning the Second Amendment was that if exchange rates reflected underlying conditions, the overall system would be more stable, even if this resulted in fluctuations in members’ exchange rates. Reflecting this approach, a key obligation under the original Article IV—the requirement to collaborate to promote “exchange stability”—was modified in the Second Amendment to become the requirement to collaborate to promote a “stable system of exchange rates.” The stated objective is to achieve the stability of the system— not the stability of exchange rates as such—and such stability would be best served if exchange rates were permitted to fluctuate in response to underlying conditions.
- ***Second, given the important relationship between a member’s domestic policies and its exchange rate, the stability of the overall system of exchange rates is enhanced by the pursuit of domestic policies that create the underlying conditions for economic and financial stability.*** While fluctuations of exchange rates would be inevitable—particularly with respect to those members that chose to float their currencies—erratic disruptions and disorderly developments in exchange rates would be limited if members pursued appropriate economic policies. In recognition of this relationship between domestic policies and the exchange rate system, the Second Amendment introduced obligations with respect to members’ domestic policies. However, as will be discussed in this paper, these obligations are of a particularly “soft” nature, out of a recognition that members should not have to give up a significant degree of sovereignty with respect to policies that, while they may have an international impact, are of a domestic nature.
- ***Finally, with respect to members’ exchange rate policies, members should avoid pursuing policies that are designed to either interfere with the adjustment process or gain an unfair competitive advantage over other members.*** In particular, a specific obligation under Article IV, Section 1 is the requirement that members “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.” As will be discussed, this obligation is broad enough to include both overvalued and undervalued exchange rates. Moreover, unlike the obligations with respect to domestic policies, members’ exchange rate obligations are of a “hard” nature, reflecting the international nature of these policies. As will be discussed in Section II of this paper, the potential applicability of the obligation to avoid manipulation is constrained by the need to determine intent; this determination, however, is made independently by the Fund and is not based exclusively on the member’s representation of its motives.

4. ***While the present Article IV sets forth obligations of members, it also sets forth obligations for the Fund.*** Under Article IV, Section 3(a), the Fund is required to oversee the international monetary system to ensure its effective operation and to oversee the compliance of each member with its obligations under Article IV. Because of the particular importance of members' exchange rate obligations, the Articles give the Fund even more specific direction with respect to how members' compliance with these obligations is to be monitored: Article IV, Section 3(b) requires the Fund to exercise firm surveillance over the exchange rate policies of members and to adopt specific principles for the guidance of members with respect to those policies. As a means of fulfilling this requirement, the Fund adopted the principles contained in the 1977 Decision on Surveillance over Exchange Rate Policies (the "1977 Decision"), which is a subject of the present review. To enable the Fund to perform its surveillance obligation, Article IV, Section 3(b) also requires each member to provide the Fund with the information necessary for this purpose and to consult with the Fund upon request.

5. ***The remainder of this paper examines those provisions of Article IV that are of the greatest relevance to the present review.*** Section II provides an overview of Article IV, Section 2, which sets forth the rights of members with respect to their choice of exchange arrangements. Section III analyses members' obligations under Article IV, Section 1 to collaborate with the Fund to assure orderly exchange arrangements and to promote a stable system of exchange rates. Section IV examines the Fund's surveillance responsibilities under Article IV, Section 3 and, in that context, discusses both: (a) the present relationship between the 1977 Decision and members' exchange rate obligations; and (b) the scope for evolution of this relationship. Section V offers conclusions.

6. ***Any examination of Article IV must be prefaced with an acknowledgement of the challenge of interpreting its provisions.*** Unlike other provisions of the Second Amendment, the substance of Article IV was effectively negotiated by a small group of members outside the Executive Board and represented a delicate political compromise among these members. When the text was presented to the Executive Board by these members, it was generally understood that the scope for substantive change was very limited, notwithstanding the fact that a number of Executive Directors—and staff—expressed concern regarding the vagueness and ambiguity of a number of its terms. As a result, there is very little legislative history to illuminate the meaning of the provisions. As was noted by the Executive Director of one of the members that authored the text, it was envisaged that greater precision would emerge over time:

“[P]recision and purity of language—obviously desirable goals—were most difficult to achieve when a compromise was involved. That some terms were vague was of course a matter of some importance, as it was experience gained by their use that would give them precise meanings. Surely some of the terms used by the framers at Bretton Woods were considered vague in 1944, but they had sharpened and acquired

precision as time had progressed. The [proposed] text had evolved over many hours of negotiation, and he would be reluctant to see any changes made”.¹

7. *Since the adoption of the Second Amendment and the 1977 Decision, the Fund has not sought to elucidate the meaning of members’ obligations under Article IV for purposes of its bilateral surveillance activities.* As will be described in this paper, however, the Board could choose to place greater reliance on the legal framework of Article IV, but in a manner that continues to ensure flexibility and the maintenance of the cooperative nature of the Fund.

II. Exchange Arrangements Under Article IV, Section 2

8. *Before examining the scope of members’ freedom with respect to their choice of “exchange arrangements”, it is important to have an understanding of the meaning of this term.* While the term “exchange arrangement” is not specifically defined under the Articles, the use of the term in Article IV, Section 2 indicates that it refers to the overall method that a member uses to determine the value of its currency against other currencies (see Box 1). For example, a decision to peg one’s currency against a specified currency of another member would represent one type of exchange arrangement, while the decision to freely float would represent another type of exchange arrangement.

Box 1. Article IV, Section 2 of the Fund’s Articles of Agreement

Section 2: General exchange arrangements

(a) Each member shall notify the Fund, within thirty days after the date of the second amendment of this Agreement, of the exchange arrangements it intends to apply in fulfillment of its obligations under Section 1 of this Article, and shall notify the Fund promptly of any changes in its exchange arrangements.

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

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

¹ Statement of Mr. Wahl, EBM/75/203, December 22, 1975, p. 17.

9. ***However, an issue that is central to any analysis of Article IV is the nature of the distinction between the term “exchange arrangements” and “exchange rate policies”, the latter term being used in Article IV, Section 3 in the context of the Fund’s surveillance activities.*** Although the term “exchange rate policies” is also not defined, principles of statutory construction require that these two terms be given different meanings from each other.² In that regard, it has been noted that “exchange arrangements refer to a broad classification or framework of a member’s exchange system, while the term ‘exchange rate policies’ refer to the actions or inactions of members in the operation of their arrangements”.³ However, where the line is drawn between these two terms depends on the exchange arrangement adopted by the member. For example, a member may notify the Fund that its exchange arrangement under Article IV, Section 2 is one where its currency is allowed to float, subject to periodic intervention in amounts to be determined from time to time in the light of developing economic conditions. It has been understood that, in this circumstance, a member’s policy as to how it would approach intervention decisions would constitute its exchange rate policy rather than its exchange arrangement.⁴ However, in circumstances where a member chooses an exchange arrangement that involves pegging its currency to the currency of another member (or a basket of currencies), it has also been understood that the “exchange arrangement” includes not only the currencies being used, but also the rate being used for this purpose.⁵ However, and as will be discussed further in Sections III and IV of this paper, the fact that, in this case, the exchange rate forms part of the exchange arrangement does not deprive the Fund of its jurisdiction over this rate when it determines whether the member is fulfilling its obligations regarding its exchange rate policies.

10. ***Article IV, Section 2 gives members considerable freedom in the choice of their exchange arrangements.*** Of the types of exchange arrangements that members may choose, Article IV, Section 2 expressly contemplates the pegging of a member’s currency to the SDR, the pegging to another denominator, and “cooperative arrangements under which

² “[W]hen the legislature uses certain language in one part of the statute and different language in another, the court assumes that different meanings were intended.” N.J. Singer, *Statutes and Statutory Construction*, (6th Edition 2000), p. 194.

³ Sir Joseph Gold, *Exchange Rates in International Law and Organization* (American Bar Association, 1988), p. 113. As a general matter, the extensive writings of Sir Joseph Gold, former General Counsel of the Fund, provide an invaluable resource to any examination of the meaning of Article IV. Among other things, he was consulted on the preparation of the draft text of Article IV before it was presented to the Executive Board and, therefore, has some knowledge of the authors’ intentions that are not evident in the rather sparse legislative history of Article IV. Other publications of Sir Joseph Gold that are of relevance to this topic include *Interpretation: The IMF and International Law* (Kluwer Law International, 1996); *Developments in the International Monetary System, the International Monetary Fund and the International Monetary Law Since 1971* (Martinus Nijhoff, 1983); *Legal and Institutional Aspects of the International Monetary System: Selected Essays, Volume II* (IMF, 1983); *Legal Effects of Fluctuating Exchange Rates* (IMF, 1990).

⁴ *Implementation of The Second Amendment—Notification of Exchange Arrangements under Article IV, Section 2*, SM/77/277, November 28, 1977, p. 2.

⁵ *Id.*

members maintain the value of their currencies in relation to the value of another member's currency or a group of currencies". However, the list set forth in Article IV, Section 2 is illustrative rather than exhaustive and it is specifically provided that a member may use "other exchange arrangements of a member's choice".

11. ***The only type of exchange arrangement that is specifically precluded under Article IV, Section 2 is one that relies on gold as the denominator.*** This prohibition reflects a principal objective of the Second Amendment, which was to reduce the role of gold in the international monetary system.

12. ***Members are required to provide an accurate notification to the Fund regarding their exchange arrangements and of any changes they make to them.*** This notification is for the information of the Fund; the Fund's consent is not required for a member's initial choice of exchange arrangement, nor for subsequent changes. Changes must be notified "promptly" and the Board has interpreted this as requiring notification within three days of the modification.⁶ Shortly after the adoption of the Second Amendment, the Board set out guidelines on the types of changes to an exchange arrangement that would require notification.⁷

13. ***Notwithstanding the broad freedom that members have in this area, a member's choice of exchange arrangement must be consistent with its obligations under the Articles.*** A member cannot put in place an exchange arrangement that would give rise to a breach of an obligation under the Fund's Articles. For example, a member could not maintain an exchange arrangement that gave rise to a multiple currency practice that was inconsistent with Article VIII, Section 3.

14. ***Perhaps of even greater relevance for this review, a member could not put in place an exchange arrangement that would give rise to a breach of its obligations under Article IV, Section 1, the content of which will be discussed in detail in the next section.*** Indeed, this limitation is expressly referred to in various sections of Article IV, including: (i) Article IV, Section 2(a) (which provides that each member shall notify the Fund of "the exchange arrangements it intends to apply in fulfillment of its obligations under [Article IV,] Section 1"), (ii) Article IV, Section 2(c) (which refers to "the right of members to have exchange arrangements of their choice consistent with the purposes of the Fund and the obligations under Article IV, Section 1"), and (iii) Article IV Section 3 (which, in the context of the Fund's surveillance responsibilities, refers to "other exchange arrangements of a member's choice consistent with the purposes of the Fund and Article VI Section 1").⁸

⁶ See *Chairman's Summing Up, Annual Review of the Implementation of Surveillance* (EBM/82/44), April 9, 1982, p. 13.

⁷ [Notification of Exchange Arrangements under Article IV, Section 2](#), Decision No. 5712-(78/41), adopted March 23, 1978.

⁸ Although the legislative history of Article IV is not extensive, there was also some analysis of this issue when the draft provision was discussed in the Executive Board. In particular, the then General Counsel noted that "the freedom of members to choose was protected although, of course, they remained subject to the obligations of

(continued...)

15. ***The fact that a member's obligations under Article IV, Section 1 may limit the ability of a member to exercise a right that is specifically recognized under the Articles has been discussed in other contexts.*** Most importantly, the Articles specifically confer upon members the right to exercise controls on capital movements.⁹ However, it has been understood that a member may not impose capital controls if such controls are used to manipulate the member's exchange rate "in order to prevent balance of payments adjustment or to gain an unfair competitive advantage over other members" within the meaning of Article IV, Section 1.¹⁰

III. The Obligations of Members under Article IV, Section 1

16. This section examines the obligations of members under Article IV, Section 1, perhaps the most complex provision of the Fund's Articles (the text is set forth in Box 2). For analytical purposes, it is helpful to divide Article IV, Section 1 into three parts. The first part contains a rather lengthy preamble to the general obligation of Article IV. (The text of the preamble does not, on its own, constitute an obligation). The second part sets forth the general obligation itself; namely, the requirement of each member to undertake "to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates." Finally, the third part identifies four specific obligations whose performance is judged to be of particular relevance to the general obligation to collaborate. Each part will be discussed in turn.

A. The Preamble

17. ***By setting forth the "essential purpose" and a "principal objective" of the international monetary system, the preamble may be understood as identifying the broader economic benefits that flow from members' adherence to their obligations under Article IV, Section 1.*** The "essential purpose" of the international monetary system is

Article IV, Section 1." See EBM/75/206, December 23, 1975, p. 15. See also, *Surveillance over Exchange Rate Policies; Legal Aspects of the Discussion of SM/77/33, SM/77/59*, March 21, 1977, p. 1.

⁹ Article VI, Section 3.

¹⁰ Under the 1977 Decision, one of the "developments" that "might indicate the need for discussion with a member" regarding the observance of the principle relating to exchange rate manipulation includes the introduction of or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital. See also, statements by the General Counsel during the 1977 Executive Board discussions of the 1977 Decision in which he clarified that the imposition of capital controls or the capital flows that could occur in the absence of such controls could be legally used as an indicator justifying a need for discussion between the Fund and the member of the appropriateness of the member's exchange policies. The General Counsel reasoned that as with other provisions of the Articles, the members' freedom in terms of capital controls was circumscribed by the member's obligations under Article IV. EBM/77/9, January 17, 1977, p. 10; EBM/77/10, January 19, 1977, pp. 7, 9, and 17. See also EBM/77/10, January 19, 1977, pp. 16-18 for the discussion of the same issue during the Board discussions of the 1977 discussions.

identified as “provid[ing] a framework that facilitates the exchange of goods, services and capital among countries and sustains sound economic growth”. Moreover, a principal

Box 2. Article IV, Section 1 of the Fund’s Articles of Agreement

Section 1: General obligation of members

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective 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. In particular, each member shall:

- i. endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
- ii. seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
- iii. 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; and
- iv. follow exchange policies compatible with the undertakings under this Section.

objective of the system is “the continuing development of the underlying conditions that are necessary for financial and economic stability”. The assumption underlying the preamble is that, to the extent that members observe their general obligations set forth in Article IV, Section 1, they will enhance the effective functioning of the international monetary system and, thereby, contribute to the realization of the broader economic benefits identified in this text.

18. ***The identification of these broader economic benefits in the preamble does not mean that the achievement of these benefits has become a purpose of the Fund. The preamble sets forth the purposes of the international monetary system—not those of the Fund.*** While the achievement of these broader benefits could have been incorporated into Article I as a purpose of the Fund at the time of the Second Amendment, this would have been understood as a significant expansion of the Fund’s mandate, something which the drafters wished to avoid. It certainly would have increased the tension with other provisions of the Articles. For example, to the extent that the facilitation of the exchange of capital became a purpose of the Fund, such a purpose would have been difficult to reconcile with members’ general right to maintain capital controls under Article VI, Section 3.

19. ***Although the text of the preamble does not give rise to obligations, it can be used as a tool to interpret those obligations that are set forth in Article IV, Section 1. Similarly, it provides a useful means of understanding the scope of the Fund’s surveillance***

responsibilities under Article IV, Section 3. In particular, the definition of the essential purpose of the international monetary system is of relevance when examining the Fund’s responsibility to “oversee the international monetary system”, which is generally referred to as “multilateral surveillance”.

B. The General Obligation: The Undertaking to Collaborate

20. *As noted, the general obligation of Article IV is to “collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates”.* Before analyzing in detail the content of this obligation, it is important to examine its relationship with the four specific obligations that follow it, two of which relate to domestic policies and two of which involve external policies. Importantly, the sentence that links the general obligation to the specific obligations reads “In particular, each member shall:”. Based on the use of the term “in particular” in this sentence, it may be concluded that the four specific obligations, while they represent “particularly” important steps that members must take to fulfill their general obligation to collaborate, are not the only such steps that must be taken; i.e. the general obligation of collaboration is broader in scope than the sum total of the four specific obligations.¹¹ A contrary interpretation—one which would conclude that the specific obligations exhaust the content of the general obligation—would render the general obligation redundant, contrary to general principles of statutory construction.¹²

21. *The above conclusion is of considerable relevance when one considers the concept of “collaboration”, particularly in light of the way this term was understood and used prior to the Second Amendment.* Prior to the Second Amendment, Article IV, Section 4(a) provided as follows:

“Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members and to avoid competitive exchange alterations.”

22. *The collaboration undertaking set forth in the above provision was relied upon as a basis for the Fund to call on members to take specific actions or refrain from taking specific actions.* While such a call could—and, on occasion, did—constitute a requirement (with the implication that failure by a member to heed the call could give rise to a breach of the obligation of collaboration), the Fund often exercised its authority under this provision by making recommendations, preferring a “softer” means of guiding the membership as to their

¹¹ Sir Joseph Gold, *Exchange Rates in International Law and Organization* (American Bar Association, 1988), p. 104.

¹² “A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous”; Norman J. Singer, *Statutes and Statutory Construction*, at pp. 185–86. Moreover, as is noted by Sir Joseph Gold, former General Counsel of the Fund, such an interpretation of “in particular” is also supported by the interpretation that has been given to the term in other provisions of the Articles; See *Exchange Rates in International Law and Organization*, at p. 104.

obligations under the Articles. It was understood that failure to abide by such recommendations would not constitute a breach of the obligation to collaborate.¹³ The Fund made considerable use of this collaboration obligation during the period between the breakdown of the par value system and the Second Amendment as a means of limiting exchange rate instability and competitive depreciation (see Box 3). Following a similar approach, the Fund could rely on the collaboration undertaking set forth in the present Article IV, Section 1 as a basis for either requiring or recommending that members take— or refrain from taking—those actions that, while not included in any of the specific obligations listed in Article IV, Section 1, are considered by the Fund to be necessary—in light of changing circumstances—to assure orderly exchange arrangements and to promote a stable system of exchange rates.

23. ***Indeed, in one respect the collaboration undertaking contained in Article IV, Section 1 is broader than the pre-Second amendment version.*** While the earlier version only required collaboration with the Fund, the present Article IV, also specifically requires members to collaborate with each other. Although, as in many other aspects of Article IV, Section 1, the legislative history provides little guidance as to the intent of this expansion, it is clear that the need for co-operation among members in the conduct of their policies had become increasingly relevant by the time of the Second Amendment.¹⁴ It should be emphasized, however, that, although this provision specifically contemplates collaboration among members, it is the Fund—and not its members—that has the exclusive authority to determine whether such collaboration satisfies the requirements of Article IV, Section 1.

¹³ As noted by Sir Joseph Gold, it was recognized that, if members did not adhere to recommendations, the Fund could revisit the issue and determine whether a firmer approach was needed. “Although provisions imposing obligations to collaborate are expressed in mandatory terms, the IMF has assumed that the exacting administration authorized by such a provision permits a less rigorous approach, without any sacrifice of authority should firmer administration of it become advisable”; *Interpretation: The IMF and International Law*, at p. 337.

¹⁴ The expansion of the obligation to collaborate to include collaboration among members may have been inspired by certain arrangements that existed at the time of the Second Amendment, such as the “snake” and the practice of pegging to certain leading currencies. The “snake” was an arrangement between several European countries by which each participant maintained a fixed relationship between its currency and the currency of other participants, with narrow margins for transactions involving these currencies.

Box 3. Duty to Collaborate under Article IV, Section 4(a) of the original Articles of Agreement

Prior to the Second Amendment, Article IV, Section 4(a) set forth a general obligation to collaborate as follows: “Each member undertakes to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations”. On a number of occasions, the Fund relied on this provision to either call on or recommend to members that they take certain actions or refrain from taking actions in order to achieve the objectives set forth in this provision. For example:

1. **1947 Decision on Multiple Currency Practices.** Notwithstanding the express language of Article XIV, Section 2, which allowed members to maintain and adapt to changing circumstances (and, in some cases, to introduce) restrictions on payments and transfers for current international transactions at their discretion during the post-war transitional period, the Fund decided that members were required to obtain the approval of the Fund before introducing or adapting multiple currency practices pursuant to their duty to collaborate with the Fund under Article IV, Section 4(a). Specifically, the sense of the meeting was that “*the provisions in Article XIV, Section 2, regarding the transitional period did not modify members’ obligations under Article IV, Section 4, irrespective of the particular exchange device involved.*”^{1/} The Board adopted a decision approving the text of a communication to be sent to all members on multiple currency practices. This communication required a determination by the Fund of the consistency of the member’s proposed action (i.e. either introduction or adaptation of a multiple currency practice) with Article IV, Section 4(a) and indicated that a duty to consult with and obtain the approval of the Fund is implicit in both Article IV, Section 4(a) and in Article XIV, Section 2.^{2/}

2. **Recommendations made during 1971–74 Regarding Exchange Rate Policies.** During the period of 1971–74, the Executive Board adopted a number of decisions designed to provide guidance to members as to how they should conduct their exchange rate policies in an environment when the par value system was no longer fully operational. For example, in 1971 the Fund adopted—and, in 1973, subsequently revised—decisions aimed at establishing a system corresponding to the par value system but with greater flexibility. The decisions identified practices that members “*may wish to follow in present circumstances consistently with Article IV, Section 4(a)...*” (emphasis added). The decisions did not impose an obligation but, rather, indicated that members would be “deemed to be acting in accordance with Article IV, Section 4(a)” with regard to the introduction of wider margins by a member or the communication of a central rate with wider margins, if they followed the practices spelled out in the decisions.^{3/} On June 13, 1974, the Board adopted a decision and its attached memorandum (*the Guidelines for the Management of Floating Exchange Rates*), which focused on the intervention policies to be followed by members with a floating exchange system. The decision “recommend[s], pursuant to Article IV, Section 4(a) that, in present circumstances, members should use their best endeavors to observe the guidelines set forth and explained in the memorandum.”^{4/}

¹ See EBM/47/237, December 18, 1947.

² See EBM/47/237, December 18, 1947 and Executive Board Document No. 235, Revision 2, Attachment 8.

³ See Decision No. 3463-(71/126) on Central Rates and Wider Margins—Temporary Regime and Decision No. 4083-(73/104), adopted respectively December 18, 1971 and November 7, 1973.

⁴ See Decision No. 4232-(74/67), adopted June 13, 1974, and Annex I attached to Executive Board Decision No 4232-(74/67).

24. ***The nature of the actions that members must take to satisfy the obligation of collaboration can only be determined in light of the objectives of this collaboration: to “promote orderly exchange arrangements and a stable system of exchange rates”.*** Each of these objectives is examined in turn, beginning with “a stable system of exchange rates” because its intended meaning—although still somewhat obscure—is perhaps easier to ascertain than that of “orderly exchange arrangements.”

25. ***A Stable System of Exchange Rates.*** As was noted in the Introduction, by the time of the Second Amendment, there was a concern that the par value system had created rigidity without stability, with members failing to adjust—or delaying adjustment—even in circumstances of fundamental disequilibrium. It was believed that, in the medium term, the overall monetary system would operate more effectively—and, accordingly, be in a better position to achieve its purposes—if exchange rates were permitted to move in response to underlying conditions, particularly if these underlying conditions benefited from the pursuit of appropriate domestic economic policies. It is for this reason that the objective of collaboration set forth in the original Article IV—the requirement to collaborate to promote “exchange stability”—was modified in the Second Amendment to become the requirement to collaborate to promote a “stable system of exchange rates.” The present objective is to achieve the stability of the system—not stability of exchange rates as such—and the underlying assumption is that such stability is best achieved if exchange rates reflected underlying conditions that, in turn, are directed towards achieving economic and financial stability, as indicated in the preamble to Article IV, Section 1.¹⁵ As will be seen, the important relationship between domestic economic policies and the effective operation of the international monetary system is made explicit in the specific obligations of Article IV, Section 1.

26. ***Even if a member’s exchange arrangement includes a specified exchange rate, the member’s ability to choose this rate would be constrained by its obligation under Article IV, Section 1 to collaborate with the Fund to promote a stable system of exchange rates.*** As noted in the previous section, in circumstances where a member has pegged its currency to other currencies, the value at which this pegging is to occur has been understood as part of a member’s exchange arrangement that requires notification to the Fund. Notwithstanding the fact that a member has a general right to select the exchange arrangements of its choice, in these circumstances this right would be limited by the exchange rate obligations set forth in Article IV, Section 1. Moreover, and as is discussed in the following section, these rates would be the subject of Fund surveillance under Article IV, Section 3(b).

27. ***Orderly Exchange Arrangements.*** As noted in the previous section, exchange arrangements are generally understood as referring to the overall framework that a member

¹⁵ The reference to “exchange stability” in the purposes of the Fund under Article I was left intact out of a reluctance on the part of members to change the language of the purposes in the context of the Second Amendment of the Articles. See Joseph Gold, *Developments in the International Monetary System, the International Monetary Fund and the International Monetary Law Since 1971* (Martinus Nijhoff, 1983), at p. 216.

uses to determine the value of its currency against other currencies. Prior to the Second Amendment, members undertook to collaborate to “maintain orderly exchange arrangements with other members”. This text was generally understood as supporting the maintenance of the par value system which, as noted in the Introduction, only allowed members to value their currencies in terms of gold, either directly or through the U.S. dollar. Given the freedom accorded to members in the choice of their exchange arrangements, it may seem somewhat surprising that “orderly exchange arrangements” was retained as one of the objectives of the duty to collaborate under the revised Article IV. Although the legislative history is silent on the question, it must be assumed that, notwithstanding the continuity of language, it was intended that the underlying meaning of this objective would change in a manner that takes into account the change made to the other objective of the obligation to collaborate (i.e., the change from “exchange stability” to a “stable system of exchange rates”, and the broad freedom given to members to put in place exchange arrangements of their choice). As noted above, even where the exchange arrangement actually includes a specified exchange rate, the right of the member to select this component would be constrained by its obligations regarding a stable system of exchange rates. However, the question arises as to whether the overall methodology chosen for calculating the value of the member’s currency (rather than the specified rate in question) could give rise to an arrangement that is “disorderly” within the meaning of Article IV, Section 1. One example would appear to be a multiple exchange rate system arising from segmented markets, even one which arises from capital transactions and, accordingly, is not inconsistent with a member’s obligations under Article VIII, Section 3.¹⁶

C. The Specific Obligations

28. *Article IV, Section 1 identifies four specific obligations whose performance is considered to be of particular relevance to the general obligation to collaborate.* To the extent that a member breaches one of these specific obligations, it would also be in breach of the general obligation of collaboration. However, adherence to these specific obligations does not necessarily mean that the member will always be in compliance with the general obligation. As noted above, the Fund has the authority to call upon the member to take additional action—or to refrain from taking certain actions—that it considers appropriate in light of the obligation to collaborate. Each of these specific obligations is discussed in turn.

Direction of Economic and Financial Policies (Article IV, Section 1(i))

29. *Article IV, Section 1(i) requires each member to “endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances.”* As discussed above, this

¹⁶ From the very beginning of the Fund, it was recognized that multiple currency practices, by virtue of the fact that they constitute a system of exchange rates, raise issues under Article IV, Section 4(a). In one paper, it was noted that “[T]he proposal to introduce a new multiple currency practice necessarily involves a threat to exchange stability or orderly exchange arrangements or constitutes a possible exchange alteration.” See *Certain Aspects of the Jurisdiction of the Fund over Multiple Currency Practices*, (note to Committee on Spreads and Multiple Currency Practices, June 3, 1947), at p. 6.

specific obligation reflects the view that, although exchange rates should be permitted to move in line with underlying conditions, the stability—and overall predictability—of the system of exchange rates would be enhanced through the pursuit of appropriate economic policies. Accordingly, this obligation describes the types of domestic policies that would be appropriate for this purpose. In that regard, it recognizes that the exchange rate system will only be stable on a sustainable basis if domestic policies are directed towards economic growth—albeit the type of growth that is “orderly” and is accompanied by “reasonable price stability”. Relative to the pre-Second Amendment text of Article IV, which focused exclusively on policies relating to exchange rates and exchange arrangements (i.e., external policies), this provision is significant because it extends members’ obligations—and therefore the Fund’s jurisdiction—to domestic policies. It should be emphasized, however, that this obligation is a particularly weak one—precisely because it does relate to domestic policies. As noted above, members are only required to “endeavor” to direct domestic policies towards the “objective” of fostering orderly economic growth and with “due regard to the circumstances”.

30. *The legislative history of the phrase sheds some light on the phrase “fostering orderly economic growth with reasonable price stability”.* Earlier drafts of this provision placed greater emphasis on price stability relying on the phrase “orderly economic growth within the context of reasonable price stability”. The change to “orderly economic growth with reasonable price stability” gave somewhat greater emphasis to growth.¹⁷

Promotion of Stability (Article IV, Section 1(ii))

31. *Article IV, Section 1(ii) requires each member to “seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions”.* Although the language of this provision is not explicit, the drafting history indicates that the policies referred to in this provision are domestic rather than external policies. In particular, efforts in the Executive Board to insert the word “exchange” before stability were rejected.¹⁸ Moreover, the reference to “a monetary system” in Article IV, Section 1(ii) may be contrasted with the reference in the preamble to Article IV, Section 1 to the “international monetary system.” Reflecting the focus on domestic policies, the obligation is similar in nature to that of Article IV, Section 1(i); namely, it is very soft: members are required to “seek” to promote stability by “fostering” underlying economic and financial conditions. As with Article IV, Section 1(i), the assumption is that, by fostering orderly underlying economic conditions and a stable monetary system at the domestic level, members help ensure orderly exchange arrangements and a stable system of exchange rates. With respect to the phrase a “monetary system that does not tend to produce erratic disruptions”, it is not clear whether the phrase “erratic

¹⁷ Sir Joseph Gold, *Exchange Rates in International Law and Organization*, p. 106.

¹⁸ EBM/75/207, December 23, 1975, p. 29. More generally, for a discussion of the distinction between domestic and exchange rate policy obligations under Article IV, Section 1, see Sir Joseph Gold, *Exchange Rates in International Law and Organization*, p. 107.

disruptions” only refers to disruptions in exchange rates or whether it has a broader meaning. At a minimum, and consistent with the general philosophy that underlies Article IV, Section 1, it would cover erratic disruptions in exchange rates that are not the result of orderly underlying economic and financial conditions.

Exchange Rate Manipulation (Article IV, Section 1(iii))

32. *As noted above, Article IV, Section 1 also establishes specific obligations respecting a member’s external policies.* The first of these is set out in Article IV, Section 1 (iii) which requires members to “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.” Unlike members’ obligations respecting domestic policies, this provision establishes a “hard” obligation that prohibits specific conduct, reflecting the view that such policies are a more central concern of the international community.

33. *Article IV, Section 1(iii) is a relatively complex provision and not all of its terms are easily understood— or easily applied.* In particular, it is not clear what type of activity was intended to be covered by the phrase “manipulating the international monetary system” (as distinguished from the other prohibited activity, that of manipulating “exchange rates”). In addition, the determination as to whether the competitive advantage obtained by a member through manipulation is “unfair” would require the exercise of considerable judgment.

34. *Notwithstanding the above, a number of the key elements of Article IV, Section 1(iii) are sufficiently clear to provide guidance as to how the provision was intended to be applied.* Its interpretation is facilitated by the fact that the Executive Board considered its application in the context of the preparation of the 1977 Decision which was adopted by the Executive Board after the Board of Governors’ adoption of the Second Amendment (but before the Second Amendment entered in force). Drawing on these discussions, the following observations can be made with respect to Article IV, Section 1(iii).

(a) *First, there are different ways in which a member could potentially “manipulate” exchange rates within the meaning of Article IV, Section 1(iii).* For example, it could occur through excessive intervention in the exchange markets or through the imposition of capital controls. Moreover, manipulation would not necessarily require that official intervention— whatever its form—result in the movement of the exchange rate. In some cases, the manipulation may be designed to prevent movement in the rate.

(b) *Second, the term “in order to prevent balance of payments adjustment” is sufficiently broad to cover situations where a member is manipulating its exchange rate in a manner that makes it either overvalued or undervalued.*

(c) *Third, and perhaps most importantly, a member will only be found in breach of Article IV, Section 1(iii) if the determination is made that the member manipulated its exchange rate for the purpose of preventing effective balance of payments adjustment.* The fact that the measure has the effect of preventing adjustment is not sufficient—the use of the phrase “in order to” means that a determination of intent is required. This does not mean,

however, that the Fund is required to accept the member's own representation of its motives. In terms of the way the Fund determines intent, the discussion surrounding the 1977 Decision is of relevance. As is contemplated under the 1977 Decision, certain developments could be identified that would trigger discussion with the authorities; e.g. "protracted large-scale intervention in one direction in the exchange market". At that point, the Fund would ask the member to explain the motivation behind its actions. The Fund would give the member the opportunity to represent the purpose of the measure and the Fund would give this representation the benefit of any reasonable doubt. Ultimately, however, the Fund would make an independent assessment whether the member's representation was correct, taking into account all available and relevant information regarding the member's exchange rate policy. On that basis, the Fund would make a determination as to whether the actions in question were being taken for one of the purposes identified in Article IV, Section 1(iii). As was explained in a staff paper that was prepared for purposes of the discussions surrounding the 1977 Decision, this is the approach that the Fund generally followed in other contexts when determining whether a measure has been introduced for "balance of payments purposes".¹⁹

Exchange Policies Compatible with Undertakings of Article IV, Section 1 (Article IV, Section 1(iv))

35. *Finally, Article IV, Section 1(iv) requires members to "follow exchange policies compatible with the undertakings" of Article IV, Section 1.* Since this provision addresses aspects of a member's external policies, it establishes a "hard" obligation that is expressed in terms of achieving results, not merely "endeavoring" or "seeking" to achieve results. In terms of the meaning of this obligation, however, this provision is the least specific of all of the obligations identified under Article IV, Section 1 and the legislative history reveals that, at the time of its adoption, there was some uncertainty as to its meaning.

36. *A threshold issue is the intended meaning of "exchange policies".* Since the term is different from "exchange rate policies", it must be assumed that the obligation is intended to cover a different category of external policies that is broader than "exchange rate policies". One possibility is that it is intended to ensure that members' use of exchange controls is consistent with these undertakings. Among other things, such an interpretation would serve to confirm that, while members have the general right to maintain exchange controls that are consistent with their obligations under Article VIII, they may not do so if these controls are used in a manner that is inconsistent with their obligations under Article IV. However, although there was some discussion of the meaning of this provision (see below), there is no evidence that it was intended to include exchange controls.²⁰

¹⁹ See *Surveillance over Exchange Rate Policies: Balance of Payments Purposes*, SM/77/97, April 28, 1977. To illustrate this approach, the paper referred to the Fund's interpretation of "for balance of payment purposes" clauses in the context of Fund arrangements.

²⁰ See EBM/75/205, December 23, 1975,, pp. 17–20.

37. *Although the term “exchange policies” is sufficiently broad to cover exchange rate policies, it is not clear how this provision was intended to interact and supplement the other specific obligations set forth in Article IV, Section 1.* In terms of its relationship with members’ obligations regarding domestic policies, one interpretation would be that a member should follow exchange rate policies that support a member’s ability to pursue the types of domestic policies that are identified in these provisions. Such an interpretation would create the result, however, of members’ having to adhere to “firm” obligations regarding external policies in order to fulfill their “soft” obligations relating to domestic policies. Moreover, during the Executive Board meeting where the draft of this provision was discussed,²¹ the Economic Counsellor expressed concern that this interpretation could yield results that have the “opposite” effect of the overall thrust of Article IV, Section 1; namely it could subordinate the stability of the exchange rate system to domestic policy priorities. Specifically, he noted that the philosophy underlying Article IV, Section 1 was that, by adhering to their obligations to pursue appropriate domestic economic policies, the exchange rate system would be more stable. However, he expressed concern that Article IV, Section 1(iv) could be interpreted as meaning, for example, that a member should pursue an exchange rate policy that promoted domestic price stability—even if that exchange rate was overvalued. Although the text was retained, the Executive Director of one of the authoring members acknowledged that this provision would need to be interpreted “loosely” and, in any event, could not be used to justify the maintenance of unrealistic exchange rates.

38. *At least with its application to exchange rate policies, perhaps Article IV, Section 1(iv) can be most easily interpreted as requiring members to follow exchange rate policies that support the general obligation set forth in Article IV, Section 1; namely, the obligation “to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates”.* In contrast to the specific obligation regarding exchange rate manipulation—which is an obligation of restraint—this obligation is one that would also require members to take positive measures in this area. This interpretation would appear to be supported by the 1977 Decision. Specifically, while the first principle set forth in that decision is clearly designed to provide guidance regarding the manipulation obligation (indeed, it simply restates the text of Article IV, Section 1(iii)), the two remaining principles address intervention policies, exhorting members to: (a) “intervene in the exchange market to counter disorderly conditions” (consistent with the general obligation to promote a stable system of exchange rates) and (b) “take into account in their intervention policies the interests of other members” (consistent with the general obligation to collaborate with “other members”).

39. *Irrespective of the interpretation of Article IV, Section 1(iv), if the Fund wishes to provide further guidance to members as to those exchange rate obligations under Article IV, Section 1 that go beyond the obligation to avoid exchange rate manipulation, it may rely directly on the general obligation to collaborate to promote a stable system of exchange rates.* As is discussed earlier, and consistent with the approach that was adopted

²¹ See EBM/75/205, December 23, 1975, p. 17.

prior to the adoption of the Second Amendment, the Fund could call on members to pursue such exchange rate policies that it views as being necessary to achieve the objective of achieving a stable system of exchange rates. In this regard, and as noted earlier, the specific obligations contained in Article IV, Section 1(i) through (iv), while being of particular importance with respect to the Fund's jurisdiction under Article IV, do not exhaust it.

IV. The Fund's Responsibilities Under Article IV, Section 3

40. *Article IV, Section 3(a) sets forth two distinct obligations for the Fund.* The first requires the Fund to "oversee the international monetary system to ensure its effective operation". This provision provides the basis for the Fund's multilateral surveillance activities, which include the World Economic Outlook and the multilateral consultation process that was recently initiated. The second obligation requires the Fund to "oversee the compliance of each member with its obligations under Article IV, Section 1". Accordingly, this general oversight obligation applies not only to the general obligation to collaborate but also to all of the specific obligations enumerated in Article IV, Section 1(i) through (iv), including the obligations regarding domestic policies.

41. *However, because of the particular importance of members' obligations regarding their exchange rate policies, Article IV provides the Fund with more specific direction as to how it is to oversee members' compliance with these obligations.* (See Box 4).

Specifically, Article IV Section 3(b) provides that, in order to fulfill this general oversight function, the Fund shall "exercise firm surveillance over the exchange rate policies members and shall adopt specific principles for the guidance of all members with respect to those policies." As a means of enabling the Fund to carry out this function, each member is required to: (a) provide the Fund with the information necessary to conduct surveillance over such policies; and (b) when requested by the Fund, to consult with the Fund regarding its exchange rate policies. The requirement of the Fund to adopt specific principles in this area provides the legal basis for the principles contained in the 1977 Decision, which specifically provides that it has been adopted in order for the Fund to perform its responsibilities under Article IV, Section 3(b) (i.e., firm surveillance over exchange rate policies) rather than the more general obligation under Article IV, Section 3(a) (which requires the Fund to oversee *all* of members' obligations under Article IV, Section 1).

Box 4. Article IV, Section 3 of the Fund's Articles of Agreement

Section 3. Surveillance over exchange arrangements

(a) 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.

(b) In order to fulfill its functions under (a) above, 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. 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 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.

42. **When considering the existing principles mandated under Article IV, Section 3(b)—and any possible modifications to such principles—the following should be noted.**

43. ***First, the specific principles mandated by Article IV, Section 3(b) are only required with respect to those obligations under Article IV, Section 1 that deal with “exchange rate policies”.*** Accordingly, and in light of the analysis set forth in the previous section, these obligations comprise members' obligations under Article IV, Section 1(iii) and (iv) and any exchange rate actions the Fund may call on members to take pursuant to the general obligation to collaborate in the promotion of a stable system of exchange rates under Article IV, Section 1. While it is open for the Fund to adopt principles for the guidance of members in complying with their obligations respecting domestic policies under Article IV, Section 1(i) and (ii)(or any other domestic policies that the Fund may determine are necessary in light of the general obligation to collaborate), it is not required to do so. Consistent with the above, the 1977 Decision focuses on members' exchange rate policies, albeit with an explicit recognition that there is a close relationship between these policies and domestic policies.²² As was noted in a recent paper, however, the surveillance process has

²² As is evident from the section of the 1977 Decision entitled “Principles of Fund Surveillance over Exchange Rate Policies,” exchange rate policies have been understood by the Executive Board as embracing a broad range of external policies that are specifically pursued for balance of payments purposes; e.g. “the introduction of or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital.” Moreover, to the extent that certain domestic policies are also pursued for balance of payments purposes, the indicators suggest that these would also be included; specifically, “the pursuit, for

(continued...)

increasingly focused on those policies of members that relate to their performance of domestic policy obligations under Article IV, Section 1; i.e., Article IV, Section (i) and (ii).²³

44. ***Second, since the principles to be adopted under Article IV, Section 3(b) are intended to provide “guidance” as to how a member’s exchange rate policies will be consistent with its obligations under Article IV, Section 1, failure to abide by these principles would not necessarily mean that a member is in breach of these obligations.***

Under the existing 1977 Decision, and as noted in Section II of this paper, the principle that specifically addresses exchange rate manipulation (Principle A) simply repeats the language of Article IV, Section 1(iii). Accordingly, a determination that a member has not adhered to this principle would effectively constitute a determination that a member is in breach of its obligations under the Articles. (The “guidance” is effectively provided by the list of “developments” which, under terms of the decision, “might indicate the need for discussion with a member”). In contrast, however, there is no evidence that the remaining principles (Principles B and C) were ever understood as actually constituting obligations under Article IV, Section 1, either under the general collaboration obligation set forth in that provision or under Article IV, Section 1(iv) (which requires members to pursue exchange policies that are consistent with their undertakings under Article IV, Section 1). However, to the extent that a member’s policies are in harmony with these principles, the Fund would be precluded from finding that a member is in breach of these obligations.

45. ***Third, to the extent that the Fund wishes to revise and update its principles on those exchange rate policies that are unrelated to manipulation for balance of payments purposes, such a step could be taken on the basis of the Fund’s authority to require or recommend that members pursue – or refrain from pursuing – specified exchange rate policies pursuant to their general obligation to collaborate to promote a stable system of exchange rates.***²⁴ Consistent with the approach followed prior to the Second Amendment, the Fund could decide that, in lieu of identifying exchange rate action that would constitute obligations under the general obligation to collaborate set forth in Article IV, it would issue recommendations with respect to such actions. Failure to adhere to such recommendations would not, in and of itself, constitute a breach of the obligation under the Articles.

balance of payments purposes, of monetary and other domestic financial policies that provide abnormal encouragement or discouragement to capital flows.” However, domestic policies pursued for these specific purposes should be distinguished from domestic policies that only have this effect. The latter category would not be considered “exchange rate policies” within the meaning of the 1977 Decision.

²³ [*Biennial Review of the Implementation of the Fund’s Surveillance and the 1977 Surveillance Decision—Modalities of Surveillance*](#), Appendix 1 (SM/04/212, July 2, 2004).

²⁴ Consistent with general principles of statutory construction, any call by the Fund for members to pursue particular exchange rate policies—or to refrain from pursuing certain policies—could not be so general as to make the specific obligations set forth in Article IV, Section 1 redundant. For example, a call to members to avoid all forms of exchange rate misalignment (irrespective of the motivation) would effectively render Article IV, Section 1(iii) redundant.

46. ***Finally, while the principles under Article IV, Section 3(b) must be consistent with members' exchange arrangements, they are not intended to provide guidance with respect to these exchange arrangements.*** As noted in this paper, members' rights regarding their choice of exchange arrangements are qualified by their obligations under Article IV, Section 1. Specifically, to the extent to which the member's exchange arrangement includes a specified exchange rate, the scrutiny of this rate in light of a member's obligation to promote a stable system of exchange rates is a proper subject of the principles issued under Article IV, Section 3(b). However, there also may be situations where Fund is of the view that the underlying methodology relied upon by the members for valuing their currencies (rather than the rate itself) constitutes a "disorderly exchange arrangement" within the meaning of Article IV, Section 1. While the Fund could issue guidelines to members as to what type of arrangements would be considered disorderly, these guidelines would be issued under Article IV, Section 1 rather than Article IV, Section 3(b).

V. Conclusions

47. ***Since the adoption of the Second Amendment and the 1977 Decision, the Fund has refrained from elucidating the meaning of members' obligations under Article IV for purposes of its bilateral surveillance activities.*** Taking into account the substance of these obligations, as described in this paper, the Executive Board could choose to place greater reliance on the legal framework of Article IV, but in a manner that continues to ensure flexibility and the maintenance of the cooperative nature of the Fund. Specifically:

48. ***With respect to members' exchange rate policies,*** the principles that the Fund is required to adopt to provide guidance to members in this area could be updated in a manner that takes into account the substance of members' obligations under Article IV, Section 1. One of these obligations prohibits exchange rate manipulation for the purposes identified in Article IV and further guidance could be given as to how this obligation will be applied in practice, taking into account developments since 1977. As has been described in this paper, however, the obligations relating to exchange rate policies are not limited to members' obligations regarding exchange rate manipulation for balance of payments reasons. The Fund could, for example, make specific recommendations regarding other exchange rate policies it believes members should adopt as a means of complying with their general obligation to "collaborate with the Fund and other members to . . . promote a stable system of exchange rates".

49. ***With respect to members' exchange arrangements,*** while this term is not specifically defined under the Articles, its use in Article IV, Section 2 confirms that it is intended to include the overall method that a member uses to determine the value of its currency against other currencies (e.g. pegging vs. floating). While the Articles confirm that members may choose whichever exchange arrangement they wish (other than one that relies on gold as the denominator), members must exercise this freedom in a manner that is consistent with their obligations under the Articles. First, members must provide an accurate notification to the Fund regarding their exchange arrangements and any changes to those arrangements. Second, in circumstances where a member has actually specified the exchange rate that it will use when implementing its exchange arrangement and this forms part of the member's

notification, the rate specified is subject to members' obligations regarding their exchange rate policies, discussed above. Finally, a member's exchange arrangement must be consistent with its general obligation under Article IV "to collaborate with the Fund to assure orderly exchange arrangements".

50. ***With respect to members' domestic policies.*** Article IV identifies certain domestic policy obligations, the adherence to which is considered to be of particular importance to the members' general obligation to collaborate with the Fund to assure orderly exchange arrangements and to promote a stable system of exchange rates. As discussed in the paper, while these policies are of international concern because of their impact on external stability, the relevant obligations are of a "soft" nature, requiring efforts rather than the achievement of results. To the extent that the Fund were to identify other domestic policies that members should take pursuant to the general obligation of collaboration, any such obligations would also need to be of a similarly soft nature. Any guidelines or principles that would be adopted for this purpose would be adopted under Article IV, Section 1 rather than Article IV, Section 3(b), the latter dealing with exchange rate policies.