BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

June 14, 1974

TO: Federal Open Market Committee

FROM: Arthur L. Broida

Enclosed for your information are copies of (1) the communique issued following the final meeting of the Committee of Twenty, with certain attachments, and (2) "Guidelines for the Management of Floating Exchange Rates," approved by the Committee of Twenty.

Enclosures

INTERNATIONAL MONETARY FUND
19th and H Streets N. W., Washington, D.C. 20431

PRESS RELEASE NO. 74/30

FOR IMMEDIATE RELEASE
June 13, 1974

The Executive Directors of the International Monetary Fund, and the Deputies of the Committee of Twenty, have discussed "Guidelines for the Management of Floating Rates," as set forth in the attached memorandum. The members of the Committee of Twenty have also examined this memorandum. The Executive Directors have now decided to recommend, pursuant to Article IV, Section 4(a) of the Fund's Articles of Agreement, that in present circumstances, Fund members should use their best endeavors to observe the guidelines set forth and explained in the memorandum. Consultations with members with floating currencies will be based on the memorandum. These guidelines will be reviewed from time to time in order to make any adjustments that may be appropriate.

Guidelines for the Management of Floating Exchange Rates

Introduction

There is widespread agreement that the behavior of governments with respect to exchange rates is a matter of international concern and a matter for consultation and surveillance in the Fund. This is no less true when rates are floating than when they are contained within fixed margins and are changed by par value and central rate adjustments.

The Fund cannot legally authorize floating but it can exercise surveillance over the manner in which members fulfill their undertaking, under Article IV, Section 4(a), "to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members and to avoid competitive exchange alterations." The following guidelines, though not exhausting the possibilities of action by the Fund under this Article, are intended to provide criteria that members would observe in performing their undertaking and that the Fund would observe in exercising surveillance in present circumstances.

These guidelines are based on the assumption that in any situation of floating it may be desirable (a) to smooth out very short-run fluctuations in market rates and (b) to offer a measure of resistance to market tendencies in the slightly longer run, particularly when they are leading to unduly rapid movements in the rate, and (c) to the extent that it is possible to form a reasonable estimate of the medium-term norm for a country's exchange rate, to resist movements in market rates that appear to be deviating substantially from that norm. Guidelines of this kind are necessary, *inter alia*, in order to arrive at a clear conception of what competitive exchange alteration is, and to provide safeguards against it.

The guidelines also take into account:

(a) that national policies, including those relating to domestic stabilization, should not be subjected to greater constraints than are clearly necessary in the international interest;

(b) that a degree of uncertainty necessarily attaches to any estimate of a medium-term normal exchange rate, that this uncertainty is particularly great in present circumstances, and that on occasion the market view may be more realistic than any official view whether of the country primarily concerned or of an international body; and

(c) that in view of the strength of short-term market forces it may at times be unavoidable to forego or curtail official intervention that would be desirable from the standpoint of exchange stability if such intervention should involve an excessive drain on reserves or an impact on the money supply which it is difficult to neutralize.

The guidelines are intended to provide the basis for a meaningful dialogue between the Fund and member countries with a view to promoting international consistency during a period of widespread floating. They are termed guidelines rather than rules to indicate their tentative and experimental character. They should be adaptable to changing circumstances. No attempt is here made to indicate the precise procedures through which they would be implemented. These will be considered later, but they must essentially rest on an intensification of the confidential interchange between the member and the Fund.

In the application of the guidelines it is to be expected that, in view of the emphasis laid by the Committee of Twenty at their fifth (Rome) meeting on the importance in present circumstances of avoiding competitive depreciation, particular attention would be attached to departures from the guidelines in the direction of depreciation. Special consideration will also be given to the manner in which the guidelines should be applied by developing countries, taking account of the stage of evolution of their exchange markets and intervention practices.

The guidelines should be understood in the light of the commentary which follows.

The Guidelines

(1) A member with a floating exchange rate should intervene on the foreign exchange market as necessary to prevent or moderate sharp and disruptive fluctuations from day to day and from week to week in the exchange value of its currency.

(2) Subject to (3)(b), a member with a floating rate may act, through intervention or otherwise, to moderate movements in the exchange value of its currency from month to month and quarter to quarter, and is encouraged to do so, if necessary, where factors recognized to be temporary are at work. Subject to (1) and (3)(a), the member should not normally act aggressively with respect to the exchange value of its currency (i.e., should not so act as to depress that value when it is falling, or to enhance that value when it is rising).

(3)

(a) If a member with a floating rate should desire to act otherwise than in accordance with (1) and (2) above in order to bring its exchange rate within, or closer to, some target zone of rates, it should consult with the Fund about this target and its adaptation to changing circumstances. If the Fund considers the target to be within the range of reasonable estimates of the medium-term norm for the exchange rate in question, the member would be free, subject to (5), to act aggressively to move its rate towards the target zone, though within that zone (2) would continue to apply.

(b) If the exchange rate of a member with a floating rate has moved outside what the Fund considers to be the range of reasonable estimates of the medium-term norm for that exchange rate to an extent the Fund considers likely to be harmful to the interests of members, the Fund will consult with the member, and in the light of such consultation may encourage the member, despite 2 above, (i) not to act to moderate movements toward this range, or (ii) to take action to moderate further divergence from the range. A member would not be asked to hold any particular rate against strong market pressure.

(4) A member with a floating exchange rate would be encouraged to indicate to the Fund its broad objective for the development of its reserves over a period ahead and to discuss this objective with the Fund. If the Fund, taking account of the world reserve situation, considered this objective to be reasonable and if the member's reserves were relatively low by this standard, the member would be encouraged to intervene more strongly under Guideline (2) to moderate a movement in its rate when the rate was rising than when it was falling. If the member's reserves were relatively high by this standard it would be encouraged to intervene more strongly to moderate a movement in its rate when the rate was falling than when it was rising. In considering target exchange rate zones under (3), also, the Fund would pay due regard to the desirability of avoiding an increase over the medium term of reserves that were recognized by this standard to be relatively high, and the reduction of reserves that were recognized to be relatively low.

(5) A member with a floating rate, like other members, should refrain from introducing restrictions for balance of payments purposes on current account transactions or payments and should endeavor progressively to remove such restrictions of this kind as may exist.

(6) Members with a floating rate will bear in mind, in intervention, the interests of other members including those of the issuing countries in whose currencies they intervene. Mutually satisfactory arrangements might usefully be agreed between the issuers and users of intervention currencies, with respect to the use of such currencies in intervention. Any such arrangements should be compatible with the purposes of the foregoing guidelines. The Fund will stand ready to assist members in dealing with any problems that may arise in connection with them.

Commentary

General

Certain of the terms used in the guidelines may be defined as follows:

(i) "A member with a floating exchange rate" means a member whose currency is floating independently in the sense that it is not pegged, within relatively narrow margins, to any other currency or composite of currencies. Members whose currencies are pegged to particular floating currencies, or to composites of such currencies, within these margins would be exempt from these guidelines, though not from any general principles relating to adjustment. Members which, though their currencies are pegged to another currency, change the peg frequently in the light of some formula relating, e.g., to price indices, would be expected to discuss this formula and any changes therein with the Fund. Members whose currencies are pegged to a composite of other currencies (e.g., members whose effective rates are fixed) would likewise be expected to discuss with the Fund the composite in question and any changes therein. Members whose currencies are floating jointly under mutual intervention arrangements with relatively narrow margins would be exempted from the intervention guidelines so far as intervention in each other's currencies is concerned, but would be held responsible to the Fund for their exchange market intervention vis-à-vis the rest of the world. As regards capital controls, official financing, and other measures to influence capital flows, each member belonging to such a group would be responsible for its measures judged in relation to its overall balance of payments situation.

(ii) "Exchange market intervention" would normally be measured by the movement of reserves, adjusted as appropriate for compensatory official borrowing. Consideration might also be given to including in the concept of intervention changes in official foreign exchange positions other than reserves.

(iii) "Action to influence an exchange rate" includes, besides exchange market intervention, other policies that exercise a temporary effect on the balance of payments and hence on exchange rates, and that have been adopted for that purpose. Such policies may take the form of official forward exchange market intervention, official foreign borrowing or lending, capital restrictions, separate capital exchange markets, various types of fiscal intervention, and also monetary or interest rate policies. Monetary or interest rate policies adopted for demand management purposes or other policies adopted for purposes other than balance of payments purposes would not be regarded as action to influence the exchange rate.

(iv) Where the terms "exchange rate" or "exchange value" are employed with respect to any currency it is assumed that these would normally be expressed in terms of effective rates, i.e., the value of the currency would be measured relative to a representative set of currencies rather than relative to its intervention currency alone. The set chosen for this purpose should, in principle, vary from country to country, and the currencies in the set should be weighted according to their importance to the country in question. The composition of the set might be based on trade and financial relationships or on trade relationships alone. If trade-weighted, it might be derived from the Multilateral Exchange Rate Model, or based on bilateral trade relationships. In some cases the basket used for the valuation of the SDR might be satisfactory for this purpose also. In some cases, finally, the rate vis-à-vis a single currency might provide a satisfactory approximation to an effective rate.

On Guideline (1)

Known large once-for-all or reversible transactions would be largely offset and their effects spread over time. In addition, intervention would be undertaken to moderate large day-to-day or week-to-week movements in rates due to speculative or other factors. Such intervention, if properly conducted, should tend to net out over time.

It is unlikely to be necessary for the issuer of the principal intervention currency itself to intervene from day to day in the manner described in this guideline.

On Guideline (3)

(i) The concept of a medium-term norm for an exchange rate is employed explicitly in (a) and implicitly in (b) of Guideline (3). By this is meant a rate that would tend to bring about equilibrium in the "underlying" balance of payments, i.e., in the overall balance in the absence of cyclical and other short-term factors affecting the balance of payments, including government policies which are, or, on internationally accepted principles, ought to be temporary. If the member concerned so proposes and the Fund agrees, "equilibrium" could allow for an internationally appropriate rate of increase or decrease in the member's reserves. The "medium-term" might be considered to refer to a period of about four years. Seasonal, speculative, and cyclical factors whose effects were reversible over such a period would be ignored.

(ii) An advantage of conceiving medium-term norms or target zones in terms of effective rates is that so long as the effective rate remains constant the balance of trade or currency payments of the floating country would not be greatly affected by changes in the relative exchange rates of the currencies of other countries. This should reduce the frequency with which it would be necessary to change zone boundaries, or the magnitude of the changes involved. It would be open to a member if it so desired to express its target rate or zone not as one that is constant over time but as one that is rising or falling at a certain rate or at a rate dependent, for example, on an index of relative price or cost levels.

(iii) Under Guideline (3)(b) the Fund would be authorized to take the initiative in situations where it considered that a member's rate was likely to become harmful to the interests of members whether as a result of market forces or of action by the member. Recommendations to a member under this provision would be made by the Executive Directors, on a proposal by the Managing Director, but the Managing Director would not make such a proposal except after consultation with the member.

(iv) The greater the degree of uncertainty regarding the balance of payments situation and prospects of a country the wider would be the range of reasonable estimates of the medium-term norm for its exchange rate, and the wider would be the deviation beyond this range which would occur before the Fund would make any suggestions under Guideline (3)(b). The Fund's right to make suggestions under this guideline will, in any case, be exercised with restraint.

(v) In any suggestions the Fund might make under Guideline (3)(b), it would give a preference to liberalizing as opposed to restricting ways of exercising a given effect on exchange rates, but would bear in mind the distinction between capital controls applied for temporary balance of payments reasons and those applied for other economic and social reasons.

On Guideline (6)

This guideline would imply that in their use of their customary reserve currencies members with a floating rate, while recognizing the need of issuing countries for reasonable freedom of exchange rate movement, should not be precluded from intervening in a manner conformable with the guidelines. Among the problems that might arise regarding the use of intervention currencies, in the resolution of which the Fund might be of service, are those regarding the circumstances in which a member might intervene in a currency other than its customary reserve currency, the problem of interventions that move the value of the currency of intervention in an undersirable direction, and the problem of mutually offsetting interventions.

INTERNATIONAL MONETARY FUND

19th and H Streets N. W., Washington, D.C. 20431

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FOR IMMEDIATE RELEASE
June 13, 1974

Communiqué of the
Committee of the Board of Governors
on International Monetary Reform and Related Issues

1. The Committee of the Board of Governors of the International Monetary Fund on Reform of the International Monetary System and Related Issues (the Committee of Twenty) held its sixth and final meeting in Washington on June 12-13, 1974, under the chairmanship of Mr. Ali Wardhana, Minister of Finance for Indonesia. Mr. Johannes Witteveen, Managing Director of the International Monetary Fund, took part in the meeting which was also attended by Mr. Gamani Corea, Secretary-General of the UNCTAD, Mr. Frederic Boyer de la Giroday, Director of Monetary Affairs of the EEC, Mr. René Larre, General Manager of the BIS, Mr. Emile van Lennep, Secretary-General of the OECD, Mr. Olivier Long, Director-General of the GATT, and Sir Denis Rickett, Vice-President of the IBRD.

2. The Committee concluded its work on international monetary reform; agreed on a program of immediate action; and reviewed the major problems arising from the current international monetary situation.

3. The program of immediate action is as follows:

(a) Establishment of an Interim Committee of the Board of Governors of the Fund with an advisory role, pending establishment by an amendment of the Articles of Agreement of a Council with such decision-making powers as are conferred on it.

(b) Strengthening of Fund procedures for close international consultation and surveillance of the adjustment process.

(c) Establishment of guidelines for the management of floating exchange rates.

(d) Establishment of a facility in the Fund to assist members in meeting the initial impact of the increase in oil import costs.

(e) Provision for countries to pledge themselves on a voluntary basis not to introduce or intensify trade or other current account measures for balance of payments purposes without a finding by the Fund that there is balance of payments justification for such measures.

(f) Improvement of procedures in the Fund for management of global liquidity.

(g) Further international study in the Fund of arrangements for gold in the light of the agreed objectives of reform.

(h) Adoption for an interim period of a method of valuation of the SDR based on a basket of currencies and of an initial interest rate on the SDR of 5 per cent.

(i) Early formulation and adoption of an extended Fund facility under which developing countries would receive longer-term balance of payments finance.

(j) Reconsideration by the Interim Committee, simultaneously with the preparation by the Executive Board of draft amendments of the Articles of Agreement, of the possibility and modalities of establishing a link between development assistance and SDR allocation.

(k) Establishment of a joint ministerial Committee of the Fund and World Bank to carry forward the study of the broad question of the transfer of real resources to developing countries and to recommend measures.

(l) Preparation by the Executive Board of draft amendments of the Articles of Agreement for further examination by the Interim Committee and for possible recommendation at an appropriate time to the Board of Governors.

These measures are described in more detail in the statement attached to this communiqué.

4. Members of the Committee expressed their serious concern at the acceleration of inflation in many countries. They agreed on the urgent need for stronger action to combat inflation, so as to avoid the grave social, economic and financial problems that would otherwise arise. They recognized that, while international monetary arrangements can help to contain this problem, the main responsibility for avoiding inflation rests with national governments. They affirmed their determination to adopt appropriate fiscal, monetary and other policies to this end. In the discussion Members of the Committee urged that the multilateral trade negotiations in the framework of GATT should continue to be regarded as a matter of priority.

5. The Committee noted that, as a result of inflation, the energy situation and other unsettled conditions, many countries are experiencing large current account deficits that need to be financed. The Committee recognized that sustained cooperation would be needed to ensure appropriate financing without endangering the smooth functioning of private financial markets and to avert the danger of adjustment action that merely shifts the problem to other countries. Particular attention was drawn to the pressing difficulties of the most severely affected developing countries. Members of the Committee therefore strongly emphasized their request to all countries with available resources and to development finance institutions to make every effort to increase the flow of financial assistance on concessionary terms to these countries.

6. In concluding its work on international monetary reform, the Committee agreed to transmit a final Report on its work, together with an Outline of Reform, to the Board of Governors. These documents will be published shortly.

DETAILED STATEMENT

Detailed statement of immediate steps to assist the functioning of the international monetary system

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Introduction

1. The Committee recognizes that it will be some time before a reformed system can be finally agreed and fully implemented. It therefore proposes that, in the interim period, the Fund and member countries should pursue the general objectives set out in paragraph 1 of the Outline and should observe, so far as they are applicable, the principles contained in Part I of the Outline. It further proposes that a number of steps should be taken immediately to begin an evolutionary process of reform and to help meet the current problems facing both developed and developing countries, and calls upon members to collaborate with the Fund and with each other to give effect to those proposals as set out below.

Interim Committee of the Board of Governors on the International Monetary System

2. The Committee recommends the establishment of an Interim Committee of the Board of Governors on the International Monetary System, with an advisory role in those areas in which the Council referred to in paragraph 31 of the Outline will have decision-making powers, namely, in supervising the management and adaptation of the monetary system, overseeing the continuing operation of the adjustment process, and dealing with sudden disturbances which might threaten the system. It notes that the Executive Directors are accordingly preparing for adoption by the Board of Governors a Resolution to establish the Interim Committee. It is envisaged that the new Committee will hold its first meeting at the time of the Annual Meeting in September.

The adjustment process

3. The Committee recognizes that in the interim period, with significant changes in prospect for the world balance of payments structure, there is a need for close international consultation and surveillance of the adjustment process. It recommends that countries should be guided in their adjustment action by the general principles set out in paragraph 4 of the Outline. It calls upon members to cooperate with one another and with

international institutions, during the current period of exceptional and widespread payments imbalances, to find orderly means to deal with these imbalances without adopting policies that would aggravate the problems of other countries, and to promote equilibrating capital flows: in this connection the Committee has endorsed the immediate establishment of a facility in the Fund to assist members in meeting the initial impact of the increase in oil import costs. The Committee calls upon the Fund to exercise surveillance of the adjustment process through the Council (or, for the time being, the Interim Committee of the Board of Governors) and the Executive Directors, on the lines of the procedures set out in paragraphs 5-10 of the Outline, and subject for the time being to the following provisos, namely that:

(a) the Fund will seek to gain further experience in the use of objective indicators, including reserve indicators, on an experimental basis, as an aid in assessing the need for adjustment, but will not use such indicators to establish any presumptive or automatic application of pressures;

(b) determination of what is a disproportionate movement in reserves will be made in the light of the broad objectives of member countries for the development of their reserves over a period ahead, as discussed with the Fund; and

(c) the pressures which may be applied to countries in large and persistent imbalance will continue to be those at present available to the Fund.

Exchange rates

4. The Committee stresses that, during the interim period, exchange rates will continue to be a matter for international concern and consultation and attaches particular importance to the avoidance of competitive depreciation or undervaluation. The Committee notes with satisfaction that in accordance with its recommendation the Executive Directors are adopting a decision on guidelines for the management of floating exchange rates during the present period of widespread floating.

Controls

5. The Committee recommends that, during the interim period, countries should be guided by the principles set out in paragraphs 14-17 of the Outline in relation to controls and to cooperative action to limit disequilibrating capital flows. The Committee attaches particular importance to the avoidance of the escalation of restrictions on trade and payments for balance of payments purposes during the interim period. The Committee invites members to subscribe on a voluntary basis to the Declaration concerning trade and other current account measures for balance of payments purposes attached to this statement. The Committee invites the Executive Directors to establish the necessary procedures in connection with the Declaration, and to make arrangements for continuing close coordination with the GATT.

Global Liquidity

6. (a) The Committee calls upon members to cooperate with the Fund during the interim period in seeking to promote the principle of better management of global liquidity as set out in paragraph 2(d) of the Outline. It recommends that the Fund should assess global reserves and take decisions on the allocation and cancellation of SDRs in accordance with paragraph 25 of the Outline, and should periodically review the aggregate volume of official currency holdings in accordance with paragraph 19 of the Outline and, if they are judged to show an excessive increase, should consider with the countries concerned what steps might be taken to secure an orderly reduction.

(b) The Committee further recommends that the Fund should give consideration to substitution arrangements.

(c) Finally, the Committee recommends that there should be further international study in the Fund of arrangements for gold in the light of the agreed objectives of reform.

Valuation of the SDR

7. The Committee notes with satisfaction that, following its recommendation concerning the interim valuation and interest rate of the SDR, the Executive Directors are adopting decisions on these questions.

The special interests of developing countries

8. The Committee recognizes the serious difficulties that are facing many developing countries, and agrees that their needs for financial resources will be greatly increased. It urges all members with available resources to make every effort to supply these needs on appropriate terms. To this end it calls upon countries with available resources and upon development finance institutions to make arrangements to increase the flow of concessionary funds, and to give consideration to various measures including the redistribution of aid effort in favor of countries in greatest need, interest subsidies, and short-term debt relief on official loans in the special case of countries without access to financial markets. The Committee urges the Executive Board to proceed to an early formulation and adoption of a new facility in the Fund under which developing countries would receive longer-term balance of payments finance. The Committee is not unanimous on the question of establishing a link between development assistance and SDR allocation. The Committee is agreed that the Interim Committee should reconsider, simultaneously with the preparation by the Executive Board of draft amendments of the Articles of Agreement, which it is envisaged would be presented for the approval of the Board of Governors by February 1975, the possibility and modalities of establishing such a link.

Ministerial Committee on the Transfer of Real Resources

9. The Committee recommends the establishment of a joint ministerial Committee of the Fund and World Bank to carry forward the study of the broad question of the transfer of real resources to developing countries, and to recommend measures to be adopted in order to implement its conclusions. It invites the Managing Director to discuss with the President of the World Bank the preparation of appropriate parallel draft Resolutions on the establishment of such a joint ministerial Committee for adoption by the respective Boards of Governors. It recommends that the joint ministerial Committee should also give urgent attention to the problems of the developing countries most seriously affected by exceptional balance of payments difficulties in the current situation, bearing in mind the need for coordination with other international bodies, and that preparatory work on this aspect should be started immediately, in advance of the establishment of the Committee.

General review of quotas

10. The Committee notes that work has started on the current general review of Fund quotas and urges the Executive Directors to complete their work as soon as possible, bearing in mind the general purposes of the reform.

Amendments of the Articles of Agreement

11. The Committee has asked the Executive Board to prepare draft amendments of the Articles of Agreement, as needed to give effect to Part II of the Outline or as otherwise desired, for further examination by the Interim Committee, and for possible recommendation at an appropriate time to the Board of Governors. In particular draft amendments should be prepared on the following proposals:

(a) to establish the Council referred to in paragraph 31 of the Outline;

(b) to enable the Fund to legalize the position of countries with floating rates during the interim period;

(c) to give permanent force to the voluntary pledge described in paragraph 5 above concerning trade or other current account measures for balance of payments purposes;

(d) to authorize the Fund to establish, as and when agreed, a Substitution Account;

(e) to amend the present provisions concerning gold;

(f) to authorize the Fund to implement a link between development assistance and SDR allocation; and

(g) to introduce improvements in the General Account and in the characteristics of and rules governing the use of the SDR, as well as any other consequential amendments.

It is envisaged that such draft amendments, if agreed, would be presented for the approval of the Board of Governors at latest by the date fixed for completion of the current general review of Fund quotas, i.e., by February 1975.

ATTACHMENT

Declaration on Trade Measures

The Committee of the Board of Governors of the International Monetary Fund on Reform of the International Monetary System and Related Issues has stressed the importance of avoiding the escalation of restrictions on trade and payments for balance of payments purposes. Accordingly, certain members of the Fund have expressed their wish to subscribe to a Declaration as follows to give effect to that recommendation.

DECLARATION

A. A member of the Fund that subscribes to this Declaration represents thereby that, in addition to observing its obligations with respect to payments restrictions under the Articles of Agreement of the Fund, it will not on its own discretionary authority introduce or intensify trade or other current account measures for balance of payments purposes that are subject to the jurisdiction of the GATT, or recommend them to its legislature, without a prior finding by the Fund that there is balance of payments justification for trade or other current account measures.

B. A member that subscribes to this Declaration will notify the Fund as far in advance as possible of its intention to impose such measures. If circumstances preclude the Fund from making the finding referred to in A above promptly after such notification, the member may nevertheless impose such measures, but will withdraw the measures, within such a period as may be fixed by the Fund in consultation with the member concerned, if the Fund finds that there is no balance of payments justification for trade or other current account measures.

C. In arriving at the findings referred to above, the Executive Directors are requested to take into account the special circumstances of developing countries.

D. In connection with this Declaration arrangements will be made for continuing close coordination between the Fund and the GATT.

E. This Declaration shall become effective among subscribing members when members having 65 per cent of the total voting power of members of the Fund have accepted it, and shall expire two years from the date on which it becomes effective unless it is renewed.