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## Legal Models for the International Regulation of Exchange Rates

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*International Monetary Fund*

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# LEGAL MODELS FOR THE INTERNATIONAL REGULATION OF EXCHANGE RATES

*Joseph Gold\**

## INTRODUCTION

No legal scholar has contributed more to the study of the harmonization of national interests by international agreement than Professor Eric Stein. This essay in his honor examines some of the efforts that have been made since the Bretton Woods Conference of July 1944 to bring order into the important international relationships that are called exchange rates. The subject has a further pertinence because of Eric Stein's work on the European Community. The law of the Community on exchange rates has been affected by the fortunes of the law of the International Monetary Fund (IMF). The Treaty of Rome relied to a large extent on the legal order established originally by the IMF's Articles of Agreement, but the Community has attempted to create its own system as the wider order of the IMF has come under the pressure of troublesome economic developments. Here is another aspect of harmonization: the law of the European collectivity must fit into the law of the broader society of nations. Finally, the subject is timely because the behavior of exchange rates is a constant preoccupation of monetary authorities and scholars and provokes them to call for improvements in international monetary arrangements.

### *National and International Interests*

The exchange rate for a country's currency is one of the most important prices in the national economy, and often the most important price, but the exchange rate is also a price in the international economy. The exchange rate between the currencies of two countries is a relationship between the currencies and between the economies of the two countries. "In an open trade and payments system exchange rates are bound to lie at the center of economic relations between sovereign states."<sup>1</sup> This fact suggests that exchange rates should be subject to international agreement in some form if disorder is to be avoided in economic relations among states.

Nevertheless, the traditional view could be expressed by the Permanent Court of International Justice in 1929 in the simple assertion that "[i]t is indeed a generally accepted principle that a State is entitled to regulate its own currency."<sup>2</sup> The Bretton Woods Conference, in producing the Articles of Agreement of the IMF, revolutionized international monetary law and international economic relations. Lord Keynes, one of the leaders in this

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1. GROUP OF THIRTY, THE PROBLEMS OF EXCHANGE RATES 10 (1982).

2. Case of Serbian Loans, 1929 P.C.I.J., ser. A, Nos. 20/21, at 44.

revolution, wrote about the necessity for change in a letter dated May 29, 1945 to Edward M. Bernstein of the U.S. Treasury:

Pigou has just called my attention to a passage in Marshall's Evidence before the Gold and Silver Commission—Q.10,006, more than fifty years ago (have we yet asked more than 10,000 questions about Bretton Woods?) as follows:—

I think that there is a real, though very slow-moving, tendency for national interests to overrule provincial interests, and international interests to overrule national, and I think the time will come at which it will be thought as unreasonable for any country to regulate its currency without reference to other countries as it would be to have signalling codes at sea which took no account of the signalling codes at sea of other countries.

So once more we may hope the old man has been right, with not much more of a time-lag than it is reasonable to expect, at least in international affairs.<sup>3</sup>

The participants in the Bretton Woods Conference accepted the principle that because exchange rates were matters of international concern, they should be subject to international consultation and agreement. A major argument to support this radical change was that the pooling of authority by all countries would protect the agreed exchange rate of each country's currency from unfair competition by other countries when establishing the exchange rates for their currencies.<sup>4</sup>

International monetary conditions have become turbulent in recent years. Great changes have occurred in the law governing exchange rates, and, as noted earlier, proposals have been made for further developments. It is useful, therefore, to attempt to isolate some essential characteristics of various models that have been employed, or have been recommended, for the regulation of exchange rates by procedures not solely dependent on the exercise of discretion by the issuer of the currency.

Procedures that are not confined to the exercise of discretion of the issuer imply a role for an entity external to the issuer. Some of the main elements to be discussed in the models that involve such an entity are:

- (i) the fixed or floating character of the exchange rate for a currency;
- (ii) the initiative that can be taken to establish the exchange rate;
- (iii) the external entity authorized to react to the exchange rate;
- (iv) the stage at which the external entity reacts;
- (v) the majority for the decision of the external entity by which it reacts.

#### *Former Par Value System of IMF*

The original Articles of the IMF, which became effective on December 27, 1945, established a par value system<sup>5</sup> that distributed legal authority in

3. THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES, VOLUME XXVI, ACTIVITIES 1941-1946: SHAPING THE POST-WAR WORLD, BRETTON WOODS, AND REPARATIONS 195 (D. Moggridge ed. 1980).

4. 3 J. HORSEFIELD, THE INTERNATIONAL MONETARY FUND 1945-1965, at 65-66 (1969) [hereinafter cited as 3 J. HORSEFIELD].

5. For a detailed discussion and references, see Gold, *Developments in the International Monetary System, the International Monetary Fund, and International Monetary Law Since 1971*, 174 ACADEMY OF INTERNATIONAL LAW, RECUEIL DES COURS 107 (1982) [hereinafter cited as *Developments in the International Monetary System*]; Gold, *Legal Structure of Par*

relation to the exchange rate of a member's currency between the IMF and the member. Each member had to reach agreement with the IMF on an initial par value for the member's currency in terms of gold as the common denominator of the system.<sup>6</sup> The IMF would deem an initial par value suitable if it could be sustained without the need for undue financial support by the IMF.

The objective of the par value system was the stability of exchange rates, while avoiding rigidity. To provide elasticity, the Articles permitted changes in par values. A member could propose a change in the par value of its currency, but, to promote stability, the member's privilege was formulated negatively, and the test to be met by a proposal was severe: "A member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium."<sup>7</sup> A proposal was not justified if it was intended to deal with a transitory problem. The IMF's pool of resources could be drawn on to enable a member to ride out such a problem without a change of par value.

A proposed change, which had to be to another fixed value, had to be sufficient to correct the fundamental disequilibrium. A proposed devaluation was objectionable if it was excessive, because it would be unfairly competitive with other members. A proposed revaluation was objectionable if it was inadequate, because it would excite the prospect of further changes and encourage speculation, which would lead to unstable exchange rates.

A member had to consult the IMF before making any change of par value. The concurrence of the IMF was necessary, except in some situations of minor importance. If the IMF was satisfied that a proposal met the test for changes, the IMF had to concur in the proposal. The IMF could not object if, for example, it would have preferred the member to follow deflationary policies and avoid a change of par value.

Each member had to adopt measures consistent with the Articles that would make the par value for the member's currency effective in exchange transactions within its territories. The measures had to ensure that transactions for the exchange of the member's currency and another member's currency were conducted at exchange rates that did not go beyond narrow limits as defined by the Articles. These limits were above and below the relationship (the parity) between the two currencies that was derived from their par values. The measure chosen by the U.S. to perform its obligation to maintain the par value of the dollar was the readiness of the U.S. to buy and sell gold for dollars with the monetary authorities of other members at prices based on the par value. The measure chosen by other members was their readiness, whenever necessary, to intervene in the exchange markets by buying and selling dollars (or another currency convertible into dollars) for their own currency. The rates of exchange in these transactions had to

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*Value System Before Second Amendment*, in *LEGAL AND INSTITUTIONAL ASPECTS OF THE INTERNATIONAL MONETARY SYSTEM: SELECTED ESSAYS* 520 (1979).

6. The par value could be fixed in relation to the U.S. dollar of the gold value as of July 1, 1944, but the effect was simply to fix the par value indirectly in terms of gold.

7. Article IV, Section 5(a), Articles of Agreement of the International Monetary Fund, *opened for signature* July 22, 1944, 20 U.S.T. 2755, T.I.A.S. No. 1501, 2 U.N.T.S. 39.

be kept within the defined limits around the parity between their currency and the dollar and the other intervention currency of their choice.

The IMF was not empowered to authorize a member to adopt a floating exchange rate for its currency instead of maintaining an effective par value.<sup>8</sup> A rate floated when the exchange rates in transactions were not kept within the defined limits around parities. The fundamental assumption of the par value system was that fixed rates produced better economic results than floating rates. In addition, governments had concluded that fixed rates could be maintained without unacceptable difficulties and that international control could be exercised more effectively over fixed rates.

Another principle of the Articles was that a member should have a unitary exchange rate for its currency. A member should not have different rates for different transactions (multiple currency practices) or exchange rates for its currency that were not consistent with all the parities between its currency and other currencies and therefore were necessarily less favorable for some as compared with other currencies (discriminatory currency arrangements). These two categories of exchange measures were prohibited because they harmed the member that imposed them or other members. The IMF was authorized, nevertheless, to permit a member to depart from a unitary exchange rate for its currency. If the IMF approved a member's request to impose a multiple currency practice, the reason normally was that the member could not readily institute other, and possibly nonmonetary, measures with equivalent effect when dealing with an exchange emergency. The IMF would approve the practice for a limited period only. The IMF became increasingly reluctant to approve discriminatory currency arrangements.

The objective of the original Articles can be summarized as the maintenance of fixed, unitary, and nondiscriminatory exchange rates that carried the endorsement of the international community as expressed in decisions of the IMF. Multiple currency practices and discriminatory currency arrangements were interferences with the pattern of exchange rates that would result from the full realization of the objective of the par value system. The prohibition of these measures, and the IMF's authority to approve derogations, are preserved by the present Articles notwithstanding the disappearance of the par value systems. The economic reasons for continuing to prefer rates that are unitary and nondiscriminatory, even though they are not fixed or endorsed as they were in the days of the par value system, are similar to those of the past.

When the original Articles were being negotiated, the United States favored a transfer to the IMF of greater authority over exchange rates than

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8. Under the original Articles, the IMF had authority, in the event of an emergency or the development of unforeseen circumstances threatening the operations of the IMF, to suspend the provisions on the limits around parities that had to be observed in exchange transactions. The authority was conferred on the IMF because of the unprecedented character of the par value obligations. A unanimous vote of the Executive Directors was required for a suspension up to 120 days and an 80 per cent majority of total voting power in the Board of Governors for an additional period not exceeding 240 days. Par values were not abrogated by a suspension, but suspension validated floating for the time being. For this reason, a decision to suspend was not considered after August 15, 1971, because it was assumed that some members would not agree to validate the action taken by the United States on that date.

the United Kingdom was willing to concede. The United Kingdom succeeded in negotiating acceptance of the principle that a member would retain ultimate authority over the exchange rate for its currency if an irreconcilable difference with the IMF about a change were to arise. If the IMF objected to a change of par value as proposed by a member, but the member nevertheless put the change into effect, the unauthorized change would not be deemed to be a violation of the Articles. The member was shielded against the odium of violation, even though the member was automatically denied the use of the IMF's resources in support of the new par value and even though ineligibility to use the resources was also the penalty for a violation. If the difference of opinion persisted beyond a reasonable period, the IMF could compel the member to withdraw from the organization. The power to compel withdrawal demonstrated how central was the international acceptability of exchange rates in the compact among members represented by the Articles.

The decisions of the IMF in the exercise of its authority over exchange rates were taken with a majority of the votes cast in the Executive Board. Each Executive Director could cast, as a unit, the number of votes allocated to the member that appointed him, or to the group of members that elected him, according to the formula for weighted voting power in the Articles. The existence of a simple majority of the votes cast was determined on any occasion without reference to the votes of Executive Directors who abstained in the voting. It was conceivable, therefore, that a decision might be taken by a proportion of voting power that was less than a majority of the total voting power of all members. These provisions on voting have not been amended when a simple majority suffices.

It is remarkable that countries, in moving from the uncontrolled national determination of exchange rates to international regulation, accepted the exercise of international authority by decisions taken with so small a proportion of total voting power.<sup>9</sup> This development was not less remarkable because a member was entitled to have its votes cast even when a decision related to its own currency. No member could carry or veto these decisions by the exercise of its own voting power.

The negotiators of the original Articles required high majorities of total voting power for only a few categories of decisions on exchange rates or other matters. The United States may have refrained from negotiating a broad veto for itself because of the enormous strength of its economy and currency and the influence it expected to have as a result. Led by the United States, the negotiators held the view that the business of the IMF should be conducted expeditiously. A simple majority of the votes cast was more likely to promote the dispatch of business. This majority would prevent obstruction by a dissident minority, because Executive Directors who sat on the fence by abstaining would not be able to obstruct those who stood erect and were counted. Once a proposal involving an exchange rate

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9. Gold, *The Origins of Weighted Voting Power in the Fund*, FINANCE AND DEVELOPMENT, Mar. 1981, at 25. The Plan for a Stabilization Fund prepared by H.D. White of the U.S. Treasury proposed, in versions of April 1942 and July 19, 1943, that, in the interest of stability, changes in exchange rates should be permitted only by decisions of the Fund adopted with a high majority of the total voting power. See 3 J. HORSEFIELD, *supra* note 3, at 60, 89.

was on the agenda of the Executive Board, delay in taking a decision because a special majority had to be marshalled could be particularly harmful. Knowledge of the proposal while still unresolved might become public and provoke destabilizing speculation.

In the par value system of the original Articles, the five variable elements in the models discussed in this article were treated as follows:

(i) A member had to establish a par value for its currency in terms of gold as the common denominator of the system, which meant that the member established exchange rates for its currency that were fixed within narrow margins above and below parities.

(ii) A member had the power of initiative to propose the par value for its currency.

(iii) The IMF was required to concur in or object to the member's proposed choice of par value.

(iv) A member had to seek the reaction of the IMF before establishing a par value.

(v) The IMF reacted by means of decisions taken with a majority of the votes cast in the Executive Board.

#### *Possible Future Par Value System of IMF*

After the collapse of the original par value system, the Articles of the IMF were rewritten by the Second Amendment, which became effective on April 1, 1978, and is still in force. The present Articles contain provisions on a revised par value system<sup>10</sup> that can be brought into operation by a decision of the Executive Board taken with a majority of eighty-five percent of the total voting power. The conditions in which the decision could be taken are specified in the Articles.<sup>11</sup> The provisions that would regulate the revised system, if it were called into being, draw on the original Articles but have been modified to avoid the rigidity that became a feature of the former par value system and to take account of other lessons of experience. As a result of this approach, there are important legal differences between the two systems.<sup>12</sup>

Three of the chief differences involve the common denominator, floating exchange rates, and the majorities for decisions. The common denominator of the revised system would be selected by the IMF, but the choice of gold or a currency is prohibited, because experience has shown that they would not function efficiently. It is assumed, but not required, that the common denominator would be the SDR, the monetary reserve asset created by the First Amendment, which took effect on July 28, 1969. The negotiators did not prescribe the SDR because of some apprehension that the IMF's method of valuing it might not be wholly satisfactory for the par value system. If, however, the majority existed for calling the par value

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10. Schedule C, Second Amendment to the Articles of Agreement of the International Monetary Fund, *entered into force* Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8937.

11. Article IV, Section 4, Second Amendment to the Articles of Agreement of the International Monetary Fund, *entered into force* Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8937.

12. For a detailed examination of the differences, see *Developments in the International Monetary System*, *supra* note 5, at 245-62.

system into existence, it is unlikely that a majority could not be found for ensuring that a satisfactory method of valuing the SDR was in place.

A member would not be bound to establish a par value for its currency and would not have to give a reason for its decision to refrain. Nor would the member have special obligations because of this decision. Members would have greater freedom, therefore, than was foreseen by the *Outline of Reform* presented to the Board of Governors on June 4, 1974 by its Committee on Reform of the International Monetary System and Related Issues (Committee of 20 or C-20). The *Outline* assumed that at some time a system of "stable but adjustable par values" would be instituted without precluding floating rates "in particular situations, subject to Fund authorization, surveillance, and review." The language was deliberately vague, so that the IMF would have been able to define "particular situations." Furthermore, authorization would have been given only "on condition that the country undertakes to conform with agreed guidelines for conduct."<sup>13</sup>

If a member proposed a par value under the revised system of the Articles, but the IMF decided to object by a majority of the votes cast, the par value would not take effect for the purposes of the Articles. If the IMF did not object and the par value became effective in this way, the member would have to ensure that the rates in exchange transactions within its territories did not go beyond defined limits around parities. To permit greater flexibility, these limits could be, and probably would be, broader than those of the original Articles.

Under the original par value system, a member could propose a change in the par value of its currency only to correct a fundamental disequilibrium. The purpose of this language also was to promote stability, but it seemed to suggest that a member could not move to change a par value before falling into the abyss of deep disequilibrium. The revised system would permit a member to propose a change either to correct a fundamental disequilibrium that had developed or to prevent one from developing.

In either circumstance, the change could be made only on the proposal of the member, after consultation with the IMF, and with its concurrence. If the IMF objected, the change would not become effective for the purposes of the Articles. If the member instituted the change notwithstanding the objection of the IMF, not only would the par value be ineffective for the IMF but in addition the member would be in violation of the Articles. The concept of the unauthorized change as undesirable but not a violation has disappeared. The Articles instruct the IMF to discourage the maintenance of an unrealistic par value. This instruction would have to be reconciled somehow with the absence of authority for the IMF to propose the change that should be made. The Managing Director would not be prevented from suggesting privately the par value that he would support as realistic if the member were to propose it.

The original Articles did not permit a member to jettison the anchor of a par value. The revised system would allow a member to give notice that it

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13. COMMITTEE ON REFORM OF THE INTERNATIONAL MONETARY SYSTEM AND RELATED ISSUES, INTERNATIONAL MONETARY REFORM: DOCUMENTS OF THE COMMITTEE OF TWENTY 11-12 (1974).



intended to terminate a par value without establishing a new one, but the IMF could object to this action by a decision taken with eighty-five percent of the total voting power. The IMF would not be required to decide that it concurred if it did not object. If the member terminated the par value notwithstanding the objection of the IMF, the member would be in violation of the Articles. The par value, however, would cease to exist for the purposes of the Articles.

Under the original Articles, if a currency was floating, the IMF could not recognize the disappearance of the par value as a legal fact. The purpose of the legal fiction that the par value still existed was to put pressure on members not to abandon par values, but the IMF's assertion that a par value persisted in law after it had disappeared in fact seemed bizarre when inquiries were made about the legal status of the currency. To avoid this situation, the Second Amendment is emphatic in declaring that in certain circumstances a par value would cease to exist for the purposes of the Articles. Under the revised par value system, a member might forbear from giving notice that it was terminating a par value even though few or no exchange transactions involving the currency were conducted at exchange rates based on parities with other currencies. In the interest once again of realism, the IMF would have the authority in these circumstances to find that the par value had ceased to exist for the purposes of the Articles. If the par value of a member's currency was terminated by the member or ceased to exist under a decision of the IMF, the member would not be prevented from establishing a par value at a later date.

For most of the decisions on exchange rates, a majority of the votes cast would suffice. This majority has been retained for the reasons that justified it under the original Articles. The majority of eighty-five percent of total voting power would be required, however, for decisions to call the revised par value system into operation or to object to an intended termination of a par value. The explanation of the requirement of this high majority, and of some other features of the revised system, is the position taken by the United States in the negotiation of the Second Amendment. The United States had concluded that the former par value system had given the United States less freedom to manage the exchange rate for its currency than had been available to other members. They had established exchange rates for their currencies in relation to the U.S. dollar as the currency of the most powerful economy. In effect, therefore, other members had determined exchange rates for the dollar. The United States believed that if it had taken an initiative to change the par value of the dollar, other members would have made corresponding changes that would have cancelled the benefit that the United States was seeking.

In the drafting of the Second Amendment, the United States wanted to be assured that it would not be locked once again into its former predicament if the revised par value system began to operate. Under the present Articles, therefore, the United States would be entitled to refrain from establishing an initial par value, although it is difficult to imagine that the United States would make this choice after voting in favor of calling the revised par value system into being. Moreover, the United States would be able to terminate a par value for the dollar, in effect at will, because the voting power of the United States would enable it, without the support of

any other member, to veto a proposed decision of the IMF to object to the termination.

The requirement of the majority of eighty-five percent for some decisions on exchange rates can be understood to reflect a wider distribution of economic and financial power in the world than existed at the time of the Bretton Woods Conference. The implication of the special majority is that the United States cannot assume that its view will predominate because of its role in the world.

The main elements in the revised par value system have been arranged as follows:

(i) Par values for currencies would be fixed in terms of a common denominator, which would produce exchange rates fixed within prescribed margins around the parities with other currencies that had par values, but the floating of a currency could be valid.

(ii) A member could decide not to establish an initial par value; the member could take the initiative at any time to propose a par value or the termination of an existing par value (i.e., without proposing a change to a new par value).

(iii) The IMF would be required to concur in or object to a proposed par value, and it could object to the termination of a par value.

(iv) A member would have to seek the reaction of the IMF before establishing a par value and would have to give notice before terminating a par value, but the IMF could find that a par value had ceased to exist even in the absence of notice.

(v) The IMF would react to a proposal to establish a par value by a decision taken with a majority of the votes cast, but eighty-five percent of the total voting power would be necessary for a decision by the IMF to object to an intention to terminate a par value.

#### *Present IMF Law*

The law of the IMF that governs exchange rates at the present time is fundamentally different from the original law or the provisions governing the possible future par value system, even though the principle that exchange rates are matters of international concern has not been forsaken. The balance of authority over exchange rates between the IMF and members that prevailed in the past has been altered and now tilts strongly toward members.<sup>14</sup>

Formerly, only one exchange arrangement was in full accord with the law and spirit of the Articles: a par value accepted by the IMF. A member is free now to choose its exchange arrangement, with only one exception. A member may not maintain the value of its currency in terms of gold, because a gradual reduction in the role of gold in the international monetary system is one of the objectives of the Second Amendment. Furthermore, a member, having chosen its exchange arrangement, may determine the value of its currency in relation to other currencies by action or may permit the value to develop by inaction. A member is not required, as a condition of

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14. For the present provisions on exchange arrangements, see Article IV, Second Amendment to the Articles of Agreement of International Monetary Fund, *entered into force* Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8973.

selecting its exchange arrangement or of determining the external value of its currency, to seek the concurrence of the IMF.

This freedom for members has produced a casserole of exchange arrangements composed of ingredients so numerous and so varied that classification of them by the IMF requires eleven columns, garnished with eleven footnotes for deviations and nuances. To give some impression of this complexity, it is sufficient to tabulate the headings and subheadings of this classification:

*Pegged*

U.S. dollar; French franc; other currency; SDR; other composite

*Flexibility Limited vis-à-vis a Single Currency or Group of Currencies*

Single currency; cooperative arrangements

*More flexible*

Adjusted according to a set of indicators; other managed floating; independently floating

The United States, as the main advocate of the freedom described above, argued that the stability of exchange rates had become a fetish that had contributed to the breakdown of the par value system. Members should be free to choose their domestic policies without the constraint imposed by an obligation to maintain an external value for their currencies. If members pursued policies to bring about orderly underlying conditions, the result would be a stable system of exchange rates, although not necessarily stable rates, because rates should be permitted to respond suitably to changing conditions.

Members had to be subject to some obligations, notwithstanding the broad freedom assured to them, or else freedom would become license. To achieve the new goal of a stable system, the Articles impose some obligations on the way members behave in applying their chosen exchange arrangement, although the obligations lack precision.

Each member is subject to a general obligation to collaborate with the IMF and other members "to assure orderly exchange arrangements and to promote a stable system of exchange arrangements."<sup>15</sup> Four obligations of a more specific character provide some content for this general obligation. Two of the more specific obligations are more hortatory than peremptory. They have been drafted in this way because they are not confined to members' external policies. The other two obligations relate to external policies only, for which reason it was more difficult to resist sharper language. No one of the general or more specific obligations is formulated in language that makes nonobservance apparent without a decision of the IMF. Nothing in a member's behavior now would be comparable to the obvious failure of a member to maintain an effective par value in the days of the par value system.

The five obligations are not limited to current conditions. The obligations will have to be observed at all times and would apply if the IMF were to make the recommendations referred to below or were to call the revised par value system into being.

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15. Article IV, Section 1, Second Amendment to the Articles of Agreement of International Monetary Fund, entered into force Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8973.

The IMF is required to monitor the international monetary system, in order to ensure its effective operation, and also the compliance of each member with its obligations of behavior. To fulfill these functions, the IMF must exercise "firm surveillance" over the exchange rate policies of members. For this purpose, the IMF is directed to adopt "specific principles for the guidance of all members with respect to those policies," but the principles must not interfere with the freedom of members to choose their exchange arrangements. The IMF consults with members on their exchange rate policies. A member's failure to observe a specific principle of guidance would not be considered in itself a breach of obligation. The IMF would have to take account of this failure, but of all other relevant circumstances as well, in deciding whether a member was failing to perform an obligation. Decisions of the IMF in the exercise of its powers of surveillance are taken with a majority of the votes cast.

The IMF's duty to oversee the international monetary system must be distinguished from the function of helping the system to develop. In accordance with this function, the IMF "may make provision for general exchange arrangements." This language means no more than that the IMF may recommend a particular kind of exchange arrangement to the membership at large. An implication of the provision is that the recommended exchange arrangement is already in widespread use. The IMF cannot impose an obligation on members to apply the exchange arrangement, because the Articles declare that members retain their freedom of choice even after the IMF makes a recommendation. Nevertheless, a recommendation would have moral weight, and because it would exert this pressure, a majority of eighty-five percent of the total voting power has been made necessary for a decision to present recommendations to members.

Under the law now in force under the Articles, the five variables can be summarized as follows:

- (i) A member is not required to have a fixed exchange rate for its currency, but a member may peg its currency to any denominator of its choice except gold.
- (ii) A member is authorized not only to choose its exchange arrangement but also to establish and manage the exchange rate for its currency or to refrain from doing so by allowing the rate to float.
- (iii) The IMF is not authorized to concur in or object to a member's choice of exchange arrangement.
- (iv) The IMF can decide that a member's behavior in applying its exchange arrangement is not in accordance with its obligations as stated in the Articles or with the IMF's specific principles of guidance as declared from time to time.
- (v) The decisions in (iv) above are taken with a majority of the votes cast.

#### *Central Rates and Target Zones*

For a few years after the breakdown of the par value system, there was a common assumption that agreement would be reached on the restoration of such a system, although with improvements. In that period, the IMF adopted what was described as a temporary regime of central rates and wider margins. The rules of the regime were a stopgap device that could not validate exchange rates under the unamended Articles, but were

designed to minimize disorder at a time when the par value system was ineffective. Members were told that if they acted in accordance with the rules of the temporary regime, they would be deemed to be collaborating with the IMF in current conditions, although conformity with these rules would not be considered the exclusive mode of collaboration.<sup>16</sup>

The essence of the first decision on central rates was that a member would be deemed to be collaborating with the IMF if the member maintained a stable rate for its currency as the basis for exchange transactions in its territory. A rate was "stable" if it was based on a central rate expressed directly or indirectly in terms of gold. An initial or subsequent central rate communicated to the IMF took effect under the decision unless the IMF found the rate unsatisfactory. A central rate had the virtue that, because it was not recognized as a par value, the procedures under the Articles and under a member's domestic law for the establishment of a par value did not have to be followed for the establishment of a central rate, and the IMF did not have to concur in the rate, although the IMF reserved the right to find that a communicated rate was unsatisfactory.

The second decision on central rates did not require the direct or indirect expression of a central rate in terms of gold. It was sufficient if the currency was stable in terms of another currency, even if that other currency was not itself maintained as a stable currency in the sense of the first decision and floated independently.

For members with currencies that were floating independently, which were defined as currencies that were not pegged within relatively narrow margins to another currency or composite of currencies, the IMF adopted a decision on June 13, 1974, entitled Guidelines for the Management of Floating Exchange Rates.<sup>17</sup> The IMF recommended that if a currency was floating independently, the issuer should use its best endeavors to observe the Guidelines, but the IMF did not purport to treat observance as obligatory. Throughout its history, the IMF has been reluctant to prescribe specific obligations for members to collaborate. Guidelines have seemed to be preferable because they can be administered flexibly and because they can be modified by decisions as experience is gained or as conditions change.

Practices that accorded with the Guidelines were not validated by them if they were not in conformity with the Articles. The Guidelines were no more capable of conferring validity under the unamended Articles than were the decisions on central rates and wider margins. Only observance of the provisions of the Articles on par values and exchange rates could confer legality on exchange rates before the Second Amendment.

The first two of the six Guidelines of 1974 defined conduct that a member should follow (i) to smooth out fluctuations in the exchange rate for the member's currency from day to day and from week to week and (ii) to moderate movements from month to month and from quarter to quarter. The third Guideline recognized that a member might wish to act otherwise than in accordance with the first two Guidelines in order to bring the exchange rate within, or closer to, some target zone of rates.

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16. SELECTED DECISIONS OF THE INTERNATIONAL MONETARY FUND 13-21 (8th issue 1976).

17. *Id.* at 21-30.

A member disposed to establish a target zone was expected to consult the IMF about this zone and its adaptation to changing circumstances. If the IMF considered the zone to be within the range of reasonable estimates of the medium-term norm for the exchange rate, the member would be free to move its exchange rate toward the zone, subject to certain reservations, even if this action was not in accordance with the first two Guidelines. The concept of the norm was that of an exchange rate that would tend to bring about equilibrium in the balance of payments as defined. The medium-term was expressed, with evident hesitancy, to be a period of about four years.

If a member had a medium-term norm for its currency, and if the IMF concluded that the exchange rate had moved outside the range of reasonable estimates for the norm to an extent that was likely to be harmful to the interests of members, the IMF could take the initiative to approach the member. The IMF could make recommendations, but only after the Managing Director had consulted the member. The IMF was to observe restraint in all cases, but particularly if there was great uncertainty regarding the balance of payments situation and prospects of a member.

The Guidelines were abrogated as a result of the Second Amendment of the Articles. The IMF is now required to adopt specific principles for the guidance of "all members." The reference to all members reflects the freedom that members have to choose their exchange arrangements, the policy of avoiding any legal or moral implication that pegging is preferable to floating, and dissatisfaction with the concentration of the Guidelines on members with unpegged currencies.

The performance of exchange rates in present conditions has been the subject of much criticism. Target zones, in concept at least, offer an obvious halfway house between the fixity of a par value system and the permissiveness of the current law. It is not surprising, therefore, that some economists are now recommending target zones, with some role for the IMF, although there is also much resistance to the suggestion of target zones.<sup>18</sup>

If there were to be enough official sympathy for target zones, the IMF could act in support of them and could have a role in their administration under a variety of powers in the present Articles. The IMF could rely on the obligation of members to collaborate, the power to adopt specific principles of guidance, or the power to recommend general exchange arrangements.<sup>19</sup>

The Guidelines of 1974 dealt with the five variables in the following manner:

- (i) A target zone was a compromise between fixed and floating exchange rates.

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18. For the opposing views of two ex-U.S. Treasury officials, compare Roosa, *Intervention Methods Can Define Target Zones*, J. of Com., June 3, 1983, at 4A, col. 2, with Widman, *Exchange Rate Targeting Will Not Work*, J. of Com., Dec. 16, 1982, at 4A, col. 2; see also J. WILLIAMSON, *THE EXCHANGE RATE SYSTEM* (1983). These authors do not discuss the 1974 Guidelines on target zones or the reasons for the failure of the idea as embodied in the Guidelines.

19. Another technique would be available but would be less appealing. The IMF could call the par value system into operation and establish wide limits around parities. The Articles provide already for limits as broad as 4 ½ percent, but the IMF could establish other limits by decisions taken with 85 percent of the total voting power.

(ii) A member, and not the IMF, could take the initiative to establish a target zone.

(iii) A member that decided to establish a target zone was to consult the IMF on it. The IMF, it seemed, could endorse or oppose the target zone the member was choosing. It was also implied that if the IMF opposed the choice, the member would be acting inappropriately, although not necessarily illegally, by departing from those Guidelines that could be neglected if the IMF had endorsed the member's target zone.

(iv) It was implied that the IMF should have the opportunity to react before a target zone was established, although reaction after the event was not precluded.

(v) All decisions of the IMF under the Guidelines would be taken with a majority of the votes cast.

### *European Monetary System*

The fluctuation of exchange rates, particularly for the U.S. dollar, has led to an important development in the regulation of exchange rates. The European Community (EC) concluded that the instability of exchange rates was prejudicial to its objectives. The European Council, after meeting in Bremen, issued a communiqué on July 7, 1978, announcing the intention to create the European Monetary System (EMS) in the hope of establishing "a zone of monetary stability" in Europe. A Resolution of the Council on December 5, 1978, established the structure of the EMS and an Agreement of March 13, 1979, among the Central Banks of the EC set forth the operating procedures.<sup>20</sup> The EMS is more than an attempt to bring order into exchange arrangements in the EC; the EMS is intended to promote the integration of the EC. The exchange rate arrangements of the EMS can be considered a regional par value system based upon a common denominator of its own, the European Currency Unit (ECU), which is also a monetary asset and has even further functions in the EMS and in other activities of the EC. The EMS began to operate on March 13, 1979.

The ECU is a basket of defined amounts of the currencies of EC members, except the Greek drachma, which will be included in the basket not later than the end of 1985. The amounts of currencies in the basket can be revised in certain circumstances. Revisions, which are to be made in line with underlying economic criteria, have to be mutually accepted, which suggests that the agreement is necessary of all the issuers of currencies in the basket. The original basket has not been changed so far (the end of 1983).

Members of the EC may elect to participate in the exchange arrangements of the EMS. All members have become participants, except the United Kingdom and Greece, which may participate later. Each participant establishes a central rate for its currency in terms of the ECU. Initial central rates were established by agreement. The central rates among parties to the narrow margins arrangement ("the snake"), which preceded the

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20. TEXTS CONCERNING THE EUROPEAN MONETARY SYSTEM (1979) and 12 EUR. ECON. (July 1982) include the constitutive documents of the EMS.

EMS,<sup>21</sup> correspond to the central rates established under that arrangement. The central rates of the currencies of other participants in the exchange arrangements of the EMS were based on prevailing exchange rates, with necessary adjustments, between the currencies of these participants and the currencies of parties to "the snake."

Adjustments in central rates are subject to "mutual agreement by a common procedure which will comprise all countries participating in the exchange rate mechanism and the Commission."<sup>22</sup> It is not clear from this language whether changes can be made only by unanimous agreement among the participants and the Commission of the EC, but adjustments seem to have been made with common consent before the changes were put into effect. Common consent is feasible among so small a number of participants, even if hard bargaining precedes common consent. No provision is made for weighted voting power. It would be without legal impact on decisions for which unanimity was required. The justification for common consent is the obvious one of the economic consequences of a change in central rate for partners in so close an undertaking as the EMS. Opposing views have been expressed by expert commentators on whether a participant violates Community law by changing a central rate notwithstanding the absence of agreement in the common procedure.<sup>23</sup>

The need for common consent is understandable for the further reason that an adjustment of the central rate for a participant's currency modifies the central rate for the currency of all other participants in an opposite direction. An adjustment produces this consequence because the number of units of a participant's currency in the ECU is fixed and the value of them, therefore, is affected by the adjustment. The values in relation to the ECU of all other currencies that compose the ECU change as a result of the change in value of a component currency.

An unusual feature of the procedure for common consent is that the amount of change in a central rate appears to be the subject of negotiation and counter-proposals.<sup>24</sup> This practice differs from the procedure for changes in par values under the former par value system of the IMF. A member proposed a change, but the IMF was not authorized to negotiate a different change. The word "concur" instead of "agree" to describe a possible reaction of the IMF was carefully chosen to emphasize the member's authority over its currency and to create a presumption in favor of the IMF's acceptance of a proposal. The IMF, it is true, could object to the amount of a proposed change as inadequate or excessive, but it was then the member's privilege to make a new proposal if it wished. The IMF could

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21. For differences between the EMS and the snake, see J. GOLD, *SDRs, CURRENCIES, AND GOLD: FOURTH SURVEY OF NEW LEGAL DEVELOPMENTS* 63-64 (1980).

22. *TEXTS CONCERNING THE EUROPEAN MONETARY SYSTEM*, *supra* note 20, at 44-45.

23. Smits, *Some Aspects of the Monetary Law of the European Community*, *JURIDICA* n.120 (1984) (forthcoming). There is no express concept in the EMS that resembles the unauthorized change of par value under the original Articles of the IMF.

24. The first multilateral negotiation of changes made in exchange rates appears to have been the one, engaged in by ten of the main industrialized members of the IMF, that led to the Smithsonian agreement of December 18, 1971.



not decide that the member had to make a new proposal or what that proposal had to be.

A bilateral relationship arises between each pair of currencies as a consequence of central rates under EMS arrangements. Participants must observe limits of 2.25 percent above and below the bilateral relationship between the currencies involved in spot exchange transactions. When a currency reaches the upper or lower limit against another currency, the central bank of each of the two participants must intervene in the exchange market in the currency of the other participant. Italy avails itself of the privilege of limits of six percent, but they are to be gradually reduced as economic conditions permit.

A "divergence indicator" has been defined that gives a signal if the exchange rate of a currency is moving out of line with the average exchange rates of all other currencies. If a participant's currency crosses its "threshold of divergence," a presumption arises that the participant will correct the situation by adequate measures, which may include a change in central rate, but the choice of measures is left to the participant. If, "on account of special circumstances," measures are not taken, an explanation must be given to the other participants.

European countries outside the EC with particularly close economic and financial ties with the EC may join in the exchange arrangements of the EMS. Agreements would have to be reached for this purpose among all the central banks involved. No agreements had been reached by the end of 1983. The EC has declared that the EMS is, and will remain, fully compatible with the relevant provisions of the IMF's Articles.

The five variable elements have been incorporated in the EMS in the following manner:

- (i) A participant must establish a fixed central rate for its currency in terms of the ECU.
- (ii) A participant can take the initiative to change the central rate for its currency.
- (iii) The other participants and the EC Commission must react to a proposed change in central rate.
- (iv) A participant must seek this reaction before making a change.
- (v) It seems that the unanimous agreement of the other participants and the Commission is necessary.

The EMS is not the only regional agreement among countries by which they accept some *de jure* or *de facto* limitation on their freedom to determine exchange rates. The arrangements vary greatly in their complexity, the degree of limitation they apply, and their objectives. Monetary unions and monetary zones are among the arrangements.<sup>25</sup>

### *Imposed Exchange Rates*

In all the models considered above, the issuer of a currency retains legal authority, although in different degrees, to determine the exchange rate of its currency. In other models, the exchange rate of a currency may be im-

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25. Collyns, *Alternatives to the Central Bank in the Developing World*, in IMF OCCASIONAL PAPER 29 (1983).

posed by an external entity. It is astonishing to recall that H.D. While, the main official in the United States behind the plan for a Stabilization Fund in the early forties, thought that the organization should establish the rate of exchange for a member's currency at which the organization would conduct transactions with the member.<sup>26</sup> He recognized that the Stabilization Fund's action might have the effect of determining the exchange rate for exchange transactions even when the Fund was not a party to them.<sup>27</sup> The idea did not prevail, except as noted below, even though the United States had greater influence in the negotiation of the original Articles than any other country.

Two provisions of the original Articles did confer authority on an external entity to affect the exchange rate of a currency. The IMF could decide, on its own initiative and by a majority of the total voting power (in contrast to a majority of the votes cast), to make uniform proportionate changes in the par values of all currencies, provided that such a change was approved by every member that had ten percent of the total quotas. The proviso was intended to be a discreet formula for vetoes that the United States and the United Kingdom would be able to exercise. The objective of the provision was to permit the IMF to expand or contract international liquidity by devaluing or revaluing all currencies, or, in other words, to increase or decrease the price of gold in currency, because gold was the common denominator of the par value system.<sup>28</sup>

A uniform proportionate change in the par values of all currencies would not have affected the parities between currencies. Nevertheless, to respect the authority of members over their currencies, the Articles permitted a member that acted promptly to prevent the change from applying to its own currency. If a member exercised this option, it would be revaluing its currency against the currencies of members that were accepting the effect of a uniform proportionate devaluation, or devaluing its currency against the currencies of members that were accepting the effect of a uniform proportionate revaluation. In either of these circumstances, the decision of the IMF would have brought about, in a certain sense, a change in the parities between the currencies of the member that took itself out of the decision and other currencies. The IMF never took a decision to make a uniform proportionate change in the par values of all currencies.

The other provision on exchange rates imposed by an external entity related to the separate currencies of a member's dependencies. A member

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26. See 3 J. HORSEFIELD, *supra* note 3, at 42, 60 & 89.

27. "[T]he authority to set the rates of exchange at which the Fund is willing to operate can be an important and in some cases a decisive influence on the rate at which transactions are made outside of the Fund." 3 J. Horsefield, *supra* note 3, at 60.

28. Article IV, Section 7, Articles of Agreement of the International Monetary Fund, *opened for signature* July 22, 1944, 20 U.S.T. 2775, T.I.A.S. No. 1501, 2 U.N.T.S. 39. In the First Amendment, the provision was modified by substituting the majority of 85 percent of total voting power and abrogating the proviso (the effect of which was to deprive the United Kingdom of its former veto). The Second Amendment substitutes the majority of 70 percent of the total voting power. See Schedule C, paragraph 11, Second Amendment to the Articles of Agreement of the International Monetary Fund, *entered into force* Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8937. The provision relates not to the control of liquidity, but to the necessity to adapt the SDR basket in certain circumstances if the par value system of Schedule C is in force and the SDR is the common denominator.

had to undertake that the Articles would be observed in respect of all its dependent territories, whatever their status might be in constitutional or international law. Dependent territories could not, and cannot now, become members. They may have their own currencies, however, called "separate currencies" by the Articles, and some of these currencies may be important in international payments. Under the par value system, a member was responsible to the IMF for establishing, and had the privilege of changing, the par values of separate currencies in accordance with the procedures of the Articles. A member's constitutional or political arrangements might have conceded actual authority to the government of a dependency over the exchange rate of its currency, but these arrangements did not affect the relationship between the member and the IMF or the member's responsibility as described above.<sup>29</sup>

### *Legal Effectiveness*

The effectiveness of a system for the international regulation of exchange rates may be judged by reference to the purposes of the system, which are likely to be economic. That judgment can be left to economists. They will not agree among themselves. Effectiveness can be judged according to another criterion. It is more objective and within the province of international law. To what extent have the legal prescriptions of a system been observed? This inquiry can go beyond compliance and encompass the question of the extent to which countries have undertaken to observe the prescriptions. The distinction between economic and legal effectiveness is not complete. Legal effectiveness connotes economic effectiveness because it can be assumed that if a system does not satisfy economic aspirations, governments may decide not to observe the legal prescriptions of the system or to withdraw from it.

By August 15, 1971, 118 countries had become members of the IMF. The major countries that had not become members were the U.S.S.R., which had attended the Bretton Woods Conference, and Switzerland, which had not. Swiss representatives have frequently asserted that they are more punctilious in conforming to the underlying principles of the Bretton Woods system than some members, notwithstanding the absence of an undertaking. Over the course of time, Cuba, Czechoslovakia, Indonesia, and Poland withdrew from the IMF, but Indonesia reentered with little delay. Only the case of Czechoslovakia involved issues related to the provisions on par values.

In the period 1945 to 1955, various members that had established par values floated their currencies in violation of their obligations. Other members had not established par values, or were applying multiple currency practices that made their par values wholly or largely meaningless, or were applying restrictions on payments and transfers for current international transactions as measures in support of their par values. An established par

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29. See Article IV, Section 9, Articles of Agreement of the International Monetary Fund, opened for signature July 22, 1944, 20 U.S.T. 2775, T.I.A.S. No. 1501, 2 U.N.T.S. 39. For the somewhat similar provision of the present Articles, see Article V, Section 5, Second Agreement to the Articles of Agreement of the International Monetary Fund, entered into force Apr. 1, 1978, 29 U.S.T. 2203, T.I.A.S. No. 8937.

value, therefore, did not mean that a member had achieved an exchange system that was the ideal of the Articles.

On March 15, 1971, when the IMF issued its last *Schedule of Par Values*, 26 of the 117 members at that time had not yet established par values and 8 that had done so were failing in their obligations to make their par values effective. The 26 members were not in violation because the IMF had not called on them to establish initial par values. The IMF recognized that the economic circumstances of these members would have prevented them from maintaining effective par values. The IMF's restraint demonstrated that par values were not the optimal exchange arrangement for all members at all times. The IMF encouraged some members that had established par values but were in difficulties to float their currencies as a transition to new and effective par values. All but one of the 34 members were developing countries. It must not be thought that the exchange systems of all the other 83 members were free from multiple currency practices or restrictions on payments and transfers.

Too gloomy a deduction must not be drawn from these statistics. With the exception of Canada for lengthy periods, and the Federal Republic of Germany and the Netherlands for brief periods, developed members maintained effective par values. It follows that the world's trade and payments were conducted in large part on the basis of effective par values. On August 15, 1971, the floating of the dollar in violation of the obligations of the United States under the Articles brought the par value system of the Articles to a violent end.

After the breakdown, many members availed themselves of the IMF's decisions on central rates and wider margins for a time. The United States never declared a central rate and devalued the dollar twice, but took no action to make the par value effective. It was left to other members that wished to maintain a fixed relationship to the dollar, either on the basis of a par value or a central rate, to take the measures necessary for this purpose. The United Kingdom decided to allow sterling to float independently in June 1972, and Japan took the same step for the yen in February 1973. The Canadian dollar floated at all times; the floating of the Italian lira began on February 13, 1973. A number of members of the EC maintained narrow margins based on central rates for transactions involving their own currencies, and wider margins in relation to the dollar ("the snake in the tunnel"), but in March 1973 abandoned these latter margins. The French franc was allowed to float in January 1974.

The experience of the past was being reversed: the currencies of major industrialized countries were floating while many developing countries sought to peg their currencies in some way. The floating of major currencies was one of the main reasons why the Guidelines on the Management of Floating Exchange Rates were adopted. The decision was never more than a gesture. No member declared a target zone. The members that had floating currencies resented the stricter surveillance that was to be exercised over them as compared with members that pegged their currencies. This lesson in resistance to asymmetry explains why the Second Amendment refers to the IMF's duty to adopt specific principles for the guidance of "all members" with respect to their exchange rate policies.

Nothing has been published that suggests a finding by the IMF of a violation of the present provisions of the Articles on exchange arrangements or of the nonobservance by a member of the IMF's specific principles. As noted already, the corollary of the imprecision of the present law is that the inconsistency of a member's behavior with the Articles or with the specific principles cannot be determined without a decision of the IMF. The absence of a decision need not imply consistency because of the IMF's traditional preference for quiet persuasion and its reluctance to adopt censorious decisions.

The discipline that an international organization can exert is stronger if the organization's authority is exercised before a member initiates policies. If the organization can act only after policies are in place, discipline is weaker because members are more willing to run the risk of formal disapproval. They know that this reaction is unlikely and that a finding of violation is even more unlikely.

U.S. negotiators hoped that the IMF's jurisdiction over exchange rate policies would become firmer notwithstanding the imprecision of the relevant provisions of the Second Amendment. As the IMF accumulated experience in performing its function of firm surveillance, an expanding code of specific principles would be formulated. U.S. negotiators cited the example of case-law in common law systems. This analogy has proved to be inapposite: the three specific principles announced originally by the IMF, in language as imprecise as the Articles, have not been sharpened or augmented. Experience has resulted in a progressive elaboration of the procedures for surveillance but not of the specific principles.<sup>30</sup>

No participant in the exchange arrangements of the EMS has withdrawn from them, although from time to time the newspapers have reported that a member was considering withdrawal. In this respect, the EMS has been more effective than "the snake," in which participation shrank from time to time. Although no participant has withdrawn from the exchange arrangements of the EMS, their effectiveness has been diminished by the decision of the United Kingdom not to participate in them.

All changes in central rates have been made in accordance with the legal provisions governing the EMS, although there has been some criticism that the number and increasing frequency of changes are evidence that a zone of stability has not been achieved. The reply is made that the EMS should be considered a system of neither fixed nor floating exchange rates but a system of jointly managed rates.

### *Some General Reflections*

1. The models for the international regulation of exchange rates that have been or are in force demonstrate that, for the last four decades, governments have accepted the principle that exchange rates are properly matters of international concern. Governments have given practical expression to this concern by subjecting exchange rates to international agreement or at least to international scrutiny. The right to initiate changes in exchange

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30. For a more detailed account of the present position, see Gold, *Strengthening the Soft International Law of Exchange Arrangements*, 77 AM. J. INTL. L. 443 (1983).

rates has been among the retained powers. The IMF's former authority to decide on a uniform proportionate change in the par values of the currencies of all members had no practical importance.

2. The unwillingness of governments to concede the power of initiative to international organizations is matched by the unwillingness of governments to accept dictation by formula. In the discussions of reform in the Committee of 20, U.S. representatives proposed "objective indicators" in the shape of staggered changes in the level of a member's monetary reserves. These developments would have created an obligation or at least a strong presumption that a member should take steps, including possibly a change in exchange rate, to adjust the balance of payments. The U.S. representatives argued that governments and the public would prefer the mechanism of objective indicators, and graduated pressures based on them, rather than the exercise of discretion by an international organization. The assumption about the preference of other governments proved to be wrong: the U.S. ideas received little support and much opposition. The exercise of discretion by the IMF was preferred because a government would have the opportunity to persuade the IMF that the government's action or inaction was justifiable.<sup>31</sup>

The divergence indicator of the EMS is an objective indicator, but one that relies on a formula based on the behavior of exchange rates and not changes in monetary reserves. The indicator is a remarkable development, even if it creates no more than a presumption of the need to take action, and even if the indicator was invented as a compromise between opposing groups in the negotiation of a crucial feature of the exchange arrangements of the EMS.

3. A study confined to the legal provisions of any system for the regulation of exchange rates will not provide a true impression of the system. The life of a system depends on the administration of it once the negotiators have finished their task. To understand the par value system, for example, it must be realized that the administration of the legal provisions was affected by two tendencies, which may seem to have been contradictory but which were not difficult to reconcile. The international staff tended to conclude that all aspects of exchange were subject to the scrutiny of the IMF. The Executive Board was not disposed to limit the jurisdiction of the IMF in matters relating to exchange rates, but, in applying the law, tended to give the benefit of any doubt to a member. It is possible that these two tendencies will be present in any system administered by an organization that includes within its structure a permanent staff and an executive organ composed of persons appointed or elected by member governments.

4. The coexistence of a variety of international arrangements for the regulation of exchange rates can pose a problem of reconciliation when a country belongs to more than one of these arrangements. The EC was aware of this problem when it declared that the EMS is and will remain fully compatible with the relevant provisions of the IMF's Articles. The "snake" was a cooperative arrangement among some members of the EC that was in existence when the Second Amendment was negotiated. Some

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31. See *Developments in the International Monetary System*, *supra* note 5, at 193-201.

of the countries that belonged to both the EC and the IMF negotiated express mention of cooperative arrangements among the arrangements that members can maintain consistently with their freedom of choice, even though this mention is redundant. Nevertheless, it is possible to imagine that problems of reconciliation might arise in the operation of the EMS and the IMF.

An example can be cited of a problem of reconciling the EMS, not with a multilateral organization such as the IMF, but with so intimate a bilateral arrangement as the Economic Union of Belgium and Luxembourg (BLEU). When the central rate of the Belgian franc in the EMS was reduced on February 22, 1982, the Luxembourg authorities, whose franc is legally the equivalent of the Belgian franc, are said to have complained that they were not consulted in advance. This situation hastened parliamentary approval in Luxembourg of the statute of May 20, 1983, authorizing the creation of a central monetary institution for that country with power to break the equivalence between the two currencies.

Membership in the IMF has been open to countries that belong to a monetary union. The IMF recognizes only the individual membership of states. It has been necessary, therefore, for the IMF to conclude that each member of a monetary union will be able to perform its obligations under the Articles notwithstanding the close association that members of the union must maintain in matters relating to their common currency.

5. A lesson of monetary history is that exchange arrangements are not permanent. There may be an alternation between fixed and floating systems. When the present system of free choice was introduced, the way in which it would behave was not foreseen. The economics of floating is being learned slowly. The dissatisfaction with which many monetary authorities view present multilateral arrangements has not yet led to a widely acceptable alternative.

To arrive at such an alternative would be an immense task. Power is distributed in the present world. The United States cannot exercise the overwhelming influence that it enjoyed in the years when its leadership produced the original Articles of the IMF. If its positive power is now less, its negative power is still enormous. That is to say, if the United States does not lead, it cannot be made to move, and its movement is necessary for change.

If the international community were to arrive at agreement on an alternative to the present system, the Articles as now written would provide ample accommodation for change however sharp it might be. It is probably important to realize that the Articles would permit measured evolution. The IMF could adopt specific principles for the guidance of all members with respect to their exchange arrangements, and the IMF could give content to the obligation of members to collaborate with the IMF and other members to bring about orderly arrangements and to promote a stable system of exchange rates. All these possibilities exist even if it never becomes feasible to call into operation the flexible par value system included in the Articles.